

Financial Supervision Commission Clients' Investments Regulatory Code

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FINANCIAL SUPERVISION COMMISSION

CLIENTS' INVESTMENTS

REGULATORY CODE

The following Code is issued by the Financial Supervision Commission in exercise of the powers conferred on it by Section 6 of the Investment Business Act 1991, and all other powers enabling it in that behalf. All correspondence relating to this Code should be addressed initially to the Financial Supervision Commission.

Adopted by Financial Supervision Commission on 14 November 1991, with amendments adopted on 13 February 1992 and 27 March 1996

Approved by Tynwald on 10 December 1991, 17 March 1992 and 21 May 1996

Price: £1.00

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1. CITATION, COMMENCEMENT, INTERPRETATION AND APPLICATION

1.1 Citation and Commencement

This Code may be cited as the "Financial Supervision Commission (Clients' Investments) Regulatory Code" and shall come into operation on 1st December 1991.

1.2 Interpretation

A Guidance Note appended to a paragraph gives guidance as to how the Commission considers it would operate in particular circumstances. It is not part of the Code.

The Interpretation Act 1976 applies to the interpretation of this Code and, unless the context otherwise requires, expressions defined therein have the same meanings when used in this Code.

The glossary contained in the Financial Supervision Commission (General Requirements) Regulatory Code applies to the interpretation of this Code.

The principal objective of this Code is to ensure that where licenceholders have responsibility for investments belonging to others, adequate arrangements are maintained to ensure that such investments are properly recorded, identified, segregated and controlled, so that at any time investments belonging to others are accounted for and no administrative or financial difficulties to which the licenceholder is exposed would have adverse consequences for its clients or other persons.

1.3 Application

This Code applies to all holders of investment business licences issued under Section 3 of the Investment Business Act 1991, [with the exception of holders of Category 5 investment business licences.]

- 1.4 This Code applies when a licenceholder is in possession or control of Clients' Title Documents relating to investment business conducted by it in accordance with the provisions of the Investment Business Act 1991.

[] added by SD 155/96

Guidance Note

Where a licenceholder provides clients' safe custody services which are not related to investment business conducted by it, this Code does not apply. For the avoidance of doubt, licenceholders should have a written agreement with the client in such circumstances, explaining the nature of the services offered and the fact that those services are not regulated by Codes issued under the Investment Business Act 1991.

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- 1.5 **"In possession or control"** includes circumstances where a licenceholder or its own custodian or nominee or an eligible custodian has responsibility for documents evidencing title to client investments.
- 1.6 Except in the case of bearer documents, title to which passes by delivery, the definitive record of legal ownership of stocks, shares or debentures is normally provided by the register of holders maintained by, or on behalf of, the issuer. In the case of registered securities, documents evidencing title include share certificates. However, where depository arrangements exist with custodians who operate **"fungible accounts"** (including book entry systems for recording entitlement to pooled securities, whether in registered or bearer form, which are not assigned to individual holders by serial number or otherwise) **"documents evidencing title"** will include records maintained by such custodians which may be evidenced electronically.
- 1.7 **"Own Custodian or nominee"** means a nominee company which acts only in accordance with the directions or instructions of the licenceholder. Only companies over which the licenceholder has control can be included in this definition, hence a licenceholder's parent or holding company cannot reasonably be regarded as meeting this requirement.
- 1.8 This Code applies to investments set out in Paragraphs 1 to 6 of Schedule 2 to the Investment Business Order 1991. It does not apply to documents relating to investments such as life assurance or pensions policies, unless the context of the Code requires otherwise.
- 1.9 This Code does not apply where Clients' Title Documents relating to Investments are held or controlled in a **"Post Office"** capacity while they are in transit to or from clients. Provided such documents are registered in the name of the client and forwarded to him within 2 business days, such investments are not covered by the overall reconciliation requirements.
- 1.10 "Clients' Title Documents" means documents of title relating to investments which are in the possession or control of the licenceholder by virtue of the fact that an investment business transaction has or is to take place.

