



PUBLIC CONSULTATION PAPER

NO. 4/2016

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

The Securities Commission Malaysia (SC) invites your written comments to this consultation paper. Comments are due by 28 November 2016 and should be sent to:

Supervision Department
Securities Commission Malaysia
3 Persiaran Bukit Kiara, Bukit Kiara,
50490 Kuala Lumpur
E-mail : feedbackt&c@seccom.com.my
Fax : + 603-2091 0760

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This public consultation paper is dated 12 Oct 2016

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Overview

- 1.1 The purpose of this Consultation Paper (CP) is to seek feedback on the regulatory framework for trustees and custodians, as a capital market service provider under section 76A¹ of CMSA.
- 1.2 The SC recognises the significant role played by trustees and custodians in maintaining investors' trust in the capital market by safeguarding investors' assets and interest. In view of the important functions undertaken by these entities, the SC is proposing to revise the regulatory framework that includes streamlining entry standards and ongoing conduct obligations that will create a level playing field among trustees and custodians.
- 1.3 This framework is consistent with SC's efforts in realigning its regulatory approach from product-focussed to intermediary/activity-focussed. This framework will focus on conduct regulation to ensure that trustees and custodians prioritise investors in all of their decision making process. In addition, it will emphasise board and management responsibilities by holding them accountable for the conduct of the registered entity and their representatives. These changes entail extending the regulatory framework to include all persons carrying out capital market activities, including trustees and custodians, in order to instil trust and confidence in the capital market².
- 1.4 In 2012, the CMSA was amended with the introduction of section 76A which provides for the registration of persons providing capital market services.
- 1.5 This CP on the regulatory framework for persons providing trustee or custodial services in Malaysia is divided into two parts:
 - (i) Part I: Registration framework
 - (ii) Part II: Roles and Responsibilities of Board of Directors and Key Personnel

¹ Section 76A enables the SC to specify any service to be a capital market service and requires persons providing such services to apply to the SC to be registered under section 76A.

² A number of international initiatives have been rolled out to enhance the protection of investors' rights and interest as well as the safety of their assets globally, spearheaded by IOSCO as well as by regulators in other jurisdictions such as Australia, US and EU.

- 1.6 The objectives of the framework are to–
- (i) establish entry standards to ensure that only those who are fit and proper can be registered as a trustee or custodian;
 - (ii) establish governance structure for registered trustees and custodians to enhance the effectiveness of their oversight functions;
 - (iii) standardise the current prudential requirements, which include shareholders' fund and paid-up capital of registered trustees or custodians to ensure business continuity;
 - (iv) streamline the professional indemnity insurance which trustees and custodians must undertake and maintain to manage risks associated with the business operations;
 - (v) establish minimum standards of conduct for registered trustees and custodians in order to promote higher standards in the industry;
 - (vi) enhance efficiency by streamlining the current requirements from product based registration³ to intermediary/activity based registration; and
 - (vii) enable effective supervision of registered trustees and custodians.
- 1.7 Unless otherwise stated, only trustees and custodians registered under this framework will be able to act as a trustee or custodian for the purposes of the CMSA.
- 1.8 Further, the names of registered trustees and custodians will be listed in a public register to enable the public to identify who are able to undertake the trustee and custodial services.
- 1.9 In addition to the proposed requirements under the framework, all trustees must continue to observe and comply with the existing requirements stipulated in the relevant product guidelines⁴ .

³ The current framework for the registration of trustees is based on the products that they act as a trustee, for example, UTS, PRS and bonds.

⁴ *Guidelines on Unit Trust Funds; Guidelines on Private Retirement Schemes; Practice Note on Registration for the Purpose of Acting as a Bond Trustee; Guidelines on Allowing a person to be appointed to act as a trustee under subsection 69(2) of SCA 1993; Guidelines of Private Debt Securities, Guidelines on the Offering of Islamic Securities; Guidelines on Real Estate Investment Trusts; Guidelines on Compliance Function for Fund Management Companies.*

1.10 The SC may, upon registering the applicant, grant a modification or variation to the requirements and conditions, subject to justifications provided by a trustee or custodian.

Malaysian landscape

1.11 Trustees and custodians play a critical role in maintaining investors' trust and confidence in the capital market by protecting their assets and ensuring compliance with the trust deed. In Malaysia, we note that some trustees have also provided custodial services in response to investor's preference to deal with businesses that provide a more comprehensive service to meet the investors' needs.

1.12 As of 31 December 2015, approximately RM1.7 trillion of assets belonging to investors are held by trustees and custodians.

1.13 In Malaysia,–

- (i) 17 trustees are already operating as trustee for bond, UTS and PRS under the respective product guidelines. These trustees hold RM1.5 trillion of assets on behalf of investors.
- (ii) 73 custodians are providing custodial services in the Malaysian capital market. Of the 73, 22 are global banks providing custodial services in relation to assets outside Malaysia. Most of these global custodians are appointed by clients and not by CMSL holders.

