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PART 5

CLIENTS' INVESTMENTS

General

5.1 Application to investment businesses

So far as applicable, this Part applies to all licenceholders authorised to carry on regulated activities falling within Class 2 in relation to such activities carried on in or from the Island.

5.2 Application to CIS service providers

(1) This rule applies to a licenceholder authorised to carry on an activity falling within paragraph (3), (4) or (5) of Class 3 in relation to such activities carried on in or from the Island.

(2) Subject to paragraph (3), so far as applicable the following provisions of this Part apply to the licenceholder as they apply to a licenceholder referred to in rule 5.1, with any necessary modifications, as if —

- (a) references to a client were references to any scheme mentioned in paragraph (1) (so that each scheme shall be treated as a separate client),
- (b) references to safe-custody services were to activities referred to in paragraph (1), and
- (b) references to a client's investments were to an investment which is an asset of such a scheme.

(3) In relation to a licenceholder referred to in paragraph (1) above, any reference to an eligible custodian in this Part (as applied by paragraph (2)) is to any licenceholder authorised to carry on an activity falling within paragraph (3), (4) or (5) of Class 3.

5.3 Interpretation

(1) In this Part —

"eligible custodian" means (subject to rule 5.2(3)) —

- (a) a licenceholder authorised to carry on safe-custody services;
- (b) the licenceholder's own custodian; or
- (c) a person carrying on business in a country or territory outside the Island —
 - (i) whose business includes the provision of services which, if carried on in the Island, would be safe-custody services, and
 - (ii) who the licenceholder reasonably believes is subject to regulation and supervision in relation to those services by a regulatory body or agency of government in that country;

"investment" means any of the following (as defined in the Regulated Activities Order 2008) —

- (a) a share;
- (b) a debenture;
- (c) a government security;
- (d) a warrant;
- (e) a certificate representing securities;
- (f) a unit in a collective investment scheme, including a share in, or security of, an open-ended investment company;

"registrable investment" means an investment the title to which is entered in a register;

"safe-custody services" means services consisting of regulated activities falling within paragraph (5) of Class 2 (safeguarding and administering investments under a contractual relationship);

"title document" means —

- (a) a share certificate or stock certificate; and
 - (b) any other document which is evidence of title to an investment.
- (2) In this Part references to documents in the possession or under the control of a licenceholder include documents which —
- (a) are in the possession or under the control of the licenceholder's own custodian, or
 - (b) at the request of the licenceholder are in the possession or under the control of any other eligible custodian.
- (3) In this Part a reference to a licenceholder's own custodian is to a wholly-owned subsidiary of the licenceholder which —
- (a) carries on no other business than providing safe-custody services, and
 - (b) acts only in accordance with the directions or instructions of the licenceholder.

5.4 Records of transactions

(1) A licenceholder must maintain records containing entries of all purchases and sales of, and other transactions relating to, an investment which the licenceholder undertakes on behalf of a client, including —

- (a) the nature and amount of the investment;
- (b) the identity of the client;
- (c) the nature of the transaction;
- (d) the time and date of the transaction; and
- (e) the identity of any intermediary who handled the transaction.

(2) The records referred to in paragraph (1) must enable investments to which they relate to be traced into and out of brokerage accounts.

(3) The licenceholder must preserve any records referred to in paragraph (1) for not less than 6 years.

Safe-custody services

5.5 Records of safe-custody investments

- (1) A licenceholder must maintain such records as are necessary to identify —
 - (a) every investment in relation to which it provides safe-custody services,
 - (b) the client to whom that investment belongs; and
 - (c) where the title to the investment is in documentary form, the location of every title document relating to the investment;
 - (d) where the title to the investment is in electronic form, the form and location of any record of the title;
 - (e) where the investment is a registrable investment, the registrar and the person in whose name it is registered.
- (2) Where an investment referred to in paragraph (1)(a), or a title document relating to such an investment, is held for the licenceholder by an eligible custodian, the licenceholder must —
 - (a) maintain such records as are necessary to enable it to ascertain which custodian is holding the investment or document, and
 - (b) ensure that the custodian maintains the records referred to in paragraph (1) in relation to the investment or document.

5.6 Use of custodians

- (1) A licenceholder must not —
 - (a) recommend to a client that a person other than the licenceholder undertake safe-custody services for the client, or
 - (b) procure the client's agreement to such a person so acting;unless that person is an eligible custodian.
- (2) Where a licenceholder arranges for any safe-custody services to be provided by the licenceholder's own custodian, the licenceholder must ensure that the custodian complies with the following requirements of this Part.
- (3) Where a licenceholder arranges for any safe-custody services to be provided by an eligible custodian other than the licenceholder's own custodian, the licenceholder must comply with paragraphs (4) and (5).
- (4) The licenceholder must —
 - (a) exercise reasonable skill, care and diligence in the selection of the custodian, and
 - (b) must, so long as the arrangement is in force, satisfy itself that the custodian continues to be suitable (including obtaining confirmation that it continues to be an eligible custodian).
- (5) The licenceholder must also ensure that the custodian has acknowledged in writing to the licenceholder that —

