



SUBJECT: Trustees and Custodian Guideline

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SCOPE: Collective Investment Schemes

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SECTION I: OVERVIEW

1. Introduction

The Securities Act, 2010 ('the Act') requires a manager of a collective investment scheme ('scheme' or CIS) to appoint a trustee or custodian to safeguard the rights and interests of participants to ensure that:

- the scheme is managed by the manager in accordance with the Act, the FSRA Act, the trust deed, the Securities Act, 2010, Rules made under the Act, and the prospectus;
- the constituents of the scheme's property do not cause an infringement of the Act, or the FSRA Act;
- the manager is adopting procedures and methods which are appropriate to ensure that the price of a unit of a scheme is correct; and
- the manager makes and retains sufficient records to document its activities completely and to show compliance with the Act, the FSRA Act and any Guidance Note issued by FSRA including this Guidance Note.

In this Note, reference to a trustee means a trustee and/or custodian appointed in terms of section 54 of the Securities Act, 2010.

A. Nature and Purpose of the Guidance Note

This Guidance Note has been prepared to provide guidance in matters pertaining to Trustees and Custodians under Section 54 and Section 56 of the Securities Act, 2010 and the FSRA Act, 2010. These guidelines do not replace or override any legislative provisions. Trustees and Custodians are therefore advised to read these guidelines in conjunction with the Act, FSRA Act and Rules made under those Acts.

The main purpose of the guideline is to set out a framework which can be used by trustees or custodians in executing their duties and functions for safeguarding investors' assets and interest.

B. Definitions

In this guideline, unless the context otherwise indicates-

“assets” means the investments comprising or constituting a portfolio of a collective investment scheme and include any income accruals derived or resulting from the investments in the portfolio which are held for or are due to the investors in that portfolio;

“the Act” means the Securities Act, 2010;

“Authority” means the Financial Services Regulatory Authority established in terms of the Financial Services Regulatory Act 2010;

“Collective investment scheme” means an arrangement in respect of property of any description, including money, the purpose or effect of which is to enable a person taking part in the arrangement, whether by becoming the owner of the property or any part of it or otherwise, to participate in or receive profits or income arising from acquisition, holding, management or disposal of the property or sums paid out of such profits or income and where;

“custodian” means a custodian appointed in terms of section 54 of the Act;

“manager” means in relation to a collective investment scheme, a person, by whatever name called, who is authorized in terms of Part IV of the Act to manage, operate or control a scheme;

“scheme” means a collective investment scheme.

“Registrar” means the Registrar of Capital Markets appointed under Section 3 of the Securities Act, 2010.

” *right*” includes a requisition or joining in a requisition to convene any meeting or a right to give notice of any resolution or to circulate any statement or to consent to any short notice of any meeting.

“*voting*” includes giving any consent to or approval of any arrangement, scheme or resolution or any alteration in or abandonment of any rights attaching to any part of the scheme property.

SECTION II: REGISTRATION FRAMEWORK

A. Qualifications of Trustees and Custodians

Pursuant to Section 55 of the Act, a trustee or custodian can be any of the following persons:

- a company registered as a company under the Companies Act, 2009;
- an institution licensed to carry on business as a banking institution under the Financial Institutions Act, 2005; or,
- an institution which is registered as an insurer under the Insurance Act, 2005.

Further, a company or institution should not become or act as a trustee or custodian under a scheme unless it:

- maintains a capital and reserves together amounting to not less than an amount prescribed by the Registrar; and
- has been registered by the Registrar as a trustee or custodian and is in possession of valid licence setting forth the fact of that registration

A. Licensing of Trustee and Custodians

1. General Requirements

The Authority may grant a licence in terms of Section 37 of the FSRA Act or vary a licence in terms of Section 43 of the FSRA Act only if the Authority is satisfied that, having regard to any conditions imposed on the licence, the applicant (trustee) is capable of effectively performing (or will, after the variation, be capable of effectively performing) the functions of a supervisor in respect of registered schemes the supervision of which is covered by the licence.

