ASIC
Australian Securities & Investments Commission

REPORT 531

Review of compliance with asset holding requirements in funds management and custodial services

June 2017

About this report

In 2016–17, ASIC reviewed a number of asset holders to assess compliance with Regulatory Guide 133 *Managed investments and custodial or depository services: Holding assets* (RG 133) and related instruments.

This report sets out the findings from our review, and recommendations for improving compliance.

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.

Disclaimer

This report 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 report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

Contents

Executive summary

1 Gatekeepers such as responsible entities and custodians play a crucial role in ensuring the overall health of the financial system. Their conduct influences the level of investor trust and confidence in the financial system.

2 The custody—or safekeeping—of assets is a critical function. Without appropriate safeguards by the asset holder, which can be a responsible entity or separate custodian, there is a potential threat to client assets. Custody can also involve complex functions, such as pricing and reporting. Adequate resources and an appropriate risk management framework are therefore necessary for asset holders to ensure that their safekeeping of assets and related functions are satisfactorily performed.

Regulatory framework for holding assets

3 Following an extensive review of the industry in 2010–12, we issued Report 291 *Custodial and depository services in Australia* (REP 291), which identified some key risks to client assets, from the perspective of both the asset holders and their clients.

4 In 2013, we released:

(a) a revised version of Regulatory Guide 133 *Managed investments and custodial or depository services: Holding assets* (RG 133), which sets out our policy about the holding of assets; and

(b) Class Order [CO 13/1409] *Holding assets: Standards for responsible entities* and Class Order [CO 13/1410] *Holding assets: Standards for providers of custodial and depository service*.

We also amended Class Order [CO 04/194] *Managed discretionary accounts*, which set out the legal requirements for asset holding in relation to managed discretionary account (MDA) services.

Note: [CO 04/194] has since been repealed and replaced with ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968.

5 Asset holders that are subject to RG 133 include:

(a) responsible entities of registered managed investment schemes (registered schemes);

(b) licensed providers of custodial or depository services (licensed custody providers);

(c) operators of MDA services that are responsible to clients for assets held under an MDA service; and

Note: Revised Regulatory Guide 179 *Managed discretionary accounts* (RG 179) does not affect the application of RG 133 to MDA arrangements. RG 133 continues to apply

(except for the compliance committee requirements) where the client (or client's agent) does not hold the legal title to portfolio assets.

(d) investor directed portfolio service (IDPS) operators that are responsible to clients for assets held under an IDPS.

6 Also relevant, and setting out ASIC's capital requirements for asset holders, are:

(a) Regulatory Guide 166 *Licensing: Financial requirements* (RG 166); and

(b) Class Order [CO 13/760] *Financial requirements for responsible entities and operators of investor directed portfolio services* for responsible entities and Class Order [CO 13/761] *Financial requirements for custodial or depository service providers* for custodians.

7 Asset holders must comply with the applicable capital requirements to obtain and maintain their Australian financial services (AFS) licence. The capital requirements include having:

(a) sufficient financial resources to conduct the financial services business in compliance with the *Corporations Act 2001* (Corporations Act), including carrying out supervisory arrangements;

(b) a financial buffer that decreases the risk of a disorderly or non-compliant wind-up if the business fails; and

(c) incentives for the owners to comply through risk of financial loss (see RG 166.3).

Our review of asset holders

8 In late 2016 and early 2017, we considered it timely to review industry's compliance with the new requirements.

9 We adopted a risk-based and random selection process to identify 19 target entities, including both responsible entities and custodians.

Findings and outcomes of our review

10 While there were some examples of good practice, overall we found that compliance with RG 133 and the related instruments fell short of our expectations. Generally, there was a poor level of understanding of the requirements in RG 133 among the responsible entities and smaller custodians that we reviewed. For further information see Table 1 in Section C, which sets out the areas where we found the most instances of non-compliance or poor practice.

11 In summary, we found that:

(a) all entities were in compliance with their applicable net tangible assets (NTA) requirements;

(b) several entities demonstrated comprehensive compliance with RG 133 and the related instruments, and have a significant commitment to operating their business in a compliant manner, with priority given to this by the board and senior staff;

(c) in some instances, there was poor awareness and understanding of RG 133 and the related instruments, resulting in poor compliance—including in relation to the execution of compliant custody agreements;

(d) some entities were not well resourced at the director and compliance staff level, and did not respond to our review inquiries comprehensively or in the allocated timeframe;

(e) some entities did not have automated and efficient processes and systems, in contrast to others, potentially leading to greater operational risk;

(f) some responsible entities could not locate key documentation following the acquisition of a business, highlighting that a change in custodian or transfer of a responsible entity business represents a significant operational challenge, as it diverts resources from day-to-day tasks;

(g) some responsible entities that hold assets for a registered scheme (also referred to as 'self-custody') demonstrated poor understanding and management of conflicts of interest; and

(h) the selection and monitoring of custodians (or an internal custody function) was not given the level of priority and commitment that we expect following the publication of RG 133.

Next steps

12 As a result of our review, we have required entities to rectify identified breaches and to amend or update their custody agreements and risk management arrangements, to improve ongoing compliance.

13 Two entities remain the subject of high-intensity, broad-based surveillance at the time of this report, and we have required two entities to address specific concerns identified through the review.

14 Custody is and will remain a focus of ASIC going forward. We will continue to engage with industry and industry bodies.

15 We expect entities that provide custodial services to review the findings of this report and incorporate the recommendations into their own policies and operational practices. We will take action as necessary where we identify any deficiencies.

A Regulatory framework for holding assets

Key points

Asset holders derive their obligations from their AFS licence, the Corporations Act, and other legislation (such as the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006*). They should also take into account ASIC's regulatory guidance.

ASIC's regulatory scope

16 ASIC is responsible for:

(a) granting AFS licences for operating a registered scheme or wholesale scheme, or for providing custodial or depository services; and

(b) monitoring AFS licensees' compliance with their licence conditions, the Corporations Act and related regulatory guidance.

17 The term 'custodial or depository service' is defined in s766E of the Corporations Act. It refers to the holding, in certain circumstances, of financial products or a beneficial interest in financial products (other than as a trustee of a registrable superannuation entity or as holder of the assets of a registered scheme).

18 In connection with their business of holding assets, a custodian may provide additional services, such as trade settlement, reconciliations, fund accounting, unit pricing and reporting. However, these functions are not 'financial services' within the meaning of s766E of the Corporations Act.

AFS licensee obligations

19 Certain requirements apply to all AFS licensees—for example, under s912A, asset holders as AFS licensees must:

(a) do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly;

(b) have in place adequate arrangements for the management of conflicts of interest (see Regulatory Guide 181 *Licensing: Managing conflicts of interest* (RG 181)); and

(c) have adequate risk management arrangements (see Regulatory Guide 104 *Licensing: Meeting the general obligations* (RG 104)).

