



Submission in response to
ASIC Consultation Paper 86: Competition for market
services – trading in listed securities and related data

August 2007

Executive Summary

SEGC is pleased to have the opportunity to make a submission in relation to ASIC's Consultation Paper 86: *Competition for market services – trading in listed securities and related data* (the Paper).

One area yet to be addressed which is of particular interest to SEGC is the compensation regime provisions for financial markets in the Corporations Act (the Act) and Regulations appear not to be designed to deal with a situation where a participant of both Australian Securities Exchange¹ (ASX) and another market, can trade ASX securities on both markets. Accordingly, amendments will be required to deal with this situation.

Background

The National Guarantee Fund (NGF) was created in 1987 as a means of enhancing confidence in trading on the ASX. The NGF is a compensation regime under Division 4, Part 7.5 of the Act. The NGF is administered by the Securities Exchanges Guarantee Corporation Limited (SEGC), a non-consolidated wholly owned subsidiary of the ASX.

The funding arrangements for the NGF were originally created from pooling part of the assets of the fidelity funds formerly operated by state exchanges. Subsequently, interest from broker trust accounts and investment earnings has been added to NGF funds.

At present, the source of income for the NGF is investment earnings. Previously, interest from broker trust accounts was included in NGF funds but from March 2004 this interest is no longer available to the NGF.

Compensation arrangements – Divisions 3 and 4 of Part 7.5 of the Corporations Act and Regulations

Under Division 4 of Part 7.5 of the Regulations, the NGF provides investor protection by providing a means of redress for clients of stockbrokers in certain circumstances, including:

- where the broker has failed to complete a sale or purchase of securities entered into on the ASX's equities and debt market and where those transactions are required to be reported to the ASX by the stockbroker ('contract guarantee');
- where a stockbroker makes an unauthorised transfer of securities;
- where a stockbroker cancels or fails to cancel a certificate of title to quoted securities contrary to the operating rules of the ASX Settlement and Transfer Corporation Pty Limited (ASTC); and
- where a person has entrusted property to a stockbroker who subsequently becomes insolvent and therefore cannot meet its obligations to that person.²

The NGF is only available in relation to conduct of a participant of the ASX who enters into a reportable transaction³ on the ASX. Other stock exchanges such as the Bendigo Stock Exchange and the National

¹ This body was formerly known as the Australian Stock Exchange.

² Respectively, subdivisions 4.3, 4.7, 4.8 and 4.9 of Part 7.5 of the *Corporations Regulations 2001*.

³ As defined in regulation 7.5.01 of the *Corporations Regulations 2001*.

Stock Exchange of Australia.⁴ have their own compensation arrangements. These compensation arrangements are governed by separate rules in Division 3 of Part 7.5 of the Act and Regulations.

A problem which may arise in relation to compensation arrangements is highlighted in section 885D, Division 3 of Part 7.5 of the Act.

Section 885D(1) was intended to ensure that there is a necessary connection with a particular market⁵. Under this section, if a loss could be connected to two or more markets all of which have Division 3 compensation arrangements, but it is not clear which, the client would not be entitled to compensation. Section 885D(2) provides if the loss could be connected to two or more markets, one of which has Division 4 compensation arrangements (ie the ASX market), but it is not clear which, the client may be entitled to compensation from the NGF. These situations could arise where the loss relates to the misappropriation of money or property held by a participant for a client in circumstances where the client is trading on more than one market.

The NGF provisions in Division 4 of Part 7.5 of the Regulations are drafted in such a way that they may cover losses even if those losses relate to trading on another market (ie the AXE market). In particular, Subdivision 4.7 of Part 7.5 (unauthorised transfer) applies where an ASX participant transfers securities without authority of a client. This is not confined to transfers on the ASX market. Hence, the NGF could cover a loss even if the unauthorised transfer occurred on another market (ie AXE market) by say an AXE participant, who is also a participant of ASX.

Subdivision 4.9 of Part 7.5 of the Regulations (claims in respect of insolvent participants) applies when a client entrusts property to an ASX participant. Hence, if a participant of another market (ie AXE), which is also a participant of ASX becomes insolvent then its clients could possibly claim on the NGF.

Conclusion

The uncertainty resulting from s885D is not in the interest of clients of participants of ASX or participants of another market.

⁴ This body was formerly known as the Stock Exchange of Newcastle.

⁵ Explanatory Memorandum to the Financial Services Reform Bill para 10.28.