

Deloitte.

Depository Services
An approach designed
to fit your needs



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Introduction

The continuously evolving market and regulatory environment in asset servicing is an outstanding opportunity to re-assess measurement and mitigation of risks. The depositary is at the heart of these developments and has the pragmatic solutions to take advantage of this opportunity.

The role of the depositary is evolving

Since 2008, depositaries have come under scrutiny and are being heavily impacted by various factors such as:

- Pressure for an increased level of service from asset managers, driving new product and/or service offerings
- Greater product complexity
- Pressure on fees
- Market events and the introduction of new regulatory measures

Regulations such as the Alternative Investment Fund Managers Directive (AIFMD), the forthcoming UCITS V and the recently released CSSF Circular 14/587 are continuing to clarify the role and responsibilities of the depositary.

In addition, certain financial authorities have placed the burden of proof for the depositary's readiness at the level of the AIFM through the regulatory filing process.

As a result, AIFMs will need to increase due diligence of depositaries and implement specific supervisory processes.

Opportunities

We believe that there is a growing trend for depositaries to review their safekeeping and supervision functions:

- Governance and functional organisation
- Contractual management
- Operating model
- Control framework
- Historical (e.g. day-to-day administration) and new processes (e.g. cash monitoring, ex-custody)

With its pragmatic and practical insights, Deloitte has assisted various depositaries to ensure regulatory readiness and review their operating models.

Service offering

Tailor-made solutions enable you to select what you need

Deloitte Luxembourg is highly focused on regulatory matters and has a coordination role for various EMEA regulatory initiatives within Deloitte's network.

The main building blocks of our value proposition derive from Deloitte Luxembourg's recognised industry expertise:

- Regulatory consulting practice specialised in asset servicing
- EMEA Centre for Regulatory Strategy
- Proven track record in reviewing asset servicing operating models

We propose a tailored and comprehensive approach covering the following aspects:



Health Check

We review the depository's current organisation and processes, followed by a gap analysis in light of the regulatory requirements and solutions available to address any gaps identified.



Remedial planning and implementation

We assist the depository in organising and planning the implementation of new requirements and provide guidance on key operational set-up decisions, control framework upgrades or service offering reviews.



ISAE 3402/SSAE 16 examination

We conduct independent reviews on the adequacy and operating effectiveness of the depository's internal control procedures and provide 'reasonable assurance' on the depository's control environment, including advice on best practices and improvement opportunities.



Stress Scenario Analysis & Internal Capital Needs

We can help you to improve the quality and completeness of stress testing programmes (and related ICAAP components) and provide methodological support for translating risk analysis into internal capital assessment requirements.

The modules are offered to our clients in a bundled pack or as separate assignments.

How will your operating model evolve?

Main impacts on Depositaries

In a nutshell, the regulation establishes:

- **Safekeeping and segregation** of financial instruments that can be held in custody, including when safekeeping is delegated to an eligible third party sub-custodian (including due diligence requirements)
 - **Record-keeping and ownership verification** of other assets
 - **Conflict of interest management** or avoidance between portfolio management, safekeeping and brokerage activities
 - **Cash flow monitoring**, consisting of identifying all of the AIF's cash accounts, ensuring all accounts are opened with eligible entities, reconciling all cash flows, and ensuring all cash payments are authorised and in line with the economical and investment objectives of the fund
 - **Oversight**, mainly of AIF share/unit dealing, NAV calculation principles, the receipt of transaction proceeds due to the AIF, AIF income distribution allocation, compliance with investment restrictions; it is important to know that existing control frameworks can be leveraged for various oversight activities. Deloitte can help you set up a pragmatic and risk-based control framework
 - **Liability** — the depositary has strict liability for the loss of any financial instrument but can, under specific conditions, discharge the liability to a third-party safekeeping delegate (not applicable under UCITS V)
- **Prime brokerage set-up** — new models have to be put in place to comply with AIFMD requirements (i.e. safekeeping of financial asset collateral, reconciliation, re-hypothecation monitoring). Deloitte can assist you in the selection and set-up of your Prime Brokerage model(s)
 - **Collateral management** obligations for the depositary, which will be analysed, defined and implemented in connection with EMIR and ESMA UCITS guidelines on securities lending
 - **Contractual set-up** — depositary agreements and sub-custody agreements will need to be reviewed in accordance with AIFMD requirements and the new liability regime



Our pragmatic approach

Target Operating Model

Deloitte helps you align your operating model to your strategy and service offering.

Our team of specialists can assist you with:

- Analysis of your current operating model
- Definition of a target operating model and alignment to business strategy
- Implementation of the target operating model, including definition of project roadmaps, prioritisation versus criticality, technical set-up, training and change management
- Definition of KPIs for ongoing measurement of performance and alignment to the strategy of the new operating model

Implementation of specific processes (examples)

Due diligence

We provide due diligence on the fund and its management company, the asset holding counterparties, and other service providers.

