



**ASIC**

Australian Securities & Investments Commission

CONSULTATION PAPER 132

# Trustee companies: Financial requirements and conduct obligations

March 2010

## About this paper

This consultation paper sets out ASIC's proposals on the financial resource requirements to apply to trustee companies that provide traditional trustee company services (traditional services).

The purpose of this paper is to seek the views of trustee companies, their clients and legal advisers, and other interested parties on the proposals we have developed about financial requirements and risk management for trustee companies. We also seek comments on whether we should provide guidance on any other conduct obligations that trustee companies providing traditional services should meet.

### 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 15 March 2010 and is based on the Corporations Act as at 15 March 2010.

### 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.

Regulations about trustee companies are yet to be issued. We will consider the regulations in issuing our final regulatory guidance.

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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 the financial resource requirements for trustee companies that provide traditional services. 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 Business Cost Calculator Report and/or a Regulation Impact Statement: see Section C, '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 7 April 2010 to:

Kelly Fung  
Lawyer  
Strategic Policy  
Australian Securities and Investments Commission  
GPO Box 9827  
Sydney NSW 2001  
facsimile: 02 9911 2414  
email: [policy.submission@asic.gov.au](mailto:policy.submission@asic.gov.au)

## What will happen next?

<b>Stage 1</b>	15 March 2010	ASIC consultation paper released
<b>Stage 2</b>	7 April 2010	Comments due on the consultation paper
	April 2010	Drafting of amendments to RG 166
<b>Stage 3</b>	May 2010	Re-release of RG 166

## A Regulation of trustee companies

### Key points

Traditional trustee company services (traditional services) will be regulated as a financial service under the Corporations Act. A trustee company that provides those services will need to hold an AFS licence covering those services.

Trustee companies will be subject to conduct obligations, including the obligations to have adequate financial resources and risk management systems.

This paper:

- sets out our proposals on the financial requirements that should apply to trustee companies providing traditional services; and
- seeks views on whether we should consider giving any specific guidance on other conduct obligations that trustee companies providing traditional services should meet.

### Traditional services to be a 'financial service' under Chs 5D and 7

- 1 The Council of Australian Governments agreed on 26 March 2008 that the Australian Government would assume responsibility for regulating traditional services provided by trustee companies.
- 2 The *Corporations Legislation Amendment (Financial Services Modernisation) Act 2009* (Modernisation Act) was enacted on 6 November 2009. It amends the *Corporations Act 2001* (Corporations Act) and regulates traditional services provided by trustee companies as financial services under Chs 5D and 7 of the Corporations Act.

Note: Section 601RAB(1) of the Corporations Act provides that a trustee company is an entity that is prescribed in the regulations as a trustee company. The regulations have not been finalised as at the date of this consultation paper.

- 3 Under the Corporations Act, traditional services provided by a trustee company are specifically included as a financial service under s766A(1A). This means that a trustee company providing traditional services will be required to obtain an Australian financial services (AFS) licence and will be subject to the conduct obligations in Ch 7 of the Corporations Act, including the obligation to have adequate financial resources.

Note: Section 601RAC of the Corporations Act defines traditional services as:

- (a) performing estate management functions (as defined in s601RAC(2));
- (b) preparing a will, a trust instrument, a power of attorney or an agency arrangement;

- (c) applying for probate of a will, applying for grant of letters of administration, or electing to administer a deceased estate;
- (d) establishing and operating common funds; and
- (e) any other services prescribed by the regulations for the purpose of s601RAC(1).

4 We are aware that some trustee companies already hold an AFS licence which, among other things, authorises them to provide custodial and depository services. Custodial and depository services are not considered to be traditional services provided by trustee companies but are regulated under Ch 7 of the Corporations Act as a separate type of financial service. Trustee companies that already hold an AFS licence will need to vary their licence to obtain an authorisation to provide traditional services.

Note: Section 601RAC(3) excludes from the definition of traditional services the following activities:

- (a) operating a registered scheme;
- (b) providing a custodial or depository service;
- (c) acting as trustee for debenture holders under Ch 2L;
- (d) acting as a receiver or other controller of property of a corporation under Part 5.2;
- (e) acting as trustee of a superannuation fund, an approved deposit fund or a pooled superannuation trust (within the meaning of the *Superannuation Industry (Supervision) Act 1993*); or
- (f) acting in any other capacity prescribed by the regulations for the purpose of s601RAC(3)(f).

5 Trustee companies will remain subject to relevant state and territory laws that require a company to have (or to have staff who have) particular qualifications or experience if the company is to provide traditional services of a particular kind: s601RAE(3). The regulations may prescribe relevant state and territory laws that will or will not apply to trustee companies: s601RAE(4).

