Explanatory Statement

ASIC Corporations (Financial Requirements for Responsible Entities, IDPS Operators and Corporate Directors of Retail CCIVs) Instrument 2023/647 and *ASIC Corporations (Amendment and Repeal) Instrument 2023/649*

This is the Explanatory Statement for *ASIC Corporations (Financial Requirements for Responsible Entities, IDPS Operators and Corporate Directors of Retail CCIVs) Instrument 2023/647* (the **Instrument**) and the *ASIC Corporations (Amendment Repeal) Instrument 2023/649* (the **Amendment/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 responsible entities of registered schemes, operators of investor-directed portfolio services (**IDPS operators**) or corporate directors of retail corporate collective investment vehicles (**retail CCIV**s). The Instrument modifies the *Corporations Act 2001* (the **Corporations Act**) by inserting section 912AA. Section 912AA requires responsible entities, IDPS operators and corporate directors of retail CCIVs 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 13/760] *Financial requirements for responsible entities and operators of investor directed portfolio services* (**CO 13/760**), which was issued in 2013, and *ASIC Corporations (Financial Requirements for Corporate Directors of Retail Corporate Collective Investment Vehicles) Instrument* 2022/449 (**LI 2022/449**). The Instrument combines CO 13/760 and LI 2022/449 into a single legislative instrument. CO 13/760 was due to expire or 'sunset' on 1 October 2023 and LI 2022/449 was to be repealed 1 October 2024, respectively. Following consultation, ASIC considered that CO 13/760 and LI 2022/449 were each

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 13/760 and LI 2022/449 have been remade in a combined 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. In light of there being no significant changes to the financial requirements detailed in CO 13/760 and LI 2022/449, this Explanatory Statement should be read in conjunction with the Explanatory Statements for CO 13/760 and the ASIC Corporations (Financial Requirements for Corporate Directors of Retail Corporate Collective Investment Vehicles) Instrument 2022/449.

4. Under the Instrument, we have extended the financial requirements under CO 13/760 and LI 2022/449 for a five-year period to 1 October 2028. In addition, we have extended to 1 October 2028 the corresponding financial requirements for custodians under ASIC Class Order [CO 13/761] *Financial requirements for custodial or depository service providers*.

5. The Amendment/Repeal Instrument repeals CO 13/760 and LI 2022/449 as these instruments are superseded by the Instrument upon its commencement. The Amendment/Repeal Instrument repeals CO 13/760 and LI 2022/449 ahead of their automatic repeal on 1 October 2023 and 1 October 2024, respectively. In addition, the Amendment/Repeal Instrument amends various legislative instruments to change cross-references to [CO 13/760] and [CO 13/761] to the Instrument and *ASIC Corporations (Financial Requirements for Custodial or Depository Service Providers) Instrument 2023/648*, respectively.

6. ASIC makes the 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. ASIC makes the Amendment/Repeal Instrument:

   (a) under subsection 926A(2) in respect of the repeal of [CO 13/760], [CO 13/761] and LI 2022/449; and

   (b) under subsections 283GA(1), 601QA(1), 655A(1), 741(1), 926A(2), 992B(1), 1020F(1) and 1100ZK(2) in relation to the amendment of various legislative instruments that referred to [CO 13/760], [CO 13/761] or LI 2022/449.

7. Section 912AA contains the following requirements:

   (a) tailored cash needs requirements;

   (b) net tangible assets requirements;

   (c) cash or cash equivalents requirements; and

(d) audit opinion requirements in relation to the licensee's financial requirements.

Purpose of the instrument

8. The purpose of the Instrument is to continue the financial requirements set out in CO 13/760 and LI 2022/449 in substantially the same form.

9. The Instrument was issued because CO 13/760 and LI 2022/449 were due to sunset under the *Legislation Act 2003* (the **Legislation Act**) on 1 October 2023 and 1 October 2024, respectively. Under the Legislation Act, legislative instruments (such as class orders) cease automatically, or sunset, after 10 years, unless action is taken to preserve them.

