

CAYMAN ISLANDS



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THE SECURITIES INVESTMENT BUSINESS LAW (2003 REVISION)

**THE SECURITIES INVESTMENT BUSINESS (CONDUCT OF
BUSINESS) REGULATIONS 2003**

ARRANGEMENT OF REGULATIONS

PART I – PRELIMINARY

1. Citation and commencement.
2. Definitions.

PART II– GENERAL

3. Application of regulations and conflict between regulations.
4. Insurance.
5. Disclosure of regulator.
6. Conduct of officers and employees.
7. Gifts or inducements.
8. Record keeping.
9. Notifications.

PART III – ADVERTISING STANDARDS

10. Advertisements.

PART IV – STANDARDS FOR DEALINGS WITH CLIENTS

11. Required standards of a licensee.
12. Classification of clients.
13. Provision for cessation of business.
14. Lending to clients.
15. Client agreement.
16. Exemption from client agreement.

17. Provisions of a client agreement.
18. Contingent liability investment agreement.
19. Discretionary portfolio management agreement.
20. Contract note.
21. Information in a contract note.
22. Complaints procedure.
23. Access to records.
24. Periodic statements.

PART V- CLIENT ASSETS AND MONEY

25. References to client.
26. Mandates.
27. Safeguarding of client assets.
28. Maintenance of adequate records.
29. Segregation of client assets.
30. Registration and recording.
31. Physical custody of documents of title.
32. Stock lending.
33. Reconciliation.
34. Further reconciliation.
35. Correction of discrepancies.
36. Client Statements.
37. Client money

38. Money not considered “client money”
39. Segregation of client money.
40. Client bank accounts.
41. Holding client money with group company.
42. Transfer of client money to a third party
43. Bank not to combine client’s money and licensee’s money.
44. Client money requirement.
45. Reconciliation of client money balances.
46. When money is no longer client money.

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**THE SECURITIES INVESTMENT BUSINESS LAW
(2003 REVISION)**

**THE SECURITIES INVESTMENT BUSINESS (CONDUCT OF
BUSINESS) REGULATIONS, 2003**

The Governor in Cabinet, in exercise of the powers conferred by section 11 of the Securities Investment Business Law (2003 Revision) makes the following regulations –

PART I – PRELIMINARY

1. (1) These regulations may be cited as the Securities Investment Business (Conduct of Business) Regulations, 2003. Citation

(2) These regulations come into force on 29 July, 2003.

2. In these regulations, unless the context otherwise requires- Definitions

“advertisement” means any form of offer, invitation, inducement or sales promotion in relation to securities however communicated, promulgated, published or distributed;

“approved bank” means-

- (a) a bank licensed under the Banks and Trust Companies Law (2003 Revision);
- (b) a bank regulated by, and in good standing with, a recognised overseas banking regulatory authority; or
- (c) any other bank or category of bank approved by the Authority;

“client” means, subject to Part V, a person with or for whom securities investment business is transacted, but for the purposes of these regulations does not include a market counterparty;

“client assets” means securities held for or on behalf of a client and any other assets which may be so held with such securities; and assets cease to be client assets when a licensee has disposed of them in accordance with a valid instruction from the client;

“client bank account” means a current or a deposit account at an approved bank that-

- (a) is in the name of the licensee; and
- (b) includes in its title an appropriate description to distinguish the money in the account from the licensee's money;

“client money” means money of any currency which, in the course of carrying on securities investment business, a licensee holds for, or receives from or on behalf of, a client, but does not include money specified in regulation 38;

“collateral” means assets which belong to a client and which are held or controlled by the licensee under the terms of a deposit, pledge, charge or other arrangement to secure the client's obligation in connection with securities investment business;

“contingent liability” means a contract for differences, a future or an option under the terms of which the client is or may be liable to make further payments to when the transaction falls to be completed or upon the earlier closing out of his position;

“custodian” means an authorised or recognised custodian as defined in the Companies Law (2003 Revision) or, in the case of securities which are the property of a professional client, any person whom the licensee reasonably believes to be in the business of the provision of securities custodial services;

“employee” includes a manager and a corporate secretary;

“financial resources” means the resources defined in Schedule 1 of the Securities Investment Business (Financial Requirements and Standards) Regulations, 2003;

