



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 114

Client money relating to dealing in OTC derivatives

August 2009

About this paper

This consultation paper seeks feedback from financial services licensees and their clients on our proposed guidance on the client money provisions and how we expect financial services licensees to comply with these provisions in the context of dealings in OTC derivatives.

It seeks comments on specific issues and the draft regulatory guide.

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 paper was issued on 7 August 2009 and is based on the Corporations Act as at 7 August 2009.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

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The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information.

We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our policy on the client money provisions. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Business Cost Calculator report and/or a Regulation Impact Statement: see Section C, 'Regulatory and financial impact'.

Making a submission

We will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by 18 September 2009 to:

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What will happen next?

Stage 1	7 August 2009	ASIC consultation paper released
Stage 2	18 September 2009	Comments due on the consultation paper
Stage 3		Finalisation of regulatory guide

A Background

- 1 In recent times, retail investors have become increasingly involved in trading in over-the-counter derivatives (OTC derivatives) on a margin basis. As part of this trading, retail investors pay money to financial services licensees (e.g. brokers) who they engage to trade derivatives on their behalf (e.g. to cover the margin or hold as free equity).
- 2 The *Corporations Act 2001* (Corporations Act) contains a regime that financial services licensees must comply with when holding this money (the client money provisions). These provisions seek to ensure that client money is held separately from the licensee's own money and is only used as permitted under the client money provisions.
- 3 We are concerned that retail investors are not fully aware of the risks to which they are exposed when paying client money to a licensee. Licensees could provide better disclosure of these risks.
- 4 We are also concerned as to whether financial services licensees are fully aware of their obligations under the provisions, particularly relating to uses of client money and the limitations as to what money can be retained in a client money account.

The need for guidance

- 5 The client money provisions, as they apply to dealings in OTC derivatives, expose clients of a financial services licensee to the risk that they may not receive all of their client money back. This can be referred to as counterparty risk. ASIC is concerned to ensure that retail investors considering trading in OTC derivatives are fully aware of the risks associated with that trading and that financial services licensees properly disclose that risk.
- 6 ASIC has therefore produced a draft regulatory guide (draft guide) that sets out in greater detail our views on the operation of the client money provisions, in the context of dealings in OTC derivatives, and specific actions that licensees should take to ensure they fully comply with the provisions and properly inform their clients of the risks to which they are exposed: see Appendix.

Aims and objectives of client money guidance

- 7 ASIC believes that issuing this guidance will:
- improve financial services licensees' compliance with the client money provisions,
 - improve financial services licensees' disclosure of the risks that a client is exposed to by virtue of the client money provisions, and
 - improve the awareness of investors of how a financial services licensee handles a client's money and the risks that a client bears.

B Scope of the draft guide

Key points

The client money provisions in the Corporations Act require a financial services licensee to treat certain money received from clients as client money by:

- holding it separate from the licensee's money in a client money account;
- requiring that the licensee use and withdraw money from the client money account as provided for in the client money provisions.

Clients are exposed to the risk that they may not receive all of their client money back despite the protections in the Corporations Act.

What is client money?

- 8 Client money is money paid to a financial services licensee:
- in connection with either a financial service that has been provided (or that will or may be provided) to a client or a financial product held by a client; and
 - by a client or a person acting on behalf of a client or to the licensee in the licensee's capacity as a person acting on behalf of the client.
- 9 Client money does not relate to all money paid by, or on behalf of, a client to a financial services licensee.

What can be included in a client money account?

- 10 The client money provisions limit the money that can be included in a client money account (see Section C of the draft guide).
- 11 We consider that the client money provisions have the effect that a licensee cannot keep its own money in a client money account. This follows directly from the provisions prescribing the money that can be deposited into a client money account.

Your feedback

B1Q1 Do you agree with our guidance as to the money which may be deposited and retained in a client money account? If not, what money do you consider can be retained in a client money account?

B1Q2 Are 'buffers' used in client money accounts?

- B1Q3 Is there any aspect of our suggested guidance on buffers that you consider would present difficulties for your business? If so, how?
- B1Q4 Can you foresee any additional costs associated with following the suggested guidance? If so, what will they be?

