Capital Market Association Eastern Caribbean

Guidance Note: Capital Liquidity

References: Chapter 3 CMAEC Business Rules

## Introduction

This guidance note has been issued to assist Exchange brokers to comply with their capital liquidity obligations under the CMAEC Business Rules.

## Regulatory Objectives

The capital liquidity regime imposed on Exchange brokers under the CMAEC Business Rules is aimed at ensuring that Exchange brokers have adequate capital to meet their obligations and any associated risks associated with those obligations.

## Background

The Exchange's capital liquidity regime builds on the key financial and capital obligations of securities dealers under the laws so as to provide an appropriate operating environment for Exchange brokers and their clients.

Some Exchange brokers will not be members of any other stock exchange and are therefore likely to have existing capital adequacy and/or surplus liquid asset requirements included in their securities dealers license conditions.

The Exchange intends to make it as simple as possible for members of different regulatory regimes to exhibit compliance with the Exchange's capital liquidity regime.

## Primary Obligations of Exchange Brokers

Chapter 3 of the CMAEC Business Rules sets out the capital liquidity requirements of Exchange brokers. These provisions should be read closely with the financial obligation provisions contained in Chapter 2 of the CMAEC Business Rules.

The primary obligations of Exchange brokers under Chapter 3 are to:

- maintain at all times a surplus liquid capital (as defined in the CMAEC Business Rules) of $50,000 or 5% of adjusted liabilities, whichever is the greater;
- notify the Exchange if they breach this requirement; and

- comply with a reporting regime.

As noted above, while Exchange broker's are responsible for satisfying the requirements in Chapter 3, the capital liquidity regime has been designed, as far as possible, to build upon the existing Corporations Act regime.

## Surplus Liquid Capital

Under CMAEC Business Rule 3.2, a CMAEC broker's surplus liquid capital is

calculated as follows: A + B + C – D – E

Where:

A means the Exchange broker's current assets

B means assets of the Exchange broker that are capable of being realised within one month (and which the Exchange Accountant has approved for inclusion in the Exchange brokers surplus liquid capital calculation)

C means subordinated debt owed by the Exchange broker that the Exchange Accountant has approved for inclusion in the Exchange broker's surplus liquid capital calculation

D means the Exchange broker's total liabilities less any amounts approved by the Exchange Accountant for exclusion from the Exchange broker's surplus liquid capital calculation

E means assets of the Exchange broker that are prescribed as excluded assets by the Exchange.

Surplus liquid capital therefore includes current assets together with any other assets the Exchange approves for inclusion (under the heading of realisable within one month or approved subordinated debt). From this combined figure is then deducted the entire amount of an Exchange broker's liabilities and any excluded assets.

## Surplus Liquid Capital Calculation

As noted above, the Exchange surplus liquid capital calculation is made up of a number of elements. The Exchange's policy on how each of the elements should be calculated is set out below.

*Current Assets*

Current assets are taken from an Exchange broker's balance sheet and should illustrate liquid assets or non- cash assets that are capable of being realised into cash.

The Exchange expects Exchange brokers to exclude any current assets which do not have a ready market, any receivable the recovery of which is doubtful or not capable of being realised within 12 months, amounts owing from associates, assets lodged with FSA or assets encumbered to support a performance guarantee or bond, any assets to the extent they have been charged or pledged and intangible assets.

Securities should be valued at the lower of market or cost and should be valued net of realisation costs.

The Exchange specifically allows Exchange brokers to include assets other than current assets as part of a surplus liquid capital calculation provided the Exchange Accountant has approved such an inclusion. The Exchange Accountant will deal with specific requests for inclusions by Exchange brokers on a case by case basis.

*Subordinated Debt*

The Exchange Accountant will deal with requests by Exchange brokers to include subordinated debt in their surplus liquidity calculation on a case by case basis.

Approval for inclusion of subordinated debt will not be given unless the amount owed under the subordination agreement will not be paid until all other debts which the Exchange broker owes are repaid.

*Total Liabilities*

The Exchange surplus liquid capital calculation includes an Exchange broker's total liabilities, not just current liabilities. Exchange brokers should therefore include contingent liabilities.

*Excluded Assets*

Exchange brokers should take the same approach to excluded assets.The Exchange may, on a case by case basis, require the exclusion of assets.

*Adjusted Liabilities*

Exchange brokers are required under CMAEC Business Rule 3.1 to maintain a level of surplus liquid capital of not less than $50,000 or 5% of their adjusted liabilities, whichever is greater.

The Exchange regards adjusted liabilities as being an Exchange broker's total liabilities without reference to funds held or obligations associated with an Exchange broker's trust account(s).

*Exchange Broker Summary Return*

Under CMAEC Business Rule 3.5 an Exchange broker must prepare and keep available for inspection by the Exchange Accountant a summary return of their surplus liquid capital position.

This obligation is an ongoing requirement and Exchange brokers should use the summary return and the overall capital liquidity reporting regime as a method of internal control of their business.

The form and style of the summary return is best developed by each Exchange broker. The Exchange may, however, require an Exchange broker to modify the style and content of their summary return to more clearly meet the spirit and intent of Rule 3.5.

*Monthly Surplus Liquid Capital Return*

In addition to their summary return, Exchange brokers must, under CMAEC Business Rule 3.6, forward a completed return of surplus liquid asset calculations to the Exchange Accountant on a monthly basis.

Annexure 3A contains the form that should be used by Exchange brokers to meet their requirements under Rule 3.6.

*Monthly Aged Debtor return (Rule 3.7)*

Under CMAEC Business Rule 3.7 an Exchange broker must forward an aged debtors return to the Exchange Accountant on a monthly basis.

The Exchange will accept any well ordered return adopting current industry accounting conventions showing the aged position of an Exchange broker's debtors. The Exchange may require an Exchange broker to modify the style and content of their return if it is unclear to the Exchange how the reported level of debtors and their aging has been reconciled.

*Exemptions*

The Exchange has the power to grant an exemption from all or any of the Rules in Chapter 3. While the Exchange will consider requests for exemptions on a case by case basis, the Exchange does not envisage granting any broad exemptions from the capital liquidity rules.

## Scope of Guidance Note

This guidance note is intended to assist Exchange brokers to comply with their obligations under the CMAEC Business Rules. It is not exhaustive, does not in any way act as a substitute for any CMAEC Business Rules and is not binding on the Exchange in its application of the Rules in any particular case.

This guidance note also does not attempt to summarise the requirements Exchange brokers may be subject to under other capital liquidity regimes. Exchange brokers should satisfy themselves that they are complying with their obligations under any other relevant capital liquidity regimes in addition to their obligations under the CMAEC Business Rules.

This guidance note does not constitute legal advice by the Exchange. Where appropriate, Exchange brokers should obtain their own professional advice about compliance with their obligations under the CMAEC Business Rules.