



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 302

Proposed changes to ASIC's capital requirements for market participants

July 2018

About this paper

This consultation paper sets out our proposed changes to the ASIC Market Integrity Rules (Securities Markets – Capital) 2017 and the ASIC Market Integrity Rules (Futures Markets – Capital) 2017.

We are seeking feedback from our stakeholders on our proposals to make new rules, amend existing rules and remove rules.

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 4 July 2018 and is based on the Corporations Act as at the date of issue.

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 capital requirements for market participants. 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 Regulation Impact Statement: see Section E, 'Regulatory and financial impact'.

Making a submission

You may choose to remain anonymous or use an alias when making a submission. However, if you do remain anonymous we will not be able to contact you to discuss your submission should we need to.

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

Please refer to our [privacy policy](#) for more information about how we handle personal information, your rights to seek access to and correct personal information, and your right to complain about breaches of privacy by ASIC.

Comments should be sent by 15 August 2018 to:

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What will happen next?

Stage 1	4 July 2018	ASIC consultation paper released
Stage 2	15 August 2018	Comments due on the consultation paper
Stage 3	February 2019	Feedback report to be released ASIC capital market integrity rules to be finalised
Stage 4	2019	ASIC capital market integrity rules to commence Regulatory guide released

A Background

Key points

We have supervised the capital and reporting requirements for non-clearing market participants since 1 August 2011 when supervision transferred from ASX to ASIC. Prior to the transfer of supervision, ASX had not made substantive changes for non-clearing market participants since the year 1999/2000 when ASX Business Rule 1A took effect.

At the time of the transfer of supervision we indicated that, after we had supervised capital and reporting for a period, we would review the regime and its specific rules to determine whether any changes might be needed.

We have now reviewed the capital requirements imposed on market participants by the ASIC market integrity rules, and we are proposing to make a number of changes to simplify and improve the current capital regime.

The ASIC market integrity rules for capital

- 1 Part 7.2A of the *Corporations Act 2001* (Corporations Act) gives ASIC the power to make market integrity rules dealing with activities and conduct in relation to licensed financial markets, including market participants on the relevant market.
- 2 In 2011, we made capital market integrity rules for market participants of the ASX, ASX 24 and Chi-X markets, followed by the SSX and FEX markets in 2013 and 2014 respectively. In 2017, these rules were consolidated into the ASIC Market Integrity Rules (Securities Markets – Capital) 2017 (Securities Capital Rules) and the ASIC Market Integrity Rules (Futures Markets – Capital) 2017 (Futures Capital Rules).
- 3 Market participants (other than principal traders or clearing participants) of the ASX, ASX 24, Chi-X, SSX, NSXA and FEX markets are subject to the financial requirements of the ASIC market integrity rules for capital. All other holders of an Australian financial services (AFS) licence (except for bodies regulated by the Australian Prudential Regulation Authority (APRA)) must meet the financial requirements set out in [Regulatory Guide 166](#) *Licensing: Financial requirements* (RG 166).
- 4 We impose capital requirements to protect the integrity of the market and to protect investors. The capital requirements create a financial buffer that decreases the risk of a disorderly or non-compliant wind-up. They also help to ensure a market participant's continuing capacity to meet financial obligations to clients.

Purpose of consultation

- 5 In Sections B, C and D of this paper we are seeking your feedback on our proposed changes to the Futures Capital Rules and the Securities Capital Rules.
- 6 The proposed changes will ensure the capital regime is fit for purpose and will apply a more consistent capital framework across market intermediaries. In particular, the proposed changes aim to remove a number of discrepancies between the ASIC market integrity rules and the financial requirements of the AFS licensing regime and the market operator's capital requirements. Our proposed rules also aim to bring our capital regime into line with international capital frameworks.
- 7 A number of our proposed changes seek to simplify the capital requirements by removing redundant rules and forms, while others aim to update the capital requirements to take account of the risks associated with operating a market participant business. The proposed rules will also help to better protect investors from the risk of losses arising from the disorderly failure of a market participant's business.
- 8 We consider that elements of the current capital requirements are outdated and are not able to adequately address the risks of operating a market participant business today. We took over the supervision of capital and reporting requirements from ASX in 2011 in their existing form, and we have not reviewed the adequacy of these requirements until now. Prior to the transfer of supervision, ASX had not made any substantive changes to the capital requirements for non-clearing market participants since at least 2000 when ASX Business Rule 1A took effect.
- 9 We also consider that the current capital requirements have fallen out of step with the financial requirements of the AFS licensing regime (which was most recently updated in 2015). For example, we often require certain AFS licensees to hold more capital than market participants for the same level of risk, and impose liquidity management requirements on AFS licensees (but not market participants). We also note that while the Securities Capital Rules impose a \$100,000 core capital requirement on market participants, the financial requirements of the AFS licensing regime require retail OTC derivative issuers to hold net tangible assets of \$1 million, and foreign exchange dealers to hold \$10 million in tier 1 capital (if they elect not to hold adjusted surplus liquid funds).
- 10 If we decide to implement changes to the capital requirements as a result of this consultation process we will look to release new guidance in the form of a regulatory guide. This regulatory guide would give practical guidance on how market participants may decide to meet their obligations under the capital market integrity rules.

B Futures Capital Rules

Key points

The proposed changes to the Futures Capital Rules are:

- requiring market participants of futures markets to comply with a risk-based capital regime instead of the existing net tangible asset regime;
- creating a single capital rule book for securities and futures market participants; and
- introducing a commodity position risk amount.

The draft rules are available on our [consultation papers webpage](#) under CP 302.

Risk-based capital framework

Proposal

B1 We propose to move market participants of futures markets from the existing net tangible asset (NTA) regime to a risk-based capital regime, which would involve creating one capital rule book for securities market participants and futures market participants.

This proposal would require market participants of futures markets (the ASX 24 and FEX markets) to calculate their total risk requirement, and at all times hold liquid capital in excess of this amount.

The proposed single capital framework for both securities and futures market participants would operate in largely the same way as the existing risk-based capital requirements of the Securities Capital Rules, and would not change the capital requirements of market participants of securities markets. All of the existing requirements of the Securities Capital Rules, apart from the minimum core capital requirement, would apply to futures market participants including the proposed changes outlined in Sections C and D below.

We propose that market participants of futures markets would be required to comply with a minimum core capital requirement of \$1,000,000.

We propose to provide a six-month transition period from the time the consolidated capital rule book is registered on the Federal Register of Legislation to the time the consolidated capital rules come into force.

Your feedback

- B1Q1 Do you agree that market participants of futures markets should be subject to a risk-based capital framework? If not, please provide detailed reasons.
- B1Q2 Do you consider a minimum core capital requirement of \$1,000,000 to be an appropriate threshold? If not, please provide details.
- B1Q3 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).
- B1Q4 Would you prefer ASIC to retain the existing NTA requirement or move to a risk-based approach? Please give detailed reasons for your answer.
- B1Q5 Do you foresee any practical issues with imposing a risk-based capital framework on participants of futures markets?
- B1Q6 Do you consider six months to be an appropriate length of time to allow futures market participants to transition from the NTA requirement to the risk-based capital framework?

Rationale

- 11 Our proposal to require market participants of futures markets to comply with a risk-based capital framework would replace the existing NTA requirement and would require a market participant to maintain liquid capital greater than its total risk requirement. We also propose that market participants of futures markets that have a ratio of liquid capital to total risk requirement of 1.2 or less be required to provide weekly or daily risk-based capital returns to ASIC.
- 12 This proposal would involve creating one capital rule book for market participants of both the securities and futures markets and would be largely based on the existing risk-based capital requirements contained in the Securities Capital Rules. The proposed consolidated market integrity rules for capital would not change the existing capital requirements of market participants of securities markets.
- 13 We consider risk-based approaches to capital are preferable to non-responsive regimes such as the NTA requirement (when applied on a standalone basis without an additional risk-based component) as they ensure that market participants have sufficient capital to cover fluctuating risks. Another advantage of adopting a risk-based capital framework is that it encourages market participants to engage in risk reduction techniques, so as to lower their overall capital requirement.

- 14 Most capital regimes in jurisdictions comparable to Australia impose a risk-based approach to capital, and our proposal would more closely align the ASIC market integrity rules with international capital frameworks.
- 15 We also consider that a uniform risk-based approach across both securities and futures markets would create efficiencies for market participants who wish to operate in multiple markets.

Commodity position risk

Proposal

- B2** We propose to introduce a commodity position risk amount to the position risk requirement. This would require market participants to hold additional capital to account for the position risk of holding commodity derivatives or commodity spot positions.

