



ASIC
Australian Securities &
Investments Commission

Explanatory Statement

ASIC Corporations (Financial Requirements for Issuers of Retail OTC Derivatives) Instrument 2022/705 and ASIC Corporations (Repeal) Instrument 2022/704

This is the Explanatory Statement for *ASIC Corporations (Financial Requirements for Issuers of Retail OTC Derivatives) Instrument 2022/705* (the **Instrument**) and *ASIC Corporations (Repeal) Instrument 2022/704* (the **Repeal Instrument**).

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

Summary

1. The Instrument imposes specific financial requirements on Australian financial services (AFS) licensees that are authorised to make a market in over-the-counter (OTC) derivatives to retail clients. The Instrument modifies the *Corporations Act 2001* (the **Corporations Act**) by inserting section 912AB. Section 912AB requires retail OTC derivative issuers to comply with additional provisions set out in the Instrument as part of satisfying the obligation to have adequate financial resources under paragraph 912A(1)(d) of the Corporations Act.
2. The Instrument preserves the effect of Class Order [CO 12/752] *Financial requirements for retail OTC derivative issuers* (**CO 12/752**), which was introduced in 2012. CO 12/752 was due to expire or ‘sunset’ on 1 October 2022. Following consultation, ASIC considered that CO 12/752 was operating effectively and efficiently to achieve its objectives and continued to form a necessary and useful part of the legislative framework.
3. As a result, CO 12/752 has been remade as a legislative instrument, with only minor drafting changes to reflect ASIC’s current style and format, remove redundant provisions and update definitions, while preserving the current effect of the instrument. The Instrument has been remade for a period of five years.
4. The Repeal Instrument repeals CO 12/752 as it is superseded by the Instrument upon its commencement. The Repeal Instrument repeals CO 12/752 ahead of its automatic repeal on 1 October 2022.

5. ASIC makes the Instrument and the Repeal Instrument under paragraph 926A(2)(c) of the Corporations Act. That paragraph provides that ASIC may declare provisions to which section 926A applies (i.e. Part 7.6, other than Divisions 4 and 8) in relation to a person or financial product, or a class of persons or financial products, as if specified provisions were omitted, modified or varied as specified in the declaration.
6. Section 912AB contains the following requirements:
 - (a) a cash needs requirement;
 - (b) financial requirements for licensees transacting with clients;
 - (c) reporting triggers and requirements for financial requirement conditions;
 - (d) the obligation to lodge an audit opinion on the financial requirements to the extent the opinion is for a part of a financial year or other period during which the licensee was covered by subsection 912AB(1).

Purpose of the instrument

7. The Corporations Act sets out the obligations of an AFS licensee: see section 912A. These obligations include that the licensee have available adequate resources (including financial) to provide the financial services covered by the AFS licence and to carry out supervisory arrangements: see paragraph 912A(1)(d). This obligation does not apply to bodies regulated by the Australian Prudential Regulation Authority (**APRA**).
8. The purpose of the Instrument is to impose specific financial requirements on AFS licensees that are not regulated by APRA to ensure that they meet those obligations under the Corporations Act. We apply these financial requirements using ASIC's statutory power to modify Pt 7.6 of the Corporations Act, or by AFS licence conditions. The financial requirements that apply to AFS licensees vary depending on the nature of the financial service activities conducted by the AFS licensee.
9. In 2012, we introduced specific financial requirements for retail OTC derivative issuers (section 912AB of the Corporations Act (as inserted by CO 12/752)). Under the *Legislation Act 2003* (the **Legislation Act**), legislative instruments (such as class orders) cease automatically, or sunset, after 10 years, unless action is taken to preserve them. CO 12/752 was due to sunset on 1 October 2022 if not remade.
10. The purpose of sunsetting is to ensure that instruments are kept up to date and only remain in force while they are fit for purpose, necessary and relevant. Following consultation, ASIC formed the view that CO 12/752 was operating effectively and efficiently, and continued to form a necessary and useful part of the legislative framework. Therefore this class order was remade using ASIC's current style and format, while preserving the current effect of the instrument.

