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Investment Managers
Australian Securities and Investments Commission (ASIC)
GPO Box 9827
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Consultation Paper 367 *Remaking ASIC class orders: CO 13/760, CO 13/761, and ASIC Instrument 2022/449*

To whom it may concern

Ernst & Young Australia (EY) welcomes the opportunity to offer its views on Consultation Paper 367 *Remaking ASIC class orders on financial requirements: [CO 13/760], [CO 13/761], and ASIC Instrument 2022/449*, issued by ASIC.

We support ASIC's request to seek feedback on proposals to remake 'sunsetting' class orders that impose financial resource requirements on the managed funds industry.

- ASIC Class Order [CO 13/760] Financial requirements for responsible entities and operators of investor directed portfolio services, which is due to expire on 1 October 2023;
- ASIC Class Order [CO 13/761] Financial requirements for custodial or depository service providers, which is due to expire on 1 October 2023; and
- ASIC Corporations (Financial Requirements for Corporate Directors of Retail Corporate Collective Investment Vehicles) Instrument 2022/449, which is due to expire on 1 October 2024.

Our responses follow and include further clarifying details.

B2Q2 - Significant issues with the operation of CO 13/761

EY is aware of two issues that relate to the operation of CO 13/761.

The first relates to whether the Net Tangible Assets (**NTA**) requirement applies to licensees with the requisite AFSL authorisation that fall into the category of an incidental provider where they currently do not operate a custodial service or provide custodial services.

The second relates to the definition of Average Revenue which in RG 166 *AFS Licensing : Financial requirements (RG 166)*, includes a note that “the revenue of a licensee includes any revenue of an authorised representative of the licensee acting on the licensee’s behalf”. However, this note is absent from the existing class order and proposed instrument.

B1Q4 / B2Q4 / B3Q2 - Significant issues with the operation of the various class orders

In relation to the different definition of “intangible assets” across the various class orders, instruments and RG 166 including the class orders and instrument that are subject to the current consultation. Specifically, whether it is ASIC’s intention to include or exclude a deferred tax asset (**DTA**) in the definition of an intangible assets applicable to different licensees.

Our comments are detailed below.

1. Net Tangible Asset Requirement for Incidental Providers

Background

Under section 912AC(4)(b) of the *Corporations Act 2001* (Cth) (the Act) (as modified by ASIC Class Order CO 13/761), licensees who are incidental custodial providers are required to hold at all times NTA of \$150,000 or 10% of average revenue, whichever is greater. Currently, licensees may only be exempted from the NTA requirement if the licensee’s custodial services are held by a third-party custodian pursuant to section 912AC(5) of the Act.

Section 912AC(12) of the Act provides that an incidental provider means a licensee that is authorised to provide custodial or depository services and only provides custodial services where it is necessary to do so in order to provide other financial services to clients, and the custodial or depository services revenue must be less than 10% of its financial services business revenue.

EY Comment

We have received comments from our clients who fall into the incidental provider definition, but despite holding a custodial authorisation, do not currently operate a custodial service or provide custodial services. The current legislation does not mention whether the NTA requirement applies to licensees in such circumstances, notwithstanding that the entities have an AFSL authorisation to provide custodial services.

We understand ASIC has previously expressed the position that NTA obligations apply to licensees by the mere fact that a licensee holds a custodial authorisation, and that ASIC has used section 912AC of the Act (as modified by ASIC Class Order CO 13/761) to support this position.

EY reserves its position on the issue but has sighted advice that licensees do not have to meet an NTA requirement where the licensee does not actually operate a custodial service or provide custodial services, notwithstanding that their AFS licence authorises them to do so. Some of these arguments are summarized in the following two paragraphs:

- i. RG 166 provides that the NTA requirements 'apply to a provider of custodial or depository services'. Pursuant to section 766E of the Corporations Act, a licensee provides custodial or depository services if they hold financial products in trust for a client. On this basis, it can be argued that having a custodial authorisation does not make a licensee a 'custodial or depository services' provider. Rather, a licensee only becomes a custodial or depository services provider when it begins to hold financial products on behalf of its clients.
- ii. The language in section 912AC(1)(a) of the Corporations Act (as modified by CO 13/761) that the section applies to 'a financial services licensee that holds an Australian financial services license authorising it to provide a custodial or depository service' does not mean that having a custodial authorisation obliges licensees to meet the NTA requirements. Rather the authorisation clarifies the target audience of the section as licensees must have the authorisation to provide the service by law. The language around authorisations in section 912AC(1)(a) therefore qualify the section as opposed to denoting that all licensees with custodial authorisations are subject to NTA requirements.

