About this guide

This guide sets out the financial requirements you must meet as the holder of an Australian financial services (AFS) licence. The requirements vary depending on the financial products and services you offer.

If you are a body regulated by the Australian Prudential Regulation Authority (APRA), as defined in s3(2) of the Australian Prudential Regulation Authority Act 1998 (APRA Act), and are not required to comply with s912A(1)(d), this guide does not apply to you.

Note: APRA, and not ASIC, imposes requirements for financial resources for bodies it regulates. This applies even if only a part of your financial services business is an activity that is regulated by APRA.
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 version was issued in November 2012 and is based on legislation and regulations as at the date of issue. This version restructures and clarifies previous versions of Regulatory Guide 166 Licensing: Financial requirements (RG 166) and incorporates content previously published in Regulatory Guide 239 Retail OTC derivative issuers: Financial requirements (RG 239) (now withdrawn).

Previous versions:

Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.
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A Overview

Key points

This guide explains the financial requirements that you must meet as the holder of an Australian financial services (AFS) licence. These requirements vary in their application depending on the nature, scale and complexity of your financial services business.

The requirements do not apply to you if you are a body regulated by APRA: see RG 166.15–RG 166.17.

If you are prudentially regulated overseas, you can apply to us for relief from the requirements: see RG 166.18–RG 166.22.

What are the financial requirements?

RG 166.1 As the holder of an Australian financial services (AFS) licence, you have certain obligations under the Corporations Act 2001 (Corporations Act). For example, you must:

(a) have available adequate financial resources to provide the financial services covered by your AFS licence and to carry out supervisory arrangements (see s912A(1)(d));

(b) do all things necessary to ensure that the financial services covered by your AFS licence are provided efficiently, honestly and fairly (see s912A(1)(a));

(c) have adequate risk management systems (see s912A(1)(h)); and

(d) comply with the conditions on your AFS licence (see s912A(1)(b)), including the prescribed conditions under reg 7.6.04 of the Corporations Regulations 2001 (Corporations Regulations).

Note: We ask questions and may also request supporting documents in the licensing process to help us decide if an applicant is likely to meet these obligations: see Regulatory Guides 1–3 AFS Licensing Kit (RG 1–3).

RG 166.2 This guide explains the financial requirements that we impose on AFS licensees to meet their obligations under the Corporations Act. Table 1 summarises the financial requirements.
Table 1: Summary of the financial requirements for AFS licensees

<table>
<thead>
<tr>
<th>Financial requirement</th>
<th>Who the requirement applies to</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base level financial requirements:</td>
<td>The base level financial requirements apply to all licensees, except those listed in RG 166.13. The base level financial requirements are explained in Section B.</td>
</tr>
<tr>
<td>• the solvency and net assets requirement;</td>
<td></td>
</tr>
<tr>
<td>• the cash needs requirement; and</td>
<td>Note: ‘Tailored’ base level financial requirements apply to some AFS licensees: see Appendices 1–8. Table 2 at the end of this section provides an overview of how the financial requirements apply to particular categories of AFS licensee.</td>
</tr>
<tr>
<td>• the auditing requirement.</td>
<td></td>
</tr>
<tr>
<td>Additional requirements:</td>
<td>The SLF requirement applies to licensees that hold client money or property: see Section C.</td>
</tr>
<tr>
<td>• the surplus liquid funds (SLF) requirement;</td>
<td>The ASLF requirement applies to licensees that transact with clients as principal: see Section D. See Note: OTC retail derivative issuers and foreign exchange dealers that elect to meet a capital requirement generally do not need to meet the ASLF requirement: see Appendices 7–8.</td>
</tr>
<tr>
<td>• the adjusted surplus liquid funds (ASLF)</td>
<td></td>
</tr>
<tr>
<td>requirement.</td>
<td></td>
</tr>
</tbody>
</table>

RG 166.3 We impose these financial requirements to help ensure that:

(a) you have sufficient financial resources to conduct your financial services business in compliance with the Corporations Act (including carrying out supervisory arrangements);

(b) there is a financial buffer that decreases the risk of a disorderly or non-compliant wind-up if the business fails; and

(c) there are incentives for your owners to comply through risk of financial loss.

RG 166.4 In setting financial requirements, we seek to set minimum standards that are framed as clearly and simply as possible so as to provide certainty. We seek to avoid any:

(a) unreasonable burden in maintaining particular levels of assets or in reporting; and

(b) unjustifiable barriers to market entry for providing different kinds of financial services.

RG 166.5 ASIC is not a prudential regulator. Therefore, our financial requirements do not seek to prevent AFS licensees from:

(a) becoming insolvent; or

(b) failing because of poor business models or cash flow problems.
How to comply with the financial requirements

RG 166.6 We generally apply our financial requirements by using our statutory power to modify Pt 7.6, or by AFS licence conditions. Pro Forma 209 Australian financial services licence conditions (PF 209) sets out our standard licence conditions, including licence conditions for financial requirements. The financial requirements operate in this way:

(a) More than one requirement can apply to you—if so, you have to comply with each of them.

(b) If you are required to have assets to meet one requirement, you can also count those assets for another applicable requirement. For example, if you are a responsible entity and need to have $5 million NTA, you can take into account those assets to meet the cash needs requirement in Appendix 2.

(c) You must monitor your compliance with each of your obligations and be satisfied that you are continuously complying.

(d) If you become aware that you have significantly breached, or are likely to significantly breach, a financial requirement, you must give us a written report on the matter under s912D(1).

Note: For further guidance about reporting breaches of licence conditions, see Regulatory Guide 78 Breach reporting by AFS licensees (RG 78).

RG 166.7 You must comply with any requirements applying to you via our modification of Pt 7.6 and/or your AFS licence conditions: see s912A(1)(b) and 912A(1)(c). Meeting the financial requirements will help to ensure that you have adequate financial resources as required by s912A(1)(d) and an adequate risk management system as required by s912A(1)(h).

RG 166.8 This guide is not designed to ensure that you will be able to compensate clients if you breach the AFS licensee obligations in Ch 7 of the Corporations Act. In developing this guide, we have been mindful that there are separate, specific obligations to have compensation arrangements under s912B. Under s912B, a licensee must have compensation arrangements that comply with requirements in any regulations, or requirements, made by us.

RG 166.9 Meeting the financial requirements will also contribute to your continuing capacity to meet financial obligations to clients. However, it is not the focus of this guide to protect clients against credit risk.

Note: For a list of key relevant regulatory guides setting out other licensee obligations, see ‘Related information’. 
Managing financial risk

RG 166.10 We set minimum financial requirements to promote appropriate financial risk management, taking into account the nature, scale and complexity of an AFS licensee’s business. While our requirements are not aimed at preventing licensee failure, they are intended to help ensure that cash shortfalls do not put compliance with the licensee obligations at risk.

RG 166.11 To satisfy your obligation under s912A(1)(h), we expect your risk management systems to specifically deal with the risk that your financial resources will not be adequate to ensure that you are able to carry on your business in compliance with the AFS licensee obligations, or to wind up your business in an orderly manner.

Note: For further guidance about risk management systems, see Regulatory Guide 104 Licensing: Meeting the general obligations (RG 104).

Who this guide applies to

RG 166.12 The AFS licensee obligations and our licence conditions apply whether you are a natural person, a partnership, one of several trustees, or a body corporate. For partnerships and trustees, it is sufficient if any of the partners complies under s761F(1)(a) or any of the trustees under s761FA(3)(a).

RG 166.13 This guide applies to all AFS licensees, except:

(a) bodies regulated by APRA that are not subject to s912A(1)(d) (see RG 166.15–RG 166.17);

(b) bodies subject to an alternative form of foreign prudential regulation—where we are satisfied that the foreign prudential regulation appropriately addresses the licensee obligations for financial resources and risk management (see RG 166.18–RG 166.22); and

(c) market and clearing participants if the financial requirements of the relevant market or clearing and settlement facility are an adequate substitute (see Appendix 1).

RG 166.14 The financial requirements vary in their application depending on the nature, scale and complexity of your financial services business. See Table 2 at the end of this section for an overview of how the financial requirements apply to particular categories of AFS licensee.

Bodies regulated by APRA

RG 166.15 The regulatory regime generally does not subject bodies regulated by APRA to requirements under the Corporations Act for resources and risk management systems: see s912A(1)(d) and 912A(1)(h). This recognises that APRA’s prudential regulation addresses these issues.
RG 166.16 If you are a body regulated by APRA, and are not required to comply with s912A(1)(d), we will not require you to comply with our financial requirements. However, as a condition of your AFS licence, you must remain at all times a body regulated by APRA and your auditor must confirm this to us annually on a positive assurance basis, and at any other time that we request: see PF 209, condition 27.

RG 166.17 The AFS licensee obligations and our licence conditions also apply if you are a related body corporate of a body regulated by APRA, but are not yourself a body regulated by APRA. We note that APRA regulation focuses on the capacity of the body it regulates to meet financial commitments to relevant parties and applies requirements to other group members only in so far as relevant for that purpose. The financial capacity of a subsidiary of an Australian authorised deposit-taking institution (Australian ADI) may not, for example, be material to APRA’s purposes in regulating the ADI.

**Foreign prudentially regulated licensees**

RG 166.18 We consider that recognition of adequate prudential regulation by APRA might equally be applied to prudential regulation by some foreign regulators. If we can be satisfied that there is an alternative form of foreign prudential regulation that appropriately addresses the AFS licensee obligations for financial resources and risk management, we will seek to avoid regulatory duplication.

RG 166.19 If you are prudentially regulated overseas, you can apply to us for relief from the financial requirements. We will give this relief on a case-by-case basis if we are satisfied that you are regulated in a way that is comparable to regulation by APRA for entities of that kind (e.g. a general insurer or deposit-taking institution). If you are a deposit-taking institution, when we consider comparability, we will take into account the extent to which the relevant foreign prudential regulation is consistent with the Basel Committee guidelines for regulating deposit-taking institutions.

RG 166.20 If your application does not contain all relevant information, we will generally refuse it. In limited circumstances, we may consider delaying a decision on your application until you provide more information.

RG 166.21 If we decide not to impose financial requirements on you, you must still comply with the other licensee obligations.

**How to apply for relief**

RG 166.22 To apply for relief from the financial requirements, follow these steps:

(a) Include with your AFS licence application, request for variation of licence, or request for exemption from or modification of a requirement,
a submission for ASIC not to impose its standard licence conditions about financial requirements.

(b) Ensure that your application complies with Regulatory Guide 51 Applications for relief (RG 51).

(c) Candidly set out all information that may be relevant to your application, including details about the foreign regulatory arrangements.

You can also contact ASIC on 1300 300 630 (or +61 3 5177 3988 if dialling from overseas) for information and assistance.

How to use this guide

RG 166.23 As an AFS licensee, you must meet the financial requirements explained in Sections B–D of this guide (except for licensees listed in RG 166.13)—that is, the base level financial requirements, as well as the SLF and ASLF requirements (if applicable).

RG 166.24 In addition, certain categories of AFS licensee must meet ‘tailored’ and/or additional financial requirements that reflect the particular financial products and services offered: see Appendices 1–8. Different financial services activities mean that different financial requirements apply. The categories of AFS licensee for which tailored or additional financial requirements apply are:

(a) Appendix 1: Market and clearing participants;
(b) Appendix 2: Responsible entities;
(c) Appendix 3: Investor directed portfolio services;
(d) Appendix 4: Custodial or depository services;
(e) Appendix 5: Trustee companies providing traditional services;
(f) Appendix 6: Issuers of margin lending facilities;
(g) Appendix 7: Foreign exchange dealers; and
(h) Appendix 8: Retail OTC derivative issuers.

RG 166.25 If your AFS licence authorises you for any one of the types of financial products or services covered by Appendices 1–8, you must meet a combination of the standard financial requirements in Sections B–D, as well as the tailored and additional requirement(s) explained in the relevant appendix. The appendices explain, for particular categories of AFS licensee, which ‘standard’ financial requirements apply and which ‘tailored’, or additional, financial requirements apply.
RG 166.26 Depending on the types of financial products and services you offer, more than one set of financial requirements may apply to you. If this is the case, you need to meet all applicable requirements; however, there is no need to hold separate assets to meet each requirement and you can count the same assets to meet multiple requirements.

RG 166.27 Table 2 summarises the structure of this guide and how the requirements might apply to you.

Revisions to financial requirements in this guide

RG 166.28 Revised financial requirements have been incorporated into this guide for the following categories of AFS licensee:

(a) responsible entities (see RG 166.30); and
(b) retail OTC derivative issuers (see RG 166.31).

RG 166.29 The financial requirements for the remaining categories of AFS licensee are unchanged from the previous version of this guide released in June 2010.

Responsible entities

RG 166.30 Revised financial requirements were released as ‘draft updated RG 166’ in November 2011: see the appendix to Report 259 Draft RG 166 Financial requirements, including requirements for REs that will apply from Nov 2012 (REP 259). These revised financial requirements have been incorporated into Appendix 2 of this guide and apply from 1 November 2012.

Retail OTC derivative issuers

RG 166.31 Revised financial requirements for retail OTC derivate issuers were released in August 2012 as Regulatory Guide 239 Retail OTC derivative issuers: Financial requirements (RG 239). These revised financial requirements have been incorporated into Appendix 8 of this guide, and are being implemented in stages from 31 January 2013 until 31 January 2014: see RG 166.286–RG 166.293.

Note: RG 239 has now been withdrawn.
Table 2: What requirements apply?

<table>
<thead>
<tr>
<th>Category of AFS licensee</th>
<th>Base level financial requirements (Section B)</th>
<th>Additional requirements (Sections C–D and Appendices 1–8)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Solvency and positive net assets requirement</td>
<td>Cash needs requirement</td>
<td>Audit requirement</td>
</tr>
<tr>
<td>All AFS licensees (except bodies regulated by APRA and others listed in RG 166.13): see Sections B–D</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ if required to by one of Appendices 1–8</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ if holding client money or property valued at $100,000 or more</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ if transacting with clients as principal</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Note: OTC retail derivative issuers and foreign exchange dealers electing to meet a capital requirement generally do not need to meet the ASLF requirement.</td>
</tr>
<tr>
<td>Market and clearing participants: see Appendix 1</td>
<td>The financial requirements do not apply if the financial requirements of the relevant market or clearing and settlement facility are an adequate substitute.</td>
<td></td>
</tr>
<tr>
<td>Responsible entities: see Appendix 2</td>
<td>✓</td>
<td>✓ tailored</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ tailored</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ if holding client money or property valued at $100,000 or more</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ if transacting with clients as principal</td>
</tr>
<tr>
<td>Investor directed portfolio service (IDPS) operators: see Appendix 3</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ if holding client money or property valued at $100,000 or more</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ if transacting with clients as principal</td>
</tr>
<tr>
<td>Custodial or depository services: see Appendix 4</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ depending on the nature of your business</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ if holding client money or property valued at $100,000 or more</td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ if transacting with clients as principal</td>
</tr>
<tr>
<td>Category of AFS licensee</td>
<td>Base level financial requirements (Section B)</td>
<td>Additional requirements (Sections C–D and Appendices 1–8)</td>
</tr>
<tr>
<td>-------------------------</td>
<td>-----------------------------------------------</td>
<td>----------------------------------------------------------</td>
</tr>
<tr>
<td></td>
<td>Solvency and positive net assets requirement</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash needs requirement</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Audit requirement</td>
<td></td>
</tr>
<tr>
<td></td>
<td>NTA requirement</td>
<td></td>
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<tr>
<td></td>
<td>SLF requirement</td>
<td></td>
</tr>
<tr>
<td></td>
<td>ASLF requirement</td>
<td></td>
</tr>
<tr>
<td>Trustee companies providing traditional services: see Appendix 5</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Issuers of margin lending facilities: see Appendix 6</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Foreign exchange dealers: see Appendix 7</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Retail OTC derivative issuers: see Appendix 8</td>
<td>✓</td>
<td>✓ tailored</td>
</tr>
</tbody>
</table>
B The base level financial requirements

Key points

The base level financial requirements apply to all AFS licensees except bodies regulated by APRA and others listed in RG 166.13. As a licensee, you must meet the following base level financial requirements:

- the solvency and positive net assets requirement (see RG 166.34–RG 166.36);
- the cash needs requirement (see RG 166.37–RG 166.63); and
- the audit requirement (see RG 166.64–RG 166.70).

Some AFS licensees may have to comply with additional requirements that reflect specific business risks: see Table 2 in the Overview.

We expect that most small business licensees that do not hold client money or property over $100,000 will only need to comply with the base level financial requirements to meet their AFS licence conditions.

RG 166.32 You can only comply with your obligations as an AFS licensee if you have the resources, including financial resources, to do so. The financial resources you have must be enough to cover any risks your business faces that may affect your cash position and that it is reasonable for you to plan to manage. As a licensee, you must meet the following base level financial requirements:

- **The solvency and positive net assets requirement**—At all times you must be solvent (i.e. be able to pay all your debts as and when they become due and payable) and have total assets that exceed total liabilities (as shown in your most recent annual balance sheet lodged with us), and at all times have no reason to suspect that total assets would no longer exceed total liabilities on a current balance sheet.

  Note: If you have more liabilities than assets, you can apply an alternative test. You can calculate on the basis of adjusted assets and adjusted liabilities as defined in Section E. For example, this may apply to you if you rely on an undertaking from an eligible provider such as an Australian ADI.

- **The cash needs requirement**—You must have sufficient resources to meet your anticipated cash flow expenses.

- **The audit requirement**—You must include information about your compliance with the financial requirements in your audit report under s989B(3).

RG 166.33 Tailored base level financial requirements that reflect specific business risks apply to certain AFS licensees: see Table 2 in the Overview and Appendices 1–8 at the end of this guide.
The solvency and positive net assets requirement

Who the solvency and positive net assets requirement applies to

The solvency and positive net assets requirement applies to all AFS licensees (except those listed in RG 166.13).

RG 166.34 The Corporations Act requires directors of a company to prevent insolvent trading by the company: see Div 3 of Pt 5.7B. It is not appropriate for any AFS licensee, including a natural person, to carry on a financial services business while insolvent.

RG 166.35 It is also not appropriate that you carry on a financial services business with liabilities exceeding your assets. AFS licensees that trade when insolvent or while having negative net assets are unlikely to have the resources to carry on the financial services business in compliance with the licensee obligations under Ch 7 of the Corporations Act.

RG 166.36 You should continuously monitor your solvency, but we do not require you to continuously monitor your net assets position. However, you must review it if you have some reason to doubt you have adequate net assets.

The cash needs requirement

Who the cash needs requirement applies to

The cash needs requirement applies to all AFS licensees (except those listed in RG 166.13).

A tailored cash needs requirement applies to:
- responsible entities (see Appendix 2); and
- retail OTC derivative issuers (see Appendix 8).

RG 166.37 As a condition of your AFS licence, you must have sufficient resources to meet your anticipated cash flow expenses (cash needs requirement). Because of the large range of sizes and types of AFS licensee, there are several options that can be used to satisfy the cash needs requirement.

RG 166.38 Unless a tailored cash needs requirement applies to you, you can meet the cash needs requirement by choosing one of five options:

(a) Options 1 or 2 are ‘basic’ options and we expect that most small business AFS licensees will only need to consider complying with Options 1 or 2, and will generally prefer Option 2; or

(b) Options 3, 4 or 5—these options do not require you to prepare projections and may be more suitable for your business if you:

(i) are part of a corporate group; or
(ii) have general financial support from an Australian ADI, or, in some cases, have financial support from foreign deposit-taking institutions; and

(iii) can comply with the requirements for the relevant option.

Note: You must meet all the requirements of the option you select.

RG 166.39 Table 3 gives an overview of the five options available for meeting the cash needs requirement. For the definitions for calculating cash needs, including ‘cash’, ‘cash flow’, ‘eligible provider’ and ‘relevant trust’, see Section E.

Table 3: The five options available to AFS licensees for meeting the cash needs requirement

<table>
<thead>
<tr>
<th>Option</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Reasonable estimate projection plus cash buffer</td>
<td>Option 1 is designed for licensees that maintain a certain level of cash or other liquid financial resources at all times (e.g. by way of commitments by a parent company). We expect this option will be relevant for some small business licensees.</td>
</tr>
<tr>
<td>See RG 166.42–RG 166.46</td>
<td></td>
</tr>
<tr>
<td>2 Contingency-based projection</td>
<td>Option 2 is suitable for all kinds of licensees, including small business licensees that do not always maintain cash or commitments of support from others. We expect this option will be most relevant for small business licensees.</td>
</tr>
<tr>
<td>See RG 166.47–RG 166.49</td>
<td></td>
</tr>
<tr>
<td>3 Financial commitment by an Australian ADI or comparable foreign institution</td>
<td>Option 3 is relevant to licensees that can draw on financial backing from an Australian ADI or a relevantly recognised foreign regulated deposit-taking institution.</td>
</tr>
<tr>
<td>See RG 166.52</td>
<td>We expect this option will not be relevant for small business licensees: see Table 6 and Information release (IR 03-26) Alternative means to satisfy cash needs requirement under PS 166.</td>
</tr>
<tr>
<td>4 Expectation of support from an Australian ADI or comparable foreign institution</td>
<td>Option 4 is relevant to subsidiaries of certain prudentially regulated bodies.</td>
</tr>
<tr>
<td>See RG 166.53</td>
<td>We expect this option will not be relevant for small business licensees: see Table 6 and IR 03-26.</td>
</tr>
<tr>
<td>5 Parent entity prepares cash flow projections on a consolidated basis</td>
<td>Option 5 is relevant to licensees in corporate groups that plan cash flows on a group basis. We expect this option will not be relevant for small business licensees: see Table 6 and Information release (IR 03-44) ASIC provides further options to meet cash needs requirements. There are alternatives under Option 5: Option 5A (suitable for a licensee with a commitment from a parent) and Option 5B (suitable for a licensee without a commitment from a related body corporate).</td>
</tr>
<tr>
<td>See RG 166.54</td>
<td></td>
</tr>
</tbody>
</table>
Basic options (Options 1 and 2)

RG 166.40 Options 1 and 2 are different ways for you to show how you will manage the effect of risks on your cash position through your own projections. Neither option requires you to have at any one time all the cash you might need to meet all your liabilities over the next 3 months.

