



ASIC
Australian Securities &
Investments Commission

Explanatory Statement

ASIC Corporations (Amendment) Instrument 2021/230 and ASIC Corporations (Licence Conditions – Treatment of Lease Assets) Instrument 2021/229

This is the Explanatory Statement for the *ASIC Corporations (Amendment) Instrument 2021/230* (the **Amending Instrument**) and the *ASIC Corporations (Licence Conditions – Treatment of Lease Assets) Instrument 2021/229* (the **Licence Conditions Instrument**).

The Explanatory Statement is approved by the Australian Securities and Investments Commission (**ASIC**).

Summary

1. The Amending Instrument and the Licence Conditions Instrument are referred to collectively as **the Instruments** in this Explanatory Statement.
2. ASIC has issued the Instruments to change an aspect of the calculation of financial requirements imposed on some Australian financial services licensees (**AFS licensees**) in respect of the treatment of a lessee's right-of-use asset under Australian Accounting Standard AASB 16 *Leases* (**AASB 16**). In broad terms, the Instruments will allow an AFS licensee to include a right-of-use asset under AASB 16 in their calculation of 'adjusted assets' and, consequently, the licensee's calculation of net tangible assets (**NTA**), surplus liquid funds (**SLF**) and adjusted surplus liquid funds (**ASLF**), to the extent that the licensee is required to satisfy one or more of the NTA, SLF and ASLF requirements. An AFS licensee's NTA equals its 'adjusted assets' minus its 'adjusted liabilities'. When calculating its NTA, an AFS licensee must deduct 'excluded assets'.
3. The Amending Instrument amends three ASIC Class Orders that impose NTA requirements on various categories of AFS licensees. Under subsection 926A(2) of the *Corporations Act 2001* (the **Act**), the Amending Instrument varies the following Class Orders:
 - (a) ASIC Class Order [CO 13/760] – *Financial requirements for responsible entities and operators of investor directed portfolio services* ([**CO 13/760**]);
 - (b) ASIC Class Order [CO 13/761] – *Financial requirements for custodial or depository service providers*; ([**CO 13/761**]); and

- (c) ASIC Class Order [CO 12/752] – *Financial requirements for retail OTC derivative issuers* ([CO 12/752]).
4. [CO 13/760], [CO 13/761] and [CO 13/761] (the **Relevant Class Orders**) insert notional provisions in the Act that impose financial requirements, including NTA. The Amending Instrument changes the definition of ‘excluded assets’ in the notional provisions inserted by the Relevant Class Orders so that a right-of-use asset is not an excluded asset and, consequently, may be included by an AFS licensee in the adjusted assets calculation and, ultimately, NTA.
 5. Under subsection 926A(2), the Licence Conditions Instrument inserts subsection 912A(4A) into the Act. The effect of the inserted provision is to deem that a right-of-use asset under a lease is not an excluded asset for the purposes of an AFS licensee’s general duty under paragraph 912A(1)(b) of the Act to comply with its licence conditions, which includes a licensee’s financial requirements. A right-of-use asset is deemed to not be included in ‘excluded assets’ despite anything to the contrary in a condition of an AFS licence. The Licence Conditions Instrument operates in relation to NTA, ASLF and SLF. In relation to SLF and ASLF, these requirements are derived from NTA. Excluded assets are not counted in the calculation of adjusted assets and, therefore, excluded assets are not included in the calculation of NTA.
 6. In addition to the Licence Conditions Instrument, ASIC has changed the standard AFS licence conditions in ASIC Pro Forma 209 *Australian financial services licence conditions* so that, under the standard licence conditions, the calculation of adjusted assets does not include a right-of-use asset. This change flows through to NTA, SLF and ASLF requirements.

Purpose of the instruments

7. The Instruments are designed to address an anomaly that flows from a lessee applying AASB 16. There is an anomaly in that, when calculating adjusted assets, an AFS licensee will generally be required to exclude the right-of-use asset under AASB 16 as an intangible asset, but the licensee will generally have to include the corresponding lease liability in the calculation of adjusted liabilities. Intangible assets are a category of excluded assets: please refer to paragraph (a) of the definition of ‘excluded assets’ in each of the Relevant Class Orders and PF 209. This treatment may result in an AFS licensee being unable to satisfy their NTA, SLF or ASLF requirements.
8. When the remaining lease term is more than 12 months, an entity must recognise the right-of-use asset as a non-current asset and the corresponding lease liability is apportioned to its current liability and non-current liability components. Under the definitions of ASLF and SLF in PF 209, an AFS licensee must not count in the calculation of ASLF and SLF any non-current assets and non-current liabilities. Therefore, where the remaining lease term exceeds 12 months, an AFS licensee must only include the current liability portion, and must not include the non-current right-of-use asset and the non-current liability portion, in calculating SLF and ASLF (where applicable). In

contrast, when the remaining lease term is 12 months or less, a lessee has to recognise the right-of-use asset as a current asset and the lease liability as a current liability and the licensee must include these amounts in their calculation of SLF and ASLF.