PART I: Registration Framework

- 2.1 This part of the CP sets out the salient features of the registration framework for trustees and custodians under section 76A of the CMSA.
- 2.2 In formulating the framework, the SC has taken into consideration regulatory approaches for trustees and custodians in various jurisdictions, including Australia, Hong Kong, Singapore and United Kingdom⁵.
- 2.3 The SC is also mindful that any regulation imposed must be proportionate to the level of risk posed by trustees and custodians.
- 2.4 The following areas covered under the framework:
- (i) Categories of trustees and custodians that require registration;
 - (ii) Registration criteria, including entry standards and ongoing obligations; and
 - (iii) Fit and proper requirements.

A. Categories of trustees and custodians that require registration

- 2.5 The framework proposes registration requirements for the following:
- (i) Any entity providing trustee services for a UTS, PRS, bond or sukuk;
 - (ii) Any entity providing custodial services appointed by a CMSL holder for assets held within or outside Malaysia; and
 - (iii) Any entity providing custodial services appointed by clients for assets held within Malaysia.
- 2.6 The SC is of the view that foreign custodians appointed by a CMSL holder for assets held outside Malaysia should be included in the registration under this framework

⁵ In UK and Hong Kong, the FCA and SFC respectively, authorises entities carrying out trustee and custodial services by way of granting approval to the trustees and custodians. In Singapore, MAS authorises provision of trustee services, but requires a license for entity providing custodial services. In addition, in Singapore, the authorisation for trustee services is granted via approval, which is similar to UK and Hong Kong. In Australia, however, ASIC requires persons providing trustee and custodial services to be licensed.

given that monies for investments are raised from investors in Malaysia. Further, the foreign custodian must be authorised or recognised in an acceptable jurisdiction⁶.

2.7 Custodians appointed by clients to perform custodial services in Malaysia would be included under this registration framework as the custodial services are carried out in Malaysia. However, registration under this framework would **not** be applicable for foreign custodians appointed directly by the client to carry out custodial services in a foreign jurisdiction. CMSL holders must inform their clients who directly appoint foreign custodians for custodial services in foreign jurisdiction on the roles and obligations of the custodians to their clients.

2.8 In the case of Bond Trustee, the general requirement is that a trust deed⁷ and trustee⁸ are required for any issue, offer for subscription or purchase, or invitation to subscribe for or purchase any debenture. However, issuance of foreign currency denominated

⁶ The SC may consider a foreign custodian located in an acceptable jurisdiction, i.e. Jurisdiction which are listed in the Appendix A of the *IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information* (IOSCO MMOU) or a jurisdiction with which the SC has adequate bilateral relationships to be exempted from the registration framework.

⁷ Section 258 of the CMSA:

(1) Every person issuing, offering for subscription or purchase, or making an invitation to subscribe for or purchase, any debenture shall—

(a) enter into a trust deed that meets the requirements of section 259;
(b) appoint a trustee who is a person eligible to be appointed or to act as trustee in accordance with section 260; and
(c) comply with the requirements and provisions of this Division.

(2) A person issuing, offering for subscription or purchase, or making an invitation to subscribe for or purchase, any debenture shall not allot such debenture unless the person has entered into a trust deed that meets with the requirements of section 259 and has appointed a trustee who is a person eligible to be appointed or to act as trustee under section 260.

(3) A person issuing, offering for subscription or purchase, or making an invitation to subscribe for or purchase, any debenture shall not revoke the trust deed unless the person has repaid all amounts payable under the debenture in accordance with the terms, provisions and covenants of the debenture and the trust deed.

(4) A person who contravenes subsection (1), (2) or (3) commits an offence and shall, on conviction, be liable to a fine not exceeding RM3 million or imprisonment for a term not exceeding 10 years, or to both.

⁸ Section 260 (1) of the CMSA:

A trustee shall be—

(a) a company registered as a trust company under the *Trust Companies Act 1949* [Act 100]; or
(b) a corporation that is a public company under the *Companies Act 1965* or under the laws of any other country, which has been approved by the Commission to act as trustee for the purposes of this Act.

⁹ Schedule 8 (11) of CMSA – Issues of, offers for subscription or purchase of, or invitations to subscribe for or purchase, debentures to which Subdivision 1 of Division 4 of Part IV and Section 283 of Subdivision 2 of Division 4 of Part VI shall not apply.

