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Guernsey Financial
Services Commission

Custodians of Open-Ended Collective Investment Schemes with Indirectly Held Assets

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1. Purpose

The purpose of this Guidance Note is to set out the standards of conduct expected of Designated Custodians when they act for Open-Ended Collective Investment Schemes (hereinafter referred to as “Scheme(s)”) where Scheme assets are held indirectly, for example, where assets are held in a separate legal structure. This Guidance Note presents ways of complying with the Rules set out below. The Designated Custodian may adopt other appropriate and effective measures to those set out in this Guidance Note, including policies, procedures and controls (including, where applicable, at group level), so long as it can demonstrate that such measures achieve compliance with the Rules.

The Bailiwick’s National Risk Assessment on Money Laundering and Terrorist Financing reaffirmed that Schemes may be exposed to criminality; for example they could be controlled by parties who wish to misuse a Scheme for fraudulent purposes or used for money laundering. In order to mitigate the risk of the Scheme itself being used for criminal purposes it is the Commission’s expectation that the Designated Custodian should be able to demonstrate knowledge of the underlying assets of the Scheme and this Guidance Note presents ways of doing this. Designated Custodians should be cognisant of their obligations to perform ongoing and effective monitoring of transactions or other activity as required by Paragraph 11(1)(b) of the Proceeds of Crime Law and Chapter 11 of the Handbook on Countering Financial Crime and Terrorist Financing.

2. Application & Interpretation

This Guidance Note applies to Designated Custodians of Guernsey Open-Ended Schemes. For the avoidance of doubt this includes Schemes authorised (as Class A, Class B or Class Q Schemes) or registered under the Law as Open-Ended Schemes.

Unless the context otherwise requires, the terms expressed in this guidance note have the same meaning as they have in the Law and the Rules, and the following expressions shall have the following meaning:

“**Asset**” means the property of the Scheme;

“**Class A Rules**” means The Collective Investment Schemes (Class A) Rules 2002;

“**Class B Rules**” means The Authorised Collective Investment Schemes (Class B) Rules 2013;

“**Class Q Rules**” means The Collective Investment Schemes (Qualifying Professional Investor Funds) (Class Q) Rules 1998;

“**Designated Custodian**” means the licensee designated as the custodian of an Open-Ended Scheme under Section 8 of the Law. For the avoidance of doubt, this includes Schemes authorised under the Law as Class A Schemes, Class B Schemes or Class Q Schemes or registered under the Law as Open-Ended Schemes; references to “**the Trustee**” within the Rules also means Designated Custodian;

“**Law**” means The Protection of Investors (Bailiwick of Guernsey) Law, 1987, as amended;

“**Operating Company**” means a company that makes goods or provides a service that it then sells to customers or clients;

The “**Proceeds of Crime Law**” means The Criminal Justice (Proceeds of Crime) (Bailiwick of Guernsey) Law, 1999, as amended;

“**Registered CIS Rules**” means The Registered Collective Investment Scheme Rules 2018;

“**Rules**” means the Class A Rules, the Class B Rules, the Class Q Rules and the Registered CIS Rules collectively;

“**Schemes**” means Open-Ended Schemes authorised under the Law as Class A Schemes, Class B Schemes or Class Q Schemes or registered under the Law as Open-Ended Schemes.

3. The Rules

The relevant detail of the Rules is extracted below:

Rule 7.10(1) of the Class A Rules states:

“The trustee shall be responsible for the safekeeping of all of the scheme property of the authorised scheme (other than tangible movable property) entrusted to it and shall ensure that any of that scheme property in registered form shall, as soon as practicable, be registered in the name of the trustee, or without prejudice to rule 7.15, its nominee and that any transaction entered into for the purposes of Section K of Part 5 is entered into in such manner as to ensure that any resulting benefit is received by the trustee and held by it as part of the scheme property.”