Uses of client money

- 12 Section D of the draft guide contains ASIC's views on how a financial services licensee may use client money.
- 13 The draft guide sets out our view that a financial services licensee should not, irrespective of the terms of its contract with a client, withdraw any money from a client money account for its own purposes.

Your feedback

- B1Q5 Do you agree with our guidance as to the permitted uses of client money?
- B1Q6 Is there any aspect of our suggested guidance on use of client money that you consider would present difficulties for your business? If so, how?
- B1Q7 Can you foresee any additional costs associated with following the suggested guidance? If so, what will they be?

General

Your feedback

- B1Q8 Do you agree with our interpretation of the client money provisions as set out in the draft guide? If not, please describe how you interpret the provisions.
- B1Q9 Do you think we should deal with any other aspect of the client money provisions? If yes, please detail.

C Regulatory and financial impact

- 14 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us we think they will strike an appropriate balance between:
- (a) ensuring that retail investors are fully informed as to how their client money is held and used by a financial services licensee; and
 - (b) allowing a financial services licensee to conduct its business without undue regulation.
- 15 Before settling on a final policy, we will comply with the requirements of the Office of Best Practice Regulation (OBPR) by:
- (a) considering all feasible options;
 - (b) if regulatory options are under consideration, undertaking a preliminary assessment of the impacts of the options on business and individuals or the economy;
 - (c) if our proposed option has more than low impact on business and individuals or the economy, consulting with OBPR to determine the appropriate level of regulatory analysis; and
 - (d) conducting the appropriate level of regulatory analysis, that is, completing a Business Cost Calculator report (BCC report) and/or a Regulation Impact Statement (RIS).
- 16 All BCC reports and RISs are submitted to the OBPR for approval before we make any final decision. Without an approved BCC report and/or RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.
- 17 To ensure that we are in a position to properly complete any required BCC report or RIS, we ask you to provide us with as much information as you can about:
- (a) the likely compliance costs;
 - (b) the likely effect on competition; and
 - (c) other impacts, costs and benefits,
- of our proposals or any alternative approaches: see ‘The consultation process’ p. 4.



ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 000

Client money relating to dealing in OTC derivatives

August 2009

About this guide

This is a guide for financial services licensees who are required to hold client money and for investors who pay money to a financial services licensee for the purpose of trading in derivatives in the over-the-counter (OTC) market.

This guide provides an overview of the client money provisions in Div 2 of Pt 7.8 of the *Corporations Act 2001* (Cth) (the client money provisions) generally and, in particular, the specific provisions that relate to derivatives.

DRAFT

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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 on 5 August 2009 and is based on legislation and regulations as at 5 August 2009.

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

In complying with the client money provisions, a financial services licensee must:

- identify what client money is (see RG 000.2–RG 000.3);
- ensure that client money, and no other money, is paid into a client money account (see RG 000.4–RG 000.7);
- only use and withdraw client money as provided for in the client money provisions and properly inform clients about the risks associated with that use (see RG 000.8–RG 000.12).

Clients are exposed to counterparty risks notwithstanding these protections: see RG000.13–RG 000.17.

ASIC may take action if it becomes aware that a financial services licensee has failed to comply with the client money provisions: see RG 000.19.

- RG 000.1 The client money provisions protect the interests of clients of financial services licensees by:
- (a) separating client money from money belonging to the licensee;
 - (b) generally requiring that licensees hold client money on trust;
 - (c) limiting the uses of client money;
 - (d) limiting the circumstances in which client money may be withdrawn from client money accounts;
 - (e) specifying how client money may be dealt with if a licensee ceases to be licensed or becomes insolvent;
 - (f) requiring auditors to verify the licensee's compliance with the client money provisions; and
 - (g) imposing sanctions on licensees who fail to comply with the client money provisions.

What is client money?

- RG 000.2 Client money is money paid to a financial services licensee:
- (a) in connection with either a financial service that has been provided (or that will or may be provided) to a client or a financial product held by a client; and

- (b) by a client or a person acting on behalf of a client or to the licensee in the licensee's capacity as a person acting on behalf of the client.

Note: Client money can also include subscription money received from a client for a product to be issued. This regulatory guide does not deal with receipt of subscription money.

