

26 September 1997

**REQUEST FOR COMMENT ON THE STOCK EXCHANGE'S PROPOSED
SECURITIES TRANSFER SYSTEM**

The Securities Commission seeks comment on a proposed extension to the system for electronic transfer of securities on the New Zealand Stock Exchange (NZSE). Comments are required by 20 October 1997.

The Commission may recommend to the Government that it approve a new system for the electronic transfer of securities. The NZSE has requested that the Commission recommend approval of an extension to the presently operating FASTER system. The proposed extension will enable people to buy and sell securities quoted on the NZSE without using written transfer forms or share certificates.

This letter describes how the proposed system works, and highlights issues for consideration. A more detailed system description, provided by the NZSE, is **attached** to this letter.

Background

In 1992 the Commission recommended the approval of the system for the transfer of securities known as FASTER. FASTER stands for Fully Automatic Screen Trading and Electronic Registration. FASTER is a system for the trading, transfer and registration of securities. The system approved in 1992 provides for the electronic transfer of securities between brokers. The system established Broker Transfer Accounts (BTAs) on share registers of listed companies. The electronic transfers only occur between these BTA's. A security holder selling securities must produce both a written transfer form and a share certificate, and the listed company must, after registration of the transfer, send a share certificate to the new holder.

The Proposed System

The NZSE wishes to extend the FASTER system. The proposed extension will allow all securities transfers of listed companies to be entirely electronic. Transactions through FASTER will occur without the need for written transfer forms or share certificates. Users of the system will be known as system Participants, and may either be Members of the Stock Exchange (i.e.

brokers), or certain Non-Member Participants. Members of the NZSE must connect to FASTER. In place of certificates, companies will send to the new holder a statement setting out details of that person's holding. The statement will also include an Authorisation Code for each security holding. In order to effect a transfer of securities through FASTER the security holder must provide both a shareholder number and an Authorisation Code to the registry. Security holders will also be able to make transfers outside of FASTER, by means of written transfer forms.

Transaction Details

The transactions involved in FASTER differ for Member Participants, who trade principally on behalf of clients, and Non-Member Participants, who trade only in their own securities.

For Member Participants, transactions through FASTER retain the current structure, with modifications to allow the use of Authorisation Codes in place of certificates, and electronic rather than paper transfer forms. The key transactions will be:

1. *Client Inward Transfer (CIT)* - This is a transfer of securities from a client who wishes to sell securities into a Member Participant's FASTER Transfer Account (FTA), (another name for the BTA). The client will supply to the Member Participant a shareholder number, an Authorisation Code, and a description of the securities to be sold (i.e. the name of the issuer, the amount of the holding, etc).

This transaction will not be supported by a written transfer form or share certificate. The Member Participant will enter the CIT into the system, and will be responsible for ensuring that the correct details are provided, and for establishing the identity of the client.

2. *Claim of Delivery (COD)* - This is an electronic transfer initiated by a selling Member Participant to transfer securities associated with a trade from its own FTA to the FTA of a buying Member Participant. This transfer is completed in exchange for value.
3. *Client Outward Transfer (COT)* - This is a transfer of securities from a Member Participant's FTA to a buying client. The company (usually through a registry) will send a statement of the shareholding to the client within five business days of the transfer. This statement will contain a new Authorisation Code for the securities if the holding is a new one.

Non-Member Participants will be able to deal only in securities that are registered in their own name, or the name of a nominee that they control. As Non-Member Participants can access only their own accounts, they will not be issued with an Authorisation Code. For Non-Member Participants (and Member Participants when they are dealing on their own account) the key transactions will be:

1. *Owned Inward Transfer (OIT)* - This is a transfer of securities from a Participant's account to that Participant's FTA.

2. *Participant to Participant Transfer (PPT)* - This is a transfer from one Participant's FTA to that of another Participant.

Statements and Authorisation Codes

Under the proposed extension to the FASTER system listed companies will no longer issue share certificates and the process of transfer through FASTER will be paperless. Listed companies will be required by the Listing Rules of the NZSE to send out statements to holders of securities, setting out essential details of the securities and the issuer, and including an Authorisation Code for each holding. The statement must be sent within one week of any security transfer, and on request if a statement has not been provided within the last six months. Certificates will not be required for a transfer. Written transfers will still be possible outside the FASTER system, on the form currently in use, with the Authorisation Code taking the place of the certificate number on the transfer form.

Under the NZSE Regulations, securities held in BTA's will be held on trust for the clients concerned. Brokers may only use BTA's for the purpose of effecting a transfer of securities or holding securities pending completion of a contract for transfer of those securities.

Legal Requirements

Under section 7 of the Securities Transfer Act 1991, the Governor General may, on the advice of the Minister of Commerce given in accordance with a recommendation of the Securities Commission, approve a system that is wholly or partly electronic for the transfer of securities. The Commission may not make a recommendation to the Minister of Commerce under this section unless it has done everything reasonably possible to consult with such persons and organisations or their representatives as the Commission considers will be substantially affected by any Order in Council made in accordance with the recommendation.

The Commission invites comments on the proposed extension to the FASTER system. The Commission suggests that those wishing to comment might consider the particular points listed in the Schedule attached, although the Commission will be pleased to receive comments on any other aspect of the proposal.

Enquiries may be directed to Mr Liam Mason, a member of the Commission staff, and submissions should be directed for his attention.

Yours faithfully,

J. Farrell
Chief Executive

SCHEDULE

1. Policy Considerations

The New Zealand securities market should provide internationally competitive securities transfer and registration systems. These systems should be fast, cost-effective, and appropriately safe for investors.

The NZSE proposal for the extension of the FASTER system is intended to increase the efficiency of the exchange by reducing time lag in the settlement of shares. Prior to the introduction of FASTER in 1992, settlement of shares could take as long as 30 days after the date of transfer (T + 30). With the first part of FASTER implemented, the NZSE advises that settlement times are down to around T + 5. The goal with the extension of the FASTER system is to achieve settlement reliably in T + 3. This will accord with recognized international best practice.¹

2. Fraud

An important question is whether the proposed extension to FASTER would leave trading in securities more open to fraudulent abuse than under existing procedures. The key issue in relation to this proposal is whether the ability to effect a transfer by production of a shareholder number and an Authorisation Code renders the transaction more vulnerable to fraud than a transfer supported with a written transfer form and share certificate.

There will always be a risk of fraud or personation of a shareholder resulting in wrongful transfers of securities. The NZSE argue that the use of an Authorisation Code and statement do not increase this risk, as the requirement that a person produce an Authorisation Code, a shareholder number, and details of the securities to be transferred reproduces at least the level of protection currently afforded.

