

CHAPTER 3

DEALER'S PRUDENTIAL SOUNDNESS

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DEALER'S PRUDENTIAL SOUNDNESS.

Each *APX broker must have appropriate capital liquidity to meet their financial situation. Capital liquidity must be maintained at not less than \$100,000 or 5% of the *adjusted liabilities whichever is greater.

An *APX broker must maintain adequate accounts and records to detail each trade undertaken by it on behalf of each client and must maintain the records for a period of a minimum of seven years.

Each *APX broker must maintain a trust account as required by section 981B of the *Act.

An *APX broker must lodge a monthly trial balance, quarterly statements of capital liquidity, an annual return and a schedule of investments.

All *APX brokers must maintain appropriate professional indemnity insurance.

* See Chapter 1 for defined terms.

• See **Rule 3.1.1** for defined terms

CAPITAL LIQUIDITY REQUIREMENTS.

DEFINITIONS AND INTERPRETATION.

3.1.1. The following definitions apply for Capital Liquidity requirements:

- (a) **“adequately secured”** is an amount owing to an *APX broker that is secured by:
- (i) an enforceable charge over *securities for which there exists a *ready market and the market value of those *securities is not less than 105% of the amount owing; or
 - (ii) a registered first mortgage over real estate that has a fair market valuation of not less than the amount owing.

Loans or advances excluded in their own right will not be included as tangible assets in adjustments (i) and (ii) because they are secured by a charge over real property or a guarantee or an indemnity from a proprietary company.

- (b) **“adjusted liabilities”** means *total liabilities adjusted for *liabilities inclusions and *liabilities exclusions.
- (c) **“approved subordinated debt”** means an amount owing by an *APX broker which is payable at a time or by instalments approved by *APX and is to the satisfaction of *APX effectively subordinated so that any right of the creditor in question to receive payment in the case of bankruptcy of or any composition or compromise with creditors by or appointment of a trustee in bankruptcy or in the case of liquidation, liquidator in respect of the *APX broker is extinguished to such extent as will ensure payment or provision for payment in full of all claims of all other present and future creditors of the *APX broker in priority to the claim of the subordinated creditors and in respect of which a *approved subordinated loan deed has been executed under seal by the *APX broker, the *lender and *APX (or on behalf of *APX by its delegate or sub-delegate as *APX may determine from time to time) and which contains provisions which may be imposed by *APX having regard to the nature of the business conducted or to be conducted by the *APX broker, which has a capital structure which complies with **Rule 3.2.1** and any subordinated debt agreement which has been made, complies with the provisions of **Rule 3.1.1(d)**.
- (d) **“approved subordinated loan deed”** means a deed of subordination which includes provisions to the following effect:
- (i) no alteration to be made to the *subordinated loan deed without the agreement of all parties and that such variation must be executed under seal by all parties to the *deed;
 - (ii) full details of the terms and conditions governing each loan are set out in the *deed and in particular that *APX can be satisfied that the borrower has made adequate arrangements to cover liquid asset requirements on the maturity date of any loan for a fixed term, and, is to be advised full particulars of each loan prior to the making thereof;
 - (iii) repayment of a loan in whole or in part must not take place without the prior approval of *APX and that *APX may withhold its consent if it is not satisfied

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that the *APX broker is capable of continuing to comply with any of the *Business Rules of *APX or any conditions of its dealer's licence following repayment of a loan;