RG 000.3 The client money provisions do not apply to:

- (a) money paid as remuneration payable to the licensee;
- (b) money paid to reimburse (or discharge a liability incurred by) the licensee for payment made to acquire a financial product;
- (c) money paid to acquire a financial product from the licensee; or
- (d) loan money; or
- (e) money paid to be credited to a deposit product.

Note: See Section B for further information.

What is a client money account?

RG 000.4 A client money account must be designated as a client money account for the purposes of s981B of the Corporations Act and is:

- (a) an account with an Australian ADI;
- (b) an account with an approved foreign bank;
- (c) a cash management trust; or
- (d) a cash common fund.

Note: See Section C for further information.

RG 000.5 Generally a client money account is operated as a trust account. However, if a licensee is required to call margins from a client under the operating rules of a licensed financial market or a clearing or settlement facility, the licensee may operate the client money account as either a clients' segregated account or a trust account. In either case, the account is subject to the statutory protections on use, withdrawals and distribution of client money in the event of the licensee's insolvency or ceasing to carry on business. In this regulatory guide, we use the term 'client money account' generally, irrespective of whether it is operated as a trust account or a clients' segregated account.

Note: See Section C for further information.

Permitted deposits into client money accounts

RG 000.6 The licensee may only pay the following money into a client money account:

- (a) client money;
- (b) interest on client money;
- (c) interest on permitted investments using client money or the realisation of permitted investments; or
- (d) certain other matters specified by the regulations.

RG 000.7 The client money provisions do not permit licensees to deposit their own funds into client money accounts.

Note: See Section C for further information.

Permitted investments of client money

RG 000.8 Client money may be invested in certain permitted investments, including:

- (a) investment in a way that trustees are for the time being authorised by law to invest trust funds;
- (b) investment on deposit with an Australian ADI or eligible money market dealer; and
- (c) investment in a security issued or guaranteed by the Commonwealth or a state or territory.

RG 000.9 Generally a licensee may only invest client money in a permitted investment where the licensee has obtained the client's written agreement about how the earnings or losses on the investment are to be dealt with and how the investment is to be realised.

Note: See Section D for further information.

Permitted uses of, and withdrawals from, client money accounts

RG 000.10 A licensee may make the following payments out of a client money account:

- (a) making a payment to, or in accordance with the written direction of, a person entitled to the money;
- (b) defraying brokerage and other proper charges;
- (c) paying to the licensee money to which the licensee is entitled; and
- (d) making a payment that is otherwise authorised by law or pursuant to the operating rules of a licensed financial market.

- RG 000.11 A licensee must ensure that it complies with its obligations as a financial services licensee when making any withdrawals from a client money account: see RG 000.49.
- RG 000.12 In addition to these payments, specific rules apply for dealings in derivatives. A financial services licensee may use client money to meet obligations incurred by the licensee in connection with margining, guaranteeing, securing, transferring, adjusting or settling dealings in derivatives by the licensee, including dealings on behalf of people other than the client: see s981D.

Counterparty risks

- RG 000.13 Even though the client money account is a separate account subject to a statutory trust, clients are exposed to counterparty risk with respect to client money. That is, the risk that in the event of the failure of another client or the licensee, a client will not receive all of their client money back. This arises because:
- (a) the licensee is permitted to use client money to meet obligations incurred by the licensee in connection with margining, guaranteeing, securing, transferring, adjusting or settling dealings in derivatives by the licensee, including dealings on behalf of people other than the client; and
 - (b) the licensee may make a payment out of client money if it has obtained a written direction from the person entitled to the money – customer contracts of many financial services licensees dealing in derivatives may contain a broad authorisation from clients for the licensee to make withdrawals from client money for any purpose whatsoever.

Note: See Section D for further information.

- RG 000.14 Before depositing client money with a licensee, clients need to assess the risks that arise with client moneys being used when trading in derivatives. Licensees, after considering any risk for clients could advise clients that they are able to:
- (a) ask for details of the licensee's policies about use of client money (e.g. when will one client's client money be used to meet the obligations arising from trading of another client); and
 - (b) minimise this risk by keeping the minimum client money with a licensee to reduce their exposure.
- RG 000.15 We consider that licensees need to clearly and prominently disclose in Product Disclosure Statements (PDSs) the nature of the counterparty risk for client money used for derivatives. Licensees need to carefully assess what

information should be included in the PDS, and other disclosures given to clients, to allow potential clients to properly evaluate and quantify the nature of the risk, if any, to client money. This could include financial information of the licensee, so that a potential client can adequately quantify the licensee's solvency.