The proposed commodity position risk amount is calculated by converting commodity derivative positions to 'commodity equivalents' and applying a position risk factor, or by applying a position risk factor to the spot price.

For the purposes of this proposed rule, we propose to insert the following definitions:

Commodity includes wheat, sorghum, feed barley, canola, electricity, natural gas, precious metals, raw materials and agricultural products.

Commodity Derivative includes:

- (a) a Future over a Commodity;
- (b) a forward contract over a Commodity;
- (c) a CFD over a Commodity or a basket or index product based on a Commodity; and
- (d) an Option over a Commodity and an Option over a product referred to in paragraph (a).

We propose to introduce the following commodity position risk factors:

Table A5.1.8: Commodity Position Risk Factors

Standard Method	
Commodity spot, forward and futures	8%
Options implied volatility	25%

Your feedback

- B2Q1 Do you agree that market participants should be required to hold additional capital if they hold commodity positions? If not, please provide detailed reasons.
- B2Q2 Do you consider the proposed commodity position risk amount adequately addresses the position risk of holding commodity positions? If not, please provide details.
- B2Q3 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).
- B2Q4 Do you foresee any practical issues with imposing a commodity position risk amount?
- B2Q5 Do you agree with the proposed commodity position risk factors? If not, please provide details.

Rationale

- 16 Currently, commodity positions such as grain and energy derivatives are not specifically addressed in the Securities Capital Rules, and are therefore subject to the 'unusual or non-standard exposures' capital requirement under Rule S1A.2.9. The unusual or non-standard exposures requirement imposes a capital requirement equal to the full market value of the transaction.
- 17 Rather than imposing a capital requirement equal to the full market value of the transaction, our proposed commodity position risk amount seeks to provide a more risk-sensitive approach. We propose that commodity exposures be multiplied by a position risk factor that changes depending on the type of financial instrument being held.

C Securities Capital Rules

Key points

The proposed changes to the Securities Capital Rules include:

- an increased core capital requirement;
- new requirements such as reporting a net asset balance of zero or lower and an underwriting risk requirement;
- the removal of some rules and risk calculation methods; and
- amended definitions of key terms.

The draft rules are available on our [consultation papers webpage](#) under CP 302.

Increased core capital requirement

Proposal

- c1 We propose to amend Rule S1A.2.1 of the Securities Capital Rules so that a market participant of a securities market must ensure that its core capital is at all times not less than \$500,000.

Your feedback

- C1Q1 Do you agree that the core capital requirement should be increased?
- C1Q2 Do you consider that this proposal provides greater protection for retail clients?
- C1Q3 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).
- C1Q4 Do you consider the proposed core capital requirement too onerous? If so, why?
- C1Q5 What do you consider an appropriate length of time for market participants of securities markets to meet the minimum core capital requirement of \$500,000?
- C1Q6 Should ASIC instead introduce a two-tier core capital requirement that distinguishes between market participants based on the type of business being conducted (e.g. a \$500,000 core capital requirement for market participants that hold client money, and a \$250,000 core capital requirement for market participants that do not hold client money)?

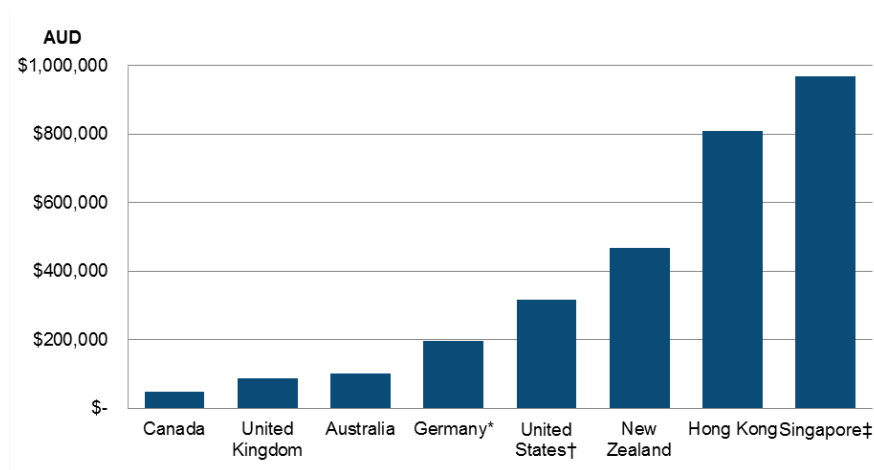
Rationale

- 18 The core capital requirement has remained at \$100,000 for more than 17 years, during which time the risks associated with operating a financial services business have increased. Movements in inflation have also reduced the value of the core capital requirement in real terms.
- 19 This proposal seeks to create a financial buffer that decreases the risk of market disruption from a disorderly wind-up by ensuring that a market participant can be unwound without losses by clients and creditors. It will also provide greater client money protection by increasing a market participant's ability to absorb losses, which reduces the risk that a market participant will use client money to fund operating expenses.
- 20 A market participant must hold enough capital to absorb losses incurred from liquidating its own positions or from closing out a customer's defaulting positions guaranteed to the clearer. We consider a \$500,000 core capital requirement is an appropriate level to cover this risk.
- 21 We have considered the capital frameworks of New Zealand and Singapore, where the base-level capital requirement is approximately \$500,000. We consider that the current core capital requirement of \$100,000 is low and not reflective of the risks faced by market participants.
- 22 Figure 1 shows how ASIC's \$100,000 core capital requirement compares with the base-level capital requirement in comparable jurisdictions.

Note 1: The exchange rates used in Figure 1 were correct as at 14 March 2018.

Note 2: See Table 1 in the appendix for an accessible version of Figure 1.

Figure 1: Comparison of base-level capital requirements



* €50,000 if not authorised to hold client money.

† US\$50,000 for introducing brokers.

‡ S\$500,000 for licence holders who do not carry client positions; S\$250,000 for licence holders who do not carry client positions, deal only with accredited investors, and do not hold client money.

- 23 In the 12 months to 30 April 2018 three market participants (out of a total of 35) consistently held core capital of less than \$500,000. A further two market participants had a core capital balance of less than \$500,000 at some point during the same period.

Underwriting and sub underwriting risk requirement

Proposal

- c2 We propose to implement the following underwriting and sub underwriting risk requirement in Annexure 4 to Schedule 1A of the Securities Capital Rules:

A4.1.1 Nature of underwriting risk amount

The Underwriting and Sub Underwriting Risk Requirement is the absolute sum of the individual underwriting risk amounts calculated using the methods of calculation set out in this Annexure 4.

A4.1.2 Method

The underwriting risk amount for each Underwriting Commitment or Sub Underwriting Commitment (**Relevant Commitment**) made by a Market Participant:

- (a) is the product of:
 - (i) the amount underwritten or sub underwritten by the Market Participant under the Relevant Commitment, less any part of that amount that has been:
 - (A) sub underwritten under a Sub Underwriting Commitment; or
 - (B) received under a client placement; and
 - (ii) the underwriting risk factor specified in Table A5.4.1, Annexure 5; and
 - (iii) the relevant standard method Position Risk Factor specified in Part A5.1; and
- (b) commences on the first date upon which funds can be accepted by the Market Participant for the issue of the Financial Instrument that is the subject of the Relevant Commitment; and
- (c) ceases once the Relevant Commitment becomes unconditional.

A4.1.3 Underwriting—Counterparty risk

- (1) A Market Participant that makes an Underwriting Commitment must:
 - (a) treat as a Positive Credit Exposure any amount outstanding from a client (**Buying Client**) that has made an application to buy the Financial Instruments the subject of the Underwriting Commitment, as at the closing date for applications;
 - (b) calculate in accordance with Annexure 1 to this Schedule a counterparty risk amount on that Positive Credit Exposure, from

- the time that the Market Participant pays the issuer until the time the Buying Client pays the Market Participant; and
- (c) for the purposes of calculating a counterparty risk amount under paragraph (b), use the “cost” or “subscription” price as the market value of the Financial Instruments if the market value is not known.
- (2) The Market Participant may, for the purposes of calculating a counterparty risk amount under paragraph (1)(b), reduce the amount of its Positive Credit Exposure by any part of that amount that has been sub underwritten under a Sub Underwriting Commitment.

A4.1.4 Underwriting—Position risk

- (1) A Market Participant that makes an Underwriting Commitment or Sub Underwriting Commitment (each a **Relevant Commitment**) must:
- (a) treat as a principal position any shortfall in applications to buy the Financial Instruments the subject of the Relevant Commitment, as at the closing date for applications; and
- (b) calculate in accordance with Annexure 3 to this Schedule a position risk amount in respect of that principal position, from the time of the closing date for applications; and
- (c) for the purposes of calculating a position risk amount under paragraph (b), use the “cost” or “subscription” price as the market value of the Financial Instruments if the market value is not known.
- (2) The Market Participant may, for the purposes of calculating a position risk amount under paragraph (1)(b), reduce the amount of its principal position by any part of that amount that has been sub underwritten under a Sub Underwriting Commitment.

