



ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 166

Licensing: Financial requirements

Chapter 7 — Financial services and markets

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From 5 July 2007, this document may be referred to as Regulatory Guide 166 (RG 166) or Policy Statement 166 (PS 166). Paragraphs in this document may be referred to by their regulatory guide number (e.g. RG 166.1) or their policy statement number (e.g. PS 166.1).

What this guide is about

RG 166.1 This guide sets out the financial requirements you will have to meet as the holder of an Australian financial services (AFS) licence. The requirements will vary depending on the financial products and services you offer.

RG 166.2 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*, this guide does not apply to you. APRA, and not ASIC, imposes any requirements for financial resources that are to apply to the bodies APRA regulates. This applies even if only a part of your financial services business is an activity that is regulated by APRA.

Note 1: This guide *does* apply to you if you are a subsidiary or a related body corporate of a body regulated by APRA, unless you are yourself also a body regulated by APRA.

Note 2: If you are a body regulated by APRA, 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 Pro Forma 209 *Australian financial services licence conditions* [PF 209], condition 27.

RG 166.3 This guide explains:

A our general policy approach on financial requirements

see RG 166.5–RG 166.24

B what financial requirements apply to licensees generally

see RG 166.25–RG 166.53

C what additional requirements apply to licensees that are:

- (a) responsible entities;
- (b) investor directed portfolio services (IDPS) operators; or
- (c) operators of other custodial or depository services

see RG 166.54–RG 166.76

D when market and clearing participants are excluded from our financial requirements

see RG 166.77–RG 166.94

E what additional financial requirements apply to licensees that hold client money or property

see RG 166.95–RG 166.103

F what additional financial requirements apply to licensees that transact with clients as principal

see RG 166.104–RG 166.124

G what financial requirements apply to licensees that deal in foreign exchange contracts

see RG 166.125–RG 166.127

H what definitions are used in calculating financial requirements for Sections C, E and F

see RG 166.128–RG 166.184

RG 166.4 Under this guide, different conduct means that different requirements apply. More than one requirement may apply in your case.

Table 1 on page 5 summarises the structure of this guide and how it might apply to you.

RG 166.4A For a discussion of our approach to the other licensee obligations, see:

- (a) Regulatory Guide 146 *Training of financial product advisers* (RG 146);
- (b) Regulatory Guide 164 *Licensing: Organisational capacities* (RG 164);
- (c) Regulatory Guide 165 *Licensing: Internal and external dispute resolution* (RG 165);
- (d) Regulatory Guide 167 *Licensing: Discretionary powers* (RG 167);
- (e) Regulatory Guide 175 *Licensing: Financial product advisers—Conduct and disclosure* (RG 175);
- (f) Regulatory Guide 181 *Licensing: Managing conflicts of interest* (RG 181).

Important note: This guide was first published on 28 November 2001. It has been amended to reflect changes made to the Corporations Act, Corporations Regulations, ASIC policy and instruments issued before 15 June 2007, and to provide some clarifications.

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Table 1: Summary of RG 166

Note: This summary only shows how the parts of this guide relate to each other. For details of our policy, see Sections A to G. Section H explains what definitions are used in calculating financial requirements for Sections C, E and F.

Who is affected	Summary of our policy requirements	What attracts financial requirements	What sub-classes of licensee are primarily affected
Section A: Our general policy on financial requirements			
All licensees not regulated by APRA	Risk management systems must address risk to financial resources	Holding an AFS licence	All licensees except APRA-regulated bodies
Section B: Base level financial requirements			
All licensees except licensees regulated by APRA and market and clearing participants that Section D says need not comply	Positive net assets and solvent Sufficient cash resources to cover next 3 months' expenses with adequate cover for contingencies Audit compliance annually and when we ask	Holding an AFS licence	Providers of financial product advice (advisers) Dealers Responsible entities and IDPS operators Custodial or depository service providers Market makers
Section C: Managed investments and custody services			
Responsible entities and IDPS operators Providers of custodial or depository services	Net tangible assets (NTA) requirement of up to \$5 million for responsible entities, IDPS operators and custodial or depository service providers	Acting as a responsible entity, IDPS operator or a provider of a custodial or depository service This requirement is in addition to the requirements in Section B and, if applicable, Sections E, F and G	Responsible entities and IDPS operators Custodial or depository service providers
Section D: Market and clearing participants			
Market and clearing participants	Meet the requirements in the market's or clearing house's operating rules Have adequate risk management systems, including addressing financial resources	Requirements in Sections B, C, E, F and G do not apply to financial services businesses connected with participation in the market	ASX and SFE market and clearing participants based on current business rules Participants in other licensed markets or clearing and settlement facilities if we agree

Who is affected	Summary of our policy requirements	What attracts financial requirements	What sub-classes of licensee are primarily affected
Section E: Licensees holding client money or property			
Licensees holding client assets	Surplus liquid funds (SLF) of \$50,000	<p>Holding client assets over \$100,000, including money in a separate account, or money or assets on trust for clients in certain situations</p> <p>This requirement is in addition to the requirements in Section B and, if applicable, Sections C, F and G</p>	Some dealers
Section F: Licensees with financial obligations from transacting with clients as principal			
Licensees owing liabilities or contingent liabilities by entering into transactions with clients	<p>Tiered adjusted surplus liquid funds (ASLF) requirement from \$50,000 to \$100 million</p> <p>ASLF calculation contains adjustments for assets and contingent liabilities</p> <p>Requirement for board consideration when trigger points are reached</p>	<p>Having such liabilities or contingent liabilities beyond \$100,000</p> <p>This requirement is in addition to the requirements in Section B and, if applicable, Sections C, E and G</p>	<p>Market makers</p> <p>Underwriters</p> <p>Some dealers</p> <p>Foreign exchange dealers (who elect to comply with Section F)</p>
Section G: Foreign exchange dealers			
Licensed foreign exchange dealers	\$10 million tier one capital	<p>Financial services business of foreign exchange contracts</p> <p>If financial services business is only of entering into foreign exchange contracts, Section F does not apply unless licensee elects to comply with Section F not Section G</p> <p>This requirement is in addition to the requirements in Section B and, if applicable, Sections C, E and F</p>	Foreign exchange dealers (who elect to comply with Section G)

A Our general policy on financial requirements

Note: The financial requirements set out in this guide do not apply to a licensee that is a body regulated by APRA.

Our policy

RG 166.5 We have set financial requirements that you must meet as the holder of an AFS licence. These requirements:

- (a) are set out in Sections B to G of this guide; and
- (b) vary in their application depending on the nature, scale and complexity of your financial services business.

RG 166.6 We apply our financial requirements by 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 conditions operate in this way:

- (a) more than one licence condition 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 licence condition, you can also count those assets for another applicable condition;
- (c) you must monitor your compliance with each of your obligations and be satisfied that you are continuously complying; and
- (d) if you become aware that you have significantly breached, or are likely to significantly breach, a licence condition, 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).

Risk management

RG 166.7 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 licensee obligations, or to wind up your business in an orderly manner.

Note: For further guidance about risk management systems, see Regulatory Guide 164 *Licensing: Organisational capacities* (RG 164).

Foreign prudentially regulated licensees

RG 166.8 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. 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 166.9 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.

How to apply for relief

- Include with your licence application or request for variation of licence a submission for ASIC not to impose its standard licence conditions about financial requirements.
- Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).
- Candidly set out all information that may be relevant to your application, including details as to the foreign regulatory arrangements.

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

Underlying principles

RG 166.10 We are not a prudential regulator and this guide is not intended to ensure that you will meet your financial commitments (including commitments to your clients or market counterparties).

RG 166.11 We impose financial requirements to help ensure that:

- (a) you have sufficient financial resources to conduct your financial services business in compliance with the *Corporations Act 2001* (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 166.12 In setting licence conditions for 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.

Foreign prudentially regulated licensees

RG 166.13 If we can be satisfied that there is an alternative form of foreign prudential regulation that appropriately addresses the licensee obligations for financial resources and risk management, we will seek to avoid regulatory duplication.

Explanations

RG 166.14 As a licensee, among other obligations, 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.

Note: We will 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 the RG 1–RG 3 *AFS Licensing Kit*.

RG 166.15 The 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 166.16 The licensee obligations and our licence conditions also apply if you are a related body corporate of 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 authorised deposit-

taking institution (ADI) may not, for example, be material to APRA's purposes in regulating the ADI.

RG 166.17 You must comply with your licence conditions: see s912A(1)(b). Meeting the financial requirements under our licence conditions 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 166.18 Deleted.

