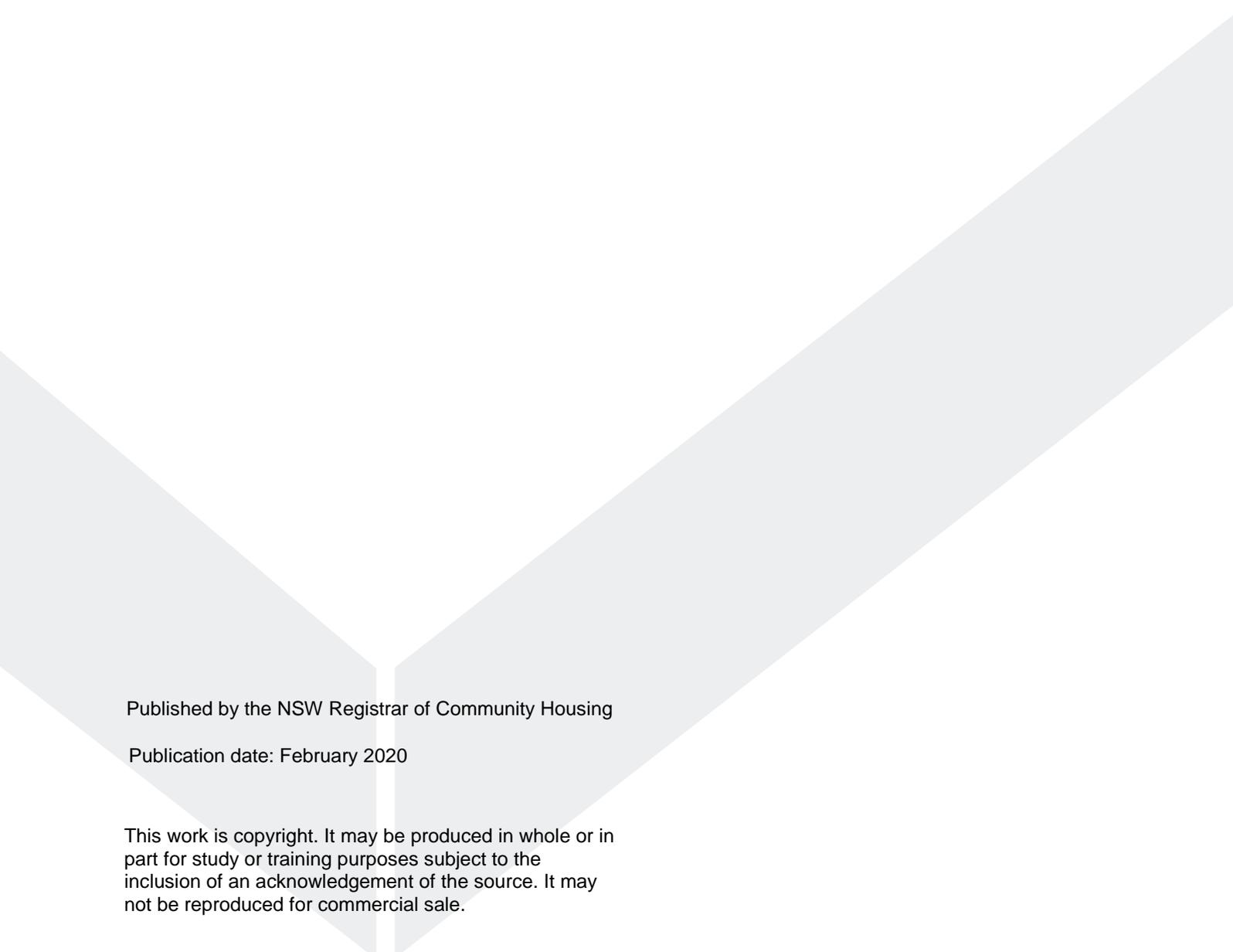


# New South Wales Local Scheme

## Guidance Note: Affiliated Entity Arrangements



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# 1. Introduction

**The Registrar of Community Housing assesses providers' suitability to be registered and monitors providers' ongoing compliance with the Community Housing Providers (Adoption of National Law) Act 2012 (NSW), including the performance requirements of the NSW Local Scheme (NSW Local Scheme) Regulatory Code.**

To make these assessments, the Registrar needs to consider a registered provider in light of its relationships with other persons or entities, where those relationships could materially affect its community housing activities. This Guidance Note refers to these persons or entities as 'affiliated entities', and to the relationships or arrangements between them and the provider as 'affiliated entity arrangements'.

