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EDR Review Secretariat
Financial System Division
Markets Group
The Treasury
Langton Crescent
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By email to EDRreview@treasury.gov.au

REVIEW OF THE FINANCIAL SYSTEM EXTERNAL DISPUTE RESOLUTION FRAMEWORK

Thank you for the opportunity to make a submission to the Review. Our comments focus on compensation arrangements for clients of brokers on the securities markets operated by ASX.

ASX recognizes that last resort compensation schemes can play an important role in enhancing customer confidence by delivering equitable outcomes where customers have experienced certain financial losses as a result of the provision of financial services. This has certainly been the experience with securities market compensation schemes (e.g the National Guarantee Fund (NGF)) which, in conjunction with improvised regulatory oversight, has enhanced investor confidence in dealing in securities markets.

ASX acknowledges that it is necessary to measure the potential benefits of broader compensation arrangements against the risk that they may heighten moral hazard risks, as posited by the St John review. However, we are not aware of any evidence that the introduction of a last resort compensation scheme for the equity market has generated greater risk taking by financial service providers. These risks are managed by ensuring appropriate regulatory arrangements are in place.

The compensation scheme covering the equity market, the NGF (which was formed by combining a number of previously State-based schemes), remains an important protection that retail investors turn to when there is a broker fraud or insolvency event. There are a number of refinements that can ensure that the NGF is available for this primary purpose. These changes would mean that the compensation scheme better reflects current market structure and practice as well as supporting the scheme's long-term financial stability.

Regardless of the Government's decision on whether to establish a single broad based last resort compensation scheme across a range of financial services, there is a strong case that the NGF should remain as a standalone compensation scheme for activities conducted through participants on licensed equity markets. Should the Government proceed with a broader scheme it will be necessary to clearly delineate what activities are covered by each scheme, given they may operate under different heads of claim.

Following are some responses to specific questions posed in the supplementary consultation paper.

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Q4. What are the strengths and weaknesses of the National Guarantee Fund?

The National Guarantee Fund is administered by Securities Exchanges Guarantee Fund Ltd (SEGC). It provides compensation for clients of brokers on the market operated by ASX Limited for losses including those related to the inappropriate transfers of cash or securities or of property entrusted to brokers that become insolvent. The scheme protects investors and maintains retail investor confidence in dealing through licensed brokers and in the listed market, which was the original purpose of the NGF[1].

The NGF is a pre-funded scheme that was initially seeded from the interest on customer funds held in broker trust accounts and has grown to hold net assets valued at $102 million as at 30 June 2016.

While the NGF remains an important protection for retail investors and should continue to be the primary compensation fund applying in relation to trading on the ASX equity market, we submit that reform to update existing arrangements is necessary as a result of the significant changes to the market structure and participant processes since the NGF was established.

The key priority amongst reforms to the NGF should be the capping of claims. There is currently no limit to claims (other than an overall cap in relation to participant insolvency) and a large claim (e.g. from a large institutional investor) could potentially exhaust the fund's resources and trigger the replenishment requirements.

Capping of claims is true to the original purpose of establishing the NGF, to maintain retail investor confidence, through limiting claims to a size that more closely reflect retail investor activity. It also provides a sounder financial footing for the NGF going forward and is consistent with other compensation arrangements in Australia such as the Government's guarantee of bank deposits held in Authorised Deposit-taking Institutions. This reform is also consistent with international best practice. Table 1 compares the features of the NGF to similar compensation arrangements in the UK, USA, Canada, Singapore and Hong Kong. All of these compensation arrangements have caps on claims.

Compensation arrangements associated with activity conducted on other licensed markets in Australia (e.g. Chi-X (Australia), the National Stock Exchange and the Sydney Stock Exchange) currently have caps of $100,000 per claim and $1 million per event.

The ASIC approved external dispute resolution scheme operated by the Financial Ombudsman Service (FOS) covers disputes for claims of up to $500,000 in relation to the provision of a financial service by a financial services provider (including a broker) and may make awards against a financial service provider for amounts up to $309,000.

The Corporations Act has an existing provision that can facilitate the introduction of a cap on NGF compensation claims through regulations that may 'impose an upper limit on the amount of compensation to which a person is entitled in respect of a claim in particular circumstances, or an upper limit on the total amount of compensation to which persons are entitled in respect of claims referable to a particular event or circumstance' (s888C(2)(d)). There is an existing cap of 15% of the [assets of the] NGF for any individual broker insolvency.

A regulation can be made to introduce a cap on individual claims. While the quantum of the cap would need to be considered in the context of the seize and nature of retail shareholder and self-managed superannuation fund activities, a level of say $1 million per claimant with a sub-limit of $250,000 with

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[1] Australian Stock Exchange and National Guarantee Fund Bill 1987, Second Reading Speech by the Hon. Lionel Bowen, MP, Deputy Prime Minister and Attorney-General, page 4..

respect to cash may be appropriate. The current cap of 15% of the NGF for each broker insolvency should remain.

ASX also supports reform to the NGF heads of claim, which are complex, can lead to investor confusion about the extent of NGF cover and have not been reviewed for many years as market structure and practice have developed.

