



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 140

Responsible entities: Financial requirements

September 2010

About this paper

This Consultation Paper sets out ASIC's proposals on the financial requirements to apply to responsible entities of registered managed investment schemes.

The purpose of this paper is to seek the views of responsible entities and their clients, investors, legal advisers and other interested parties on the proposals we have developed about financial requirements and risk management for responsible entities.

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 30 September 2010 and is based on the Corporations Act as at 30 September 2010.

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 financial requirements for responsible entities. 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 D Regulatory and financial impact](#), p. 20.

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 15 November 2010 to:

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What will happen next?

Stage 1	30 September 2010	ASIC consultation paper released
Stage 2	15 November 2010	Comments due on the consultation paper
Stage 3	March 2011	Regulatory guide released

A Background to the proposals

Key points

Interests in registered managed investment schemes are regulated as financial products under the *Corporations Act 2001* (Corporations Act). A responsible entity of a registered managed investment scheme must hold an Australian financial services (AFS) licence covering that activity.

AFS licensees are subject to conduct obligations, including the obligation to have adequate financial resources and risk management systems, unless they are a body regulated by the Australian Prudential Regulation Authority (APRA).

This Consultation Paper sets out our proposals on the financial requirements that should apply to AFS licensees that act as a responsible entity for registered managed investment schemes. The proposals in this Consultation Paper would replace the cash needs requirement in RG166.22(c). The base level financial requirements in RG166.22(a), (b) and (d) would remain unchanged.

Financial requirements for responsible entities

- 1 The licensing provisions of the *Financial Services Reform Act 2001* commenced on 11 March 2002. Under this regime, responsible entities of registered managed investment schemes must obtain an Australian financial services (AFS) licence. AFS licensees are subject to the conduct obligations of Ch 7 of the *Corporations Act 2001* (Corporations Act), including, among other things, obligations to have:
 - (a) adequate resources available to provide the financial services covered by the licence and to carry out supervisory arrangements (s912A(1)(d)), and
 - (b) adequate risk management systems (s912A(1)(h)).
- 2 As part of ASIC's role as regulator of the financial services industry, we are responsible for setting the financial requirements that an AFS licensee must meet. These are set out in Regulatory Guide 166: *Licensing: Financial requirements* (RG 166) and apply to AFS licensees by way of conditions on their AFS licence.
- 3 RG 166 states that ASIC imposes financial requirements on AFS licensees to ensure that:
 - (a) they have sufficient financial resources to conduct their 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 owners to comply with the Corporations Act through risk of financial loss.
- 4 There has not been a significant review of the financial requirements for responsible entities since the implementation of the financial services reform legislation in 2002. In this time, the managed investment industry has undergone significant change. The events of recent years have also highlighted the need for review of the policies in RG 166 to ensure sufficient rigour in the financial risk frameworks of businesses seeking to manage money on behalf of members.

The purpose of our proposals

- 5 In developing these proposals we have been mindful of the fundamental purpose of the financial requirements for AFS licensees and focused on the most suitable mechanisms for achieving this purpose in the context of the managed investment industry. These proposals align with the underlying principles outlined in RG 166.11–166.13 and RG 166.68–166.69. Specifically, these proposals seek to:
- (a) ensure a responsible entity has adequate financial requirements to meet its operating costs (e.g. the costs of ensuring compliance with the Corporations Act) throughout the life of its schemes;
 - (b) align the interests of responsible entities and scheme investors by ensuring that responsible entities are entities of substance and that shareholders in responsible entities have sufficient equity in the business to have a real incentive to ensure its success;
 - (c) limit the risk that a responsible entity will become insolvent because it has assumed liability for the debts of others, including members of its corporate group (e.g. under a guarantee, indemnity or tax-sharing arrangement);
 - (d) ensure Australia provides comparable investor protection to other leading financial centres and comparable regulatory regimes; and
 - (e) provide some level of assurance that, if the responsible entity does fail, there is sufficient money available for the orderly transition to a new responsible entity or to wind up the scheme.
- 6 These proposals do not seek to:
- (a) prevent responsible entities from becoming insolvent due to poor business models or cash flow problems (other than because they have assumed liability for others' debts);

- (b) prevent schemes from failing due to poor business models or cash flow problems; or
- (c) provide compensation to scheme members who suffer a loss, for whatever reason.

