



ASIC

Australian Securities & Investments Commission

REPORT 197

Response to submissions on CP 132 Trustee companies: Financial requirements and conduct obligations

May 2010

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 132 *Trustee companies: Financial requirements and conduct obligations* (CP 132) and details our response to those issues.

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.

This report does not contain ASIC policy. Please see Regulatory Guide 104 *Licensing: Meeting the general obligations* (RG 104), Regulatory Guide 126 *Compensation and insurance arrangements for AFS licensees* (RG 126), Regulatory Guide 133 *Managed investments: Scheme property arrangements* (RG 133), Regulatory Guide 166 *Licensing: Financial requirements* (RG 166) and Information Sheet 106 *Trustee companies: Minimum standards for trustee companies holding estate assets* (INFO 106).

Contents

A	Overview/Consultation process	4
	Responses to consultation.....	5
B	Financial requirements for trustee companies.....	6
	Application of the net tangible assets requirement.....	6
C	Other requirements for trustee companies.....	8
	Training, code of conduct and indemnity insurance	8
	Compliance programs, and accounting and auditing standards	9
	Appendix: List of non-confidential respondents	10

A Overview/Consultation process

- 1 Under the *Corporations Legislation Amendment (Financial Services Modernisation) Act 2009*, trustee companies that provide traditional trustee company services (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 2001* (Corporations Act), including the obligation to have adequate risk management systems and adequate financial resources.
- 2 In Consultation Paper 132 *Trustee companies: Financial requirements and conduct obligations* (CP 132), we consulted on the financial resources and risk management requirements we should apply to trustee companies that provide traditional services.
- 3 In CP 132 we proposed that the following financial requirements in Regulatory Guide 166 *Licensing: Financial requirements* (RG 166) should apply to a trustee company not regulated by APRA that provides traditional services:
 - (a) the requirement to have risk management systems to specifically deal with the risk that the trustee company's 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;
 - (b) the base level requirements set out in Section B of RG 166 about solvency and cash flow; and
 - (c) the net tangible assets (NTA) requirement in Section C of RG 166, so that the trustee company will be required to hold at least \$5 million NTA at all times that it provides traditional services.
- 4 We also sought feedback on whether ASIC should provide specific guidance on any other conduct obligations that trustee companies providing traditional services will be required to meet.
- 5 This report highlights the key issues that arose out of the submissions received to CP 132 and our responses to those issues.
- 6 This report is not meant to be a comprehensive summary of all responses received. Nor is it meant to be a detailed report on every question from CP 132. We have limited this report to the key issues.

Responses to consultation

- 7 We received three responses to CP 132 including from a relevant industry body and an individual. We thank the respondents for taking the time to send us their comments.
- 8 There was support among respondents for requiring trustee companies that provide traditional services to have risk management systems that address risk to financial resources and to meet the base level financial requirements set out in Section B of RG 166. The issue of whether trustee companies should also be required to hold at least \$5 million in net tangible assets (NTA) is discussed further in Section B.
- 9 One respondent to CP 132 also made a number of other helpful comments in relation to guidance on other matters that ASIC should give to trustee companies providing traditional services. These are addressed in Section C.
- 10 For a list of non-confidential respondents to CP 132, see the Appendix to this report. Copies of the non-confidential submissions are on the ASIC website at www.asic.gov.au/cp under CP 132.

B Financial requirements for trustee companies

Key points

In CP 132, we proposed that a trustee company not regulated by APRA that provides traditional services should be required to hold at least \$5 million net tangible assets (NTA) at all times that it provides traditional services.

While there was some support for our proposal, one respondent suggested that the NTA requirement should only apply where a trustee company operates a common fund.

Another respondent recommended that trustee companies should instead be required to:

- maintain a set ratio between assets held in trust and the capital base of the company; and
- lodge a \$10 million security bond.

Application of the net tangible assets requirement

- 11 In CP 132, we proposed that a trustee company not regulated by APRA that provides traditional services should be required to hold at least \$5 million NTA at all times that it provides traditional services.
- 12 There was some support for our proposal. However, one respondent recommended that, generally, trustee companies providing traditional services should not be required to hold \$5 million in NTA, as clients choose trustee companies on the basis of their reputation and competence rather than on the basis of their financial resources. The respondent was concerned that requiring trustee companies to hold at least \$5 million NTA would reduce competition or at least would not have the effect of increasing competition in the industry, as it would preclude many smaller firms (e.g. lawyers, accounting firms and some financial services providers) from operating in the industry. The respondent was also concerned that the NTA requirement would reduce consumer protection, as without the \$5 million NTA requirement, many smaller firms would be encouraged to operate as a licensed trustee company and come under ASIC supervision. The respondent said, however, that it would be appropriate for the NTA requirement to apply where a trustee company operates a common fund, as operating a common fund is similar in nature to operating a responsible entity or a custodial service.
- 13 Another respondent recommended that instead of holding at least \$5 million NTA at all times, trustee companies should be required to maintain a set ratio between assets held in trust and the capital base of the company, and to

lodge a security bond of at least \$10 million in cash with, for example, the Reserve Bank of Australia.

