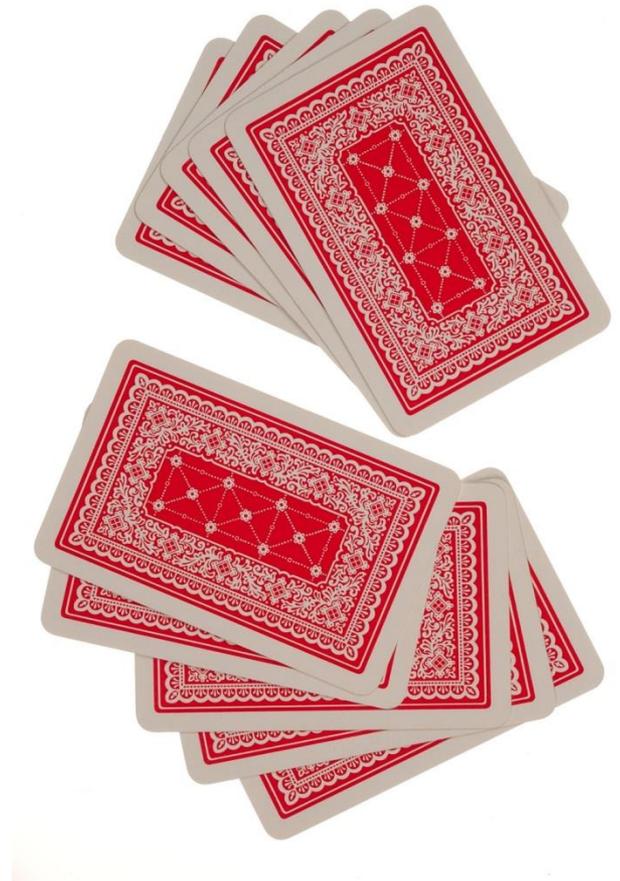


AIFMD Depository

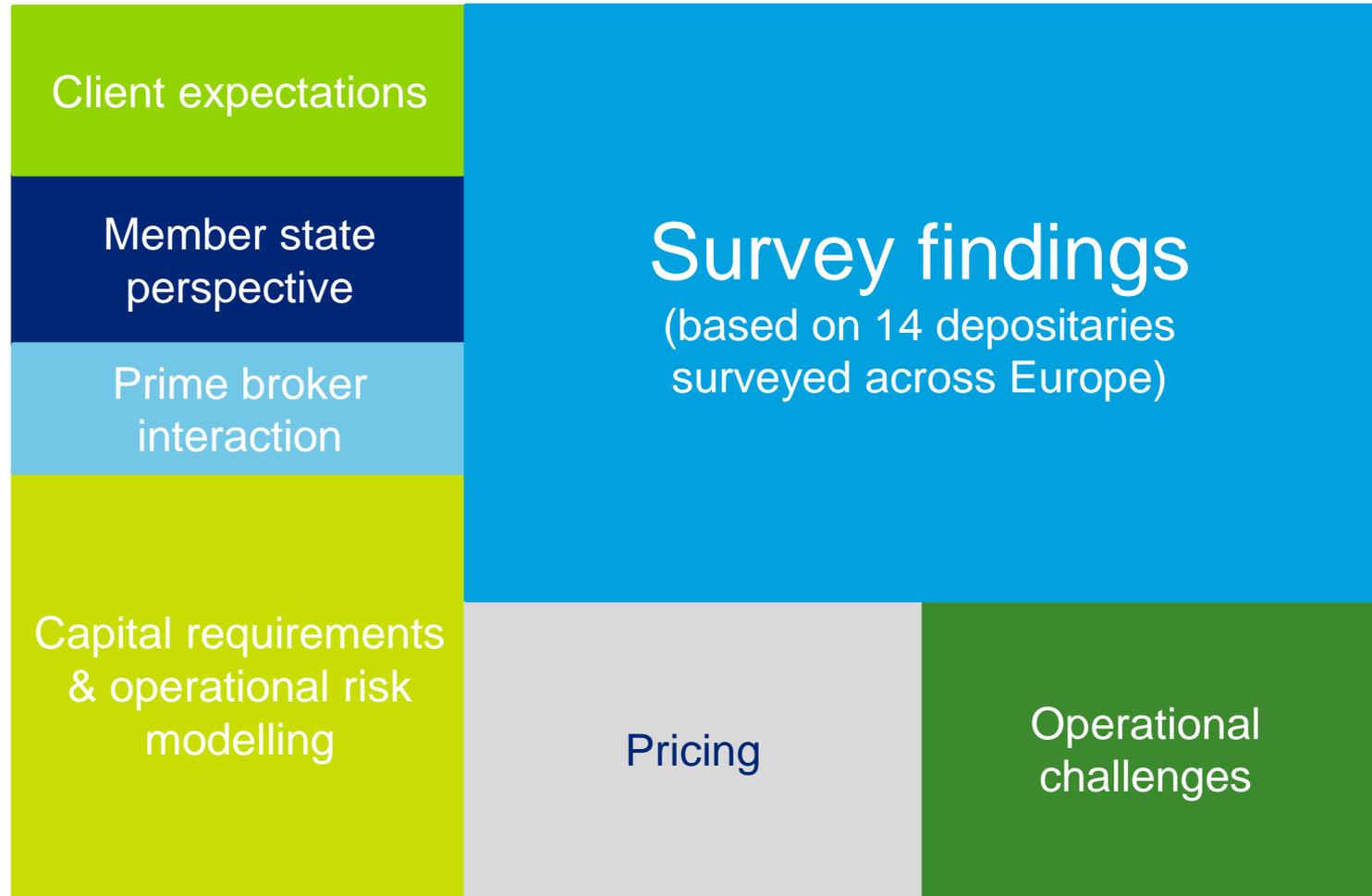
Taking a risk intelligent approach

White Paper findings

Leading business advisors

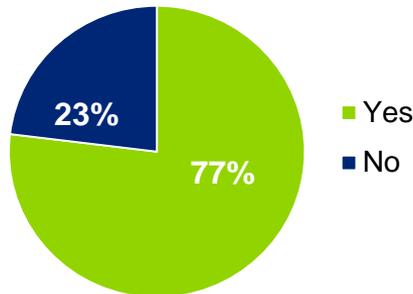


Introduction

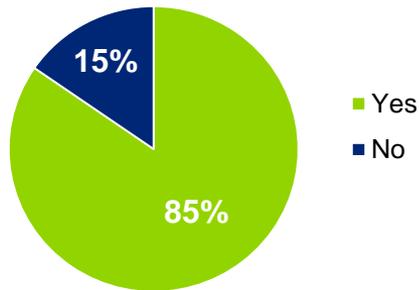


Depository preparations

Are you ready for the onboarding of your entire client base by 22 July 2014?



Do you plan to increase headcount as a result of AIFMD?