Note: Custodians do not have to demonstrate to ASIC compliance with the risk management requirement if they are regulated by the Australian Prudential Regulation Authority (APRA) and are not a registrable superannuation entity (RSE) licensee.

Financial requirements

20 An asset holder must satisfy the minimum financial requirements in:

(a) s912AA(4) of [CO 13/760] if they are a responsible entity; and

(b) s912AC(4) of [CO 13/761] if they are a custodian.

21 In addition, they must also satisfy the requirements in RG 166:

(a) the base level requirements in Section B;

(b) the surplus liquid funds requirement in Section C; and

(c) the requirements in the relevant appendix.

22 An entity providing a custodial or depository service should at all times have minimum NTA of $10 million, unless the custodial or depository service is incidental to the provision of another financial service provided by it or a related body corporate that is not an IDPS. With certain exceptions, unless a responsible entity has $10 million NTA, it must appoint a custodian to hold the scheme property and ensure that the custodian holds $10 million NTA, is an authorised deposit-taking institution (ADI) or is appointed by an ADI.

23 Additional financial requirements may also apply, depending on the other financial services business of the entity.

24 Generally, if a responsible entity engages a custodian that holds NTA of at least $10 million, the responsible entity must hold at all times a minimum of whichever is greater:

(a) $150,000;

(b) 0.5% of the average value of scheme property and IDPS property up to $5 million NTA; or

(c) 10% of the average responsible entity and IDPS revenue.

25 Generally, if a responsible entity does not engage a custodian as above, it must at all times hold a minimum NTA equalling whichever is greater of:

(a) $10 million; or

(a) 10% of the average responsible entity and IDPS revenue.

26 If a licensee is not a responsible entity and is exempt from the NTA requirements under [CO 13/761], the licensee will be required to comply with the financial resource requirements imposed by their licence. At a minimum, these financial resource requirements will include an obligation for the licensee to be able to pay all of its debts when they become payable and to maintain positive net assets.

27 However, the AFS licence financial requirements discussed at paragraphs 20–26 do not apply if the custodian entity is regulated by APRA and is not an RSE licensee.

ASIC's guidance

28 We reissued RG 133 in 2013, in line with ASIC's strategic priority of promoting investor and financial consumer trust and confidence by holding gatekeepers to account. Gatekeepers play a crucial role in ensuring the overall health of the financial system, so people can have trust and confidence in the system. We consider responsible entities and their custodians to be significant gatekeepers in safeguarding the assets of registered managed investment schemes (registered schemes).

29 RG 133 provides guidance on the minimum standards for responsible entities of registered schemes and other asset holders in relation to holding assets, to ensure they meet their obligations under their AFS licence. The guide applies to:

(a) responsible entities of registered schemes;

(b) licensed custody providers, including (where relevant) entities that provide custodial or depository services incidentally;

(c) operators of MDA services that are responsible to clients for assets held under an MDA service; and

(d) IDPS operators that are responsible to clients for assets held under an IDPS.

30 RG 133 sets out:

(a) obligations that apply to AFS licensees in relation to holding assets;

(b) minimum standards and related requirements that an asset holder must meet;

(c) what AFS licensees must do if they engage another asset holder;

(d) requirements for documented compliance measures; and

(e) limited relief for responsible entities from the obligation to separate assets, allowing the use of omnibus accounts—and the requirements that apply when other AFS licensees use omnibus accounts.

31 To meet the minimum standards, asset holders must:

(a) have an adequate organisational structure (see RG 133.31–RG 133.36);

(b) have adequate staffing capabilities (see RG 133.37–RG 133.40);

(c) have adequate capacity and resources to perform core administrative activities (see RG 133.41–RG 133.44); and

(d) hold assets on trust for the client, which includes the obligation to separate assets (see RG 133.45–RG 133.48).

32 An AFS licensee must keep records for seven years demonstrating compliance with the minimum standards for organisational structure, staffing capabilities, and capacity and resources: see RG 133.49.

33 An asset holder that is an AFS licensee must conduct checks on its clients before providing the service and then, as appropriate, to ensure that it meets its licensee obligations: see RG 133.50–RG 133.53.

Custody agreements

34 RG 133 also explains the requirements that apply if an AFS licensee engages a custodian or sub-custodian, including the obligation to ensure that the custodian meets the minimum standards and that the custody agreement meets certain content requirements.

35 A responsible entity that engages a custodian to hold scheme property or assets on its behalf must ensure it has a written agreement with the custodian that meets the requirements in s601FCAB(2)–(5), as inserted by [CO 13/1409]: see RG 133.80–RG 133.120.

36 The custody agreement must incorporate terms specifying:

(a) that the responsible entity:

  (i) has the right to review and monitor the custodian, and any sub-custodian, on an ongoing basis; and

  (ii) may terminate the agreement for breaches of the agreement;

(b) that the custodian must:

  (i) certify to the responsible entity at least every 13 months that it has complied with the terms of the agreement;

  (ii) acknowledge that the assets are held for the responsible entity;

  (iii) provide access and assistance to an auditor in relation to the financial statements;

  (iv) notify material or systemic breaches of the agreement; and

  (v) maintain business continuity arrangements;

(c) how instructions are given by the responsible entity to the custodian;

(d) procedures for the daily reconciliation of omnibus accounts;

(e) the terms on which the custodian is authorised to engage another person to hold scheme property assets; and

(f) the reporting arrangements to ASIC if the custodian suspects that the responsible entity has breached its obligations to report its own breaches—however, the agreement must not contain any provision requiring the custodian to disclose that it has communicated with ASIC concerning a suspected contravention of the law.

Note: For a complete discussion of the obligations, see [CO 13/1409].

IOSCO custody standards

37 RG 133 and related instruments establish new minimum standards requiring asset holders to maintain an adequate organisational structure (including a separation of functions of the custody and non-custody businesses), staffing capabilities, capacity and resources. In addition, custodial assets must be held on trust and segregated, subject to the conditional use of omnibus accounts.

38 In November 2015, the Board of the International Organization of Securities Commissions (IOSCO) published a report on *Standards for the custody of collective investment schemes' assets* (PDF 300 KB) (IOSCO custody standards). We consider that our domestic requirements are consistent with the IOSCO custody standards—for example:

(a) Standard 3 requires that collective investment scheme assets be entrusted to a third party that is functionally independent from the responsible entity. Although RG 133 permits the responsible entity to safe keep the assets rather than engaging a separate custodian, to do so significant capital requirements apply (under [CO 13/761], the responsible entity must have NTA of at least $10 million) and the responsible entity must ensure that the custody arm of its business is functionally separate from its responsible entity arm, in accordance with the minimum standards set out at RG 133.31–RG 133.36 and RG 133.196. This separation must be for all reporting lines up to the CEO level (i.e. the head of the custody business should not report to or be the same as the head of the responsible entity business).

