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[redacted]
Senior Executive Leader
Financial Advice and Investment Management
Australian Securities and Investments Commission
Level 5/100 Market St
Sydney NSW 2000

via email: rri.consultation@asic.gov.au

Dear [redacted]

Consultation Paper 388 – Net tangible assets requirements for responsible entities

One Investment Group (**OIG**) welcomes the opportunity to provide a submission to the Australian Securities and Investment Commission's (**ASIC's**) consultation on *Net tangible assets requirements for responsible entities*.

OIG supports ASIC's review of the net tangible assets (**NTA**) requirements for responsible entities as the thresholds have not been updated since 2013, but the costs of operating managed investment schemes (**MIS**) have increased both in terms of regulatory burdens and the wider operating environment for financial services.

OIG supports changing NTA requirements, particularly at the lower end of the requirements and considers any changes for responsible entities must be done at the same time as other AFS licensees to ensure there is alignment between licensees reducing the opportunity for arbitrage between the NTA requirements.

While NTA may be considered as supporting the operational resilience of responsible entities, NTA is considered by licensees as a form of ring-fenced regulatory capital that is not used in the licensees' day-to-day operations but rather to facilitate an orderly transition or wind-up of schemes, the NTA requirements should be calibrated with this in mind.

OIG therefore supports reforms that:

- increase baseline thresholds with larger proportionate increases at the lower end of the existing requirements and CPI increases to the upper-end;
- align adjustments across all licensee authorisations to avoid arbitrage; and
- simplify compliance arrangements so that monitoring is transparent and consistent.

OIG also considers it important that any changes are accompanied by appropriate transition periods to ensure that reforms are implemented in an orderly and proportionate manner.

Options for increasing the NTA requirement for responsible entities

Option 1:
Increase NTA in line with CPI

B1Q1 Please provide your feedback on this option, including reasons in support of your views.

OIG supports a measured, proportionate uplift to the current NTA thresholds.

The thresholds have not been updated since 2013 so their real value, and potentially their effectiveness, may have eroded over time. A targeted increase would help ensure the framework continues to support an orderly transition or wind-up of schemes where the responsible entity fails.

While OIG supports increasing the thresholds, we note that most responsible entities do not operate as trading business, incurring liabilities relating to employees, premises or other operating expenses, and accordingly NTA increases do not necessarily support day-to-day operational capability. NTA is more closely aligned with ring-fenced regulatory capital to be used in the case of collapse as an operational safeguard.

When considering the need for increases to NTA requirements, it is important to reflect on the fact that recent scheme collapses were not directly caused by the NTA levels of the responsible entities involved. In fact, even if responsible entities had held higher NTAs, this would not have prevented the schemes from failing, nor would it have resulted in improved financial outcomes for investors.

The failures of responsible entities may be linked to the collapse of the schemes they operate where member claims have exceeded the available insurance and compensation, resulting in the depletion of NTA reserves even before the responsible entity itself failed. Therefore, increases to NTA thresholds should be viewed within this broader context, recognising that higher NTAs alone may not address the underlying causes or mitigate the consequences of scheme failures.

B1Q2 Do you agree that applying a CPI-linked increase to the financial thresholds specified in the NTA requirement is appropriate to support the objectives of the NTA requirement? If not, why not?
B1Q3 Are there alternative measures to CPI that you consider more appropriate for this purpose? Please provide details.

OIG supports the use of CPI increases as a simple and transparent mechanism to adjust thresholds over time. OIG accepts that care will be needed to select the CPI to be used as price indexing is different in each capital city and will impact responsible entities differently, but with no uniform operating model, having a uniform index that is capable of being independently tracked and planned for is preferred.