Rule 4.05(2) of the Class B Rules states:

“The trustee shall be responsible for the safekeeping of all the scheme property. The trustee shall be liable to the authorised scheme in the event that the loss of any scheme property occurs as a result of the trustee’s unjustifiable failure to perform its obligations or its proper performance of them.”

Rule 5.03(2) of the Class Q Rules states:

“The custodian/trustee shall take into its custody or under its control all the scheme property”.

Rule 3.02(1) of the Registered CIS Rules states:

“The designated custodian or designated trustee of a registered open-ended investment scheme shall take into its custody or under its control all the scheme property and hold it in trust in accordance with the scheme particulars”.

4. Guidance

4.1 The Requirement to Look-through

The Commission recognises that the use of separate legal holding structures may be necessary for certain Scheme and asset types. Nevertheless, in order for the Designated Custodian to fulfil its duty of safe keeping set out within the Rules its responsibility does not stop at the asset holding level, rather the Designated Custodian should consider whether it is necessary to look through to the ultimate asset.

4.2 Risk Based Approach

The Designated Custodian may take a risk-based approach to the application of this Guidance Note.

One way of doing this is to assess, and appropriately document at Scheme take-on, all relevant custody risks throughout the custody chain. This may include due diligence on the promoter/sponsor together with an assessment of relevant third parties to the Scheme (i.e. those who may exert influence or control over the structure such as the investment adviser and/or manager). In the context of this Guidance Note the term due diligence goes beyond a basic assessment of verification of identity or other checks undertaken in respect of anti-money laundering or the countering of financing of terrorism.

A Designated Custodian's review of counterparties may be based on the nature, scale and complexity of the business and how it fits into the firm's own business risk appetite but the Designated Custodian may wish to include an assessment of who the fund promoter is, their track record and integrity.

Where risks are identified by the Designated Custodian, for example in lengthy or complex custody chains where there is a risk that record keeping may not be accurate, it may be appropriate to document the Designated Custodian's mitigation of those risks.

It is suggested that custody risks be monitored throughout the relationship; it may be appropriate to base the frequency of these risk reviews using a risk-based approach in line with the asset type and dealing frequency.

An example of the risk based approach is where an asset is held via an SPV that the Scheme does not control and did not establish for the purposes of control and where that asset represents an immaterial proportion of the Scheme's overall portfolio. In this example look through processes may not apply. At all times the Designated Custodian should document its processes and decision making. This approach does not remove any requirements or obligations the Designated Custodian has under the Proceeds of Crime Law.

4.3 Ownership Verification

As part of their function Designated Custodians perform appropriate ownership verification and record keeping around the safekeeping of the assets of Schemes. The purpose of ownership verification is to ensure that each asset is ultimately owned by the Scheme in the proportion recorded. The type of evidence acquired will depend on the type of asset, but may include land registry checks for property, share registers, copies of audited accounts, or independent valuations. The Designated Custodian may wish to seek independent advice where assets are held overseas as to how to evidence adequate title to those assets. Copies of any advice received should be retained.

The Designated Custodian may wish to consider whether it has access without undue delay to all the relevant information it needs in order to perform its ownership verification and record-keeping duties. Timing of access will depend on the dealing frequency and type of assets of the scheme.

In order to mitigate the risk that assets are not owned by a Scheme in the proportion recorded, the Designated Custodian may wish to consider what reasonable steps it can take to ascertain that the Scheme ultimately owns or has title to each asset, no matter how held, and consider what processes and procedures it has in place to be able to record and verify that asset on an ongoing basis. The method of verification will vary depending on the asset type and the jurisdiction in which it is held and it is for the Designated Custodian to apply its professional judgement to determine the most appropriate method where it considers necessary.

The Designated Custodian may wish to consider whether it has in place reasonable processes and procedures such that assets of the Scheme cannot be assigned, transferred, exchanged or delivered without the Designated Custodian having been informed of such transactions.

