



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 197

Holding scheme property and other assets

December 2012

About this paper

This consultation paper seeks feedback on our proposals to update our guidance for responsible entities of registered managed investment schemes on holding scheme property and other assets.

The proposals in this paper are also relevant for:

- licensed providers of custodial or depository services (licensed custody providers);
- operators of managed discretionary account (MDA) services who are responsible to clients for holding assets under an MDA service; and
- investor directed portfolio service (IDPS) operators who are responsible to clients for holding assets under an IDPS.

A draft updated version of Regulatory Guide 133 *Managed investments and custody: Holding scheme property and other assets* (RG 133) is attached to this paper.

Note: For the definitions of key terms in this consultation paper, see 'Key terms' in the attached draft updated RG 133.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This paper was issued on 20 December 2012 and is based on the Corporations Act as at the date of issue.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

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The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information. We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our policy on holding scheme property and other assets. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Regulation Impact Statement: see Section D, 'Regulatory and financial impact'.

Making a submission

We will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by 28 February 2013 to:

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What will happen next?

Stage 1	20 December 2012	ASIC consultation paper released
Stage 2	28 February 2013	Comments due on the consultation paper
Stage 3	June 2013 (expected)	Updated regulatory guide released
Stage 4	1 July 2014	Proposed requirements would apply

A Background to our proposals

Key points

We are reviewing what requirements and guidance should apply to:

- responsible entities of registered managed investment schemes in holding scheme property and other assets;
- licensed providers of custodial or depository services (licensed custody providers);
- operators of managed discretionary account (MDA) services who are responsible to clients for holding assets under an MDA service; and
- investor directed portfolio service (IDPS) operators who are responsible to clients for holding assets under an IDPS.

We propose to clarify and significantly strengthen the standards that asset holders must meet as important gatekeepers in the financial services industry.

We have also identified additional matters that we propose responsible entities of registered schemes should consider when they or a related party hold scheme property and other assets.

Our proposals include guidance on how Australian financial service (AFS) licensees can demonstrate compliance with their obligations.

Based on feedback to this paper, we propose to update Regulatory Guide 133 *Managed investments: Scheme property arrangements* (RG 133) so that it reflects current law and practice. A draft updated version of RG 133 is attached.

Reviewing our guidance

- 1 The substantive changes proposed to our existing regulatory guidance have arisen from a number of related matters including:
 - (a) the findings set out in Report 291 *Custodial and depository services in Australia* (REP 291);
 - (b) our recent surveillance work of existing major custodial providers;
 - (c) our recognition of the role of responsible entities, licensed custody providers, MDA operators and IDPS operators as important gatekeepers in the financial services industry; and
 - (d) the recommendations of the Parliamentary Joint Committee on Corporations and Financial Services (PJC) *Inquiry into the collapse of Trio Capital* (Trio Report) on use of the term ‘custodian’ and that ASIC should consider the safeguards that a custodian could put in place to ensure it can identify and report suspicious transfers that do not trigger the anti-money laundering provisions.
- 2 In its report, the PJC stated that it strongly supports ASIC’s program to review custodian businesses and identify those issues requiring regulatory reform.

Proposed changes to our guidance

Holding client assets

3 We propose to modify the *Corporations Act 2001* (Corporations Act) by class order so that asset holders must meet certain minimum standards from 1 July 2014. We consider that this would be an appropriate transitional period.

4 The minimum standards are intended to provide more assurance that arrangements for holding scheme property and other assets of registered schemes, MDA services and IDPS services and financial products or beneficial interests in financial products that are held in the provision of custodial or depository services contribute to promoting confident and informed retail investors and consumers.

AFS licence obligations

5 Our proposals for minimum standards cover and extend the requirements currently applying to Australian financial services (AFS) licensees as set out in Pro Forma 209 *Australian financial services licence conditions* (PF 209), Conditions 34 and 35. They also cover Conditions 44, 45 and 46 that are imposed on all AFS licensees who are authorised to operate registered schemes involving primary production as a responsible entity: see paragraphs 18–20.

6 This means that, following the transitional period, the modified provisions would apply, replacing the current AFS licence conditions.

7 We would give guidance on measures that AFS licensees can put in place to demonstrate compliance with their obligations, including on issues that we have not previously addressed. This includes obligations relating to:

- (a) engaging another asset holder;
- (b) conducting client checks; and
- (c) ensuring that any agreement with a third party asset holder meets certain requirements.

Custodial and depository services

8 The definition of ‘custodial and depository services’ in s766E of the Corporations Act relates to holding financial products or beneficial interests in financial products. In addition to the safe keeping of these assets, it covers activities inherent in holding the assets or necessarily incidental to it.

9 Our proposals would apply to all licensed custody providers, regardless of whether the services are provided as a main business of the provider or merely incidentally. For the proposed minimum standards, the nature and scale of the services provided may affect what is required to meet these standards.

- 10 For the purposes of our proposals, we consider that the following services form part of the custodial or depository service:
- (a) *Corporate actions and proxy voting*: This involves processing the rights and obligations associated with securities in safekeeping. Corporate actions typically relate to the reorganisation or restructure of the capital of a listed company or registered scheme. Common corporate actions events include dividend re-investment plans, offers made on the basis of holding the assets such as certain placements, and right issues.
 - (b) *Income and distributions*: This involves paying distributions and redemptions on behalf of the client.
 - (c) *Tax reclamations*: This involves reclaiming recoverable portions of taxes withheld from interest or dividend payments by foreign taxation authorities.
 - (d) *Trade settlement*: This involves settling trades through the change in title and the delivery of property or cash.
 - (e) *Reconciliations*: This involves reconciling the custodian's own records against the records of various third parties, such as fund managers, banks, other custodians or depositories.
 - (f) *Record keeping and reporting*: This involves maintaining statements of holdings, completed transaction reports, outstanding items and valuations.

The list is not exhaustive. Other services may be provided from time to time that may be considered a core custody function.

- 11 Other services that may be provided by a licensed custody provider include:
- (a) fund accounting;
 - (b) unit pricing and determining asset values and net asset value;
 - (c) compliance monitoring and reporting; and
 - (d) performance measurement and monitoring.

Reporting suspicious matters

- 12 In the Trio Report, the PJC urged ASIC to consider the safeguards that a custodian could put in place to ensure it can identify and report suspicious transfers that do not trigger the anti-money laundering provisions.
- 13 Providers of 'designated services' have reporting obligations under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act) and, specifically, the obligation to lodge suspicious matter reports with AUSTRAC. Such designated service providers may include, relevantly, responsible entities, licensed custody providers, MDA operators and IDPS operators.

- 14 Suspicious matter reporting extends to information that may be relevant to the investigation or prosecution of an offence against a law of the Commonwealth or state or territory.
- 15 We consider that it may be appropriate that a wider whistleblowing culture and framework be established in the financial services industry, not limited to the ‘suspicious transfers’ referred to in the Trio Report.
- 16 We propose to require by class order that a responsible entity, licensed custody provider, MDA operator or IDPS operator must ensure that an agreement with any asset holder they engage in connection with the scheme obliges the asset holder to have adequate arrangements to report to ASIC within 10 business days if it suspects that the client may be in breach of s601FC(1)(l) (for responsible entities only) or s912D of the Corporations Act. This requirement would not apply to a sub-custodian engaged by the asset holder.

Relief from the obligation to separate assets

- 17 We propose to continue, with some amendments, our relief under Class Order [CO 98/51] *Relief from duty to separate assets of a managed investment scheme*, which permits the conditional use of omnibus accounts.

Note As part of a different consultation process, we will consider whether to renew or withdraw Class Order [CO 03/1110] *Prime brokerage services: Relief from obligation to hold scheme property on trust*, Class Order [CO 03/1111] *Prime brokerage services: Relief from obligation to hold scheme property separately* and Class Order [CO 03/1112] *Relief from obligation to hold client money on trust*.

Land used in primary production schemes

- 18 We also propose to make some changes to requirements for primary production schemes that include rights for use of land.
- 19 We propose that registered interests in the land on which the production activity is to occur must be held by members, on trust for members or by a person controlled by members. Where the interest is in the lease, we propose some additional requirements to reduce the risk that the lease will not continue for the duration of the scheme.
- 20 The proposed requirements would apply by modification to the Corporations Act under class order. These requirements would help ensure that the rights of members to use the relevant land have some protection through an appropriate registered interest and that the way in which the registered interest is held ensures that it cannot be adversely affected by certain other interests.

Issues for consideration

Use of the term 'custodian'

- 21 There has been discussion of an 'expectation gap' between what retail investors understand of the role of custodian and what a custodian is legally required to do. The Trio Report identified this as an issue.
- 22 In addition, the PJC considered that the word 'custodian' particularly as used in Product Disclosure Statements (PDSs) is inappropriate and recommended that ASIC find another term which does not give unwarranted reassurance to investors.
- 23 Our objective is to reduce the expectation gap by exploring whether different terminology should be used in communications with retail clients about the role of custodian.

Special custody assets

- 24 In this paper, we invite feedback on whether we should allow an extended classes of assets to be held by responsible entities on certain conditions, even if they do not hold the specified level of net tangible assets (NTA) usually required under Regulatory Guide 166 *Licensing: Financial requirements* (RG 166), or as proposed in Consultation Paper 194 *Financial requirements for custodial or depository services providers* (CP 194) for the holding of scheme property or other assets.

Other provisions

- 25 In other respects, we consider that the requirements in existing RG 133 would generally continue with clarification and updates.
- 26 This paper highlights those areas of proposed substantial change that we think are likely to be the subject of most comment. However, we welcome submissions on any aspect of the attached draft updated RG 133.

B Proposed changes to our guidance

Key points

We consider that custody standards for holding scheme property and other assets should be more clearly articulated to better help promote investor confidence.

Proposed changes to our requirements and guidance cover:

- requirements for asset holders to hold assets on trust and separately, and meet minimum standards (see proposal B1);
- engaging another asset holder and conducting client checks (see proposal B2);
- agreements with third party asset holders (see proposal B3);
- reporting suspicious matters (see proposal B4);
- relief from the obligation to separate assets (see proposal B5); and
- requirements for primary production schemes that include rights for use of land (see proposal B6).

Holding client assets

Proposal

- B1** We propose to modify the Corporations Act by class order so that from 1 July 2014, asset holders would be required to:
- (a) hold the relevant assets on trust for their client and separately from their own assets, or the assets of any other scheme or any other person, subject to the permitted use of omnibus accounts (see proposal B5); and
 - (b) meet minimum standards for:
 - (i) organisational structure;
 - (ii) staff capabilities;
 - (iii) capacity and resources; and
 - (iv) checks on clients.

We would give guidance on how AFS licensees can demonstrate compliance with their obligations, including processes for engaging another asset holder and conducting client checks (see proposal B2) and agreements with third party asset holders (see proposal B3).

See Sections C–F of draft updated RG 133.

Your feedback

- B1Q1 Do you agree with our proposed modification, including the minimum standards and how they would apply? If not, why not?
- B1Q2 Are the proposed topics for minimum standards appropriate? If not, why not?
- B1Q3 Are there any additional topics that should be included?
- B1Q4 Are there any arrangements other than holding on trust that would protect against insolvency of the asset holder? If so, what are they and when would they be appropriate?
- B1Q5 To what extent if any should the standards apply differently to MDA operators and IDPS operators? Please explain.
- B1Q6 Is the proposed transitional period until 1 July 2014 appropriate? Should a different transitional period apply?
- B1Q7 What costs would arise from this proposal? Please quantify these costs.

Rationale

- 27 Where a responsible entity holds scheme property, that property is held on trust: s601FC(2). Subject to any relief that applies, a responsible entity must hold scheme property in a way which ensures that those assets are:
- (a) clearly identified as scheme property (s601FC(1)(i)(i)); and
 - (b) held separately from the property of the responsible entity and from the property of any other scheme (s601FC(1)(i)(ii)).
- 28 The object of these provisions is to ensure that scheme property is kept safe and used only for the authorised purposes. Our proposed modification builds on these provisions for registered schemes to ensure that arrangements for holding assets that are held by persons as asset holders generally are effective to address the risk of insolvency.

Engaging another asset holder and client checks**Proposal**

- B2** We propose to state the following expectations, which we consider are part of the obligations for AFS licensees who engage another asset holder:
- (a) *Documented processes*: Responsible entities, licensed custody providers, MDA operators and IDPS operators should follow and document an appropriate process in selecting an appropriate asset holder or master custodian. We expect this process to address among other factors, compliance with the minimum standards, competency, the adequacy of financial, human and IT resources, and risk management systems of the asset holder. If the appointed person is to act as a master custodian, consideration should be given to how it will ensure that any asset holder it engages will address those matters.

- (b) *Pre-contract and ongoing inquiries:* Licensed custody providers should diligently consider what pre-contract inquiries and ongoing inquiries in relation to their clients are necessary at reasonable intervals to provide reasonable assurance that the asset holder's activities will not be facilitating unlawful activities, including considering the matters at paragraph 31 if appropriate. We consider that these inquiries are part of an adequate risk management system that AFS licensees, other than certain bodies regulated by the Australian Prudential Regulation Authority (APRA), are required to have in place under s912A(1)(h).

Your feedback

- B2Q1 Do you agree with this proposal? Please explain your response.
- B2Q2 Are there any inquiries listed in paragraph 31 that a licensed custody provider would not normally do in the ordinary course of business?
- B2Q3 To what extent would some of the proposed requirements be already included in your existing framework under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act)?
- B2Q4 Is the proposed transitional period until 1 July 2014 appropriate for this proposal? Should a different transitional period apply?
- B2Q5 What costs would arise from these proposals? Please quantify these costs.