- 7 As outlined in RG 166, in setting licence conditions for financial requirements, we seek to set minimum standards that are framed as clearly and simply as possible so as to provide certainty. Balanced against the need to ensure that responsible entities have sufficiently rigorous frameworks to support the management of other people's money is a need to avoid an unreasonable burden in maintaining particular levels of assets or reporting, and unjustifiable barriers to market entry for providing different kinds of financial services.
- 8 As a whole, the proposals are aimed at providing a structured approach to dealing with both expected and unexpected risks across a 12-month forecast period. The proposals in this Consultation Paper would replace the cash needs requirement in RG166.22(c). The other base level financial requirements in RG166.22(a), (b) and (d) would remain unchanged. The proposals do not apply to bodies regulated by APRA.

B Our proposals

Key points

Our proposals are aimed at providing a structured approach to dealing with both expected and unexpected risks across a 12-month forecast period. We propose to:

- restrict guarantees and indemnities to related parties to maximise the likelihood that a responsible entity will survive the insolvency of a parent or related entity (see paragraphs 9–13);
- require rolling 12-month cash flow projections to increase the visibility of cash flow issues in a 'business as usual' situation (see paragraphs 14–21); and
- change both the quantum and liquidity provisions of the net tangible assets (NTA) requirement to ensure adequate resources are available to deal with unexpected situations over the full 12-month forecast (see paragraphs 22–46).

Restricting guarantees and indemnities to related parties

- 9 There are currently no significant restrictions in regard to responsible entities providing guarantees or indemnities. To maximise the likelihood that responsible entities will survive the insolvency of a parent, related entity or other third party, we propose to prohibit responsible entities from providing certain guarantees and indemnities.

Proposal

- B1** We propose that an AFS licensee that operates as a responsible entity should:
- (a) be prohibited from providing guarantees in its capacity as the responsible entity of a scheme;
 - (b) where the responsible entity manages more than one scheme, be prohibited from providing guarantees in their personal capacity;
 - (c) be restricted from providing indemnities in its capacity as the responsible entity of a scheme other than indemnities in relation to that scheme's default; and
 - (d) in the event that it is part of a tax consolidation group, be required to execute a tax sharing agreement (TSA) that ensures that the responsible entity can only ever be liable for its portion of any group tax liability.

Your feedback

B1Q1 Do you agree with this proposal? If not, why not?

- B1Q2 Will you need to restructure your business to meet these requirements?
- B1Q3 Are there any practical problems with the implementation of this proposal? Please give details.
- B1Q4 What would be the financial impact of this proposal on your business?
- B1Q5 Are there any circumstances in which this proposal should not apply? If yes, why?
- B1Q6 Will there be an effect on competition as a result of this change?
- B1Q7 Do you think there will be a disproportionate impact on responsible entities of certain types of schemes?

Rationale

- 10 There are currently no significant restrictions in regard to providing guarantees or indemnities to related parties. These commitments have proven problematic in a number of recent group collapses. In those cases, such arrangements have meant there have not been sufficient resources to ensure ongoing compliance with Corporations Act requirements, to allow for any orderly wind up of the scheme or for the transition of the scheme to a different responsible entity.
- 11 A primary aim of this proposal is to reduce the risk that responsible entities are affected by financial issues that relate to other entities. Specifically, the goal is to reduce the risk that a failure within a group will result in a responsible entity being incapable of performing its functions.
- 12 To maximise the likelihood that a responsible entity will survive the insolvency of a parent, related entity or other third parties, responsible entities should be prohibited from providing certain guarantees and indemnities. This prohibition should extend to the responsible entity being party to any cross-guarantee agreements.
- 13 In many instances the remoteness of a responsible entity is seen as good risk management for the responsible entity and it may be that many businesses are already operating in this way. However, we are aware that some businesses may require restructuring of their arrangements under this proposal.

Requiring rolling 12-month cash flow projections

- 14 Cash flow projections are an important tool in identifying potential risks to a business. We propose the introduction of a requirement for longer cash flow projections for responsible entities.

Proposal

- B2** We propose that responsible entities be required to prepare, and make available to ASIC upon request, rolling cash flow forecasts with anticipated revenue and expenses over at least 12 months, to be approved by the directors of the responsible entity.