RG 166.19 This guide is not designed to ensure that you will be able to compensate clients if you breach the licensee obligations in Chapter 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 166.20 Assets used to meet one licence condition may be used to meet another condition. For example, if you are a responsible entity and need to have \$5 million NTA under Section C, you can take into account the assets that give you that NTA to meet our cash needs requirement under paragraph (c) of RG 166.25.

RG 166.21 Meeting our 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.

RG 166.22 This guide supersedes our previous policies on financial requirements under the old Corporations Act: see Regulatory Guide 167 *Licensing: Discretionary powers* (RG 167).

Foreign prudentially regulated licensees and APRA

RG 166.23 The regulatory regime 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. We consider that this recognition of adequate prudential regulation by APRA might equally be applied to prudential regulation by some foreign regulators. We will consider applications to exclude licence conditions for financial requirements if you are subject to a level of foreign prudential regulation that is comparable to that provided by APRA for the kind of licensee that you are (e.g. a general insurer or a deposit-taking institution).

RG 166.24 If we decide not to impose financial requirements on you by licence condition, you must still comply with the other licensee obligations.

B Base level financial requirements

Note: The requirements in Section B apply to all licensees except certain market and clearing participants (see Section D) and bodies regulated by APRA. Some licensees may have to comply with additional requirements: see Sections C and E–G. We expect that, to meet their licence conditions under the guide, most small business licensees that do not hold client money or property over \$100,000 will only need to comply with the requirements set out in Section B.

Our policy

RG 166.25 You must:

- (a) at all times be solvent—that is, be able to pay all your debts as and when they become due and payable;
- (b) 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 H. For example, this may apply to you if you rely on an undertaking from an ADI.

- (c) meet our cash needs requirement by complying at all times with one of Options 1 to 5 (see RG 166.26 and Tables 1A to 3); and

Note: We expect that most small business licensees will only need to consider complying with Options 1 or 2, and will generally prefer Option 2.

- (d) meet the audit requirement set out in RG 166.27–RG 166.28.

Note 1: For principles underlying our policy, see RG 166.29–RG 166.30.

Note 2: For an explanation of our policy, see RG 166.31–RG 166.53.

Cash needs requirement

RG 166.26 You can meet our cash needs requirement by choosing either Option 1 (see Table 2) or Option 2 (see Table 3). Alternatively, you may choose Option 3, 4 or 5 (see RG 166.26B–RG 166.26E) if one of those options is more suitable for you and if you:

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

- (c) you can comply with the requirements for the relevant option.

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

RG 166.26A A short description of the options follows:

- (a) 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);

Note: We expect this option will be relevant for some small business licensees.

- (b) 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 most small business licensees will prefer this option;

Important note: We expect this option will be most relevant for small business licensees.

- (c) 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;

Note 1: We expect this option will not be relevant for small business licensees.

Note 2: For further information, see RG 166.26C and RG 166.49B. See also Information Release [IR 03-26].

- (d) Option 4 is relevant to subsidiaries of certain prudentially regulated bodies; and

Note 1: We expect this option will not be relevant for small business licensees.

Note 2: For further information, see RG 166.26D and RG 166.49C. See also Information Release [IR 03-44] *ASIC provides further options to meet cash needs requirements*.

- (e) Option 5 is relevant to licensees in corporate groups that plan cash flows on a group basis.

Note 1: We expect this option will not be relevant for small business licensees.

Note 2: There are alternatives under Option 5: Option 5A (most suitable for licensees with a commitment from a parent) and Option 5B (most suitable for a licensee without a commitment from a related body corporate). For further information, see RG 166.26E and RG 166.49D. See also [IR 03-44].

Table 2: Option 1—Reasonable estimate projection plus cash buffer

You must meet all these requirements	
Projection	<p>1 Prepare a projection of cash inflow and outflow (cash flows) over at least the next 3 months based on your <i>reasonable estimate</i> of what is likely to happen over this term.</p> <p>2 Document your calculations and assumptions, and describe in writing why they are the appropriate assumptions.</p> <p>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.</p>
Financial resources	<p>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.</p> <p>5 Have in cash an amount equal to 20% of the greater of:</p> <p>(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</p> <p>(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.</p>

Note 1: For item 1, you can take into account, for example, the following factors in preparing your projection if you reasonably believe they are likely to be available:

- (a) assets you hold at the time the projection starts that can be used to pay your liabilities; and
- (b) inflow you may receive including:
 - (i) income from your business;
 - (ii) amounts that you may borrow (e.g. under an overdraft); and
 - (iii) amounts that you may receive from your owners or associates as financial support.

Note 2: Table 4 after RG 166.26E provides some key definitions relevant to this option, including a definition of ‘cash’ for the purposes of item 5.

Note 3: For item 2, we expect that a description in writing of the calculations and assumptions will vary according to the nature, scale and complexity of the licensee’s business.

Table 3: Option 2—Contingency-based projection

You must meet all these requirements	
Projection	<p>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 <i>commercial contingencies</i>. 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.</p> <p>2 Document your calculations and assumptions, and describe in writing why they are the appropriate assumptions.</p> <p>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.</p>
Financial resources	<p>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.</p>

Note 1: For item 1, we would normally expect you to take into account:

- (a) assets you hold at the start of the projection term that can be used to pay your liabilities; and
- (b) inflow you may receive including:
 - (i) income from your business or sale of your business;
 - (ii) amounts that you may borrow (e.g. under an overdraft); and
 - (iii) 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.

Note 2: For item 2, we expect that a description in writing of the calculations and assumptions will vary according to the nature, scale and complexity of the licensee's business.

Note 3: Table 4 provides some key definitions relevant to this option. The definition of 'cash' will not be relevant to licensees using Option 2.

When a licensee need not prepare projections (Options 3 to 5)

RG 166.26B You may fulfil your cash needs requirement without preparing cash flow projections by using Option 3, 4 or 5. These options are generally only available to licensees within corporate groups or who 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

RG 166.26C Under this option, an Australian ADI or another entity (such as a foreign deposit-taking institution) approved for this purpose in writing by us must give you an enforceable and unqualified commitment.

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.

The provider of the commitment must be required to pay an unlimited amount on demand from to time:

- (a) to you; or
- (b) to the extent of the liability, to:
 - (i) your creditors; or
 - (ii) a trustee for your creditors.

You must 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

RG 166.26D Under this option, you must:

- (a) 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.

- (b) 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;
- (c) ensure that a responsible officer has documented that they have the reasonable expectation in paragraph (b) 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; and
- (d) keep the document in paragraph (c) 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.

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

RG 166.26E Under this option, you must ensure that:

- (a) your cash flows and the cash flows of each of your related bodies corporate, other than any body regulated by APRA, (the licensee group) are managed on a consolidated basis;
- (b) there is a body corporate within the licensee group of which all members of the licensee group are subsidiaries (the parent entity);
- (c) the parent entity complies with Option 1 or 2, as if:
 - (i) it were the licensee;
 - (ii) cash flows of any member of the licensee group were cash flows of the licensee; and
 - (iii) any cash held by a member of the licensee group (other than as trustee of a trust) were held by the licensee;
- (d) 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 paragraph (c). 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.

- (e) either of the following applies:
- (i) *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; or
 - (ii) *Alternative B*:
 - (A) you 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;
 - (B) you have ensured that a responsible officer has documented that they have the reasonable expectation in paragraph (e)(ii)(A) 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
 - (C) you must keep the document in paragraph (e)(ii)(B) 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; and
 - (f) you have no reason to believe that the parent entity has not complied with the requirement in paragraph (c) or has failed to comply, in a material respect, with its obligations under Chapter 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.

Note: Table 4 provides some key definitions relevant to this option.

Table 4: Definitions for calculating base level financial requirements

Cash	<p>For the purposes of item 5 of Table 2 (relating to Option 1), cash means:</p> <ul style="list-style-type: none"> (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 definition below) 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 paragraph (b) of the definition below, 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. <p>This includes any cash in a relevant trust (see definition below) if you have no reason to believe that the cash will not be available to meet all of your projected cash flows.</p> <p style="padding-left: 40px;">Note: Examples under paragraph (b) are an overdraft facility from a bank or a binding assurance of support from a well-capitalised listed company. Examples of what you may not treat as cash are illiquid assets or financial support you think you will receive but do not have an entitlement to demand as cash.</p>
Cash flow	<p>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.</p>
Eligible provider	<p>We have reproduced here the definition of 'eligible provider' from Section H of this guide for the convenience of licensees to whom only the base level financial requirements in Section B apply. For a brief explanation of this definition, see RG 166.167.</p> <p>Eligible provider means:</p> <ul style="list-style-type: none"> (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): <ul style="list-style-type: none"> (i) whose ordinary shares are listed on a licensed market or an ASIC-approved foreign exchange under Regulatory Guide 72 <i>Foreign securities prospectus relief</i> (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 you have no reason to believe the entity no longer has net assets of at least that amount; <p style="padding-left: 40px;">Note: If the provider is not otherwise required to lodge financial statements with us, you must ensure that their financial statements are lodged with your balance sheet under s989B(2).</p>

- Eligible provider (cont.)**
- (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;

Note: We may publish a list for this purpose.