RG 166.41 Compliance with either Option 1 or 2 will meet the cash needs requirement under our AFS licence conditions and help to ensure you adequately manage financial risks. However, ultimately you must determine what additional measures are appropriate in your circumstances to satisfy your obligation under s912A(1)(h) to have an adequate risk management system.

Option 1: Reasonable estimate projection plus cash buffer

RG 166.42 We expect that Option 1 would be more suitable for larger businesses or those that have external sources of financial support. Option 1 allows you to rely on a simpler calculation based on having in effect 18 days outgoings (i.e. 20% of 3 months) available to you in liquid form. Such a cash buffer will help you manage commercial contingencies.

RG 166.43 Where you have this buffer, we will not require you to document a projection based on the commercial contingencies that may adversely affect your cash position, as is required under Option 2. If you rely on Option 1, you need only prepare a projection based on what you reasonably estimate is most likely. This projection will help you to measure how much cash you might have to hold as a cash buffer to satisfy Option 1.

RG 166.44 To provide a yardstick, you must also calculate how much cash you might have to hold as a cash buffer based on the previous financial year’s cash outflow (if you have done a profit and loss statement for a previous financial year).

RG 166.45 In the end, the cash you have to hold as a cash buffer will be either an amount based on last year’s results or an amount based on your cash flow projection, whichever is the greater.

RG 166.46 Table 4 summarises the requirements you must meet if you choose Option 1: see Section E for key definitions relevant to this option, including a definition of ‘cash’ for the purposes of item 5.
### Table 4: Option 1: Reasonable estimate projection plus cash buffer

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Details</th>
</tr>
</thead>
</table>
| **Projection** | 1 Prepare a projection of cash inflow and outflow (cash flows) over at least the next 3 months based on your reasonable estimate of what is likely to happen over this term.  
  
  Note: You can take into account, for example, the following factors in preparing your projection if you reasonably believe they are likely to be available: assets you hold at the time the projection starts that can be used to pay your liabilities; and inflow you may receive, including income from your business, amounts that you may borrow (e.g. under an overdraft), and amounts that you may receive from your owners or associates as financial support.  
  
  2 Document your calculations and assumptions, and describe in writing why they are the appropriate assumptions.  
  
  Note: We expect that a description in writing of your calculations and assumptions will vary according to the nature, scale and complexity of your business.  
  
  3 Update the projection of cash flows when it ceases to cover the next 3 months, or if you have reason to suspect that an updated projection would show you were not meeting your AFS licence conditions. |
| **Financial resources** | 4 Show, based on your projection of cash flows, that you will have access as needed to enough financial resources to meet your liabilities over the projected term of at least the next 3 months, including any additional liabilities you project you will incur during that term.  
  
  5 Have in cash an amount equal to 20% of the greater of:  
  
  (a) the cash outflow for the projected period of at least the next 3 months (if the projection covers a period longer than 3 months, the cash outflow may be adjusted to produce a 3-month average); or  
  
  (b) your actual cash outflow for the most recent financial year for which you have prepared a profit and loss statement, adjusted to produce a 3-month average. |

#### Option 2: Contingency-based projection

RG 166.47 Option 2 is potentially suitable for all AFS licensees, especially small businesses that do not always maintain cash or commitments of support from others. Option 2 allows you to demonstrate that the risk that you will not have access to adequate cash is sufficiently small by calculating a projection that takes into account a range of commercial contingencies that could impact on your cash position.

RG 166.48 Your projection should demonstrate the effect of the combination of eventualities that makes it most difficult for you to show you will have sufficient cash. However, you can disregard highly unlikely contingencies or combinations of contingency. For example, when calculating what cash you will have available, you can take into account income you expect to receive. However, you also have to take into account the risk that you could have a shortfall in cash inflow. This might arise, for instance, because of bad debts, or increased prices from your suppliers. You would need to take into account these eventualities unless you reasonably believe they are highly unlikely to materially impact on you if the other contingencies you are planning for occur. Similarly, you can take into account the financial support you expect
a parent company or other entity would provide if needed, but only to the extent that the risk that the support would not be provided is highly unlikely.

Note: If you have sufficient financial support from a parent or related entity, you may be able to use Option 3, 4 or 5 instead.

RG 166.49 Table 5 summarises the requirements you must meet if you choose Option 2: see Section E for key definitions relevant to this option (the definition of ‘cash’ will not be relevant to licensees using Option 2).

Table 5: Option 2: Contingency-based projection

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Description</th>
</tr>
</thead>
</table>
| **Projection** | 1 Prepare a projection of cash inflow and outflow (cash flows) over at least the next 3 months that shows your estimate of what would happen if your ability to meet your liabilities over the projected term was adversely affected by commercial contingencies. This includes any liabilities you might incur during the term of the projection. You have to take into account all contingencies that are sufficiently likely for a reasonable licensee to plan how they might manage them.  
Note: We would normally expect you to take into account assets you hold at the start of the projection term that can be used to pay your liabilities and inflow you may receive, including: income from your business or sale of your business; amounts that you may borrow (e.g. under an overdraft); and amounts that you may receive from your owners or associates as financial support.  
However, you may have to reduce the amount of assets and inflow you take into account as part of planning to meet commercial contingencies (e.g. if you lose a key client, or someone who pays you income has a systems failure that delays payments). You will not have to take into account these occurrences if it is highly unlikely that they would materially affect your cash position.  
2 Document your calculations and assumptions, and describe in writing why they are the appropriate assumptions.  
Note: We expect that a description in writing of your calculations and assumptions will vary according to the nature, scale and complexity of your business.  
3 Update the projection of cash flows when it ceases to cover the next 3 months, or if you have reason to suspect that an updated projection would show you were not meeting your licence conditions. |
| **Financial resources** | 4 Show, based on the projection of cash flows, that you will have access as needed to enough financial resources to meet your liabilities over the projected term of at least the next 3 months, including any additional liabilities you might incur during that term. |

Options that do not require projections (Options 3–5)

RG 166.50 In addition to Options 1 and 2, we have provided three further options for AFS licensees that are able to meet their cash needs requirement in a manner that does not involve providing individual cash flow projections: see Table 6. This may be either because they have alternative means of demonstrating that they are likely to have sufficient cash, or because they are part of a large corporate group that manages cash as an economic entity and will prepare appropriate projections.
These options are generally only available to AFS licensees within corporate groups or that have general financial support from an Australian ADI or in some cases a relevantly recognised foreign deposit-taking institution. They are not likely to be relevant to most small business licensees. For these licensees, Options 1 and 2 are most relevant and we expect most small business licensees will prefer Option 2.

Option 3: Financial commitment by an Australian ADI or comparable foreign institution

This option is suitable for AFS licensees able to meet the cash needs requirement in a manner that does not involve providing cash flow projections. In this case, an Australian ADI (or a foreign deposit-taking institution we agree is subject to comparable regulation) has given the licensee (generally, its subsidiary) an enforceable and unqualified commitment to meet the licensee’s financial obligations. This option is necessarily restricted to licensees with a high assurance of adequate cash flow and adequate liquidity risk management overseen by a prudential regulator.

Note: See condition 13(c)(iii) of PF 209 for further details.

Option 4: Expectation of support from an Australian ADI or comparable foreign institution

This option is suitable for AFS licensees that are subsidiaries of an Australian ADI or a foreign deposit-taking institution we agree is subject to comparable regulation for the purposes of this policy. It allows the licensee to rely on an expectation of support, even if there is no enforceable commitment from the parent company. The support can be in the form of a commitment to the licensee or a guarantee for the benefit of creditors generally. The expectation of support must apply in all contingencies that a licensee should reasonably plan for. This is similar to the requirement that the licensee would need to meet if it were using Option 2 for cash inflow from the parent company to be recognised. This means that if the licensee were to prepare projections under Option 2, the projected inflow from the parent company would always offset any cash outflows projected.

Note: See condition 13(c)(iv) of PF 209 for further details.

Option 5: Parent entity prepares cash flow projections on a consolidated basis

This option is suitable for AFS licensees within a corporate group that manages cash flows on a consolidated basis. Under this option, the parent entity prepares cash flow projections that comply with Option 1 or 2. Where there are group-wide cash flow projections, the licensee can then either rely on:

(a) the parent giving an enforceable and unqualified commitment, which is similar to that provided by an eligible provider under Option 3; or
(b) the availability of group resources, based on the reasonable expectation of its responsible officer that it can meet the cash needs requirement in all commercial contingencies for which it should reasonably plan in a way similar to Option 4.

Note: See condition 13(c)(v) of PF 209 for further details.

Table 6: Options 3–5: No projections required

| Option 3: Financial commitment by an Australian ADI or comparable foreign institution | 1 | Have an enforceable and unqualified commitment from an Australian ADI or another entity (such as a foreign deposit-taking institution) approved for this purpose in writing by us. Note: For the purposes of this policy, we may recognise a foreign deposit-taking institution that is regulated in accordance with the Basel Committee guidelines for regulating deposit-taking institutions, which are comparable to the regulation of ADIs. |
| 2 | Ensure that the provider of the commitment pays an unlimited amount on demand from time to time: |
|   | (a) to you; or |
|   | (b) to the extent of the liability, to: |
|   | (i) your creditors; or |
|   | (ii) a trustee for your creditors. |
| 3 | Reasonably expect, based on documented assumptions, that the commitment will remain effective for at least the next 3 months. These assumptions should take into account all commercial contingencies you should reasonably plan for. Note: The definition of 'cash' will not be relevant to licensees using Option 3. This term is not used under this option. |

| Option 4: Expectation of support from an Australian ADI or comparable foreign institution | 1 | Be a subsidiary of an Australian ADI or an entity approved for this purpose in writing by us. Note: We may approve a foreign deposit-taking institution that is regulated in accordance with the Basel Committee guidelines for regulating deposit-taking institutions, which are comparable to the regulation of ADIs. |
| 2 | Reasonably expect (based on access to funds from related bodies corporate) that you will have adequate resources (when needed) to meet your liabilities (including any additional liabilities that you might incur during that period) for at least the next 3 months. You must take into account all commercial contingencies for which you should reasonably plan. |
| 3 | Ensure that a responsible officer has documented that they have the reasonable expectation in item 2 for at least the following 3-month period, together with their reasons for forming the expectation, the contingencies for which you consider it is reasonable to plan, the assumptions made concerning the contingencies and the basis for selecting those assumptions. |
| 4 | Keep the document in item 3 for at least 5 years after the end of the last financial year that includes a part of the period to which the document relates, and give it to us if we request it. Note: The definition of 'cash' will not be relevant to licensees using Option 4. This term is not used under this option. |
### Option 5: Parent entity prepares cash flow projections on a consolidated basis

**1.** Your cash flows and the cash flows of each of your related bodies corporate (the licensee group), other than any body regulated by APRA, are managed on a consolidated basis.

**2.** There is a body corporate within the licensee group of which all members of the licensee group are subsidiaries (the parent entity).

**3.** The parent entity complies with Option 1 or 2, as if:
   - (a) it were the licensee;
   - (b) cash flows of any member of the licensee group were cash flows of the licensee; and
   - (c) any cash held by a member of the licensee group (other than as trustee of a trust) were held by the licensee.

**4.** The parent entity’s registered company auditor gives us a report, together with your annual audit report, as required under your licence, for each of your financial years (and for any other period that we request it, by a date that we request it) about your parent entity’s compliance with Option 1 or 2, consistent with item 3. This report is similar to the report that would be required from your auditor if you were complying with Option 1 or 2 for that period.

   Note: For the terms of the report about compliance with our financial requirements, see PF 209, condition 28.

**5.** Either of the following applies:
   - (a) **Alternative A:** The parent entity has provided an enforceable and unqualified commitment to pay you on demand from time to time an unlimited amount or to meet your liabilities (including any additional liabilities that you might incur while the commitment applies), which you reasonably expect will apply for at least the next 3 months, taking into account all commercial contingencies for which you should reasonably plan.
   - (b) **Alternative B:** You:
     - (i) reasonably expect (based on access to cash from members of the licensee group) that you will have adequate resources to meet your liabilities (including any additional liabilities that you might incur) for at least the next 3 months, taking into account all commercial contingencies for which you should reasonably plan;
     - (ii) ensure that a responsible officer documents that they have this reasonable expectation for at least the following 3-month period, together with the reasons for forming the expectation, the contingencies for which you consider it is reasonable to plan, the assumptions made concerning the contingencies and the basis for selecting those assumptions; and
     - (iii) keep this document for at least 5 years after the end of the last financial year that includes a part of the period to which the document relates, and give it to us if we request it by a date we request.

**6.** You have no reason to believe that the parent entity has not complied with item 3 or has failed to comply, in a material respect, with its obligations under Ch 2M or, if the parent entity is not a company, under any other laws (whether law in Australia or not) relating to financial reporting that apply to it.
Projections, budgeting and risk management

RG 166.55 If an AFS licensee does not have enough cash to meet its liabilities, particularly over a short timeframe like 3 months, there is a greater risk that the licensee may not provide financial services in compliance with the licensee obligations under Ch 7 of the Corporations Act. If cash outflow is planned for and covered, it is less likely that a licensee will feel pressured to cut costs on its compliance arrangements or engage in non-complying conduct.

RG 166.56 Budgeting to meet current and future liabilities and to take into account risks facing the business is good business practice. Planning and monitoring will help an AFS licensee to put in place and maintain appropriate arrangements (including compliance measures) to ensure adequate financial resources are available when required. This is particularly relevant in periods of higher risk for the business (e.g. when a business is growing rapidly or when a new business is in its early stages).

RG 166.57 As part of meeting your obligation to have an adequate risk management system under s912A(1)(h), you need to take into account the risks your business faces and the impact of failing to meet your liabilities. We believe that this is an appropriate part of business and risk management for both small and large AFS licensees.

RG 166.58 Taking into account commercial contingencies, AFS licensees should have sufficient, or access to sufficient, financial resources to cover their liabilities when needed. We recognise that planning on a 12-month basis may be appropriate for many businesses. However, we require as a minimum that planning cover at least the next 3-month period.

Note: The required access to financial resources also needs to cover any additional liabilities that might be incurred over the next 3-month period.

RG 166.59 We are concerned to ensure that AFS licensees monitor their anticipated cash inflow and outflow with enough forward thinking to be able to determine whether there is a real risk that a shortfall will occur over at least the next 3 months. The continuing short-term operation of your financial services business should not be put at risk because you do not reasonably plan to address commercial contingencies.

Note: Under reg 7.6.04(1)(a), you must lodge a notice with us within one business day of any event occurring that may make a material adverse change to your financial position as previously lodged with us. Having budgets will help you to comply with this obligation.

RG 166.60 You can manage the effect of risks that would give rise to a cash shortfall in a number of ways. For example, you may plan to deal with your cash needs by:

(a) injecting additional cash through your owner’s equity or borrowings;
(b) planning to realise liquid assets;
(c) deferring or avoiding expenses which are not necessary to your business or compliance obligations; or

(d) reducing your own drawings or remuneration.

Documenting your plans

RG 166.61 If you comply with Option 1 or 2, it is important that you document your planning process by setting out the results of your planning in a projection and setting out the basis on which it is developed. In planning to meet your commitments, you are better placed than us to determine what risks your business faces and whether these risks are material enough so that it is reasonable for you to plan to meet them. Documenting this assessment helps you to show that you are complying with the AFS licensee obligations and helps you to test and improve your planning processes over time.

Note 1: If you can rely on financial support as set out in Options 3 to 5 and you choose to use one of those options in preference to Option 1 or 2, you do not have to prepare cash flow projections.

Note 2: If you choose Option 4 or 5B, one of your responsible officers must document that they have a reasonable expectation of financial support from related bodies.

RG 166.62 We expect that the amount of documentation you need will vary depending on the nature, scale and complexity of your business. Normally, more documentation will be required where the projected cash position is underpinned by forecasts of likely continuing conduct by others who are not under legal commitments (e.g. clients’ goodwill) than where you are relying on legal rights you have against creditworthy entities to provide cash.

RG 166.63 Reference in documentation to meeting the requirements of industry codes and practices may be useful in helping you to show that your projection meets our requirements. Established industry standards and practices can help you to identify risks and their materiality and how to manage them.

Note: For information about how and when ASIC will approve financial services sector codes of conduct under s1101A of the Corporations Act, see Regulatory Guide 183 Approval of financial services sector codes of conduct (RG 183).

The audit requirement

Who the audit requirement applies to

The audit requirement applies to all AFS licensees (except those listed in RG 166.13).

A tailored audit requirement applies to:

- responsible entities (see Appendix 2); and
- retail OTC derivative issuers (see Appendix 8).
RG 166.64  As a condition of your AFS licence, you must include information about your compliance with the financial requirements in your audit report under s989B(3) (audit requirement).

RG 166.65  The audit report you give us for each financial year under s989B(3) must also contain information about compliance with our financial requirements. If you do not have to provide an audit report under s989B(3), you must still provide us with an audit report about compliance with our financial requirements. You must also give us this information if we request it for a specified period at another time: see s912C(2).

Note: For the terms of the report about compliance with our financial requirements, see PF 209, condition 28.

RG 166.66  The report must contain statements by a registered company auditor addressed to you and ASIC as to whether for the relevant period:

(a) on a positive assurance basis (i.e. an audit basis), in the auditor’s opinion you have complied with our financial requirements other than certain aspects of Options 1 to 5 of the cash needs requirement (see condition 28(d)(i) of PF 209); and

Note: For those AFS licensees that have to meet the adjusted surplus liquid funds (ASLF) requirement in Section D of this guide, the auditor may assume the appropriateness of any adjustments produced by a risk exposure calculation system if we have allowed use of the system as a substitute for standard adjustments: see RG 166.126–RG 166.133. Most licensees will not have to comply with the ASLF requirement.

(b) on a negative assurance basis (i.e. a review basis), the auditor has no reason to believe that:

(i) you did not satisfy the requirements of s912A(1)(h) for managing the risk of having insufficient financial resources to meet the financial requirements; or

(ii) you failed to comply with certain elements of the options to satisfy the cash needs requirement (see condition 28(d)(ii) of PF 209).

Note: We also expect that when giving negative assurance for the purposes of RG 166.66(b), the auditor will take into consideration any information the auditor has from the audit undertaken for RG 166.66(a).

RG 166.67  Since Pt 7.8 already requires audited accounts, asking for opinions in the annual audit on an AFS licensee’s compliance with the financial requirements is unlikely to be a significant additional expense, and will substantially enhance compliance by the licensee with its financial resources and risk management obligations under s912A(1).

RG 166.68  The opinion concerning compliance with the risk management system requirement under s912A(1)(h) and some aspects of our conditions about projections need only be on a negative assurance basis, following a review. To give negative assurance, the auditor will have to see your documentation.
(including your projection) and determine if there is any reason to believe they are not properly prepared. The auditor does not have to give a positive audit opinion about the projections or form a positive opinion that they are reasonable.

RG 166.69 We require only negative assurance on some matters because we recognise the additional burden on an auditor involved in giving audit assurance as to an AFS licensee’s compliance with requirements involving projections or other expectations concerning future events or the adequacy of risk management systems.

RG 166.70 We will not routinely monitor your compliance with the financial requirements. Normally, when we want to check compliance, we will consider asking for an audit. We envisage asking for an audit if we suspect that you may not be complying with your financial resources or risk management obligations (e.g. because of credible complaints). We will allow a reasonable time for you to comply as appropriate in the circumstances.
C The SLF requirement: Licensees that hold client money or property

Key points

If you hold client money or property, you must hold at least $50,000 in surplus liquid funds (SLF) unless the value of the money and property for all clients in total is less than $100,000 (the SLF requirement).

The SLF requirement is on top of the base level financial requirements in Section B applying to all AFS licensees, and the ASLF requirement (see Section D) if this requirement applies to you.

If an AFS licensee does not have a certain buffer of liquid assets, there is an increased risk that client money or property may be applied to meet the licensee’s financial obligations, rather than being held in accordance with its duties to clients.

The SLF requirement

Who the SLF requirement applies to

All AFS licensees (except those listed in RG 166.13) must comply with the SLF requirement if they hold client money or property valued at $100,000 or more.

RG 166.71 If the value of the money and property you hold for all clients in total is over $100,000, you must hold at least $50,000 in SLF if at any time you:

(a) are required to hold money in a separate account under Div 2 of Pt 7.8;
(b) hold money or other property on trust for a client or are required to do so under reg 7.8.07(2) or otherwise; or
(c) have the power to dispose of a client’s property under power of attorney or otherwise.

Note: Payments received by an AFS licensee as the proceeds of insurance claims are not client money. Such money is held at the risk of the insurer: s985B(3). Dealing in an insurance product that is a necessary or incidental part of the settlement of claims for that product is not a financial service: reg 7.1.33(2)(b).

RG 166.72 In calculating whether the money and property has a value of less than $100,000, you need not include:

(a) money that has satisfied a client’s liability on an insurance contract because you are acting under a binder or s985B applies (dealing with discharge of the insured), or property acquired by investment of that money; or
(b) the value of property where you merely hold a document of title, and the client has legal title to the property.

Note: If you are a responsible entity, the property to which the document of title relates may count for calculating your NTA requirement: see Appendix 2.

**Underlying principles**

**RG 166.73** It is internationally accepted that, in addition to the regulatory protections provided by separation of accounts and trust arrangements, financial requirements should apply to financial services providers that hold client assets.

**RG 166.74** Where an AFS licensee holds money paid for insurance by their client and is acting under a binder in accepting the insurance or s985B applies, the risk of loss is on the insurer and not the client in relation to the financial service. When money is held only in that circumstance, the SLF requirement will not apply.

**RG 166.75** We do not apply the SLF requirement if you have less than $100,000 of client money or property. This is because the fixed SLF requirement may be disproportionately burdensome relative to the risk. This applies where, for example, a small payment is received in error from clients and needs to be banked to arrange its application or refund.

