

Principles and Guidelines Relating to the Custody of Fund Assets



FINANCIAL SERVICES AUTHORITY

Bois De Rose Avenue
P.O. Box 991
Victoria
Mahé
Seychelles

Tel: +248 4380800
Fax: +248 4380888
Website: www.fsaseychelles.sc
Email: enquiries@fsaseychelles.sc

Version: 29th March, 2022

Table of Contents

Interpretations	3
Introduction	5
Legal Basis	5
Principles on the Custody of Fund Assets	6
Guidance Notes to the Mutual Fund functionaries	7
1. Selection of the custodian	7
2. Appointment of sub-custodian	8
3. Custody Agreement	8
4. Disclosures	9
5. Record Keeping	9
6. Protection of assets	9
7. Notifications.....	10

Interpretations

In this guideline:

“client” in the context of a custodian, means a mutual fund.

“mutual fund” means a collective investment scheme, or a mutual fund as defined under the Mutual Fund and Hedge Fund Act, 2008, and includes –

- (i) an umbrella fund whose equity interests are split or segregated into different funds or sub-funds;
- (ii) a hedge fund;

“fund manager” means a collective investment scheme manager also referred to as the mutual fund manager;

“custodian” includes a “trustee” or “depository”, but not a sub-custodian. It is the responsible entity which has been entrusted with the safekeeping and record keeping of the assets of the mutual fund;

“custody” consists of the safekeeping and record-keeping of fund assets (depending on the type of asset owned by the mutual fund to ensure the legal integrity of the asset;

“depository” means an entity which is responsible for the custody of fund assets, and is charged with additional oversight responsibilities in relation to the conduct of the responsible entity;

“the Authority” means the Financial Services Authority;

“functionaries” includes managers, administrators, custodians, investment advisors and prime brokers and, in the case of a fund that is a unit trust, the trustee, regardless of where they are domiciled;

“the Act” - Mutual Fund and Hedge Fund Act, 2008;

“fund assets” means assets owned by the mutual fund, held on behalf of clients, which are either

- (i) assets which can be held in custody (“custodial assets”), whether by physical delivery to the custodian or by way of registration in book-entry form in the accounts of the mutual fund opened with the custodian,
- (ii) or other assets which by their nature cannot be held in custody (“non-custodial assets”, e.g. derivative instruments) which are subject to the custodian's record-keeping obligation;

“operator”, in relation to a mutual fund means -

- (a) where the mutual fund is a company, a director of that company or an alternate director and any other person designated an officer of that company by its constitutional documents, by resolution of directors or other instrument;
- (b) where the mutual fund is a unit trust, a trustee of that trust;
- (c) where the mutual fund is a partnership, a general partner in that partnership;

“responsible entity” means the entity or entities that has/have overall responsibility for the management and performance of the functions of the mutual fund, in particular, its compliance with the legal and regulatory framework in its respective jurisdiction;

“Sub custodian” is a third party entity appointed by the custodian typically by way of written agreement to safe keep fund assets on behalf of that custodian;

“Trustee” means the entity responsible for holding the fund assets of a mutual fund on trust for the holder of the mutual fund, which is structured as a unit trust. The Trustee could also be responsible for compliance with some aspects of the legal and regulatory framework.

Introduction

This document contains guiding principles for the custody of fund assets as well as guidance notes which further clarify the requirements of the Authority.

The guidance notes are not exhaustive and the Authority reserves the right to vary these requirements as may be deemed necessary. The fund, its fund administrator, and its custodians are encouraged to apply the principles to the best of their ability, and should take a comply or explain approach to these principles.

The Authority may from time to time, when necessary, amend these principles in consultation with the relevant stakeholders.

Legal Basis

The Act requires pursuant to Section 3(5)(g) that the custodian is a licensed bank under the Financial Institutions Act, 2004 or a licensed trustee services provider under the International Corporate Service Providers Act, 2003, or such other financial institution or person in or outside Seychelles as may be approved by the Authority.

