



ASIC

Australian Securities & Investments Commission

REPORT 552

Response to submissions on CP 273 Repealing ASIC class orders on holding client assets

November 2017

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 273 *Repealing ASIC class orders on holding client assets* (CP 273) and details our responses 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.

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A Overview/Consultation process

- 1 In [Consultation Paper 273](#) *Repealing ASIC class orders on holding client assets* (CP 273), we consulted on proposals to repeal the following class orders because, in our view, they no longer served a regulatory purpose:
 - (a) Class Order [CO 03/1110] *Prime brokerage: Relief from holding client property on trust*;
 - (b) Class Order [CO 03/1111] *Prime brokerage: Relief from holding scheme property separately*; and
 - (c) Class Order [CO 03/1112] *Relief from obligation to hold client money on trust*.
- 2 This report highlights the key issues that arose out of the submissions received on CP 273 and our responses to those issues.
- 3 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 273. We have limited this report to the key issues.
- 4 We received three responses to CP 273, two of which were marked 'confidential'. The non-confidential respondent to CP 273 is shown in the appendix. A copy of this submission is currently on the ASIC website under [CP 273](#).

Responses to consultation

- 5 We received three responses to CP 273: two from entities that operate prime brokerage businesses and one from an industry body. We are grateful to respondents for taking the time to send us their comments.
- 6 Generally, respondents did not support the proposal to repeal the class orders, and submitted a preference for the class orders to be remade. The respondents further submitted that, if we decided to repeal the class orders, affected parties would require sufficient time to apply for individual relief on equivalent terms.
- 7 The main issues raised by respondents related to:
 - (a) increased funding costs to prime brokers, which would be passed on to clients;
 - (b) the provision of alternative relief by ASIC to affected parties; and
 - (c) timing of the repeal of the class orders.

- 8 Based on the feedback received, we have decided to:
- (a) repeal [CO 03/1111]; and
 - (b) extend [CO 03/1110] and [CO 03/1112] for a further 12 months to 30 September 2018 to provide potentially affected stakeholders with adequate time to consider making alternative arrangements.
- 9 [ASIC \(Amendment, Repeal and Transitional\) Instrument 2017/839](#), which commenced on 26 September 2017:
- (a) repeals [CO 03/1111];
 - (b) repeals [CO 03/1110] and [CO 03/1112], while providing transitional relief to extend their effect for 12 months;
 - (c) amends [Class Order \[CO 13/1409\]](#) *Holding assets: Standards for responsible entities* to remove the reference to [CO 03/1111]; and
 - (d) amends [Class Order \[CO 13/1410\]](#) *Holding assets: Standards for providers of custodial and depository services* to reflect the 12-month transitional period in relation to the repeal of [CO 03/1110] and [CO 03/1112].

B Repealing ASIC class orders

Key points

Industry submissions stated that an absence of relief would restrict the ability of prime brokers to operate their businesses on current terms and would increase the cost of compliance.

We have extended the operation of [CO 03/1110] and [CO 03/1112] by a further 12 months to provide applicants with sufficient time to put alternative arrangements in place, including seeking relief from the applicable requirements. We have repealed [CO 03/1111] in its entirety as we consider this relief is no longer required.

- 10 The responses we received all submitted a preference that we should remake the class orders (i.e. not repeal them or allow them to lapse). The responses noted that if we nevertheless decided to repeal the class orders, affected parties would require sufficient time to seek relief on equivalent or similar terms.
- 11 The responses submitted that the cost of services provided to clients would increase. None of the responses provided a quantified figure of the potential impact of the repeal of each class order.

Class Order [CO 03/1110] *Prime brokerage: Relief from holding client property on trust*

Background

- 12 [CO 03/1110] exempts prime brokers who are Australian authorised deposit-taking institutions (ADIs) from the requirements to hold property on trust for the benefit of a client.
- 13 The conditions of [CO 03/1110] are:
- (a) the property consists of securities;
 - (b) the client is a wholesale client;
 - (c) the prime broker holds the property under the terms of a prime brokerage agreement; and
 - (d) the prime broker and the client have agreed in writing that the prime broker does not hold the property on trust for the client.

Impact of repealing [CO 03/1110]

- 14 One respondent submitted that repealing [CO 03/1110] (without allowing for the granting of individual relief) would severely curtail a prime broker's right of rehypothecation. Securities being held on trust would otherwise be

unavailable for use in securities lending, or as collateral for a loan to the relevant client. The respondent submitted that costs in securities lending would increase, along with more onerous impediments for borrowers. The respondent also submitted that these increased costs and impediments would be borne by clients, and/or result in decreased business efficiency and competition. None of the responses provided any specific or broad estimate of costs that would be incurred by the repeal of [CO 03/1110].

- 15 Another respondent submitted that there would be costs incurred in having to redraft and renegotiate prime brokerage agreements, and that individual applicants for relief, as well as ASIC, would incur costs in preparing and considering such applications.

ASIC's response

[CO 03/1110] applies to a small set of prime brokers (those who are Australian ADIs). We consider that granting individual relief, in appropriate circumstances, is preferable to remaking the class order.

We have extended the operation of [CO 03/1110] by 12 months to 30 September 2018, to provide potentially affected stakeholders with adequate time to consider making alternative arrangements.