OIG does not support alternatives such as changes in funds under management or changes in operating scale or business complexity with these risks being too subjective and difficult to monitor and to plan for and may disrupt competition. For example, when the complexity of a product increases such that the current fund-specific-responsible entity seeks the appointment of an independent responsible entity, the NTA requirements for operating that scheme should not vary between responsible entities and an independent responsible entity should not have to raise capital to be appointed as responsible entity because the mismanagement of the prior responsible entity has made this a more risky scheme to operate. Equally allowing responsible entities the ability to determine their NTA based on their operating costs could allow responsible entities to under-invest in their operational capability to reduce their NTA requirements. Having uniform requirements based on AFSL authorisations ensures all licensees must meet minimum standards supporting competition.

We do not agree that measures more closely aligned to MIS growth better reflect changes in operational scale, as larger responsible entities are more likely to have the capability to operate at scale having invested in automation and other systems making their operations more efficient than, for example, single fund operators and the existing framework already incorporates scaling mechanisms through revenue and asset-based tests, so this proposal risks being duplicative.

If NTA requirements are intended to support a responsible entity to transition a failed scheme or distressed scheme, OIG invites ASIC to consider whether there is scope to offer protection to responsible entities willing to step in and operate the failed scheme or other schemes operated by the impacted responsible entity, reducing the reliance on NTA requirements. At present, when a scheme or responsible entity faces difficulties, the risk of exposure for any potential replacement responsible entity is too great to accept and the scheme and existing responsible entity will likely collapse together. An appropriate "safe-harbour scheme" where a new responsible entity could assist any receiver or manager appointed to a failed scheme/responsible entity without assuming the liabilities of that responsible entity may produce better outcomes for investors and other stakeholders.

B1Q5 Would it be appropriate for ASIC to introduce an ongoing indexation mechanism (e.g. periodic CPI adjustment) for increasing the financial thresholds in the NTA requirement? Why or why not?

For the reasons given above, OIG does not support the introduction of an annual ongoing mechanism to ensure that NTA thresholds increase in line with a uniform measure to estimate cost increases. Costs do not increase in a uniform way and those responsible entities that develop cost efficiencies risk being penalised. OIG supports having certainty for periods of 3 to 5 years and then, if changes are required, a scaled implementation period for any increases.

B1Q6 What impact will this proposal have on competition?

An objective targeted increase to NTA thresholds (rather than subjective measures), implemented over time and in a proportionate manner, is not expected to have a material impact on competition given the number of existing responsible entities.

It is likely to place financial pressure on responsible entities with smaller revenue bases, such as "internal" responsible entities. This may force such businesses to appoint an external professional responsible entity business to act as the operators of their schemes.

Competition should be balanced with consumer protection, however approaches that promote clarity over complexity and staged increases in capital requirements over increases that could have unintended consequences should be favoured.

OIG invites ASIC to consider the cumulative impact of reforms to ensure changes are proportionate and balanced, not adversely affecting competition against consumer protection.

Option 2:
Increase the $150,000 minimum under the concessional NTA requirement

B2Q1 Please provide your feedback on this option, including reasons in support of your views.

OIG supports consideration of an increase to the minimum NTA requirement under the concessional framework as the current minimum requirement of $150,000 has not been updated for a significant period and is unlikely to reflect the contemporary costs associated with supporting a responsible entity during a transitional period.

Raising the minimum threshold would also underscore the expectation that responsible entities are well-established and capable of meeting ongoing obligations and delivering appropriate investor outcomes. Additionally, with a higher minimum threshold, the responsible entity has more “skin in the game” aligning responsible entities more closely with the members of the schemes they operate by ensuring that responsible entities have meaningful capital to lose if they are not appropriately resourced to operate their schemes, manage related risks and respond to emerging issues. This is particularly important at the lower end of the market, where a higher baseline can help reduce the risks associated with under-resourced operators, without placing unnecessary burden on more established entities.

B2Q2 Do you prefer proposal B2(a) or B2(b)? Please provide reasons.
B2Q3 If we adopt proposal B2(a), what should the fixed amount be? What is the basis for this?
B2Q4 Do you agree that this proposal is appropriate to support the objectives of the NTA requirement? If not, why not?

OIG prefers proposal B2(a)—an uplift to the fixed minimum NTA threshold—over proposal B2(b).