Note: The relevant state legislation is to be prescribed in regulations to be made under s601RAE(4) of the Corporations Act.

6 Transitional arrangements will apply to the process of licensing trustee companies in relation to their provision of traditional services. Under these transitional arrangements, trustee companies that hold an AFS licence at the commencement of the regulations can continue to provide traditional services for six months after commencement without obtaining an authorisation to provide traditional services. After that time, trustee companies will be required to hold that licence authorisation or cease to provide traditional services.

Note: See Division 2 of Part 10.12 of the Corporations Act for more information about the transitional arrangements that will apply.

## Financial requirements for trustee companies

- 7 Trustee companies holding an AFS licence with an authorisation for traditional services must have:
- (a) available adequate financial resources to provide the financial services covered by the AFS licence and to carry out supervisory arrangements (s912A(1)(d)); and
  - (b) adequate risk management systems (s912A(1)(h)),
- as well as comply with their other licence obligations.

Note: The financial resource requirements do not apply to a body regulated by the Australian Prudential Regulation Authority (APRA).

- 8 As part of our role as regulator of the financial services industry, we are responsible for administering the financial requirements that an AFS licensee must meet. These requirements are set out in Regulatory Guide 166 *Licensing: Financial requirements* (RG 166) and apply to AFS licensees by way of conditions on their AFS licence.
- 9 Traditional services provided by trustee companies have not previously been regulated as a financial service under the Corporations Act. Accordingly, a number of amendments to RG 166 are necessary to ensure that we impose appropriate financial requirements on trustee companies providing traditional services.
- 10 We have set out proposed financial requirements for trustee companies providing traditional services in Section B of this consultation paper.

## Other requirements for trustee companies

- 11 At this stage, we have limited our proposed guidance to the financial requirements that trustee companies providing traditional services must meet. This is on the basis that trustee companies are familiar with any other financial services obligations that may apply to them under the new regime.
- 12 Guidance is currently available for AFS licensees on how to meet their general obligations. We also provide some specific guidance—for example, on the minimum standards trustee companies must meet in holding trust assets for custodians of scheme property in Regulatory Guide 133 *Managed investments: Scheme property arrangements* (RG 133).
- 13 We will consider whether to provide specific guidance on other conduct obligations that trustee companies providing traditional services will need to meet (e.g. disclosure and training obligations) at a later date.



*Your feedback*

- A1Q1 For trustee companies providing traditional services, are there any conduct obligations other than the obligation to have adequate financial resources about which you think we should give specific guidance? If so, please give details.
- A1Q2 Should we provide specific guidance on the minimum standards trustee companies must meet in holding trust assets, as we have for custodians of scheme property in RG 133? If so, please give reasons.

## B Proposals to ensure a trustee company has adequate financial resources

### Key points

We propose that:

- a trustee company not regulated by APRA that provides traditional services should be required to have risk management systems to specifically deal with the risk its financial resources will not be adequate to ensure that it is able to carry on its business in compliance with the licensee obligations, or to wind up its business in an orderly manner (see proposal B1 and paragraphs 18–19);
- a trustee company providing traditional services should meet the base level financial requirements set out in Section B of RG 166 (see proposal B2 and paragraphs 20–23); and
- a trustee company providing traditional services should hold at least \$5 million in net tangible assets (NTA) at all times that the trustee company provides such services (see proposal B3 and paragraphs 25–27).

### Overview of proposed financial requirements for trustee companies

- 14 Trustee companies that provide traditional services (except those regulated by APRA) will be required to meet the financial requirements in RG 166.
- 15 The requirements in RG 166 vary in their application depending on the nature, scale and complexity of the financial services business.
- 16 Table 1 summarises the financial requirements we believe should apply to trustee companies providing traditional services.
- 17 Trustee companies may have financial requirements that are in addition to those set out in Table 1. This may occur as result of a trustee company providing other financial services. For example, a trustee company that is authorised to provide a margin lending facility will also have to meet the financial requirements associated with that activity, such as holding adjusted surplus liquid funds: see Section F of RG 166.