- (a) it will not have or claim any right to sell or pledge the client's investment or any lien or right of retention over any title document relating to it;
- (b) it will not part with possession of any such title document otherwise than to the licenceholder or on the licenceholder's instructions;
- (c) it will hold any such document so that it is readily apparent that the investment to which it relates does not belong to the custodian, the licenceholder or an associate of the licenceholder or custodian; and
- (d) it will, not less than once every 6 months and at other times on the request of the licenceholder, prepare and deliver to the licenceholder a statement, made up as at a date specified by the licenceholder (being a date not earlier than 4 weeks before the statement is delivered), specifying in relation to each description of investment —
 - (i) the investments held by the custodian for the licenceholder;
 - (ii) the title documents relating to those investments which are held by the custodian; and
 - (ii) in the case of registrable investments, the amount so held in each different name or designation;
- (e) it will not arrange for any safe-custody services to be provided on its behalf by any person other than an eligible custodian.

5.7 Registrable investments

(1) Where a licenceholder provides safe-custody services relating to a registrable investment of a client, it must arrange that the investment is registered —

- (a) in the name of the client, or
- (b) with the consent of the client, in the name of an eligible custodian.

(2) Where the licenceholder's own investment and a client's investment are registered in the same name, the licenceholder must —

- (a) secure that the client's investment is registered in a designated account different from the account in which the licenceholder's investment is registered; and
- (b) where appropriate, hold separate certificates evidencing the title to the licenceholder's own investment and the title to the client's investment.

5.8 Reconciliation of investments and title documents

(1) A licenceholder which provides safe-custody services in relation to a client's investments must —

- (a) reconcile its books and records at 2 dates during every year, not more than 8 months nor less than 4 months apart, by either —
 - (i) the total check method (see paragraph (2)), or
 - (ii) with the consent of the Commission, the rolling stock check method (see paragraph (3)); and
- (b) promptly correct any discrepancies which are revealed.

(2) The total check method comprises the following steps, to be taken in respect of all the client's investments —

- (a) the physical counting and inspection of all title documents relating to the investments which are in the possession or under the control of the licenceholder, or a check of the electronic records referred to in rule 5.5(1)(d) and relating to the investments, as the case may require; and
- (b) a check of all records maintained by the licenceholder under rule 5.5 against those title documents or electronic records;
- (c) obtaining a written statement (in the form specified in rule 5.6(5)(d)) from any custodian other than the licenceholder's own custodian of the investments held by it on behalf of the licenceholder.

(3) The rolling stock check method comprises the steps referred to in paragraph (2)(a), (b) and (c), to be taken in respect of the client's investments of a particular description, so that those steps are taken in respect of all the client's investments on a rolling basis within every period of 6 months.

(4) The Commission shall not consent to the use of the rolling stock check method unless it is satisfied, on the basis of a report from the licenceholder's auditors, that the licenceholder has in place a system of internal control which is adequate to ensure as far as reasonably practicable that an up-to-date record is maintained of all clients' investments in respect of which the licenceholder provides safe-custody services.

(5) A licenceholder must carry out the reconciliation required by paragraph (1) not later than the end of 3 months from the date at which the count or check referred to in paragraph (2)(a) was carried out.

- (6) In carrying out the reconciliation the licenceholder must —
 - (a) in every case, reconcile the results with its own records in respect of each client;
 - (b) in the case of a registrable investment, reconcile any discrepancy revealed by (a) above with the records of the registrar of the investment; and
 - (c) in the case of documents held by a custodian other than the licenceholder's own custodian, reconcile the statement received with the licenceholder's own records in respect of each client.
- (7) The licenceholder must —
 - (a) ensure that the counting and reconciliation of title documents required by this rule are —
 - (i) carried out, or observed and reviewed, by persons who are not responsible for the origination or maintenance of the licenceholder's records, and
 - (ii) supervised by a responsible officer; and
 - (b) retain for not less than 6 years all working papers which have been created to assist in the reconciliation.

(8) The licenceholder must immediately notify the Commission in writing, with details, where —

- (a) it has not carried out or is not able to carry out the reconciliation required by paragraph (1), or
- (b) it has completed the reconciliation but —
 - (i) is not able to correct any discrepancy, or
 - (ii) more than 6 months after completion, a discrepancy has not been corrected.

5.9 Periodical statements

(1) Unless expressly instructed to the contrary in writing by the client, a licenceholder must, every 6 months or, if the client's holding is unchanged, every year, deliver to each client for whom it provides safe-custody services a statement of the investments to which those services relate.

- (2) A statement under paragraph (1) must —
 - (a) be sent or delivered to the client within 6 weeks of the date as at which it is made; and
 - (b) distinguish between investments held —
 - (i) by the licenceholder;
 - (ii) by the licenceholder's own custodian; and
 - (iii) by an eligible custodian other than the licenceholder or the licenceholder's own custodian.