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 13/760 and LI 2022/449 were operating effectively and efficiently, and continued to form a necessary and useful part of the legislative framework. Therefore, these legislative instruments were remade using ASIC's current style and format, while preserving the current effect of the instrument.

11. The Instrument remade CO 13/760 and LI 2022/449 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 2028;

    (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.

12. The financial requirements in section 912AA reflect the general objectives of the AFS licence requirements in Regulatory Guide 166 *AFS licensing: Financial requirements* (**RG 166**). The requirements aim to ensure that:

    (a) a licensee has sufficient financial resources to conduct their financial services businesses in compliance with the Corporations Act (including carrying out supervisory arrangements);

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

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

13. The purpose of the Amendment/Repeal Instrument is to repeal CO 13/760 and LI 2022/449 as these instruments are superseded by the Instrument upon its commencement. The Amendment/Repeal Instrument also repeals [CO 13/761] *Financial requirements for custodial or depository service providers* (**CO 13/761**) as that instrument is also superseded by the *ASIC Corporations (Financial Requirements for Custodial or Depository Service Providers) Instrument 2023/648.* The Amendment/Repeal Instrument repeals CO 13/760, CO 13/761 and LI 2022/449 ahead of their automatic repeal on 1 October 2023 and 1 October 2024, respectively, in accordance with section 50 of the Legislation Act. The Amendment/Repeal Instrument also amends various instruments so that cross-references to [CO 13/760] and [CO 13/761] are updated.

Consultation

14. In March 2023, ASIC consulted on the remake of CO 13/760 and LI 2022/449 in Consultation Paper 367: *Remaking ASIC class orders: [CO 13/760], [CO 13/761] and ASIC Instrument 2022/449* (**CP 367**). In CP 367, ASIC proposed the remake of CO 13/760 and LI 2022/449, without significant changes, and for a period of five years.

15. ASIC received seven submissions in response to CP 367. The feedback on CP 367 generally supported our proposals to remake [CO 13/760] and ASIC Instrument 2022/449 without substantive changes. Report 769 *Response to submissions on CP 367 Remaking ASIC class orders on financial requirements* (Report 769) summarises the key issues raised in submissions and ASIC's responses. As outlined in Report 769, ASIC has provided additional explanation in this explanatory statement and additional guidance in RG 166 in response to some of the issues raised. The Instrument also corrects the definition of 'excluded assets'.

16. ASIC has self-certified that it is not required to prepare an Impact Analysis for the Instrument. This is because, following a formal consultation process with affected stakeholders, ASIC has assessed that [CO 13/760] and ASIC Instrument 2022/449 are operating effectively and efficiently.

Operation of the instrument

General

17. Section 5 of the Instrument inserts section 912AA of the Corporations Act which, under subsection 912AA(1), applies to AFS licensees that are responsible entities, IDPS operators or corporate directors of retail CCIVs, other than a licensee that is:

    (a) a body regulated by the Australian Prudential Regulation Authority (**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.

18. Subsection 912AA(2) specifies that a licensee to which section 912AA applies is taken to have complied with the conditions (if any) of its AFS license that relate to tailored cash needs, NTA and audit opinion requirements.

Tailored cash needs requirements

19. Subsection 912AA(3) requires a licensee to prepare a cash flow projection covering at least the next 12 months based on what is reasonably likely to happen over this period. The cash flow projection must be approved by directors of the licensee at least once a quarter as satisfying the cash needs requirement. The licensee must document the calculations and assumptions used in preparing the projection and describe why those assumptions are appropriate. The cash flow projection must be updated in certain circumstances.

NTA requirement

20. Subsection 912AA(5) sets out various scenarios where the *fund assets* are held by parties other than the AFS licensee, such as a custodian or a sub-custodian appointed by that custodian. The NTA requirement applies to all licensees that hold a licence authorisation to operate a registered managed investment scheme or to operate an IDPS, whether or not the licensee actually provides that financial service at the time. Where a licensee satisfies relevant requirements in subsection 912AA(5), the licensee may hold a lower net tangible assets (**NTA**) requirement.

