

Funds Management & Financial Services Alert

Increase in capital requirements for wholesale trustees and custodians

August 2013

In brief:

- Trustees of wholesale schemes will be required to hold NTA amounting to the greater of \$150,000 and 10% of average revenue, unless they appoint an external custodian which meets the new requirements.
- Custodians and responsible entities who undertake self-custody will be required to hold NTA amounting to the greater of \$10 million and 10% of average revenue.
- New cash flow and audit obligations apply, including quarterly approval of cash flow projections by the board.
- The new financial requirements will apply from 1 July 2013 for new licensees. For existing licensees, there will be a one year transition period and compliance will be required from 1 July 2014.

ASIC has increased the financial requirements for custodians and trustees of wholesale managed investment schemes. ASIC class order 13/761 *Financial requirements for custodial or depository service providers (CO 13/761)* and ASIC's updated regulatory guide 166 *Licensing: Financial requirements (RG 166)* contain the changes.

NTA requirements

Under the changes, custodians are required to hold net tangible assets (NTA) amounting to the greater of \$10 million and 10% of average revenue. Providers of custodial and depository services who meet the definition of 'incidental provider', such as most trustees of wholesale funds, are required to hold NTA amounting to the greater of \$150,000 and 10% of average revenue unless they appoint a third party custodian which meets these requirements.

An 'incidental provider' is a financial services licensee that is authorised to provide a custodial or depository service:

- that does not provide any custodial or depository services other than services which:
 - are a need of the person to whom the services are provided because of, or in order to obtain the provision of other financial services by the licensee or its related bodies corporate; and
 - do not form part of an IDPS; and
- whose custodial or depository services revenue is less than 10% of its financial services business revenue.

ASIC has continued its old policy that an example of an 'incidental provider' may include the trustee of an unregistered scheme that holds financial products as part of the scheme on behalf of clients, which occurs after the trustee has provided financial product advice and/or dealing services in respect of those interests on behalf of the clients.

The NTA must be held in 'liquid assets' with at least 50% in cash or cash equivalents. 'Liquid assets' means cash or

cash equivalents and assets that a licensee can reasonably expect to realise for market value within six months, that are free from encumbrances and, in the case of receivables, free from any right of set-off.

In the circumstances where a third party custodian is appointed and it meets the NTA requirements, the new rules do not exempt the trustee from maintaining surplus liquid funds of \$50,000 where that requirement is triggered.

Also, trustees must hold a 'reasonable belief' that any custodian it appoints meets the requirements. ASIC says that trustees are taken to have this belief if they receive a written assurance from the custodian each year that they meet the NTA requirements and there is no reason for the trustee to suspect that the custodian does not continue to comply with the NTA requirements.

Cashflow projections

All licensed custodial and depository service providers are subject to new requirements regarding the preparation of cash flow projections and liquidity, including requirements to:

- prepare a cash flow projection over at least 12 months;
- update this monthly or more frequently if there is a material change; and
- have the cash flow projection approved at least quarterly by the board as satisfying ASIC's requirements.

New audit requirements

A licensee's annual audit must include an opinion on the licensee's compliance with the NTA requirements (including its composition), the cashflow requirements and, where the licensee is relying on being an 'incidental provider', that the revenue from providing custodial services is less than 10% of its financial services business revenue.

Implementation

The new financial requirements will apply from 1 July 2013 for new licensees. For existing licensees, there will be a one year transition period and compliance will be required from 1 July 2014.

Wholesale trustees currently are required to hold \$50,000 in surplus liquid funds if they hold \$100,000 or more of client property. So the new requirements will be a marked increase in the level of capital they are required to hold. In addition, 50% will need to be held in cash and 100% in liquid assets. For custodians and responsible entities performing self-custody, the capital requirement will effectively double.

Thomsons Lawyers can assist you to understand how to comply with the new requirements. Please contact Chris Mee for further information.

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For further information, please [click here](#) to contact our national Funds Management & Financial Services team