- (e) a foreign deposit-taking institution we approve in writing for this purpose (see RG 166.166);
- (f) a clearing and settlement (CS) facility licensee; or
- (g) in exceptional circumstances, an entity of undoubted financial substance we approve in writing for this purpose.

Relevant trust Relevant trust means a trust:

- (a) of which the licensee is trustee;
- (b) through which the licensee carries on substantially all of its financial services business; and
- (c) that is not a registered managed investment scheme or a superannuation entity as defined in s10(1) of the *Superannuation Industry (Supervision) Act 1993*.
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Audit

RG 166.27 The audit report you must 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 166.28 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 (see condition 28(d)(i) of [PF 209]); and

Note: For those licensees that have to meet the ASLF requirement under Section F, 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 under RG 166.140. 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 our requirements; or
 - (ii) you failed to comply with certain elements of the options to satisfy our cash needs requirement (see condition 28(d)(ii) of [PF 209]).

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

Underlying principles

RG 166.29 You can only comply with your obligations as a 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.

RG 166.30 We set minimum financial resource requirements to promote appropriate financial risk management, taking into account the nature, scale and complexity of a licensee's business. Our aim is not to ensure that licensees do not fail, but to help ensure that cash shortfalls do not put compliance with the licensee obligations at risk.

Explanations

Solvency

RG 166.31 The Corporations Act requires directors of a company to prevent insolvent trading by the company: see Div 3 of Part 5.7B. It is not appropriate for any licensee, including a natural person, to carry on a financial services business while insolvent. It is also not appropriate that you carry on a financial services business with liabilities exceeding your assets. Licensees who 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 Chapter 7 of the Corporations Act.

RG 166.32 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.

Cash needs requirement

Projections, budgeting and risk management

RG 166.33 If a licensee does not have enough cash to meet its liabilities, particularly over a short time frame like 3 months, there is a greater risk that the licensee may not provide financial services in compliance with the licensee obligations under Chapter 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 166.34 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 a 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 166.35 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 licensees.

RG 166.36 Taking into account commercial contingencies, 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 166.37 We are concerned to ensure that 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 166.38 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 166.39 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 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 Options 1 or 2, you do not have to prepare cash flow projections.

Note 2: If you choose Option 4 or 5B (see paragraph (e)(ii) of RG 166.26E), one of your responsible officers must document that they have a reasonable expectation of financial support from related bodies.

RG 166.40 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 166.41 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).

Options 1 and 2 generally

RG 166.42 Because of the large range of sizes and types of licensee, we have decided to give several options that can be used to satisfy the cash needs requirement. 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.

Note: We expect that most small business licensees will only need to consider complying with Options 1 or 2, and will generally prefer Option 2.

RG 166.43 Compliance with either Option 1 or 2 will meet the cash needs requirement under our licence condition 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 166.44 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. By having a cash buffer, you will have a buffer to help you manage commercial contingencies.

RG 166.45 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 by 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 166.46 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 166.47 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.

Option 2—Contingency-based projection

RG 166.48 Option 2 is potentially suitable for all 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 166.49 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: see RG 166.49A–RG 166.49D.

Options 3 to 5 generally

RG 166.49A In addition to Options 1 and 2, we have provided three further options for licensees that are able to meet their cash needs requirement in a manner that does not involve providing individual cash flow projections. 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.

Option 3—Financial commitment by an ADI or comparable foreign institution

RG 166.49B This option is suitable for 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(d)(iii) of [PF 209] for further details.

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

RG 166.49C This option is suitable for 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(d)(iv) of [PF 209] for further details.

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

RG 166.49D This option is suitable for 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 (referred to as Option 5A in Table 1A); 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 (referred to as Option 5B in Table 1A).

Note: See condition 13(d)(v) of [PF 209] for further details.

Audit

RG 166.50 Audit opinions about compliance with financial requirements were a feature of regulation of licensed securities dealers under the old Corporations Act and apply appropriately to all kinds of licensee under the regulatory regime.

RG 166.51 Since Part 7.8 already requires audited accounts, asking for opinions in the annual audit on a licensee's compliance with our 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 166.52 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 166.52A We require only negative assurance on some matters, as we recognise the additional burden on an auditor involved in giving audit assurance as to a licensee's compliance with requirements involving projections or other expectations concerning future events or the adequacy of risk management systems.

RG 166.53 We will not routinely monitor your compliance with 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 Managed investments and custody services

Note: See Section H for definitions used in calculating financial requirements in this section. For a list of these definitions, see RG 166.128.

Our policy

RG 166.54 If you are a responsible entity, an IDPS operator or licensed to provide a custodial or depository service (other than incidentally to another financial services business, as discussed in RG 166.75), additional financial requirements apply.

Note: These requirements are on top of the base level requirements in Section B applying to all licensees and the requirements in Sections E, F and G (if these sections apply to you).

RG 166.55 The requirements in Section C do not apply to:

- (a) certain market and clearing participants (see Section D); or
- (b) bodies regulated by APRA.

Responsible entities

RG 166.56 If you are a responsible entity, you must hold at all times a minimum NTA of 0.5% of the value of:

- (a) the assets; plus
- (b) any other scheme property not counted in calculating the value of the assets,

of the registered schemes you operate, with a minimum requirement of \$50,000 and a maximum requirement of \$5 million.

RG 166.56A The value of assets and other 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 Chapter 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 1: 'Assets' are as defined by applicable accounting principles.

Note 2: 'Scheme property' is defined in s9 of the Corporations Act.

RG 166.57 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.

Requirements relating to custody

RG 166.58 You must hold \$5 million NTA rather than the amount required by RG 166.56, 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 is an eligible custodian;

Note: For a definition of 'eligible custodian', see RG 166.62A.

- (b) all the scheme property or assets of the scheme not held by members are special custody assets or tier \$500,000 class assets, each of which are held by you or a custodian appointed by you (or a sub-custodian appointed by that custodian), and:

- (i) if you hold the scheme property or assets, you have \$500,000 NTA; or
- (ii) if a custodian or sub-custodian holds the scheme property or assets, the custodian has \$500,000 NTA, or is an eligible custodian; or

Note 1: For a definition of 'eligible custodian', see RG 166.62A.

Note 2: For a definition of 'special custody assets', see RG 166.181.

Note 3: For a definition of 'tier \$500,000 class assets', see RG 166.184.

- (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 is an eligible custodian; or
- (iii) the members of the scheme.

Note: For a definition of 'eligible custodian', see RG 166.62A.

RG 166.59 If assets are held by a custodian who only holds special custody assets, the custodian need not have the required NTA (for the purposes of paragraph (c)(iii) of RG 166.58) if the only assets it holds for the scheme are those in paragraphs (a), (c) and (g) of the definition of

‘special custody assets’ (see RG 166.181) or, if the audited trust account is a regulated trust account, paragraph (d) of RG 166.181.

Investor directed portfolio services (IDPS)

RG 166.60 If you operate an IDPS, you must hold at all times at least \$50,000 NTA if you:

- (a) do not perform transactional functions, do not hold IDPS property and do not hold other assets of the IDPS; and
- (b) ensure that any person for whom you are responsible to clients for:
 - (i) transactional functions—is an eligible custodian or holds a minimum NTA of 0.5% of the value of:
 - (A) the assets; plus
 - (B) any other scheme property or IDPS property not counted in calculating the value of assets,
 of the:
 - (C) registered schemes for which you are the responsible entity; and
 - (D) IDPS you operate or for which you perform transactional functions.

This NTA requirement is subject to a minimum requirement of \$50,000 and a maximum requirement of \$5 million;

- (ii) holding IDPS property or other assets of the IDPS—is an eligible custodian or holds at least \$5 million NTA; and
- (iii) in either case—is liable to you or clients directly for due performance of the function.