9. The purpose of the Amending Instrument is to allow an AFS licensee to include a right-of-use asset in its calculation of NTA. The Licence Condition Instrument has the purpose of deeming that a right-of-use asset is not included in the definition of 'excluded assets' and, therefore, will be included in an AFS licensee's adjusted assets calculation. This treatment applies despite an inconsistent licence condition, including a definition in the licence that applies for the purposes of a condition, that would otherwise apply such that a right-of-use asset would be an excluded asset. The Licence Condition Instrument operates in respect of licence conditions such that an AFS licensee may include a right-of-use asset in its calculation of NTA and, to the extent that a right-of-use asset is a current asset, in the calculation of SLF and ASLF.

Consultation

10. On 7 July 2020, ASIC issued a temporary no-action position pending the outcome of a consultation process later that year. Under this temporary no-action position, ASIC stated that it will not take regulatory action against an AFS licensee for a breach of a financial requirement that is solely caused by the exclusion of a right-of-use asset from the AFS licensee's adjusted assets if that exclusion was the result of the right-of-use asset being an intangible asset under AASB 16. The no-action position is set out in ASIC's Media Release 20-158MR: <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2020-releases/20-158mr-asic-issues-no-action-position-to-allow-right-of-use-lease-assets-to-count-in-satisfying-afs-licensee-requirements/> .
11. In December 2020, ASIC published Consultation Paper 336: *Financial requirements: Treatment of lease assets* (<https://download.asic.gov.au/media/5890613/cp336-published-11-december-2020.pdf>) (CP 336), which set out the proposals to allow an AFS licensee to include a right-of-use asset in its calculation of NTA and, where applicable, SLF and ASLF. CP 336 recommended changes to the Relevant Class Orders and a deeming provision in relation to licence conditions in substantially the same form as that set out in the Instruments. In addition, CP 336 proposed to make corresponding changes to PF 209 and minor adjustments to ASIC's guidance in Regulatory Guide 166: *Licensing: Financial requirements*.
12. ASIC received 14 submissions in response to CP 336. The submissions were generally supportive of the proposals in CP 336.

Operation of the Instrument

Effect

13. The Instruments commence on the day after they are registered on the Federal Register of Legislation.

Amending Instrument

14. Schedule 1 to the Amending Instrument sets out the changes to the Relevant Class Orders. In each of the Relevant Class Orders, the following paragraph is inserted after paragraph (e) in the definition of ‘excluded assets’:

(ea) a right-of-use asset arising under a lease;

15. The definition of ‘excluded assets’ is set out:
 - (a) for [CO 13/760]: in notional subsection 912AA(11) of the Act. [CO 13/760] inserted a notional section 912AA, which sets out financial requirements, including NTA, for responsible entities of registered schemes and investor-directed portfolio service operators;
 - (b) for [CO 13/761]: in notional subsection 912AC(12) of the Act. [CO 13/761] inserted a notional section 912AC, which sets out financial requirements, including NTA, for custodial or depository service providers; and
 - (c) for [CO 12/752]: in notional subsection 912AB(13) of the Act. [CO 12/752] inserted a notional section 912AB, which sets out financial requirements, including NTA, for AFS licensees that issue derivatives to retail clients.
16. After paragraph (d) of the definition of ‘excluded assets’ in the Relevant Class Orders, the remainder of the definition consists of items that are preceded by the words “but, despite anything in the paragraphs above, does not include the following:”. Therefore, the addition of paragraph (ea) to the ‘excluded assets’ definition means that a right-of-use asset is not an excluded asset.
17. The Amending Instrument does not have an expiry date. This is because the Amending Instrument amends the Relevant Class Orders, which have their own sunset dates under the *Legislation Act 2003* (the **LA**). Under the LA, [CO 12/752] is due to sunset on 1 October 2022, while [CO 13/760] and [CO 13/761] are due to sunset on 1 October 2023.

Licence Conditions Instrument

18. Section 5 of the Licence Conditions Instrument provides that Division 3 of Part 7.6 of the Act applies to all AFS licensees as if section 912A of the Act were modified or varied by the addition of a new subsection 912A(4A). Subsection 912A(4A) provides that, for the purposes of paragraph 912A(1)(b), a right-of-use asset arising under a lease is taken not to be included in the definition of

‘excluded assets’ in an AFS licence. Under subsection 912A(4A), a right-of-use asset is deemed to not be an excluded asset despite anything to the contrary in a condition of the licence, including in a definition in the licence that applies for the purposes of a condition.

19. The Licence Conditions Instrument deems that a right-of-use asset is not an excluded asset. As a result, a right-of-use asset will be included in an AFS licensee’s adjusted assets and, consequently, included in the licensee’s NTA and, where applicable, ASLF and SLF. In relation to the calculation of SLF and ASLF, the general exclusion of non-current assets and non-current liabilities continues to apply. Therefore, where a lease has a remaining term of more than 12 months, the right-of-use asset under AASB 16 will be classified as a non-current asset and a licensee will not be permitted to include it in their calculation of SLF and ASLF.
20. The deeming effect of the Licence Conditions Instrument means that it is unnecessary for ASIC to vary existing AFS licence conditions to ensure that AFS licensees may include a right-of-use asset in their calculation of NTA and, where applicable, SLF and ASLF.
21. Section 6 of the Licence Conditions Instrument provides that instrument will cease to operate on its repeal date of 1 May 2026.

