



ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 166

Licensing: Financial requirements

July 2015

About this guide

This guide sets out the financial requirements you must meet as the holder of an Australian financial services (AFS) licence. The requirements vary depending on the financial products and services you offer.

If you are a body regulated by the Australian Prudential Regulation Authority (APRA), as defined in s3(2) of the *Australian Prudential Regulation Authority Act 1998* (APRA Act), and are not required to comply with s912A(1)(d) of the *Corporations Act 2001* (Corporations Act), this guide does not apply to you.

Note: From 1 July 2015, if you are the holder of a registrable superannuation entity (RSE) licence from APRA that is also authorised to operate registered managed investment schemes, you will be required to comply with s912A(1)(d).

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This version was issued in July 2015 and is based on legislation and regulations as at the date of issue.

Previous versions:

- Superseded Regulatory Guide 166, issued December 2009, reissued 7 May 2010, November 2012, June 2013 and November 2013
- Superseded Regulatory Guide 239 *Retail OTC derivative issuers: Financial requirements*, issued July 2012, incorporated into Regulatory Guide 166 in November 2012 and withdrawn
- Superseded Policy Statement 166, issued 28 November 2001, reissued June 2007, rebadged as a regulatory guide 5 July 2007

Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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A Overview

Key points

This guide explains the financial requirements that you must meet as the holder of an Australian financial services (AFS) licence. These requirements vary in their application depending on the nature, scale and complexity of your financial services business.

The requirements do not apply to you if you are a body regulated by APRA; however, if you hold a registrable superannuation entity (RSE) licence and are also authorised to operate registered managed investment schemes, these requirements will apply: see RG 166.15–RG 166.17. If you are prudentially regulated overseas, you can apply to us for relief from the requirements: see RG 166.18–RG 166.22.

What are the financial requirements?

- RG 166.1 As the holder of an Australian financial services (AFS) licence, you have certain obligations under the *Corporations Act 2001* (Corporations Act). For example, you must:
- (a) have available adequate financial resources to provide the financial services covered by your AFS licence and to carry out supervisory arrangements (see s912A(1)(d));
 - (b) do all things necessary to ensure that the financial services covered by your AFS licence are provided efficiently, honestly and fairly (see s912A(1)(a));
 - (c) have adequate risk management systems (see s912A(1)(h)); and
 - (d) comply with the conditions on your AFS licence (see s912A(1)(b)), including the prescribed conditions under reg 7.6.04 of the Corporations Regulations 2001 (Corporations Regulations).
- Note: We ask questions and may also request supporting documents in the licensing process to help us decide if an applicant is likely to meet these obligations: see Regulatory Guides 1–3 *AFS Licensing Kit* (RG 1–3).
- RG 166.2 This guide explains the financial requirements that we impose on AFS licensees to meet their obligations under the Corporations Act. Table 1 summarises the financial requirements.
- RG 166.3 We impose these financial requirements to help ensure that:
- (a) you have sufficient financial resources to conduct your financial services business in compliance with the Corporations Act (including carrying out supervisory arrangements);

- (b) there is a financial buffer that decreases the risk of a disorderly or non-compliant wind-up if the business fails; and
- (c) there are incentives for your owners to comply through risk of financial loss.

Table 1: Summary of the financial requirements for AFS licensees

Financial requirement	Who the requirement applies to
<p>Base level financial requirements:</p> <ul style="list-style-type: none"> • the solvency and net assets requirement; • the cash needs requirement; and • the audit requirement. 	<p>The base level financial requirements apply to all licensees, except those listed in RG 166.13. The base level financial requirements are explained in Section B.</p> <p>Note 1: If you are granted a limited AFS licence, the audit requirement will not apply to you if you are only licensed to provide one or more limited financial services and you do not deal with money to which Div 2 of Pt 7.8 of the Corporations Act applies: see reg 7.8.12A. You will be able to lodge a compliance certificate rather than have to undertake an annual audit: see Information Sheet 179 <i>Applying for a limited AFS licence</i> (INFO 179) for more guidance. However, you will still need to lodge financial statements (as required by s989B(1) and 989B(2)). For the definitions of 'limited AFS licence' and 'limited financial services', see 'Key terms'.</p> <p>Note 2: 'Tailored' base level financial requirements apply to some AFS licensees: see Appendices 1–8. Table 2 at the end of this section provides an overview of how the financial requirements apply to particular categories of AFS licensee.</p>
<p>Additional requirements:</p> <ul style="list-style-type: none"> • the surplus liquid funds (SLF) requirement; and • the adjusted surplus liquid funds (ASLF) requirement. 	<p>The SLF requirement applies to licensees that hold client money or property: see Section C.</p> <p>The ASLF requirement applies to licensees that transact with clients as principal: see Section D.</p> <p>Note: Retail OTC derivative issuers and foreign exchange dealers that elect to meet a capital requirement generally do not need to meet the ASLF requirement: see Appendices 7–8.</p>

RG 166.4 In setting financial requirements, we seek to set minimum standards that are framed as clearly and simply as possible so as to provide certainty. We seek to avoid any:

- (a) unreasonable burden in maintaining particular levels of assets or in reporting; and
- (b) unjustifiable barriers to market entry for providing different kinds of financial services.

RG 166.5 ASIC is not a prudential regulator. Therefore, our financial requirements do not seek to prevent AFS licensees from:

- (a) becoming insolvent; or
- (b) failing because of poor business models or cash flow problems.

How to comply with the financial requirements

RG 166.6 We generally apply our financial requirements by using our statutory power to modify Pt 7.6, or by AFS licence conditions. Pro Forma 209 *Australian financial services licence conditions* (PF 209) sets out our standard licence conditions, including licence conditions for financial requirements. The financial requirements operate in this way:

- (a) More than one requirement can apply to you—if so, you have to comply with each of them.
- (b) If you are required to have assets to meet one requirement, you can also count those assets for another applicable requirement. For example, if you are a responsible entity and need to have \$10 million NTA, you can take into account those assets to meet the cash needs requirement in Appendix 2.
- (c) You must monitor your compliance with each of your obligations and be satisfied that you are continuously complying.
- (d) If you become aware that you have significantly breached, or are likely to significantly breach, a financial requirement, you must give us a written report on the matter under s912D(1).

Note: For further guidance about reporting breaches of licence conditions, see Regulatory Guide 78 *Breach reporting by AFS licensees* (RG 78).

RG 166.7 You must comply with any requirements applying to you via our modification of Pt 7.6 and/or your AFS licence conditions: see s912A(1)(b) and 912A(1)(c). Meeting the financial requirements will help to ensure that you have adequate financial resources as required by s912A(1)(d) and an adequate risk management system as required by s912A(1)(h).

RG 166.8 This guide is not designed to ensure that you will be able to compensate clients if you breach the AFS licensee obligations in Ch 7 of the Corporations Act. In developing this guide, we have been mindful that there are separate, specific obligations to have compensation arrangements under s912B. Under s912B, a licensee must have compensation arrangements that comply with requirements in any regulations, or requirements, made by us.

RG 166.9 Meeting the financial requirements will also contribute to your continuing capacity to meet financial obligations to clients. However, it is not the focus of this guide to protect clients against credit risk.

Note: For a list of key relevant regulatory guides setting out other licensee obligations, see 'Related information'.

Managing financial risk

- RG 166.10 We set minimum financial requirements to promote appropriate financial risk management, taking into account the nature, scale and complexity of an AFS licensee's business. While our requirements are not aimed at preventing licensee failure, they are intended to help ensure that cash shortfalls do not put compliance with the licensee obligations at risk.
- RG 166.11 To satisfy your obligation under s912A(1)(h), we expect your risk management systems to specifically deal with the risk that your financial resources will not be adequate to ensure that you are able to carry on your business in compliance with the AFS licensee obligations, or to wind up your business in an orderly manner.

Note: For further guidance about risk management systems, see Regulatory Guide 104 *Licensing: Meeting the general obligations* (RG 104).

Who this guide applies to

- RG 166.12 The AFS licensee obligations and our licence conditions apply whether you are a natural person, a partnership, one of several trustees, or a body corporate. For partnerships and trustees, it is sufficient if any of the partners complies under s761F(1)(a) or any of the trustees under s761FA(3)(a).
- RG 166.13 This guide applies to all AFS licensees, except:
- (a) bodies regulated by APRA that are not subject to s912A(1)(d) (see RG 166.15–RG 166.17);
 - (b) bodies subject to an alternative form of foreign prudential regulation—where we are satisfied that the foreign prudential regulation appropriately addresses the licensee obligations for financial resources and risk management (see RG 166.18–RG 166.22); and
 - (c) market and clearing participants if the financial requirements of the relevant market or clearing and settlement facility are an adequate substitute (see Appendix 1).
- RG 166.14 The financial requirements vary in their application depending on the nature, scale and complexity of your financial services business. See Table 2 at the end of this section for an overview of how the financial requirements apply to particular categories of AFS licensee.

Bodies regulated by APRA

- RG 166.15 The regulatory regime generally does not subject bodies regulated by APRA to requirements under the Corporations Act for resources and risk management systems: see s912A(1)(d) and 912A(1)(h). However, if you are

an RSE licensee authorised to operate registered managed investment schemes, the requirements in s912A(1)(d) and 912A(1)(h) will apply.

- RG 166.16 If you are a body regulated by APRA, and are not required to comply with s912A(1)(d), we will not require you to comply with our financial requirements. However, as a condition of your AFS licence, you must remain at all times a body regulated by APRA and your auditor must confirm this to us annually on a positive assurance basis, and at any other time that we request: see PF 209, condition 27.
- RG 166.17 The AFS licensee obligations and our licence conditions also apply if you are a related body corporate of a body regulated by APRA, but are not yourself a body regulated by APRA. We note that APRA regulation focuses on the capacity of the body it regulates to meet financial commitments to relevant parties and applies requirements to other group members only in so far as relevant for that purpose. The financial capacity of a subsidiary of an Australian authorised deposit-taking institution (Australian ADI) may not, for example, be material to APRA's purposes in regulating the ADI.

Foreign prudentially regulated licensees

- RG 166.18 We consider that recognition of adequate prudential regulation by APRA might equally be applied to prudential regulation by some foreign regulators. If we can be satisfied that there is an alternative form of foreign prudential regulation that appropriately addresses the AFS licensee obligations for financial resources and risk management, we will seek to avoid regulatory duplication.
- RG 166.19 If you are prudentially regulated overseas, you can apply to us for relief from the financial requirements. We will give this relief on a case-by-case basis if we are satisfied that you are regulated in a way that is comparable to regulation by APRA for entities of that kind (e.g. a general insurer or deposit-taking institution). If you are a deposit-taking institution, when we consider comparability, we will take into account the extent to which the relevant foreign prudential regulation is consistent with the Basel Committee guidelines for regulating deposit-taking institutions.
- RG 166.20 If your application does not contain all relevant information, we will generally refuse it. In limited circumstances, we may consider delaying a decision on your application until you provide more information.
- RG 166.21 If we decide not to impose financial requirements on you, you must still comply with the other AFS licensee obligations.

How to apply for relief

- RG 166.22 To apply for relief from the financial requirements, follow these steps:
- (a) Include with your AFS licence application, request for variation of licence, or request for exemption from or modification of a requirement,

a submission for ASIC not to impose its standard licence conditions about financial requirements.

- (b) Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).
- (c) Candidly set out all information that may be relevant to your application, including details about the foreign regulatory arrangements.

You can also contact ASIC on 1300 300 630 (or +61 3 5177 3988 if dialling from overseas) for information and assistance.

How to use this guide

- RG 166.23 As an AFS licensee, you must meet the financial requirements explained in Sections B–D of this guide (except for licensees listed in RG 166.13)—that is, the base level financial requirements, as well as the SLF and ASLF requirements (if applicable).
- RG 166.24 In addition, certain categories of AFS licensee must meet ‘tailored’ and/or additional financial requirements that reflect the particular financial products and services offered: see Appendices 1–8. Different financial services activities mean that different financial requirements apply. The categories of AFS licensee for which tailored or additional financial requirements apply are:
- (a) market and clearing participants (see Appendix 1);
 - (b) responsible entities (see Appendix 2);
 - (c) investor directed portfolio services (see Appendix 3);
 - (d) custodial or depository services (see Appendix 4);
 - (e) trustee companies providing traditional services (see Appendix 5);
 - (f) issuers of margin lending facilities (see Appendix 6);
 - (g) foreign exchange dealers (see Appendix 7); and
 - (h) retail over-the-counter (OTC) derivative issuers (see Appendix 8).
- RG 166.25 If your AFS licence authorises you for any one of the types of financial products or services covered by Appendices 1–8, you must meet a combination of the standard financial requirements in Sections B–D, as well as the tailored and additional requirement(s) explained in the relevant appendix. The appendices explain, for particular categories of AFS licensee, which ‘standard’ financial requirements apply and which ‘tailored’, or additional, financial requirements apply.
- RG 166.26 Depending on the types of financial products and services you offer, more than one set of financial requirements may apply to you. If this is the case, you need to meet all applicable requirements; however, there is no need to hold separate assets to meet each requirement and you can count the same assets to meet multiple requirements.

RG 166.27 Table 2 summarises the structure of this guide and how the requirements might apply to you.

Revisions in this update of RG 166

RG 166.28 This update of RG 166 reflects changes to the Corporations Act, effective from 1 July 2015, which discontinued the exemption from the obligation in s912A(1)(d) for RSE licensees that also are the responsible entity of a registered managed investment scheme.

Table 2: What requirements apply?

Category of AFS licensee	Base level financial requirements (Section B)			Additional requirements (Sections C–D and Appendices 1–8)		
	Solvency and positive net assets requirement	Cash needs requirement	Audit requirement	NTA requirement	SLF requirement	ASLF requirement
All AFS licensees except bodies regulated by APRA and others listed in RG 166.13: see Sections B–D Note: If you are an RSE licensee authorised to operate registered managed investment schemes, these requirements apply	✓	✓	✓ ¹	✓ if required in one of Appendices 1–8	✓ if holding client money or property valued at \$100,000 or more	✓ if transacting with clients as principal ²
Market and clearing participants: see Appendix 1	The financial requirements do not apply if the financial requirements of the relevant market or clearing and settlement facility are an adequate substitute.					
Responsible entities: see Appendix 2	✓	✓ tailored	✓ tailored	✓	✓ if holding client money or property valued at \$100,000 or more	✓ if transacting with clients as principal
Investor directed portfolio service (IDPS) operators: see Appendix 3	✓	✓ tailored	✓ tailored	✓	✓ if holding client money or property valued at \$100,000 or more	✓ if transacting with clients as principal
Custodial or depository services: see Appendix 4	✓	✓ tailored	✓ tailored	✓ depending on the nature of your business	✓ if holding client money or property valued at \$100,000 or more	✓ if transacting with clients as principal
Trustee companies providing traditional services: see Appendix 5	✓	✓	✓	✓	✓ if holding client money or property valued at \$100,000 or more	✓ if transacting with clients as principal

Category of AFS licensee	Base level financial requirements (Section B)			Additional requirements (Sections C–D and Appendices 1–8)		
	Solvency and positive net assets requirement	Cash needs requirement	Audit requirement	NTA requirement	SLF requirement	ASLF requirement
Issuers of margin lending facilities: see Appendix 6	✓	✓	✓	✓	✓ if holding client money or property valued at \$100,000 or more	✓ if title to the security provided for the loan passes away from the client, or otherwise transacting with clients as principal
Foreign exchange dealers: see Appendix 7	✓	✓	✓	×	✓ if holding client money or property valued at \$100,000 or more	✓ you can choose to comply with the ASLF requirement or a capital requirement
Retail OTC derivative issuers: see Appendix 8	✓	✓ tailored	✓ tailored	✓ this replaces the ASLF requirement	✓ if holding client money or property valued at \$100,000 or more	×

¹ If you are granted a limited AFS licence, the audit requirement will not apply to you if you are only licensed to provide one or more limited financial services and you do not deal with money to which Div 2 of Pt 7.8 of the Corporations Act applies: see reg 7.8.12A. You will be able to lodge a compliance certificate rather than have to undertake an annual audit: see INFO 179 for more guidance. However, you will still need to lodge financial statements (as required by s989B(1) and 989B(2)).

² OTC retail derivative issuers and foreign exchange dealers electing to meet a capital requirement generally do not need to meet the ASLF requirement.

B The base level financial requirements

Key points

The base level financial requirements apply to all AFS licensees except bodies regulated by APRA and others listed in RG 166.13. However, if you are an RSE licensee authorised to operate registered managed investment schemes, these requirements will apply.

As a licensee, you must meet the following base level financial requirements:

- the solvency and positive net assets requirement (see RG 166.32–RG 166.34);
- the cash needs requirement (see RG 166.35–RG 166.61); and
- the audit requirement (see RG 166.62–RG 166.68).

Some AFS licensees may have to comply with additional requirements that reflect specific business risks: see Table 2 in the Overview.

We expect that most small business licensees that do not hold client money or property over \$100,000 will only need to comply with the base level financial requirements to meet their AFS licence conditions.

RG 166.29 You can only comply with your obligations as an AFS licensee if you have the resources, including financial resources, to do so. The financial resources you have must be enough to cover any risks your business faces that may affect your cash position and that it is reasonable for you to plan to manage.

RG 166.30 As an AFS licensee, you must meet the following base level financial requirements:

- (a) *The solvency and positive net assets requirement*—At all times you must be solvent (i.e. be able to pay all your debts as and when they become due and payable) and have total assets that exceed total liabilities (as shown in your most recent annual balance sheet lodged with us), and at all times have no reason to suspect that total assets would no longer exceed total liabilities on a current balance sheet.

Note: If you have more liabilities than assets, you can apply an alternative test. You can calculate on the basis of adjusted assets and adjusted liabilities as defined in Section E. For example, this may apply to you if you rely on an undertaking from an eligible provider such as an Australian ADI.

- (b) *The cash needs requirement*—You must have sufficient resources to meet your anticipated cash flow expenses.

- (c) *The audit requirement*—You must include information about your compliance with the financial requirements in your audit report under s989B(3).

Note: If you are granted a limited AFS licence, the audit requirement will not apply to you if you are only licensed to provide one or more limited financial services and you do not deal with money to which Div 2 of Pt 7.8 of the Corporations Act applies: see

reg 7.8.12A. You will be able to lodge a compliance certificate rather than have to undertake an annual audit: see INFO 179 for more guidance. However, you will still need to lodge financial statements (as required by s989B(1) and 989B(2)).

- RG 166.31 Tailored base level financial requirements that reflect specific business risks apply to certain AFS licensees: see Table 2 in the Overview and Appendices 1–8 at the end of this guide.

The solvency and positive net assets requirement

Who the solvency and positive net assets requirement applies to

The solvency and positive net assets requirement applies to all AFS licensees (except those listed in RG 166.13).

- RG 166.32 The Corporations Act requires directors of a company to prevent insolvent trading by the company: see Div 3 of Pt 5.7B. It is not appropriate for any AFS licensee, including a natural person, to carry on a financial services business while insolvent.
- RG 166.33 It is also not appropriate that you carry on a financial services business with liabilities exceeding your assets. AFS licensees that trade when insolvent or while having negative net assets are unlikely to have the resources to carry on the financial services business in compliance with the licensee obligations under Ch 7 of the Corporations Act.
- RG 166.34 You should continuously monitor your solvency, but we do not require you to continuously monitor your net assets position. However, you must review it if you have some reason to doubt you have adequate net assets.

The cash needs requirement

Who the cash needs requirement applies to

The cash needs requirement applies to all AFS licensees (except those listed in RG 166.13).

A tailored cash needs requirement applies to:

- responsible entities (see Appendix 2);
- IDPS operators (see Appendix 3);
- custodial or depository service providers (see Appendix 4); and
- retail OTC derivative issuers (see Appendix 8).

- RG 166.35 As a condition of your AFS licence, you must have sufficient resources to meet your anticipated cash flow expenses (cash needs requirement). Because

of the large range of sizes and types of AFS licensee, there are several options that can be used to satisfy the cash needs requirement.

- RG 166.36 Unless a tailored cash needs requirement applies to you, you can meet the cash needs requirement by choosing one of five options:
- (a) Options 1 or 2 are ‘basic’ options and we expect that most small business AFS licensees will only need to consider complying with Options 1 or 2, and will generally prefer Option 2.
 - (b) Options 3, 4 or 5 do not require you to prepare projections and may be more suitable for your business if you:
 - (i) are part of a corporate group; or
 - (ii) have general financial support from an Australian ADI, or, in some cases, have financial support from foreign deposit-taking institutions; and
 - (iii) can comply with the requirements for the relevant option.

Note: You must meet all the requirements of the option you select.

- RG 166.37 Table 3 gives an overview of the five options available for meeting the cash needs requirement. For the definitions for calculating cash needs, including ‘cash’, ‘cash flow’, ‘eligible provider’ and ‘relevant trust’, see Section E.

Table 3: The five options available to AFS licensees for meeting the cash needs requirement

Option	Description
1 Reasonable estimate projection plus cash buffer See RG 166.40–RG 166.44	Option 1 is designed for licensees that maintain a certain level of cash or other liquid financial resources at all times (e.g. by way of commitments by a parent company). We expect this option will be relevant for some small business licensees.
2 Contingency-based projection See RG 166.45–RG 166.47	Option 2 is suitable for all kinds of licensees, including small business licensees that do not always maintain cash or commitments of support from others. We expect this option will be most relevant for small business licensees.
3 Financial commitment by an Australian ADI or comparable foreign institution See RG 166.50	Option 3 is relevant to licensees that can draw on financial backing from an Australian ADI or a relevantly recognised foreign regulated deposit-taking institution. We expect this option will not be relevant for small business licensees: see Table 6 and Information release (IR 03-26) <i>Alternative means to satisfy cash needs requirement under PS 166</i> .
4 Expectation of support from an Australian ADI or comparable foreign institution See RG 166.51	Option 4 is relevant to subsidiaries of certain prudentially regulated bodies. We expect this option will not be relevant for small business licensees: see Table 6 and IR 03-26.

Option	Description
5 Parent entity prepares cash flow projections on a consolidated basis See RG 166.52	Option 5 is relevant to licensees in corporate groups that plan cash flows on a group basis. We expect this option will not be relevant for small business licensees: see Table 6 and Information release (IR 03-44) <i>ASIC provides further options to meet cash needs requirements</i> . There are alternatives under Option 5: Option 5A (suitable for a licensee with a commitment from a parent) and Option 5B (suitable for a licensee without a commitment from a related body corporate).

Basic options (Options 1 and 2)

- RG 166.38 Options 1 and 2 are different ways for you to show how you will manage the effect of risks on your cash position through your own projections. Neither option requires you to have at any one time all the cash you might need to meet all your liabilities over the next 3 months.
- RG 166.39 Compliance with either Option 1 or 2 will meet the cash needs requirement under our AFS licence conditions and help to ensure you adequately manage financial risks. However, ultimately you must determine what additional measures are appropriate in your circumstances to satisfy your obligation under s912A(1)(h) to have an adequate risk management system.

Option 1: Reasonable estimate projection plus cash buffer

- RG 166.40 We expect that Option 1 would be more suitable for larger businesses or those that have external sources of financial support. Option 1 allows you to rely on a simpler calculation based on having in effect 18 days outgoings (i.e. 20% of 3 months) available to you in liquid form. Such a cash buffer will help you manage commercial contingencies.
- RG 166.41 Where you have this buffer, we will not require you to document a projection based on the commercial contingencies that may adversely affect your cash position, as is required under Option 2. If you rely on Option 1, you need only prepare a projection based on what you reasonably estimate is most likely. This projection will help you to measure how much cash you might have to hold as a cash buffer to satisfy Option 1.
- RG 166.42 To provide a yardstick, you must also calculate how much cash you might have to hold as a cash buffer based on the previous financial year's cash outflow (if you have done a profit and loss statement for a previous financial year).
- RG 166.43 In the end, the cash you have to hold as a cash buffer will be either an amount based on last year's results or an amount based on your cash flow projection, whichever is the greater.
- RG 166.44 Table 4 summarises the requirements you must meet if you choose Option 1: see Section E for key definitions relevant to this option, including a definition of 'cash' for the purposes of item 5.

Table 4: Option 1: Reasonable estimate projection plus cash buffer

You must meet all these requirements	
Projection	<p>1 Prepare a projection of cash inflow and outflow (cash flows) over at least the next 3 months based on your reasonable estimate of what is likely to happen over this term.</p> <p>Note: You can take into account, for example, the following factors in preparing your projection if you reasonably believe they are likely to be available: assets you hold at the time the projection starts that can be used to pay your liabilities; and inflow you may receive, including income from your business, amounts that you may borrow (e.g. under an overdraft), and amounts that you may receive from your owners or associates as financial support.</p> <p>2 Document your calculations and assumptions, and describe in writing why they are the appropriate assumptions.</p> <p>Note: We expect that a description in writing of your calculations and assumptions will vary according to the nature, scale and complexity of your business.</p> <p>3 Update the projection of cash flows when it ceases to cover the next 3 months, or if you have reason to suspect that an updated projection would show you were not meeting your AFS licence conditions.</p>
Financial resources	<p>4 Show, based on your projection of cash flows, that you will have access as needed to enough financial resources to meet your liabilities over the projected term of at least the next 3 months, including any additional liabilities you project you will incur during that term.</p> <p>5 Have in cash an amount equal to 20% of the greater of:</p> <p>(a) the cash outflow for the projected period of at least the next 3 months (if the projection covers a period longer than 3 months, the cash outflow may be adjusted to produce a 3-month average); or</p> <p>(b) your actual cash outflow for the most recent financial year for which you have prepared a profit and loss statement, adjusted to produce a 3-month average.</p>

Option 2: Contingency-based projection

- RG 166.45 Option 2 is potentially suitable for all AFS licensees, especially small businesses that do not always maintain cash or commitments of support from others. Option 2 allows you to demonstrate that the risk that you will not have access to adequate cash is sufficiently small by calculating a projection that takes into account a range of commercial contingencies that could impact on your cash position.
- RG 166.46 Your projection should demonstrate the effect of the combination of eventualities that makes it most difficult for you to show you will have sufficient cash. However, you can disregard highly unlikely contingencies or combinations of contingency. For example, when calculating what cash you will have available, you can take into account income you expect to receive. However, you also have to take into account the risk that you could have a shortfall in cash inflow. This might arise, for instance, because of bad debts, or increased prices from your suppliers. You would need to take into account these eventualities unless you reasonably believe they are highly unlikely to materially impact on you if the other contingencies you are planning for occur. Similarly, you can take into account the financial support you expect

a parent company or other entity would provide if needed, but only to the extent that the risk that the support would not be provided is highly unlikely.

Note: If you have sufficient financial support from a parent or related entity, you may be able to use Option 3, 4 or 5 instead.

RG 166.47 Table 5 summarises the requirements you must meet if you choose Option 2: see Section E for key definitions relevant to this option (the definition of ‘cash’ will not be relevant to licensees using Option 2).