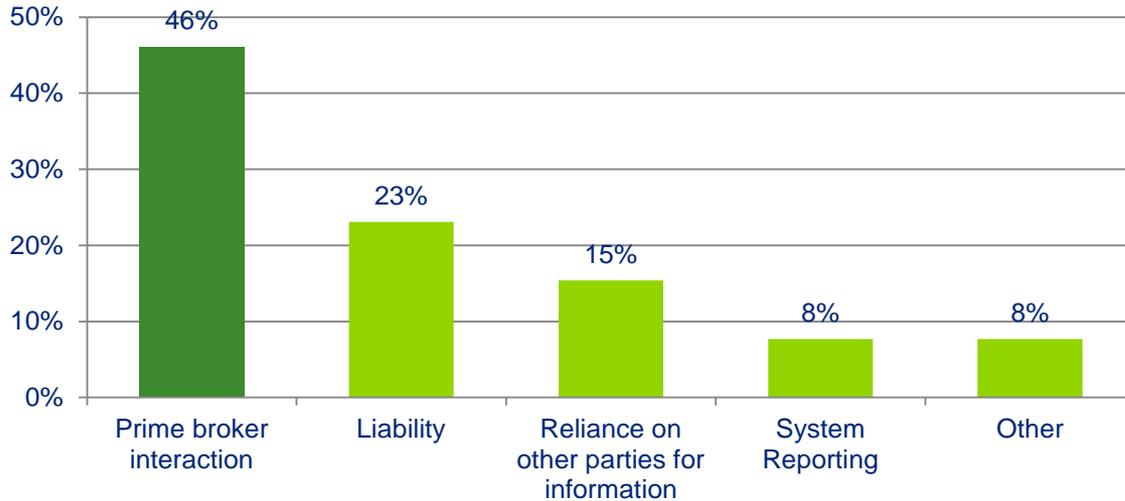
Depository 'To Do' list:

- Implement new cash flow monitoring requirements
- Implement new oversight controls on subs/reds accounts
- Implement new prime broker sub-custody and reporting arrangements
- Ensure new asset segregation and reconciliation requirements are met at sub-custody level
- Implement new ownership verification and record keeping requirements and be able to produce a real-time inventory of OTC positions
- Increase due diligence and compliance monitoring of sub-custodians
- Increase monitoring of income distribution
- Monitor timeliness of settlements
- Increase frequency of valuation verifications
- Conduct a risk assessment of the AIF strategy and the AIFM organisation
- Ensure compliance with the sub-custody delegation framework
- Implement look through on safe-keeping of financial instruments in custody
- Take action to mitigate liability risk

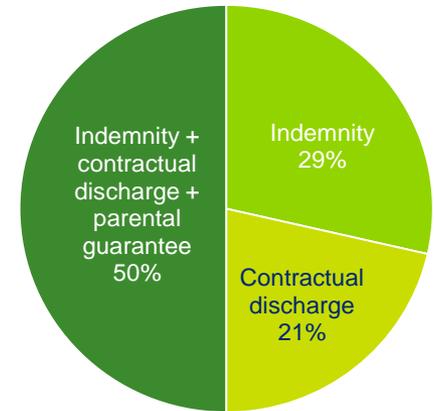
- The majority of depositaries are ready or “nearly ready” for 22 July 2014
- The vast majority of depositaries plan to increase headcount (typically by 5-10%, up to 20% in some cases)
- Enhancing information flows and applying the new operating model to clients are key areas of focus

Prime broker interaction – the No. 1 concern

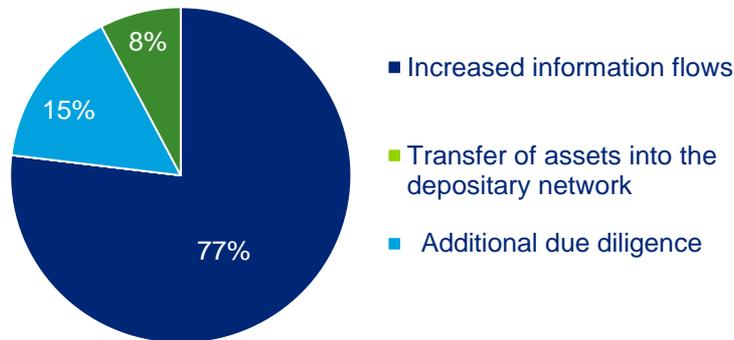
What is your biggest concern relating to the AIFMD depositary requirements?