A further issue is whether, in the event of a fraud, the disenfranchised shareholder would be in any worse position under the extended FASTER system than he or she would be under the present system. Under the present law a transfer effected by a forged transfer form is of no effect, and a defrauded owner can require the company to rectify the share register.

Under the proposed extensions to FASTER, the greater burden of liability in such cases will fall on Members of the NZSE. It is intended that both security holders and listed companies be protected in the case of fraudulent transfer of securities. The position as the Commission understands it may be summarised as follows:

- a. The existing rule regarding forged transfers will extend to situations where a person uses another's Authorisation Code to transfer securities without the

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The 1996 survey by Federation International des Bourses de Valeurs (FIBV) "Clearing and Settlement Best Practices" identified international best practice as generally including T + 3 settlement.

consent of the holder, to the extent that the true owner of the securities will be able to require reinstatement on the share register. The present law will also apply in situations where a person makes a transfer otherwise than through FASTER, via a written transfer form.

- b. Coinciding with the introduction of the extension to FASTER, and to provide certainty about the operation of the rule regarding forged transfers, the NZSE will amend the Listing Rules so that a listed company will be required to reinstate or compensate any security holder where a CIT is effected by a person "in any circumstance where that person does not have the proper authority of the shareholder to execute the transfer".
- c. Under FASTER, a COT to a bona fide purchaser for value cannot be cancelled or reversed by an issuer in any circumstance. Thus, where a bona fide purchaser purchases securities from a person who has obtained them through a fraudulent transaction, the listed company will not be able to challenge the title of the purchaser. Under FASTER both sellers and purchasers have recourse under the Listing Rules, if necessary at the expense of the listed company (subject to any liability of the broker). Under the terms of the Listing Agreement between each listed company and the NZSE, the Listing Rules are believed to be enforceable by every security holder and former security holder, by provision in the Listing Agreement for the application of the Contracts (Privity) Act 1982.
- d. The chain of liability under FASTER rests on the rule that a broker or other intermediary who brings about a forged transfer, even innocently, is bound under the common law to indemnify the company against liability of the company to the displaced owner. The Listing Rules also provide that every Broker who forwards a CIT to the registry of an issuer will be deemed to warrant to the Issuer that the transfer is valid and has been authorised by the holder of the securities. It will be the responsibility of the broker to verify the identity of anyone who instructs a broker to carry out a CIT.

The NZSE informs us that insurance cover in favour of listed companies will be arranged by them to provide for situations where brokers are unable to indemnify companies for any loss caused by an invalid transfer.

While it is open to the NZSE to alter the Listing Rules at any time, the NZSE has proposed that it continue to provide the Securities Commission with an assurance that it will permit listed companies to disconnect their registries from the FASTER system should it amend any of the Listing Rules relating to the FASTER system (L.R. 11.4.1 to L.R. 11.4.8). It is proposed also that this assurance include an undertaking that no waivers will be granted in respect of these Listing Rules, and that the NZSE will arrange insurance for listed companies as referred to above. Should this assurance be given directly to listed companies? If so, in what form?

The risk of fraud will be reduced if security holders take appropriate care to protect their

authorisation codes and shareholder numbers. Security holders may expect to be advised that their Authorisation Code is a valuable asset, which should not be disclosed to any person.

3. Mistake

In the absence of fraud, the NZSE advise that it is unlikely that a CIT could be completed by mistake, given the detailed information that has to be entered onto the system by the Broker. The last digit of the Authorisation Codes will be a check-digit, which should help brokers reduce the risk of transfers being rejected by the system because the code is incorrect. As with fraud, brokers are responsible for any CIT forwarded to a Registry.

The Commission is advised by the NZSE that where a broker acts in breach of the NZSE Regulations and enters a CIT in anticipation of receiving the required verification or Authorisation Code, then the broker will be deemed to be acting as principal, and will be responsible for the transfer. This is, in effect, the position which applies at present when a broker sells for a client prior to receiving the necessary authority (i.e. certificate and signed transfer forms) to execute the transfer. The insurance provisions discussed above are intended to apply in this situation also.

4. Control of Automation Risks

The NZSE has devised certain security provisions to support FASTER. The basic system has now been operating for four years, during which time, we are informed, there have been no significant faults detected in the system security. With the advent of a fully electronic transfer system it is important to review experience to date and to consider what new risks might be created for the market and market participants. A particular issue is whether the scripless transfer process creates new difficulties in identification of security holders, and what should be done to minimise these risks. In the consultation paper sent out on 24 December 1991 relating to the initial FASTER proposal, the Commission noted four areas that had previously been identified by the US General Accounting Office² as needing to be addressed in an automation context:

- a. security to prevent unauthorised access and misuse of data;
- b. capacity planning to deal with sudden increases in demand;
- c. contingency systems to ensure continuous service in the event of system failure, natural disaster or intentional malicious act;
- d. independent technical reviews to confirm that the system performs and continues to perform as intended.

²

Report of the US General Accounting Office "Global Financial Markets: International Co-ordination Can Help Address Automation Risks" September 1991.

The NZSE has outlined its proposals for system security on page 14 of the system description. The Commission is not qualified to analyse the adequacy of the NZSE's system security in this respect, and does not intend to undertake such analysis. However any comment on the adequacy or otherwise of the NZSE proposals in this regard would be welcomed.

5. Share Certificates

No share certificates will be issued by listed companies under the proposed system, except where these are required to residents of overseas jurisdictions. Transfers effected otherwise than through FASTER may be made using the transfer form set out in the First Schedule to the Securities Transfer Act 1991, with the Authorisation Code used as the Identification Number, in place of the Certificate Number.

The NZSE has consulted with the Bankers Association on the issue of using securities as collateral for loans in the absence of certificates. The NZSE inform us that agreement has been reached whereby security holders wishing to use securities as collateral will sign a form authorising the cancellation of their existing Authorisation Code. A new Authorisation Code will not be issued until the listed company is advised by the collateral holder, who will be the nominee of the security holder for this purpose.

6. Legal Title

The Commission is advised by the NZSE that the use of electronic transfer forms and Authorisation Codes will not affect the issue of transfer of legal title to securities. They advise that legal title will still transfer at the moment that the name of the transferee is entered onto the share register.

As at present, a transfer through FASTER may involve several changes of legal ownership, as transfers arising in the course of CIT's, COD's and PPT's will be recorded on the share registers of listed companies. We are informed, however, that beneficial ownership will move directly from the original security holder to the eventual buyer of the securities.

