Alternative Investment Management Association
Australian Branch
[redacted] **– Managing Director Australia**
[redacted]
Aima.org

NTA requirements - Consultation feedback Regulatory Reform and Implementation
Australian Securities and Investments Commission
GPO Box 9827
Melbourne VIC 3001

Delivery by email: rri.consultation@asic.gov.au

Dear ASIC

Response to Consultation Paper 338 Net tangible assets requirement for responsible entities (CP 388)

Background

Responsible entities of registered schemes must comply with specified NTA requirement as part of satisfying their obligation to have available adequate resources (including financial, technological and human resources) to provide the financial services covered by their Australian financial service licence (AFSL) and carry out supervisory arrangements (refer to section 912A(1)(d) of the *Corporations Act 2001* (Cth) (**Corporations Act**).

We set out below our general observations to CP 388. Our more detailed response to each proposal raised in CP 388 is set out in **Annexure A** to this letter.

General observations

We support the principle that NTA requirements ought to be periodically reviewed and we suggest every 10 years or so is a sensible timeframe. The current regulatory framework provides ASIC with this opportunity for review as the detailed financial requirements are set through legislative instruments via modification powers set out in the Corporations Act rather than being hardwired into more permanent legislation. This flexibility enables review and change where warranted. However, we note ASIC's opening comments in CP 388 that you seek feedback on current NTA requirements for responsible entities (and similar requirements that apply to other fund managers) *in light of recent scheme collapses*. It is important to note here that the purpose of the NTA requirement is to ensure that responsible entities are of sufficient financial substance to ensure they can carry out their fiduciary and ongoing legal and operational duties as they hold and protect the money of others, particularly during times of stress. As ASIC acknowledges in CP 388, the financial requirements for responsible entities are **not** intended to address market or credit risks, or to prevent entities from becoming insolvent or failing. Importantly, they are also not designed to compensate clients for unexpected losses.

The recent *Shield* and *First Guardian* failures, and almost 15 years before that *Trio Capital*, would not have been prevented by different NTA requirements. While investigations into the Shield and First Guardian failures are in their early stages, publicly available information suggests poor governance and improper conduct underly the collapses rather than deficiencies in NTA. It follows that review of the NTA requirements applicable to responsible entities should more closely align with the objectives of the requirements (that is, ensuring financial resilience of responsible entities so they may carry out their fiduciary and ongoing legal and operational duties as they hold and protect the money of others). Any change in financial requirements should be clearly supported by evidence that incremental capital held materially improves investor protection outcomes. CP 388 does not provide any insight into whether current NTA requirements operate as intended or identify clear gaps or deficiencies in intended policy objectives.

Increase to NTA operating as a barrier to entry

Currently there are only a handful of responsible entities operating in the Australian market, some of whom have been caught up in Shield and First Guardian.

We think it is important that our members have a wide choice of responsible entities or even the option to operate as their own responsible entity if they so select (which was the intention of the responsible entity structure when introduced).

The practical reality is that increases to NTA could act as a barrier to our members from providing funds to retail clients (as defined in *the Corporations Act 2001* (Cth)). A response resulting in sharp increases in base capital requirement could have unintended consequences, including raising barriers to entry for new responsible entities or investment managers, in both cases wishing to make their products available to retail clients. This could have the unintended outcome of reducing choice to consumers and increasing focus on wholesale markets. For that reason, we do not support a substantial increase to the current NTA test.

<u>About AIMA</u>

AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 2,000 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2.5 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. In addition, AIMA has over 150 local based corporate members including managers and key service providers. For further information, please visit AIMA's website, www.aima.org. AIMA's affiliate association, The Alterative Credit Council (ACC) deals specifically with non-bank and private credit.

Should you wish to discuss any aspect of this submission, please contact:

[redacted]
Managing Director
Head of Australia
AIMA Australia
AIMA email: [redacted]

Yours faithfully

[redacted], Managing Director, AIMA Australia National Group.