Other issues

- RG 000.16 A licensee must keep financial records in sufficient detail to explain all money received or paid by the licensee in relation to the client money accounts it holds.
- RG 000.17 The auditor's report accompanying the licensee's financial statements must contain a statement of the auditor's opinion of the licensee's compliance with the client money provisions.
- RG 000.18 The Corporations Act provides for how client money is to be dealt with if a licensee ceases to be licensed or becomes insolvent.

Note: See Section E for further information

ASIC's role

- RG 000.19 If we become aware that a licensee has not complied with the client money provisions, we may take appropriate action by:
- (a) requiring the licensee to take remedial action;
 - (b) taking civil or criminal action in the courts against the licensee; or
 - (c) taking administrative action against the licensee, such as imposing additional licence conditions.

Note: See Section E for further information

B Identifying client money

Key points

Client money is defined in s981A of the Corporations Act: see RG 000.20.

The client money provisions do not apply to all money received by a licensee from a client: see RG 000.22.

What is client money?

- RG 000.20 Client money is money paid to a financial services licensee:
- (a) in connection with either a financial service that has been provided (or that will or may be provided) to a client or a financial product held by a client; and
 - (b) by a client or a person acting on behalf of a client or to the licensee in the licensee's capacity as a person acting on behalf of the client.

Note: See s981A.

- RG 000.21 If a licensee, as an issuer or seller of financial products, receives money for the issue or purchase of a financial product and the issue or purchase does not occur immediately after receiving the money and the licensee deposits it into a client money account, then that money is also client money: s1017E and 981B(1)(b)(iv) and regs 7.8.01(6) and (7).

What is not client money?

- RG 000.22 The client money provisions do not apply to:
- (a) money paid by way of remuneration payable to the licensee;
 - (b) money paid to reimburse (or discharge a liability incurred by) the financial services licensee for payment made to acquire a financial product (or to indemnify the licensee in respect of such a liability);
 - (c) money paid to acquire a financial product or an increased interest in a financial product from the licensee;
 - (d) loan money;
- Note: Loan money is defined in s982A and the provisions relating to loan money are contained in Subdivision B of Div 2 of Pt 7.8.
- (e) money deposited to the credit of a deposit product with the licensee; or

- (f) property other than money (for example, share certificates).

Note: Div 3 of Pt 7.8 deals with other property given to a licensee by clients in connection with a financial service or financial product.

C Client money accounts

Key points

Client money accounts are generally trust accounts but can be operated as a clients' segregated account in certain circumstances: see RG 000.26.

Client money accounts must be designated as such and only certain money may be paid into them: see RG 000.30.

Licencees are not permitted to deposit their own funds into a client money account: see RG 000.38–RG 000.39.

Licencees are entitled to the interest on money in a client money account provided this is disclosed to the client: see RG 000.40–RG 000.41.

What is a client money account?

RG 000.23 A client money account is an account maintained by a licensee into which client money is paid. It may consist of a single account or two or more accounts: s981B(2).

RG 000.24 A client money account must be established as one of the following:

- (a) an account with an Australian ADI;
- (b) an account with an approved foreign bank;
- (c) a cash management trust; or
- (d) a cash common fund.

Note: See s981B, regs 7.8.01(2) and (5) and Class Order [CO 04/1063] *Section 981B money in cash common funds*

RG 000.25 Client money belonging to a client is held on trust by the licensee for the benefit of that client. The trust continues even where the licensee ceases to be licensed or there has been a breach of a relevant financial services law: s981H, regs 7.8.01(5), 7.8.03(5) and 7.8.04.

Note: Class Order [CO 03/1112] *Relief from obligation to hold client money on trust* grants a licensee who is an Australian ADI relief from the obligation to hold a client's money on trust where the client is a wholesale client and the licensee and client agree in writing.

Nature of a client money account

RG 000.26 A client money account must be opened as a trust account except where a licensee is required to call margins from a client under the operating rules of a licensed financial market or a clearing and settlement facility. In this case, the licensee may operate the account as a clients' segregated account and may pay all client money into that account (i.e. even if some of that client money is not for the purposes of margins collected under the operating rules of a clearing and settlement facility): reg 7.8.09.