Your feedback

- B2Q1 Do you agree with this proposal? If not, why not?
- B2Q2 What additional costs will be incurred by your business as a result of these proposals?
- B2Q3 Are there any practical problems with the implementation of this proposal? Please give details.

Rationale

- 15 Cash flow forecasting is an important tool which demonstrates that a responsible entity can meet anticipated expenses.
- 16 This proposal would replace the current cash needs requirements set out in RG 166.22(c). Currently, as part of the base level financial requirements, an AFS licensee must comply with one of the following options (broadly stated):
- (a) show, based on the projection of cash flows and on an individual or in certain cases group basis, that it will have access to enough financial resources to meet its liabilities over the projected term of at least the next 3 months, including any additional liabilities that may be incurred during this time;
 - (b) show that an authorised deposit-taking institution (ADI) has given the AFS licensee an enforceable and unqualified commitment to meet the AFS licensee's financial obligations; or
 - (c) if the AFS licensee is a subsidiary of an Australian ADI, or an entity approved for this purpose in writing by us, show:
 - (i) it reasonably expects (based on funds from related bodies corporate) that it will have adequate resources (when needed) to meet its liabilities (including any additional liabilities that may be incurred during that period) for at least the next 3 months; and
 - (ii) the basis for the expectation is appropriately documented.
- 17 Requiring rolling 12-month cash flow forecasting addresses expected risk and should, in many cases, result in a higher level of focus and governance around cash flow forecasts and cash planning than currently exists. We acknowledge that forecasts such as these are only as sound as the assumptions on which they are based and the rigour with which they are

- prepared. For this reason, we think it is important for directors of a responsible entity to review them.
- 18 Cash flow forecasts will need to be updated when material changes occur to the cash flow forecast assumptions.
- 19 We will maintain the right to request a copy of the cash flow forecasts at any time and will exercise this right when appropriate. This should increase the likelihood that forecasts are prepared with the requisite detail and provide us with a useful tool to more fully understand the workings of a responsible entity that finds itself in distress.
- 20 We believe that longer cash flow forecasts will assist the directors of a responsible entity to identify potential cash flow problems at an earlier stage, providing the opportunity to take corrective action.
- 21 RG 166 provides substantial guidance on the audit requirements for cash flow forecasts. Currently, there is a requirement for positive assurance on compliance with financial conditions of the licence other than the cash need requirements. For cash flow projections, negative assurance is required on the reasonableness of assumptions used and positive assurance on their calculation. It is our intention to maintain this approach to the audit requirements.

Increasing the NTA capital requirements

- 22 AFS licensees that are responsible entities should have adequate resources available to meet their operating expenses and ensure an orderly transition to a new responsible entity or wind up of the scheme if the responsible entity fails. We are proposing to amend AFS licence conditions to achieve this.

Proposal

- B3** We propose that:
- (a) one of the following 2 options be adopted as the method for calculating the amount of NTA a responsible entity is required to hold. (This amount is to be held in the form specified in proposal B4):
 - (i) the greater of: \$150,000; 0.5% of the average value of scheme property (capped at \$5 million); and 10% of its average gross revenue (with no maximum); or
 - (ii) 10% of its average gross revenue with a minimum of \$500,000 and no maximum;
 - (b) if the average gross revenue of a responsible entity is below a minimum percentage of the average value of scheme property, that a minimum percentage, set at between 1 and 2%, be used to calculate the required NTA; and

- (c) eligible undertakings that may be included in the NTA calculation be limited to those provided by an ADI or which are otherwise approved by us.

Note: an example of how these new requirements might apply is contained in Table 1 on page 16.

- (d) the amount of funds under management and NTA held by a responsible entity be submitted to ASIC annually.