Our services cover:

- Designing or updating due diligence policy and procedures, including questionnaires aligned to regulatory requirements and best market practices
- Where required, performing on-site due diligence visits to the relevant third parties
- Evaluating due diligence reports performed by third parties on behalf of the depositary
- Carrying out AIF risk assessments and performance evaluations, including a review of AIFM operations and controls with respect to the AIF
- Drafting a summary and recommendations based on results of the due diligence reviews performed

Control Framework

We will apply our wide-ranging expertise to ensure that the depositary's control framework complies with the law and market requirements. Based on the gaps identified, our services may encompass:

- Re-designing and updating a practical and risk-based depositary control framework to expand the depth and breadth of controls
- Drafting and updating policies and processes and implementing forms, templates or checklists
- Implementing the updated depositary control framework
- Providing customised training for depositary staff with respect to regulatory requirements and/or proper implementation of updated internal controls and procedures

For these services, Deloitte offers you market experts from multidisciplinary teams in strategy, regulatory and advisory services (accounting, tax, audit, IT and other consulting services) with a vast range of experience in the local and international investment industry.

We are aware that "one size does not fit all", and will focus on providing you with a customised service and on building a dedicated team that best fits your specific needs.



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ISAE 3402/SSAE 16 examination

Reinforcing confidence through demonstration of effective controls

Challenging environment

Due to increasing regulatory pressure, such as AIFMD, ISAE 3402/SSAE 16 reports have become increasingly prevalent in the marketplace.

An ISAE 3402/SSAE 16 report provides an independent examination of the adequacy of control procedures and “reasonable assurance” with respect to the processing control environment that could impact the client’s internal control.

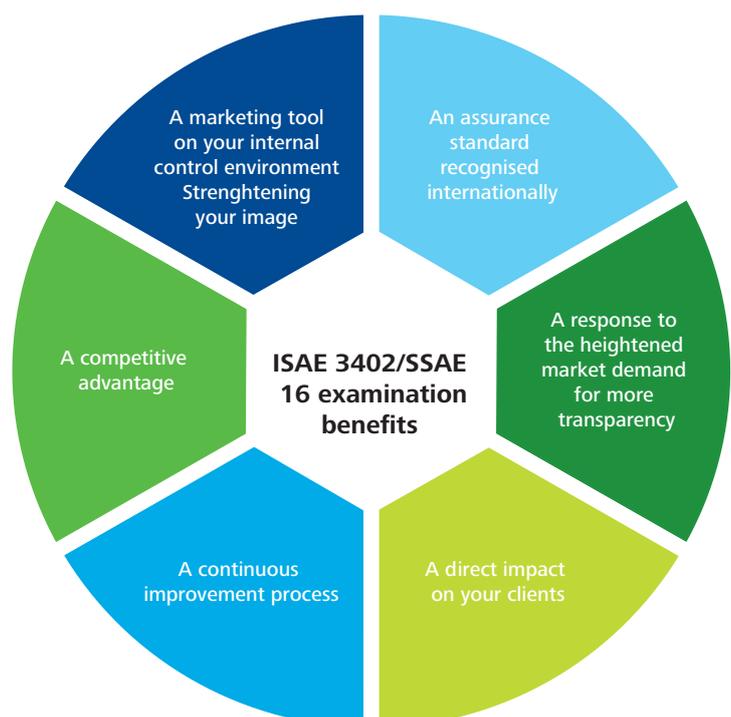
In addition, such reports help the depositary overcome the following key challenges facing the financial services industry:

- Market and regulatory demand for greater accountability and transparency are reaching unprecedented levels
- The recent degree of loss and public outrage combined with the prevalence of outsourcing have put a great deal of pressure on service providers to demonstrate strong internal controls to their clients
- Growing willingness on the part of market players to obtain reassurance on service providers’ internal controls from a trusted independent source
- Strengthened due diligence processes for prospective clients requesting and evaluating the quality of service providers, where independent assurance reports are highly appreciated, if not required

Scope of the ISAE 3402/SSAE 16 examination

In the context of the AIFMD, the depositary is generally required to cover the following areas of their internal control environment in their ISAE 3402/SSAE 16 reports:

- Oversight obligations
- Cash monitoring
- Collateral management
- Safekeeping and segregation of financial assets
- Record-keeping of other assets
- Delegation and due diligence



Our business partnering approach

At Deloitte, we have the depth and breadth of services within our organisation to deliver leading practices to you on industry and ISAE 3402/SSAE 16 matters.

We work with our clients to proactively identify value-added business insights, provide suggestions for improvement throughout the engagement, and ensure a smooth and consistent process.

