24 April 2017

Mr James Mason
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: insolvency@treasury.gov.au

Dear Mr Mason

Insolvency Law Reform
Stay on enforcing rights because of arrangements or restructures

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on an aspect of the draft Treasury Laws Amendment (2017 Enterprise Incentives No.2) Bill 2017 (Draft Bill) relating to the stay on enforcing rights because of arrangements or restructures.

Chapter 2 of the Draft Bill Schedule 1, Part 2 entitled "*Stay on enforcing rights merely because of arrangements or restructures*" will amend the voluntary administration regime contained in Part 5.3A of the Corporations Act and schemes of arrangement under Part 5.1 of the Corporation Act. An ipso facto clause allows one party to terminate or modify the operation of a contract upon the occurrence of some specific event. In the context of insolvency, such clauses allow one party to terminate or modify the contract when formal insolvency proceedings are started, such as on the appointment of a voluntary administrator. Ipso facto clauses which allow a contract to be terminated or varied solely due to the fact that an 'insolvency event' has occurred, regardless of continued payment or performance, would be stayed during a formal restructure. This will be subject to exceptions where ipso facto clauses are inherently necessary to the operation of a contract. The Draft Bill achieves this by broadly stating that *"a right under a contract, agreement or arrangement is, by force of this subsection, not enforceable against [a relevant entity] merely because [it is subject to the relevant event]"*. This is commonly referred to as a "stay".

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AFMA appreciates that that the drafters have taken account of our concerns expressed in response to the consultation last year on this matter. With regard to financial contracts mitigation of the undesirable impact on financial contracts will be achieved by applying an exemption:

- in a type of contract specified in regulations;
- of a kind prescribed in the ministerial determination;
- in agreements made after the commencement of a scheme of compromise for a Part 5.1 body or administration of a company;
- that manage financial risk associated with a financial product that is commercially necessary for that type of financial product.

AFMA is of the view that as a matter of general principle in relation to financial contracts there should be no interference with the current right of a creditor with a security interest over the whole, or substantially the whole, of the property of a company under administration to take enforcement action. The ability of a creditor to contract to stand outside the voluntary administration procedure is an important feature of the current law to preserve a stable financial system. Our members are to continuing to deliberate on which of forms of financial contracts should be specifically identified for exemption by regulation.

Nevertheless, there is a type of contract that needs to be unambiguously exempted in the law itself because of its fundamental importance to financial system stability. The Explanatory Memorandum to the Draft Bill indicates that it is Government policy is to exclude close-out netting contracts such as ISDA Master Agreements and other agreements under the *Payment Systems and Netting Act* 1998 from the stay. However, the manner in which these agreements could be excluded through potential regulation is inadequate and differs from the approach which has been taken in other legislation. It is essential that there be no ambiguity with regard to the primacy of the Payment Systems and Netting Act in relation to to netting contracts. This issue has been extensively discussed in the past with the Treasury with regard to the 2008 amendments to the *Banking Act* 1959.

AFMA is of the view that the current drafting of the Draft Bill applies the stay to all contracts, agreements or arrangements (including ISDA Master Agreements), and only (potentially) excludes these agreements through the regulations. This approach could cause some conflict with the provisions of the Payment Systems and Netting Act which provide that the protections of the Payment Systems and Netting Act apply “despite any other law” as the Draft Bill will be a subsequent law, creating legal confusion about the will of the Parliament.

The primacy of the protections of the Payment Systems and Netting Act is of a crucial public policy importance. For this reason, we believe it is important that the Draft Bill clarifies its interaction with the protections of the Payment Systems and Netting Act. Accordingly, we would recommend that the legislation state simply say:

> *"If there is any inconsistency between this Act and the Payment Systems and Netting Act 1998, the Payment Systems and Netting Act 1998 prevails to the extent of the inconsistency."*

This aligns with the approach already taken by Parliament in other Australian legislation, including the *Personal Property Securities Act* 2009. We also consider that this approach aligns with the existing policy of the Government and would ensure that the protection of key financial market infrastructure and arrangements under the Payment Systems and Netting Act continues to apply in a clear manner.

AFMA has had the benefit of seeing the comments on the Draft Bill prepared by the International Swaps and Derivatives Association (ISDA) and we agree with and also commend their comments to you.

AFMA would be pleased to provide further comment if desired. Please contact David Love either on 02 9776 7995 or by email dlove@afma.com.au if further clarification or elaboration is desired.

Yours sincerely

David Love
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