Your feedback

- B3Q1 What benefits and disadvantages do you consider will result from proposal B3(a)(i)?
- B3Q2 What benefits and disadvantages do you consider will result from proposal B3(a)(ii)?
- B3Q3 Which option (proposal B3(a)(i) or proposal B3(a)(ii)), or combination of elements of the options, do you think most appropriately measures the level of risk carried by a responsible entity? Why?
- B3Q4 What effect will this proposal have on the capital currently held by your business? Please quantify these amounts.
- B3Q5 Do you agree that this proposal will achieve our aims specified in paragraphs 3, 5 and 6? If not, why not?
- B3Q6 Do you think there is a more appropriate method for calculating a requirement to meet our aims specified in paragraphs 3, 5 and 6? Please give details.
- B3Q7 Do you think the provisions in proposal B3(b) are appropriate when gross revenue is less than the relevant minimum? Do you think the range of between 1 and 2% is appropriate? If not, why not? Please provide quantification of examples in your response if appropriate.
- B3Q8 What impact will this proposal have on your business costs? How will you manage these changes?
- B3Q9 Will this proposal result in increased fees for members?
- B3Q10 What impact will this proposal have on competition?
- B3Q11 Will this proposal impact responsible entities of different types of schemes in different ways?
- B3Q12 Are there any practical problems with the implementation of this proposal?

Rationale

- 23 It is important that responsible entities maintain adequate capital to ensure the proper performance of their functions. We consider it appropriate that businesses wanting to take on the responsibility of managing investors' money maintain sufficient equity within the business to closely align their interests with those of their investors, and that there is sufficient capital to wind up the scheme if it fails.

- 24 The current capital requirements for responsible entities of registered managed investment schemes have not been revised since they were established in March 2002. In the wake of the global financial crisis, there is good reason to question whether the current requirements are still adequate to retain investor confidence in the managed investment sector.
- 25 Current requirements outlined in RG166.63 are for a responsible entity to hold a minimum NTA of 0.5% of the value of the assets plus any other scheme property not counted in calculating the value of the assets of the registered schemes it operates, with a minimum requirement of \$50,000 and a maximum requirement of \$5 million.
- 26 Our proposal to change the capital requirements represents in some cases a significant increase in the current minimum capital requirements and is aimed at ensuring that a responsible entity has adequate resources to establish and maintain a responsible framework to manage money from retail members in the ordinary course of events and when unexpected situations arise.
- 27 While the proposal for longer cash flow forecasts is aimed at increasing visibility of cash flow issues that may arise in a 'business as usual' situation, the proposed changed capital requirements are designed to provide a buffer which can be used when businesses are confronted by the unexpected.

Global comparisons

- 28 As Australia strives to increase its profile as a financial centre, increasing minimum responsible entity capital requirements to a level that is globally comparable should provide long-term benefits. The current minimum requirement of \$50,000 is significantly below global and regional peers. European regulators, including the UK Financial Services Authority (FSA), require a minimum of approximately \$180,000, while the US Securities and Exchange Commission (SEC) and the Ontario Securities Commission (OSC) require \$120,000 and \$110,000 respectively. The Monetary Authority of Singapore (MAS) requires \$840,000 and the Hong Kong Securities and Futures Commission (SFC) requires \$760,000 (including \$460,000 in cash).

Registrable superannuation entities

- 29 In line with RG 166.68(d), the proposal takes into account for comparison the regulations for registrable superannuation entities (RSEs) who are trustees of public offer superannuation funds. Those RSEs using an external custodian must hold a minimum of \$100,000 in liquid assets.

Enhancing the current capital regime

- 30 The introduction of the gross revenue measure is designed to capture the operating risks of responsible entities that generate significant income

unrelated to scheme activities and responsible entities with high levels of scheme assets.