**Table 1: Summary of proposed financial requirements for trustee companies not regulated by APRA that provide traditional services**

Proposed financial requirements	Summary of requirement	Relevant guidance in RG 166
Risk management	Risk management systems must address risk to financial resources	See RG 166.14 in Section A, 'Our general policy on financial requirements'
Base level financial requirements	<p>Must have positive net assets and be solvent</p> <p>Must have sufficient cash resources to cover next 3 months expenses with adequate cover for contingencies</p> <p>Must audit compliance annually and when we ask</p>	See RG 166.22 and following paragraphs in Section B, 'Base level financial requirements'
Net tangible assets (NTA)	<p>Must have minimum NTA of \$5 million</p> <p>(This requirement is in addition to the base level financial requirements in Section B of RG 166)</p>	See RG 166.63 and following paragraphs in Section C, 'Trustee companies, managed investments, custody services and margin lending facilities'

## Risk management

- 18 Under Section A of RG 166, an AFS licensee is required to have risk management systems that specifically deal with the risk that its financial resources will not be adequate to ensure that it is able to carry on its business in compliance with its licensee obligations, or to wind up its business in an orderly manner.

Note: For guidance about risk management systems, see Regulatory Guide 104 *Licensing: Meeting the general obligations* (RG 104).

### Proposal

- B1** We propose that a trustee company not regulated by APRA that provides traditional services will be required to have risk management systems to specifically deal with the risk its financial resources will not be adequate to ensure that it is able to carry on its business in compliance with the licensee obligations, or to wind up its business in an orderly manner.

#### *Your feedback*

- B1Q1 Do you agree with this approach? If not, why not?
- B1Q2 Are there any aspects of traditional services that make this proposal impractical?
- B1Q3 Please give details of any additional costs associated with the implementation of this proposal.

## Rationale

- 19 This requirement applies to all AFS licensees except licensees regulated by APRA. We believe that it is also appropriate to apply this requirement to trustee companies that provide traditional services.

## Application of the base level requirements

- 20 The base level requirements in Section B of RG 166 are that an AFS licensee must at all times:
- (a) be solvent;
  - (b) have assets that exceed liabilities as shown in the most recent annual balance sheet lodged with ASIC and have no reason to suspect that assets no longer exceed liabilities on a current balance sheet;
  - (c) meet the cash flow requirements by complying with one of Options 1 to 5; and
  - (d) meet the audit requirements.

Note: For guidance on calculating the financial requirements under Section B, see RG 166.22–RG 166.44.

## Proposal

- B2** We propose that a trustee company not regulated by APRA that provides traditional services will be required to comply with the base level financial requirements set out in Section B of RG 166.

### *Your feedback*

B2Q1 Do you agree with this approach? If not, why not?

B2Q2 Are there any aspects of a trustee company's traditional activities that make compliance with this proposal unnecessary or unreasonably onerous?

B2Q3 Please give details of any additional costs associated with the implementation of this proposal.

## Rationale

- 21 The base level financial requirements in Section B of RG 166 apply to all AFS licensees except licensees regulated by APRA and market and clearing participants. We believe that it is also appropriate to apply these requirements to trustee companies that provide traditional services.
- 22 A trustee company that provides traditional services will not be able to comply with its licence obligations unless it has sufficient financial resources to do so and is solvent. Requiring a trustee company to annually audit its compliance with these requirements is necessary to help ensure compliance with key licensee obligations.

- 23 Further, we see no basis for treating trustee companies that provide traditional services differently from other licensees in Section B of RG 166.

## Application of the net tangible assets requirement

- 24 Under Section C of RG 166, an AFS licensee is required at all times to hold minimum net tangible assets (NTA) of up to \$5 million if the licensee is:
- (a) a responsible entity;
  - (b) an IDPS operator;
  - (c) licensed to provide a custodial or depository service (other than incidentally to another financial services business); or
  - (d) an issuer of a margin lending facility.

Note: For guidance on the definitions used in calculating the financial requirements under Section C, see Section H of RG 166.

### Proposal

- B3** We propose to amend Section C of RG 166 so that a trustee company not regulated by APRA that provides traditional services must hold at least \$5 million NTA at all times that the trustee company provides traditional services.

#### *Your feedback*

B3Q1 Do you agree with this proposal? If not, why not?

B3Q2 Do you think there are any circumstances where this proposal should not apply?

B3Q3 Please give details of any costs created by our proposal for both trustee companies and their clients. For example, will trustee companies have to change the amount of financial resources currently held under relevant state and territory requirements? How will this cost be passed on?

B3Q4 Are there any aspects of traditional services that make this proposal impractical?

### Rationale

- 25 We believe that a client using traditional services provided by a trustee company is typically placing substantial trust in the trustee company that provides those services and the trustee company should have some financial substance.
- 26 We think that our proposed approach is consistent with the financial requirements that we impose on providers of similar types of financial services.