21. Where subsection 912AA(5) applies, the lower NTA requirement under paragraph 912AA(4)(a) will apply. This provision requires the licensee to hold the amount that is the greatest of:

(a) $150,000;

(b) 0.5% of the average value of fund assets, up to $5 million NTA; or

(c) 10% of average revenue.

22. If subsection 912AA(5) does not apply, the higher NTA requirement under paragraph 912AA(4)(b) will apply. This provision requires the licensee to hold the amount the greater of:

(a) $10 million; or

(b) 10% of average revenue.

Average value of fund assets

23. The term *fund assets* means scheme property of registered schemes, IDPS property or assets of retail CCIVs: see the definition in s912AA(11).

24. The term *value of fund assets* combines the terms 'value of scheme and IDPS property' in [CO 13/760] and 'value of CCIV assets, scheme property and IDPS property' in ASIC Instrument 2022/449 on substantially the same terms. The definition in s912AA(11) means the aggregate of the value of scheme property or retail CCIV assets (excluding the value of cross-invested shares for a retail CCIV) that would be recognised in a balance sheet prepared under Chapter 2M and, in relation to IDPS property and other property of a registered scheme or retail CCIV, the market value of the asset.

25. In relation to assets that would be recognised in a hypothetical Chapter 2M balance sheet, an AFS licensee must use the carrying amount shown for that asset, being its gross value. For example, for the purposes of obtaining the value of real property that is subject to a mortgage, the AFS licensee uses only its gross value, being the value of the real property, and is not permitted to deduct the amount of a liability that is connected to the asset.

26. There are some asset categories where the carrying amount for the asset includes an adjustment from its gross value. For example, the carrying amount for property, plant and equipment is the gross value minus accumulated depreciation and impairment losses. Those deductions are permitted because they are required to obtain the value of the asset that would be recognised in a hypothetical Chapter 2M balance sheet for the asset.

27. The term *average value of fund assets* is defined in s912AA(11) and means the greater of:

    (a) the current value of fund assets; or

    (b) an average that is calculated using end-of-month values of fund assets and forecast values for remaining months in the current financial year.

28. The averaging of actual end-of-month asset values and forecast asset values is designed to ensure that a licensee's NTA requirement is not reduced because of a drop in the value of fund assets, which might itself indicate the potential for the licensee's financial resources to be strained.

Average revenue

29. The definition of the term *revenue* covers all of a licensee's revenue under the Australian accounting standards: see s912AA(11). The licensee must add any amounts paid or payable for the performance of the obligations imposed on the licensee in connection with operating a registered scheme, IDPS or retail CCIV.

30. The term *revenue* is all-inclusive in that it includes revenue where it has been earned by agents acting on the licensee's behalf, in connection with a registered scheme, IDPS or retail CCIV.

31. The term *average revenue* is defined in subsection 912AA(11). In summary, the definition refers to an amount based on the average of the licensee's revenue for up to the last two preceding financial years (starting from when the licensee was first authorised to operate a registered scheme, IDPS or retail CCIV) and an estimate of the forecast revenue for the remainder of the financial year.

Liquidity requirement

32. There are two components under the liquidity requirement in subsection 912AA(8):

    (a) paragraph 912AA(8)(a) requires the licensee to hold the greater of $150,000 or 50% of the NTA requirement that would be required to be held under paragraph 912AA(4) as cash or cash equivalents. Cash or cash equivalents is defined in subsection 912AA(11); and

    (b) paragraph 912AA(8)(b) requires the licensee to hold liquid assets in an amount that is at least 100% of the required NTA. Liquid assets is defined in subsection 912AA(11).

Audit opinion

33. Subsections 912AA(9) and (10) set out the requirements for the contents and lodging of an opinion of a registered company auditor (**audit opinion**) covering the period during which the licenee was authorised to operate a registered scheme, retail CCIV or IDPS. The auditor is required to provide an audit opinion on a 'positive assurance' basis on the matters specified in paragraph 912AA(9)(a) and an opinion on a 'negative assurance' basis on the matters specified in paragraph 912AA(9)(b).