“financial resources requirement” means the requirement defined in Schedule 1 of the Securities Investment Business (Financial Requirements and Standards) Regulations, 2003;

“group company” means a company within a “group of companies” as defined in section 3;

“high net worth person” means-

- (i) an individual whose net worth is at least \$800,000 or its equivalent in any other currency; or
- (ii) any person that has total assets of not less than \$4,000,000 or its equivalent in any other currency;

“Law” means the Securities Investment Business Law (2003 Revision);

“licensee” means a person licensed under the Law;

“market counterparty” means-

- (a) a government;
- (b) a central bank or other national monetary authority;
- (c) a supranational;
- (d) a state investment or public debt management body;
- (e) a professional client where classified as a market counterparty under the provisions of regulation 12;

“nominee company” means a company controlled by-

- (a) the licensee;
- (b) a group company;
- (c) a securities investment business intermediary that is an exchange or
- (d) a custodian;

“OTC” means over the counter, whereby in relation to any security, the security is not subject to the rules of any exchange;

“OTC counterparty” means a counterparty to an OTC transaction;

“private client” means a client who is not a professional client;

“professional client” means a client who is-

- (a) a public authority;
- (b) a securities investment business intermediary;
- (c) a sophisticated person of category (a) or (b);
- (d) a high net worth person specified under sub-paragraph (ii), other than an individual;
- (e) an unregulated mutual fund;
- (f) a sophisticated person specified under paragraph (c); or
- (g) a private client where classified as a professional client under the provisions of regulation 12;

“recognised overseas banking regulatory authority” means the equivalent banking regulator within the same country or territory as a recognised overseas regulatory authority;

“reconciliation” means the identification and explanation of individual items of difference between two sets of records, but does not include the processing of necessary adjustments;

“section” means a section of the Securities Investment Business Law (2003 Revision); and

“securities investment business intermediary” means an exchange, clearinghouse, intermediate broker, settlement agent, or OTC counterparty;

“sophisticated person” means a person-

- (a) regulated by the Authority;
- (b) regulated by a recognised overseas regulatory authority;
- (c) any of whose securities are listed on recognised securities exchange; or
- (d) who -
 - (i) by virtue of knowledge and experience in financial and business matters is reasonably to be regarded as capable of evaluating the merits of a proposed transaction; and
 - (ii) participates in a transaction with a value or in monetary amounts of at least \$80,000 or its equivalent in any other currency, in the case of each single transaction; and

“unregulated mutual fund” means a mutual fund falling under the exemption in section 4(4) of the Mutual Funds Law (2003 Revision) and a mutual fund not otherwise covered by that Law.

PART II– GENERAL

3. (1) Subject to sub-regulation (2), these regulations apply to all licensees. Application of regulations and conflict between regulations
- (2) In respect of a licensee who is also licensed under another regulatory law, where there is a conflict between the requirements of these regulations and the requirements under that other regulatory law or any regulations made thereunder, or associated market practice, the Authority may waive or modify the application of these regulations to the extent that, in the opinion of the Authority, the proper conduct of securities investment business by the licensee is not adversely affected.
- (3) The Authority shall issue guidance under section 12 in respect of matters covered by these Regulations.
- (4) Without prejudice to the generality of subregulation (3), the guidance will cover in particular matters in regulations 8, 11, 27, 34, and 40.
4. (1) A licensee shall at all times maintain insurance to cover, at least- Insurance
- (a) professional indemnity;
 - (b) the professional liability of senior officers and corporate secretaries; and
 - (c) and business interruption,
- in an amount appropriate to the size, complexity and nature of the securities investment business of the licensee.
- (2) A licensee shall file with the Authority current details of the insurance required under subregulation (1) prior to the renewal of a licensee’s securities investment business licence.
5. (1) A licensee shall ensure that the fact that it is regulated by the Authority is disclosed in all correspondence, advertisements and other documents relating to the licensee’s securities investment business. Disclosure of regulator
- (2) A licensee shall not represent to any person that, because of its status as a licensee, it is indemnified by the Authority or by the government against any loss or damage which may arise from the conduct of its business as a licensee.
6. (1) A licensee shall ensure that every senior officer and employee of the licensee enters into a written undertaking to observe the requirements of sub-regulation (3). Conduct of officers and employees

(2) A licensee shall designate its senior officers' and employees' own accounts, and any other accounts subject to the requirements in sub-regulation (3), in a manner that enables such accounts to be distinguished from client accounts.