Encl

Annexure A | Response to CP 388 proposals

<table>
<tr><th>Proposal</th><th>Requested Feedback</th><th>Response</th></tr>
<tr><td rowspan="3">B1 Under Option 1, we would increase the financial thresholds in the NTA requirement for responsible entities to reflect cumulative CPI growth since 2013. This would (in approximate terms) raise the:
a) $150,000 NTA minimum to $200,000;
b) $500,000 NTA minimum to $700,000;
Note: The $500,000 NTA minimum forms part of the concessional NTA requirement for responsible entities that hold Tier $500,000 class assets (see Section C).
c) $5 million cap that applies to the average value of fund assets limb of the concessional NTA requirement to $6.9 million; and
d) $10 million NTA minimum to $13.8 million.</td><td>B1Q1 Please provide your feedback on this option, including reasons in support of your views.</td><td>We do not support adjustment to the financial requirements based on CPI. Instead, we think a more robust review of the purpose of the NTA requirements and what they are designed to achieve ought to occur (that is, ensuring financial resilience of responsible entities so they may carry out their fiduciary and ongoing legal and operational duties as they hold and protect the money of others). An evidenced based approach to what level of financial requirements is required to address this purpose should be undertaken.
We acknowledge the current financial requirements were set in 2013 (some 13 years ago). We consider it more appropriate to fully review the current requirements, and whether they operate as intended and service the relevant policy objectives, than simply apply a CPI adjustment.
Further, we note that changes to the $10m NTA minimum may further reduce competition in the custodian market. There are currently relatively few custodians operating in the Australian market place and lack of services to small funds was identified as an issue in ASIC REP702 (3.2.3.2).</td></tr>
<tr><td>B1Q2 Do you agree that applying a CPI-linked increase to the financial thresholds specified in the NTA requirement is appropriate to support the objectives of the NTA requirement? If not, why not?</td><td>As above.</td></tr>
<tr><td>B1Q3 Are there alternative measures to CPI that you consider more appropriate for this purpose? Please provide details.</td><td>Periodic review of NTA requirements (every 10 years or so) will achieve greater alignment with the true objectives of financial requirements and the risks they intend to mitigate, and setting the appropriate thresholds, than mechanical CPI adjustment. A 10 year timeframe should provide a sufficient period to take an evidenced based approach to considering the risks the NTA requirements are designed to mitigate and whether they are working as intended.</td></tr>
</table>

Proposal	Requested Feedback	Response
		As referred to in our opening comments, the recent *Shield* and *First Guardian* failures, and before that *Trio Capital*, would not have been prevented by different NTA requirements. While investigations into the Shield and First Guardian failures are in their early stages, publicly available information suggests poor governance and improper conduct underly the issues rather than deficiencies in NTA. It follows that review of the NTA requirements applicable to responsible entities should more closely align with the objectives of the requirements (that is, ensuring financial resilience of responsible entities so they may carry out their fiduciary and ongoing legal and operational duties as a fiduciary for other peoplesmoney). Any change in financial requirements should be clearly supported by evidence that incremental capital held materially improves investor protection outcomes. Mechanical CPI adjustments do not achieve this outcome.
	B1Q4 For existing responsible entities, what effect would this option have on your business (including the amount of capital you hold and compliance costs)? Is this proposal likely to affect fees for scheme members? Please provide specific details and dollar estimates.	The proposed one-off CPI adjustment will have minimal impact on the business of many existing responsible entities. In particular, the minimum NTA uplift proposed to the \$150,000 and \$500,000 threshold will be negligible. The uplift to \$5 million and \$10 million respectively will be marginally more relevant. It is difficult to determine if these uplifts will have material impact on fees for scheme members. They would, however, potentially increase the barriers to entry for new entrants in the responsible entity market.
	B1Q5 Would it be appropriate for ASIC to introduce an ongoing indexation mechanism (e.g. periodic CPI adjustment) for increasing the financial thresholds in the NTA requirement? Why or why not?	No. For the reasons stated above, we support periodic review of NTA requirements (every 10 years or so) rather than ongoing CPI adjustment. Further, tracking annual CPI adjustment may be more complicated in cash flow forecasting. This mechanism also runs contrary to the notion that it is possible that NTA requirements ought to decrease at a