Rationale

- 29 Responsible entities, licensed custody providers, MDA operators and IDPS operators have obligations under the AML/CTF Act to conduct certain 'know your client' risk-based due diligence inquiries, to the extent that they are 'designated service providers' under this Act.
- 30 In addition, we believe it is appropriate for asset holders to conduct pre-contract inquiries and ongoing enquiries at reasonable intervals in relation to their clients which should provide reasonable assurance that the asset holder can meet its obligations and will not be facilitating unlawful activities.
- 31 It would generally be appropriate to include the following initial inquiries to understand the client and the asset holder's ability to perform its obligations:
- (a) credit assessments;
 - (b) review of the scope of business and breadth of the operation for which custody is provided, including what financial products or beneficial interests in financial products or other assets the client seeks to be held;
 - (c) review of corporate records, licence and other regulatory documents, including disclosure documents, that may be relevant;

- (d) review of quality of data and information;
- (e) review of the systems interfaces;
- (f) identification and valuation of assets (and reconciliation on transition from a retiring custodian);
- (g) understanding the process of providing instructions to the asset holder, including from a third party fund manager or investment administrator, and the extent to which risks associated with preparing, approving and sending instructions to the asset holder will be managed;
- (h) an assessment of whether the asset holder is able to carry out the mandate of the client (e.g. can the asset hold the type of assets involved and provide the reporting required by the client for these assets?).

32 Ongoing inquiries may include repeating these initial inquiries at intervals appropriate for the client (i.e. more frequently for clients that may be categorised as ‘high risk’ and less frequently for clients that may be categorised as ‘low risk’), regular meetings of senior or key relationship staff and additional inquiries that might be raised. Further risk and operational assessment of client arrangements should be considered following adverse change to the client’s business, such as loss of key senior personnel, significant drop of revenue or other significant negative events.

Agreement with third party asset holder

Proposal

- B3** We propose to modify the existing requirements for agreements between a responsible entity, IDPS operator, MDA operator or a master custodian on the one hand and the master custodian or asset holder on the other hand as follows:
- (a) Under the terms of the client agreement, the asset holder and any master custodian (as applicable) must indemnify the client against any loss or damage that arise from a failure to comply with the client agreement or to meet prevailing standards of good practice for holding assets in the places for which the assets are held.
 - (b) If it is not possible for a responsible entity, IDPS operator or MDA operator who is responsible to clients for holding assets or a master custodian to obtain an indemnity on reasonable commercial terms for particular assets located outside Australia, as an AFS licensee it must:
 - (i) take all reasonable steps to negotiate the most favourable liability provisions for the client; and
 - (ii) consider what additional protections it should reasonably have in place to manage the associated risks (e.g. requiring more frequent checks).

We also consider that the indemnity in proposal B3(a) should be required under an agreement between a licensed custody provider and retail client for the provision of a custodial or depository service.

Your feedback

- B3Q1 Do you agree with our proposal for agreements between a responsible entity, IDPS operator, MDA operator or a master custodian on the one hand and the master custodian or asset holder on the other hand, including for assets located outside Australia? Please state your reasons.
- B3Q2 Do you agree that the indemnity in proposal B3(a) should be required under an agreement between a licensed custody provider and retail client? If not, why not?
- B3Q3 Is the proposed transitional period until 1 July 2014 appropriate? Should a different transitional period apply?
- B3Q4 What costs would arise from this proposal? Please quantify these costs.

Rationale

- 33 The agreement between the client and the asset holder or master custodian is important in establishing the rights and obligations of the parties on a number of important matters. We consider it is appropriate for the client to be adequately protected by the asset holder or master custodian from the consequence of their default, or for a master custodian from the default of the asset holder where possible, in order to ensure the master custodian can provide the required indemnity to the client.
- 34 Our proposal is consistent with a similar obligation imposed by APRA on Registrable Superannuation Entities (RSE) licensees in APRA Prudential Standard SPS 231 *Outsourcing*, issued in November 2012.
- 35 For registered schemes, property that is recoverable from an indemnity for loss or damage would form part of the scheme property under s601FB(4).
- 36 We also consider that retail clients should have similar protection against default in agreements with licensed custody providers.

Reporting suspicious matters**Proposal**

- B4** We propose to modify the Corporations Act by class order to require responsible entities, licensed custody providers, MDA operators and IDPS operators to ensure that the agreement with any custodian they engage in connection with holding client assets obliges the asset holder to have adequate arrangements to ensure that it will report to ASIC within 10 business days if it suspects that the client may be in breach of s912D or, where relevant, s601FC(1)(l).

Your feedback

- B4Q1 What benefits would this proposal have? Could it potentially deter some illegal behaviour in the market? Please explain.
- B4Q2 Are there any barriers to establishing and maintaining a transparent whistleblowing framework and policy, to the extent that this is not already maintained under your AML/CTF policy? Will the proposal bridge some of these barriers?
- B4Q3 Given custodians' obligations under the AML/CTF Act for clients of their designated services, what impact, if any, will the proposal have on their day-to-day interaction with clients?
- B4Q4 In what circumstances could you envisage reporting your concerns about suspicious behaviour to ASIC?
- B4Q5 Would the proposed framework represent a cultural shift for your organisation?
- B4Q6 Would it be appropriate for this obligation to be extended to sub-custodians where assets are located in Australia?
- B4Q7 Is the proposed transitional period until 1 July 2014 appropriate? Should a different transitional period apply?
- B4Q8 What costs would arise from this proposal? Please quantify these costs.

Rationale

- 37 Providers of designated services, including responsible entities, licensed custody providers, MDA operators and IDPS operators have reporting obligations under the AML/CTF Act and, specifically, the obligation to lodge suspicious matter reports with AUSTRAC.
- 38 We consider that there may be circumstances where suspicious activity in financial services may not be required to be reported under the AML/CTF Act. This may be the case, for example, if the suspicious activity relates to services that are not designated services, or the reporting entity does not consider, even though it is concerned about the activity, that its suspicion meets the requirements to report to AUSTRAC.
- 39 Where the AML/CTF Act may not apply, we consider that it is good practice for providers of custodial and depository services to foster a whistleblowing culture and framework, where misconduct, or suspected misconduct, of clients is reportable to ASIC under their risk management arrangements.
- 40 The proposed requirement is intended to facilitate and promote an open dialogue with ASIC about matters that may be of concern and that may not otherwise be brought to our attention. We consider that our proposal will bridge any barriers to an open dialogue with ASIC, as identified in our surveillance of the custodial industry, notwithstanding the AML/CTF Act and 'whistleblower protection' in the Corporations Act.

- 41 In relation to asset holders, we think that there may be instances where client assets are at risk if there is not a transparent whistleblowing framework and culture for financial industry participants.

Relief from the obligation to separate assets

Proposal

B5 We propose to continue to give relief as currently provided under Class Order [CO 98/51] *Relief from duty to separate assets of a managed investment scheme*, with some amendments, to allow the use of omnibus accounts for certain assets, subject to conditions: see Table 1.

Under our proposal, this conditional relief would apply more generally to allow use of omnibus accounts for:

- (a) assets of registered schemes, IDPS services and MDA services; and

Note: Under proposal B1, assets of registered schemes, client assets of IDPSs and client portfolio assets of MDAs must be held separately from the assets of any other scheme or any other person.

- (b) financial products and beneficial interests in financial products held in the provision of a custodial or depository service by an AFS licensee where the client has consented in writing.

Table 1: Use of omnibus accounts

Type of asset	Proposed conditions
<p>Our proposed relief for omnibus accounts would apply to the following types of assets:</p> <ul style="list-style-type: none"> • cash (including foreign exchange); • accounts and deposits with a bank or financial institution; • securities (as defined in s92(1)); or • derivatives (other than a chattel or real property mortgage). 	<ol style="list-style-type: none"> 1. The property of the scheme is held separately from the assets of the responsible entity, IDPS operator or MDA operator and the asset holder. 2. The responsible entity, IDPS operator or MDA operator ensures that the asset holder: <ul style="list-style-type: none"> • maintains adequate records at all times showing the entitlement of clients in the account; • performs regular reconciliation procedures appropriate to the nature of the assets held; • is able to perform the administrative functions required in connection with holding such assets (including processing voting and corporate actions); and • ensures that the account is always sufficient to meet the entitlement the client and any other person has in relation to that account. 3. The responsible entity, IDPS operator or MDA operator must be of the opinion that use of such an account does not expose its clients to unreasonable risk and is in the best interests of its clients in the circumstances. 4. This opinion must be certified annually by the responsible entity, IDPS operator or MDA operator with the reasons set out and the certification kept for five years after it has ceased to be the current document that enables use of the omnibus account.

Type of asset	Proposed conditions
	<p>5. For the provision of a custodial or depository service that does not relate to an IDPS or MDA service, we also expect the licensed custody provider to comply with condition 1 and to ensure that it:</p> <ul style="list-style-type: none"> • maintains adequate records at all times showing the entitlement of clients in the account; • performs regular reconciliation procedures appropriate to the nature of the assets held; • is able to perform the administrative functions required in connection with holding such assets (including processing voting and corporate actions); and • ensures that the account is always sufficient to meet the entitlement the client and any other person has in relation to that account.

Your feedback

- B5Q1 Do you agree with our proposal to continue our relief for the use of omnibus accounts under [CO 98/51], including extending this relief to the particular assets in proposal B5(a) and financial products in proposal B5(b)? If not, why not?
- B5Q2 Are the proposed conditions for use of omnibus accounts appropriate? If not, why not?
- B5Q3 Should the conditions apply to all the types of assets listed in Table 1? If not, why not?
- B5Q4 The current list of assets under [CO 98/51] is quite broad. Is it common practice for responsible entities to rely on the relief in [CO 98/51]? Should any other type of asset be added or removed in the revised class order?
- B5Q5 Do responsible entities rely on eligible SELECT master agreements for the purposes of this relief? If so, should this continue and why?
- B5Q6 What are the material operational and other risks to client assets arising from the use of omnibus accounts?
- B5Q7 What are the costs and benefits of using individual accounts?
- B5Q8 Since the current relief under [CO 98/51] was provided, what effect have industry and technological developments had on the costs and benefits of using individual accounts relative to omnibus accounts?
- B5Q9 Should we require a particular level of frequency of reconciliations (e.g. daily) and that unreconciled variances be reported to the client if they may reflect a broader problem with systems or are of significant magnitude? If not, why not?
- B5Q10 Is the proposed transitional period until 1 July 2014 appropriate? Should a different transitional period apply?
- B5Q11 What costs would arise from this proposal? Please quantify these costs.

Rationale

- 42 Subject to any relief that applies, a responsible entity must hold scheme property in a way which ensures that those assets are:
- (a) clearly identified as scheme property (s601FC(1)(i)(i)); and
 - (b) held separately from the property of the responsible entity and from the property of any other scheme (s601FC(1)(i)(ii)).
- 43 It may not always be possible to hold scheme property in a way that is identifiable, other than through the records of the responsible entity and persons acting on its behalf, as property of the relevant registered scheme and no other person. For example, the responsible entity may need to have, perhaps through custodians, accounts at central securities depositories that cover multiple underlying beneficial interests.
- 44 We consider it is appropriate for assets to be identified so that:
- (a) for registered schemes, the responsible entity can confirm how each asset or type of asset comprising the scheme property is held; and
 - (b) in the event of insolvency of the asset holder (including where engaged by a master custodian), the client can identify and reclaim any scheme property held by that asset holder.
- 45 Under our proposal, we would continue to allow the use of omnibus accounts for certain assets, subject to conditions. It is industry practice in Australia and many overseas jurisdictions for asset holders to operate omnibus accounts for certain types of assets.
- 46 Our proposed modification by class order under proposal B1 builds on the requirement for registered schemes to ensure that arrangements for holding assets as asset holder generally are effective to address the risk of insolvency. We consider that the same considerations that may in some circumstances make it appropriate for responsible entities to use omnibus accounts may also apply in the broader context of assets holders, where the client is a wholesale client, or an AFS licensee is arranging for the provision of a custodial or depository service to the client and takes responsibility to ensure that the client's assets are protected.
- 47 For registered schemes, the responsible entity retains responsibility for the decision to use such accounts and ensuring that the asset holder performs regular reconciliations.
- 48 In forming an opinion on whether use of an omnibus account is in the best interests of clients, the likely cost savings are relevant. Other considerations include the extent of any risks arising from settlement failures or other circumstances that might result in the value of client assets being diminished because of circumstances relating to other property.

- 49 Where custodial or depository services involving the use of an omnibus account are provided to retail clients, the licensed custody provider, MDA operator or IDPS operator should consider the appropriateness of the arrangements. Retail clients may not fully appreciate the risks involved in the use of omnibus accounts if regulated disclosure requirements for managed investment schemes do not apply. We therefore consider that licensed custody providers should be responsible for considering these risks, making appropriate disclosure, obtaining written consent from clients and ensuring that clients are not disadvantaged.

Land used in primary production schemes

Proposal

- B6** We propose to modify the Corporations Act by class order so that certain additional requirements would apply to responsible entities for interests in registered schemes involving primary production that include rights for use of land and that are offered after 31 December 2013. Under our proposed modifications:
- (a) the responsible entity must ensure that registered interests in the land are held by members, on trust for members, or by an entity that is controlled by members for the duration of the scheme; and
 - (b) where the registered interest is a lease:
 - (i) the constitution of the registered scheme must give the responsible entity the power to require members to make payments to ensure the obligations under the terms of any lease;
 - (ii) the responsible entity must retain any amounts paid by members in relation to the lease as scheme property until the money is used to meet lease payments; and
 - (iii) the terms of the lease must not be less favourable to the scheme than those that would apply on an arm's length basis and must exclude any action by the lessor or a head lessor in connection with the lease that would adversely affect the interests of members, other than where members or the responsible entity for the scheme are in default of their obligations under the lease and the head lessor has a right to take action because the breach has not been remedied within a reasonable time.

Your feedback

- B6Q1 Do you agree with our proposal? If not, why not?
- B6Q2 What are the barriers to and costs associated with holding property on trust?
- B6Q3 Are there any other changes that may be appropriate for how assets of primary production schemes that include rights for use of land should be held?