- 27            Our proposed approach is also broadly consistent with the way in which the financial requirements currently apply under the more recently updated state legislation for trustee companies.

## C Regulatory and financial impact

- 28 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) protecting consumers by ensuring that trustee companies that provide traditional services have:
    - (i) adequate financial resources to conduct their business in compliance with the Corporations Act;
    - (ii) a financial buffer should the business fail; and
    - (iii) incentives to comply through risk of financial loss; and
  - (b) implementing financial requirements in a way that is not overly burdensome.
- 29 Before settling on a final policy, we will comply with the requirements of the Office of Best Practice Regulation (OBPR) by:
- (a) considering all feasible options;
  - (b) if regulatory options are under consideration, undertaking a preliminary assessment of the impacts of the options on business and individuals or the economy;
  - (c) if our proposed option has more than low impact on business and individuals or the economy, consulting with OBPR to determine the appropriate level of regulatory analysis; and
  - (d) conducting the appropriate level of regulatory analysis—that is, completing a Business Cost Calculator report (BCC report) and/or a Regulation Impact Statement (RIS).
- 30 All BCC reports and RISs are submitted to the OBPR for approval before we make any final decision. Without an approved BCC report and/or RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.
- 31 To ensure that we are in a position to properly complete any required BCC report or RIS, we ask you to provide us with as much information as you can about:
- (a) the likely compliance costs;
  - (b) the likely effect on competition; and
  - (c) other impacts, costs and benefits,
- of our proposals or any alternative approaches: see ‘The consultation process’, p. 4.

## Key terms

Term	Meaning in this document
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries out a financial services business to provide financial services <p>Note: This is a definition contained in s761A of the Corporations Act.</p>
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001
financial service	Has the meaning given in Div 4 of Pt 7.1 of the Corporations Act
Modernisation Act	<i>Corporations Legislation Amendment (Financial Services Modernisation) Act 2009</i>
RG 166 (for example)	An ASIC regulatory guide (in this example numbered 166)
traditional services	Traditional trustee company services as defined in s601RAC(1) of the Corporations Act, which are: <ul style="list-style-type: none"> <li>performing estate management functions (as defined in s601RAC(2));</li> <li>preparing a will, a trust instrument, a power of attorney or an agency arrangement;</li> <li>applying for probate of a will, applying for grant of letters of administration, or electing to administer a deceased estate;</li> <li>establishing and operating common funds; and</li> <li>any other services prescribed by the regulations for the purpose of s601RAC(1).</li> </ul>
trustee company	Has the same meaning as in s601RAB of the Corporations Act



## List of proposals and questions

Proposal	Your feedback
See paragraphs 11–13.	<p>A1Q1 For trustee companies providing traditional services, are there any conduct obligations other than the obligation to have adequate financial resources about which you think we should give specific guidance? If so, please give details.</p> <p>A1Q2 Should we provide specific guidance on the minimum standards trustee companies must meet in holding trust assets, as we have for custodians of scheme property in RG 133? If so, please give reasons.</p>
<p>B1 We propose that a trustee company not regulated by APRA that provides traditional services will be required to have risk management systems to specifically deal with the risk its financial resources will not be adequate to ensure that it is able to carry on its business in compliance with the licensee obligations, or to wind up its business in an orderly manner.</p>	<p>B1Q1 Do you agree with this approach? If not, why not?</p> <p>B1Q2 Are there any aspects of traditional services that make this proposal impractical?</p> <p>B1Q3 Please give details of any additional costs associated with the implementation of this proposal.</p>
<p>B2 We propose that a trustee company not regulated by APRA that provides traditional services will be required to comply with the base level financial requirements set out in Section B of RG 166.</p>	<p>B2Q1 Do you agree with this approach? If not, why not?</p> <p>B2Q2 Are there any aspects of a trustee company's traditional activities that make compliance with this proposal unnecessary or unreasonably onerous?</p> <p>B2Q3 Please give details of any additional costs associated with the implementation of this proposal.</p>
<p>B3 We propose to amend Section C of RG 166 so that a trustee company not regulated by APRA that provides traditional services must hold at least \$5 million NTA at all times that the trustee company provides traditional services.</p>	<p>B3Q1 Do you agree with this proposal? If not, why not?</p> <p>B3Q2 Do you think there are any circumstances where this proposal should not apply?</p> <p>B3Q3 Please give details of any costs created by our proposal for both trustee companies and their clients. For example, will trustee companies have to change the amount of financial resources currently held under relevant state and territory requirements? How will this cost be passed on?</p> <p>B3Q4 Are there any aspects of traditional services that make this proposal impractical?</p>