

## THE ASSOCIATION OF GLOBAL CUSTODIANS

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### Via Courier

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### **Re: Documentation Requests from Local Custodians to meet local Anti-Money Laundering and Know Your Customer (KYC) due diligence requirements**

Dear Sirs:

We write on behalf of the members of the Association of Global Custodians<sup>1</sup> to convey members' views regarding the extensive documentation requests members have received from local custodians based on the local understanding of the Anti-Money Laundering and Know Your Customer ("KYC") due diligence requirements in

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<sup>1</sup> The Association is an informal group of 11 member banks, listed on the letterhead above, that provide securities safekeeping and asset-servicing functions to cross-border institutional investors worldwide. (HSBC Securities Services is participating in this letter as a global custodian in London; Citibank is participating as Citibank NA Global Custody.) Members provide custody-related services to most types of institutional investors, including investment funds, pension funds, and insurance companies; and in that role facilitate transactions and settlements of transactions for cross-border investors in Indian securities markets.

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India. Members believe that existing regulatory requirements imposed on global custodians by home-jurisdiction banking and market regulators ensure suitable KYC due diligence as a general matter. Satisfying those requirements effectively within the global custody structural context should provide a reliable basis for basic KYC regulatory purposes in India (as it does in other markets).

### Background.

Global custodians have been operating client accounts in India since the time FII regulations came into force. A large majority of foreign investments in India, especially through the Portfolio Investment Scheme, operate within the Global Custody structure. Global custodians are typically large international banks subject to KYC laws and regulations in their home jurisdictions as well as related laws and regulations in the countries where they conduct business. Global custodians typically appoint one or more local market custodians to service their investor client accounts in India, as in other countries. The local-market servicing arrangements operate under an agreement that runs between the global custodian and the local custodian. In that context, a local custodian takes instructions only from the global custodian, and the global custodian in turn takes its instructions from its foreign investor client. The local custodian typically does not have direct contact or direct interaction with the foreign investor.

The documentation listed below has been requested by local custodians in India to meet their understanding of the local KYC due diligence requirements.

#### *a. Documentation already submitted to local custodians:*

- Power of attorney, as granted to the local sub-custodian through the custodian;
- License issued by the relevant statutory bodies or jurisdiction, where applicable or certified copy of constitutive documents, such as trust deed or partnership agreement (usually only in the cases of FIIs);

#### *b. New Documents requested by some local custodians:*

- Tax ID in name of the client (PAN card);
- Copy of latest audited financial statement of the FII;

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- Certificate of incorporation/ Registration certificate/ Equivalent documents;
- Memorandum and Articles of Association/ Trust deed (In the absence of a trust deed, a declaration from the corporate customer outlining the ownership structure of the company with details of trustees, settlers / grantors, protectors and beneficiaries)/ Equivalent documents;
- Proof of address in name of the client such as utility bill, bank statement;
- Board of Directors' resolution and / or Power of Attorney (POA) granted to managers, officers or employees to transact on behalf of the client;
- List of directors, with their KYC documents (Photo-identity proof and proof of address);
- KYC documents (Photo-identity proof and proof of address) and photograph of all authorised persons, delegates and any other individuals who have a POA to operate the account. In case of a trust, KYC documents for trustees, settlor, beneficiaries, protector and grantor also;
- Organisation/ownership structure showing the percentage of shareholding owned by, and country of incorporation of, each intermediate company to the Ultimate Beneficial Owner(s) of the company. "Ultimate Beneficial Owner" means a natural person who ultimately owns or controls 25% or more in the client, and includes a person who exercises ultimate effective control over a juridical person; and
- KYC documents (Photo-identity proof and proof of address) of all the Ultimate Beneficial Owners who are natural persons.

### Comments Regarding the Documentation and Levels of Difficulty for Global Custodians.

As a general principle, obtaining personal information relating to individuals, such as proof of address and information relating to individual shareholders of an institutional customer, is -- and typically will be -- very difficult. For example, for institutional customers that are collective investment funds, such as pension funds and mutual

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funds, “beneficial owners” are the unit holders in the case of an investment trust and the pensioners and their beneficiaries in the case of a pension plan. Most such beneficial owners are individuals, and unless the fund’s global custodian is also providing ancillary services such as Transfer Agency, Unit Registrar, or benefit plan recordkeeping, the custodian would not have access to beneficial owners’ personal information, nor would it be practical to obtain beneficial owner level information. Particularly in the case of a broad-based fund, the number of beneficial owners is very sizeable and typically changes daily as individual investors buy and sell fund interests. Indeed, when foreign mutual funds and pension funds register as institutional investors with foreign market regulatory authorities, most regulators, for example -- those in Korea, Taiwan and China -- recognize and understand these “institutional” characteristics.