2. RESTRICTION TO ELIGIBLE CUSTODIANS

- 2.1 If an investment business client does not wish to retain his own title documents, then a licenceholder shall not:-
- (a) recommend to a client that a person other than the licenceholder shall act as the registered holder of the client's registerable investments or as the custodian of Clients' Title Documents relating to Investments belonging to the client; or
 - (b) procure the client's agreement to such a person so acting;
- unless that person is an eligible custodian.
- 2.2 **"Eligible Custodian"** means:-

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- (a) a banking institution licensed in a jurisdiction which, in the judgement of the Commission, exercises proper licensing and supervision and subscribes to the principles of the International Concordat on Banking Supervision;
- (b) a nominee company with no other business which acts solely in accordance with the directions or instructions of the licenceholder, and is subject to this Code;
- (c) a person not resident in the Isle of Man whom the licenceholder reasonably believes to be a person:-
 - (i) whose business includes the provision of investment custodial services; **and**
 - (ii) who, in providing those services is subject to regulation and supervision by a regulatory body or agency of government in the country in which that person carries on that business.

3. REGISTERABLE INVESTMENTS

A licenceholder shall arrange that the registerable investments belonging to an investment business client are registered either in the name of the client or in the name of an eligible custodian.

4. SAFEKEEPING OF CLIENTS' TITLE DOCUMENTS

- 4.1 A licenceholder is responsible for the safekeeping of Clients' Title Documents while those documents are in its possession or under its control and must exercise no less care than it would for its own title documents.
- 4.2 A licenceholder is responsible for the custodianship of any documents or certificates belonging to its investment business clients which have for any reason or under any circumstances come into its possession or control, and is so responsible until they are delivered to the client or, on the client's instructions, to someone other than an eligible custodian acting for the licenceholder.
- 4.3 Unless the client takes delivery of or responsibility for them himself, a licenceholder must either itself keep safe an investment business Client's Title Documents, or else arrange and take responsibility for their safe-keeping by an "eligible custodian".
- 4.4 **Safekeeping by the Licenceholder**

Where a licenceholder itself has custody of any Clients' Title Documents then, unless the Client's Title Documents are properly in the custody of an eligible custodian acting for the licenceholder, the responsibility of the licenceholder is as follows:-

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- (a) the licenceholder shall hold those Clients' Title Documents in its own possession in safe custody and shall not part with possession of any of them to any person other than the client except on his instructions subject only to the terms of any agreement with the client;
 - (b) the documents shall be held in such manner that it is readily apparent that the investments to which they relate do not belong to the licenceholder or to an associate of the licenceholder. The licenceholder must clearly segregate all Clients' Title Documents that are in its own custody from any other Title Documents held under the control of the licenceholder. Where Clients' Title Documents, title to which passes by delivery, are held by the licenceholder, the licenceholder must take increased care in the custody of these documents.

In such cases, they shall be kept in locked custody with two or more keys and/or combination locks required to enter any particular stronghold, each key or combination to be held or controlled by separate individuals;
 - (c) there should be an adequate system of internal control over access to and over the safekeeping of the Clients' Title Documents, particularly where title passes by delivery; and
 - (d) if the licenceholder holds documents of title or documents evidencing title to investments belonging to a client and some of them are held as security for a loan to that client and others of them are not, those which are so held shall be identified in the licenceholder's records as so held and distinguished from those which are not so held.
- 4.5 The licenceholder must maintain adequate insurance arrangements at all times to cover non-registered securities. Such arrangements must, as a minimum, extend to the licenceholder's own custodian or nominee. Details of the cover, supported by documentary evidence, shall be supplied to the Commission on request and confirmed annually.

Guidance Note

What is regarded as "adequate" will depend on the circumstances of the licenceholder. The insurance arrangements would normally be expected to include cover for negligence and accidental loss of documents, fire, flood, theft, and employee fidelity.

4.6 Use of Own Custodian

Where a licenceholder arranges for the safekeeping of any Clients' Title Documents and those Clients' Title Documents are properly in the custody of the licenceholder's own custodian, the licenceholder shall be responsible for ensuring that the custodian complies with the requirements of Codes 4.4 and 4.5 as though:-

- (a) those Codes applied to the custodian; **and**
- (b) the references to the licenceholder in those Codes were references to the custodian.