A fixed minimum delivers a requirement that is clear, straightforward and predictable, and it better supports the objective of ensuring responsible entities hold a baseline level of financial resources.

OIG does not support the “per scheme” model contemplated by B2(b). In practice, responsible entities typically operate with shared people, systems, governance and infrastructure across multiple schemes. A per-scheme requirement would therefore risk overstating the underlying risk and could disproportionately affect multi-scheme business models without any corresponding increase in the risks being managed.

OIG considers a $1 million minimum threshold strikes an appropriate balance. It is a meaningful uplift from current settings that supports the objective of ensuring responsible entities have sufficient operational capacity, while avoiding an increase that would create undue barriers to entry or reduce competition.

If the minimum threshold is increased in this manner, we believe it should operate for a minimum period and there should be clarity about how the threshold will be reviewed and changed in the future. Businesses need certainty.

More generally, increasing the minimum threshold can support the objectives of the NTA framework, provided it remains directed to operational capability and resilience, and does not operate as a prudential capital buffer.

B2Q6 What effect will this proposal have on competition?

Increasing the minimum concessional NTA threshold to $1 million over an appropriate transitional period is unlikely to have a material impact on competition.

This level represents a proportionate uplift that supports alignment between responsible entities and members supporting confidence in the industry while maintaining accessibility for new and emerging participants.

As above, OIG notes the risk to industry if the current reforms being contemplated are not considered holistically.

Option 3:
Increase the $5 million cap under the concessional NTA requirement

B3Q1 Please provide your feedback on this option, including reasons in support of your views.
B3Q2 If we adopt this proposal, what do you think the new cap should be? What is the basis for this?
B3Q3 Do you agree that this proposal is appropriate to support the objectives of the NTA requirement? If not, why not?

OIG considers that any adjustment to the $5 million cap should be undertaken in a staggered and proportionate manner, consistent with the approach outlined under Option 1.

While the current cap has not been updated since 2013 making a modest uplift appropriate (to ensure that the cap achieves its legislative objective), OIG does not support a material increase to the cap. We believe that the more significant and beneficial change would increasing the minimum threshold as referred to above.

The purpose of the NTA requirement is support the responsible entity in a transitional phase not to manage market or credit risks and significantly increasing the cap without a clear link to the risks the framework is designed to address, would increase costs to members (as responsible entities would need to charge higher fees to justify the reduction in performance these higher capital requirements would impose on responsible entities).

OIG supports maintaining the cap in real terms through a measured adjustment mechanism, such as indexation. This would ensure that the cap continues to operate effectively over time, without introducing disproportionate increases in capital requirements.

Appropriateness of the liquidity component

B4Q1 Do you consider the cash or cash equivalents and liquid assets requirements imposed on responsible entities remain appropriate? Please provide specific details and reasons.

OIG notes that most responsible entities do not operate as trading businesses (incurring no expenses in relation to employees, premises or IT for example) and accordingly while the liquidity framework plays an important role in ensuring that responsible entities will have access to sufficient liquid resources if they need to meet short-term obligations during a transitional phase, it is rare that the financial requirements used in NTA satisfaction are used to support the ongoing operation of schemes or the responsible entity itself.

Accordingly, a requirement for an RE to hold liquid assets equal to 100% of the NTA requirement is not commensurate to the risk. While it is important that responsible entities maintain adequate liquidity, requiring the full NTA amount to be held in liquid assets can result in capital being held in a highly constrained form, limiting flexibility and efficiency in capital management and increasing the fees paid by members to support the return required by operators to bare the risks of being a responsible entity.

A more calibrated approach would ensure that liquidity requirements continue to support operational resilience, without imposing unnecessary constraints.

B4Q2 If we adopt Option 1 (proposal B1), should we increase the cash or cash equivalents minimum requirement (currently, $150,000) to reflect cumulative CPI growth since 2013?
B4Q3 If we adopt Option 2 (proposal B2) or Option 3 (proposal B3), should we make any changes to the cash or cash equivalents or liquid assets requirements? Please provide specific details and reasons.