- (iv) specific acknowledgement by the lender that any right of the lender to payment in the case of bankruptcy of or any composition or compromise with creditors by or appointment of a trustee in bankruptcy or in the case of liquidation, liquidator in respect of the *APX broker or *directors or any of them is extinguished to such extent as will ensure payment or provision for payment in full of all claims of all other present and future creditors of the *APX broker in priority to the claim of the lender;
 - (v) specific acknowledgement by the lender that any right to receive interest and principal payments, are subordinated at all times during the term of the loan, to all other creditors; and
 - (vi) specific acknowledgement by the lender that the obligation to repay the loan, and to pay interest, is suspended if net capital falls below the minimum set for the borrower's financial services licence.
- (e) **“associates”** included:
- (i) a spouse of the dealer or relative of the dealer or spouse;
 - (ii) a *director of the licensed company, a spouse of such a *director, or a relative of such *director or spouse;
 - (iii) a director of a related body corporate of the dealer, a spouse of such a director, or a relative of such director or spouse;
 - (iv) an employee of the dealer, a spouse of such an employee, or a relative of such an employee or spouse;
 - (v) a trustee of a trust under which the dealer or a person referred to in paragraphs (i) to (iv), whether individually or collectively, has a beneficial interest of not less than 30% of the net assets of the trust;
 - (vi) a corporation where one or more persons referred to in paragraphs (i) to (v), either individually or collectively, has a beneficial interest in share in the body corporation which has a nominal value of not less than 30% of the nominal value of issued capital of the body corporate;
 - (vii) a corporation in which the dealer has a relevant interest in not less than 30% of the issued voting shares;
 - (viii) a corporation which holds a relevant interest in not less than 30% of the issued voting shares of the dealer;
 - (ix) an *affiliate of an *APX broker; and
 - (x) any person who is an associate of the dealer for the purpose of Division 2 of Part 1.2 of the *Act (other than a bank or corporation concerning which a declaration is in force under s65 of the *Act).

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- (f) **“current assets”** are those assets expected to be realised or capable of being realised within 12 months.
- (g) **“current asset exclusions”** includes:
 - (i) * securities, promissory notes and bills of exchange which do not have a ready market but which have been classified as current assets in the balance sheet;
 - (ii) receivables, the recovery of which is doubtful, or which are not capable of being realised within 12 months;
 - (iii) amounts owing from associates which are not adequately secured;
 - (iv) amounts owing from any trust in respect of which the dealer or an associate may exercise any form of power or control and which are not adequately secured;
 - (v) assets lodged with * ASIC for the purpose of a security pursuant to section 914A of the * Act;
 - (vi) assets to the amount which they have been charged or pledged for the purposes of arranging a security pursuant to section 914A of the * Act;
 - (vii) funds available on demand by way of a letter of guarantee;
 - (viii) other current assets which are not capable of realisation within 12 months;
 - (ix) any assets which may be regarded on the basis of generally accepted accounting principles as being intangible;
 - (x) any asset which represents the dealer's right of indemnity from the assets of a trust where the dealer is the trustee; and
 - (xi) adjustments to current asset exclusions approved by APX.
- (h) **“current asset inclusions”** includes:
 - (i) * securities, promissory notes and bills of exchange which have a ready market but which have not been classified in the accounts as a current assets; and
 - (ii) adjustments to current assets inclusions approved by * APX.
- (i) **“liabilities exclusions”** includes:
 - (i) * approved subordinated debt approved by * APX;
 - (ii) loans subject to * APX approved back-to-back arrangements; and
 - (iii) adjustments to liabilities exclusions approved by * APX.
- (j) **“liabilities inclusions”** includes:
 - (i) contingent liabilities where it is probable an actual liability will arise; and
 - (ii) adjustments to liabilities inclusions approved by * APX.

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- (k) “**liquid assets**” means the total of current assets (from the balance sheet) adjusted for any *current asset inclusions and current asset exclusions.
- (l) “**ready market**” is taken to exist for:
 - (i) *securities, promissory notes or bills of exchange traded in a recognised market in which independent, bona fide offers to buy and sell are regularly made so that a price reasonably related to the last sale price or current bona fide competitive bid and offer quotations can be determined promptly and where payment will be received within customary period; and
 - (ii) any *security which *APX has approved in writing.
- (m) “**surplus liquid funds**” means the excess of liquid assets over adjusted liabilities.
- (n) “**total liabilities**” means the total liabilities of the licensee other than shareholders funds.
- (o) “**valuing of liquid assets**” are valued by the following methods:
 - (i) all securities, promissory notes and bills of exchange having a *ready market are to valued at a value not in excess of market value; and
 - (ii) all other assets are to be valued at the lower of cost or net realisable value.

