

BANKING GUIDANCE NOTE (BGN 9.0)

Fiduciary Deposits

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Financial Supervision Commission *Barrantee Oaseirys*

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Appendix I – Glossary

I. Introduction and scope

1.1 Applicability of the guidance note

This guidance note applies to banks and branches in the Isle of Man, acting in either an agent bank, or recipient bank, capacity (see section 1.2 for definitions). For the purpose of this guidance note they are collectively referred to as “banks” or “bank”.

1.2 What is a fiduciary deposit?

Fiduciary deposits are a financial product that involve the specific commissioning by a customer of a bank (commonly referred to as the “agent bank”) to invest the customer's assets with a third party bank (commonly referred to as the “recipient bank”) in the name of the agent bank but for the account and at the sole risk of the customer. The customer normally pays a fee (commission) to the agent bank for the execution of this service.

1.3 What is the rationale for fiduciary deposits?

The service is normally aimed at high net worth customers who have substantial portfolios of assets, one part of which may be cash. Monies are placed in the agent bank's name and as such can sometimes receive rates of interest closer to those normally paid only to banks or large institutions.

Banks consider that this service spreads the risk for customers, reduces administration (i.e. customer only has to open a relationship with one bank, rather than various institutions), encourages active cash management and, for high net worth individuals, is often one 'asset class' of a substantial asset portfolio. Fiduciary deposits can often be provided on flexible maturity terms, from overnight to longer term, and for most currencies.

2. Relationships between the parties

2.1 Relationship between the agent bank and its customer

The customer normally maintains an ordinary account relationship with the agent bank. The customer signs an instruction form which allows the agent bank to invest the customer's funds with recipient banks on a fiduciary basis. This may be on a discretionary or non-discretionary basis and is at the customer's sole risk. The agent bank, by accepting the instruction, undertakes to place the funds with recipient banks in the bank's own name and to credit the reimbursed amount (including all interest received – the agent bank should not take a margin on the deposit) to the customer's account with the agent bank, including the interest paid by the recipient bank. The funds may be placed by the agent bank in the agent bank's name for one customer, or on a pooled basis. As remuneration for this service, the agent bank normally debits the customer's account with a fiduciary commission (at reimbursement date or otherwise).

The customer generally has no rights against the agent bank regarding the deposit and interest (except where the agent bank may have acted negligently) until these are received back by the agent bank from the recipient bank. At this point a contractual right in favour of the customer against the agent bank may exist.

2.2 Relationship between the agent bank and recipient bank

Generally, the acceptance of fiduciary deposits from an agent bank is no different from the acceptance of ordinary inter-bank deposits. The recipient bank's contractual relationship is with the agent bank only.

2.3 Relationship between the agent bank's customer and the recipient bank

There is generally considered to be no contractual relationship between the agent bank's customer and the recipient bank. However, if the agent bank is acting as an "agent" in accordance with relevant laws of agency, a relationship may exist between the ultimate customer and the recipient bank.

3. Treatment of fiduciary deposits

3.1 General

Fiduciary deposits placed by the agent bank are generally treated as inter-bank placements by the recipient bank. The deposit is not on the balance sheet of the agent bank.

When entering into a fiduciary agreement the customer assumes the risk of the recipient bank failing. Customers can give the agent bank full discretion to place their funds with recipient banks where the agent bank normally transacts business. Alternatively, customers may instruct the agent bank to place their funds with specified recipient banks chosen by the customer.

3.2 Banking returns

3.2.1 Acting as agent bank

The deposits are off balance sheet and should be reported as a memorandum item in form SR-2C section 5. Guidance is also included in BGN2.1 (or any subsequent revisions thereto).

3.2.2 Acting as recipient bank

Fiduciary deposits should be shown on the balance sheet in section 13 of form SR-1, as a deposit from another bank. The same disclosure should be made in any applicable reporting in other forms (such as liquidity SR-3A).

3.3 Liquidity risk

The recipient bank assumes the liquidity risk associated with the fiduciary deposits (re maturity) but the agent bank will have more knowledge of the behaviour of the depositors and the inherent “stickiness”. The recipient bank should have due regard to the Commission’s guidance note BGN5.0 (or any subsequent revisions thereto) when assessing the impact on its liquidity profile. Fiduciary deposits would not normally be considered in respect of the Commission’s behavioural adjustment methodology.

4. Notification to the Commission

If a bank wishes to act as the agent bank this would be regarded as a change in product or service and the bank should pre notify the Commission in accordance with Code 49 (incorporated banks) or Code 93 (branches).

5. Risk to the customer

Fiduciary deposits are lodged by the agent bank at the sole risk of the customer with the recipient bank concerned. The agent bank in the Isle of Man should adequately inform its customers of their rights and protection under the Isle of Man Depositors’ Compensation Scheme (see *section 8 for more details*) or any other relevant depositor protection scheme (for example the recipient bank may be outside the Isle of Man).

The contract or bank mandate between the agent bank and its customer should contain a suitable clause highlighting the risks and requiring the customer to sign as having understood these before entering into the transaction.

6. Internal controls, policies and procedures

The Commission expects agent banks to have appropriate internal controls, policies and procedures in place with regard to the offering of a fiduciary deposit service. This is not limited to, but should include:

- a) Adequate disclosures to customers;
- b) Adequate accounting records and designation of accounts;
- c) Robust reconciliation processes; and,
- d) Adequate treasury policies and procedures (re use of recipient banks), including limits, bank ratings, segregation of duties, confirmations of trades etc.

The fiduciary agreement should include the following as a minimum:

- a) Duties of the agent bank;
- b) An explicit clause defining the fiduciary deposit – i.e. monies placed in the name of the agent bank for the account and at the sole risk of the customer;
- c) Management/Commission fees;
- d) Payment deadlines;
- e) Advice of placements;
- f) List of acceptable banks (unless the agent bank has full discretion);
- g) List of acceptable instruments;
- h) Reporting requirements; and,
- i) Cancellation/exit period.

Agent banks should take legal advice as appropriate to ensure all risks are adequately addressed.

7. KYC/DD requirements

The Commission considers that the KYC/DD obligations regarding the customer rest with the agent bank. The recipient bank has no obligation to conduct KYC/DD on the underlying customer as its applicant for business is the agent bank.

8. Compensation schemes

8.1 General

The Isle of Man Depositors' Compensation Scheme ("the Scheme") provides compensation for eligible protected deposits made with banks that are members of the Scheme. The level of compensation is up to 75% of the first £20,000 (i.e. maximum pay out of £15,000 per eligible protected deposit). Full details of the provisions of the Scheme are contained within the Banking Business (Compensation of Depositors) Regulations 1991, as amended.

8.2 Protection for customers under the Scheme

If the agent bank fails, the customer(s) cannot make a claim under the Scheme against the agent bank. The deposit is still held with the recipient bank (which may or may not be located in the Isle of Man) and is not a "deposit" of the agent bank.

If the recipient bank (in the Isle of Man) fails (and is a member of the Scheme), the underlying customer(s) may be able to make a claim under the Scheme subject to the nature of the relationship between the customer(s), agent bank and recipient bank and depending on how this would be interpreted in accordance with the Banking Business (Compensation of Depositors) Regulations 1991, as amended.

Appendix I – Glossary

“Bank” is the Isle of Man incorporated bank.

“Branch” means a branch in the Isle of Man of a bank incorporated outside the Isle of Man.

“Code” means reference to a specific section of the Banking (General Practice) Regulatory Code 2005, as amended.

“KYC/DD” means Know Your Customer / Due Diligence, as commonly referred to in the Anti Money Laundering Guidance Notes.