RG 000.27 However, in each case:

- (a) client money is segregated from the licensee's own funds; and
- (b) one client's client money is commingled with other client funds. This means that clients are exposed to the risk that they may not receive all the money owed to them if there is a deficiency in the client money account and the licensee becomes insolvent or is otherwise unable to pay the deficiency.

RG 000.28 Client money is taken to be held in trust for the benefit of the client (see s981H), except for that portion of money paid to a licensee for margins required under the operating rules of a clearing or settlement facility: reg 7.8.01(5). However, in the event of the licensee's insolvency, a client money account is taken to be subject to a trust in favour of each person who is entitled to be paid money from that account: reg 7.8.03(4).

No security

RG 000.29 Client money (when in a client money account and before and after it is paid into a client money account) is not capable of being attached or otherwise taken in execution or being made subject to a set-off or charging order (other than at the suit of a person who is otherwise entitled to the money or investment): s981E.

What money can be paid into a client money account

RG 000.30 The only money that may be paid into a client money account is:

- (a) client money;
- (b) interest on client money;
- (c) interest or other similar payments on permitted investments using client money or the realisation of permitted investments;
- (d) an amount equivalent to any losses made on permitted investments using client money (see RG 000.43);

- (e) money paid to a licensee from or on behalf of an insured person for an insurer, or vice versa, in connection with a contract of insurance;
- (f) money paid by a licensee into a client money account due to the requirements of operating rules of a licensed financial market;
- (g) money received pursuant to s1017E by an issuer or seller of financial products where the issue or transfer of the financial product does not occur immediately after receiving the money;

Note: Money received under s1017E may also be paid into an insurance broking account maintained under s26 of the *Insurance (Agents and Brokers) Act 1984*.

- (h) mixed money (see RG 000.32–RG 000.34); and
- (i) unidentified money (RG 000.35–RG 000.37).

Note: See s981B and regs 7.8.01(3), (4), (4A) and (6).

RG 000.31 A licensee must pay client money into a client money account on the day the licensee receives it or on the next business day: s981B.

Mixed money

RG 000.32 Mixed money is money that is received by the licensee as a single payment and is not wholly client money but includes client money.

RG 000.33 If mixed money is paid into a client money account, the licensee should remove the part of the mixed money that is not client money as soon as practicable, but within one month after the mixed money is paid into the client money account: regs 7.8.01(12) and (14).

RG 000.34 We consider that it is important for a licensee to ensure separation of client money and its own money. This should allow the clear identification of client money and as such should assist in the proper distribution of client money in the event of the licensee's insolvency or otherwise ceasing to carry on business.

Unidentified money

RG 000.35 Unidentified money is money that the licensee receives as a single payment and at the time of receipt the licensee is unable to identify whether the money is client money or mixed money that might include client money.

RG 000.36 If unidentified money is paid into a client money account, the licensee must identify any part of the money that is not client money and remove it from the client money account as soon as practicable: regs 7.8.01(13) and (14).

- RG 000.37 We would expect licensees to treat unidentified money as client money until they can satisfy themselves that the money, or a portion of it, is not client money.

Licensee's moneys in client money accounts

- RG 000.38 The client money provisions do not permit licensees to deposit funds belonging to the licensee into client money accounts, by way of 'buffer' or otherwise. Buffers are often used by a licensee as a way of ensuring that there are adequate funds in the client money account to make sure that the licensee does not face a shortfall in the account when payments are made from the account, for example, as a result of incorrect bank fees or other unintended or uncontrollable errors that may reduce the balance in the account.
- RG 000.39 While this may provide some administrative benefit, we do not accept that the buffer would remove the need to self-report a shortfall in a client money account that would arise but for the amount of the buffer in the account.

Interest on client money account

- RG 000.40 If a licensee discloses to the client that the licensee is keeping any interest earned on the account, the licensee is entitled to the interest (if any) on a client money account: see reg 7.8.02(7).
- RG 000.41 We consider that to meet this disclosure requirement and retain the interest, a licensee should clearly and prominently disclose that it intends to retain interest. We consider that the ideal time for this to be done is at the time when other details of the client money arrangements are disclosed, for example, in the PDS for the product for which client money is required to be paid to the licensee.