For the purposes of Rule A4.1.2(a), we propose to introduce the following underwriting risk factor:

Table A5.4.1: Underwriting Risk Factor

Risk Factor	
All Underwritings	5%

For the purposes of the underwriting risk requirement, we propose to amend the following definition:

Underwriting Commitment means a commitment to take up Financial Instruments where others do not acquire or retain them under an underwriting agreement or other similar agreement calculated using:

- (a) the price stated in the underwriting or similar agreement; or
- (b) in the case of a new float where the price is not known, the indicative price, until the price is known.

Your feedback

- C2Q1 Do you agree that a market participant should hold additional capital if it engages in underwriting or sub underwriting activity? If not, please provide reasons.
- C2Q2 Do you consider our proposed underwriting and sub underwriting risk requirement adequately addresses underwriting risk? Does your business have alternative approaches to manage underwriting risk?
- C2Q3 Do you agree that a market participant need not hold additional capital if the underwriting or sub underwriting is fully sub underwritten or fully subscribed? If not, please provide reasons.
- C2Q4 Are you satisfied that our proposed underwriting and sub underwriting risk requirement adequately addresses the risk of regulatory arbitrage among entities that engage in underwriting/sub underwriting?
- C2Q5 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).
- C2Q6 Is it sufficiently clear how the underwriting and sub underwriting risk requirement must be calculated?

Rationale

- 24 We consider that a market participant should hold additional capital if it engages in underwriting or sub underwriting activity. This proposed change seeks to address the risk of losses resulting from an under-subscribed underwriting or sub underwriting where the issue is not sub underwritten. Market integrity is likely to be jeopardised by the disorderly failure of a market participant where its counterparties depend on its financial performance.
- 25 To account for the fact that a market participant's contingent liability under an underwriting/sub underwriting is reduced by sub underwritings and/or funds received by the underwriter/issuer under client placements, we propose that a market participant only calculate its underwriting risk amount on the net underwriting/sub underwriting commitment. The net underwriting/sub underwriting commitment is calculated by reducing the total amount of the relevant commitment by any amount that has been sub underwritten, or by funds received by the underwriter/issuer under a client placement. We propose that an underwriting risk factor and position risk factor be applied to the net underwriting/sub underwriting commitment to derive the underwriting risk requirement.
- 26 In proposing an underwriting and sub underwriting risk requirement, we are mindful of the possibility for regulatory arbitrage among entities that engage

in underwriting activities. Indeed, this proposal removes the potential for regulatory arbitrage as our proposed underwriting and sub underwriting risk requirement aims to reach a level of equivalence with the existing financial requirements for AFS licensees.

- 27 AFS licensees that incur actual or contingent liabilities when transacting with clients as principal (other than where the contingent liabilities, if crystallised, are less than \$100,000) must comply with the adjusted surplus liquid funds (ASLF) requirement. For an underwriting, the ASLF requirement obliges AFS licensees to hold \$50,000, plus 5% of adjusted liabilities between \$1 million and \$100 million, plus 0.5% of adjusted liabilities exceeding \$100 million. There is a maximum requirement of \$100 million ASLF.
- 28 In calculating ASLF for an underwriting, an AFS licensee may make adjustments to reflect that an asset will be acquired if the contingent liability crystallises. The standard adjustment for a contingent liability under an underwriting or sub underwriting is 5%. However, that asset cannot be allowed to count in excess of the liability and has to be discounted for market and credit risk. The discount factors are 16% for equities and debt instruments, and 8% for derivatives and sub underwriting receivables.
- 29 For example, if an AFS licensee fully underwrites a \$100 million securities issue (and has 50% of it sub underwritten), the AFS licensee must hold \$50,000 plus 5% of the total contingent liability (i.e. \$5 million). The AFS licensee may make an adjustment to reflect that it will receive a sub underwriting receivable if the contingent liability crystallises. The standard adjustment for a contingent liability is 5% (i.e. \$5 million); however, this amount must be discounted by 8% (i.e. a total adjustment of \$4.6 million). Therefore, in this example the AFS licensee must hold ASLF of \$450,000 (i.e. \$50,000 + \$5 million – \$4.6 million).
- 30 Under our proposed underwriting and sub underwriting risk requirement, a market participant that fully underwrites a \$100 million securities issue (and has 50% of it sub underwritten) would need to calculate its underwriting and sub underwriting risk requirement by applying an underwriting risk factor (i.e. 5%) and position risk factor (i.e. 16%, assuming that the issue is not an equity in a recognised market index) to its net underwriting exposure (i.e. \$50 million). Therefore, in this example the market participant must hold additional liquid capital of \$400,000 (i.e. \$50 million x 5% x 16%).
- 31 Our proposal to insert Rule A4.1.3 (Underwriting—Counterparty risk) does not impose any new requirements, but instead seeks to remind market participants of the counterparty risk that may arise following an underwriting commitment. Once an underwriting commitment ceases, a market participant must calculate a counterparty risk amount on any exposure to clients where a client has made an application for securities but where payment remains outstanding.

- 32 Similarly, our proposal to insert Rule A4.1.4 (Underwriting—Position risk) does not impose new requirements, but reminds market participants of the position risk that may arise following an underwriting or sub underwriting commitment. Once an underwriting or sub underwriting commitment ceases, a market participant must calculate a position risk amount on any principal position acquired from a shortfall in applications.

Counterparty risk requirement sub underwritten positions method

Proposal

- c3 We propose to implement a sub underwritten positions method to the counterparty risk requirement in Annexure 1 to Schedule 1A of the Securities Capital Rules:

A1.2.7 Sub Underwritten Positions method

For a Market Participant that has received a Sub Underwriting Commitment, the counterparty risk amount in respect of the Sub Underwriter is:

- (a) from the time the Sub Underwriting Commitment is entered into until the time the Sub Underwriting Commitment becomes unconditional, the product of:
 - (i) the amount sub underwritten by the Sub Underwriter under the Sub Underwriting Commitment, less any part of that amount that has been:
 - (A) secured by collateral which is Liquid, evidenced in writing and valued at the mark-to-market value; or
 - (B) received from the Sub Underwriter; and
 - (ii) the sub underwriting risk factor specified in Table A5.2.3, Annexure 5;
- (b) from the time the Sub Underwriting Commitment becomes unconditional until 31 days after the Sub Underwriting Commitment becomes unconditional, 100% of the amount sub underwritten by the Sub Underwriter under the Sub Underwriting Commitment that remains due from the Sub Underwriter.

For the purposes of Rule A1.2.7, we propose to introduce the following sub underwriting risk factor:

Table A5.2.3: Sub Underwriting Risk Factor

Risk Factor	
All Sub Underwriting Commitments	2%

For the purposes of the sub underwritten positions method, we propose to insert/amend the following definitions:

Sub Underwriter means a person who has made a Sub Underwriting Commitment.

Sub Underwriting Commitment means a commitment to take up Financial Instruments where others do not acquire or retain them under a sub underwriting agreement or other similar agreement calculated using:

- (a) the price stated in the sub underwriting or similar agreement; or
- (b) in the case of a new float where the price is not known, the indicative price, until the price is known.

Your feedback

- C3Q1 Do you agree that a market participant should hold additional capital if it engages a sub underwriter? If not, please provide reasons.
- C3Q2 Do you consider our proposed sub underwritten positions method adequately addresses the counterparty risk associated with sub underwriting? Does your business have alternative approaches for managing this risk?
- C3Q3 Do you agree that the counterparty risk amount for a sub underwriting should commence at the time the sub underwriting commitment is entered into, and cease 31 days after the commitment becomes unconditional? If not, please provide reasons.
- C3Q4 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).
- C3Q5 Is it sufficiently clear how the counterparty risk requirement using the sub underwritten positions method must be calculated?

Rationale

- 33 We consider that a market participant should hold additional capital if it engages a sub underwriter to sub underwrite an issue, and this proposal seeks to address the counterparty risk generated by a sub underwriter counterparty.
- 34 To help mitigate the risk that a sub underwriter will fail to meet its sub underwriting commitment, we propose that a market participant should be required to calculate a counterparty risk requirement by applying a sub underwriting risk factor to its net sub underwriting exposure.
- 35 Under Rule A1.1.1 of the Securities Capital Rules this amount may be further reduced by a counterparty risk weighting, which varies depending on the type of counterparty providing the sub underwriting commitment.