(b) Standard 5 requires that a responsible entity use appropriate care, skill and diligence in appointing a custodian. Standard 6 requires the responsible entity to consider, at a minimum, a custodian's legal regulatory status, financial resources and organisational capabilities. Similarly, RG 133 contains requirements regarding the initial selection by a responsible entity of the custodian, and the custodian of its sub-custodians.

(c) Standards 7 and 8 require the responsible entity to document its relationship with the custodian and subsequently monitor compliance. The requirements in RG 133 require custody and sub-custody agreements to contain certain terms and provide appropriate protection for the client and the underlying investors.

B Our review of asset holders

Key points

Our review was focused on all areas of compliance with RG 133 and the applicable instruments.

We selected the entities to review using a combination of a risk based and random selection methodology.

We reviewed information provided to us and also met with the management of some entities.

Purpose and scope of our review

39 A two-year transition period was provided for asset holders to comply with the minimum standards and related requirements in RG 133 and related instruments. This ended in November 2015. We considered it timely and appropriate to review industry's compliance with the new requirements.

40 In late 2016 and early 2017, we conducted a risk-based review of 19 AFS licensees that either operate registered schemes (responsible entities) or provide custodial services, or both. The reviewed licensees also included IDPS operators and several licensees that undertake self-custody.

41 Our review focused on all areas of compliance with RG 133 and the applicable instruments. In particular, we reviewed compliance with:

(a) the NTA requirements, as explained in RG 166 and associated instruments;

(b) disclosure to retail clients of relationships with asset holders; and

(c) the minimum standards, including:

(i) engagement and oversight of custodians and sub-custodians;

(ii) holding assets on trust;

(iii) handling of special custody assets;

(iv) organisational structure requirements;

(v) training and competence requirements; and

(vi) internal processes and procedures for the operation of omnibus accounts, record keeping, managing conflicts of interest, and breach reporting.

42 As part of the current review, we also examined 2014–15 and 2015–16 financial reports from a number of AFS licensees that hold authorisations to

provide custodial or depository services, to determine whether the licensees were complying with their NTA requirements under:

(a) s912AC of the Corporations Act, as inserted by [CO 13/761]; and

(b) where the licensee is a responsible entity, s912AA of the Corporations Act, as inserted by [CO 13/760].

Selection of entities

43 We selected entities for review using a combination of:

(a) random sample, to ensure a representative cross-section of industry having regard to diversity of operations, relative size and organisational structures;

(b) risk-based selection, drawing on intelligence from previous surveillances and data analysis, to include entities:

(i) with a history of non-compliance with AFS licensee obligations or financial services laws, both significant and minor, or individual or continuing breaches;

(ii) in respect of which we had existing concerns about compliance and risk management generally (which may have been unrelated to paragraph 43(b)(i));

(iii) that operate both a responsible entity and custodial function;

(iv) that outsource either their responsible entity or custodial function (or both where relevant) to third parties; or

(v) we considered were otherwise likely to demonstrate high risks of non-compliance, due to the nature or size of their operation; and

(c) a 'control', where we selected entities that did not trigger the concerns in paragraphs 43(b)(i)–43(b)(v).

44 We selected 15 responsible entities and five custodians, many of which perform both functions and some of which we had engaged with during our previous review in 2010–12 and subsequently for Consultation Paper 197 *Holding scheme property and other assets* (CP 197).

Review methodology

45 We sought information from the selected licensees by issuing notices using ASIC's power under s912E of the Corporations Act (s912E notices) and s30 of the *Australian Securities and Investment Commission Act 2001* (s30 notices). We also conducted a number of on-site visits.

46 Our review methodology involved:

(a) collating and reviewing all—or a sample of—each entity's current custody agreements;

(b) assessing all responsible entities and custodians using data available to ASIC, including publicly available information;

(c) analysing information, obtained from responsible entities under s912E notices, about compliance with AFS licence conditions, RG 133 and [CO 13/1409];

(d) analysing information, obtained from custodians under s30 notices and s912E notices, about compliance with AFS licence conditions, RG 133 and [CO 13/1410];

(e) meeting directly with executive management and operational staff; and

(f) analysing additional information provided orally and in written format during the meetings referred to in paragraph 46(e).

47 For each licensee, we also reviewed their Form FS70 *Australian financial services licensee profit and loss statement and balance sheet* and Form FS71 *Auditor's report for AFS licensee*.

Further surveillance and monitoring

48 Two entities remain the subject of further surveillance as at the time of this report due to specific concerns that we identified during our review, including:

(a) lack of functional separation;

(b) over-reliance on the self-certification, against Guidance Standard 007 *Audit implications of the use of service organisations for investment management services*, provided by the custodian (GS 007 report) to monitor custodians, in lieu of a more proactive oversight;

(c) failure to adequately address conflicts of interest;

(d) inability to locate all current custody agreements and novations of, or amendments to, those agreements;

(e) no process or policy for appointing and monitoring external custodians;

(f) failure to provide ongoing training; and

(g) absence of a breach register.

C Findings and outcomes of our review

Key points

This section sets out the key findings from our review.

In particular, it covers findings that fell below our expectations or where there was a general lack of knowledge or understanding of the requirements. Overall, many entities—particularly responsible entities—lacked both understanding of and compliance with the regulatory requirements.

Where possible, we have provided examples of poor compliance and strong compliance with the relevant requirements, and made recommendations for improving compliance.

Two entities remain the subject of additional surveillance at the time of this report, which may entail further analysis, rectification of additional issues, imposition of additional conditions on their AFS licence and possible enforcement action.

Key findings

49 The key findings, actions and recommendations from our review are summarised in Table 1 and Table 2, and our detailed findings and examples are set out in paragraphs 52–112.

Areas of non-compliance and poor practices

50 Table 1 sets out the areas where we found the most instances of non-compliance or poor practice.

Table 1: Areas of non-compliance and poor practices

Area	Findings	Actions taken	Recommendations
RG 133 requirements	Many responsible entities had poor knowledge and understanding of the requirements of RG 133 and acceptable practice, suggesting that asset holding and administration was not prioritised by the board and compliance team.	We raised concerns with nine responsible entities and custodians. We required four entities to take immediate steps to update custody agreements and/or confirm compliance with minimum standards. Two entities are subject to further surveillance.	Responsible entities and custodians should review their custody arrangements and ensure they comply with the minimum standards in Sections B and C of RG 133, including RG 133.80–RG 133.120, and: • [CO 13/1409] at s601FCAA(1)–(12), for responsible entities; and • [CO 13/1410] at s912AAC(1)–(15) for custodians. We expect responsible entities to give a high priority to custody functions and relationships (whether internal or external) by integrating RG 133 compliance requirements into their risk management framework. This includes a thorough understanding of and compliance with all requirements in RG 133.