The Registrar may not register any company or institution as a trustee or custodian unless the Registrar is satisfied that:

- The company meets the capital requirements prescribed the Registrar; and
- The financial and commercial standing and independence of the company is such that it is fit for assuming the functions of a trustee or custodian and that the company or institution by reason of the nature of its business is sufficiently experienced and equipped to assume such functions.

2. Prudential Requirements

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. Furthermore, the paid-up capital and the shareholders' equity must be not less than E1 000 000 (one million emalangeni).

B. Fit and Proper Requirements

In assessing the fitness and probity of key personnel the FSRA will consider issues that relate to the following in terms of the Guideline on the Fit and Proper Test for Licenced Persons under the Section 31 of the Securities Act, 2010 and Section 37 of the FSRA Act, 2010:

- (i) Financial status;
- (ii) Educational or other qualifications or experience;
- (iii) Ability to perform the function efficiently;
- (iv) Honesty and fairness;
- (v) Reputation and Character;
- (vi) Financial integrity;
- (vii) Reliability.

For the purposes of this guideline, “key personnel” means any member of the board of directors and senior management.

C. Appointment of Trustees or Custodian

A licensed scheme manager must exercise due diligence to appoint an independent trustee to carry out instructions of the licensee in accordance with a trust deed and the securities laws and regulations in terms of section 55 of the Act.

The key criteria on which the initial due diligence will be based is as follows:

- i. The custodian's legal and regulatory status. This refers to the appropriateness of the entity to act as a custodian.
- ii. Capital and financial resources requirements. This refers to the credit worthiness of the custodian.
- iii. Organizational capabilities, i.e. the human resources, the management, the IT systems and processes, and the infrastructure necessary to hold the assets and ensure the safe keeping of assets, and the robustness of the risk management framework.

D. Selection of Trustee or Custodian

In selecting the most appropriate trustee the diligence which is conducted should seek to establish that a trustee can perform its responsibilities effectively, so that the risks associated with safe custody are minimized. If a scheme wishes to manage assets in several jurisdictions, the selection process should ensure suitable sub-custodians are available to carry out the work locally. The guidance which is given below applies in respect of both domestic and foreign custody.

- **Reputation**

The reputation of a trustee should be considered. This can be established in several ways. If a scheme has had previous dealings with the trustee these can be considered. References can be obtained, including from existing customers. Credit ratings can be obtained which may provide further information. In addition, industry publications and surveys may provide relevant information.

- **Expertise**

The selection process should ensure a trustee is able to carry out the duties which are assigned to it. Different types of scheme require differing custodial arrangements such as custodian of property fund.

- **Network**

If a trustee has a network in different jurisdictions, it may be able to provide a more integrated and effective custody service due the experience it has acquired. This may be important to a scheme which manages assets in different jurisdictions and would thus be a relevant consideration in the selection process.

- **Prevailing Custodial Practices**

The selection process should consider prevailing local practices. This includes the manner in which securities are maintained (e.g. whether they are held in physical or uncertificated form) and the physical protections which are available for certificated securities (e.g. the use of vaults or other facilities). The method of keeping custodial records (e.g. the use of computers, microfilm or paper records) and custodial communications systems (e.g. the use of electronic media, telex or telephone) and the quality of any technology used should also be considered. If there are accepted practices in a jurisdiction it is possible that all trustee will operate on a similar basis. Trustee may, however, operate to differing standards within that regime. Where an operator of a scheme is not satisfied with a local practice, it may be necessary to negotiate additional protections for scheme assets, such as contractual protections or enhanced monitoring of custodial activity.

- **Special Arrangements designed to reduce or mitigate custodial risks**

There may be special arrangements in place which should be considered at the time of selection. Such arrangements may include insurance or guarantees covering the loss of assets. Special procedures may also be in operation which depart from local practices and are designed to reduce custodial risks. For example, a scheme and a custodian may enter into contractual arrangements that supplement a country's prevailing custodial practices.

- **Disclosure of Risks**

The contract should require the trustee to declare to the manager any risks that arise from the custody arrangement, so that the manager can determine whether and how those risks should be disclosed to potential investors in the scheme.