D Permitted uses of, and withdrawals from, client money accounts

Key points

Client money may be invested in certain permitted investments, provided the licensee has obtained the client's written agreement in relation to the terms of the investment: see RG 000.42–RG 000.46.

A licensee may make certain withdrawals from a client money account, including:

- paying to the licensee money to which the licensee is entitled;
- making a payment in accordance with the written direction of a person entitled to the money; and
- using client money relating to a derivative for the purpose of meeting obligations incurred by the licensee in connection with margining or related purposes (see RG 000.47–RG 000.50).

Where client money for derivatives is used to meet obligations of the licensee, licensees can use the client money belonging to one client for some aspects of dealings in derivatives on behalf of other clients: see RG 000.51–RG 000.55.

Permitted investments using client money

- RG 000.42 Client money may be invested in the following kinds of investments:
- (a) investment in any manner in which trustees are for the time being authorised by law to invest trust funds;
 - (b) investment on deposit with an eligible money market dealer;
 - (c) investment on deposit at interest with an Australian ADI;
 - (d) the acquisition of cash management trust interests;
 - (e) investment in a security issued or guaranteed by the Commonwealth or a state or territory;
 - (f) investment on deposit with a clearing and settlement facility.

Note: See reg 7.8.02.

- RG 000.43 A licensee must not invest client money in any of the above ways unless the money is money to which the client is entitled and the licensee has obtained the client's written agreement to the following matters:
- (a) the making of the investment;

- (b) how earnings on the investment are to be dealt with (including whether or not the earnings are to be shared, and whether or not the earnings are to be paid into the account);
- (c) how the realisation of the investment is to be dealt with (including whether or not the capital invested, and the proceeds of the investment, are to be deposited into the account);
- (d) how any losses made on the investment are to be dealt with (including the circumstances in which the licensee is required to pay an amount equal to the difference between the amount invested and the amount received, into the account or otherwise); and
- (e) the fee (if any) that the licensee proposes to charge for the investment.

Note: Client money that relates to money paid by an insured person for an insurer in relation to a contract of insurance or vice versa is not subject to the above requirements provided that the balance of the client money account and the amount invested is at least the sum of any amounts that the insurer and the insured are entitled to receive from the client money account. For further information, see reg 7.8.02.

- RG 000.44 Interest or other earnings on permitted investments of client money or the proceeds of the realisation of such an investment must be dealt with in accordance with the written agreement between the licensee and the client: reg 7.8.02(8).
- RG 000.45 The making of an investment in accordance with the specific direction of a client is not considered to be a permitted investment. Rather this would be considered to be a withdrawal from the client money account in accordance with the written direction of a person entitled to the money: see RG 000.47.
- RG 000.46 If money in a client money account has been invested, the investment is taken to be subject to a trust in favour of each person who is entitled to be paid money from the client money account to the extent that the person is entitled to the money: regs 7.8.03(5) and 7.8.04.

Permitted withdrawals from client money account

- RG 000.47 Payments may be made out of a client money account in any of the following circumstances:
- (a) making a payment to, or in accordance with the written direction of, a person entitled to the money;
 - (b) defraying brokerage and other proper charges;
 - (c) paying to the licensee money to which the licensee is entitled;
 - (d) making a payment of moneys due to an insurer in connection with a contract of insurance;
 - (e) making a payment that is otherwise authorised by law;

- (f) paying to the licensee money to which the licensee is entitled pursuant to the operating rules of a financial market;
- (g) making a payment to another licensee provided that the receiving licensee is notified that the money has been withdrawn from client money and pays it into its client money account.

Note: See reg 7.8.02.

RG 000.48 The scope of a licensee's power to withdraw money from a client money account is very broad as a licensee may make a payment in accordance with the written direction of the client. ASIC has seen client contract terms in which authorisation is obtained from a client to withdraw money for any purpose.

RG 000.49 While the wording of the legislation may appear broad enough to permit this general right, we consider that reliance on such a right by a licensee could be inconsistent with the licensee's:

- (a) obligations to hold the client money on trust for the benefit of the client; and
- (b) general licence obligations under the Act, including to have adequate arrangements to manage conflicts of interest and to act efficiently, honestly and fairly.