(11) An issue, offer of invitation made in relation to a foreign currency denominated debenture to-

(a) an underwriter under an underwriting or initial purchase agreement;
(b) a unit trust scheme or prescribed investment scheme;
(c) a holder of a CMSL who carries on the business of dealing in securities;
(d) a closed end fund approved by the Commission;
(e) a holder of a CMSL who carries on the business of fund management;
(f) a corporation with total net assets exceeding RM10 million or its equivalent in foreign currencies based on the last audited account;
(g) a licensed offshore bank as defined under the *Offshore Banking Act 1990*; or
(h) an offshore insurer as defined under the *Offshore Insurance Act 1990*.

debentures to persons identified in Paragraph 11 of Schedule 8 of the CMSA⁹ is exempted from the requirements of having a trust deed and trustee.

Notwithstanding this exemption, an issuer of such foreign currency denominated debenture may opt to appoint a trustee if it wishes to do so. In the event that the issuer appoints a local trustee, it must be a trustee which is registered with the SC. If they seek to appoint a foreign trustee, the said trustee must be authorised or recognised in an acceptable jurisdiction. This approach is similar to foreign custodians as stated in Paragraph 2.6 above.

Question 1

Should registration be extended to entities other than those proposed in paragraph 2.5 and 2.6 above? 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.

B. Registration criteria, entry standards and ongoing obligations

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

- 2.9 Trustees and custodians are required to have sufficient financial resources to ensure that they have the sufficient capability to discharge their statutory functions, operate the business efficiently and to ensure business continuity.
- 2.10 In Australia¹⁰, ASIC introduced the requirement for custodians to meet NTA requirements of A\$10 million or 10 per cent of "average revenue". In Hong Kong, the SFC requires a trustee to have a minimum issued and paid-up capital of HK\$10 million or its equivalent in foreign currency. In Singapore, MAS imposes a base capital requirement of S\$1million on a trustee.
- 2.11 In Malaysia, trustee for bond, UTS and PRS are currently required to have a minimum shareholders' fund with a minimum issued and paid-up capital as set out in the table below.

| Entity | Issued and paid-up capital (RM) | Shareholders' funds (RM) |
|-------------------|---------------------------------|--------------------------|
| Unit trust scheme | Not less than 500,000 | N/A |
| Debentures/bond | Not less than 500,000 | 1,000,000 |
| PRS | Not less than 500,000 | 1,000,000 |
| Custodians | N/A | N/A |

- 2.12 The SC is proposing a minimum issued, paid-up capital and shareholders' fund of RM1 million for registered trustees and custodians, which is higher than the current issued and paid-up capital requirements. As for the proposed shareholders' fund, it will be similar to the current requirement, which is RM1 million, and will now be applicable to trustees and custodians.

Question 5

Do you agree with the SC's proposal to impose minimum issued, paid-up capital and

¹⁰ See ASIC Report 352: Response to submissions on CP 194 Financial requirements for custodial or depository service providers (June 2013) - Requirement of A\$5 million NTA was increased to A\$10 million in 2014.

shareholders' fund of RM1 million for registered trustees and custodians who seek to be registered under this framework? Please provide reasons for your answer.

Professional Indemnity Insurance (PII)

2.13 The SC is proposing that trustees and custodians should undertake and maintain a PII to manage risks associated with the business operations.

2.14 Currently, trustees for bond and PRS are required to obtain PII coverage of at least RM5 million in the first year of its registration by the SC and to increase that to at least RM10 million in the second year and thereafter.

2.15 In other jurisdictions, the requirements to maintain PII are as follows:

| | Australia | Singapore | Hong Kong |
|------------|--|--|---|
| PII amount | A limit of at least A\$2 million for any one claim and in the aggregate for licensees with total revenue from financial services provided to retail clients of A\$2 million or less. | 1) Obtain PII for such amount and on such terms as may be specified by MAS; or 2) Provide MAS with a performance bond, guarantee or any similar instrument from its holding company as may be specified by MAS. | Trustees are required to arrange for adequate indemnity insurance in respect of prescribed risks. |

2.16 The SC is of the view that trustees and custodians must maintain a PII which commensurate with the nature, activity, complexity and risks of the trustee and custodial businesses.

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 extend 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.

Compliance and Internal Audit Functions and Risk Management Framework

- 2.17 The SC recognises that trustee and custodian businesses face various risks relating to the safekeeping of assets. To mitigate and manage these risks, it is proposed that trustees and custodians seeking to register under this framework should satisfy the SC that it has an effective compliance and internal audit function in place. Further, the board should satisfy the SC that it has in place a robust risk management framework.
- 2.18 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 internal controls.
- 2.19 The risk management framework should be able to identify, assess, monitor and respond to all material risk to the business. The framework should also ensure that there is regular reporting to the board.
- 2.20 In Australia, an RE¹¹ must have an approved compliance plan and demonstrate the capability to carry out the compliance plan. The plan must be lodged with ASIC and

sets out adequate measures that the RE will apply in operating the scheme to ensure compliance with laws and the scheme's constitution.

