

## ASIC CLASS ORDER [CO 13/1412]

### EXPLANATORY STATEMENT

Prepared by the Australian Securities and Investments Commission  
*Corporations Act 2001*

The Australian Securities and Investments Commission (*ASIC*) makes Class Order [CO 13/1412] *Investor directed portfolio services: Amendment of Class Order [CO 13/763]* under paragraph 926A(2)(c) of the *Corporations Act 2001* (the *Act*).

Paragraph 926A(2)(c) of the Act provides that ASIC may declare that Part 7.6 (other than Divisions 4 and 8) of the Act applies in relation to a person or financial product, or a class of persons or financial products, as if specified provisions were omitted, modified or varied as specified in the declaration.

#### 1. Background

An 'IDPS' is an investment platform known as an investor directed portfolio service, consisting of a number of functions including a custody, settlement and reporting system and service with the following key features, among others:

- (a) the clients of the IDPS have the sole discretion to decide what (but not necessarily when) assets will be acquired or disposed of, subject to certain exceptions;
- (b) subject to any prior contrary directions, in order to ensure payment of moneys for which the client is liable, a client may direct an operator to do certain things, such as realise assets held on account for the client.

On 28 June 2013, ASIC issued Class Order [CO 13/763] *Investor directed portfolio services* which modifies the Act as it applies to a person operating or involved in the operation or promotion of an IDPS, and to a person offering or issuing accessible securities through an IDPS, as discussed in Regulatory Guide 148 *Platforms that are managed investment schemes (RG 148)*. ASIC also re-released RG 148 on that date.

On 3 August 1998, ASIC released Regulatory Guide 133 *Managed investments: Scheme property arrangements (RG 133)* providing guidance on the minimum standards in holding scheme property of registered managed investment schemes and other assets. RG 133 also applies to investor directed portfolio services (*IDPS*), in respect of the IDPS property held in an IDPS.

In July 2012, ASIC released Report 291 *Custodial and depository services in Australia*, which discusses our review of the Australian custodial industry, the current regulatory regime and matters that we consider to be 'good practice'.

In July 2013, ASIC completed a review of RG 133. In implementing the policy described in the replacement RG 133, ASIC made a number of class orders, which include [CO 13/1412]. [CO 13/1412] amends Class Order [CO 13/763].

## 2. Purpose of this class order

The introduction of RG 133 in 1998 and its last update in 1999 were made when the managed investments regime was first introduced. Since then, the managed investments industry and the IDPS industry have undertaken significant growth and evolution.

ASIC's recent surveillance work of existing major custodial providers and other regulatory activities in this industry have highlighted the need to adequately address these developments. ASIC recognises that responsible entities, licensed custody providers, MDA operators and IDPS operators are important gatekeepers in the financial services industry. Therefore ASIC considered it important to review and update the guidance provided in RG 133.

The purpose of [CO 13/1412] is to impose minimum standards on IDPS operators for holding IDPS property to ensure that efficient operational arrangements exist and IDPS property is not exposed to unnecessary risks because of the way they are held. If the IDPS operator has delegated the holding of IDPS property to a custodian, [CO 13/1412] requires that the IDPS operator must do all things necessary to ensure compliance by the custodian with those minimum standards. To satisfy its duties as an Australian financial services licensee (*AFS licensee*), an IDPS operator must meet, or ensure that the other asset holder meet, these minimum asset holding standards. We consider that these standards adopt and extend conditions 34 and 35 *Agreement with Holder of Financial Product on Trust* in Pro Forma 209 *Australian financial services licence conditions (PF 209)*, which are imposed on responsible entities, licensed custody providers and IDPS operators. At the same time, we have updated PF 209 to reflect the changes in [CO 13/1412].

## 3. Operation of this class order

[CO 13/1412] amends Class Order [CO 13/763] by replacing notional subsection 912AD(22) of the Act, amending subsection 912AD(42) and inserting additional subsections 912AD(40A) to 912AD(40M). The amendments take effect from 2 January 2014, subject to transitional provisions.