Table 5: Option 2: Contingency-based projection

You must meet all these requirements	
Projection	<p>1 Prepare a projection of cash inflow and outflow (cash flows) over at least the next 3 months that shows your estimate of what would happen if your ability to meet your liabilities over the projected term was adversely affected by commercial contingencies. This includes any liabilities you might incur during the term of the projection. You have to take into account all contingencies that are sufficiently likely for a reasonable licensee to plan how they might manage them.</p> <p>Note: We would normally expect you to take into account assets you hold at the start of the projection term that can be used to pay your liabilities and inflow you may receive, including: income from your business or sale of your business; amounts that you may borrow (e.g. under an overdraft); and amounts that you may receive from your owners or associates as financial support.</p> <p>However, you may have to reduce the amount of assets and inflow you take into account as part of planning to meet commercial contingencies (e.g. if you lose a key client, or someone who pays you income has a systems failure that delays payments). You will not have to take into account these occurrences if it is highly unlikely that they would materially affect your cash position.</p> <p>2 Document your calculations and assumptions, and describe in writing why they are the appropriate assumptions.</p> <p>Note: We expect that a description in writing of your calculations and assumptions will vary according to the nature, scale and complexity of your business.</p> <p>3 Update the projection of cash flows when it ceases to cover the next 3 months, or if you have reason to suspect that an updated projection would show you were not meeting your licence conditions.</p>
Financial resources	<p>4 Show, based on the projection of cash flows, that you will have access as needed to enough financial resources to meet your liabilities over the projected term of at least the next 3 months, including any additional liabilities you might incur during that term.</p>

Options that do not require projections (Options 3–5)

RG 166.48 In addition to Options 1 and 2, we have provided three further options for AFS licensees that are able to meet their cash needs requirement in a manner that does not involve providing individual cash flow projections: see Table 6. This may be either because they have alternative means of demonstrating that they are likely to have sufficient cash, or because they are part of a large corporate group that manages cash as an economic entity and will prepare appropriate projections.

RG 166.49 These options are generally only available to AFS licensees within corporate groups or that have general financial support from an Australian ADI or in some cases a relevantly recognised foreign deposit-taking institution. They are not likely to be relevant to most small business licensees. For these licensees, Options 1 and 2 are most relevant and we expect most small business licensees will prefer Option 2.

Option 3: Financial commitment by an Australian ADI or comparable foreign institution

RG 166.50 This option is suitable for AFS licensees able to meet the cash needs requirement in a manner that does not involve providing cash flow projections. In this case, an Australian ADI (or a foreign deposit-taking institution we agree is subject to comparable regulation) has given the licensee (generally, its subsidiary) an enforceable and unqualified commitment to meet the licensee's financial obligations. This option is necessarily restricted to licensees with a high assurance of adequate cash flow and adequate liquidity risk management overseen by a prudential regulator.

Note: See condition 13(c)(iii) of PF 209 for further details.

Option 4: Expectation of support from an Australian ADI or comparable foreign institution

RG 166.51 This option is suitable for AFS licensees that are subsidiaries of an Australian ADI or a foreign deposit-taking institution we agree is subject to comparable regulation for the purposes of this policy. It allows the licensee to rely on an expectation of support, even if there is no enforceable commitment from the parent company. The support can be in the form of a commitment to the licensee or a guarantee for the benefit of creditors generally. The expectation of support must apply in all contingencies that a licensee should reasonably plan for. This is similar to the requirement that the licensee would need to meet if it were using Option 2 for cash inflow from the parent company to be recognised. This means that if the licensee were to prepare projections under Option 2, the projected inflow from the parent company would always offset any cash outflows projected.

Note: See condition 13(c)(iv) of PF 209 for further details.

Option 5: Parent entity prepares cash flow projections on a consolidated basis

RG 166.52 This option is suitable for AFS licensees within a corporate group that manages cash flows on a consolidated basis. Under this option, the parent entity prepares cash flow projections that comply with Option 1 or 2. Where there are group-wide cash flow projections, the licensee can then either rely on:

- (a) the parent giving an enforceable and unqualified commitment, which is similar to that provided by an eligible provider under Option 3; or

- (b) the availability of group resources, based on the reasonable expectation of its responsible officer that it can meet the cash needs requirement in all commercial contingencies for which it should reasonably plan in a way similar to Option 4.

Note: See condition 13(c)(v) of PF 209 for further details.

Table 6: Options 3–5: No projections required

You must meet all these requirements	
Option 3: Financial commitment by an Australian ADI or comparable foreign institution	<p>1 Have an enforceable and unqualified commitment from an Australian ADI or another entity (such as a foreign deposit-taking institution) approved for this purpose in writing by us.</p> <p>Note: For the purposes of this policy, we may recognise a foreign deposit-taking institution that is regulated in accordance with the Basel Committee guidelines for regulating deposit-taking institutions, which are comparable to the regulation of ADIs.</p> <p>2 Ensure that the provider of the commitment pays an unlimited amount on demand from time to time:</p> <p>(a) to you; or</p> <p>(b) to the extent of the liability, to:</p> <p>(i) your creditors; or</p> <p>(ii) a trustee for your creditors.</p> <p>3 Reasonably expect, based on documented assumptions, that the commitment will remain effective for at least the next 3 months. These assumptions should take into account all commercial contingencies you should reasonably plan for.</p> <p>Note: The definition of 'cash' will not be relevant to licensees using Option 3. This term is not used under this option.</p>
Option 4: Expectation of support from an Australian ADI or comparable foreign institution	<p>1 Be a subsidiary of an Australian ADI or an entity approved for this purpose in writing by us.</p> <p>Note: We may approve a foreign deposit-taking institution that is regulated in accordance with the Basel Committee guidelines for regulating deposit-taking institutions, which are comparable to the regulation of ADIs.</p> <p>2 Reasonably expect (based on access to funds from related bodies corporate) that you will have adequate resources (when needed) to meet your liabilities (including any additional liabilities that you might incur during that period) for at least the next 3 months. You must take into account all commercial contingencies for which you should reasonably plan.</p> <p>3 Ensure that a responsible officer has documented that they have the reasonable expectation in item 2 for at least the following 3-month period, together with their reasons for forming the expectation, the contingencies for which you consider it is reasonable to plan, the assumptions made concerning the contingencies and the basis for selecting those assumptions.</p> <p>4 Keep the document in item 3 for at least 5 years after the end of the last financial year that includes a part of the period to which the document relates, and give it to us if we request it.</p> <p>Note: The definition of 'cash' will not be relevant to licensees using Option 4. This term is not used under this option.</p>

You must meet all these requirements

Option 5: Parent entity prepares cash flow projections on a consolidated basis

- 1 Your cash flows and the cash flows of each of your related bodies corporate (the licensee group), are managed on a consolidated basis.
- 2 There is a body corporate within the licensee group of which all members of the licensee group are subsidiaries (the parent entity).
- 3 The parent entity complies with Option 1 or 2, as if:
 - (a) it were the licensee;
 - (b) cash flows of any member of the licensee group were cash flows of the licensee; and
 - (c) any cash held by a member of the licensee group (other than as trustee of a trust) were held by the licensee.
- 4 The parent entity's registered company auditor gives us a report, together with your annual audit report, as required under your licence, for each of your financial years (and for any other period that we request it, by a date that we request it) about your parent entity's compliance with Option 1 or 2, consistent with item 3. This report is similar to the report that would be required from your auditor if you were complying with Option 1 or 2 for that period.

Note 1: If you are granted a limited AFS licence, the audit requirement will not apply to you if you are only licensed to provide one or more limited financial services and you do not deal with money to which Div 2 of Pt 7.8 of the Corporations Act applies: see reg 7.8.12A. You will be able to lodge a compliance certificate rather than have to undertake an annual audit: see INFO 179 for more guidance. However, you will still need to lodge financial statements (as required by s989B(1) and 989B(2)).

Note 2: For the terms of the report about compliance with our financial requirements, see PF 209, condition 28.
- 5 Either of the following applies:
 - (a) *Alternative A*: The parent entity has provided an enforceable and unqualified commitment to pay you on demand from time to time an unlimited amount or to meet your liabilities (including any additional liabilities that you might incur while the commitment applies), which you reasonably expect will apply for at least the next 3 months, taking into account all commercial contingencies for which you should reasonably plan.
 - (b) *Alternative B*: You:
 - (i) reasonably expect (based on access to cash from members of the licensee group) that you will have adequate resources to meet your liabilities (including any additional liabilities that you might incur) for at least the next 3 months, taking into account all commercial contingencies for which you should reasonably plan;
 - (ii) ensure that a responsible officer documents that they have this reasonable expectation for at least the following 3-month period, together with the reasons for forming the expectation, the contingencies for which you consider it is reasonable to plan, the assumptions made concerning the contingencies and the basis for selecting those assumptions; and
 - (iii) keep this document for at least 5 years after the end of the last financial year that includes a part of the period to which the document relates, and give it to us if we request it by a date we request.
- 6 You have no reason to believe that the parent entity has not complied with item 3 or has failed to comply, in a material respect, with its obligations under Ch 2M or, if the parent entity is not a company, under any other laws (whether law in Australia or not) relating to financial reporting that apply to it.

Projections, budgeting and risk management

- RG 166.53 If an AFS licensee does not have enough cash to meet its liabilities, particularly over a short timeframe like 3 months, there is a greater risk that the licensee may not provide financial services in compliance with the licensee obligations under Ch 7 of the Corporations Act. If cash outflow is planned for and covered, it is less likely that a licensee will feel pressured to cut costs on its compliance arrangements or engage in non-complying conduct.
- RG 166.54 Budgeting to meet current and future liabilities and to take into account risks facing the business is good business practice. Planning and monitoring will help an AFS licensee to put in place and maintain appropriate arrangements (including compliance measures) to ensure adequate financial resources are available when required. This is particularly relevant in periods of higher risk for the business (e.g. when a business is growing rapidly or when a new business is in its early stages).
- RG 166.55 As part of meeting your obligation to have an adequate risk management system under s912A(1)(h), you need to take into account the risks your business faces and the impact of failing to meet your liabilities. We believe that this is an appropriate part of business and risk management for both small and large AFS licensees.
- RG 166.56 Taking into account commercial contingencies, AFS licensees should have sufficient, or access to sufficient, financial resources to cover their liabilities when needed. We recognise that planning on a 12-month basis may be appropriate for many businesses. However, we require as a minimum that planning cover at least the next 3-month period.
- Note: The required access to financial resources also needs to cover any additional liabilities that might be incurred over the next 3-month period.
- RG 166.57 We are concerned to ensure that AFS licensees monitor their anticipated cash inflow and outflow with enough forward thinking to be able to determine whether there is a real risk that a shortfall will occur over at least the next 3 months. The continuing short-term operation of your financial services business should not be put at risk because you do not reasonably plan to address commercial contingencies.
- Note: Under reg 7.6.04(1)(a), you must lodge a notice with us within one business day of any event occurring that may make a material adverse change to your financial position as previously lodged with us. Having budgets will help you to comply with this obligation.
- RG 166.58 You can manage the effect of risks that would give rise to a cash shortfall in a number of ways. For example, you may plan to deal with your cash needs by:
- (a) injecting additional cash through your owner's equity or borrowings;
 - (b) planning to realise liquid assets;
 - (c) deferring or avoiding expenses which are not necessary to your business or compliance obligations; or
 - (d) reducing your own drawings or remuneration.

Documenting your plans

RG 166.59 If you comply with Option 1 or 2, it is important that you document your planning process by setting out the results of your planning in a projection and setting out the basis on which it is developed. In planning to meet your commitments, you are better placed than us to determine what risks your business faces and whether these risks are material enough so that it is reasonable for you to plan to meet them. Documenting this assessment helps you to show that you are complying with the AFS licensee obligations and helps you to test and improve your planning processes over time.

Note 1: If you can rely on financial support as set out in Options 3 to 5 and you choose to use one of those options in preference to Option 1 or 2, you do not have to prepare cash flow projections.

Note 2: If you choose Option 4 or 5B, one of your responsible officers must document that they have a reasonable expectation of financial support from related bodies.

RG 166.60 We expect that the amount of documentation you need will vary depending on the nature, scale and complexity of your business. Normally, more documentation will be required where the projected cash position is underpinned by forecasts of likely continuing conduct by others who are not under legal commitments (e.g. clients' goodwill) than where you are relying on legal rights you have against creditworthy entities to provide cash.

RG 166.61 Reference in documentation to meeting the requirements of industry codes and practices may be useful in helping you to show that your projection meets our requirements. Established industry standards and practices can help you to identify risks and their materiality and how to manage them.

Note: For information about how and when ASIC will approve financial services sector codes of conduct under s1101A of the Corporations Act, see Regulatory Guide 183 *Approval of financial services sector codes of conduct* (RG 183).

The audit requirement

Who the audit requirement applies to

The audit requirement applies to all AFS licensees (except those listed in RG 166.13 and limited AFS licensees).

Note: For the definition of limited AFS licensee, see 'Key terms'.

A tailored audit requirement applies to:

- responsible entities (see Appendix 2);
- IDPS operators (see Appendix 3);
- custodial or depository service providers (see Appendix 4); and
- retail OTC derivative issuers (see Appendix 8).

RG 166.62 As a condition of your AFS licence, you must include information about your compliance with the financial requirements in your audit report under s989B(3) (audit requirement).

RG 166.63 The audit report you give us for each financial year under s989B(3) must also contain information about compliance with our financial requirements. If you do not have to provide an audit report under s989B(3), you must still provide us with an audit report about compliance with our financial requirements. You must also give us this information if we request it for a specified period at another time: see s912C(2).

Note: For the terms of the report about compliance with our financial requirements, see PF 209, condition 28.

RG 166.64 The report must contain statements by a registered company auditor addressed to you and ASIC as to whether for the relevant period:

- (a) on a positive assurance basis (i.e. an audit basis), in the auditor's opinion you have complied with our financial requirements other than certain aspects of Options 1 to 5 of the cash needs requirement (see condition 28(d)(i) of PF 209); and

Note: For those AFS licensees that have to meet the adjusted surplus liquid funds (ASLF) requirement in Section D of this guide, the auditor may assume the appropriateness of any adjustments produced by a risk exposure calculation system if we have allowed use of the system as a substitute for standard adjustments: see RG 166.123–RG 166.130. Most licensees will not have to comply with the ASLF requirement.

- (b) on a negative assurance basis (i.e. a review basis), the auditor has no reason to believe that:
 - (i) you did not satisfy the requirements of s912A(1)(h) for managing the risk of having insufficient financial resources to meet the financial requirements; or
 - (ii) you failed to comply with certain elements of the options to satisfy the cash needs requirement (see condition 28(d)(ii) of PF 209).

Note: We also expect that when giving negative assurance for the purposes of RG 166.64(b), the auditor will take into consideration any information the auditor has from the audit undertaken for RG 166.64(a).

RG 166.65 Since Pt 7.8 already requires audited accounts, asking for opinions in the annual audit on an AFS licensee's compliance with the financial requirements is unlikely to be a significant additional expense, and will substantially enhance compliance by the licensee with its financial resources and risk management obligations under s912A(1).

RG 166.66 The opinion concerning compliance with the risk management system requirement under s912A(1)(h) and some aspects of our conditions about projections need only be on a negative assurance basis, following a review. To give negative assurance, the auditor will have to see your documentation

(including your projection) and determine if there is any reason to believe they are not properly prepared. The auditor does not have to give a positive audit opinion about the projections or form a positive opinion that they are reasonable.

RG 166.67 We require only negative assurance on some matters because we recognise the additional burden on an auditor involved in giving audit assurance as to an AFS licensee's compliance with requirements involving projections or other expectations concerning future events or the adequacy of risk management systems.

RG 166.68 We will not routinely monitor your compliance with the financial requirements. Normally, when we want to check compliance, we will consider asking for an audit. We envisage asking for an audit if we suspect that you may not be complying with your financial resources or risk management obligations (e.g. because of credible complaints). We will allow a reasonable time for you to comply as appropriate in the circumstances.

C The SLF requirement: Licensees that hold client money or property

Key points

If you hold client money or property, you must hold at least \$50,000 in surplus liquid funds (SLF) unless the value of the money and property for all clients in total is less than \$100,000 (the SLF requirement).

The SLF requirement is on top of the base level financial requirements in Section B applying to all AFS licensees, and the ASLF requirement (see Section D) if this requirement applies to you.

If an AFS licensee does not have a certain buffer of liquid assets, there is an increased risk that client money or property may be applied to meet the licensee's financial obligations, rather than being held in accordance with its duties to clients.

The SLF requirement

Who the SLF requirement applies to

All AFS licensees (except those listed in RG 166.13) must comply with the SLF requirement if they hold client money or property valued at \$100,000 or more.

RG 166.69 If the value of the money and property you hold for all clients in total is over \$100,000, you must hold at least \$50,000 in SLF if at any time you:

- (a) are required to hold money in a separate account under Div 2 of Pt 7.8;
- (b) hold money or other property on trust for a client or are required to do so under reg 7.8.07(2) or otherwise; or
- (c) have the power to dispose of a client's property under power of attorney or otherwise.

Note: Payments received by an AFS licensee as the proceeds of insurance claims are not client money. Such money is held at the risk of the insurer: s985B(3). Dealing in an insurance product that is a necessary or incidental part of the settlement of claims for that product is not a financial service: reg 7.1.33(2)(b).

RG 166.70 In calculating whether the money and property has a value of less than \$100,000, you need not include:

- (a) money that has satisfied a client's liability on an insurance contract because you are acting under a binder or s985B applies (dealing with discharge of the insured), or property acquired by investment of that money; or
- (b) the value of property where you merely hold a document of title, and the client has legal title to the property.

Note: If you are a responsible entity, the property to which the document of title relates may count for calculating your NTA requirement: see Appendix 2.

Underlying principles

- RG 166.71 It is internationally accepted that, in addition to the regulatory protections provided by separation of accounts and trust arrangements, financial requirements should apply to financial services providers that hold client assets.
- RG 166.72 Where an AFS licensee holds money paid for insurance by their client and is acting under a binder in accepting the insurance or s985B applies, the risk of loss is on the insurer and not the client in relation to the financial service. When money is held only in that circumstance, the SLF requirement will not apply.
- RG 166.73 We do not apply the SLF requirement if you have less than \$100,000 of client money or property. This is because the fixed SLF requirement may be disproportionately burdensome relative to the risk. This applies where, for example, a small payment is received in error from clients and needs to be banked to arrange its application or refund.
- RG 166.74 We do not base the amount of SLF required on the amount of client money or property you hold. We are only seeking to reduce a risk that, at a particular time, you will be subject to pressure to use client money or property to meet your own liabilities. We are not seeking, by imposing financial requirements, to provide a source of compensation for clients whose money or property is misused.

D The ASLF requirement: Licensees that transact with clients as principal

Key points

As an AFS licensee, you must comply with the adjusted surplus liquid funds (ASLF) requirement in RG 166.75 if:

- certain circumstances concerning transactions with clients apply to you (see RG 166.76); or
- you are a foreign exchange dealer that chooses to comply with this requirement (even if it would not otherwise apply to you) rather than the requirement in Appendix 7 for \$10 million of Tier 1 capital.

AFS licensees that are required to have ASLF of more than \$50,000 must follow reporting and risk management measures when certain trigger points are reached: see RG 166.81–RG 166.85.

This requirement is additional to the base level financial requirements that apply to AFS licensees generally and any additional financial requirements that may apply to you.

The ASLF requirement

Who the ASLF requirement applies to

All AFS licensees (except those listed in RG 166.13) must comply with the ASLF requirement if they transact with clients as principal (as defined in RG 166.76).

An NTA requirement replaces the ASLF requirement for retail OTC derivative issuers (see Appendix 8).

Foreign exchange dealers can choose to comply with the ASLF requirement or a capital requirement: see Appendix 7.

RG 166.75 If the ASLF requirement applies to you (see RG 166.76), you must hold at least the sum of:

- \$50,000; plus
- 5% of adjusted liabilities between \$1 million and \$100 million; plus
- 0.5% of adjusted liabilities for any amount of adjusted liabilities exceeding \$100 million.

There is a maximum requirement of \$100 million ASLF.

When does the ASLF requirement apply?

RG 166.76 The ASLF requirement applies to you if:

- (a) you incur actual or contingent liabilities of the relevant kind;
- (b) this occurs by entering into a transaction with a client; and
- (c) the transaction is entered into in the course of providing a financial service to the client.

Note: 'Actual or contingent liabilities of the relevant kind' includes a liability under a non-standard margin lending facility to transfer equivalent marketable securities to the client: see Section E for the relevant definition.

RG 166.77 For the purposes of RG 166.76, a client includes a person who acquires or disposes of financial products in a transaction that you entered into at a price you stated in the course of making a market.

RG 166.78 The ASLF requirement does not apply to you if:

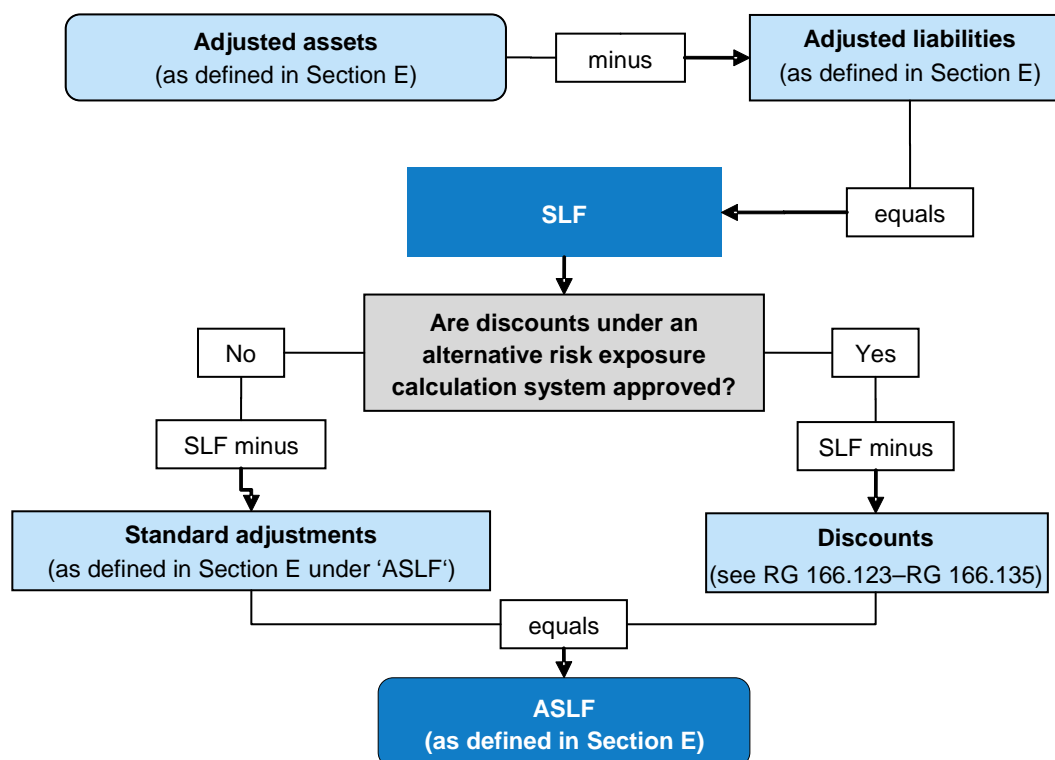
- (a) the total of:
 - (i) the current liabilities that would be included in the calculation of your adjusted liabilities; and
 - (ii) the contingent liabilities that if crystallised would be a current liability and be included in the calculation of your adjusted liabilities,
 is less than \$100,000; or
- (b) you have no:
 - (i) liabilities to clients that would be included in calculating your adjusted liabilities; or
 - (ii) contingent liabilities to clients which if crystallised would be included in calculating your adjusted liabilities,
 other than under debentures you issued under Ch 2L.

Note: In determining whether the ASLF requirement applies to you, certain liabilities can be disregarded: see RG 166.80.

How is ASLF calculated?

RG 166.79 To help you understand how to calculate ASLF, see Figure 1 and the definition of 'ASLF' in Section E. For the definition of 'adjusted liabilities', see Section E.

Figure 1: How to calculate ASLF



What liabilities can be disregarded?

- RG 166.80 For the purposes of determining whether your actual and contingent liabilities are less than \$100,000 (see RG 166.78), you can disregard a liability or contingent liability that:
- (a) is a contingent liability (and not a liability) that is not:
 - (i) a derivative; or
 - (ii) a contingent liability from underwriting securities or managed investment products;
 - (b) you reasonably estimate has a probability of less than 5% of becoming an actual liability;
 - (c) is covered by money or property that you hold in a separate account under Pt 7.8 or on trust for clients;
 - (d) is adequately secured (see the definition of 'adequately secured' in Section E);
 - (e) is a liability incurred by entering into a transaction on a licensed market that is to be settled using a clearing and settlement facility, the operation of which is authorised by an Australian clearing and settlement facility licence;

- (f) is under a foreign exchange contract and you are required by a condition in your licence reflecting Appendix 7 to have \$10 million of Tier 1 capital;
 - (g) is under a derivative where:
 - (i) you do not make a market in derivatives;
 - (ii) you entered into the dealing for the purposes of managing a financial risk;
 - (iii) your dealings in derivatives are:
 - (A) not a significant part of your business; or
 - (B) even if they are a significant part of your business, then they are not a significant part of the combined business of yourself and your related bodies corporate; and
 - (iv) you did not enter into the dealing on the instructions of another person;
 - (h) is under a foreign exchange contract where you:
 - (i) do not make a market in foreign exchange contracts;
 - (ii) entered into the contract for the purposes of enabling a payment in one of the currencies under the foreign exchange contract; and
 - (iii) did not enter into the foreign exchange contract on the instructions of another person;
- Note: If you are entering into foreign exchange contracts, see also Appendix 7.
- (i) is a liability that was not incurred in:
 - (i) providing a financial service by entering into transactions with clients; or
 - (ii) transactions that you entered into at a price you stated in the course of making a market; or
 - (j) is under a margin lending facility where you agree to provide credit to another person, to the extent that any portion of the credit remains undrawn.

What are the reporting triggers?

RG 166.81 If:

- (a) you are required to have ASLF of more than \$50,000; and
- (b) your ASLF is below the trigger points in RG 166.82,

you must not enter into any transactions with clients that could give rise to financial obligations, until your governing body has certified in writing that, having conducted reasonable inquiry into your financial position, there is no reason to believe that you may fail to meet your AFS licensee obligations.

- RG 166.82 Each of the following is a trigger point:
- (a) if you have between \$1 million and \$100 million in adjusted liabilities—when your ASLF is less than 5.5% of adjusted liabilities; and
 - (b) if you have more than \$100 million in adjusted liabilities and you do not have \$100 million ASLF—when your ASLF is less than \$500,000 in excess of the amount that you must have.
- RG 166.83 You must ensure a further certification is made at least monthly until your ASLF continuously exceeds the trigger point for at least one month.
- RG 166.84 You must keep each certification for at least 5 years. You must provide ASIC with a copy of each certification within 3 business days of the date of each certification.
- RG 166.85 Your governing body must affirm that there will be compliance with financial requirements when trigger points are reached. This enables them to put into place any additional measures that may be needed to ensure you do not breach your AFS licence conditions or other licensee obligations.