4.4 Documentation and Record-keeping

The Designated Custodian may wish to consider whether it maintains sufficient and reliable information as a record of those assets for which it has performed ownership verification. The records should be maintained by the Designated Custodian and kept up to date. Designated Custodians may wish to consider applying a documented risk-based approach in respect of the timing of reviews; which may vary depending on the asset type and frequency of dealing of the scheme.

The Designated Custodian may wish to consider the detail of its records of assets held by any third party to whom custody functions are delegated or to any third party that maintains records or control of the underlying assets.

The Designated Custodian may wish to consider how regularly reviews of this take place. Factors may include the nature of the assets and frequency of dealing of the Scheme and it may be appropriate that this be undertaken on a documented risk based approach.

4.5 Minimum Criteria for Licensing

The Commission will take this Guidance Note into account when assessing a Firm's compliance with the minimum criteria for licensing under the Law.

4.6 The Depositary Requirements Guidance Note

Where the Depositary Requirements Guidance Note applies to a Designated Custodian the Depositary Requirements Guidance Note takes precedence.

4.7 Limited Exceptions to the Application of this Guidance Note

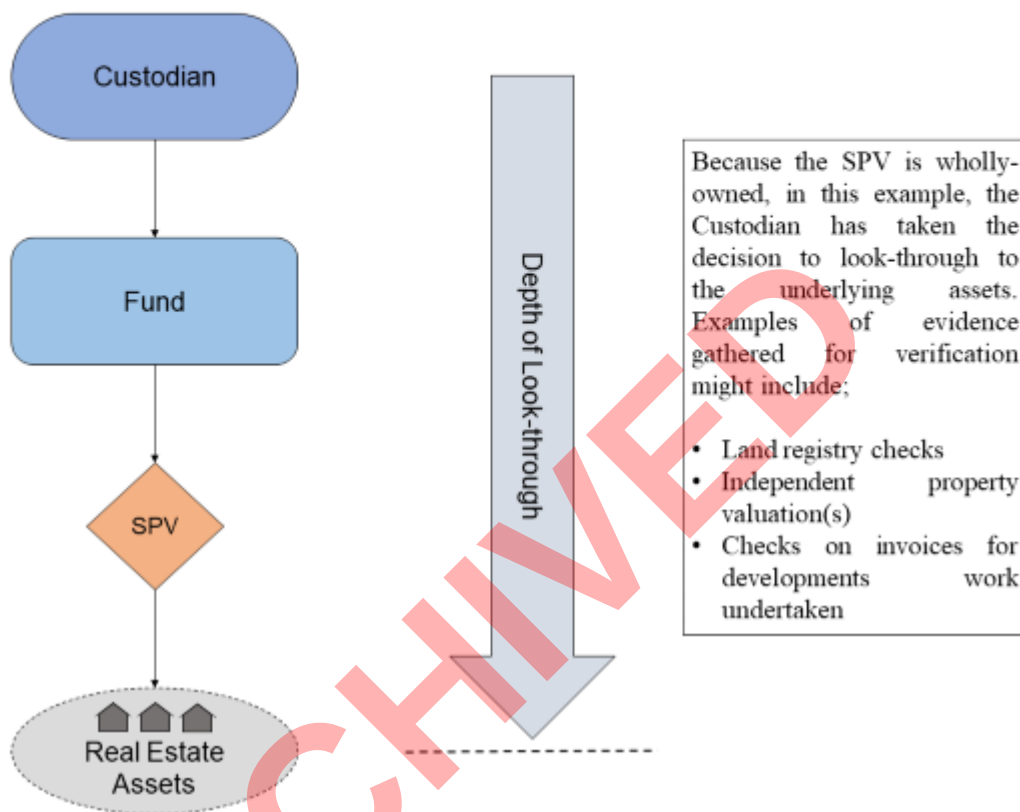
Regulated Custodians: This Guidance Note does not apply where an asset in the underlying structure is held by a Regulated Custodian. In respect of any Regulated Custodians outside of the Bailiwick, the relevant custody arrangements must meet the applicable regulatory requirements of the jurisdiction concerned. In order to be able to place reliance on this exception the Designated Custodian should make sufficient enquiries into the underlying structure to satisfy itself that the Custodian (or equivalent custody arrangements) are appropriately regulated.

