



Link'n Learn

AIFMD Implementation

Depository webinar

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Leading business advisors



Presenters



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AIFMD overview



AIFMD Depositary regime

- Applies to EU AIFs managed by an EU AIFM (July 2014 at latest)
- Depositary functions must be carried out by one or more entities for a non-EU AIF with EU AIFM
- To access the EU passport in 2015, non-EU AIFs will need a depositary
- By 2018 all funds in scope that are marketed into Europe will need to appoint a depositary

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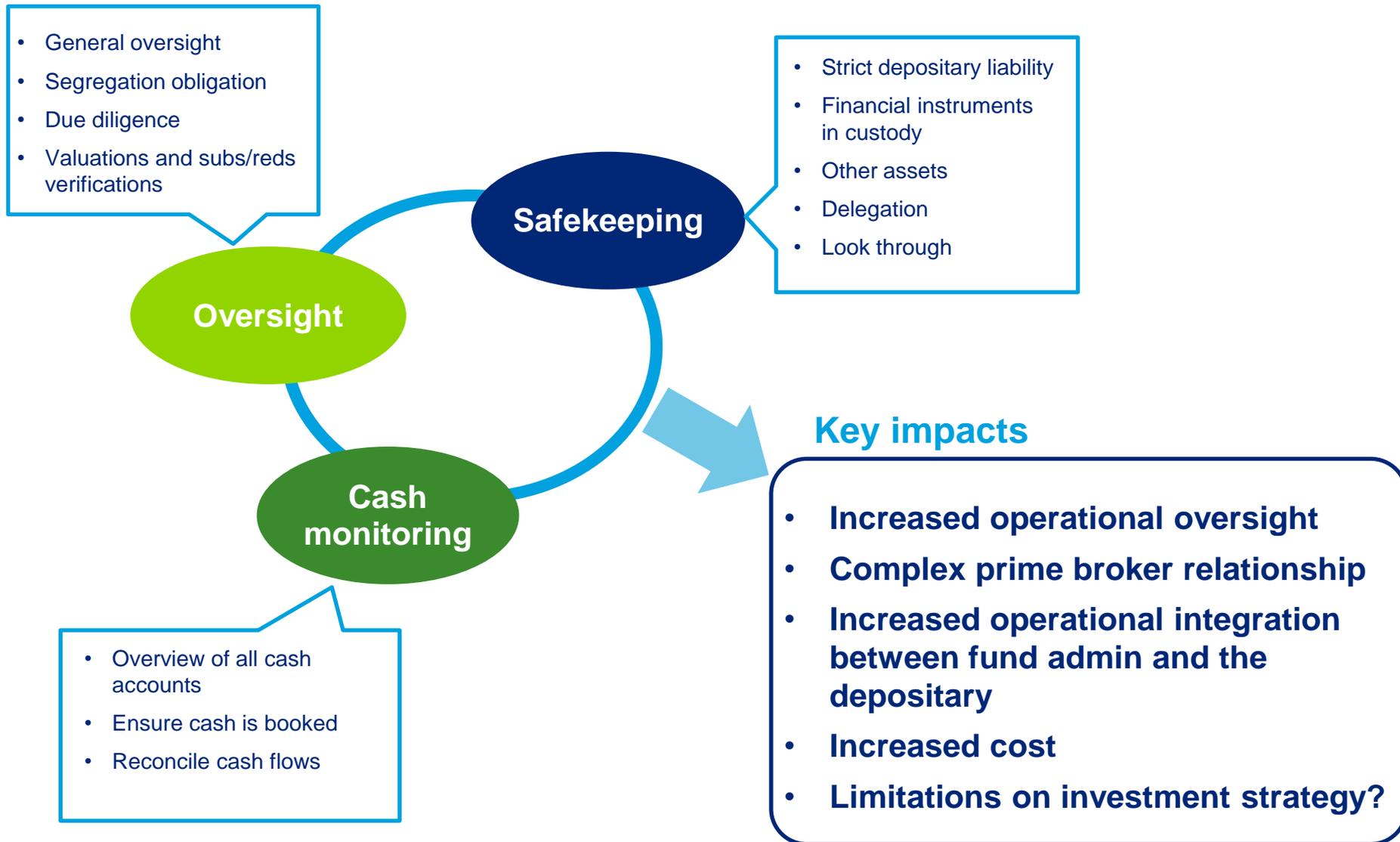
Other key duties and operational aspects