(3) A senior officer or employee shall obtain the prior written consent of the licensee in order to deal with his own account in securities of any kind in respect of which the licensee carries on securities investment business and such permission may be general or specific, and the senior officer or the employee shall-

- (a) not deal in securities for his own account with any of the licensee's clients;
- (b) report promptly to the licensee within 2 business days any transaction for his own account for which permission is required which he enters into otherwise than through the licensee unless he has arranged for the licensee to receive promptly a copy of the contract or similar note issued in respect of the transaction; and
- (c) not deal for his own account at a time or in a manner, which he knows or should know, is likely to have a direct adverse effect on the particular interests of any client of the licensee.

(4) Where a senior officer or employee is precluded from entering into a transaction for his own account, he shall not procure any other person to enter into such a transaction on his behalf.

(5) Subregulations (1) to (4) do not apply to senior officers and employees who are not involved to any material extent in, or do not have access to trading or client information or such kind of information about the licensee's securities investment business.

(6) A senior officer or employee who contravenes sub-regulation (3) or (4) commits an offence and is liable on summary conviction to a fine not exceeding \$5,000.

Gifts or inducements

7. A licensee shall establish and maintain compliance procedures designed to ensure that no senior officer accepts any gift or inducement that is likely to conflict with his duties to any client of the licensee.

Record keeping

8. (1) In addition to the requirements in the Securities Investment Business (Financial Requirements and Standards) Regulations, 2003, a licensee shall establish and maintain procedures to ensure that sufficient information is recorded and retained about its securities investment business, in relation to-

- (a) advertisements;

- (b) clients;
- (c) senior officers and employees;
- (d) the licensee itself; and
- (e) securities investment business transactions.

(2) A licensee shall retain records for a minimum period of 5 years from the relevant date.

(3) The nature of the records to be maintained and the relevant dates to be used under sub-regulation (2) shall be contained in guidance issued by the Authority.

9. In addition to the notification requirements under section 7(4), a licensee shall notify the Authority immediately in writing of the occurrence of any of the following, in relation to the licensee or its securities investment business, as the case may be-

Notifications

- (a) the presentation of a petition for the winding up of the licensee or of a company which is a subsidiary or holding company of the licensee or the summoning of any meeting to consider a resolution to wind up any of them;
- (b) the application by any person for the appointment of a receiver, administrator or trustee of the licensee or a subsidiary or holding company of the licensee;
- (c) the making, or any proposals for the making, of a composition or arrangement with a creditor or creditors of the licensee, or a subsidiary or holding company of the licensee;
- (d) the appointment of inspectors by a statutory or other regulatory authority to investigate the affairs of the licensee, or a subsidiary or holding company of the licensee;
- (e) the bringing of any action against the licensee, or a subsidiary or holding company of the licensee, under the Law;
- (f) any claims on or material changes to the licensee's insurance arrangements;
- (g) any resignations or dismissals of senior officers or senior employees of the licensee or holding company of the licensee;
- (h) where the licensee becomes aware that an senior officer or employee has been engaged in activities involving fraud or other dishonesty;
- (i) any material breakdown of administrative or control procedures (including breakdowns of computer systems or other problems resulting or likely to result in failure to maintain proper records), and the steps that the licensee proposes to take to correct the problem;

- (j) the date on which it proposes to cease to carry on securities investment business and the reasons for the cessation;
- (k) the inability of the licensee to perform the calculations required under regulation 44;
- (l) the inability of the licensee to perform any of the reconciliations required under any regulations or to correct any deficiencies identified by the reconciliations;
- (m) a breach by the licensee of regulations 4 and 6 of the Securities Investment Business (Financial Requirements and Standards Regulations), 2003 together with details of the steps which the licensee is taking to remedy the breach;
- (n) where a licensee has reason to believe that it will be unable to-
 - (i) submit a financial reporting statement as required by the Securities Investment Business (Financial Requirements and Standards) Regulations, 2003; or
 - (ii) make a payment to a securities investment business intermediary by the due date as required under the rules of any of those intermediaries, thereby causing the default of the licensee under those rules;
- (o) the failure of any approved bank, securities investment business intermediary or other entity with which the licensee has deposited or to which it has passed client money; and for these purposes, “failure” means the appointment of a liquidator, receiver, administrator or trustee in bankruptcy or any equivalent procedure in the relevant jurisdiction;
- (p) where a licensee becomes aware of any actual or contingent claim in relation to securities investment business by or against the licensee where any amount claimed or disputed is likely to exceed 10% of the licensee’s financial resources;
- (q) where a licensee’s financial resources fall below 110% of its financial resources requirement and its adjusted total assets fall by 10% from the figure shown on its most recent financial reporting statement;
- (r) where a licensee’s unsecured borrowings exceed 10 times its adjusted total assets, unless the loans are subordinated loans which qualify as eligible capital substitutes; or to extent that the licensee's position in those investments is a long position; and
- (s) any other matter material to the Authority's supervision of the licensee, as may be set out in guidance.

