



# Holding Assets

The information in this briefing paper is current as of May 2018.

CompliSpace Pty Ltd

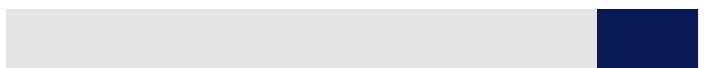
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# 1. In Brief

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Gatekeepers such as Responsible Entities (RE's), fund managers and custodians play a crucial role in ensuring the overall health of the financial services industry, and the safe custody of assets is a critical function. Without appropriate safeguards by these asset holders, there is a potential threat to client assets and this reflects on the level of investor trust and confidence which is subsequently placed on them.

Adequate resources and appropriate risk management frameworks are necessary to ensure the safekeeping of assets and related functions are performed satisfactorily.

In June 2017, ASIC published the results of their latest surveillance in [Report 531: Review of Compliance with Asset Holding Requirements in Funds Management and Custodial Services](#) (ASIC's Report).

The focus of the ASIC Report was general compliance with RG 133 and associated ASIC Class Orders [Class Order CO 13/1409: Holding Assets: Standards for Responsible Entities](#) and [Class Order CO 13/1410: Holding Assets: Standard for Custodial or Depository Service Providers](#). Since June 2017 ASIC has continued to survey the sector as part of a wider review of the fund and asset management industry within Australia.

This briefing note is designed to provide clarity for RE's, fund managers and custodians who hold scheme assets and/or custodial property for their clients.

## 2. What is the regulatory framework?

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AFS licensees must do all things necessary to ensure that they carry on the financial services for which they are licensed efficiently, honestly and fairly.

The regulatory framework surrounding holding assets applies to:

- ✓ RE's of registered management investment schemes
- ✓ licensed providers of Custodial or Depository Services
- ✓ Investor Directed Portfolio Service (IDPS) operators that are responsible to clients for assets held under an IPDS, and
- ✓ unregistered Schemes which operate a custodial function

To assist the asset holders with their compliance obligations, ASIC's [Regulatory Guide 133: Managed Investments and Custodial or Depository Services: Holding Assets](#) explains the obligations that apply to AFS licensees in relation to holding assets and sets out minimum standards for asset holders.

ASIC has also released the following legislative instruments that apply to specific class of AFS licensees:

- ✓ [Class Order CO 13/1409: Holding Assets: Standard for Responsible Entities](#), and
- ✓ [Class Order CO 13/1410: Holding Assets: Standards for Providers of Custodial and Depository Services](#).

It should be noted that both current Class Orders may apply to a single AFS licensee. It is important to remember that the obligations under RG 133 and the Class Orders are in addition to the general AFS licence conditions.

## 3. Outcomes of Review

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ASIC's report highlighted areas where regulatory compliance was strong, but also highlighted common areas of weakness across the industry. The report states that the review found that there was generally a poor level of understanding of the requirements in RG 133 by RE's and smaller custodians that were reviewed by ASIC.

Most of the review focused on compliance with the Minimum Standards, namely whether the asset holders (both in terms of RE's/fund managers and custodians) met the Minimum Standards where some or all assets were held by the asset holder, and whether any third-party asset holder appointed to hold assets on their behalf (i.e. external custodians or sub-custodians) met the standards.

A summary of common weaknesses identified by ASIC in this report, and by us [in our previous article](#) in June 2017, include:

## Adequate Organisational Structure

Asset holders must ensure that their business has an organisational structure which allows for the satisfactory separation of functions between their custody function and other parts of the business, including separation of staff and reporting lines. If this function is outsourced to an external custodian, the requirements on the external custodian are the same.

Examples of poor compliance included failing to have a separate board of directors where RE's and custodians where dual in-house RE and custody functions were maintained and the failure to adequately separate the directors who are signatories for both functions; revealing a lack of understanding of conflicts of interest that exist from such a structure.

## Adequate Capacity and Resources

ASIC's expectations are clearly set out in RG133 in respect of staffing, capacity and resources.