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Future depositary landscape

Overview of AIFMD depositary regime

AIFMD depositary regime – Key features



Depository liability regime

Safekeeping rules

Custody	Other assets	Cash
<ul style="list-style-type: none"> • Listed securities • Physical securities • Target funds shares (except when local regulation requires to record shares of funds with the name of investors) • Loan certificates/loan contracts • Target funds with capital commitments • Non-cash collateral given (if no transfer of property) • Collateral received • Physical certificates in vault that can be safe kept and have ISIN, WPKN, etc. • Commercial papers 	<ul style="list-style-type: none"> • Target funds shares (in cases where local regulation requires to record shares of funds with the name of investors) • OTC derivatives • Listed futures and options • Private Equity direct investments • Non-securitised loans • Real estate direct investments • Collectible assets direct investments • Forwards 	<ul style="list-style-type: none"> • Cash collateral • Cash accounts • Time deposits / Third party time deposits • Third party fiduciary deposits • Spot exchange • Fiduciary time deposits

Rule
<ul style="list-style-type: none"> • General rule (1): The following if they are capable of being registered or held in an account directly or indirectly in the name of the depositary. <ul style="list-style-type: none"> • Transferable securities • Money market instruments • Units of collective investment schemes • General rule (2): Financial instruments that can be physically delivered to the depositary shall always be included in the scope of the custody duties of the depositary. • Exemption: Financial instruments if in accordance with applicable national law, are only directly registered in the name of the AIF with the issuer itself or its agent, such as a registrar or a transfer agent, shall not be held in custody.

Constructing liability

A Liability clause

The depositary shall be liable to the AIF or to the investors of the AIF, for the loss by the depositary or a third party to whom the custody of financial instruments held in custody has been delegated. The depositary's liability shall not be affected by any delegation.

The depositary shall not be liable if it can prove that the loss has arisen as a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.

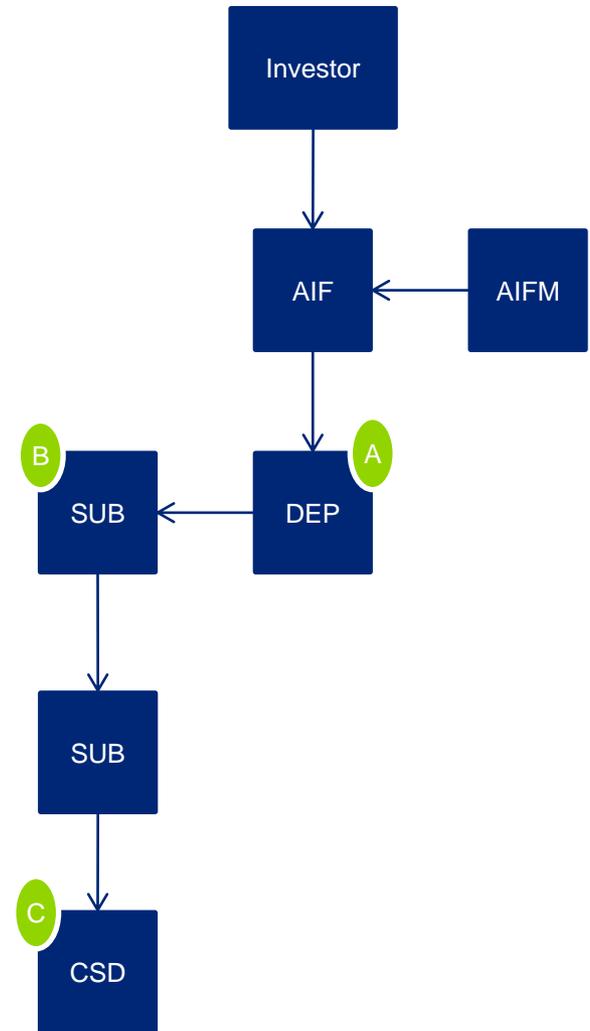
B Liability discharge

Liability discharge is possible if it passes a series of tests:

- Ability for claim to be taken by AIF or AIFM
- Objective reason
- Anti avoidance
- Due diligence
- Delegate expertise
- Segregation
- 3rd country test
- Other contractual

C CSS/CSD Exemption

The provision of services as specified by Directive 98/26/EC by securities settlement systems as designated for the purposes of that Directive or the provision of similar services by third-country securities settlement systems shall not be considered a delegation of its custody functions (i.e. and therefore no associated liability).



