

# **AIDE MEMOIRE #3**

## **Criteria for Approval of Authorised Custodians of Bearer Shares of BVI Incorporated Companies**

**May 2004**

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## 1. INTRODUCTION

### 1.2 Reason for this Aide Memoire

This Aide Memoire builds on Aide Memoire #2, “The Control of BVI-Issued Bearer Shares”, issued in October 2002 by the Financial Services Commission of the British Virgin Islands (“the Commission”). Aide Mémoire #2 clarified proposed legislation aimed at controlling the issue of bearer shares.

Subsequently, the BVI legislature approved the International Business Companies (Amendment) Acts of 2003 and 2004. These provide the legal framework for immobilising bearer shares and are due to come into force on 1 January 2005. Legislators also approved the Financial Services Commission (Amendment) Act of 2004. This Act details the regulatory framework for immobilising bearer shares, in particular the rules governing custodians, and is due to come into force on 1 July 2004.

Under the new legislation, International Business Companies (IBCs) formed before 1 January 2005 will have until 31 December 2010 to place their bearer shares with a custodian and immobilise them. IBCs formed after 1 January 2005 must do this from their date of formation.

To enable custodians of bearer shares of BVI-incorporated companies to be in place by 1 January 2005, the Commission will consider applications to act as custodians from 1 July 2004.

In preparation for this, the current Aide Memoire details the criteria the Commission will use for approval of custodians.

There are two categories of custodians: “authorised” and “recognised”.

### **1.3 Authorised Custodians**

An authorised custodian may be:

- An existing service provider currently licensed by any BVI financial legislation; or
- A company incorporated in or from outside the BVI that is not resident in and does not have a place of business in the BVI.

These should apply in writing to the Commission for status as an authorised custodian approved to hold BVI bearer shares.

All applicants for approval as authorised custodians will have to satisfy the Commission that they meet the fit and proper criteria and that they have the necessary security and compliance systems and procedures in place for safe custody of their bearer shares.

### **1.4 Recognised Custodians**

A recognised custodian may be an investment exchange or clearing organization that operates securities clearance or settlement systems in a jurisdiction which is a member of the Financial Action Task Force and that the Commission identifies and publishes in the Gazette.

A list of currently recognised custodians is provided at the Appendix.

## **2. CRITERIA FOR APPROVAL OF AUTHORISED CUSTODIANS**

### **2.1 Statement of Objectives**

The Commission is responsible under section 50A of the Financial Services Commission (Amendment) Act of 2004 for approving authorised custodians of BVI bearer shares. This section sets out the criteria for approval of authorised custodians.

The ongoing duties and responsibilities of custodians are set out in Section 8 of the International Business Companies (Amendment) Act, No. 4 of 2003.

### **2.2 Licensing Criteria**

#### **a) Fit and Proper Test**

All applicants for approval as authorised custodians must meet the Commission's "fit and proper" test. This seeks to assess the honesty and integrity, competence and financial soundness of approved persons to fulfil their duties and responsibilities as authorised custodians.

To assess **honesty and integrity**, the Commission will consider, inter alia, the following:

- Criminal records;
- Financial position;
- Civil actions against individuals to pursue personal debts;
- Refusal of admission to, or expulsion from, professional bodies;
- Sanctions applied by regulators of other similar industries; and
- Previous questionable business practices.

To determine **competence**, the Commission will review, inter alia, the applicant's formal qualifications and previous experience and track record.

To establish **financial soundness and solvency**, the Commission will assess, inter alia, the applicant's historic financial stability and future financial projections.

For a body corporate incorporated and operating outside the BVI, the Commission will also have regard to the prudential regulation and anti-money laundering regulations with which such a body should have complied.

Note:

- The fit and proper requirements of the BVI's other regulatory laws are equally applicable to the approval process for authorised custodians.
- Any actual or potential change affecting the fit and proper status of persons performing custodian duties must be immediately notified to the Commission. The Board of the licensed entity is responsible for monitoring and reporting such changes.

**b) Internal Control Systems and Procedures**

All applicants seeking approval as authorised custodians must satisfy the Commission that they have internal control systems and procedures in place for the secure custody of bearer shares, as below.

**i. Procedures and Policies**

Authorised custodians should have documented procedures and policies for the secure custody of bearer shares. These should include the following:

- Know Your Customer/Customer Due Diligence (KYC/CDD) procedures, including Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) reporting obligations;
- Suspicious transaction reporting;
- Standard written custodian agreements;
- Arrangements for safekeeping of shares;
- Sound record keeping practices and procedures; and
- Satisfactory management information systems.

**ii. Due Diligence for the Acceptance of Bearer Shares**

Authorised custodians should have adequate and properly documented due diligence policies and procedures for the review and acceptance of bearer shares.