**RG 166.76** We do not base the amount of SLF required on the amount of client money or property you hold. We are only seeking to reduce a risk that, at a particular time, you will be subject to pressure to use client money or property to meet your own liabilities. We are not seeking, by imposing financial requirements, to provide a source of compensation for clients whose money or property is misused.
The ASLF requirement: Licensees that transact with clients as principal

**Key points**

As an AFS licensee, you must comply with the adjusted surplus liquid funds (ASLF) requirement in RG 166.77 if:

- certain circumstances concerning transactions with clients apply to you (see RG 166.78); or
- you are a foreign exchange dealer that chooses to comply with this requirement (even if it would not otherwise apply to you) rather than the requirement in Appendix 7 for $10 million of Tier 1 capital.

AFS licensees that are required to have ASLF of more than $50,000 must follow reporting and risk management measures when certain trigger points are reached: see RG 166.83–RG 166.87.

This requirement is additional to the base level financial requirements that apply to AFS licensees generally and any additional financial requirements that may apply to you.

The ASLF requirement

**Who the ASLF requirement applies to**

All AFS licensees (except those listed in RG 166.13) must comply with the ASLF requirement if they transact with clients as principal (as defined in RG 166.78).

An NTA requirement replaces the SLF requirement for retail OTC derivative issuers (see Appendix 8).

Foreign exchange dealers can choose to comply with the ASLF requirement or a capital requirement: see Appendix 7.

**RG 166.77**

If the ASLF requirement applies to you (see RG 166.78), you must hold at least the sum of:

- (a) $50,000; plus
- (b) 5% of adjusted liabilities between $1 million and $100 million; plus
- (c) 0.5% of adjusted liabilities for any amount of adjusted liabilities exceeding $100 million.

There is a maximum requirement of $100 million ASLF.
When does the ASLF requirement apply?

RG 166.78 The ASLF requirement applies to you if:
(a) you incur actual or contingent liabilities of the relevant kind;
(b) this occurs by entering into a transaction with a client; and
(c) the transaction is entered into in the course of providing a financial service to the client.

Note: ‘Actual or contingent liabilities of the relevant kind’ includes a liability under a non-standard margin lending facility to transfer equivalent marketable securities to the client: see Section E for the relevant definition.

RG 166.79 For the purposes of RG 166.78, a client includes a person who acquires or disposes of financial products in a transaction that you entered into at a price you stated in the course of making a market.

RG 166.80 The ASLF requirement does not apply to you if:
(a) the total of:
   (i) the current liabilities that would be included in the calculation of your adjusted liabilities; and
   (ii) the contingent liabilities that if crystallised would be a current liability and be included in the calculation of your adjusted liabilities,

   is less than $100,000; or

(b) you have no:
   (i) liabilities to clients that would be included in calculating your adjusted liabilities; or
   (ii) contingent liabilities to clients which if crystallised would be included in calculating your adjusted liabilities, other than under debentures you issued under Ch 2L.

Note: In determining whether the ASLF requirement applies to you, certain liabilities can be disregarded: see RG 166.82.

How is ASLF calculated?

RG 166.81 To help you understand how to calculate ASLF, see Figure 1 and the definition of ‘ASLF’ in Section E. For the definition of ‘adjusted liabilities’, see Section E.
**What liabilities can be disregarded?**

RG 166.82 For the purposes of determining whether your actual and contingent liabilities are less than $100,000 (see RG 166.80), you can disregard a liability or contingent liability that:

(a) is a contingent liability (and not a liability) that is not:
   
   (i) a derivative; or
   
   (ii) a contingent liability from underwriting securities or managed investment products;

(b) you reasonably estimate has a probability of less than 5% of becoming an actual liability;

(c) is covered by money or property that you hold in a separate account under Pt 7.8 or on trust for clients;

(d) is adequately secured (see the definition of ‘adequately secured’ in Section E);

(e) is a liability incurred by entering into a transaction on a licensed market that is to be settled using a clearing and settlement facility, the operation of which is authorised by an Australian clearing and settlement facility licence;
(f) is under a foreign exchange contract and you are required by a condition in your licence reflecting Appendix 7 to have $10 million of Tier 1 capital;

(g) is under a derivative where:
   (i) you do not make a market in derivatives;
   (ii) you entered into the dealing for the purposes of managing a financial risk;
   (iii) your dealings in derivatives are:
      (A) not a significant part of your business; or
      (B) even if they are a significant part of your business, then they are not a significant part of the combined business of yourself and your related bodies corporate; and
   (iv) you did not enter into the dealing on the instructions of another person;

(h) is under a foreign exchange contract where you:
   (i) do not make a market in foreign exchange contracts;
   (ii) entered into the contract for the purposes of enabling a payment in one of the currencies under the foreign exchange contract; and
   (iii) did not enter into the foreign exchange contract on the instructions of another person;

Note: If you are entering into foreign exchange contracts, see also Appendix 7.

(i) is a liability that was not incurred in:
   (i) providing a financial service by entering into transactions with clients; or
   (ii) transactions that you entered into at a price you stated in the course of making a market; or

(j) is under a margin lending facility where you agree to provide credit to another person, to the extent that any portion of the credit remains undrawn.

What are the reporting triggers?

RG 166.83 If:

(a) you are required to have ASLF of more than $50,000; and

(b) your ASLF is below the trigger points in RG 166.84,

you must not enter into any transactions with clients that could give rise to financial obligations, until your governing body has certified in writing that, having conducted reasonable inquiry into your financial position, there is no reason to believe that you may fail to meet your AFS licensee obligations.
RG 166.84 Each of the following is a trigger point:

(a) if you have between $1 million and $100 million in adjusted liabilities—when your ASLF is less than 5.5% of adjusted liabilities; and

(b) if you have more than $100 million in adjusted liabilities and you do not have $100 million ASLF—when your ASLF is less than $500,000 in excess of the amount that you must have.

RG 166.85 You must ensure a further certification is made at least monthly until your ASLF continuously exceeds the trigger point for at least one month.

RG 166.86 You must keep each certificate for at least 5 years.

RG 166.87 Your governing body must affirm that there will be compliance with financial requirements when trigger points are reached. This enables them to put into place any additional measures that may be needed to ensure you do not breach your AFS licence conditions or other licensee obligations.

**Purpose of the ASLF requirement**

RG 166.88 Market integrity can be jeopardised by disorderly failure of AFS licensees where their counterparties depend on their financial performance. Setting a scaleable and certain standard focusing on liquidity is consistent with international regulatory practice and appropriate management of risks that would impact on your financial stability. We do not seek to prevent failures of licensees, as we are not a prudential regulator. We seek to reduce the risk that failure will occur in circumstances that put at risk your compliance with the licensee obligations.

RG 166.89 Monitoring of trigger points and going through internal processes to comply with certification requirements is an appropriate risk management measure.

RG 166.90 The ASLF requirement applies in some circumstances where you are or may become liable for more than $100,000 in aggregate to clients from transactions you entered into with them. The ASLF requirement is not triggered by liability covered by money held in a separate account under s981B, or other money or property held on trust for a client. If your assets are held separately from clients’ assets, the risk to your financial resources is less because you will not have to use your own assets to meet your financial obligations to clients. The ASLF requirement does not apply to you if your only liabilities to clients are under debentures under Ch 2L. Chapter 2L sets the requirements Parliament thinks appropriate for debenture issuers.

RG 166.91 The ASLF requirement generally only applies when money in excess of $100,000 is owed. The $50,000 minimum ASLF required would be disproportionate to the risk for any lesser obligation.
The $50,000 minimum amount is consistent with the minimum requirement for AFS licensees that hold client money or property.

The required level of ASLF is set at 5% subject to reduced rates where ASLF of more than $5 million is required. Imposing a requirement based on ASLF of 5% broadly reflects the requirements for licensed securities dealers under the old Corporations Act (i.e. as in force immediately before commencement of the Financial Services Reform Act 2001 (FSR Act) on 11 March 2002). However, the requirement is not fully comparable. The approach in this policy involves changes to the calculation of SLF, such as requirements for discounting of assets to reflect market and credit risk.

A reduced ASLF requirement applies where you have at least $5 million in ASLF (bearing in mind that there is a maximum requirement of $100 million ASLF). To meet our objectives, the ASLF requirement need not increase with adjusted liabilities to such an extent as set out in RG 166.77 where more than $5 million is required (or, in cases where $100 million ASLF is held, at all). For example, economies of scale will facilitate economical use of resources in providing capacity to carry on your business in compliance with the AFS licensee obligations or to wind up the business in an orderly manner. The financial requirements are not intended to give assurance of financial capacity to meet liabilities to clients.

The ASLF requirement applies regardless of whether liabilities are to retail or wholesale clients. Regulation of licensees is designed to promote market integrity, efficiency and confidence, as well as consumer protection. We anticipate that the ASLF requirement will apply to persons such as market makers in derivatives (other than derivatives which are foreign exchange contracts, unless the AFS licensee chooses to be subject to the ASLF requirement rather than the requirements in Appendix 7), underwriters of securities issues, issuers of non-cash payment facilities, and dealers in the fixed interest market.

We have noted the requirements that apply for broker–dealers in the United States and certain financial services providers in the United Kingdom. These requirements incorporate a scaleable element and require detailed calculation to quantify risks.

We have adopted a simple approach that is different from regulatory approaches involving more sophisticated adjustments for risk, such as are necessary for prudential regulation. Our focus is on the risk of you being unable to comply with your AFS licensee obligations, and therefore causing a disruption to the market.
Derivatives

RG 166.98 If you only transact with clients by entering into derivatives for the purpose of managing your financial risks, you may be exempted from the requirement to be licensed for this activity under reg 7.6.01(1)(m)–(ma). If you require an AFS licence only for other products and services you provide, but fall within the exemption in reg 7.6.01(1)(m)–(ma) for your derivatives trading, the ASLF requirement may not apply to you (unless you undertake other activities that trigger the ASLF requirement, such as underwriting securities). In this case, you will only need to meet the financial requirements applying to your non-derivatives financial services activities.

RG 166.99 For example, if you are a responsible entity, and only transact with clients by dealing in derivatives to manage your financial risk within the scope of the exemption in reg 7.6.01(1)(m), you are not likely to need to meet the ASLF requirement. Instead, you must meet the NTA requirement applying to responsible entities: see Appendix 2.
E Definitions for calculating financial requirements

Key points

This section sets out the definitions for calculating the financial requirements that apply to you as an AFS licensee.

We seek to enable calculations for financial requirements that best balance the following objectives. They must:

• be as easily understood and certain as possible;
• not be subject to manipulation;
• be based on accepted accounting principles; and
• be a meaningful measure to achieve the purpose of the relevant requirement.

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### Adequately secured

** RG 166.100 ** Adequately secured means:

(a) secured by an enforceable charge over financial products (other than financial products issued by the AFS licensee or its associate) if:

(i) the financial products are:

(A) regularly traded on:

(i) a financial market (as defined in s767A(1) and disregarding s767A(2)) operated by a market licensee or a licensee other than the licensee or its associate that in the reasonable opinion of the licensee produces sufficiently reliable prices to assess the value of the security provided by the charge;

(ii) an ASIC-approved foreign market under Regulatory Guide 72 *Foreign securities prospectus relief* (RG 72); or
(III) a foreign market approved in writing for the purpose by us (see RG 166.101); or

(B) interests in a registered scheme for which withdrawal prices are regularly quoted by the responsible entity, and the licensee believes on reasonable grounds that withdrawal may be effected within 5 business days; and

(ii) the market value of these financial products equals not less than 120% of the amount owing or 109% of the amount owing if the financial products are debt instruments; or

(b) secured by a registered first mortgage over real estate that has a fair market valuation at least equal to 120% of the amount owing; or

(c) owing from a provider that is an eligible provider for the category of licensee in question; or

(d) secured by an enforceable charge over amounts owing to another licensee which themselves are adequately secured.

**Approval of a foreign market**

**RG 166.101** We will approve a foreign market for the purposes of RG 166.100(a)(i)(A)(III) if the AFS licensee demonstrates that it is a market in which independent, bona fide offers to buy and sell are regularly made, so that a price reasonably related to the last sale price or current bona fide competitive bid and offer quotations can be determined promptly, and payment may reasonably be expected to be received within the customary period.

**How to apply for approval of a foreign market**

**RG 166.102** To apply for approval of a foreign market:

(a) Include a submission for approval with your AFS licence application or request for variation of licence, or at a later time when needed.

(b) Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).

(c) Candidly set out all information that may be relevant to your application, including details as to the effectiveness of the market’s price formation and settlement processes.

You can also contact ASIC on 1300 300 630 for information and assistance.
Adjusted assets

Adjusted assets means the value of total assets at the time of calculation as they would appear on a balance sheet made up for lodgement as part of a financial report under Ch 2M at the time of calculation, on the basis that the AFS licensee is a reporting entity:

(a) minus the value of excluded assets;

(b) minus the value of any receivable of the licensee, up to the amount that the licensee has excluded from adjusted liabilities on the basis that there is an enforceable right of set-off with that receivable;

(c) minus the value of any assets that are encumbered as a security against liability to a person that provides a security bond to us up to the amount of the bond;

(d) minus the value of any assets that may be required to be applied to satisfy a liability under a credit facility that is made without recourse to the licensee up to the amount of that liability excluded from adjusted liabilities;

(e) plus

(i) the amount of any eligible undertaking that is not an asset; or

(ii) if the eligible undertaking is for an unlimited amount, an unlimited amount;

provided that if the eligible undertaking is given by a person who is an eligible provider only because of RG 166.142(b) of the definition of eligible provider, the amount added may be no more than one-quarter of the eligible provider’s net assets (excluding intangible assets) as shown in the most recent audited financial statements of the provider lodged with us;

(f) for calculating ASLF, plus the value of any current assets of any trust (other than a registered scheme) of which the licensee is trustee except to the extent the value exceeds the sum of:

(i) the current liabilities of the trust; and

(ii) any adjustments to ASLF that are a result of current assets, liabilities and contingent liabilities of the trust for accounting purposes being included when calculating adjustments; and

Note: We require licensees that are trustees to take into account liabilities and contingent liabilities as if they were not incurred as trustee: see RG 166.113. However, we recognise that the licensee should be able to include trust assets (subject to adjustments under RG 166.108) when calculating ASLF up to but not more than is necessary to cover the liabilities and the amount required to be adjusted due to the nature of the trust assets and for contingent liabilities.

(g) for calculating ASLF, plus the applicable percentage of the value of any current assets that would be acquired in return for paying a contingent
liability except to the extent that that value exceeds the amount which is the applicable percentage of the contingent liability (see RG 166.108(c)(i) and RG 166.108(c)(iii)).

Note: The rights of an underwriter against a sub-underwriter are treated as an asset for this purpose.

### Adjusted liabilities

**RG 166.104** Adjusted liabilities means the value of total liabilities at the time of calculation as they would appear on a balance sheet made up for lodgement as part of a financial report under Ch 2M, on the basis that the AFS licensee is a reporting entity:

(a) minus the amount of any liability under any subordinated debt approved by us;

(b) minus the amount of any liability that is the subject of an enforceable right of set-off, if the corresponding receivable is excluded from adjusted assets;

(c) minus the amount of any liability under a credit facility that is made without recourse to the licensee;

(d) for calculating ASLF, plus the amount of the total current liabilities of any trust (other than a registered scheme) of which the licensee is trustee;

(e) plus the value of any assets that are encumbered as a security against another person’s liability, but only up to the amount of that other person’s liability secured or the value of the assets encumbered after deducting any adjustments, whichever is lower;

Note 1: RG 166.104(e) does not apply if the other person’s liability is owed jointly by the licensee and that other person (i.e. to avoid double counting).

Note 2: For responsible entities, the value of encumbered assets is only included in RG 166.104(e) to the extent that it is not already included in RG 166.104(f) below.

(f) for responsible entities, plus the maximum potential liability of any guarantee provided by the AFS licensee other than a:

(i) guarantee limited to an amount recoverable out of any scheme property of a managed investment scheme operated by the licensee; or

(ii) guarantee of the obligations of another member of a stapled group, except where the licensee is the responsible entity of a registered scheme that is not part of the stapled group.

Note 1: For an unregistered scheme, ‘scheme property’ in RG 166.104(f)(i) is taken to have the same meaning as if the scheme were registered.
Note 2: ‘Stapled group’ means the group of entities consisting of:
(a) one or more stapled issuers that are issuers of securities that must be transferred together; and
(b) all wholly owned entities controlled by the stapled issuers.

Note 3: ‘Stapled issuer’ means an entity for which a security must be transferred together with a security of one or more other entities under:
(a) the terms on which it is traded on a prescribed financial market;
(b) the constitution of the entity; or
(c) the terms of issue.

### Deed of subordination

**RG 166.105** We will generally only approve subordinated debt if it is in substantially the same form as Pro Forma 63 *Deed of subordination* (PF 63).

**RG 166.106** We have updated PF 63 to clarify that the debt cannot be repaid without ASIC’s consent even after the AFS licensee ceases to hold a licence. We consider that this may help ensure that former licensees meet obligations to clients and wind up their businesses in an orderly way.

### Adjusted surplus liquid funds (ASLF)

**RG 166.107** ASLF means surplus liquid funds (calculated for ASLF purposes) either:
(a) minus the standard adjustments (see RG 166.108–RG 166.114); or
(b) minus the adjustments produced by a risk exposure calculation system we allow to be used instead of one or more of the standard adjustments (see RG 166.126–RG 166.138).

Note: To help you understand how ASLF is calculated, see Figure 1 in Section D.

### Standard adjustments

**RG 166.108** The standard adjustments are:
(a) discounts as follows:
   (i) 8% for the values that reflect obligations to pay a certain sum maturing beyond 12 months unless the interest rate applicable is reset to reflect market interest rates at least annually; and
   (ii) 16% for the values that reflect any assets other than:
       (A) an obligation to pay you a certain sum;
       (B) a derivative; or
       (C) an interest in property held in trust by another licensee under Div 3 of Pt 7.8 or the rights to money held by another licensee in an account under s981B;
(b) 8% of the values that reflect others’ obligations to pay you a certain sum except to the extent that the asset is adequately secured or is a right against a licensee in respect of money or property held by the licensee in an account under s981B or held in trust under Div 3 of Pt 7.8;

Note: If discounts under RG 166.108(a) apply, this calculation is to be performed after those discounts are calculated.

(c) the following amounts for contingent liabilities and contingent liabilities of any trust (other than a registered scheme) of which the licensee is trustee:

(i) 5% of any contingent liabilities that can be quantified under an underwriting or sub-underwriting of financial products except:

(A) during the 5 business days after the commitment is assumed; and

(B) during any period it is unlawful to accept applications for the financial products to which the underwriting relates (such as under s727(3) or 1016B) and the period ending 5 business days after the first day on which it becomes lawful to accept applications; and

(C) to the extent that the underwriter holds funds from persons seeking to acquire the financial products subject to the underwriting;

Note: For this purpose, an underwriting is an enforceable obligation to acquire financial products in defined circumstances. An obligation to use best endeavours to arrange for acquisitions of financial products is not an underwriting for this purpose.

(ii) 5% of the potential liability of any contingent liabilities that can be quantified under a derivative other than to the extent there is an offsetting position in:

(A) the ‘something else’ for the purposes of s761D(1)(c);

(B) another derivative relating to that something else; and/or

(C) a thing that is so similar to the something else as to make the probability of net loss from the liability under the derivative exceeding any increase in value of the thing less than 5% in the reasonable and documented opinion of the licensee, except to the extent that the licensee is of the reasonable opinion that the risk that they will become liabilities (or become liabilities to a greater extent than taken into account for the purposes of applying the adjustment) because of a change in the price or value of the something else is trivial;

Note: In assessing the probability of net loss, the likelihood of the licensee being able to dispose of the derivative so as to avoid further loss can be taken into account.

(iii) 20% of the potential liability of any contingent liabilities that can be quantified under a guarantee or indemnity;
(d) the relevant percentage as set out in RG 166.108(c)(ii)–RG 166.108(c)(iii) of the amounts that in the licensee’s reasonable opinion is the maximum amount that the licensee may be liable for in relation to a contingent liability referred to in RG 166.108(c) where the maximum liability cannot be quantified; and

Note: Trivial risks that the amount may be higher in the case of RG 166.108(c)(ii) because of a change in the price or value of the something else can be disregarded.

(e) where the licensee has agreed to sell an asset that it does not hold, the amount of the adjustment that would apply if it held that asset is to be applied against adjusted assets.

RG 166.109 For the purposes of the standard adjustments, the risk that a contingent liability will become a liability may be treated as trivial if the probability that this will occur is reasonably estimated by the AFS licensee as less than 5%.

RG 166.110 For RG 166.107(a) and RG 166.107(b), discounts apply against the value of current assets:

(a) used in calculating adjusted assets;

(b) of any trust (other than a registered scheme) of which the licensee is a trustee (see RG 166.103(f)(ii));

(c) that are deducted under RG 166.103(c);

(d) that are deducted under RG 166.103(d) as assets to which recourse may be had for a liability of the licensee where the licensee’s liability is limited to those assets but the total discounts applied to those assets shall not exceed any excess of the value of the licensee’s assets to which recourse may be taken over the amount of the liability; and

(e) that is the applicable percentage of the current assets that would be acquired in return for paying a contingent liability under RG 166.108(c)(i) or RG 166.108(c)(iii).

RG 166.111 The AFS licensee does not have to apply the discounts to the value of amounts payable from a client in the ordinary course of its financial services business for financial products that the client has agreed to buy, if the money is required to be—and in the reasonable estimation of the licensee probably will be—paid no more than 5 business days after the client became liable.

Note: For further explanation, see RG 166.120.

RG 166.112 There is a common calculation framework for SLF and NTA. We do not require that non-current liabilities be included in calculating adjusted liabilities.

RG 166.113 To prevent avoidance and promote competitive neutrality we require that, where the AFS licensee is trustee, it must take into account trust liabilities and contingent liabilities as if they were held beneficially. Trust assets can
also be counted, subject to the standard adjustments but not so as to allow
the licensee to rely on trust assets to meet ASLF requirements that do not
arise from the relevant trust.