Placing liability

A

Depository

Liabe in the first instance unless it can prove otherwise.

If depository “discharges” liability down the custody chain it can fully escape liability.

If depository asked for a contractual “indemnity” from it’s sub-custodian or prime broker then it still remains liable under the directive but has managed the liability contractually.

B

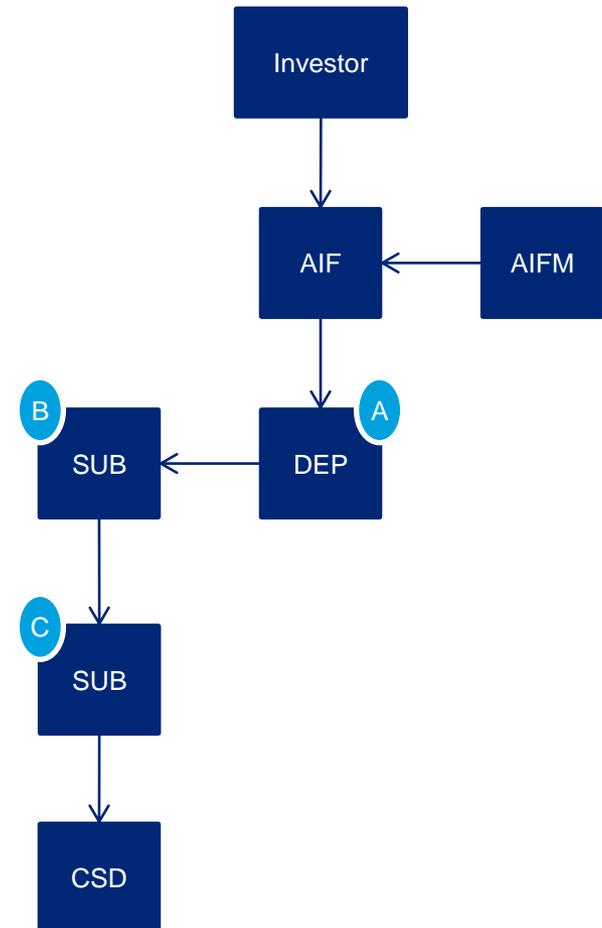
Prime Broker

Where prime brokers hold “custody” assets they would be a “sub-custodian” of the depository, unless they are a depository themselves.

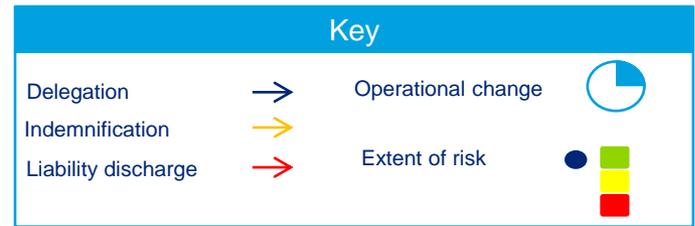
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Global custodian / sub-custodian

Various operational provisions apply to the sub-custodian (i.e. segregation) but liability rules only apply when there is a “discharge” of liability or where contractual arrangements are in place.