ASIC's response

We think that trustee companies should be required to hold a minimum level of NTA—not only where they operate a common fund, but also where they provide other traditional services. Clients typically place substantial trust in the trustee company that provides traditional services and it is appropriate that the trustee company should have some financial substance.

We recognise there is a risk that requiring trustee companies to hold \$5 million NTA may mean that some companies wanting to provide traditional services may not apply to be authorised to provide traditional services where they will not administer significant estate assets. In limited circumstances, it may be an unreasonable burden for a trustee company to meet the \$5 million NTA requirement. We have revised RG 166 to say that we will consider giving relief from the \$5 million NTA requirement on a case-by-case basis where a trustee company does not operate a common fund and either:

- does not have a present or future right of any kind to hold trust property or estate assets; or
- has rights in relation to trust property or estate assets that are not significant in comparison to the \$5 million NTA.

We think that requiring a trustee company to maintain a set ratio between assets held in trust and the capital base of the company is inconsistent with our policy in RG 166 for all other AFS licensees. In RG 166, we require providers of custodial and depository services to hold at least \$5 million NTA at all times: see Section C of RG 166. We consider it appropriate to apply the same requirement to trustee companies that provide traditional services, given that the activities performed by a trustee company are similar to those performed by a custodian.

We also think that a security bond requirement is not consistent with the approach that we have taken in the regulation of other AFS licensees. However, we think that, consistent with our current approach for providers of custodial and depository services, it is appropriate that trustee companies providing traditional services be required to hold surplus liquid funds (SLF) where the trustee company holds client assets or money. We note that all trustee companies that currently hold AFS licences are already meeting the SLF requirement in Section E of RG 166.

Trustee companies that provide traditional services will, in the future, be required to comply with separate, specific obligations to have compensation arrangements under s912B. Regulatory Guide 126 *Compensation and insurance arrangements for AFS licensees* (RG 126) sets out how AFS licensees can comply with this obligation. We are proposing to hold further consultation later this year on the compensation requirements that trustee companies will be required to meet.

C Other requirements for trustee companies

Key points

In CP 132, we sought feedback on whether we should provide specific guidance on any other conduct obligations that trustee companies providing traditional services will be required to meet.

One respondent to CP 132 suggested that we give specific guidance to trustee companies in relation to the following matters:

- training, code of conduct and indemnity insurance; and
- compliance programs, accounting and auditing standards.

- 14 In CP 132, we sought feedback on whether we should provide specific guidance on any other conduct obligations that trustee companies providing traditional services will be required to meet.

Training, code of conduct and indemnity insurance

- 15 One respondent recommended that ASIC should require trustee companies to set out staff competencies and the range of services offered. The respondent also suggested that we should require trustee companies to lodge training plans for staff, a copy of indemnity insurance, and a code of conduct in relation to each traditional service offered.

ASIC's response

We have already given general guidance to AFS licensees on training and other licensee obligations such as compliance obligations and financial reporting that we think can be applied by trustee companies providing traditional services.

Regulatory Guide 104 *Licensing: Meeting the general obligations* (RG 104) sets out key compliance concepts and what we look for when assessing compliance with the general licensee obligations under s912A(1), including training and competence, and the requirements to ensure that financial services are provided efficiently, honestly and fairly and to take reasonable steps to ensure that representatives comply with financial services laws.

We have also given guidance in RG 126 to AFS licensees in relation to professional indemnity insurance cover. We will be consulting about the compensation requirements for trustee companies later this year.

We will consider any code of conduct industry may develop that follows the approach that we have outlined in Regulatory Guide 183 *Approval of financial services sector codes of conduct* (RG 183). We do not expect that every industry association will have a code of conduct because the Corporations Act does not

make codes of conduct mandatory: see s1101A and RG 183 at RG 183.6.

Compliance programs, and accounting and auditing standards

- 16 One respondent suggested that trustee companies should be required to comply with Australian Standard AS 3806-2006 *Compliance Programs* and accounting and auditing standards specific to trustee companies.

ASIC's response

We have given guidance to AFS licensees in RG 104 that in thinking through compliance obligations, it might be helpful to consider AS 3806-2006: see RG 104.42. Our approach to industry standards is that they may act as a guide to industry; however, we expect that a trustee company holding an AFS licence, and all other AFS licensees, will comply with the law. Therefore, we do not generally mandate compliance with industry standards.

A trustee company providing traditional services will be required to prepare financial statements and lodge those with ASIC. The financial statements will need to comply with the Corporations Act, which includes complying with relevant accounting and auditing standards. Therefore, we do not think that we need to specifically mandate that a trustee company comply with relevant accounting and audit requirements.

Appendix: List of non-confidential respondents

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- First Samuel Limited
 - Trustee Corporations Association
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