PART III – ADVERTISING STANDARDS

10. (1) This Part applies to all holders of securities investment business licences issued under section 6, but does not govern advertisements that are only made to or directed at persons who are market counterparties or professional clients. Advertisements

- (2) An advertisement shall not contain or include-
 - (a) a statement, promise or forecast which is misleading;
 - (b) a statement, promise or forecast which the licensee does not, at the time the advertisement is issued or made, have reasonable grounds for believing to be true;
 - (c) a statement of opinion held by any person which the licensee does not at the time the advertisement is issued or made have reasonable grounds for believing to be the honestly held opinion of that person at that time;
 - (d) a misleading statement about the scale of activities of, or any of the activities of, or the resources of or available to, the licensee or the licensee's group of companies;
 - (e) a statement relating to past performance unless-
 - (i) the basis on which such performance is measured is clearly stated and the presentation is not misleading;
 - (ii) it is accompanied by a warning that past performance is not necessarily a guide to future performance; and
 - (iii) the past performance is relevant to the investment or the services offered by the licensee;
 - (f) a statement relating to taxation benefits unless it is properly qualified to show what it means in practice and to whom such benefits apply; or
 - (g) a comparison with other forms of investment unless the basis of comparison is clearly stated and the comparison is fair.
- (3) The content and format of any advertisement shall not:
 - (a) be so designed as to be likely to be misunderstood;
 - (b) be so designed as to disguise the significance of any warning statement or information which is required to be included or provided under this Part;
 - (c) be presented in such a way that it is not clearly identifiable as an advertisement; or

- (d) signify in any way that the advertisement is approved by the Authority.
- (4) An advertisement shall-
 - (a) identify the licensee who issued or made it or caused it to be issued or made including a full address; and
 - (b) disclose the identity of the licensee's regulator.
- (5) An advertisement shall specify all of the terms and conditions that attach to an investment unless:
 - (a) the terms and conditions which are specified give a fair indication of the nature of the investment and the risks involved; and
 - (b) the advertisement contains or provides information as to how a written statement of all the terms and conditions can be obtained.
- (6) An advertisement shall disclose any special areas of risk relating to the investment, including limited marketability.
- (7) In the case of an investment the value of which may fluctuate or is not guaranteed (or both), the advertisement shall state that fact prominently.
- (8) In the case of an investment the value of which is guaranteed, the advertisement shall state clearly the nature of the guarantee and to what it relates and whether there are any matters that may affect the investor's ability to benefit from it.
- (9) An advertisement shall not specify a rate of return without specifying how it is calculated and such return or calculation shall include any element that involves any potential reduction of the investor's capital.
- (10) An advertisement inviting investment in futures, options, and contracts for differences and other derivatives shall contain or provide a warning of the financial risks attached to such type of investment.
- (11) A licensee shall keep a record of all advertisements issued or made by it in accordance with regulation 8 and any relevant guidance issued by the Authority under that regulation.

PART IV – STANDARDS FOR DEALINGS WITH CLIENTS

Required standards of a licensee

- 11. (1) A licensee shall -
 - (a) act with high standards of market conduct, integrity and fair dealing in the conduct of securities investment business;

- (b) act with due skill, care and diligence in providing any service which he provides or holds himself out as willing to provide;
- (c) ensure that clients are provided with sufficient and timely disclosure regarding-
 - (i) the licensee's fees, commission and recoverable disbursements;
 - (ii) any risks associated with an investment strategy recommended to a client by the licensee; and
 - (iii) any other matter reasonably to be regarded as necessary to enable the client to make informed decisions regarding securities investment business conducted with or through a licensee; and
- (d) except where execution-only services are being provided by the licensee take reasonable steps to ensure that, in relation to a private client, any investment strategy in connection with securities investment business recommended to or executed on behalf of such client is suitable, having regard to all the relevant facts.