RG 000.50 Further, the client money provisions have been designed to protect the interests of clients of licensees and to limit the permitted uses of client money. Thus, it would not be consistent with the intention of the client money provisions for a licensee to attempt to circumvent the restrictions imposed by the Corporations Act by obtaining a broad authorisation to use client moneys for the licensee's own purposes.

Permitted use of client money for derivatives

RG 000.51 If the money required to be placed in a client money account relates to a derivative or a dealing in a derivative, the licensee may use the money for the purpose of meeting obligations incurred by the licensee in connection with margining, guaranteeing, securing, transferring, adjusting or settling dealings in derivatives by the licensee, including dealings on behalf of people other than the client: s981D.

RG 000.52 This permitted use does not, however, extend to obligations incurred by the licensee's own (or proprietary) trading in derivatives, that is, trading by the licensee using its own money so as to make a profit for itself.

RG 000.53 Clients should be aware that all money that relates to a derivative or a dealing in a derivative that they deposit in a client money account can be

used for margining and other purposes related to dealings in derivatives and not just the amount relating to an individual client's margin payments.

- RG 000.54 The fact that licensees can use the client money belonging to one client for meeting margin obligations on behalf of other clients means that one client's money for dealing in derivatives may be used to satisfy obligations arising from dealings on behalf of another client of the licensee. This exposes the client to the risk that they may not receive all the money held by the licensee on their behalf in the client money account if there is a deficit in the client money account and the financial services licensee becomes insolvent or is otherwise unable to pay the deficiency.
- RG 000.55 We consider that this risk should be clearly and prominently explained to clients before they transfer any client money to a financial services licensee. For example, we consider that clear and prominent disclosure should be included in the initial PDS as part of any discussion of the need to pay client money to be held by the licensee. We would regard a PDS as misleading if it did not do this.

E Other aspects of client money

Key points

A licensee must keep financial records in sufficient detail to explain all money received or paid by the licensee in relation to client money accounts: see RG 000.56.

The auditor's report accompanying the licensee's financial statements must contain a statement of the auditor's opinion of the licensee's compliance with the client money provisions: see RG 000.57.

The Corporations Act provides for how client money is to be dealt with if a licensee ceases to be licensed or becomes insolvent: see RG 000.58–RG 000.60.

ASIC may take administrative, civil or criminal action if the client money provisions have not been complied with: see RG 000.61–RG 000.64.

Financial records and auditor's certification

RG 000.56 A licensee must keep financial records that correctly record and explain all money received or paid by the licensee in relation to a client money account: s988A and 988E and reg 7.8.11.

RG 000.57 An auditor's report lodged with the licensee's financial statements pursuant to subsection 989B(3) of the Corporations Act must contain a statement of the auditor's opinion of:

- (a) the effectiveness of internal controls used by a licensee to comply with the client money provisions;
- (b) whether each client money account required to be maintained by the licensee has been operated and controlled in accordance with the client money provisions; and
- (c) whether all necessary records, information and explanations were received from the licensee.

Note: See reg 7.8.13.

How client money is dealt with if licensee ceases to be licensed

RG 000.58 The Corporations Act provides for how client money is to be dealt with if a licensee:

- (a) ceases to be licensed (including a cessation because the licensee's AFSL has been suspended or cancelled);
- (b) becomes insolvent under an administration, has an administrator or receiver appointed or is subject to similar proceedings; or
- (c) ceases to carry on an activity authorised by the AFSL and is paid money in relation to that activity.

Note: See reg 7.8.03(2).

RG 000.59 If any of the above events occurs, client money is to be paid as follows:

- (a) the first payment is of money that has been paid into the account in error;
- (b) if money has been received on behalf of insured persons in accordance with a contract of insurance, the second payment is payment to each insured person entitled to receive money from the client money account in respect of claims that have been made and then in respect of other matters;
- (c) the next payment is payment to each person who is entitled to be paid money from the client money account;
- (d) if the money in the client money account is not sufficient to be paid in accordance with paragraph (a), (b) or (c), the money must be paid in proportion to the amount of each person's entitlement; and
- (e) if there is money remaining in the account after payments made in accordance with the above, the remaining money is taken to be money payable to the licensee.