Unusual or non-standard exposures—Credit derivatives

Proposal

- c4** We propose to insert a new rule in Schedule 1A of the Securities Capital Rules which would require a market participant to calculate an unusual or non-standard exposure risk amount for credit derivatives. The proposed rule applies a standard 8% risk weighting and a counterparty-specific risk weighting to either the notional amount or the maximum payout of the credit derivative.

Your feedback

- C4Q1 Do you agree that a market participant should be required to calculate a credit derivative-specific non-standard risk amount? If not, please provide details.
- C4Q2 Do you consider that this proposal adequately addresses the counterparty risk of credit derivatives?
- C4Q3 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).

Rationale

- 36 As credit derivatives are not specifically described in Schedule 1A of the Securities Capital Rules, a market participant with an exposure arising from credit derivatives must currently calculate an unusual or non-standard exposure risk amount equal to the full market value of the transaction.
- 37 Our proposed unusual or non-standard exposure risk amount for credit derivatives seeks to provide a more risk-sensitive approach to calculating a position risk amount for credit derivatives (including but not limited to credit default swaps and first-to-default baskets).
- 38 By applying a counterparty-specific risk weighting, we propose that the capital requirement incurred by a market participant from purchasing or issuing credit derivatives is responsive to the risk posed by the market participant's counterparty.

Removal of risk calculation methods

Proposal

- c5** We propose to remove a number of risk calculation methods in the Securities Capital Rules to make it easier for market participants to calculate their risk requirements. We propose to remove:
- (a) Part A3.3 Building block method—Equity position risk;
 - (b) Part A3.4 Contingent loss matrix method—Equity position risk;

- (c) Part A3.7 Arbitrage method—Equity position risk;
- (d) Part A3.12 Building block method—Debt position risk;
- (e) Part A3.13 Contingent loss matrix method—Debt position risk; and
- (f) Part A3.20 Contingent loss matrix method—Foreign exchange position risk.

Your feedback

- C5Q1 Do you agree that reducing the number of risk calculation methods will make it easier to comply with the Securities Capital Rules? If not, please provide reasons.
- C5Q2 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).
- C5Q3 Would you prefer ASIC to retain the existing risk calculation methods, or make further changes to simplify risk requirement calculations? Please give detailed reasons for your answer, and include in your response what risk calculation methods (if any) you consider can either be removed from the rules or simplified.

Rationale

- 39 We consider that reducing the number of risk calculation methods in the Securities Capital Rules will make it easier for market participants to calculate their risk requirement and understand when additional capital should be held.
- 40 The risk calculation methods we propose to remove are not currently employed by any market participants, and we do not consider it likely that these methods will be used in the future.

Amended counterparty risk requirement

Proposal

- c6** We propose to amend the methods used for measuring counterparty risk amounts in the Securities Capital Rules to allow market participants to use the non-margined financial instruments method to calculate counterparty risk for unsettled trades in margined equities, debt instruments and warrants.

We also propose to amend the margined financial instruments method so that the counterparty risk amount (where a market participant does not charge an initial margin, or charges an amount lower than the applicable percentage in Table A5.2.2) is the applicable minimum initial margin specified in Table A5.2.2 (along with any uncollected variation margin).

Your feedback

- C6Q1 Do you agree that margined equities, debt instruments and warrants should be subject to the non-margined financial instruments method? If not, please provide details.
- C6Q2 Do you agree that where an initial margin isn't charged (or where the initial margin is low) that the counterparty risk amount should be the potential credit exposure factor in Table A5.2.2?
- C6Q3 Do you consider that this proposal adequately addresses counterparty risk?
- C6Q4 Is it sufficiently clear how the counterparty risk requirement must be calculated?
- C6Q5 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).

Rationale

- 41 The non-margined financial instruments method is currently only available to market participants where the unsettled trades in financial instruments are not margined and not covered by one of the other calculation methods. The counterparty risk amount under the non-margined financial instruments method is 3% of the client balance (where the trades have not remained unsettled for more than 10 business days). Alternatively, the counterparty risk amount under the margined financial instruments method is 100% of the client balance.
- 42 As market participants are generally not required to pay cash margins (or impose cash margins on the client), we consider that margined equities, debt instruments and warrants can be subject to the non-margined financial instruments method.
- 43 ASX Clear amended the non-margined financial instruments method in the ASX Clear Operating Rules in June 2013, allowing clearing participants to use the non-margined financial instruments method to calculate counterparty risk for unsettled trades in margined equities, debt instruments and warrants.
- 44 Our proposal would align the counterparty risk requirement with the non-margined financial instruments method in the ASX Clear Operating Rules. This would ensure that the Securities Capital Rules do not impose a higher counterparty risk requirement on market participants than those imposed on clearing participants of the ASX market.
- 45 The proposal to require a market participant that does not charge an initial margin (or charges an initial margin lower than the applicable percentage in Table A5.2.2) to calculate its counterparty risk amount as the applicable

potential credit exposure factor specified in Table A5.2.2 (along with any uncollected variation margin) seeks to impose a minimum counterparty risk amount for margined financial instruments.

- 46 Our proposal would remove the ability of market participants to circumvent holding additional capital for the counterparty risk of margined financial instruments by not charging an initial margin, or charging a low initial margin.

Requirement to report a net asset balance of zero or lower

Proposal

- c7 We propose to introduce a requirement into Rule 9.2.2 of the Securities Capital Rules so that a market participant must notify ASIC immediately if its net assets are equal to or fall below zero. Should net assets be equal to or fall below zero, we propose that we may direct a market participant to provide a daily capital liquidity return to ASIC.

Your feedback

- C7Q1 Do you agree that market participants with negative net assets should be required to lodge daily returns with ASIC? If not, please provide reasons.
- C7Q2 Do you consider that this proposal will help ASIC to identify liquidity and solvency issues in a more timely manner?

Rationale

- 47 Requiring a market participant to notify ASIC if its net assets are equal to or fall below zero will provide ASIC with insight into liquidity and solvency issues. Requiring a daily lodgement of an ad hoc risk-based return or summary risk-based return will allow ASIC to closely monitor the financial health of a market participant with solvency issues.
- 48 A positive net asset requirement is already a requirement for AFS licensees.

Reporting requirements of 'partnership' market participants

Proposal

- c8 We propose that market participants that are partnerships have the same reporting requirements as market participants that are not partnerships. To this end, we propose to remove:
- (a) Rules 9.2.3(c) and 9.2.3(d);
 - (b) Rules 9.2.4(1)(b), 9.2.4(1)(f) and 9.2.4(1)(g);
 - (c) Rule 9.2.5; and

- (d) Schedule 1C Form 7: Risk-Based Capital Requirements—
Partnership Statutory Declaration.

We also propose to remove the text 'if the Market Participant is not a partnership' from Rules 9.2.3(a), 9.2.3(b), 9.2.4(1)(a), 9.2.4(1)(d) and 9.2.4(1)(e).

Your feedback

- C8Q1 Do you consider that market participants that are partnerships should largely be required to comply with the same requirements as other market participants? If not, please provide reasons.
- C8Q2 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).

Rationale

- 49 The existence of different requirements for market participants that are partnerships has been a source of confusion for other market participants, and adds complexity to the Securities Capital Rules.
- 50 We believe that market participants that are partnerships should largely be required to comply with the same requirements as other market participants, and that removing most references to market participants that are partnerships will simplify the Securities Capital Rules.
- 51 Currently, market participants that are partnerships are required to submit their annual audited risk-based return and associated documents to ASIC within two months of the end of the market participant's financial year, as opposed to three months. Market participants that are partnerships are also required to submit to ASIC (within 10 business days after the end of June and December each year) a partnership statutory declaration.

Aged debtors report

Proposal

- c9 We propose to insert an aged debtors report into Schedule 1C of the Securities Capital Rules.

Your feedback

- C9Q1 Do you agree that a market participant should be required to disclose its aged debtors to ASIC? If not, please provide details.

Rationale

- 52 We propose to insert an aged debtors report into the forms in Schedule 1C of the Securities Capital Rules, so that a market participant must disclose its aged receivables to ASIC in its monthly risk-based return.
- 53 Receivables often form a significant part of a market participant's balance sheet, and the recoverability of receivables becomes increasingly important during times of liquidity stress. Our proposal seeks to provide ASIC with a greater understanding of a market participant's financial situation, and removes the need for ASIC to request this information under notice.

Removal of subordinated debt from core capital calculation

Proposal

- C10** We propose to remove the ability of a market participant to meet its core capital requirement through the use of approved subordinated debt by removing Rule S1A.2.4(8) of the Securities Capital Rules.

If we decide to adopt proposal C1 of this paper, we may allow market participants to rely on Rule S1A.2.4(8) for a transitional 24-month period.