RG 166.114 We require adjustments to be made to reflect in a limited way possible
market and credit risks affecting assets and contingent liabilities. We
recognise that our requirements do not necessarily accurately reflect risks to
assets or the risk of off-balance sheet exposures. However, we believe our
requirements are more likely to result in requirements that are more
consistent with our policy objectives than if we disregard risks to assets and
contingent liabilities. We are prepared to examine further the appropriate
amount of the adjustments if industry submissions indicate they are
unreasonably burdensome or that they are leading to significant distortions
that are not overcome by the use of models.

Risks to assets

RG 166.115 To take into account risks that assets may not be available to meet your
liabilities, we require adjustments to be made. The standard adjustments
tackle market risk and counter-party credit risk. Since these risks are
separate, we require their cumulative effect to be quantified by applying
adjustments for both risks where relevant.

RG 166.116 Financial requirements imposed on broker–dealers in the United States under
Rule 15c3–1 of the Securities and Exchange Commission’s (SEC) financial
responsibility rules, and in Hong Kong and the United Kingdom under
financial requirements for financial services providers that have liabilities to
clients, all require discounting of assets to reflect risks.

RG 166.117 We also recognise the relative risk of different assets in our financial
requirements for certain market participants: see, for example, Chapter 8 of
ASIC Market Integrity Rules (ASX Market) 2010. The amount of discount
required for assets such as shares in the ASLF calculation (i.e. 16%: see
RG 166.108(a)(ii)) broadly reflects our capital requirements for certain
market participants in relation to position risk for shares not included in an
index. While our capital requirements for certain market participants are
structured differently and so are not directly comparable, we have adopted
this figure as a basis for adopting a discount level for market risk.

RG 166.118 Reflecting Basel Committee guidelines, APRA generally requires ADIs to
meet capital requirements by holding 8% of capital. While not directly
comparable (and noting our additional requirement for a surplus of assets over
liabilities), we have adopted this as a basis for requiring an 8% discount based
on credit risk. Prudential regulators such as APRA also have requirements
that differentiate between asset types and can impose capital requirements of
up to 100% of exposures. We do not differentiate between asset types in this
way, as our financial requirements are not imposed for the purpose of
prudential regulation and we seek to avoid unnecessary complexity. However, it is appropriate that, in calculating ASLF, there be some recognition of the relative safety of holding certain kinds of assets. ASLF is a measure that helps to indicate when you may be at risk of having insufficient financial resources to comply with your AFS licensee obligations.

RG 166.119 The levels of discount reflect only very broadly the extent of risk. We have chosen these discount levels to promote simplicity and reduce errors, classification issues, and regulatory and compliance costs. We do not require fine assessments of relative risk of assets, nor do we require that you take into account the very significant implications for risk of potential correlations in exposures that may have a risk-reducing effect. Changes may occur over time in the relative risks associated with certain assets. The relatively arbitrary quantification of certain percentage requirements to help achieve the objectives of the FSR Act is not consistent with an elaborate specification of various discount levels. Balancing these considerations with the need for some recognition of relative risk, we have adopted the simple percentage discounting factors stated in this guide.

RG 166.120 We exclude financial products that relate to short-term settlements from discounting. This is to avoid excessive financial requirements based on short-term liabilities, where market and credit risk are limited and of short duration. These liabilities will still trigger the requirement for the tiered level of ASLF.

Contingent liabilities

Note: For the definition of ‘actual or contingent liabilities of the relevant kind’ for the purposes of determining whether the ASLF requirement will apply to you, see RG 166.125.

RG 166.121 In calculating ASLF, we require adjustments to reflect the risk that contingent liabilities from derivatives, underwriting, and guarantees and indemnities may need to be satisfied within the current period. A derivative may be shown as an asset or liability on a mark-to-market basis. However, this represents the derivative’s current value and not the range of risks it exposes you to.

RG 166.122 To give weight to such contingent liabilities, we require that from 5% to 20% of their value be deducted in calculating ASLF. Any liability that is probable (i.e. more than 50% probability) is an actual and not a contingent liability in any case. Where an asset will be acquired if the contingent liability crystallises, the asset may be included. Such an asset cannot be allowed to count in excess of the liability and has to be discounted for market and credit risk as appropriate. For underwriting liabilities, this applies to the financial products that the underwriter has agreed to acquire, and the rights against any sub-underwriter that require the sub-underwriter to satisfy part of the underwriting commitment.
RG 166.123  For example, if an underwriter fully underwrites a $320 million securities issue (and has 50% of it sub-underwritten), the underwriter must take into account 5% of the total price to be paid in the worst case under the underwriting agreement as a liability (i.e. $16 million). The underwriter may then assume that, if it were called on to pay 5% of the underwritten amount, it would get 2.5% of the total underwritten amount in securities (i.e. securities which in this example the licensee values at $8 million) and 2.5% from the sub-underwriter (i.e. $8 million). These calculations assume that the liability under the underwriting commitment is a contingent liability (i.e. its probability is less than 50%).

RG 166.124  However, both the securities and benefit of the sub-underwriting commitment may have to be discounted. If the securities are shares, they would have to be discounted by 16% so that, for ASLF purposes, after adjustment the right to the shares would offset the contingent liability up to $6.72 million. The value of the contingent sub-underwriting receivable would have to be discounted by 8% (assuming the sub-underwriter is not an eligible provider) so that, for ASLF purposes, it would offset the contingent liability by a further $7.36 million. Therefore, in this example, in order to offset fully the $16 million that is deducted from ASLF because of the $320 million underwriting commitment, the underwriter would need to have adjusted assets of $1.92 million from other sources (i.e. $16 million – $6.72 million – $7.36 million).

Actual or contingent liabilities of the relevant kind

RG 166.125  For the purposes of determining whether the ASLF requirement will apply to you (see RG 166.78), an actual or contingent liability of the relevant kind means:

(a) an actual or contingent monetary liability; or

(b) an actual or contingent liability under a non-standard margin lending facility, in the circumstances determined under the terms of the facility, to transfer marketable securities to the client.

Note: For the definition of a ‘non-standard margin lending facility’ see ‘Key terms’.

Risk exposure calculation system

RG 166.126  In some cases and on application to us, we may allow different discounts other than the standard adjustments to be applied. We will allow different discounts where we are satisfied by external evidence that the AFS licensee has an appropriate risk exposure calculation system. The system would need to incorporate a model with several essential components to quantify the exposure of the licensee that the corresponding standard adjustments would otherwise cover. These components are as follows:
(a) for RG 166.108(a), the value of the assets would be less than their current value if the assets were required to be realised at a particular future time;

Note 1: The licensee may choose the future time based on when the liabilities of the licensee that are due within 12 months will be payable, or can simplify the calculation by referring to an average time until the liabilities become payable.

Note 2: When the licensee considers loss of value, the licensee can take into account the net loss after any offsets by other gains under derivatives or otherwise to the extent of the probability the licensee will receive them if its assets lose value.

Note 3: The licensee can only take into account gains from derivatives if the licensee’s risk exposure calculation system also calculates the risk of loss from derivatives.

(b) for RG 166.108(b), financial obligations to the licensee will not be performed when due, or at all; and

(c) for RG 166.108(c)(ii) and RG 166.108(d) (insofar as it relates to RG 166.108(c)(ii)), loss will arise because contingent liabilities will crystallise from derivatives without offsetting gain.

RG 166.127 The system must include measures to ensure that there is:

(a) a functionally independent and appropriately qualified and experienced team responsible for assessing the risks that may impact on the relevant exposure and documenting their findings;

(b) frequent reporting about the risks to management with sufficient authority to enforce steps to reduce risks;

Note: These reports must be considered by management, and the continuing appropriateness of the model assessed by management and documented.

(c) back testing of the amounts calculated by the system against experience of losses, and that changes are made to the system to address any material deficiencies testing has identified;

(d) appropriate use of external sources of information such as ratings information to assess credit risk;

(e) a risk management system that is documented and implemented, including appropriate limits on exposures and internal controls; and

(f) assurance that all practicable steps are taken to ensure that information is entered into the model generating the quantifications in accordance with the model’s requirements without material error.

RG 166.128 We will not assess the model used in the system ourselves as we are not a prudential regulator. We will require evidence that the model used in the system is substantially the same as has been accepted as the basis for quantifying exposures of another entity by:

(a) APRA; or
(b) another prudential regulator we accept for the purpose (including a foreign regulator).

If we accept use of the system as a substitute for the adjustments that would otherwise apply, AFS licence conditions will require the licensee to implement the system and monitor that the licensee continuously implements all the necessary procedures.

RG 166.129 We have provided an alternative to the standard adjustments because we are conscious that you may be able to quantify your risk in a way that is more accurate than our specifications. However, we will only allow use of systems for risk calculation where there is a means of recognition that is consistent with efficient administration. We need to be satisfied, based on checks performed by appropriate independent experts, that the system is robust and controlled by appropriately enforceable parameters to enable verification and consistency as part of your risk management system.

RG 166.130 If you are able to demonstrate you have an appropriate risk exposure calculation system incorporating a model that has been accepted by a prudential regulator, it provides a basis for us to allow the model to be used for calculating exposures. Entities with significant exposures to derivatives will ordinarily have such systems to comply with their duty to have an adequate risk management system. The standard adjustments may be appropriate, if you have limited exposure to risks of this kind. Even in this case, compliance with the ASLF requirement does not limit your obligation to have an adequate risk management system: see s912A(1)(h).

RG 166.131 We understand that some AFS licensees will not be in a position to adopt a model that has been approved by a prudential regulator. We will consider reviewing our policy to cater for these exceptional circumstances if industry demonstrates there is a need for, and an appropriate means of obtaining assurance about, use of other models to calculate exposures.

RG 166.132 We encourage development of guidance about risk exposure calculation systems and other risk management practices by industry bodies. Prudential regulators and auditors may take note of these guidelines in coming to their own assessments. We will not be approving risk exposure calculation systems whether they have been developed by industry bodies or others, but will rely on a combination of the evidence in RG 166.128 and certificates and audit reports (see RG 166.134–RG 166.138). The certificates require the chief executive officer and governing body of the AFS licensee to assure us that the risk calculation exposure system meets appropriate standards and is supplemented by assurance by the auditor that the processes that are key elements of an effective system are being implemented.
How to apply to be allowed to use a risk calculation exposure system

RG 166.133 To apply to be allowed to use a risk calculation exposure system:
(a) Include a submission for approval with your licence application or request for variation of licence, or at a later time when needed.
(b) Ensure that your application complies with Regulatory Guide 51 Applications for relief (RG 51).
(c) Include the certificates and evidence set out in this guide.
(d) Candidly set out all information that may be relevant to your application.

You can also contact ASIC on 1300 300 630 for information and assistance.

Certification and audit report requirements

RG 166.134 We will require a certificate by the chief executive and an audit report about any risk exposure calculation system if we are asked to allow it to be used as a substitute for the standard adjustments.

RG 166.135 We require a certificate by the chief executive endorsed by the governing body of the AFS licensee:
(a) at the time of the application;
(b) every 3 months; and
(c) at any other time we require a certificate.

RG 166.136 The certificate must state that:
(a) the licensee has identified all material risks the licensee faces that may impact on the calculation of the relevant exposure;
(b) the licensee has established systems to monitor those risks, including by adequate and timely reporting processes and by applying a model that is appropriate to the licensee;
(c) those risk management systems (and in particular the risk exposure calculation system) are operating effectively and are adequate having regard to the risks they are designed to control;
(d) the measures in RG 166.127 are being effectively implemented; and
(e) the description of the licensee’s risk management systems provided to the licensee’s registered company auditor is accurate and current.

RG 166.137 We also require a report by a registered company auditor that the auditor has reviewed the risk exposure calculation system and has no reason to believe that:
(a) the licensee is not applying its risk exposure calculation system, incorporating the model that we are being asked to allow, or have allowed, to be used to calculate adjustments for ASLF, to determine those adjustments; or
(b) during the period for the report, the licensee has not materially failed to ensure that there is:
   (i) a functionally independent team, including relevantly qualified and experienced staff responsible for assessing the risks that may impact on the relevant exposure and documenting its findings;
   (ii) frequent reporting about the risks to management with sufficient authority to enforce steps to reduce risks;
   (iii) back testing of the amounts calculated by the system against experience of losses, and that changes are made to the system to address any material deficiencies testing has identified;
   (iv) use of external sources of information such as ratings information to assess credit risk;
   (v) a risk management system that is documented and implemented, which includes limits on exposures and internal controls; and
   (vi) a reasonable system designed to ensure that that information is input into the model generating the quantifications in accordance with the model’s requirements without material error.

RG 166.138 This report would be required:
(a) at the time of the application for a reasonable period before the application;
(b) at the time the audit report on the licensee’s financial statements as required under s989B(3) is lodged in respect of the relevant financial year; and
(c) any other time we require and for the period we require.

Note: In preparing an audit report on the AFS licensee’s compliance with our financial requirements, the auditor may assume the appropriateness of any adjustments produced by a risk exposure calculation system if we have allowed use of the system as a substitute for the standard adjustments.

Cash (for Option 1 of the cash needs requirement)

RG 166.139 For the purposes of item 5 of Table 4 (relating to Option 1), cash means:
(a) current assets valued at the amount of cash for which they can be expected to be exchanged within 5 business days; or
(b) a commitment to provide cash from an ‘eligible provider’ (see RG 166.142–RG 166.146) that can be drawn down within 5 business
days and has a maturity of at least a month provided that, if the commitment is given by a person who is only an eligible provider under RG 166.142(b), the maximum amount of the commitment that may be counted as cash is one-quarter of the eligible provider’s net assets (excluding intangible assets) as shown in the most recent audited financial statements of the provider lodged with us.

RG 166.140 This includes any cash in a ‘relevant trust’ (see RG 166.161) if you have no reason to believe that the cash will not be available to meet all of your projected cash flows.

**Cash flow (for the cash needs requirement)**

RG 166.141 For the purposes of calculating the cash needs requirement, references to your cash flow include your own cash flow and any cash flow of a ‘relevant trust’ (see definition below), but do not include cash flows of any other trust.

**Eligible provider**

RG 166.142 Except where otherwise specified in this section, eligible provider means:

(a) an Australian ADI;

(b) an entity (other than a registered scheme of which the licensee or the licensee’s associate is the responsible entity):

(i) whose ordinary shares are listed on a licensed market or an ASIC-approved foreign exchange under Regulatory Guide 72 *Foreign securities prospectus relief* (RG 72); and

(ii) that has net assets (excluding intangible assets) of more than $50 million, as shown in the most recent audited financial statements of the provider lodged with us. This applies if the licensee has no reason to believe the entity no longer has net assets of at least that amount;

Note: The type of provider described in RG 166.142(b) is not an eligible provider for responsible entities.

(c) an Australian government (i.e. the Commonwealth or a state or territory government) or a government of a country that is a member of the Organisation for Economic Co-operation and Development (OECD country government), or an agency or instrumentality of an Australian or OECD country government;

Note: We would consider you to be an agency or instrumentality of a government if you represent that government and you are conferred with all the powers, privileges, rights and remedies, or their equivalent, of that government.
(d) a foreign deposit-taking institution that is regulated by an ASIC-approved regulator;

(e) a foreign deposit-taking institution we approve in writing for this purpose (see RG 166.144);

(f) a clearing and settlement facility (CS facility) licensee; or

(g) in exceptional circumstances, an entity of undoubted financial substance we approve in writing.

RG 166.143 If the provider is not otherwise required to lodge financial statements with us, the AFS licensee must ensure that their financial statements are lodged with its balance sheet under s989B(2).

RG 166.144 We will approve a foreign deposit-taking institution if the AFS licensee demonstrates to us that the foreign deposit-taking institution is prudentially regulated to appropriate standards under the Basel Committee guidelines.

RG 166.145 We do not recognise a body as an eligible provider merely on the basis of ratings in relation to its debt instruments. However, where exceptional circumstances make it necessary for you to rely on such an entity to provide an eligible undertaking, we will take into account ratings information in assessing whether the body has undoubted financial substance. This evidence may be significant but alone will not be determinative.

How to apply for approval of an eligible provider

RG 166.146 To apply for approval of an eligible provider:

(a) Include a submission for approval with your licence application or request for variation of licence, or at a later time when needed.

(b) Ensure that your application complies with Regulatory Guide 51 Applications for relief (RG 51).

(c) Candidly set out all information that may be relevant to your application, including details as to the foreign regulatory arrangements or financial substance of the provider, and other exceptional circumstances.

You can also contact ASIC on 1300 300 630 for information and assistance.

Eligible undertaking

RG 166.147 Eligible undertaking means the amount of a financial commitment payable on written demand by the AFS licensee provided by an eligible provider in the form of an undertaking to pay the amount of the financial commitment to the licensee, and that:

(a) is an enforceable and unqualified obligation; and
(b) remains operative (even if, for example, the licensee ceases to hold an AFS licence) until we consent in writing to the cancellation of the undertaking.

RG 166.148 An AFS licensee cannot include as an eligible undertaking any amount committed that would be repayable as a current liability or, for calculating NTA, as a liability by the licensee if money were paid.

Note: For calculating NTA, a credit facility cannot be counted as an eligible undertaking. For calculating SLF, only a credit facility that if drawn down would not result in a current liability can count as an eligible undertaking.

RG 166.149 We will consider allowing an AFS licensee to treat as an eligible undertaking a financial commitment in a different form, if the licensee demonstrates that in exceptional circumstances:

(a) it would be impracticable or unreasonably burdensome for the financial support to be obtained by an undertaking complying with RG 166.147; and

(b) the financial commitment would be as effective in meeting the objectives of the financial requirements as an undertaking complying with RG 166.147.

RG 166.150 For example, we have allowed an AFS licensee that is a custodian of a superannuation entity to, in certain circumstances, treat an ‘approved guarantee’ obtained for the purpose of meeting its obligations under s123 of the Superannuation Industry (Supervision) Act 1993 (SIS Act) as an eligible undertaking.

RG 166.151 If the amount of an eligible undertaking is unlimited, the AFS licensee will have satisfied any applicable NTA, SLF or ASLF requirement. This does not apply if the eligible undertaking is given by a person who is an eligible provider only because of RG 166.142(b). In this case, the amount added to the licensee’s adjusted assets can be no more than one-quarter of:

(a) the eligible provider’s net assets (excluding intangible assets) as shown in the most recent audited financial statements of the provider lodged with us; or

(b) if you have reason to believe that the eligible provider would have assets less intangible assets in a balance sheet made currently of a lesser amount, one-quarter of the amount that you reasonably believe the eligible provider has.

How to apply for approval of an eligible undertaking

RG 166.152 To apply for approval of an eligible undertaking:

(a) Include a submission for approval with your licence application or request for variation of licence, or at a later time when needed.
(b) Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).

(c) Candidly set out all information that may be relevant to your application, including details as to the unreasonableness of the burden, effectiveness of the undertaking, and other exceptional circumstances.

You can also contact ASIC on 1300 300 630 for information and assistance.

### Excluded assets

**RG 166.153** Excluded assets means:

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

(b) except when allowed under RG 166.155 or RG 166.156, assets owing or receivables (‘receivables’) from, or assets invested in, any person who:

(i) is an associate (as defined in the Corporations Act) of the licensee;

(ii) was an associate of the licensee (as defined in the Corporations Act or the old regulatory regime) at the time the liability was incurred or the investment was made; or

(iii) became liable to the licensee because of, or in connection with, the acquisition of interests in a managed investment scheme the licensee operates;

(c) except when allowed under RG 166.156, assets:

(i) held as a beneficial interest or interest in a managed investment scheme; or

(ii) invested in any superannuation product,

in respect of which the AFS licensee or its associate may exercise any form of power or control;

(d) except when allowed under RG 166.155 or RG 166.156, receivables from the trustee of any trust in respect of which the licensee or its associate may exercise any form of power or control.

**RG 166.154** Despite RG 166.153(b) and RG 166.153(d), a receivable is not excluded to the extent that:

(a) it is adequately secured; or

(b) the following apply:

(i) it is receivable as a result of a transaction entered into by the licensee in the ordinary course of its business on its standard commercial terms applicable to persons that are not associated with the licensee on an arm’s length basis;
(ii) no part of the consideration for the transaction is, in substance, directly or indirectly invested in the licensee;

(iii) the total value of such assets (before any discount is applied) is not more than 20% of the assets less liabilities of the licensee; and

(iv) for the purposes of calculating ASLF, the amount is further discounted by 10% of the value after any standard adjustments (see RG 166.108) or other discounts (see RG 166.126); or

(c) the following apply:

(i) it is receivable from an insurance company that is a body regulated by APRA and results from a transaction entered into by the licensee in the ordinary course of its business on its standard commercial terms applicable to persons that are not associated with the licensee on an arm’s length basis;

(ii) there is no reason to believe that any amount invested in the licensee would not have been invested if the transactions that caused the receivable had not taken place or were not at the time of the investment expected to take place;

(iii) there is no reason to believe that the recoverability of the receivable will materially depend on the value of an investment by any person in the licensee; and

(iv) the total value of the receivables under this paragraph (c) before any discount is applied is not more than 60% of the adjusted liabilities of the licensee; or

(v) we consent in writing to the licensee treating the amount owing as not being an excluded asset having regard to evidence that:

(A) the assets do not arise from a transaction to avoid our financial requirements;

(B) recovery is highly probable; and

(C) it would be unreasonably burdensome to have structured the transaction so that the amount owing was not an excluded asset.

Despite RG 166.153(b) and RG 166.153(d), the AFS licensee can include a receivable to the extent that it is owing by way of fees from, or under rights of reimbursement for expenditure by the licensee out of property of, a superannuation entity as defined in the SIS Act, an investor directed portfolio service (IDPS) or a registered scheme (scheme) to the extent that the receivable:

(a) exceeds amounts invested by the entity, IDPS or scheme in, or lent (other than by way of a deposit with an Australian ADI in the ordinary course of its banking business) directly or indirectly by the entity, IDPS or scheme to, the licensee, a body corporate the licensee controls, a
RG 166.156 Despite RG 166.153(c), the AFS licensee does not have to exclude interests in a managed investment product unless any part of the amount invested is, in substance, directly or indirectly invested in the licensee.