Incorporation by reference

22. The Instruments do not incorporate any matter by reference.

Retrospective application

23. The Instruments do not have retrospective application.

Legislative instrument and primary legislation

24. The subject matter and policy implemented by the Instruments is more appropriate for a legislative instrument rather than primary legislation because the Instruments propose to make only minor and uncontroversial changes to existing ASIC legislative instruments and AFS licence conditions. In contrast, if the changes were implemented by amending primary legislation, then the government would need to make wholesale changes to Part 7.6 of the Act, which deals with AFS licensees, in order to codify the financial requirements for AFS licensees. These reforms would be extensive and would add significant complexity and length to Part 7.6 of the Act. The magnitude of these reforms would far outweigh the extent and relative significance of the changes regarding the treatment of right-of-use assets. In addition, the matters contained in the Instruments are specific amendments designed to ensure the application of the Act remains flexible to adapt to market developments and applies in a way consistent with the intended policy and the enabling provisions in the Act. As a result, it is more suitable for the changes to the legal position to be implemented by legislative instrument than by primary legislation.

25. Although subsection 50(1) of the LA sets a default sunset period of 10 years for legislative instruments, the Licence Conditions Instrument will expire on 1 May 2026, which is a sunset period of approximately five years. This sunset period balances the benefits to AFS licensees that flow from the changes to calculating NTA, SLF and ASLF in relation to leased assets with maintaining sufficient parliamentary oversight of legislative instruments. The Relevant Class Orders, which are amended by the Amending Instrument, are due to expire in 2022 ([CO 12/752]) and 2023 ([CO 13/760] and [CO 13/761]).

Legislative authority

26. The Instruments are made under section 926A of the Act.
27. The Instruments are disallowable legislative instruments.

Statement of Compatibility with Human Rights

28. The Explanatory Statement for a disallowable legislative instrument must contain a Statement of Compatibility with Human Rights under subsection 9(1) of the *Human Rights (Parliamentary Scrutiny) Act 2011*. A Statement of Compatibility with Human Rights is in the Attachment.

Statement of Compatibility with Human Rights

This Statement of Compatibility with Human Rights is prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

ASIC Corporations (Amendment) Instrument 2021/230 (the Amending Instrument) and ASIC Corporations (Licence Conditions – Treatment of Lease Assets) Instrument 2021/229 (the Licence Conditions Instrument), collectively ‘the Instruments’

Overview

1. The Amending Instrument changes three ASIC Class Orders – [CO 13/760], [CO 13/761] and [CO 12/752] (the **Relevant Class Orders**) – in order to enable an Australian financial services licensee (**AFS licensee**) that is a lessee to include a right-of-use asset under Australian Accounting Standard AASB 16 *Leases* in its calculation of ‘adjusted assets’ and, in turn, the AFS licensee’s calculation of net tangible assets (**NTA**). In calculating ‘adjusted assets’, an AFS licensee does not include assets that fall within the definition of ‘excluded assets’ in the Relevant Class Orders.
2. The Licence Conditions Instrument insert a provision in section 912A of the *Corporations Act 2001* (the **Act**) that will deem that an AFS licensee’s right-of-use asset is not an excluded asset for the purposes of the AFS licensee’s duty under s912A(1)(b) of the Act to comply with its licence conditions, despite anything to the contrary in a condition of the licence. This Licence Conditions Instrument will override existing definitions of ‘excluded assets’ in the licence conditions of AFS licensees that might otherwise have the effect of applying to a right-of-use asset and, in turn, preventing an AFS licensee from including a right-of-use asset in its calculation of NTA and, where applicable, surplus liquid funds (**SLF**) and adjusted surplus liquid funds (**ASLF**). The Licence Conditions Instrument supports the operation of the Amending Instrument with respect to NTA and, in relation to SLF and ASLF, it has the effect of allowing an AFS licensee to include a right-of-use asset in the calculation of SLF or ASLF to the extent that the right-of-use asset is a current asset.
3. The Instruments are declarations under paragraph 926A(2)(c) of the Act that modify provisions of Part 7.6 of the Act. In the case of the Amending Instrument, it modifies notional provisions of Part 7.6 of the Act that are inserted into Part 7.6 of the Act by the Relevant Class Orders.
4. The Instruments address the anomalous position, and the potential unfairness that flows from this position, that previously existed where an AFS licensee is not allowed to include a right-of-use asset in its calculation of adjusted assets

and, by extension, NTA and, where applicable, SLF and ASLF, but the licensee is required to include the corresponding lease liability.

5. The Licence Conditions Instrument will expire on 1 May 2026. The Amending Instrument changes the Relevant Class Orders, which are due to sunset on 1 October 2022 ([CO 12/752]) and 1 October 2023 ([CO 13/760] and [CO 13/761]).

Assessment of human rights implications

6. The Instruments do not engage any of the applicable rights or freedoms as they remove a potentially unfair anomaly in an AFS licensee's calculation of NTA, SLF and ASLF.

Conclusion

7. The Instruments are compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.