7. Transitional Provisions

The NZSE proposes that shareholders will receive a statement of holding with their Authorisation Code before the date on which the NZSE converts to the proposed system. Shareholders and other interested parties will also receive information about the change. The Commission is advised by the NZSE that existing certificates will have no status beyond that of a statement, and that existing certificates will not need to be returned or destroyed. Companies will have to determine the status of certificates where these are already issued and where transfers are sought to be made outside the FASTER system.

8. Approval Function

If the Commission makes a recommendation to the Minister of Commerce to approve the system, then it will do so on the basis of the system as outlined in the system description attached or any modification that might be made prior to a recommendation by the Commission. The NZSE has responsibility for ensuring that the system operates within the parameters set out in the system description.



New Zealand
Stock Exchange

General Description of the FASTER System for
Paperless Clearing, Settlement and Registration of Securities
Listed on the New Zealand Stock Exchange

1. Introduction

1.1 Purpose of this Document

This document is a general description of FASTER (Fully Automatic Screen Trading and Electronic Registration). FASTER is a comprehensive system which includes provisions for recording and completing the transfer of securities listed on the New Zealand Stock Exchange (NZSE). FASTER consists of many component parts and provides the regulatory, administrative and computing systems by which NZSE listed securities are traded, cleared, settled and information distributed electronically to the market.

The NZSE is currently proposing an extension to FASTER to provide for paperless settlement. Paperless settlement will allow for full electronic transfer of securities without any written documents to support the transfer. This document describes FASTER as it would exist after the implementation of the proposed paperless settlement. This may be used as a reference document by any parties that are interested in gaining a business understanding of FASTER under paperless settlement.

The document provides an overview of FASTER to assist the reader in understanding the processes used to execute and complete the transfer of securities in exchange for value on the New Zealand market. The roles and responsibilities of the different parties involved in FASTER, the regulatory environment under which they operate and the key features of the FASTER systems and processes are outlined. The systems are not described at a detailed or operational level. Should the reader require further and/or more detailed descriptions of any of the FASTER components they should contact the NZSE.

1.2 Structure and Scope of this Document

This document is structured to provide information at two levels:

1. an overview of the NZSE trading and settlement environment and FASTER; and
2. a more in depth description of the FASTER transactions and the parties, procedures and responsibilities involved in the processing of these transactions.

The overview of the NZSE trading environment and FASTER (in sections 2 to 4) includes:

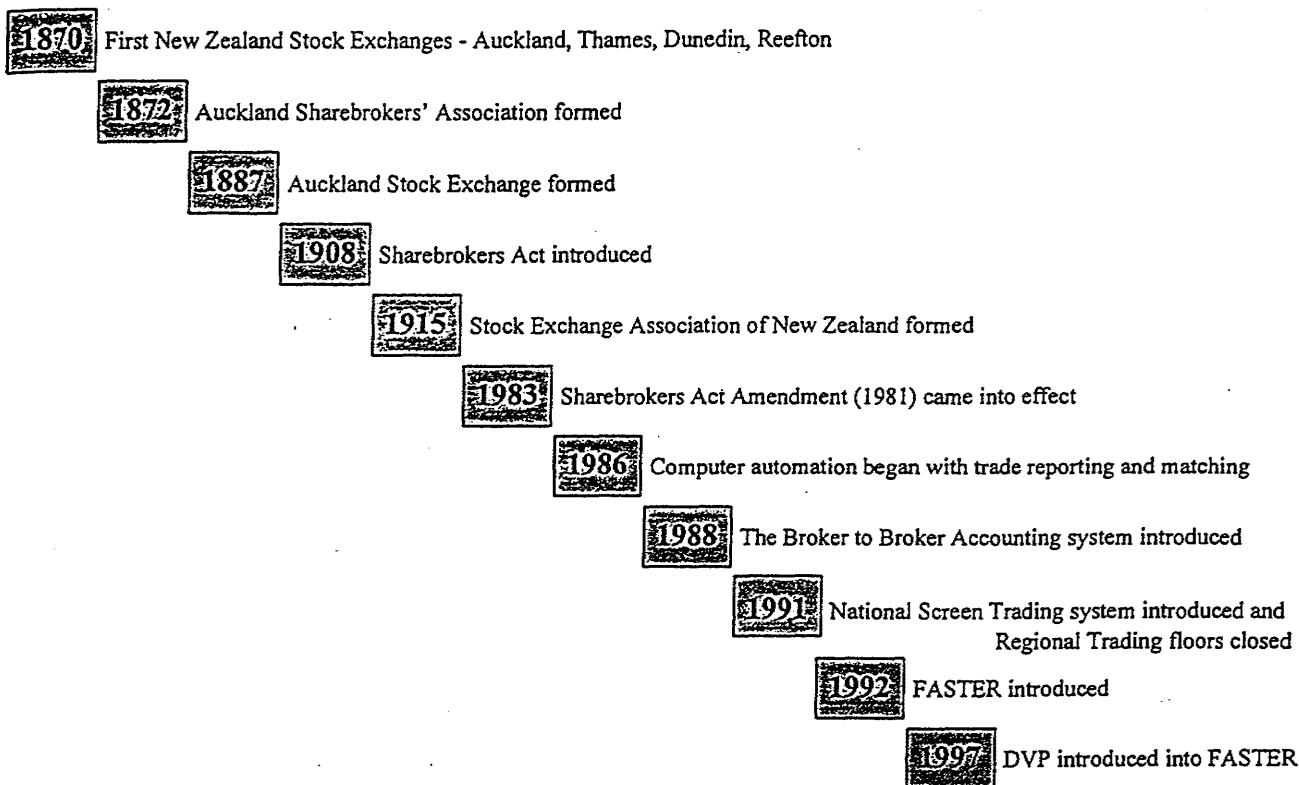
- background information on the NZSE regulatory, trading and settlement environment;
- background information on the development and adoption of initiatives to improve the settlement process;
- an overview of the key features and concepts of FASTER; and
- an overview of the transactions involved in the end to end FASTER process.

The description of the FASTER transactions, parties and procedures (in sections 5 to 14) includes:

- a description of each transaction in the FASTER process including process flow diagrams and descriptions of processing steps; and
- a description of the key responsibilities and obligations of each of the parties involved in FASTER.

2. Background

2.1 Brief History of the New Zealand Stock Exchange



The first stock exchanges in New Zealand were formed in Auckland, Thames, Dunedin and Reefton in the 1870's. These were the financial centres of the early gold fields. As the gold fever waned the Thames and Reefton exchanges fell by the wayside but Auckland and Dunedin began to develop commercially and industrially, along with Wellington and Christchurch where exchanges had also been established.

Until 1872, no attempt was made to provide a system which would directly facilitate the transfer of securities and the dissemination of market information. In that year, 12 brokers formed the Auckland Sharebrokers' Association.

