

9 September 2020

Dear CEO

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

Our recent Thematic Review of a Custodian’s role in respect of Indirectly Held Assets of Open-Ended Collective Investment Schemes (“Thematic Review”) found no significant regulatory concerns, however it did identify that further Commission guidance in this area would be welcomed.

#### **Guidance for Consultation**

Rules applicable to Open-Ended Collective Investment Schemes place a responsibility on the Custodian to ensure safekeeping of Fund property. However, where property is indirectly held by a Fund, for example through a Special Purpose Vehicle (“SPV”), the Rules do not specify whether there is a duty to look through to the underlying assets or provide examples for Custodians on how or how often they could fulfil these duties.

We appreciate judgement is required when assessing how far a Firm should go in verifying assets. The degree of asset verification will depend on the nature and complexity of an asset and additional consideration should arise when assets are held indirectly. Our proposed guidance therefore seeks to provide some examples of how Rules might be complied with, and identifies some safe harbours. Put simply, the proposed guidance seeks to clarify the Commission’s expectations in relation to a Custodian discharging its duties when an asset is held indirectly.

#### **Thematic Review**

We selected this area for a Thematic Review as historically the Commission has identified examples where Custodians failed to adequately oversee assets held indirectly (for example via SPVs), resulting in potential breaches of scheme particulars, potential investor loss and risking bringing the reputation of the Bailiwick into disrepute. Additionally, Guernsey Open-Ended Collective Investment Schemes, regularly include structures with indirectly held assets, particularly for assets such as property or loan notes.

Overall, we were pleased to note no adverse systemic issues, although this was potentially because Custodians’ stated risk appetite in this area has diminished over recent years.

Our Thematic Review (a mixture of questionnaires and interviews with Guernsey Custodians), focused on (1) assessment of risks at take on, (2) verification of asset ownership, and (3) oversight processes.

- 1) We found that whilst Custodians did undertake risk assessments of new promoters and potential Schemes, there was scope for a more formal documented approach, at take on, of the potential risks within the custody chain to enable a Custodian to adopt a documented risk based approach. Equally, there was scope for consideration of whether indirectly held assets should be a standalone risk consideration.
- 2) Verification of assets is at the heart of a Custodian's role. Guernsey Custodians are responsible for a wide range of assets, held via a wide range of legal structures, and the method and extent of verification will vary accordingly. Rules and the Proceeds of Crime Law already exist to mitigate the risk that assets are not owned by a Scheme in the proportion recorded, however feedback received indicated that further guidance regarding how to comply with the Rules would be welcomed.
- 3) Effective oversight processes are important to mitigate the risk that assets may be incorrectly priced or transferred out of a Scheme without a Custodian's knowledge. We found a variety of risk based approaches (including real time access to assets, regular reconciliations and regular reporting by an Administrator) and that the responsibilities would be set out within a Service Level Agreement (or similar). Custodians demonstrated adequate oversight in the cases selected for the Thematic Review.

We welcome all feedback to the proposed Guidance Note through responses to the Consultation Paper by 21 October 2020. We would like to take the opportunity to thank the Custodian community for its notable support throughout the Thematic Review and for its initial welcome of the proposed Guidance Note.

Yours sincerely

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