Stockbrokers
And Financial Advisers
Association Limited

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ASIC CONSULTATION PAPER CP 302 – CAPITAL REQUIREMENTS FOR MARKET PARTICIPANTS

We refer the ASIC Consultation Paper CP 302 – Proposed Changes to ASIC's Capital Requirements for Market Participants.

The Stockbrokers and Financial Advisers Association ("SAFAA") has some comments to make in relation to certain specific items in the proposed changes.

In general, members have indicated that they are in a position to meet the proposed new capital requirements and understand ASIC's objectives in carrying out the review of capital requirements.

We make the following comments:

1. **CP302(C11) Updated accounting terminology to align them with the Australian Accounting Standards.** Members have noted that ASIC is not currently proposing to clarify/amend the capital liquidity requirements for the imminent release of AASB 16 Leases. The new standard will force participants to recognise the gross cost of lease obligations as a "Right of Use" asset and a corresponding

liability for payments due under the lease. This will have consequences which include the effect of significantly increasing the value of Excluded Assets and therefore the requirement to hold additional cash to offset (i.e. additional to the 30-40% impact set out with regards to proposal C1 above).

The underlying economics of leasing arrangements have not changed, it is just that the new accounting principles bring those obligations on to the balance sheet.

There is currently an offsetting provision where Participants can apply to ASIC to have a related asset and liability offset on the grounds that they arise from the same contract.

Members note that ASX Clear have allowed an offset for the liability against the asset for leases, and ASIC should do the same by allowing that assets and liabilities arising from AASB16 be automatically offset/netted off in its Capital Requirements.

2. **CP302(D1) – Liquidity requirements.** In relation to the 12-month cash flow and accompanying requirements, Members who are Clearing Participants have indicated that, as the requirements are aligned to ASX Clear, then they have no issues with meeting the proposed requirements.

   Firms who do not clear strongly argue that the requirements are excessive and unnecessary. Those firms argue that the proposal places additional administration, processes and approvals that provide no additional commercial value or governance/assurance to current monitoring of liquidity obligations. Those firms argue that the risk-based model is far superior to the cash flow model in that it is more responsive to changing market conditions and changes to a participant's financial performance and position.

   If the proposed change is pursued, one suggestion to better balance the administrative burden would be to replace the ongoing 12-month update requirement with an annual requirement where the update obligation applies only where a material change to cash flow or business operations occurs.

3. **Exclusion of Approved Subordinated Debt**. The exclusion of subordinated debt is viewed as unjustified. Subordinated debt is seen as a potentially important tool in the case of unforeseen short term drops in liquidity, for example, arising from market shocks or other unforeseen events or factors. Drawing on subordinated debt in those circumstances can be a practical and flexible, and a less costly way of dealing with the need to maintain capital in such

circumstances. The alternative of increasing a Participant's capital base raises questions of timing and Corporations Act legal and procedural requirements. There is also the impact that additional share capital would have on shareholders forgoing a significant proportion of future dividends. There is also then the question of retiring the capital if it is no longer needed. Retaining approved subordinated debt as an option to utilize in such circumstance is seen as important.

We would be happy to discuss any issues arising from these comments, or to provide any further material that may assist. Should you require any further information, please contact the writer on or email .

Yours sincerely,