- B6Q4 Should leases that are relied on for meeting the requirements in proposal B6(b) contain further particular provisions to address the risk to members from failure to meet the terms of the lease? For example, should we require that the amount of rent for the expected duration of the scheme that has not been paid be held on trust for members to avoid the risk of rental defaults due to failure of the responsible entity or default by other members in making contributions (i.e. where the duration of the scheme means this is commercially practicable)? Please give reasons.
- B6Q5 Is the proposed transitional period until 1 July 2014 appropriate? Should a different transitional period apply?
- B6Q6 What costs would arise from this proposal? Please quantify these costs.

Rationale

- 50 Under the proposed modifications, responsible entities will not be allowed to rely on interests in land they hold beneficially (unless the responsible entity is controlled by members).
- 51 The purpose of this proposal is to reduce the risk of a scheme's ability to operate being affected by the rights of other parties outside the scheme. This risk is not one that retail investors would ordinarily see as part of the risks they assume in investing in a primary production scheme. However, this protection is not complete, in that the interest held may be a lease, and failure to meet obligations under a lease may result in the lease being terminated.
- 52 In the case of primary production schemes, we have given guidance that this risk is an important matter for disclosure in any PDS for the scheme: see *Regulatory Guide 232 Agribusiness managed investment schemes: Improving disclosure for retail investors* (RG 232).

C Issues for consideration

Key points

We consider that there may be a more appropriate way to label and describe the custodial function in disclosure documents for retail clients, including PDSs, and seek your feedback on this issue.

We also invite your feedback on extending the list of 'special custody assets' in RG 166 to include additional types of assets, such as certain derivatives.

Use of the term 'custodian'

Issue

c1 We consider that product issuers and licensed custody providers should clearly describe the role of an asset holder in any PDSs, Financial Services Guide (FSGs) and other material available to retail clients to:

- (a) ensure that clients are unlikely to be misled; and
- (b) minimise the possibility of giving retail clients unwarranted reassurance because of the custodian's appointment.

Your feedback

C1Q1 Do you agree with our view? Please explain your response.

C1Q2 Should we give guidance to encourage or require the use of alternative terms such as 'asset holder' or 'depository' where appropriate?

C1Q3 Does our view reflect industry practice? If not, why not.

C1Q4 What costs would be involved in disclosing this information? Please quantify these costs.

Rationale

- 53 There has been discussion of an 'expectation gap' between what retail investors understand to be the role of a custodian and what custodians do or are legally required to do.
- 54 The PJC considered that the word 'custodian', particularly as used in PDSs, is inappropriate and urged ASIC to find another term which does not give unwarranted reassurance to investors.
- 55 We think that it is appropriate to consult with industry when considering any change of term. However, we think it is important that communications to retail clients explain the role of an asset holder when any reference is made to such a custodian.

Special custody assets

Issue

c2 We are considering whether to extend the list of 'special custody assets' that a responsible entity may hold without meeting the relevant net tangible assets (NTA) requirement in Regulatory Guide 166 *Licensing: Financial requirements* (RG 166). Options include the following:

- (a) *Option 1*: Not extending the definition of special custody assets or tier \$500,000 assets to include any additional types of assets.

Note: For the definition of 'special custody assets' and 'tier \$500,000 assets', see RG 166.

- (b) *Option 2*: Extending the list of special custody assets to include the assets listed in Table 2 on the conditions described (or on other appropriate conditions).

Table 2: Possible additions to 'special custody assets' under Option 2

Type of asset	Conditions that would apply
1. Derivatives under which the holder may be liable for future payments and margin accounts relating to those derivatives	<p>This would apply only if:</p> <ul style="list-style-type: none"> the responsible entity has directed in writing to the counterparty—or in case of traded derivatives, the market participant acting for the responsible entity (or its agent)—that any payments are to be made only to meet obligations to the counterparty or participant, or to a person who meets the relevant NTA requirement or is an eligible custodian (complying custodian) or as the complying custodian directs; and the complying custodian has copies of the written direction and has substantially immediate access at all relevant times to information about transactions in the derivatives or on the margin account.
2. Securities or interests in a managed investment scheme where the securities or interests or any associated contractual arrangements may give rise to a liability for the holder and it is not reasonably practicable to negotiate to make reasonably appropriate provision for a holding by a person other than the responsible entity	<p>This would apply only if:</p> <ul style="list-style-type: none"> the responsible entity has directed in writing that any payments are to be made to meet obligations to a party to the contractual arrangement and notified to a complying custodian, or paid to a complying custodian or as the complying custodian directs; and copies of the written direction and certificates or other title documents are held by the complying custodian.

Type of asset	Conditions that would apply
3. Deposit-taking facilities with an Australian authorised deposit-taking institution (ADI) or a bank outside Australia regulated under Basel guidelines, and money payable under the facility	<p>This would apply only if we are satisfied that the holding of these assets by a custodian is unreasonable or impracticable in a particular set of circumstances. The circumstances may include:</p> <ul style="list-style-type: none"> • whether the ADI is the custodian; • who are the signatories to the account; • the timing issues and operational demands posed by custodial involvement; • whether, under arrangements with the ADI, any payments can only be made to payees approved by a complying custodian; and • whether the complying custodian has substantially immediate access at substantially all times to information about transactions using the facility.

Your feedback

- C2Q1 Which option do you consider to be the most appropriate for each of the assets listed in Table 2 and why?
- C2Q2 Do you think it is appropriate for the types of assets listed under Option 2 to be held by a responsible entity who does not meet the relevant NTA requirement? Please explain.
- C2Q3 What risks might arise if a responsible entity who does not meet the NTA requirement holds these types of assets? Do you think the proposed conditions deal adequately with these risks for each type of asset? If not, why not?
- C2Q4 In what circumstances would it be impracticable to negotiate appropriate provisions for a custodian to hold:
- (a) derivatives which may carry a liability for the holder?
 - (b) securities or interests in a managed investment scheme under a private equity arrangement which may carry a liability for the holder?
 - (c) deposit-taking facilities with an ADI or foreign equivalent?
- C2Q5 In what circumstances would it be impracticable or unreasonable for a custodian to hold or arrange for another asset holder to act on its behalf in holding a deposit-taking facility that is scheme property?
- C2Q6 We understand that some custody clients, including responsible entities, have arranged for a custodian to hold each of the assets listed under Option 2. What measures have been taken by the responsible entity and custodian in these cases for each type of asset to address risks?
- C2Q7 Should we make any other changes to the assets which are treated as special custody assets or tier \$500,000 assets? If so, what assets and in what circumstances?

Rationale

- 56 To hold scheme property, a responsible entity must generally have \$5 million NTA: see RG 166 and [CO 11/1140] *Financial requirements for responsible entities*. This requirement is under review: see Consultation Paper 194 *Financial requirements for custodial or depository services providers* (CP 194).
- 57 Where the responsible entity does not meet the relevant NTA requirement, it must ensure that all of the scheme property and other assets of registered schemes, other than ‘special custody assets’ or ‘tier \$500,000 assets’, are held by a person that meets the relevant NTA requirement. A similar requirement applies to IDPS operators.
- 58 Based on our industry liaison, it is apparent that, notwithstanding the current requirement, it may be common industry practice for a responsible entity to hold certain types of assets that are not special custody assets, even if the responsible entity does not have the required NTA: see REP 291. This raises the question of whether a responsible entity should be allowed to hold certain additional types of assets in this situation.
- 59 We are interested in industry’s view on whether certain assets could be added to the definition of ‘special custody assets’ in RG 166 without compromising the policy intention of the requirements in that guide. The policy intention is that:
- (a) AFS licensees have sufficient financial resources to conduct their financial services business in compliance with the Corporations Act (including carrying out supervisory arrangements);
 - (b) AFS licensees have a financial buffer that decreases the risk of a disorderly or non-compliant winding-up if the business fails; and
 - (c) there are incentives for business owners to comply through risk of financial loss.
- 60 An element of the rationale for treating certain assets as special custody assets is that the commercial benefits of allowing them to be held by the responsible entity (or other person) without the relevant NTA may be significant. In particular, this may be the case where, given the volume and nature of the transactions in the relevant assets, there is less need to apply more sophisticated asset holding systems, which would be likely to require additional resources.
- 61 However, this is not in itself sufficient as arrangements must also not result in inappropriate risk. For special custody assets, the associated risks are reduced because:
- (a) in the case of potential fraud, the assets cannot readily be transferred or encumbered at close to their market value and so transactions would be likely to attract scrutiny; and/or

- (b) the risks to ensuring appropriate record keeping from the absence of separate involvement by a complying custodian in making transactions can be adequately addressed through custody standards with, in some cases, particular safeguards that are relevant to the type of asset.

62 We should note that, at this stage, we are not satisfied that the proposed conditions under Option 2 are sufficient to address the policy considerations in paragraph 59.

Interim approach

63 We do not intend to take any enforcement action on non-compliance that reflects current industry practice as identified in REP 291 until we consider the responses to this paper.

D Regulatory and financial impact

64 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us, we think they will strike an appropriate balance between:

- (a) the need to promote confident and informed investors in managed investment schemes and consumers of licensed custody providers' services; and
- (b) the need to ensure that requirements for holding client assets are not unreasonably burdensome or impractical.

65 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:

- (a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;
- (b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and
- (c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).

66 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.

67 To ensure that we are in a position to properly complete any required RIS, please give us as much information as you can about our proposals or any alternative approaches, including:

- (a) the likely compliance costs;
- (b) the likely effect on competition; and
- (c) other impacts, costs and benefits.

See 'The consultation process', p. 4.

List of proposals and questions

Proposal/issue	Your feedback
<p>B1 We propose to modify the Corporations Act by class order so that from 1 July 2014, asset holders would be required to:</p> <ul style="list-style-type: none"> (a) hold the relevant assets on trust for their client and separately from their own assets, or the assets of any other scheme or any other person, subject to the permitted use of omnibus accounts (see proposal B5); and (b) meet minimum standards for: <ul style="list-style-type: none"> (i) organisational structure; (ii) staff capabilities; (iii) capacity and resources; and (iv) checks on clients. <p>We would give guidance on how AFS licensees can demonstrate compliance with their obligations, including processes for engaging another asset holder and conducting client checks (see proposal B2) and agreements with third party asset holders (see proposal B3).</p> <p>See Sections C–F of draft updated RG 133.</p>	<p>B1Q1 Do you agree with our proposed modification, including the minimum standards and how they would apply? If not, why not?</p> <p>B1Q2 Are the proposed topics for minimum standards appropriate? If not, why not?</p> <p>B1Q3 Are there any additional topics that should be included?</p> <p>B1Q4 Are there any arrangements other than holding on trust that would protect against insolvency of the asset holder? If so, what are they and when would they be appropriate?</p> <p>B1Q5 To what extent if any should the standards apply differently to MDA operators and IDPS operators? Please explain.</p> <p>B1Q6 Is the proposed transitional period until 1 July 2014 appropriate? Should a different transitional period apply?</p> <p>B1Q7 What costs would arise from this proposal? Please quantify these costs.</p>
<p>B2 We propose to state the following expectations, which we consider are part of the obligations for AFS licensees who engage another asset holder:</p> <ul style="list-style-type: none"> (a) <i>Documented processes</i>: Responsible entities, licensed custody providers, MDA operators and IDPS operators should follow and document an appropriate process in selecting an appropriate asset holder or master custodian. We expect this process to address among other factors, compliance with the minimum standards, competency, the adequacy of financial, human and IT resources, and risk management systems of the asset holder. If the appointed person is to act as a master custodian, consideration should be given to how it will ensure that any asset holder it engages will address those matters. (b) <i>Pre-contract and ongoing inquiries</i>: Licensed custody providers should diligently consider what pre-contract inquiries and ongoing inquiries in relation to their clients are necessary at reasonable intervals to provide reasonable assurance that the asset holder's activities will not be facilitating unlawful activities, including considering the matters at paragraph 31 if appropriate. We consider that these inquiries are part of an adequate risk management system that AFS licensees, other than certain bodies regulated by the Australian Prudential Regulation Authority (APRA), are required to have in place under s912A(1)(h). 	<p>B2Q1 Do you agree with this proposal? Please explain your response.</p> <p>B2Q2 Are there any inquiries listed in paragraph 31 that a licensed custody provider would not normally do in the ordinary course of business?</p> <p>B2Q3 To what extent would some of the proposed requirements be already included in your existing framework under the <i>Anti-Money Laundering and Counter-Terrorism Financing Act 2006</i> (AML/CTF Act)?</p> <p>B2Q4 Is the proposed transitional period until 1 July 2014 appropriate for this proposal? Should a different transitional period apply?</p> <p>B2Q5 What costs would arise from these proposals? Please quantify these costs.</p>