E. Contractual Agreements

The trustee should establish and keep a signed trust deed between the manager and the trustee, and it should provide for -

- a) the custodian accepting custody of specified assets;
- b) the trustee agreeing to observe the provisions of the constitutive documents or prospectus or offering document of the collective investment scheme and of the custodian agreement;
- c) requirements with regards to the location of assets;
- d) the method of holding assets;
- e) the standard of care to be exercised by the trustee and its responsibility for loss;
- f) the trustee to forthwith submit a report to the Authority, and a copy thereof to the scheme manager and scheme, in relation to any failure of the scheme manager or scheme to meet the requirements applicable.

In addition to the trust deed a trustee should have a contract in writing with the operator of a scheme or a scheme itself, which should be reviewed periodically. The contract should set out the rights and responsibilities of the scheme manager and the trustee in order to

ensure that the assets in the scheme are protected. The provisions must include, at least, the following provisions:

1. Authority to Give Instructions

The agreement should address the issue of which employees of the scheme or the operator are permitted to give instructions to the trustee. The types of acceptable instructions should also be specified. This will improve efficiency, safeguard scheme assets and ensure the scheme manages effectively its day-to-day relationship with the trustee.

2. Service Level

The agreement should specify the types of service which the trustee is required to perform. The standards should cover all the activities which the trustee is required to undertake. These may include agreeing on the way transactions should be settled, the frequency of reconciliations and the reporting of problems to the scheme.

3. Access

As the manager, accountants and the regulator of the scheme may require access to a trustee's internal procedures and records from time to time, the frequency and type of access should be specified in the agreement. Access may be required to conduct periodic inspections of the trustee's operation or to resolve problems which may have arisen in connection with the scheme.

4. Indemnification

The manager and the trustee should agree the terms, if any, on which a scheme is to be indemnified in the event of loss. There may be loss to a scheme as a result of the trustee failing in its obligations under the agreement.

5. Sub - Custodian

Where a trustee may use the services of a sub-custodian in this or in other jurisdictions, a written agreement should be required to be in place between the custodian and the sub-custodian. The ability to retain a sub-custodian and any specification or limitation of the services to be provided should be set out in the contract. The contract should specify the trustee's liability for the actions of a delegate. The contract should specify that the trustee is responsible for the actions of the sub-custodian.

6. Liquidation

The contract should require that in the event that the manager is potentially going out of business or liquidity, the manager should promptly advise the FSRA and the trustee.

SECTION III: ROLES AND RESPONSIBILITIES FOR TRUSTEES AND CUSTODIANS

A custodian is an entity appointed by the responsible entity and entrusted with the custody of the assets. The principal activity for which a trustee is engaged by a scheme or responsible entity is the oversight of the manager, custody of property of the fund, the duty to inform the Authority of misconduct, violations, irregularities, and breaches that have been committed by the scheme manager, control of the scheme property, and to perform administration or ancillary services, as described below.

1. *Oversight of the manager*

- i. The trustee or custodian must exercise due care and diligence in discharging its functions and duties, including safeguarding the rights and interests of participants. The trustee or custodian should take reasonable care to ensure-
 - (a) that the scheme is managed by the manager in accordance with the Act, the FSRA Act, the trust deed, all relevant Guidelines (including these Guidelines) and the prospectus; and
 - (b) the constituents of the scheme's property do not cause an infringement of the Act, the FSRA Act and these Guidelines.
 - (c) Where there is a conflict in the provisions stipulated above and the provision of the Act, the provisions of the Act should prevail.
- ii. The trustee or custodian should take reasonable care to ensure, on a continuing basis, that-
 - (a) the manager makes and retains sufficient records to document its activities completely and to show compliance with the Act, the FSRA Act and these Guidelines.

