

EXPOSURE DRAFT

EXPLANATORY STATEMENT

Issued by authority of the Minister for Revenue and Financial Services, Minister for Women and the Minister Assisting the Prime Minister for the Public Service

Corporations Act 2001

Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018

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

Subparagraphs 415D(6)(b)(i), 434J(5)(b)(i) and 451E(5)(b)(i) of the Act provide that regulations can prescribe a right contained in a kind of contract, agreement or arrangement to which subsections 415D(1), 434J(1) and 451E(1) respectively do not apply.

The *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017* (“**the Amending Act**”) inserted provisions into the Act to stay the enforcement of ipso facto clauses against relevant entities (“**the ipso facto stay**”). The ipso facto stay applies to clauses (including self-executing clauses) which entitle a party to enforce a right under a contract, agreement or arrangement (collectively, “**arrangements**”) on the occurrence of various insolvency-related trigger events regardless of the counterparty’s continued performance of its obligations under the contract.

The lack of protection from the operation of ipso facto clauses has been a key criticism of Australia’s insolvency regime in general, particularly in the context of the voluntary administration regime contained in Part 5.3A of the Act and compromises and arrangements under Part 5.1 of the Act.

The amendments made by the Amending Act were one aspect of reforms to Australia’s insolvency law and formed part of the National Innovation and Science Agenda (“**NISA**”). The reforms aim to promote a culture of entrepreneurship and innovation which will in turn reduce the stigma of failure and help drive business growth, local jobs and global success. The reforms made by the Amending Act promote business recovery and restructuring as a means to drive cultural change. The stay on ipso facto clauses assists businesses to continue to trade in order to recover from an insolvency event instead of preventing their successful rehabilitation.

The ipso facto stay also promotes the objectives of the current restructuring regime in the Act by assisting viable but financially distressed or insolvent companies to continue to operate while they restructure their business.

The operation of ipso facto clauses can reduce the scope for a successful restructure, destroy the enterprise value of a business entering formal administration, or prevent the sale of the business as a going concern. These outcomes can also reduce or eliminate returns in subsequent liquidation by disrupting the businesses’ contractual

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arrangements and destroying goodwill, potentially prejudicing other creditors and defeating the purpose of a voluntary administration.

The ability of a business' suppliers, customers or other creditors to terminate a contract solely due to the financial position of the company or the commencement of a formal restructure increases uncertainty for the potential investor and makes the business a less attractive investment opportunity. As a result, the operation of ipso facto clauses may deter such investment, or reduce the price a potential investor is willing to pay for a business.

As a result of the amendments made by the Amending Act, certain rights that amend or terminate an arrangement will not be enforceable and are stayed where a company enters a scheme of arrangement, appoints a managing controller or has come under voluntary administration, except in limited circumstances.

The amendments made by the Amending Act include a provision that allow regulations to prescribe the kinds of arrangements where the rights contained in those arrangements will not be subject to the ipso facto stay. Similarly, a Ministerial declaration may exclude the enforcement of certain rights within a contract from the operation of the stay even when the contract as a whole is not excluded. This reflects the fact that there are a variety of situations where staying the operation of ipso facto clauses is either unnecessary or undesirable. For example, the ipso facto stay should not apply to certain kinds of arrangements where:

- arrangements are required or contemplated by Australia's laws or where international obligations would be disturbed;
- markets have evolved to depend on established systems and expectations and the ipso facto stay would significantly disrupt those markets;
- sophisticated counterparties traditionally negotiate their own arrangements in relation to complex transactions or complex financial products and the ipso facto stay would undermine those arrangements;
- the ipso facto stay would lead to unintended consequences or would severely disadvantage some contracting parties;
- parties have already entered into arrangements to attempt to alleviate a business' financial stress and staying ipso facto clauses would undermine or significantly change the terms of those arrangements; or
- the operation of an ipso facto clause is inherent to the operation of a contract and staying it would lead to a perverse outcome.