Area	Findings	Actions taken	Recommendations
Custody agreements (RG 133.80–RG 133.120)	Some entities did not: • have executed copies of all current custody agreements; • have custody agreements that strictly complied with the content requirements in RG 133 and related instruments; • have custody agreements that appeared to comply with the content requirements set out in RG 133.80 and RG 133.115 ('content requirements'); and • provide information to satisfy ASIC that their custody agreements met with the content requirements.	We required five responsible entities and custodians to review and amend their custody agreements. As a result, three entities amended their custody agreements. As stated, two entities are under ongoing surveillance.	Responsible entities and custodians should review RG 133 and where necessary, revise their custody agreements to ensure they comply with the content requirements in RG 133.80–RG 133.120 and: • [CO 13/1409] at s601FCAB(2)–(5), for responsible entities; and • [CO 13/1410] at s912AAD(2)–(4), for custodians.
Change management (REP 291 at paragraphs 95–97, RG 133.143(k) and [CO 13/1409] at s601FCAA(6))	Change in ownership of the responsible entity, or change in custodian or sub-custodian, causes additional operational risk during the transition. One newly-acquired responsible entity could not locate current custody agreements.	We required one responsible entity to locate all of its custody agreements to ensure they reflected current commercial terms and the requirements in RG 133 and related instruments. This entity is one of the two entities identified for further surveillance.	Entities should regularly review their custody agreements to ensure they are current and correctly reflect the requirements in RG 133. Entities contemplating an acquisition should conduct comprehensive due diligence on the target, including arrangements with custodians as well as the custody agreements themselves.

Area	Findings	Actions taken	Recommendations
Adequacy of capacity and resources (RG 133.41–RG 133.44, [CO 13/1409] at s601FCAA(3)(d) and [CO 13/1410] at s912AAC(8)(d))	Several entities had inadequate compliance resources. One entity engaged external consultants to respond to our information request. Three responsible entities required the assistance of the custodian to respond to our request and four requested additional time from us to respond to the information provided by the custodian. Most (80%) of responsible entities outsourced the custody function to an external custodian, either wholly or for the majority of assets.	We discussed resourcing requirements with five entities, and all of these acknowledged that their custody function was probably under-resourced. As stated, two of these entities are under ongoing surveillance.	As AFS licensees, responsible entities and custodians must have adequate risk management systems. Entities should review and, if necessary, amend their risk management arrangements against our guidance in Regulatory Guide 259 *Risk management systems of responsible entities* (RG 259). We expect responsible entities and custodians to actively and continually monitor their compliance arrangements and resources to ensure they remain adequate. The requirement to maintain adequate resources also includes: • properly vetting prospective employees and, once employed, using appropriate safeguards to reduce operational risk; • ensuring staffing capability so that custodial staff have the knowledge and skills to perform their assigned responsibilities properly; and • other requirements that apply generally to AFS licensees, such as effective breach monitoring and reporting processes.
Manual processing (REP 291 at paragraphs 117–119 and RG 133.44)	There remains a reliance on many diverse systems and manual processes, increasing operational risk. There is limited appetite to automate systems and processes.	We discussed the status of systems and processes with all custodians we visited, and stressed the need to ensure these remain secure and efficient to minimise operational risk.	As AFS licensees, responsible entities and custodians must have adequate risk management systems. Entities should review and, if necessary, amend their risk management arrangement against our guidance in RG 259.

Area	Findings	Actions taken	Recommendations
Understanding and management of conflicts (RG 133.24–RG 133.34, RG 133.70, [CO 13/1409] at s601FCAA(2) and [CO 13/1410] at s912AAC(7))	Self-custody entities revealed a lack of understanding of conflicts of interest that exist because of the dual in-house responsible entity and custody functions. These conflicts were therefore not managed. For example, one entity had the same directors and signatories on the board of the responsible entity and the custodian subsidiary. In addition, one entity did not have a conflicts of interest policy governing its relationship between it and its related party custodian.	We are undertaking specific surveillance of the conflict management framework for one entity.	Responsible entities and custodians should review our guidance in RG 133 as well as RG 181 and, where necessary, restructure their arrangements to ensure that conflicts management is adequate, implemented and maintained. Conflicts management is key to delivering financial products and services that are aligned with consumer needs and preferences. In addition, we expect there to be complete functional separation between the responsible entity function and the custodial function, including different staff and reporting lines.
Selection and monitoring of custodians (RG 133.71–RG 133.74)	Cost—rather than quality of service—was a significant driver for responsible entities selecting custodians, and for custodians selecting sub-custodians. One responsible entity particularly appeared to rely on the self-certification by the custodian. We consider that this does not equate to adequate monitoring as required by RG 133. Some entities did not have a formal selection process.	As a result of our inquiries, three responsible entities became aware of their non-compliance and undertook to rectify this. We have written to three other entities about establishing and complying with an appropriate monitoring process, as required by the relevant instruments and RG 133.	It is essential that all AFS licensees identify and engage competent service providers. Responsible entities and custodians should review our guidance in RG 133 and, where necessary, revise their selection policies in accordance with the requirements in RG 133.71–RG 133.74 and: • [CO 13/1409] at s601FCAA(7), (8), (10) and (11), for responsible entities; and • [CO 13/1410] at s912AAC(11), (12) and (14), for custodians. Reliance on the self-certification of custodians does not constitute adequate monitoring. We expect responsible entities to conduct their own independent monitoring, including through a program of regular on-site visits with custodial staff.

Area	Findings	Actions taken	Recommendations
NTA requirements	All licensees complied with their NTA requirements for the relevant periods. Our review highlighted the limited information provided in Form FS70 about a licensee's compliance with its specific NTA requirements. For example, it does not expressly require information about whether a licensee is an incidental provider of custodial and depository services, or is relying on an exemption under s912AC. We are considering options for obtaining such information from licensees.	One entity failed to demonstrate compliance. We engaged with this licensee and they were subsequently able to demonstrate compliance.	Licensees should review our guidance in RG 166 and related class orders [CO 13/760] and [CO 13/761]. Where necessary, licensees will need to restructure their arrangements to ensure that they comply with the financial resource requirements.
Unregistered schemes	One entity did not understand that RG 133 and [CO 13/1410] apply to the custody of assets of unregistered schemes.	As a result of our inquiries, this entity became aware of their non-compliance and undertook to rectify it.	Responsible entities and custodians should review their custody arrangements for unregistered schemes and ensure they comply with the minimum standards in RG 133. Where the responsible entity holds the assets, there will not be a custody agreement but there should still be separation and visibility of functions (e.g. holding, reconciling and pricing, which may be very different and separate from the responsible entity function).

Areas of strong compliance and good practices

51 While our review revealed areas of poor practice, we also found areas of strong compliance and examples of good practice—these are set out in Table 2. Generally, we found the larger entities (especially among the custodians) appeared to allocate more resources and attention to compliance with RG 133 and related instruments. This is especially in the case of custodians who focus on asset holding as their primary business activity.