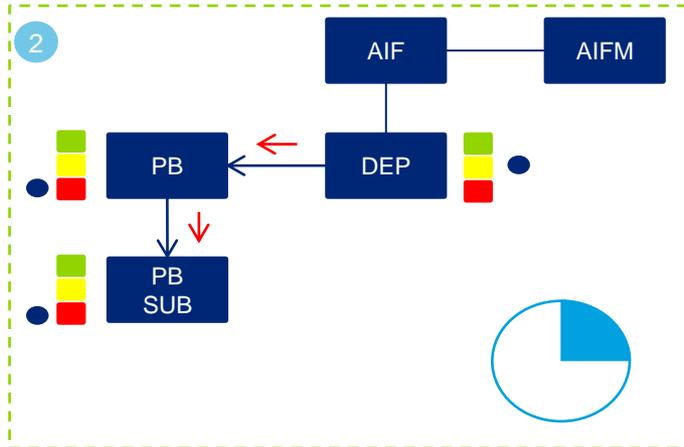
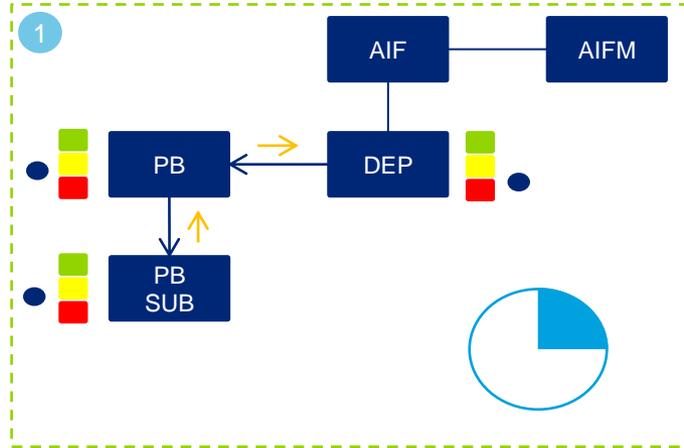


Prime broker models



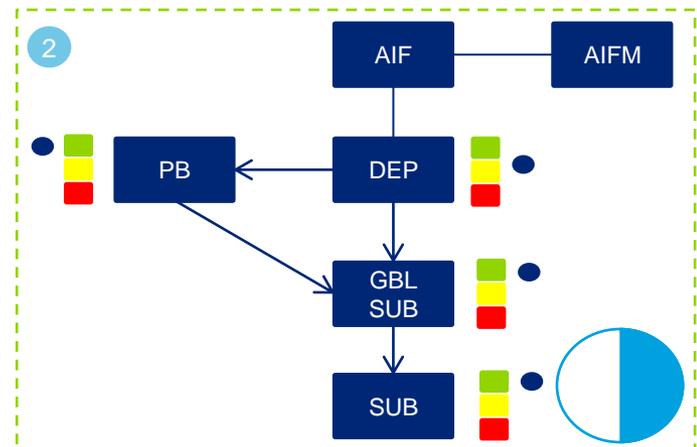
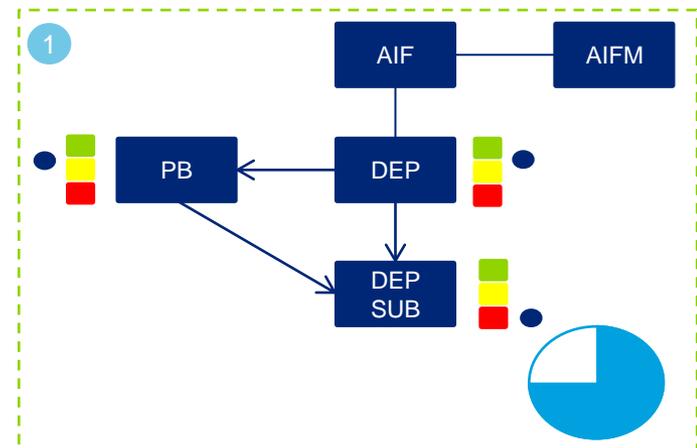
A

Depository delegates to the prime broker who then uses its internal sub-custody network