The Regulations amend the *Corporations Regulations 2001* and insert new provisions that prescribe the kinds of contracts, agreements and arrangements for the purposes of subparagraphs 415D(6)(b)(i), 434J(5)(b)(i) and 451E(5)(b)(i) of the Act. This will ensure that rights in those kinds of arrangements remain available to the parties to those arrangements should the events in subsections 415D(1), 434J(1) and 451E(1) respectively occur.

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Submissions received in a public consultation, which took place during the development of the Amending Act, proposed the kinds of arrangements which should be excluded from the operation of the ipso facto stay. These submissions were taken into account in developing the Regulations. Further submissions were received in targeted consultations which took place during the development of the Regulations.

The Regulations will commence on 1 July 2018, and apply from that date.

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Explanation of provisions

Clauses 1, 2, 3 and 4—Machinery provisions

Clauses 1 to 4 of the *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018* (“**the Regulations**”) are machinery provisions setting out:

- the name of the Regulations;
- the day the Regulations commenced;
- the authority for making the Regulations; and
- that the items in the schedule to the Regulations amend or repeal each instrument that is specified in the schedule and have effect according to their terms.

Item 1 of Schedule 1—Prescribed kinds of contracts, agreements or arrangements for the purposes of section 415D of the *Corporations Act 2001*

Item 1 of Schedule 1 inserts regulation 5.1.50 into the *Corporations Regulations 2001* (“**the Corporations Regulations**”). Regulation 5.1.50 provides that rights contained in the kinds of contracts, agreements or arrangements referred to in subregulation 5.3A.50(2) are not subject to the stay in section 415D of the *Corporations Act 2001* (“**the Act**”).

Item 2 of Schedule 1—Prescribed kinds of contracts, agreements or arrangements for the purposes of section 434J of the Act

Item 2 of Schedule 1 inserts regulation 5.2.50 into the *Corporations Regulations*. Regulation 5.2.50 provides that rights contained in the kinds of contracts, agreements or arrangements referred to in subregulation 5.3A.50(2) are not subject to the stay in section 434J of the Act.

Item 3 of Schedule 1—Prescribed kinds of contracts, agreements or arrangements for the purposes of section 451E of the Act

Item 3 of Schedule 1 inserts regulation 5.3A.50 into the *Corporations Regulations*. Subregulation 5.3A.50(1) provides that rights contained in the kinds of contracts, agreements or arrangements referred to in subregulation 5.3A.50(2) are not subject to the stay in section 451E of the Act.

Subregulation 5.3A.50(2) provides a list of the kinds of contracts, agreements or arrangements under which rights are not subject to the stays in sections 415D, 434J and 451E of the Act.

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Arrangements relating to laws and international obligations

Paragraph (a)—agreements within the meaning of Convention in the *International Interests in Mobile Equipment (Cape Town Convention) Act 2013*

Paragraph (a) prescribes that the operation of the stay on the enforcement of ipso facto clauses (“**the ipso facto stay**”) does not apply to agreements within the meaning of ‘Convention’, as defined in section 3 of the *International Interests in Mobile Equipment (Cape Town Convention) Act 2013* (“**the CTCA**”). Convention, in section 3 of the CTCA, means the *Convention on International Interests in Mobile Equipment* done at Cape Town on 16 November 2001, as amended and in force for Australia from time to time (“**the Cape Town Convention**”).

The CTCA enacts the Cape Town Convention and associated *Protocol on Matters Specific to Aircraft Equipment* into Australian law.

The Cape Town Convention standardises transactions involving movable property by creating international standards for the registration of contracts of sale, security interests, leases and conditional sales contracts. The *Protocol on Matters Specific to Aircraft Equipment* is a protocol that was signed at the same time as the Cape Town Convention and facilitates the financing of aircraft by providing creditors with an internationally recognised set of rights in the event of a debtor’s default or insolvency, and allowing creditors to register their interests in an international register to guarantee the priority of their claim against other parties.

Agreement is defined in Article 1 of the Cape Town Convention as a security agreement, a title reservation agreement or leasing agreement. It is intended that each of these agreements are captured by the provision and the respective rights contained in those agreements are not affected by the ipso facto stay.