Proposal/issue	Your feedback
<p>B3 We propose to modify the existing requirements for agreements between a responsible entity, IDPS operator, MDA operator or a master custodian on the one hand and the master custodian or asset holder on the other hand as follows:</p> <p>(a) Under the terms of the client agreement, the asset holder and any master custodian (as applicable) must indemnify the client against any loss or damage that arise from a failure to comply with the client agreement or to meet prevailing standards of good practice for holding assets in the places for which the assets are held.</p> <p>(b) If it is not possible for a responsible entity, IDPS operator or MDA operator who is responsible to clients for holding assets or a master custodian to obtain an indemnity on reasonable commercial terms for particular assets located outside Australia, as an AFS licensee it must:</p> <p>(i) take all reasonable steps to negotiate the most favourable liability provisions for the client; and</p> <p>(ii) consider what additional protections it should reasonably have in place to manage the associated risks (e.g. requiring more frequent checks).</p> <p>We also consider that the indemnity in proposal B3(a) should be required under an agreement between a licensed custody provider and retail client for the provision of a custodial or depository service.</p>	<p>B3Q1 Do you agree with our proposal for agreements between a responsible entity, IDPS operator, MDA operator or a master custodian on the one hand and the master custodian or asset holder on the other hand, including for assets located outside Australia? Please state your reasons.</p> <p>B3Q2 Do you agree that the indemnity in proposal B3(a) should be required under an agreement between a licensed custody provider and retail client? If not, why not?</p> <p>B3Q3 Is the proposed transitional period until 1 July 2014 appropriate? Should a different transitional period apply?</p> <p>B3Q4 What costs would arise from this proposal? Please quantify these costs.</p>
<p>B4 We propose to modify the Corporations Act by class order to require responsible entities, licensed custody providers, MDA operators and IDPS operators to ensure that the agreement with any custodian they engage in connection with holding client assets obliges the asset holder to have adequate arrangements to ensure that it will report to ASIC within 10 business days if it suspects that the client may be in breach of s912D or, where relevant, s601FC(1)(l).</p>	<p>B4Q1 What benefits would this proposal have? Could it potentially deter some illegal behaviour in the market? Please explain.</p> <p>B4Q2 Are there any barriers to establishing and maintaining a transparent whistleblowing framework and policy, to the extent that this is not already maintained under your AML/CTF policy? Will the proposal bridge some of these barriers?</p> <p>B4Q3 Given custodians' obligations under the AML/CTF Act for clients of their designated services, what impact, if any, will the proposal have on their day-to-day interaction with clients?</p> <p>B4Q4 In what circumstances could you envisage reporting your concerns about suspicious behaviour to ASIC?</p> <p>B4Q5 Would the proposed framework represent a cultural shift for your organisation?</p> <p>B4Q6 Would it be appropriate for this obligation to be extended to sub-custodians where assets are located in Australia?</p>

Proposal/issue	Your feedback
	<p>B4Q7 Is the proposed transitional period until 1 July 2014 appropriate? Should a different transitional period apply?</p> <p>B4Q8 What costs would arise from this proposal? Please quantify these costs.</p>
<p>B5 We propose to continue to give relief as currently provided under Class Order [CO 98/51] <i>Relief from duty to separate assets of a managed investment scheme</i>, with some amendments, to allow the use of omnibus accounts for certain assets, subject to conditions: see Table 1.</p> <p>Under our proposal, this conditional relief would apply more generally to allow use of omnibus accounts for:</p> <p>(a) assets of registered schemes, IDPS services and MDA services; and</p> <p style="padding-left: 40px;">Note: Under proposal B1, assets of registered schemes, client assets of IDPSs and client portfolio assets of MDAs must be held separately from the assets of any other scheme or any other person.</p> <p>(b) financial products and beneficial interests in financial products held in the provision of a custodial or depository service by an AFS licensee where the client has consented in writing.</p>	<p>B5Q1 Do you agree with our proposal to continue our relief for the use of omnibus accounts under [CO 98/51], including extending this relief to the particular assets in proposal B5(a) and financial products in proposal B5(b)? If not, why not?</p> <p>B5Q2 Are the proposed conditions for use of omnibus accounts appropriate? If not, why not?</p> <p>B5Q3 Should the conditions apply to all the types of assets listed in Table 1? If not, why not?</p> <p>B5Q4 The current list of assets under [CO 98/51] is quite broad. Is it common practice for responsible entities to rely on the relief in [CO 98/51]? Should any other type of asset be added or removed in the revised class order?</p> <p>B5Q5 Do responsible entities rely on eligible SELECT master agreements for the purposes of this relief? If so, should this continue and why?</p> <p>B5Q6 What are the material operational and other risks to client assets arising from the use of omnibus accounts?</p> <p>B5Q7 What are the costs and benefits of using individual accounts?</p> <p>B5Q8 Since the current relief under [CO 98/51] was provided, what effect have industry and technological developments had on the costs and benefits of using individual accounts relative to omnibus accounts?</p> <p>B5Q9 Should we require a particular level of frequency of reconciliations (e.g. daily) and that unreconciled variances be reported to the client if they may reflect a broader problem with systems or are of significant magnitude? If not, why not?</p> <p>B5Q10 Is the proposed transitional period until 1 July 2014 appropriate? Should a different transitional period apply?</p> <p>B5Q11 What costs would arise from this proposal? Please quantify these costs.</p>

Proposal/issue	Your feedback
<p>B6 We propose to modify the Corporations Act by class order so that certain additional requirements would apply to responsible entities for interests in registered schemes involving primary production that include <i>rights</i> for use of land and that are offered after 31 December 2013. Under our proposed modifications:</p> <p>(a) the responsible entity must ensure that registered interests in the land are held by members, on trust for members, or by an entity that is controlled by members for the duration of the scheme; and</p> <p>(b) where the registered interest is a lease:</p> <p>(i) the constitution of the registered scheme must give the responsible entity the power to require members to make payments to ensure the obligations under the terms of any lease;</p> <p>(ii) the responsible entity must retain any amounts paid by members in relation to the lease as scheme property until the money is used to meet lease payments; and</p> <p>(iii) the terms of the lease must not be less favourable to the scheme than those that would apply on an arm's length basis and must exclude any action by the lessor or a head lessor in connection with the lease that would adversely affect the interests of members, other than where members or the responsible entity for the scheme are in default of their obligations under the lease and the head lessor has a right to take action because the breach has not been remedied within a reasonable time.</p>	<p>B6Q1 Do you agree with our proposal? If not, why not?</p> <p>B6Q2 What are the barriers to and costs associated with holding property on trust?</p> <p>B6Q3 Are there any other changes that may be appropriate for how assets of primary production schemes that include rights for use of land should be held?</p> <p>B6Q4 Should leases that are relied on for meeting the requirements in proposal B6(b) contain further particular provisions to address the risk to members from failure to meet the terms of the lease? For example, should we require that the amount of rent for the expected duration of the scheme that has not been paid be held on trust for members to avoid the risk of rental defaults due to failure of the responsible entity or default by other members in making contributions (i.e. where the duration of the scheme means this is commercially practicable)? Please give reasons.</p> <p>B6Q5 Is the proposed transitional period until 1 July 2014 appropriate? Should a different transitional period apply?</p> <p>B6Q6 What costs would arise from this proposal? Please quantify these costs.</p>
<p>C1 We consider that product issuers and licensed custody providers should clearly describe the role of an asset holder in any PDSs, Financial Services Guide (FSGs) and other material available to retail clients to:</p> <p>(a) ensure that clients are unlikely to be misled; and</p> <p>(b) minimise the possibility of giving retail clients unwarranted reassurance because of the custodian's appointment.</p>	<p>C1Q1 Do you agree with our view? Please explain your response.</p> <p>C1Q2 Should we give guidance to encourage or require the use of alternative terms such as 'asset holder' or 'depository' where appropriate?</p> <p>C1Q3 Does our view reflect industry practice? If not, why not.</p> <p>C1Q4 What costs would be involved in disclosing this information? Please quantify these costs.</p>

Proposal/issue	Your feedback
<p>C2 We are considering whether to extend the list of 'special custody assets' that a responsible entity may hold without meeting the relevant net tangible assets (NTA) requirement in Regulatory Guide 166 <i>Licensing: Financial requirements</i> (RG 166). Options include the following:</p> <p>(a) <i>Option 1</i>: Not extending the definition of special custody assets or tier \$500,000 assets to include any additional types of assets.</p> <p style="padding-left: 40px;">Note: For the definition of 'special custody assets' and 'tier \$500,000 assets', see RG 166.</p> <p>(b) <i>Option 2</i>: Extending the list of special custody assets to include the assets listed in Table 2 on the conditions described (or on other appropriate conditions).</p>	<p>C2Q1 Which option do you consider to be the most appropriate for each of the assets listed in Table 2 and why?</p> <p>C2Q2 Do you think it is appropriate for the types of assets listed under Option 2 to be held by a responsible entity who does not meet the relevant NTA requirement? Please explain.</p> <p>C2Q3 What risks might arise if a responsible entity who does not meet the NTA requirement holds these types of assets? Do you think the proposed conditions deal adequately with these risks for each type of asset? If not, why not?</p> <p>C2Q4 In what circumstances would it be impracticable to negotiate appropriate provisions for a custodian to hold:</p> <p>(a) derivatives which may carry a liability for the holder?</p> <p>(b) securities or interests in a managed investment scheme under a private equity arrangement which may carry a liability for the holder?</p> <p>(c) deposit-taking facilities with an ADI or foreign equivalent?</p> <p>C2Q5 In what circumstances would it be impracticable or unreasonable for a custodian to hold or arrange for another asset holder to act on its behalf in holding a deposit-taking facility that is scheme property?</p> <p>C2Q6 We understand that some custody clients, including responsible entities, have arranged for a custodian to hold each of the assets listed under Option 2. What measures have been taken by the responsible entity and custodian in these cases for each type of asset to address risks?</p> <p>C2Q7 Should we make any other changes to the assets which are treated as special custody assets or tier \$500,000 assets? If so, what assets and in what circumstances?</p>

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Attachment: Draft regulatory guide



ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 133

Managed investments and custody: Holding scheme property and other assets

December 2012

About this guide

This guide is for responsible entities of registered managed investment schemes. It explains the Australian financial services (AFS) licence obligations that apply to these entities in relation to holding scheme property and other assets and sets out minimum standards for asset holders.

This guide is also relevant for:

- licensed providers of custodial or depository services (licensed custody providers);
- operators of managed discretionary account (MDA) services who are responsible to clients for holding assets under an MDA service; and
- investor directed portfolio service (IDPS) operators who are responsible to clients for holding assets under an IDPS.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This draft version was issued in December 2012 and is based on legislation and regulations as at the date of issue.

Previous version:

- Superseded Regulatory Guide 133 *Managed investments: Scheme property arrangements*, issued 3 August 1998, updated on 6 October 1998 and 2 June 1999, rebadged as a regulatory guide on 5 July 2007.

Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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A Overview

Key points

The *Corporations Act 2001* (Corporations Act) highlights the importance of arrangements to ensure proper standards for the safe keeping of scheme property and other assets.

This guide explains:

- the obligations that apply to AFS licensees in relation to holding scheme property and other assets (see Section B);
- the minimum standards an asset holder must meet (see Section C);
- what AFS licensees must do if they engage another asset holder (see Section D);
- what should be included in compliance measures (see Section E);
- what relief we have given from the obligation to separate scheme property from other assets (see Section F); and
- what requirements apply to primary production schemes that include rights for use of land (see Section G).

Who this guide applies to

RG 133.1 This guide sets out minimum standards for responsible entities of registered managed investment schemes in relation to holding scheme property and other assets to ensure they meet their obligations under their Australian financial services (AFS) licence.

RG 133.2 This guide is also relevant for:

- (a) licensed providers of custodial or depository services (licensed custody providers), including, where relevant, entities that provide custodial or depository services incidentally;
- (b) operators of managed discretionary account (MDA) services who are responsible to clients for holding assets under an MDA service; and
- (c) investor directed portfolio service (IDPS) operators who are responsible to clients for holding assets under an IDPS.

Note: For a discussion of the definition of ‘custodial and depository services’ in s766E of the Corporations Act, see Section B of this guide. See Section C of Consultation Paper 194 *Financial requirements for custodial or depository services* (CP 194) for an explanation of ‘incidental custodial and depository services’.

RG 133.3 Table 1 summarises the requirements that apply to different entities and when they apply.

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Table 1: Timing for implementation

Who it applies to	What applies	When it applies
Responsible entities, licensed custody providers, MDA operators or IDPS operators who currently hold client assets or arrange for client assets to be held by another asset holder	The minimum standards for asset holders in Section C of this guide	From 1 July 2014 Note: For a comparison of the requirements that apply to existing asset holders before and after 1 July 2014, see the appendix to this guide.
Responsible entities, licensed custody providers, MDA operators or IDPS operators who are likely to hold client assets or arrange for client assets to be held by another asset holder after 1 July 2014	The minimum standards for asset holders in Section C of this guide	From the time you hold client assets or arrange for client assets to be held by another asset holder
Responsible entities of registered schemes involving primary production that include rights for use of land and that are offered after 31 December 2013	The requirements in Section G of this guide	From 1 July 2014

Holding client assets

- RG 133.4 If you are a responsible entity, licensed custody provider, MDA operator or IDPS operator who holds client assets or arranges for client assets to be held by another asset holder, we consider that to meet your obligations as an AFS licensee, you must ensure that certain minimum standards for asset holders are met: see Section B of this guide.
- RG 133.5 The minimum standards apply regardless of whether:
- you are the asset holder or you engage another asset holder; or
 - the custodial and depository services are provided as a main business of the provider or merely incidentally.
- RG 133.6 In some cases, the nature and scale of the services provided may affect what is required to meet these standards.

Minimum standards for asset holders

- RG 133.7 As an asset holder, you must:
- hold the relevant assets on trust for the client and separately from your own assets, or the assets of any other scheme or any other person, subject to the permitted use of omnibus accounts (see RG 133.13–RG 133.18); and
 - meet certain other minimum standards for asset holders.
- See Class Order [CO 13/xx] *Title* and Section C of this guide.
- RG 133.8 If you are the asset holder, you must meet these standards. If you engage another asset holder, you must ensure that the asset holder meets these standards.

Engaging another asset holder

- RG 133.9 If you are an AFS licensee and you engage another asset holder, either directly or indirectly through a master custodian, you must:
- (a) ensure that the asset holder meets the minimum standards in Section C;
 - (b) document the processes you have followed or will follow for appointing, monitoring and reviewing the activities of the asset holder or master custodian and taking appropriate action should any deficiency be identified; and
 - (c) ensure that there is an agreement with any asset holder you engage that addresses certain key issues. The agreement must generally be in writing.

See Section D of this guide.

Compliance measures

- RG 133.10 You must implement documented measures to ensure you comply with your obligations in relation to the client assets for which you are responsible: see Section E of this guide. The required compliance measures may vary, depending on the nature and amount of assets and who holds them.
- RG 133.11 For responsible entities, compliance measures for holding scheme property form part of your compliance plan required under s601HA, adequately supported by appropriate policies and procedures, and they must meet particular requirements depending on the situation.
- RG 133.12 We have not prescribed in detail what should be included in documented compliance measures for licensed custody providers, MDA operators for assets held under an MDA service, or IDPS operators for assets held under an IDPS.