11. The purpose of the Repeal Instrument is to repeal CO 12/752 as it is superseded by the Instrument upon its commencement. The Repeal Instrument repeals CO 12/752 ahead of its automatic repeal on 1 October 2022 in accordance with section 50 of the Legislation Act.
12. The Instrument remade CO 12/752 subject to the following minor changes:
 - (a) removed the required NTA requirement for AFS licensees that applied until 31 January 2014;
 - (b) provided an expiry date of 1 October 2027;
 - (c) updated the name of the legislative instrument;
 - (d) reflected current drafting practice and updated the format of the current document;
 - (e) simplified the drafting to give greater clarity;
 - (f) updated legislative references and definitions; and
 - (g) corrected any minor drafting errors.
13. The financial requirements in section 912AB reflect the general objectives of the AFS licence requirements in Regulatory Guide 166 AFS licensing: Financial requirements (**RG 166**). The requirements aim to:
 - (a) ensure that a retail OTC derivative issuer has sufficient financial resources to conduct their financial services businesses in compliance with the Corporations Act (including carrying out supervisory arrangements);
 - (b) ensure that a retail OTC derivative issuer makes adequate provision for expected expenses and carries sufficient financial resources to protect against operational risk that could lead to unexpected losses or expenses; and
 - (c) increase the financial buffer held by a retail OTC derivative issuer to decrease the risk of a disorderly or non-compliant wind up if the business fails, and ensure that the buffer is adequate to meet the administration costs of smaller issuers.

Consultation

Original consultation on financial requirements for retail OTC derivative issuers

14. In 2011, ASIC sought feedback on proposed financial requirements for retail OTC derivative issuers in Consultation Paper 156: *Retail OTC derivative issuers: Financial requirements (CP 156)*. In response to CP 156, ASIC received some submissions from licensees who would be subject to the changes, as well as one submission from an industry body. ASIC then contacted other

issuers who may be affected by the changes, to obtain information about how the changes would affect these issuers. Around half of contacted issuers (17 in total) provided the information requested.

15. ASIC also prepared a Regulatory Impact Statement for CO 12/752, which was approved by the Office of Best Practice Regulation.

Consultation on remake of CO 12/752

16. In July 2022, ASIC consulted on the remake of CO 12/752 in Consultation Paper 363: *Remaking ASIC class order on financial requirements for retail OTC derivative issuers: [CO 12/752] (CP 363)*. In CP 363, ASIC proposed the remake of CO 12/752, without significant changes, and for a period of five years.
17. ASIC did not specifically or separately consult on the Repeal Instrument, as ASIC proposed to remake the instrument rather than to revoke the instrument.
18. We received one submission in relation to CP 363. The submission was made jointly by the Corporations Committee and Financial Services Committee of the Business Law Section of the Law Council of Australia (**Law Council**). The submission agreed that CO 12/752 forms a necessary and useful part of the legislative framework governing retail OTC derivative issuers.
19. The Law Council's view was that CO 12/752 strikes an appropriate balance between seeking to ensure that issuers maintain sufficient resources to support their businesses, without imposing an unreasonable burden on retail OTC derivative issuers or operating as an impediment to competition in the market. In particular, the Law Council agreed with the proposals to remake CO 12/752 for a further five years and also to retain the existing financial, reporting and audit requirements. ASIC has published the submission on the ASIC website.
20. ASIC has self-certified that it is not required to prepare a Regulatory Impact Statement for the Instrument. This is because following a formal consultation process with affected stakeholders, ASIC has assessed that CO 12/752 is operating effectively and efficiently.

Operation of the instrument

ASIC Corporations (Financial Requirements for Issuers of Retail OTC Derivatives) Instrument 2022/705

21. Section 1 of the Instrument provides that the name of the legislative instrument is *ASIC Corporations (Financial Requirements for Issuers of Retail OTC Derivatives) Instrument 2022/705*.
22. Section 2 of the Instrument provides that the instrument commences on the day after it is registered on the Federal Register of Legislation.

- 23. Section 3 of the Instrument provides that this instrument is made under paragraph 926A(2)(c) of the Corporations Act.
- 24. Section 4 of the Instrument provides that references to the “Act” in the instrument means the “Corporations Act”.
- 25. Section 5 of the Instrument inserts section 912AB *Adequate financial resources for financial services licensees that issue derivatives to retail clients* in its relative order into Division 3 of Part 7.6 of the Corporations Act.