Class Order [CO 03/1111] *Prime brokerage: Relief from holding scheme property separately*

Background

- 16 [CO 03/1111] exempts a responsible entity of a registered scheme from the obligation to hold scheme property separately, and declares that the relevant provision of the *Corporations Act 2001* (Corporations Act) be modified to allow the responsible entity to appoint a prime broker who is an Australian ADI to hold scheme property on its behalf if certain conditions are met.
- 17 In particular, [CO 03/1111] allows a responsible entity to appoint an ADI as agent to hold scheme property on its behalf where the ADI deposits the money into a bank account with itself and uses this money in the ordinary course of its banking business.
- 18 The conditions of [CO 03/1111] are:
- (a) the scheme property consists of money;
 - (b) the scheme property is held by a person (the 'prime broker') who is an Australian ADI under the terms of a prime brokerage agreement between the prime broker and the responsible entity; and

- (c) the responsible entity takes reasonable steps to ensure the prime broker has in place adequate arrangements for managing conflicts of interest that may arise wholly, or partially, in connection with holding the scheme property on behalf of the responsible entity.

Impact of repealing [CO 03/1111]

- 19 None of the respondents addressed our proposal to repeal [CO 03/1111] from the perspective of being a responsible entity. We received no submissions from responsible entities. One of the respondents indicated that a number of its clients (responsible entities) may be affected by the repeal of [CO 03/1111], but mainly due to the proposal to repeal [CO 03/1112].

ASIC response

We consider that the relief in [CO 03/1111] is no longer required by prime brokers and their responsible entity clients. [Regulatory Guide 133](#) *Managed investments and custodial or depository services: Holding assets* (RG 133) states, at RG 133.47: 'In the case of a deposit-taking facility, it is the rights under the facility rather than any money that has been deposited in that account which comprise the client assets and it is these rights that should be held on trust'. As a result, we consider that the repeal of [CO 03/1111] has no effect on prime brokers and their clients.

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

Background

- 20 [CO 03/1112] exempts an Australian financial services (AFS) licensee that is an Australian ADI from the obligation to hold a client's money on trust where the client is a wholesale client and the AFS licensee and the client agree to this in writing.
- 21 The conditions of [CO 03/1112] are:
- (a) the money that is paid is in connection with:
 - (i) a financial service provided to the client as a wholesale client; or
 - (ii) a financial product acquired by a person as a wholesale client; and
 - (b) the AFS licensee and the client have agreed in writing that the AFS licensee does not hold the money on trust for the benefit of the client.

Impact of repealing [CO 03/1112]

- 22 Two responses to CP 273 submitted that repealing [CO 03/1112] without providing individual relief on similar terms would prevent a prime broker (who is also an Australian ADI) from holding client money in a bank account maintained by the prime broker and dealing with this money in the ordinary course of the prime broker's banking business. The prime broker would be required to deposit client money with another Australian ADI which would then be free to deal with the monies in the ordinary course of its banking business. There appears to be no appreciable, reduced risk to such client monies. However, the administrative burden and cost of establishing and maintaining such third-party deposit accounts would be considerable.

ASIC's response

[CO 03/1112] also applies to the same set of prime brokers (those who are Australian ADIs). We consider that granting individual relief, in appropriate circumstances, may be preferable to remaking the class order.

We have extended the operation of [CO 03/1112] by 12 months to 30 September 2018 to provide potentially affected stakeholders with adequate time to consider making alternative arrangements.

Other relief

- 23 In CP 273, we outlined our preference to repeal [CO 03/1110], [CO 03/1111] and [CO 03/1112] and not remake them. We considered that any residual need for relief would be more appropriately addressed on a case-by-case basis.
- 24 The responses to CP 273 indicated that, if these ASIC class orders were to be repealed, sufficient time should be given to affected stakeholders to apply to ASIC for relief on equivalent or substantially similar terms, to minimise any disruption to business.

ASIC's response

We have repealed [CO 03/1111] as we consider that this relief is not required (see paragraph 27 below).

From the responses we received from industry, [CO 03/1110] and [CO 03/1112] appear to apply to a small set of AFS licensees and/or wholesale clients.

We have extended the operation of [CO 03/1110] and [CO 03/1112] to 30 September 2018 to provide potentially affected stakeholders with adequate time to consider making alternative arrangements.

- 25 [CO 13/1409] incorporates [CO 03/1111] by reference. Therefore, we have also amended [CO 13/1409] to reflect the repeal of [CO 03/1111].
- 26 Similarly, [CO 13/1410] refers to [CO 03/1110] and [CO 03/1112]. We have amended [CO 13/1410] to reflect the 12-month transitional period of the repeal of [CO 03/1110] and [CO 03/1112], during which the relief will remain in force.
- 27 As noted above, we consider that the relief in [CO 03/1111] is not required by responsible entities. We have made statements in RG 133 to the effect that money held on deposit with an ADI cannot be held on trust and therefore cannot be held ‘separately’; rather, it is the rights under the deposit-taking facility that form scheme property and should be held on trust. As a result, we consider that [CO 03/1111] can be repealed without effect on prime brokers and their clients.

Appendix: List of non-confidential respondents

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- Alternative Investment Management Association
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