



## **“B”**

### **STATEMENT OF SUBSTANCE & PURPOSE ON TRINIDAD AND TOBAGO SECURITIES AND EXCHANGE COMMISSION’S DRAFT BY LAWS 2020 FOR CREATION OF A PORTFOLIO MANAGER**

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#### **BACKGROUND**

With enactment of the Securities Act 2012, (“the Act”) the Securities and Exchange Commission (“the Commission”) obtained the power to conduct compliance reviews of its registrants. In exercising this power, between 2016 and 2018, the Division of Compliance and Inspections (“C&I”) conducted compliance reviews of all investment advisers registered as at March 31, 2018. Of the reviews undertaken, staff of the Commission (“Staff”) found that these IAs were operating contrary to their registration status, and appeared instead to be carrying out broker-dealer (“BD”) activities, based upon Staff’s interpretation of what such activities entailed. Section 4 of the Act provides as follows:

*“broker-dealer” means a person engaging in, or holding himself out as engaging in, the business of- (a) effecting transactions in securities for the account of others; . . .”*

*“investment advice” means advice with respect to an investment in, or the purchase, sale or holding of, a security”;*

*“investment adviser” means a person engaging in, or holding himself out as engaging in, the business of providing investment advice, ”.*



Having regard to the above definitions, Staff are of the view that only registered BDs are permitted to effect transactions on the account of others, while *registered IAs are permitted to only provide investment advice in respect of investment in, purchase, sale or holding of a security.*

As such, in April 2018, C&I conducted a thematic review of the eight remaining IAs on the Commission's register at the time, to determine whether they were also operating outside the scope of the legislative provision for their registration status. Following this exercise, as at 30 November 2018, 3 registrants applied for de-registration, all as a direct result of the findings related to C&I's compliance review; and in one instance, an IA applied for and received approval as a BD as the team was of the view that the IA was conducting BD activities. Therefore, as at end November 2018, there were 13 IAs registered with the Commission (a decline of 30% or 4 IAs in 8 months).

The Commission conducted research on legislative requirements in other jurisdictions and concluded that the business of a portfolio manager is not conceptualised within the categories of registrants under the Act. To treat with this gap in the legislative framework, the Commission embarked on a two-tiered approach to address the issue:

1. Market guidance and a limited time exemption

In the short term, the Commission issued guidance to all registered IAs highlighting the activities that require registration as a BD. Further, IAs were informed that the Board will grant exemptions (upon application), on a case by case basis, from the requirement to register as a BD under section 51(1), to registered IAs who are conducting any one or a combination of the following (BD) activities:

- a. instructing a local or foreign broker dealer to effect transactions on behalf of the IA's clients, based on the investment decision made by the client after consideration of the IA's advice;
- b. having non-discretionary control of client portfolios and compensated via investment advisory or asset/portfolio management fees.

Registered IAs who are conducting the identified BD activities were given the following options: (1) cease and desist all BD activity, (2) seek exemption for activities outlined above, or (3) apply within 6 months for registration as a broker dealer. The interim regularization exemptions if granted are effective for a period of 18 months (commencing



December 3<sup>rd</sup> 2019), or until the appropriate amendments are made to the securities legislation.

## 2. Creation of By-laws for Portfolio Manager

As a long-term measure to support securities market development, the Commission sought to develop a new sub-category of BD (portfolio manager), to regulate wealth/portfolio management activities. In accordance with section 148 of the Act, Staff are seeking to create a sub-category of BD, in the form of By-laws for the business of a Portfolio Manager. These By-laws seek to establish, *inter alia*, the registration requirements, permitted activities, minimum capital requirements and conduct of business rules for portfolio managers.

Staff is of the view that these proposed By-laws are suitable for Trinidad and Tobago's securities market and are consistent with international best practice.

## **Legislative Requirements**

Section 148 provides that the Minister of Finance may, on the recommendation of the Commission, make By-laws as set out in the provision. Section 149 requires that the Commission engage in public consultation prior to effecting a By-law.

## **KEY POLICIES CONTAINED WITHIN THE PROPOSED PORTFOLIO MANAGER BY-LAWS**

### **1. Registration**

- i. A new sub-category of broker-dealer was created, permitting this person to carry on business of a portfolio manager only.
- ii. Current broker-dealers can be a portfolio manager provided that they meet the requirements of a restricted broker-dealer.

### **2. Capital Requirement**

There is a two-tier capital requirement for restricted broker-dealers (portfolio manager):



- i. seventy-five thousand dollars, where a portfolio manager provides non-discretionary portfolio management services only; and
- ii. one hundred and twenty-five thousand dollars where a portfolio manager provides discretionary portfolio management services or a combination of discretionary or non-discretionary portfolio management services.