A properly documented account acceptance process will help to ensure that the custodian has sufficient information to make informed decisions and that the services the customer wants the custodian to perform are legal and within the custodian's capabilities. The account acceptance process should include:

- An assessment of the proposed relationship between the customer and custodian, including a review of the products and services needed by the customer; and
- Customer information necessary to facilitate custody transactions where applicable.

Most importantly, KYC/CDD procedures should at all times be consistent with the BVI's AML/CFT regulations. A critical aspect of the KYC/CDD procedures and policies is the identification and verification of beneficial owners of bearer shares.

**iii. Custodian Agreement**

Authorised custodians should have custodian agreements with all clients for whom bearer shares are held. These should be standardised wherever possible, and any deviations from the standardised agreement should be reviewed to ensure adequate protection for the client.

Although the range and extent of services provided may vary among custodians, as a minimum, custody agreements should include the following:

- Establish the duties and responsibilities of the custodian;
- Require clients to authorise properly all instructions relating to bearer shares: properly authorised instructions are secure instructions that can be authenticated by such means as written instructions, test keys, SWIFT instructions or other electronic authentication methods;
- Include the frequency with which the custodian is required to report to the Commission as well as to the client;
- Provide that where the custodian receives notice that the Commission is undertaking an investigation into the beneficial owner of bearer shares, the custodian shall not be prevented by the agreement with the client from granting the Commission access to its premises to inspect all relevant books, records and accounts held in its capacity as custodian of bearer shares for the beneficial owner; and
- Not prohibit the access and inspection arrangements that are an important part of regulatory supervision;
- Provide information on request to the Commission without the Commission having to visit premises and conduct a search of relevant files.

**iv. Segregation and Safekeeping of Bearer Shares**

All bearer shares must be held under joint control and appropriate safekeeping measures must be in place.

Bearer shares must be kept separate from the assets of the custodian. This will involve holding bearer shares in the name of the beneficial owner, together with the number of shares held for each client.

The risks associated with the holding of bearer shares must be assessed and addressed by appropriate risk management techniques and internal controls.

**v. Record Keeping**

Custodians should have in place an adequate system for the recording of appropriate information on bearer shares. An adequate system is one which ensures that information on those who control BVI companies is readily accessible to the Commission.

Record-keeping services should meet the customer's specialised needs and comply with applicable record-keeping and reporting requirements in the BVI, including those relating to anti-money laundering regulations and best practices.

**2.3 Duties and Responsibilities of Authorised Custodians**

All applicants for approval as authorised custodians should have internal control systems and procedures in place that will enable compliance with the duties and responsibilities set out in the International Business Companies (Amendment) Act, No. 4 of 2003, as outlined below.

Failure by custodians to perform these duties is punishable on conviction by a fine.

**a) Notification of Registered Agent**

The authorised custodian must notify the registered agent of the company within fourteen (14) days of the receipt of the bearer share (or shares), that it is the custodian of the bearer share.

**b) Keeping Records**

- i.** The authorised custodian must keep a notice of the information relating to the beneficial owner of the bearer share. Such information should include:
  - The full name of the beneficial owner of the bearer share;
  - The full name of any other person having an interest in that share; and
  - Any other prescribed information.
- ii.** The authorised custodian must keep a notice when there is a transfer of beneficial ownership of, or interest in, the bearer share. This must be submitted to the registered agent of the company who owns the bearer share.

iii. The authorised custodian must keep a record of the location of the bearer share at:

- Its principal office in the BVI; or
- At such office in the BVI as may be approved by the Commission in writing.

iv. Where an authorised custodian transfers possession of a bearer share in accordance with the law, the authorised custodian must:

- Make a copy of all notices provided to it by the company or the person that deposited the bearer shares;
- Retain the copies for such period as may be prescribed; and
- Deliver, with the bearer share, all original notices provided to it by the company that issued the bearer shares or the person that deposited the shares.

**c) Security of Bearer Shares**

The authorised custodian must ensure that the bearer shares remain in his custody and control at all times whether or not the shares are kept inside or outside the BVI.

Access to bearer shares should be restricted to:

- Senior personnel; and
- Occasions when it is necessary in order to act on instructions relating to delivery or transfer of bearer shares.

There should be adequate physical infrastructure in place to ensure the security of the bearer shares, such as a secured vault and alarm systems. Bearer shares should only be out of the vault when the custodian receives or delivers them.

Vault control procedures should at a minimum ensure segregation of the bearer shares from the custodian's own assets, provide dual control over custody assets, restrict access to authorised personnel and maintain records of who has access to the vault and proper asset transfers.

Detailed records of all deposits and withdrawals of bearer shares should be kept. The vault record should include the initials of the joint custodian's member of staff, the date of vault transactions, description and amounts of bearer shares, identity of the affected accounts, and the reasons that assets are withdrawn.