Proposal	Requested Feedback	Response
		point in time if evidence suggests that responsible entities do not require additional financial requirements.
	B1Q6 What impact will this proposal have on competition?	As above, this would have minimal impact on incumbent responsible entities but may potentially increase the barriers to entry for new entrants in the responsible entity market.
	B1Q7 Do you see any practical difficulties with this approach? If so, please provide details.	Tracking annual CPI adjustment may be more complicated in cash flow forecasting and financial reporting.
B2 Under Option 2, we would increase the $150,000 minimum for responsible entities under the concessional NTA requirement: a) to a higher fixed dollar amount of up to $1 million; or b) by applying this limb of the NTA formula on a per scheme basis, so a responsible entity must hold minimum NTA of the greater of: i. $150,000 per scheme operated; ii. 0.5% of the average value of fund assets (up to $5 million); or iii. 10% of average revenue.	B2Q1 Please provide your feedback on this option, including reasons in support of your views.	Although uplifting the $150,000 minimum to say $1 million would have minimal impact as most existing responsible entities with viable businesses already hold in excess of $1 million in NTA, we consider this higher minimum may serve as a barrier to entry for new entrants or investment managers who may wish to act as their own responsible entities, given the relatively few number of responsible entities in market. The end outcome is less choice for retail clients and fewer retail funds.
	B2Q2 Do you prefer proposal B2(a) or B2(b)? Please provide reasons.	We prefer proposal B2(a) subject to our comments. As noted above, uplifting the $150,000 minimum to say $1 million would have minimal impact as most responsible entities with viable businesses already hold in excess of $1 million in NTA. Further, we consider this higher minimum may serve as a positive barrier to entry. In so far as proposal B2(b) is concerned, it is unclear to us whether it is just the $150,000 minimum that applies on a per scheme basis or if the intention is that the 0.5% and the 10% of average revenue also be applied on a per scheme basis. From the commentary in CP 388, we assume the intention is that it is just the $150,000 that applies on a per scheme basis. Either way, we do not support proposal B2(b) that this limb of the NTA apply on a per scheme basis.

Proposal	Requested Feedback	Response
		CP 388 provides that a rationale for this change is to promote commitment to the viability of each scheme as well as to assist with the orderly wind up of all schemes if the responsible entity fails. The operating costs for schemes are typically met out of the costs of the scheme itself or, if the scheme is subscale, out of the resources of the responsible entity or third-party investment manager appointed to manage the assets of the scheme. NTA is not used to underpin the operating costs of a scheme. When assessing the financial viability of a scheme from the outset, good responsible entities engage in significant due diligence to assess the estimated initial set setup costs and ongoing costs associated with the scheme over its intended life. This involves a careful analysis of the scheme's investment strategy and objective, design and distribution intentions, service providers and general market conditions. These costs vary depending on many factors and an arbitrary and static $150,000 threshold may bear no resemblance to the initial and ongoing costs actually involved on a per scheme basis. For most funds, in particular liquid schemes, the wind up costs per scheme are significantly less than $150,000. We query what evidence ASIC has to suggest that on average the costs of termination and wind up are $150,000 per scheme. In any event, the wind up costs of schemes are typically met out of the scheme assets and NTA is not used for this purpose. There is therefore a disconnect between the level of NTA required to be held on a per scheme basis and the risks the thresholds are intending to mitigate. Further, if a 'per scheme' model was adopted (which we do not support), the model may be circumvented via use of multi class attribution managed investment schemes or other structures. So the proposed model may be flawed in any event.

Proposal	Requested Feedback	Response
	B2Q3 If we adopt proposal B2(a), what should the fixed amount be? What is the basis for this?	We suggest a lower amount of $0.25m is a sensible threshold and appears broadly in line with international standards. .
	B2Q4 Do you agree that this proposal is appropriate to support the objectives of the NTA requirement? If not, why not?	For the reasons stated at B2Q2 above, we do not consider proposal B2(b) supports the policy objectives of the NTA requirements.
	B2Q5 For existing responsible entities, what effect would this proposal have on your business (including the amount of capital you hold and compliance costs)? Is this proposal likely to affect fees for scheme members? Please provide specific details and dollar estimates.	As noted above, the impact of proposal B2(a) and uplifting the $150,000 minimum to say $250,000 would have minimal impact as most responsible entities with viable businesses already hold this amount of capital. The impact of proposal B2(b) is potentially more significant for larger responsible entities in particular. If a responsible entity operates say 35 registered schemes, then at a minimum their NTA will be $5,250,000. In this scenario, given the “greater of” language in the proposal B2(b), the responsible entity would need to hold the greater of $5,250,000 (as limb (ii) will not apply given the cap if $5 million) and 10% of average revenue.
	B2Q6 What effect will this proposal have on competition?	As above. The proposal potentially impacts the larger responsible entities more with +100 schemes.
	B2Q7 Do you see any practical difficulties with this approach? If so, please provide details.	As noted above, we still consider there to be misalignment between the $150,000 cost estimate to establish and operate a relatively simply and liquid scheme and/or terminate and wind up a relatively simply and liquid scheme. If an in-principle decision is made by ASIC to apply this cost on a per scheme basis is made (which we don’t support), then a more accurate and evidenced based approach to the actual / likely costs incurred on a per scheme basis needs to be undertaken. Perhaps a distinction needs to be drawn between simple and complex schemes and a higher level applies to more complex