These agreements are prescribed on the basis that the CTCA implements international obligations and any agreements and rights contemplated by those instruments should be preserved from the effect of the ipso facto stay.

While there are already provisions in the *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017* that seek to guarantee the primacy of the CTCA, the agreements contained in the Cape Town Convention are also prescribed in the Regulations to provide the greatest possible degree of certainty that they are not captured by the ipso facto stay.

Paragraph (b)—Government licences or permits

Paragraph (b) prescribes that the ipso facto stay does not apply to arrangements that are licences or permits issued by the Commonwealth, a State or a Territory, an authority of the Commonwealth or of a State or a Territory, or a local government, such as a council.

Government licences and permits can come with certain conditions for their validity. Those conditions can form a contract, agreement or arrangement between the issuing body and the holder of the licence or permit. The holder must comply with the conditions of the licence or permit, otherwise it may be revoked by the issuing authority.

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Conditions that accompany the licence or permit are often in place for public safety and the greater good of the community. If those conditions are not satisfied, the issuing body might not consider it appropriate that the holder retain the licence or permit.

The ipso facto stay was not intended to prevent Governments from terminating Government issued licences or permits on the grounds of a relevant insolvency event, if not entering the insolvency event was a condition of the licence.

To provide certainty that Government issued licences and permits are not subject to the ipso facto stay, they have been excluded under this provision.

Arrangements relating to securities and financial products

Paragraph (c)—arrangements that are derivatives

Paragraph (c) prescribes that any contract, agreement or arrangement that is a derivative is not to be subject to the ipso facto stay.

A derivative, for the purposes of this paragraph, is defined in section 761D of the Act and means an arrangement where a party agrees to provide consideration to someone in the future, and the amount of consideration to be paid is dependent on the value of something else, such as an asset, rate, index or commodity.

Derivative transactions are generally governed by a master agreement, such as that published by the International Swaps and Derivatives Association (“**the ISDA**”). Parties to relevant transactions can agree that the terms in the ISDA master agreement will automatically apply. The ISDA master agreement (as it stands from time to time) may provide for netting, set-off and various standard termination rights, each of which may be triggered by a relevant insolvency event.

The ipso facto stay could undermine the utility of an ISDA master agreement and any other derivative arrangements and disturb a large number of subordinate agreements made in reliance on their terms. For this reason any contracts, agreements or arrangements that are derivatives will be excluded from the ipso facto stay.

Paragraph (d)—arrangements for underwriting securities or financial products

Paragraph (d) prescribes that the ipso facto stay does not apply to arrangements for the underwriting of securities or financial products.

Underwriting services are generally provided by financial institutions who accept the financial risk and liability arising out of certain transactions and guarantee payment to cover damage or financial loss.

The provision is intended to capture arrangements between an underwriter and an entity which is issuing or selling securities or financial products such as shares or insurance.

It is common for an agreement to underwrite the offering of securities of an entity to be conditional on the entity being solvent at the time at which the underwriting is to take place. The commercial arrangement is not intended to extend as far as binding underwriters to subscribe for the securities of an insolvent issuer.

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This paragraph recognises that the ipso facto stay is not intended to curtail the rights of an underwriter who has promised to subscribe for securities to terminate that arrangement on the occurrence of an insolvency event.

Parliament has previously similarly recognised the importance of rights to termination for insolvency in the context of takeovers or mergers (for example, see paragraph 652C(1)(h) and subsection 652C(2) of the Act).

Paragraph (e)—contracts for the subscribing, or procuring subscribers, for securities

Paragraph (e) prescribes that the ipso facto stay does not apply to contracts, agreements or arrangements under which a party is, or may be liable to subscribe for, or to procure subscribers for, securities or financial products.

There are many arrangements, relating to subscribing for securities or financial products that may not be strictly considered to be underwriting agreements for the purposes of paragraph (d). This paragraph excludes those arrangements from the operation of the stay for the same reasons as those at paragraph (d) above.

