

Proposed increased financial requirements for REs—have your say

We recently reported on ASIC Consultation Paper 140, which outlines ASIC's proposed financial reforms for responsible entities (REs) including increased financial resource requirements (http://www.mcmahonclarke.com/September_2010_1_cfm#3).

These reforms will have a very significant impact on the funds management industry. If implemented in their current form, the changes are likely to lead to decreased competition through forced consolidation and rationalisation. We expect some managers will have to merge or even leave the industry. ASIC have conceded as much.

It is the proposed new NTA liquidity requirement which is likely to have the biggest impact.

The reforms (based upon ASIC Consultation Paper 140) can be summarised as follows:

Restricting guarantees and indemnities

REs will be—

- prohibited from giving guarantees in their capacity as RE for a fund
- prohibited from providing guarantees in their own corporate (i.e., "personal") capacity, where they manage more than one fund
- restricted from providing indemnities as RE, other than indemnities in relation to a fund's "default", and
- required to execute a tax sharing agreement where the RE is part of a tax consolidation group, to ensure that the RE can only ever be liable for its portion of any group tax liability.

Rolling 12-month cashflow projections

REs will be required to prepare, and make available to ASIC on request, rolling 12-month cashflow forecasts, which must be approved by the board.

Increased NTA capital requirements

Firstly, ASIC is proposing that one of the following two options be adopted for calculating the amount of NTA a responsible entity is required to hold—

- the greater of—(a) \$150,000; (b) 0.5 percent of the average value of fund property (capped at \$5 million); and (c) 10 percent of the RE's average gross revenue, or
- 10 percent of average gross revenue, with a minimum NTA requirement of \$500,000 and no maximum.

Secondly, if average gross revenue of the RE is below a minimum (as yet unstated) percentage of the average value of all fund property, then a percentage between 1 percent and 2 percent (but again yet to be set) will be used to calculate the required NTA.

The use of "eligible undertakings" to help meet NTA will be curtailed. They will now be limited to undertakings provided by banks and other authorised deposit taking institutions (unless otherwise approved by ASIC).

Finally, an RE's level of funds under management, and the RE's NTA, must be submitted to ASIC, annually.

New NTA liquidity requirements

As noted earlier, we expect this is the proposed reform which will have the most substantial impact.

ASIC is proposing REs be required to hold 50 percent of their NTA as cash or cash equivalents, with the balance of the required NTA to be all held in "liquid assets".

"Liquid assets" will be—

- money in a bank account (available for withdrawal immediately, or otherwise on maturity of a fixed term not exceeding six months)
- a bank bill with a maturity date not exceeding six months, or
- an asset the RE can reasonably expect to realise for its market value within six months.

Crucially, it seems all "liquid assets" must also be free from any charges or other encumbrances (e.g., a fixed and floating charge to a financier) and, for receivables, free from any rights of set-off.

The proposed implementation and transition arrangements are as follows:

1. The reforms will be effective for all new REs as of 1 July 2011.
2. A transition period for existing REs will be implemented, as either—
 - (a) 12 months until 1 July 2012, or
 - (b) 24 months until 1 July 2013.

Obviously, these are major reforms. It is vital that the industry has its say on them.

McMahon Clarke Legal is in the process of drafting a submission to ASIC.

We invite and encourage you to provide relevant comments on the proposals to us by **Friday 29 October 2010**. Please provide your comments or feedback to Andrew Shearer-Smith or Chris Mee.



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