Note 1: For a definition of ‘transactional functions’, see Regulatory Guide 148 *Investor directed portfolio services* at RG 148.38.

Note 2: For a definition of ‘eligible custodian’, see RG 166.62A.

RG 166.61 If you operate an IDPS, you must have at least \$5 million NTA at any time that:

- (a) you hold IDPS property or other assets of the IDPS; or
- (b) any other person:
 - (i) that holds IDPS property or other assets of the IDPS; and
 - (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.

Note: For a definition of 'eligible custodian', see RG 166.62A.

RG 166.62 If you operate an IDPS and RG 166.60–RG 166.61 do not apply, you must hold at all times a minimum NTA of 0.5% of the value of:

- (a) the assets; plus
 - (b) any other scheme property and IDPS property not counted in calculating the value of assets,
- of the:
- (c) registered schemes for which you are the responsible entity; and
 - (d) IDPS you operate or for which you perform transactional functions.

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.

Eligible custodian

Note: We have reproduced here the definition of 'eligible custodian' from RG 166.164A for the convenience of licensees to whom the financial requirements in Section C apply.

RG 166.62A An eligible custodian is:

- (a) an Australian ADI; or
- (b) a market participant or a clearing participant (if our financial requirements do not apply to the licensee for all financial services under Section D of this guide); or
- (c) a sub-custodian appointed by one of the above.

Custodial or depository services

RG 166.63 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 1: '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.

Note 2: RG 166.75 discusses when custody will be regarded as incidental to the provision of other financial services.

Underlying principles

RG 166.64 If you provide a financial service of holding or managing others' assets, you should demonstrate your financial commitment and substance to promote the confidence of those for whom you act.

Explanations

Responsible entities

RG 166.65 When applying the NTA requirement, we will calculate the required amount of NTA based on all scheme assets including, but not limited to, scheme property as defined by s9.

RG 166.66 If the responsible entity has \$5 million NTA, no NTA requirement will apply to the custodian under the responsible entity's licence. However, the custodian may be required to have \$5 million NTA under its own licence (if it has one).

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 166.67 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 protection; and
- (d) comparable regulatory regimes, such as the *Superannuation Industry (Supervision) Act 1993* (SIS Act) for public offer superannuation funds.

RG 166.68 We will not require the NTA calculation to address market or credit risks to assets, or the risk of contingent liabilities crystallising. 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.

Requirements relating to custody

RG 166.69 Generally, a custodian (whether it is you or a third party custodian) must have at least \$5 million NTA. This ensures that a 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 166.70 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 166.71 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 resources 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 166.72 If the responsible entity holds scheme property, then it must generally also comply with Section E. If Section E requires \$50,000 SLF, the responsible entity must comply with this requirement in addition to the NTA requirement in RG 166.58–RG 166.59. For example, a responsible entity that was required to have \$100,000 NTA would need another \$50,000 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 ADI.

These assets would not be required to be current assets, as the \$50,000 in the ADI account satisfies the SLF requirement.

IDPS

RG 166.73 We are substantially continuing 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. Accordingly, we will apply a similar NTA requirement of \$5 million.

RG 166.74 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.

Custodial or depository services

RG 166.75 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. Substantial operating capacity is usually required for stand-alone custody businesses. It is particularly important that there is opportunity for an orderly winding up of any stand-alone custody business in order to prevent client loss, as the custodian may hold assets of many different clients coming from different sources.

RG 166.76 We have required custodians of IDPS (see RG 148) 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.

D Market and clearing participants

Our policy

RG 166.77 If you are a participant in a licensed market or a clearing participant in a licensed clearing and settlement facility (CS facility), our financial requirements will not apply to you as long as we are satisfied that the market's or CS facility's financial requirements are an adequate substitute for our financial requirements.

Note: For a definition of 'clearing participant', see 'Key terms'.

How will we assess a market's or clearing facility's financial requirements?

RG 166.78 When assessing whether the financial requirements with which you must comply as a market or clearing participant are an adequate substitute, we will see if 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 166.79 We will focus on the operating rules of the market or CS facility and how they are enforced. We will 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 166.80 If a licensee only conducts a financial services business in its capacity as a market or clearing participant or incidentally to that role, we may consider that the relevant financial requirements applying to such participants adequately address the objectives of our own financial requirements for the licensee. 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.

When will we review adequacy?

RG 166.81 We will assess the adequacy of the financial requirements applying to market or CS facility 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.

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.

RG 166.82 We may also review the adequacy of a market or CS facility licensee's financial requirements at any time.

RG 166.83 We will publish which markets or CS facilities we have been satisfied have adequate substitute financial requirements for this purpose: see RG 166.86–RG 166.87.

How does our policy affect your AFS licence?

RG 166.84 Even if 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 market or CS facility's operating rules that relate to financial requirements, taking into account any waiver by the market or CS facility licensee;
- (b) if applicable under RG 166.80, your financial services business is limited to participating in the relevant market or CS facility and incidental business that is supervised by the market licensee or CS facility licensee; and
- (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 applicable under RG 166.80, your financial services business was limited to participating in the relevant market or CS facility and incidental business that is supervised by the market licensee or CS

facility licensee throughout any part of the relevant period during which you relied on being a market or clearing participant.

What if a market's or clearing facility's financial requirements cease to be an adequate substitute?

RG 166.85 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.

Current markets and CS facilities

RG 166.86 We consider that financial requirements of ASX Limited (ASX) are currently an adequate substitute for our financial requirements in the provision of any financial service: see RG 166.91. In the case of ASX this applies only to participants as defined under ASX's operating rules (other than a principal trader, unless the principal trader is registered as a market maker).

RG 166.86A We consider that the requirements of Australian Clearing House Pty Ltd (ACH) are correspondingly an adequate substitute for our requirements in the provision of any financial service: see RG 166.91. In the case of ACH, this applies only to a clearing participant in the licensed CS facility operated by ACH as defined in the operating rules of the licensed CS facility.

RG 166.87 We consider that the financial requirements applying to participants in the market conducted by Sydney Futures Exchange Limited (SFE) are currently an adequate substitute for our financial requirements only for licensees whose financial services are limited to participating in SFE's market—that is, for those participants in SFE's market who carry on other financial services only in their capacity as a market participant, or incidentally to that role and that SFE supervises: see RG 166.93.

Underlying principles

RG 166.88 Where a market or CS facility licensee regulates the financial position of its participants in a way that adequately substitutes for our financial requirements, we will avoid subjecting licensees to two sets of financial requirements.

Explanations

RG 166.89 In assessing the adequacy of the financial requirements applying to participants in a licensed market or CS facility, we will take

into account 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);
- (b) have adequate risk management systems, which would include addressing financial risks as discussed at RG 166.7; and
- (c) comply with our licence condition requiring the licensee to comply with financial requirements under the market or CS facility's operating rules.

Current markets and CS facilities

RG 166.90 In view of the combined effect of the financial requirements for each of ASX, ACH and SFE participants under current business rules, and the supervisory role played by ASX, ACH and SFE and other circumstances, we do not need to set further financial requirements for those participants at this stage, at least for their participation in the relevant market or CS facility. We will take the same view of other markets or CS facilities conducted by market or CS facility licensees if we form the view that the operating rules are, in all the circumstances, an adequate substitute for our financial requirements.

RG 166.91 We note that ASX's requirements are based on an approach that is consistent with the European Capital Adequacy Directive. As these requirements take into account and address the risks arising from other forms of business beyond stockbroking, they provide a basis to generally exclude our financial requirements for participants in ASX. ACH's requirements reflect ASX's requirements.

RG 166.92 Deleted.

RG 166.93 In the case of SFE participants (that are not ASX or ACH participants), the exclusion of our financial requirements applies only to those participants who provide financial services solely as a participant in SFE's market, or financial services incidental to participating in the market that is supervised by SFE. SFE's requirements are based on NTA levels and are not directed to financial resources that may be needed as a result of other business.

RG 166.94 We will review our approach to ASX, ACH and SFE when there is any change to their operating rules. If an exchange asks us to, we will review the financial requirements applying under the operating rules of other market licensees to see if they are an adequate substitute.

E Holding client money or property

Note: See Section H for definitions used in calculating financial requirements in this section. For a list of these definitions, see RG 166.128.

Our policy

RG 166.95 If you hold client money or property, additional financial requirements apply in certain circumstances.

Note: These requirements are on top of the base level requirements in Section B applying to all licensees and the requirements in Sections C, F and G (if these sections apply to you).