Paragraphs (f) and (g)—arrangements where an Australian company issues securities, or offers securities under a rights issue

Paragraphs (f) and (g) prescribes that the ipso facto stay does not apply to arrangements under which a body corporate incorporated in Australia issues securities, or offers securities under a rights issue.

If the stay were to apply to these arrangements, it may prevent Australian institutions from enforcing rights based on events of default that are typical and long-accepted in financial markets. This may adversely affect Australian companies seeking to access that capital. The relevant securities may include instruments such as bonds or debentures.

Paragraph (h)—arrangements for the sale of a business

Paragraph (h) prescribes that the ipso facto stay does not apply to arrangements for the sale of all, or substantially all, of a business. This paragraph clarifies that a purchase by way of the sale of securities or financial products in the entity being purchased is also captured.

The sale and purchase of a business in financial trouble is often negotiated as an alternative to a formal insolvency process.

The operation of the ipso facto stay on arrangements for the sale of a business in financial trouble can significantly impact the sale price. If the stay was to operate, the sale price would be lower to take into account a purchaser having to complete the purchase of a business that is subject to a formal insolvency process rather than being able to terminate the agreement. This will significantly impact the inflow of capital into a business in financial trouble and make it more difficult to extricate an otherwise performing business from an insolvency or restructuring process.

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To ensure the ipso facto stay does not impact on the sale price of businesses, arrangements for the sale of businesses are excluded from the stay.

Paragraph (i)—arrangements for issuance of securities or financial products belonging to a pre-1 July 2018 class of fungible securities or financial products

Paragraph (i) prescribes that the ipso facto stay does not apply to certain arrangements related to debt capital market transactions.

It is common in debt capital markets for an issue of tradable notes or bonds (known as ‘notes’) to be made so as to be consolidated with an earlier issue into a single series. All notes in a series are treated, in effect, as being fungible.

Issuance in series, sometimes known as ‘tapping’, can be more convenient to issuers and investors than a new non-fungible series because liquidity in a consolidated series can be higher than liquidity in smaller non-fungible issues. The availability of secondary market trading prices for existing notes also makes ‘tapping’ attractive.

It is critical to fungibility that the rights attaching to all notes in the series are the same. It would be impractical if some rights on some notes were stayed and others not. That would mean the new notes could not be considered fungible, and, in effect, the legislation would preclude tapping. This would disrupt the usual operation of capital markets.

As such, the stay does not apply to a note that is issued after the commencement of the stay date on terms that it is to be consolidated, and form a single class, with earlier issued notes, where the terms are identical in all respects with such notes (except for such details as their respective issue dates, interest commencement dates and issue prices).

Paragraph (j)—margin lending facilities

Paragraph (j) prescribes that the ipso facto stay does not apply to ‘margin lending facilities’.

A margin loan generally lets the borrower borrow money to invest and uses those investments as security for the loan. Margin lending is specifically regulated in the Act.

A ‘margin lending facility’ is, as defined in section 761EA of the Act, a standard margin lending facility, a non-standard margin lending facility or a facility declared to be a margin lending facility. It is intended that this provision captures all of those facilities.

The operation of a margin lending contract is time-critical and relies on the operation of ipso facto clauses for its timely operation. The operation of an ipso facto clause is inherent to the operation of such contracts and staying it would lead to a perverse outcome. As such, margin lending facilities are excluded from the operation of the stay.

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Paragraph (k)—arrangements for the issuing of covered bonds

Paragraph (k) prescribes that the ipso facto stay does not apply to covered bond transactions.

‘Covered bonds’ are defined in section 26 of the *Banking Act 1959* as bonds, notes or other debentures issued by an authorised deposit taking institution (“**ADI**”) secured by assets owned by a covered bond special purpose vehicle and, from the investor’s perspective, are recoverable from the ADI. In other words, covered bonds are a form of secured funding for financial institutions.