In addition, members note that global custodian banks are fully-regulated in their country of domicile, and all national-level banking agencies responsible for supervision of global custodians impose strict accountability for compliance with KYC regulations. Furthermore, all global custodian banks follow KYC-related global procedures that consist of having robust customer identification programmes in general, including use of a risk-based approach to customer due diligence under which enhanced due diligence is conducted for customers that fall into high risk categories. Lastly, the global custodian client base is primarily institutional investors who are themselves regulated and therefore generally are low risk in nature as compared to individuals or retail investors.

Furthermore, under internationally-agreed FATF AML Customer Due Diligence (CDD) recommendations, a global custodian bank, as an “equivalently regulated financial institution”, qualifies for reduced or “simplified due diligence” (“SDD”). For more details on the risk-based approach and SDD see “Global Custody Structure Special Factors” in Annexure I.

FATF recommendations also allow local custodians to rely on the global custodian in order to satisfy the local custodian’s KYC duties, usually via the provision of an AML Comfort Letter, or other form of introduction, confirming that the global custodian has performed CDD.

Given the above, specific documentation requirements imposed in India would trigger re-documentation across a large client base, which will not be practical and may be infeasible to a large extent. Also, the additional and extensive documentation (or re-documentation) of all clients will likely not mitigate exposure to money laundering and

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terrorist financing in material ways and will draw resources away from the identification and monitoring of investor-clients who truly pose a higher risk. *(For details regarding "Global Custody Structure Special Factors" please refer to Annexure I.)*

Supplementally, Association members wish to underscore that local India regulations include provisions which recognize that KYC due diligence requirements may vary depending on the account structure, investor class, product segmentation and the internal policy of the local custodian bank. Also, as you would be aware, SEBI guidelines recognize that – in view of the diversity of SEBI registered intermediaries – the appropriate method of implementation of the Anti Money Laundering standards may differ from case to case. As SEBI guidelines note:

*While it is recognized that a 'one size – fits- all' approach may not be appropriate for the securities industry in India, each registered intermediary should consider the specific nature of its business organizational structure, type of customers and transactions, etc. when implementing the suggested measures and procedures to ensure that they are effectively applied. The overriding principle is that they should be able to satisfy themselves that the measures taken by them are adequate, appropriate and follow the spirit of these measures and the requirements as enshrined in the Prevention of Money Laundering Act, 2002.*

Association members also emphasize that the local custodian banks in India adhere to the rules and regulations of RBI, including Know Your Client and Anti Money Laundering standards. Indeed, RIB Master Circular dated July 1, 2010 on Know Your Customer (KYC) norms/Anti-Money Laundering (AML) standards/Obligation of banks under PMLA, 2002 explicitly provides the following KYC/AML related guidance for client accounts opened by professional intermediaries:

*"Where banks rely on customer due diligence (CDD) done by an intermediary, they should satisfy themselves that the intermediary is regulated and supervised and has adequate systems in place to comply with KYC requirements. It should be understood that the ultimate responsibility of knowing the customer lies with the bank"*

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### Recommendation

In light of the above commentary, Association members propose that the end-customer due diligence process followed for the FII/FII sub-accounts, FDI, FVCI and GDR/FCCB conversion accounts under the Global Custody structure should entail local custodians taking a *combination of some or all (as necessary) of the following documents at an investing-entity level.*

- Power of attorney, as granted by the investing client to the local custodian through the global custodian;
- Copy of registration approval issued by SEBI, where applicable (usually only in the cases of FIIs);
- Copy of Income Tax PAN card in the name of the investor verified with the original
- Copies of Certificate of incorporation/ Registration certificate or equivalent documents
- Copies of Memorandum and Articles of Association/Trust deed or equivalent documents
- Copy of proof of address (these additional documents should be required only if the power of attorney or constitution documents do not bear an address of the investor)
- List of directors and stakeholder for entities registered as 'proprietary' or 'corporate accounts'. For broad based funds, this requirement will not be applicable as these are equivalent to mutual fund schemes having broad-based and widely-dispersed retail individual participation.

Members believe that the presence of a combination of some or all of these documents on file should provide adequate evidence and suitable comfort that measures mandated by the extant Anti Money Laundering regulations have been satisfied in spirit and law for foreign investors investing within and pursuant to a global custody structure.

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We appreciate the opportunity to convey members' views on these issues. For your convenience, we attach an Annexure that sets out the foregoing points in greater detail. Members stand ready to provide supplemental information should that be useful. For additional information, please contact the undersigned as an initial matter.

Sincerely, yours



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Baker & McKenzie LLP  
Counsel to the Association

CC: Shri. U K Sinha  
The Chairman  
Securities and Exchange Board of India

Shri. Anand Sinha  
Deputy Governor  
Reserve Bank of India

Chief General Manager  
Reserve Bank of India  
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ANNEXURE I

## **Annexure I: Global Custody Structure Special Factors**

### **A. Global Custodians are Regulated Entities**

Global custodians are global banking organizations and are required to adhere to stringent Anti Money Laundering norms laid out by the regulators in their respective jurisdictions e.g. The Hong Kong Monetary Authority, The Financial Services Authority, The Federal Reserve, Office of the Comptroller of the Currency, U.S. Department of Treasury and Die Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) for Germany regulated investors.