- 31 The intention is that gross revenue will at least include all fees paid by the schemes of the responsible entity to the responsible entity or third parties in relation to the performance of the responsible entity's obligations. This applies even if some of those obligations may actually be performed by third parties. If the average gross revenue of a responsible entity is below a minimum percentage of the average value of scheme property, we propose that a minimum percentage, set at between 1 and 2%, would be used to calculate the required NTA. We will determine the percentage that will apply based on feedback received in response to this Consultation Paper.
- 32 Although it is not designed to prevent a responsible entity from failing, the NTA requirement provides some protection against unexpected risk from changes in costs and revenues. It will assist in the orderly transition of scheme assets in the event that a responsible entity fails.
- 33 Proposal B3(a)(i) increases the minimum requirement to ensure an appropriate minimum level of resources. The existing amount based on the average value of scheme property will still apply so that no responsible entity will have to provide less capital than is currently required. Our intention under this option is to enhance the current capital regime by imposing additional capital requirements in circumstances where additional risk is present, and so this proposal contains the additional element of a sum based on the average gross revenue.
- 34 We believe that operational risk exists for all revenue levels. Therefore, we have not imposed a cap on the NTA required by the average gross revenue calculation.
- 35 Proposal B3(a)(ii) also raises the minimum requirement, but does not contain the link to assets under management and therefore may result in some responsible entities having to hold a smaller amount in NTA than is currently required.
- 36 A responsible entity that does not use an external custodian will continue to be required to hold \$5 million NTA, subject to existing exemptions for tier \$500,000 assets and special custody assets.
- 37 It is proposed that only eligible undertakings provided by an ADI or approved by ASIC be included in the NTA calculation. Undertakings by listed entities on the basis of specified net asset levels, including from listed parent companies of a responsible entity, will no longer be considered eligible undertakings. This proposal aims to better insulate a responsible entity's capital base from the impact of parent collapses.

- 38 We would also retain the discretion to determine a higher NTA requirement for responsible entities with higher operating risk, such as those carrying significant counterparty or market risk.

Comparison of proposal B3(a)(i) and proposal B3(a)(ii)

- 39 We intend to consider which option should be implemented (if any) following a review of submissions to this Consultation Paper. An example of the impact of the two proposals on the NTA requirement of a number of hypothetical responsible entities is provided in Table 1.

Table 1: Impact of proposal B3(a)(i) and proposal B3(a)(ii)

	Funds under management (\$'000)	Revenue (\$'000)	NTA requirement (\$'000)		
			Current RG166.25	Proposal B3(a)(i)	Proposal B3(a)(ii)
Example A	50,000	500	250	250	500
Example B	500,000	5,000	2,500	2,500	500
Example C	1,000,000	60,000	5,000	6,000	6,000
Example D	5,000,000	50,000	5,000	5,000	5,000
Example E	7,500,000	75,000	5,000	7,500	7,500

Consolidation and rationalisation of sector

- 40 Implementation of these proposals may lead to some consolidation and rationalisation of the sector. Some responsible entities may be forced to restructure to raise the requisite capital or may merge with others in order to meet the capital requirements. It is also possible that some businesses may restructure to remove non-scheme-related activities from the responsible entity. This may act to enhance the benefits described in our proposal in paragraphs 9–13 of making responsible entities more remote from non-scheme-related activity.
- 41 There are potential benefits in reducing the number of responsible entities where those that remain are well capitalised and more stable as a result.

Specifying the NTA liquidity requirements

- 42 A responsible entity should have adequate cash on hand to address unexpected and immediate cash requirements. We propose that responsible entities be required to hold a proportion of their required NTA in cash or

cash equivalents to assist the responsible entity to meet unexpected and immediate cash requirements. The balance of the NTA requirement is to be held in liquid assets.

Proposal

B4 We propose that responsible entities be required to hold:

- (a) 50% of the required NTA as cash or cash equivalents with a minimum of \$150,000; and
- (b) the balance of the required NTA in liquid assets, with 'liquid assets' being defined as assets that are:
 - (i) money in an account or money on deposit with a bank that is available for withdrawal immediately, or otherwise upon maturity of a fixed term not exceeding 6 months during the normal business hours of the bank;
 - (ii) a bank bill with a maturity date not exceeding 6 months; or
 - (iii) an asset the responsible entity can reasonably expect to realise for its market value within 6 months; and
 - (iv) free from encumbrances and, in the case of receivables, free from any right of set off.

Your feedback

B4Q1 Do you agree with this proposal? If not, why not?

B4Q2 Do you think that this proposal is likely to increase fees for members? Please provide details, including quantification of how fees may be affected.

B4Q3 Is 6 months a reasonable period within which remaining assets must be convertible to cash reasonable? If you do not agree, why not?

B4Q4 Are there any circumstances in which this proposal should not apply? Please give details.

B4Q5 What impact will this proposal have on your business costs? Please quantify your response where appropriate.

B4Q6 How will you manage any change to your business costs?

B4Q7 What impact will this proposal have on competition?

B4Q8 Will this proposal affect the responsible entities of different types of schemes in different ways?

B4Q9 Are there any practical problems with the implementation of this proposal?