As the bonds are secured against a pool of assets, investors in covered bonds are able to draw on the pool of assets securing the bond if the issuer experiences an insolvency event. Covered bonds are specifically regulated to ensure investors are adequately protected. The operation of the ipso facto stay to these arrangements can undermine their purpose and intended effect. Covered bond transactions are excluded from the ipso facto stay to provide certainty to investors that they can draw on the pool of assets securing the covered bonds if the issuer experiences a relevant insolvency event.

Complex arrangements between sophisticated parties

Paragraph (l)—arrangements to which a special purpose vehicle is a party

Paragraph (l) prescribes that the ipso facto stay does not apply to contracts, arrangements or agreements to which a special purpose vehicle (“**SPV**”) is a party.

An SPV is an entity such as a company, trust or partnership that is created to carry out a specific business purpose or activity. For example, SPVs can play an integral part of asset securitisation arrangements.

Securitisation involves pooling various types of financial assets and selling the related cash flows, in one consolidated financial instrument, to third party investors as securities. Contractual debts (such as mortgages, loans and credit cards) are types of financial assets that are often securitised.

A typical securitisation arrangement involving an SPV involves:

- a sponsor pooling together financial assets and selling them to an SPV;
- an SPV purchasing those financial assets and issuing marketable securities to third party investors; and
- service providers who assist and facilitate the transactions.

Arrangements to which an SPV is a party are typically agreed between sophisticated counterparties who arrange for, and agree on, a bespoke set of rules to apply in the event that a party becomes insolvent. In those instances, it is preferable that the agreed rules, which may provide for the operation of ipso facto clauses, continue to apply, and for that reason such arrangements are excluded from the stay.

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Paragraph (m)—arrangements for the keeping source code in escrow

Paragraph (m) prescribes that the ipso facto stay does not apply to escrow arrangements, including arrangements which grant a licensee a right to access the source code of software when the licensor experiences a relevant insolvency event.

Where a party obtains a licence to software, there is a risk that they will lose access to the source code necessary to continue to operate that software if the licensor fails to maintain it (which may occur as the result of an insolvency event). An escrow arrangement provides for the source code to be deposited with a third party and entitles the licensee to access the source code where the licensor experiences an insolvency event. These arrangements are prescribed on the basis that it would undermine their purpose if the ipso facto stay were to apply.

Paragraph (n)—arrangements for the commercial charter of a ship

Paragraph (n) prescribes that the ipso facto stay does not apply to arrangements for the commercial charter of a ship, if that ship is not an Australian ship and the purpose of the charter was for an Australian exporter to export goods to another country.

Where an Australian exporter charters a foreign ship, it is common for the governing agreement to contain the right to terminate the agreement on the financial failure of the ship owner. It is beneficial for Australian exporters who charter foreign ships to retain this right to terminate. Additionally, foreign laws often allow termination on similar grounds and not excluding these arrangements from the ipso facto stay has the potential to put Australian exporters at a commercial disadvantage in the international market.

Arrangements relating to debt and the ranking of creditors

Paragraph (o)—subordination arrangements

Paragraph (o) prescribes that the ipso facto stay does not apply to subordination arrangements.

A subordination arrangement is an agreement that establishes one debt as ranking behind another debt in the priority for collecting the repayment debts from a debtor. Priority of debts can become an issue in the context of insolvency.

For example, Creditor A and Creditor B could enter into an agreement where Creditor A agrees to rank its debt behind Creditor B's debt in return for some sort of consideration. If Company Z, the company which owes a debt to both Creditor A and Creditor B, is wound up, Creditor B would rank first in the priority of debts between Creditor A and Creditor B.

It is not the purpose of the ipso facto stay provisions to affect either the statutory waterfall of agreed priorities in insolvency, or any contractual arrangement between a company's creditors which may change their respective priorities. For this reason it is appropriate to exclude such arrangements from the scope of the stay.

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Paragraph (p)—flawed asset arrangements

Paragraph (p) prescribes that the ipso facto stay does not apply to flawed asset arrangements.