The transitional provisions provide that the minimum standards set out in new notional subsections 912AD(22) and (40C) to (40K) apply from 2 January 2015 to a AFS licensee that is authorised to operate an IDPS before 2 January 2014. The custody agreement content requirements set out in new notional subsection 912AD(40A) and which must be included in the IDPS operator's agreement with a custodian that holds IDPS property apply from 1 November 2015 to an AFS licensee that is authorised to operate an IDPS before 2 January 2014.

The minimum standards require the IDPS operator to satisfy, and where it has engaged a custodian, do all things necessary to ensure that the custodian satisfies certain minimum standards in relation to holding IDPS property. The IDPS operator must also do all things necessary to ensure that any sub-custodian engaged directly or indirectly by a custodian to hold IDPS property satisfies the minimum standards applying to custodians, subject to an exception in relation to certain overseas assets.

The minimum standards require, among other things, that:

- a) The IDPS operator must do all things necessary to ensure that all IDPS property held by it is held on trust for the relevant client or clients and all IDPS property held by a custodian or sub-custodian is held so that the relevant client or clients have a beneficial interest in the IDPS property (other than in certain circumstances where the IDPS property is located outside of Australia).
- b) The IDPS operator must do all things necessary to ensure that IDPS property held by a custodian or sub-custodian is, as far as practicable, clearly identified and held separately from property in which the IDPS operator or the person holding the IDPS property has an interest and from the property of any other person other than clients of the IDPS, except where it is permissible to use omnibus accounts in respect of the property referred to in subparagraph (40C)(b)(ii) on the conditions set out in subsection (40D).
- c) The IDPS operator must have, or do all things necessary to ensure that the custodian and any sub-custodians have, an organisational structure that supports compliance with the above requirement for IDPS property to be held separately and must segregate custodial staff in a way that minimises any potential conflict of interests and have a documented policy to support this.
- d) The IDPS operator must do all things necessary to ensure that custodial staff have the necessary capacity and resources to perform core administrative activities.
- e) The IDPS operator must keep records for 7 years demonstrating how it complies with the above minimum standard requirements.
- f) The IDPS operator must have an established process to monitor and assess the custodian's performance of its obligations.
- g) The IDPS operator must not permit a custodian or sub-custodian to be involved in discretionary decisions concerning a deposit account, unless the IDPS operator is satisfied that the custodian or sub-custodian has set out in writing and implements reasonable processes for, determining which account to use, monitoring performance by the account issuer of the issuer's obligations in relation to the account and taking action if the issuer fails to meet its obligations.
- h) The IDPS operator must do all things necessary to ensure that it keeps records of the IDPS property in a way that enables the holding of the IDPS property to be conveniently and properly audited by an auditor of the IDPS operator and any custodian or sub-custodian keeps such records in relation to any IDPS property the custodian or sub-custodian holds.

An IDPS operator that complies with these minimum standards is taken to comply with the conditions (if any) of its Australian financial services (*AFS licence*) that refer to ASIC Policy Statement 133 or ASIC Regulatory Guide 133 as applying on a certain date.

Subsection 912AD(40A) stipulates minimum content requirements for the IDPS operator's agreement with a custodian. In particular:

- a) If the IDPS operator holds a beneficial interest in the IDPS property on behalf of the relevant client or clients, it must have a written agreement with the custodian that

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meets the relevant requirements subject to limited exceptions for overseas property and for a custodian that it controls.