Table 2: Areas of strong compliance and good practices

Area	Findings	Action taken	Recommendations
NTA compliance	Many entities demonstrated a thorough understanding of their NTA requirements. Compliance was also embedded generally into their business practices and culture. In addition, they had access to resources to invest in other systems and processes to leverage off the advantages of scale, leading to further automation, efficiencies and cost reduction.	We identified a potential lack of understanding by one entity. We have corresponded separately with this entity on the issue.	We recommend that licensees review their capital requirements under: • for custodians—[CO 13/761] and Appendix 4 of RG 166; and • for responsible entities—[CO 13/760] and Appendix 2 of RG 166.
Appropriate investment in automation	Some entities that were larger and ostensibly well-resourced demonstrated a significant commitment to continual investment in systems and processes, including outsourcing all or part of a process where that improved overall efficiency and reduced costs	No specific action was taken.	As stated, entities and custodians must have adequate risk management systems and resources. We recommend that responsible entities and custodians continually monitor and regularly review their compliance arrangements to ensure they have adequate resources. This may include a commitment to investment in new technology, systems and processes where efficiencies can be improved and operational risk reduced.

Compliance with custody requirements

General knowledge and understanding of the requirements

52 A number of entities demonstrated poor knowledge or understanding of RG 133 and related instruments. These included both responsible entities and custodians, in relation to both registered and unregistered schemes.

53 One entity did not consider that RG 133 applied to the custody of unregistered schemes. In fact, custody of the assets of an unregistered scheme is included in the definition of 'custodial and depository service', and is therefore subject to the requirements in RG 133. ASIC's oversight of the custody of unregistered schemes is achieved via [CO 13/1410], while [CO 13/1409] applies to the custody of registered schemes.

54 We expect responsible entities to give a high priority to custody functions and relationships (whether internal or external), by integrating RG 133 compliance requirements with their risk management, identification and assessment processes.

Compliance framework

55 Some entities were not aware of the applicable requirements or are not able to demonstrate that they are compliant.

56 An AFS licensee's compliance framework underpins the way it conducts its financial services business. We assessed the compliance framework of each entity based on:

(a) how the entity responded to our review inquiries (including the timeliness and who provided the response);

(b) whether the entity demonstrated compliance with the custody requirement under review; and

(c) the priority the business places on ensuring compliance with its custody requirements (including whether there is adequate engagement and oversight by senior management).

Culture

57 Another area of focus was entities' responses to the requirements in RG 133, as these are a good indicator of the entity's culture.

58 *ASIC's Corporate Plan 2016–17 to 2019–20: Focus 2016–17* noted that where culture, incentive structures and systems are poor or misaligned, the conduct of the gatekeepers we regulate can conflict with clients' interests and can lead to unfair outcomes.

59 In our review, we gave particular focus to the response of the organisation to compliance with RG 133 in assessing culture—for example, whether:

(a) the organisation has a culture of adopting generic policies designed to merely satisfy a regulatory requirement, without tailoring the policies to the business and embedding the key messages from the policies into the culture, systems and processes of the business; or

(b) there was a strong awareness of and organisational response to the matter of compliance, so that the requirements were 'front of mind' for directors and employees and embedded into the culture of the organisation, from the top down and across all levels.

Examples of poor compliance

60 Some examples of poor compliance that we found during the review included:

(a) not being able to locate custody agreements;

(b) not having signed copies of custody agreements and not being able to produce amendments to existing custody agreements;

(c) failing to correctly name the funds for which custody was outsourced;

(d) having a website referring to an entity that did not exist;

(e) a lack of engagement by senior management in the custody component of the business; and

(f) A general lack of awareness and understanding of the obligations for custody.

61 In one instance, an entity (one of the two entities selected for further surveillance) recently had an ownership change and the new owners did not conduct sufficient due diligence during the acquisition to adequately understand the requirements of the entity's custody business. The entity could not provide basic custody agreements, or relevant policies and procedures underpinning the custody side of its business.

Examples of strong compliance

62 For entities that demonstrated stronger compliance with the requirements in RG 133 and associated instruments, we identified that the custody function and the custody relationship (whether internal or external) are given a high priority by the business. This was demonstrated in several ways, including where:

(a) the board and compliance staff had a thorough understanding of the requirements in RG 133 and associated instruments;

(b) discussion of the custodial function is a standing item at both board and committee meetings—it is not seen as a matter that is 'outsourced' or of low priority for the business;

(c) the entity is able to readily access detailed information about its custodians and provide up-to-date copies of compliant current custody arrangements;

(d) there is a demonstrated process for the selection and change of custodian and/or sub-custodian (where relevant);

(e) there is a formal process for reporting and rectifying breaches;

(f) there is a demonstrated process for monitoring and supervising the custodian and/or sub-custodian (as relevant); and

(g) the entity is able to identify any risks to its business caused by the custodian function, and has a program to eliminate and manage these risks.

63 For two of the entities we reviewed (notably larger entities), it was clear that there has been investment in the automation of the custody function. To the extent possible, we encourage the use of automation for monitoring and reporting on compliance. Automatic systems and processes reduce reliance on manual processes and, when properly used, reduce operational risk and improve overall compliance.

Compliance with financial resource requirements

NTA requirements

64 The NTA requirements are contained in [CO 13/761] for custodians and [CO 13/760] for responsible entities. Guidance on the application of the NTA requirements is provided in RG 166.

65 We found strong compliance in this area, with the majority of respondents demonstrating a good understanding of the NTA requirements and producing evidence to substantiate compliance.

66 Only one entity, on initial assessment, failed to adequately demonstrate compliance with their NTA requirements. This entity has been selected for further surveillance because of other compliance issues, which will involve a further follow-up with the board of directors and an additional request for the entity to comply (if it continues to demonstrate non-compliance). If compliance is not achieved for the other compliance issues, we will consider the appropriate regulatory action to take against this entity, which may include taking enforcement action or cancelling their AFS licence.

67 Compliance with the financial resource requirements is a fundamental obligation of an AFS licensee. We observed, through this review and other surveillances, that a lack of compliance or understanding of the NTA requirements is typically a red flag for other areas of non-compliance.

Compliance with the minimum standards

Organisational structure

68 Our expectations about an asset holder's organisational structure are set out in RG 133.31–RG 133.36. We expect there to be complete functional separation between the responsible entity function and the custodial function, with different staff and reporting lines.

Note: See also [CO 13/1409] at s601FCAA(2) and [CO 13/1410] at s912AAC(7)).

69 The rationale underpinning this requirement is to ensure that the entity does not co-mingle its own assets with those of any other client or any other managed investment scheme (except to the extent permitted for omnibus accounts).

Examples of poor compliance

70 We found two instances of non-compliance with the organisational structure requirements. One of these entities has been selected for further surveillance and the other is currently a conducting a review and implementing changes to its structure. As discussed at paragraph 66, if compliance is ultimately not achieved, we will consider the appropriate regulatory action to take against any non-complying entity.