A flawed asset is generally understood to be a conditional debt which is not payable until a condition has been met or some event has occurred. For example, an arrangement between a bank and its customer where the customer deposits funds with the bank and those funds are not repayable by the bank until certain events have occurred, such as the repayment of another specified debt, is a flawed asset arrangement.

For the purposes of the operation of the stay on ipso facto clauses, flawed asset arrangements may be treated in much the same way as a right of set-off, close-out netting arrangements or arrangements that change the priority of creditors and so it is appropriate to exclude them from the operation of the stay for the same reason.

Paragraph (q)—factoring arrangements

Paragraph (q) prescribes that the ipso facto stay does not apply to debt factoring agreements.

Debt factoring occurs when an entity sells debts that are owed to it (such as accounts receivables or invoices for goods/services where amounts are owing to the entity) to a third party. The debts are usually sold at a discount. The entity receives a monetary payment from a third party in exchange for transferring the debt. The debt then becomes payable to the third party. Businesses may enter into debt factoring arrangements to improve their cash flow.

Where parties have already entered into arrangements to attempt to alleviate a business' financial stress, such as factoring arrangements, staying ipso facto clauses would undermine or significantly change the terms of those arrangements and so these arrangements are excluded.

Arrangements relating to financial markets, and clearing and settlement facilities

Paragraph (r)—the operating rules (other than the listing rules) of a financial market

Paragraph (r) prescribes that the operating rules (other than the listing rules) of any financial market licensed under Part 7.2 of the Act are not to be subject to the stay.

Part 7.2 of the Act governs the licensing of financial markets. Licensed markets must be run in accordance with the market's operating rules, which take effect as a contract under seal between licensees and participants in accordance with section 793B of the Act. The operating rules may provide for the suspension or expulsion of participants when they experience a relevant insolvency event. The operating rules are important to the operation of licensed financial markets in the manner contemplated by the Act, and therefore are appropriate to exclude from the ipso facto stay.

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Paragraph (s)—the operating rules of a clearing and settlement facility

Paragraph (s) prescribes that the operating rules of a clearing and settlement facility licensed under Part 7.3 of the Act are not subject to the ipso facto stay. A clearing and settlement facility provides a mechanism for parties to financial product transactions to meet certain obligations to each other.

Part 7.3 of the Act governs the licensing of clearing and settlement facilities. Licensed facilities must be run in accordance with their operating rules, which take effect as a contract under seal between licensees and participants in accordance with section 822B of the Act. These operating rules may provide for the suspension or expulsion of participants when they experience a relevant insolvency event, and must provide for how defaults are to be managed. The operating rules are important to the operation of these facilities in the manner contemplated by the Act and therefore are appropriate to exclude from the operation of the ipso facto stay.

Paragraph (s) also extends the exclusion from the operation of the ipso facto stay to securities settlement facilities which are exempt from the licensing requirement (but would otherwise be required to be licensed under Part 7.3 of the Act).

Paragraph (t)—arrangements that confer rights on the operator of a financial market or clearing and settlement facility in relation to the operation of the market or facility

Paragraph (t) prescribes that any contract, agreement or arrangement that confers rights on the operator of a financial market, clearing system, settlement system or payment system in relation to the operation of the market, system or facility are not subject to the ipso facto stay. It follows that parties to those arrangements will be able to enforce the rights in those arrangements in the event of any insolvency events.

This exclusion is intended to capture markets, systems and arrangements which are not required to be approved or licensed under relevant legislation (but are otherwise similar to such arrangements). The operating rules of such markets or systems may entitle the operator to exclude, suspend or take other action in relation to a participant who has experienced an insolvency event. Such rights are important to the stable operation of the relevant markets and systems, irrespective of their licensing or approval status, and so such rules are excluded from the stay.

Paragraph (u)—arrangements for which the parties include the Reserve Bank of Australia and the operator of a clearing and settlement facility

Paragraph (u) prescribes that any contract, agreement or arrangement for which the parties include the Reserve Bank of Australia and the operator of a clearing and settlement facility is not subject to the ipso facto stay.