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4.7 Use of Eligible Custodians other than Own Custodian

Where a licenceholder employs the services of an eligible custodian which is not the licenceholder's own custodian to hold Clients' Title Documents, the licenceholder shall be responsible for ensuring that the custodian has acknowledged in writing to the licenceholder that:-

- (a) it will not have or claim any lien or right of retention over the Clients' Title Documents relating to investments placed in its custody or any right to sell or pledge any of those investments; **and**
- (b) it will not part with possession of any of those Clients' Title Documents otherwise than to the licenceholder or on the licenceholder's instructions; **and**
- (c) it will hold Clients' Title Documents in such a manner that it is readily apparent that the investments to which they relate do not belong to the licenceholder or to an associate of the licenceholder; **and**
- (d) adequate insurance cover is maintained for **all** Clients' Title Documents which are non-registered securities (see also Guidance Note to Code 4.5); **and**
- (e) it will, not less frequently than once in every six 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 six weeks before the statement is delivered to the licenceholder), specifying in relation to each description of Investment:-
 - (i) the Clients' Title Documents which were held by the custodian for the licenceholder; and
 - (ii) where the Investment is a registerable Investment, the amount so held in each different name or designation; **and**
- (f) it will **not**, if, in acting for a licenceholder, it has appointed a sub-custodian, seek to avoid responsibility for the acts or omissions of its appointed sub-custodian.

4.8 If an eligible custodian acting for a licenceholder has appointed a sub-custodian, the licenceholder should obtain confirmation from the eligible custodian that the sub-custodian(s) meet the requirements of Code 2.2.

4.9 A licenceholder shall maintain such records as are necessary to identify the location and ownership of each Client Title Document. Where documents are held for the licenceholder by an eligible custodian the licenceholder shall maintain such records as are necessary to enable it to ascertain which eligible custodian is holding each document. In such circumstances, the licenceholder is also responsible for ensuring

that the eligible custodian maintains such records as are necessary to identify the location and ownership of each Client Title Document.

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Attention is drawn to the requirements of the Financial Supervision Commission (Conduct of Business) Regulatory Code 8.7.

5 . PERIODIC STATEMENTS OF HOLDINGS

- 5.1 Unless expressly instructed to the contrary in writing by its client, a licenceholder which is responsible in accordance with this Code for holding custodianship must deliver a statement to its clients every six months (or if the holding is unchanged at least every year) by providing each of them with a list of holdings. The statement should be made up to a date not earlier than six weeks before the date on which the statement is sent or delivered to the client.
- 5.2 Where a licenceholder is providing discretionary management or advice in relation to a client's portfolio but is only responsible for custody of clients' title documents in respect of a part of that portfolio, the statement should distinguish investments held:-
- (a) by the licenceholder
 - (b) by the licenceholder's own custodian
 - (c) by the licenceholder's eligible custodian
 - (d) otherwise (including by the client and or under the client's direct control).

6 . LOANS OF INVESTMENTS

- 6.1 A licenceholder shall not lend Clients' Title Documents to a third party unless:-
- (a) the prior consent of the Commission for this activity has been obtained in writing; and
 - (b) the client has expressly agreed in the Client Agreement, or otherwise by prior written agreement from the client; and
 - (c) all monies, fees or commissions earned thereby shall be received for the account of the client and dealt with in accordance with the Financial Supervision Commission (Clients' Money) Regulatory Code.
- 6.2 Clients' Documents of Title should only be lent to eligible borrowers who are either:-
- (a) Stock Exchange Money Brokers authorised by The Securities and Futures Authority in UK; or
 - (b) institutions specifically approved for this purpose by the Commission.
- 6.3 Where Clients' Title Documents have been lent to a third party proper records should be maintained.

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The records maintained under this Code should include: -

- (a) the date at which the Client's Title Document came into or left the possession or control of the licenceholder;
- (b) the nature of the Client's Title Document;
- (c) the nature, amount and nominal value of the investment to which the Client's Title Document relates;
- (d) the identity of the borrower, destination of the lent documents and confirmation of receipt by the borrower except where documents are lent through a money broker listed in Part II of Schedule 6 of the Financial Supervision Commission (Authorised Collective Investment Schemes) Regulations 1988 (G.C. 236/88), in which case, the name of the broker should be recorded; and
- (e) details of the lending transaction, including remuneration.