71 In one instance, where the custodial function is provided internally, there was no separation of the responsible entity and custodian function. Both the responsible entity and custodian businesses had the same board of directors, and two of the directors were signatories to all group bank accounts and performed activities across both businesses. It was of even further concern that, while this entity acknowledged the potential for a conflict of interest, it did not demonstrate adequate management of the conflict of interest. This arrangement does not comply with either:

(a) the organisational structure requirement to ensure functional separation (see RG 133.31–RG 133.36 and [CO 13/1409] at s601FCAA(2)); or

(b) the requirement to adequately address the conflicts of interest (see s912A(1)(aa) and RG 181).

72 For the other entity, although the day-to-day operations of the custodian appear to be functionally separate from the rest of the corporate group, there is no true separation and the custodial function is treated as a business division of the responsible entity.

Examples of appropriate compliance to manage conflicts

73 For the small number of responsible entities who use self-custody, we observed the following examples of appropriate control for the management of conflicts:

(a) robust information barriers between the responsible entity and custodial function;

(b) separate boards and reporting lines;

(c) physical separation of the responsible entity and custodian, even in different geographical locations;

(d) no common functions shared across the responsible entity and custodial business, other than some IT licences or the legal and compliance function;

(e) the custodian function is not treated as a business division of the responsible entity, but as an entirely different function; and

(f) breaches by the custodian are reported to the responsible entity and appropriate action taken by the responsible entity.

Staffing capabilities

74 Our expectations about an asset holder's staffing capabilities are set out in RG 133.37–RG 133.40. We expect custodial staff to have the knowledge and skills to perform their assigned responsibilities properly and to be provided with adequate ongoing training and educational programs to maintain their knowledge at the necessary level.

> Note: See also [CO 13/1409] at s601FCAA(3)(a) and (b), and [CO 13/1410] at s912AAC(8)(a) and (b).

75 We expect asset holders to properly vet prospective employees and, once employed, to ensure safeguards (e.g. mandatory absence periods, dual approval processes and staff rotation) are put in place to reduce operational risk, especially fraudulent conduct.

76 A number of asset holders did not provide appropriate compliance training for new custodial staff. Some entities could not demonstrate any ongoing training targeted at custodial staff, and the majority of entities indicated that they met their training obligations through 'on the job' training but did not provide evidence of any structured training for custodial staff.

77 In our view, relevant and ongoing training is not only important in ensuring that staff have up-to-date knowledge to properly complete their roles—a compliant culture also demands that the expectations of the business (including new policies and procedures) are communicated to all levels of staff.

Capacity and resources

78 Our expectations about an asset holder's capacity and resources are set out in RG 133.41–RG 133.44. We expect custodial staff to be allowed the time and authority to perform the duties associated with holding client assets. This means the asset holder must make resources available to custodial staff, including in specialist areas, to the extent necessary for them to adequately perform their duties.

> Note: See also [CO 13/1409] at s601FCAA(3)(c) and (d), and [CO 13/1410] at s912AAC(8)(c) and (d).

79 We expect asset holders to have:

(a) effective breach monitoring and reporting processes;

(b) regular training procedures;

(c) a robust risk identification and assessment process—asset holders must consider operational risks in holding assets, including breach of client guidelines and instructions, misdealing, pricing errors and settlement errors, fraud, and failure to respond to corporate actions; and

(d) adequate capacity and resources to carry out their licensed operations—this includes having up-to-date IT infrastructure, and competent operational and compliance staff who are supported with the necessary training and management oversight.

80 We received strong feedback from entities that the custody business continues to experience high levels of margin pressure. Some larger organisations have tried to address this by off-shoring and/or automating some low-skill, repetitive functions to improve efficiency and reduce cost. However, it is questionable whether there is scope for further cost cutting by smaller custodians.

81 While the scope of our review did not include cost pressures and resourcing, we observed:

(a) that four entities showed signs of insufficient resources—for example, having one staff member responsible for multiple roles, including oversight of both operations and compliance;

(b) of the entities referred to in paragraph 81(a), in two of our onsite review meetings the responsible staff (either compliance staff or senior managers) were unprepared and lacked knowledge in custody and/or financial services;

(c) a concerning lack of engagement by senior management of one entity in its custody business; and

(d) that one entity engaged external consultants to assist with its response to our questionnaire. As our questions were about basic compliance with existing custody requirements, we did not envisage that such work would need to be outsourced.

82 Given our findings above, we queried whether there is adequate resourcing in a number of these entities. We consider these findings to be potential red flags, which may warrant further surveillance.

Holding assets on trust

83 Our expectations about holding assets on trust are set out in RG 133.45–RG 133.48.

Note: See also [CO 13/1409] at s601FCAA(1), and [CO 13/1410] at s912AAC(2).

84 As expected, overall compliance in this area was high.

Omnibus accounts

85 We took the opportunity to look into entities which use omnibus accounts, relying on the relief from the obligation to hold assets separately: see RG 133.151–RG 133.154 and [CO 13/1409]. We found that—apart from the much larger custodian entities—many entities either:

(a) did not use omnibus accounts; or

(b) only used such accounts for clearing accounts, which are reconciled daily.

86 Many businesses operate separate accounts for each client and each asset type.

87 Where operational efficiency and cost savings can be achieved through the use of omnibus accounts, they should be considered. However, entities must consider the conditions, including the requirement to perform daily reconciliations, in [CO 13/1409].

Tier $500,000 class assets

88 We asked responsible entities about the holding of Tier $500,000 class assets, including special custody assets (i.e. assets that are permitted to be held by a responsible entity rather than a custodian, where the responsible entity does not have $10 million NTA). Tier $500,000 class assets include assets such as fixed term property schemes and pooled mortgage schemes. Special custody assets typically include derivatives, private equity interests, and bank accounts.

89 As expected, a number of smaller entities held such assets. We identified concerns during our review of one entity that had engaged a related party to hold assets. This entity has been selected for further surveillance.

Record keeping

90 An AFS licensee must keep, for seven years, records demonstrating how it has met the minimum standards for organisational structure, staffing capabilities, and capacity and resources as described in RG 133.31–RG 133.44: see RG 133.49.

Note: See also [CO 13/1409] at s601FCAA(5) and [CO 13/1410] at s912AAC(10).

91 We found compliance with the record-keeping requirement to be lower than expected—some of examples of our findings are set out below:

(a) Two entities had difficulty locating current custody agreements or providing a properly executed custody agreement. We were particularly concerned by entities that were unable to produce valid, up-to-date custody agreements. In addition to the legal requirement to enter into a compliant written agreement, the custody agreement is also an important tool to establish the role and responsibilities of each party, including the services to be provided by the custodian at the agreed price.

(b) Many entities continue to reveal a high level of reliance on manual processes, and the use of disparate systems. This, in addition to legacy systems, poses significant operational risks for asset holders. We encourage asset holders to consolidate and simplify systems and standardise processes where possible. However, we acknowledge that this is not always possible—in one example, the client base and assets base were so diverse and non-uniform that it was not commercially viable for the entity to standardise the instruction and reporting process.