OIG considers that any uplift in NTA thresholds should be paired with a review of the liquidity settings, rather than being applied on a one-for-one basis by default.

Under the current framework, liquidity requirements are directly tied to NTA, so increasing NTA can have a compounding impact on the amount of capital that must be maintained in liquid form.

Accordingly, where NTA thresholds are raised, ASIC should reassess whether the existing liquidity calibration remains appropriate, so the overall regime continues to operate in a proportionate way and stays focused on the risks it is intended to address.

B4Q4 Should we continue to calculate the cash or cash equivalents and liquid assets requirements as a proportion of the NTA the responsible entity is required to hold, or should we use an alternative formula or approach? Please provide specific details and reasons.

OIG supports continuing to link liquidity requirements to NTA, as it provides a clear and consistent basis for the framework.

That said, the setting of the link could be reconsidered. A more proportionate calibration could involve:

- lowering the percentage of NTA that must be held in liquid assets; and/or
- bringing the liquid-asset requirement closer to the existing cash (or cash-equivalents) requirement.

For example, ASIC could set the liquid-asset requirement at a lower ratio (such as 50% of NTA), rather than maintaining the current 100% setting.

This would preserve a clear, enforceable liquidity requirement, while giving entities greater flexibility in how they manage capital.

Transition period to help responsible entities comply with any increased requirement

B5Q1 Do you agree that we should provide a transition period if we decide to adopt one or more of proposals B1–B4?

B5Q2 Do you agree with the transition period being six months? If not, why not?

OIG supports providing a transition period so responsible entities can meet any revised NTA settings and related liquidity requirements.

A transition period helps ensure reforms are implemented in a managed and orderly way, particularly where changes to capital structures, governance arrangements and internal policies are required.

Although a six-month period may be achievable in some circumstances, it may be difficult for some responsible entities—especially where additional capital must be raised or internal sign-offs (including Board approval) are needed.

A longer transition period would provide additional certainty and help minimise unintended disruption, while still enabling reforms to take effect within a reasonable timeframe. For some responsible entities they will want to first try to raise the capital and if that is not possible, they will need time to transition their schemes to another provider. Finding a replacement responsible entity, preparing notices of meetings, holding meetings and then recording the change with ASIC, all take time.

Again the transition timeframe must consider the cumulative effect of changes across the managed investment scheme regime and where various of the NTA and liquidity settings are adjusted at once, additional time may be necessary to allow responsible entities to respond in a coordinated and efficient way.

Alternative approaches

B6Q1 Do you consider that there are alternative approaches to increasing the NTA requirement that are preferable? Please provide details.

If the NTA requirements are not considered operational capital but regulatory capital intended to only be used to transition the operations of failed responsible entity to an operating responsible entity, it may be appropriate to consider the NTA requirements in wider context of what liabilities would be transferred to an incoming responsible entity and what would remain with the old responsible entity. Member outcomes may be better where a scheme is able to transition to a new responsible entity with the liability for any past bad-acts being clearly being allocated to the distressed responsible entity. This allocation would need to flow through to AFCA's jurisdiction to prevent AFCA allocating liability to the new responsible entity because it considered it "fair" to do so.

B6Q2 Other than the objectives described in paragraph 6, are there other factors that we should consider when setting the NTA requirement for responsible entities (noting that the focus of the requirement is on ensuring responsible entities have adequate financial resources under s912A(1)(d) of the Corporations Act)?

When considering changes to the NTA framework, it is important to recognise that capital settings are only one part of a wider regulatory regime, including governance, risk management and supervisory oversight.

Recent scheme failures suggest that shortcomings in areas such as governance, conflicts management and conduct are often the primary causes of poor outcomes. Capital increases on their own are unlikely to remedy these issues.

A more effective approach is to ensure financial requirements are complemented by:

- robust governance and clear accountability arrangements;
- strong risk management and compliance capabilities; and
- targeted supervision and enforcement that is calibrated to risk.