Purpose of the ASLF requirement

- RG 166.86 Market integrity can be jeopardised by disorderly failure of AFS licensees where their counterparties depend on their financial performance. Setting a scalable and certain standard focusing on liquidity is consistent with international regulatory practice and appropriate management of risks that would impact on your financial stability. We do not seek to prevent failures of licensees, as we are not a prudential regulator. We seek to reduce the risk that failure will occur in circumstances that put at risk your compliance with the licensee obligations.
- RG 166.87 Monitoring of trigger points and going through internal processes to comply with certification requirements is an appropriate risk management measure.
- RG 166.88 The ASLF requirement applies in some circumstances where you are or may become liable for more than \$100,000 in aggregate to clients from transactions you entered into with them. The ASLF requirement is not triggered by liability covered by money held in a separate account under s981B, or other money or property held on trust for a client. If your assets are held separately from clients' assets, the risk to your financial resources is less because you will not have to use your own assets to meet your financial obligations to clients. The ASLF requirement does not apply to you if your only liabilities to clients are under debentures under Ch 2L. Chapter 2L sets the requirements Parliament thinks appropriate for debenture issuers.

- RG 166.89 The ASLF requirement generally only applies when money in excess of \$100,000 is owed. The \$50,000 minimum ASLF required would be disproportionate to the risk for any lesser obligation.
- RG 166.90 The \$50,000 minimum amount is consistent with the minimum requirement for AFS licensees that hold client money or property.
- RG 166.91 The required level of ASLF is set at 5% subject to reduced rates where ASLF of more than \$5 million is required. Imposing a requirement based on ASLF of 5% broadly reflects the requirements for licensed securities dealers under the old Corporations Act (i.e. as in force immediately before commencement of the *Financial Services Reform Act 2001* (FSR Act) on 11 March 2002). However, the requirement is not fully comparable. The approach in this policy involves changes to the calculation of SLF, such as requirements for discounting of assets to reflect market and credit risk.
- RG 166.92 A reduced ASLF requirement applies where you have at least \$5 million in ASLF (bearing in mind that there is a maximum requirement of \$100 million ASLF). To meet our objectives, the ASLF requirement need not increase with adjusted liabilities to such an extent as set out in RG 166.75 where more than \$5 million is required (or, in cases where \$100 million ASLF is held, at all). For example, economies of scale will facilitate economical use of resources in providing capacity to carry on your business in compliance with the AFS licensee obligations or to wind up the business in an orderly manner. The financial requirements are not intended to give assurance of financial capacity to meet liabilities to clients.
- RG 166.93 The ASLF requirement applies regardless of whether liabilities are to retail or wholesale clients. Regulation of licensees is designed to promote market integrity, efficiency and confidence, as well as consumer protection. We anticipate that the ASLF requirement will apply to persons such as market makers in derivatives (other than derivatives which are foreign exchange contracts, unless the AFS licensee chooses to be subject to the ASLF requirement rather than the requirements in Appendix 7), underwriters of securities issues, issuers of non-cash payment facilities, and dealers in the fixed interest market.
- RG 166.94 We have noted the requirements that apply for broker-dealers in the United States and certain financial services providers in the United Kingdom. These requirements incorporate a scalable element and require detailed calculation to quantify risks.
- RG 166.95 We have adopted a simple approach that is different from regulatory approaches involving more sophisticated adjustments for risk, such as are necessary for prudential regulation. Our focus is on the risk of you being unable to comply with your AFS licensee obligations, and therefore causing a disruption to the market.

Derivatives

- RG 166.96 If you only transact with clients by entering into derivatives for the purpose of managing your financial risks, you may be exempted from the requirement to be licensed for this activity under reg 7.6.01(1)(m)–(ma). If you require an AFS licence only for other products and services you provide, but fall within the exemption in reg 7.6.01(1)(m)–(ma) for your derivatives trading, the ASLF requirement may not apply to you (unless you undertake other activities that trigger the ASLF requirement, such as underwriting securities). In this case, you will only need to meet the financial requirements applying to your non-derivatives financial services activities.
- RG 166.97 For example, if you are a responsible entity, and only transact with clients by dealing in derivatives to manage your financial risk within the scope of the exemption in reg 7.6.01(1)(m), you are not likely to need to meet the ASLF requirement. Instead, you must meet the NTA requirement applying to responsible entities: see Appendix 2.

E Definitions for calculating financial requirements

Key points

This section sets out the definitions for calculating the financial requirements that apply to you as an AFS licensee.

We seek to enable calculations for financial requirements that best balance the following objectives. They must:

- be as easily understood and certain as possible;
- not be subject to manipulation;
- be based on accepted accounting principles; and
- be a meaningful measure to achieve the purpose of the relevant requirement.

Summary of definitions

RG 166.98 Table 7 lists the definitions in this section, grouped under three categories:

- general definitions for all AFS licensees;
- specific definitions for responsible entities, IDPS operators and custodians; and
- specific definitions for retail OTC derivative issuers in calculating NTA.

Table 7: Definitions in this section

Category	Definition	Reference
General definitions for all AFS licensees	Adequately secured	RG 166.99
	Adjusted assets	RG 166.100
	Adjusted liabilities	RG 166.101–RG 166.103
	Adjusted surplus liquid funds (ASLF)	RG 166.104–RG 166.135
	Approved foreign market	RG 166.136–RG 166.137
	Cash (for Option 1 of the cash needs requirement)	RG 166.138–RG 166.139
	Cash flow (for the cash needs requirement)	RG 166.140
	Eligible provider	RG 166.141–RG 166.145
	Eligible undertaking	RG 166.146–RG 166.151
	Excluded assets	RG 166.152–RG 166.158
	Net tangible assets (NTA)	RG 166.159

Category	Definition	Reference
	Relevant trust (for the cash needs requirement)	RG 166.160
	Surplus liquid funds (SLF)	RG 166.161
Specific definitions for responsible entities, IDPS operators and custodians	Average responsible entity and IDPS revenue	RG 166.162
	Average revenue	RG 166.163
	Average value of scheme property and IDPS property	RG 166.164
	Calculation date	RG 166.165
	Cash or cash equivalents	RG 166.166
	Custodial or depository services revenue	RG 166.167
	Eligible custodian	RG 166.168
	Eligible provider	RG 166.169–RG 166.170
	Financial services business revenue	RG 166.171
	First financial year	RG 166.172
	Incidental provider	RG 166.173
	Liquid assets	RG 166.174
	Regulated trust account	RG 166.175
	Responsible entity and IDPS revenue	RG 166.176
	Special custody assets	RG 166.177
Tier \$500,000 class assets	RG 166.178	
Value of scheme property and IDPS property	RG 166.179	
Specific definitions for retail OTC derivative issuers in calculating NTA	Average revenue	RG 166.180
	Cash or cash equivalents	RG 166.181
	Eligible provider	RG 166.182
	Liquid assets	RG 166.183

General definitions for all AFS licensees

Adequately secured

RG 166.99 Adequately secured means, in relation to an AFS licensee:

- (a) secured by an enforceable security interest over financial products (other than financial products issued by the licensee or its associate) if:
 - (i) the financial products are:
 - (A) regularly traded on:
 - (I) a financial market (as defined in s767A(1) and disregarding s767A(2)) operated by a market licensee, or an AFS licensee other than the licensee or its associates that, in the reasonable opinion of the licensee, produces sufficiently reliable prices to assess the value of the security provided by the security interest;
 - (II) an ASIC-approved foreign market under Regulatory Guide 72 *Foreign securities prospectus relief* (RG 72); or
 - (III) a foreign market approved in writing for this purpose by us (see the definition of ‘approved foreign market’ in RG 166.136); or
 - (B) interests in a registered scheme for which withdrawal prices are regularly quoted by the responsible entity, and the licensee believes on reasonable grounds that withdrawal may be effected within 5 business days; and
 - (ii) the market value of these financial products is at least 120% of the amount owing, or at least 109% of the amount owing if the financial products are debt instruments; or
- (b) secured by a registered first mortgage over real estate that has a fair market valuation of at least 120% of the amount owing; or
- (c) owing from an eligible provider for the category of licensee in question; or
- (d) secured by an enforceable security interest over amounts owing to another AFS licensee which themselves are adequately secured.

Adjusted assets

RG 166.100 Adjusted assets means, in relation to an AFS licensee, the value of total assets as they would appear on a balance sheet at the time of calculation made up for lodgement as part of a financial report under Ch 2M if the licensee were a reporting entity:

- (a) minus the value of excluded assets that would be included in the calculation;

- (b) minus the value of any receivable that would be included in the calculation, up to the amount that the licensee has excluded from adjusted liabilities on the basis that there is an enforceable right of set-off with that receivable;
- (c) minus the value of any assets that would be included in the calculation that are encumbered as a security against liability to a person that provides a security bond to us, up to the amount of the bond;
- (d) minus the value of any assets that would be included in the calculation that may be required to be applied to satisfy a liability under a credit facility that is made without recourse to the licensee up to the amount of that liability excluded from adjusted liabilities;
- (e) plus:
 - (i) the amount of any eligible undertaking that is not an asset; or
 - (ii) if the eligible undertaking is for an unlimited amount, an unlimited amount,

provided that if the eligible undertaking is given by a person who is an eligible provider only because of RG 166.141(b) of the definition of 'eligible provider', the amount added may be no more than one-quarter of the eligible provider's net assets (excluding intangible assets) as shown in the most recent audited financial statements of the provider lodged with us;

- (f) for calculating ASLF, plus the value of any current assets of any trust (other than a registered scheme) of which the licensee is trustee, except to the extent the value exceeds the sum of:
 - (i) the current liabilities of the trust; and
 - (ii) any adjustments to ASLF that are a result of current assets, liabilities and contingent liabilities of the trust for accounting purposes being included when calculating adjustments; and

Note: We require licensees that are trustees to take into account liabilities and contingent liabilities as if they were not incurred as trustee: see RG 166.110. However, we recognise that the licensee should be able to include trust assets (subject to adjustments under RG 166.105) when calculating ASLF up to but not more than is necessary to cover the liabilities and the amount required to be adjusted due to the nature of the trust assets and for contingent liabilities.

- (g) for calculating ASLF, plus the value of the applicable percentage of the value of any current assets that would be acquired in return for paying a contingent liability, except to the extent that this value exceeds the amount which is the applicable percentage of the contingent liability (see RG 166.105(c)(i) and RG 166.105(c)(iii)).

Note: The rights of an underwriter against a sub-underwriter are treated as an asset for this purpose.

Adjusted liabilities

RG 166.101 Adjusted liabilities means, in relation to an AFS licensee, the amount of total liabilities as they would appear on a balance sheet at the time of calculation made up for lodgement as part of a financial report under Ch 2M if the licensee were a reporting entity:

- (a) minus the amount of any liability under any subordinated debt approved by us in writing;
- (b) minus the amount of any liability that is the subject of an enforceable right of set-off, if the corresponding receivable is excluded from adjusted assets;
- (c) minus the amount of any liability under a credit facility that is made without recourse to the licensee;
- (d) for calculating ASLF, plus the amount of the total current liabilities of any trust (other than a registered scheme) of which the licensee is trustee;
- (e) plus the value of any assets that are encumbered as a security against another person's liability where the licensee is not otherwise liable, but only up to the lower of:
 - (i) the amount of that other person's liability; or
 - (ii) the value of the assets encumbered after deducting any adjustments;

Note 1: RG 166.101(e) does not apply if the other person's liability is owed jointly by the licensee and that other person (i.e. to avoid double counting).

Note 2: For responsible entities, the value of encumbered assets is only included in RG 166.101(e) to the extent that it is not already included in RG 166.101(f).

- (f) for responsible entities, plus the maximum potential liability of any guarantee provided by the AFS licensee other than a:
 - (i) guarantee limited to an amount recoverable out of any scheme property of a managed investment scheme operated by the licensee; or
 - (ii) guarantee of the obligations of another member of a stapled group, except where the licensee is the responsible entity of a registered scheme that is not part of the stapled group.

Note 1: For an unregistered scheme, 'scheme property' in RG 166.101(f)(i) is taken to have the same meaning as if the scheme were registered.

Note 2: 'Stapled group' means the group of entities consisting of:

- (a) one or more stapled issuers that are issuers of securities that must be transferred together; and
- (b) all wholly owned entities controlled by the stapled issuers.

Note 3: 'Stapled issuer' means an entity for which a security must be transferred together with a security of one or more other entities under:

- (a) the terms on which it is traded on a prescribed financial market;

- (b) the constitution of the entity; or
- (c) the terms of issue.

Deed of subordination

- RG 166.102 We will generally only approve subordinated debt if it is in substantially the same form as Pro Forma 63 *Deed of subordination* (PF 63).
- RG 166.103 PF 63 clarifies that the debt cannot be repaid without ASIC's consent even after the AFS licensee ceases to hold a licence. We consider that this may help ensure that former licensees meet obligations to clients and wind up their businesses in an orderly way.

Adjusted surplus liquid funds (ASLF)

- RG 166.104 ASLF means surplus liquid funds (calculated for ASLF purposes) minus either:
- (a) the standard adjustments (see RG 166.105–RG 166.111); or
 - (b) the adjustments produced by a risk exposure calculation system we allow to be used instead of one or more of the standard adjustments (see RG 166.123–RG 166.135).

Note: To help you understand how ASLF is calculated, see Figure 1 in Section D.

Standard adjustments

- RG 166.105 The standard adjustments are:
- (a) discounts as follows:
 - (i) 8% for the values that reflect obligations to pay you a certain sum maturing beyond 12 months, unless the interest rate applicable is reset to reflect market interest rates at least annually; and
 - (ii) 16% for the values that reflect any assets other than:
 - (A) an obligation to pay you a certain sum;
 - (B) a derivative; or
 - (C) an interest in property held in trust by another licensee under Div 3 of Pt 7.8 or the rights to money held by another licensee in an account under s981B;
 - (b) 8% of the values that reflect others' obligations to pay you a certain sum, except to the extent that the asset is adequately secured or is a right against another AFS licensee in respect of money or property held by that other licensee in an account under s981B or held in trust under Div 3 of Pt 7.8;

Note: If discounts under RG 166.105(a) apply, this calculation is to be performed after those discounts are calculated.

- (c) the following amounts for contingent liabilities and contingent liabilities of any trust (other than a registered scheme) of which the licensee is trustee:
- (i) 5% of any contingent liabilities that can be quantified under an underwriting or sub-underwriting of financial products except:
 - (A) during the 5 business days after the commitment is assumed; and
 - (B) during any period it is unlawful to accept applications for the financial products to which the underwriting relates (such as under s727(3) or 1016B) and the period ending 5 business days after the first day on which it becomes lawful to accept applications; and
 - (C) to the extent that the underwriter holds funds from persons seeking to acquire the financial products subject to the underwriting;

Note: For this purpose, an underwriting is an enforceable obligation to acquire financial products in defined circumstances. An obligation to use best endeavours to arrange for acquisitions of financial products is not an underwriting for this purpose.

- (ii) 5% of the potential liability of any contingent liabilities that can be quantified under a derivative, other than to the extent there is an offsetting position in:
 - (A) the ‘something else’ for the purposes of s761D(1)(c);
 - (B) another derivative relating to that something else; and/or
 - (C) a thing that is so similar to the something else as to make the probability of net loss from the liability under the derivative exceeding any increase in value of the thing less than 5% in the reasonable and documented opinion of the licensee,

except to the extent that the licensee is of the reasonable opinion that the risk that they will become liabilities (or become liabilities to a greater extent than taken into account for the purposes of applying the adjustment) because of a change in the price or value of the something else is trivial;

Note: In assessing the probability of net loss, the likelihood of the licensee being able to dispose of the derivative so as to avoid further loss can be taken into account.
- (iii) 20% of the potential liability of any contingent liabilities that can be quantified under a guarantee or indemnity;
- (d) the relevant percentage as set out in RG 166.105(c)(ii)–RG 166.105(c)(iii) of the amounts that in the licensee’s reasonable opinion is the maximum amount that the licensee may be liable for in relation to a contingent liability referred to in RG 166.105(c) where the maximum liability cannot be quantified; and

Note: Trivial risks that the amount may be higher in the case of RG 166.105(c)(ii) because of a change in the price or value of the something else can be disregarded.

- (e) where the licensee has agreed to sell an asset that it does not hold, the amount of the adjustment that would apply if it held that asset is to be applied against adjusted assets.
- RG 166.106 For the purposes of the standard adjustments, the risk that a contingent liability will become a liability may be treated as trivial if the probability that this will occur is reasonably estimated by the AFS licensee as less than 5%.
- RG 166.107 For RG 166.104(a) and RG 166.104(b), discounts apply against the value of current assets:
- (a) used in calculating adjusted assets;
 - (b) of any trust (other than a registered scheme) of which the licensee is a trustee (see RG 166.100(f)(ii));
 - (c) that are deducted under RG 166.100(c);
 - (d) that are deducted under RG 166.100(d) as assets to which recourse may be had for a liability of the licensee where the licensee's liability is limited to those assets, but the total discounts applied to those assets shall not exceed any excess of the value of the licensee's assets to which recourse may be taken over the amount of the liability; and
 - (e) that is the applicable percentage of the current assets that would be acquired in return for paying a contingent liability under RG 166.105(c)(i) or RG 166.105(c)(iii).
- RG 166.108 The AFS licensee does not have to apply the discounts to the value of amounts payable from a client in the ordinary course of its financial services business for financial products that the client has agreed to buy, if the money is required to be—and in the reasonable estimation of the licensee probably will be—paid no more than 5 business days after the client became liable.
- Note: For further explanation, see RG 166.117.
- RG 166.109 There is a common calculation framework for SLF and NTA. We do not require that non-current liabilities be included in calculating adjusted liabilities.
- RG 166.110 To prevent avoidance and promote competitive neutrality we require that, where the AFS licensee is trustee, it must take into account trust liabilities and contingent liabilities as if they were held beneficially. Trust assets can also be counted, subject to the standard adjustments but not so as to allow the licensee to rely on trust assets to meet ASLF requirements that do not arise from the relevant trust.
- RG 166.111 We require adjustments to be made to reflect in a limited way possible market and credit risks affecting assets and contingent liabilities. We recognise that our requirements do not necessarily accurately reflect risks to assets or the risk of off-balance sheet exposures. However, we believe our

requirements are more likely to result in requirements that are more consistent with our policy objectives than if we disregard risks to assets and contingent liabilities. We are prepared to examine further the appropriate amount of the adjustments if industry submissions indicate they are unreasonably burdensome or that they are leading to significant distortions that are not overcome by the use of models.

Risks to assets

- RG 166.112 To take into account risks that assets may not be available to meet your liabilities, we require adjustments to be made. The standard adjustments address market risk and counter-party credit risk. Since these risks are separate, we require their cumulative effect to be quantified by applying adjustments for both risks where relevant.
- RG 166.113 Financial requirements imposed on broker-dealers in the United States under Rule 15c3-1 of the Securities and Exchange Commission's (SEC) financial responsibility rules, and in Hong Kong and the United Kingdom under financial requirements for financial services providers that have liabilities to clients, all require discounting of assets to reflect risks.
- RG 166.114 We also recognise the relative risk of different assets in our financial requirements for certain market participants: see, for example, Chapter 8 of ASIC Market Integrity Rules (ASX Market) 2010. The amount of discount required for assets such as shares in the ASLF calculation (i.e. 16%: see RG 166.105(a)(ii)) broadly reflects our capital requirements for certain market participants in relation to position risk for shares not included in an index. While our capital requirements for certain market participants are structured differently and so are not directly comparable, we have adopted this figure as a basis for adopting a discount level for market risk.
- RG 166.115 Reflecting Basel Committee guidelines, APRA generally requires ADIs to meet capital requirements by holding 8% of capital. While not directly comparable (and noting our additional requirement for a surplus of assets over liabilities), we have adopted this as a basis for requiring an 8% discount based on credit risk. Prudential regulators such as APRA also have requirements that differentiate between asset types and can impose capital requirements of up to 100% of exposures. We do not differentiate between asset types in this way, as our financial requirements are not imposed for the purpose of prudential regulation and we seek to avoid unnecessary complexity. However, it is appropriate that, in calculating ASLF, there be some recognition of the relative safety of holding certain kinds of assets. ASLF is a measure that helps to indicate when you may be at risk of having insufficient financial resources to comply with your AFS licensee obligations.
- RG 166.116 The levels of discount reflect only very broadly the extent of risk. We have chosen these discount levels to promote simplicity and reduce errors,

classification issues, and regulatory and compliance costs. We do not require fine assessments of relative risk of assets, nor do we require that you take into account the very significant implications for risk of potential correlations in exposures that may have a risk-reducing effect. Changes may occur over time in the relative risks associated with certain assets. The relatively arbitrary quantification of certain percentage requirements to help achieve the objectives of the FSR Act is not consistent with an elaborate specification of various discount levels. Balancing these considerations with the need for some recognition of relative risk, we have adopted the simple percentage discounting factors stated in this guide.

- RG 166.117 We exclude financial products that relate to short-term settlements from discounting. This is to avoid excessive financial requirements based on short-term liabilities, where market and credit risk are limited and of short duration. These liabilities will still trigger the requirement for the tiered level of ASLF.

Contingent liabilities

Note: For the definition of 'actual or contingent liabilities of the relevant kind' for the purposes of determining whether the ASLF requirement will apply to you, see RG 166.122.

- RG 166.118 In calculating ASLF, we require adjustments to reflect the risk that contingent liabilities from derivatives, underwriting, and guarantees and indemnities may need to be satisfied within the current period. A derivative may be shown as an asset or liability on a mark-to-market basis. However, this represents the derivative's current value and not the range of risks it exposes you to.
- RG 166.119 To give weight to such contingent liabilities, we require that from 5% to 20% of their value be deducted in calculating ASLF. Any liability that is probable (i.e. more than 50% probability) is an actual and not a contingent liability in any case. Where an asset will be acquired if the contingent liability crystallises, the asset may be included. Such an asset cannot be allowed to count in excess of the liability and has to be discounted for market and credit risk as appropriate. For underwriting liabilities, this applies to the financial products that the underwriter has agreed to acquire, and the rights against any sub-underwriter that require the sub-underwriter to satisfy part of the underwriting commitment.
- RG 166.120 For example, if an underwriter fully underwrites a \$320 million securities issue (and has 50% of it sub-underwritten), the underwriter must take into account 5% of the total price to be paid in the worst case under the underwriting agreement as a liability (i.e. \$16 million). The underwriter may then assume that, if it were called on to pay 5% of the underwritten amount, it would get 2.5% of the total underwritten amount in securities (i.e. securities which in this example the licensee values at \$8 million) and 2.5% from the sub-underwriter (i.e. \$8 million). These calculations assume that the

liability under the underwriting commitment is a contingent liability (i.e. its probability is less than 50%).

- RG 166.121 However, both the securities and benefit of the sub-underwriting commitment may have to be discounted. If the securities are shares, they would have to be discounted by 16% so that, for ASLF purposes, after adjustment the right to the shares would offset the contingent liability up to \$6.72 million. The value of the contingent sub-underwriting receivable would have to be discounted by 8% (assuming the sub-underwriter is not an eligible provider) so that, for ASLF purposes, it would offset the contingent liability by a further \$7.36 million. Therefore, in this example, in order to offset fully the \$16 million that is deducted from ASLF because of the \$320 million underwriting commitment, the underwriter would need to have adjusted assets of \$1.92 million from other sources (i.e. \$16 million – \$6.72 million – \$7.36 million).

Actual or contingent liabilities of the relevant kind

- RG 166.122 For the purposes of determining whether the ASLF requirement will apply to you (see RG 166.76), an actual or contingent liability of the relevant kind means:
- (a) an actual or contingent monetary liability; or
 - (b) an actual or contingent liability under a non-standard margin lending facility, in the circumstances determined under the terms of the facility, to transfer marketable securities to the client.

Note: For the definition of a 'non-standard margin lending facility' see 'Key terms'.

Risk exposure calculation system

- RG 166.123 In some cases and on application to us, we may allow different discounts other than the standard adjustments to be applied. We will allow different discounts where we are satisfied by external evidence that the AFS licensee has an appropriate risk exposure calculation system. The system would need to incorporate a model with several essential components to quantify the exposure of the licensee that the corresponding standard adjustments would otherwise cover. These components are as follows:

- (a) for RG 166.105(a), the value of the assets would be less than their current value if the assets were required to be realised at a particular future time;

Note 1: The licensee may choose the future time based on when the liabilities of the licensee that are due within 12 months will be payable, or can simplify the calculation by referring to an average time until the liabilities become payable.

Note 2: When the licensee considers loss of value, the licensee can take into account the net loss after any offsets by other gains under derivatives or otherwise to the extent of the probability the licensee will receive them if its assets lose value.

Note 3: The revenue of a licensee includes any revenue of an authorised representative of the licensee acting on the licensee's behalf.

- (b) for RG 166.105(b), financial obligations to the licensee will not be performed when due, or at all; and
- (c) for RG 166.105(c)(ii) and RG 166.105(d) (insofar as it relates to RG 166.105(c)(ii)), loss will arise because contingent liabilities will crystallise from derivatives without offsetting gain.

RG 166.124 The system must include measures to ensure that there is:

- (a) a functionally independent and appropriately qualified and experienced team responsible for assessing the risks that may impact on the relevant exposure and documenting their findings;
- (b) frequent reporting about the risks to management with sufficient authority to enforce steps to reduce risks;

Note: These reports must be considered by management, and the continuing appropriateness of the model assessed by management and documented.

- (c) back testing of the amounts calculated by the system against experience of losses, and that changes are made to the system to address any material deficiencies testing has identified;
- (d) appropriate use of external sources of information such as ratings information to assess credit risk;
- (e) a risk management system that is documented and implemented, including appropriate limits on exposures and internal controls; and
- (f) assurance that all practicable steps are taken to ensure that information is entered into the model generating the quantifications in accordance with the model's requirements without material error.

RG 166.125 We will not assess the model used in the system ourselves as we are not a prudential regulator. We will require evidence that the model used in the system is substantially the same as has been accepted as the basis for quantifying exposures of another entity by:

- (a) APRA; or
- (b) another prudential regulator we accept for the purpose (including a foreign regulator).

If we accept use of the system as a substitute for the adjustments that would otherwise apply, AFS licence conditions will require the licensee to implement the system and monitor that the licensee continuously implements all the necessary procedures.

RG 166.126 We have provided an alternative to the standard adjustments because we are conscious that you may be able to quantify your risk in a way that is more accurate than our specifications. However, we will only allow use of systems for risk calculation where there is a means of recognition that is consistent

with efficient administration. We need to be satisfied, based on checks performed by appropriate independent experts, that the system is robust and controlled by appropriately enforceable parameters to enable verification and consistency as part of your risk management system.