Note: See reg 7.8.03(6).

RG 000.60 For each person who is entitled to be paid money from a client money account, the account is taken to be subject to a trust in favour of the person: reg 7.8.03(4). Similarly, if money in a client money account has been invested the investment is taken to be subject to a trust in favour of each person who is entitled to be paid money from the account: reg 7.8.03(5). These arrangements override anything to the contrary in the *Bankruptcy Act 1966* or a law relating to companies: reg 7.8.03(7).

Administrative action

- RG 000.61 ASIC may take administrative action to vary, suspend or cancel an AFSL where breaches of the client money provisions have occurred: Subdiv C of Div 4 of Pt 7.6.
- RG 000.62 ASIC may also take administrative action to ban or disqualify a person who has not complied with the client money provisions: Div 8 of Pt 7.6.

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Enforcement options

- RG 000.63 ASIC may apply to the Court for an order to restrain dealings in respect of client money accounts and to make orders relating to the payment or freezing of money: s983A–983E.
- RG 000.64 A licensee commits an offence if it is required to pay client money into a client money account and does not do so or if the licensee fails to comply with the client money provisions: s993B and 993C.

Key terms

Term	Meaning in this document
ASIC	Australian Securities and Investments Commission
Australian ADI	An authorised deposit taking institution within the meaning of the <i>Banking Act 1959</i> and a person who carries on State banking within the meaning of paragraph 51(xiii) of the Constitution Note: This is a definition contained in s9
Australian financial services licence or AFSL	A 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
clearing and settlement facility	A clearing and settlement facility as defined in Div 6 of Pt 7.1
client money	Money that is paid to a financial services licensee pursuant to s981A
client money account	An account that is maintained for s981B, whether maintained as a trust account or a clients' segregated account
client money provisions	Div 2 of Pt 7.8 of the Corporations Act
[CO 03/1112] (for example)	An ASIC class order (in this example, numbered 03/1112)
Corporations Act	<i>Corporations Act 2001</i> including any regulations made for the purposes of the Act
Corporations Regulations	Corporations Regulations 2001
derivative	Has the meaning given to that term in s761D
Div 2	A division of a part of the Corporations Act (in this example, numbered 2)
financial market	A facility through which: <ul style="list-style-type: none"> offers to acquire or dispose of financial products are regularly made or accepted; or offers or invitations are regularly made to acquire or dispose of financial products that are intended to result or may reasonably be expected to result, directly or indirectly, in the making or acceptance of such offers. Note: This is a definition contained in s767A

Term	Meaning in this document
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; • manages financial risk; and/or • makes non-cash payments. <p>Note: This is a definition contained in s763A</p>
financial service	<p>A person provides a financial service if they:</p> <ul style="list-style-type: none"> • provide financial product advice; • deal in a financial product; • make a market for a financial product; • operate a registered scheme; • provide a custodial or depository service; or • engage in conduct prescribed by the Corporations Regulations. <p>Note: This is a definition contained in s766A</p>
financial services licensee or licensee	<p>A person who holds an Australian financial services licence</p> <p>Note: This is a definition contained in s761A</p>
OTC derivative	A derivative that is entered into over-the-counter and not through a licensed financial market
Pt 7.8 (for example)	A part of the Corporations Act (in this example, numbered 7.8)
PDS	Product Disclosure Statement
reg 7.8.01 (for example)	A regulation in the Corporations Regulations (in this example, numbered 7.8.01)
s981D (for example)	A section of the Corporations Act (in this example, numbered 981D)

Related information

Headnotes

client money, client money account, trust account, clients' segregated account, mixed money, unidentified money, buffers, derivatives

Class orders

[CO 03/1112] *Relief from obligation to hold client money on trust*

[CO 04/1063] *Section 981B money in cash common funds*

Legislation

Bankruptcy Act 1966

Corporations Act 2001 Div 2 of Pt 7.8, s981A, 981B, 981C, 981D, 981E, 981F, 981G, 981H; *Corporations Regulations 2001* regs 7.8.01, 7.8.02, 7.8.03, 7.8.04

Media and information releases

[IR 04-47] *ASIC provides relief for client money held in cash common funds*