In 1887 the Auckland Sharebrokers' Association changed its name to the Auckland Stock Exchange but it was 1910 before a meeting could be convened with other exchanges to agree on common rules. The Sharebrokers Act 1908 introduced compulsory licensing for sharebrokers. In 1915 the Stock Exchange Association of New Zealand, a loose-knit body of regional exchanges and forerunner to the present New Zealand Stock Exchange, was formed.

The NZSE has evolved over the years since 1915 when the Stock Exchange Association of New Zealand was formed to co-ordinate the activities of the then autonomous stock exchanges throughout the country. Those exchanges were located at Auckland, Wellington, Christchurch and Thames. The NZSE today operates under the authority of the Sharebrokers Amendment Act 1981 which came into effect in 1983.

In 1986 computer automation started with the capture of trades and quotes from the then four regional trading floors. Trades were then matched and errors corrected. Price information was collected and disseminated electronically as one national market. It was at this time that the messaging system which is now central to FASTER was created.

During 1988, the exchange made a comprehensive review of its management structure and systems. The Broker to Broker Accounting system (BBA) was introduced in 1988 and a Board of Directors was appointed with effect from April 1989 to replace the traditional council and executive. Members also voted to do away with separate local exchanges, and the management of trading floors became the responsibility of the Board of the Exchange.

On 24 June 1991, an era ended with the implementation of the Screen Trading system and the abolition of the open outcry market carried out at the regional trading floors. The regional trading floors were closed and there is now one centralised electronic market in New Zealand.

In 1992, the NZSE introduced FASTER to facilitate the electronic movement of securities for settlement. In 1997 FASTER was enhanced to include Delivery versus Payment (DVP) allowing for the irrevocable transfer of securities against simultaneous transfer of same day funds.

2.2 Structure of the New Zealand Stock Exchange

The Exchange is funded from annual fees and transaction charges paid by Members, fees paid by listed public companies, and charges for information supplied.

Membership of the NZSE is on either an individual or corporate basis. Members must have a current sharebroking licence. Membership Rules are published and approved by the Governor General and Executive Council. Members jointly elect a board which is responsible for the management and control of the NZSE. The board consists of up to ten members, at least two non-members and a Managing Director. The Managing Director reports directly to the board and is responsible for the general operation of the NZSE.

The NZSE has been a full member of the FIBV (Federation Internationale des Bourses de Valeurs or International Federation of Stock Exchanges) since 1985 and EAOSSEF (East Asian and Oceania Stock Exchanges' Federation) since 1989.

2.3 Regulatory Environment

The Sharebrokers Amendment Act 1981 establishes the NZSE as a body corporate. The NZSE supersedes the Stock Exchange Association of New Zealand which was originally established in 1915. The Act makes the NZSE responsible for the operation of a national stock exchange, specifying rules for listing and trading of securities, and promoting uniform standards of conduct within its members. All members of the NZSE must hold a current Sharebrokers Licence.

The Securities Commission was established by the Securities Act of 1978. It has an advisory role, and an administrative role in enforcing the provision of the Securities Act relating to prospectuses and advertisements. The Act and the Securities Regulations of 1983 made under it are administered by the Commission and establish the minimum disclosure required to ensure public subscribers are adequately informed about publicly offered securities. Under the Securities Amendment Act of 1988, the Commission also has responsibility in relation to insider trading cases and the filing of Notices by Substantial Security Holders.

The behaviour of companies and their directors is governed by the Companies Acts (1955 and 1993). These provide the basic shareholder protection measures which ensure fair treatment and protection of rights.

2.4 Listing Rules

The Listing Rules of the NZSE, in addition to statutory and common law, provide a more comprehensive set of rules to be observed by an issuer who lists and has securities quoted on the NZSE. The issuer of any

security listed on the NZSE must comply with the Listing Rules which form a contract, enforceable for the benefit of all shareholders, between the NZSE and the Issuer whose securities are traded through the NZSE Screen Trading system.

2.5 Market Surveillance

An important feature of the Listing Rules is the provision of an independent market surveillance system. Its main features are:

- *Market Surveillance Panel.* This is a panel of respected professionals, a majority of whom are not NZSE Members, whose role broadly is to monitor the quality of information provided by listed issuers, to investigate suspected non-compliance, and from time to time to recommend changes to the Listing Rules.
- *Surveillance Executive.* The Panel is supported by a full-time executive of three professionals who have the power to inspect a company's records.
- *Provision of Bonds.* Listed issuers must post a bond with the NZSE to ensure the costs of any investigation are met.

2.6 NZSE Membership

No person may act as a sharebroker in New Zealand unless they are the holder of a current sharebroker's Licence. Licences are issued by the District Courts. Sharebrokers wishing to join the New Zealand Stock Exchange must become Members of the NZSE. Membership is either on an individual or corporate basis. Individual Members must be fit and proper persons without a record of dishonest or fraudulent activities. Members must meet qualifications and experience requirements. All Member firms must meet strict capital adequacy requirements and have suitable systems and procedures.

The NZSE has rules and regulations to govern the conduct of Members at all times. There is also a Code of Practice which Members must follow. The Code of Practice provides the assurance that New Zealand's standards are internationally acceptable and consistent with the recommendations of the International Organisation of Securities Commissions (IOSCO) and the FIBV.

2.7 Trading Mechanism

The NZSE operates a *continuous retail auction* market during designated trading hours. The market currently trades 9.30 a.m. to 3.30 p.m.

The market is fully automated with dealers participating directly from Members' offices throughout New Zealand (i.e. there are no trading floors). Orders to buy and sell are placed directly into the trading system and are matched in accordance with strict price and time priority algorithms. A pre-opening session is used at the start of each trading day to establish an opening price for that day.

2.8 International Initiatives to Improve Settlement

International initiatives to improve settlement systems have been underway since 1987, when the FIBV established a task force to consider the issue.

Other respected bodies to instigate work on them were:

- The European Economic Community (D.G.XV) - report published in English in March 1989.

- The Group of Thirty (G-30) - report published March 1989.
- The International Society of Securities Administrators, (ISSA) - 12 recommendations published in its report of a symposium in May 1988.

The FIBV Task Force members participated in all of these. As a result, G-30 concentrated on all clearing and settlement activities and the FIBV Task Force concentrated on cross-border settlement activities. The G-30's report was published in June 1989. The G-30 recommendations are summarised in Appendix I.

The recommendations of G-30 and the FIBV Task Force have been supported internationally. The FIBV added two more recommendations for cross-border settlement, but without a timetable for implementation as that depends on the development and maturity of national settlement systems. These were:

1. National and International depositories should develop cross-border settlement links.
2. Securities should be immobilised in the country of origin and transferred by book entry. Listings abroad should be in original form.