We note the above interpretations but make no comment as to their validity.

Accordingly, the following requires clarification:

1. Whether the proposed instrument could provide more specific guidance on what NTA applies for an AFSL holder that has an authorisation to provide custodial services, but in practice, does not provide those services?
2. What is ASIC's position on custodial authorisations that are held but not used by a licensee? Specifically, whether licensees are able to continue to hold such authorisations.

2. Definition of Average licensed custodial or depository service revenue

Background

The definition of Average licensed custodial or depository service revenue at RG 166.167 includes the following note below the definition:

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

However, the proposed instrument does not include the same note.

EY Comment

EY seeks to clarify the definition of “average revenue” under the proposed new instrument subject to this consultation, and whether it should align to RG 166.

1. Accordingly, the following requires clarification: Whether the proposed instrument could provide more specific guidance in respect of the treatment of revenue of any authorised representative acting on the licensee's behalf.
2. Whether the Note in RG166.167 has the force of law if it is not included in the proposed instrument.

3. Definition of “intangible assets” with respect to a Deferred Tax Asset (DTA)

Background

The proposed instruments subject to this consultation and *ASIC Corporations (Financial Requirements for Issuers of Retail OTC Derivatives) Instrument 2022/705* (ASIC Instrument 2022/705), which is not subject to this consultation, contain conflicting and misaligned definitions of “intangible assets”, with respect to whether a DTA should be included or excluded as an “intangible asset”. Furthermore RG 166 is silent on how to treat a DTA. The definition of “intangible assets” in the proposed Instruments, ASIC Instrument 2022/705 and RG 166 are stated below:

Proposed new instruments:

***excluded assets** means in relation to a financial services licensee:*

*(a) intangible assets (**excluding**, for the avoidance of doubt, a deferred tax asset) other than a right-of-use asset arising under a lease*

ASIC Instrument 2022/705, clause 13:

***excluded assets** means in relation to a financial services licensee:*

*(a) intangible assets (**including**, for the avoidance of doubt, a deferred tax asset)*

RG 166: AFS licensing: Financial requirements, RG166.153:

***Excluded assets** means, in relation to an AFS licensee:*

(a) intangible assets (i.e. non-monetary assets without physical substance)

EY Comment

Further clarification is required in respect of the definition of “intangible assets” under the proposed new instruments subject to this consultation, as well as the definition in ASIC Instrument 2022/705 and RG 166.

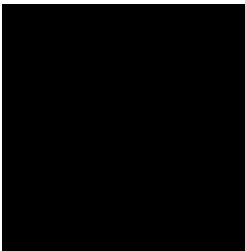
Accordingly, the following requires clarification:

1. We understand the definition in the proposed instruments to mean that a deferred tax asset should be excluded from the definition of an intangible asset. Similarly, a right-of-use asset should also be excluded from the definition of an intangible asset. We recommend that the language used in the definition is simplified for ease of understanding.

2. Is it ASIC's intention for licensees to treat DTAs differently where they have authorisation as a retail OTC derivative issuer? The definition of an intangible asset in ASIC Instrument 2022/705, requires that a DTA is included as an intangible asset, not excluded.
3. Is it ASIC's intention to update RG 166 definitions so as to provide more clarity to licensees not subject to this consultation, or other instrument, as to whether DTAs should be included or excluded when determining intangible assets?

We would be pleased to discuss our comments with ASIC or its staff. If you wish to do so, please contact [REDACTED]

Yours sincerely,



Ernst & Young Australia