Rationale

- 43 To ensure a responsible entity has adequate cash available to address unexpected and immediate expenses, we believe that there should be liquidity requirements.
- 44 A requirement to hold 50% of NTA in cash or cash equivalents (with a minimum of \$150,000) may assist a responsible entity to meet anticipated and unanticipated expenses over the first 6 months of the cash flow forecast period. The remainder of the NTA requirement, which under this proposal would be required to be held in assets able to be converted into cash within 6 months, should be available within a reasonable timeframe to enable the responsible entity to continue to meet its expenses over the full 12-month cash flow forecast period.
- 45 As one of the purposes of the NTA requirement is to ensure funds are available for use in situations that are not anticipated, it is logical that a portion of these funds be available at call, with the balance available within a reasonable timeframe.
- 46 Current arrangements require in some instances a cash component of 20% of cash outflows for the next 3 months, but only if a responsible entity elects 'Option 1' in RG 166.25 in order to meet its cash needs requirement. In light of recent market experience, we consider that these arrangements are inadequate. For those businesses that choose to meet their current cash needs requirement under Option 1, the amount of available cash required equates to approximately 18 days of expected cash flow in a 'business as usual' situation. For businesses that choose any of Options 2–5 in RG 166, there is no requirement for them to have cash on hand.

C Proposed implementation and transition period

Key points

We consider it appropriate for the proposed reforms to be implemented as soon as practicable. Some businesses may require restructuring or recapitalisation to meet the revised requirements. A transition period may therefore be appropriate.

Proposal

- c1 We propose:
- (a) that the reforms will be effective for new REs as of 1 July 2011; and
 - (b) to implement a transition period for existing REs of either:
 - (i) 12 months until 1 July 2012; or
 - (ii) 24 months until 1 July 2013.

Your feedback

C1Q1 Do you agree with the proposed timeframe for the implementation of the proposals in this Consultation Paper?

C1Q2 Do you require a transition period to ensure that adequate arrangements are in place to meet the requirements of the proposals? If so, is 12 months a sufficient period? If a transition period longer than 24 months is required please explain why.

Rationale

- 47 We believe our proposals are important to ensure the stability of the managed investment sector and as such should be implemented as soon as practicable. We acknowledge the possibility that some businesses may either choose to restructure or need to recapitalise as a result of the proposals.
- 48 The earliest practical time for the implementation of the proposals for new REs would be 1 July 2011. Subject to feedback received regarding the need for a transition period, we may provide a 12-month or 24-month transition period for existing REs until 1 July 2012 or 1 July 2013, respectively, as appropriate.

D Regulatory and financial impact

- 49 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) protecting consumers by ensuring that businesses that act as responsible entities for registered managed investment schemes have adequate financial resources to conduct their business in compliance with the Corporations Act and in a responsible manner; and
 - (b) implementing financial requirements in a way that is not overly burdensome.
- 50 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) undertaking a preliminary assessment of the impacts of the options on business and individuals or the economy; and
 - (c) conducting the appropriate level of regulatory analysis, that is, complete a Regulation Impact Statement (RIS).
- 51 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.
- 52 To ensure that we are in a position to properly complete any required 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.
- 53 We invite you to propose alternatives to our proposals providing reasoning as to why you think the alternative will produce a better outcome.

Key terms

Term	Meaning in this document
AFS licence	<p>An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries out a financial services business to provide financial services</p> <p>Note: This is a definition contained in s761A of the Corporations Act.</p>
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
Australian ADI	Has the meaning given in s9 of the Corporations Act
average gross revenue	<p>For responsible entities up to and including the second year of operation—means the average of the actual annualised gross revenue for the current year and the amount of gross revenue forecast for the forecast year</p> <p>For responsible entities after the first 2 years of operation—means the average of the actual gross revenue for the preceding 2 years and the amount of gross revenue forecast for the forecast year</p>
average value of scheme property	<p>For responsible entities up to and including the second year of operation – means the average of the actual value of scheme property and other assets of registered schemes and IDPS it operates as at 30 June for the current year and the forecast value of the scheme property for the forecast year</p> <p>For responsible entities after the first 2 years of operation – means the average of the actual value of scheme property and other assets of registered schemes and IDPS it operates as at 30 June for the preceding 2 years and the forecast value of the scheme property for the forecast year</p>
cash and cash equivalents	Has the meaning given in the Australian Accounting Standards—that is, cash is cash on hand and demand deposits, and cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001