- RG 166.127 If you are able to demonstrate you have an appropriate risk exposure calculation system incorporating a model that has been accepted by a prudential regulator, it provides a basis for us to allow the model to be used for calculating exposures. Entities with significant exposures to derivatives will ordinarily have such systems to comply with their duty to have an adequate risk management system. The standard adjustments may be appropriate, if you have limited exposure to risks of this kind. Even in this case, compliance with the ASLF requirement does not limit your obligation to have an adequate risk management system: see s912A(1)(h).
- RG 166.128 We understand that some AFS licensees will not be in a position to adopt a model that has been approved by a prudential regulator. We will consider reviewing our policy to cater for these exceptional circumstances if industry demonstrates there is a need for, and an appropriate means of obtaining assurance about, use of other models to calculate exposures.
- RG 166.129 We encourage development of guidance about risk exposure calculation systems and other risk management practices by industry bodies. Prudential regulators and auditors may take note of these guidelines in coming to their own assessments. We will not be approving risk exposure calculation systems whether they have been developed by industry bodies or others, but will rely on a combination of the evidence in RG 166.125 and certificates and audit reports: see RG 166.131–RG 166.135. The certificates require the chief executive officer and governing body of the AFS licensee to assure us that the risk calculation exposure system meets appropriate standards and is supplemented by assurance by the auditor that the processes that are key elements of an effective system are being implemented.

How to apply to be allowed to use a risk calculation exposure system

- RG 166.130 To apply to be allowed to use a risk calculation exposure system:
- (a) Include a submission for approval with your licence application or request for variation of licence, or at a later time when needed.
 - (b) Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).
 - (c) Include the certificates and evidence set out in this guide.
 - (d) Candidly set out all information that may be relevant to your application.

You can also contact ASIC on 1300 300 630 for information and assistance.

Certification and audit report requirements

- RG 166.131 We will require a certificate by the chief executive and an audit report about any risk exposure calculation system if we are asked to allow it to be used as a substitute for the standard adjustments.
- RG 166.132 We require a certificate by the chief executive endorsed by the governing body of the AFS licensee:
- (a) at the time of the application;
 - (b) every 3 months; and
 - (c) at any other time we require a certificate.
- RG 166.133 The certificate must state that:
- (a) the licensee has identified all material risks the licensee faces that may impact on the calculation of the relevant exposure;
 - (b) the licensee has established systems to monitor those risks, including by adequate and timely reporting processes and by applying a model that is appropriate to the licensee;
 - (c) those risk management systems (and in particular the risk exposure calculation system) are operating effectively and are adequate having regard to the risks they are designed to control;
 - (d) the measures in RG 166.124 are being effectively implemented; and
 - (e) the description of the licensee's risk management systems provided to the licensee's registered company auditor is accurate and current.
- RG 166.134 We also require a report by a registered company auditor that the auditor has reviewed the risk exposure calculation system and has no reason to believe that:
- (a) the licensee is not applying its risk exposure calculation system, incorporating the model that we are being asked to allow, or have allowed, to be used to calculate adjustments for ASLF, to determine those adjustments; or
 - (b) during the period for the report, the licensee has not materially failed to ensure that there is:
 - (i) a functionally independent team, including relevantly qualified and experienced staff responsible for assessing the risks that may impact on the relevant exposure and documenting its findings;
 - (ii) frequent reporting about the risks to management with sufficient authority to enforce steps to reduce risks;
 - (iii) back testing of the amounts calculated by the system against experience of losses, and that changes are made to the system to address any material deficiencies testing has identified;

- (iv) use of external sources of information such as ratings information to assess credit risk;
- (v) a risk management system that is documented and implemented, which includes limits on exposures and internal controls; and
- (vi) a reasonable system designed to ensure that that information is input into the model generating the quantifications in accordance with the model's requirements without material error.

RG 166.135 This report would be required:

- (a) at the time of the application for a reasonable period before the application;
- (b) at the time the audit report on the licensee's financial statements as required under s989B(3) is lodged in respect of the relevant financial year; and
- (c) any other time we require and for the period we require.

Note: In preparing an audit report on the AFS licensee's compliance with our financial requirements, the auditor may assume the appropriateness of any adjustments produced by a risk exposure calculation system if we have allowed use of the system as a substitute for the standard adjustments.

Approved foreign market

RG 166.136 An approved foreign market means a foreign market that we will approve for the purposes of RG 166.99(a)(i)(A)(III) if the AFS licensee demonstrates that it is a market in which independent, bona fide offers to buy and sell are regularly made, so that a price reasonably related to the last sale price or current bona fide competitive bid and offer quotations can be determined promptly, and payment may reasonably be expected to be received within the customary period.

How to apply for approval of a foreign market

RG 166.137 To apply for approval of a foreign market for the purposes of RG 166.99(a)(i)(A)(III):

- (a) Include a submission for approval with your AFS licence application or request for variation of licence, or at a later time when needed.
- (b) Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).
- (c) Candidly set out all information that may be relevant to your application, including details as to the effectiveness of the market's price formation and settlement processes.

You can also contact ASIC on 1300 300 630 for information and assistance.

Cash (for Option 1 of the cash needs requirement)

- RG 166.138 For the purposes of item 5 of Table 4 (relating to Option 1), cash means:
- (a) current assets valued at the amount of cash for which they can be expected to be exchanged within 5 business days; or
 - (b) a commitment to provide cash from an ‘eligible provider’ (see RG 166.141–RG 166.145) that can be drawn down within 5 business days and has a maturity of at least a month provided that, if the commitment is given by a person who is only an eligible provider under RG 166.141(b), the maximum amount of the commitment that may be counted as cash is one quarter of the eligible provider’s net assets (excluding intangible assets) as shown in the most recent audited financial statements of the provider lodged with us.
- RG 166.139 This includes any cash in a ‘relevant trust’ (see RG 166.160) if you have no reason to believe that the cash will not be available to meet all of your projected cash flows.

Cash flow (for the cash needs requirement)

- RG 166.140 For the purposes of calculating the cash needs requirement, references to your cash flow include your own cash flow and any cash flow of a ‘relevant trust’ (see definition below), but do not include cash flows of any other trust.

Eligible provider

- RG 166.141 Except where otherwise specified in this section, eligible provider means:
- (a) an Australian ADI;
 - (b) an entity (other than a registered scheme of which the licensee or the licensee’s associate is the responsible entity):
 - (i) whose ordinary shares are listed on a licensed market or an ASIC-approved foreign exchange under Regulatory Guide 72 *Foreign securities prospectus relief* (RG 72); and
 - (ii) that has net assets (excluding intangible assets) of more than \$50 million, as shown in the most recent audited financial statements of the provider lodged with us. This applies if the licensee has no reason to believe the entity no longer has net assets of at least that amount;

Note: The type of provider described in RG 166.141(b) is not an eligible provider for responsible entities, IDPS operators or custodians: see RG 166.169–RG 166.170.

- (c) an Australian government (i.e. the government of the Commonwealth or of a state or territory) or the government of a country that is a member of the Organisation for Economic Co-operation and Development

(OECD country government), or an agency or instrumentality of an Australian or OECD country government;

Note: We would consider you to be an agency or instrumentality of a government if you represent that government and you are conferred with all the powers, privileges, rights and remedies, or their equivalent, of that government.

- (d) a foreign deposit-taking institution that is regulated by a regulator approved in writing by us for this purpose;
- (e) a foreign deposit-taking institution we approve in writing for this purpose (see RG 166.143);
- (f) a clearing and settlement facility (CS facility) licensee; or
- (g) in exceptional circumstances, an entity of undoubted financial substance we approve in writing.

RG 166.142 If the provider is not otherwise required to lodge financial statements with us, the AFS licensee must ensure that their financial statements are lodged with its balance sheet under s989B(2).

RG 166.143 We will approve a foreign deposit-taking institution if the AFS licensee demonstrates to us that the foreign deposit-taking institution is prudentially regulated to appropriate standards under the Basel Committee guidelines.

RG 166.144 We do not recognise a body as an eligible provider merely on the basis of ratings in relation to its debt instruments. However, where exceptional circumstances make it necessary for the licensee to rely on such an entity to provide an eligible undertaking, we will take into account ratings information in assessing whether the body has undoubted financial substance. This evidence may be significant but alone will not be determinative.

How to apply for approval of an eligible provider

RG 166.145 To apply for approval of an eligible provider:

- (a) Include a submission for approval with your licence application or request for variation of licence, or at a later time when needed.
- (b) Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).
- (c) Candidly set out all information that may be relevant to your application, including details as to the foreign regulatory arrangements or financial substance of the provider, and other exceptional circumstances.

You can also contact ASIC on 1300 300 630 for information and assistance.

Eligible undertaking

RG 166.146 Eligible undertaking means the amount of a financial commitment payable on written demand by the AFS licensee, provided by an eligible provider in the form of an undertaking to pay the amount of the financial commitment to the licensee, and that:

- (a) is an enforceable and unqualified obligation; and
- (b) remains operative (even if, for example, the licensee ceases to hold an AFS licence) until we consent in writing to the cancellation of the undertaking.

RG 166.147 An AFS licensee cannot include as an eligible undertaking any amount committed that would be repayable as a current liability or, for calculating NTA, as a liability by the licensee if money were paid.

Note: For calculating NTA, a credit facility cannot be counted as an eligible undertaking. For calculating SLF, only a credit facility that if drawn down would not result in a current liability can count as an eligible undertaking.

RG 166.148 We will consider allowing an AFS licensee to treat as an eligible undertaking a financial commitment in a different form, if the licensee demonstrates that in exceptional circumstances:

- (a) it would be impracticable or unreasonably burdensome for the financial support to be obtained by an undertaking complying with RG 166.146; and
- (b) the financial commitment would be as effective in meeting the objectives of the financial requirements as an undertaking complying with RG 166.146.

RG 166.149 For example, we have allowed an AFS licensee that is a custodian of a superannuation entity to, in certain circumstances, treat an ‘approved guarantee’ obtained for the purpose of meeting its obligations under s123 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) as an eligible undertaking.

RG 166.150 If the amount of an eligible undertaking is unlimited, the AFS licensee will have satisfied any applicable NTA, SLF or ASLF requirement. This does not apply if the eligible undertaking is given by a person who is an eligible provider only because of RG 166.141(b). In this case, the amount added to the licensee’s adjusted assets can be no more than one-quarter of:

- (a) the eligible provider’s net assets (excluding intangible assets) as shown in the most recent audited financial statements of the provider lodged with us; or
- (b) if you have reason to believe that the eligible provider would have assets less intangible assets in a balance sheet made currently of a lesser

amount, one-quarter of the amount that you reasonably believe the eligible provider has.

How to apply for approval of an eligible undertaking

RG 166.151 To apply for approval of an eligible undertaking:

- (a) Include a submission for approval with your licence application or request for variation of licence, or at a later time when needed.
- (b) Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).
- (c) Candidly set out all information that may be relevant to your application, including details as to the unreasonableness of the burden, effectiveness of the undertaking, and other exceptional circumstances.

You can also contact ASIC on 1300 300 630 for information and assistance.

Excluded assets

RG 166.152 Excluded assets means, in relation to an AFS licensee:

- (a) intangible assets (i.e. non-monetary assets without physical substance);
- (b) except when allowed under RG 166.154 or RG 166.155, receivables from, or assets invested in, any person who:
 - (i) is an associate (as defined in the Corporations Act) of the licensee;
 - (ii) was an associate of the licensee (as defined in the Corporations Act or the old regulatory regime) at the time the liability was incurred or the investment was made; or
 - (iii) became liable to the licensee in connection with the acquisition of interests in a managed investment scheme the licensee operates;
- (c) except when allowed under RG 166.155, assets:
 - (i) held as a beneficial interest or interest in a managed investment scheme; or
 - (ii) invested in a superannuation product,

in respect of which the licensee or an associate may exercise any form of power or control; and
- (d) except when allowed under RG 166.154 or RG 166.155, receivables from a trustee of a trust in respect of which the licensee or an associate may exercise any form of power or control.

RG 166.153 Despite RG 166.152(b) and RG 166.152(d), a receivable is not an excluded asset to the extent that:

- (a) it is adequately secured; or

- (b) the following apply:
 - (i) it is receivable as a result of a transaction entered into by the licensee in the ordinary course of its business on its standard commercial terms applicable to persons that are not associated with the licensee on an arm's length basis;
 - (ii) no part of the consideration for the transaction is, in substance, directly or indirectly invested in the licensee;
 - (iii) the value of the receivable (before any discount is applied) is not more than 20% of the assets less liabilities of the licensee; and
 - (iv) for the purposes of calculating ASLF, the amount is further discounted by 10% of the value after any standard adjustments (see RG 166.105) or other discounts (see RG 166.123); or
- (c) the following apply:
 - (i) it is receivable from an insurance company that is a body regulated by APRA and results from a transaction entered into by the licensee in the ordinary course of its business on its standard commercial terms applicable to persons that are not associated with the licensee on an arm's length basis;
 - (ii) the licensee has no reason to believe that any amount invested in the licensee would not have been invested if the transaction that caused the receivable had not taken place or was not at the time of the investment expected to take place;
 - (iii) the licensee has no reason to believe that the recoverability of the receivable will materially depend on the value of an investment by any person in the licensee; and
 - (iv) the total value of the receivables under this paragraph (c) before any discount is applied is not more than 60% of the adjusted liabilities of the licensee disregarding this paragraph (c); or
 - (v) we consent in writing to the licensee treating the receivable as not being an excluded asset having regard to evidence that:
 - (A) the receivable does not arise from a transaction to avoid our financial requirements;
 - (B) recovery is highly probable; and
 - (C) it would be unreasonably burdensome to have structured the transaction so that the receivable was not an excluded asset.

RG 166.154 Despite RG 166.152(b) and RG 166.152(d), the AFS licensee can include a receivable to the extent that it is owing by way of fees from, or under rights of reimbursement for expenditure by the licensee out of property of, a superannuation entity as defined in the SIS Act, an investor directed portfolio service (IDPS) or a registered scheme (scheme) to the extent that the receivable:

- (a) exceeds amounts invested by the entity, IDPS or scheme in, or lent (other than by way of a deposit with an Australian ADI in the ordinary course of its banking business) directly or indirectly by the entity, IDPS or scheme to, the licensee, a body corporate the licensee controls, a body corporate that controls the licensee or a body corporate that the licensee's controller controls;
- (b) if receivable by way of fees, represents no more than the amount of fees owing for the previous 3 months; and
- (c) if receivable under rights of reimbursement for expenditure by the licensee, has not been receivable for more than 3 months.

RG 166.155 Despite RG 166.152(c), the AFS licensee does not have to exclude interests in a managed investment product unless any part of the amount invested is, in substance, directly or indirectly invested in the licensee.

RG 166.156 The intention of RG 166.152 is that the value of investments in regulated schemes on ordinary business terms can count towards your NTA or SFL, unless any part of that investment or the value provided in connection with the receivable is, in turn, invested in or lent to you. Allowing investments in those schemes to be reinvested in you or lent to you might be used as a device to artificially inflate your NTA or SLF. The intention is that these amounts should not count towards NTA even if other entities are interposed in the flow of funds and even if the sequence of the flow of funds does not start from you.

RG 166.157 The requirement in RG 166.152(b)(ii) has a similar rationale.

How to apply for consent to an amount owing not being an excluded asset

RG 166.158 To apply for consent to an amount owing not being an excluded asset:

- (a) Include a submission for approval with your AFS licence application or request for variation of licence, or at a later time when needed.
- (b) Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).
- (c) Candidly set out all information that may be relevant to your application, including evidence that the assets do not arise from a transaction to avoid our financial requirements, there is strong evidence of recoverability and it would be unreasonably burdensome to have structured the transaction so that the asset was not an excluded asset.

You can also contact ASIC on 1300 300 630 for information and assistance.

Net tangible assets (NTA)

RG 166.159 NTA means the AFS licensee's adjusted assets minus adjusted liabilities.

Relevant trust (for the cash needs requirement)

- RG 166.160 For the purposes of calculating the cash needs requirement, relevant trust means a trust:
- (a) of which the AFS licensee is trustee;
 - (b) through which the AFS licensee carries on substantially all of its financial services business;
 - (c) that is not a registered managed investment scheme or a superannuation entity as defined in s10(1) of the SIS Act; and
 - (d) that is not a trust to which a trustee company provides traditional services.

Surplus liquid funds (SLF)

- RG 166.161 SLF means the AFS licensee's adjusted assets minus the licensee's adjusted liabilities:
- (a) plus any non-current liabilities that were used in calculating adjusted liabilities and the value of any assets that are encumbered (where the licensee is not liable and the assets do not secure another person's current liability) that were added when calculating the licensee's adjusted liabilities;
 - (b) minus any non-current assets that were used in calculating adjusted assets; and
 - (c) if the licensee is an eligible provider under RG 166.141(b)—plus one-quarter of the value of its non-current assets minus any intangible assets and the amount of its non-current liabilities.

Specific definitions for responsible entities, IDPS operators and custodians

Average responsible entity and IDPS revenue

- RG 166.162 For an AFS licensee authorised to operate a registered scheme as a responsible entity or an IDPS, average responsible entity and IDPS revenue means:
- (a) for a licensee in its first financial year—the licensee's forecast of its responsible entity and IDPS revenue from the calculation date for the remainder of the first financial year pro-rated to a 12-month period;
 - (b) for a licensee in its second financial year of being authorised to operate a registered scheme as a responsible entity or an IDPS—the aggregate of the licensee's:

- (i) estimate of its responsible entity and IDPS revenue for the second financial year-to-date; and
- (ii) forecast of its responsible entity and IDPS revenue for the remainder of the second financial year;
- (c) for a licensee in its third financial year of being authorised to operate a registered scheme as a responsible entity or an IDPS—the average of:
 - (i) the aggregate of the licensee’s:
 - (A) estimate of its responsible entity and IDPS revenue for the third financial year-to-date; and
 - (B) forecast of its responsible entity and IDPS revenue for the remainder of the third financial year; and
 - (ii) the licensee’s responsible entity and IDPS revenue for its second financial year; and
- (d) for all subsequent financial years of a licensee—the average of:
 - (i) the aggregate of the licensee’s:
 - (A) estimate of its responsible entity and IDPS revenue for the current financial year-to-date; and
 - (B) forecast of its responsible entity and IDPS revenue for the remainder of the current financial year;
 - (ii) the licensee’s responsible entity and IDPS revenue for the last preceding financial year; and
 - (iii) the licensee’s responsible entity and IDPS revenue for the second preceding financial year.

Note 1: We expect responsible entities and IDPS operators to base their forecast on reasonable assumptions and to take into account the actual revenue over that financial year-to-date in making the forecast.

Note 2: When preparing an opinion to enable the responsible entity or IDPS operator to comply with notional s912AA(9) applying under Class Order [CO 13/760] *Financial requirements for responsible entities and operators of investor directed portfolio services*, we would not expect the auditor to express an audit opinion or conduct a review of the forecasts made but merely to audit that they exist in purported compliance.

Average revenue

RG 166.163 For an AFS licensee with an authorisation to provide custodial or depository services, average revenue means:

- (a) for a licensee in its first financial year of being authorised to provide a custodial or depository service or holding scheme property or assets of a registered scheme or IDPS property—the licensee’s forecast of its revenue from the calculation date for the remainder of the first financial year, pro-rated to a 12-month period;

- (b) for a licensee in its second financial year of being authorised to provide a custodial or depository service or holding scheme property or assets of a registered scheme or IDPS property—the aggregate of the licensee’s:
 - (i) estimate of its revenue for the second financial year-to-date; and
 - (ii) forecast of its revenue for the remainder of the second financial year; and
- (c) for a licensee in its third financial year of being authorised to provide a custodial or depository service or holding scheme property or assets of a registered scheme or IDPS property—the average of:
 - (i) the aggregate of the licensee’s:
 - (A) estimate of its revenue for the third financial year-to-date; and
 - (B) forecast of its revenue for the remainder of the third financial year; and
 - (ii) the licensee’s revenue for its second financial year in which it was authorised to provide a custodial or depository service; and
- (d) for all subsequent financial years—the average of:
 - (i) the aggregate of the licensee’s:
 - (A) estimate of its revenue for the current financial year-to-date; and
 - (B) forecast of its revenue for the remainder of the current financial year;
 - (ii) the licensee’s revenue for the last preceding financial year; and
 - (iii) the licensee’s revenue for the second preceding financial year.

Note 1: We expect providers to base their forecast on reasonable assumptions and to take into account the actual revenue over the financial year to date in making the forecast.

Note 2: See also the definition of ‘custodial or depository services revenue’ in RG 166.167.

Note 3: The revenue of a licensee includes any revenue of an authorised representative of the licensee acting on the licensee’s behalf.

Average value of scheme property and IDPS property

RG 166.164 Average value of scheme property and IDPS property means, in relation to registered schemes and IDPSs operated by an AFS licensee, the greater of:

- (a) the current value of scheme property and IDPS property; and
- (b) the value of scheme property and IDPS property in the following circumstances:
 - (i) for a licensee in its first financial year of—the average of:
 - (A) the value of scheme property and IDPS property at the end of each calendar month since the calculation date; and

- (B) the forecast value of scheme property and IDPS property at the end of each calendar month for the remainder of the first financial year; and
- (ii) for a licensee in its second financial year of being authorised to operate a registered scheme as a responsible entity or an IDPS—the average of:
 - (A) the value of scheme property and IDPS property at the end of each calendar month since the calculation date; and
 - (B) the forecast value of scheme property and IDPS property at the end of each calendar month for the remainder of the second financial year; and
- (iii) for all subsequent financial years of a licensee after the first 2 financial years of operating a registered scheme as a responsible entity or an IDPS—the average of:
 - (A) the value of scheme property and IDPS property at the end of each calendar month since the beginning of the second preceding financial year; and
 - (B) the forecast value of scheme property and IDPS property at the end of each calendar month for the remainder of the current financial year.

Note: We do not require licensees to perform monthly valuations of scheme property. In determining the frequency of valuations of scheme property of a registered scheme, licensees should take into account the nature of the property: see s601FC(1)(j).

Calculation date

RG 166.165 Calculation date means the day on which the AFS licensee was authorised to operate any registered scheme or IDPS for a responsible entity or IDPS operator or, for a custodian, to provide custodial or depository services or hold scheme property or assets of a registered scheme or IDPS property.

Note: The 'calculation date' applies to the first date on which the licensee is authorised in the current authorisation period.

Cash or cash equivalents

RG 166.166 For responsible entities, IDPS operators and custodians, cash or cash equivalents means:

- (a) cash on hand, demand deposits and money deposited with an Australian ADI that is available for immediate withdrawal;
- (b) short-term, highly liquid investments that are readily convertible to known amounts of cash that are subject to an insignificant risk of changes in value;
- (c) the value of any eligible undertaking provided by an eligible provider; and

- (d) a commitment by an eligible provider to provide cash upon request within 5 business days upon request:
 - (i) which will not expire within the next 6 months and which cannot be withdrawn by the provider without giving at least 6 months written notice to the person to whom the commitment is made; and
 - (ii) in relation to which any cash provided is not repayable for at least 6 months.

Custodial or depository services revenue

RG 166.167 Custodial or depository services revenue, in relation to an AFS licensee, means the aggregate of the AFS licensee's:

- (a) estimate of the revenue attributable to custodial or depository services provided by the licensee and its related bodies corporate for the current financial year-to-date; and
- (b) forecast of such revenue for the remainder of the financial year;

determined on the basis that such revenue must at least include the cost of providing those services.

Note: See also the definition of 'average revenue' in RG 166.163.

Eligible custodian

RG 166.168 Eligible custodian means:

- (a) an Australian ADI;
- (b) a market participant or a clearing participant as specified in Class Order [CO 13/760] *Financial requirements for responsible entities and operators of investor directed portfolio services* and Class Order [CO 13/761] *Financial requirements for custodial or depository service providers*; or
- (c) a sub-custodian appointed by one of the above.

Eligible provider

RG 166.169 For custodians, eligible provider means:

- (a) an Australian ADI; or
- (b) an entity approved by ASIC in writing for this purpose.

RG 166.170 For responsible entities and IDPS operators, eligible provider means, in addition to RG 166.169(a)–RG 166.169(b):

- (a) an Australian government (i.e. the government of the Commonwealth or of a state or territory), or the government of a country that is a member of the Organisation for Economic Cooperation and Development

(OECD country government), or an agency or instrumentality of an Australian or OECD country government; or

Note: We would consider you to be an agency or instrumentality of a government if you represent that government and you are conferred with all the powers, privileges, rights and remedies, or their equivalent, of that government.

- (b) a foreign deposit-taking institution:
 - (i) that is regulated by a regulator approved in writing by ASIC for this purpose; or
 - (ii) approved in writing by ASIC for this purpose; or
- (c) an Australian CS facility licensee within the meaning of s761A.

Financial services business revenue

RG 166.171 Financial services business revenue means, in relation to an AFS licensee, the aggregate of the licensee's:

- (a) estimate of the revenue attributable to the financial services business of the licensee and its related bodies corporate for the current financial year to date, excluding any revenue attributable to custodial or depository services provided by the licensee or a related body corporate; and
- (b) forecast of such revenue for the remainder of the financial year;

determined on the basis that the revenue attributable to custodial or depository services must at least include the cost of providing those services.

First financial year

RG 166.172 First financial year means, in relation to an AFS licensee, the financial year in which the calculation date occurs.

Incidental provider

RG 166.173 Incidental provider means an AFS licensee that is authorised to provide a custodial or depository service:

- (a) that does not provide any custodial or depository services other than services which:
 - (i) are a need of the person to whom the services are provided because of, or in order to obtain the provision of other financial services by the licensee or its related bodies corporate;
 - (ii) do not form part of an IDPS; and
- (b) whose custodial or depository services revenue is less than 10% of its financial services business revenue.

Liquid assets

RG 166.174 Liquid assets means, in relation to an AFS licensee:

- (a) cash or cash equivalents other than a commitment of the kind specified in RG 166.166(d); and
- (b) assets that the licensee can reasonably expect to realise for their market value within 6 months,

that are free from encumbrances and, in the case of receivables, free from any right of set-off.

Regulated trust account

RG 166.175 Regulated trust account means a trust account maintained by:

- (a) a licensed trustee company within the meaning of Ch 5D of the Corporations Act or the public trustee of a state or territory;
- (b) a solicitor unless moneys in the account include moneys that are excluded from regulation as trust money under laws of the state or territory relating to legal practitioners that are relevant to operation of the trust account by the solicitor;
- (c) a real estate agent under the law of a state or territory; or
- (d) an entity other than the licensee and that provides protections similar to the accounts described in paragraphs (a) to (c), and is approved in writing by ASIC for this purpose.

Responsible entity and IDPS revenue

RG 166.176 Responsible entity and IDPS revenue means, in relation to an AFS licensee:

- (a) the licensee's revenue (within the meaning given by the accounting standards); and
- (b) to the extent it is not the licensee's revenue (within the meaning of the accounting standards)—any amount paid or payable out of scheme property for the performance of the obligations imposed on the licensee as a responsible entity in connection with the registered schemes it operates, even if those obligations are performed by another entity (including asset management, investment management, property management, scheme administration and custodial and trustee services); and
- (c) to the extent it is not the licensee's revenue (within the meaning of the accounting standards), any amount paid or payable out of IDPS property for the performance of the obligations imposed on the licensee as an IDPS operator, even if those obligations are performed by another entity.

