

EXPLANATORY STATEMENT for ASIC Client Money Reporting Rules 2017

Prepared by the Australian Securities and Investments Commission

1. Corporations Act 2001

The Australian Securities and Investments Commission (ASIC) makes the ASIC Client Money Reporting Rules (the Rules) under subsection 981J(1) of the *Corporations Act 2001* (the Corporations Act).

Subsection 981J(1) provides that ASIC may, by legislative instrument, make rules dealing with matters as permitted by Subdivision AA of Division 2 of Part 7.8 of the Corporations Act, for purposes relating to derivative retail client money.

2. Background

In early 2017, the Australian Parliament passed the Treasury Laws Amendment (2016 Measures No. 1) Bill 2016 and the Corporations Amendment (Client Money) Regulations 2017. These legislative reforms removed a number of broad exceptions in the Corporations Act that permitted licensees that deal in derivatives to use client money for a wide range of purposes, including as the licensee's own working capital.

Under these reforms, ASIC was given the power to make new client money reporting rules which may impose reporting and reconciliation requirements on licensees. ASIC was given this power to assist it in effectively monitoring the use of client money and identifying where client money has been used for a non-permitted purpose by a licensee.

Ministerial consent is not required for ASIC to make a client money reporting rule. However, ASIC must consult the public about any proposed client money reporting rule before making such a rule.

3. Purpose of the instrument

The purpose of the Rules is to apply more formal and consistent standards across the derivatives sector and ensure greater transparency in relation to a licensee's receipt and use of derivative retail client money. The Rules will enhance ASIC's surveillance of the retail derivatives sector by requiring licensees to report discrepancies in client money balances to ASIC in a timely manner. This will benefit retail investors by reducing the risk of losses associated with non-permitted withdrawals, fraud and other operational breaches by the licensee.

The Rules will further reduce risk to retail clients by ensuring that a licensee's directors are actively involved in the record-keeping and reconciliation processes and therefore aware of how the licensee is using and recording derivative retail client money.

4. Operation of the instrument

Reportable client money

The Rules impose record-keeping, reconciliation and reporting obligations on licensees which hold 'reportable client money'. For the purposes of the Rules, 'reportable client money' is derivative retail client money which relates to derivatives which are not traded on a licensed domestic exchange.

A carve-out is provided in relation to client money held in relation to derivatives traded on licensed domestic exchanges as the participants of those exchanges are already subject to stringent reporting and reconciliation requirements under the ASIC market integrity rules. ASIC is responsible for supervising compliance with the market integrity rules and therefore there is already greater regulatory transparency in relation to that client money.

Application of the Rules to licensees subject to market integrity rules

Licensees which are participants in the ASX 24 market or the FEX market are not required to perform reconciliations of reportable client money which is already the subject of reconciliations performed in compliance with the ASIC Market Integrity Rules (ASX 24 Market) 2010, the ASIC Market Integrity Rules (FEX Market) 2013 or the ASIC Market Integrity Rules (Futures Markets) 2017. ASIC has included this carve-out to avoid an unnecessary duplication of obligations as these market participants are already required to perform reconciliations of client money held in relation to futures contracts traded on overseas exchanges. Furthermore, these market participants do not need to comply with the Rules if the only reportable client money received by the participant is reconciled in compliance with these market integrity rules.

Record-keeping requirements

Under the Rules, a licensee is required to keep the following records for at least seven years from the date the record is made:

- (a) a record of the amount of reportable client money it has received from, on behalf of, or for the benefit of a client and is required under Division 2 of Part 7.8 of the Corporations Act to hold in a client money account for that client; and
- (b) a record of the total amount of reportable client money it has received from, on behalf of, or for the benefit of all clients and is required under Division 2 of Part 7.8 of the Corporations Act to hold in a client money account for all clients.

A licensee is also required to comply with:

- (a) a written request from a client for records the licensee is required under the Rules to keep in relation to that client within five business days; and
- (b) a written request from ASIC for any record the licensee is required to keep under the Rules within five business days.

Reconciliation requirements

Under the Rules, a licensee is required to complete an accurate daily and monthly reconciliation of:

- (a) the amount of reportable client money held in a client money account for each client, and on a total basis; and
- (b) the corresponding amount of reportable client money recorded for each client, and on a total basis, in the licensee's records which are kept in accordance with the Rules.

In addition, a licensee must retain a written record of these reconciliations for at least seven years from the date the reconciliation is performed.

A licensee must also determine, in writing, on or before the day it is first required to comply with its reconciliation requirements, the time of day and timezone at which it will perform the reconciliations required by the Rules. The licensee must use this time for the purposes of complying with its reconciliation requirements each day. The licensee may change the time and timezone in writing before the change takes effect and must notify ASIC in writing of such a change before it takes effect.

Reporting requirements

Licensees must provide a written report to ASIC within five business days if it:

- (a) fails to perform a reconciliation as required by the Rules; or
- (b) a reconciliation performed under the Rules identifies a difference between the amount of client money held in a client money account and the amount required to be held in that account which is recorded in the licensee's records.

A licensee must also prepare and give to ASIC within four calendar months of the end of each financial year:

- (a) a directors' declaration that states whether, in the directors' opinion, the licensee has complied with the Rules; and
- (b) an external auditor's report in the form specified by the Rules that states whether, in the auditor's opinion, the licensee has systems that have enabled it to comply with the Rules.

Supervisory policies and procedures

Under the Rules a licensee must also:

- (a) establish and implement policies and procedures designed to ensure compliance with the Rules; and
- (b) keep those policies and procedures up to date.

5. Consultation

ASIC has consulted with stakeholders through Consultation Paper 291 *Reporting rules: Derivative retail client money* (CP 291) which was issued on 11 July 2017 and was open for comment until 8 August 2017. ASIC received 12 submissions in response to CP 291, the majority of which were supportive of ASIC's proposal to make the Rules.

ASIC consulted with the Office of Best Practice Regulation which assessed that a Regulatory Impact Statement was not necessary for the Rules as the implementation of the Rules is of a machinery nature.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

ASIC Client Money Reporting Rules 2017

The ASIC Client Money Reporting Rules 2017 (the Rules) 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*.

Overview

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Human rights implications

This legislative instrument does not engage any of the applicable rights or freedoms.

Conclusion

This legislative instrument is compatible with human rights as it does not raise any human rights issues.

Australian Securities and Investments Commission