(2) Where there is or may be in respect of a securities investment business transaction a conflict of interest between a licensee and a client or between clients of a licensee, the licensee shall take reasonable steps to ensure that clients are given fair treatment.

(3) The Authority will issue guidance on matters provided for by this regulation.

12. (1) A licensee shall classify all persons with or for whom it transacts securities investment business as either private clients, professional clients or market counterparties.

Classification of clients

(2) A licensee may classify a client who would otherwise be a private client as a professional client where-

- (a) the client falls within the definition of a high net worth person where an individual; or
- (b) where the client falls within the definition of a sophisticated person under paragraph (d) (i) or (ii)

and the licensee -

- (i) has taken reasonable care to determine that the client has sufficient experience and understanding so as not to require the protections provided for private clients;

- (ii) has given a clear written warning to the client of the protections under the Law and any regulations made under the Law which he will lose; and
- (iii) has obtained the client's written consent after the client has had a proper opportunity to consider that warning.

(3) A licensee may classify a client who would otherwise be a professional client, except where he attains such classification by operation of subsection (2), as a market counterparty where –

- (a) the client falls within categories (a), (b) or (c) of the definition of professional client and is not acting for an underlying client;
- (b) the client is a company or partnership falling within category (d) of the definition of professional client and has a net worth of \$12,000,000 or, where a company, a net turnover of \$22,000,000, or the equivalent in any other currency; and
- (c) before commencing securities investment business with the client on a market counterparty basis, the licensee advises the client in writing of the protections under the Law or any regulations made under the Law he will lose as a result, and the client does not object to being classified as a market counterparty.

(4) Where a licensee has classified a client as a professional client or a market counterparty under the provisions of sub regulations (2) or (3), it shall review such classifications at least annually, to ensure that the classifications remain appropriate.

Provision for cessation of business

13. Where a licensee decides to cease any securities investment business, the licensee shall ensure that any such business that is outstanding is properly completed or is transferred to another licensee.

Lending to clients

14. (1) A licensee shall not knowingly lend money or extend credit to a private client in connection with securities investment business, and shall not arrange for any other person to do so, unless-

- (a) the licensee has made and recorded an assessment of the private client's financial standing, based on information disclosed by that client, and it is satisfied that the arrangements for the loan or credit and the amount concerned are suitable in relation to the type of securities investment agreement proposed or likely to be entered into by the licensee; and
- (b) the client has given his prior written consent to both the maximum amount of the loan or credit and the amount or basis of any charges to be levied in connection with the loan or credit.

(2) Sub-regulation (1) does not apply where a licensee-

- (a) settles a securities transaction in the event of default or late payment by the client; or
- (b) extends credit to cover a margin call made on a private client for a period not exceeding than 5 business days.

15. Subject to regulation 16, a licensee which conducts securities investment business with any client shall do so by means of a written agreement which shall include, at a minimum, the matters set out in regulation 17. Client agreement

16. A client agreement is not required for- Exemption from client agreement

- (a) the issue of any tipsheet, brokers' circular or other investment publication;
- (b) deals effected or arranged on behalf of an execution-only client.

17. A client agreement shall include- Provisions of a client agreement

- (a) the nature of services to be provided by the licensee under the agreement;
- (b) by way of annual letter forming part of the agreement, the client's investment objectives and any restrictions on investments or markets in which funds may be invested;
- (c) in respect of fees payable by the client to the licensee-
 - (i) the basis and method of the calculation;
 - (ii) the basis of payment whether by bill or by deduction from income or capital; and
 - (iii) the frequency of payment;
- (d) the fact that the licensee is regulated in the conduct of its securities investment business by the Authority;
- (e) the manner in which the instructions may be given by the client for any transaction;
- (f) where the licensee is acting as securities manager, the initial value and composition of the managed portfolio and the period of account for which statements of the portfolio are to be provided, in accordance with regulation 24;
- (g) the arrangements for handling and accounting for client money, including details of the payment of interest;
- (h) where the licensee is providing custody services in respect of client assets, terms and conditions relating to-
 - (i) registration, if the assets will not be registered in the client's name;
 - (ii) claiming and receiving dividends, interest payments and other rights accruing to the client;
 - (iii) exercising voting, conversion and subscription rights;
 - (iv) dealing with takeovers, other offers or capital reorganisations;