7. RECONCILIATION OF CLIENTS' INVESTMENTS

- 7.1 A licenceholder shall carry out periodic reconciliations of Clients' Title Documents in its possession or control. Except in the circumstances set out in Code 7.2 below, the reconciliations must be performed as at two given dates during every calendar year (being at intervals of not more than eight nor less than four calendar months) in respect of all such Clients' Title Documents.
- 7.2 Subject to permission having been granted by the Commission, and that permission not having been withdrawn, the licenceholder may as an alternative to the above procedures conduct such counts and reconciliations on a **rolling basis**. Permission to adopt this alternative will only be given where the Commission is satisfied, on the basis of a report from the licenceholder's auditors (in the form set out in the Financial Supervision Commission (Audit Requirements) Regulatory Code) that the licenceholder has in place a system of internal control which is adequate to ensure as far as is reasonably practicable that an up-to-date record is maintained of all Clients' Title Documents relating to its clients' investments, either: -
- (a) by reference to the issuer of each investment to which a Client's Title Document relates;
or
 - (b) by reference to each client for whom Client's Title Documents are held, provided that each such Client's Title Document is identified so as to reflect that client's entitlement to that investment.

Where Clients' Title Documents are recorded by reference to the issuer of each investment a licenceholder must maintain an up-to-date record of all the clients for whom those Clients' Title Documents are held in a way which enables any transaction in that investment for each client to be identified at any time and traced through the licenceholder's accounting system.

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Guidance Note

This alternative allows the licenceholder to adopt the "rolling basis of reconciliation". The Commission considers it appropriate for most licenceholders to adopt the basis of reconciliation required under Code 7.1 but acknowledges that this will not be the most practicable method for some licenceholders and therefore provides the option under Code 7.2. The requirements to be satisfied under this alternative method are necessarily stricter as the risks of teeming and lading are increased. Licenceholders should ensure the timing of reconciliations of particular Clients' Title Documents are adequately spread. For example, the reconciliation of a particular stock on two successive days but in separate six-month periods would be unacceptable as it would amount in practice to a reconciliation at virtually twelve month intervals.

- 7.3 A licenceholder shall carry out the reconciliation prescribed by Codes 7.1 or 7.2 (as the case may be) within a period no later than the end of three calendar months from the date at which the particular Clients' Title Documents were counted or confirmed. The following activities should be carried out for the purposes of reconciliation:-
- (a) inspecting and counting Clients' Title Documents in its, or its own custodian's, possession; and
 - (b) requesting any custodian acting for the licenceholder which is not the licenceholder's own custodian, to prepare and deliver to the licenceholder a statement (in the same manner and form as is required by Code 4.7) of those Clients' Title Documents held by that custodian which are being reconciled by the licenceholder at that time under Codes 7.1 and 7.2. above; and
 - (c) in each case:-
 - (i) reconciling the results with its own records in respect of each client; and
 - (ii) in the case of a registerable investment, reconciling any discrepancy revealed by the reconciliation in (i) above with the records of the person responsible for the registration of title to that investment; and
 - (iii) in the case of a custodian acting for the licenceholder which is not the licenceholder's own custodian, reconciling the statement received with the licenceholder's own records in respect of each client; and
 - (iv) in each case, correcting any difference.
- 7.4 The licenceholder shall:-
- (a) ensure that the counting and reconciliation of Clients' Title Documents required under this Code is carried out by, or observed and reviewed by, those who are not responsible for the origination or maintenance of such records and that the work is supervised by a responsible officer; and

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- (b) retain for not less than six years all working papers which have been created to assist in the reconciliation pursuant to Codes 7.1 and 7.2.
- 7.5 Licenceholders should require their auditors to report to the Commission in accordance with the Financial Supervision Commission (Audit Requirements) Regulatory Code.

Guidance Note

Licenceholders should advise their auditors in sufficient time of the planning, timing and location of their physical counts of clients' investments, to enable the auditor to assess the extent to which it should be in attendance at such counts.

- 7.6 The licenceholder shall give written notice and details forthwith to the Commission if it has not carried out the reconciliation required by the Financial Supervision Commission (Clients' Investments) Regulatory Code 7 or if, having done so, it is unable to correct any differences.