Progress on development of improved international settlement has been complicated by jurisdictional and national competition and investor protection issues, but countries have remained committed to realising the benefits underlying the G-30 recommendations.

Other studies have added to the demands to reduce the risk and costs involved in settlement by reducing delivery delays (e.g. the US report of the Bachmann Task Force on Clearance and Settlement Reform in the US Securities Markets - May 1992 has led to the introduction of T + 3 settlement in the US).

The International Society of Securities Administrators (ISSA) has been encouraging the development of more efficient settlement internationally. ISSA have revised the G-30 goals following a series of Regional meetings.

The FIBV has also undertaken a benchmarking survey of all its members in 1996 - "Clearing and Settlement Best Practices". Together with the ISSA revision; the FIBV survey shows generally that international best practice now includes T+3 and DVP (same day funds).

The proposed new goals are as follows:

ISSA/G30 Recommended Goals

1. All comparisons of trade between direct market participants (i.e. brokers, broker/dealer and other exchange members) should be accomplished by T+0. Matched trade details should be linked to the settlement system.
2. Indirect market participants (such as institutional investors and other indirect trading counterparties) should achieve positive affirmation of trade details on T+1.
3. Each country should have in place an effective and fully developed central securities depository, organised and managed to encourage the broadest possible direct and indirect industry participation. *The range of depository eligible instruments should be as wide as possible. Immobilisation or dematerialisation of financial instruments should be achieved to the utmost extent possible.*

If several central securities depositories exist in the same market, they should operate under compatible rules and practices, with the aim of reducing settlement risk and enabling efficient use of funds and available cross-collateral.
4. Each market is encouraged to reduce settlement risk by introducing either Real Time Gross Settlement or a trade netting system that fully meets the "Lamfalussy-Recommendations".
5. Delivery versus payment (DVP) should be employed as the method of settling all securities transactions. *DVP is defined as follows: Simultaneous, final, irrevocable and immediately available exchange of securities and cash on a continuous basis throughout the day.*
6. Payments associated with the settlement of securities transactions and the servicing of securities portfolios should be made consistent across all instruments and markets by adopting the "same day" funds convention. *(unchanged)*
7. A rolling settlement system should be adopted by all markets. *Final settlement for all trades should occur no later than by T+3.*
8. Securities lending and borrowing should be encouraged as a method of expediting the settlement of securities transactions. Existing regulatory and taxation barriers that inhibit the practice of lending and borrowing securities should be removed.
9. Each country should adopt the standard for securities messages developed by the International Organisation of Standardisation (ISO Standard 7775). In particular, countries should adopt the ISIN numbering system for securities issues as defined in the ISO Standard 6166.

3. FASTER Overview

3.1 History and Goals of FASTER

The NZSE's introduced the Broker to Broker Accounting (BBA) system as the first step to achieving the G30 goals in 1988. BBA achieved goals 1 and 2. The NZSE and the New Zealand securities industry recognised the need to extend this system to provide a securities clearing and settlement system to comply with the international best practices and the remaining ISSA/G-30 recommendations. A joint industry effort between the NZSE, the NZSE Members and the Listed Companies was initiated to develop a staged approach to the achievement of all the ISSA/G-30 recommendations in the most efficient and effective way for the New Zealand securities market. This effort resulted in what is today known as FASTER which was first introduced in 1992.

FASTER has since been progressively developed to keep pace with international standards. As of February 1997, FASTER complied with seven of the nine ISSA/G-30 recommended goals (goals 1 through 6 and 9) and continues to be an internationally competitive securities clearing and settlement system.

FASTER has created the equivalent of a central registry, by connecting the registries of all listed companies in a single system. This avoids the costs of a central depository by providing a direct on-register transfer following a trade. FASTER also supports the Listed Companies' interests in having a competitive registry service available by allowing several registries to connect.

FASTER has resulted in the elimination of documents for the transfer of securities between Members. This has helped the NZSE reduce the average settlement period between member firms from T+28 in the early eighties to T+5 in 1989 and an average of T+2.5 today. Large trades (over \$100,000) continue to settle on a fixed T+5 basis.

The combined effect of FASTER has been to reduce costs significantly for the operation of the NZSE, the registries and the NZSE Member Firms. Investors have received these benefits through the competitive operation of Member Firms and Listed Companies which has reduced costs.

Volumes of trade processed through the NZSE increased 15.3% in 1996 and is now more than three times higher than the pre-FASTER level in 1991. The unit cost of processing transfers have decreased markedly as a result of the volume growth and cost savings that have been achieved through FASTER (leaving aside the growth in other registry activities). The NZSE charge to members for matching and settling a trade is now 30% of the pre-FASTER cost five years ago. Further reductions are anticipated.

