EXPOSURE DRAFT

EXPLANATORY STATEMENT

Issued by authority of the Assistant Treasurer

Corporations Act 2001

Corporations Amendment (National Guarantee Fund Payments) Regulations 2019

Section 1364 of the *Corporations Act 2001* (the Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the relevant Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

Section 888C of Act states that regulations may determine the amount of compensation to which a person is entitled in respect of a claim on the National Guarantee Fund (NGF), including by setting an upper limit on the amount of compensation.

The Act regulates corporations and financial services, including licensed financial services markets. In particular, Part 7.5 establishes a compensation regime for clients who incur a loss connected with the ASX, for example, due to a dealer becoming insolvent and failing to meet its obligations to the client. This compensation regime is called the NGF.

The purpose of the *Corporations Amendment (National Guarantee Fund Payments) Regulations 2019* (the NGF Regulations) is to amend the *Corporations Regulations 2001* (the Corporations Regulations) to cap compensation payments made out of the NGF.

Before the NGF Regulations, there was only a cap on claims made under one of the four heads of claim. This created the risk that one or more large claims could severely deplete the fund.

The NGF Regulations replace the existing cap with three new caps on payments out of the NGF which cover all of the heads of claim. First, it caps the amount that a claimant may receive for claims relating to the same event and the same participant at $1 million. Second, it caps the cash component of any such claim at $250,000. Third, if the participant becomes insolvent, the NGF Regulations cap the total amount paid out of the NGF in relation to that participant at 15 per cent of the minimum amount in the NGF as at the end of the day on which the participant became insolvent.

Together, these caps aim to ensure the sustainability of the NGF.

Details of the NGF Regulations are set out in the Attachment.

The enabling Act does not specify any conditions that need to be satisfied before the power to make the NGF Regulations may be exercised.

The NGF Regulations commence on the day after registration and the new caps apply to claims arising after the date of registration.

ATTACHMENT

Details of the *Corporations Amendment (National Guarantee Fund Payments) Regulations 2009*

Clause 1 – Name of the Regulations

The name of the instrument is the *Corporations Amendment (National Guarantee Fund Payments) Regulations 2019* (the NGF Regulations).

Clause 2 – Commencement

Clause 2 states that the Regulations commence on the day after the instrument is registered.

Clause 3 – Authority

The Regulations are made under section 888C of the *Corporations Act 2001* (the Act). That section of the Act gives power for the regulations to set an upper limit on the amount of compensation payable out of the National Guarantee Fund (NGF).

Clause 4 - Schedules

This clause states that the *Corporations Regulations 2001* (the Corporations Regulations) are amended as set out in the applicable items in the Schedule and that any other item in the Schedules has effect according to its terms.

Schedule 1 – Amendments

Item 1

Item 1 inserts regulation 7.5.18A. This regulation ensures that the new caps are taken into account before applying all other regulations which require the SEGC to pay an amount in relation to a claim. The SEGC may be required to pay an amount in respect of contract guarantees (Subdivision 4.3), if a dealer transfers securities without authority (Subdivision 4.7), if there is a contravention of the ASTC's certificate cancellation provisions (Subdivision 4.8), if a dealer becomes insolvent (Subdivision 4.9).

Interest and other amounts relating to claims falling under Subdivisions 4.3 to 4.9 may also be payable under one of the general provisions in Subdivision 4.10. From the structure of the regulations, it follows that provisions in Subdivision 4.10 are also subject to the caps (which are themselves located in Subdivision 4.10). This is clarified by the new note to regulation 7.5.18A

Item 2

This item repeals regulation 7.5.71 which sets a cap on claims per participant made under the insolvency head of claim. This regulation is no longer required as it is being replaced with a new participant cap that applies to all heads of claim.

Item 3

Item 3 caps the amount of claims in relation to a participant and the amount of claims per claimant. These new caps are designed to reduce the risk of the fund being depleted by a large claim or several large claims relating to a single participant.

Participant cap (regulation 7.5.72A)

New regulation 7.5.72A imposes a cap on claims relating to losses connected with a particular participant or past participant.