Relief from the obligation to separate assets

- RG 133.13 We have given limited relief to responsible entities and other asset holders from the obligation to separate assets, when holding certain classes of scheme property separate from the property of other schemes would be impracticable or unreasonably burdensome: see Class Order [CO 98/51] *Relief from the obligation to separate assets of a managed investment scheme* and Section F of this guide. Our relief allows the limited use of omnibus accounts.
- RG 133.14 Generally, unless an exemption applies, as a responsible entity that holds scheme property on trust under s601FC(2), you must ensure that property of the registered scheme is:
- (a) clearly identified as scheme property (s601FC(1)(i)(i)); and
 - (b) held separately from your property and the property of any other scheme (s601FC(1)(i)(ii)).

- RG 133.15 The scheme property to which the trust under s601FC(2) applies is any scheme property you hold as a responsible entity. If you engage another person to hold scheme property, any rights that the asset holder holds in relation to that property are scheme property. This property must therefore be held on trust and segregated from your own property and the property of any other scheme.
- RG 133.16 In certain circumstances, the effect of these provisions may be unreasonably burdensome and unnecessary to provide adequate protection for members.
- RG 133.17 Under [CO 13/xx], an asset holder who is not a responsible entity is also required to hold scheme property on trust and separate from its own property and the property of any other person or scheme, subject to the permitted use of omnibus accounts.
- RG 133.18 To be allowed to use omnibus accounts, these asset holders must comply with the requirements for use of omnibus accounts in [CO 98/51], even if the property does not comprise assets of a managed investment scheme.

Land used in primary production schemes

- RG 133.19 Where an offer of interests in a registered scheme involving primary production is made with, or includes, an offer of rights for the land on which the scheme will occur, certain additional requirements apply: see Class Order [CO 13/xx] *Title* and Section G of this guide.
- RG 133.20 Under [CO 13/xx]:
- (a) the interest must be held by members or on trust for members by another person that owes duties to, or is controlled by, members;
 - (b) if the interest is a lease, certain additional requirements must be met; and
 - (c) the instrument reflecting the protective interest must be lodged before or immediately after the interest in the scheme is issued.
- RG 133.21 These requirements ensure that:
- (a) the rights of members to have use of any land in Australia on which the primary production occurs is protected though an appropriate registered interest under state or territory land title laws; and
 - (b) the way in which the registered interest is held ensures that it cannot be adversely affected by either the interests of others in the land and so far as possible, any future interests, unless the interest of others was properly created by the responsible entity in accordance with its duties.

B Holding client assets

Key points

As an AFS licensee, if you hold or arrange for the holding of client assets, you must ensure that the minimum standards for asset holders in Section C of this guide are met. These standards ensure that clients' interests are better protected.

If you hold client assets, you must meet the minimum standards.

If you engage another asset holder, you must ensure that the asset holder meets the minimum standards: see Section D.

Why are minimum standards needed?

- RG 133.22 A responsible entity must act in the best interests of members in exercising its powers and carrying out its duties, and this includes its powers and duties as trustee of scheme property.

Note: A responsible entity or another person engaged by it to hold assets of a registered scheme does not need to hold an AFS licence authorising it to provide a custodial or depository service for this purpose. This is because holding those assets is not regulated as a custodial or depository service under s766E(3)(b) of the Corporations Act. Holding assets is a part of the operation of the registered scheme by the responsible entity.

- RG 133.23 As AFS licensees, responsible entities, licensed custody providers, MDA operators and IDPS operators must do all things necessary to ensure that they carry on the financial services for which they are licensed honestly, efficiently and fairly.

Note: An MDA operator for an MDA service must be a licensed custody provider unless another custody provider directly contracts with all retail clients to be the asset holder. See Regulatory Guide 179 *Managed discretionary accounts* (RG 179).

- RG 133.24 If an MDA operator or IDPS operator arranges for client assets that are financial products to be held by an asset holder, it is providing a financial service of dealing in financial products.

- RG 133.25 We have set minimum standards for asset holders: see Section C of this guide. To satisfy their duties as AFS licensees, responsible entities, licensed custody providers, MDA operators and IDPS operators who hold client assets or arrange for client assets to be held must ensure that the asset holder meets these minimum custody standards.

- RG 133.26 We believe that clients' interests will be better protected if asset holders are required to meet minimum standards to ensure that:

- (a) client assets are not exposed to unnecessary risks because of the way they are held; and
- (b) efficient operational arrangements exist for holding and dealing with client assets.

- RG 133.27 An asset holder's arrangements for meeting the minimum standards may vary depending on the particular assets being held. We have not prescribed specific arrangements for different asset holders.

Who must meet the standards?

If you are the asset holder

- RG 133.28 If you apply for an AFS licence as a licensed custody provider (including if you are an MDA operator or IDPS operator), or if you are a responsible entity that is the asset holder, you will need to demonstrate that you meet the minimum standards in Section C of this guide. These standards apply while the assets are held.

- RG 133.29 If you are an AFS licensee, you must also meet any other obligations that apply to your licence.

Note: See Regulatory Guide 104 *Licensing: Meeting the general obligations* (RG 104) and Regulatory Guide 105 *Licensing: Organisational competence* (RG 105).

If you engage another asset holder

- RG 133.30 As a responsible entity, licensed custody provider, MDA operator or IDPS operator, you may engage another asset holder. This might be because you do not wish to be an asset holder for those assets or you are not permitted to hold assets under your AFS licence—for example, because you cannot meet the financial requirements in Regulatory Guide 166 *Licensing: Financial requirements* (RG 166) or under Class Order [CO 11/114] *Financial requirements for responsible entities*.

Note: A responsible entity remains responsible to members for the actions, or failures to act, of any asset holder holding scheme property on its behalf: see s601FB(2).

- RG 133.31 If you are a responsible entity and you engage another asset holder because you do not meet the financial requirements under [CO 11/1140], you must ensure that all the relevant assets are held by another person, apart from any exceptions permitted under [CO 11/1140] for 'tier \$500,000 assets' and 'special custody assets'.

Note: See RG 166 and [CO 11/1140] for the definitions of these terms.

- RG 133.32 You must also ensure that the scheme property is held on trust by the asset holder and segregated from the asset holder's own property and the property of any other scheme, subject to any relief that would permit the use of omnibus accounts: see Section F.

- RG 133.33 If you apply for an AFS licence as a responsible entity, licensed custody provider, MDA operator or IDPS operator and you plan to engage another asset holder, you will need to demonstrate that you will ensure that any asset holder who holds client assets on your behalf meets the minimum standards in Section C: see Section D.
- RG 133.34 The asset holder you engage may or may not be an AFS licensee. If the asset holder is providing a financial service to clients on your behalf, it will generally need to be either your authorised representative, exempted from holding an AFS licence, or acting on behalf of another licensee: see s911B(1).
- RG 133.35 The asset holder may also be providing a financial service to you. If so, provided the requirements in reg 7.6.01(1)(k) of the Corporations Regulations 2001 (Corporations Regulations) are satisfied, the asset holder may not need an AFS licence to hold the client assets that are financial products or beneficial interests in financial products.
- RG 133.36 This exemption may be relevant to sub-custodians and applies if:
- (a) the asset holder holds the financial products on trust for a licensed custody provider; and
 - (b) the licensed custody provider in turn holds the beneficial interest on trust for the client.
- RG 133.37 The exemption under reg 7.6.01(1)(k) takes into account the responsibility of an AFS licensee who holds the beneficial interest in the financial products, which may be a financial service provided to the person for whom the beneficial interest is held, to ensure that the holder of the financial products meets appropriate standards.
- RG 133.38 The requirement that asset holders meet the minimum standards in Section C reflects this responsibility by applying to AFS licensees who directly or indirectly engage others as asset holders of client assets. Ensuring that asset holders meet the minimum standards helps AFS licensees meet their licensee obligations and safeguards clients' interests.

What services are provided?

- RG 133.39 The minimum standards in Section C apply to all providers of custodial or depository services, regardless of whether the services are provided as a main business of the provider or merely incidentally. In some cases, the nature and scale of the services provided may affect what is required to meet these standards.
- RG 133.40 If you are a responsible entity, licensed custody provider, MDA operator or IDPS operator and you engage another asset holder, the asset holder is likely

to provide other related services in relation to those assets. We consider that the following services form part of the custodial or depository service:

- (a) *Corporate actions and proxy voting*: This involves processing the rights and obligations associated with securities in safekeeping. Corporate actions typically relate to the reorganisation or restructure of a listed company's or registered scheme's capital. Common corporate actions events include dividend re-investment plans, offers made on the basis of holding the assets such as certain placements and right issues.
- (b) *Income and distributions payments*: This involves making these payments on behalf of the client.
- (c) *Tax reclamations*: This involves reclaiming recoverable portions of taxes withheld from interest or dividend payments by foreign taxation authorities.
- (d) *Trade settlement*: This involves settling trades through the change in title and the delivery of property or cash.
- (e) *Reconciliations*: This involves reconciling the custodian's own records against the records of various third parties, such as fund managers, banks, other custodians or depositories.
- (f) *Record keeping and reporting*: This involves maintaining statements of holdings, completed transaction reports, outstanding items and valuations.

The list is not exhaustive. Other services may be provided from time to time that may be considered a core custody function.

RG 133.41 Other services that may be provided by a licensed custody provider include:

- (a) fund accounting;
- (b) unit pricing and determining asset values and net asset values;
- (c) compliance monitoring and reporting; and
- (d) performance measurement and monitoring.

Note: Information Sheet 141 *Dealing and providing a custodial or depository service as a secondary services* (INFO 141) may also be relevant in determining whether an intermediary is providing a custodial or depository service and subject to this guide.

C Minimum standards for asset holders

Key points

If you hold client assets, you must hold assets on trust and separately, and meet certain other minimum standards. As an AFS licensee, if you engage another asset holder, you must ensure that the asset holder meets these standards.

To meet the minimum standards, asset holders must have adequate:

- organisational structure;
- staffing capabilities; and
- capacity and resources.

Asset holders should also conduct reasonable checks on clients to reduce the risk that they are involved, knowingly or otherwise, in unlawful conduct by clients.

Your obligations

- RG 133.42 If you are an asset holder, you must:
- (a) hold the relevant assets on trust for your client and separately from your own assets, or the assets of any other scheme or any other person, subject to the permitted use of omnibus accounts (see Section F); and
 - (b) meet certain minimum standards relating to:
 - (i) organisation structure;
 - (ii) staffing capabilities;
 - (iii) capacity and resources; and
 - (iv) checks on clients.

See Class Order [CO 13/xx] *Title*.

- RG 133.43 As an AFS licensee, if you engage another asset holder, you must ensure that the asset holder meets these standards.
- RG 133.44 This section includes some specific guidance for AFS licensees who engage another asset holder. For more detailed guidance on the obligations that apply generally to AFS licensees who engage another asset holder, see Section D.

Organisational structure

- RG 133.45 The asset holder must have an organisational structure that supports the identification and segregation of scheme property from its own assets, and those of any other client or any other managed investment scheme.
- RG 133.46 If a conflict of interest exists or might arise between holding client assets and other operational areas of the asset holder or any associated entity, the asset

holder must ensure that staff who are involved in holding client assets are segregated from the staff involved in the other operational area in a way that minimises the potential for conflict: see RG 133.49. This is particularly important where the asset holder is the responsible entity or an IDPS operator performing transactional functions, or a related body corporate.

RG 133.47 In addition, the asset holder must have a documented policy, approved by its board of directors, of ensuring that staff engaged in asset holding functions are not influenced to act other than in accordance with the duties that would apply to an unrelated client. The asset holder must undertake appropriate and systematic checks to ascertain and document if there has been any attempt to inappropriately influence custody staff and take appropriate action if this occurs.

Note: In addition, where the asset holder is an AFS licensee, it has a general obligation to adequately manage conflicts of interest: see Regulatory Guide 181 *Licensing: Managing conflicts of interest* (RG 181).

RG 133.48 The asset holder's business must be structured so that managers of staff involved in holding assets who are not involved in potentially conflicting activities can report directly to the board of directors of the responsible entity and of the asset holder and for a registered scheme, the compliance committee. The reporting lines must be independent of potentially conflicting activities up to the point of reporting to managing director level.

RG 133.49 The asset holder must also be structured so that managers can ensure that the duties of staff involved in holding client assets and their managers do not extend to other functions that may create conflicts of interest. These staff and their managers must not also be responsible for investment decisions, trading decisions or other decisions resulting in the movement of scheme property or other client assets. There should be an adequate physical separation between staff involved in holding assets and other staff involved in these decisions to reduce, so far as reasonably practicable, the risk of inappropriate influence on decisions relating to holding of scheme assets.

Staffing capabilities

RG 133.50 Staff of the asset holder who are involved in holding assets must have the knowledge and skills necessary to perform their functions properly. The asset holder must provide adequate ongoing training and educational programs so that staff knowledge remains at a level necessary for performing their assigned responsibilities. The training should cover the asset holder's legal obligations.

RG 133.51 Responsible entities, licensed custody providers, MDA operators and IDPS operators must conduct 'know your staff' risk-based due diligence inquiries under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act).

RG 133.52 Notwithstanding these inquiries, we would expect that, at a minimum, appropriate resume, police and reference checks would be carried out with appropriate oversight and staff rotation, to address risk of fraud.