Affiliated entities can be entities related to the registered provider as a result of a corporate relationship (e.g. a related body corporate) as a result of a contractual relationship (e.g. a service provider) or otherwise. The key element is the potential for the relationship or arrangement to have a material effect on a provider's ability to comply with its obligations under the National Law (NSW).

The purpose of this Guidance Note is to assist community housing providers in determining:

- when to disclose affiliated entity arrangements
- how to disclose affiliated entity arrangements
- what to disclose about affiliated entity arrangements

- specific requirements arising from affiliated entity arrangements, including corporate governance requirements and risk management requirements.

## 2. Requirements to which this Guidance Note Relates

### 2.1 Regulatory Framework Requirements

The Registrar considers affiliated entity arrangements to be relevant when carrying out a number of the Registrar's functions and powers under the National Law (NSW), including the following.

#### Registration

The Registrar will take into account affiliated entity arrangements when exercising the following functions in relation to registration of a community housing provider:

1. Determining what information is required on application for registration, including:
  - (a) approving a form of application for registration, and
  - (b) requiring information or documents for the purposes of determining an application, including information on:
    - (i) the exercise of the provider's functions and any arrangements with other persons in relation to the exercise of the provider's functions, and
    - (ii) the affairs of the provider.
2. Determining what category (Tier) of registration is appropriate.
3. Determining whether the application should be approved, including:
  - (a) whether the community housing provider will comply with National Law (NSW), and
  - (b) whether the community housing provider will comply with any conditions to which its registration will be subject, and
  - (c) whether the application is appropriate in the circumstances.

#### Ongoing obligations

The Registrar will also take into account affiliated entity arrangements when exercising the following functions following registration of a community housing provider.

1. Determining whether to request information from a community housing provider using the Registrar's information-gathering powers, including the Registrar's power to request:
  - (a) information with respect to the exercise of the Registrar's functions, including arrangements with other persons with respect to the exercise of the provider's functions, and
  - (b) information in relation to the affairs of the provider.
2. Determining whether the community housing provider should disclose certain events, including:
  - (a) whether there has been a change in the affairs of the provider that may have an adverse impact on its compliance with the National Law (NSW).
  - (b) whether there has been a decision to conduct a vote at a meeting on a matter that could affect the community housing provider's eligibility to be registered or its category (Tier) of registration.
3. Determining whether the community housing provider is complying with the National Law (NSW) and whether to issue a notice of non-compliance.

#### Additional standard condition

In addition, disclosure of affiliated entity arrangements may be required under any additional standard condition of registration made under the National Law (NSW).

## 2.2 Tier Guidelines and Evidence Guidelines

Both the Tier Guidelines and the Evidence Guidelines discuss affiliated entity arrangements and their relevance to the regulatory assessments addressed in those Guidelines.

For the purposes of the Tier Guidelines, affiliated entity arrangements of an entity refer to:

- a body corporate that controls the entity (e.g. parent company), or
- a body corporate that controls or partly controls the community housing assets and activities of the entity (e.g. special purpose vehicle or joint venture company), or
- a body corporate that undertakes community housing or other activities and is controlled or partly controlled by the entity (e.g. community housing subsidiaries, other subsidiaries), or
- a body corporate or unincorporated body that undertakes community housing activities under contract or agreement on behalf of the entity (e.g. service agreements), or
- other arrangements that affect the ability of the entity to maintain control over activities and decisions that impact on complying with the National Law (NSW).

## 3. Approach to Affiliated Entity Arrangements

### 3.1 What are Affiliated Entity Arrangements?

Affiliated entity arrangements are relationships or arrangements between a community housing provider and other entities or individuals.

The Registrar will consider affiliated entity arrangements when exercising the Registrar's functions under the National Law (NSW) and in particular when exercising a power referred to in Section 2 of this Guidance Note. When considering affiliated entity arrangements, the Registrar will look at the substance of the relationship rather than its strict legal status.

