



## **PUBLIC RESPONSE PAPER**

**NO. 2/2018**

### **PROPOSED REGULATORY FRAMEWORK FOR TRUSTEES AND CUSTODIANS UNDER SECTION 76A OF CMSA 2007**

The Securities Commission Malaysia (SC) issues this Public Response Paper in response to feedback received pursuant to the *Public Consultation Paper* on the proposed regulatory framework for Trustees and Custodians under section 76A of CMSA 2007 dated 12 October 2016.

This Public Response Paper is dated 19 October 2018

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## **1.0 Introduction**

- 1.1. On 12 October 2016, the SC published a *Public Consultation Paper* (CP) to invite feedback on the SC's proposed regulatory framework for Trustees and Custodians.
- 1.2. The CP was opened for public feedback from 12 October 2016 to 28 November 2016.
- 1.3. A total of 24 respondents, which include local and foreign custodian banks, investment banks, fund management companies, trustees, REITS managers, a stand-alone custodian, Bursa Malaysia (ICM Department), and an individual have responded to the CP.
- 1.4. The SC would like to thank all respondents for their valuable and constructive feedback and suggestions, which have been duly considered in the finalisation of the regulatory framework.
- 1.5. Key feedback from the industry and the SC's responses are summarised in the following sections.

## **2.0 FEEDBACK ON PROPOSED FRAMEWORK FOR REGISTRATION OF TRUSTEES AND CUSTODIANS**

### **2.1 Registration of Custodians**

2.1.1 In relation to the proposed registration of custodians, of the 24 respondents, 10 had agreed and five disagreed, while nine respondents had abstained from providing a view on this issue or had stated neutrality over the proposal. Respondents who agreed with the proposed registration of custodians, including foreign custodians appointed by a CMSL holder to provide custodial services in Malaysia, were of the view that every entity involved should be registered especially for transparency purposes. This would be better in terms of client asset protection, and to facilitate swifter action to be taken in ensuring continued preservation of client asset where there is a direct regulatory relationship between the regulator and the custodian. Respondents, who have agreed, were also of the view that it can provide a level playing field among entities providing custodial services to Malaysian investors.

2.1.2 Respondents who disagreed highlighted concerns over possible regulatory arbitrage as a result of the registration framework, specifically between the SC and BNM, in the case of licensed banks providing custodial services in the capital market; as well as between the SC and an equivalent foreign regulator, in the case of a foreign custodian.

2.1.3 The SC acknowledges that the proposed registration of custodians may give rise to regulatory burden to certain entities, particularly those who are also licensed or otherwise regulated by another competent regulator. In this regard, the SC recognises that banks who are primarily licensed with BNM to carry out an approved business under the *Financial Services Act*

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*2013 (FSA) or Islamic Financial Services Act 2013 (IFSA)*, and who are providing custodial services in the capital market would be impacted. Taking into consideration the relevant responses, the SC has decided to review the proposed framework for the registration of custodians.

- 2.1.4 However, the SC remains firm in its stance and intention to ensure parity of regulation for every entity that provides custodial services in the Malaysian capital market. As mentioned before, custodians play a very significant role in the safe keeping of clients' assets, and thus are important in maintaining the integrity of the Malaysian capital market, the investors' trust and confidence in the industry.
- 2.1.5 While the SC remains firm in its stance to have direct regulation of custodians via a registration framework, the SC nevertheless does not intend to impose excessive regulatory requirements on entities which would be subject to the regulation and supervision of both the SC and BNM. As such, the SC shall continue to have further discussions and collaboration with the relevant industry players and BNM to find the best resolution that meets the SC's intended outcome in a fair manner.
- 2.1.6 In this regard, the SC has decided to adopt a phased approach for the implementation of the proposed regulatory framework for trustees and custodians. The registration framework for trustees will be rolled out first. The proposed registration framework for custodians is deferred to such a later date to be announced.

2.1.7 In view of the above, for the purpose of this Response Paper, the SC's response shall only be in the context of the framework for the registration of trustees.

## 2.2 **Categories of trustees that require registration**

2.2.1 In the CP, it was proposed that the registration framework should cover:

- (a) Any entity providing trustee services for a UTS, PRS, corporate bond or sukuk;
- (b) Any entity providing custodial services appointed by a CMSL holder for assets held within or outside Malaysia; and
- (c) Any entity providing custodial services appointed by clients for assets held within Malaysia.