Proposal	Requested Feedback	Response
		schemes were costs to establish, operate and wind up are clearly demonstrable.
B3 Under Option 3, we would increase the current $5 million cap on the average value of fund assets limb of the concessional NTA requirement to a higher dollar amount. Currently, the calculation is 0.5% of the average value of fund assets, capped at $5 million.	B3Q1 Please provide your feedback on this option, including reasons in support of your views.	We do not support Option 3. As noted above, review of the NTA requirements applicable to responsible entities should more closely align with the objectives of the requirements (that is, ensuring financial resilience of responsible entities so they may carry out their fiduciary and ongoing legal and operational duties as they act as a fiduciary in respect of other peoples money). Any change in financial requirements should be clearly supported by evidence that incremental capital held materially improves investor protection outcomes. ASIC has not provided any commentary or evidence to suggest that increasing the $5 million cap will enhance the policy objectives of the NTA requirements. If the 10% of average revenue limb remains, we consider increasing the $5 million cap will be largely irrelevant as medium to larger sized responsible entities already exceed the $5 million cap and hold NTA referable to 10% of average revenue.
	B3Q2 If we adopt this proposal, what do you think the new cap should be? What is the basis for this?	No comment.
	B3Q3 Do you agree that this proposal is appropriate to support the objectives of the NTA requirement? If not, why not?	As noted above, if the 10% of average revenue limb remains, we consider increasing the $5 million cap will be largely irrelevant as medium to larger sized responsible entities already exceed the $5 million cap and hold NTA referable to 10% of average revenue.
	B3Q4 For existing responsible entities, what effect would this proposal have on your business (including the amount of capital you hold and compliance costs)? Is this proposal likely to affect fees for scheme members?	As above, the impact is likely negligible for medium to larger sized responsible entities.

Proposal	Requested Feedback	Response
	Please provide specific details and dollar estimates.	
	B3Q5 What effect will this proposal have on competition?	Minimal.
	B3Q6 Do you see any practical difficulties with this approach? If so, please provide details.	As above.
B4 We are not making a formal proposal, but we seek your feedback on questions B4Q1–B4Q3.	B4Q1 Do you consider the cash or cash equivalents and liquid assets requirements imposed on responsible entities remain appropriate? Please provide specific details and reasons.	As above, we consider the purpose of the NTA requirement is to ensure that responsible entities are of sufficient financial substance to ensure they can carry out their fiduciary and ongoing legal and operational duties as they act as a fiduciary in respect of other peoples money, particularly during times of stress. The nature of holding cash or cash equivalents and liquid assets goes to ease of recourse/access in the event the relevant responsible entity suffers a failure. We consider that the cash or cash equivalents and liquid assets requirements imposed on responsible entities remain appropriate and are aligned with the objectives of the requirements.
	B4Q2 If we adopt Option 1 (proposal B1), should we increase the cash or cash equivalents minimum requirement (currently, $150,000) to reflect cumulative CPI growth since 2013?	See comments above. We do not support increases based on CPI. Instead we support periodic review of NTA requirements (every 10 years or so) rather than CPI adjustment.
	B4Q3 If we adopt Option 2 (proposal B2) or Option 3 (proposal B3), should we make any changes to the cash or cash equivalents or liquid assets requirements? Please provide specific details and reasons.	We consider that the cash or cash equivalents and liquid assets requirements imposed on responsible entities remain appropriate and are aligned with the objectives of the requirements. Some members have experienced difficulty at times with using bank guarantees to support the cash or cash equivalents tests with ASIC being unclear internally on

Proposal	Requested Feedback	Response
		what it considers to be acceptable terms for a guarantee. This can slow down AFSL applications / variations when ASIC seeks to review guarantee terms.
	B4Q4 Should we continue to calculate the cash or cash equivalents and liquid assets requirements as a proportion of the NTA the responsible entity is required to hold, or should we use an alternative formula or approach? Please provide specific details and reasons.	As above, we are broadly comfortable with the existing requirements and do not support change here.
B5 If we adopt any of proposals B1–B4, we propose that a transition period of six months would apply.	B5Q1 Do you agree that we should provide a transition period if we decide to adopt one or more of proposals B1–B4?	Yes.
	B5Q2 Do you agree with the transition period being six months? If not, why not?	No, six months should be a minimum, with 18 months more likely appropriate. It will take some time for responsible entities to go into the capital and other markets to source and secure relevant funding in order to meet any changed NTA requirements. If the requirements are imposed in too short a timeframe, this risks creating an adverse impact in those markets, including lack of supply and increased cost of funding.
B6 We are not making a formal proposal, but we seek your feedback on questions B6Q1–B6Q2	B6Q1 Do you consider that there are alternative approaches to increasing the NTA requirement that are preferable? Please provide details.	As noted earlier, any change in financial requirements should be clearly supported by evidence that incremental capital held materially improves investor protection outcomes. CP 388 does not provide any insight into whether current NTA requirements operate as intended or identify clear gaps or deficiencies in intended policy objectives. Without the evidence, it is difficult to provide any meaningful comment here.
	B6Q2 Other than the objectives described in paragraph 6, are there other factors that we should consider when setting the NTA requirement for responsible entities (noting	We agree with the objectives in paragraph 6 of CP 388. Importantly, ASIC must not lose sight of the fact that the NTA requirements are not (and should not be) designed to compensate clients for unexpected losses.