The Registrar is aware that affiliated entity arrangements potentially cover a very broad range of relationships and activities. The Registrar will have regard to affiliated entity arrangements only where the Registrar considers this is necessary and in a manner that is appropriate to the assessed level of risk of non-compliance. Of note, the Registrar will consider the regulatory oversight arrangements for affiliated entities when advising the level of engagement.

The Registrar has a regulatory interest in affiliated entity arrangements where, in the Registrar's opinion, those arrangements either have a material impact on, or potentially have a material impact on, a matter which is relevant to the Registrar's exercise of the Registrar's functions and powers under the National Law (NSW). This will include a community housing provider's affiliated entity arrangements which have a material impact, or may have a material impact, on the ability of the community housing provider to comply with its obligations under the National Law (NSW).

Section 3.2 of this Guidance Note gives guidance as to what affiliated entity arrangements the Registrar will consider material. Section 3.3 describes some common types of affiliated entity arrangements.

### **3.2 When are Affiliated Entity Arrangements Material?**

When determining whether an affiliated entity arrangement is material, the Registrar will focus on whether the affiliated entity arrangement gives rise to, or may give rise to, any of the following five risks. When assessing whether these risks arise, the Registrar will examine the affiliated entity arrangement in the context of the affairs of a community housing provider as a whole and may also consider circumstances which apply to the community housing sector as a whole.

#### **1. Governance controls**

The risk that a community housing provider is not adequately governed to support the aims and the intended outcomes of the provider's obligations under the National Law (NSW).

For example:

- the provider's governance controls do not appropriately address conflicts of interest or potential conflicts of interest (e.g. the decisions of a community housing provider are unduly influenced by a director who is a nominee of a related entity or a staff member of the provider is also a director of an entity doing business with the provider)
- where complexity in the affiliated arrangements calls into doubt the ability of Government to recover its assets or interests in the event of a provider's business failure.

#### **2. Financial contagion risk**

The risk of an adverse effect on a community housing provider's financial position. For example, the registered

community housing provider enters into a joint venture with an affiliated entity (which may or may not be related to community housing activities) and the failure of that joint venture would have an adverse effect on the financial position or viability of the community housing provider.

A provider's financial position is particularly important, given that one object of registration under the Act is to identify appropriate entities to which Government funding for community housing might be provided under legislation.

#### **3. Service failure or poor tenant outcomes**

The risk that an affiliated entity arrangement or a failure to adequately control that arrangement may adversely affect the provision of tenant and housing services by a community housing provider.

For example, the community housing provider outsources management of some of its owned/leased community housing assets to another entity. The provider does not maintain sufficient control over that function, and the other entity does not manage those assets in a way that is consistent with the community housing provider's responsibilities under the National Law (NSW).

#### **4. Reputation risk**

The risk that an affiliated entity relationship or arrangement results in damage to the community housing provider's reputation or to the reputation of a community housing sector. This reputational damage may result from actual impropriety or breach, or from a perception that this has occurred.

For example, the community housing provider may have a subsidiary which engages in fraudulent activities and this may result in a perception that the provider is involved in, or had knowledge of, those activities.

## 5. Systemic risk

The risk that the inter-relationships between community housing providers and other community housing providers, either directly or as a result of arrangements with affiliated entities, are such that the realisation of a risk in one area will have systemic effect on the community housing sector as a whole.

For example, a number of large community housing providers all outsource the management of their community housing assets to a single entity. If that management entity fails, there will be a disproportionate effect on the sector as a whole.

The Registrar may request information on an affiliated entity relationship in order to assess whether the relationship is material. For example, the Registrar may wish to have information on all entities with which the provider has a particular relationship (or with which it may potentially have that relationship) so that it can determine whether that relationship is sufficiently material to impose special conditions on it.

The Registrar will make an assessment of whether an affiliated entity arrangement is material on a case-by-case basis as the Registrar considers necessary to fulfil regulatory functions under the National Law (NSW).

### 3.3 Types of Affiliated Entity Arrangements

Affiliated entity arrangements which are of interest to the Registrar commonly arise in three situations.

#### 1. Group structures, joint ventures and partnerships

Entities that are part of a community housing provider's corporate group and entities with which a provider jointly carries out significant activities (e.g. under a partnership or joint venture) are affiliated entities of the provider.

The number of community housing providers that are part of a corporate group is increasing, as is the number of providers entering into joint venture or partnership arrangements related to their community housing activities.