RG 166.96 The requirements in Section E do not apply to:

- (a) some market and clearing participants (see Section D); or
- (b) bodies regulated by APRA.

RG 166.97 If at any time, you:

- (a) are required to hold money in a separate account under Div 2 of Part 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,

you must hold at least \$50,000 in SLF unless the value of the money and property for all clients in total is less than \$100,000.

Note: Payments received by a 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 166.98 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 the purposes of calculating your NTA requirement in Section C: see RG 166.56 and RG 166.56A.

Underlying principles

RG 166.99 If a 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.

Explanations

RG 166.100 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 166.101 Where a 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 financial requirements for holding client assets will not apply.

RG 166.102 We do not apply the requirement if you only 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 166.103 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.

F Transacting with clients as principal

Note 1: See Section H for definitions used in calculating financial requirements in this section. For a list of these definitions, see RG 166.128.

Note 2: If you are a foreign exchange dealer, you may elect to comply with the ASLF requirement in RG 166.104 (even if it would not otherwise apply to you), or alternatively with the \$10 million of tier one capital requirement under Section G. For further information, see RG 166.109A, RG 166.123B and RG 166.125.

Our policy

The ASLF requirement

RG 166.104 You must comply with the adjusted surplus liquid funds (ASLF) requirement if:

- (a) certain circumstances concerning transactions with clients apply to you (see RG 166.105–RG 166.109); or
- (b) you are a foreign exchange dealer who elects to comply with this requirement and not Section G (see RG 166.109A).

The amount of ASLF required is 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.

Note 1: To help you understand how to calculate ASLF, see Figure 1 (immediately after RG 166.113) and the definition of ASLF in Section H at RG 166.135.

Note 2: Refer to RG 166.133 for the definition of ‘adjusted liabilities’.

RG 166.104A The requirements in this section do not apply to:

- (a) some market and clearing participants (see Section D); and
- (b) bodies regulated by APRA.

When does the ASFL requirement apply for transactions with clients?

RG 166.105 The ASLF requirement applies to you if:

- (a) you incur actual or contingent monetary liabilities;
- (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.

For this purpose, 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. The ASLF requirement will not apply to you if RG 166.106 applies to you.

Note: The ASLF requirement is additional to the base level requirements in Section B that apply to licensees generally and the requirements in Sections C, E and G (if these sections apply to you).

RG 166.106 The requirements in this section do 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 Chapter 2L.

Note: In determining whether the ASLF requirement applies to you, certain liabilities can be disregarded as set out in RG 166.109.

RG 166.107 Moved to RG 166.109A.

RG 166.108 Moved to paragraph (a) of RG 166.106.

What liabilities can be disregarded

RG 166.109 For the purposes of RG 166.106 (e.g. in determining whether your actual and contingent liabilities are less than \$100,000), you can disregard a liability or contingent liability that:

- (a) is a contingent liability (and not a liability) that is neither a derivative nor 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 Part 7.8 or on trust for clients;
- (d) is adequately secured under paragraph (a) or (b) of RG 166.130;
- (e) is a liability incurred by entering into a transaction on a licensed market that is to be settled using a CS facility, the operation of which is authorised by an Australian CS facility licence;
- (f) is under a foreign exchange contract and you are required by a condition in your licence reflecting Section G to have \$10 million of tier one 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; or

Note: If you are entering into foreign exchange contracts, see also RG 166.109A.

- (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.

When does the ASLF requirement apply to foreign exchange dealers?

RG 166.109AIf:

- (a) you carry on a business of entering (as principal) into foreign exchange contracts (that are financial products) in Australia; and

- (b) the only current liabilities that would be, or contingent liabilities that if crystallised would be, a current liability that would be counted in calculating your adjusted liabilities are under foreign exchange contracts (including foreign exchange contracts that are derivatives),

you may choose to meet either:

- (c) the ASLF requirement in RG 166.104 (even if it would not otherwise apply to you); or
- (d) the requirement to hold \$10 million of tier one capital under Section G (see RG 166.125).

If you choose to meet the ASLF requirement in these circumstances, RG 166.106 and RG 166.109 do not apply to you (e.g. you must comply with this section even if your liabilities plus contingent liabilities are less than \$100,000).

Note: If you carry on a business that includes entering (as principal) into foreign exchange contracts (that are financial products) in Australia and paragraphs (a) to (c) of RG 166.105 apply to you because of liabilities or contingent liabilities that are not under foreign exchange contracts, you must comply with the ASLF requirement (unless you are covered by RG 166.106). If you comply with the ASLF requirement, you do not have to meet the requirement to hold \$10 million of tier one capital under Section G (see RG 166.125).

Reporting triggers

RG 166.110 If:

- (a) you are required to have ASLF of more than \$50,000; and
- (b) your ASLF is below the trigger points defined at RG 166.113,
- 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 enquiry into your financial position, there is no reason to believe that you may fail to meet your licensee obligations.

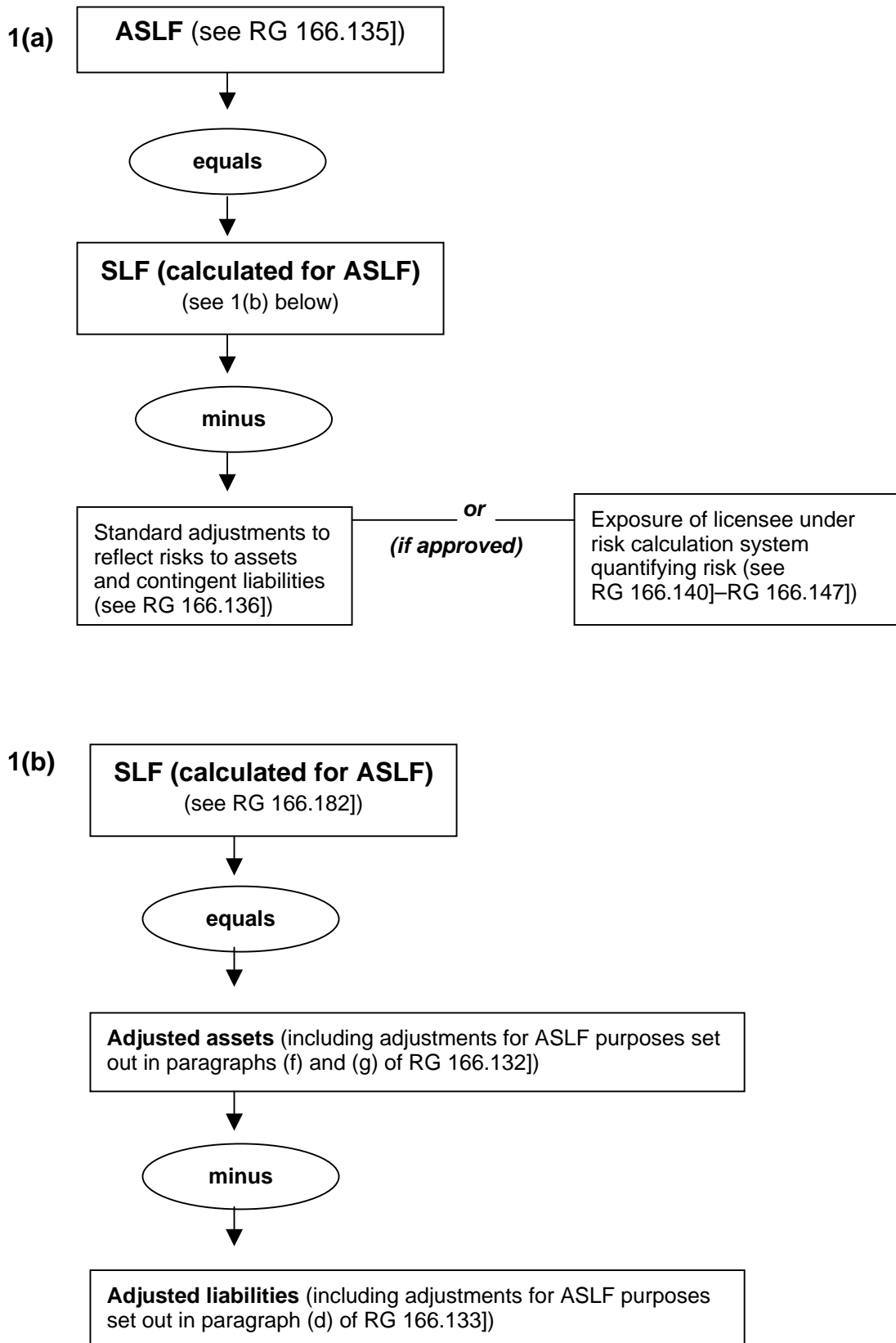
RG 166.111 You must ensure a further certification is made at least monthly until your ASLF continuously exceeds the trigger point for at least one month.