Note: An amount under paragraph (b) or (c) excludes any audit fees paid or payable to an auditor engaged to meet any audit requirements under the Corporations Act.

Special custody assets

RG 166.177 Special custody assets means, in relation to a registered scheme or an IDPS operated by an AFS licensee:

- (a) for serviced strata schemes, cash held in a regulated trust account for the purposes of:
 - (i) refurbishing or improving real property associated with the scheme; or
 - (ii) alleviating seasonal fluctuations in payments of income from the scheme in accordance with provisions in the constitution, provided that no more is held than the licensee reasonably considers necessary for the relevant purpose;
- (b) currency and chattels (other than documents) that it would not be reasonably practicable for a person other than the licensee to hold;
- (c) funds received from members of the scheme or clients of the IDPS within the previous 6 months held in a regulated trust account;
- (d) cash held for up to 3 months in an account with an Australian ADI styled as a trust account that is audited at least once every 6 months by a registered company auditor where the auditor's report states that in the auditor's opinion the account has been operated in accordance with the trust:
 - (i) pending payment to members of the scheme or clients of the IDPS;
 - (ii) to meet expected expenses (not including investments) over a 3-month period; or
 - (iii) pending application in acquiring a mortgage and paying any fees and costs incidental to the acquisition;

Note: The auditor's report should be provided to the licensee's board or compliance committee (as appropriate).

- (e) contractual, lease or licence rights that are not assignable except with the consent of the member or client or that it would not be reasonably practicable to assign (other than to a new responsible entity or IDPS operator), and any documents evidencing those contractual, lease or licence rights;
- (f) assets of trivial value;
- (g) land and other real property of a time-sharing scheme and levies of a time-sharing scheme which are held in an account with an Australian ADI styled as a trust account that is audited at least once every 6 months by a registered company auditor where the report from the auditor is provided to the responsible entity's board or compliance committee and states that in the auditor's opinion the account has been operated in accordance with the trust;
- (h) mortgages or documents of title held under a mortgage where:

- (i) particular members have a specific beneficial or legal interest in the mortgage;
 - (ii) the mortgage was acquired after disclosure in writing to the relevant members or clients (at the time of the acquisition) of all information that would have been required to be in a Product Disclosure Statement (PDS) (or in relation to mortgages acquired before Div 2 of Pt 7.9 applied to interests in the registered scheme, a disclosure document under Ch 6D) if an offer of interests in the registered scheme conferring rights in connection with that mortgage had been made immediately before the mortgage;
 - (iii) either:
 - (A) the mortgage was acquired on the specific direction of the relevant members or clients (at the time of acquisition of the interest); or
 - (B) the members or clients are able to withdraw from that mortgage for a period of 14 days commencing on the date of disclosure under paragraph (h)(ii); and
 - (iv) it is not reasonable to expect that the mortgage will be sold before its discharge;
- (i) for a responsible entity, a derivative and any contractual right (the margin repayment right) for the payment of any balance owing to the licensee in relation to dealings in derivatives, including margining those dealings through transactions in a deposit-taking facility notified to the licensee if all of the following apply:
- (i) the licensee has directed in writing the other party (the counterparty) to the derivative or, in the case of a derivative acquired through a financial market, the market participant acting for the licensee, that any amounts payable by the counterparty or market participant in connection with the derivative to or at the direction of the licensee are to be made only:
 - (A) to the deposit-taking facility (if any); or
 - (B) to a custodian that complies with RG 166.214 or RG 166.216 in Appendix 2 or a sub-custodian appointed by such a custodian; (each, a complying custodian); or
 - (C) as the complying custodian directs;
 - (ii) if there is a margin repayment right held as scheme property, the licensee has directed in writing the person liable to pay the balance to which the right relates that any amounts payable to or at the direction of the licensee that affect the amount of the balance to which the margin repayment rights relate are to be made only to, or as directed by, a complying custodian;

- (iii) a complying custodian and, if the direction refers to a complying custodian, that complying custodian is given a copy of each written direction given for the purposes of paragraph (i) and (ii) within one business day and is given authority to require the counterparty or market participant to provide:
 - (A) written confirmation that the direction remains in effect; and
 - (B) reasonable access on each business day in the place where the person given the direction is located to information about all transactions under the derivative, the acquisition or disposal of the derivative and transactions affecting the amount of the balance to which the margin repayment right relates to which the direction relates for at least one month after the transaction, acquisition or disposal; and
- (iv) the complying custodian has contracted in writing with the licensee to:
 - (A) require the provision of and, where obtained, keep for 7 years a copy of records to which access is given under paragraph (iii) to it of all transactions under the derivative, the acquisition or disposal of the derivative or any transactions affecting the amount of the balance to which the margin repayment right relates to which the direction relates for at least one month after the transaction, acquisition or disposal; and
 - (B) check whether it appears that:
 - (I) those transactions comply with the direction, a copy of which has been given to the complying custodian under paragraph (iii);
 - (II) the complying custodian has been given copies of authorisations for those transactions that comply with requirements for confirming the identity of the person providing authorisation and the process of authorisation notified to the complying custodian in writing by the licensee;
 - (III) a transaction has been entered in response to every authorisation, a copy of which has been given to the complying custodian where the authorisation appears to meet the licensee's requirements notified to the complying custodian in writing;

and, if not, notify the licensee in writing and keep a copy of the notification for 7 years;
- (j) for a responsible entity, a security or interest in a managed investment scheme and any chose in action that is not a financial product related to

the acquisition or holding of securities or interests in a managed investment scheme (associated chose in action) where:

- (i) the security or interest is not of a class that is able to be traded on a financial market; and
- (ii) the security or interest or any associated chose in action may give rise to a liability for the holder under its terms; and
- (iii) the licensee reasonably considers that it is not reasonably practicable to ensure the exclusion of liability of the person holding the security or interest or any associated chose in action that may arise from that holding; and
- (iv) the licensee has given a written direction to:
 - (A) the issuer of the security, interest or associated chose in action; and
 - (B) any counterparties that may be liable to pay or arrange to pay the holder of the security, interest or associated chose in action,

that any payments that are to be made to the licensee under the security, interest or associated chose in action must be paid to the complying custodian, or as that complying custodian directs in writing;

- (v) any certificates or other title documents and copies of the written directions are held by the complying custodian or by a person acting on its behalf, and the complying custodian has authority to require the issuer and any such counterparty to confirm in writing that the direction remains in effect;
- (vi) the complying custodian has contracted in writing to keep for 7 years a copy of records relating to the security, interest or associated chose in action that are available to it relating to the acquisition or disposal of the security, interest or associated chose in action or transactions under the security, interest or associated chose in action; and
- (vii) the complying custodian has contracted in writing to check whether it appears that:
 - (A) those transactions comply with the direction, a copy of which has been given to the complying custodian under paragraph (v); and
 - (B) the complying custodian has been given copies of the authorisations for those transactions that comply with requirements for confirming the identity of the person providing authorisation and the process of authorisation notified to the complying custodian in writing by the licensee;

(C) a transaction has been entered in response to every authorisation, a copy of which has been given to the complying custodian where the authorisation appears to meet the licensee's requirements notified to the complying custodian in writing,

and, if not, notify the licensee in writing and keep a copy of the notification for 7 years;

Note: Paragraph (j) will typically apply to some private equity assets.

(k) for a responsible entity, a deposit-taking facility with an Australian ADI or a body formed or incorporated outside Australia which is authorised to accept deposits and is prudentially regulated by a government or an agency of a government in relation to its deposit-taking activities (foreign ADI) if the responsible entity reasonably considers that holding the deposit-taking facility by another person would raise unreasonable operational difficulties or be impracticable where all of the following apply:

- (i) the issuer of the deposit-taking facility and the responsible entity have a written arrangement under which the issuer would not be likely to make any payments that are to be made under the facility to a person not approved by a complying custodian and which authorises the issuer to disclose at any time whether the arrangement remains current to the complying custodian;
- (ii) a copy of the written arrangement is held by the complying custodian;
- (iii) the complying custodian has reasonable access on each business day that the issuer is open for business to information about transactions for at least 2 years before that business day using the facility and access to all the information that the responsible entity has a right to be given or is given in relation to the facility;
- (iv) the complying custodian has agreed to keep for 7 years all records relating to transactions under the facility to which access is given under paragraph (iii);
- (v) the complying custodian has agreed to check whether it appears that:
 - (A) those transactions comply with the arrangement, a copy of which has been given to the complying custodian under paragraph (ii);
 - (B) the complying custodian has been given copies of authorisations for those transactions that comply with the requirements for confirming the identity of the person providing authorisation and the process of authorisation

notified to the complying custodians by the responsible entity in writing; and

- (C) a transaction has been entered in response to every authorisation, a copy of which has been given to the complying custodian where the authorisation appears to meet the responsible entity's requirements notified to the complying custodian in writing;

and, if not, notify the responsible entity in writing and keep a copy of that notification for 7 years;

- (l) a deposit-taking facility with an Australian ADI or a foreign ADI if the responsible entity reasonably considers that holding the deposit-taking facility by another person would raise unreasonable operational difficulties or be impracticable where:
 - (i) the use of the facility for payments is intended by the responsible entity to be limited to the making of payments to a complying custodian who has been engaged to hold the scheme property and persons that the responsible entity or its agents believe are members of the scheme; and
 - (ii) the responsible entity does not permit any payments to be made from the facility except to the complying custodian, as directed by the complying custodian or in accordance with instructions made by a person that, except with the consent in writing of ASIC:
 - (A) carries on a business consisting of or including maintaining registers of members of registered schemes under Ch 2C;
 - (B) is not the responsible entity or its related body corporate;
 - (C) the responsible entity reasonably believes has net assets of at least \$250,000 as its net assets would appear in a balance sheet if lodged under Ch 2M at that time or it appeared that the person has such net assets on the basis of its balance sheet most recently lodged under Ch 2M; and
 - (D) the responsible entity reasonably believes has not and will not provide an instruction for a payment that results in the responsible entity being in significant breach of s912D of the Corporations Act;
- (m) a deposit-taking facility with an Australian ADI or a foreign ADI where the issuer of the deposit-taking facility:
 - (i) is a complying custodian who holds other scheme property of the scheme or IDPS property of the IDPS;
 - (ii) has agreed to ensure that staff who are involved with the provision of custodial services, and not involved in the provision of banking services, check whether each transaction complies with

requirements for confirming the identity of the person providing the authorisation and the process of authorisation notified to the complying custodian by the licensee in writing; and

- (iii) keeps a copy of the records of each transaction, including how it was authorised and any notification given under paragraph (ii) for 7 years; and
- (n) any chose in action that is not a financial product and which is not reasonably practicable to assign other than to the relevant member or members of the scheme or to the clients of the IDPS (as applicable), or together with other property that is a special custody asset (e.g. contractual rights in connection with a mortgage).

Tier \$500,000 class assets

RG 166.178 Tier \$500,000 class assets means, in relation to a registered scheme:

- (a) real property (including mortgages or leases over or licences in relation to real property) that is intended to be kept for the whole duration of the scheme, or the relevant mortgage;
- (b) physical assets which as a matter of reasonable practice can be held by a custodian (such as currency, valuables or precious metals);
- (c) funds held in a regulated trust account that were received from members within the previous:
 - (i) 6 months, if held for the purposes of the initial investment by the responsible entity as part of the scheme; or
 - (ii) 13 months, if held pending payment of expenses of the scheme; or
- (d) special custody assets.

Value of scheme property and IDPS property

RG 166.179 For an AFS licensee at a time, the value of scheme property and IDPS property means the aggregate of:

- (a) the value of the scheme property and any other assets (including mortgages held by members of a mortgage scheme and managed as part of the scheme) of the registered schemes operated by the licensee as responsible entity; and
- (b) the value of the IDPS property of the IDPSs operated by the licensee; determined as follows:
 - (c) in the case of assets of a scheme that would be recognised in preparing a balance sheet for members under Ch 2M—the value as if at that time such a balance sheet was being prepared; and
 - (d) in the case of any other scheme property or IDPS property—its market value at that time.

Specific definitions for retail OTC derivative issuers in calculating NTA

Average revenue

RG 166.180 For an AFS licensee with an authorisation to make a market in derivatives to retail clients and that owes liabilities or contingent liabilities by entering into derivatives with retail clients, average revenue means:

- (a) in its first financial year of being authorised to provide those financial services, the licensee's forecast of its revenue from the calculation date for the remainder of the first financial year pro-rated to a 12-month period;
- (b) in its second financial year of being authorised to provide those financial services, the average of the aggregate of the licensee's:
 - (i) actual revenue for the second financial year-to-date;
 - (ii) reasonable forecast of its revenue for the remainder of the second financial year; and
 - (iii) revenue in the first financial year from the calculation date pro-rated to a 12-month period;
- (c) in its third financial year of being authorised to provide those financial services, the average of:
 - (i) the aggregate of the licensee's:
 - (A) revenue for the third financial year-to-date;
 - (B) reasonable forecast of its revenue for the remainder of the third financial year;
 - (ii) licensee's revenue for its second financial year; and
 - (iii) the revenue in the first financial year from the calculation date pro-rated to 12-month period; and
- (d) for all subsequent financial years, the average of:
 - (i) the aggregate of the licensee's:
 - (A) revenue for the current financial year-to-date; and
 - (B) reasonable forecast of its revenue for the remainder of the current financial year;
 - (ii) the licensee's revenue for the last preceding financial year; and
 - (iii) the licensee's revenue for the second preceding financial year.

Cash or cash equivalents

- RG 166.181 For an AFS licensee with an authorisation to make a market in derivatives to retail clients and that owes liabilities or contingent liabilities by entering into derivatives with retail clients, cash or cash equivalents includes:
- (a) cash on hand, demand deposits and money deposited with an Australian ADI that is available for immediate withdrawal;
 - (b) short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value;
 - (c) the value of any eligible undertaking provided by an eligible provider; and
 - (d) a commitment to provide cash from an eligible provider that can be drawn down within 5 business days and has a maturity of at least 6 months.

Eligible provider

- RG 166.182 For an AFS licensee with an authorisation to make a market in derivatives to retail clients and that owes liabilities or contingent liabilities by entering into derivatives with retail clients, eligible provider means either:
- (a) an Australian ADI; or
 - (b) an entity we approve in writing for this purpose.

Liquid assets

- RG 166.183 For an AFS licensee with an authorisation to make a market in derivatives to retail clients and that owes liabilities or contingent liabilities by entering into derivatives with retail clients, liquid assets means either:
- (a) cash or cash equivalents, other than those defined at RG 166.166(d); or
 - (b) an asset the issuer can reasonably expect to realise for its market value within 6 months,
- that are free from encumbrances and, in the case of receivables, free from any right of set off.

Key terms

Term	Meaning in this document
ACH	Australian Clearing House Ltd
adequately secured	See RG 166.99 in Section E for the meaning of this term
ADI	An authorised deposit-taking institution within the meaning of the <i>Banking Act 1959</i>
adjusted assets	See RG 166.100 in Section E for the meaning of this term
adjusted liabilities	See RG 166.101–RG 166.103 in Section E for the meaning of this term
adjusted surplus liquid funds (ASLF)	See RG 166.104–RG 166.135 in Section E for the meaning of this term
AFS licence	An Australian financial services licence under s913B that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act Note: This is a definition contained in s761A.
approved foreign market	A foreign market that we will approve for the purposes of RG 166.99(a)(i)(A)(III); see RG 166.136–RG 166.137 Note: This is different from an ASIC-approved foreign market under RG 72
APRA	Australian Prudential Regulation Authority
APRA Act	<i>Australian Prudential Regulation Authority Act 1998</i>
APX	Asia Pacific Exchange Limited or the exchange market operated by APX
ASIC	Australian Securities and Investments Commission
ASIC Market Integrity Rules (APX)	ASIC Market Integrity Rules (APX Market) 2013—rules made by ASIC under s798G of the Corporations Act for trading on APX
ASIC Market Integrity Rules (ASX)	ASIC Market Integrity Rules (ASX Market) 2010—rules made by ASIC under s798G of the Corporations Act for trading on ASX
ASIC Market Integrity Rules (ASX 24)	ASIC Market Integrity Rules (ASX 24 Market) 2010—rules made by ASIC under s798G of the Corporations Act for trading on ASX 24
ASIC Market Integrity Rules (Chi-X)	ASIC Market Integrity Rules (Chi-X Australia Market) 2011—rules made by ASIC under s798G of the Corporations Act for trading on Chi-X

Term	Meaning in this document
ASIC Market Integrity Rules (Competition)	ASIC Market Integrity Rules (Competition in Exchange Markets) 2011—rules made by ASIC under s798G of the Corporations Act that are common to markets dealing in equity market products and CGS depository interests quoted on ASX
ASX	ASX Limited (ACN 008 624 691) or the exchange market operated by ASX Limited
ASX 24	The exchange market formerly known as Sydney Futures Exchange (SFE), operated by Australian Securities Exchange Limited
ASX 24 Operating Rules	ASX Limited's operating rules, which replace the pre-existing SFE Operating Rules
ASX Clear	ASX Clear Pty Limited (ACN 001 314 503) formerly known as Australian Clearing House. A CS facility licensee
ASX Clear (Futures)	ASX Clear (Futures) Pty Limited (ACN 050 615 864) formerly known as SFE Clearing Corporation Pty Limited. A CS facility licensee
ASX Market Rules	Previous operating rules made by ASX Limited dealing with activities or conduct of its market and of persons in relation to the market
ASX Operating Rules	ASX Limited's operating rules, which replace the pre-existing ASX Market Rules
Australian ADI	An ADI or a person who carries on state banking within the meaning of paragraph 51(xiii) of the Constitution
average responsible entity and IDPS revenue	See RG 166.162 in Section E for the meaning of this term
average revenue (custodial or depository service providers)	See RG 166.163 in Section E for the meaning of this term
average revenue (retail OTC derivative issuers)	See RG 166.180 in Section E for the meaning of this term
average value of scheme property and IDPS property (responsible entities and IDPS operators)	See RG 166.164 in Section E for the meaning of this term
Basel Committee guidelines	The Basel Committee on Banking Supervision's publications <i>Core Principles for Effective Banking Supervision</i> (September 1997) and <i>Capital Accord</i> (July 1988, as amended September 1997) or later publications by the Basel Committee
body regulated by APRA	Has the meaning given in s3(2) of the <i>Australian Prudential Regulation Authority Act 1998</i>

Term	Meaning in this document
calculation date (responsible entities, IDPS operators and custodians)	See RG 166.165 in Section E for the meaning of this term
cash	See RG 166.138–RG 166.139 in Section E for the meaning of this term when calculating the cash needs requirement (Option 1)
cash flow	See RG 166.140 in Section E for the meaning of this term when calculating the cash needs requirement
cash or cash equivalents (responsible entities, IDPS operators and custodians)	See RG 166.166 in Section E for the meaning of this term
cash or cash equivalents (retail OTC derivative issuers)	See RG 166.181 in Section E for the meaning of this term
Ch 7 (for example)	A chapter of the Corporations Act (in this example numbered 7), unless otherwise specified
Chapter 6 (ASX) and (Chi-X) (for example)	A chapter of the ASIC Market Integrity Rules (ASX) and ASIC Market Integrity Rules (Chi-X) (in this example numbered 6)
Chi-X	Chi-X Australia Pty Limited or the exchange market operated by Chi-X
clearing participant	A participant as defined in s761A of the Corporations Act in relation to a CS facility where that clearing and settlement facility is a licensed CS facility
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001
CS facility	A clearing and settlement facility
CS facility licensee	A person who holds an Australian CS facility licence Note: This is a definition contained in s761A.
custodian	A provider of a custodial or depository service as defined in s766E or a person that holds scheme property or assets of a registered scheme or IDPS
custodial or depository services revenue (responsible entities, IDPS operators and custodians)	See RG 166.167 in Section E for the meaning of this term

Term	Meaning in this document
eligible custodian (responsible entities, IDPS operators and custodians)	See RG 166.168 in Section E for the meaning of this term
eligible provider	See RG 166.141–RG 166.145 in Section E for the meaning of this term
eligible provider (responsible entities, IDPS operators and custodians)	See RG 166.169–RG 166.170 in Section E for the meaning of this term
eligible provider (retail OTC derivative issuers)	See RG 166.182 in Section E for the meaning of this term
eligible undertaking	See RG 166.146–RG 166.151 in Section E for the meaning of this term
estate assets	Assets (including assets in common funds) of an estate in relation to which a trustee company is performing estate management functions
estate management functions	Has the same meaning as in s601RAC(2) of the Corporations Act
excluded assets	See RG 166.152–RG 166.158 in Section E for the meaning of this term
financial product	<p>A facility through which, or through the acquisition of which, a person does one or more of the following:</p> <ul style="list-style-type: none"> • makes a financial investment (see s763B); • manages financial risk (see s763C); • makes non-cash payments (see s763D) <p>Note: This is a definition contained in s763A of the Corporations Act: see also s763B–765A.</p>
financial services business revenue (responsible entities, IDPS operators and custodians)	See RG 166.171 in Section E for the meaning of this term
first financial year (responsible entities, IDPS operators and custodians)	See RG 166.172 in Section E for the meaning of this term

Term	Meaning in this document
foreign exchange contract	Has the same meaning as in s761A of the Corporations Act Note: This definition includes derivatives (as defined in s761D) that are foreign exchange contracts (as defined in s761A) and may, for example, include a contract for delivery of foreign currency, where the rate at which the exchange takes place is determined with reference to interest rates or interest rate differentials. It does not include a contract that is to be settled by adjustment rather than the delivery of any foreign currency.
foreign exchange dealer	A person who carries on a business of entering, as principal, into foreign exchange contracts in Australia
FSR Act	<i>Financial Services Reform Act 2001</i>
governing body	The board of directors, committee of management or other governing body of the entity, including, in relation to a licensee who is a natural person, that person
investor directed portfolio service (IDPS)	Has the same meaning as in Class Order [CO 13/763] <i>Investor directed portfolio services</i> or any class order that amends or replaces that class order
IDPS property	Property acquired or held through an IDPS other than property held by a client
incidental provider (responsible entities, IDPS operators and custodians)	See RG 166.173 in Section E for the meaning of this term
licensed CS facility	A CS facility the operation of which is authorised by an Australian CS facility licence Note: This is a definition contained in s761A.
licensed market	A financial market the operation of which is authorised by an Australian market licence Note: This is a definition contained in s761A.
licensee	A person who holds an AFS licence
licensee obligations	The obligations of an AFS licensee as set out in s912A and 912B of the Corporations Act, and the requirement to be of good fame and character as included in s913B
limited AFS licence	An AFS licence that only includes authorisations to provide one or more limited financial services
limited AFS licensee	A person who holds a limited AFS licence
limited financial services	Has the meaning given in regs 7.6.01BA(3), 7.6.04(3), 7.8.12A(4) and 7.8.14B(3) of the Corporations Regulations
liquid assets (responsible entities, IDPS operators and custodians)	See RG 166.174 in Section E for the meaning of this term

Term	Meaning in this document
liquid assets (retail OTC derivative issuers)	See RG 166.183 in Section E for the meaning of this term
margin lending facility	A 'margin lending facility' as defined in s761EA(1) of the Corporations Act, including: <ul style="list-style-type: none"> • a standard margin lending facility; or • a non-standard margin lending facility; or • a facility declared by ASIC to be a margin lending facility under s761EA(8) of the Corporations Act
market licensee	A person who holds an Australian market licence Note: This is a definition contained in s761A.
market participant	An entity that is a participant of a financial market on which financial products are traded
net tangible assets (NTA)	See RG 166.159 in Section E for the meaning of this term
non-standard margin lending facility	Has the same meaning as in s761EA(5) of the Corporations Act
old Corporations Act	The <i>Corporations Act 2001</i> as in force immediately before the commencement of the FSR Act (i.e. 11 March 2002)
old regulatory regime (as applicable)	The relevant legislation and relevant industry codes, standards or practices (however enforceable at law) related to the provision of financial services and applying immediately before commencement of the FSR Act (i.e. 11 March 2002)
OECD country government	The government of a country that is a member of the Organisation for Economic Cooperation and Development
OTC	Over the counter
PF 209	Pro Forma 209 <i>Australian financial services licence conditions</i>
Pt 7.9 (for example)	A part of the Corporations Act (in this example numbered 7.9)
RBA	Reserve Bank of Australia
reg 7.6.04 (for example)	A regulation of the Corporations Regulations (in this example numbered 7.6.04)
regulated superannuation fund	Has the meaning given in the SIS Act
regulated trust account (responsible entities and IDPS operators)	See RG 166.175 in Section E for the meaning of this term
relevant trust	See RG 166.160 in Section E for the meaning of this term for the cash needs requirement

Term	Meaning in this document
responsible entity and IDPS revenue	See RG 166.176 in Section E for the meaning of this term
RG 136 (for example)	An ASIC regulatory guide (in this example numbered 136)
RSE licence	Registrable superannuation entity licence (granted by APRA)
RSE licensee	A person who holds a registrable superannuation entity licence (granted by APRA)
s912A (for example)	A section of the Corporations Act (in this example numbered 912A), unless otherwise specified
secured property	Has the same meaning as in s761EA(2)(c) of the Corporations Act
SFE	The market formerly known as Sydney Futures Exchange (now ASX 24)
SIS Act	<i>Superannuation Industry (Supervision) Act 1993</i>
special custody assets (responsible entities and IDPS operators)	See RG 166.177 in Section E for the meaning of this term
standard margin lending facility	Has the same meaning as in s761EA (2) of the Corporations Act
surplus liquid funds (SLF)	See RG 166.161 in Section E for the meaning of this term
Tier \$500,000 class assets (responsible entities and IDPS operators)	See RG 166.178 in Section E for the meaning of this term
traditional services	<p>'Traditional trustee company services' as defined in s601RAC(1) of the Corporations Act, including:</p> <ul style="list-style-type: none"> • performing estate management functions (as defined in s601RAC(2)); • preparing a will, a trust instrument, a power of attorney or an agency arrangement; • applying for probate of a will, applying for grant of letters of administration, or electing to administer a deceased estate; • establishing and operating common funds; and • any other services prescribed by the Corporations Regulations as traditional trustee company services
transferred securities	Has the same meaning as in s761EA(5)(a) of the Corporations Act
trustee company	Has the same meaning as in s601RAB of the Corporations Act

Term	Meaning in this document
value of scheme property and IDPS property (responsible entities and IDPS operators)	See RG 166.179 in Section E for the meaning of this term
wholesale client	A client defined as such under s761G of the Corporations Act

Related information

Headnotes

adjusted surplus liquid funds requirement, AFS licence, AFS licence conditions, AFS licensee, ASLF requirement, audit requirement, Australian financial services licence, average revenue, cash and cash equivalents, cash needs requirement, client assets, custodial or depository services, financial resources, foreign exchange dealers, holding client money, IDPS, investor directed portfolio service, licensing, limited AFS licence, limited AFS licensee, limited financial services, market participants, net tangible assets, NTA, NTA requirement, reporting triggers, responsible entities, risk exposure calculation system, risk management systems, SLF requirement, solvency and positive net assets requirement, surplus liquid funds requirement, traditional services, transactions with a client, trustee companies