Who section 912AB applies to

- 26. Subsection 912AB(1) applies to AFS licensees that are authorised to make a market in derivatives to retail clients and who owe liabilities or contingent liabilities to retail clients in respect of derivatives transactions. That is, a licensee must actually be operating a retail OTC derivatives business—rather than merely being authorised under its AFS licence to operate one—in order to be subject to the Instrument.
- 27. Subsection 912AB(1) does not apply to:
 - (a) a body regulated by APRA that is not required to comply with paragraph 912A(1)(d) of the Corporations Act; or
 - (b) a market participant; or
 - (c) a clearing participant.

This is because other requirements apply to these AFS licensees under ASIC or APRA policy.

Complying with AFS licence conditions

- 28. Subsection 912AB(2) specifies that a licensee to which section 912AB applies is taken to have complied with the conditions (if any) of its AFS license that relate to any of the following:
 - (a) a cash needs requirement;
 - (b) financial requirements for licensees transacting with clients;
 - (c) reporting triggers and requirements for financial requirement conditions;
 - (d) the obligation to lodge an audit opinion on the financial requirements to the extent the opinion is for a part of a financial year or other period during which the licensee was covered by subsection 912AB(1).

Cash needs requirement

- 29. Paragraph 912AB(3)(a) requires the licensee to prepare in each March, June, September and December, a projection of the licensee’s cash flows over at least

the next 12 months based on the licensee's reasonable estimate of revenues and expenses over this period; and

30. Paragraph 912AB(3)(b) requires the licensee to have the projection certified by the following persons as being based on the licensee's reasonable estimate of revenues and expenses over the relevant period:
 - (a) if the licensee is a body corporate, the directors of the licensee;
 - (b) if the licensee is a partnership or the trustees of a trust, the partners of the licensee or the trustees;
 - (c) if the licensee is a natural person, the person; and
31. Paragraph 912AB(3)(c) requires the licensee to document the calculations and assumptions used in preparing the projection, and describe in writing why the assumptions are appropriate; and
32. Paragraph 912AB(3)(d) requires the licensee to update the projection of the licensee's cash flows if there is reason to suspect that an updated projection would show the licensee was not meeting the requirements in subparagraphs 912AB(3)(e)(i) or (ii); and
33. Subparagraph 912AB(3)(e)(i) requires the licensee to certify in writing, based on the projection of the licensee's cash flows, that the licensee will have access when needed to enough financial resources to meet its liabilities over the projected term of at least the next 12 months, including any additional liabilities it projects will be incurred during that; and
34. Subparagraph 912AB(3)(e)(ii) requires the licensee to certify in writing, based on the projection of the licensee's cash flows, that the licensee will hold at all times during the period to which the projection relates in cash or cash equivalents, an amount equal to or greater than the current amount the licensee is required to hold in cash or cash equivalents under subsection 912AB(5); and
35. Paragraph 912AB(3)(f) requires the licensee to make the cash flow projections available to ASIC upon request.

Net tangible assets

36. Subsection 912AB(4) provides that the licensee must have at all times NTA of at least the greater of:
 - (a) \$1,000,000; or
 - (b) 10% of average revenue of the licensee.
37. 'NTA' is defined in subsection 912AB(13) as adjusted assets minus adjusted liabilities. The terms 'adjusted assets' and 'adjusted liabilities' are also defined in section 912AB(13).

38. ‘Average revenue’ is also defined in subsection 912AB(13) and means:

- (a) for a licensee in its first financial year, a reasonable forecast of its revenue from the calculation date for the remainder of the first financial year pro-rated to a 12 month period (paragraph 912AB(13)(a)).
- (b) for a licensee in its second financial year, the average of:
 - (i) the aggregate of the licensee’s:
 - (A) revenue for the second financial year to date; and
 - (B) reasonable forecast of its revenue for the remainder of the second financial year; and
 - (ii) the licensee’s revenue in the first financial year from the calculation date pro-rated to a 12 month period (paragraph 912AB(13)(b)).
- (c) for a licensee in its third financial year, the average of:
 - (i) the aggregate of the licensee’s:
 - (A) revenue for the third financial year to date; and
 - (B) reasonable forecast of its revenue for the remainder of the third financial year; and
 - (ii) the licensee’s revenue in the first financial year from the calculation date pro-rated to a 12 month period and the revenue for its second financial year (paragraph 912AB(13)(c)).
- (d) for all subsequent financial years of a licensee, the average of:
 - (i) the aggregate of the licensee’s:
 - (A) revenue to date in the current year; and
 - (B) reasonable forecast of revenue for the remainder of the current year; and
 - (ii) the actual revenue in the previous two years (paragraph 912AB(13)(d)).