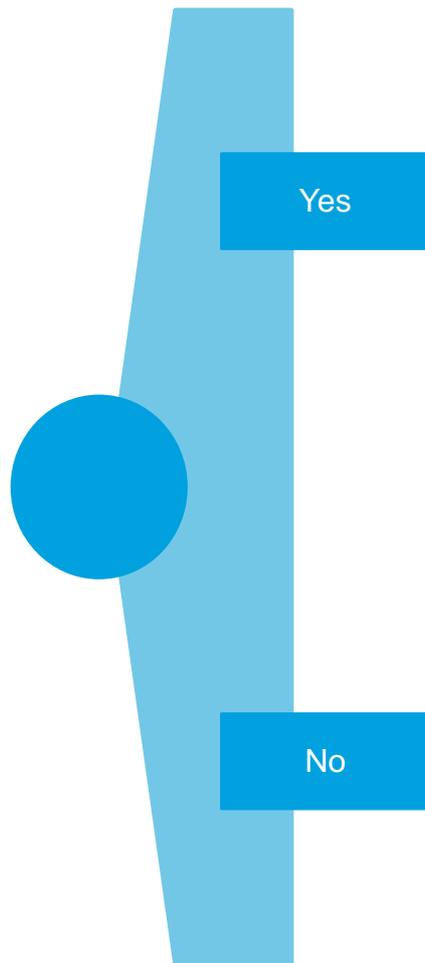


B

Depository delegates to the prime broker who then uses the depository's internal sub-custody network



Will price & risk drive market concentration / movements?



- **Counterparty risk (AIFM):** Where does the AIFM come out on the price / counterparty risk equation?
- **Counterparty risk (PB):** Are the prime brokers comfortable with counterparty (collateral) risk if assets are held outside their network?
- **Asset location:** How does the risk perception change depending on the location of assets?
- **Current client base:** How much “cross selling” occurs within the depositaries
- **Relationship:** Who owns the relationship with the client?
- **Current risk perception:** What level of risk do the depositaries and prime brokers think that they are currently assuming?
- **Operational challenges:** Due diligence / segregation / monitoring

Other key duties and operational aspects

Safekeeping of “other assets”

Ownership verification and record keeping

Access information without undue delay

Produce a “comprehensive and up-to-date inventory” of assets at any time

Non-credit institution depositary

- Member state flexibility to permit a non-credit institution depositary for other assets
- 5 year lockup
- Generally no investment in custody assets
- Foreseen for private equity and real estate



Opportunity for PE and RE administrators

- ✓ Leverage existing expertise
- ✓ Leverage existing relationships
- ✓ Ability to serve small structures profitably
- ? Treatment of custody assets

Cash monitoring

Appropriate cash accounts	Ensure ...opened with entities referred to in points (a), (b) and (c) of Article 18(1) of Directive 2006/73/EC ...and which are subject to prudential regulation and supervision that has the same effect as Union law
Reconciliation	Implement effective and proper procedures to reconcile all cash flow movements and perform such reconciliations on a daily basis
End of day check	Implement appropriate procedures to identify at the close of business day significant cash flows
Review / monitor procedures	Review periodically the adequacy of those procedures... Monitor on an on-going basis the outcomes of the reconciliations
Own records	Check the consistency of its own records of cash positions with those of the AIFM...[using 3 rd party data]

Data feeds from PB to Depository

Duplication of fund admin work

Lengthen end of day reconciliation process

How far to look down PE/RE structures?

Own independent reconciliation

How much control reliance?