financial product	<p>Generally, 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: See Div 3 of Pt 7.1 of the Corporations Act for the exact definition</p>
financial service	Has the meaning given in Div 4 of Pt 7.1 of the Corporations Act
gross revenue	Gross revenue means the revenue of the responsible entity and includes any fees paid by the schemes of the responsible entity to the responsible entity or third parties in relation to the performance of the responsible entity's obligations for the schemes, even if some of those obligations may be actually performed by third parties
liquid assets	<p>Assets that are:</p> <ul style="list-style-type: none"> • money in an account or money on deposit with a bank that is available for withdrawal immediately, or otherwise upon maturity of a fixed term not exceeding 6 months during the normal business hours of the bank; • a bank bill with a maturity date not exceeding 6 months; or • an asset the responsible entity can reasonably expect to realise for its market value within 6 months, and <p>free from encumbrances, and in the case of receivables, free from any right of set off</p>
net tangible assets (NTA)	Means the AFS licensee's adjusted assets less adjusted liabilities as defined in RG166
revenue	<p>Has the meaning given in the Australian Accounting Standards. For the purposes of this Consultation Paper, it includes revenue arising from:</p> <ul style="list-style-type: none"> • the sale of goods; • the rendering of services (e.g. fee income); • interest; • royalties; • dividends; • commissions; • rental income; and • construction contract revenue
registered managed investment scheme	Means a managed investment scheme as defined in s9 of the Corporations Act and registered as described in Ch 5C of the Corporations Act
RG 166 (for example)	An ASIC regulatory guide (in this example numbered 166)

special custody assets	Has the meaning given in RG 166
tax consolidation group	A group as described in s703.5 of the <i>New Business Tax System (Consolidation) Act (No.1) 2002</i>
tax sharing agreement (TSA)	An agreement as described in s721.25 of the <i>New Business Tax System (Consolidation) Act (No.1) 2002</i>
tier \$500,000 assets	Has the meaning given in RG 166

List of proposals and questions

Proposal	Your feedback
<p>B1 We propose that an AFS licensee that operates as a responsible entity should:</p> <p>(a) be prohibited from providing guarantees in its capacity as the responsible entity of a scheme in respect of any obligations other than obligations of that scheme;</p> <p>(b) where the responsible entity manages more than one scheme, be prohibited from providing guarantees in their personal capacity;</p> <p>(c) be restricted from providing indemnities in its capacity as responsible entity of a scheme other than indemnities in relation to the responsible entity's own default; and</p> <p>(d) in the event that it is part of a tax consolidation group, be required to execute a tax sharing agreement (TSA) that ensures that the responsible entity can only ever be liable for its portion of any group tax liability.</p>	<p>B1Q1 Do you agree with this proposal? If not, why not?</p> <p>B1Q2 Will you need to restructure your business to meet these requirements?</p> <p>B1Q3 Are there any practical problems with the implementation of this proposal? Please give details.</p> <p>B1Q4 What would be the financial impact of this proposal on your business?</p> <p>B1Q5 Are there any circumstances in which this proposal should not apply? If yes, why?</p> <p>B1Q6 Will there be an effect on competition as a result of this change?</p> <p>B1Q7 Do you think there will be a disproportionate impact on responsible entities of certain types of schemes?</p>
<p>B2 We propose that responsible entities be required to prepare and make available to ASIC, upon request, rolling cash flow forecasts with anticipated revenue and expenses over at least 12 months, to be approved by the directors of the responsible entity.</p>	<p>B2Q1 Do you agree with this proposal? If not, why not?</p> <p>B2Q2 What additional costs will be incurred by your business as a result of these proposals?</p> <p>B2Q3 Are there any practical problems with the implementation of this proposal? Please give details.</p>