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Capacity and resources

- RG 133.53 The asset holder's staff must have the necessary capacity to perform the administrative activities associated with holding client assets. This will vary depending on the nature of the assets. If you are an AFS licensee that engages another asset holder, you must ensure that the asset holder's staff has this capacity.
- RG 133.54 The asset holder must make resources available to staff involved in holding client assets, including in specialist areas, to the extent necessary for them to adequately carry out their duties.
- RG 133.55 Generally, the necessary capacity is likely to include having:
- (a) computer systems which are reasonably up to date and secure from any actual or potential threats including from fraud;
 - (b) systems capable of handling record keeping and transaction processing that will be needed (given the volume of transactions), and capable of separately and verifiably identifying assets for each registered scheme or other client, particularly when omnibus accounts are used;
 - (c) systems capable of handling client instructions for assets held (including exercising voting rights or other rights conferred on the asset holder on client instructions);
 - (d) procedures for accurately recording all client assets held, all movements of those assets and how they were authorised, and all income, pricing and other related administrative activities;
 - (e) access to information sources that may be relevant to corporate actions and proxy voting, and pricing information;
 - (f) memberships at depositories, where relevant to client assets;
 - (g) access to and, if necessary, membership of, any relevant settlement and clearance systems;
 - (h) where appropriate, access to relevant and appropriate domestic or global sub-custodial networks;
 - (i) where physical assets are held, secure physical storage;
 - (j) appropriate business continuity and disaster recovery procedures; and
- Note: At the date of issue of this guide, bodies regulated by the Australian Prudential Regulation Authority (APRA) are excluded from the requirement for risk management systems under s912A(1)(h).
- (k) appropriate systems and procedures for change management.
- RG 133.56 In all circumstances, such systems, processes and procedures should ensure that opportunities for fraud and operational error are reduced as far as reasonably practicable. We expect that, as part of having adequate risk management arrangements, AFS licensees that are responsible for holding client assets where high-volume transactions are likely to occur will ensure that, except as may be needed in exceptional circumstances, automated systems are used to authenticate instructions rather than manual systems (e.g. faxes).

Checks on clients

- RG 133.57 Responsible entities, licensed custody providers, MDA operators and IDPS operators have obligations under the AML/CTF Act to conduct certain ‘know your client’ risk-based due diligence inquiries, to the extent that they are ‘designated service providers’ under the AML/CTF Act.
- RG 133.58 In addition, if not carried out under the AML/CTF Act, we expect asset holders to conduct pre-contract and ongoing inquiries at reasonable intervals in relation to their clients to provide reasonable assurance that their activities as an asset holder will not be facilitating unlawful activities and that they are acting within their authority and can provide the services they are engaged to provide. Such inquiries may form part of the adequate risk management systems that AFS licensees must have in place under s912A (except for bodies regulated by APRA that are excluded from this requirement).
- RG 133.59 Initial inquiries may include:
- (a) credit assessments;
 - (b) review of the scope of business and breadth of the operation for which custody is provided, including what financial products or beneficial interests in financial products or other assets the client seeks to be held;
 - (c) review of corporate records, licence and other regulatory documents, including disclosure documents, that may be relevant.
 - (d) review of quality of data and information;
 - (e) review of systems interfaces;
 - (f) identification and valuation of assets (and reconciliation on transition from a retiring custodian);
 - (g) understanding the process of providing instructions to the asset holder, including from a third party fund manager or investment administrator, and the extent to which risks associated with preparing, approving and sending instructions to the asset holder will be managed;
 - (h) an assessment of whether the asset holder is able to carry out the mandate of the client (e.g. can the asset hold the type of assets involved and provide the reporting required by the client for these assets?).
- RG 133.60 Ongoing inquiries may include repeating these initial inquiries at intervals appropriate for the client (i.e. more frequently for clients that may be categorised as ‘high risk’ and less frequently for clients that may be categorised as ‘low risk’), regular meetings of senior or key relationship staff and additional inquiries that might be raised. Further risk and operational assessment of client arrangements should be considered following adverse change to the client’s business, such as loss of key senior personnel, significant drop of revenue or other significant negative events.

D Engaging another asset holder

Key points

You must take certain steps to protect clients if you are a responsible entity, licensed custody provider, MDA operator or IDPS operator and you arrange for another person to hold client assets.

You must:

- ensure that the asset holder can meet the minimum standards in Section C of this guide and document how you do this; and
- monitor ongoing compliance with these standards and deal appropriately with any deficiencies that arise.

If you engage another asset holder, generally you must enter into a written agreement with that asset holder that meets certain requirements.

If you arrange for a master custodian to engage the asset holder, you must enter into an agreement with the master custodian.

For retail clients, we expect the engagement of the asset holder to be disclosed and the role of the asset holder to be properly explained.

Your obligations

RG 133.61 If you are an AFS licensee and engage another person as asset holder, directly or indirectly through a master custodian, you must take certain steps to ensure that the third party asset holder can hold the scheme property and other assets in a way that meets your AFS licence obligations: see Table 2.

RG 133.62 A responsible entity that engages an asset holder to hold scheme property is also ultimately responsible to members for the acts and omissions of the asset holder under s601FB(2) of the Corporations Act.

Table 2: Ensuring that you meet your obligations

Steps	Description
1. Document your processes	<p>This includes the processes you have followed or will follow for appointing, monitoring and reviewing the activities of the third party asset holder or master custodian. Where the third party asset holder is a related party, you must have adequate arrangements to manage any conflicts of interest under s912A(1)(aa) to ensure that you meet all your obligations, including that the minimum standards in Section C are met.</p> <p>Note: See also RG 181.</p>
2. Ensure that any relevant master custodian has adequate processes	<p>This includes adequate processes for selecting, monitoring and reviewing any other person it engages as asset holder, including where the third party asset holder is a related party, and taking appropriate action in case of any deficiency of performance.</p>

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Steps	Description
3. Conduct regular checks	<p>This includes seeking:</p> <ul style="list-style-type: none"> • information to satisfy yourself that the asset holder's internal processes and controls are adequate and continue to operate effectively and that they are subject to appropriate independent checking, and • periodic information from the asset holder about the effectiveness of such controls, and actions taken or planned to address any concerns. <p>We expect that where appropriate you will arrange for an independent audit of the effectiveness of the custodian's controls, such as an audit based on Guidance Statement GS 007 <i>Implications of the use of service organisations for investment management services</i>, issued by the Auditing and Assurance Standards Board (AUASB).</p> <p>Note: GS 007 is designed to provide detailed and transparent reporting on relevant control frameworks of custodians. It includes guidance on how to apply the AUASB's relevant auditing and assurance standards when preparing audit and assurance reports on the description, design and operating effectiveness of the service organisation's controls over the investment management services.</p>
4. Ensure that there is a legally enforceable agreement with any asset holder you engage	<p>The agreement should address the issues set out in Table 3. For a responsible entity, MDA operator or IDPS operator, there must be an agreement with any master custodian and between any master custodian and asset holder that addresses these issues: see RG 133.76–RG 133.77. The agreement must generally be in writing, unless you meet the criteria in RG 133.78–RG 133.79.</p> <p>Note: See RG 104 and Regulatory Guide 94 <i>Unit pricing: Guide to good practice</i> (RG 94).</p>

Ensuring the asset holder meets minimum standards

- RG 133.63 The minimum standards in Section C apply to all asset holders, regardless of whether you engage the asset holder directly or the asset holder is engaged by another person authorised by you (master custodian). The standards also apply if there are further links in a chain (e.g. a sub sub-custodian).
- RG 133.64 You do not routinely need to explain to us how your choice of asset holder or master custodian will meet the minimum standards when you apply for an AFS licence. However, if you plan to engage another person as asset holder, directly or indirectly through a master custodian, you must be able to demonstrate how you will:
- (a) ensure any asset holder that is engaged meets the minimum standards;
 - (b) monitor ongoing compliance with these standards and deal with any deficiencies that arise; and
 - (c) achieve the outcomes in paragraphs (a) and (b) where the asset holder has outsourced any of its obligations to be performed in an offshore jurisdiction.

RG 133.65 To check compliance, we may ask for written evidence at any time about how you are satisfied that a particular person should be appointed or remain as the asset holder.

Selecting an asset holder

RG 133.66 You must follow an appropriate and documented process in selecting an appropriate asset holder or master custodian. We expect you to consider, for example:

- (a) the adequacy of financial, human and technological resources, and risk management systems of the asset holder; and
- (b) where you engage a master custodian, the basis under which the master custodian will engage any sub-custodian.

RG 133.67 If you are a responsible entity, MDA operator or IDPS operator, the engagement must be in accordance with a documented policy approved by your directors, which provides a detailed framework for engagements, including appropriate management of any conflict of interest that might arise in relation to the engagement.

RG 133.68 The effectiveness of the policy must be monitored at appropriate intervals by the directors, or in the case of a responsible entity, by the compliance committee of any relevant registered scheme. At our request, you must at your own expense, arrange for an appropriately qualified and independent person to prepare a report on the effectiveness of the policy.

RG 133.69 You must establish adequate procedures for giving instructions to the asset holder and ensure that the associated operational risk is managed appropriately. You should have regard to relevant industry best practice for providing instructions, including data, when establishing your procedures for interacting with the asset holder.

RG 133.70 We expect that the risks arising from engaging an asset holder will be addressed in your risk management arrangements where these arrangements are required under s912A. We also expect you to apply appropriate resources to monitor that any arrangements for holding assets are consistent with your obligations, including ensuring that the minimum standards for asset holders in Section C are met: see RG 133.72–RG 133.73.

RG 133.71 When contracting with the asset holder, you should also require that the existence of a trust for the underlying assets is identified to the relevant counterparties, unless this is impracticable given market practices.

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Monitoring ongoing compliance

- RG 133.72 You must have an established process to monitor and assess the asset holder's performance of its obligations. If you delegate decisions to the asset holder about which Australian deposit-taking institution (ADI) or equivalent it uses, you must be satisfied about its processes for determining, monitoring and taking action in case of a deficiency in relation to that asset holding. In addition, if you permit the asset holder to choose to use its associate, you must ensure that the conflict is managed to result in a no less favourable outcome than if there was not association. If you are a responsible entity, you must also comply with Pt 5C.7 of the Corporations Act.
- RG 133.73 You must take all necessary steps to ensure that full identification of your assets is made in the records of the asset holder, and that internal and external audit processes are able to verify this. You must also ensure that there is some formal annual, and when requested, acknowledgement by the asset holder that any relevant assets are held in compliance with the minimum standards in Section C of this guide, including that the assets are held on trust and separated, subject to the permitted use of omnibus accounts: see Section F. This also applies where a master custodian engages an asset holder.

Agreement with third party asset holder

If you engage another asset holder

- RG 133.74 If you engage another asset holder, your agreement with the asset holder must address the issues set out in column 2 of Table 3.

If you are engaged as an asset holder by a retail client

- RG 133.75 If you are engaged as an asset holder by a retail client, including as an MDA operator and IDPS operator, your agreement with the retail client must address the issues set out in column 3 of Table 3, as relevant.

Table 3: What your agreement must cover

Area	If you engage an asset holder	If you are engaged as an asset holder by a retail client
Nature of the agreement, monitoring and instructions	<p>The agreement with the asset holder must address:</p> <ul style="list-style-type: none"> the nature of the arrangement and the obligations of each party to the agreement; the rights that you have for the ongoing review and monitoring of the asset holder and any sub-custodians, and the standards against which their performance will be assessed. These rights and standards must be adequate to ensure that you can meet your obligations to your clients under the Corporations Act and the standards applying in the relevant markets for the assets held; and how instructions will be given to the asset holder (these provisions must include adequate controls to ensure that you are taking care to manage operational risk). 	<p>The agreement with the retail client must address:</p> <ul style="list-style-type: none"> the nature of the arrangement and the obligations of each party to the agreement; and how instructions will be given to you.
Minimum standards	<p>Under the agreement, the asset holder must agree to certify to you in writing at least annually that it:</p> <ul style="list-style-type: none"> meets, and acknowledges that it is under an obligation to continue to meet, the minimum standards for asset holders set out in [CO 13/xx] (whether or not there is any explicit reference to that class order in the agreement); is complying with the agreement, and has acknowledged the manner in which it holds assets where appropriate. 	<p>Under the agreement, you must agree that you will acknowledge the manner in which you hold the assets or certain types of assets where appropriate.</p>
Engaging another asset holder	<p>The agreement must specify that, before arranging for your assets to be held by another asset holder as agent, the asset holder will provide you with written notice of the identity of each agent asset holder.</p>	<p>The agreement must specify that, before arranging for the assets to be held by another asset holder as agent, you will provide the retail client with written notice of the identity of each agent asset holder.</p>
Confidentiality	<p>The agreement must specify that the asset holder will keep any information about the relationship and the assets held securely in confidence, apart from any disclosure to ASIC or as permitted by law.</p>	<p>The agreement must specify that you will keep any information about the relationship and the assets held securely in confidence, apart from any disclosure to ASIC or as permitted by law.</p>

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Area	If you engage an asset holder	If you are engaged as an asset holder by a retail client
Encumbrances	<p>The agreement must specify that the asset holder is prohibited from taking or granting a charge, mortgage, lien or other encumbrance over, or in relation to, the assets held under the agreement unless it is:</p> <ul style="list-style-type: none"> • taken in favour of the asset holder for expenses and outlays made within the terms of the agreement and relating to the asset holder's duties as such (but not including unpaid fees of the asset holder) and the agreement expressly authorises the encumbrance; or • granted to a person other than the asset holder on your written instructions and in accordance with the agreement. 	<p>The agreement must specify that you are prohibited from taking or granting a charge, mortgage, lien or other encumbrance over, or in relation to, the assets held under the arrangement unless it is:</p> <ul style="list-style-type: none"> • taken in your favour for expenses and outlays made within the terms of the agreement and relating to your duties as such (but not including your unpaid fees) and the agreement expressly authorises the encumbrance; or • granted to a person other than you on the written instructions of the retail client and in accordance with the agreement.
Contingency planning	<p>The agreement must specify that the asset holder will establish and maintain adequate arrangements to enable it to provide the services under the agreement, in any contingency for which it should reasonably plan.</p>	<p>The agreement must specify that you will establish and maintain adequate arrangements to enable you to provide the services under the agreement, in any contingency for which you should reasonably plan.</p>
Indemnity	<p>The agreement must specify that the asset holder will:</p> <ul style="list-style-type: none"> • indemnify you for any loss or damage that arises from a failure by the asset holder to comply with the terms of the agreement or meet prevailing standards of good practice for holding assets in the places for which the assets are held; and • maintain a minimum level of professional indemnity insurance which is reasonable and is at least as much as would be required if the asset holder were an AFS licensee (i.e. if it is not an AFS licensee). 	<p>The agreement must specify that, if there is a loss due to a failure by you or your sub-custodians to comply with the terms of the agreement or meet prevailing standards of good practice for holding assets in the places for which the assets are held, you will indemnify the retail client for any such loss or damage arising from the failure.</p>
Record keeping and auditing	<p>The agreement must specify:</p> <ul style="list-style-type: none"> • how the asset holder will keep and maintain records of the assets held, the transactions and how they were authorised, and make these records available to you, including what verification procedures it has in place for the appropriately frequent reconciliation and checking of the balances of the assets it holds; and • any requirements for reporting by the asset holder. 	<p>The agreement must specify:</p> <ul style="list-style-type: none"> • how you will keep and maintain records of the assets held, the transactions and how they were authorised and make these records available to the retail client, including what verification procedures you have in place for the appropriately frequent reconciliation and checking of the balances of scheme property you hold; and • any requirements for reporting by you.