Proposal	Requested Feedback	Response
	that the focus of the requirement is on ensuring responsible entities have adequate financial resources under s912A(1)(d) of the Corporations Act)?	
C1 We are not making a formal proposal, but we seek your feedback on questions C1Q1–C1Q2.	C1Q1 Do you consider that responsible entities should continue to be subject to a concessional NTA requirement if they meet the requirements relating to custody or fund assets described in paragraphs 29–31? Please give reasons.	Yes, these concessional NTA requirements remain appropriate structurally and are well understood in the market. As referred to in our opening comments, the recent *Shield* and *First Guardian* failures, and before that Trio Capital, would not have been prevented by different NTA requirements, including altering the concessional NTA requirement.
	C1Q2 Are there any aspects of the concessional NTA requirement that you think we should change? If so, please provide details about what you think should be changed and your preliminary views about how the change could be achieved.	The definition of “special custody assets” is at times hard to work through. The list of assets considered to be “special custody assets” should be reviewed to ensure it remains robust and relevant in light of funds in the market place and new asset classes growing in popularity. It is also not clear why registered scheme enjoy the benefit of concessional NTA requirements, and the application of Tier $500,000 assets and special custody assets, but unregistered schemes have no similar exemptions.
D1 If we adopt any of the proposals to increase the NTA requirement for responsible entities (see Section B), we propose to apply: a) the same increased NTA requirements to IDPS operators and corporate directors of retail CCIVs; and b) any changes made to the liquidity component (see proposal B4) and the concessional NTA requirement (see proposal C1) for responsible entities	D1Q1 Do you agree with this approach? If not, why not? D1Q2 Do you see any practical difficulties with this approach? If so, please provide details. D1Q3 For existing fund operators, if we adopt this approach, what impact would this have on your business (including the amount of capital you hold and compliance costs)? Is this proposal likely to affect fees for your clients? Please provide specific details and dollar estimates.	We support continued alignment between registered schemes and retail CCIVs and there should not be a regulatory arbitrage favouring one vehicle over another. We make no comment on the NTA requirements applicable to IDPS as we consider these to be different services and products compared to a registered scheme and a separate NTA requirement ought apply.
	D1Q1 Do you agree with this approach? If not, why not?	As above.

Proposal	Requested Feedback	Response
to IDPS operators and corporate directors.	D1Q3 For existing fund operators, if we adopt this approach, what impact would this have on your business (including the amount of capital you hold and compliance costs)? Is this proposal likely to affect fees for your clients? Please provide specific details and dollar estimates.	No comment.
D2 We are not making a formal proposal, but we seek your feedback on questions D2Q1–D2Q3.	D2Q1 Given the alignment between the existing NTA requirements for responsible entities and licensed custodial or depository service providers, should we conduct a review and consult on increasing the NTA requirement for licensed custodial or depository service providers?	As above, we make no comment on the NTA requirements applicable to custodial or depository service providers as we consider these to be different services compared to a registered scheme and a separate NTA requirement ought apply.
	D2Q2 Do you consider that we should conduct a review and consult on increasing (or otherwise amending) any of the requirements that apply to other AFS licensees outlined in Table 1? Please give reasons why or why not.	As above, we make no comment on the NTA requirements applicable to other product issuers and service providers as we consider these to be different services compared to a registered scheme and a separate NTA requirement ought apply. For completeness we note ASIC is currently consulting on *ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968* and we presume the financial requirements applicable to MDA services will be considered. It makes sense that the review into MDA services take into account the feedback to CP 388 as relevant to MDA services.
	D2Q3 If we were to increase any of the requirements in Table 1, what are your preliminary views on the approach we should adopt to increasing the requirement (noting the approaches we have proposed for responsible entities in Section B)?	No comment.

Proposal	Requested Feedback	Response
D3 We are not making a formal proposal, but we seek your feedback to question D3Q1.	D3Q1 Should we impose an NTA requirement on other categories of AFS licensees or should we maintain the status quo? Please give reasons.	No comment.