Proposal	Your feedback
<p>B3 We propose that:</p> <p>(a) one of the following 2 options be adopted as the method for calculating the amount of NTA a responsible entity is required to hold. (This amount to be held in the form specified in proposal B4):</p> <p>(i) the greater of: \$150,000; 0.5% of the average value of scheme property (capped at \$5 million); and 10% of its average gross revenue (with no maximum); or</p> <p>(ii) 10% of its average gross revenue with a minimum of \$500,000 and no maximum;</p> <p>(b) if the average gross revenue of a responsible entity is below a minimum percentage of the average value of scheme property, that a minimum percentage, set at between 1 and 2%, be used to calculate the required NTA; and</p> <p>(c) eligible undertakings that may be included in the NTA calculation be limited to those provided by an ADI or which are otherwise approved by us</p> <p>(d) the amount of funds under management and NTA held by a responsible entity be submitted to ASIC annually.</p>	<p>B3Q1 What benefits and disadvantages do you consider will result from proposal B3(a)(i)?</p> <p>B3Q2 What benefits and disadvantages do you consider will result from proposal B3(a)(ii)?</p> <p>B3Q3 Which option (proposal B3(a)(i) or proposal B3(a)(ii)), or combination of elements of the options, do you think most appropriately measures the level of risk carried by a responsible entity? Why?</p> <p>B3Q4 What effect will this proposal have on the capital currently held by your business? Please quantify these amounts.</p> <p>B3Q5 Do you agree that this proposal will achieve our aims specified in paragraphs 3, 5 and 6? If not, why not?</p> <p>B3Q6 Do you think there is a more appropriate method for calculating a requirement to meet our aims specified in paragraphs 3,5 and 6? Please give details.</p> <p>B3Q7 Do you think the provisions in proposal B3(b) are appropriate when gross revenue is less than the relevant minimum? Do you think the range of between 1 and 2% is appropriate? If not, why not? Please provide quantification of examples in your response if appropriate.</p> <p>B3Q8 What impact will this proposal have on your business costs? How will you manage these changes?</p> <p>B3Q9 Will this proposal result in increased fees for members?</p> <p>B3Q10 What impact will this proposal have on competition?</p> <p>B3Q11 Will this proposal impact responsible entities of different types of schemes in different ways?</p> <p>B3Q12 Are there any practical problems with the implementation of this proposal?</p>

Proposal	Your feedback
<p>B4 We propose that responsible entities be required to hold:</p> <p>(a) 50% of the required NTA as cash or cash equivalents with a minimum of \$150,000; and</p> <p>(b) the balance of the required NTA in liquid assets, with 'liquid assets' being defined as assets that are:</p> <p>(i) money in an account or money on deposit with a bank that is available for withdrawal immediately, or otherwise upon maturity of a fixed term not exceeding 6 months during the normal business hours of the bank;</p> <p>(ii) a bank bill with a maturity date not exceeding 6 months; or</p> <p>(iii) an asset the responsible entity can reasonably expect to realise for its market value within 6 months; and</p> <p>(iv) free from encumbrances and, in the case of receivables, free from any right of set off.</p>	<p>B4Q1 Do you agree with this proposal? If not, why not?</p> <p>B4Q2 Do you think that this proposal is likely to increase fees for members? Please provide details, including quantification of how fees may be affected.</p> <p>B4Q3 Is 6 months a reasonable period within which remaining assets must be convertible to cash? If you do not agree, why not?</p> <p>B4Q4 Are there any circumstances in which this proposal should not apply? Please give details.</p> <p>B4Q5 What impact will this proposal have on your business costs? Please quantify your response where appropriate.</p> <p>B4Q6 How will you manage any change to your business costs?</p> <p>B4Q7 What impact will this proposal have on competition?</p> <p>B4Q8 Will this proposal affect the responsible entities of different types of schemes in different ways?</p> <p>B4Q9 Are there any practical problems with the implementation of this proposal?</p>
<p>C1 We propose:</p> <p>(a) that the reforms will be effective for new REs as of 1 July 2011; and</p> <p>(b) to implement a transition period for existing REs of either:</p> <p>(i) 12 months until 1 July 2012; or</p> <p>(ii) 24 months until 1 July 2013.</p>	<p>C1Q1 Do you agree with the proposed timeframe for the implementation of the proposals in this Consultation Paper?</p> <p>C1Q2 Do you require a transition period to ensure that adequate arrangements are in place to meet the requirements of the proposals? If so, is 12 months a sufficient period? If a transition period longer than 24 months is required please explain why.</p>