3.1.2. Expressions that are defined in the accounting standards (as defined in the *Act) and that are not defined in these Rules, have the meaning given in the accounting standards.

LIQUIDITY REQUIREMENTS.

3.2.1. An *APX broker must ensure at all times that its *surplus liquid funds are not less than \$100,000 or 5% of its *adjusted liabilities, whichever is the greater.

3.2.2. An *APX broker must prepare and keep available for inspection by the *examining accountant a summary return, in the form prescribed by *APX from time to time, showing the level of *surplus liquid funds, the level of *adjusted liabilities and the level of *surplus liquid funds as a proportion of *adjusted liabilities.

3.2.3. An *APX broker must, within five *business days after the last day of each month, lodge with *APX a completed return, in the form prescribed by *APX, showing in respect of the previous month:

- (a) the *surplus liquid funds calculations of the *APX broker, including:
 - (i) if *APX has notified the *APX broker that it requires the *surplus liquid funds calculations to be audited by the *APX broker's *auditor – a report from the *APX broker's *auditor of its audit of the *surplus liquid funds calculations; or
 - (ii) otherwise – a declaration signed by 2 directors of the *APX broker that the *surplus liquid funds calculations are true and correct and calculated in accordance with these Rules; and

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(b) aged debtors of the *APX broker.

3.2.4. An *APX broker must notify *APX within three *business days of any of the following:

- (a) A decrease in *current assets (other than as a result of a movement in a client's account) of more than 5%; or
- (b) An increase in current liabilities (other than as a result of a movement in a client's account) of more than 5%.

3.2.5. *APX may, with prior written approval from *ASIC, grant to an *APX broker an exemption from these liquidity requirements on such terms as *APX may determine.

3.2.6. An *APX broker must immediately notify *APX if its *surplus liquid funds are at any time less than the minimum amount required by **Rule 3.2.1**.

ACCOUNTS AND RECORDS.

RECORDS.

3.3. An *APX broker must maintain records in sufficient detail to show particulars of:

- (a) *Client agreement forms for the opening of accounts, setting out:
 - (i) The client name;
 - (ii) The client address to which contract notes to be sent;
 - (iii) Telephone, facsimile and e-mail contact details.

The *client agreement form must be signed by the client and lodged with *APX prior to the commencement of trading.

- (b) All moneys received or paid by the *APX broker, including trust account receipts and payments;
- (c) All orders received for the purchase or sale of *securities must include details of:
 - (i) the identity of the person who received the order;
 - (ii) the date and time that the order was received;
 - (iii) the name of the natural person placing the order (unless that person is the client);
 - (iv) the name of the client;
 - (v) a description of and number of *securities to be bought and sold;
 - (vi) the price limit or price related instructions;
 - (vii) the time limit on the order (if any);

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- (viii) whether or not any advice was given to the client in connection with the order; and
 - (ix) any other relevant instructions;
- and must be serially numbered and retained for 7 years whether or not the order is executed.
- (d) All purchases and sales of * securities as * principal by the * APX broker and the charges and credits arising from them.
 - (e) All transactions by the * APX broker with or for the account of:
 - (i) each of the parties referred to in **Rule 3.1.1(e)**; and
 - (ii) other * APX brokers.
 - (f) All income from commissions, interest and other sources and all expenses, commissions and interest paid.
 - (g) All assets and liabilities, including contingent liabilities of the * APX Broker.
 - (h) All * securities which are the property of the * APX broker, showing with whom they are deposited and, if held otherwise than by the * APX broker, whether they have been lodged as collateral security for loans or advances.
 - (i) All * securities which are not the property of an * APX broker but for which that * APX broker or any nominee controlled by it is accountable, showing by whom and for whom those * securities are held and:
 - (i) in respect of those which are held for safe custody – details sufficient to identify those * securities. All * securities held for safe custody must be registered either in the name of the client or the * APX broker's nominee;
 - (ii) in respect of those which are deposited with any person or firm or corporation as collateral security for loans or advances made to the * APX broker – details sufficient to identify those * securities. The deposit of those * securities as collateral security must be authorised in writing by the owner of the * securities or another person lawfully entitled to give that authorisation. The authority must specify the period for which the * securities may be deposited.
 - (j) All underwriting agreements and transactions entered into by the * APX broker;
- and the * APX broker must retain copies of such documentation and all trade confirmations for not less than seven years.