Claims subject to the cap

The cap applies to all claims that have not been settled on the day after a participant or past participant becomes insolvent. This may include claims made before the participant became insolvent, as well as claims made after the insolvency.

Unlike the cap in former regulation 7.5.71, the new participant cap applies to claims made under any head of claim. That is, the cap applies to claims which are not caused by or are in any way referable to the insolvency.

The cap does not apply to claims that are settled on the day the participant becomes insolvent or on a day before that day. This reflects the fact that the cap can only be applied when the SEGC has a degree of confidence that no claims with respect to future conduct relating to the participant will arise. Before a participant becomes insolvent, there is an ongoing prospect of new claims arising as a result of the participant's future conduct. After a participant has become insolvent and enters into external administration, it defaults under the market operating rules, cannot continue to trade on the market in the usual way and cannot engage in any future conduct that gives rise to further new claims (apart from those resulting from the insolvency).

Amount of the cap

The cap on claims relating to a participant or past participant is set at 15 per cent of the minimum amount of the NGF as at the end of the day that the participant becomes insolvent.

The minimum amount of the NGF is not the same as the actual amount in the NGF. The minimum amount is set by the SEGC and approved by the Minister (see existing section 889I of the Act).

When determining the total of the amounts paid out of the NGF to claimants, the SEGC must disregard any amount paid out of the NGF:

- that is repaid to the NGF; and
- as does not exceed the amount recovered by the SEGC because of the exercise of a right or remedy of the claimant to which the SEGC is subrogated.

The amounts that are disregarded by the SEGC when determining the total of the amounts paid out of the NGF generally mirror the amounts that were disregarded under the participant cap on insolvency claims in former regulation 7.5.71.

SEGC's power to determine the maximum amount of a claim

The SEGC is given the power to determine in writing whether the cap applies to the claim and the maximum amount in relation to the claim that results from applying the provisions relating to the cap. The SEGC may also revise a determination because of section 33 of the *Acts Interpretation Act 1901* which provides that a power to make an instrument (such as a determination) includes the power to remake it.

When determining the maximum amount in relation to the claim, the SEGC must ensure, as far as practicable, that the proportion of each claimant's claim that is compensated is as nearly as practicable the same for each claimant. In mathematical terms, the amount given by the below formula should be roughly the same for each claimant:

total compensation received ÷ total claim

where:

total compensation received is the compensation received from both the NGF and other sources

total claim is the maximum amount of the claimant's claim after applying the claimant cap in regulation 7.5.72B (see below)

The amount that the SEGC pays out of the NGF cannot exceed the maximum amount determined by the SEGC.

Claimant caps (regulation 7.5.72B)

New regulation 7.5.72B sets two claimant-related limits on the amount of compensation. These two caps apply separately to each claimant. Unlike the participant cap in regulation 7.5.72A, the claimant caps do not aggregate the total amount of all claims relating to a single participant across multiple claimants.

Claims subject to the caps

The claimant caps apply to claims made under any of the four heads of claim. Claims settled both before and after insolvency are subject to the cap.

Amount of the caps

The first claimant cap is a cap on the total amount paid out of the NGF. It is set at $1 million.

The second claimant cap is a cap on the portion of the claims that relate to cash held with the participant immediately before the event. It is set at $250,000. This is the same as the amount of the cap on the Australian Government's guarantee of deposits held in Authorised Deposit-taking Institutions under the Financial Claims Scheme.

The cash cap applies to the amount held with the participant or past participant immediately before the event. In other words, it does not include any additional cash that may be deposited in the participant's account after the participant defaults under the market operating rules and the participant's open positions are closed out (if those amounts are otherwise covered by the NGF).[1]

Claims included in the caps

The claimant caps apply separately to each event and each participant. In other words, the cap applies to the sum of all claims which:

- are made by the same claimant;
- relate to the same event or circumstance; and
- relate to losses caused by, or otherwise connected with, the same participant.