The following factors were taken into consideration in determining the capital requirement recommended in these By-laws:

- the PM will not be executing trades on behalf of clients and will therefore not be exposed to clearing and settlement risk from acting as an agent and not exposed to market risk from acting as a principal;
- These By-laws require portfolio managers to hold client assets at a third-party custodian, and holding and use of client funds by broker-dealers are regulated by section 107 of the Act;
- Portfolio managers are not exposed to underwriting risk as a broker-dealer that conducts business as an underwriter; and
- Further, By-law 58 of the Securities (General) By-laws requires segregation of client securities from that of a broker-dealer

### **3. Permitted Activities**

The new sub-category of broker-dealer created does not entail the full operational ambit of a broker-dealer registered under section 51 of the Act. As such, the activities being allowed under the restricted broker-dealer (portfolio manager) are constrained to activities that are typically within the remit of portfolio manager.

### **4. Continuous Disclosure**

Created financial statement requirements similar to that of the Act and General By-laws.

### **5. Books and records**

Created books and records requirements similar to that of the General By-laws for a portfolio manager.





## **OVERVIEW OF THE BY-LAWS**

**PART I** of these By-laws, comprising Clauses 1 to 5, outlines the connection with these By-laws to the Securities Act 2012 and the Securities (General) By-laws 2015. This Part also gives definitions for key terms that have not been previously defined in the Securities legislation that are pertinent to these By-laws including definitions of “discretionary authority”, “investment management documents” and “portfolio manager”.

**PART II** of these By-laws, comprising Clauses 6 to 9, outlines the fiduciary duties of a portfolio manager and its senior officers, employees and delegates, the composition of directors of a portfolio manager and the duty to submit to the Commission, information related to portfolio management services.

**PART III** of these By-laws outlines the registration requirements. Clause 10 describes the categories of registration permitted to carry on the business of a portfolio manager.

**PART IV** of these By-laws, comprising Clause 11, covers the eligibility requirements for a portfolio manager and establishes the capital requirements and registration, renewal and reinstatement criteria.

**PART V** of these By-laws covers authorization of a portfolio manager by the Commission.

**PART VI** of these By-laws defines the permitted activities of a portfolio manager.

**PART VII** of these By-laws covers the internal controls a portfolio manager must implement for its operation. Clause 15 requires the establishment of a compliance function responsible for developing, assessing, monitoring and reporting on various aspects of compliance with internal policies and procedures, laws and regulations. Clause 16 requires an assessment of the internal controls and processes at least every two years while Clause 17 states criteria required if an internal auditor of the portfolio manager conducts the assessment on internal controls and processes. Clauses 18 and 19 highlight that key duties and functions of the portfolio manager must be appropriately segregated.



**PART VIII** of these By-laws covers the continuous disclosure obligations of a portfolio manager. Clause 20 stipulates that financial statement requirements for broker-dealers in the Act and General By-laws also apply to a portfolio manager. Clause 23 covers the filing of material filed abroad.

**PART IX** of these By-laws, comprising Clauses 24 and 25 outlines the maintenance of accurate books and records.

**PART X** of these By-laws covers conflicts of interest. Clause 26 gives guidance on general duties relating to conflicts and areas to be covered by a portfolio manager's policies and procedures. Clause 28 outlines general disclosure obligation while clause 29 requires disclosure of interests in investments or holdings in securities and any interests in special purpose arrangements by the portfolio manager, its senior officers, investment committee members, agents and employees. Clause 30 covers recusal from meetings where conflicts of interest may arise. Clauses 31 covers rebates and soft commission arrangements. Clauses 32 and 33 cover the general duty with respect to transactions with related parties.

**PART XI** of these By-laws relate to the conduct of business of a portfolio manager. Clauses 34 to 36 highlight the duty of care of a portfolio manager. Clauses 37 to 39 outline investments with portfolio mandates. Clause 40 outlines defensive positions and the procedure when a defensive action is taken. Clause 41 is a general clause which states that all transactions carried out by or on behalf of the clients shall be at arm's length terms and executed on the best available terms. Clause 44 deals with order allocations. Clause 46 requires portfolio managers to enter into an investment agreement with clients before providing any services. Clause 47 outlines the contents of the investment management agreement.



## **SCHEDULES TO THE BY-LAWS**

### **SCHEDULE I: Fee Schedule**





## **REFERENCES**

1. Securities Act Chap. 83:02;
2. Securities (General) By-Laws, 2015;