The provisions of this **Rule** shall to the extent to which they are applicable apply not only to records of the * APX broker's principal office but also to those of any branch office and to any nominee company beneficially owned and operated by an * APX broker for the purpose of conducting the business of the * APX broker.

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TRUST ACCOUNT.

- 3.4.1.** An *APX broker must open and maintain at least one trust account with an *Australian ADI in accordance with the *Act.
- 3.4.2.** An *APX broker must pay into a trust account maintained by the *APX broker on receipt:
- (a) all money received from or on account of any person for *securities purchased or to be purchased, provided that where the whole amount received relates to *securities previously paid for by the *APX broker that money need not be paid into the trust account;
 - (b) all money received for or on account of any person for *securities sold which is not paid to that person or as that person directs;
 - (c) all money received from or on account of any person being application money for *securities or call money payable on *securities or any other payment and not paid direct to the person entitled to it;
 - (d) all money received from or for or on account of any person and which is required by law to be paid into or held in a trust account maintained by the *APX broker.
- 3.4.3.**
- (a) All money which is required by **Rule 3.4.2** to be paid into an *APX broker's trust account, but which is received by the *APX broker after *Australian ADI trading hours, must be paid into the trust account on the first *business day following the date of receipt.
 - (b) An *APX broker is prohibited from making an agreement under subsection 981H(2) of the Act.
- 3.4.4.** All money received by an *APX broker for or on account of any client and which is required by **Rule 3.4.2** to be paid into a trust account must be retained in the trust account until:
- (a) withdrawn for the purpose of reimbursing brokerage and other proper charges attributable to the purchase of *securities for or on account of that person;
 - (b) withdrawn for the purpose of reimbursing money expended in the purchase of *securities for or on account of that person;
 - (c) paid to the person entitled to it or in accordance with the written directions of that person;
 - (d) paid to *APX in accordance with the provisions of the *Act;
 - (e) paid as otherwise authorised by law.
- 3.4.5.** An *APX broker borrowing money in connection with the financial services business carried on by the *APX broker must be deposited within the time specified in **Rule 3.4.3** to the *APX broker's separate trust account with an *Australian ADI that contains no money other than money lent to the *APX broker, until and unless the *APX broker receives from the lender executed loan documentation which specifies that the *APX broker is not obliged to hold the money in trust, which may take the form of **Appendix 3-1**.

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TRIAL BALANCES.

- 3.5.** An *APX broker must ensure not later than the tenth *business day of every month, that the books of account are in balance as at the end of the immediate preceding month, and a record of the monthly trial balances must be retained by the *APX broker until such time as each succeeding audit under the *Act is completed.

ANNUAL ACCOUNTS AND AUDIT.