- b) If the IDPS operator does not hold a beneficial interest in the IDPS property on behalf of the relevant client or clients (i.e. the IDPS operator arranges for the IDPS property to be held by a custodian on behalf of the relevant client or clients):
  - (i) it must have a written agreement with the custodian that meets the relevant requirements; and
  - (ii) it must do all things necessary to ensure that the custodian has a written agreement with each sub-custodian that the custodian engages to hold the IDPS property that also satisfies the minimum content requirements, subject to limited exceptions for overseas property and for a sub-custodian that the custodian controls.
- c) Among other things the custody agreement must have provisions specifying rights that the IDPS operator has for the ongoing review and monitoring of the custodian and any sub-custodian, specifying how instructions will be given and to the effect that the custodian must not take a security interest over IDPS property unless it is permitted under the agreement and does not cover the custodian's unpaid fees. The custody agreement must specify the terms on which the custodian is authorised to engage a sub-custodian.
- d) The IDPS operator must ensure that the custody agreement has reasonable liability provisions and if appropriate contains reasonable indemnity provisions in relation to losses caused to the IDPS operator in that capacity by the custodian's acts and omissions that relate to that agreement.
- e) The custody agreement must require the custodian to certify to the IDPS operator in writing at least every 13 months that the custodian believes on reasonable grounds that the custodian and each sub-custodian has met the terms of the agreement and certain minimum custodial standards that apply in relation to the custodian and sub-custodians under section 912AD, other than as disclosed in writing to the IDPS operator or that the custodian reasonably believes are trivial. The custody agreement must also provide the IDPS operator with a right to terminate in certain specified circumstances including in circumstances that involve the IDPS operator having reasonable grounds for believing that the custodian or a sub-custodian has not complied with or is unlikely to comply with these minimum standards.

A IDPS operator that complies with these requirements in relation to an arrangement with a custodian is taken to comply with any conditions of its AFS licence concerning the arrangement.

#### **4. Consultation**

On 20 December 2012, ASIC released Consultation Paper 197 *Holding scheme property and other assets (CP 197)* seeking feedback on our proposals to update our guidance for responsible entities of registered managed investment schemes on holding scheme property and other assets. These proposals were also relevant for licensed custody providers, MDA operators and IDPS operators. The consultation period closed on 28 February 2013.

ASIC received 8 non-confidential responses to the proposals in CP 197 from industry bodies, financial services providers and academic. CP 197 can be found on ASIC's website.

The Office of Best Practice Regulation has approved the attached Regulation Impact Statement for regulation to implement the policy in the replacement of RG 133.

## Statement of Compatibility with Human Rights

*Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011*

### ASIC Class Order [CO 13/1412]

This class order is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

#### Overview of the class order

The class order relates to investment platforms known as ‘IDPSs’, being an investor directed portfolio service consisting of a number of functions including a custody, settlement and reporting system and service where clients of the IDPS typically have the sole discretion to decide what assets will be acquired or disposed of and have the power to direct an IDPS operator to do certain things, such as realise assets for the client.

The general purpose of the class order is to strengthen the regulation of an financial services licensee authorised to operate an IDPS, and any custodian it engages, to ensure that IDPS property is not exposed to unnecessary risks by the way it is held or dealt with by the licensee or its custodian.

Developed in consultation with industry, the class order specifies the minimum standards that an IDPS operator must meet in holding IDPS property or arranging for IDPS property to be held by another asset holder.

Key aspects of these standards are:

- a) The IDPS operator must do all things necessary to ensure that all IDPS property held by it or by a custodian it engages is ultimately held on trust for the relevant client or clients of the IDPS and is held separately from any other property, subject to certain limited exceptions.
- b) The IDPS operator must do all things necessary to ensure that it, any custodian and any sub-custodian has an organisational structure that supports compliance with the requirement for IDPS property to be held separately.
- c) The IDPS operator must do all things necessary to segregate custodial staff from non-custodial staff, in a way that minimises the potential for conflict.
- d) The IDPS operator must do all things necessary to ensure that it, any custodian and any sub-custodians have the knowledge and skills necessary to perform their duties.

The class order also establishes minimum requirements that apply to agreements between IDPS operators and custodians and between custodians and sub-custodians.

**Human rights implications**

This class order does not engage any of the applicable rights or freedoms.

**Conclusion**

This class order is compatible with human rights as it does not raise any human rights issues.