(c) A few entities use manual and time-consuming verification processes (e.g. two signatures in clients' instructions, designated email accounts, two authorised officers to action instructions via a password-protected log in, separate accounts, and call backs where the client reads the original instruction to the custodian). Given the increased use of technology in the custody industry, we expect that there will be more automation in future.

(d) One entity could not locate all custody agreements for a responsible entity business which it had acquired. We found this unacceptable. A purchaser inherits the compliance agreements of a newly acquired business, even where this was broadly identified in the due diligence, and must be able to produce records to demonstrate how it meets the minimum standards.

92 Ownership changes in responsible entities, including changes in the custodian or sub-custodian, are common. These changes can alter the risk profile of the entity, as assets and records are transferred from one entity to another. As discussed in REP 291 at paragraphs 95–97, the transition needs to be adequately managed.

Compliance when engaging another asset holder

93 Responsible entities, licensed custody providers, MDA operators and IDPS operators have certain obligations under RG 133 and the relevant instruments when arranging for another person to hold client assets—these include:

(a) establishing a basis to be confident that the asset holder will meet the minimum standards, and documenting this;

(b) monitoring ongoing compliance with the minimum standards and dealing appropriately with any deficiencies that arise (see RG 133.65–RG 133.79 and [CO 13/1409] at s601FCAA(7));

(c) ensuring that there is a legally enforceable agreement, which addresses certain issues, with any asset holder that they engage (see RG 133.80 and [CO 13/1409] at s601FCAB) or any master custodian that they engage (see RG 133.116–RG 133.120);

(d) where retail clients are involved, disclosing the engagement of the asset holder and their role (see RG 133.121–RG 133.122); and

(e) if a responsible entity changes the asset holder, considering whether it is appropriate to obtain an independent report on the transfer of assets (see RG 133.123 and [CO 13/1409] at s601FCAA(6)).

Selection and monitoring

94 We found that the processes for selecting an external custodian, and any subsequent monitoring, generally fell short of the required standards. This was particularly evident in the engagement of related party custodians.

95 Several responsible entities do not appear to conduct any formal and objective assessment against comparable competitors, when engaging a related custodian. We do not consider that a responsible entity is acting in the best interests of investors if it does not objectively assess whether its custodian is the preferred choice. Entities must follow the requirements in RG 133.71–RG 133.74 (see also [CO 13/1409] at s601FCAA(10) and (11)).

96 For monitoring a related custodian, some responsible entities rely on the self-certification provided by the custodian (GS 007 reports) and do not objectively or independently assess the performance of the custodian. We expect the responsible entity to formally and thoroughly review compliance by the custodian, as if the custodian were an independent agent.

97 Responsible entities should not only appoint custodians based on the cost–benefit considerations, but should also conduct an extensive risk assessment of the potential custodian, taking into account the following factors (among others):

(a) expertise and market reputation;

(b) arrangements and technical capabilities in holding and safeguarding assets and in dealing with corporate actions;

(c) credit rating and protection of assets in the event of an insolvency by the custodian; and

(d) sub-custodian network, where relevant.

98 In relation to monitoring a custodian, we expect responsible entities not to merely rely on the self-certification provided by the custodian—responsible entities should:

(a) for a related custodian—appoint an independent person to periodically assess the performance of the custodian; and

(b) for an external custodian—undertake a formal and periodic review process to assess compliance by the custodian. Ideally, this should be an on-site audit, conducted by a person with sufficient experience but not associated with the custodian entity.

Custody agreement

99 As noted earlier in this report, documenting and recording the custody agreement is an area with low levels of compliance. One entity, as a result of ASIC's review, discovered that it did not have an appropriate compliant custody agreement in place. This entity subsequently lodged a breach notification to this effect.

100 However, where entities did produce legally enforceable custody agreements, the overwhelming majority of these agreements were sufficiently detailed and complied with the relevant requirements.

101 Where a responsible entity has engaged a custodian, we expect the custody agreement to not merely mimic the minimum requirements under RG 133—it must be sufficiently detailed to ensure certainty of the key terms that must be incorporated: see paragraph 36. While many entities have chosen to use industry standard documentation, some agreements did not include sufficient detail about:

(a) the duties and responsibilities of the custodians, and their liability in the event of operational failure or loss;

(b) the process for the selection and change of custodian and/or sub-custodian (where relevant);

(c) the process for reporting and rectifying breaches;

(d) the process for overseeing, monitoring and supervising the custodian and/or sub-custodian (as relevant);

(e) where the custodial is a related party of the responsible entity, procedures and authorities for:

(i) passing instructions to and from the responsible entity;

(ii) withdrawing any asset from the account; and

(iii) claiming and receiving dividends, interest or any entitlement accruing to the client;

(iv) providing all reasonable access and assistance to any auditor engaged to audit the licensee's financial statements or the financial statements of a registered scheme; and

(v) the seven-year retention period for records related to mortgages, security interests, liens or encumbrances (after cessation of that security);

(f) specific services and service levels for the particular client—for example, trade instruction cut-offs for domestic and overseas markets, corporate event reporting, proxy voting, and income collection; and

(g) the form of proper instruction, including a list of names and signatures of authorised persons, as well as the process for providing and effecting those instructions.

Functional separation

102 We expect there to be a complete functional separation between the responsible entity function and the custodial function.

103 Where the responsible entity and the custodian belong to the same corporate group, functional separation requires complete separation of custodial staff from the responsible entity arm. Responsible entities and custodians should also have different boards, with at least a majority of different directors and a full separation of activities and functions.

Disclosure

104 We observed generally strong compliance in the area of disclosure to retail clients. Responsible entities did refer to the custodial relationship and the identity of their custodians in their Product Disclosure Statements (PDSs).

Breach reporting

105 Most entities have a firm-wide approach to breach identification and reporting to ASIC, and were able to produce a clear breach register as required by Regulatory Guide 78 *Breach reporting by AFS licensees* (RG 78).

106 We note that a low number of recorded breaches does not necessarily mean that an entity is compliant. Conversely, a high number of recorded breaches

can indicate that the entity has implemented a thorough breach identification, recording and ultimately rectification process.

107 Where the custodian has breached an obligation under its custodial arrangement, this can cause the responsible entity to breach its own obligations. It is then important for the custodian and the responsible entity to separately determine whether the breach is significant, and therefore reportable to ASIC.

Managing changes in ownership

108 When there is a change in ownership or a merger or acquisition of the responsible entity or custodian, or where the responsible entity changes its custodian, we expect responsible entities to:

(a) enter into a compliant custody agreement at the same time, or immediately after, the change is effected;

(b) before the change—consider any operational risks in asset management as part of the due diligence, to decide whether a change of ownership, merger or acquisition should proceed; and

(c) after the change—manage the business integration, including the operational risks in asset management, as a discrete, organisation-wide project that is owned and overseen by the board. This approach helps ensure that it is given, and continues to be given, the appropriate resources and attention required for effective implementation.