ASX would support reform so that the loss covered is limited to:

- financial loss resulting from the insolvency of a broker;
- in respect of a claim for failure of the broker to return or account for securities or cash entrusted to, or in control of, the broker;
- where the cash or securities were entrusted in connection with only the broker's securities business and the broker's actions as a participant of a member exchange.

The capping of claims should be the first priority and should not be delayed if reform to the heads of claim takes longer to implement.

ASX also has a separate compensation fund which covers claims in relation to the futures market. Claims on this fund are capped.

Q30. How should any compensation scheme of last resort interact with other compensation schemes?

To the extent that losses are covered by the NGF they should not also be covered by another compensation scheme of last resort. However, it is important to ensure that the extent of NGF coverage is clear, to avoid investor confusion as to what is covered by the NGF and what may be covered by another compensation scheme. In particular, any reform to the NGF claims provisions should make it clear that NGF coverage only applies to brokers' activities in dealing with securities on the market, and not to other business activities that brokers may be involved in.

ASX would be happy to expand on any of the matters raised in this submission. Any questions should be addressed in the first instance to Sally Palmer (E: sally.palmer@asx.com.au; Ph: 9227 0920) or Gary Hobourn (E: gary.hobourn@asx.com.au; Ph: 9227 0930).

Yours sincerely,

Gary Hobourn.

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Table 1 - Overseas Compensation Funds

Country	UK	US	Canada	Singapore	Hong Kong	Australia
Name of fund	Financial Services Compensation Scheme (FSCS).	Securities Investor Protection Corporation (SIPC).	Canadian Investor Protection Fund (CIPF).	Fidelity Fund.	Investor Compensation Fund	National Guarantee Fund (NGF)
Claims coverage	The FSCS is the statutory compensation fund of last resort for customers of authorised financial services firms. FSCS can pay compensation if a firm authorised by the Financial Services Authority (FSA) is unable, or likely to be unable, to pay claims against it.	The SIPC assists individuals whose money, stocks and other securities are stolen by a broker or put at risk when a brokerage fails for other reasons such as bankruptcy.	The CIPF covers the financial losses experienced by customers solely as a result of the insolvency of a CIPF member. Such loss must be in respect of a claim for the failure of the member to return or account for securities, cash balances, commodities, futures contracts, segregated insurance funds or other property received, acquired or held by the member in an account for the customer.	The Fidelity Fund is designed to protect investors from financial losses due to any defalcation committed by a member of the Exchange or the insolvency of a member of the Exchange. Claims may only be made if the monetary loss was: a) in connection with a dealing or trading in the Exchange; b) by a member of the Exchange; and c) in relation to any money received by that member, its agent or as a trustee.	The Investor Compensation Fund covers defaults of exchange participants and non-exchange participants including licensed intermediaries and authorised financial institutions. Default means an intermediary, its employee or its associated person is in bankruptcy, winding up, or insolvency, or breach of trust, defalcation, fraud, or misfeasance.	The NGF is a compensation fund that is available to meet valid claims arising from dealings with brokers on the ASX market, in the circumstances set out in the legislation. It covers contract guarantee, unauthorised transfer of securities and property entrusted to or received by a broker that subsequently becomes insolvent.

Country	UK	US	Canada	Singapore	Hong Kong	Australia
Who can claim	In relation to investment claims, private investors and small companies that have suffered financial loss can claim.	Most customers of failed SIPC-member brokerage firms when assets are missing from customer accounts.	Any customer having a securities or commodity and futures contracts account with a CIPF member used solely for the purpose of transacting securities or commodity and futures contracts business (dealing as principal or agent).	Investors, with the exception of accredited investors.	Investors of any nationality who suffer pecuniary losses as a result of default of a licensed intermediary or authorised financial institution in relation exchange-traded products in Hong Kong	Clients who deal through a Dealer in securities quoted or admitted to trading status on the financial market operated by ASX
Amount of fund*	Funded by levies	US$2.7bn – as at 31 December 2016 (A$3.6bn)	C$473m, as at December 2015 (A$473m)	S$52m (A$49m)	HK$2.2bn as at 31 March 2016 (A$372m)	$102m as at 30 June 2016
Claim limits	The maximum level of compensation in relation to investments is £50,000 (A$84,240) per customer.	US$500,000 (A$656,944) per customer, including a maximum of US$250,000 (A$328,472) for cash claims.	The limit is C$1m (A$1m) for any combination of cash, securities and other property in a customer's general account, and an additional $1m for each separate account.	S$50,000 per claim (A$47,411)	The compensation is applied on a per-investor basis with a compensation limit of HK$150,000 (A$25,273) for trading securities and futures contracts respectively	There is no maximum amount that applies to any individual claim. For claims for property entrusted to a Dealer the total available for all claims for any one insolvent Dealer is 15% of the "Minimum Amount" of the Fund
Link	http://www.fscs.org.uk/	http://www.sipc.org/	http://www.cipf.ca	http://sgx.com/wps/portal/sgxweb/home/mygateway/inv_protection	http://www.hkicc.org.hk/index.htm	http://www.segc.com.au/pdf/ngf_information_booklet.pdf

* Currency conversions are as at 28 June 2017.