The reasons for community housing providers establishing or entering these arrangements are predominantly to:

- quarantine assets
- create/access economies of scale
- create/access economies of specialisation and expertise
- spread risk
- use special purpose vehicles for increased investment.

Group structures include related bodies' corporate such as subsidiaries and holding companies. They also include other entities associated with the community housing provider in this way, including:

- special purpose vehicles
- joint ventures (whether or not incorporated)
- public private partnerships.

#### 2. Relationships of control or significant influence

A community housing provider's affiliated entities also include any person who controls the provider or is otherwise in a position of significant influence in relation to the provider.

A person controls the provider if he/she has the capacity to determine the outcome of decisions about the provider's financial and operating policies. In determining whether a person has this capacity, the practical influence the person can exert (rather than the rights he/she can enforce) is the issue to be considered and any practice or pattern of behaviour affecting the provider's financial or operating policies is to be taken into account (even if it involves a breach of an agreement or a breach of trust).

The notion of 'control' is interpreted by the Registrar in a manner that reflects section 50AA of the Corporations Act 2001 (Cth).

A provider's majority shareholder and its officers (and those of any entity that controls the provider) are assumed to be in positions of significant influence in relation to the provider. A person is also in a position of significant influence if the provider's directors are accustomed to act in accordance with the person's instructions or wishes (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or his/her business relationship with the directors or the provider), if he/she makes or participates in making decisions that affect the whole or a substantial part of the provider's operations, or if the person has the capacity to significantly affect the provider's financial standing or its compliance with the National Law (NSW).

### **Outsourcing arrangements**

Entities to which a community housing provider has outsourced a material activity are also affiliated entities of the provider. Outsourcing involves a provider entering into an arrangement with any other entity/person to perform, on a continuing basis, a material activity that would otherwise be carried out by the provider itself and that is relevant to its performance of its obligations under the National Law (NSW).

The outsourcing arrangement may be with an entity or a person that is already related to the provider (e.g. a group member) or it may be with an entity or person who is otherwise independent of the provider.

## **4. Disclosure of Affiliated Entity Arrangements**

### **4.1 General**

Disclosure of affiliated entity arrangements must be made in writing. The disclosure must be supported by documents or materials which:

- (a) provide sufficient detail to allow the Registrar to assess the materiality of the affiliated entity arrangement, and
- (b) address how any relevant risks will be addressed by the provider.

The onus is on the providers to disclose affiliated entity arrangements at registration and on an ongoing basis. Failure to disclose material arrangements on application for registration is grounds for rejecting an application for registration. A failure to comply with ongoing disclosure obligations constitutes non-compliance with the National Law (NSW).

Providers should have regard to the Evidence Guidelines in determining their disclosure obligations in relation to affiliated entity arrangements.

Sections 4.2 and 4.3 give community housing providers' guidance on disclosure of affiliated entity arrangements on application and on an ongoing basis.

### **4.2 Information to be Disclosed on Application**

Information on affiliated entity arrangements will include information on the following types of arrangements.

#### **Group structures**

- A group organisational chart showing the relationship between the community housing provider and all group entities.

- Details of group members (e.g. name, place of incorporation, board composition, nature of business and any other additional information required by the Registrar for a better understanding of the risk profiles of individual group members).
- Management structure of group including key risk management reporting lines.
- Intra-group support arrangements.
- Intra-group financial exposures.
- The business case for the establishment of the group.
- Other information required for effective supervision of the group.

#### **Partnership and joint ventures**

- Details of any arrangement the provider has with one or more other entities under which it carries out significant joint activities (e.g. under a partnership or joint venture), including the identity of those entities.
- Details of any connection or relationship between the entity and the provider, any officer of the provider and any person who controls the provider.

#### **Relationships of control and significant influence**

- Details of any person (other than a related body corporate or officer of the provider, details of which have otherwise been provided) who controls the provider or is in a relationship of significant influence with the provider and the nature of that relationship.

#### **Outsourcing arrangements**

- Details of any entity/person to whom a material activity has been outsourced and the key terms of the outsourcing.
- Details of the measures in place to ensure that the provider can identify,

manage, mitigate and report on risks associated with outsourcing.

#### **Other affiliated entity arrangements**

- Details of any other affiliated entity arrangements that are relevant to the exercise of the Registrar's functions under the Act or that may impact on the provider's compliance with the Act.