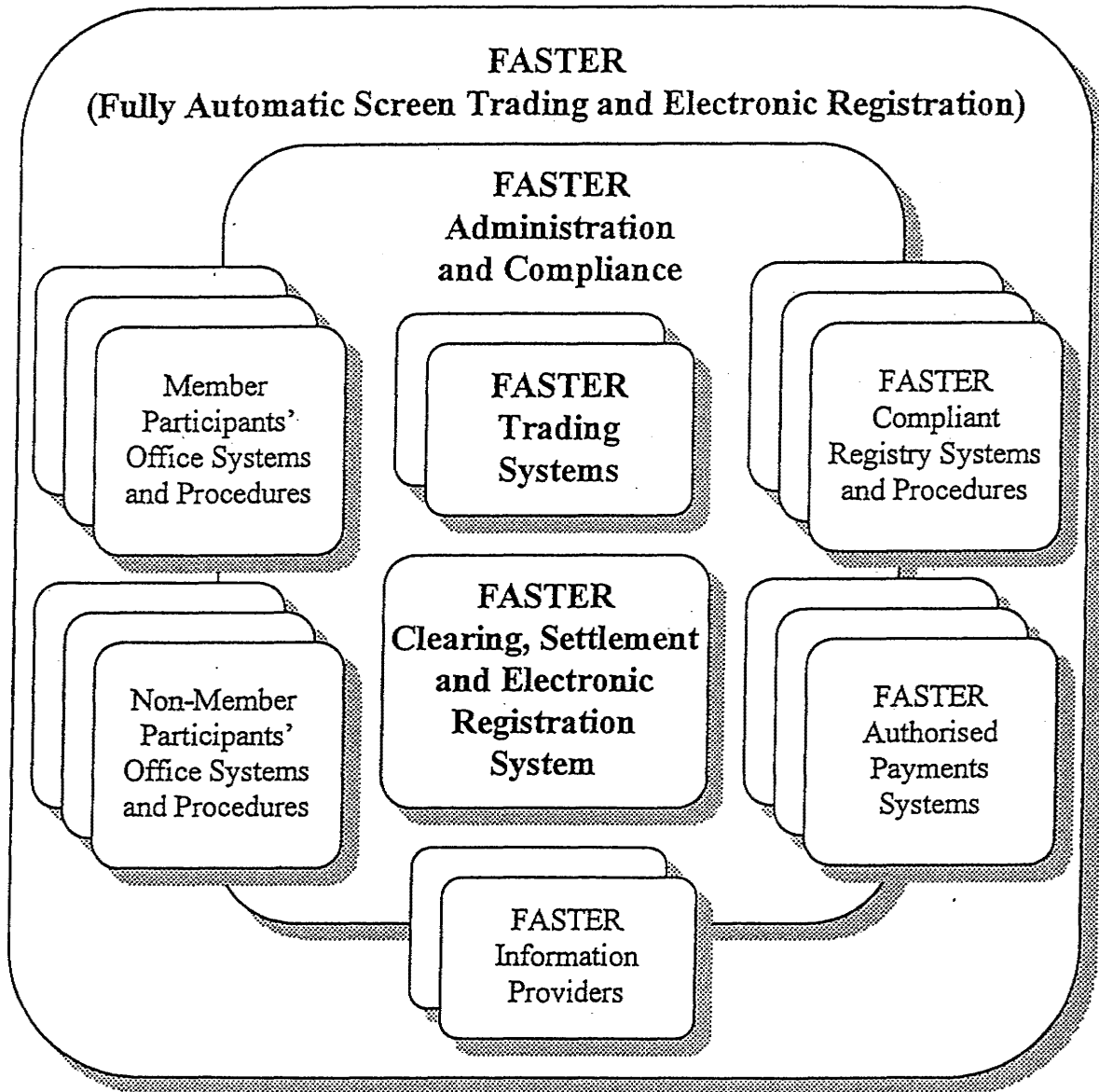
As well as the cost and efficiency benefits that have been achieved through FASTER, the rigorous regulatory environment that FASTER operates in also provides an additional risk reduction benefit. The NZSE Listing Rules and the NZSE Rules and Regulations enforce high quality disciplines and risk management procedures that the Listed Companies and NZSE Members must abide by.

In order to further improve the performance of FASTER, in line with international best practice standards, the NZSE is proposing that FASTER be extended to include paperless settlement. Paperless settlement will further reduce the unit cost of settling a trade and will allow New Zealand to achieve, or better, the international standard of T+3. Under paperless settlement the requirement for delivery of share certificates and transfer forms prior to settlement is removed and the time and costs associated with handling these documents is eliminated. Paperless settlement will also eliminate the risks associated with these paper based transfer authorisation documents.

Written transfers will still be able to be used for those parties that wish to transfer Securities outside of the FASTER system.

The Government has provided the legislative framework through the Securities Transfer Act and the changes to the Companies Act which permit systems for the electronic transfer of securities and remove the status of a certificate as prima facie evidence of title.

3.2 Parties Involved in FASTER



3.2.1 FASTER Participants

The term "Participant" refers to brokers and any other organisations that have direct access to the FASTER system and have been approved by the NZSE to enter electronic transfers of securities. Participants are required to accept an agreement with the NZSE governing their terms of access to the FASTER system. All Participants must undergo a NZSE accreditation test of their computer systems and procedures to ensure that they comply with FASTER standards.

3.2.1.1 Member Participants

Member Participants are firms that have membership of the NZSE. Only Member Participants are able to execute transfers of clients' securities on their behalf in order to settle a trade. Participants wishing to trade on the NZSE must become Members of the NZSE. All deliveries of New Zealand listed equity securities between Members take place through FASTER.

3.2.1.2 Non-Member Participants

Non-member Participants (NMPs) can participate in FASTER in the same way as Members except that they do not have direct access to the NZSE Screen Trading system and do not have the ability to transfer clients' securities. NMPs can only transfer securities for which they have legal title to or authority to transfer (i.e. from their nominee accounts). Access to securities for transfer is granted by the Registries, through the FASTER system. NMPs can transfer their own securities to other accounts that they own or to other shareholders' accounts. Non-members have the option of executing such transfers in exchange for value under DVP.

Non-member Participation is available to any organisation or individual who wishes to connect to FASTER. NMPs are required to provide their own hardware and meet the costs of connection to the system. These costs have tended to make it impractical for small investors to connect. The Non-Member Participation facility is primarily for institutional investors and custodial companies.

3.2.2 Listed Companies and Registries

Listed Companies are issuers of securities which are quoted and traded on the New Zealand Stock Exchange. Listed Companies are bound by the NZSE Listing Rules and all New Zealand Listed Companies are required to have the register of their securities with a FASTER approved Registry. The Registries and FASTER Participants act as agents for the Listed Companies.

3.2.3 Shareholders

A shareholder is a person or an organisation that has a holding of securities. Shareholders are indirectly a party to FASTER in that shareholder orders given to Members to buy and sell Listed Securities are matched and settled through FASTER.