RG 166.112 You must keep each certificate for at least 5 years.

RG 166.113 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.

Figure 1: How to calculate ASLF



Underlying principles

RG 166.114 Market integrity can be jeopardised by disorderly failure of 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.

Reporting triggers

RG 166.115 Monitoring of trigger points, and going through internal processes to comply with the certification requirements set out in RG 166.110–RG 166.113, is an appropriate risk management measure.

Explanations

RG 166.116 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 Chapter 2L. Chapter 2L sets the requirements Parliament thinks appropriate for debenture issuers.

RG 166.117 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.

RG 166.118 The \$50,000 minimum amount is consistent with the minimum requirement for licensees that hold client money or property. It is also consistent with the minimum requirement for responsible entities and IDPS operators, although in the case of responsible entities and IDPS operators, NTA is required.

RG 166.119 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. 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.

RG 166.120 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 166.104 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 licensee obligations or to wind up the business in an orderly manner. Our financial requirements are not intended to give assurance of financial capacity to meet liabilities to clients.

RG 166.121 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 licensee chooses to be subject to the ASLF requirement rather than the requirements in Section G: see RG 166.109A), underwriters of securities issues, issuers of non-cash payment facilities, and dealers in the fixed interest market.

RG 166.122 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.

RG 166.123 We are adopting 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 licensee obligations, and therefore causing a disruption to the market.

Derivatives

RG 166.123A Section F is not generally designed to apply if you only transact with clients by entering into derivatives for the purpose of managing your financial risks. For example, where a responsible entity enters into a derivative for the purpose of managing a financial risk, Section F is not generally intended to apply. This reflects aspects of the exemption from the requirement to be licensed under reg 7.6.01(1)(m). Such conduct is characteristic of a range of activities (such as the operation of managed investment schemes) that give rise to risks that are not most appropriately dealt with by the ASLF requirement. For

registered schemes, NTA requirements will apply to the responsible entity under Section C.

Foreign exchange dealings

RG 166.123B If you are a licensee who would be required by Section G to have \$10 million of tier one capital, you may choose instead to comply with the ASLF requirement when you apply for your AFS licence or when you apply for a variation of your AFS 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 instead choose to comply with Section G and are required to have \$10 million of tier one capital by Section G, then foreign exchange contracts will not be counted in determining whether the ASLF requirement is triggered in your case.

Note: Foreign exchange dealers who already hold an AFS licence that includes a condition requiring them to comply with the \$10 million of tier one capital may apply to us for a variation of their licence conditions if they wish to comply instead with Section F of this guide.

RG 166.123C If you enter 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. The foreign exchange contracts that may be disregarded are specified in paragraph (h) of RG 166.109. 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.

Reporting triggers

RG 166.124 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 licence conditions or other licensee obligations.

G Foreign exchange dealers

Note: If you are a foreign exchange dealer, you may elect to comply with the ASLF requirement in Section F (even if it would not otherwise apply to you), or alternatively with the \$10 million of tier one capital under Section G. This choice of options does not apply where you would be subject to Section F other than because of your liabilities or contingent liabilities under foreign exchange contracts. For further information, see RG 166.109A, RG 166.123B and RG 166.125.

Our policy

RG 166.125 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 one capital (defined as if you were an ADI);
or
- (b) satisfy the ASLF requirement in Section F as stated in RG 166.104.

RG 166.125A This requirement does not apply if the counterparty to each foreign exchange contract that you enter into in Australia is:

- (a) an ADI; or
- (b) a person that has a condition in their AFS licence specifically requiring them to have \$10 million of tier one capital.

Note 1: For the definition of 'tier one 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 one capital does not apply to you, Section F may still apply to you.

Underlying principles

RG 166.126 This policy approach is designed to give the licensees described above 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 requirements in Section F. These licensees were subject to the RBA's former requirements before FSR commencement (i.e. 11 March 2002). We do not see any basis at this stage for requiring such licensees to have to comply with more onerous financial requirements than those applied by the RBA (apart from the base level requirements in Section B) if their

financial service business is limited to those activities. There have been no problems in the foreign exchange market that would justify a departure from those requirements.

Explanations

RG 166.126A The requirement in RG 166.125 applies to those who enter into foreign exchange contracts, but not to those who merely arrange foreign exchange contracts. For example, Section G does not apply to foreign exchange brokers 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 foreign exchange broker taking on the contract as principal, Section G may apply. Persons who were merely arranging for others to enter foreign exchange contracts were not required by the RBA to be authorised dealers prior to FSR commencement (i.e. 11 March 2002).

Note: For a definition of 'foreign exchange contract', see 'Key terms'.

RG 166.126B Prior to FSR commencement (ie 11 March 2002), the RBA did not require persons who only entered 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 one capital. We will take the same approach and apply this to licensees who only enter foreign exchange contracts with those entities that are required to comply with Section G (and do not opt to comply with Section F) or are ADIs. ADIs would have been able to qualify as authorised foreign exchange dealers but Section G does not apply to them, as they are bodies regulated by APRA.

RG 166.126C Consistent with the approach of the RBA prior to FSR commencement, Section G does not apply to foreign exchange contracts entered into outside of Australia.

RG 166.127 You may choose to meet the ASLF requirement in Section F instead of the \$10 million of tier one capital requirement in certain circumstances: see RG 166.109A.

H Definitions for calculating financial requirements

Our policy

RG 166.128 This section sets out the definitions that are used in determining what financial requirements under Section C (managed investments and custody services), Section E (holding client money or property) and Section F (transacting with clients as principal) apply to you as a licensee in calculating the amount required. We have included explanations with the definitions where appropriate.

Definition	Paragraph(s)
Adequately secured	RG 166.130–RG 166.131
Adjusted assets	RG 166.132
Adjusted liabilities	RG 166.133–RG 166.134
Adjusted surplus liquid funds (ASLF)	RG 166.135–RG 166.164
Eligible custodian	RG 166.164A
Eligible provider	RG 166.165–RG 166.167
Eligible undertaking	RG 166.168–RG 166.170
Excluded assets	RG 166.171–RG 166.176
Net tangible assets (NTA)	RG 166.178
Regulated trust account	RG 166.180
Special custody assets	RG 166.181
Surplus liquid funds (SLF)	RG 166.182
Tier \$500,000 class assets	RG 166.184

Underlying principles

RG 166.129 We seek to enable calculations for financial requirements that best balance the following objectives. They must be:

- (a) as easily understood and certain as possible;
- (b) not subject to manipulation;
- (c) based on accepted accounting principles; and
- (d) a meaningful measure to achieve the purpose of the relevant requirement.

Adequately secured	<p>RG 166.130 Adequately secured means:</p> <p>(a) secured by an enforceable charge over financial products (other than financial products issued by the licensee or its associate) if:</p> <p>(i) the financial products are:</p> <p>(A) regularly traded on:</p> <p>(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;</p> <p>(II) an ASIC-approved foreign market under Regulatory Guide 72 <i>Foreign securities prospectus relief</i> (RG 72); or</p> <p>(III) a foreign market approved in writing for the purpose by us; or</p> <p>(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</p> <p>(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</p> <p>(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</p> <p>(c) owing from an eligible provider; or</p> <p>(d) secured by an enforceable charge over amounts owing to another licensee which themselves are adequately secured.</p>
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Approval of a foreign market	<p>RG 166.131 We will approve a foreign market for the purposes of paragraph (a)(i)(A)(III) of RG 166.130 if the 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.</p>
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How to apply for approval of a foreign market

- Include a submission for approval with your licence application or request for variation of licence, or at a later time when needed.
- Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).
- 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 Infoline on 1300 300 630 for information and assistance.

Adjusted assets

RG 166.132 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 Chapter 2M at the time of calculation, on the basis that the 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 paragraph (b) of the definition of eligible provider in RG 166.165, 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: As explained in RG 166.149, we require licensees that are trustees to take into account liabilities and contingent liabilities as if they were not incurred as trustee. However, we recognise in paragraph (f) of RG 166.132 that the licensee should be able to include trust assets (subject to adjustments under RG 166.135) 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 as set out in paragraphs (c)(i) and (iii) of RG 166.136 of the value of any current assets that would be acquired in return for paying a contingent liability referred to in paragraphs (c)(i) and (iii) of RG 166.136 except to the extent that that value exceeds the amount which is the applicable percentage as set out in paragraphs (c)(i) and (iii) of RG 166.136 of the contingent liability.