#### **4.3 Ongoing Disclosure**

Providers must comply with the ongoing disclosure obligations under the Act and with any additional standard condition made by the Registrar under the Act.

Each registered community housing provider must notify the Registrar:

- (a) of any change to the affiliated entity arrangements disclosed in accordance with section 4.2 above
- (b) if the provider enters into any new affiliated entity arrangements
- (c) if the provider becomes aware of a failure to disclose information previously required

Disclosure is not required prior to entry into the affiliated entity arrangement unless the specific disclosure provision requires earlier disclosure (e.g. the provider makes a decision to conduct a vote at a meeting on a matter that could affect the provider's eligibility to be registered or its category of registration).

If a community housing provider is unsure about whether an affiliated entity arrangement is material and should be disclosed, or when the disclosure should be made, the provider is encouraged to contact the Registrar as soon as possible to discuss any issues arising. Where a provider does not have the opportunity to discuss the matter with the Registrar, but is in doubt about the materiality of the arrangements, the provider should disclose the arrangement to the Registrar.

## 5. Response to Affiliated Entity Arrangements

### 5.1 General

The role of the Registrar is not to approve affiliated entity arrangements. The Registrar will use information about affiliated entity arrangements to assess the impact, if any, on the provider's Tier of registration and on its assessment of whether the provider is complying with its obligations under the National Law (NSW) or is likely to comply with those obligations.

### 5.2 Determining Tier of Registration

The Registrar will consider affiliated entity arrangements when determining a provider's appropriate Tier of registration.

Relevant factors include:

- the number of entities in the corporate group and the nature, scale and scope of their operations
- whether the community housing provider or members of its group carry out operations other than community housing operations and the nature of those operations (i.e. how diversified the group is)
- whether the main business of the group is the provision of community housing
- whether the provider outsources any of its functions
- whether the affiliated entities are regulated as community housing providers or otherwise regulated under a different regulatory scheme
- each entity's business case
- the nature of any financial arrangements which form part of the provider's affiliated entity arrangements.

### 5.3 Impact on Risk Assessment and Regulatory Oversight

Affiliated entity arrangements are likely to affect the Registrar's determination of the risk inherent in the community housing provider's operations. The risk profile of a provider will affect the level of regulatory engagement required and the nature of that engagement. Community housing providers must have adequate systems, policies and procedures in place to manage, monitor and control all forms of risk arising from their association with affiliated entities (including with respect to reputational risk, corporate entity risk, governance risk and financial risk).

### 5.4 Group Structures

There are a number of matters that the Registrar will examine when assessing providers in group structure arrangements, including:

- the need to implement and maintain effective financial reporting, including where relevant as between entities, and effective financial forecasting taking into account the related party arrangement and its likely impact on operations and obligations under relevant corporations' law
- terms and management of any cross guarantees
- terms and management of debt financing
- the need to ensure operations are subject to sound governance and decision making processes
- terms and management of any other agreements with group entities relevant to the community housing provider's compliance with its obligations under the Act and to fulfilling the performance requirements of the NSWLS Regulatory Code, including service provision agreement

- risk planning and risk mitigation strategies (including with respect to reputational risk, governance risk, corporate entity risk, and financial risk).

Community housing providers should be financially viable on a stand-alone basis, even if another member of the group is also a registered community housing provider.

A registered community housing provider must carry out its obligations under the Act and must have structures in place to manage any conflicts of interest between those obligations and the interests of any group member.

### 5.5. Agreements with Group Entities

Community housing providers should be aware of particular risks arising from agreements entered into with associated entities which are members of a provider's group.

Risks arising from those relationships should be addressed by the provider at least as strictly as it would address exposures to unrelated parties. It is also prudent to set limits on exposures to related entities at both an individual and an aggregate level.