Liquidity requirement

39. Subsection 912AB(5) provides that the licensee must hold at all times:

- (a) cash and cash equivalents in an amount that is at least 50% of the required NTA; and
- (b) liquid assets in an amount that is at least 50% of the required NTA.

40. The subsection also requires that money that is in an account held by the licensee for the purposes of section 981B or other cash or cash equivalents that are held in respect of any liability or obligation to clients not be counted towards either requirement.
41. Subsection 912AB(6)) requires the licensee to lodge with ASIC a statement in writing setting out its NTA at the end of its financial year and details of the calculation.
42. The statement required by subsection 912AB(6) must be lodged by the same time the licensee must lodge its balance sheet in accordance with s989B of the Act.

Reporting triggers and requirements for financial requirement conditions

43. Subsection 912AB(7) defines as a notifiable event any instance where the NTA of the licensee is at any time less than the required NTA or greater than the required NTA but equal to or less than 110% of the required NTA.
44. Under subsection 912AB(7), the licensee must, by the following times, lodge a written report with ASIC that specifies the NTA of the licensee as at the date of the report:
 - (a) within three business days after becoming aware of the notifiable event; and
 - (b) on the first day of every month unless, as at the last day of the preceding month, the NTA is greater than 110% of the required NTA;
45. Subsection 912AB(8) provides that where the NTA of the licensee is less than the required NTA for any consecutive period of two months, the licensee must notify, in writing, the following persons of the deficiency within 3 business days after that 2 month period:
 - (a) each person to whom it provides financial services; and
 - (b) each person for the benefit of whom it holds money or property on trust under Divisions 2 or 3 of Part 7.8.
46. Subsection 912AB(9) provides that, subject to subsection 912AB(10), where the NTA of the licensee is at any time less than the required NTA, the licensee must not enter into a transaction with any person to whom it provides financial services that could give rise to further liabilities, contingent liabilities or other financial obligations of the licensee unless the issuer's board of directors, or other governing body, have certified in writing that, having conducted reasonable enquiries into the financial position of the licensee, there is no reason to believe that:

- (a) the licensee will not comply with section 912A except to the extent that paragraph 912A(1)(c) requires compliance with subsections 912AB(4) and (5); and
- (b) there is or will be a deficiency in any accounts maintained by the licensee for the purposes of section 981B.

47. Subsection 912AB(10) provides that, where the NTA of the licensee is at any time equal to or less than 75% of the required NTA, the licensee must not enter into a transaction with any person to whom it provides financial services that could give rise to further liabilities, contingent liabilities or other financial obligations of the licensee.

Audit opinion on financial requirements

- 48. Subsection 912AB(11) contains the requirements for the audit report issuers must lodge with ASIC each financial year. The auditor must provide an audit opinion on the matters covered at paragraph 912AB(11)(a) and provide a ‘negative assurance’ opinion, based on a review, of the matters at paragraph 912AB(11)(b).
- 49. Subsection 912AB(12) provides that the audit opinion must be lodged with ASIC by no later than:
 - (a) for each financial year of the licensee, the day the licensee is required to lodge a balance sheet under section 989B; and
 - (b) for any period of time that ASIC directs, the date ASIC directs the audit opinion to be lodged.

Definitions

- 50. Subsection 912AB(13) sets out the definitions for terms used in the Instrument. Most definitions (other than those already referred to in this explanatory statement) generally reflect the definitions in RG 166, Class Order 13/760: *Financial requirements for responsible entities and operators of investor directed portfolio services and ASIC Corporations (Financial Requirements for Corporate Directors of Retail CCIVs) Instrument 2022/449*, with appropriate amendments for the retail OTC derivative issuer context.