In addition, the custodian's management information system (MIS) should be reliable and secure and have adequate, scalable capacity. Contingency plans and back-up facilities should be established to allow for timely recovery of operations.

**d) Transfer of Bearer Shares**

Where an authorised custodian transfers possession of a bearer share in a company to another authorised custodian or to the company, it shall, within seven (7) days, send a notice of transfer in the prescribed form to the registered agent of the company.

The authorised custodian holding a bearer share in a company must not transfer possession of the bearer share to any person other than:

- Another authorised custodian who has agreed to hold the bearer share;
- The company where the bearer share is to be, or has been, converted to or exchanged for a registered share, redeemed or repurchased by the company, or cancelled or forfeited; or
- The registered agent of the company.

The company has an obligation to keep the authorised custodian informed of changes to the registered agent.

**e) Ceasing to be an Authorised Custodian**

If it ceases to qualify as an authorised custodian or desires to cease acting as custodian in respect of a bearer share, the authorised custodian is required to give notice to:

- The company;
- The beneficial owner; and
- Any person who has an interest in the bearer share.

In the event of a change of registered agent, the registered agent receiving the notice or bearer shares has an obligation to forward the relevant notice or bearer shares to the new registered agent of record.

**f) Reconciliation of Clients' Activities in Bearer Shares**

Appropriate accounting systems and internal controls must be in place to facilitate the reconciliation on a regular basis of all activities relating to bearer shares held by the custodian. The reconciliation process should include:

- Counting of all bearer shares held for each client to ensure that they reconcile with the client's activity summary in bearer shares;
- Ensuring that reconciliations are carried out by a person who is independent of the production or maintenance of the records to be reconciled;
- Reconciling changes in the bearer share's position each day that a change in the position occurs;
- Reconciling bearer shares at a minimum period of twice a year, other than when a change occurs.
- Investigating promptly any accounting and recording discrepancies of bearer shares;
- Reporting any exceptions noted in the reconciliation process to management in a timely manner.

An authorised custodian must inform the Commission in writing without delay if it has not complied with these requirements or is unable in any material respect to reconcile its activities relating to bearer shares.

**g) Reporting of Bearer Shares Activity**

Custodians should ensure that reporting and record keeping systems provide activity and exception reports that allow them effectively to identify and monitor the risks in their custody operations.

Custodians must report regularly, as required by the Commission, on their holding of bearer shares and on any suspicious activity, in accordance with the legislation. Custodians should also provide their clients with regular statements on bearer shares held, unless otherwise instructed by their clients.

**2.4 Compliance Audit**

- a) Entities licensed to provide custodian services are required to engage an external auditor approved by the Commission to perform an annual compliance audit of the extent to which custody services are being provided in accordance with the stipulations set out in this Aide Memoire.
- b) The Commission may require at any time a special compliance audit of the licensed custodian at the custodian's expense.
- c) The annual compliance audit will be regarded as acceptable to the Commission providing the audit is sufficiently guided by the stipulations set out in this Aide Memoire and by the *Guidelines to Auditors for the Annual Compliance Audit of Custodians*, which will be subsequently issued by the Commission. The custodian should provide the Commission with a Certificate of Compliance.

**2.5 Application Checklist for all Authorised Custodians****a) Auditor's Consent**

Applicants must provide a letter of consent from an auditor approved by the Commission, agreeing to conduct the compliance audit as required above.

**b) Business Plan**

The business plan of the entity in relation to its proposed custody services should include as a minimum the following:

- Level of expertise of management in the custody business;
- Information on its financial strength and insurance coverage; and
- Evidence that the custodian has in place systems and controls to satisfy the on-going criteria for authorised custodians as stipulated in this Aide Memoire.

**c) Certificate of Incorporation/Continuance for the applicant****d) Memorandum and/or Articles of Association and/or By-Laws for the applicant**

**e) Audited financial statements for the applicant for the last three years**

If the applicant is a start-up company, it should provide an audited opinion balance sheet and projected financial statements for at least three years.

**f) An organisational chart**

**g) A manual detailing the applicant's internal control systems and procedures to secure the custody of bearer shares**

**h) Resumes and two references for the executive management team of the applicant**

The resume should provide a summary of the officer's qualification and experience.

**APPENDIX – LIST OF RECOGNISED CUSTODIANS AS AT 5 MAY 2004**

- The Canadian Depository for Securities
- The Central Depository (Pte) Ltd (Singapore)
- The Central Moneymarkets Unit (Hong Kong)
- Clearstream Banking Luxembourg
- The Depository Trust Company (USA)
- Euroclear
- Hong Kong Securities Clearing Company Ltd
- Indeval (Mexico)
- Monte Titoli (Italy)
- The National Securities Clearing Corporation (USA)
- SIS SegInterSettle AG (Switzerland)