- 3.6.1.** An *APX broker must cause accounts relating to its business to be prepared for each financial year ending 30th June or such other date as advised to *APX in the form prescribed by *APX.
- 3.6.2.** An *APX broker must bring into account the assets and liabilities of the broking business in the balance sheet at such amounts and must be classified and described therein in such manner that the balance sheet gives a true and fair view of the state of affairs of such business as at the date to which it is made up.
- 3.6.3.** An *APX broker must lodge with the *examining accountant, within two months after the end of the *APX broker's financial year in each year, the accounts referred to in **Rule 3.6.1**. If *APX is satisfied that circumstances warrant an extension of time, it may extend, by not more than one month, the time for the lodgment of the accounts.
- 3.6.4.** An *APX broker must appoint an *auditor of its financial statements.
- 3.6.5.** If *APX objects to an *auditor which has been appointed by an *APX broker, *APX must notify the *APX broker in writing. On receipt of such a notice, the *APX broker must replace the *auditor objected to with another *auditor.
- 3.6.6.** If an *APX broker removes an *auditor or the *auditor retires the *APX broker must appoint an *auditor to fill any vacancy in the office of *auditor within 10 *business days of the vacancy occurring or such other time as is prescribed by the *Act.
- 3.6.7.** An *APX broker must within 5 *business days of:
- (a) the appointment of an *auditor;
 - (b) the removal or retirement of an *auditor;
- notify *APX of that appointment, removal or retirement.
- 3.6.8.** An *APX broker must, within two months after the end of the *APX broker's financial year, lodge with the *examining accountant an *auditor's report for each financial year. If *APX is satisfied that circumstances warrant an extension of time, it may extend, by not more than one month, the time for the lodgment of the *auditor's report. A copy of the *auditor's report must be forwarded to the *examining accountant at the same time the *APX broker lodges its accounts pursuant to **Rule 3.6.3**.
- 3.6.9.** An *APX broker with one or more nominee companies must include the records of each nominee company in the audit.
- 3.6.10.** An *APX broker must not place any limitations on the extent of an audit conducted by its *auditors. If any restriction is imposed, the *auditors must report the matter to the *examining accountant in the audit report.

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3.6.11. * APX will prescribe the form of the * auditor's report.

3.6.12. An * APX broker must:

- (a) have its internal control procedures audited once during the * APX broker's financial year.
- (b) give its * auditors access to the * APX broker's premises and must supply to its * auditors all records, documents, data and other information (including copies of each schedule prepared during the immediately preceding financial year of the * APX broker in accordance with **Rule 3.9.3**) required by its * auditors to conduct an audit.
- (c) lodge with the * examining accountant, at the same time the * APX broker lodges its accounts pursuant to **Rule 3.6.3**, a report by its * auditor on the audit of the internal control procedures under **Rule 3.6.12(a)**.
- (d) if * APX considers that extraordinary circumstances have arisen, have its internal control procedures audited again, in which case the * APX broker must lodge with the * examining accountant a further * auditor's report by such date as is specified by * APX.

INSURANCE - STOCKBROKERS' INDEMNITY.

3.7.1. Subject to **Rule 3.7.3** every * APX broker must:

- (a) on an annual basis take out and maintain in full force and effect professional indemnity and such other insurance policies which provide to the * APX broker cover against liability for negligence, errors, omissions, misstatements, statutory warranties and indemnities, infidelity of staff and loss, destruction or deprivation of * securities or other documents of title; and
- (b) ensure that the insurance taken out and maintained in accordance with **Rule 3.7.1(a)**, is of a kind and amount which a reasonable person would determine to be adequate having regard to the nature and extent of the business carried on by the * APX broker and the responsibilities and risks assumed or which may be assumed by the * APX broker in connection with that business.

3.7.2. An * APX broker must, in respect of any liability or potential liability of the type referred to in **Rule 3.7.1**, notify * APX of :

- (a) any circumstance which is likely to give rise to a claim;
- (b) the receipt of a notice from any person of any intention to make a claim;
- (c) the details of any claim; and
- (d) any other matter which * APX may require in relation to any insurance policy maintained pursuant to **Rule 3.7.1**.

3.7.3. The * APX broker must advise * APX in writing by no later than 31 July in each year of the amount of cover provided to the * APX broker pursuant to **Rule 3.7.1**.

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RETURNS.

SCHEDULE OF INVESTMENTS.