This highlights the need for any NTA changes to be proportionate, targeted and aligned to the risks they are intended to address, rather than being treated as a replacement for the broader regulatory framework.

Appropriateness of the concessional NTA requirement for responsible entities

C1Q1 Do you consider that responsible entities should continue to be subject to a concessional NTA requirement if they meet the requirements relating to custody or fund assets described in paragraphs 29–31? Please give reasons.

Subject to our comments above, OIG supports retaining the concessional NTA requirement where a compliant custodian or other conditions relating to custody of scheme assets are satisfied.

These concessional settings recognise differing operational models are appropriate and reflect an existing key structural feature of many managed investment schemes where scheme assets are held by an independent external custodian, rather than by the responsible entity. In that context, the complexities related to the transition from one responsible entity to another are greatly reduced where the assets are held by a custodian and accordingly NTA requirements intended to address transitional requirements are correspondingly lower.

Continuing the concessional framework helps avoid duplicative capital requirements within the broader scheme structure and ensures financial resource obligations remain focused on the risks the responsible entity actually bears.

OIG also considers the concessional framework supports competition and market diversity by enabling third-party custody arrangements and avoiding unnecessary barriers to entry for responsible entities that do not take on direct custody risk. Custodians have specialist requirements in terms of market connectivity and asset safeguarding that are beyond many responsible entities.

Finally, the concessional settings should be viewed as operating within (and supported by) the broader regulatory framework, including governance, compliance and supervisory oversight, to ensure risks continue to be managed appropriately.

C1Q2 Are there any aspects of the concessional NTA requirement that you think we should change? If so, please provide details about what you think should be changed and your preliminary views about how the change could be achieved.

OIG considers the concessional NTA framework remains broadly fit for purpose and should be maintained.

That said, there may be value in making targeted updates to ensure the framework continues to work effectively over time. These could include:

- refreshing the thresholds to reflect changes in the operating environment, consistent with the approach outlined in Options 1 and 2; and
- clarifying and strengthening the eligibility conditions for the concessional framework, particularly those relating to custody arrangements.

However, OIG does not support removing the concessional framework or making changes that would materially increase capital requirements in circumstances where custody risk is already mitigated through an independent custodian.

Financial resource settings should remain directed to the responsible entity's operational capability and resilience, and be calibrated to the risks it is expected to manage.

NTA requirements for other AFS licensees

Proposed changes to the NTA requirements for IDPS operators and corporate directors of retail CCIVs

OIG supports applying NTA requirements consistently across comparable activities, to promote a level playing field and reduce the scope for regulatory arbitrage.

Where an entity undertakes multiple functions, it is important to consider how the requirements operate in practice. For example, where a responsible entity also acts as an IDPS operator, the settings should appropriately recognise the integrated nature of the business, rather than duplicating or layering requirements in a way that overstates the underlying risk.

Any reforms should remain proportionate to the functions performed and be calibrated to the risks the entity is expected to manage.

Seeking feedback on amending the NTA requirements that apply to other AFS licensees

D2Q2 Do you consider that we should conduct a review and consult on increasing (or otherwise amending) any of the requirements that apply to other AFS licensees outlined in Table 1? Please give reasons why or why not.

OIG supports a review that brings consistency and reduces complexity across the financial services industry.

There should be a review of the appropriate NTA requirements for all AFS licensees. We do not support changes that would only impact responsible entities.

Seeking feedback on imposing NTA requirements on AFS licensees that currently do not have requirements

D3Q1 Should we impose an NTA requirement on other categories of AFS licensees or should we maintain the status quo? Please give reasons.

OIG supports applying NTA requirements consistently across comparable activities, to promote a level playing field and reduce the scope for regulatory arbitrage.

OIG welcomes the opportunity to further discuss the matters outlined in this submission and, if you have any questions relating to our submission, kindly contact [redacted] on [redacted] or by email [redacted].

Yours sincerely

[redacted]

CEO
One Investment Group

[redacted]

Head of Legal, Risk & Compliance
One Investment Group