Area	If you engage an asset holder	If you are engaged as an asset holder by a retail client
	<p>The asset holder must also confirm that it will meet requirements to provide all reasonable access and assistance to:</p> <ul style="list-style-type: none"> • any auditor engaged to audit your financial statements or your controls to ensure compliance under a requirement of the Corporations Act (including under ASIC exemptions or modifications); or • if you are a responsible entity, any auditor of the entity, of the scheme or of the compliance plan—or the compliance committee. <p>Note 1: Under reg 5C.4.02, an agent of a responsible entity, such as an asset holder, must give the auditor of the scheme's compliance plan access to the books of the scheme, and assist in the conduct of the audit. Under reg 5C.5.01, responsible entities and their agents must give the compliance committee access to the books of the scheme and assist the committee in the performance of its functions.</p> <p>Note 2: We may require an AFS licensee and an agent of responsible entity to assist us in checking compliance: see s601FF and 912E and reg 5C.2.01. We also have powers to require production of books under the <i>Australian Securities and Investments Commission Act 2001</i> (ASIC Act).</p>	
Reporting breaches	<p>The asset holder must agree to notify the following of any material and/or systemic breaches of the agreement for consideration within a reasonable timeframe of it becoming aware of the breach:</p> <ul style="list-style-type: none"> • the board of directors of the AFS licensee who appointed it; or • if the licensee is a responsible entity, the compliance committee of any relevant scheme. <p>The asset holder must also agree to establish and maintain adequate arrangements to ensure that it will report to ASIC within 10 business days if it suspects you have breached your obligations to report your own breaches as required by s912D or, where relevant, s601FC(1)(i) of the Corporations Act.</p>	

Area	If you engage an asset holder	If you are engaged as an asset holder by a retail client
Terminating the agreement	<p>The agreement must set out the circumstances in which you have the right to terminate, including at a minimum that you may terminate the agreement without payment if you have reasonable grounds for believing that the asset holder is not complying with or is unlikely to comply with the requirements of applicable law (including as applying to you under modification by ASIC). Other grounds for termination that must be set out if appropriate include where:</p> <ul style="list-style-type: none"> • the asset holder is unable or about to become unable, to meet its liabilities (e.g. because of impending insolvency, external administration or receivership); or • there is a change in the effective control of the custodian (e.g. through an acquisition of merger) without your consent. <p>On termination of the agreement, the asset holder must agree to transfer any relevant assets into your name (if not already held in your name) or otherwise arrange for them to be transferred as you lawfully direct (including to another asset holder).</p> <p>The agreement should also:</p> <ul style="list-style-type: none"> • refer to the timeframe within which assets are to be transferred after termination; and • provide for other obligations of the parties at termination, including the payment of outstanding fees and charges to the asset holder and any costs of the transfer. 	<p>The agreement must set out the circumstances in which the retail client has the right to terminate, including at a minimum that the client may terminate the agreement without payment if they have reasonable grounds for believing that you are not complying with or are unlikely to comply with the requirements of applicable law (including as applying to you under modification by ASIC). Other grounds for termination that must be set out if appropriate include where:</p> <ul style="list-style-type: none"> • you are unable, or about to become unable, to meet your liabilities (e.g. because of impending insolvency, external administration or receivership); or • there is a change in the effective control of the custodian (e.g. through an acquisition of merger) without your consent. <p>On termination of the agreement, you must agree to transfer the assets into the name of the retail client or otherwise arrange for them to be transferred as they lawfully direct (including to another asset holder).</p> <p>The agreement should also:</p> <ul style="list-style-type: none"> • refer to the timeframe within which assets are to be transferred after termination; and • provide for other obligations of the parties at termination, including the payment of outstanding fees and charges to you and any costs of the transfer.

If a master custodian engages the asset holder

- RG 133.76 In many cases, a responsible entity, MDA operator or IDPS operator will not directly engage an asset holder, but will engage a master custodian that engages the asset holder. As far as possible, the same minimum standards should apply for an asset holder that is engaged by a master custodian, except that the provisions for reporting breaches to ASIC need not be included.
- RG 133.77 If you engage a master custodian who appoints a third party asset holder, you must enter into an agreement with the master custodian reflecting the terms in column 2 of Table 3. That agreement must contain an obligation on the master custodian you engage to ensure that any agreement between the master custodian and asset holder is on substantively the same terms as required under RG 133.74, other than the provisions for reporting breaches to ASIC, to the extent it is practicable from time to time to obtain the services of an asset holder for the relevant assets outside Australia that meets those terms.
- RG 133.78 In some cases, it may not reasonably practicable for an asset holder or master custodian to hold relevant assets that are located outside Australia. In this case, the agreement with a sub-custodian does not need to contain the provisions relating to indemnity or to the minimum standards in [CO 13/xx] or be in writing, to the extent that the asset holder establishes by documentary evidence that it is not practicable to engage a sub-custodian that is willing to include such matters in the agreement.
- RG 133.79 However, in that case:
- (a) the asset holder must disclose in writing to its client if the agreement does not contain the relevant matter;
 - (b) the asset holder must obtain the most favourable liability provisions that can be reasonably negotiated; and
 - (c) the asset holder or master custodian must certify why using the sub-custodian would be in the best interests of the members of the relevant scheme or retail client.

Disclosure of relationship with asset holder

- RG 133.80 For retail clients, we expect the role of the asset holder to be properly explained in the PDS (or IDPS Guide) and other communications that refer to the asset holder. To promote understanding, in communications to retail clients, the role of the asset holder should be explained in a clear concise and effective manner, including the nature of the services undertaken.
- RG 133.81 Where some of the scheme property may not be held on trust by the asset holder, these circumstances may also need to be explained in communications.

Change of asset holder

- RG 133.82 If you need to change the asset holder, you must obtain an independent audit that all assets to be transferred have been identified and transferred as required.

E Compliance measures

Key points

As an AFS licensee, you must have documented measures to ensure that you comply with your obligations in relation to client assets.

Compliance measures may vary depending on the nature and amount of assets and who holds them.

Compliance plans may need to satisfy particular requirements depending on your situation.

Compliance measures must cover risks to client assets

RG 133.83 All AFS licensees must establish and maintain compliance measures as a condition of their AFS licence. As a responsible entity, licensed custody provider, MDA operator or IDPS operator who is responsible for client assets, your documented compliance measures must include measures to minimise the risks to clients from any non-compliance in holding these assets.

RG 133.84 If you are a responsible entity, you must have a compliance plan for each registered scheme that sets out adequate measures to ensure that you comply with your obligations under the Corporations Act and the scheme constitution: s601HA.

Note: See Regulatory Guide 132 *Managed investments: Compliance plans* (RG 132).

RG 133.85 If you are a licensed custody provider, MDA operator or IDPS operator, you must establish and maintain adequate documented measures to demonstrate that you are complying with your AFS licence obligations.

Compliance measures may vary

RG 133.86 We have not prescribed in detail what measures for dealing with client assets should be included in the compliance plan of a responsible entity, or in the documented compliance measures of a licensed custody provider, MDA operator or IDPS operator. This is consistent with our general approach to documenting compliance measures in RG 132.

RG 133.87 There will be different risks to clients arising out of the different ways that client assets are held, including whether you are the asset holder or you engage another asset holder. We also recognise that what is required in documented compliance measures will depend on the nature and amount of assets held.

RG 133.88 For example, more sophisticated compliance measures, processes and procedures may be required by a stand-alone custody business that provides services for a full range of financial products, compared to an AFS licensee who holds only a limited range and value of assets.

If you are the asset holder

RG 133.89 If you are the asset holder, your documented compliance measures should include:

- (a) regular checks to ensure that all record keeping for the client assets is carried out in a timely and accurate manner; and
- (b) measures for ensuring that the minimum standards in Section C of this guide are met.

If another person is the asset holder

RG 133.90 If you engage another person as an asset holder, you must ensure that clients are protected from the possible compliance risks arising from this arrangement.

RG 133.91 Your documented compliance measures must set out what measures you will take to minimise these risks. This would include, for example, measures for ensuring that:

- (a) you will allow a person to be the asset holder only if they meet the minimum standards in Section C;
- (b) the activities of the asset holder will be actively monitored and appropriate action taken in case of deficiencies; and
- (c) any agreement entered into with the asset holder will remain compliant and current.

Compliance plans

RG 133.92 For registered schemes, Ch 5C recognises that there are risks to scheme members depending on how the scheme property is held. The compliance plan should describe in some detail the scheme property arrangements.

RG 133.93 For example, the compliance plan of a registered scheme must set out arrangements for ensuring that scheme property is clearly identified as scheme property and held separately from the property of the responsible entity and property of any other scheme: see s601HA(1)(a) and RG 132. Table 4 lists examples of what should be addressed in the compliance plan, depending on your situation.

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Table 4: Responsible entities: What to address in your compliance plan

Your situation	What your compliance plan should include
<p>You hold assets for a registered scheme (sometimes called 'self-custody').</p>	<p>Your compliance plan must:</p> <ul style="list-style-type: none"> • comply with RG 132; • set out how you will deal with risks to scheme members that might arise from non-compliance by you in holding scheme property; and • include measures to satisfy the board or compliance committee, on a regular basis, that you are complying with your obligations under s601FC(1)(i) (i.e. that scheme property is clearly identified as scheme property and held separately from your property and the property of any other scheme) and that you are meeting the minimum standards in Section C of this guide.
<p>You hold assets where it may not be practicable to identify that they are held on trust.</p>	<p>Your compliance plan must include specific measures to ensure you comply with your obligations to scheme members for those assets. The plan might, for example, include special authorisation procedures.</p>
<p>You have engaged an asset holder who is your related body corporate or other associate.</p>	<p>If you arrange for a person who is legally or commercially related to you to be the asset holder, we expect you to include the same types of measures that you would use if you were the asset holder.</p>

F Relief from the obligation to separate assets

Key points

As a responsible entity, you must ensure that scheme property is clearly identified as scheme property and held separately from your property and the property of any other scheme.

Under [CO 13/xx], asset holders who are not responsible entities are also required to hold the relevant assets on trust for their clients and separately from their own assets, and the assets of any other scheme or any other person.

We have given limited class order relief to responsible entities from this requirement, and make similar exceptions for other asset holders, to allow the use of omnibus accounts.

Obligation to hold scheme property separately

- RG 133.94 A responsible entity must ensure that scheme property is:
- (a) clearly identified as scheme property;
 - (b) held separately from its own assets; and
 - (c) held separately from the property of any other scheme: s601FC(1)(i).
- RG 133.95 In some circumstances, it may not be appropriate to separate scheme property of a registered scheme from property of other schemes. Holding certain classes of scheme property separate from the property of other schemes may be inconsistent with market practice where it is likely to substantially add to the cost of holding scheme assets.
- RG 133.96 We have modified the Corporations Act to give limited relief from s601FC(1)(i) in certain circumstances to ensure that the interests of investors are not put at any additional risk of being lost by any pooling arrangements: see Class Order [CO 98/51] *Relief from obligation to separate assets of a managed investment scheme*.

Relief for omnibus accounts

- RG 133.97 Our relief under [CO 98/51] applies to holding certain financial assets where:
- (a) the property of the scheme is held separately from the assets of the responsible entity and the asset holder;
 - (b) the responsible entity ensures that the asset holder:
 - (i) maintains adequate records at all times showing the entitlement of clients in the account;

- (ii) performs regular reconciliation procedures appropriate to the nature of the assets held;
 - (iii) is able to perform the administrative functions required in connection with holding such assets (including processing voting and corporate actions); and
 - (iv) ensures that the account is always sufficient to meet the entitlement the responsible entity and any other person has in relation to that account;
- (c) the responsible entity certifies annually that the use of the omnibus account does not expose its members to unreasonable risk and is in the best interests of members of the scheme; and
 - (d) the responsible entity keeps a record of this certification for five years after it has ceased to be the current document that enables the use of the omnibus account.

RG 133.98 Other asset holders, including IDPS operators and MDA operators, may take advantage of our relief for use of omnibus accounts on corresponding conditions to those in RG 133.97(b), even if the property does not comprise assets of a managed investment scheme.

RG 133.99 For retail clients as in the case of IDPS and MDA services, the potential use of omnibus accounts must be notified in the asset holder's Financial Services Guide and expressly agreed to in writing by the retail client.

RG 133.100 Our relief under [CO 98/51] applies to cash (including foreign exchange), accounts and deposits with a bank or financial institution, securities, interests in a managed investment scheme and derivatives.

Rationale

RG 133.101 If s601FC(1)(i) were strictly applied, responsible entities who use, or whose asset holders use, omnibus accounts would be in breach of the obligation to clearly identify scheme property and hold it separately from the property of any other scheme.