Operating Companies: This Guidance Note does not apply where an asset is an Operating Company. In order to be able to place reliance on this exception the Designated Custodian should make sufficient enquiries into the investment to satisfy itself that this is the case.

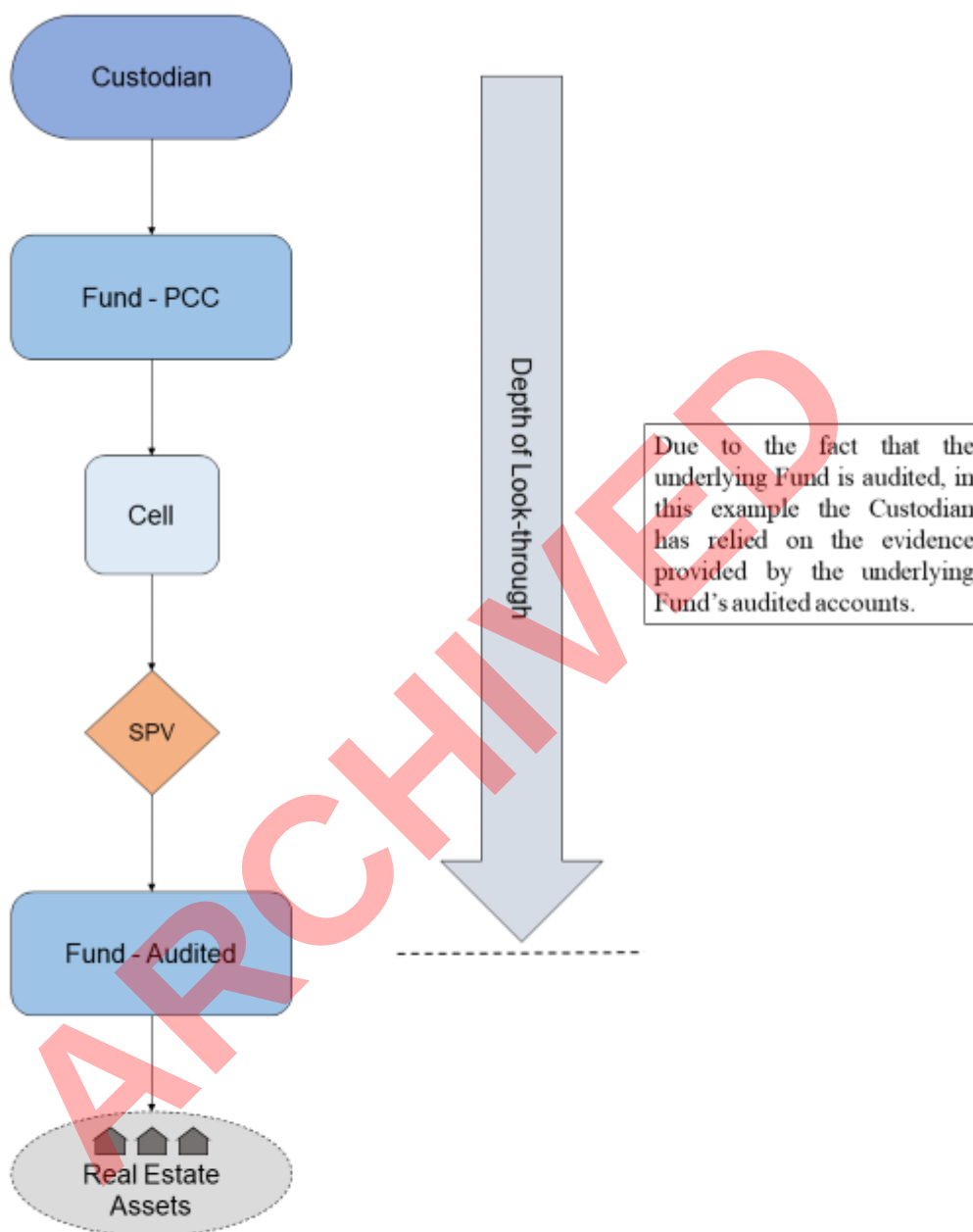
The appendix to this Guidance Note provided examples of how Custodians might apply this guidance in respect of different structure types.