RG 166.157 The intention of RG 166.153 is that the value of investments in regulated schemes on ordinary business terms can count towards your NTA or SFL, unless any part of that investment or the value provided in connection with the receivable is, in turn, invested in or lent to you. Allowing investments in those schemes to be reinvested in you or lent to you might be used as a device to artificially inflate your NTA or SLF. The intention is that these amounts should not count towards NTA even if other entities are interposed in the flow of funds and even if the sequence of the flow of funds does not start from you.

RG 166.158 The requirement in RG 166.153(b)(ii) has a similar rationale.

**How to apply for consent to an amount owing not being an excluded asset**

RG 166.159 To apply for consent to an amount owing not being an excluded asset:

(a) Include a submission for approval with your AFS licence application or request for variation of licence, or at a later time when needed.

(b) Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).

(c) Candidly set out all information that may be relevant to your application, including evidence that the assets do not arise from a transaction to avoid our financial requirements, there is strong evidence of recoverability and it would be unreasonably burdensome to have structured the transaction so that the asset was not an excluded asset.

You can also contact ASIC on 1300 300 630 for information and assistance.

**Net tangible assets (NTA)**

RG 166.160 NTA means the AFS licensee’s adjusted assets less adjusted liabilities.
Relevant trust (for the cash needs requirement)

RG 166.161 For the purposes of calculating the cash needs requirement, relevant trust means a trust:

(a) of which the AFS licensee is trustee;
(b) through which the AFS licensee carries on substantially all of its financial services business;
(c) that is not a registered managed investment scheme or a superannuation entity as defined in s10(1) of the SIS Act; and
(d) that is not a trust to which a trustee company provides traditional services.

Responsible entity definitions

Average responsible entity revenue

RG 166.162 Average responsible entity revenue means:

(a) for a licensee in its first financial year—the licensee’s forecast of its responsible entity revenue from the commencement date for the remainder of the first financial year pro-rated to a 12-month period;

(b) for a licensee in its second financial year in which it is authorised to operate a registered scheme as a responsible entity—the aggregate of the licensee’s:

(i) estimate of its actual responsible entity revenue for the second financial year to date; and
(ii) forecast of its responsible entity revenue for the remainder of the second financial year;

(c) for a licensee in its third financial year in which it is authorised to operate a registered scheme as a responsible entity—the average of:

(i) the aggregate of the licensee’s:

(A) estimate of its actual responsible entity revenue for the third financial year to date; and

(B) forecast of its responsible entity revenue for the remainder of the third financial year; and

(ii) the licensee’s responsible entity revenue for its second financial year in which it is authorised to operate a registered scheme as a responsible entity; and

(d) for all subsequent financial years—the average of:

(i) the aggregate of the licensee’s:
(A) estimate of its actual responsible entity revenue for the current financial year to date; and

(B) forecast of its responsible entity revenue for the remainder of the current financial year;

(ii) the licensee’s responsible entity revenue for the last preceding financial year; and

(iii) the licensee’s responsible entity revenue for the second preceding financial year.

Note 1: We expect responsible entities to base their forecast on reasonable assumptions and to take into account the actual revenue over that financial year to date in making the forecast.

Note 2: When preparing an opinion to enable the responsible entity to comply with notional s912AA(9) applying under Class Order [CO 11/1140] Financial requirements for responsible entities, we would not expect the auditor to express an audit opinion or conduct a review of the forecasts made but merely to audit that they exist in purported compliance.

**Average value of scheme property**

RG 166.163 For responsible entities, average value of scheme property means the greater of:

(a) the current value of scheme property; and

(b) the value of scheme property in the following circumstances:

(i) for a licensee in its first financial year of operation of a registered scheme as a responsible entity—the average of:

   (A) the value of scheme property at the end of each calendar month since the commencement date; and

   (B) the forecast value of scheme property at the end of each calendar month for the remainder of the first financial year;

(ii) for a licensee in its second financial year of operation of a registered scheme as a responsible entity—the average of:

   (A) the value of scheme property at the end of each calendar month since the commencement date; and

   (B) the forecast value of scheme property at the end of each calendar month for the remainder of the second financial year; and

(iii) for a licensee after the first two financial years of operation of a registered scheme as a responsible entity—the average of:

   (A) the value of scheme property at the end of each calendar month since the beginning of the second preceding financial year; and
the forecast value of scheme property at the end of each calendar month for the remainder of the current financial year.

Note: We are not requiring that licensees perform monthly valuations of scheme property. In determining the frequency of valuations of scheme property, licensees should have regard to the nature of the property: see s601FC(1)(j).

Cash or cash equivalents

RG 166.164 For responsible entities, cash or cash equivalents means:

(a) cash on hand, demand deposits and money deposited with an Australian ADI that is available for immediate withdrawal;
(b) short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value;
(c) the value of any eligible undertaking provided by an eligible provider; and
(d) a commitment to provide cash from an eligible provider that can be drawn down within 5 business days and has a maturity of at least 6 months.

Commencement date

RG 166.165 For responsible entities, commencement date means the day on which the AFS licensee was authorised to operate any registered scheme.

Note: The ‘commencement date’ applies to the first date on which the responsible entity is authorised to operate a registered scheme in the current authorisation period.

Eligible custodian

RG 166.166 An eligible custodian is:

(a) an Australian ADI; or
(b) a market participant or a clearing participant as specified in Class Order [CO 11/1140] Financial requirements for responsible entities; or
(c) a subcustodian appointed by one of the above.

First financial year

RG 166.167 For responsible entities, first financial year means the financial year in which the commencement date occurs.
Liquid assets

RG 166.168 For responsible entities, liquid assets means:

(a) cash or cash equivalents other than as specified in RG 166.164(d); and
(b) assets that the licensee can reasonably expect to realise for their market value within 6 months,

that are free from encumbrances and, in the case of receivables, free from any right of set-off.

Regulated trust account

RG 166.169 Regulated trust account means:

(a) a trust account maintained by a licensed trustee company within the meaning of Ch 5D of the Corporations Act or the Public Trustee of a state or territory;
(b) a trust account maintained by a solicitor unless moneys in the account include moneys that are excluded from regulation as trust money under laws of the state or territory relating to legal practitioners that are relevant to operation of the trust account by the solicitor;
(c) a trust account maintained by a real estate agent under the law of a state or territory; or
(d) a trust account maintained by an entity other than the licensee and that provides protections similar to the accounts described in paragraphs (a) to (c), and is approved in writing by ASIC for this purpose.

Responsible entity revenue

RG 166.170 Responsible entity revenue means:

(a) the licensee’s revenue (within the meaning given by the accounting standards); plus
(b) to the extent it is not the licensee’s revenue (within the meaning of the accounting standards)—any amount, paid or payable out of scheme property for the performance of the obligations imposed on the licensee as a responsible entity in connection with the registered schemes it operates, even if those obligations are performed by another entity (including asset management, investment management, property management, scheme administration and custodial and trustee services).

Note 1: An amount under RG 166.170(b) excludes any audit fees paid or payable to an auditor engaged to meet any audit requirements under the Corporations Act.

Note 2: A responsible entity may have regard to any current guidance provided by industry bodies, in consultation with ASIC, to assist it to calculate its revenue for the purposes of RG 166.170.
Special custody assets

RG 166.171 Special custody assets means:

(a) for serviced strata schemes, cash held in a regulated trust account for the purposes of:

   (i) refurbishing or improving real property associated with the scheme; or

   (ii) alleviating seasonal fluctuations in payments of income from the scheme in accordance with provisions in the constitution,

   provided that no more is held than the licensee reasonably considers necessary for the stated purpose;

(b) currency and chattels (other than documents) that it would not be reasonably practicable for a person other than the responsible entity to hold;

(c) funds received from members of the scheme within the previous 6 months held in a regulated trust account;

(d) cash held for up to 3 months in an account with an Australian ADI styled as a trust account that is audited at least once every 6 months by a registered company auditor where the auditor’s report states that in the auditor’s opinion the account has been operated in accordance with the trust:

   (i) pending payment to members;

   (ii) to meet expected expenses (not including investments) over a 3-month period; or

   (iii) pending application in acquiring a mortgage and paying any fees and costs incidental to the acquisition;

   Note: The auditor’s report should be provided to the licensee’s board or compliance committee (as appropriate).

(e) contractual, lease or licence rights that are not assignable except with the consent of the member or that it would not be reasonably practicable to assign (other than to a new responsible entity), and any documents evidencing those contractual, lease or licence rights;

(f) assets of trivial value;

(g) land and other real property of a time-sharing scheme and levies of a time-sharing scheme which are held in an account with an Australian ADI styled as a trust account that is audited at least once every 6 months by a registered company auditor where the report from the auditor is provided to the responsible entity’s board or compliance committee and states that in the auditor’s opinion the account has been operated in accordance with the trust; and
(h) mortgages or documents of title held under a mortgage where:
   (i) particular members have a specific beneficial or legal interest in the mortgage;
   (ii) the mortgage was acquired after disclosure in writing to the relevant members (at the time of the acquisition) of all information that would have been required to be in a Product Disclosure Statement (PDS) if an offer of interests in the registered scheme conferring rights in connection with that mortgage had been made immediately before the mortgage;
   (iii) either of the following applies:
      (A) the mortgage was acquired on the specific direction of the relevant members (at the time of acquisition of the interest); or
      (B) members are able to withdraw from that mortgage for a period of 14 days commencing on the date of disclosure under paragraph (h)(ii); and
   (iv) the scheme does not involve the mortgage being sold before its discharge.

Tier $500,000 class assets

RG 166.172 Tier $500,000 class assets means:
   (a) real property (including mortgages or leases over or licences in relation to real property) that is intended to be kept for the whole duration of the scheme, or the relevant mortgage;
   (b) physical assets including currency which as a matter of reasonable practice can be held by a custodian (such as valuables or precious metals);
   (c) funds held in a regulated trust account that were received from members within the previous:
      (i) 6 months, if held for the purposes of the initial investment by the responsible entity as part of the scheme; or
      (ii) 13 months, if held pending payment of expenses of the scheme; or
   (d) special custody assets.

Value of scheme property

RG 166.173 For responsible entities, value of scheme property means the value of:
   (a) assets (including mortgages held by members of a mortgage scheme and managed as part of the scheme);
   (b) any scheme property not counted in calculating the value of assets; and
   (c) any IDPS property not counted under paragraphs (a) or (b).
Retail OTC derivative issuers definitions for calculating NTA

**Average revenue**

RG 166.174 For an AFS licensee with an authorisation to make a market in derivatives to retail clients and that owes liabilities or contingent liabilities by entering into derivatives with retail clients:

(a) in its first financial year of being authorised to provide those financial services, the licensee’s forecast of its revenue from the calculation date for the remainder of the first financial year pro-rated to a 12-month period;

(b) in its second financial year of being authorised to provide those financial services, the average of the aggregate of the licensee’s:
   (i) actual revenue for the second financial year to date;
   (ii) reasonable forecast of its revenue for the remainder of the second financial year; and
   (iii) revenue in the first financial year from the calculation date pro-rated to a 12-month period;

(c) in its third financial year of being authorised to provide those financial services, the average of:
   (i) the aggregate of the licensee’s:
      (A) revenue for the third financial year to date;
      (B) reasonable forecast of its revenue for the remainder of the third financial year;
   (ii) licensee’s revenue for its second financial year; and
   (iii) the revenue in the first financial year from the calculation date pro-rated to 12-month period; and

(d) for all subsequent financial years, the average of:
   (i) the aggregate of the licensee’s:
      (A) revenue for the current financial year to date; and
      (B) reasonable forecast of its revenue for the remainder of the current financial year;
   (ii) the licensee’s revenue for the last preceding financial year; and
   (iii) the licensee’s revenue for the second preceding financial year.
Cash or cash equivalents

RG 166.175 This includes:

(a) cash on hand, demand deposits and money deposited with an Australian ADI that is available for immediate withdrawal;

(b) short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value;

(c) the value of any eligible undertaking provided by an eligible provider; and

(d) a commitment to provide cash from an eligible provider that can be drawn down within 5 business days and has a maturity of at least 6 months.

Eligible provider

RG 166.176 Either:

(a) an Australian ADI; or

(b) an entity we approve in writing for this purpose.

Liquid assets

RG 166.177 Either:

(a) cash or cash equivalents, other than those defined at RG 166.164(d); or

(b) an asset the issuer can reasonably expect to realise for its market value within 6 months, that are free from encumbrances and, in the case of receivables, free from any right of set off.

Surplus liquid funds (SLF)

RG 166.178 SLF means the AFS licensee’s adjusted assets less the licensee’s adjusted liabilities:

(a) plus any non-current liabilities that were used in calculating adjusted liabilities and the value of any assets that are encumbered (where the licensee is not liable and the assets do not secure another person’s current liability) that were added when calculating the licensee’s adjusted liabilities;

(b) minus any non-current assets that were used in calculating adjusted assets; and

(c) if the licensee is an eligible provider under RG 166.142(b)—plus one-quarter of the value of its non-current assets minus any intangible assets and the amount of its non-current liabilities.
### Key terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning in this document</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACH</td>
<td>Australian Clearing House Ltd</td>
</tr>
<tr>
<td>adequately secured</td>
<td>See Section E for the meaning of this term</td>
</tr>
<tr>
<td>ADI</td>
<td>An authorised deposit-taking institution within the meaning of the <em>Banking Act 1959</em></td>
</tr>
<tr>
<td>adjusted assets</td>
<td>See Section E for the meaning of this term</td>
</tr>
<tr>
<td>adjusted liabilities</td>
<td>See Section E for the meaning of this term</td>
</tr>
<tr>
<td>adjusted surplus liquid funds (ASLF)</td>
<td>See Section E for the meaning of this term</td>
</tr>
<tr>
<td>AFS licence</td>
<td>An Australian financial services licence under s913B that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A.</td>
</tr>
<tr>
<td>AFS licensee</td>
<td>A person who holds an AFS licence under s913B of the Corporations Act Note: This is a definition contained in s761A of the Corporations Act.</td>
</tr>
<tr>
<td>APRA</td>
<td>Australian Prudential Regulation Authority</td>
</tr>
<tr>
<td>APRA Act</td>
<td><em>Australian Prudential Regulation Authority Act 1998</em></td>
</tr>
<tr>
<td>ASIC</td>
<td>Australian Securities and Investments Commission</td>
</tr>
<tr>
<td>ASIC Market Integrity Rules (ASX)</td>
<td>ASIC Market Integrity Rules (ASX Market) 2010—rules made by ASIC under s798G of the Corporations Act for trading on ASX</td>
</tr>
<tr>
<td>ASIC Market Integrity Rules (ASX 24)</td>
<td>ASIC Market Integrity Rules (ASX 24 Market) 2010—rules made by ASIC under s798G of the Corporations Act for trading on ASX 24</td>
</tr>
<tr>
<td>ASIC Market Integrity Rules (Chi-X)</td>
<td>ASIC Market Integrity Rules (Chi-X Australia Market) 2011—rules made by ASIC under s798G of the Corporations Act for trading on Chi-X</td>
</tr>
<tr>
<td>ASIC Market Integrity Rules (Competition)</td>
<td>ASIC Market Integrity Rules (Competition in Exchange Markets) 2011—rules made by ASIC under s798G of the Corporations Act that are common to markets dealing in equity market products quoted on ASX</td>
</tr>
<tr>
<td>ASX</td>
<td>ASX Limited (ACN 008 624 691) or the exchange market operated by ASX Limited</td>
</tr>
<tr>
<td>ASX 24</td>
<td>The exchange market formerly known as Sydney Futures Exchange (SFE), operated by Australian Securities Exchange Limited</td>
</tr>
<tr>
<td>Term</td>
<td>Meaning in this document</td>
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<td>-------------------------------------</td>
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</tr>
<tr>
<td>ASX 24 Operating Rules</td>
<td>ASX Limited’s new operating rules, which replace the pre-existing SFE Operating Rules</td>
</tr>
<tr>
<td>ASX Clear</td>
<td>ASX Clear Pty Limited (ACN 001 314 503) formerly known as Australian Clearing House. A CS facility licensee</td>
</tr>
<tr>
<td>ASX Clear (Futures)</td>
<td>ASX Clear (Futures) Pty Limited (ACN 050 615 864) formerly known as SFE Clearing Corporation Pty Limited. A CS facility licensee</td>
</tr>
<tr>
<td>ASX Market Rules</td>
<td>Previous operating rules made by ASX Limited dealing with activities or conduct of its market and of persons in relation to the market</td>
</tr>
<tr>
<td>ASX Operating Rules</td>
<td>ASX Limited’s new operating rules, which replace the pre-existing ASX Market Rules</td>
</tr>
<tr>
<td>Australian ADI</td>
<td>An ADI or a person who carries on state banking within the meaning of paragraph 51(xiii) of the Constitution</td>
</tr>
<tr>
<td>average responsible entity revenue</td>
<td>See Section E for the meaning of this term under ‘Responsible entity definitions’</td>
</tr>
<tr>
<td>average revenue (for retail OTC derivate issuers)</td>
<td>See Section E for the meaning of this term under ‘Retail OTC derivative issuer definitions’</td>
</tr>
<tr>
<td>average value of scheme property (responsible entities)</td>
<td>See Section E for the meaning of this term under ‘Responsible entity definitions’</td>
</tr>
<tr>
<td>Basel Committee guidelines</td>
<td>The Basel Committee on Banking Supervision’s publications Core Principles for Effective Banking Supervision (September 1997) and Capital Accord (July 1988, as amended September 1997) or later publications by the Basel Committee</td>
</tr>
<tr>
<td>body regulated by APRA</td>
<td>Has the meaning given in s3(2) of the Australian Prudential Regulation Authority Act 1998</td>
</tr>
<tr>
<td>cash</td>
<td>See Section E for the meaning of this term for calculating the cash needs requirement (Option 1)</td>
</tr>
<tr>
<td>cash flow</td>
<td>See Section E for the meaning of this term for calculating the cash needs requirement</td>
</tr>
<tr>
<td>cash or cash equivalents (responsible entities)</td>
<td>See Section E for the meaning of this term under ‘Responsible entity definitions’</td>
</tr>
<tr>
<td>cash or cash equivalents (retail OTC derivate issuers)</td>
<td>See Section E for the meaning of this term under ‘Retail OTC derivative issuer definitions’</td>
</tr>
<tr>
<td>commencement date (responsible entities)</td>
<td>See Section E for the meaning of this term under ‘Responsible entity definitions’</td>
</tr>
<tr>
<td>Term</td>
<td>Meaning in this document</td>
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</tr>
<tr>
<td>Ch 7 (for example)</td>
<td>A chapter of the Corporations Act (in this example numbered 7), unless otherwise specified</td>
</tr>
<tr>
<td>Chapter 6 (ASX) and (Chi-X)</td>
<td>A chapter of the ASIC Market Integrity Rules (ASX) and ASIC Market Integrity Rules (Chi-X) (in this example numbered 6)</td>
</tr>
<tr>
<td>Chi-X</td>
<td>Chi-X Australia Pty Limited or the exchange market operated by Chi-X</td>
</tr>
<tr>
<td>clearing participant</td>
<td>A participant as defined in s761A of the Corporations Act in relation to a CS facility where that clearing and settlement facility is a licensed CS facility</td>
</tr>
<tr>
<td>Corporations Act</td>
<td>Corporations Act 2001, including regulations made for the purposes of the Act</td>
</tr>
<tr>
<td>Corporations Regulations</td>
<td>Corporations Regulations 2001</td>
</tr>
<tr>
<td>CS facility</td>
<td>A clearing and settlement facility</td>
</tr>
<tr>
<td>CS facility licensee</td>
<td>A person who holds an Australian CS facility licence</td>
</tr>
<tr>
<td>Note: This is a definition contained in s761A.</td>
<td></td>
</tr>
<tr>
<td>eligible custodian</td>
<td>See Section E for the meaning of this term under ‘Responsible entity definitions’</td>
</tr>
<tr>
<td>eligible provider</td>
<td>See Section E for the meaning of this term</td>
</tr>
<tr>
<td>eligible provider (retail OTC derivative issuers)</td>
<td>See Section E for the meaning of this term under ‘Retail OTC derivative issuers’</td>
</tr>
<tr>
<td>eligible undertaking</td>
<td>See Section E for the meaning of this term</td>
</tr>
<tr>
<td>estate assets</td>
<td>Assets (including assets in common funds) of an estate in relation to which a trustee company is performing estate management functions</td>
</tr>
<tr>
<td>estate management functions</td>
<td>Has the same meaning as in s601RAC(2) of the Corporations Act</td>
</tr>
<tr>
<td>excluded assets</td>
<td>See Section E for the meaning of this term</td>
</tr>
<tr>
<td>financial product</td>
<td>Generally, a facility through which, or through the acquisition of which, a person does one or more of the following:</td>
</tr>
<tr>
<td>• makes a financial investment (see s763B);</td>
<td></td>
</tr>
<tr>
<td>• manages financial risk (see s763C);</td>
<td></td>
</tr>
<tr>
<td>• makes non-cash payments (see s763D)</td>
<td></td>
</tr>
<tr>
<td>Note: See Div 3 of Pt 7.1 for the exact definition.</td>
<td></td>
</tr>
<tr>
<td>first financial year (responsible entities)</td>
<td>See Section E for the meaning of this term under ‘Responsible entity definitions’</td>
</tr>
<tr>
<td>Term</td>
<td>Meaning in this document</td>
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<tr>
<td>foreign exchange contract</td>
<td>Has the same meaning as in s761A of the Corporations Act</td>
</tr>
<tr>
<td></td>
<td>Note: This definition includes derivatives (as defined in s761D) that are foreign exchange contracts (as defined in s761A) and may, for example, include a contract for delivery of foreign currency, where the rate at which the exchange takes place is determined with reference to interest rates or interest rate differentials. It does not include a contract that is to be settled by adjustment rather than the delivery of any foreign currency.</td>
</tr>
<tr>
<td>foreign exchange dealer</td>
<td>A person who carries on a business of entering, as principal, into foreign exchange contracts in Australia</td>
</tr>
<tr>
<td>FSR Act</td>
<td>Financial Services Reform Act 2001</td>
</tr>
<tr>
<td>governing body</td>
<td>The board of directors, committee of management or other governing body of the entity, including, in relation to a licensee who is a natural person, that person</td>
</tr>
<tr>
<td>IDPS</td>
<td>An investor directed portfolio service, as defined in RG 148</td>
</tr>
<tr>
<td>IDPS property</td>
<td>Property acquired or held through an IDPS other than property held by a client</td>
</tr>
<tr>
<td>licensed CS facility</td>
<td>A CS facility the operation of which is authorised by an Australian CS facility licence</td>
</tr>
<tr>
<td></td>
<td>Note: This is a definition contained in s761A.</td>
</tr>
<tr>
<td>licensed market</td>
<td>A financial market the operation of which is authorised by an Australian market licence</td>
</tr>
<tr>
<td></td>
<td>Note: This is a definition contained in s761A.</td>
</tr>
<tr>
<td>licensee</td>
<td>A person who holds an AFS licence</td>
</tr>
<tr>
<td>licensee obligations</td>
<td>The obligations of an AFS licensee as set out in s912A and 912B of the Corporations Act, and the requirement to be of good fame and character as included in s913B</td>
</tr>
<tr>
<td>liquid assets (responsible entities)</td>
<td>See Section E for the meaning of this term under ‘Responsible entity definitions’</td>
</tr>
<tr>
<td>liquid assets (retail OTC derivative issuers)</td>
<td>See Section E for the meaning of this term under ‘Retail OTC derivative issuers definitions’</td>
</tr>
<tr>
<td>margin lending facility</td>
<td>Means ‘margin lending facility’ as defined in s761EA(1) of the Corporations Act and includes:</td>
</tr>
<tr>
<td></td>
<td>• a standard margin lending facility; or</td>
</tr>
<tr>
<td></td>
<td>• a non-standard margin lending facility; or</td>
</tr>
<tr>
<td></td>
<td>• a facility declared by ASIC to be a margin lending facility under s761EA(8) of the Corporations Act</td>
</tr>
<tr>
<td>market licensee</td>
<td>A person who holds an Australian market licence</td>
</tr>
<tr>
<td></td>
<td>Note: This is a definition contained in s761A.</td>
</tr>
</tbody>
</table>
### Term | Meaning in this document
--- | ---
market participant | An entity that is a participant of a financial market on which financial products are traded
net tangible assets (NTA) | See Section E for the meaning of this term
non-standard margin lending facility | Has the same meaning as in s761EA(5) of the Corporations Act
old Corporations Act | The *Corporations Act 2001* as in force immediately before FSR commencement (i.e. 11 March 2002)
old regulatory regime (as applicable) | The relevant legislation and relevant industry codes, standards or practices (however enforceable at law) related to the provision of financial services and applying immediately before FSR commencement (i.e. 11 March 2002)
PF 209 | Pro Forma 209 *Australian financial services licence conditions*
Pt 7.9 (for example) | A part of the Corporations Act (in this example numbered 7.9)
RBA | Reserve Bank of Australia
reg 7.6.04 (for example) | A regulation of the Corporations Regulations (in this example numbered 7.6.04)
regulated trust account | See Section E for the meaning of this term under ‘Responsible entity definitions’
relevant trust | See Section E for the meaning of this term for the cash needs requirement
responsible entity revenue | See Section E for the meaning of this term under ‘Responsible entity definitions’
RG 136 (for example) | A regulatory guide (in this example numbered 136)
Rule 2.1.2 (ASX) (for example) | A rule of the ASIC Market Integrity Rules (ASX) (in this example numbered 2.1.2)
Rule 2.1.2 (ASX 24) (for example) | A rule of the ASIC Market Integrity Rules (ASX 24) (in this example numbered 2.1.2)
Rule 2.1.2 (Chi-X) (for example) | A rule of the ASIC Market Integrity Rules (Chi-X) (in this example numbered 2.1.2)
Rule 6.5.1 (Competition) (for example) | A rule of the ASIC Market Integrity Rules (Competition) (in this example numbered 6.5.1)
Rule 5.6.3 (ASX) and (Chi-X) (for example) | A rule of the ASIC Market Integrity Rules (ASX) and ASIC Market Integrity Rules (Chi-X) (in this example numbered 5.6.3)
s912A (for example) | A provision of the Corporations Act (in this example numbered 912A), unless a contrary intention appears
<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning in this document</th>
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</thead>
<tbody>
<tr>
<td>secured property</td>
<td>Has the same meaning as in s761EA(2)(c) of the Corporations Act</td>
</tr>
<tr>
<td>SFE</td>
<td>The market formerly known as Sydney Futures Exchange (now ASX 24)</td>
</tr>
<tr>
<td>SIS Act</td>
<td><em>Superannuation Industry (Supervision) Act 1993</em></td>
</tr>
<tr>
<td>special custody assets</td>
<td>See Section E for the meaning of this term under ‘Responsible entity definitions’</td>
</tr>
<tr>
<td>standard margin lending facility</td>
<td>Has the same meaning as in s761EA (2) of the Corporations Act</td>
</tr>
<tr>
<td>surplus liquid funds (SLF)</td>
<td>See Section E for the meaning of this term</td>
</tr>
<tr>
<td>Tier $500,000 class assets</td>
<td>See Section E for the meaning of this term under ‘Responsible entity definitions’</td>
</tr>
<tr>
<td>traditional services</td>
<td>Means ‘traditional trustee company services’ as defined in s601RAC(1) of the Corporations Act and includes: • performing estate management functions (as defined in s601RAC(2)); • preparing a will, a trust instrument, a power of attorney or an agency arrangement; • applying for probate of a will, applying for grant of letters of administration, or electing to administer a deceased estate; • establishing and operating common funds; and • any other services prescribed by the Corporations Regulations as traditional trustee company services.</td>
</tr>
<tr>
<td>transferred securities</td>
<td>Has the same meaning as in s761EA(5)(a) of the Corporations Act</td>
</tr>
<tr>
<td>trustee company</td>
<td>Has the same meaning as in s601RAB of the Corporations Act</td>
</tr>
<tr>
<td>value of scheme property (responsible entities)</td>
<td>See Section E for the meaning of this term under ‘Responsible entity definitions’</td>
</tr>
<tr>
<td>wholesale client</td>
<td>A client defined as such under s761G of the Corporations Act</td>
</tr>
</tbody>
</table>
Related information