- (v) the provision of statements under regulation 36;
- (vi) the extent of the licensee's liability in the event of a default by a custodian, provided that the licensee may not disclaim responsibility for losses arising directly from the fraud, wilful default or negligence of the licensee;
- (i) in respect of any contractual right of the licensee to realise a private client's assets-
 - (i) the circumstances in which and the action it may take to do so; and
 - (ii) the specific assets over which it may do so;
- (j) the client's right of inspection of copy contract notes, vouchers and copies of entries in books or electronic recording media relating to the client's transactions with a statement that such records will be maintained for a period of 5 years from the date of the transaction; and
- (k) in relation to any stock lending activity consented to by a private client, appropriate terms and conditions, including –
 - (i) the securities to be lent;
 - (ii) the type and value of collateral from the borrower; and
 - (iii) the method and amount of payment due to the private client in respect of the lending; and
- (l) arrangements for bringing the agreement to an end.

Contingent liability investment agreement

18. Where a licensee is effecting transactions in a contingent liability investment on behalf of a private client, the client agreement shall specify, in addition to the items in regulation 17-

- (a) the circumstances in which the licensee may require additional money from the client by way of margin;
- (b) that the minimum margin to be required for an on-exchange transaction shall be equal to the margin requirements of the relevant securities investment business intermediary;
- (c) the form in which the margin may be provided, and the timing thereof; and
- (d) the steps that the licensee may be required or entitled to take in the event that the client fails to provide the required margin.

Discretionary portfolio management agreement

19. (1) Where a licensee is exercising discretionary portfolio management for a client, in addition to the items in regulation 17, the client agreement shall specify the following:

- (a) the extent of discretion to be exercised by the licensee, including any restrictions on the category of investment in which the funds comprised in the portfolio may be invested, or on the amount, or the proportion of the fund which may be invested in any category or any one investment;

- (b) the frequency with which the client is to be supplied with a statement of the money and the investments comprised in the portfolio and a valuation thereof and the basis of the valuation;
- (c) if the agreement is to include a measure of portfolio performance, the basis on which that performance is to be measured; and
- (d) whether hedging or borrowing powers are to be used, and the nature of such powers and limits on their use.

(2) A licensee, on accepting the portfolio referred to under sub-regulation (1), shall as soon as is practical, send to the client a statement showing the current market value and composition of the portfolio.

20. (1) Subject to sub-regulation (2), after a transaction has been carried out for a client, the licensee shall send to the client or to his order promptly, a contract note with the essential features of the transaction, in accordance with regulation 21.

Contract note

(2) A licensee is not required to issue a contract note to a client where the client has requested in writing that contract notes should not be issued.

21. A contract note shall include the following information-

Information in a contract note

- (a) name and the address of the licensee and the capacity in which the licensee is acting;
- (b) the client's name or other designation and account number;
- (c) the date of the transaction;
- (d) description of the security and the size of the transaction;
- (e) the nature of the transaction and the unit price;
- (f) total cost or proceeds, as the case may be, of the transaction;
- (g) amount of remuneration and commission of the licensee;
- (h) amount of expenses, fees, taxes or duties;
- (i) settlement date; and
- (j) foreign exchange rate (where applicable).

22. The licensee shall establish effective complaints handling systems and procedures that ensure that-

Complaints procedure

- (a) adequate records of complaints, including a central register, are established and maintained; and
- (b) all complaints are responded to in writing within 14 days of receipt of such complaints.

23. For the period during which it is required to keep relevant records under these regulations, a licensee shall make available to any client on request, within a reasonable period of time after such request is made-

Access to records

- (a) those parts of any written material and records which relate to that client and which the licensee has sent, or is required to send, to that client under these regulations; and
- (b) copies of any correspondence received from that client relating to securities investment business.

Periodic statements 24. A licensee that manages a portfolio for a client shall provide a written statement to him-

- (a) annually at the request of the client unless paragraph (c) applies;
- (b) once every quarter unless paragraphs (a) or (c) applies; or
- (c) monthly where the client's portfolio includes an uncovered open position in a contingent liability investment,

and such statement shall contain adequate information on the value and composition of the portfolio as at the end of the period covered by the statement.