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

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- Adjusted liabilities** RG 166.133 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 Chapter 2M, on the basis that the 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 (as well as for RG 166.105–RG 166.109A), plus the amount of the total current liabilities of any trust (other than a registered scheme) of which the licensee is trustee; and
 - (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 under RG 166.135 whichever is lower.

Note: Paragraph (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).

Deed of subordination RG 166.133A 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 166.134 We have updated [PF 63 to clarify that the debt cannot be repaid without ASIC’s consent even after the licensee ceases to hold an AFS 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 166.135 ASLF means surplus liquid funds (calculated for ASLF purposes) either minus:
- (a) the adjustments set out in RG 166.136 (the standard adjustments); or
 - (b) the adjustments produced by a risk exposure calculation system we allow under RG 166.140 to be used instead of one or more of the standard adjustments.

Note: To help you understand how ASLF is calculated, see Figure 1 (immediately after RG 166.113).

RG 166.136 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 Part 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 Part 7.8;

Note: If discounts under paragraph (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 section 727(3) or section 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 paragraphs (c)(ii) to (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 paragraph (c) where the maximum liability cannot be quantified; and

Note: Trivial risks that the amount may be higher in the case of paragraph (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 166.137 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 licensee as less than 5%.

RG 166.138 For paragraphs (a) and (b) of RG 166.136 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 paragraph (f)(ii) of RG 166.132);
- (c) that are deducted under paragraph (c) of RG 166.132;
- (d) that are deducted under paragraph (d) of RG 166.132 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;
- (e) that is the applicable percentage of the current assets that would be acquired in return for paying a contingent liability referred to in paragraph (c)(i) or (iii) of RG 166.136.

RG 166.139 The 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 166.156.

**Risk exposure
calculation
system**

RG 166.140 In some cases and on application to us, we may allow different discounts to be applied to those set out in RG 166.136. We will allow different discounts where we are satisfied by external evidence that the licensee has an appropriate risk exposure calculation system: see RG 166.142. The system would need to incorporate a model with several essential components to quantify the exposure of the licensee that the corresponding standard adjustment in RG 166.136 would otherwise cover. These components are as follows:

- (a) for paragraph (a) of RG 166.136, 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 paragraph (b) of RG 166.136, financial obligations to the licensee will not be performed when due, or at all; and
- (c) for paragraphs (c)(ii) and (d) (insofar as it relates to paragraph (c)(ii)) of RG 166.136, loss will arise because contingent liabilities will crystallise from derivatives without offsetting gain.

How to apply to be allowed to use a risk calculation exposure system

- Include a submission for approval with your licence application or request for variation of licence, or at a later time when needed.
- Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).
- Include the certificates and evidence set out in this guide.
- Candidly set out all information that may be relevant to your application.

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

RG 166.141 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 166.142 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;
- (b) another prudential regulator we accept for the purpose (including a foreign regulator); or
- (c) ASX.

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

RG 166.143 We may consider reviewing our policy to allow, in exceptional circumstances, other models that have not been accepted by a prudential regulator or ASX as a substitute for the standard adjustments.

Certification and audit report requirements	<p>RG 166.144 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 described in RG 166.136.</p> <p>RG 166.145 We require a certificate by the chief executive endorsed by the governing body of the licensee:</p> <ul style="list-style-type: none">(a) at the time of the application;(b) every 3 months; and(c) at any other time we require a certificate. <p>RG 166.146 The certificate must state that:</p> <ul style="list-style-type: none">(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 set out in RG 166.141 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. <p>RG 166.147 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:</p> <ul style="list-style-type: none">(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:<ul style="list-style-type: none">(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 their 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.
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This report would be required:

- (a) at the time of the application for a reasonable period prior to 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 licensee's compliance with our financial requirements for paragraph (a) of RG 166.28, 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 under RG 166.140.

Explanation: Adjusted surplus liquid funds (ASLF)

RG 166.148 We required securities licensees to meet SLF requirements under the old Corporations Act. ASLF is broadly calculated along similar lines, but with some significant modifications. 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 166.149 To prevent avoidance and promote competitive neutrality we require that, where the 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 required under RG 166.136 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 166.150 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 166.151 To take into account risks that assets may not be available to meet your liabilities, we require adjustments to be made. The adjustments address market risk (see paragraph (a) of RG 166.136) and counter-party credit risk (see paragraph (b) of RG 166.136). Since these risks are separate, we require their cumulative effect to be quantified by applying adjustments for both risks where relevant.

RG 166.152 Financial requirements imposed on broker dealers in the United States under SEC Rule 15c3-1, 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 166.153 ASX also recognises the relative risk of different assets in its financial requirements for market participants. The amount of discount required for assets such as shares (i.e. 16%) broadly reflects ASX requirements for position risk for shares not included in an index. ASX requirements are structured differently and so are not directly comparable. However, we have adopted this figure as a basis for adopting a discount level for market risk.

RG 166.154 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 licensee obligations.

RG 166.155 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 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 166.156 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

RG 166.157 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 166.158 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 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 166.159 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 166.160 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).

Risk exposure calculation system

RG 166.161 We are conscious that you may be able to quantify your risk in a way that is more accurate than our specifications. We will allow use of systems for risk calculation where there is a means of recognition that is consistent with efficient administration. We will not approve particular models as we are not a prudential regulator. We do 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 166.162 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 or ASX, 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 set out at RG 166.136 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 166.163 We understand that some licensees will not be in a position to adopt a model that has been approved by a prudential regulator or ASX. 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 166.164 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 the combination of the certificates, audit reports and evidence set out at RG 166.142 and RG 166.144–RG 166.147. The certificates require the chief executive officer and governing body of the 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.

**Eligible
custodian**

RG 166.164A An eligible custodian is:

- (a) an Australian ADI; or
 - (b) a market participant or a clearing participant (if our financial requirements do not apply to the licensee for all financial services under Section D of this guide);
or
 - (c) a sub-custodian appointed by one of the above.
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- Eligible provider** RG 166.165 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 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;
 - (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;

Note: We may publish a list for this purpose.
 - (e) a foreign deposit-taking institution we approve in writing for this purpose under RG 166.166;
 - (f) a CS facility licensee; or
 - (g) in exceptional circumstances, an entity of undoubted financial substance we approve in writing.

RG 166.165A If the provider is not otherwise required to lodge financial statements with us, the licensee must ensure that their financial statements are lodged with its balance sheet under s989B(2).

RG 166.166 We will approve a foreign deposit-taking institution if the licensee demonstrates to us that the foreign deposit-taking institution is prudentially regulated to appropriate standards under the Basel Committee guidelines.

How to apply for approval of an eligible provider

- Include a submission for approval with your licence application or request for variation of licence, or at a later time when needed.
- Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).
- 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 Infoline on 1300 300 630 for information and assistance.

Explanation: Eligible provider

RG 166.167 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. We are prepared to review our policy about who may be an eligible provider and the use of ratings in the light of experience including any application under paragraph (g) of RG 166.165.

Eligible undertaking

RG 166.168 Eligible undertaking means the amount of a financial commitment payable on written demand by the 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 166.168A A 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 NTA purposes a credit facility cannot be counted as an eligible undertaking. For SLF only a credit facility that if drawn down would not result in a current liability can count as an eligible undertaking.

RG 166.169 We will consider allowing a 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 166.168; and
- (b) the financial commitment would be as effective in meeting the objectives of the financial requirements as an undertaking complying with RG 166.168.

RG 166.169A For example, we have allowed a licensee who 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* as an eligible undertaking.

RG 166.170 If the amount of an eligible undertaking is unlimited, the 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 paragraph (b) of RG 166.165. 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

- Include a submission for approval with your licence application or request for variation of licence, or at a later time when needed.
- Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).
- 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 Infoline on 1300 300 630 for information and assistance.

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- Excluded assets** RG 166.171 Excluded assets means:
- (a) intangible assets (i.e. non-monetary assets without physical substance);
 - (b) except when allowed under RG 166.172 or RG 166.173, 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 166.174, 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 licensee or its associate may exercise any form of power or control;
 - (d) except when allowed under RG 166.172 or RG 166.173, 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 166.172 Despite paragraphs (b) and (d) of RG 166.171, 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 adjustment required by RG 166.136 or RG 166.140; 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
- (d) we consent in writing to the licensee treating the amount owing as not being an excluded asset having regard to evidence that:
- (i) the assets do not arise from a transaction to avoid our financial requirements;
 - (ii) recovery is highly probable; and
 - (iii) it would be unreasonably burdensome to have structured the transaction so that the amount owing was not an excluded asset.