2.2.2 Respondents were asked to give comments to the following questions:

### **Question 1**

Should registration be extended to entities other than those proposed in [paragraph 2.5 and 2.6 of the CP]? Please provide reasons for your answer.

### **Question 2**

Do you agree that a foreign custodian appointed by a CMSL holder for assets held outside Malaysia should be subjected to registration under the framework? Please provide reasons for your answer.

### **Question 3**

Do you agree that foreign custodian who is directly appointed by the client for custodial services in Malaysia should be required to be registered under the framework? Please provide reasons for your answer.

**Question 4**

Do you agree that foreign custodian who is directly appointed by the client for custodial services in a foreign jurisdiction should not be required to be registered under the framework? Please provide reasons for your answer.

Feedback from respondents

2.2.3 Most of the respondents agree with the proposed registration of entities providing trustee services in the Malaysian capital market. There is strong support for such registration to ensure parity of regulation among all entities providing such trustee services. Respondents were of the view that not only could it lead to better supervision by the SC, the information required to be reported can facilitate the SC's efforts in formulating initiatives to further enhance the industry in terms of client asset protection, as well as to evaluate weaknesses and disparity, if any.

**The SC's position**

Registration of trustees

2.2.4 The SC is of the view that the proposed registration of trustees would not cause any undue or additional regulatory cost to entities that provide such trustee services in view of the fact that such entities are currently already under the SC's regulation, albeit through various routes based on product offering, with differing requirements. The proposed registration framework serves to streamline the registration process, whereby there would be a one-off registration under section 76A of the CMSA for entities that wish to provide trustee services in the Malaysian capital market. The SC would also set out the eligibility requirements for registration, as well as the continuous obligation required and expected of registered trustees.

- 2.2.5 In this regard, the SC will specify trustee services as a capital market service pursuant to section 76A of the CMSA.
- 2.2.6 The SC wishes to also clarify that the requirement for registration of trustees under the proposed framework is applicable to trustees referred to in sections 139ZC, 260, 289 and 290 of the CMSA.

#### Registration of Custodians

- 2.2.7 The SC remains in its stance and intention to ensure parity of regulation for every entity that provides custodial services in the Malaysian capital market. As mentioned before, custodians play a very significant role in the safe keeping of clients' assets, and thus are important in maintaining the integrity of the Malaysian capital market, the investors' trust and confidence in the industry.
- 2.2.8 The SC acknowledges that the proposed registration of custodians may give rise to regulatory burden to certain entities, particularly those who are also licensed or otherwise regulated by another competent regulator. In this regard, the SC recognises that banks who are primarily licensed with BNM to carry out an approved business under the *Financial Services Act 2013* (FSA) or *Islamic Financial Services Act 2013* (IFSA), and who are providing custodial services in the capital market would be impacted.
- 2.2.9 In this regard, while the SC remains firm in its stance to have direct regulation of custodians via the proposed registration framework, in view of their importance in client asset protection, the SC does not intend to impose excessive regulatory requirements on entities which would be subject to the regulation and supervision of both the SC and BNM. This would require further discussions and collaboration with the relevant



industry players and BNM to find the best resolution that meets the SC's intended outcome in a fair manner.

2.2.10 As such, the SC has decided to adopt a phased approach for the implementation of the proposed regulatory framework for trustees and custodians. The registration framework for trustees will roll out first. The proposed registration framework for custodians is deferred to a later date.

### **2.3 Feedback on proposals relating to registration criteria, entry standards and ongoing obligations**

2.3.1 Notwithstanding the SC's proposed phased approach for the registration of custodians, as mentioned in paragraph 2.1.13 above, the following are the relevant responses from the CP, relating to custodians.

#### Prudential requirements, i.e. shareholders' fund and paid-up capital

##### **Question 5**

Do you agree with the SC's proposal to impose minimum issued, paid-up capital and shareholders' fund of RM1 million for registered trustees and custodians who seek to be registered under this framework? Please provide reasons for your answer.

#### Feedback from respondents

2.3.2 A majority of the respondents agreed that the proposed minimum issued, paid-up capital and shareholders' fund of RM1 million would be sufficient.