PART V- CLIENT ASSETS AND MONEY

References to client 25. For the purposes of this Part, unless otherwise expressly provided, references to "client" shall be deemed to include a market counterparty.

Mandates 26. A licensee shall establish and maintain adequate records and internal controls in respect of any mandate from a client under which the licensee may control a client's assets or liabilities in connection with securities investment business.

Safeguarding of client assets 27. A licensee shall ensure that it secures adequate protection for assets belonging to a client when it is accountable for them, in accordance with this Part and any guidance issued by the Authority.

Maintenance of adequate records 28. Where a licensee holds assets as collateral and has exercised any associated rights to treat the assets as its own, the licensee shall ensure that it maintains adequate records to enable it to meet any future obligations including the return of equivalent assets to the client.

Segregation of client assets 29. (1) In addition to complying with section 10, a licensee shall ensure that where assets belonging to a client are held with a custodian, the custodian's records show clearly that the assets belong to one or more clients of the licensee.

(2) For the purposes of section 10, assets under the control of a licensee that belong directly to a company within the same group of companies as the licensee are to be segregated from client assets, unless the company has agreed to be treated as a client who is dealt with at arm's length.

30. A licensee shall effect appropriate registration or recording of legal title to client assets in the name of – Registration and recording
- (a) the client;
 - (b) a nominee company;
 - (c) a custodian, where the licensee has notified the client in writing, or the licensee, where the licensee has obtained the prior written consent of a private client, or in the case of a professional client or a market counterparty, has notified the client,

in the case where the asset is subject to the law or market practice of a jurisdiction outside the Islands and the licensee has taken reasonable steps to determine that it is in the best interests of the client to register or record it in that way or that it is not feasible to do otherwise, having regard to the applicable law or market practice; or

- (d) any other person, at the written direction of the client, provided that in the case of a private client, that other person is not a company within the same group of companies as the licensee.
31. (1) Physical possession of any documents of title shall be held - Physical custody of documents of title
- (a) by the licensee;
 - (b) by a custodian; or
 - (c) in the case of a market counterparty or professional client, in accordance with their written instructions.

(2) A licensee shall ensure that the arrangements for the physical custody of any documents of title to client assets are appropriate to the value and risk of loss of the assets concerned, and that there are adequate controls to safeguard the assets from damage, misappropriation or other loss.

32. A licensee shall not engage in stock lending activity with or for a private client or professional client unless the activity is covered in the client agreement under regulation 17. Stock lending

33. A licensee shall, not less than once every 5 weeks, or with the permission of the Authority, not less than once every 6 months, perform a reconciliation of its records of client assets for which it is accountable but which are not in the licensee's physical custody, with statements obtained from custodians or other persons responsible for maintaining records of legal entitlement. Reconciliation

34. (1) A licensee shall, not less than once every 6 months, carry out- Further reconciliation

- (a) a count of all client assets it (or a nominee company or group company) physically holds and a reconciliation with its records of such holdings; and
 - (b) a reconciliation between the licensee's (or a nominee company's or group company's) records of holdings of client assets and the records of the location of such holdings.
- (2) The reconciliation shall be performed by –
- (a) the total count method; or
 - (b) an alternative method approved by the Authority, provided that confirmation is provided by the licensee's auditor that the licensee has systems and controls in place to enable it to adequately perform such alternative method.

Correction of discrepancies

35. A licensee shall promptly correct any discrepancies revealed by the reconciliations and make good, or provide the equivalent of, any unreconciled shortfall for which there are reasonable grounds for concluding that the licensee is responsible.

Client Statements

36. (1) A licensee shall as often as necessary or on at least one date during its financial year and not less than 6 months after the previous statement date, provide all active clients within 5 weeks of the date as at which the statement is made with a statement listing all client assets for which the licensee is accountable.

- (2) Statements under sub-regulation (1) shall –
- (a) identify assets registered in the client's own name separately from those registered otherwise;
 - (b) identify separately any client assets that are being used as collateral;
 - (c) show the market value as at the statement date of any collateral held; and
 - (d) in respect of a private client, base the statement on either the trade date or the settlement date and notify the client which basis has been used.