Paragraph (v)—arrangements under which participants in a clearing and settlement facility settle obligations on behalf of other participants in the facility

Paragraph (v) prescribes that any contract, agreement or arrangement under which participants in the clearing and settlement facility settle obligations on behalf of other participants in those systems is not subject to the ipso facto stay.

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‘Participant’, for the purposes of this paragraph, is defined in section 761A of the Act and means, in relation to a clearing and settlement facility, a person who is allowed to directly participate in the facility under the facility’s operating rules. ‘Participant’ in this context also includes a recognised affiliate when used within the provisions outlined in paragraph (a) of the definition of ‘participant’ in section 761A of the Act.

This exclusion is intended to capture arrangements which may not fall within the various legislative schemes governing clearing and settlement systems. This exclusion is intended to capture systems such as the Australian Paper Clearing System and the Bulk Electronic Clearing System. To preserve the stability and manage the risks of the relevant systems, it is important that the co-ordinator or other relevant parties remain able to enforce rights when they receive notice that a participant has experienced an insolvency event. In particular, this exclusion is also intended to preserve the rights of the operator of the system under any associated rules or regulations which govern that system where these take effect as a contract, arrangement or agreement.

Netting arrangements

Paragraph (w)—legally enforceable arrangements that support an approved RTGS system

Paragraph (w) prescribes that Real Time Gross Settlement (“**RTGS**”) systems (including associated operating rules) approved under section 9 of the *Payment Systems and Netting Act 1998* (“**PSN Act**”) are not subject to the ipso facto stay.

RTGS systems allow participants to set off their gross financial obligations against each other to reach a net position and settle their payments. An RTGS system can be approved by the Reserve Bank of Australia under section 9 of the PSN Act if, among other things, the system is supported by a legally enforceable arrangement between the participants in the system and the rules that govern the system empower the system administrator to suspend participants when they enter external administration.

The PSN Act provides various protections to transactions carried out through approved RTGS systems. In particular, such transactions are irrevocable and cannot be ‘clawed back’ when a participant enters insolvency. Therefore it is vital for the stability of these systems that the administrator remains able to exercise certain rights when a participant experiences an insolvency event.

The Act and PSN Act each provide that the PSN Act is to prevail over the stay to the extent of any inconsistency. However, in order to provide the highest possible level of certainty to participants, these systems are also prescribed in the Corporations Regulations.

Paragraph (x)—approved netting arrangements

Paragraph (x) prescribes that various types of approved netting contracts, agreements and arrangements are not to be subject to the stay. Broadly speaking, netting arrangements allow the participants to set off their gross financial obligations against each other to reach a net position and settle their payments accordingly. Netting may occur periodically (for example, at the end of each business day) or on the termination

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of the parties' obligations. As such, both netting and termination may be triggered by one of the parties experiencing an insolvency event.

The Act and PSN Act each provide that the PSN Act is to prevail over the stay to the extent of any inconsistency. However, in order to provide the highest possible level of certainty to participants, these systems are also prescribed in the Corporations Regulations.

It is intended that multilateral netting arrangements approved under Part 3 of the PSN Act, including any rules or arrangements that govern their operation, are captured under this provision. The RBA may approve multilateral netting arrangements under section 11 of the PSN Act, however a precondition is that a coordinator may exclude a party from the arrangement if they enter external administration.

These arrangements are captured in order to preserve the intended operation of the arrangements. This will provide certainty to parties that rights contained in these arrangements are not subject to the ipso facto stay.

Paragraph (y)—arrangements that confer rights on the operator of an approved RTGS system or the coordinator of an approved netting arrangement

Paragraph (y) prescribes that any contract, agreement or arrangement that confers rights on the operator of an approved RTGS system or the coordinator of an approved netting arrangement in relation to the operation of that system or netting arrangement is not subject to the ipso facto stay.

Paragraph (z)—arrangements under which parties to an approved RTGS or netting arrangement settle obligations on behalf of other parties to the arrangement

Paragraph (z) prescribes that any contract, agreement or arrangement under which parties to an approved netting arrangement may settle obligations on behalf of other parties to that approved netting arrangement is not subject to the ipso facto stay.