3.3 Responsibilities and Obligations of FASTER Parties

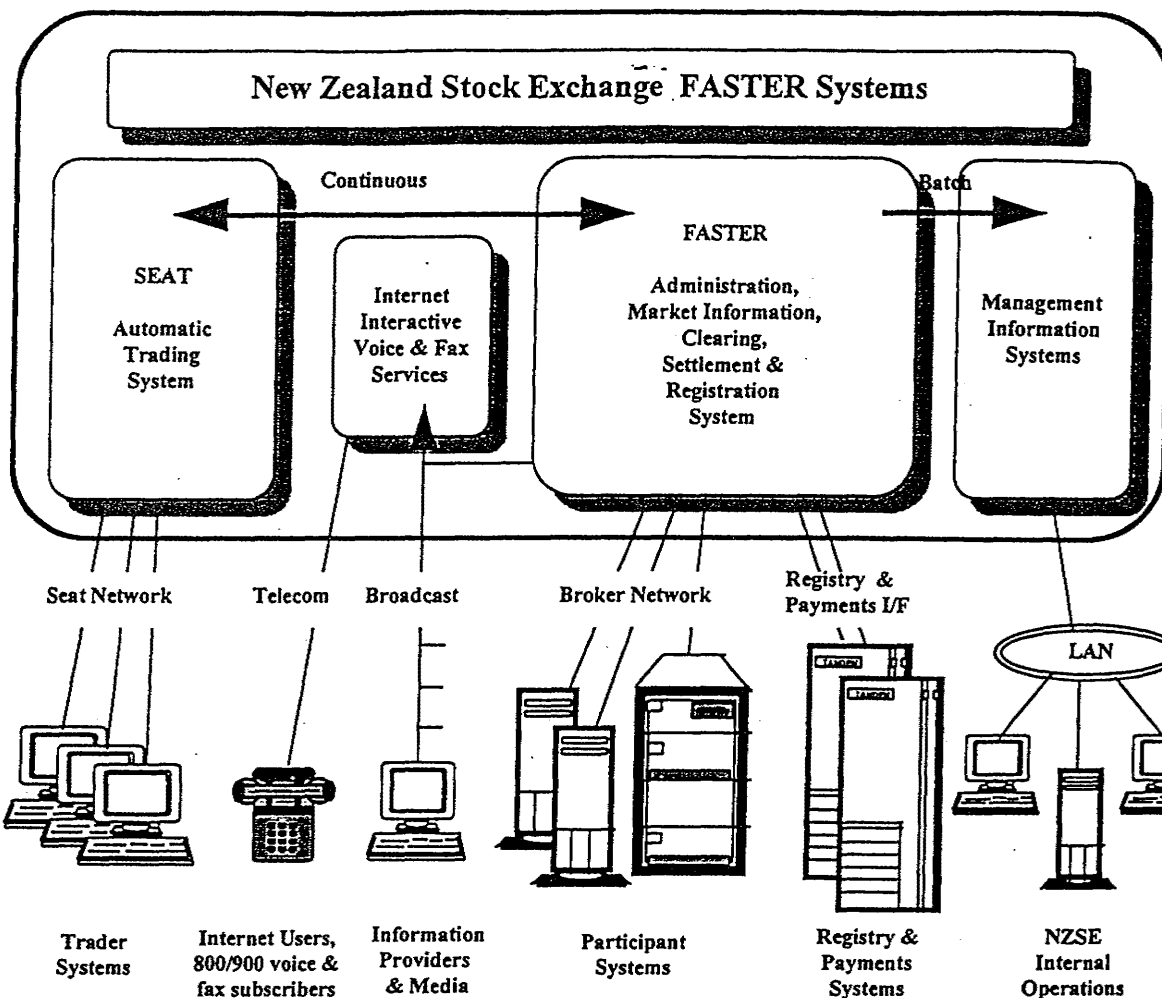
The persons or organisations that are party to FASTER have certain responsibilities and obligations in regard to their operations within FASTER. These responsibilities and obligations stem from legal statutes and contractual agreements that these parties are bound to abide by. See the section on Responsibilities and Obligations in this document for further details.

3.4 FASTER Technical Environment

FASTER includes numerous computer systems operated by: the NZSE, Participants, Registries and payments organisations. These are connected by the NZSE's FASTER system and associated data network. All participating systems connect to FASTER via this network and the FASTER system provides all of the message switching, logging and non-repudiation required to safely process transfers.

The FASTER system is able to provide all participants and users with a single and consistent view of all Registries. FASTER therefore operates as a virtual Central Registry and provides facilities comparable to the Central Depository system operated in some countries.

The following diagram depicts the FASTER technical environment:



3.4.1 The FASTER System

The FASTER System runs on a Tandem Non-stop computer. The FASTER system automatically currently receives trades from the NZSE Screen Trading system, keeps track of obligations and manages unsettled trades. Transactions to deliver and settle trades may also be entered into the FASTER system by Non-member Participants. This central FASTER system provides all of the message switching, logging and non-repudiation required to pass these transactions to the various Registries and Payment Systems for processing.

3.4.2 Registry Systems

Registries are commissioned by Listed Companies to keep a register of ownership of the Listed Companies' issued securities. The Registries operate computer systems to achieve this purpose. Registry systems must comply with FASTER standards for functionality and performance.

3.4.3 Trading System

The NZSE operates a screen trading system that is referred to as the SEAT system. The NZSE SEAT system is a version of The Australian Stock Exchange SEATS system and has been modified for New Zealand conditions. The SEAT system is currently the principal source of trades entering the FASTER system. As trades are matched in the SEAT system they are passed to the FASTER system where they are recognised as unsettled trades. Other transfers may be entered directly into FASTER by Participants and confirmed by both parties.

3.4.4 Member Systems

The FASTER system requires all active Member Firms to have systems that can connect directly to the FASTER system. All active trading firms must have either their office systems permanently on-line to the FASTER system or have a Terminal based connection in order to receive advice of matched trades and perform clearing, settlement and registration.

There are two methods by which a Participant may access FASTER:

1. *FASTER Terminal Interface.* The Terminal Interface allows access to the FASTER system using screens developed by NZSE. Members using the Terminal Interface for FASTER transactions must ensure that the transactions are reflected in their in-house accounting systems.
2. *FASTER Gateway Interface.* The Gateway interface is a communication protocol that allows the transfer of data between computer systems. Gateway is used by most Members' in-house systems to interface to the FASTER System.

3.4.5 Payment Systems

The FASTER system can be linked to external Payment Systems that are able to provide guaranteed same day irrevocable funds for settlement. FASTER currently connects to the Reserve Bank's AustraClear Payment System.

3.5 FASTER Transfer Accounts

All FASTER Participants (both Members and Non-members) operate FASTER transfer accounts. These are non-certificated holding accounts which reside on the Registries' systems. All Participant transfers are electronically executed in and out of FASTER transfer accounts by FASTER transactions.

Rules govern the use of FASTER transfer accounts. Participants may not retain holdings in these accounts for any purpose other than awaiting settlement, and must be able to account for the true beneficial owners at any point in time.

3.6 CLIENT Statements

Under the paperless system, the traditional share certificates are replaced by statements that list the details of shareholders' security holdings. These physical statements have no legal value and do not have to be presented with a transfer when securities are sold.

Weekly statements are provided in the case where security transfer transactions take place. These statements will show the transactions as well as the resultant holding. Statements will cover all the current holdings of the shareholder at the Registry, i.e. for more than one company.

Registries are also required to issue a full statement of holding on request, not more often than every six months, that includes details of the nature of the securities held.

3.7 Authorisation Code

Each statement sent to a shareholder will show a current Authorisation Code that is required to be disclosed to enable the transfer of securities. For each shareholder, a separate Authorisation Code will apply to each class of securities in a company held by that shareholder.

The Authorisation Code has to be presented together with a Shareholder Number to authorise a sale and transfer of securities. The Authorisation Code can give access to all or part of a holding of a particular security.

Shareholders may contact the Registry in order to split a security holding that they own across two Authorisation Codes. One (the existing) Authorisation Code is then used to access a specified quantity of the security and the other (new) Authorisation Code will access the holding balance. This service may be chargeable.