They require custody staff to have the skills and knowledge to perform their assigned responsibilities and ASIC expect that these staff members are given ongoing training and education. The asset holder is expected to adequately screen potential new custody staff members in accordance with their risk management frameworks to minimise operational risk, such as fraudulent activity. If this function is outsourced to an external custodian, the requirements on the external custodian are the same.

Custody staff are also expected to be provided with appropriate time and resources to carry out their functions by ensuring that the asset holder has:

- ✓ effective breach management controls
- ✓ regular training procedures
- ✓ robust identification and assessment processes
- ✓ and an up-to-date IT infrastructure.

Examples of failing to meet this requirement include having staff members responsible for more than one role, inexperienced compliance or senior staff and engaging external consultants to assist on basic compliance requirements.

## Alternative Method of Holding Assets

ASIC confirmed that the requirement for RE's to hold assets on trust was being met, and RE's who chose to use omnibus accounts used them sparingly and with satisfactory results.

ASIC did confirm that if a RE can achieve operational efficiency or cost savings through the use of omnibus accounts, they should consider them. However, the RE will be subject to the requirement to reconcile such accounts daily.

## Outsourcing Custody

Asset holders have an obligation to hold an effective and compliant custody agreement with the entities which they engage. The agreement must be in writing and incorporate various specific terms such as those relating to the:

- ✓ rights to review and monitor the custodian
- ✓ certification of compliance by the custodian
- ✓ notification of material or systemic breaches by the custodian
- ✓ terms upon which the custodian can engage a third party
- ✓ reporting arrangements to ASIC by the custodian

ASIC identified poor cultural practices surrounding compliance in this area. Examples included not having custody agreements which complied with the content requirements of RG 133, not having signed copies of all current custody agreements, not being able to produce amendments to existing agreements or failing to name funds for which custody was outsourced.

## Ongoing Monitoring

Once appointed, the third-party custodian must be monitored to ensure that it is meeting the Minimum Standards. ASIC has found continued weaknesses in the ongoing monitoring of custody contractual terms, including an over reliance on self-attestations received from the outsourced custodian, or a failure to receive or action reports

received from the third-party custodian.

It is clear from the ASIC Report, and also further ASIC releases such as [RG 259: Risk Management Systems of Responsible Entities](#), that the level of diligence to be applied when monitoring external service providers, particularly custodians, needs to be increased, with sole reliance on self-certification by custodians in place of independent monitoring to be avoided.

## Disclosure

Although ASIC found entities to be adequately compliant in this area, it is worth reiterating the need for RE's to ensure that custodian relationships must be disclosed in Product Disclosure Statements when the RE is dealing with retail clients.

## Other Findings

Further findings of ASIC's review included:

- ✓ A lack of understanding that RG 133 applies to the custody of assets of unregistered schemes
- ✓ Poor knowledge and understanding of the requirements of RG 133 and acceptable practice
- ✓ The reliance on manual processes thereby increasing operational risk

## 4. How CompliSpace can help

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At CompliSpace we combine governance, risk, compliance and policy management expertise with technology solutions to deliver sustainable governance solutions to businesses in every state and territory in Australia. Our team of lawyers and industry experts actively monitor changes to relevant laws and registration standards and deliver a full suite of online policies, procedures and governance programs that enable businesses to continuously comply with their legal and regulatory obligations.

In response to ASIC's review and recommendations, CompliSpace has developed policies, procedures and training which respond to the unique needs of asset holders, specifically in the financial services industry. The content within the policies outlines compliance with ASIC's minimum standards as outlined in Regulatory Guide 133 as well as compliance with the additional obligations in the Class Orders and regulatory compliance reviewed in ASIC Report 531.

CompliSpace works with businesses to tailor compliance and risk management systems to a company's individual needs and characteristics, ensuring meaningful compliance with their legal and regulatory obligations.

If you are looking to update your existing content, contact us on:

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