ASIC Corporations (Repeal) Instrument 2022/704

- 51. Section 1 of the Repeal Instrument provides that the name of the legislative instrument is *ASIC Corporations (Repeal) Instrument 2022/704*.
- 52. Section 2 of the Repeal Instrument provides that the instrument commences on the day after it is registered on the Federal Register of Legislation.
- 53. Section 3 of the Repeal Instrument provides that this instrument is made under paragraph 926A(2)(c) of the Corporations Act.

54. Section 4 and Schedule 1 of the Repeal Instrument has the effect of repealing the whole of CO 12/752.

Legislative authority

55. ASIC makes the Instrument and the Repeal Instrument under paragraph 926A(2)(c) of the Corporations Act.

56. The Instrument is disallowable under section 42 of the Legislation Act.

57. The Repeal Instrument is automatically repealed in accordance with section 48A of the Legislation Act.

58. Under subsection 33(3) of the *Acts Interpretation Act 1901* (as in force as at 1 January 2005 and as applicable to the relevant powers because of section 5C of the Act), where an Act confers a power to make, grant or issue any instrument (including rules, regulations or by-laws), the power shall be construed as including a power exercisable in the like manner and subject to the like conditions (if any) to repeal, rescind, revoke, amend, or vary any such instrument.

Why the measure is in delegated legislation rather than primary legislation

59. ASIC considers that the modifications made by the Instrument are more appropriate in a legislative instrument rather than primary legislation at this time because:

- (a) the modifications made by the Instrument are highly specific amendments designed to ensure the application of primary legislation is consistent with the intended policy and the enabling provisions in the primary legislation;
- (b) the Instrument preserves the effect of CO 12/752, which was otherwise due to sunset on 1 October 2022; and
- (c) following consultation, ASIC considered that CO 12/752 was operating effectively and efficiently to achieve its objectives and continued to form a necessary and useful part of the legislative framework;
- (d) ASIC understands that the Government will consider whether to make future amendments to the Corporations Act to incorporate the Instrument into primary law or regulations. Therefore the Instrument has been remade for five years to allow sufficient time for this to occur.

The appropriate duration of the Instrument

60. ASIC considers that five years is the appropriate duration for the Instrument because a five-year period for the Instrument gives Treasury and ASIC time to undertake a thorough review of the Instrument, consult on incorporating the Instrument into primary law or regulations and make the required amendments to the primary law or regulations.

Statement of Compatibility with Human Rights

61. 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 (Financial Requirements for Issuers of Retail OTC Derivatives) Instrument 2022/705 and ASIC Corporations (Repeal) Instrument 2022/704.

Overview

1. *ASIC Corporations (Financial Requirements for Issuers of Retail OTC Derivatives) Instrument 2022/705* (the **Instrument**) imposes specific financial requirements on Australian financial services (AFS) licensees that are authorised to make a market in over-the-counter (OTC) derivatives to retail clients. The Instrument modifies the *Corporations Act 2001* (the **Corporations Act**) by inserting section 912AB. Section 912AB requires retail OTC derivative issuers to comply with additional provisions set out in the Instrument as part of satisfying the obligation to have adequate financial resources under paragraph 912A(1)(d) of the Corporations Act.
2. The Instrument preserves the effect of Class Order [CO 12/752] *Financial requirements for retail OTC derivative issuers* (**CO 12/752**), which was introduced in 2012. CO 12/752 was due to expire or ‘sunset’ on 1 October 2022. Following consultation, ASIC considered that CO 12/752 was operating effectively and efficiently to achieve its objectives and continued to form a necessary and useful part of the legislative framework.
3. As a result, CO 12/752 was remade as a legislative instrument, with only minor drafting changes to reflect ASIC’s current style and format, remove redundant provisions and update definitions, while preserving the current effect of the instrument.
4. *ASIC Corporations (Repeal) Instrument 2022/704* (the **Repeal Instrument**) repeals CO 12/752 as it is superseded by the Instrument upon its commencement. The Repeal Instrument repeals CO 12/752 ahead of its automatic repeal on 1 October 2022.

Assessment of human rights implications

5. The Instrument and Repeal Instrument does not engage any of the applicable rights or freedoms

Conclusion

6. The Instrument and the Repeal Instrument is 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.