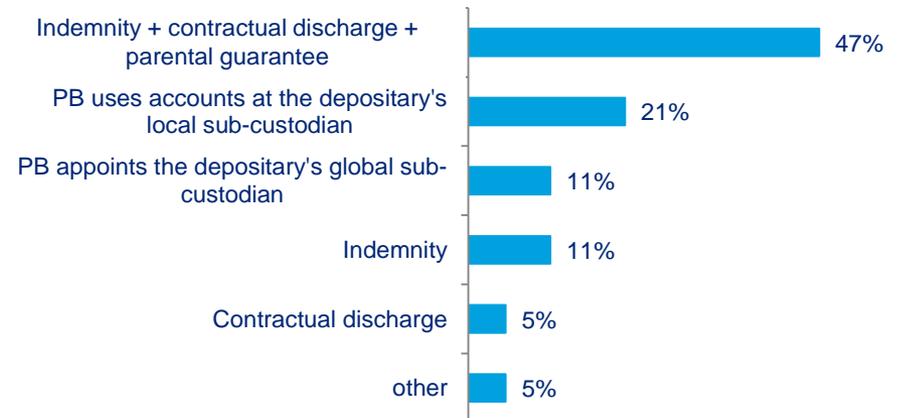
Which PB model did you opt for in advance of 22 July 2013?



What changes have you, or are you planning to make in relation to prime broker interaction?

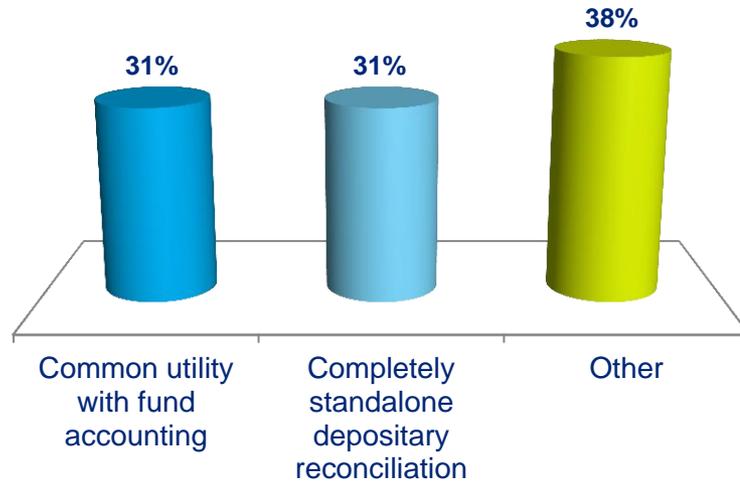


Which of these models is acceptable to you over the longer term?



Cash monitoring

How do you plan to address the cash monitoring requirements?



- The extent to which the depositary can rely on information compiled by other parties and the definition of what constitutes an independent depositary “reconciliation” is one of the key matters of interpretation.
- Just over a third of respondents is leveraging off the administrator’s fund accounting tool while the same proportion is conducting a completely standalone depositary reconciliation.
- The largest share, at 38%, is using another methodology. Some of these methodologies may also leverage off inputs from service providers, e.g. by way of an independent control on cash balance reconciling items from the administrator and comparing this line by line to the prime broker cash flows.

Data feeds from PB to depositary

Leverage off fund admin. reconciliation process?

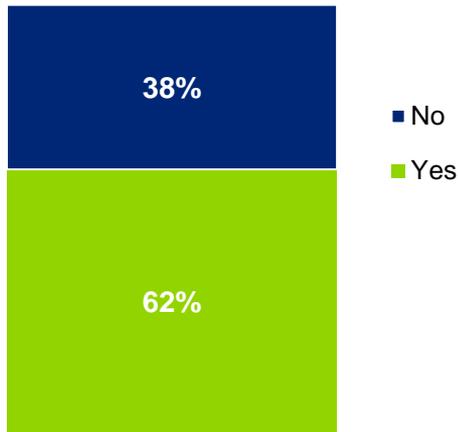
Duplication of fund admin. reconciliation process?

Definition of reconciliation?