Excluded assets

34. ASIC received submissions in response to CP 367 which requested clarification with respect to the treatment of 'deferred tax assets' in the definition of 'excluded assets' that applied under [CO 13/760]. Under [CO 13/760], 'deferred tax assets' were excluded from the definition even though they are intangible assets, which are generally included in the definition of 'excluded assets'. In relation to the treatment of 'deferred tax assets', we have made this consistent with *ASIC Corporations (Financial Requirements for Issuers of Retail OTC Derivatives) Instrument 2022/705,* which expressly includes 'deferred tax assets' in the definition of 'excluded assets'.

35. This instrument also makes a correction in paragraph (c) of the definition of 'excluded assets' so that all categories of assets set out in paragraph (c) will be excluded where the licensee may exercise any form of power or control over them.

Incorporation by reference

36. The Instrument and the Amendment/Repeal Instrument do not incorporate by reference any documents.

Retrospective application

37. The Instrument and the Amendment/Repeal Instrument do not have retrospective application.

Legislative instrument and primary legislation

38. The subject matter and policy implemented by this instrument is more appropriate for a legislative instrument rather than primary legislation 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 13/760 and LI 2022/449, which were otherwise due to sunset on 1 October 2023 and 1 October 2024, respectively; and

    (c) following consultation, ASIC considered that CO 13/760 and LI 2022/449 were operating effectively and efficiently to achieve their objectives and continued to form necessary and useful parts of the legislative framework.

Duration of the Instrument

39. ASIC considers that five years is the appropriate duration for the Instrument.

Legislative authority

40. The source of power to make the Instrument is paragraph 926A(2)(c) of the Corporations Act. The sources of power to make the Amendment/Repeal Instrument are subsections 283GA(1), 601QA(1), 655A(1), 741(1), 926A(2), 992B(1), 1020F(1) and 1100ZK(2) of the Corporations Act.

41. The Instrument and the Amendment/Repeal Instrument are disallowable legislative instruments.

Statement of Compatibility with Human Rights

42. 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.

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 Responsible Entities, IDPS Operators and Corporate Directors of Retail CCIVs) Instrument 2023/647 (the Instrument)* and *ASIC Corporations (Amendment and Repeal) Instrument 2023/649* (the *Amendment/Repeal Instrument*)**

Overview

1. The Instrument imposes financial requirements on three types of Australian Financial Services licensees – responsible entities, operators of investor-directed portfolio services and corporate directors of retail corporate collective investment vehicles. The Instrument continues the financial requirements under its predecessor instruments, ASIC Class Order [CO 13/760] *Financial requirements for responsible entities and operators of investor directed portfolio services* (**CO 13/760**) and *ASIC Corporations (Financial Requirements for Corporate Directors of Retail Corporate Collective Investment Vehicles) Instrument 2022/449* (**LI 2022/449**), with minor and technical changes only.

2. The Amendment/Repeal Instrument repeals [CO 13/760] and LI 2022/449 as these instruments are superseded by the Instrument upon its commencement. The Amendment/Repeal Instrument repeals [CO 13/760] and LI 2022/449 ahead of their automatic repeal on 1 October 2023 and 1 October 2024, respectively. The Amendment/Repeal Instrument also repeals CO 13/761 ahead of its automatic repeal on 1 October 2023. In addition, the Amendment/Repeal Instrument amends various legislative instruments to change cross-references to [CO 13/760] and [CO 13/761] to the Instrument and *ASIC Corporations (Financial Requirements for Custodial or Depository Service Providers) Instrument 2023/648*, respectively.

Assessment of human rights implications

3. The Instrument and the Amendment/Repeal Instrument do not engage any of the applicable rights or freedoms.

Conclusion

4. The Instrument and the Amendment/Repeal Instrument 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*.