Class orders

[CO 12/752] *Financial requirements for retail OTC derivative investors*

[CO 13/760] *Financial requirements for responsible entities and operators of investor directed portfolio services*

[CO 13/761] *Financial requirements for custodial or depository service providers*

[CO 13/763] *Investor directed portfolio services*

Pro formas

PF 63 *Deed of subordination*

PF 209 *Australian financial services licence conditions*

Regulatory guides

RG 1–3 *AFS Licensing Kit*

RG 36 *Licensing: Financial product advice and dealing*

RG 51 *Applications for relief*

RG 72 *Foreign securities prospectus relief*

RG 78 *Breach reporting by AFS licensees*

RG 104 *Licensing: Meeting the general obligations*

RG 105 *Licensing: Organisational competence*

RG 121 *Doing financial services business in Australia*

RG 126 *Compensation and insurance arrangements for AFS licensees*

RG 133 *Managed investments and custodial or depository services: Holding assets*

RG 146 *Training of financial product advisers*

RG 148 *Platforms that are managed investment schemes*

RG 165 *Licensing: Internal and external dispute resolution*

RG 167 *Licensing: Discretionary powers*

RG 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)*

RG 175 *Licensing: Financial product advisers—Conduct and disclosure*

RG 176 *Licensing: Discretionary powers—Wholesale foreign financial service providers*

RG 181 *Licensing: Managing conflicts of interest*

RG 182 *Dollar disclosure*

RG 183 *Approval of financial services sector codes of conduct*

RG 192 *Licensing: Wholesale equity venture capital schemes*

RG 226 *Guidance on ASIC market integrity rules for capital and related requirements: ASX, ASX 24, Chi-X and APX markets*

Legislation

APRA Act, s3(2)

Corporations Act, Ch 2C, Ch 2L, Ch 2M, Ch 5 Pt 5.7B Div 3, Ch 7 Pt 7.8, s9, 601FC(1)(j), 727(3), 761A, 761F(1)(a), 761FA(3)(a), 761D(1)(c), 766E, 766E(3), 766E(3)(b), 767A(1), 767A(2), 912A, 912A(1), 912A(1)(a), 912A(1)(b), 912A(1)(d), 912A(1)(h), 912AA(9), 912AB(11), 912B, 912C(2), 912D, 912D(1B), 981B, 985B, 985B(3), 989B, 989B(1), 989B(2), 989B(3), 1101A, 1017B

Corporations Regulations, regs 7.6.01BA(3), 7.6.04, 7.8.07(2), 7.8.12A, 7.8.14B

SIS Act, s10(1), 123

Consultation papers

CP 109 *Margin lending: Financial requirements*

CP 132 *Trustee companies: Financial requirements and conduct obligations*

CP 140 *Responsible entities: Financial requirements*

CP 156 *Retail OTC derivative issuers: Financial requirements*

CP 161 *Proposed ASIC market integrity rules for capital and related requirements: ASX, ASX 24 and Chi-X markets*

CP 176 *Review of ASIC policy on platforms: Update to RG 148*

CP 194 *Financial requirements for custodial or depository service providers*

CP 197 *Holding scheme property and other assets*

Reports

REP 177 *Response to submissions on CP 109 Margin lending: Financial requirements*

REP 197 *Response to submissions on CP 132 Trustee companies: Financial requirements and conduct obligations*

REP 259 *Response to submissions on CP 140 Responsible entities: Financial requirements*

REP 293 *Response to submissions on CP 156 Retail OTC derivative issuers: Financial requirements*

REP 244 *Response to submissions on CP 161 Proposed ASIC market integrity rules for capital and related requirements: ASX, ASX 24 and Chi-X markets*

REP 351 *Response to submissions on CP 176 Review of ASIC policy on platforms: Update to RG 148*

REP 352 *Response to submissions on CP 194 Financial requirements for custodial or depository service providers*

REP 376 *Response to submissions on CP 197 Holding scheme property and other assets*

Information sheets

INFO 179 *Applying for a limited AFS licence*

Media and information releases

12-180MR *New financial requirements for issuers of over-the-counter derivatives*

12-279 MR ASIC consults on revised financial requirements for C & D service providers and holding assets of managed investment schemes

13-153MR New ASIC guidance for platforms a boost for investors

13-154MR New financial requirements for custodians

ASIC forms

Form FS70 Australian financial services licensee profit and loss statement and balance sheet

Form FS71 Australian financial services licensee audit report

Appendix 1: Market and clearing participants

Key points

Our financial requirements will not apply to you as long as:

- if you are a market participant of ASX, Chi-X or APX, you comply with the financial requirements in the ASIC market integrity rules for the relevant market (taking into account any waiver by ASIC);
- if you are a market participant of ASX 24, you restrict your financial services business to participating in the ASX 24 market and incidental business, and you comply with the financial requirements in the ASIC market integrity rules for the ASX 24 market (taking into account any waiver by ASIC); or
- if you are a market participant in another licensed financial market, or a clearing participant in a licensed clearing and settlement facility (CS facility), we are satisfied that the financial requirements of the market or CS facility are an adequate substitute for the financial requirements in the AFS licence.

Financial requirements under market integrity rules

RG 166.184 Market participants (other than principal traders or clearing participants) of the ASX, ASX 24, Chi-X and APX markets are subject to financial requirements under ASIC market integrity rules: see Chapter 8 of the ASIC Market Integrity Rules (ASX Market) 2010; Chapter 5 of the ASIC Market Integrity Rules (ASX 24 Market) 2010; Chapter 8 of the ASIC Market Integrity Rules (Chi-X Australia Market) 2011; Chapter 8 of the ASIC Market Integrity Rules (APX Market) 2013; and Regulatory Guide 226 *Guidance on ASIC market integrity rules for capital and related requirements: ASX, ASX 24, Chi-X and APX markets* (RG 226).

Note 1: For definitions of ‘clearing participant’ and ‘market participant’, see ‘Key terms’.

Note 2: In this appendix, and in this guide more broadly, we refer to ‘our financial requirements’ as the financial requirements we apply to AFS licensees using our statutory power to modify Pt 7.6 of the Corporations Act, or by AFS licence conditions. These should be distinguished from the financial requirements applying to market and clearing participants via ASIC market integrity rules or the rules of the relevant market.

RG 166.185 For an ASX, Chi-X or APX market participant (other than principal trader or a clearing participant), we consider the financial requirements in the ASIC market integrity rules are an adequate substitute for the financial requirements in the AFS licence in the provision of any financial service. This is because the financial requirements in the ASIC market integrity rules

for the ASX, Chi-X and APX markets take into account and address the risks arising from other forms of business beyond stockbroking.

- RG 166.186 For an ASX 24 market participant (other than a principal trader, clearing participant or ASX 24 market participant that is also an ASX, Chi-X or APX market participant), we consider the financial requirements in the ASIC market integrity rules are an adequate substitute for the financial requirements in the AFS licence, only where the licensee restricts its financial services business to participating in the ASX 24 market and incidental business. This is because the financial requirements in the ASIC market integrity rules for the ASX 24 market are based on NTA levels and are not directed to financial resources that may be needed as a result of other business.
- RG 166.187 Where in future we make ASIC market integrity rules imposing financial requirements on licensed financial markets other than ASX, ASX 24, Chi-X or APX, we will consider whether those financial requirements are an adequate substitute for the financial requirements in the AFS licence, having regard to the nature of the market and other relevant factors.

How will we assess the adequacy of a market or clearing facility's financial requirements?

- RG 166.188 If you are a participant of:
- (a) a licensed financial market other than ASX, ASX 24, Chi-X or APX (or any other licensed financial market for which ASIC makes market integrity rules imposing financial requirements that ASIC considers an adequate substitute for the financial requirements in the AFS licence); or
 - (b) a licensed CS facility;

the financial requirements in the AFS licence will not apply to you if we are satisfied that the market's or licensed CS facility's financial requirements are an adequate substitute for the financial requirements in the AFS licence.

- RG 166.189 When assessing whether the financial requirements with which you must comply as a market or clearing participant are an adequate substitute for our financial requirements, we will consider whether these requirements are at least equivalent in effectiveness to the financial requirements:
- (a) we impose on other licensees; and
 - (b) that apply to market or clearing participants in major overseas jurisdictions.

- RG 166.190 In particular, we will consider the obligations that the market or clearing participant will have as a licensee, including the obligation to:

- (a) have available adequate financial resources to conduct its financial services business in compliance with the Corporations Act (including carrying out supervisory arrangements);
- (b) have adequate risk management systems, which would include addressing certain financial risks (see RG 166.11); and
- (c) comply with our licence condition requiring the licensee to comply with financial requirements under the market or CS facility's operating rules.

RG 166.191 We will focus on the operating rules of the market or CS facility and how they are enforced. We will also take into account the extent and nature of waivers that the market licensee or CS facility licensee gives to its market or clearing participants.

Note: A market or CS facility licensee is a person authorised to operate a market or CS facility under the Corporations Act (as the case may be): see 'Key terms'.

RG 166.192 We may consider that the relevant financial requirements applying to a market or clearing participant adequately address the objectives of our own financial requirements for the licensee if the licensee only conducts a financial services business as a market or clearing participant, or incidentally to this role. In this case, our financial requirements will not apply as long as the licensee limits its financial services business to participating in that market or CS facility and incidental business that is supervised by the relevant market or CS facility licensee.

RG 166.193 We set out below which markets or CS facilities we are satisfied have financial requirements (other than financial requirements in the ASIC market integrity rules) that are an adequate substitute for the financial requirements in the AFS licence: see RG 166.197–RG 166.200.

When will we assess or review adequacy?

RG 166.194 We will assess the adequacy of the financial requirements applying to market or clearing participants:

- (a) when an application for an Australian market or CS facility licence is made, if the applicant requests it;
- (b) if we have previously assessed a market or CS facility licensee's financial requirements to be an adequate substitute for our requirements, but there is a material change in:
 - (i) operating rules;
 - (ii) the market's or CS facility's licence conditions;
 - (iii) the market or CS facility licensee's conduct (particularly supervision); or
 - (iv) our policy on financial requirements for licensees; or

(c) at another time, if the market or CS facility licensee asks us to.

RG 166.195 The fact that an amendment to operating rules has not been disallowed does not prevent us from reconsidering our view of the market or CS facility licensee's financial requirements on the basis of the new rule.

RG 166.196 We may also decide to review the adequacy of a market or CS facility licensee's financial requirements, or the financial requirements in ASIC market integrity rules at any time.

Which markets and CS facilities currently have financial requirements that are an adequate substitute?

ASX Clear Pty Limited

RG 166.197 We consider that the financial requirements of ASX Clear Pty Limited (ASX Clear) are an adequate substitute for the financial requirements in the AFS licence in the provision of any financial service. This applies only to a clearing participant in the licensed CS facility operated by ASX Clear as defined in the operating rules of ASX Clear.

RG 166.198 Like the financial requirements in the ASIC market integrity rules for the ASX and Chi-X markets, the financial requirements of ASX Clear take into account and address the risks arising from other forms of business beyond stockbroking.

ASX Clear (Futures) Pty Limited

RG 166.199 We consider that the requirements of ASX Clear (Futures) Pty Limited (ASX Clear (Futures)) are an adequate substitute for our requirements only for licensees that restrict their financial services business to participating in ASX Clear (Futures) (and, if the clearing participant is also a market participant, in the ASX 24 market) and incidental business. This applies only to a clearing participant in the licensed CS facility operated by ASX Clear (Futures) as defined in the operating rules of ASX Clear (Futures).

RG 166.200 Like the financial requirements in the ASIC market integrity rules for the ASX 24 markets, the financial requirements of ASX Clear (Futures) are based on NTA levels and are not directed to financial resources that may be needed as a result of other business.

How does our policy affect your AFS licence?

RG 166.201 Even if the financial requirements in the ASIC market integrity rules apply to you as a participant in a licensed market, or you are a participant in a

market or CS facility that we consider has financial requirements that are an adequate substitute for our financial requirements, we will still include our standard financial requirements in your licence conditions. However, we will also impose additional conditions providing that the standard requirements do not apply as long as:

- (a) you comply with the financial requirements in the ASIC market integrity rules or the market's or CS facility's operating rules, taking into account any waiver by ASIC or the market or CS facility licensee;
- (b) if you are a market participant and/or clearing participant of ASX 24, you restrict your financial services business to participating in the ASX 24 market and/or ASX Clear (Futures), and incidental business;
- (c) for each financial year during which you relied on being a market or clearing participant, and at other times for a period we request, you give us an auditor's opinion on a positive assurance basis stating that:
 - (i) you were a market or clearing participant at all times during the relevant period during which you relied on being a market or clearing participant; and
 - (ii) if you are a market participant and/or clearing participant of ASX 24, you restricted your financial services business to participating in the ASX 24 market and/or ASX Clear (Futures) and incidental business throughout any part of the relevant period during which you relied on being a market or clearing participant.

What if the requirements cease to be adequate?

RG 166.202 If we consider that the financial requirements of a licensed market or CS facility are no longer an adequate substitute for our financial requirements, we may give you notice in writing that our financial requirements will apply from a specified future date. Under your licence conditions, this notice will mean that, from that date, our financial requirements apply to you.

Appendix 2: Responsible entities

Key points

If you are a responsible entity authorised to operate a managed investment scheme, you must meet:

- the standard solvency and positive net assets requirement;
- a tailored cash needs requirement;
- a tailored audit requirement;
- a net tangible assets (NTA) requirement; and
- depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

What requirements apply?

RG 166.203 A responsible entity authorised to operate a managed investment scheme must meet:

- (a) the standard solvency and positive net assets requirement (see RG 166.32–RG 166.34 in Section B);
- (b) a tailored cash needs requirement (see RG 166.204–RG 166.205);
- (c) a tailored audit requirement (see RG 166.206–RG 166.208);
- (d) a net tangible assets (NTA) requirement with requirements for holding cash or cash equivalents and holding liquid assets (see RG 166.209–RG 166.235); and
- (e) depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

Note: The financial requirements for responsible entities are set out in [CO 13/760].

The tailored cash needs requirement

Note: This requirement replaces the standard cash needs requirement in Section B of this guide.

RG 166.204 You must meet the tailored cash needs requirement for responsible entities. You will need to prepare a cash flow projection (see Table 8), which covers a period of at least 12 months—that is, you must assess your cash needs over at least a 12-month forward period.

RG 166.205 You must update your cash flow projection when those cash flows cease to cover the next 12 months, there is a material change or there is reason to suspect that an updated projection would differ materially from the current

projection or show that you were not meeting items 5 or 6 in Table 8. Your board must approve the cash flow projection at least quarterly.

Table 8: The tailored cash needs requirement for responsible entities

You must meet all these requirements	
Projection	<p>1 Prepare a projection of your cash flows over at least the next 12 months based on your reasonable estimate of what is likely to happen over this term.</p> <p>Note: You can take into account, for example, the following factors in preparing your projection if you reasonably believe they are likely to be available: assets you hold at the time the projection starts that can be used to pay your liabilities; and inflows you may receive, including income from your business, amounts that you may borrow (e.g. under an overdraft), and amounts that you may receive from an eligible provider under an eligible undertaking.</p> <p>2 Document your calculations and assumptions on which the projection is based, and describe in writing why they are the appropriate assumptions.</p> <p>Note: We expect that a description in writing of your calculations and assumptions will vary according to the nature, scale and complexity of your business.</p> <p>3 Update your projection of cash flows when:</p> <p>(a) those cash flows cease to cover the next 12 months;</p> <p>(b) there is a material change; or</p> <p>(c) there is reason to suspect that an updated projection would differ materially from the current projection or show that you were not meeting items 5 or 6 below.</p> <p>Note: A 'material change' is a change for which it would be reasonable for you to plan by updating your cash flow projection.</p> <p>4 Have your cash flow projection approved by the board of directors at least quarterly as satisfying the requirements in this cash needs requirement.</p>
Financial resources	<p>5 Document whether, based on your projection of cash flows, you will have access as needed to enough financial resources to meet your liabilities over the projected term of at least the next 12 months, including any additional liabilities you project will be incurred during that term.</p> <p>6 Document whether, based on the projection of your cash flows, you will hold at all times during the period to which the projection relates, in cash or cash equivalents, an amount equal to or greater than the current amount you are required to hold in cash or cash equivalents: see RG 166.209–RG 166.235.</p>

The tailored audit requirement

Note: This requirement replaces the standard audit requirement in Section B of this guide.

RG 166.206 All AFS licensees must give us an audit report under s989B(3) of the Corporations Act for each financial year that includes information about compliance with the financial requirements that apply to you: see Section B. If you do not have to provide an audit report under s989B(3), you must still give us an audit report about compliance with the financial requirements. You must also give us this information if we request it for a specified period at another time: see s912C(2).

Note: For the form of this compliance report applying to licensees generally, see PF 209, condition 28.

RG 166.207 As a responsible entity, the information you must include in your audit report reflects the financial requirements that apply to you: see [CO 13/760].

RG 166.208 Your audit report must include statements by a registered company auditor addressed to you and ASIC that, for the relevant period:

- (a) in the auditor's opinion, you:
 - (i) complied with the requirements to have the cash flow projection approved by the board at least quarterly, the NTA requirement and any other financial requirements applying to you;
 - (ii) had, at all times, cash flow projections (covering at least the following 12 months) that purported to, and on their face appeared to, demonstrate your solvency; and
 - (iii) correctly calculated the cash flow projections based on the assumptions you used for the projection; and
- (b) following an examination of the calculations, assumptions and description used in preparing the cash flow projection, including the document prepared under items 5 and 6 in Table 8, the auditor has no reason to believe that:
 - (i) you did not have adequate systems for managing the risk of having insufficient financial resources to meet the NTA requirement and any other financial requirements applying to you;
 - (ii) you failed to document the calculations and assumptions used in preparing the cash flow projections and describe why they are appropriate;
 - (iii) you will not have access when needed to enough financial resources to meet your liabilities over the projected term of at least 12 months or that you will not hold at all times during the period to which the projection relates, in cash or cash equivalents, an amount equal to or greater than the current amount you are required to hold in cash or cash equivalents; and
 - (iv) the assumptions you adopted for your cash flow projections were unreasonable.

Note: We refer to the auditor statements in paragraph (a) as 'positive assurance' and the statements in paragraph (b) as 'negative assurance'. We expect that when giving negative assurance for the purposes of paragraph (b), the auditor will take into consideration any information from the audit for positive assurance.

The NTA requirement

RG 166.209 If you are a responsible entity, you must meet the NTA requirement in Table 9 that applies to you.

RG 166.210 For the purposes of meeting the NTA requirement, the value of scheme property and IDPS property must be determined as follows:

- (a) in the case of assets that would be recognised in preparing a balance sheet for members under Ch 2M—their value as if, at that time, such a balance sheet was being prepared; and
- (b) in the case of any other scheme property or IDPS property—its market value at that time.

Note: ‘Assets’ are as defined by applicable accounting principles. ‘Scheme property’ is defined in s9 of the Corporations Act.

RG 166.211 For the purpose of this calculation, mortgages held by members of a mortgage scheme and managed as part of the scheme must be treated as assets of the scheme. When determining the average value of scheme property and IDPS property, you must calculate the required amount of NTA based on all scheme assets and any scheme property as defined by s9 that is not recognised as an asset.

RG 166.212 Of the required NTA (as applicable to you), you must hold:

- (a) cash or cash equivalents valued at—at least the greater of:
 - (i) \$150,000; or
 - (ii) 50% of the required NTA; and
- (b) liquid assets to the amount of required NTA—this may include cash or cash equivalents, other than a commitment to provide cash from an eligible provider that can be drawn down within 5 business days upon request, and will not expire within the next 6 months.

Table 9: NTA requirements for responsible entities

Type of responsible entity	NTA requirement
You satisfy any of the requirements relating to custody in RG 166.214(a)–RG 166.214(c) or do not operate any registered schemes at any time	<p>1 You must hold at all times minimum NTA of the greater of:</p> <ul style="list-style-type: none"> (a) \$150,000; (b) 0.5% of the average value of scheme property and IDPS property of the registered scheme(s) and IDPS(s) you operate (if any) up to \$5 million NTA; or (c) 10% of your average responsible entity and IDPS revenue

Type of responsible entity	NTA requirement
You do not satisfy any of the requirements relating to custody in RG 166.214(a)–RG 166.214(c)	<p>2 You must hold at all times minimum NTA of the greater of:</p> <p>(a) \$10 million; or</p> <p>(b) 10% of your average responsible entity and IDPS revenue.</p> <p>Note: A person that is merely acting as a responsible entity, or who merely holds the assets of a registered scheme, is not performing a custodial or depository service under s766E(3)(b). Consistent with the focus of regulation of the operation of registered schemes being on the responsible entity, we impose the responsibility for ensuring adequate financial standing of custodians for registered schemes on the responsible entity.</p>

Definitions for the NTA requirement

RG 166.213 Definitions for calculating the required NTA for responsible entities are in Section E: see RG 166.162–RG 166.179. Relevant definitions include:

- (a) average responsible entity and IDPS revenue;
- (b) average value of scheme property and IDPS property;
- (c) calculation date;
- (d) cash or cash equivalents;
- (e) eligible provider;
- (f) first financial year;
- (g) liquid assets;
- (h) responsible entity and IDPS revenue; and
- (i) value of scheme property and IDPS property.

Requirements relating to custody

RG 166.214 You must meet the NTA requirement in item 2 of Table 9 unless, for each registered scheme you operate, any of the following requirements are satisfied:

- (a) all the scheme property and IDPS property and other assets of the scheme not held by members are held by a custodian (or a sub-custodian appointed by that custodian) who you reasonably believe meets the financial requirements for AFS licensees authorised to provide a custodial or depository service other than as an incidental provider (see Appendix 4), or by an eligible custodian;
- (b) all the scheme property and IDPS property and other assets of the scheme not held by members are Tier \$500,000 class assets, each of which are held by you or a custodian appointed by you (or a sub-custodian appointed by that custodian), and:
 - (i) if you hold the scheme property and IDPS property or assets, you have at least \$500,000 NTA; or

- (ii) if a custodian or sub-custodian holds the scheme property and IDPS property or assets, the custodian has at least \$500,000 NTA, or is an eligible custodian; or
- (c) the only scheme property and IDPS property and other assets of the scheme not held under paragraph (a) or (b) are special custody assets, each of which is held by:
 - (i) you;
 - (ii) a custodian that has the level of NTA that you are required to have (or a sub-custodian appointed by that custodian) or an eligible custodian; or
 - (iii) the members of the scheme.

Note: For the definition of 'eligible custodian', 'special custody assets' and 'Tier \$500,000 class assets', see RG 166.168 and RG 166.177–RG 166.178 in Section E.

RG 166.215 If you have obtained written assurance within the preceding 13 months from a custodian that is authorised to provide custodial or depository services that, at the time the assurance is given, it complies with the financial requirements for custodians that are not incidental providers (see Appendix 4), you are taken to have the reasonable belief referred to in RG 166.214(a) in relation to that custodian.

RG 166.216 If the custodian is not an AFS licensee authorised to provide a custodial or depository service, you must meet the NTA requirement in item 2 of Table 9 unless you have received:

- (a) written assurance within the preceding 13 months from the custodian regarding its compliance with the financial requirements that apply to custodians that are authorised to provide custodial or depository services other than as incidental providers; and
- (b) a report from a registered company auditor in respect of a period of at least 12 months, confirming the custodian's compliance with these requirements on terms reflecting the audit report required for AFS licensees.

The audit report must be received upon appointment in the first instance and must apply to a period not more than 16 months before the date it is received by you.

Note: The operation of a registered scheme or holding assets of a registered scheme does not constitute a custodial or depository service under s766E of the Corporations Act and therefore custodial or depository services authorisation is not required in order to provide these services.

RG 166.217 In relation to a custodian that was a custodian for a managed investment scheme on or before 30 June 2013 (continuing custodian), the requirements in RG 166.216 apply from the earlier of:

- (a) 31 October 2015; and

- (b) the date that the custodian first provides a copy of the report under RG 166.216 to the responsible entity or any other person.
- RG 166.218 If the custodian is not a continuing custodian under RG 166.217 and has not provided a copy of the report for the purposes of RG 166.216, the requirements apply from the earlier of:
 - (a) 16 months from the date that the custodian first became a custodian of the scheme; and
 - (b) the date that the custodian first provides the responsible entity or any other person with a copy of that report.
- RG 166.219 The first report obtained by a custodian for the purposes of RG 166.216 may cover a period of less than 12 months if it covers the period until the end of the relevant period from:
 - (a) for a continuing custodian, 1 July 2014; and
 - (b) otherwise, the date that the custodian first provided a written assurance under RG 166.216 to the licensee or any other person.
- RG 166.220 If you are relying on holding a reasonable belief that a custodian meets financial requirements for custodians to meet a lower NTA requirement and at any time you are aware of information that makes you suspect that the financial requirements for custodians will be not met by the custodian, you will need to obtain further confirmation and, where appropriate, an audit report addressing compliance with the financial requirements, before you will be taken to have the reasonable belief.
- RG 166.221 If assets are held by a custodian that only holds special custody assets, the custodian need not have the required NTA if the only assets it holds for the scheme are those specified in paragraphs (a), (c) or (g) of the definition of 'special custody assets', or paragraph (d) of that definition if the audited trust account is a 'regulated trust account': see the definitions of these terms in RG 166.175 and RG 166.177 in Section E.

Underlying principles of the NTA requirement

- RG 166.222 The NTA requirement generally aims to:
 - (a) ensure that as a responsible entity, you have adequate financial resources to meet your operating costs (e.g. the costs of ensuring compliance with the Corporations Act) throughout the life of your registered schemes and any IDPSs you operate;
 - (b) align your interests and the interests of scheme members by ensuring that you are an entity of substance and that your shareholders have sufficient equity in the business to have a real incentive to ensure its success; and

- (c) provide some level of assurance that, if you do fail, there is sufficient money available for the orderly transition to a new responsible entity or to wind up each registered scheme.

RG 166.223 The financial requirements for responsible entities take into account:

- (a) the financial requirements set out in the old Corporations Act;
- (b) the diversity of the types of schemes;
- (c) the need for investor confidence and assessment of comparable regulatory regimes in leading financial centres; and
- (d) comparable regulatory regimes, such as the SIS Act for public offer superannuation funds.

RG 166.224 We will not require the NTA calculation to address market or credit risks to assets. NTA is a measure of general financial standing. It includes non-current assets and is not specifically a measure of capacity to meet financial obligations.

RG 166.225 The requirement to hold at least 50% of the required NTA (disregarding any additional amount required by the requirements relating to custody) in cash or cash equivalents (with a minimum of \$150,000) aims to help you to meet expenditure in unanticipated situations over the coming 6-month period. The required NTA to be held as liquid assets should be realisable within 6 months so you can continue to meet your liabilities over the 12-month period.

RG 166.226 As one of the purposes of this requirement is to ensure funds are available for situations that are unanticipated, it is imperative that a portion of these funds be available at call, with the balance being available in the short term.