Headnotes

adjusted surplus liquid funds requirement, audit requirement, AFS licence, AFS licence conditions, AFS licensee, ASLF requirement, Australian financial services licence, average revenue, cash and cash equivalents, cash needs requirement, client assets, custodial or depository services, financial resources, foreign exchange dealers, holding client money, IDPS, investor directed portfolio service, licensing, market participants, net tangible assets, NTA, NTA requirement, reporting triggers, responsible entities, risk exposure calculation system, risk management systems, SLF requirement, solvency and positive net assets requirement, surplus liquid funds requirement, traditional services, transactions with a client, trustee companies

Class orders

[CO 11/1140] Financial requirements for responsible entities

[CO 12/752] Financial requirements for retail OTC derivative investors

Pro formas

PF 63 Deed of subordination

PF 209 Australian financial services licence conditions

Regulatory guides

RG 1–3 AFS Licensing Kit

RG 36 Licensing: Financial product advice and dealing

RG 51 Applications for relief

RG 72 Foreign securities prospectus relief

RG 78 Breach reporting by AFS licensees

RG 104 Licensing: Meeting the general obligations

RG 105 Licensing: Organisational competence

RG 121 Doing financial services business in Australia

RG 126 Compensation and insurance arrangements for AFS licensees

RG 133 Managed investments: Scheme property arrangements

RG 146 Training of financial product advisers
RG 148 *Investor directed portfolio services*

RG 165 *Licensing: Internal and external dispute resolution*

RG 167 *Licensing: Discretionary powers*

RG 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)*

RG 175 *Licensing: Financial product advisers—Conduct and disclosure*

RG 176 *Licensing: Discretionary powers—Wholesale foreign financial service providers*

RG 181 *Licensing: Managing conflicts of interest*

RG 182 *Dollar disclosure*

RG 183 *Approval of financial services sector codes of conduct*

RG 192 *Licensing: Wholesale equity venture capital schemes*

RG 226 *Guidance on ASIC market integrity rules for capital and related requirements: ASX, ASX 24 and Chi-X markets*

**Legislation**

Corporations Act, Ch 2L, Ch 2M, Ch 5 Pt 5.7B Div 3, Ch 7 Pt 7.8, s9, 761F(1)(a), 761FA(3)(a), 761D(1)(c), 766E(3)(b), 911A, 912A(1), 912A(1)(a), 912A(1)(b), 912A(1)(d), 912A(1)(h), 912B, 912C, 912C(2), 912D(1), 913B, 981B, 985B, 988B, 989B(2) and 989B(3)

Corporations Regulations, reg 7.6.04(1)(a) and 7.8.07(2)

APRA Act, s3(2)

SIS Act, s10(1)

**Consultation papers**

CP 109 *Margin lending: Financial requirements*

CP 132 *Trustee companies: Financial requirements and conduct obligations*

CP 140 *Responsible entities: Financial requirements*

CP 156 *Retail OTC derivative issuers: Financial requirements*

CP 161 *Proposed ASIC market integrity rules for capital and related requirements: ASX, ASX 24 and Chi-X markets*

CP 176 *Review of ASIC policy on platforms: Update to RG 148*
Reports

REP 177 Response to submissions on CP 109 Margin lending: Financial requirements

REP 197 Response to submissions on CP 132 Trustee companies: Financial requirements and conduct obligations

REP 259 Response to submissions on CP 140 Responsible entities: Financial requirements

REP 293 Response to submissions on CP 156 Retail OTC derivative issuers: Financial requirements

REP 244 Response to submissions on CP 161 Proposed ASIC market integrity rules for capital and related requirements: ASX, ASX 24 and Chi-X markets

Media and information releases

MR 01-456 ASIC releases policy statement on financial requirements

IR 02-24 Revised policy statements, PS 164, 166, 167, 169 and licensing guidance papers

IR 03-08 Pro Forma 209: AFS licence conditions

IR 03-23 Reporting requirements for AFS licensees who are individuals

IR 03-26 Alternative means to satisfy cash needs requirement under PS 166

IR 03-27 Amendment to PS 166 Financial requirements—Foreign exchange dealers

IR 03-30 Guide for AFS licensees on compliance with Policy Statement 166

IR 03-33 Amended Pro Forma 209: AFS licence conditions

IR 03-44 ASIC provides further options to meet cash needs requirements

IR 05-03 Amended Pro Forma 209: AFS licence conditions

IR 05-23 ASIC releases updated policy statements and licensing guidance papers

10-208MR ASIC issues consultation paper on financial requirements for managed investment scheme responsible entities

11-92MR ASIC consults on financial requirements for issuing retail OTC derivatives
11-113AD ASIC consults on capital and related requirements for the ASX, ASX 24 and Chi-X markets

11-154AD ASIC makes rules for capital and related requirements for ASX and ASX 24 markets

11-235AD ASIC makes rules for capital for Chi-X market

11-242MR ASIC releases new financial requirements for responsible entities

12-180MR New financial requirements for issuers of over-the-counter derivatives

**ASIC forms**

Form FS70 Australian financial services licensee profit and loss statement and balance sheet

Form FS71 Australian financial services licensee audit report
Appendix 1: Market and clearing participants

Key points

Our financial requirements will not apply to you as long as:

- if you are a market participant of ASX or Chi-X, you comply with the financial requirements in the ASIC market integrity rules for the relevant market (taking into account any waiver by ASIC);

- if you are a market participant of ASX 24, you restrict your financial services business to participating in the ASX 24 market and incidental business, and you comply with the financial requirements in the ASIC market integrity rules for the ASX 24 market (taking into account any waiver by ASIC); or

- if you are a market participant in another licensed financial market, or a clearing participant in a licensed clearing and settlement facility (CS facility), we are satisfied that the financial requirements of the market or CS facility are an adequate substitute for the financial requirements in the AFS licence.

Financial requirements under market integrity rules

RG 166.179 Market participants (other than principal traders or clearing participants) of the ASX, ASX 24 and Chi-X markets are subject to financial requirements under ASIC market integrity rules: see Chapter 8 of the ASIC Market Integrity Rules (ASX Market) 2010; Chapter 5 of the ASIC Market Integrity Rules (ASX 24 Market) 2010; Chapter 8 of the ASIC Market Integrity Rules (Chi-X Australia Market) 2011; and Regulatory Guide 226 Guidance on ASIC market integrity rules for capital and related requirements: ASX, ASX 24 and Chi-X markets (RG 226).

Note 1: For definitions of ‘clearing participant’ and ‘market participant’, see ‘Key terms’.

Note 2: In this appendix, and in this guide more broadly, we refer to ‘our financial requirements’ as the financial requirements we apply to AFS licensees using our statutory power to modify Pt 7.6, or by AFS licence conditions. These should be distinguished from the financial requirements applying to market and clearing participants via ASIC market integrity rules or the rules of the relevant market.

RG 166.180 For an ASX or Chi-X market participant (other than principal trader or a clearing participant), we consider the financial requirements in the ASIC market integrity rules are an adequate substitute for the financial requirements in the AFS licence in the provision of any financial service. This is because the financial requirements in the ASIC market integrity rules for the ASX and Chi-X markets take into account and address the risks arising from other forms of business beyond stockbroking.
RG 166.181 For an ASX 24 market participant (other than a principal trader, clearing participant or ASX 24 market participant that is also an ASX or Chi-X market participant), we consider the financial requirements in the ASIC market integrity rules are an adequate substitute for the financial requirements in the AFS licence, only where the licensee restricts its financial services business to participating in the ASX 24 market and incidental business. This is because the financial requirements in the ASIC market integrity rules for the ASX 24 market are based on NTA levels and are not directed to financial resources that may be needed as a result of other business.

RG 166.182 Where in future we make ASIC market integrity rules imposing financial requirements on licensed financial markets other than ASX, ASX 24 or Chi-X, we will consider whether those financial requirements are an adequate substitute for the financial requirements in the AFS licence, having regard to the nature of the market and other relevant factors.

How will we assess the adequacy of a market or clearing facility’s financial requirements?

RG 166.183 If you are a participant of:

(a) a licensed financial market other than ASX, ASX 24 or Chi-X (or any other licensed financial market for which ASIC makes market integrity rules imposing financial requirements that ASIC considers an adequate substitute for the financial requirements in the AFS licence); or

(b) a licensed CS facility;

the financial requirements in the AFS licence will not apply to you if we are satisfied that the market’s or licensed CS facility’s financial requirements are an adequate substitute for the financial requirements in the AFS licence.

RG 166.184 When assessing whether the financial requirements with which you must comply as a market or clearing participant are an adequate substitute for our financial requirements, we will consider whether these requirements are at least equivalent in effectiveness to the financial requirements:

(a) we impose on other licensees; and

(b) that apply to market or clearing participants in major overseas jurisdictions.

RG 166.185 In particular, we will consider the obligations that the market or clearing participant will have as a licensee, including the obligation to:

(a) have available adequate financial resources to conduct its financial services business in compliance with the Corporations Act (including carrying out supervisory arrangements);
have adequate risk management systems, which would include addressing certain financial risks (see RG 166.11); and

(c) comply with our licence condition requiring the licensee to comply with financial requirements under the market or CS facility’s operating rules.

RG 166.186 We will focus on the operating rules of the market or CS facility and how they are enforced. We will also take into account the extent and nature of waivers that the market licensee or CS facility licensee gives to its market or clearing participants.

Note: A market or CS facility licensee is a person authorised to operate a market or CS facility under the Corporations Act (as the case may be): see ‘Key terms’.

RG 166.187 We may consider that the relevant financial requirements applying to a market or clearing participant adequately address the objectives of our own financial requirements for the licensee if the licensee only conducts a financial services business as a market or clearing participant, or incidentally to this role. In this case, our financial requirements will not apply as long as the licensee limits its financial services business to participating in that market or CS facility and incidental business that is supervised by the relevant market or CS facility licensee.

RG 166.188 We set out below which markets or CS facilities we are satisfied have financial requirements (other than financial requirements in the ASIC market integrity rules) that are an adequate substitute for the financial requirements in the AFS licence: see RG 166.192–RG 166.195.

When will we assess or review adequacy?

RG 166.189 We will assess the adequacy of the financial requirements applying to market or clearing participants:

(a) when an application for an Australian market or CS facility licence is made, if the applicant requests it;

(b) if we have previously assessed a market or CS facility licensee’s financial requirements to be an adequate substitute for our requirements, but there is a material change in:

(i) operating rules;

(ii) the market’s or CS facility’s licence conditions;

(iii) the market or CS facility licensee’s conduct (particularly supervision); or

(iv) our policy on financial requirements for licensees; or

(c) at another time, if the market or CS facility licensee asks us to.
The fact that an amendment to operating rules has not been disallowed does not prevent us from reconsidering our view of the market or CS facility licensee’s financial requirements on the basis of the new rule.

We may also decide to review the adequacy of a market or CS facility licensee’s financial requirements, or the financial requirements in ASIC market integrity rules at any time.

### Which markets and CS facilities currently have financial requirements that are an adequate substitute?

#### ASX Clear Pty Limited

We consider that the financial requirements of ASX Clear Pty Limited (ASX Clear) are an adequate substitute for the financial requirements in the AFS licence in the provision of any financial service. This applies only to a clearing participant in the licensed CS facility operated by ASX Clear as defined in the operating rules of ASX Clear.

Like the financial requirements in the ASIC market integrity rules for the ASX and Chi-X markets, the financial requirements of ASX Clear take into account and address the risks arising from other forms of business beyond stockbroking.

#### ASX Clear (Futures) Pty Limited

We consider that the requirements of ASX Clear (Futures) Pty Limited (ASX Clear (Futures)) are an adequate substitute for our requirements only for licensees that restrict their financial services business to participating in ASX Clear (Futures) (and, if the clearing participant is also a market participant, in the ASX 24 market) and incidental business. This applies only to a clearing participant in the licensed CS facility operated by ASX Clear (Futures) as defined in the operating rules of ASX Clear (Futures).

Like the financial requirements in the ASIC market integrity rules for the ASX 24 markets, the financial requirements of ASX Clear (Futures) are based on NTA levels and are not directed to financial resources that may be needed as a result of other business.

### How does our policy affect your AFS licence?

Even if the financial requirements in the ASIC market integrity rules apply to you as a participant in a licensed market, or you are a participant in a market or CS facility that we consider has financial requirements that are an
adequate substitute for our financial requirements, we will still include our standard financial requirements in your licence conditions. However, we will also impose additional conditions providing that the standard requirements do not apply as long as:

(a) you comply with the financial requirements in the ASIC market integrity rules or the market’s or CS facility’s operating rules, taking into account any waiver by ASIC or the market or CS facility licensee;

(b) if you are a market participant and/or clearing participant of ASX 24, you restrict your financial services business to participating in the ASX 24 market and/or ASX Clear (Futures), and incidental business;

(c) for each financial year during which you relied on being a market or clearing participant, and at other times for a period we request, you give us an auditor’s opinion on a positive assurance basis stating that:

   (i) you were a market or clearing participant at all times during the relevant period during which you relied on being a market or clearing participant; and

   (ii) if you are a market participant and/or clearing participant of ASX 24, you restricted your financial services business to participating in the ASX 24 market and/or ASX Clear (Futures) and incidental business throughout any part of the relevant period during which you relied on being a market or clearing participant.

What if the requirements cease to be adequate?

RG 166.197 If we consider that the financial requirements of a licensed market or CS facility are no longer an adequate substitute for our financial requirements, we may give you notice in writing that our financial requirements will apply from a specified future date. Under your licence conditions, this notice will mean that, from that date, our financial requirements apply to you.
Appendix 2: Responsible entities

Key points
If you are a responsible entity authorised to operate a managed investment scheme, you must meet:

- the standard solvency and positive net assets requirement;
- a tailored cash needs requirement;
- a tailored audit requirement;
- a net tangible assets (NTA) requirement; and
- depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

What requirements apply?

RG 166.198 A responsible entity authorised to operate a managed investment scheme must meet:

(a) the standard solvency and positive net assets requirement (see RG 166.34–RG 166.36 in Section B);
(b) a tailored cash needs requirement (see RG 166.199–RG 166.200);
(c) a tailored audit requirement (see RG 166.201–RG 166.203);
(d) a net tangible assets (NTA) requirement with requirements for holding cash or cash equivalents and holding liquid assets (see RG 166.204–RG 166.207 and Table 8); and
(e) depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

The tailored cash needs requirement

Note: This requirement replaces the standard cash needs requirement in Section B of this guide.

RG 166.199 You must meet the tailored cash needs requirement for responsible entities. You will need to prepare a cash flow projection (see Table 7), which covers a period of at least 12 months—that is, you must assess your cash needs over at least a 12-month forward period.

RG 166.200 You must update your cash flow projection when those cash flows cease to cover the next 12 months, there is a material change or you have reason to suspect that an updated projection would show that you were not meeting items 5 or 6 in Table 7. Your board must approve the cash flow projection at least quarterly.
Table 7: The tailored cash needs requirement for responsible entities

<table>
<thead>
<tr>
<th>You must meet all these requirements</th>
</tr>
</thead>
</table>

Projection 1 Prepare a projection of your cash flows over at least the next 12 months based on your reasonable estimate of what is likely to happen over this term.

Note: You can take into account, for example, the following factors in preparing your projection if you reasonably believe they are likely to be available: assets you hold at the time the projection starts that can be used to pay your liabilities; and inflow you may receive, including income from your business, amounts that you may borrow (e.g. under an overdraft), and amounts that you may receive from an eligible provider under an eligible undertaking.

Projection 2 Document your calculations and assumptions on which the projection is based, and describe in writing why they are the appropriate assumptions.

Note: We expect that a description in writing of your calculations and assumptions will vary according to the nature, scale and complexity of your business.