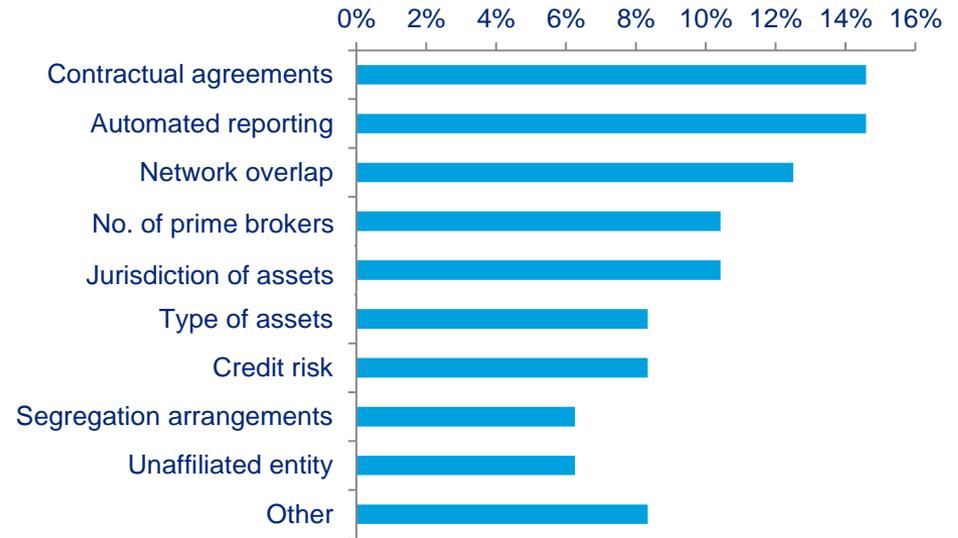
Reliance on non-affiliated fund administrators?

Depository pricing post AIFMD

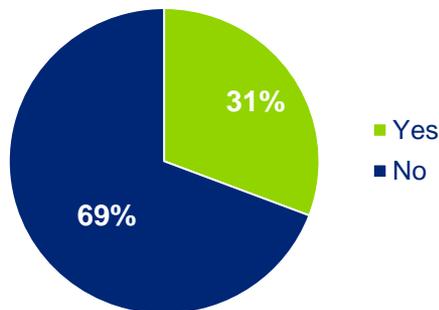
Have you developed a pricing matrix to take account of the new standard of depository liability?



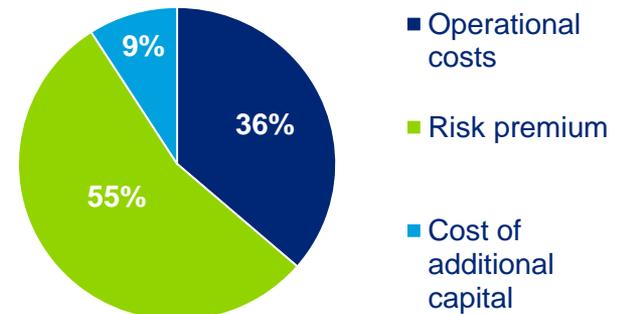
Key depository pricing factors



Will you use depository pricing as a means to drive change in prime broker models and incentivise greater operational integration?