2. *Duty to inform the Authority*

- i. Unless the trustee or custodian has taken reasonable due care to determine that certain developments are not likely to become materially significant, the trustee or custodian should inform the Authority immediately upon becoming aware of developments as a result of which it is no longer certain that-
 - (a) the scheme is managed by the manager in accordance with its management duties; and
 - (b) decisions about the constituents of the scheme property are in compliance with the requirements under the Act, FSRA Act or these Guidelines;
- ii. If the trustee or custodian becomes aware of developments which it needs to investigate in order to ascertain whether its duty to inform the Authority arises, then the trustee/custodian should immediately undertake all investigations it considers necessary;

- iii. If, after 90 days of investigations, the trustee or custodian determines that-
 - a) the developments are not, or are not likely to become, materially significant, then the Authority need not be notified; or
 - b) the developments are, or are likely to become, materially significant, then it should notify the Authority immediately.
- iv. Where the trustee undertakes investigation, it should ensure that the investigation is documented including:
 - The factors that gave rise to the suspicion and subsequent investigation.
 - The factors considered during the investigation.
 - The reasons for the decision to report / not to report to the regulator.

3. *Retirement of a trustee or Custodian*

- i. The trustee or custodian should not retire voluntarily unless, before its retirement, it has ensured that the new trustee or custodian has been informed of any developments of which the retiring trustee or custodian has informed the Authority.
- ii. Before its retirement, the trustee or custodian should take all steps and complete all documents which are necessary to ensure that transactions for the account of the authorised scheme properly entered into by the manager in accordance with its powers under these Guidelines are completed.

4. *Control over the scheme property*

- i. The trustee or custodian should take all steps and complete all documents which are necessary to ensure that transactions for the account of the authorized scheme properly entered into by the manager in accordance with its powers under these Guidelines are completed.
- ii. The trustee or custodian should take into its custody or under its control all the property of the authorised scheme and hold it in trust for the participants in accordance with these Guidelines and the trust deed.
- iii. The trustee or custodian is responsible for the collection of any income due to be paid for the account of a scheme and for claiming any repayment of tax and should hold any income received in trust for the participants in accordance with the law, these Rules and the trust deed.
- iv. The trustee or custodian should make and retain for a period of five years all such records as are necessary-
 - (a) to enable it to comply with the Act and these Guidelines; and
 - (b) to demonstrate that such compliance by it has been achieved.

- v. Where the trustee or custodian goes out of business or into liquidation, the trustee must ensure that it passes over the scheme property and records to a new trustee or custodian before it does so.

5. *Exercise of rights in respect of the scheme*

- i. The trustee or custodian should take all steps and execute all such documents as are necessary to ensure that instructions properly given to it by the manager as to the exercise of rights, including voting rights, attaching to the ownership of scheme property are carried out.
- ii. The trustee or custodian may exercise, or not exercise, any right of voting conferred by any of the scheme property which is-
 - (a) participatory interests in any other collective investment scheme managed or otherwise operated by the manager or by an associate of the manager; or
 - (b) shares in an approved investment trust which form part of the scheme property of a feeder fund managed or otherwise operated by the manager or by an associate of the manager.
- iii. The trustee or custodian should, upon the written request of the manager, from time to time execute and deliver or cause to be executed or delivered to the manager or its nominees such powers of attorney or proxies as the manager may reasonably require, in such name or names as the manager may request, authorising such attorneys and proxies to vote, consent or otherwise act in respect of all or any part of the scheme property not included in (2).
- iv. The trustee or custodian should, without undue delay, forward to the manager all notices of meetings, reports, circulars, proxy solicitations and other documents of a like nature received by it as registered participant of any investment.

6. *Ensure that the manager conducts business in terms of the Rules, Act and the trust deed.*

- i. The manager may give instructions as to the acquisition or disposal of property for the account of the authorized scheme.
- ii. Where the trustee or custodian is of the opinion that a particular acquisition or disposal of property for the account of the scheme by the manager exceeds the powers conferred on the manager by these Rules, the Act or the trust deed, the trustee or custodian may require the manager to cancel the transaction or make a corresponding acquisition or disposal to secure restoration of the previous situation and to meet any resulting loss or expense.