Your feedback

- C10Q1 Do you agree that approved subordinated debt should not be used to meet the core capital requirement? If you disagree, please provide reasons.
- C10Q2 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).
- C10Q3 Do you think a 24-month transitional period would give sufficient time to comply with an increased core capital requirement?

Rationale

- 54 Disallowing the use of subordinated debt to meet the core capital requirement under Rule S1A.2.1(b) of the Securities Capital Rules will strengthen the risk management profile of market participants. We consider capital is preferable to the use of subordinated debt because it represents a permanent commitment of funds, is freely able to absorb losses, ranks behind creditors in the event of wind-up and does not result in recurring service obligations such as interest payments.
- 55 There are currently no market participants that rely on the use of approved subordinated debt to meet the minimum core capital requirement. However,

if we adopt a higher minimum core capital requirement (see proposal C1 of this paper) then we may allow market participants to use approved subordinated debt to meet the core capital requirement for a transitional 24-month period.

Updated accounting terminology

Proposal

- c11** We propose to amend definitions in the Securities Capital Rules to update and align them with the Australian Accounting Standards. In particular, we propose to:
- (a) amend the definition of 'Financial Asset Revaluation Reserves' so that it is consistent with Accounting Standard AASB 9 *Financial Instruments*; and
 - (b) replace the term 'Future Income Tax Benefit' with 'Deferred Tax Asset'.

Your feedback

C11Q1 Do you have any comments on our proposed amendments to the definition of 'Financial Asset Revaluation Reserves' or 'Future Income Tax Benefit'?

Rationale

- 56 We propose to amend the definition of 'Financial Asset Revaluation Reserves' to become 'Financial Asset and Liability Revaluation Reserves', remove reference to 'available for sale' financial assets, and insert a reference to financial liabilities revalued at fair value through other comprehensive income. This change will align the definition with Accounting Standard AASB 9 *Financial Instruments*, which categorises financial assets and liabilities differently from the outgoing AASB 139 *Financial Instruments: Recognition and Measurement*.
- 57 We also propose to replace the outdated term 'Future Income Tax Benefit' with 'Deferred Tax Asset'.

Amended definition of 'Liquid'

Proposal

- c12** We propose to amend the definition of 'Liquid' in the Securities Capital Rules to 'realisable or otherwise convertible to cash within 31 days' (as opposed to 30 days).

Your feedback

C12Q1 Do you have any comments on our proposed amendment to the definition of 'Liquid'?

Rationale

- 58 Amending the definition of 'Liquid' from an asset 'realisable or otherwise convertible to cash within 30 days' to an asset 'realisable or otherwise convertible to cash within 31 days' will allow market participants to treat all term deposits as liquid.
- 59 This proposed change is the result of changes to liquidity requirements by APRA, whereby banks now require a minimum of 31 days' notice of early withdrawal from term deposits.

Amended definition of 'Qualifying Debt Instruments'**Proposal**

- c13 We propose to amend the definition of 'Qualifying Debt Instruments' in the Securities Capital Rules so that references to 'credit rating agencies recognised by the Australian Prudential Regulation Authority' are removed.

We also propose inserting the following definition:

Credit Rating Agency means an agency licensed by ASIC to carry on a business of providing credit ratings in Australia.

Your feedback

C13Q1 Do you have any comments on our proposed amendment to the definition of 'Qualifying Debt Instruments' or our proposed definition of 'Credit Rating Agency'?

Rationale

- 60 This proposed change is the result of a change in the regulatory and licensing framework for credit rating agencies, where credit rating agencies are required to hold an AFS licence and are regulated by ASIC.

Updated recognised market indexes table**Proposal**

- c14 We propose to update Table A5.1.6: Recognised Market Indexes in the Securities Capital Rules to recognise the following market indexes:
- (a) Euronext 100;
 - (b) NZX 50;

- (c) FTSE STI; and
- (d) KOSPI 200.

Your feedback

C14Q1 Do you agree with the inclusion of Euronext 100, NZX 50, FTSE STI and KOSPI 200 in our list of recognised market indexes? If not, please provide details.

C14Q2 Are there any other market indexes that you believe should be recognised by ASIC?

Rationale

- 61 This proposal seeks to ensure that the list of market indexes in Table A5.1.6 is current. A number of the indexes listed in the table have been renamed since Table A5.1.6 was introduced.

Updated recognised regulator tables

Proposal

- c15 We propose to update Table A5.3.1: Recognised Non European Regulator and Table A5.3.2: Recognised European Regulator in the Securities Capital Rules to recognise the following regulators:
- (a) Financial Markets Authority (New Zealand);
 - (b) New Zealand Stock Exchange (New Zealand);
 - (c) Financial Industry Regulatory Authority (United States);
 - (d) Finanstilsynet (Denmark);
 - (e) European Central Bank (European Union);
 - (f) European Securities and Markets Authority (European Union); and
 - (g) Finansinspektionen (Sweden).

Your feedback

C15Q1 Do you agree with our proposal to increase the number of recognised financial regulators? If not, please provide details.

C15Q2 Are there any other financial regulators that you believe should be recognised by ASIC?

Rationale

- 62 This proposal seeks to ensure that the list of recognised regulators in Table A5.3.1: Recognised Non European Regulator and Table A5.3.2: Recognised European Regulator is current. A number of the regulators listed in the tables have been renamed since Tables A5.3.1 and A5.3.2 were introduced.

- 63 We consider that the entities listed in Tables A5.3.1 and A5.3.2 have a level of regulatory oversight that qualifies as an approved institution for the purposes of calculating the counterparty risk amount.

D Securities Capital Rules and Futures Capital Rules

Key points

The proposed changes to the Securities Capital Rules and the Futures Capital Rules are:

- the introduction of liquidity requirements;
- exempting banks from the Securities Capital Rules and the Futures Capital Rules; and
- requiring market participants to notify ASIC of compliance with other capital requirements.

The draft rules are available on our [consultation papers webpage](#) under CP 302.

Liquidity requirements

Proposal

- D1** We propose to insert a rule in the Securities Capital Rules and the Futures Capital Rules that would require market participants to:
- (a) prepare a projection of cash flows over at least the next 12 months under both normal and stressed scenarios;
 - (b) document the calculations and assumptions on which the projection is based, and describe in writing why they are the appropriate assumptions;
 - (c) update the projection of cash flows when:
 - (i) those cash flows cease to cover the next 12 months;
 - (ii) there is a material change; or
 - (iii) there is reason to suspect that an updated projection would differ materially from the current projection;
 - (d) have the projection of cash flows approved by the board of directors of the market participant, or, if the market participant is a partnership, by two partners of the market participant, at least quarterly; and
 - (e) document a contingency funding plan, procedures for managing liquidity risks, and procedures for the escalation of liquidity issues.

Your feedback

- D1Q1** Do you agree with our proposal to impose liquidity requirements on market participants? If not, please provide detailed reasons explaining why not.

- D1Q2 Do you consider our proposals adequately address the liquidity risks likely to be faced by market participants? Does your business have alternative approaches for managing liquidity risk?
- D1Q3 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).
- D1Q4 Are the proposed liquidity requirements sufficiently clear? Do you consider that additional guidance is required?

Rationale

- 64 We consider that market participants should be required to have adequate liquidity management practices, similar to those imposed on certain AFS licensees. Our proposal is largely based on the tailored cash needs requirement, which applies to responsible entities, investor directed portfolio service (IDPS) operators, custodial or depository service providers, retail over-the-counter (OTC) derivative issuers, and crowd-sourced funding (CSF) intermediaries.
- 65 The proposed requirement to prepare a 12-month projection of cash flows under normal and stressed scenarios seeks to ensure that market participants adopt prudent practices in managing their liquidity risks across a range of different scenarios.
- 66 The proposed requirement to document assumptions and calculations seeks to ensure that market participants are able to demonstrate their liquidity management practices. The proposed requirement to have cash flows approved by the board of directors seeks to ensure that liquidity risk is considered at the board level.
- 67 We believe that market participants should be able to document a contingency funding plan, procedures for managing liquidity risk and escalation of liquidity issues. We consider that this will ensure market participants maintain a robust funding structure and have procedures in place to enable the business to withstand liquidity stress.
- 68 We consider that the majority of market participants already engage in liquidity management practices similar to our proposed requirements.

Authorised deposit taking institutions exempt from complying with ASIC's capital requirements for market participants

Proposal

- D2 We propose to exempt market participants that are also authorised deposit taking institutions from complying with the Securities Capital Rules and the Futures Capital Rules.

Your feedback

- D2Q1 Do you agree with our proposal to exempt market participants that are also authorised deposit taking institutions from complying with the Securities Capital Rules and the Futures Capital Rules? If not, please provide detailed reasons explaining why not.