Depository – additional requirements

Contractual particulars

Non-EU depository

General oversight requirements

Frequent verifications and reconciliations

Sub/reds and valuations checks

Safekeeping look-through

Delegation of depository safekeeping

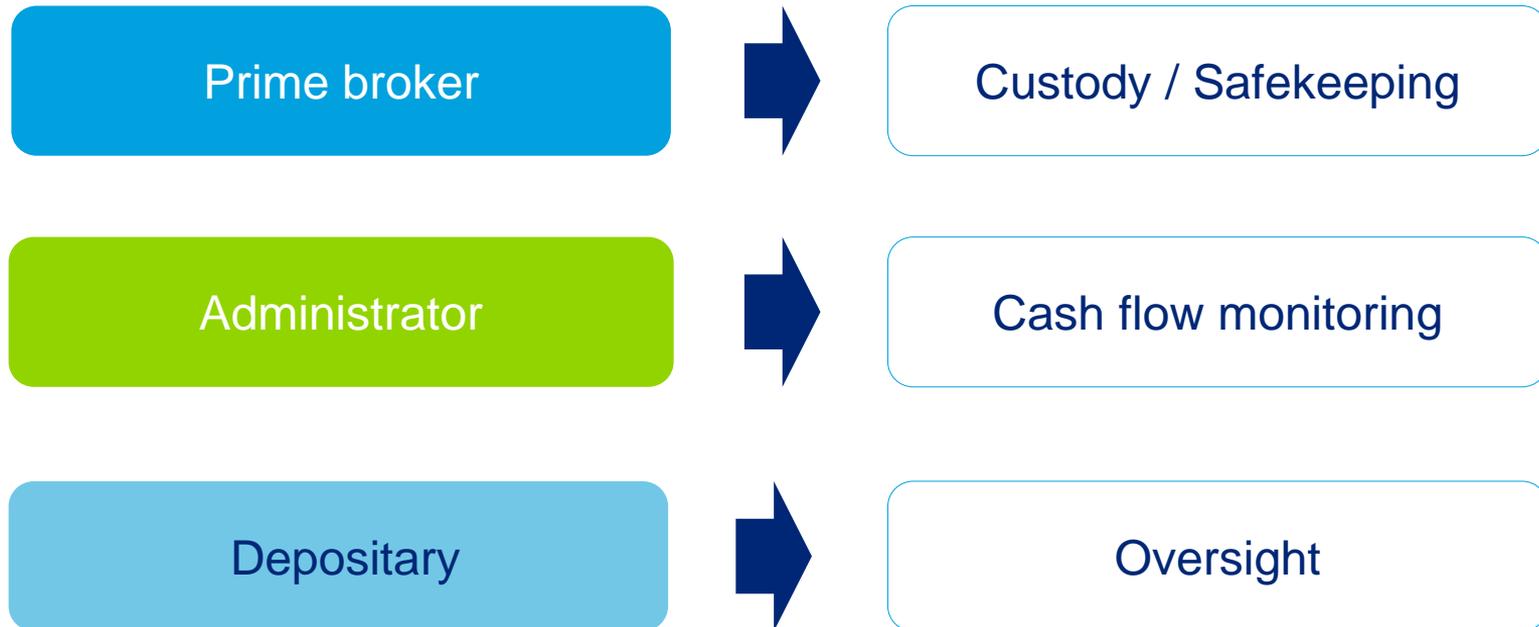
- Rigorous & comprehensive due diligence
- Country framework
- Adequate practice, procedures and internal controls
- Financial strength and reputation
- Operations and technology
- Custody risk
- Compliance monitoring
- Contingency plans

Segregation

- Maintain segregation throughout the network
- Easily distinguish assets of AIF at any time
- Record, organisational arrangements, regular reconciliations
- If local insolvency rules are deemed insufficient, to ring fence asset, the depository must assess what “additional arrangements” can be applied

Depository lite

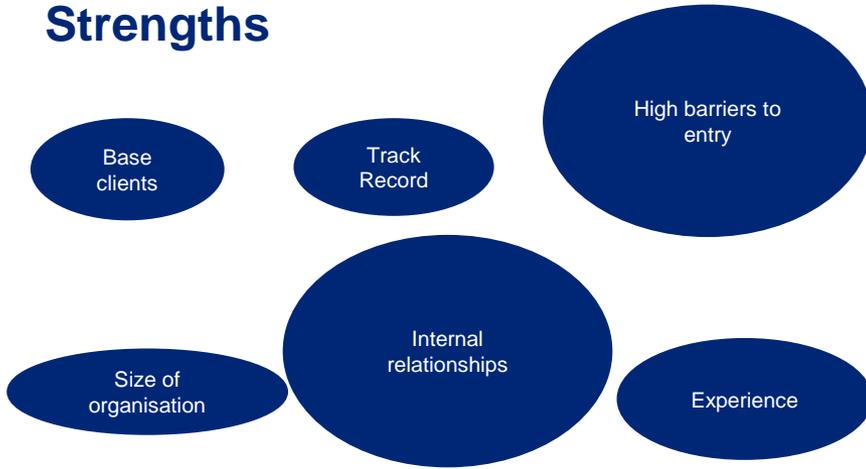
- EU AIFM / non-EU AIF with private placement until 2018 (typically UK AIFM with Cayman AIF)
- Depository Lite = Safekeeping + Oversight + Cash Monitoring (no strict liability)