The types of issues that the Registrar will examine include:

- whether the provider has properly assessed the risks arising from entering into financial support to an entity within its group and the degree of exposure to group entities
- whether the provider has clearly identified any cross-collateralisation, guarantees, equity investment or lending within the group in its business plans and financial reports
- whether the provider has ensured that any agreements with group entities are properly documented
- whether the provider has entered into agreements with group entities on terms which are the

same or better than the terms it would be reasonable to expect the provider to have made if the negotiations were at 'arms length'

- whether the provider has clear and transparent policies or agreements on affiliated entity arrangements where services are being procured or delivered between entities, including terms to ensure compliance with the NSW Local Scheme Regulatory Code and review mechanisms
- whether service provision between related entities is set out in written service level agreements or contracts
- whether the provider regularly reviews the efficiency and effectiveness of service provision within the group taking into account the scale of service provision. It is for community housing providers to decide, taking appropriate professional advice, whether there is a requirement to expose existing services to competition, in their particular circumstances.

### 5.6. Control and Independence

The Registrar expects parent community housing providers to exercise high-level control by monitoring the activities and performance of their subsidiaries. The Registrar also expects parent community housing providers to take timely and effective action if their subsidiaries do not operate within approved limits or fail to meet agreed standards of performance.

The balance between strategic control by the parent and operational independence for subsidiaries is for the group members to decide. Community housing providers should be able to demonstrate that the balance reflects the group's objectives, the legal status of its members and the risks involved. For example, a community housing provider whose subsidiaries deliver core landlord services to tenants would typically exercise a higher level of control over its subsidiaries. However, a

subsidiary set up to deliver entirely commercial activities might operate on more of an 'arms length' basis to minimise risk to the parent.

The Registrar expects community housing providers to take suitable professional advice to inform their decisions about the appropriate level of strategic control/operational independence and how to achieve this. Community housing providers should identify any risks arising from the arrangements they put in place.

The Registrar also expects community housing providers, which are parent entities, to establish clear financial and other limits within which the provider's subsidiaries should work. Examples of ways this could be managed include:

- establishing a group strategy and objectives
- the parent approving its subsidiaries' business plans
- through an independence agreement or similar procedural document
- making clear what group policies, if any, subsidiaries are expected to apply
- a clear reporting framework
- through governing body composition.

### 5.7. Governance Issues

It is important for community housing providers to ensure operations are subject to sound governance and decision-making processes. The Evidence Guidelines set out a list of governance issues that must be appropriately addressed in relation to arrangements with entities which are related to the provider. Examples include:

- relevant corporations law in relation to directors' duties and

exposure to liabilities in relation to non-wholly owned subsidiaries

- actual or perceived conflicts of interest and conflicts of duty in the board's decision making where there are shared directors or executives
- protocols for managing directors' duties and the sharing of information in accordance with relevant corporations law
- the independence of the chairperson (non-employee of the provider or related parties)
- appropriate balance between independent directors and executive directors
- clear and transparent policies and/or agreements on related party arrangements where contracting or sharing services that are relevant to achieving performance outcomes under the NSW Local Scheme Regulatory Code
- corporations' law requirements (particularly in relation to shadow directors, insolvent trading scheme and consolidated financial reporting)
- risks in relation to reputation, governance, corporate entity and financial.

Providers must also:

- maintain a risk and audit committee (or similar governance mechanism), formed with a majority of independent directors
- maintain appropriate delegation schedules.

### 5.8. Outsourcing Agreements

Registered community housing providers which enter into outsourcing arrangements (whether with a group entity or with another entity) should be aware that:

- although outsourcing may result in the service provider taking day-to-day managerial responsibility for the activity, the community housing provider remains responsible for complying with its obligations under the National Law (NSW) and remains responsible for all performance requirements that relate to the outsourced activity
- community housing providers should have measures in place to ensure that due skill and care is taken in choosing suitable services providers
- the provider's risk management framework should deal with the risks associated with the outsourcing of a material community housing activity
- outsourcing arrangements should be evidenced by a written, legally binding agreement
- providers' outsourcing agreements should include a clause that allows the Registrar access to documentation related to the outsourcing arrangement and states that the service provider, as if it were a registered community housing provider, will co-operate with the Registrar in relation to the Registrar carrying out regulatory functions under the National Law (NSW).
- community housing providers must monitor the ongoing performance of service providers
- community housing providers must maintain control over activities that impact on their compliance with the National Law (NSW)
- providers must appropriately deal with any actions by service providers that breach or may breach service level agreements or which breach or may result in a breach of the provider's obligations under the National Law (NSW).

### For more information

For more information on the NSW Local Scheme, please access the Registrar's website at

<https://www.rch.nsw.gov.au/nsw-local-scheme>.



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