Below, we have highlighted what we believe are a few of the key elements that set Deloitte apart in terms of our ability to provide superior ISAE 3402/SSAE 16 services:

- Insight into ISAE 3402/SSAE 16 report improvements—we strive to add value to the process by identifying ways to remove ambiguities from the reports so as to provide a crisp and clear picture of the control environment to the report users and their auditors
- Enhancement of controls and processes—we proactively look for opportunities throughout our ISAE 3402/SSAE 16 engagements to provide our clients with insights that will enhance their controls or processes based upon our extensive ISAE 3402/SSAE 16 experience and our knowledge of the leading-edge industry trends and developments
- Use of industry experts—we bring to the table our outstanding pool of recognised industry experts to support our core engagement team in their service delivery responsibilities—a key differentiating factor. Our holistic and business-oriented view of your operations will enable us to highlight the areas that are crucial for you and your customers, and to advise you in a proactive manner on best practices and improvement opportunities
- Proactive, open-minded and timely service: our technical expertise is delivered to our clients through our service philosophy, which emphasises open, honest and frequent communication with management to ensure smooth completion within the stated deadlines



Stress scenario analysis and internal capital needs

Accounting for regulatory-induced changes of the depositary's risk profile

Context

The latest regulatory evolutions—such as AIFMD and UCITS V—have changed the risk profile of financial institutions that operate in the investment management industry. In particular, the provisions set out in the above-mentioned directives increase the responsibilities of depositary banks and thus their operational and legal risk exposure. For instance, in the case of the loss of financial assets, the depositary bank will have to return equivalent assets without undue delay and prove that the loss was beyond its reasonable control and actions.

Sound risk management practices suggest a need to adequately identify and assess potential adverse (series of) events that could occur in the new regulatory environment so as to be better prepared for absorbing any such shocks. Moreover, this type of exercise also fulfils the expectations of regulators who have often referred to (stress) scenario analysis as being a “must-have” technique in any bank’s risk management toolkit.

In particular, the CRR/CRD IV regulatory framework requires credit institutions and investment firms to develop an “internal capital adequacy assessment process” (ICAAP) to internally assess their overall risk profile and capital adequacy. New risks arising from changing regulatory requirements should therefore be reflected in the ICAAP calculation. This calls, inter alia, for an update and review of the current operational risk and control map, as well as the stress test scenario analysis, so as to reflect the bank’s new risk exposures under AIFMD or UCITS.

Your challenge

- Having to deal with business constraints and duties on a daily basis, you may find it difficult to keep track of the ever-evolving risk and capital management regulations (AIFMD, ICAAP, Basel III, EMIR, stress testing, etc.), and you may not have fully grasped the potential consequences for your organisation

- In particular, as part of your risk management practices (and related ICAAP report duties), you must identify and assess upcoming risks and forecast the evolution of the solvency situation of your institution over the business plan cycle. These forecasts should be stress tested to assess the ability of your institution to face serious but plausible scenarios
- While some elements might be in place and there is a general understanding of stress testing, ICAAP and AIFMD, the exact extent of interaction between these elements and their potential impact on your operational processes, risk profile and risk management practices may not have been comprehensively assessed

Our solution

- Based on our cumulative experience of AIFMD and ICAAP with more than twenty institutions in Luxembourg and abroad, Deloitte can offer the appropriate levers to improve the quality and completeness of stress testing and ICAAP processes, ensuring compliance with related CSSF circulars (including 06/273 as amended, 07/301 as amended and 11/506)
- This encompasses the review, design, development and/or documentation of your (stress) scenario analysis for the operational risk events to which you could be exposed in the context of AIFMD, as well as the supporting tools, commensurate to your size, complexity and specific needs
- The full spectrum of our advisory services means we can on-board AIFMD experts to help in identifying and assessing risks by coordinating working sessions with relevant stakeholders to ensure the current approach to assessing non-financial risks (e.g. compliance, legal, operational) is up-to-date and reflects the change in risk profile entailed by AIFMD
- Assessing the “capital” component of the depositary bank servicing fee is important for maintaining the depositary bank’s competitive positioning. We can help you achieve this

It is important to know that existing control frameworks can be leveraged for various oversight activities



Contacts

Advisory & Consulting



Joël Vanoverschelde
Partner - Advisory & Consulting Leader
+352 451 452 850
jvanoverschelde@deloitte.lu



Benjamin Collette
Partner - EMEA AIFMD Leader
+352 451 452 809
bcollette@deloitte.lu



Laurent Berliner
Partner - EMEA Financial Services Industry
Enterprise Risk Services Leader
+352 451 452 328
lberliner@deloitte.lu



Simon Ramos
Partner - Strategy, Regulatory & Corporate Finance
+352 451 452 702
siramos@deloitte.lu



Jean-Philippe Peters
Partner - Governance, Risk & Compliance
+352 451 452 276
jppeters@deloitte.lu



Christopher Stuart Sinclair
Director - Strategy, Regulatory & Corporate Finance
+352 451 452 202
cstuartsinclair@deloitte.lu



Marc Noirhomme
Director - Strategy, Regulatory & Corporate Finance
+352 451 452 613
mnoirhomme@deloitte.lu



Gérard Lorent
Director - Strategy, Regulatory & Corporate Finance
+352 451 454 278
gelorent@deloitte.lu

Tax



Raymond Krawczykowski
Partner - Tax Leader
+352 451 452 500
rkrawczykowski@deloitte.lu

Audit



Sophie Mitchell
Partner - Audit Leader
+352 451 452 481
somitchell@deloitte.lu

Deloitte Luxembourg

560, rue de Neudorf
L-2220 Luxembourg
Grand Duchy of Luxembourg

Tel: +352 451 451

Fax: +352 451 452 401

www.deloitte.lu

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