RG 166.227 The requirements relating to custody ensure that a person responsible for holding the scheme property and IDPS property and other assets of the scheme (whether it is you or a third party custodian) is an entity of some substance and also that it has sufficient financial resources to enable assets to be transferred if it ceases to be a custodian. Not all custodians of registered schemes must meet the full requirements relating to custody.

RG 166.228 This recognises that, in certain circumstances:

- (a) it would be unreasonably costly or impracticable for operators of schemes and IDPSs to retain a custodian that can meet the NTA requirement;
- (b) the custodial systems for some scheme property and IDPS property need not be as sophisticated as for other schemes; and
- (c) the prospect of loss of certain types of assets due to custodial failure is less than for others or can be addressed adequately by appropriate controls involving oversight by a person other than the responsible entity, and there is a low risk of misappropriation of those asset types.

- RG 166.229 We consider that certain types of assets (see the definition of ‘special custody assets’ in RG 166.177) do not give rise to the same degree of custodial risk as other more liquid assets. For example, serviced strata schemes and mortgage syndicates not involving nominees are examples of contractual-based schemes where the contractual rights (or leases) involved may, by their nature, be unable to be misappropriated or assigned without the investors’ consent. Further types of contractual rights that do not give rise to the same degree of custodial risk as liquid assets may include:
- (a) licences of copyright in a film scheme;
 - (b) the right in some agricultural schemes to enter the land and cultivate, harvest and remove the produce; and
 - (c) the right to receive rent from a real property syndicate.
- RG 166.230 In some cases it may be impracticable for a responsible entity to engage a custodian. Derivatives and private equity interests can carry an associated liability and, as a result, it may be impracticable to require an entity separate from the responsible entity to hold the legal title to such assets. For certain deposit accounts, it may be inefficient or impractical for the custodian to be holder. Where the asset is an account with the person who is the asset holder for other assets of the scheme, it may not always be efficient to have an entity with the NTA generally required as the account holder.
- RG 166.231 It is common industry practice for the assets referred to in RG 166.230 to be held by the responsible entity in some circumstances. Generally, we allow those assets to be held by a responsible entity that does not have the NTA required to permit it to hold scheme property if certain additional controls are applied, as appropriate to the nature of each asset, to ensure that an appropriate separate person is nevertheless keeping records of relevant transactions in the assets and confirming that the transactions have been authorised in accordance with the controls determined by the responsible entity.
- RG 166.232 Applying these controls can form an element of the responsible entity meeting the custody standards in Regulatory Guide 133 *Managed investments and custodial or depository services: Holding assets* (RG 133) and the compliance arrangements that a responsible entity is required to apply. The responsible entity as the asset holder must ensure the standards are met and that controls on authorisation to engage in transactions comply with the compliance plan of the relevant scheme and the other duties of the responsible entity.
- RG 166.233 Generally, the effect of our policy is that, to hold certain types of scheme property and IDPS property, you must use a substantial custodian unless your NTA is over a specified amount. For those assets for which a reduced amount of custodial financial requirements applies under your AFS licence as a responsible entity, you must still ensure that the custodian meets the

standards for holding scheme property and IDPS property as set out in RG 133.

- RG 166.234 If you hold scheme property and IDPS property, then you must generally also comply with Section C of this guide. If you are required to hold \$50,000 surplus liquid funds under Section C (the SLF requirement), you must comply with this requirement in addition to the NTA requirement.
- RG 166.235 For example, a responsible entity that was required to have \$200,000 NTA would need another \$150,000 in assets that counted towards NTA if it had:
- (a) no liabilities; and
 - (b) \$50,000 credit in an on-demand account it beneficially held with an Australian ADI.

Appendix 3: Investor directed portfolio services

Key points

If you are an IDPS operator, you must meet:

- the standard solvency and positive net assets requirement;
- a tailored cash needs requirement;
- a tailored audit requirement;
- a net tangible assets (NTA) requirement with requirements for holding cash or cash equivalents and holding liquid assets; and
- depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

What requirements apply?

RG 166.236 You must meet the following financial requirements:

- (a) the standard solvency and positive net assets requirement (see RG 166.32–RG 166.34 in Section B);
- (b) a tailored cash needs requirement (see RG 166.237–RG 166.238);
- (c) a tailored audit requirement (see RG 166.239–RG 166.241);
- (d) a net tangible assets (NTA) requirement (see RG 166.242–RG 166.261); and
- (e) depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

Note 1: The financial requirements for IDPS operators are set out in [CO 13/760]. See also Regulatory Guide 148 *Platforms that are managed investment schemes* (RG 148).

Note 2: The requirements in this appendix do not apply to an AFS licensee that is authorised to operate a registered scheme as a responsible entity (including an IDPS-like scheme). See Appendix 2 for the requirements that apply to these licensees.

The tailored cash needs requirement

Note: This requirement replaces the standard cash needs requirement in Section B of this guide: see Table 10.

RG 166.237 You must meet the tailored cash needs requirement for IDPS operators. You will need to prepare a cash flow projection (see Table 10), which covers a period of at least 12 months—that is, you must assess your cash needs over at least a 12-month forward period.

RG 166.238 You must update your cash flow projection when those cash flows cease to cover the next 12 months, there is a material change or there is reason to suspect that an updated projection would differ materially from the current

projection or show that you were not meeting items 5 or 6 in Table 10. Your board must approve the cash flow projection at least quarterly.

Table 10: The tailored cash needs requirement for IDPS operators

You must meet all these requirements	
Projection	<p>1 Prepare a projection of your cash flows over at least the next 12 months based on your reasonable estimate of what is likely to happen over this term.</p> <p>Note: You can take into account, for example, the following factors in preparing your projection if you reasonably believe they are likely to be available: assets you hold at the time the projection starts that can be used to pay your liabilities, and inflows you may receive, including income from your business, amounts that you may borrow (e.g. under an overdraft), and amounts that you may receive from an eligible provider under an eligible undertaking.</p> <p>2 Document your calculations and assumptions on which the projection is based, and describe in writing why they are the appropriate assumptions.</p> <p>Note: We expect that a description in writing of your calculations and assumptions will vary according to the nature, scale and complexity of your business.</p> <p>3 Update your projection of cash flows when:</p> <p>(a) those cash flows cease to cover the next 12 months;</p> <p>(b) there is a material change; or</p> <p>(c) there is reason to suspect that an updated projection would differ materially from the current projection or show that you were not meeting items 5 or 6 below.</p> <p>Note: A 'material change' is a change for which it would be reasonable for you to plan by updating your cash flow projection.</p> <p>4 Have your cash flow projection approved by the board of directors at least quarterly as satisfying the requirements in this cash needs requirement.</p>
Financial resources	<p>5 Document whether, based on your projection of cash flows, you will have access as needed to enough financial resources to meet your liabilities over the projected term of at least the next 12 months, including any additional liabilities you project will be incurred during that term.</p> <p>6 Document whether, based on the projection of your cash flows, you will hold at all times during the period to which the projection relates, in cash or cash equivalents, an amount equal to or greater than the current amount you are required to hold in cash or cash equivalents under the liquidity requirement: see RG 166.166(d).</p>

The tailored audit requirement

Note: This requirement replaces the standard audit requirement in Section B of this guide.

RG 166.239 All AFS licensees must give us an audit report under s989B(3) of the Corporations Act for each financial year that includes information about compliance with the financial requirements that apply to you: see Section B. If you do not have to provide an audit report under s989B(3), you must still give us an audit report about compliance with the financial requirements. You must also give us this information if we request it for a specified period at another time: see s912C(2).

Note: For the form of this compliance report applying to licensees generally, see PF 209, condition 28.

RG 166.240 As an IDPS operator, the information you must include in your audit report reflects the financial requirements that apply to you: see [CO 13/760].

RG 166.241 Your audit report must include statements by a registered company auditor addressed to you and ASIC that, for the relevant period:

- (a) in the auditor's opinion, you:
 - (i) complied with the requirement to have the cash flow projection approved by the board at least quarterly, the NTA requirement and any other financial requirements applying to you;
 - (ii) had, at all times, cash flow projections (covering at least the following 12 months) that purported to, and on their face appeared to, demonstrate your solvency; and
 - (iii) correctly calculated the cash flow projections based on the assumptions you used for the projection; and
- (b) following an examination of the calculations, assumptions and description used in preparing the cash flow projection, including the document prepared under items 5 and 6 in Table 10, the auditor has no reason to believe that:
 - (i) you did not have adequate systems for managing the risk of having insufficient financial resources to meet the NTA requirement and any other financial requirements applying to you;
 - (ii) you failed to document the calculations and assumptions used in preparing the cash flow projections and describe why they are appropriate;
 - (iii) you will not have access when needed to enough financial resources to meet your liabilities over the projected term of at least 12 months or that you will not hold at all times during the period to which the projection relates, in cash or cash equivalents, an amount equal to or greater than the current amount you are required to hold in cash or cash equivalents; and
 - (iv) the assumptions you adopted for your cash flow projections were unreasonable.

Note: We refer to the auditor statements in paragraph (a) as 'positive assurance' and the statements in paragraph (b) as 'negative assurance'. We expect that when giving negative assurance for the purposes of paragraph (b), the auditor will take into consideration any information from the audit for positive assurance.

The NTA requirement

RG 166.242 If you are an IDPS operator, you must meet the NTA requirement in Table 11 that applies to you.

RG 166.243 For the purposes of calculating the required NTA, the average value of scheme property and IDPS property must be determined as follows:

- (a) in the case of assets that would be recognised in preparing a balance sheet for members under Ch 2M—their value as if, at that time, such a balance sheet was being prepared; and
- (b) in the case of any other scheme property or IDPS property—its market value at that time.

Note: ‘Assets’ are as defined by applicable accounting principles. ‘Scheme property’ is defined in s9 of the Corporations Act.

RG 166.244 Of the required NTA (as applicable to you), you must hold:

- (a) cash or cash equivalents valued at—at least the greater of:
 - (i) \$150,000; or
 - (ii) 50% of the required NTA; and
- (b) liquid assets to the amount of required NTA—this may include cash or cash equivalents, other than a commitment to provide cash from an eligible provider that can be drawn down within 5 business days upon request, and will not expire within the next 6 months.

Table 11: NTA requirements for IDPS operators

Type of operator	NTA requirement
You are an IDPS operator, including where you do not operate any IDPS at any time	1 You must hold at all times minimum NTA of the greater of: <ul style="list-style-type: none"> (a) \$150,000; (b) 0.5% of the average value of scheme property and IDPS property of the registered scheme(s) and IDPS(s) you operate up to \$5 million NTA; or (c) 10% of your average responsible entity and IDPS revenue.
You perform custodial functions as an IDPS operator <i>OR</i> You are an IDPS operator that is responsible to clients for holding IDPS property and you do not satisfy the requirements relating to custody in RG 166.247	2 You must hold at all times minimum NTA the greater of: <ul style="list-style-type: none"> (a) \$10 million; or (b) 10% of your average responsible entity and IDPS revenue.

Definitions for the NTA requirement

RG 166.245 Definitions for calculating the required NTA for IDPS operators are in Section E: see RG 166.162–RG 166.179. Relevant definitions include:

- (a) average responsible entity and IDPS revenue;
- (b) average value of scheme property and IDPS property;

- (c) calculation date;
- (d) cash or cash equivalents;
- (e) eligible provider;
- (f) first financial year;
- (g) liquid assets; and
- (h) responsible entity and IDPS revenue.

Requirements relating to custody

- RG 166.246 You must meet the NTA requirement in item 2 of Table 11 if you perform custodial functions as an IDPS operator.
- RG 166.247 You must also meet the NTA requirement in item 2 of Table 11 if you are responsible to clients for holding IDPS property, unless all the assets are held by a custodian appointed by you (or a sub-custodian appointed by that custodian) where the custodian is an AFS licensee authorised to provide a custodial or depository service and, except in relation to special custody assets, you reasonably believe it meets the financial requirements for custodians (see Appendix 4), or by an eligible custodian.

Note: For the definition of 'eligible custodian', see RG 166.168 in Section E.

- RG 166.248 This requirement must be met in addition to the general NTA requirement for IDPS operators in item 1 of Table 11, although you can use the assets required to meet that NTA requirement as part of your NTA for meeting this requirement.
- RG 166.249 If you have obtained written assurance within the preceding 13 months from a custodian that is authorised to provide custodial or depository services that, at the time the assurance is given, it complies with the financial requirements for custodians that are not incidental providers (see Appendix 4) you are taken to have the reasonable belief referred to in RG 166.247 in relation to that custodian.
- RG 166.250 If the custodian is not an AFS licensee authorised to provide a custodial or depository service, you must meet the NTA requirement in item 2 of Table 11 unless you have received:
- (a) written assurance within the preceding 13 months from the custodian regarding its compliance with the financial requirements that apply to custodians that are authorised to provide custodial or depository services other than as incidental providers; and
 - (b) a report from a registered company auditor in respect of a period of at least 12 months, confirming the custodian's compliance with these requirements on terms reflecting the audit report required for AFS licensees.

The audit report must be received on appointment in the first instance and must apply to a period not more than 16 months before the date it is received by you.

- RG 166.251 In relation to a custodian that was a custodian of the IDPS property on or before 30 June 2013 (continuing custodian), the requirements in RG 166.250 apply from the earlier of:
- (a) 31 October 2015; and
 - (b) the date that the custodian first provides a copy of the report under RG 166.250 to you or any other person.
- RG 166.252 If the custodian is not a continuing custodian under RG 166.251 and has not provided a copy of the report for the purposes of RG 166.250, the requirements apply from the earlier of:
- (a) 16 months from the date that the custodian first became a custodian of the IDPS property; and
 - (b) the date that the custodian first provides you or any other person with a copy of that report.
- RG 166.253 The first report obtained by a custodian may cover a period of less than 12 months if it covers the period until the end of the relevant period from:
- (a) for a continuing custodian, 1 July 2014; and
 - (b) otherwise, the date that the custodian first provided a written assurance under RG 166.250 to you or any other person.
- RG 166.254 If assets are held by a custodian that only holds special custody assets, the custodian need not have the required NTA if the only assets it holds in relation to the IDPS are those specified at RG 166.177(a), RG 166.177(c) or RG 166.177(g) in the definition of 'special custody assets', or RG 166.177(d) if the audited trust account is a 'regulated trust account': see the definition of 'regulated trust account' at RG 166.175.
- RG 166.255 If you are relying on holding a reasonable belief that a custodian meets financial requirements for custodians in order to meet a lower NTA requirement and at any time you are aware of information that makes you suspect that the financial requirements for custodians will be not met by the custodian, you will need to obtain further confirmation and, where appropriate, an audit report addressing compliance with the financial requirements, before you will be taken to have the reasonable belief.

Underlying principles of the NTA requirement

- RG 166.256 The NTA requirement for IDPS operators generally aims to:
- (a) ensure that, as an IDPS operator, you have adequate financial resources to meet your operating costs (e.g. the costs of ensuring compliance with the Corporations Act) throughout the life of your IDPS; and

- (b) provide some level of assurance that, if you do fail, there is sufficient money available for the orderly transition to a new IDPS operator or the transfer of the clients' assets to the client or as they direct.
- RG 166.257 Our approach to the NTA requirement is flexible enough to allow an IDPS to be structured in a number of ways provided that the person performing or taking responsibility for the transactional functions has the necessary level of assets. For example, if an IDPS involves a single operator contracting with clients to provide the service, it is not necessary for that person to have NTA of up to \$10 million if that sole operator engages certain other parties to carry out the custodial functions.
- RG 166.258 As with the NTA requirement for responsible entities, we will not require the NTA calculation to address market or credit risks to assets. NTA is a measure of general financial standing. It includes non-current assets and is not specifically a measure of capacity to meet financial obligations.
- RG 166.259 The revised requirement to hold at least 50% of the required NTA (disregarding any additional amount under the requirements relating to custody) in cash or cash equivalents (with a minimum of \$150,000) aims to help you to meet expenditure in unanticipated situations over the coming 6-month period. The required NTA to be held as liquid assets should be realisable within 6 months so you can continue to meet your liabilities over the 12-month period. One purpose of this requirement is to ensure funds are available for situations that are unanticipated, so it is imperative that a portion of these funds be available at call, with the balance being available in the short term.
- RG 166.260 We use revenue as a measure of the scale of operational risk facing an IDPS operator and therefore the amount of funds it should have to address these risks beyond those needed to meet liabilities. We take into account the revenue of persons performing functions forming part of the IDPS for which the IDPS operator is responsible to clients because the operational risk arising from these activities will affect the responsible IDPS operator.
- RG 166.261 The custodian of IDPS assets performs substantially the same functions as a custodian of registered managed investment scheme assets, at least in their capacity as custodian of financial products. Accordingly, we continue to align the requirement for NTA based on custody responsibilities.

Appendix 4: Custodial or depository services

Key points

If you operate a custodial or depository service, you must meet:

- the standard solvency and positive net assets requirement;
- a tailored cash needs requirement;
- a tailored audit requirement;
- a net tangible assets (NTA) requirement; and
- depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

What requirements apply?

RG 166.262 If you operate a custodial or depository service, you must meet:

- (a) the standard solvency and positive net assets requirement (see RG 166.32–RG 166.34 in Section B);
- (b) a tailored cash needs requirement (see RG 166.263–RG 166.264);
- (c) a tailored audit requirement (see RG 166.265–RG 166.268);
- (d) a net tangible assets (NTA) requirement with requirements for holding cash or cash equivalents and holding liquid assets (see RG 166.269–RG 166.289); and
- (e) depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

Note: The financial requirements for custodial or depository service providers are set out in Class Order [CO 13/761] *Financial requirements for custodial or depository service providers*.

The tailored cash needs requirement

Note: This requirement replaces the standard cash needs requirement in Section B of this guide.

RG 166.263 You must meet the tailored cash needs requirement for custodial or depository service providers. You will need to prepare a cash flow projection (see Table 12), which covers a period of at least 12 months—that is, you must assess your cash needs over at least a 12-month forward period.

RG 166.264 You must update your cash flow projection when those cash flows cease to cover the next 12 months, there is a material change or there is reason to suspect that an updated projection would differ materially from the updated

projection or show that you were not meeting items 5 or 6 in Table 12. Your board of directors must approve the cash flow projection at least quarterly.

Table 12: The tailored cash needs requirement for custodial or depository service providers

You must meet all these requirements	
Projection	<p>1 Prepare a projection of your cash flows over at least the next 12 months based on your reasonable estimate of what is likely to happen over this term.</p> <p>Note: You can take into account, for example, the following factors in preparing your projection if you reasonably believe they are likely to be available: assets you hold at the time the projection starts that can be used to pay your liabilities; and inflow you may receive, including income from your business, amounts that you may borrow (e.g. under an overdraft), and amounts that you may receive from an eligible provider under an eligible undertaking.</p> <p>2 Document your calculations and assumptions used in preparing the projection, and describe in writing why they are the appropriate assumptions.</p> <p>Note: We expect that a description in writing of your calculations and assumptions will vary according to the nature, scale and complexity of your business.</p> <p>3 Update your projection of cash flows when:</p> <ul style="list-style-type: none"> (a) those cash flows cease to cover at least the next 12 months; (b) there is reason to suspect that an updated projection would differ materially from the updated projection; or (c) there is reason to suspect that an updated projection would show that you were not meeting items 5 or 6 below. <p>Note: A 'material change' is a change for which it would be reasonable for you to plan by updating your cash flow projection.</p> <p>4 Have your cash flow projection approved in writing at least quarterly by the following persons as satisfying the requirements in this cash needs requirement:</p> <ul style="list-style-type: none"> (d) if the licensee is a body corporate—the directors of the licensee; (e) if the licensee is a partnership or the trustees of a trust—the partners of the licensee or the trustees; or (f) if the licensee is a natural person—the person.
Financial resources	<p>5 Document whether, based on your projection of cash flows, you will have access as needed to enough financial resources to meet your liabilities over the projected term of at least the next 12 months, including any additional liabilities you project will be incurred during that term.</p> <p>6 Document whether, based on the projection of your cash flows, you will hold at all times during the period to which the projection relates, in cash or cash equivalents, an amount equal to or greater than the current amount you are required to hold in cash or cash equivalents: see RG 166.255.</p>

The tailored audit requirement

Note: This requirement replaces the standard audit requirement in Section B of this guide.

RG 166.265 All AFS licensees must give us an audit report under s989B(3) of the Corporations Act for each financial year that includes information about compliance with the financial requirements that apply to you: see Section B.

- RG 166.266 If you do not have to provide an audit report under s989B(3), you must still give us an audit report about compliance with the financial requirements. You must also give us this information if we request it for a specified period at another time: see s912C(2). As a custodial or depository service provider, the information you must include in your audit report reflects the financial requirements that apply to you: see [CO 13/761].
- RG 166.267 Your audit report must include statements by a registered company auditor addressed to you and ASIC that, for the relevant period:
- (a) in the auditor's opinion, you:
 - (i) complied with the NTA requirement and any other financial requirements applying to you;
 - (ii) had, at all times, cash flow projections (covering at least the following 12 months) that purported to, and on their face appeared to, demonstrate your solvency; and
 - (iii) correctly calculated the cash flow projections based on the assumptions you based them on; and
 - (b) following an examination of the documents you relied on to create your cash flow projections, the auditor has no reason to believe that:
 - (i) you did not satisfy s912A(1)(h) of the Corporations Act for managing the risk of having insufficient financial resources to meet the NTA requirement and any other financial requirements applying to you;
 - (ii) you failed to prepare cash flow projections as required, failed to have these projections approved by your board, or failed to document the calculations used in creating the cash flow projections and explain why they are appropriate; and
 - (iii) the assumptions you used to create the cash flow projections were unreasonable.

Note: We refer to the auditor statements in paragraph (a) as 'positive assurance' and the statements in paragraph (b) as 'negative assurance'. We expect that when giving negative assurance for the purposes of paragraph (b), the auditor will take into consideration any information from the audit for positive assurance.

- RG 166.268 If you are relying on the definition of 'incidental provider' to meet the NTA requirement in item 2 of Table 13, your audit report must also include a statement that the auditor has no reason to believe that you did not satisfy the requirement in paragraph (b) of the definition of 'incidental provider': see RG 166.173.

The NTA requirement

- RG 166.269 If you are a provider of custodial or depository services, you must meet the NTA requirement in Table 13 that applies to you.

Note: 'Custodial or depository service' is defined in s766E of the Corporations Act. To find out if your service is excluded from this definition, see s766E(3) and reg 7.1.40.

- RG 166.270 Of the required NTA (as applicable to you), you must hold:
- (a) at least 50% in cash or cash equivalents; and
 - (b) 100% in liquid assets.

Table 13: NTA requirements for custodial or depository service providers

Type of provider	NTA requirement
You are an incidental provider and you satisfy the requirements relating to custody in RG 166.275	<p>1 You do not need to meet an NTA requirement as long as you continue to satisfy these requirements for the relevant custodial or depository service: see RG 166.287–RG 166.288.</p> <p>Note: You may still need to meet an NTA requirement for other financial services for which you are authorised.</p>
You are an incidental provider and you do not satisfy the requirements relating to custody in RG 166.275	<p>2 You must hold at all times minimum NTA the greater of:</p> <ol style="list-style-type: none"> (a) \$150,000; or (b) 10% of average revenue.
You satisfy the requirements for custodians in RG 166.273	<p>3 You must have at all times minimum NTA the greater of:</p> <ol style="list-style-type: none"> (a) \$10 million; or (b) 10% of average revenue.

Definitions for the NTA requirement

- RG 166.271 Definitions for calculating the required NTA for custodial or depository service providers are set out in Section E: see RG 166.162–RG 166.179.
- RG 166.272 Relevant definitions include:
- (a) average revenue;
 - (b) cash or cash equivalents;
 - (c) calculation date;
 - (d) custodial or depository services revenue;
 - (e) eligible provider;
 - (f) financial services business revenue;
 - (g) first financial year;
 - (h) incidental provider; and
 - (i) liquid assets.

Requirements relating to custody

- RG 166.273 You must meet the NTA requirement for custodians in item 3 of Table 13 if you operate a custodial or depository service that:
- (a) provides custodial or depository services other than as an incidental provider; or

- (b) acts as custodian for an IDPS.

Note: 'Custodial or depository service' is defined in s766E of the Corporations Act. To find out if your service is excluded from this definition, see s766E(3) and reg 7.1.40.

RG 166.274 You must meet the NTA requirement for incidental providers in item 2 of Table 13 if you operate an incidental custodial or depository service, unless you satisfy the requirements in RG 166.275.

RG 166.275 If you are an incidental provider, you do not need to meet the NTA requirement for incidental providers in item 2 of Table 13 if all the assets to which the custodial or depository service relates are held by a licensee (or a sub-custodian appointed by that licensee) who:

- (a) is authorised to provide a custodial or depository service and who you reasonably believe:
 - (i) meets the financial requirements for custodians in item 3 of Table 13; and
 - (ii) is not an incidental provider; or
- (b) is an eligible custodian.

Note: You may still need to meet an NTA requirement for other financial services for which you are authorised. For the definition of 'eligible custodian', see RG 166.168 in Section E.

RG 166.276 If you have obtained written assurance within the preceding 13 months from a licensee that is authorised to provide custodial or depository services that, at the time the assurance is given, it complies with the financial requirements for custodians other than as an incidental provider, you are taken to have the reasonable belief referred to in RG 166.275 in relation to that licensee.

RG 166.277 If you are relying on holding the reasonable belief in RG 166.275 to be exempt from the NTA requirement and at any time you are aware of information that makes you suspect that the financial requirements for custodians will be not met by the licensee, you will need to obtain further confirmation and, where appropriate, an audit report addressing compliance with the financial requirements, before you will be taken to have the reasonable belief.

RG 166.278 If you receive a written request from a licensee who has appointed you to provide custodial or depository services (appointing licensee) and the request is made for the purpose of assisting the appointing licensee to determine whether it meets its own obligations regarding the custody of client assets, you must (within a reasonable time) provide the appointing licensee with a statement:

- (a) about your compliance with the NTA requirements; and
 - (b) stating whether you are an incidental provider,
- at the time the statement is given.

RG 166.279 If you lodge a report with ASIC under s912D(1B) relating to a breach of this section, you must immediately notify each appointing licensee in writing.