The Authorisation Code will only change following a sale. Old codes will remain valid for one week past the weekly mailing date for statements or until the new code is first used. New codes are valid from the date of mailing of a statement meaning that there may be a period where either code is valid until the new code is used.

Issues of a new class (e.g. a rights or bonus issue) will have a new code supplied on the statement that is mailed by the Registry immediately following entitlement or allotment.

For written transfers the Authorisation Code is required on the transfer form instead of the Share Certificate Number.

3.8 FASTER Settlement (Delivery Versus Payment)

FASTER settles all trades on a trade by trade basis (i.e. no netting occurs and delivery is always against the original contracted counterparty). Furthermore, FASTER requires that the full and final settlement of a trade is completed (i.e. partial deliveries are not accepted). This includes any accruals added to the trade as a result of corporate actions. For Example, if a trade has not yet settled on the book close date for a rights issue then the trade is adjusted and have rights added to it. The underlying securities plus the rights must then be settled in full.

All trades are settled under DVP (Delivery versus Payment). Two forms of DVP are supported by FASTER as follows:

1. *Guaranteed Credit Settlement:* Guaranteed Credit Settlement is where payments for trades are accumulated within guaranteed lines of credit, during the day, and actual payments made once per day. Under this form of DVP, Participants operate within Guaranteed Credit Limits that are established with their Bank. FASTER will ensure that the accumulated obligation of the Participant does not exceed their established credit limits. Each Participant makes a single payment to the NZSE or receives a single payment from the NZSE each day in consideration of the trades delivered or received the same day. Payments are made via the Payment Systems that the FASTER system electronically interfaces with. This achieves same day irrevocable funds for trades delivered.
2. *Real Cash Settlement:* Real Cash Settlement is where two Participants agree to settle a trade for real cash. Trades must be set up to indicate this prior to delivery, and the buyer must have cash funds deposited and available in FASTER at the time of settlement. Contemporaneous exchange of securities and funds then occurs within FASTER and the funds are available for onward use or immediate withdrawal by the seller following delivery.

3.9 Common Shareholder Numbers

The NZSE provides the facility for shareholders to register themselves and have a Common Shareholder Number issued. The holder's various holdings possible at different Registries will then be recorded against the one Common Shareholder Number. In the FASTER system where the entry of a shareholder number is required, either an existing Registry Shareholder Number may be used or the allocated Common Shareholder

Number. The Common Shareholder Number has a built in check digit to safeguard against data entry errors. This facility is generally only available to market intermediaries and institutional investors. Common Shareholder Numbers are administered by the NZSE.

3.10 FASTER Audit and Security

An audit trail of all messages sent to and received from the Registries is kept by the FASTER system. FASTER records the message content, the date and time the message was sent, the Participant that submitted the transaction, the Registry and the communication link the message was sent or received on. Registries maintain a detailed history of transactions performed against their databases. This history is available for on-line enquiry using FASTER enquiries.

System Security is provided at every level of the FASTER system. If Participants use the Gateway interface to FASTER, they are required to implement additional end user security on their own systems. Users of the Terminal interface must rely on the security inherent in the FASTER and Registry systems.

The combination of security validation and audit logging provides formal non-repudiation of all FASTER transactions. FASTER messages must come from an authenticated source. Authenticated FASTER messages are processed at the appropriate Registry and the results are reported back to the source. The transaction is then considered irrevocable.

Participants' connections to the FASTER system are controlled by the NZSE. Each Participant is identified by a user ID that is associated with a NZSE Subscriber Code. Participants are allocated a password which must be changed at regular intervals. Services on the FASTER system (including FASTER Transactions) are allocated to each user ID by the NZSE. Users are restricted to accessing data that belongs to their NZSE Subscriber Code and may be restricted to some transactions depending on their user type. Registry systems provide a further level of security by ensuring a Participant can only access their own accounts or accounts for which they have authority.

Additional security is provided in the communication link between the NZSE system and the Registry systems. A logon sequence where passwords are exchanged and validated is completed before the session is established. All messages sent and received are sequence numbered to ensure that data is not lost and is processed in order. Synchronous communication protocols are used with inherent error detection and correction to prevent data corruption.

3.11 Key FASTER Transactions

In a typical transaction involving the sale of securities a selling Member will receive instructions from a selling client, complete a sale through the NZSE and send out a contract note to the client recording the details of the transaction (similarly for the buyer). The FASTER system will then be used to transfer the ownership of the securities from the seller to the selling Member, to the buying Member and to the buyer. The key FASTER transactions that are used to transfer securities are as follows:

- **Client Inward Transfer (CIT):** A CIT is issued by a selling Member Participant to move securities from the selling client's holding to the selling Member's FASTER transfer account. A CIT is currently supported by transfer documents which under paperless settlement is replaced by an Authorisation Code (similar to a Personal number).
- **Owned Inward Transfer (OIT):** An OIT is issued by a Participant to move securities from an account that the Participant owns or has authority over, to the Participant's FASTER transfer account.

- **Claim of Delivery (COD):** A COD is issued by a selling Member Participant to transfer securities associated with a trade from their FASTER transfer-account to a buying Member's FASTER transfer account. This is done in exchange for value on a DVP basis.
- **Client Outward Transfer (COT):** A COT is issued by a Participant to transfer securities from their FASTER transfer account to a nominated shareholder (i.e. the buying client).
- **Participant to Participant Transfer (PPT):** A PPT is issued by a Participant to transfer securities from their FASTER transfer account to another Participant's FASTER transfer account. There is the option to execute the transfer in exchange for value under DVP.

3.12 Corporate Actions (Diary Adjustments)

On receipt of Company Announcements information from a Listed Company, the NZSE enters Diary Adjustment details into the FASTER system. FASTER then processes these adjustments on the Books Close date by applying the benefits to all trades which are outstanding (i.e. not settled). The benefits are then passed on to the buyer when delivery is made and settlement completed. Diary Adjustments are applied to ensure that buyers receive their entitlement.

FASTER has removed the need for a books close period for trading in New Zealand. Following the close of business on the Books Close date all holdings affected by a Diary Adjustment are processed at the Registry and in the FASTER system. Entitlements are available at the start of the next business day.

3.13 Enquiry Facilities

The FASTER system includes a wide range of enquiry facilities that provide for different participant information needs as follows:

- Transaction Enquiries that provide access to the details of participants' transactions;
- Reconciliation Enquiries that provide access to FASTER balances for reconciliation with internal broker systems;
- Audit Trail Enquiries that provide access to FASTER transaction processing logs;
- Monitoring Enquiries that provide participants with details of their Settlement Position;
- Company Enquiries that provide static information regarding company officers, securities, address details and announcements; and
- Market Information Enquiries that provide statistical data in terms of trading activity, price, volume and value.