- 3.8.1.** An *APX broker must prepare a schedule of its investments as at the end of its financial year which must be included with the accounts lodged with the *examining accountant pursuant to **Rule 3.6.3**.
- 3.8.2.** *APX must prescribe the schedule of investments and the details which must be included in it.

TRUST ACCOUNT SCHEDULE.

- 3.9.1.** An *APX broker must, by no later than the first *business day of each week, reconcile the balance held by the *APX broker on the last *business day of the immediately preceding week in its trust account with the corresponding balance as recorded in the accounting records of the *APX broker.
- 3.9.2.** An *APX broker must notify *APX if it has not carried out a reconciliation under **Rule 3.9.1** in respect of a week.
- 3.9.3.** An *APX broker must, within 5 *business days after 31 March, 30 June, 30 September and 31 December in each year, cause to be prepared a schedule as at those dates showing the amount held in the *APX broker's trust account on behalf of each client and the name of each client.

UNDERWRITER'S RETURNS.

- 3.10.1.** For the purpose of this **Rule**:

- (a) The expression “**determined liability**” means the total amount for which the *APX broker is liable under an underwriting or sub-underwriting agreement less the sum of the amounts, subject to **Rule 3.10.1(b)**, laid off by the *APX broker and less also the brokerage and underwriting commission retainable by the *APX broker in respect of the issue.
- (b) A determined liability must be calculated 10 *business days after the *APX broker incurred its liability under an underwriting or sub-underwriting agreement.
- (c) Amounts laid off to a company 50% or more of the equity capital of which is owned by the *APX broker, or a *director of the *APX broker, or their *immediate family must be included in the calculation of determined liability.
- (d) *Approved subordinated debt must not be included as a liability in the calculation of an *APX broker's *net tangible assets.

- 3.10.2.** The *APX broker must, within 2 *business days, notify the *examining accountant where a determined liability in addition to other determined liabilities of an *APX broker is in excess of one half of the *APX broker's net tangible assets as shown in its most recent balance sheet lodged with the *examining accountant.

- 3.10.3.** The *APX broker must supply the *examining accountant with such information relating to the underwriting or sub-underwriting agreement as the *examining accountant may require.

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- 3.10.4.** The *examining accountant must determine a reasonably realisable value for the *securities underwritten or sub-underwritten by an *APX broker and if the determined liability of the *APX broker, less that reasonably realisable value, is in excess of 25% of the *APX broker's net tangible assets disclosed in its most recent balance sheet lodged with the *examining accountant then the *examining accountant must report that fact to *APX.
- 3.10.5.** The *examining accountant must advise *APX if the excess referred to in **Rule 3.10.4** exists after 15 *business days after the date of the *examining accountant's report. If the *examining accountant considers it appropriate, he or she may advise *APX before the 15 day period expires.
- 3.10.6.** An *APX broker which is a party to an underwriting or sub-underwriting agreement must maintain a *register showing the following:
- (a) the number of *securities the subject of the underwriting and/or sub-underwriting agreement;
 - (b) the gross amount for which the *APX broker is liable under the underwriting and/or sub-underwriting agreement;
 - (c) the dates of commencement, termination and/or crystallisation of the underwriting or sub-underwriting agreement;
 - (d) the number of *securities and the gross amount of *securities which the *APX broker has disposed of between the date of commencement, termination and/or crystallisation of the underwriting or sub-underwriting agreement.

GENERAL.

- 3.11** An *APX broker must, by the dates specified by *APX, lodge with the *examining accountant such returns may be prescribed by *APX from time to time.

INFORMATION CONTAINED IN RETURNS.

An *APX broker must prepare all returns, schedules and calculations submitted to either *APX or the *examining accountant in accordance with these Rules. A director of the *APX broker must certify that the returns, schedules or calculations have been prepared in accordance with the Rules. The information contained in such returns, schedules and calculations must be extracted from the books and records of the *APX broker and accurately reflect the state of affairs of the *APX broker.

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