Rationale

- 69 We consider that market participants that are authorised deposit taking institutions within the meaning of the *Banking Act 1959* (Cth) should be exempted from complying with the Securities Capital Rules and the Futures Capital Rules. The prudential standards applied by APRA appropriately address the financial resource and risk management obligations in the ASIC market integrity rules for capital, and this proposal seeks to avoid regulatory duplication.
- 70 While we propose that authorised deposit taking institutions be exempted from complying with the ASIC market integrity rules for capital, we also propose to be able to exclude a market participant from relying on that exception. We note that this does not interfere with ASIC's ability to relieve market participants from the obligation to comply with the Securities Capital Rules or the Futures Capital Rules, either generally or in a particular case or category.

Obligation to notify ASIC in relation to other capital requirements

Proposal

- D3 We propose to require a market participant to notify ASIC if it ceases to be a principal trader, subject to the capital requirements of an approved clearing facility, or an authorised deposit taking institution.

The proposed rule would also require a market participant to notify ASIC if it has materially breached or is no longer able to comply with the capital requirements of an approved clearing facility or of APRA, and detail what actions it has taken, or will take, to deal with the matter.

Your feedback

D3Q1 Do you agree with our proposal to require market participants to notify ASIC in relation to other capital requirements? If not, please provide detailed reasons explaining why not.

Rationale

- 71 Requiring market participants to notify ASIC in relation to other capital requirements seeks to reduce the risk that a market participant may fail to engage and comply with ASIC's capital requirements once it ceases to be a principal trader, subject to the capital requirements of a clearing facility, or an authorised deposit taking institution.

E Regulatory and financial impact

- 72 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 the integrity of the market; and
 - (b) avoiding unreasonable burden for market participants.
- 73 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:
- (a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;
 - (b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and
 - (c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).
- 74 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.
- 75 To ensure that we are in a position to properly complete any required RIS, please give us as much information as you can about our proposals or any alternative approaches, including:
- (a) the likely compliance costs;
 - (b) the likely effect on competition; and
 - (c) other impacts, costs and benefits.

See 'The consultation process', p. 4.

Appendix: Accessible version of Figure 1

76 This appendix is for people with visual or other impairments. It provides an accessible version in table format of the information contained in Figure 1.

Table 1: Comparison of base-level capital requirements

Country	Base-level capital requirements (A\$)
Canada	\$49,084
United Kingdom	\$88,882
Australia	\$100,000
Germany	\$78,831
United States	\$127,070
New Zealand	\$466,388
Hong Kong	\$810,251
Singapore	\$484,815

Germany: €50,000 if not authorised to hold client money.

United States: US\$50,000 for introducing brokers.

Singapore: S\$500,000 for licence holders who do not carry client positions; S\$250,000 for licence holders who do not carry client positions, deal only with accredited investors, and do not hold client money.

Key terms

Term	Meaning in this document
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act Note: This is a definition contained in s761A.
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASLF	Adjusted surplus liquid funds
ASX	ASX Limited or the exchange market operated by ASX Limited
capital requirements	The requirements imposed on market participants by the ASIC Market Integrity Rules (Securities Markets – Capital) 2017 and ASIC Market Integrity Rules (Futures Markets – Capital) 2017
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
CSF intermediary	An AFS licensee whose licence expressly authorises the licensee to provide a crowd-funding service Note: See s738C of the Corporations Act.
IDPS	An investor directed portfolio service as defined in Class Order [CO 13/763] <i>Investor directed portfolio services</i> or any instrument that amends or replaces that class order
market integrity rules	Rules made by ASIC, under s789G of the Corporations Act, for trading on domestic licensed markets
market participant	A person who is allowed to directly participate in the market under the operating rules of the market
NTA	Net tangible assets

List of proposals and questions

Proposal	Your feedback
<p>B1 We propose to move market participants of futures markets from the existing net tangible asset (NTA) regime to a risk-based capital regime, which would involve creating one capital rule book for securities market participants and futures market participants.</p> <p>This proposal would require market participants of futures markets (the ASX 24 and FEX markets) to calculate their total risk requirement, and at all times hold liquid capital in excess of this amount.</p> <p>The proposed single capital framework for both securities and futures market participants would operate in largely the same way as the existing risk-based capital requirements of the Securities Capital Rules, and would not change the capital requirements of market participants of securities markets. All of the existing requirements of the Securities Capital Rules, apart from the minimum core capital requirement, would apply to futures market participants including the proposed changes outlined in Sections C and D below.</p> <p>We propose that market participants of futures markets would be required to comply with a minimum core capital requirement of \$1,000,000.</p> <p>We propose to provide a six-month transition period from the time the consolidated capital rule book is registered on the Federal Register of Legislation to the time the consolidated capital rules come into force.</p>	<p>B1Q1 Do you agree that market participants of futures markets should be subject to a risk-based capital framework? If not, please provide detailed reasons.</p> <p>B1Q2 Do you consider a minimum core capital requirement of \$1,000,000 to be an appropriate threshold? If not, please provide details.</p> <p>B1Q3 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).</p> <p>B1Q4 Would you prefer ASIC to retain the existing NTA requirement or move to a risk-based approach? Please give detailed reasons for your answer.</p> <p>B1Q5 Do you foresee any practical issues with imposing a risk-based capital framework on participants of futures markets?</p> <p>B1Q6 Do you consider six months to be an appropriate length of time to allow futures market participants to transition from the NTA requirement to the risk-based capital framework?</p>

Proposal	Your feedback						
<p>B2 We propose to introduce a commodity position risk amount to the position risk requirement. This would require market participants to hold additional capital to account for the position risk of holding commodity derivatives or commodity spot positions.</p> <p>The proposed commodity position risk amount is calculated by converting commodity derivative positions to 'commodity equivalents' and applying a position risk factor, or by applying a position risk factor to the spot price.</p> <p>For the purposes of this proposed rule, we propose to insert the following definitions:</p> <p>Commodity includes wheat, sorghum, feed barley, canola, electricity, natural gas, precious metals, raw materials and agricultural products.</p> <p>Commodity Derivative includes:</p> <ul style="list-style-type: none"> (a) a Future over a Commodity; (b) a forward contract over a Commodity; (c) a CFD over a Commodity or a basket or index product based on a Commodity; and (d) an Option over a Commodity and an Option over a product referred to in paragraph (a). 	<p>B2Q1 Do you agree that market participants should be required to hold additional capital if they hold commodity positions? If not, please provide detailed reasons.</p> <p>B2Q2 Do you consider the proposed commodity position risk amount adequately addresses the position risk of holding commodity positions? If not, please provide details.</p> <p>B2Q3 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).</p> <p>B2Q4 Do you foresee any practical issues with imposing a commodity position risk amount?</p> <p>B2Q5 Do you agree with the proposed commodity position risk factors? If not, please provide details.</p>						
<p>We propose to introduce the following commodity position risk factors:</p> <p>Table A5.1.8: Commodity Position Risk Factors</p> <table border="1" data-bbox="335 1344 798 1500"> <thead> <tr> <th colspan="2">Standard Method</th> </tr> </thead> <tbody> <tr> <td>Commodity spot, forward and futures</td> <td>8%</td> </tr> <tr> <td>Options implied volatility</td> <td>25%</td> </tr> </tbody> </table>	Standard Method		Commodity spot, forward and futures	8%	Options implied volatility	25%	
Standard Method							
Commodity spot, forward and futures	8%						
Options implied volatility	25%						

Proposal	Your feedback
<p>C1 We propose to amend Rule S1A.2.1 of the Securities Capital Rules so that a market participant of a securities market must ensure that its core capital is at all times not less than \$500,000.</p>	<p>C1Q1 Do you agree that the core capital requirement should be increased?</p> <p>C1Q2 Do you consider that this proposal provides greater protection for retail clients?</p> <p>C1Q3 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).</p> <p>C1Q4 Do you consider the proposed core capital requirement too onerous? If so, why?</p> <p>C1Q5 What do you consider an appropriate length of time for market participants of securities markets to meet the minimum core capital requirement of \$500,000?</p> <p>C1Q6 Should ASIC instead introduce a two-tier core capital requirement that distinguishes between market participants based on the type of business being conducted (e.g. a \$500,000 core capital requirement for market participants that hold client money, and a \$250,000 core capital requirement for market participants that do not hold client money)?</p>