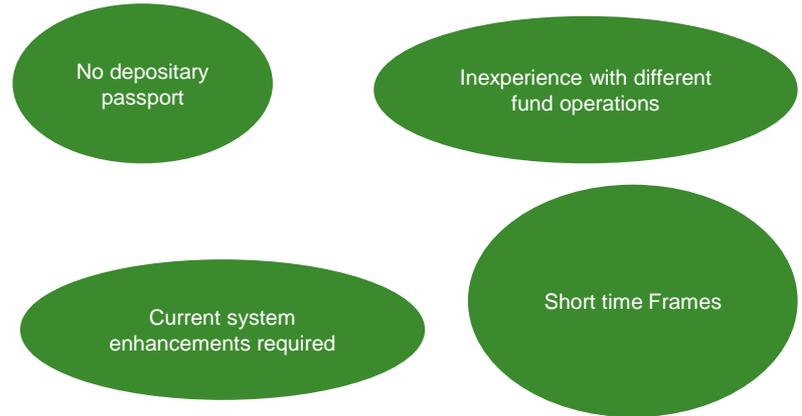
Future depositary landscape

Depository landscape

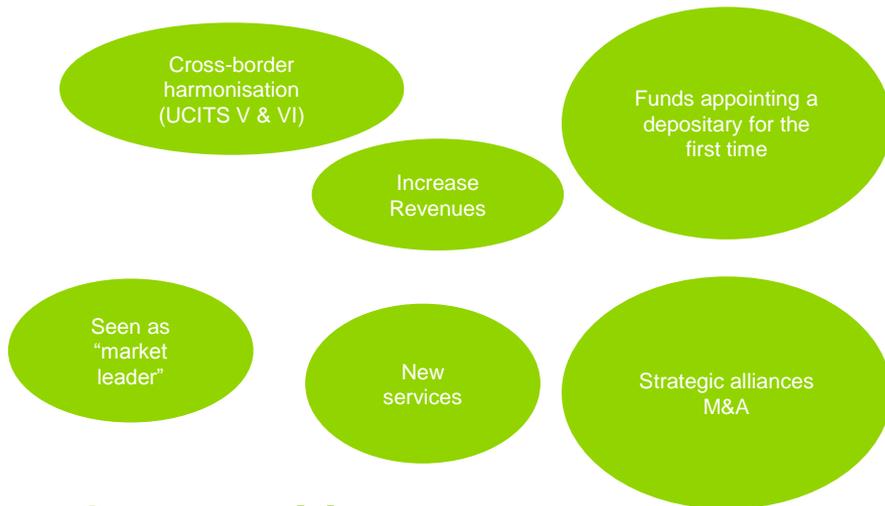
Strengths



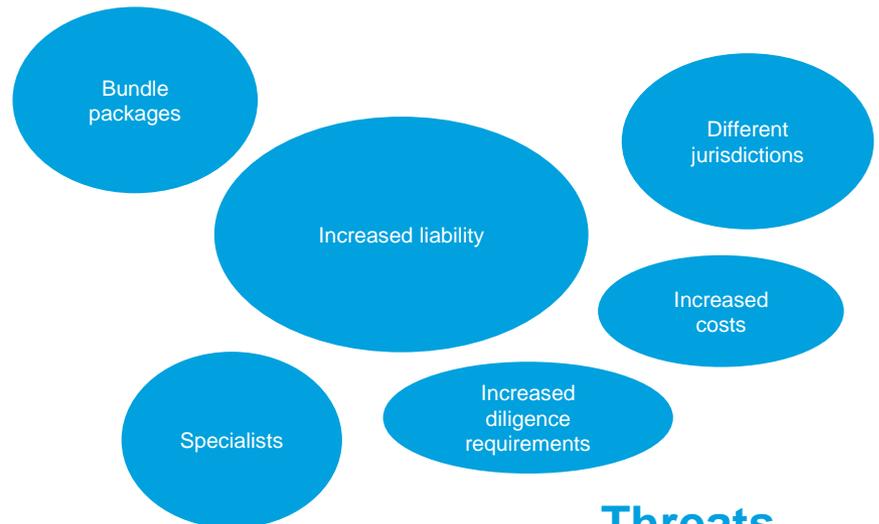
Weaknesses



Opportunities



Threats



How are depositaries preparing for AIFMD?



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