2.3.3 However, some respondents, particularly custodian banks, were of the view that since licensed banks providing custodial services are also regulated by BNM and thus are subjected to BNM's capital requirement, an additional or a separate capital requirement may be redundant. In this regard, the SC is of the view that custodians who are already subjected to a higher capital requirement would easily meet the proposed minimum requirement.

Professional Indemnity Insurance (PII)

**Question 6**

- (a) Do you agree that trustees and custodians should maintain a PII that commensurate with the nature, activity, complexity and risks of the trustee and custodial businesses? Please provide reasons for your answer.
- (b) Currently, what is the extent of PII coverage undertaken by the entity? Please provide reasons for your answer.
- (c) Based on your current business structure/operations, how much PII would you require to cover your risks? Please provide reasons for your answer.
- (d) Do you agree that if a trustee or custodian is operating as part of a group, the PII requirement will be applicable at the group level? Please provide reasons for your answer.

Feedback from respondents

2.3.4 Majority of respondents agreed that trustees and custodians should maintain a PII that commensurate with the nature, activity, complexity and risks of the trustee and custodial businesses.

2.3.5 In term of the extent of such PII coverage, a majority of the Respondents provided that their current coverage is very extensive depending on the nature, activity, complexity and risks of the entity, which can generally be summarised as follows:

- a) Actual or alleged act;
- b) Error or omission (including dishonest or fraudulent act);
- c) Breach of trust;
- d) Breach of fiduciary duty;
- e) Breach of professional duty or misrepresentation in the performance of or failure to perform professional services;
- f) Breach of confidentiality;
- g) Business continuity;
- h) Limitation of liability contracts, includes Comprehensive Crime, Damage and Civil Liability, Directors and Officers Liability and Company Reimbursement Liability Insurance; and
- i) Losses incurred by third parties due to negligent errors and omissions in the course of performing professional services.

2.3.6 The majority of respondents also agreed with the proposal that for trustees or custodians who operates as part of a group, the PII requirement should be applicable at the group level instead of at the entity level given that the group will have direct oversight on its subsidiaries. In addition, the streamlining of PII coverage at the group level provides higher limit of coverage and creates a cost saving within the group in the amount of premium paid. Nonetheless, the minimum coverage of the PII must be adequate to cover claims settlement arising from performing the businesses.

## **The SC's position**

2.3.7 The SC is of the view that the PII requirement shall be included as part of the registration requirement under the proposed framework, where the coverage must commensurate with the nature, activity, complexity and risks of the trustee and custodial businesses. In terms of trustees or custodians who operate as part of a group, the SC shall introduce a requirement for PII at group level to create cost efficiency as well as provide higher limit of coverage within the group.

### Compliance and Internal Audit Functions and Risk Management Framework

2.3.8 In the CP, the SC proposed that trustees and custodians seeking to register under this framework should have an effective compliance and internal audit function in place to mitigate and manage risks. Further, the board should satisfy the SC that it has a robust risk management framework that is able to identify, assess, monitor and respond to the risks, regardless whether its pose material or non-material impact to the business.

2.3.9 The compliance function should ensure that all legal and regulatory requirements are complied with, while the internal audit function will be responsible for providing independent assurance on the effectiveness of the entity's internal controls.

2.3.10 In response to queries received from some of the Respondents, the SC wishes to clarify that a trustee and custodian operating under a group structure may leverage the group's resources and outsource material functions such as compliance, risk management and internal audit functions to the group. In addition, the SC may also allow outsourcing arrangement of internal audit and risk management functions to an

external service provider, provided that the trustee and custodian has in place comprehensive policies and procedures to monitor as well as perform an assessment on the outsourcing of such functions on an ongoing basis.

## **2.4 Feedback on proposals relating to Roles and Responsibilities of Board and Key Personnel**

### **Question 7**

Do you agree that the board of director and senior management of a trustee and custodian must have the duties and responsibilities as discussed above in addition to any other duties and responsibilities that may be imposed by relevant laws and guidelines? Please provide reasons for your answer.