Proposal	Your feedback
<p>C2 We propose to implement the following underwriting and sub underwriting risk requirement in Annexure 4 to Schedule 1A of the Securities Capital Rules:</p> <p>A4.1.1 Nature of underwriting risk amount</p> <p>The Underwriting and Sub Underwriting Risk Requirement is the absolute sum of the individual underwriting risk amounts calculated using the methods of calculation set out in this Annexure 4.</p> <p>A4.1.2 Method</p> <p>The underwriting risk amount for each Underwriting Commitment or Sub Underwriting Commitment (Relevant Commitment) made by a Market Participant:</p> <p>(a) is the product of:</p> <p>(i) the amount underwritten or sub underwritten by the Market Participant under the Relevant Commitment, less any part of that amount that has been:</p> <p>(A) sub underwritten under a Sub Underwriting Commitment; or</p> <p>(B) received under a client placement; and</p> <p>(ii) the underwriting risk factor specified in Table A5.4.1, Annexure 5; and</p> <p>(iii) the relevant standard method Position Risk Factor specified in Part A5.1; and</p> <p>(b) commences on the first date upon which funds can be accepted by the Market Participant for the issue of the Financial Instrument that is the subject of the Relevant Commitment; and</p> <p>(c) ceases once the Relevant Commitment becomes unconditional.</p>	<p>C2Q1 Do you agree that a market participant should hold additional capital if it engages in underwriting or sub underwriting activity? If not, please provide reasons.</p> <p>C2Q2 Do you consider our proposed underwriting and sub underwriting risk requirement adequately addresses underwriting risk? Does your business have alternative approaches to manage underwriting risk?</p> <p>C2Q3 Do you agree that a market participant need not hold additional capital if the underwriting or sub underwriting is fully sub underwritten or fully subscribed? If not, please provide reasons.</p> <p>C2Q4 Are you satisfied that our proposed underwriting and sub underwriting risk requirement adequately addresses the risk of regulatory arbitrage among entities that engage in underwriting/sub underwriting?</p> <p>C2Q5 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).</p> <p>C2Q6 Is it sufficiently clear how the underwriting and sub underwriting risk requirement must be calculated?</p>

Proposal	Your feedback
<p><i>Proposal C2 (cont.)</i></p> <p>A4.1.3 Underwriting—Counterparty risk</p> <p>(1) A Market Participant that makes an Underwriting Commitment must:</p> <ul style="list-style-type: none"> (a) treat as a Positive Credit Exposure any amount outstanding from a client (Buying Client) that has made an application to buy the Financial Instruments the subject of the Underwriting Commitment, as at the closing date for applications; (b) calculate in accordance with Annexure 1 to this Schedule a counterparty risk amount on that Positive Credit Exposure, from the time that the Market Participant pays the issuer until the time the Buying Client pays the Market Participant; and (c) for the purposes of calculating a counterparty risk amount under paragraph (b), use the “cost” or “subscription” price as the market value of the Financial Instruments if the market value is not known. <p>(2) The Market Participant may, for the purposes of calculating a counterparty risk amount under paragraph (1)(b), reduce the amount of its Positive Credit Exposure by any part of that amount that has been sub underwritten under a Sub Underwriting Commitment.</p> <p>A4.1.4 Underwriting—Position risk</p> <p>(1) A Market Participant that makes an Underwriting Commitment or Sub Underwriting Commitment (each a Relevant Commitment) must:</p> <ul style="list-style-type: none"> (a) treat as a principal position any shortfall in applications to buy the Financial Instruments the subject of the Relevant Commitment, as at the closing date for applications; and 	<p><i>The feedback questions for proposal C2 are on page 40.</i></p>

Proposal	Your feedback
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Proposal C2 (cont.)

The feedback questions for proposal C2 are on page 40.

- (b) calculate in accordance with Annexure 3 to this Schedule a position risk amount in respect of that principal position, from the time of the closing date for applications; and
- (c) for the purposes of calculating a position risk amount under paragraph (b), use the “cost” or “subscription” price as the market value of the Financial Instruments if the market value is not known.

(2) The Market Participant may, for the purposes of calculating a position risk amount under paragraph (1)(b), reduce the amount of its principal position by any part of that amount that has been sub underwritten under a Sub Underwriting Commitment.

For the purposes of Rule A4.1.2(a), we propose to introduce the following underwriting risk factor:

Table A5.4.1: Underwriting Risk Factor

Risk Factor	
All Underwritings	5%

For the purposes of the underwriting risk requirement, we propose to amend the following definition:

Underwriting Commitment means a commitment to take up Financial Instruments where others do not acquire or retain them under an underwriting agreement or other similar agreement calculated using:

- (a) the price stated in the underwriting or similar agreement; or
- (b) in the case of a new float where the price is not known, the indicative price, until the price is known.

Proposal	Your feedback
<p>C3 We propose to implement a sub underwritten positions method to the counterparty risk requirement in Annexure 1 to Schedule 1A of the Securities Capital Rules:</p> <p>A1.2.7 Sub Underwritten Positions method</p> <p>For a Market Participant that has received a Sub Underwriting Commitment, the counterparty risk amount in respect of the Sub Underwriter is:</p> <p>(a) from the time the Sub Underwriting Commitment is entered into until the time the Sub Underwriting Commitment becomes unconditional, the product of:</p> <p>(i) the amount sub underwritten by the Sub Underwriter under the Sub Underwriting Commitment, less any part of that amount that has been:</p> <p>(A) secured by collateral which is Liquid, evidenced in writing and valued at the mark-to-market value; or</p> <p>(B) received from the Sub Underwriter; and</p> <p>(ii) the sub underwriting risk factor specified in Table A5.2.3, Annexure 5;</p> <p>(b) from the time the Sub Underwriting Commitment becomes unconditional until 31 days after the Sub Underwriting Commitment becomes unconditional, 100% of the amount sub underwritten by the Sub Underwriter under the Sub Underwriting Commitment that remains due from the Sub Underwriter.</p>	<p>C3Q1 Do you agree that a market participant should hold additional capital if it engages a sub underwriter? If not, please provide reasons.</p> <p>C3Q2 Do you consider our proposed sub underwritten positions method adequately addresses the counterparty risk associated with sub underwriting? Does your business have alternative approaches for managing this risk?</p> <p>C3Q3 Do you agree that the counterparty risk amount for a sub underwriting should commence at the time the sub underwriting commitment is entered into, and cease 31 days after the commitment becomes unconditional? If not, please provide reasons.</p> <p>C3Q4 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).</p> <p>C3Q5 Is it sufficiently clear how the counterparty risk requirement using the sub underwritten positions method must be calculated?</p>

For the purposes of Rule A1.2.7, we propose to introduce the following sub underwriting risk factor:

Table A5.2.3: Sub Underwriting Risk Factor

Risk Factor	
All Sub Underwriting Commitments	2%

Proposal	Your feedback
<p><i>Proposal C3 (cont.)</i></p> <p>For the purposes of the sub underwritten positions method, we propose to insert/amend the following definitions:</p> <p>Sub Underwriter means a person who has made a Sub Underwriting Commitment.</p> <p>Sub Underwriting Commitment means a commitment to take up Financial Instruments where others do not acquire or retain them under a sub underwriting agreement or other similar agreement calculated using:</p> <ul style="list-style-type: none"> (a) the price stated in the sub underwriting or similar agreement; or (b) in the case of a new float where the price is not known, the indicative price, until the price is known. 	<p><i>The feedback questions for proposal C3 are on page 43.</i></p>
<p>C4 We propose to insert a new rule in Schedule 1A of the Securities Capital Rules which would require a market participant to calculate an unusual or non-standard exposure risk amount for credit derivatives. The proposed rule applies a standard 8% risk weighting and a counterparty-specific risk weighting to either the notional amount or the maximum payout of the credit derivative.</p>	<p>C4Q1 Do you agree that a market participant should be required to calculate a credit derivative-specific non-standard risk amount? If not, please provide details.</p> <p>C4Q2 Do you consider that this proposal adequately addresses the counterparty risk of credit derivatives?</p> <p>C4Q3 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).</p>