The Act defines a custodian as every person who holds the property of a mutual fund in safe keeping.

Principles on the Custody of Fund Assets

Principle 1: The fund assets should be entrusted to a custodian that is functionally independent of the other functionaries of the mutual fund.

Principle 2: The fund assets should be appropriately segregated from:

- (a) the assets of the related entities of the mutual fund
- (b) the assets of the custodian/sub-custodian throughout the custody chain and
- (c) the assets of other schemes and other clients of the custodian throughout the custody chain.

Principle 3: The fund should seek to ensure that the custody arrangements in place are disclosed appropriately to investors in the fund offering documents or otherwise made transparent to investors.

Principle 4: The fund operator should use appropriate care, skill, and diligence when appointing a custodian and should consider a custodian's legal and regulatory status, financial resources and organizational capabilities during the due diligence process.

Principle 5: The fund operator should formally document its relationship with the custodian and the agreement should seek to include provisions about the scope of the custodian's responsibility and liability. **(please refer to guidance notes section 3 below)**

Principle 6: The fund operator should ensure that custody arrangements are monitored on an ongoing basis for compliance with the terms of the custody agreement.

Principle 7: The custodian should maintain appropriate arrangements to safeguard the clients' rights in client assets and minimize the risk of loss and misuse.

Principle 8: The custodian should ensure that there are clarity and transparency in the disclosure of the relevant fund asset protection regime(s) and arrangements and the consequent risks involved.

Guidance Notes to the Mutual Fund functionaries

1. Selection of the custodian

1.1. In line with Principle 4, the fund operator must use appropriate care and due diligence when selecting a custodian. The Authority recommends that due attention is paid to the following matters:

1.1.1. Capital and financial resources requirements

- The custodians' capability to keep fund assets safe.
- The creditworthiness of the custodian.

1.1.2. Organisational Capabilities

- The custodian has the human capital to properly record and preserve the physical and legal integrity of fund assets.

1.1.3. Management

- The competency of the Management team.
- The presence of an appropriate governance structure to ensure conflicts of interest are properly managed.

1.1.4. IT systems

- That the IT systems are maintained up-to-date, efficiently maintains the integrity of data stored in the system and are secure against cybersecurity threats.

1.1.5. Infrastructure

- That sufficient infrastructure is in place for non-standard fund assets such as physical commodities.

1.1.6. Global network

- If the fund requires global custodian services, does the custodian have the capabilities to meet this demand and what is the sub-custodian network that it uses.

1.1.7. Risk Management

- That the custodian has a robust risk management framework in place to ensure that where possible, mutual fund custody risk is mitigated.
- That the custodian regularly reconciles records to mitigate the risk of fund assets being misused/co-mingled.
- That the custodian has a contingency plan in case of natural disaster or terrorist act.

2. Appointment of sub-custodian

- 2.1 No sub-custodian shall be appointed in relation to a mutual fund unless it meets the requirements set forth in Section 3(5)(g) & 3(5)(h) of the Act ¹
- 2.2 A sub-custodian shall not exercise any function or activity in relation to a mutual fund, other than that specified under the agreement with the custodian
- 2.3 The custodian shall –
- (a) ensure that the appointed sub-custodian satisfies the requirements of these principles; and
 - (b) not more than 30 days before the end of each financial year of the mutual fund, advise the mutual fund in writing of the names and addresses of all sub-custodians and state whether each satisfies the requirements of these principles.