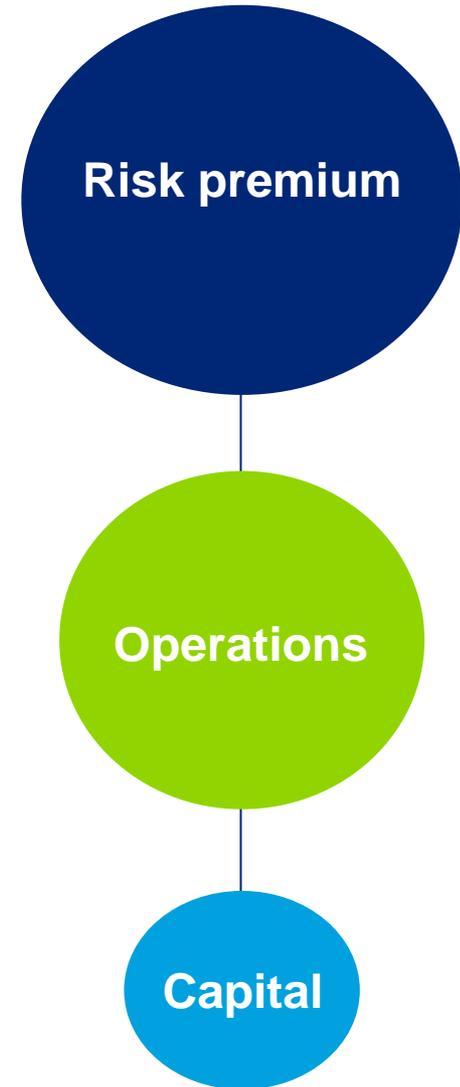
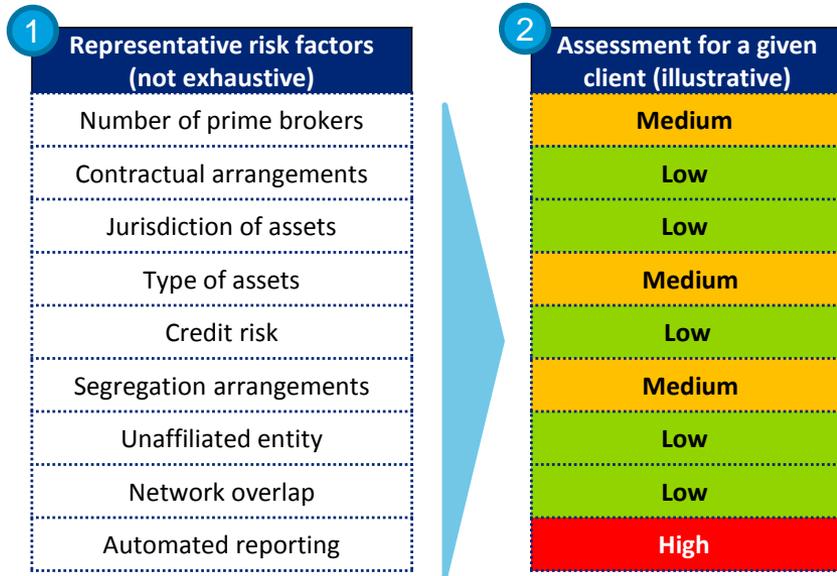