RG 133.102 A responsible entity might reasonably consider that holding scheme property separately from property of other schemes would be inappropriate if it increases the costs to scheme members without materially reducing any risk. A risk could arise from holding assets together to the extent that the assets of one client could be used to settle the obligations of another client.

RG 133.103 Ensuring efficient and compliant operation by the asset holder may include operating separate omnibus accounts for different types of clients (e.g. buy-hold clients versus broker-dealer clients). Specifically, if there is a risk of a shortfall in the holding of a client's account due to the nature of the client or the types of transactions entered into, we would expect that the asset holder would, as part of its risk management system, segregate such client or clients to minimise potential losses to other clients or to the asset holder itself.

- RG 133.104 For the purposes of our relief, we treat securities, interests in managed investment schemes and derivatives as financial assets.
- RG 133.105 Under [CO 13/xx], asset holders who are not responsible entities are also required to hold the relevant assets on trust for their clients and separately from their own assets, and the assets of any other scheme or any other person: see Section C. Our relief under [CO 98/51] allows these asset holders to use omnibus accounts, even if the property does not comprise assets of a managed investment scheme.

Other property

- RG 133.106 Our relief under [CO 98/51] does not extend to assets other than financial assets (e.g. real property). Accordingly, responsible entities or other persons holding scheme property are not permitted to hold a single piece of other property as trustee for more than one managed investment scheme.
- RG 133.107 However, we consider that the obligation to hold assets separately arises only to the extent that it is practicable to do so. This may not be possible for real property (e.g. where disclosure of trusts in the land title register may not be permitted). In this case, we accept that real property can be registered in the name of the asset holder without breaching the obligation in s601FC(1)(i) to hold the property separately from the property of the responsible entity or another scheme.
- RG 133.108 We consider the obligation to separate scheme property extends to doing all that is practicable to achieve separation given the nature of the property and its ownership. Therefore, we do not consider it necessary to give any relief from s601FC(1)(i) in this situation. However, compliance arrangements must particularly address the risks of this holding arrangement.

G Land used in primary production schemes

Note: This section applies only to responsible entities of primary production schemes.

Key points

We have modified the Corporations Act where an offer of interests in a registered scheme involving primary production is made with, or includes, an offer of rights for the land on which the scheme will occur.

The purpose of the modification is to protect members by requiring the land to be held by members or on trust for members.

The instrument to register the protective interest must be lodged under state or territory laws before or immediately after interests are issued.

Protecting members of primary production schemes

RG 133.109 In many primary production schemes, members contract with the responsible entity to set up and maintain the scheme, and harvest or extract and market the proceeds. The underlying land often remains the property of the responsible entity or an associate and reverts to them when the scheme ends.

RG 133.110 We consider that it is inconsistent with the obligation of a responsible entity to do all things necessary to ensure that it operates a registered scheme efficiently, honestly and fairly to subject the scheme to risks of failure due to inadequate protection of the rights of members to use a part of the land for the expected duration of the scheme. To provide adequate protection in relation to land, a registered interest in the land is necessary. We consider that land should be held in a way that protects members from risks outside the scope of the scheme, such as the insolvency of a landowner.

RG 133.111 Certain risks arise if members are not protected by an interest in the land needed for operation of the scheme that is registered under state or territory laws, and that is paramount and cannot lawfully be adversely affected by any existing or subsequent secured creditor or transferee, other than one whose title has been conferred by the responsible entity in accordance with its duties. Risks to members include the following:

- (a) the holder of the interest in the land may have used, or may use, the land as security without acknowledging the interests of members, and if there is a default, the secured creditor may act without regard to the interests of members;
- (b) the landowner (or a liquidator of the landowner or other person authorised to act on the landowners behalf) may transfer the land (or an interest in the land) to a transferee who may not be under an obligation to recognise the right of members regarding the land; and
- (c) it may be practically difficult to continue to operate or to wind up the scheme if the landowner has become insolvent.

RG 133.112 Where the interest in the land continues only while the interest holder meets its obligations to others with an interest in the land, such as a secured creditor or lessor, failure to meet these obligations may result in the loss of the interest. Where the security or lease has been entered by the responsible entity in accordance with its duties, risk remains and may require disclosure to retail clients.

Note: See also Regulatory Guide 232 *Agribusiness managed investment schemes: Improving disclosure for retail investors* (RG 232). RG 232 includes a disclosure principle dealing with responsible entity's disclosure obligations in relation to the arrangements entered into to secure rights of access or tenure to the resources and infrastructure required to operate the agribusiness scheme, including any land, licences or leases, and water.

Protective interest must be registered

RG 133.113 We have modified the Corporations Act so that additional requirements apply to any offer of interests in a registered scheme involving agriculture or other primary production that is made after 31 December 2013 and that is made with, or includes, an offer of rights for the land on which the scheme will occur: see Class Order [CO 13/xx] *Title*.

RG 133.114 Under [CO 13/xx]:

- (a) the rights of members to have use of the relevant land on which the primary production occurs for the expected duration of the scheme is protected through an appropriate registered interest under state or territory land title laws;
- (b) the interest cannot be adversely affected by either interests of others in the land and so far as possible, any future interests, unless the interest of others was properly created by the responsible entity in accordance with its duties;
- (c) if the registered interest is a lease, the constitution of the scheme gives the responsible entity the power to require members to make payments to ensure the obligations under the terms of any lease;
- (d) the responsible entity must retain any amounts paid by members in relation to the lease as scheme property until the money is used to meet lease payments; and
- (e) if the interest is a lease, the terms of the lease must not be less favourable to the scheme than on an arm's length basis and exclude any action by the lessor or a head lessor in connection with the lease that would adversely affect the interests of members, other than where members or the responsible entity are in default of their obligations under the lease and the breach is unable to be remedied.

RG 133.115 The interest must be held by:

- (a) the members collectively;
- (b) each member in relation to that portion of the land on which the primary production business in which the member has an interest is being conducted;
- (c) the asset holder or other person entitled to hold scheme property as trustee for members, or in trust for the responsible entity if it holds the beneficial interest in trust for members; or
- (d) the responsible entity as trustee for members.

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Appendix: Comparison of requirements that apply before and after 1 July 2014

[A comparison table will be included in the final updated guide.]

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Key terms

Term	Meaning in this document
AFS licence	An Australian financial services licence under s913B that authorises a person who carries out a financial services business to provide financial services <p>Note: 'Australian financial services licence' is defined in s761A of the Corporations Act.</p>
AFS licensee	A person who holds an AFS licence
AML/CTF Act	<i>Anti-Money Laundering and Counter-Terrorism Financing Act 2006</i>
APRA	Australian Prudential Regulation Authority
asset holder	A person who holds scheme property or other assets of a registered scheme, client assets of an IDPS, client portfolio assets of an MDA service or financial products or a beneficial interest in financial products that is held under a custodial or depository service
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i>
AUASB	Auditing and Assurance Standards Board
client	A member of a registered scheme, a client of an IDPS operator, a client of an MDA operator or a client of a custodial or depository service (as the case may be)
client assets	Scheme property of a registered scheme, the assets held under an IDPS (other than by the client), the client portfolio assets of an MDA service or financial products or a beneficial interest in financial products that is held under a custodial or depository service
client portfolio assets	Financial products and other property that are the client's contribution to an MDA service or that are derived directly or indirectly from the client's contributions
[CO 04/194] (for example)	An ASIC class order (in this example numbered 04/194)
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001
custodial or depository service	The service provided under an arrangement between the provider and the client, or between the provider and another person with whom the client has an arrangement (whether or not there are also other parties to any such arrangement), under which a financial product, or a beneficial interest in a financial product, is held by the provider in trust for, or on behalf of, the client or another person nominated by the client unless the service is not a custodial or depository service under s766E(3) <p>Note: This is a definition in s766E of the Corporations Act.</p>

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Term	Meaning in this document
financial product	<p>Generally a facility through which, or through the acquisition of which, a person does one or more of the following:</p> <ul style="list-style-type: none"> (a) makes a financial investment (see s763B); (b) manages financial risk (see s763C); (c) makes non-cash payments (see s763D) <p>Note: See Div 3 of Pt 7.1 of the Corporations Act for the exact definition.</p>
GS 007	Guidance Standard 007 <i>Implications of the use of service organisations for investment management services</i> , issued by the AUASB in October 2011
IDPS	An investor directed portfolio service, as defined in Class Order [CO 02/294] <i>Investor directed portfolio services</i>
IDPS Guide	A document provided by an IDPS operator instead of a PDS to help retail clients decide whether they should use the IDPS
IDPS operator	<p>A holder of an AFS licence that includes a condition requiring the holder to comply with the requirements of [CO 02/294], who contracts with a client for the provision of the IDPS or a function that forms part of the IDPS, or for the purposes of a licence application, a proposed IDPS operator</p> <p>Note: This is a definition contained in [CO 02/294].</p>
licensed custody provider	A person who holds an AFS licence authorising the licensee to provide a custodial or depository service
licensee obligations	The obligations of a licensee as set out in s912A and 912B and the requirement to be of good fame and character as included in s913B
master custodian	A person with primary contractual responsibility to the licensee which is authorised by the licensee to engage an an asset holder
MDA operator	<p>A person who holds an AFS licence with authorisations to provide MDA services</p> <p>Note: A detailed definition is contained in Class Order [CO 04/194] <i>Managed discretionary accounts</i>.</p>
MDA service	<p>A managed discretionary account service where:</p> <ul style="list-style-type: none"> (a) the client gives the MDA operator money or money's worth (client contributions); (b) the MDA operator has the discretion to invest in financial products using client contributions without prior reference to the client for each transaction; and (c) the MDA operator manages the client's investments as a discrete portfolio belonging to that client <p>Note: A detailed definition is contained in [CO 04/194].</p>
PDS	Product Disclosure Statement
PF 209 (for example)	An ASIC pro forma (in this example numbered 209)

Term	Meaning in this document
PJC	Parliamentary Joint Committee on Corporations and Financial Services
Product Disclosure Statement	A document that must be given to a retail client in relation to the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the Corporations Act
Pt 7.9 (for example)	A part of the Corporations Act (in this example numbered 7.9), unless otherwise specified
reg 7.6.04 (for example)	A regulation of the Corporations Regulations (in this example numbered 7.6.04)
registered scheme	A registered managed investment scheme or a proposed registered managed investment scheme Note: 'Managed investment scheme' is defined in s9 of the Corporations Act.
responsible entity	The company named in ASIC's record of the scheme's registration as the responsible entity or temporary responsible entity of the scheme Note: This is a definition contained in s9 of the Corporations Act.
retail client	A client as defined in s761G of the Corporations Act and Ch 7, Pt 7.1, Div 2 of the Corporations Regulations
RG 132 (for example)	An ASIC regulatory guide (in this example numbered 132)
s912A (for example)	A provision of the Corporations Act (in this example numbered 912A), unless otherwise specified
scheme	A managed investment scheme Note: 'Managed investment scheme' is defined in s9 of the Corporations Act.
scheme property	Means: <ul style="list-style-type: none"> (a) contributions of money or money's worth to the scheme; (b) money that forms part of the scheme property under provisions of the Corporations Act or the ASIC Act; (c) money borrowed or raised by the responsible entity for the purposes of the scheme; (d) property acquired, directly or indirectly, with, or with the proceeds of, contributions or money referred to in paragraphs (a), (b) or (c); and (e) income and property derived, directly or indirectly, from contributions, money or property referred to in paragraphs (a), (b), (c) or (d) Note: This is a definition contained in s9 of the Corporations Act.
special custody assets	Has the meaning given in [CO 11/1140]
Trio Report	<i>Inquiry into the collapse of Trio Capital</i> , PJC, June 2012

Related information

Headnotes

AFS licence obligations, agriculture, appropriate registered interest, asset holder, client assets, client interests, compliance measures, compliance plans, conflict of interest, custodial or depository service, custodian, custody, financial assets, forestry schemes, holding scheme property, IDPS, master custodian, MDA, minimum standards, obligation to hold scheme property separately, omnibus accounts, organisational structure, primary production schemes, protective interest, real property, risk of non-compliance, scheme property, staff capabilities, underlying land

Class orders and pro formas

[CO 98/51] *Relief from the obligation to separate assets of a managed investment scheme*

[CO 02/294] *Investor directed portfolio services*

[CO 03/1110] *Prime brokerage services: Relief from obligation to hold scheme property on trust*

[CO 03/1111] *Prime brokerage services: Relief from obligation to hold scheme property separately*

[CO 03/1112] *Relief from obligation to hold client money on trust*

[CO 04/194] *Managed discretionary accounts*

[CO 13/xx] *Title*

[CO 13/xx] *Title*

PF 209 *Australian financial services licence conditions*

Regulatory guides

RG 51 *Applications for relief*

RG 94 *Unit pricing: Guide to good practice* (Joint ASIC and APRA guide)

RG 104 *Licensing: Meeting the general obligations*

RG 105 *Licensing: Organisational competence*

RG 132 *Managed investments: Compliance measures*

RG 136 *Managed investments: Discretionary powers and closely related schemes*

RG 148 *Platforms that are managed investment schemes*

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RG 167 *Licensing: Discretionary powers*

RG 179 *Managed discretionary account services*

RG 181 *Licensing: Managing conflicts of interest*

Legislation

Corporations Act, Ch 5C, Div 3 of Pt 7.1, Pt 7.6, Div 2 of Pt 7.9, s601FB(2), 601FC(1)–(2), 601HA, 761A, 761G, 763B–D, 766E, 769B, 911B(1), 912A–B, 913B; Corporations Regulations, regs 5C.2.01, 5C.4.02, 5C.5.01, 7.6.01(1)(k)

Reports

REP 291 *Custodial and depository services in Australia*

Information sheets

INFO 141 *Dealing and providing a custodial or depository service as a secondary services*

Other documents

APRA, Prudential Standard SPS 231 *Outsourcing*

AUASB, GS 007 *Implications of the use of service organisations for investment management services*