(3) A statement shall include client money but a licensee, as an alternative, may provide include this instead in a separate statement provided to the client no later than 1 month after the date of the statement.

Client money

37. A licensee shall secure the proper accounting for and handling of client money.

38. For the purposes of these regulations client money does not include-
- (a) money of a professional client or market counterparty who has opted out of segregation by written notification to the licensee;
 - (b) money due and payable to the licensee;
 - (c) money of group companies, unless the licensee has been notified that the money belongs to the client of a group company or the group company is a client dealt with at arm's length; or
 - (d) money received from a client and which is due to settle a transaction within 24 hours, and where the licensee settles the transaction by the close of business on the third day following the date the money is received.
39. In order to comply with section 10, when a licensee receives client money it shall either-
- (a) pay it as soon as possible and in any event no later than the next business day after receipt, into a client bank account; or
 - (b) pay it out in accordance with regulation 46.
40. (1) Subject to regulation 42, a licensee shall ensure that client money is held at all times in a client bank account with one or more approved banks.
- (2) A licensee shall, no less than once in each financial year, take reasonable steps to confirm that the bank or banks used for client bank accounts remain appropriate for that purpose in accordance with the relevant guidance issued by the Authority.
41. (1) A licensee that holds or intends to hold client money with an approved bank that is a group company shall disclose this fact to the client in writing, together with the name of the bank, and comply with regulation 40(2).
- (2) Where a client gives written notification to a licensee that he does not want his money to be held with an approved bank that is a group company the licensee shall either-
- (a) deposit that client's money with another approved bank; or
 - (b) return that client money to, or to the order of, the client.
42. A licensee may allow a securities investment business intermediary to hold or control client money for the purpose of –
- (a) a transaction for a client with or through that intermediary; or
 - (b) meeting a client's obligation to provide collateral for a transaction,
- provided that, in the case of a private client, that client is notified that his money may be so held or controlled.

Money not considered
"client money"

Segregation of client
money

Client bank accounts

Holding client money
with group company

Transfer of client
money to a third party

- Bank not to combine client's money and licensee's money
43. A licensee shall ensure that the approved bank at which client money is held confirms to the licensee by means of provisions in the approved bank's custody agreement with the licensee, mandate provisions or otherwise in writing that it understands that all money in any client bank account of a licensee is held by the licensee as trustee and that the bank is not entitled to combine any money in such account with any other account of the licensee or to exercise any right of lien, set-off or counterclaim against money in a client bank account in respect of any debt owed by the licensee.
- Client money requirement
44. Each business day, a licensee shall ensure that the aggregate balance on its client bank accounts is, by the close of business that day, at least equal to the client money requirement as defined in guidance issued by the Authority, as at the close of business of the previous business day, and ensure that-
- (a) any shortfall is paid into a client bank account by the close of business on the day the calculation is performed; or
 - (b) any excess is withdrawn within the same time period.
- Reconciliation of client money balances
45. (1) A licensee shall, as often as is necessary to ensure the accuracy of its records, and at least once in every 5 weeks, perform reconciliations on-
- (a) the balance on each client bank account as recorded by the licensee with the balance on that account as recorded by the approved bank with which those accounts are held;
 - (b) the balance, currency by currency, on each client transaction account with securities investment business intermediaries as recorded by the licensee, with the balance as recorded by the intermediaries; and
 - (c) its records of collateral received from clients within 10 business days of the date to which the reconciliation relates.
- (2) Where any discrepancy arises in any of the reconciliations in sub-regulation (1), the licensee shall correct it as soon as possible, unless the discrepancy arises solely as a result of timing differences between the accounting systems of the approved bank or securities investment business intermediary and those of the licensee.
- (3) Where one set of records involved in the reconciliation indicates a shortfall in client money balances, for the period that such discrepancy remains unresolved, the licensee shall cover the shortfall by paying its own money into the relevant client account.
- When money is no longer client money
46. Money ceases to be client money if it is paid-
- (a) to the client, or his duly authorised representative;

- (b) to a third party on the instructions of the client, unless transferred in the course of a transaction under regulation 42;
- (c) into a bank account in the name of the client (not being an account which is also in the name of the licensee); or
- (d) to the licensee itself, where it is due and payable to the licensee.

Made in Cabinet the 22nd day of July, 2003

Carmena Watler

Clerk of Cabinet