Documentary verification of identity is driven by the risk posed by the customer to the global custodian, the custodian's current and past experience with the customer or the sponsor of the account being opened, the source of funds, geographic risk, and planned investment and transaction activity. Further all the regulators mandate a robust customer identification program that can typically involve following identification measures:

#### Documentary evidence:

For an individual, unexpired government-issued identification evidencing nationality or residence and bearing a photograph or similar safeguard, such as a driver's license or passport; and

For a person other than an individual (such as a corporation, partnership, or trust), documents showing the existence of the entity, such as certified articles of incorporation, a government-issued business license, a partnership agreement, or trust instrument.

#### Non-documentary evidence:

When using non-documentary means of verification, the custodian must identify the acceptable method of obtaining the verification. Examples of non-documentary verification include:

- Contacting a customer
- Independently verifying the customer's identity through the comparison of information provided by the customer with information obtained from a



consumer reporting agency, public database, or other source; checking references with other financial institutions

In addition to setting the standards for the documentary and non-documentary verification of the customer's identity, the custodian has procedures to obtain additional documentation or perform additional due diligence where a customer or a prospective customer is deemed to pose a higher risk for money laundering.

## **B. Risk- Based Assessment**

Most jurisdictions impose a requirement that the custodian assign money laundering risk rating to each customer. This exercise identifies customers that may pose a higher risk and the custodian conducts enhanced due diligence and imposes more extensive monitoring and more frequent risk assessment on these accounts. Furthermore, many of the anti-money laundering laws applicable to the global custodians, including those in the United States, allow for custodians to take a risk-based approach to combating money laundering. By allowing for a risk-based approach, custodians are able to allocate resources efficiently and direct their efforts to those customers and areas that pose the higher risk.

This risk-based approach is articulated in the 2007 report titled "Guidelines on the Risk-based Approach to Combating Money Laundering and Terrorist Financing" issued by the Financial Action Task Force. In this report, it has been noted that where the same standard is set for all customers and resources are evenly applied to all, there could be the unintended consequence of the customer identification or other program elements becoming simply a tick the box exercise. Most anti-money laundering regimes around the globe allow for some form of risk based approach to conducting customer due diligence.

Under a risk-based approach it is up to each firm to decide on the specific documents requested, as determined by the client's AML risk. So while some of the listed documents may be obtained using a risk-based approach, the regulations do not prescribe a specific list of universally-required documents and, therefore, custodians may not always hold the same documents for all clients.

Most importantly, where a client's risk is assessed as low, Simplified Due Diligence ("SDD") applies. This less burdensome set of KYC requirements is appropriate because the majority of custodians' FII clients are themselves regulated financial institutions or collective investment vehicles, publically listed companies, regulated employer funds, or government pension funds. As these

categories of institutions have qualified for this SDD, there is no requirement to obtain the detailed documentation listed above. However, custodians must obtain suitable evidence to document the categorization of these clients for SDD.

### **C. Product Risk Assessment by Global Custodians**

The custodian conducts a Product Risk Assessment annually that identifies products, customer types, geographies, and transaction types. The results of the risk assessment drive the standards used in the Customer Identification Program. Each customer, no matter what the level of documentation gathered, is risk rated for money laundering exposure.

### **D. Institutional Customers**

The global custodians' client base is primarily institutional customers that are organized as collective investment vehicles -- investment trusts, pension funds, etc. When an institutional customer is itself regulated, the Custodian may rely upon the fact that the customer is regulated, subject to registration by a competent authority and/or subject itself to similar anti-money laundering regulation as the custodian. Further, in such cases, the custodian will have access to resources such as information and documentation maintained on the regulator's database. For example, a regulated investment company in the United States registers with the Securities and Exchange Commission and is subject to regulation under the USA PATRIOT Act. In this case documentation would be obtained from the Securities and Exchange Commission database and only if the customer was deemed to pose a higher risk would additional documentation be obtained.

As noted above, for these institutional customers, many if not all beneficial owners are individuals, holding investment interests in a collective investment fund -- the unit holders in an investment trust or the pensioners and their beneficiaries in a pension plan. Unless the custodian is also providing ancillary services such as Transfer Agency, Unit Registrar, or benefit plan recordkeeping, the custodian would not have access to beneficial owner information, nor would it be practical to obtain that information. Even where the custodian acts in another

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capacity and is privy to beneficial owner information, the Custodian may not be required to obtain the identification documents of those individuals.

When the custodian does not have access to the underlying beneficial owner information, they will -- as part of their customer identification program conducted on their customer -- identify the regulatory regime applicable to the customer, confirm how customer due diligence is conducted on the beneficial owners and by whom, including in some cases representations and warranties in the contracts identifying who is responsible, and they will employ other means, depending upon the risk, to assure that proper anti-money laundering procedures have been conducted.