- iii. Where the trustee or custodian is of the opinion that-
 - (a) an acquisition of property by the manager necessarily involves documents evidencing title being kept in the custody of a person other than the trustee or custodian; and
 - (b) the trustee or custodian cannot reasonably be expected to accept the responsibility which would be placed upon it if it were to permit custody by such a person.

the manager should, for its own account, cancel the transaction or make a corresponding disposal if the trustee or custodian so requests.

7. *Ensure that the Manager rectifies Breaches.*

- i. The trustee or custodian should take all reasonable steps and exercise due diligence to monitor the management of the scheme property sufficiently to ensure that the manager complies with the provisions of the Act.
- ii. The manager should, immediately upon becoming aware of any breach of any provision in the Act, Rules or trust deed, take action, at its own expense, to rectify that breach.
- iii. Immediately upon the trustee or custodian becoming aware of any breach, it should take steps necessary to ensure that the manager rectifies the breach promptly.

SECTION IV: DELEGATIONS AND CONFLICTS OF INTEREST

A trustee may delegate its responsibilities when does not have the required skill in house, however the trustee must ensure that any conflict of interest is managed in order to ensure that CIS assets are not at risk.

(i) *Holding non-standard assets*

Some assets, often non-financial securities (e.g. physical commodities such as gold bullion, artwork or wine etc.), may call for specialist custodians. For example, the custody of gold bullion would require a custodian with appropriate vault facilities. The holding of such assets may introduce additional operational risks e.g. physical security of assets or other proper storage.

(ii) *Conflict of Interest Risk*

The safety and integrity of scheme assets may be at risk if the manager or the trustee fails to identify, address and monitor any conflicts of interests e.g. failure to segregate custodial staff from persons performing other functions (such as investment or trading functions) in a way that mitigates conflicts of interest which may exist.

SECTION V: RISK MANAGEMENT

A trustee or Custodian must have a risk management framework in place to manage the following risks:

(iii) *Fraud or theft*

There is a risk of loss of scheme assets if an employee of the custodian acts in a fraudulent manner (e.g., falsifying records) or steals from client accounts. The Scheme assets could also be placed at risk if a third-party act in a fraudulent manner e.g. submitting fake withdrawal instructions to the custodian purporting to be the responsible entity.

(iv) *Information technology risk*

Given that most scheme assets are held by way of registration in electronic book-entry form in the accounts of the scheme opened with the custodian, an important aspect of a custodial business involves the security and reliability of its information technology (IT).

Key IT risks include:

- a) vulnerabilities in IT security which can open the gate for fraud and loss of data integrity;
- b) existence of legacy systems which can give rise to other risks such as human error due to a higher reliance on manual input; and
- c) IT system failures which could result in the custodian failing to act on corporate events or incorrectly calculating asset values, interests, dividends, and taxes.

(v) *Inadequate record keeping*

Appropriate segregation of scheme assets depends on the trustee or custodian maintaining proper books and records. Title of scheme assets may be lost or incorrect if the trustee or custodian fails to keep or retain proper and adequate records of the identity and status of investments held or their beneficial ownership. This risk is often heightened where there is a change to the trustee's or custodian's way of operation e.g. changes to internal processes and / or updates to the IT systems used to record assets and client information.

(vi) *Legal and Compliance Risk*

Legal and compliance risk for the purposes of this Guideline is where the trustee fails to comply with the applicable laws, the terms of any authorisation it holds, any regulatory or industry requirements, or any contractual obligations.

- a) Scheme assets may be at risk if a trustee breaches its legal and / or regulatory obligations, which in some cases may result in the custodian being unable to provide

custody services for the scheme e.g. from losing its regulatory status to provide custody service or due to insolvency.

- b) Compliance failures can originate from a lack of knowledge of the policies and procedures (this could be from poor training, high staff turnover or a poor compliance culture), human error (simply missing steps in a procedure) or an intentional decision to not comply.
- c) Breaches of legal and regulatory obligations and compliance failures could jeopardise the safety of scheme assets and cause serious disruptions to the custodial arrangements.

(vii) Country Risk

Where assets are held in foreign jurisdictions, there may be specific country risks that should be taken into account e.g. the effectiveness of the local regulatory regime, whether a judgement can be enforced effectively and other factors that may make it difficult to repatriate scheme assets i.e., language barriers, time zones, lack of direct oversight and political uncertainty that may impact the custody of scheme assets.