'Parties', for the purposes of this paragraph, is defined in section 5 of the PSN Act and means a person who is a party to the approved netting arrangement in accordance with the rules governing the arrangement.

This exclusion is intended to capture arrangements which may not fall within the various legislative schemes governing approved netting arrangements.

Paragraph (za)—close-out netting contracts

Close-out netting contracts are contracts within the meaning of Part 4 of the PSN Act, including a contract for a security interest or other right with respect to property given by a person to secure the performance of their obligations under the contract.

The parties to a close-out netting contract may terminate their obligations and settle them based on a net position. The termination and subsequent netting may be

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triggered by an insolvency event. These rights are exempt from the stay, as are the parties' rights to enforce any associated security.

However, subsections 14(4) to (6) of the PSN Act limits a party's rights and obligations under a close-out netting contract in some circumstances (for example, when a person enters the contract with the knowledge that the other party was insolvent). It is not anticipated that the Regulations will alter the ordinary and usual operation of subsections 14(4) to (6) of the PSN Act.

Paragraph (zb)—arrangements where security is given over financial property in respect of obligations of a party to a close-out netting contract

The arrangements that are prescribed under paragraph (zb) are arrangements that preserve the intended operation of the arrangements prescribed under paragraph (za), and are for that reason excluded from the operation of the stay.

Paragraph (zc) and (zd)—netting markets and market netting contracts

A 'netting market' is defined in section 5 of the PSN Act and includes a market licensed under Part 7.2 of the Corporations Act, a clearing and settlement facility licensed under Part 7.3, and other markets approved by the Minister or declared in the Regulations. The ipso facto stay may undermine the operation of these markets by preventing parties from exercising netting rights arising upon relevant insolvency events, and disturb the operation of the associated market rules in unintended ways.

Part 5 of the PSN Act governs market netting contracts entered into in connection with approved netting markets. The parties to a market netting contract may be entitled to terminate their obligations and settle them based on a net position. This may, among other things, be triggered by an insolvency event. Market netting contracts have been excluded from the ipso facto stay to ensure these rights and rights for parties to enforce any associated security remain undisturbed.

Paragraph (ze)—arrangements where security is given in accordance with a market netting contract, in respect of obligations of a party to the contract

The arrangements that are prescribed under paragraph (ze) are arrangements that preserve the intended operation of the arrangements prescribed under paragraph (zd) and are for that reason excluded from the operation of the stay.

EXPOSURE DRAFT

ATTACHMENT A

Novating and assigning rights

Paragraph (zf)—novating and assigning rights from pre-1 July 2018 arrangements, varying pre-1 July 2018 arrangements

Paragraph (zf) prescribes that the ipso facto stay does not apply to arrangements entered into on or after 1 July 2018, where those arrangements are a novation or an assignment of rights under an arrangement entered into before 1 July 2018.

Novation and assignment are both acts that can involve replacing a party to an arrangement with a new party. Novation can only occur with the consent of all parties to the original arrangements while assignment is generally valid if the other party to the arrangement has been given notice.

If an arrangement contains the ability for a party to novate or assign rights in the arrangement, the novation or assignment often creates a new arrangement between all continuing parties. The new arrangement, if entered into on or after 1 July 2018, would be captured by the operation of the ipso facto stay.

It was not intended for the ipso facto stay to capture arrangements entered into as a result of rights exercised in arrangements on foot prior to the commencement of the stay provisions. On that basis, new arrangements entered into on or after 1 July 2018 as a result of exercising novation or assignment rights in arrangements entered into before 1 July 2018, will not be captured by the ipso facto stay.

On the same basis, where contracts entered into before 1 July 2018 are varied by a subsequent arrangements entered into on or after 1 July 2018, the subsequent arrangements will also not be captured by the stay.

This provision will only apply to new arrangements entered into on or after 1 July 2018 as a result of arrangements entered into before 1 July 2018.