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

- Include a submission for approval with your licence application or request for variation of licence, or at a later time when needed.
- Ensure that your application complies with Regulatory Guide 51 *Applications for relief* (RG 51).
- 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 Infoline on 1300 300 630 for information and assistance.

RG 166.173 Despite paragraphs (b) and (d) of RG 166.171, the 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 *Superannuation Industry (Supervision) Act 1993*, an IDPS or a registered scheme (scheme) to the extent that the receivable:

- (a) exceeds amounts invested by the 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 scheme to, the licensee, a body corporate the licensee controls, a body corporate that controls the licensee or a body corporate that the licensee's controller controls;
- (b) if receivable by way of fees, represents no more than fees receivable for the last 3 months; and
- (c) if receivable under rights of reimbursement for expenditure by the licensee, has not been receivable for more than 3 months.

RG 166.174 Despite paragraph (c) of RG 166.171, the 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.

Explanation: Excluded assets

RG 166.175 The intention of RG 166.171 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 166.176 The requirement in paragraph (b)(ii) of RG 166.172 has a similar rationale.

RG 166.177 Deleted.

Net tangible assets (NTA)	RG 166.178	NTA means the licensee's adjusted assets less adjusted liabilities.
	RG 166.179	Deleted.

Regulated trust account	RG 166.180	Regulated trust account means: <ul style="list-style-type: none"> (a) a trust account maintained by an authorised trustee corporation under state or territory legislation; (b) a solicitor's trust account; (c) a real estate agent's trust account; or (d) a trust account maintained by an entity other than the licensee that provides protections similar to the accounts described in paragraphs (a) to (c) and is approved by us for this purpose in writing.
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Special custody assets

RG 166.181 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 must 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) levies of a time-sharing scheme held in an account with an Australian ADI styled as a trust account that is audited at least twice annually by a registered company auditor where the auditor's report 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 if an offer of interests in the registered scheme conferring rights in connection with that mortgage had been made immediately prior to 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 prior to its discharge.

Surplus liquid funds (SLF)	<p>RG 166.182 SLF means the licensee's adjusted assets less the licensee's adjusted liabilities:</p> <ul style="list-style-type: none">(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 paragraph (b) of RG 166.165—plus one quarter of the value of its non-current assets minus any intangible assets and the amount of its non-current liabilities. <p>RG 166.183 Deleted.</p>
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Tier \$500,000 class assets	<p>RG 166.184 Tier \$500,000 class assets means:</p> <ul style="list-style-type: none">(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:<ul style="list-style-type: none">(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.
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Key terms

Note 1: For definitions of other key terms used in calculating financial requirements in this guide, see Section H.

Note 2: In this policy statement, references to particular financial products have the same meaning as in the Corporations Act (e.g. ‘superannuation fund’ and ‘non-cash payment facilities’).

RG 166.185 In this guide, a reference to:

‘ACH’ means Australian Clearing House Ltd

‘ADI’ means authorised deposit-taking institution within the meaning of the *Banking Act 1959*

‘AFS licence’ means an Australian financial services licence under s913B that authorises a person who carries out a financial services business to provide financial services

Note: This is a definition contained in s761A.

‘APRA’ means the Australian Prudential Regulation Authority

‘ASIC’ means the Australian Securities and Investments Commission

‘ASX’ means ASX Limited

‘Australian ADI’ means an ADI or a person who carries on State banking within the meaning of paragraph 51(xiii) of the Constitution

‘Basel Committee guidelines’ means 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

‘body regulated by APRA’ has the meaning given in s3(2) of the *Australian Prudential Regulation Authority Act 1998*

‘Chapter 7’ (for example) means a Chapter of the Corporations Act (in this example numbered 7)

‘clearing participant’ means a clearing participant in a licensed clearing and settlement facility (‘CS facility’), as defined in the operating rules of the licensed CS facility, which complies with the operating rules of the CS facility operated by the CS facility licensee for financial requirements, taking into account any waiver by the CS facility licensee

‘Corporations Act’ means the *Corporations Act 2001* and includes regulations made for the purposes of the Act

‘CS facility’ means a clearing and settlement facility

‘CS facility licensee’ means a person who holds an Australian CS facility licence

Note: This is a definition contained in s761A.

‘financial product’ means generally a facility through which, or through the acquisition of which, a person does one or more of the following:

- (a) makes a financial investment (see s763B);
- (b) manages financial risk (see s763C);
- (c) makes non-cash payments (see s763D)

Note: See Div 3 of Part 7.1 for the exact definition.

‘foreign exchange contract’ has the same meaning as in s761A

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.

‘foreign exchange dealer’ means a person who carries on a business of entering, as principal, into foreign exchange contracts in Australia

‘FSR Act’ means the *Financial Services Reform Act 2001*

‘governing body’ means 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

‘IDPS’ means an investor directed portfolio service, as defined in RG 148

‘IDPS property’ means property acquired or held through an IDPS other than property held by a client

‘licensed CS facility’ means a CS facility the operation of which is authorised by an Australian CS facility licence

Note: This is a definition contained in s761A.

‘licensed market’ means a financial market the operation of which is authorised by an Australian markets licence

Note: This is a definition contained in s761A.

‘licensee’ means a person who holds an AFS licence

‘licensee obligations’ means the obligations of a licensee as set out in s912A and 912B, and the requirement to be of good fame and character as included in s913B

‘market licensee’ means a person who holds an Australian market licence

Note: This is a definition contained in s761A.

‘market participant’ means a participant:

- (a) as defined in the operating rules of ASX (other than a principal trader, unless the principal trader is registered as a market maker) who complies with ASX’s operating rules for financial requirements, taking into account any waiver by ASX; or
- (b) in the licensed market operated by SFE, that:
 - (i) restricts its financial services business to participating in the licensed market and incidental business supervised by SFE; and
 - (ii) complies with SFE’s operating rules for financial requirements, taking into account any waiver by SFE

‘old Corporations Act’ means the *Corporations Act 2001* as in force immediately before FSR commencement (i.e. 11 March 2002)

‘old regulatory regime’ means (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)

‘Part 7.9’ (for example) means a Part of the Corporations Act (in this example numbered 7.9)

‘[PF 209]’ means Pro Forma 209 *Australian financial services licence conditions*

‘RG 136’ (for example) means a regulatory guide (in this example numbered 136)

‘RBA’ means the Reserve Bank of Australia

‘reg 7.6.04’ (for example) means a regulation of the Corporations Regulations 2001 (in this example numbered 7.6.04)

‘regulations’ means the Corporations Regulations 2001

‘s912A’ (for example) means a provision of the Corporations Act (in this example numbered 912A), unless a contrary intention appears

‘SFE’ means Sydney Futures Exchange Limited

‘wholesale client’ means a client defined as such under s761G

Related information

RG 166.186

Headnotes

Licensing, financial resources, risk management systems, licence conditions, cash needs requirement, audit, responsible entities, IDPS, custodial or depository services, market participants, holding client money, transactions with a client, reporting triggers, foreign exchange dealers, client assets, NTA, SLF, ASLF, risk exposure calculation system

Pro formas

Pro Forma 63 *Deed of subordination* [PF 63]

Pro Forma 209 *Australian financial services licence conditions* [PF 209]

Forms

Form FS 70 Australian Financial Services Licensee—Profit and Loss Statement and Balance Sheet

Form FS 71 Australian Financial Services Licensee—Audit Report

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 133 *Managed investments: Scheme property arrangements*

RG 146 *Training of financial product advisers*

RG 148 *Investor directed portfolio services*

RG 164 *Licensing: Organisational capacities*

RG 165 *Licensing: Internal and external dispute resolution*

RG 167 *Licensing: Discretionary powers*

RG 172 *Australian market licences: Australian operators*

RG 177 *Australian market licences: Overseas operators*

RG 179: *Managed discretionary account services*

RG 181 *Licensing: Managing conflicts of interest*

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

Legislation

Corporations Act 2001, Chapter 2L, Chapter 2M, Chapter 5 Part 5.7B Div 3, Chapter 7 Part 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, 989B, 989B(2), 989B(3), regulations 7.6.04(1)(a), 7.8.07(2), APRA Act s3(2), SIS Act s10(1)

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 released updated policy statements and licensing guidance papers*