3. Custody Agreement

- 3.1 In line with Principle 5, the appointment of a custodian of a mutual fund shall be evidenced by a written contract also referred to as the custody agreement which should be submitted to the Authority accordingly.
- 3.2 The agreement for custody and safe-keeping of the assets of the scheme shall reflect the second principle for the custody of fund assets and provide for the following –
- (a) the custodian accepting custody of such assets;
 - (b) the custodian agreeing to observe the provisions of the constitutive documents or prospectus or offering documents of the mutual fund and of the custodian agreement;
 - (c) requirements with regards to the location of assets;
 - (d) the method of holding assets;
 - (e) the standard of care to be exercised by the custodian and its responsibility for loss;
 - (f) that only the fund manager, or fund administrator or the self-managed scheme, as may be applicable, may give instructions to the custodians;
 - (g) the custodian to forthwith submit a report to the Authority, and a copy thereof to the fund administrator or fund manager as applicable, in relation to any failure of the fund administrator, fund manager or scheme to meet the requirements applicable to the conduct of its business activities.
 - (h) The agreement should state the procedures under which a custodian shall appoint a sub-custodian.

¹ The appointment of a sub-custodian shall be subject to the prior approval of the Authority.

3.3 Upon termination of a custody agreement, the mutual fund needs to take into consideration the following:

- (a) The agreement should contain termination clause which should include the notification period and reasonable timeframe for the mutual fund to transfer the fund assets to another custodian;
- (b) The termination clause should state how the assets of the mutual fund are to be treated upon termination of this agreement.

4. Disclosures

The custodian should provide on a periodic basis, as may be agreed with the operator of each mutual fund, a statement to each mutual fund, the fund administrator of that fund and other functionaries of that fund as the case may require, detailing the assets of that fund held for or on behalf of such client.

5. Record Keeping

5.1 The custodian should maintain accurate and up-to-date records and accounts of fund assets that readily establish the precise nature, amount, location and ownership status of fund assets and the clients of the custodian for whom the fund assets are held.

5.2 The records should also be maintained for a period not less than 7 years and in such a way that they may be used as an audit trail and be readily available to the Authority.

6. Protection of assets

6.1 In line with Principle 7, the custodian should maintain appropriate arrangements to safeguard and minimize the risk of loss and misuse of the fund assets. The custodian should maintain an insurance coverage to indemnify the mutual fund from any losses of the custodian. Without prejudice to its other obligations and liabilities, the custodian shall be liable to the mutual fund and participants of the schemes, as the case may be, for any loss suffered which may result from:

- (a) any unreasonable failure to exercise reasonable care to perform its obligations; or
- (b) any improper performance by it of its obligations.

6.2 When a mutual fund makes the selection and appointment of the custodian, it must take into account:

- (a) the expertise and market reputation of the custodian; and
- (b) any legal requirements related to the holding of those safe custody assets that could adversely affect the client of the custodian.

- 6.3 If a client of a custodian chooses to waive or to modify the degree of protection applicable to its assets or otherwise to opt out of the application of the custodian's client asset protection regime, such arrangements should be subject to the following safeguards:
- (a) The arrangement should only take place with the client of the custodian's explicit, recorded consent.
 - (b) Before such consent is obtained, the custodian should ensure that its client has been provided with a clear and understandable disclosure of the implications and risks of giving such consent.
 - (c) If such arrangements are limited to particular categories of the custodian's clients, clear criteria delineating those clients that fall within such categories should be defined
- 6.4 No agreement between a fund manager or fund administrator or a fund (as applicable) with a custodian or between a custodian and a sub-custodian shall provide for the creation of any encumbrance on the assets of the mutual fund except in relation to a claim for payment of the fees and expenses of the custodian or sub-custodian for acting in that capacity.
- 6.5 A custodian or sub-custodian may arrange for the deposit of assets of the mutual fund in such a way that the records of either the participant in the book-based system or the custodian or sub-custodian to establish that the ownership of the assets is vested in the mutual fund.
- 6.6 The assets of a mutual fund that is not registered in its name shall be registered in the name of the custodian or a sub-custodian of the mutual fund in such a way as to establish that the ownership of the assets is vested in the mutual fund.

7. Notifications

The custodian shall immediately notify the mutual fund and the Authority in writing within 14 days of any material changes in respect of its corporate structure, resources, systems and processes that:

- (a) affect or may affect its ability to effectively carry out its custodial services; or
- (b) affect or may affect the custodial agreement with the mutual fund.