(3) Where the licenceholder provides safe-custody services in respect of that client's investments and also manages that client's investments, the statement must also distinguish between —

- (a) investments in respect of which it provides safe-custody services and which it manages, and
- (b) investments in respect of which it provides safe-custody services but which it does not manage.

(4) The references in paragraph (3) to managing investments are to carrying on an activity falling within paragraph (4) of Class 2 in relation to those investments.

(5) The licenceholder must immediately notify the Commission in writing, with details, where it has not provided or is not able to provide a statement to a client within the time required by paragraph (2)(a).

5.10 Borrowing from a client

A licenceholder must not borrow, or permit any director or employee or a relative or associate of a director or employee of the licenceholder to borrow, any investment from a client.

5.11 Loans of investments

- (1) A licenceholder must not lend a client's investment, or any title document relating to a client's investment, to any person unless —
 - (a) the Commission has given its prior written consent to the lending of clients' investments by the licenceholder;
 - (b) the client —
 - (i) has been made aware of any effect of the transaction on his interests (in particular on his rights in relation to the investment and his tax position), and
 - (ii) has expressly agreed in writing to the loan;
 - (c) the terms of the loan are set out in —
 - (i) a written agreement between the licenceholder and the client; and
 - (ii) a written agreement between the licenceholder and the borrower; and
 - (d) the loan is authorised in writing by a key person approved for the purpose by the directors of the licenceholder.
- (2) Where a licenceholder lends such an investment or document to any person, it must maintain a record stating —
 - (a) a description (including the amount and value) of the investment;
 - (b) the nature of the transaction or other purpose for which the loan is made;
 - (c) the remuneration payable to the licenceholder in respect of the transaction;
 - (d) the remuneration (if any) payable to the licenceholder in respect of the transaction;
 - (e) the identity of the borrower;
 - (f) the nature and value of any security provided by the borrower; and
 - (g) in the case of a title document —
 - (i) a description of the document;
 - (ii) the date when the document left the possession or control of the licenceholder;
 - (iii) whether the borrower confirmed receipt of the document; and
 - (iv) the date when it came back into the possession or control of the licenceholder.
- (3) While any loan is outstanding, the licenceholder must keep under review —
 - (a) the level of exposure of the parties to the transaction,
 - (b) the risk of default by the borrower,

- (c) the value of any security referred to in paragraph (3)(f), and
- (d) any effect of the transaction on the interests of the client (in particular the matters referred to paragraph (1)(b)(i)).

5.12 Investments etc. held as collateral

(1) For the purpose of this rule a licenceholder holds a client's investment, or a title document relating to a client's investment, as collateral if with the written consent of the client he holds it as security for money which is due or may become due to the licenceholder from the client or any other person.

(2) Where a licenceholder holds a client's investments, or title documents relating to a client's investments, some (but not all) of which are held as collateral, the investments or documents which are held as collateral must be identified in the licenceholder's records as so held and distinguished from those which are not so held.

(3) The licenceholder must not, without the prior written consent of the client, return to the client an investment or title document other than the original investment or title document held as collateral; but this paragraph does not preclude the licenceholder returning the collateral in the form of cash where the investment matures.

(4) The licenceholder must not, without prior written consent of the client, use investment or title document held as collateral for the purpose of security for —

- (a) the licenceholder's own obligations; or
- (b) the obligations of another customer or person.

Safekeeping of title documents

5.13 Safekeeping of clients' title documents

(1) Where a title document relating to a client's investment is in the possession or under the control of a licenceholder, it must —

- (a) maintain a record of the location of the document;
- (b) take all proper steps to preserve the document, taking no less care of it than it ought to take if the document related to its own investment; and
- (c) continue to comply with sub-paragraphs (a) and (b) until the document is delivered to the client or, on the instruction of the client, to another person (other than the licenceholder's own custodian).

(2) In particular —

- (a) the licenceholder must not part with possession of the document to any person other than the client except —
 - (i) on the client's instructions,
 - (ii) in accordance with the terms of any written agreement with the client; or
 - (iii) pursuant to a requirement of a court of competent jurisdiction or other lawful demand;

- (b) the document shall be held so that it is readily apparent that the investment to which it relates does not belong to the licenceholder or to an associate of the licenceholder;
- (c) the document must be segregated from title documents relating to investments of persons other than that client;
- (d) a bearer document must be kept in locked custody with 2 or more keys or combination locks (or both) required to enter any particular stronghold, each key or combination to be held or controlled by a separate individual; and
- (e) the licenceholder must maintain a system of internal control over access to the document.

5.14 Safekeeping by other persons

(1) A licenceholder may not, without the consent in writing of the client, arrange for a title document relating to a client's investment to be kept by a person other than the licenceholder.

(2) Where a licenceholder arranges for a title document relating to a client's investment to be kept by a person other than the licenceholder, the licenceholder must ensure that that person complies with the requirements of rule 5.13 as though —

- (a) those rules applied to that person; and
- (b) the references to the licenceholder were references to that person.