Projection 3 Update your projection of cash flows when:
   a) those cash flows cease to cover the next 12 months;
   b) there is a material change; or
   c) you have reason to suspect that an updated projection would show that you were not meeting items 5 or 6 below.

Note: A ‘material change’ is a change for which it would be reasonable for you to plan by updating your cash flow projection.

Projection 4 Have your cash flow projection approved by the board of directors at least quarterly as satisfying the requirements in this cash needs requirement.

Financial resources 5 Show, based on your projection of cash flows, that you will have access as needed to enough financial resources to meet your liabilities over the projected term of at least the next 12 months, including any additional liabilities you project will be incurred during that term.

Financial resources 6 Demonstrate, based on the projection of your cash flows, that you will hold at all times during the period to which the projection relates, in cash or cash equivalents, an amount equal to or greater than the current amount you are required to hold in cash or cash equivalents: see RG 166.207.

The tailored audit requirement

Note: This requirement replaces the standard audit requirement in Section B of this guide.

RG 166.201 All AFS licensees must give us an audit report under s989B(3) of the Corporations Act for each financial year that includes information about compliance with the financial requirements that apply to you: see Section B. If you do not have to provide an audit report under s989B(3), you must still give us an audit report about compliance with the financial requirements. You must also give us this information if we request it for a specified period at another time: see s912C(2).

Note: For the form of this compliance report, see PF 209, condition 28.

RG 166.202 As a responsible entity, the information you must include in your audit report reflects the financial requirements that apply to you: see [CO 11/1140].
Your audit report must include statements by a registered company auditor addressed to you and ASIC that, for the relevant period:

(a) in the auditor’s opinion, you:

(i) complied with the NTA requirement in RG 166.204-RG 166.207 and Table 8 and any other financial requirements applying to you;

(ii) had, at all times, cash flow projections (covering at least the following 12 months) that purported to, and on their face appeared to, demonstrate your solvency; and

(iii) correctly calculated the cash flow projections based on the assumptions you based them on; and

(b) following an examination of the documents you relied on to create your cash flow projections, the auditor has no reason to believe that:

(i) you did not satisfy s912A(1)(h) of the Corporations Act for managing the risk of having insufficient funds to meet the NTA requirement in RG 166.204-RG 166.207 and Table 8 and any other financial requirements applying to you;

(ii) you failed to prepare cash flow projections as required, failed to have these projections approved by your board or governing body, or failed to document the calculations used in creating the cash flow projections and explain why they are appropriate; and

(iii) the assumptions you used to create the cash flow projections were inappropriate.

Note: We refer to the auditor statements in paragraph (a) as ‘positive assurance’ and the statements in paragraph (b) as ‘negative assurance’. We expect that when giving negative assurance for the purposes of paragraph (b), the auditor will take into consideration any information from the audit for positive assurance.

The NTA requirement

If you are a responsible entity, you must meet the NTA requirements set out in Table 8.

For the purposes of meeting the NTA requirement in Table 8, the value of scheme property must be determined as follows:

(a) in the case of assets that would be recognised in preparing a balance sheet for members under Ch 2M—their value as if, at that time, such a balance sheet was being prepared; and

(b) in the case of any other scheme property—its market value.

Note: ‘Assets’ are as defined by applicable accounting principles. ‘Scheme property’ is defined in s9 of the Corporations Act.
RG 166.206  For the purpose of this calculation, mortgages held by members of a mortgage scheme and managed as part of the scheme must be treated as assets of the scheme. When determining the average value of scheme property, you must calculate the required amount of NTA based on all scheme assets and any scheme property as defined by s9 that is not recognised as an asset.

Table 8: NTA requirement for responsible entities

<table>
<thead>
<tr>
<th>Type of responsible entity</th>
<th>NTA requirement</th>
</tr>
</thead>
</table>
| Responsible entities that satisfy any of the requirements relating to custody in RG 166.214(a)–RG 166.214(c) | 1 Responsible entities that satisfy any of RG 166.214(a)–RG 166.214(c) must hold at all times minimum NTA of the greater of:  
  (a) $150,000;  
  (b) 0.5% of the average value of scheme property of the registered scheme(s) and IDPS(s) you operate up to $5 million NTA; or  
  (c) 10% of your average responsible entity revenue with no maximum NTA. |
| Responsible entities that do not satisfy any of the requirements relating to custody in RG 166.214(a)–RG 166.214(c) | 2 Responsible entities that do not satisfy any of RG 166.214(a)–RG 166.214(c) must hold at all times minimum NTA of the greater of:  
  (a) $5 million;  
  (b) 10% of your average responsible entity revenue with no maximum NTA. |

Note: A person that is merely acting as a responsible entity, or who merely holds the assets of a registered scheme, is not performing a custodial or depository service under s766E(3)(b). Consistent with the focus of regulation of the operation of registered schemes being on the responsible entity, we impose the responsibility for ensuring adequate financial standing of custodians for registered schemes on the responsible entity.

RG 166.207 Of the required NTA under items 1 or 2 of Table 8 (as applicable to you), you must hold:  
(a) cash or cash equivalents valued at—at least the greater of:  
  (i) $150,000; or  
  (ii) 50% of the NTA that would be required under item 1 of Table 8; and  
(b) liquid assets to the amount of NTA that would be required under item 1 of Table 8—this may include cash or cash equivalents, other than a commitment to provide cash from an eligible provider that can be drawn down within 5 business days, and has maturity of at least 6 months.
Definitions for the NTA requirement

RG 166.208 Definitions for calculating the required NTA for responsible entities are included in Section E: see RG 166.162–RG 166.173. Relevant definitions include:

(a) average responsible entity revenue;
(b) average value of scheme property;
(c) cash or cash equivalents;
(d) commencement date;
(e) liquid assets;
(f) first financial year;
(g) responsible entity revenue; and
(h) value of scheme property.

Underlying principles of the NTA requirement

RG 166.209 The NTA requirement generally aims to:

(a) ensure that as a responsible entity, you have adequate financial resources to meet your operating costs (e.g. the costs of ensuring compliance with the Corporations Act) throughout the life of your registered schemes;

(b) align your interests and the interests of scheme members by ensuring that you are an entity of substance and that your shareholders have sufficient equity in the business to have a real incentive to ensure its success; and

(c) provide some level of assurance that, if you do fail, there is sufficient money available for the orderly transition to a new responsible entity or to wind up each registered scheme.

RG 166.210 The financial requirements for responsible entities take into account:

(a) the financial requirements set out in the old Corporations Act;
(b) the diversity of the types of schemes;
(c) the need for investor confidence and assessment of comparable regulatory regimes in leading financial centres; and
(d) comparable regulatory regimes, such as the SIS Act for public offer superannuation funds.

RG 166.211 We will not require the NTA calculation to address market or credit risks to assets. NTA is a measure of general financial standing. It includes non-current assets and is not specifically a measure of capacity to meet financial obligations.
RG 166.212 The requirement to hold at least 50% of the required NTA (disregarding any additional amount required by the requirements relating to custody) in cash or cash equivalents (with a minimum of $150,000) aims to help you to meet expenditure in unanticipated situations over the coming 6-month period. The required NTA to be held as liquid assets should be realisable within 6 months so you can continue to meet your liabilities over the 12-month period.

RG 166.213 As one of the purposes of this requirement is to ensure funds are available for situations that are unanticipated, it is imperative that a portion of these funds be available at call, with the balance being available in the short term.

Requirements relating to custody

RG 166.214 You must meet the NTA requirement in item 2 of Table 8 unless, for each registered scheme you operate, one of the following is satisfied:

(a) all the scheme property and other assets of the scheme not held by members are held by a custodian appointed by you that has $5 million NTA (or a subcustodian appointed by that custodian) or by an eligible custodian;

(b) all the scheme property and other assets of the scheme not held by members are Tier $500,000 class assets, each of which are held by you or a custodian appointed by you (or a subcustodian appointed by that custodian), and:

(i) if you hold the scheme property or assets, you have at least $500,000 NTA; or

(ii) if a custodian or subcustodian holds the scheme property or assets, the custodian has at least $500,000 NTA, or is an eligible custodian; or

(c) the only scheme property and other assets of the scheme not held under paragraph (a) or (b) are special custody assets, each of which is held by:

(i) you;

(ii) a custodian that has the level of NTA that you are required to have (or a subcustodian appointed by that custodian) or an eligible custodian; or

(iii) the members of the scheme.

Note: For the definition of ‘eligible custodian’, ‘special custody assets’ and ‘Tier $500,000 class assets’, see Section E under ‘Responsible entity definitions’.

RG 166.215 If assets are held by a custodian that only holds special custody assets, the custodian need not have the required NTA if the only assets it held for the scheme are those specified in paragraphs (a), (c) or (g) of the definition of ‘special custody assets’, or paragraph (d) of that definition if the audited trust account is a regulated trust account: see the definitions of these terms in Section E at RG 166.171.
Underlying principles of the requirements relating to custody

RG 166.216 The requirements relating to custody ensure that a person responsible for holding the scheme property and other assets of the scheme (whether it is you or a third party custodian) is an entity of some substance and also that it has sufficient financial resources to enable assets to be transferred if it ceases to be a custodian. Not all custodians of registered schemes must maintain $5 million NTA. This recognises that, in certain circumstances:

(a) it would be unreasonably costly for operators of schemes to retain a custodian that can meet the $5 million NTA requirement;
(b) the custodial systems for some scheme property need not be as sophisticated as for other schemes; and
(c) the prospect of loss of certain types of assets due to custodial failure is less than for others, and there is a low risk of misappropriation of those asset types.

RG 166.217 Serviced strata schemes and mortgage syndicates not involving nominees are examples of contractual-based schemes where the contractual rights (or leases) involved may, by their nature, be unable to be misappropriated or assigned without the investors’ consent. Further types of contractual rights that do not give rise to the same degree of custodial risk as liquid assets may include:

(a) licences of copyright in a film scheme;
(b) the right in some agricultural schemes to enter the land and cultivate, harvest and remove the produce; and
(c) the right to receive rent from a real property syndicate.

RG 166.218 Generally, the effect of our policy is that, to hold certain types of scheme property, you must use a substantial custodian unless your NTA is over a specified amount. For those assets for which a reduced amount of custodial financial requirements applies under your AFS licence as a responsible entity, you must still ensure that the custodian meets the standards for holding scheme property as set out in Regulatory Guide 133 Managed investments: scheme property arrangements (RG 133).

RG 166.219 If you hold scheme property, then you must generally also comply with Section C of this guide. If you are required to hold $50,000 surplus liquid funds under Section C (the SLF requirement), you must comply with this requirement in addition to the NTA requirement in RG 166.204–RG 166.207 and Table 8. For example, a responsible entity that was required to have $200,000 NTA would need another $150,000 in assets that counted towards NTA if it had:

(a) no liabilities; and
(b) $50,000 credit in an on-demand account it beneficially held with an Australian ADI.
Appendix 3: Investor directed portfolio services

Key points

If you operate an investor directed portfolio service (IDPS), you must meet:

- the standard solvency and positive net assets requirement;
- the standard cash needs requirement;
- the standard audit requirement;
- an NTA requirement; and
- depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

What requirements apply?

RG 166.220 If you operate an investor directed portfolio service (IDPS), you must meet:

(a) the standard solvency and positive net assets requirement (see RG 166.34–RG 166.36 in Section B);
(b) the standard cash needs requirement (see RG 166.37–RG 166.63 in Section B);
(c) the standard audit requirement (see RG 166.64–RG 166.70 in Section B);
(d) an NTA requirement (see RG 166.221–RG 166.222 and Table 9); and
(e) depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

Note 1: ASIC’s policy on financial requirements for IDPS operators is currently under review. See Consultation Paper 176 Review of ASIC policy on platforms: Update to RG 148 (CP 176).

Note 2: The requirements in this appendix do not apply to a licensee authorised to operate a registered scheme as a responsible entity or a retail OTC derivative issuer.

The NTA requirement

RG 166.221 If you operate an IDPS, you must meet the NTA requirements set out in Table 9.

RG 166.222 For the purpose of calculating the NTA requirement, the value of assets must be determined based on the value that would be required to be shown if the operator were reporting at that time to clients.
### Table 9: NTA requirement for IDPS operators

<table>
<thead>
<tr>
<th>NTA you must hold</th>
<th>When it applies</th>
</tr>
</thead>
<tbody>
<tr>
<td>At least $50,000 NTA 1</td>
<td>If you operate an IDPS, you must hold at all times at least $50,000 NTA if the following applies:</td>
</tr>
<tr>
<td></td>
<td>(a) you do not perform transactional functions, do not hold IDPS property and do not hold other assets of the IDPS; and</td>
</tr>
<tr>
<td></td>
<td>(b) you can ensure that any person for whom you are responsible to clients for:</td>
</tr>
<tr>
<td></td>
<td>(i) <strong>transactional functions</strong>—is an eligible custodian, or holds a minimum NTA of 0.5% of the value of:</td>
</tr>
<tr>
<td></td>
<td>(A) the assets; plus</td>
</tr>
<tr>
<td></td>
<td>(B) any other scheme property or IDPS property not counted in calculating the value of assets;</td>
</tr>
<tr>
<td></td>
<td>of the registered schemes for which you are the responsible entity and the IDPSs you operate or for which you perform transactional functions, with a minimum requirement of $50,000 and a maximum requirement of $5 million;</td>
</tr>
<tr>
<td></td>
<td>(ii) <strong>holding IDPS property or other assets of the IDPS</strong>—is an eligible custodian or holds at least $5 million NTA; and</td>
</tr>
<tr>
<td></td>
<td>(iii) in either case—is liable to you or clients directly for due performance of the function.</td>
</tr>
<tr>
<td>Note: For the definition of ‘transactional functions’, see Regulatory Guide 148 <strong>Investor directed portfolio services</strong> at RG 148.38. For the definition of ‘eligible custodian’, see RG 166.166.</td>
<td></td>
</tr>
<tr>
<td>At least $5 million NTA 2</td>
<td>If you operate an IDPS, you must have at least $5 million NTA at any time that:</td>
</tr>
<tr>
<td></td>
<td>(a) you hold property or other assets of the IDPS; or</td>
</tr>
<tr>
<td></td>
<td>(b) any other person:</td>
</tr>
<tr>
<td></td>
<td>(i) that holds IDPS property or other assets of the IDPS; and</td>
</tr>
<tr>
<td></td>
<td>(ii) for whom you are responsible to clients of the IDPS, does not have at least $5 million NTA unless they are an eligible custodian.</td>
</tr>
<tr>
<td>Note: For the definition of ‘eligible custodian’, see Section E.</td>
<td></td>
</tr>
<tr>
<td>NTA between $50,000 – $5 million calculated according to the value of scheme and IDPS property or other assets 3</td>
<td>If you operate an IDPS and items 1 and 2 do not apply to you, you must hold at all times a minimum NTA of 0.5% of the value of:</td>
</tr>
<tr>
<td></td>
<td>(a) the assets; plus</td>
</tr>
<tr>
<td></td>
<td>(b) any other scheme property and IDPS property not counted in calculating the value of assets</td>
</tr>
<tr>
<td></td>
<td>of:</td>
</tr>
<tr>
<td></td>
<td>(c) the registered schemes for which you are the responsible entity; and</td>
</tr>
<tr>
<td></td>
<td>(d) the IDPS you operate or for which you perform transactional functions.</td>
</tr>
<tr>
<td>This NTA requirement is subject to a minimum requirement of $50,000 and a maximum requirement of $5 million. The value must be determined based on the value that would be required to be shown if the operator were reporting at that time to clients.</td>
<td></td>
</tr>
</tbody>
</table>
Underlying principles of the NTA requirement

RG 166.223 We have substantially continued the requirement for NTA that has applied to operators and custodians of IDPS under RG 148. The custodian of IDPS assets performs substantially the same functions as a custodian of registered managed investment scheme assets, at least in their capacity as custodian.

RG 166.224 Our approach to capital requirements is flexible enough to allow an IDPS to be structured in a number of ways provided that the person performing or taking responsibility for the transactional functions has the necessary level of assets. Where an IDPS involves a single person contracting with clients to provide the service, it is not necessary for that person to have NTA of up to $5 million if that sole operator engages other parties to carry out the key transactional and custodial functions. Where the person offering the IDPS service to the client ‘badges’ a service that is substantially provided by a ‘back office’ provider, the requirements are satisfied if the back office provider, as the person performing the transactional functions, is liable to the operator (within the meaning of RG 148) or directly to the clients and has the necessary NTA.
Appendix 4: Custodial or depository services

Key points

If you operate a custodial or depository service, you must meet:
- the standard solvency and positive net assets requirement;
- the standard cash needs requirement;
- the standard audit requirement;
- an NTA requirement (unless the custody is incidental to another financial service you provide and you do not act as custodian for an IDPS); and
- depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

What requirements apply?

RG 166.225 If you operate a custodial or depository service, you must meet:
(a) the standard solvency and positive net assets requirement (see RG 166.34–RG 166.36 in Section B);
(b) the standard cash needs requirement (see RG 166.37–RG 166.63 in Section B);
(c) the standard audit requirement (see RG 166.64–RG 166.70 in Section B);
(d) an NTA requirement (unless the custody is incidental to another financial service you provide and you do not act as custodian for an IDPS) (see RG 166.226–RG 166.230); and
(e) depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

The NTA requirement

RG 166.226 You must have at all times at least $5 million NTA if you provide a custodial or depository service that:
(a) has custody of client assets other than incidentally to the provision of another financial service by you or a related body corporate; or
(b) acts as custodian for an IDPS.

Note: ‘Custodial or depository service’ is defined in s766E of the Corporations Act. To find out if your service is excluded from this definition, see s766E(3) and reg 7.1.40.
Underlying principles of the NTA requirement

RG 166.227 Some businesses are set up mainly to provide custodial or depository services, as opposed to businesses where these services are merely incidental. Clients of stand-alone custody businesses characteristically place substantial trust in the custodian. This contrasts to a degree, for example, with custodial functions that are performed incidentally such as the more limited role undertaken by nominee services provided in conjunction with stockbroking or the custodial functions that will be performed in wholesale trusts incidentally to the dealing involved in investment management.

RG 166.228 Substantial operating capacity is usually required for stand-alone custody businesses. An orderly winding up is particularly important for any stand-alone custody business to prevent client loss because the custodian may hold assets of many different clients coming from different sources.

RG 166.229 We require custodians of IDPS and of registered schemes (except for special custody assets or Tier $500,000 assets) to have $5 million NTA. This is also the appropriate benchmark for stand-alone custody businesses.

RG 166.230 These businesses often are also trustee companies that provide traditional services. Trustee companies providing traditional services will have the same NTA requirement as those that only provide custodial or depository services: see Appendix 5.
Appendix 5: Trustee companies providing traditional services

Key points

If you are a trustee company providing traditional services, you must meet:

- the standard solvency and positive net assets requirement;
- the standard cash needs requirement;
- the standard audit requirement; and
- an NTA requirement, unless you are eligible for relief;
- the surplus liquid funds (SLF) requirement where you hold client money or property valued at $100,000 or more; and
- depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

What requirements apply?

RG 166.231 If you operate a trustee company providing traditional services, you must meet:

(a) the standard solvency and positive net assets requirement (see RG 166.34–RG 166.36 in Section B);

(b) the standard cash needs requirement (see RG 166.37–RG 166.63 in Section B);

(c) the standard audit requirement (see RG 166.64–RG 166.70 in Section B);

(d) an NTA requirement, unless you are eligible for relief (see RG 166.232–RG 166.236);

(e) the surplus liquid funds (SLF) requirement where you hold client money or property valued at $100,000 or more (see Section C); and

(f) depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.
The NTA requirement

RG 166.232 You must have at all times at least $5 million NTA if you are a trustee company that provides traditional services, unless you are eligible for relief.

What relief is available?

RG 166.233 We will consider giving relief from the $5 million NTA requirement on a case-by-case basis where:

(a) a trustee company does not operate a common fund; and
(b) either:
   (i) does not have present or future rights of any kind to hold trust property or estate assets; or
   (ii) has rights in relation to trust property or estate assets that are not substantial when compared to our general requirement of $5 million NTA.

How to apply for relief

RG 166.234 To apply for relief:

(a) Include with your licence application or request for variation of licence a submission for ASIC not to impose the $5 million NTA requirement.

(b) Ensure that your application complies with Regulatory Guide 51 Applications for relief (RG 51).

(c) Candidly set out all information that may be relevant to your application, including details as to the unreasonableness of having to comply with the NTA requirement and the size and number of estates that you anticipate providing traditional services to.

You can also contact ASIC on 1300 300 630 for information and assistance.

Underlying principles of the NTA requirement

RG 166.235 A client using traditional services provided by a trustee company is typically placing substantial trust in the trustee company that provides those services and the trustee company should have some financial substance. Unlike custodial and depository service providers, trustee companies may also hold property other than financial products. Requiring trustee companies that provide traditional services to have NTA of at least $5 million will ensure that a trustee company is an entity of financial substance.

RG 166.236 However, we recognise that in certain circumstances, it may be unreasonably costly for a trustee company to meet the $5 million NTA requirement.
Appendix 6: Issuers of margin lending facilities

Key points

If you are an issuer of a margin lending facility, you must meet:

- the standard solvency and positive net assets requirement;
- the standard cash needs requirement;
- the standard audit requirement;
- an NTA requirement; and
- depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

What requirements apply?

RG 166.237 If you are an issuer of a margin lending facility, you must meet:

(a) the standard solvency and positive net assets requirement (see RG 166.34–RG 166.36 in Section B);
(b) the standard cash needs requirement (see RG 166.37–RG 166.63 in Section B);
(c) the standard audit requirement (see RG 166.64–RG 166.70 in Section B);
(d) an NTA requirement (see RG 166.238–RG 166.240); and
(e) depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

Note: Depending on your business, you may need to meet the ASLF requirement. This requirement will apply to you if you issue a non-standard margin lending facility: see RG 166.241–RG 166.243.