5. Examples

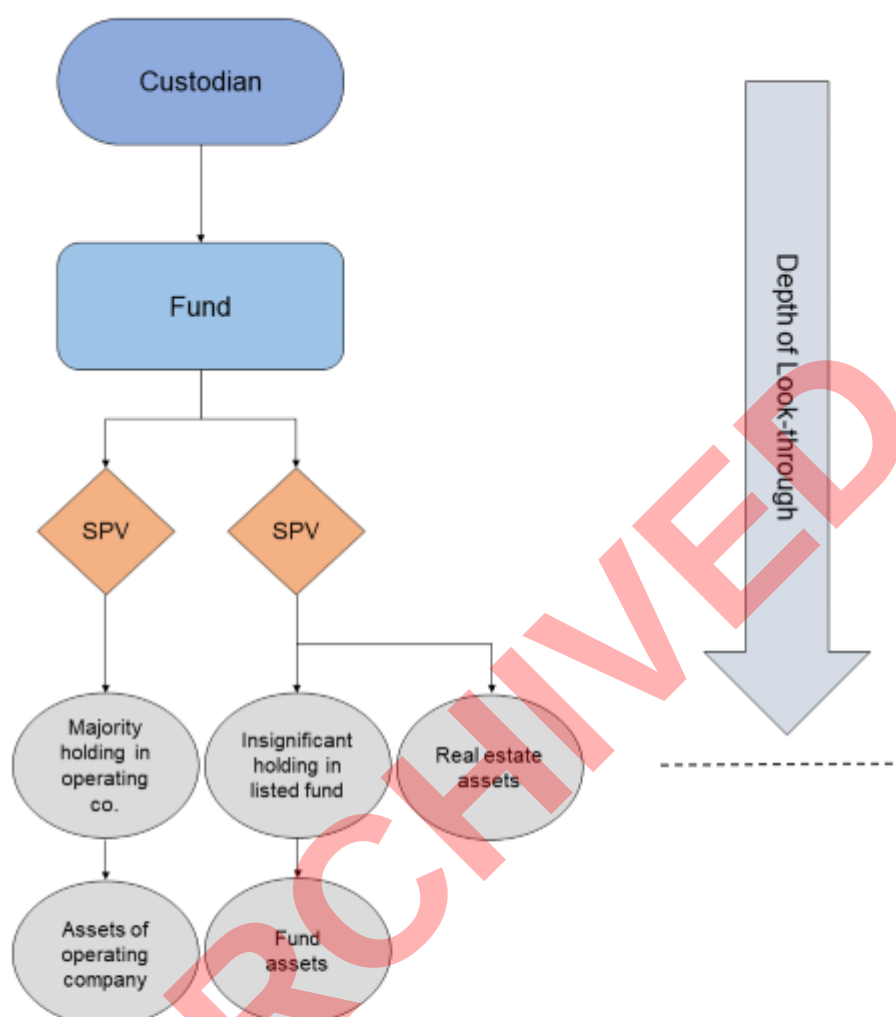
Example 1: Wholly-owned SPV with real estate assets for development



Example 2: Real estate fund of fund structure



Example 3: Assets held through SPVs



In this example the Custodian has taken a risk based approach in respect of the insignificant holding in the listed Fund and has applied the exception in respect of the operating company. In both cases there has been no look-through to the underlying assets.

Examples of evidence relied upon in this example may include;

- Share register / annual return
- Independent property valuation(s)
- Audited accounts
- Listed value

Example 4: Fund of fund structure