(viii) Concentration Risk

Concentration risk may arise if scheme assets are held by a few custodians. The provision of custody services is already concentrated among global banks and if the industry consolidates and if the global economy becomes more interconnected, there is a potential for a few large custodians to hold a significant portion of scheme assets globally.

(ix) Counterparty Risk

Typically, where cash is placed on deposit with a custodian also in the capacity of a deposit taking institution, the scheme is exposed to the credit risk of that custodian insofar as the cash deposit is concerned, and there is a risk that the custodian may default if it becomes insolvent.

(x) Reputational Risk

The crystallisation of any of the above-mentioned risks can have an adverse impact on the reputation of those involved in the custody arrangement particularly the custodian and the manager. Reputational damage could trigger a loss of investor confidence and increased redemption at the scheme or litigation against the scheme, responsible entity or custodian.

SECTION V: MONITORING AND OVERSIGHT OF CIS MANAGERS

The trustee or custodian should exercise due care and diligence in discharging its functions and duties, including safeguarding the rights and interests of participants.

- i. The trustee or custodian should take reasonable care to ensure-
 - a) that the scheme is managed by the manager in accordance with the Act, the FSRA Act, the trust deed, these Regulations and the prospectus; and
 - (b) the constituents of the scheme's property do not cause an infringement of the Act, the FSRA Act and these Rules.
- ii. The trustee or custodian should take reasonable care to ensure, on a continuing basis, that-
 - (a) the manager is adopting procedures and methods which are appropriate to ensure that the price of a unit of a scheme is correct; and
 - (b) the manager makes and retains sufficient records to document its activities completely and to show compliance with the Act, the FSRA Act and these Rules.
- iii. Reporting Frequency
 - a. The trustee/custodian should enquire into the conduct of the manager in the management of the scheme in each annual accounting period and should report on that conduct to the participants; and the report should be delivered to the manager and the Authority in good time to enable its inclusion in the annual report.
 - b. The trustee or the custodian of an authorized scheme should, in relation to each annual accounting period and half –yearly accounting period, prepare a report in respect of the period concerned.
 - c. Where a scheme's first annual accounting period is of less than twelve (12) months a half-yearly report need not be prepared for any part of that period.
 - d. The report of the trustee/custodian should state whether in the trustee/custodian's opinion the manager has managed the scheme in that period-
 - (a) in accordance with the investment and borrowing powers and restrictions applicable to the scheme; and
 - (b) otherwise in accordance with the provisions of the trust deed and the Scheme Rules.

If the manager has not done so, the trustee/custodian's report should describe any material failures and the steps which the trustee/custodian has taken as a result of those failures.

F. FILLING OF REPORTS WITH THE AUTHORITY

1. Notification of contraventions

The trustee or custodian holding a licence issued by the Authority should notify the Authority as soon as possible in writing forthwith of any failure, act or omission of the scheme manager

or the scheme, as may be applicable, constituting a breach or contravention of any of the provisions of the Act, these Guidelines, the trust deed or one of the constitutive documents of the collective investment scheme and of the steps taken by the custodian to recommend the scheme manager or the scheme to rectify the breach or contravention as soon as is reasonably practicable.

2. Financial Statements

- A trustee or custodian holding a licence issued by the Authority should file with the Authority quarterly reconciliation statements as soon as possible, but not later than 30 days after the closing date of the relevant quarter, relating to the custodial activities.
- A trustee or custodian holding a licence issued by the Authority, as soon as possible, but not later than 90 days of its balance sheet date, file with the Authority audited financial statements prepared in accordance with IFRS and audited in accordance with the International Standards on Auditing and such other standards.

The management of the trustee/custodian must be uploaded in the Bank Supervision Reporting Administration **(BSA)** System or sent to:

Q. EFFECTIVE DATE

The effective date of these Guidelines is 1st April 2020. Trustees/custodians with financial year ending on a date after four months from the effective date are expected to comply in full of these Guidelines.