The NTA requirement

RG 166.238 If you issue a margin lending facility, you must hold:

(a) NTA of at least 0.5% of the value of:
   (i) for a standard margin lending facility—the secured property;
   (ii) for a non-standard margin lending facility—any transferred securities;
   (iii) subject to a minimum requirement of $50,000 and a maximum requirement of $5 million; and
(b) at least $5 million NTA at all times:
   (i) for a standard margin lending facility where:
(A) the licensee holds the secured property and that person does not have at least $5 million NTA unless they are an eligible custodian; or
(B) any other person holds the secured property and that person does not have at least $5 million NTA unless they are an eligible custodian; or

(ii) for a non-standard margin lending facility where:

(A) the licensee is the transferee of transferred securities; or
(B) any other person is the transferee of transferred securities and that person does not have at least $5 million NTA unless they are an eligible custodian.

Note: For the definition of ‘margin lending facility’, ‘secured property’ and ‘transferred securities’, see ‘Key terms’. For the definition of ‘eligible custodian’, see Section E under ‘Responsible entity definitions’.

Underlying principles of the NTA requirement

RG 166.239 Imposing a capital requirement on issuers of margin lending facilities will ensure that an issuer is an entity of financial substance. Even if an issuer does not hold secured property or is not the transferee of transferred securities, we impose an NTA requirement of between $50,000 and $5 million. This is because the issuer will still perform a range of important functions such as assessing that the loan is not unsuitable for the client, providing funds to settle client transactions, monitoring portfolios, reporting and providing notice of margin calls.

RG 166.240 However, unless the issuer or any other person that holds secured property or is the transferee of transferred securities has NTA of over $5 million, the issuer must use a substantial custodian. The NTA requirement imposed on an issuer of a margin lending facility provides for the facility to be structured in a number of ways as long as either the issuer, or the person holding the secured property or transferred securities, has the necessary NTA.

ASLF requirement for non-standard margin lending facilities

RG 166.241 Depending on your business, you may need to meet the ASLF requirement. The ASLF requirement will apply to you if you issue a non-standard margin lending facility.

RG 166.242 Under a non-standard margin lending facility, the client transfers the title to the marketable securities provided for the loan to the client. The marketable securities are not held on trust for the benefit of the client and the client merely has the right, in the circumstances determined under the terms of the facility, to be given equivalent marketable securities. This means that the
AFS licensee will need to use its own assets to meet the financial obligations to its client and it will need to carefully manage its assets and liabilities to enable it to meet its compliance obligations.

RG 166.243 We consider that the ASLF requirement is appropriate to reflect the additional risks for managing financial resources inherent in a non-standard margin lending facility. This is because it provides a more comprehensive measure of the availability of liquid assets to the AFS licensee in light of the scale of its operations and various risks to the licensee’s financial resources in the current period.
Appendix 7: Foreign exchange dealers

Key points

If you are a foreign exchange dealer (and you are not a retail OTC derivative issuer), you must meet:

- the standard solvency and positive net assets requirement;
- the standard cash needs requirement;
- the standard audit requirement;
- the ASLF requirement or the capital requirement; and
- depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

What requirements apply?

RG 166.244 If you are a foreign exchange dealer, you must meet:

(a) the standard solvency and positive net assets requirement (see RG 166.34–RG 166.36 in Section B);
(b) the standard cash needs requirement (see RG 166.37–RG 166.63 in Section B);
(c) the standard audit requirement (see RG 166.64–RG 166.70 in Section B);
(d) the standard ASLF requirement (see Section D) or the capital requirement (see RG 166.245–RG 166.253); and

Note: You may also need to comply with the standard ASLF requirement because of financial services that do not relate to foreign exchange contracts, and in that case you must comply with it.

(e) depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

Choosing between the ASLF requirement and the capital requirement

RG 166.245 If you are a foreign exchange dealer, you may choose to comply with the ASLF requirement, rather than having $10 million of Tier 1 capital (if this requirement applies to you). You can choose this option when you apply for your AFS licence or when you apply for a variation of your licence. You will then have to comply with the ASLF requirement at all times and not merely, for example, when it would apply because you have more than $100,000 of adjusted liabilities or certain contingent liabilities. If you choose to have $10 million of Tier 1 capital, then foreign exchange contracts will not be
counted in determining whether the ASLF requirement is triggered in your case.

Note: Foreign exchange dealers that already hold an AFS licence that includes a condition requiring them to comply with the $10 million of Tier 1 capital may apply to us for a variation of their licence conditions if they wish to comply instead with the ASLF requirement.

RG 166.246 If you enter into foreign exchange contracts but do not carry on a business of entering, as principal, into foreign exchange contracts (that are financial products) in Australia, certain foreign exchange contracts are not taken into account in determining if you have at least $100,000 in adjusted or contingent liabilities and therefore are subject to the ASLF requirement. For details of the foreign exchange contracts that may be disregarded, see RG 166.248. This applies to certain foreign exchange contracts that you entered for the purposes of enabling a payment in one of the currencies under the foreign exchange contract.

Meeting the ASLF or the capital requirement

RG 166.247 If you carry on a business of entering, as principal, into foreign exchange contracts that are financial products in Australia, you must either:

(a) have $10 million of Tier 1 capital (defined as if you were an ADI); or

(b) satisfy the ASLF requirement for transacting with clients as principal in Section D of this guide.

RG 166.248 These requirements do not apply if the counterparty to each foreign exchange contract that you enter into in Australia is:

(a) an Australian ADI; or

(b) a person that has a condition in their AFS licence specifically requiring them to have $10 million of Tier 1 capital.

Note 1: For the definition of ‘Tier 1 capital’, see APRA’s Prudential Standard APS 111 Capital adequacy: Measurement of capital (May 2006) and Guidance Note AGN 111.1 Tier 1 capital (May 2006).

Note 2: For the definition of ‘foreign exchange contract’, see ‘Key terms’.

Note 3: If the requirement to have $10 million of Tier 1 capital does not apply to you, the ASLF requirement in Section D may still apply to you.

RG 166.249 You can only take advantage of the options in RG 166.247 if your current liabilities, or contingent liabilities if crystallised, as counted in calculating your adjusted liabilities are under foreign exchange contracts (including foreign exchange contracts that are derivatives).

RG 166.250 If you choose to meet the ASLF requirement in Section D, you must comply with this requirement even if your liabilities plus contingent liabilities are less than $100,000 (i.e. you cannot take advantage of the exceptions in RG 166.80).
Underlying principles of the two options

RG 166.251 Our policy gives AFS licensees that are foreign exchange dealers the option (so far as is practicable under the Corporations Act) of complying with financial requirements based on the previous policy approach of the Reserve Bank of Australia (RBA). Alternatively, they can choose to meet the ASLF requirement in Section D. These licensees were subject to the RBA’s former requirements before FSR commencement (i.e. 11 March 2002). We do not see any basis for requiring such licensees to comply with more onerous financial requirements than those previously applied by the RBA (apart from the base level financial requirements in Section B), if their financial service business is limited to those activities.

RG 166.252 The requirements in this appendix apply to some AFS licensees that enter into foreign exchange contracts, but not to those that merely arrange foreign exchange contracts. For example, the requirements do not apply to licensees that only arrange for buyers and sellers to enter into foreign exchange contracts, where the counterparties are principals to the transaction. However, where the activity involves the licensee taking on the contract as principal, the requirements may apply.

Note: Before FSR commencement (i.e. 11 March 2002), persons who were merely arranging for others to enter foreign exchange contracts were not required by the RBA to be authorised dealers. The RBA also did not require persons who only entered into contracts with authorised foreign exchange dealers to themselves be authorised and therefore they did not have to meet the requirement for $10 million of Tier 1 capital. We have taken the same approach.

RG 166.253 Consistent with the approach of the RBA before FSR commencement, the requirements in this appendix do not apply to foreign exchange contracts entered into outside Australia.
Appendix 8: Retail OTC derivative issuers

Key points

If you are a retail OTC derivative issuer, you must meet:

- the standard solvency and positive net assets requirement;
- a tailored cash needs requirement;
- a tailored audit requirement; and
- an NTA requirement—including complying with certain reporting triggers—which replaces the ASLF requirement.

These financial requirements are being implemented in stages from 31 January 2013 until 31 January 2014: see RG 166.286–RG 166.293.

What requirements apply?

RG 166.254 If you are a retail OTC derivative issuer, you must meet:

(a) the standard solvency and positive net assets requirement (see RG 166.34–RG 166.36 in Section B);

(b) a tailored cash needs requirement (see RG 166.255–RG 166.259);

(c) a tailored audit requirement (see RG RG 166.260–RG 166.262);

(d) an NTA requirement—including complying with certain reporting triggers—which replaces the ASLF requirement (see RG 166.263–RG 166.273); and

(e) depending on the financial products and services you offer, any other requirements set out in this guide that apply to you.

The tailored cash needs requirement

Note: This requirement replaces the standard audit requirement in Section B of this guide.

RG 166.255 As a retail OTC derivative issuer, you must:

(a) prepare, in each March, June, September and December, a rolling projection of your cash flows over at least the next 12 months based on your reasonable estimate of revenues and expenses over this term;

(b) have the cash flow projection approved by your board of directors, or other governing body, as being based on your reasonable estimate of revenue and expenses over the period;

(c) document the calculations and assumptions used in preparing the cash flow projection, and describe in writing why they are appropriate;
(d) update the cash flow projection if there is reason to suspect an updated projection would show you were not meeting the financial requirements applying to you;

(e) demonstrate, based on the cash flow projection, that you will have access when needed to enough financial resources to meet your liabilities over the projected term, including any additional liabilities you project may be incurred during that term;

(f) demonstrate, based on the cash flow projection, that you will have in cash or cash equivalents, at all time to which the projection relates, an amount equal to or greater than the amount you are required to have in cash or cash equivalents under the NTA requirement: see RG 166.263–RG 166.265; and

(g) make the cash flow projection available to ASIC upon request.

**Underlying principles of the tailored cash needs requirement**

RG 166.256 Cash flow projections are an important tool to help ensure that retail OTC derivative issuers can meet anticipated expenses. The requirement for a rolling 12-month cash flow projection that addresses expected operating expenses should, in many cases, result in a higher level of focus and governance around cash flow forecasting and cash planning. We acknowledge that these projections are only as sound as the assumptions on which they are based and the rigour with which they are prepared.

RG 166.257 For this reason, we think it is important for your directors to review your cash flow projections. We believe that longer cash flow projections can help your directors identify potential cash flow problems at an earlier stage, providing the opportunity to take corrective action.

RG 166.258 Cash flow projections will also need to be updated when material changes occur to the assumptions on which they are based.

RG 166.259 We may ask for a copy of your cash flow projections at any time. Projections that are prepared with the requisite detail can help us more fully understand the workings of any issuer in distress.

**The tailored audit requirement**

Note: This requirement replaces the standard audit requirement in Section B of this guide.

RG 166.260 All AFS licensees must give us an audit report under s989B(3) for each financial year that includes information about compliance with the financial requirements that apply to you: see Section B. If you do not have to provide
an audit report under s989B(3), you must still give us an audit report about compliance with the financial requirements. You must also give us this information if we request it for a specified period at another time: see s912C(2).

Note: For the form of this compliance report, see s912AB(11) as notionally applying under Class Order [CO 12/752] Financial requirements for retail OTC derivative investors.

RG 166.261 As a retail OTC derivative issuer, the information you must include in your audit report reflects the financial requirements that apply to you: see [CO 12/752].

RG 166.262 Your audit report must include statements by a registered company auditor addressed to you and ASIC that, for the relevant period:

(a) in the auditor’s opinion, you:

(i) complied with the NTA requirement in RG 166.263–RG 166.265, and any other financial requirements applying to you;

(ii) had, at all times, cash flow projections that purported to, and on their face appeared to, comply with RG 166.255; and

(iii) correctly calculated the cash flow projections based on the assumptions you based them on; and

(b) following an examination of the documents you relied on to create your cash flow projections, the auditor has no reason to believe that:

(i) you did not satisfy s912A(1)(h) of the Corporations Act for managing the risk of having insufficient funds to meet the NTA requirement in RG 166.263–RG 166.265 and any other financial requirements applying to you;

(ii) you failed to:

(A) prepare cash flow projections as required;

(B) have these projections approved by your board or governing body;

(C) document the calculations used in creating the cash flow projections and explain why they are appropriate; and/or

(D) update the cash flow projection if there is reason to suspect an updated projection would show you were not meeting the financial requirements applying to you; and

(iii) the assumptions you used to create the cash flow projections were inappropriate.

Note: We refer to the auditor statements in paragraph (a) as ‘positive assurance’ and the statements in paragraph (b) as ‘negative assurance’. We expect that when giving negative assurance for the purposes of paragraph (b), the auditor will take into consideration any information from the audit for positive assurance.
The NTA requirement

Note: Retail OTC derivative issuers need not meet the ASLF requirement for transacting with clients as principal in Section D. Instead, you must meet the NTA requirement in RG 166.263–RG 166.265.

RG 166.263 As a retail OTC derivative issuer, you must have at all times NTA of the greater of:
(a) $1,000,000; or
(b) 10% of your average revenue.

RG 166.264 You must have 50% of the required NTA in cash or cash equivalents (excluding any other cash or cash equivalents that are held in respect of any liability or obligation to clients) and 50% in liquid assets.

RG 166.265 You must report your NTA position, together with detailed working, to ASIC as part of your annual submission of Form FS70 Australian financial services licensee profit and loss statement and balance sheet as required under s989B of the Corporations Act.

Definitions for the NTA requirement

RG 166.266 Definitions for calculating the required NTA for retail OTC derivative issuers are included in Section E: see RG 166.174–RG 166.177. Relevant definitions include:
(a) average revenue;
(b) cash or cash equivalents;
(c) eligible provider; and
(d) liquid assets.

Underlying principles of the NTA requirement

RG 166.267 It is important for retail OTC derivative issuers to maintain adequate financial resources to ensure that equity owners have a financial incentive to comply with the Corporations Act and are sufficiently invested in the business to take measures to see that it succeeds.

RG 166.268 Derivatives businesses are exposed to the risk of financial expense or loss due to operational failures (e.g. information technology system malfunction or documentation errors). You should have an adequate level of financial resources to help cover operational risk.

RG 166.269 Setting the required level of NTA at the greater of $1 million or 10% of your average revenue helps ensure that, as your business grows, and your operational risk exposure consequentially increases, you have a corresponding level of financial resources.
RG 166.270 To ensure that your financial resources can be used effectively to meet unexpected losses and expenses, the required NTA must be held in a highly liquid form. Having 50% of the required NTA in cash or cash equivalents (excluding cash in client segregated accounts or other cash held in respect of any liability or obligation owed to clients) and 50% in liquid assets ensures that you can use these financial resources as and when required.

RG 166.271 The NTA requirement provides a financial buffer that decreases the risk of a disorderly or non-compliant wind-up if your business fails. The required minimum amount of NTA reflects the contemporary costs of administering the type of financial services business carried on by retail OTC derivative issuers.

RG 166.272 It also aligns Australia more closely with comparable regimes for retail OTC derivative issuers in Singapore (a minimum requirement of S$1 million) and the United Kingdom (a minimum requirement of €730,000). While the US Commodity Futures Trading Commission has a much higher minimum requirement (US$20 million), we believe this amount would be overly onerous.

RG 166.273 The simpler NTA requirement (rather than the more complex requirements in Section D) means that compliance costs for issuers should be lower and compliance should be easier for ASIC to verify.

What are the reporting triggers?

Notifiable events

RG 166.274 If you have less than the required NTA, or the amount of NTA you hold decreases from an amount greater than 110% of the required NTA to a lower amount (each being a ‘notifiable event’ under [CO 12/752]), you must lodge a report with ASIC that specifies your NTA as at the date of the report:

(a) within 3 business days after becoming aware of the notifiable event; and

(b) on the first business day of every month, unless as at the last day of the preceding month your NTA was greater than 110% of the required NTA.
Additional requirements if you have less than the required NTA

RG 166.275 If you have less than 100% of the required NTA, you will be in breach of your AFS licence conditions. You must replenish your NTA to above 100%. If you do not do this within 2 months of the date the deficiency arose, you must notify your clients about the deficiency. For the prescribed form of this notification, see Table 10.

RG 166.276 This notification should be placed prominently on the main page (homepage) of your website and be communicated to each client by email or by letter. If your trading platform allows for electronic alerts or similar, we would also expect you to use this to provide the notification to clients. However, we will not accept ongoing notifications of this type as a means of dealing with an NTA deficiency for any sustained length of time: see RG 166.279–RG 166.280.

RG 166.277 You must also not enter into any transactions with clients that could give rise to any further liabilities, contingent liabilities or other financial obligations until your board of directors, or other governing body, has certified in writing that, having conducted reasonable inquiries into your financial position, there is no reason to believe that, you may fail to meet any other of your licence conditions or obligations under s912A of the Corporations Act, including the base level financial requirements in Section B of this guide.

Having 75% or less of required NTA

RG 166.278 If you have 75% or less of the required NTA, you must not under any circumstances enter into any transactions with clients that could give rise to any further liabilities, contingent liabilities or other financial obligations.

What happens if you breach the NTA requirement?

RG 166.279 If you have less than the required NTA, you will be in breach of your AFS licence obligations. We consider any failure to meet the NTA requirement, or any of the other financial requirements in this guide, should be regarded as a significant breach that is reportable to ASIC under s912D of the Corporations Act. You should also consider whether the breach is a material change or significant event that must be notified to clients in accordance with s1017B of the Corporations Act.

Note: See RG 78 for more information about breach reporting.

RG 166.280 We may take action against you for a breach of the NTA requirement to protect clients and preserve the fair and efficient operation of financial markets.
Table 10: Prescribed form for notifying your clients of inadequate NTA

[Issuer name]

[Date]

Notification to clients: Inadequate net tangible assets (NTA)

We wish to inform you as our client that we are in breach of the requirement under our Australian financial services (AFS) licence to have NTA of the greater of:

• $1,000,000; or
• 10% of our average revenue.

We have been in breach of this requirement for over 2 months.

Our NTA as at the date of this notification, [insert current NTA], is less than our required NTA of [insert required NTA].

Why we are notifying you

As we have had inadequate NTA for over 2 months, we are required by law, as modified by the Australian Securities and Investment Commission (ASIC), to notify our clients of this.

Risks of having inadequate NTA

The purpose of the financial requirements under our AFS licence (including the NTA requirement above) is to help ensure that:

• we have sufficient financial resources to conduct our financial services business in compliance with relevant laws;
• there is a financial buffer that decreases the risk of a disorderly or non-compliant wind-up if our business fails; and
• there are incentives for the owners of our business to comply with their obligations through risk of loss.

Source: ASIC Regulatory Guide 166 Licensing: Financial requirements (RG 166).

You should consider the risk of continuing to trade with us, given that we do not have the minimum financial resources required under our AFS licence to carry on the business of a retail OTC derivative issuer.

Underlying principles of the reporting requirements

RG 166.281 The reporting requirements for retail OTC derivative issuers aim to balance:

(a) the benefits of allowing issuers to use their financial resources to respond to operational incidents and contingencies;
(b) the importance of ensuring issuers still maintain adequate financial resources to operate a business in compliance with the Corporations Act;
(c) ensuring clients and ASIC are informed of material, adverse changes to an issuer’s financial position; and
(d) establishing a framework to provide strong incentives to rectify any breach of the NTA requirement in an expeditious manner.

RG 166.282 We understand that AFS licensees may occasionally draw on some of the required NTA to meet unexpected expenses or losses arising from operational risk. However, this is nevertheless a contravention of the financial requirements that triggers reporting and notification requirements.
as outlined in RG 166.274–RG 166.277. Meanwhile, the requirement to notify us when your NTA falls from 110% to a lower amount or is less than the required NTA gives us early warning that you may be experiencing financial difficulty. Having this advance knowledge will allow us to monitor and ensure you remain in compliance with your licence conditions.

RG 166.283 If you draw down too far on your NTA, in breach of the NTA requirement, we want to ensure there are appropriate incentives for you to replenish those funds in a timely manner, as part of your breach rectification process. Accordingly, if you fail to replenish your NTA to 100% of the required NTA within 2 months, you must notify your clients of the deficiency through a prescribed disclosure. This ensures that your clients are informed about your non-compliance with the NTA requirement while you replenish your funds.

RG 166.284 We also want to ensure that, while you may dip into your NTA in certain circumstances, this action is escalated to the most senior levels of your business so that your ongoing solvency and your ability to comply with your legal obligations is assessed in detail.

RG 166.285 As a safety net, if your NTA falls to below 75% of the required NTA, you must not under any circumstances enter into any transactions with clients that could give rise to further liabilities, contingent liabilities or other financial obligations.

**When do the requirements apply?**

RG 166.286 There is a staged implementation period for retail OTC derivative issuers to make the transition to the higher level of required NTA: see [CO 12/752].

RG 166.287 From 31 January 2013 until 31 January 2014, you will be taken to have complied with the NTA requirement if you have at all times NTA of the greater of:

(a) $500,000; or
(b) 5% of your average revenue.

RG 166.288 During this implementation period, you will still need to comply with the requirement to have 50% of the required NTA in cash or cash equivalents and the other 50% as liquid assets.

Note: See Section E for the definitions of these terms.

RG 166.289 You must ensure that you have the required NTA at all times.

Note: If, during the period from 31 January 2013 until 31 January 2014, you are required to provide a notification to your clients under RG 166.275, you should use the prescribed form set out in Table 10, replacing the reference to ‘$1,000,000’ with ‘$500,000’.

RG 166.290 The other requirements, including the tailored cash needs requirement, apply from 31 January 2013.
Underlying principles of staged implementation

RG 166.291 We believe the financial requirements in this guide are important to ensure the stability of the market for retail OTC derivatives and, as such, should be implemented as soon as practicable. We also acknowledge that some businesses may either choose to restructure or need to recapitalise to meet the NTA requirement.

RG 166.292 The staged implementation period gives you the opportunity to put in place appropriate arrangements over time.

RG 166.293 Setting an interim target of 50% of the required NTA will allow you, your clients and ASIC to gauge your ability to meet the full requirement after the 12-month implementation period finishes.