Proposal	Your feedback
<p>C5 We propose to remove a number of risk calculation methods in the Securities Capital Rules to make it easier for market participants to calculate their risk requirements. We propose to remove:</p> <ul style="list-style-type: none"> (a) Part A3.3 Building block method—Equity position risk; (b) Part A3.4 Contingent loss matrix method—Equity position risk; (c) Part A3.7 Arbitrage method—Equity position risk; (d) Part A3.12 Building block method—Debt position risk; (e) Part A3.13 Contingent loss matrix method—Debt position risk; and (f) Part A3.20 Contingent loss matrix method—Foreign exchange position risk. 	<p>C5Q1 Do you agree that reducing the number of risk calculation methods will make it easier to comply with the Securities Capital Rules? If not, please provide reasons.</p> <p>C5Q2 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).</p> <p>C5Q3 Would you prefer ASIC to retain the existing risk calculation methods, or make further changes to simplify risk requirement calculations? Please give detailed reasons for your answer, and include in your response what risk calculation methods (if any) you consider can either be removed from the rules or simplified.</p>
<p>C6 We propose to amend the methods used for measuring counterparty risk amounts in the Securities Capital Rules to allow market participants to use the non-margined financial instruments method to calculate counterparty risk for unsettled trades in margined equities, debt instruments and warrants.</p> <p>We also propose to amend the margined financial instruments method so that the counterparty risk amount (where a market participant does not charge an initial margin, or charges an amount lower than the applicable percentage in Table A5.2.2) is the applicable minimum initial margin specified in Table A5.2.2 (along with any uncollected variation margin).</p>	<p>C6Q1 Do you agree that margined equities, debt instruments and warrants should be subject to the non-margined financial instruments method? If not, please provide details.</p> <p>C6Q2 Do you agree that where an initial margin isn't charged (or where the initial margin is low) that the counterparty risk amount should be the potential credit exposure factor in Table A5.2.2?</p> <p>C6Q3 Do you consider that this proposal adequately addresses counterparty risk?</p> <p>C6Q4 Is it sufficiently clear how the counterparty risk requirement must be calculated?</p> <p>C6Q5 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).</p>
<p>C7 We propose to introduce a requirement into Rule 9.2.2 of the Securities Capital Rules so that a market participant must notify ASIC immediately if its net assets are equal to or fall below zero. Should net assets be equal to or fall below zero, we propose that we may direct a market participant to provide a daily capital liquidity return to ASIC.</p>	<p>C7Q1 Do you agree that market participants with negative net assets should be required to lodge daily returns with ASIC? If not, please provide reasons.</p> <p>C7Q2 Do you consider that this proposal will help ASIC to identify liquidity and solvency issues in a more timely manner?</p>

Proposal	Your feedback
<p>C8 We propose that market participants that are partnerships have the same reporting requirements as market participants that are not partnerships. To this end, we propose to remove:</p> <ul style="list-style-type: none"> (a) Rules 9.2.3(c) and 9.2.3(d); (b) Rules 9.2.4(1)(b), 9.2.4(1)(f) and 9.2.4(1)(g); (c) Rule 9.2.5; and (d) Schedule 1C Form 7: Risk-Based Capital Requirements—Partnership Statutory Declaration. <p>We also propose to remove the text 'if the Market Participant is not a partnership' from Rules 9.2.3(a), 9.2.3(b), 9.2.4(1)(a), 9.2.4(1)(d) and 9.2.4(1)(e).</p>	<p>C8Q1 Do you consider that market participants that are partnerships should largely be required to comply with the same requirements as other market participants? If not, please provide reasons.</p> <p>C8Q2 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).</p>
<p>C9 We propose to insert an aged debtors report into Schedule 1C of the Securities Capital Rules.</p>	<p>C9Q1 Do you agree that a market participant should be required to disclose its aged debtors to ASIC? If not, please provide details.</p>
<p>C10 We propose to remove the ability of a market participant to meet its core capital requirement through the use of approved subordinated debt by removing Rule S1A.2.4(8) of the Securities Capital Rules.</p> <p>If we decide to adopt proposal C1 of this paper, we may allow market participants to rely on Rule S1A.2.4(8) for a transitional 24-month period.</p>	<p>C10Q1 Do you agree that approved subordinated debt should not be used to meet the core capital requirement? If you disagree, please provide reasons.</p> <p>C10Q2 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).</p> <p>C10Q3 Do you think a 24-month transitional period would give sufficient time to comply with an increased core capital requirement?</p>
<p>C11 We propose to amend definitions in the Securities Capital Rules to update and align them with the Australian Accounting Standards. In particular, we propose to:</p> <ul style="list-style-type: none"> (a) amend the definition of 'Financial Asset Revaluation Reserves' so that it is consistent with Accounting Standard AASB 9 <i>Financial Instruments</i>; and (b) replace the term 'Future Income Tax Benefit' with 'Deferred Tax Asset'. 	<p>C11Q1 Do you have any comments on our proposed amendments to the definition of 'Financial Asset Revaluation Reserves' or 'Future Income Tax Benefit'?</p>

Proposal	Your feedback
<p>C12 We propose to amend the definition of 'Liquid' in the Securities Capital Rules to 'realisable or otherwise convertible to cash within 31 days' (as opposed to 30 days).</p>	<p>C12Q1 Do you have any comments on our proposed amendment to the definition of 'Liquid'?</p>
<p>C13 We propose to amend the definition of 'Qualifying Debt Instruments' in the Securities Capital Rules so that references to 'credit rating agencies recognised by the Australian Prudential Regulation Authority' are removed.</p> <p>We also propose inserting the following definition:</p> <p>Credit Rating Agency means an agency licensed by ASIC to carry on a business of providing credit ratings in Australia.</p>	<p>C13Q1 Do you have any comments on our proposed amendment to the definition of 'Qualifying Debt Instruments' or our proposed definition of 'Credit Rating Agency'?</p>
<p>C14 We propose to update Table A5.1.6: Recognised Market Indexes in the Securities Capital Rules to recognise the following market indexes:</p> <ul style="list-style-type: none"> (a) Euronext 100; (b) NZX 50; (c) FTSE STI; and (d) KOSPI 200. 	<p>C14Q1 Do you agree with the inclusion of Euronext 100, NZX 50, FTSE STI and KOSPI 200 in our list of recognised market indexes? If not, please provide details.</p> <p>C14Q2 Are there any other market indexes that you believe should be recognised by ASIC?</p>
<p>C15 We propose to update Table A5.3.1: Recognised Non European Regulator and Table A5.3.2: Recognised European Regulator in the Securities Capital Rules to recognise the following regulators:</p> <ul style="list-style-type: none"> (a) Financial Markets Authority (New Zealand); (b) New Zealand Stock Exchange (New Zealand); (c) Financial Industry Regulatory Authority (United States); (d) Finanstilsynet (Denmark); (e) European Central Bank (European Union); (f) European Securities and Markets Authority (European Union); and (g) Finansinspektionen (Sweden). 	<p>C15Q1 Do you agree with our proposal to increase the number of recognised financial regulators? If not, please provide details.</p> <p>C15Q2 Are there any other financial regulators that you believe should be recognised by ASIC?</p>

Proposal	Your feedback
<p>D1 We propose to insert a rule in the Securities Capital Rules and the Futures Capital Rules that would require market participants to:</p> <ul style="list-style-type: none"> (a) prepare a projection of cash flows over at least the next 12 months under both normal and stressed scenarios; (b) document the calculations and assumptions on which the projection is based, and describe in writing why they are the appropriate assumptions; (c) update the projection of cash flows when: <ul style="list-style-type: none"> (i) those cash flows cease to cover the next 12 months; (ii) there is a material change; or (iii) there is reason to suspect that an updated projection would differ materially from the current projection; (d) have the projection of cash flows approved by the board of directors of the market participant, or, if the market participant is a partnership, by two partners of the market participant, at least quarterly; and (e) document a contingency funding plan, procedures for managing liquidity risks, and procedures for the escalation of liquidity issues. 	<p>D1Q1 Do you agree with our proposal to impose liquidity requirements on market participants? If not, please provide detailed reasons explaining why not.</p> <p>D1Q2 Do you consider our proposals adequately address the liquidity risks likely to be faced by market participants? Does your business have alternative approaches for managing liquidity risk?</p> <p>D1Q3 What impact would this proposal have on your business? Please include any benefits or costs (in dollar terms) associated with the proposal (as a one-off benefit or cost, and on an annual basis).</p> <p>D1Q4 Are the proposed liquidity requirements sufficiently clear? Do you consider that additional guidance is required?</p>
<p>D2 We propose to exempt market participants that are also authorised deposit taking institutions from complying with the Securities Capital Rules and the Futures Capital Rules.</p>	<p>D2Q1 Do you agree with our proposal to exempt market participants that are also authorised deposit taking institutions from complying with the Securities Capital Rules and the Futures Capital Rules? If not, please provide detailed reasons explaining why not.</p>
<p>D3 We propose to require a market participant to notify ASIC if it ceases to be a principal trader, subject to the capital requirements of an approved clearing facility, or an authorised deposit taking institution.</p> <p>The proposed rule would also require a market participant to notify ASIC if it has materially breached or is no longer able to comply with the capital requirements of an approved clearing facility or of APRA, and detail what actions it has taken, or will take, to deal with the matter.</p>	<p>D3Q1 Do you agree with our proposal to require market participants to notify ASIC in relation to other capital requirements? If not, please provide detailed reasons explaining why not.</p>