Most impactful factor on AIFMD depository fees



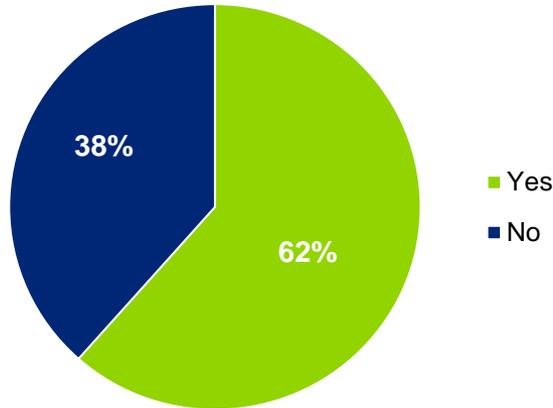
Depository pricing post AIFMD

Deriving risk premium

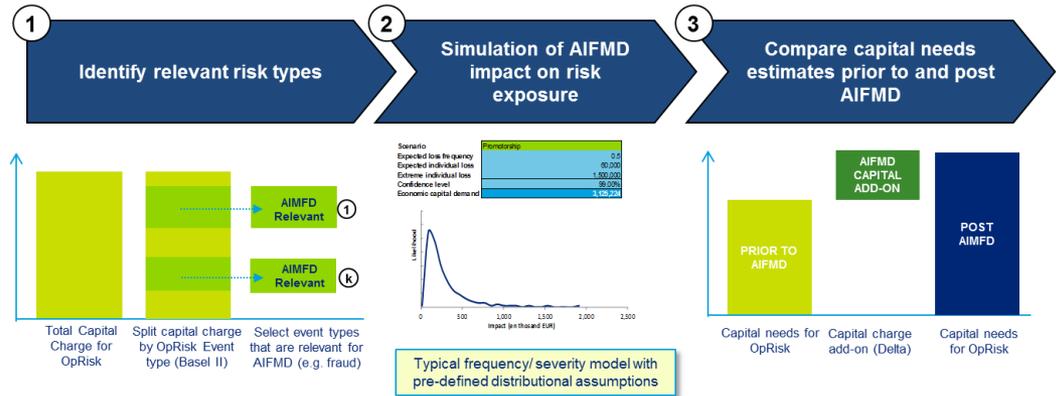


Capital

Do you consider that AIFMD depository requirements impact your internal capital requirements to cover risks?



The “delta method” to assessing capital requirements post AIFMD



Relevant operational risk categories from the Basel framework

Loss Event Types (Basel Level 1)	Relevant for AIFMD?	Examples of applicable operational risk categories (Basel Level 2)
Internal fraud	✓	Transactions not reported (intentional)
External fraud	✓	External theft and fraud
Employment practices and workplace safety	✗	n/a
Clients, products and business practices	✓	Suitability, disclosure & fiduciary Selection, sponsorship & exposure Improper business or market practices
Damage to physical assets	✗	n/a
Business disruption and system failures	✗	n/a
Execution, delivery and process management	✓	Transaction capture, execution & maintenance Customer intake and documentation Customer or client account management

- Assuming a cost of capital of 7%, the potential impact on the depository pricing model is likely to be insignificant in most cases, never exceeding 1% of the depository fees in our simulations.
- Depositaries with a limited sub-custodian network integration or weaker internal controls may need a more substantial increase in their capital base.

Key points

Prime broker

- Depositories have opted for “business as usual” models with prime brokers combined with enhanced operational oversight to mitigate risk and contractual arrangements to transfer risk.
- While some depositories are clearly concerned over the effectiveness of contractual arrangements and would like to see network integration with the prime brokers over the longer term, many appear satisfied that the contractual arrangements will provide the long term solution.
- Operational solutions that enhance information flows between prime broker and depository sub custodians may develop over time.

Pricing and costs

- Depositories need to adopt risk adjusted pricing, based on individualised scoring in relation to a range of pre-determined risk factors.
- Key risk pricing factors include contractual agreements, automated reporting, network overlap and number of prime brokers.
- The impact of capital on price is expected to be limited in the vast majority of cases. Yet increase internal capital needs could be material.
- Ongoing operational costs will likely be reflected in the depository pricing model to some extent, depending on the level of automation achieved and the increase in overheads such as staffing costs.
- Depositories will absorb one-off investment costs arising from AIFMD.

Operational

- Depositories have taken different approaches to implementing the cash flow monitoring requirements. The extent to which the depository can rely on information compiled by other parties and the definition of what constitutes an independent “reconciliation” is one of the key matters of interpretation.
- A market standard may yet evolve but in the meantime depositories may face challenges in addressing cash monitoring arrangements with non-affiliated administrators.
- Depositories may only be willing to work with fund administrators within their group or may need to price more risk sensitively for conducting duties such as cash monitoring or depository lite with other non-affiliated entities.
- Combined with other regulatory initiatives (UCITS V, UCITS VI, EMIR, Target2 Securities, CSDR, MiFID II) focussing on custody/depository services, clearing, settlement and reporting, operational integration is undoubtedly the challenge of the present and the future for depositories and other market participants.



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