The claims that are added together for the purpose of applying the cap are referred to as the ***eligible claims*.** These may include claims which are made under different heads of claim. This ensures that a claimant cannot split one claim into multiple claims so as to avoid the cap.

The ***maximum amount*** refers to the parts of the claim(s) that are allowed after applying the claimant caps. The maximum amount reflects the amount paid out of the NGF, not the claims made to the NGF.

Example 1.1

> A claimant makes one claim for $600,000 (under the insolvency head of claim) and one claim for $300,000 (under the head of claim for unauthorised transfers of securities). The SEGC determined that both claims relate to the same event and the same participant.
>
> The caps apply to the aggregate of these two claims because they relate to the same claimant, participant and event. It is irrelevant that the claims were made under different heads of claim.
>
> The claimant then makes a further claim for $400,000. This claim relates to a different participant and a different event.
>
> The $400,000 claim does not need to be aggregated with the two earlier claims when applying the caps. Instead, the cap will apply separately to the $400,000 claim as it relates to a different participant and event.

Amounts excluded from the cap

When determining the total of all eligible claims, the SEGC must disregard any amount paid out of the NGF:

- that is repaid to the NGF; and

[1] See, for example, section 15 of ASX Clear's Operating Rules.

- as does not exceed the amount recovered by the SEGC because of the exercise of a right or remedy of the claimant to which the SEGC is subrogated and does not need to be supplied to the claimant.

These are the same amounts as those excluded for the purposes of calculating the participant cap.

Interaction between the caps

Both the claimant caps and the participant cap apply in situations where the participant or past participant becomes insolvent on a day before the eligible claims are settled by the SEGC. In this situation, the SEGC must first assess each claimant's claim and apply the claimant caps. If the total of all claimants' eligible claims in relation to a participant exceed the participant cap, the SEGC must reduce the maximum amount of each claimant's claims after applying the claimant cap (***the claimant's amount***) by using the following formula:

$$\text{Amount of reduction} = \frac{\text{claimant's amount x excess}}{\text{total claimants' amounts}}$$

where:

claimant's amount means the amount that would be the maximum amount of the claimant's claim after applying the claimant caps but before applying the participant caps. For the meaning of 'maximum amount', see the explanation on page 5 under the heading 'Claims include in the cap'.

total claimants' amounts means the maximum amount of all claimants' claims after applying the claimant cap but before applying the participant cap. It is determined by adding the ***claimant's amount*** for each claim included in the participant cap.

excess is the difference between the total claimants' amount and the amount of the participant cap, that is:

Total claimants' amount – amount of the participant cap

The formula works by prorating the excess among the claims. The individual claimant's claim is then reduced by this prorated amount.

SEGC's power to determine the maximum amount of the claim

The SEGC is given the power to determine in writing whether a claim is an 'eligible claim' and the maximum amount in relation to the eligible claims that results from applying the provisions relating to the caps. The SEGC may also revise a determination because of section 33 of the *Acts Interpretation Act 1901* which provides that a power to make an instrument (such as a determination) includes the power to remake it.

The amount that the SEGC pays out of the NGF cannot exceed the maximum amount determined by the SEGC.

Item 4

Item 4 amends regulation 7.5.75 to give the SEGC a discretion to reduce the amount of compensation paid to the claimant out of the NGF by any compensation that the claimant has received, or is likely to receive, from sources other than NGF.

The reason that the SEGC has a discretion (rather than an obligation) is because it needs to consider several variables before determining whether it is appropriate to reduce the amount of compensation payable. These variables may include whether the amount paid to one claimant will reduce the amount paid to another claimant and the costs incurred by the claimant in obtaining the compensation. If the compensation has not yet been paid, the SEGC may also wish to take into account the probability of the compensation being paid and the estimated date of receipt.

Item 5

Item 5 applies the cap to a claim only if the claimant's entitlement to make that claim arose after the date of registration of the NGF Regulations.

The cap does not apply to a claim that arose on or before the date of registration, even if the claimant only submitted the claim after the day of registration. This ensures that claims arising from the same event are not treated differently depending on when the claimant actually makes the claim.