Underlying principles of the NTA requirement

- RG 166.280 A diverse range of businesses are involved in providing custodial or depository services. It is important for all providers of custodial or depository services to have the necessary systems and controls in place to support their authorisation. However, not all custody businesses need to meet the same capital requirements.
- RG 166.281 For some businesses, custodial or depository services represent a significant part of the services offered by them. Clients of these businesses place substantial trust in the custodian to ensure the safe-keeping of their assets. Substantial operating capacity is required for these custodians. An orderly winding up is particularly important for these businesses, in order to prevent client loss, because the custodian may hold assets of many different clients coming from different sources.
- Note: We apply the same requirements to custodians of registered schemes and IDPSs (except for special custody assets or Tier \$500,000 assets): see Appendices 2 and 3.
- RG 166.282 This contrasts with custodial or depository services which are provided incidentally to the provision of another financial service. We refer to licensees who provide these services as ‘incidental providers’. One example of a custodial or depository service which may be undertaken by an incidental provider is the holding of financial products as part of an unregistered managed investment scheme (other than an IDPS) by an operator of the scheme on behalf of a client, which occurs after the operator or a related body corporate has provided financial product advice and/or dealing services for those interests on behalf of the client.
- RG 166.283 A reduced capital requirement applies to incidental providers. This recognises that in some circumstances it would be unreasonably costly for incidental providers to meet the financial requirements for custodians. To meet the reduced requirement for incidental providers, you need to ensure that you meet the definition of ‘incidental provider’ in Section E under ‘Specific definitions for responsible entities, IDPS operators and custodians’: see RG 166.173.
- RG 166.284 To satisfy paragraph (a) of the definition of ‘incidental provider’, there must be a causal relationship between other financial services you provide and the custodial or depository services, such that the custodial or depository service would not be needed by the client if the other financial services were not provided. In our view, this relationship is unlikely to arise if the custodial or depository services are offered as discrete (stand-alone) services or if you advertise yourself as a ‘custodian for hire’.
- RG 166.285 To satisfy paragraph (b) of the definition of ‘incidental provider’, you must identify the revenue attributable to the custodial or depository services: see RG 166.167. We expect that this assessment will be done at least once a year. If the fees for those services are bundled, not charged or otherwise unidentifiable, we expect that you will calculate this figure based on the cost to

the business of providing these services, taking into account a share of fixed costs and the cost of capital.

- RG 166.286 It is likely that incidental providers may be authorised to provide additional financial services, to which other financial requirements in RG 166 apply. Assets used to meet one requirement in RG 166 may be used to meet another requirement.
- RG 166.287 Incidental providers who appoint a third party custodian to hold client assets on their behalf may be exempt from the NTA requirement. An example of when this may occur would be the operation of an unregistered managed investment scheme where the operator or fund manager is the trustee of a unit trust and, as such, is considered to have a beneficial interest in the assets of the scheme (and therefore requires a custodial or depository service authorisation). However, physical custody of the financial products is undertaken by a separate custodian authorised to provide custodial or depository services that meets the financial requirements for custodians in item 3 of Table 13.
- RG 166.288 An incidental provider or appointing licensee is entitled to ask a third party custodian appointed by it for written assurance of the custodian's compliance with the financial requirements for custodians, for the purpose of ensuring that the incidental provider or appointing licensee meets its own obligations regarding custody of client assets. The custodian is obliged to provide this information and to update the incidental provider if it is in significant breach of the financial requirements for custodians. This is necessary to help the incidental provider or appointing licensee form the reasonable belief that the custodian meets the financial requirements for custodians. The exemption from the NTA requirement is not available if, at any time, the incidental provider undertakes physical custody of the client assets that are financial products, rather than merely having a beneficial interest in the assets held by the custodian.
- RG 166.289 For all providers of custodial or depository services, the requirement to hold at least 50% of the required NTA in cash or cash equivalents, with 100% being held in liquid assets, aims to help you to meet expenditure in unanticipated situations over the coming 6-month period. One purpose of this requirement is to ensure funds are available for situations that are unanticipated, so it is imperative that a portion of these funds be available at call, with the balance being available in the short term.

Appendix 5: Trustee companies providing traditional services

Key points

If you are a trustee company providing traditional services, you must meet:

- the standard solvency and positive net assets requirement;
- the standard cash needs requirement;
- the standard audit requirement; and
- an NTA requirement, unless you are eligible for relief;
- the surplus liquid funds (SLF) requirement where you hold client money or property valued at \$100,000 or more; and
- depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

What requirements apply?

RG 166.290 If you operate a trustee company providing traditional services, you must meet:

- (a) the standard solvency and positive net assets requirement (see RG 166.32–RG 166.34 in Section B);
- (b) the standard cash needs requirement (see RG 166.35–RG 166.61 in Section B);
- (c) the standard audit requirement (see RG 166.62–RG 166.68 in Section B);
- (d) an NTA requirement, unless you are eligible for relief (see RG 166.291–RG 166.295);
- (e) the surplus liquid funds (SLF) requirement where you hold client money or property valued at \$100,000 or more (see Section C); and
- (f) depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

The NTA requirement

RG 166.291 You must have at all times at least \$5 million NTA if you are a trustee company that provides traditional services, unless you are eligible for relief.

What relief is available?

RG 166.292 We will consider giving relief from the \$5 million NTA requirement on a case-by-case basis where:

- (a) a trustee company does not operate a common fund; and
- (b) either:
 - (i) does not have present or future rights of any kind to hold trust property or estate assets; or
 - (ii) has rights in relation to trust property or estate assets that are not substantial when compared to our general requirement of \$5 million NTA.

How to apply for relief

RG 166.293 To apply for relief:

- (a) Include with your licence application or request for variation of licence a submission for ASIC not to impose the \$5 million NTA requirement.
- (b) Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).
- (c) Candidly set out all information that may be relevant to your application, including details as to the unreasonableness of having to comply with the NTA requirement and the size and number of estates that you anticipate providing traditional services to.

You can also contact ASIC on 1300 300 630 for information and assistance.

Underlying principles of the NTA requirement

RG 166.294 A client using traditional services provided by a trustee company is typically placing substantial trust in the trustee company that provides those services and the trustee company should have some financial substance. Unlike custodial or depository service providers, trustee companies may also hold property other than financial products. Requiring trustee companies that provide traditional services to have NTA of at least \$5 million will ensure that a trustee company is an entity of financial substance.

RG 166.295 However, we recognise that in certain circumstances, it may be unreasonably costly for a trustee company to meet the \$5 million NTA requirement.

Appendix 6: Issuers of margin lending facilities

Key points

If you are an issuer of a margin lending facility, you must meet:

- the standard solvency and positive net assets requirement;
- the standard cash needs requirement;
- the standard audit requirement;
- an NTA requirement; and
- depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

What requirements apply?

RG 166.296 If you are an issuer of a margin lending facility, you must meet:

- (a) the standard solvency and positive net assets requirement (see RG 166.32–RG 166.34 in Section B);
- (b) the standard cash needs requirement (see RG 166.35–RG 166.61 in Section B);
- (c) the standard audit requirement (see RG 166.62–RG 166.68 in Section B);
- (d) an NTA requirement (see RG 166.297–RG 166.299); and
- (e) depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

Note: Depending on your business, you may need to meet the ASLF requirement. This requirement will apply to you if you issue a non-standard margin lending facility: see RG 166.300–RG 166.302.

The NTA requirement

RG 166.297 If you issue a margin lending facility, you must hold:

- (a) NTA of at least 0.5% of the value of:
 - (i) for a standard margin lending facility—the secured property;
 - (ii) for a non-standard margin lending facility—any transferred securities;
 - (iii) subject to a minimum requirement of \$50,000 and a maximum requirement of \$5 million; and

- (b) at least \$5 million NTA at all times:
 - (i) for a standard margin lending facility where:
 - (A) the licensee holds the secured property and that person does not have at least \$5 million NTA unless they are an eligible custodian; or
 - (B) any other person holds the secured property and that person does not have at least \$5 million NTA unless they are an eligible custodian; or
 - (ii) for a non-standard margin lending facility where:
 - (A) the licensee is the transferee of transferred securities; or
 - (B) any other person is the transferee of transferred securities and that person does not have at least \$5 million NTA unless they are an eligible custodian.

Note: For the definition of 'margin lending facility', 'secured property' and 'transferred securities', see 'Key terms'. For the definition of 'eligible custodian', see Section E under 'Specific definitions for responsible entities, IDPS operators and custodians'.

Underlying principles of the NTA requirement

- RG 166.298 Imposing a capital requirement on issuers of margin lending facilities will ensure that an issuer is an entity of financial substance. Even if an issuer does not hold secured property or is not the transferee of transferred securities, we impose an NTA requirement of between \$50,000 and \$5 million. This is because the issuer will still perform a range of important functions such as assessing that the loan is not unsuitable for the client, providing funds to settle client transactions, monitoring portfolios, reporting and providing notice of margin calls.
- RG 166.299 However, unless the issuer or any other person that holds secured property or is the transferee of transferred securities has NTA of over \$5 million, the issuer must use a substantial custodian. The NTA requirement imposed on an issuer of a margin lending facility provides for the facility to be structured in a number of ways as long as either the issuer, or the person holding the secured property or transferred securities, has the necessary NTA.

ASLF requirement for non-standard margin lending facilities

- RG 166.300 Depending on your business, you may need to meet the ASLF requirement. The ASLF requirement will apply to you if you issue a non-standard margin lending facility.
- RG 166.301 Under a non-standard margin lending facility, the client transfers the title to the marketable securities provided for the loan to the client. The marketable

securities are not held on trust for the benefit of the client and the client merely has the right, in the circumstances determined under the terms of the facility, to be given equivalent marketable securities. This means that the AFS licensee will need to use its own assets to meet the financial obligations to its client and it will need to carefully manage its assets and liabilities to enable it to meet its compliance obligations.

RG 166.302 We consider that the ASLF requirement is appropriate to reflect the additional risks for managing financial resources inherent in a non-standard margin lending facility. This is because it provides a more comprehensive measure of the availability of liquid assets to the AFS licensee in light of the scale of its operations and various risks to the licensee's financial resources in the current period.

Appendix 7: Foreign exchange dealers

Key points

If you are a foreign exchange dealer (and you are not a retail OTC derivative issuer), you must meet:

- the standard solvency and positive net assets requirement;
- the standard cash needs requirement;
- the standard audit requirement;
- the ASLF requirement *or* the capital requirement; and
- depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

What requirements apply?

RG 166.303 If you are a foreign exchange dealer, you must meet:

- (a) the standard solvency and positive net assets requirement (see RG 166.32–RG 166.34 in Section B);
- (b) the standard cash needs requirement (see RG 166.35–RG 166.61 in Section B);
- (c) the standard audit requirement (see RG 166.62–RG 166.68 in Section B);
- (d) the standard ASLF requirement (see Section D) *or* the capital requirement (see RG 166.304–RG 166.312); and

Note: You may also need to comply with the standard ASLF requirement because of financial services that do not relate to foreign exchange contracts, and in that case you must comply with it.

- (e) depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

Choosing between the ASLF requirement and the capital requirement

RG 166.304 If you are a foreign exchange dealer, you may choose to comply with the ASLF requirement, rather than having \$10 million of Tier 1 capital (if this requirement applies to you). You can choose this option when you apply for your AFS licence or when you apply for a variation of your licence. You will then have to comply with the ASLF requirement at all times and not merely, for example, when it would apply because you have more than \$100,000 of adjusted liabilities or certain contingent liabilities. If you choose to have \$10 million of Tier 1 capital, then foreign exchange contracts will not be

counted in determining whether the ASLF requirement is triggered in your case.

Note: Foreign exchange dealers that already hold an AFS licence that includes a condition requiring them to comply with the \$10 million of Tier 1 capital may apply to us for a variation of their licence conditions if they wish to comply instead with the ASLF requirement.

RG 166.305 If you enter into foreign exchange contracts but do not carry on a business of entering, as principal, into foreign exchange contracts (that are financial products) in Australia, certain foreign exchange contracts are not taken into account in determining if you have at least \$100,000 in adjusted or contingent liabilities and therefore are subject to the ASLF requirement. For details of the foreign exchange contracts that may be disregarded, see RG 166.307. This applies to certain foreign exchange contracts that you entered for the purposes of enabling a payment in one of the currencies under the foreign exchange contract.

Meeting the ASLF or the capital requirement

RG 166.306 If you carry on a business of entering, as principal, into foreign exchange contracts that are financial products in Australia, you must either:

- (a) have \$10 million of Tier 1 capital (defined as if you were an ADI); or
- (b) satisfy the ASLF requirement for transacting with clients as principal in Section D of this guide.

RG 166.307 These requirements do not apply if the counterparty to each foreign exchange contract that you enter into in Australia is:

- (a) an Australian ADI; or
- (b) a person that has a condition in their AFS licence specifically requiring them to have \$10 million of Tier 1 capital.

Note 1: For the definition of 'Tier 1 capital', see APRA's Prudential Standard APS 111 *Capital adequacy: Measurement of capital* (May 2006) and Guidance Note AGN 111.1 *Tier 1 capital* (May 2006).

Note 2: For the definition of 'foreign exchange contract', see 'Key terms'.

Note 3: If the requirement to have \$10 million of Tier 1 capital does not apply to you, the ASLF requirement in Section D may still apply to you.

RG 166.308 You can only take advantage of the options in RG 166.306 if your current liabilities, or contingent liabilities if crystallised, as counted in calculating your adjusted liabilities are under foreign exchange contracts (including foreign exchange contracts that are derivatives).

RG 166.309 If you choose to meet the ASLF requirement in Section D, you must comply with this requirement even if your liabilities plus contingent liabilities are less than \$100,000 (i.e. you cannot take advantage of the exceptions in RG 166.78).

Underlying principles of the two options

RG 166.310 Our policy gives AFS licensees that are foreign exchange dealers the option (so far as is practicable under the Corporations Act) of complying with financial requirements based on the previous policy approach of the Reserve Bank of Australia (RBA). Alternatively, they can choose to meet the ASLF requirement in Section D. These licensees were subject to the RBA's former requirements before FSR commencement (i.e. 11 March 2002). We do not see any basis for requiring such licensees to comply with more onerous financial requirements than those previously applied by the RBA (apart from the base level financial requirements in Section B), if their financial service business is limited to those activities.

RG 166.311 The requirements in this appendix apply to some AFS licensees that enter into foreign exchange contracts, but not to those that merely arrange foreign exchange contracts. For example, the requirements do not apply to licensees that only arrange for buyers and sellers to enter into foreign exchange contracts, where the counterparties are principals to the transaction. However, where the activity involves the licensee taking on the contract as principal, the requirements may apply.

Note: Before FSR commencement (i.e. 11 March 2002), persons who were merely arranging for others to enter foreign exchange contracts were not required by the RBA to be authorised dealers. The RBA also did not require persons who only entered into contracts with authorised foreign exchange dealers to themselves be authorised and therefore they did not have to meet the requirement for \$10 million of Tier 1 capital. We have taken the same approach.

RG 166.312 Consistent with the approach of the RBA before FSR commencement, the requirements in this appendix do not apply to foreign exchange contracts entered into outside Australia.

Appendix 8: Retail OTC derivative issuers

Key points

If you are a retail OTC derivative issuer, you must meet:

- the standard solvency and positive net assets requirement;
- a tailored cash needs requirement;
- a tailored audit requirement; and
- an NTA requirement—including complying with certain reporting triggers—which replaces the ASLF requirement.

What requirements apply?

RG 166.313 If you are a retail OTC derivative issuer, you must meet:

- (a) the standard solvency and positive net assets requirement (see RG 166.32–RG 166.34 in Section B);
- (b) a tailored cash needs requirement (see RG 166.314–RG 166.318);
- (c) a tailored audit requirement (see RG 166.319–RG 166.321);
- (d) an NTA requirement—including complying with certain reporting triggers—which replaces the ASLF requirement (see RG 166.322–RG 166.332); and
- (e) depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

The tailored cash needs requirement

Note: This requirement replaces the standard audit requirement in Section B of this guide.

RG 166.314 As a retail OTC derivative issuer, you must:

- (a) prepare, in each March, June, September and December, a rolling projection of your cash flows over at least the next 12 months based on your reasonable estimate of revenues and expenses over this term;
- (b) have the cash flow projection approved by your board of directors, or other governing body, as being based on your reasonable estimate of revenue and expenses over the period;
- (c) document the calculations and assumptions used in preparing the cash flow projection, and describe in writing why they are appropriate;

- (d) update the cash flow projection if there is reason to suspect an updated projection would show you were not meeting the financial requirements applying to you;
- (e) demonstrate, based on the cash flow projection, that you will have access when needed to enough financial resources to meet your liabilities over the projected term, including any additional liabilities you project may be incurred during that term;
- (f) demonstrate, based on the cash flow projection, that you will have in cash or cash equivalents, at all time to which the projection relates, an amount equal to or greater than the amount you are required to have in cash or cash equivalents under the NTA requirement: see RG 166.322–RG 166.324; and
- (g) make the cash flow projection available to ASIC upon request.

Underlying principles of the tailored cash needs requirement

- RG 166.315 Cash flow projections are an important tool to help ensure that retail OTC derivative issuers can meet anticipated expenses. The requirement for a rolling 12-month cash flow projection that addresses expected operating expenses should, in many cases, result in a higher level of focus and governance around cash flow forecasting and cash planning. We acknowledge that these projections are only as sound as the assumptions on which they are based and the rigour with which they are prepared.
- RG 166.316 For this reason, we think it is important for your directors to review your cash flow projections. We believe that longer cash flow projections can help your directors identify potential cash flow problems at an earlier stage, providing the opportunity to take corrective action.
- RG 166.317 Cash flow projections will also need to be updated when material changes occur to the assumptions on which they are based.
- RG 166.318 We may ask for a copy of your cash flow projections at any time. Projections that are prepared with the requisite detail can help us more fully understand the workings of any issuer in distress.

The tailored audit requirement

Note: This requirement replaces the standard audit requirement in Section B of this guide.

- RG 166.319 All AFS licensees must give us an audit report under s989B(3) for each financial year that includes information about compliance with the financial requirements that apply to you: see Section B. If you do not have to provide

an audit report under s989B(3), you must still give us an audit report about compliance with the financial requirements. You must also give us this information if we request it for a specified period at another time: see s912C(2).

Note: For the form of this compliance report, see s912AB(11) as notionally applying under Class Order [CO 12/752] *Financial requirements for retail OTC derivative investors*.

RG 166.320 As a retail OTC derivative issuer, the information you must include in your audit report reflects the financial requirements that apply to you: see [CO 12/752].

RG 166.321 Your audit report must include statements by a registered company auditor addressed to you and ASIC that, for the relevant period:

- (a) in the auditor's opinion, you:
 - (i) complied with the NTA requirement in RG 166.322–RG 166.324, and any other financial requirements applying to you;
 - (ii) had, at all times, cash flow projections that purported to, and on their face appeared to, comply with RG 166.314; and
 - (iii) correctly calculated the cash flow projections based on the assumptions you based them on; and
- (b) following an examination of the documents you relied on to create your cash flow projections, the auditor has no reason to believe that:
 - (i) you did not satisfy s912A(1)(h) of the Corporations Act for managing the risk of having insufficient funds to meet the NTA requirement in RG 166.322–RG 166.324 and any other financial requirements applying to you;
 - (ii) you failed to:
 - (A) prepare cash flow projections as required;
 - (B) have these projections approved by your board or governing body;
 - (C) document the calculations used in creating the cash flow projections and explain why they are appropriate; and/or
 - (D) update the cash flow projection if there is reason to suspect an updated projection would show you were not meeting the financial requirements applying to you; and
 - (iii) the assumptions you used to create the cash flow projections were inappropriate.

Note: We refer to the auditor statements in paragraph (a) as 'positive assurance' and the statements in paragraph (b) as 'negative assurance'. We expect that when giving negative assurance for the purposes of paragraph (b), the auditor will take into consideration any information from the audit for positive assurance.

The NTA requirement

Note: Retail OTC derivative issuers need not meet the ASLF requirement for transacting with clients as principal in Section D. Instead, you must meet the NTA requirement in RG 166.322–RG 166.324.

- RG 166.322 As a retail OTC derivative issuer, you must have at all times NTA of the greater of:
- (a) \$1,000,000; or
 - (b) 10% of your average revenue.
- RG 166.323 You must have 50% of the required NTA in cash or cash equivalents (excluding any other cash or cash equivalents that are held in respect of any liability or obligation to clients) and 50% in liquid assets.
- RG 166.324 You must report your NTA position, together with detailed working, to ASIC as part of your annual submission of Form FS70 *Australian financial services licensee profit and loss statement and balance sheet* as required under s989B of the Corporations Act.

Definitions for the NTA requirement

- RG 166.325 Definitions for calculating the required NTA for retail OTC derivative issuers are included in Section E: see RG 166.180–RG 166.183. Relevant definitions include:
- (a) average revenue;
 - (b) cash or cash equivalents;
 - (c) eligible provider; and
 - (d) liquid assets.

Underlying principles of the NTA requirement

- RG 166.326 It is important for retail OTC derivative issuers to maintain adequate financial resources to ensure that equity owners have a financial incentive to comply with the Corporations Act and are sufficiently invested in the business to take measures to see that it succeeds.
- RG 166.327 Derivatives businesses are exposed to the risk of financial expense or loss due to operational failures (e.g. information technology system malfunction or documentation errors). You should have an adequate level of financial resources to help cover operational risk.
- RG 166.328 Setting the required level of NTA at the greater of \$1 million or 10% of your average revenue helps ensure that, as your business grows, and your operational risk exposure consequentially increases, you have a corresponding level of financial resources.

- RG 166.329 To ensure that your financial resources can be used effectively to meet unexpected losses and expenses, the required NTA must be held in a highly liquid form. Having 50% of the required NTA in cash or cash equivalents (excluding cash in client segregated accounts or other cash held in respect of any liability or obligation owed to clients) and 50% in liquid assets ensures that you can use these financial resources as and when required.
- RG 166.330 The NTA requirement provides a financial buffer that decreases the risk of a disorderly or non-compliant wind-up if your business fails. The required minimum amount of NTA reflects the contemporary costs of administering the type of financial services business carried on by retail OTC derivative issuers.
- RG 166.331 It also aligns Australia more closely with comparable regimes for retail OTC derivative issuers in Singapore (a minimum requirement of S\$1 million) and the United Kingdom (a minimum requirement of €730,000). While the US Commodity Futures Trading Commission has a much higher minimum requirement (US\$20 million), we believe this amount would be overly onerous.
- RG 166.332 The simpler NTA requirement (rather than the more complex requirements in Section D) means that compliance costs for issuers should be lower and compliance should be easier for ASIC to verify.

What are the reporting triggers?

Notifiable events

- RG 166.333 If you have less than the required NTA, or the amount of NTA you hold decreases from an amount greater than 110% of the required NTA to a lower amount (each being a 'notifiable event' under [CO 12/752]), you must lodge a report with ASIC that specifies your NTA as at the date of the report:
- (a) within 3 business days after becoming aware of the notifiable event; and
 - (b) on the first business day of every month, unless as at the last day of the preceding month your NTA was greater than 110% of the required NTA.

Additional requirements if you have less than the required NTA

- RG 166.334 If you have less than 100% of the required NTA, you will be in breach of your AFS licence conditions. You must replenish your NTA to above 100%. If you do not do this within 2 months of the date the deficiency arose, you

must notify your clients about the deficiency. For the prescribed form of this notification, see Table 14.

- RG 166.335 This notification should be placed prominently on the main page (homepage) of your website and be communicated to each client by email or by letter. If your trading platform allows for electronic alerts or similar, we would also expect you to use this to provide the notification to clients. However, we will not accept ongoing notifications of this type as a means of dealing with an NTA deficiency for any sustained length of time: see RG 166.338–RG 166.339.
- RG 166.336 You must also not enter into any transactions with clients that could give rise to any further liabilities, contingent liabilities or other financial obligations until your board of directors, or other governing body, has certified in writing that, having conducted reasonable inquiries into your financial position, there is no reason to believe that, you may fail to meet any other of your licence conditions or obligations under s912A of the Corporations Act, including the base level financial requirements in Section B of this guide.

Having 75% or less of required NTA

- RG 166.337 If you have 75% or less of the required NTA, you must not under any circumstances enter into any transactions with clients that could give rise to any further liabilities, contingent liabilities or other financial obligations.

What happens if you breach the NTA requirement?

- RG 166.338 If you have less than the required NTA, you will be in breach of your AFS licence obligations. We consider any failure to meet the NTA requirement, or any of the other financial requirements in this guide, should be regarded as a significant breach that is reportable to ASIC under s912D of the Corporations Act. You should also consider whether the breach is a material change or significant event that must be notified to clients in accordance with s1017B of the Corporations Act.

Note: See RG 78 for more information about breach reporting.

- RG 166.339 We may take action against you for a breach of the NTA requirement to protect clients and preserve the fair and efficient operation of financial markets.

Table 14: Prescribed form for notifying your clients of inadequate NTA

[Issuer name]

[Date]

Notification to clients: Inadequate net tangible assets (NTA)

We wish to inform you as our client that we are in breach of the requirement under our Australian financial services (AFS) licence to have NTA of the greater of:

- \$1,000,000; or
- 10% of our average revenue.

We have been in breach of this requirement for over 2 months.

Our NTA as at the date of this notification, [*insert current NTA*], is less than our required NTA of [*insert required NTA*].

Why we are notifying you

As we have had inadequate NTA for over 2 months, we are required by law, as modified by the Australian Securities and Investment Commission (ASIC), to notify our clients of this.

Risks of having inadequate NTA

The purpose of the financial requirements under our AFS licence (including the NTA requirement above) is to help ensure that:

- we have sufficient financial resources to conduct our financial services business in compliance with relevant laws;
- there is a financial buffer that decreases the risk of a disorderly or non-compliant wind-up if our business fails; and
- there are incentives for the owners of our business to comply with their obligations through risk of loss.

Source: ASIC Regulatory Guide 166 *Licensing: Financial requirements* (RG 166).

You should consider the risk of continuing to trade with us, given that we do not have the minimum financial resources required under our AFS licence to carry on the business of a retail OTC derivative issuer.

Underlying principles of the reporting requirements

RG 166.340 The reporting requirements for retail OTC derivative issuers aim to balance:

- (a) the benefits of allowing issuers to use their financial resources to respond to operational incidents and contingencies;
- (b) the importance of ensuring issuers still maintain adequate financial resources to operate a business in compliance with the Corporations Act;
- (c) ensuring clients and ASIC are informed of material, adverse changes to an issuer's financial position; and
- (d) establishing a framework to provide strong incentives to rectify any breach of the NTA requirement in an expeditious manner.

RG 166.341 We understand that AFS licensees may occasionally draw on some of the required NTA to meet unexpected expenses or losses arising from

operational risk. However, this is nevertheless a contravention of the financial requirements that triggers reporting and notification requirements as outlined in RG 166.333–RG 166.336. Meanwhile, the requirement to notify us when your NTA falls from 110% to a lower amount or is less than the required NTA gives us early warning that you may be experiencing financial difficulty. Having this advance knowledge will allow us to monitor and ensure you remain in compliance with your licence conditions.

- RG 166.342 If you draw down too far on your NTA, in breach of the NTA requirement, we want to ensure there are appropriate incentives for you to replenish those funds in a timely manner, as part of your breach rectification process. Accordingly, if you fail to replenish your NTA to 100% of the required NTA within 2 months, you must notify your clients of the deficiency through a prescribed disclosure. This ensures that your clients are informed about your non-compliance with the NTA requirement while you replenish your funds.
- RG 166.343 We also want to ensure that, while you may dip into your NTA in certain circumstances, this action is escalated to the most senior levels of your business so that your ongoing solvency and your ability to comply with your legal obligations is assessed in detail.
- RG 166.344 As a safety net, if your NTA falls to below 75% of the required NTA, you must not under any circumstances enter into any transactions with clients that could give rise to further liabilities, contingent liabilities or other financial obligations.