Multiple service providers

109 Some responsible entities have custodial arrangements with multiple custodians, particularly where there is a 'responsible entity for hire' arrangement. We do not consider this optimal from a compliance perspective because:

(a) it necessitates the creation of individually negotiated, bespoke agreements and custodial arrangements between the responsible entity and each custodian;

(b) it may also be less efficient for the responsible entity to engage and monitor each separate custodian; and

(c) in such instances there may be less oversight by the responsible entity of the different custodians, leading to compliance issues.

110 A large and disparate network of service providers may bring additional complexity and a higher risk of non-compliance to a business. Where they have custodial arrangements with multiple custodians, we encourage responsible entities to rationalise their network of custodians, as much as they have the opportunity to do so. Similarly, we encourage custodians to

rationalise their network of sub-custodians—for example, using one primary sub-custodian with offices in multiple jurisdictions.

Training and competence

111 As AFS licensees, we expect custodians to, among other things:

(a) maintain the competence to provide their financial services (see s912A(1)(e)); and

(b) ensure their representatives are adequately trained and are competent to provide financial services under the custodian's licence (see s912A(1)(f)).

112 To comply with these obligations, all staff with custodial functions should be given specific training on the requirements in RG 133 before they assume their role. Continuous learning should also be incorporated in staff development plans, to ensure that they maintain the competence to provide custodial services.

Key terms

Term	Meaning in this document
ADI	An authorised deposit-taking institution—a corporation that is authorised under the *Banking Act 1959*. ADIs include: • banks; • building societies; and • credit unions
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
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 held under a custodial or depository service
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 being a person for whom financial products or a beneficial interest in financial products are held in providing the custodial or depository service (as the case may be)
client assets	Scheme property or other assets 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 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 13/1409] (for example)	An ASIC class order (in this example numbered 13/1409) Note: Legislative instruments made from 2015 are referred to as ASIC instruments.
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act

Term	Meaning in this document
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) Note: This is a definition contained in s766E of the Corporations Act.
custodial staff	Natural persons who have duties relating to: • holding assets; • record keeping for assets; • checking authorisations for instructions to transact; or • functions incidental to these powers (but does not include functions that involve the exercise of a material discretion whether under an arrangement with the asset holder or a person engaged by the asset holder other than in relation to an at-call deposit account of a regulated deposit taker or transactions in foreign exchange contracts)
custodian	A provider of a custodial or depository service as defined in s766E or a person that holds scheme property of a registered scheme, assets held under an IDPS, or client portfolio assets of an MDA service
financial product	A facility through which, or through the acquisition of which, a person does one or more of the following: • makes a financial investment (see s763B); • manages financial risk (see s763C); • makes non-cash payments (see s763D) Note: This is a definition contained in s763A of the Corporations Act: see also s763B–765A.
GS 007 report	A report produced by custodians when they self-certify against Guidance Standard 007 *Audit implications of the use of service organisations for investment management services*, issued by the Auditing and Assurance Standards Board in October 2011
IDPS	An investor directed portfolio service as defined in Class Order [CO 13/763] *Investor directed portfolio services* or any instrument that amends or replaces that class order
IDPS operator	A public company that is a holder of an AFS licence that is authorised to operate an IDPS and who provides an IDPS or a function that forms part of the IDPS
IOSCO	International Organization of Securities Commissions

Term	Meaning in this document
IOSCO custody standards	The report on *Standards for the custody of collective investment schemes' assets* (PDF 300 KB), published by IOSCO in November 2015.
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 an AFS licensee as set out in s912A and 912B of the Corporations Act and the requirement to be of good fame and character as included in s913B of the Corporations Act
master custodian	A person with primary contractual responsibility to the AFS licensee who is authorised by the licensee to engage an asset holder
MDA operator	A person who holds an AFS licence with authorisations to provide MDA services Note: A detailed definition is contained in ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968.
MDA service	A managed discretionary account service where: • the client gives the MDA operator money or money's worth (client contributions); • the MDA operator has the discretion to invest in financial products using client contributions without prior reference to the client for each transaction; and • the MDA operator manages the client's investments as a discrete portfolio belonging to that client Note: A detailed definition is contained in ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968.
omnibus account	An account in which money, securities or derivatives for more than one beneficial owner are co-mingled by a custodian or a sub-custodian
PDS	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 Note: See s761A for the exact definition.
registered scheme	A managed investment scheme that is registered under s601E of the Corporations Act
responsible entity	A responsible entity of a registered scheme as defined in s9 of the Corporations Act
RG 133 (for example)	An ASIC regulatory guide (in this example numbered 133)
retail client	A client as defined in s761G of the Corporations Act and Ch 7, Pt 7.1, Div 2 of the Corporations Regulations 2001

Term	Meaning in this document
RSE licensee	Has the meaning given in s10 of the *Superannuation Industry (Supervision) Act 1993*
s912A (for example)	A section of the Corporations Act (in this example numbered 912A), unless otherwise specified
scheme property	Means: (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.
self-custody	A responsible entity or trustee holding its own assets on trust, rather than engaging a separate custodian to hold the assets
Tier $500,000 class assets	Has the meaning given in RG 166.178

Related information

Headnotes

AFS licence, AFS licence conditions, AFS licensee obligations, asset holder, assets, Australian financial services licence, client assets, compliance measures, compliance plans, conflicts of interest, custodial or depository service, custodian, IDPS, IDPS operators, investor directed portfolio service, licensed custody providers, managed discretionary account, master custodian, MDA, MDA operators, minimum standards, obligation to separate scheme property, omnibus accounts, organisational structure, registered managed investment schemes, responsible entity, scheme property, staffing

Legislative instruments

ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968

[CO 13/760] *Financial requirements for responsible entities and operators of investor directed portfolio services*

[CO 13/761] *Financial requirements for custodial or depository service providers*

[CO 13/1409] *Holding assets: Standards for responsible entities*

[CO 13/1410] *Holding assets: Standards for providers of custodial and depository services*

Regulatory guides

RG 78 *Breach reporting by AFS licensees*

RG 104 *Licensing: Meeting the general obligations*

RG 133 *Managed investments and custodial or depository services: Holding assets*

RG 166 *Licensing: Financial requirements*

RG 179 *Managed discretionary account services*

RG 181 *Licensing: Managing conflicts of interest*

RG 259 *Risk management systems of responsible entities*

Legislation

Australian Securities and Investments Commission Act 2001, s30

Corporations Act, s601FCAA(1)–(12), 601FCAB, 766E, 912A, 912AA, 912AC, 912AAC(1)–(15), 912AAD(2)–(4), 912E

Reports

REP 291 *Custodial and depository services in Australia*

ASIC forms

Form FS70 *Australian financial services licensee profit and loss statement and balance sheet*

Form FS71 *Auditor's report for AFS licensee*

Standards

GS 007 *Audit implications of the use of service organisations for investment management services*

Other ASIC publications

ASIC's Corporate Plan 2016–17 to 2019–20: Focus 2016–17