### **Feedback from respondents**

#### Board of Directors

- 2.4.1 The Respondents generally agreed with the proposal that the board of directors must be primarily accountable for ensuring operational sustainability and financial soundness of the trustee and custodian. There is also agreement that in fulfilling this role, the board of directors must-
- i) define and oversee the business plan and strategy that is appropriate to its objective, size, structure and risk profile;
  - ii) approve and oversee all key policies, internal controls and compliance with the requirements as provided under securities laws, guidelines issued by the SC and any other relevant laws;
  - iii) have a comprehensive operational system that commensurate with its business;
  - iv) implement and maintain a comprehensive governance framework, including compliance and internal audit function as well as risk management framework that commensurate with its business;

- v) have effective internal controls to safeguard clients' assets from inappropriate use by its employees;
- vi) conduct at least yearly review on the effectiveness of its internal control framework;
- vii) have appropriate mechanisms to facilitate the maintenance of assets that would enable identification of assets to respective clients; and
- viii) ensure that the internal controls are adequate and effective to identify, monitor and manage all material that may pose a threat to the clients' assets.

### Senior Management

2.4.2 The Respondents generally agreed with the proposal that the senior management of the trustee and custodian have the primary responsibility for day-to-day operations and management of the business, which include–

- i) implementing and adhering to the policies, practices and standards approved by the board of directors;
- ii) managing the risks associated with the business of a trustee or custodian include performing periodic evaluation of its risk management process;
- iii) frequently and adequately apprising the board of directors on the operations of the trustee or custodian;
- iv) ensuring that the registered entity complies with securities laws, guidelines and any other relevant laws;
- v) ensuring records are accurate, properly secured and retained;
- vi) complying with all the reporting requirements and submit any information that is required by the SC in a timely and accurate manner;
- vii) having access to all relevant information about the business on a timely basis; and

viii) seeking where appropriate all necessary advice in relation to the business and their responsibilities.

Chief Executive

2.4.3 The Respondents also agreed that the chief executive is responsible to undertake the following functions-

- (a) Ensure continuous compliance of all requirements under the *Guidelines on Registration and Conduct of Capital Market Services Providers (CMSP Guidelines)*, securities laws, relevant guidelines, trust deed or documents submitted with the SC and any other relevant laws;
- (b) Notify the SC of any material change to the information submitted to the SC within 10 business days from the date of such change; and
- (c) Undertake the role of the main contact person for the purpose of liaising with the SC.

2.4.4 The Respondents were of the view that by having dedicated duties and responsibilities for both board of directors and senior management of a trustee and custodian, it will serve as a clear guidance for them to perform their functions effectively as well as to enhance their accountability and active involvement in the entity's business.

**3.0 The Framework on the Registration of Trustees under section 76A of CMSA**

- 3.1 The SC will issue the CMSP Guidelines. These Guidelines shall specify 'trustee services' to be a capital market service pursuant to section 76A(1) of the CMSA, as well as provide the requirements for the registration of trustees and the ongoing obligations of these entities.
- 3.2 These Guidelines will also include the requirements for the registration of foreign trustee under section 260(2) of the CMSA. For the purpose of registering a foreign trustee, the SC may recognise an entity which is licenced, authorised or otherwise regulated by a comparable or equivalent regulatory authority listed under Appendix A of IOSCO MMOU.
- 3.3 In addition to the requirements for local and foreign trustee, the Guidelines will also provide requirements on the appointment of what is related-party trustee (RPT) for unit trust fund UTF and Corporate Bond or Sukuk. If the trustee intends to act as a RPT for any of the products mentioned before, they must specify their intention when they first submit their registration application. There are additional requirements imposed on the RPT as well as the rigorous ongoing monitoring mechanisms imposed on these entities.



**Abbreviations**

BNM	Bank Negara Malaysia
CP	Public Consultation paper
CMSA	<i>Capital Markets and Services Act 2007</i>
CMSL	Capital Markets Services Licence
IOSCO	International Organization of Securities Commissions
ICM	Islamic Capital Management
MMOU	Multilateral Memorandum of Understanding
PII	Professional Indemnity Insurance
PRS	Private retirement scheme
RM	Risk management
REIT	Real estate investment trust
RPT	Related-party trustee
SC	Securities Commission Malaysia
SCMA	<i>Securities Commission Malaysia Act 1993</i>
SHF	Shareholders' fund
UTF	Unit trust fund