2.21 In Hong Kong, however, there is no requirement for a trustee or custodian to establish compliance and internal audit function as well as a risk management framework. However, the trustee or custodian of a CIS is required to be approved by the SFC who may either conduct its own examination on the trustee or custodian or appoint an independent auditor to carry out that function.

C. Fit and Proper Requirements

2.22 One of the objectives of the framework is to ensure that entities registered and their key personnel are fit and proper.

2.23 In assessing the fitness and probity of an entity and its key personnel, the SC will take into consideration among others, issues affecting:

- (i) Honesty, integrity and reputation;
- (ii) Competence and capability; and
- (iii) Financial soundness¹².

2.24 For the purposes of this framework, key personnel mean any member of the board of directors and senior management.

¹¹ The concept of managed investment schemes was introduced in July 1998, by the *Managed Investments Act* (Cth), and has been defined as a scheme in which people contribute money to acquire interests to benefits produced by the scheme. The *Managed Investments Act* replaced the old "prescribed interests" regime, and its most significant change was the replacement of the roles of trustee and manager with the single [Responsible Entity](#) role. This is a dual role, of both trustee and scheme manager practice in Australia.

¹² The determination of the financial soundness of an entity, its board or key personnel includes the following:

- Being wound up or otherwise dissolved;
- Having a judgement debt being executed against it which has been returned unsatisfied in part or whole;
- Having a receiver or manager or an equivalent person being appointed within or outside Malaysia in respect of any of its property;
- Entering into a compromise or scheme of arrangement with its creditors either within or outside Malaysia;
- Being an undischarged bankrupt within or outside Malaysia.

3. **Part II: Roles and Responsibilities of Board and Key Personnel**

Board of Directors and Senior Management

- 3.1 In order to ensure proper management and running of the entity, roles and responsibilities of the board and senior management of the trustees and custodians will be specified.

Board of Directors

- 3.2 The board must be primarily accountable for ensuring operational sustainability and financial soundness of the trustee or custodian. In fulfilling this role, the board 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 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

- 3.3 The senior management of the trustee and custodian have the primary responsibility for the 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.

Responsible Person

- 3.4 The SC is proposing that the CEO or its equivalent be appointed as a Responsible Person, who will undertake the following duties:
- (i) Carry out the role of the main contact person for the purpose of liaising with the SC; and
 - (ii) Notify the SC of any material change to the information submitted to the SC within seven working days from the date of such change.

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.

4. Imposition of Fees

4.1 Registration under this framework will be subjected to the imposition of fees.

5. Treatment of existing trustees

5.1 In order to facilitate a smooth transition from the current framework to the proposed registration framework, trustees who are currently approved under sections 260 and 289 of CMSA will be deemed to be registered¹³ under the new framework.

5.2 It is acknowledged that feedback received during engagements with industry indicates that existing trustees are able to comply with the proposed framework as they have met with most of the proposed requirements.

5.3 Under the new framework, trustees will need to comply with the following requirements in the CP in addition to compliance with requirements stipulated in the relevant product guidelines:

- (i) Satisfy the SC that its board and senior management meets the proposed obligations as set out under Part II of this framework;
- (ii) Meet the minimum shareholders fund, issued and paid-up capital of RM1 million and RM500,000 respectively;
- (iii) Have in place :
 - (a) Compliance and internal audit function; and
 - (b) Risk management framework; and
- (iv) Payment of relevant fees upon registration.

¹³ Trustees will be treated as having been registered under this framework without submitting a new application subject to fees being paid.

5.4 While existing trustees will be subjected to the requirements under the framework when it comes into force, they would be given one year to comply with the requirements in paragraph (iii) (a) and (b) above.

6. General Comment

6.1 While SC seeks your feedback on the specific questions stipulated in the CP, we also welcome general comments or feedback.

Abbreviations

| | |
|-------|--|
| ASNB | Amanah Saham Nasional Bhd |
| ASIC | Australian Securities and Investments Commission |
| APRA | Australia Prudential Regulatory Authority |
| CASS | Client Asset Sourcebook |
| CIS | Collective investment scheme |
| CO | Compliance officer |
| CP | Consultation paper |
| CMSA | <i>Capital Markets and Services Act 2007</i> |
| CMSL | Capital Markets Services Licence |
| EU | European Union |
| FCA | Financial Conduct Authority |
| IA | Internal audit |
| IOSCO | International Organization of Securities Commissions |
| NTA | Net tangible asset |
| PII | Professional Indemnity Insurance |
| PRS | Private retirement scheme |
| RM | Risk management |
| REIT | Real estate investment trust |
| RE | Responsible entity |
| SC | Securities Commission Malaysia |

| | |
|------|--|
| SCMA | <i>Securities Commission Malaysia Act 1993</i> |
| SFC | Securities and Futures Commission of Hong Kong |
| SHF | Shareholders' fund |
| UTMC | Unit trust management company |
| UTS | Unit trust scheme |