



CUMMINGS

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AIFMD -
The Depository



AIFMD – The Depositary

Introduction

Under the provisions of the AIFMD, an AIFM is responsible for ensuring that a single depositary is appointed in respect of each AIF which it manages. The purpose of the depositary under the AIFMD is to ensure that an independent third party provider carries out the function of asset safekeeping separate from the management function and that investor assets are segregated from those of the AIFM.

The role of the depositary under the AIFMD is modelled on the UCITS depositary and is responsible for three core functions:

- (i) cash-flow monitoring;
- (ii) the safekeeping and record-keeping of the assets of the AIF; and
- (iii) oversight of certain operational functions.

Each of these functions is considered in more detail below.

When is a depositary required?

A depositary must be appointed for all types of AIF with the following exceptions:

- (i) a sub-threshold or small AIFM* does not need to appoint a depositary in respect of any of the AIFs it manages;
- (ii) no depositary is required for a non-EU AIF which is managed by an EU AIFM but which is not marketed in the EU; and
- (iii) no depositary is required for a non-EU AIF which is managed by a non-EU AIFM and marketed in the EU via the national private placement regime (NPPR) pursuant to Article 42 of the AIFMD**.

*A sub-threshold or small AIFM is an AIFM which manages portfolios of AIFs whose assets under management:

- (a) including any assets acquired through use of leverage, in total do not exceed a threshold of €100 million; or
- (b) in total do not exceed a threshold of €500 million where the portfolios of AIFs consist of AIFs that are unleveraged and where investors cannot redeem their interest in the first five years after investing.

**It is important to note, however, that some Member States require the appointment of a depositary as a prerequisite for marketing under the NPPR regime of that Member State.

Depo-lite

A non-EU AIF which is managed by an EU AIFM and which is marketed in the EU via the NPPR pursuant to Article 36 of the AIFMD need not appoint a single depositary but must appoint one or more entities to perform the AIFMD depositary core functions set out under Article 21(7) (cash-flow monitoring), Article 21(8) (safekeeping) and Article 21(9) (oversight), which has become known as the 'depo-lite' regime. Under the depo-lite regime, the depositary duties are essentially the same as for the full depositary regime, but the detailed AIFMD provisions on liability and delegation for depositaries do not apply to the depo-lite regime.

Who can be a depositary?

Those entities which are capable of acting as a depositary under the AIFMD are as follows:

- (i) an EU credit institution;
- (ii) a MiFID investment firm which is subject to the same capital requirements as (i) above;
- (iii) an EU entity which is eligible to act as a UCITS depositary;
- (iv) for a non-EU AIF only, the depositary may be a non-EU entity of the same nature as



- (i) or (ii) above, provided that it is subject to effective prudential regulation, including minimum capital requirements, and supervision which have the same effect as EU law and are effectively enforced; and
- (v) for an AIF whose investors cannot redeem their interest in the first five years after investing only, a notary, lawyer or registrar which:
 - (a) carries out depositary functions as part of its professional or business activities;
 - (b) is subject to mandatory professional registration or to legal or regulatory provisions or to rules of professional conduct; and (c) can provide sufficient financial and professional guarantees to enable it to perform effectively the relevant depositary functions.

An AIFM is not able to act as the depositary to its AIFs and a prime broker which acts as counterparty to the AIF may only be appointed as depositary provided it satisfies the following two conditions, namely: (1) it has functionally and hierarchically separated the performance of its depositary functions from its functions as prime broker; and (2) any potential conflicts of interest are properly identified, managed, monitored and disclosed to the AIF investors.

A depositary of an EU AIF must have either its registered office or a branch in the AIF's home Member State. A depositary of a non-EU AIF must either be established in the AIF's home country, subject to fulfilling the conditions set out in Article 21(6), or in the home Member State or Member State of reference of the AIFM.

The depositary functions

Cash-flow monitoring (Article 21(7))

The AIFMD requires the depositary to have a full overview of the cash position and cash movements of the AIF, including subscription monies.

The depositary is therefore required to ensure that the AIF's cash flows are properly monitored and in particular, ensure that all payments made by or on behalf of investors upon the subscription

of shares have been received and that all cash of the AIF has been booked in the name of the AIF or the AIFM (acting on behalf of the AIF) or in the name of the depositary (acting on behalf of the AIF) in segregated accounts with either a central bank, an EU credit institution, a bank authorised in a non-EU country or another entity of the same nature, provided that it is subject to effective prudential regulation and supervision which have the same effect as EU law and are effectively enforced.

Safekeeping (Article 21(8))

The depositary is responsible for safekeeping the assets of the AIF as follows:

- (i) for those assets that can be held in custody, the depositary must hold such assets in custody in segregated accounts so that they can be clearly identified as belonging to the AIF;
- (ii) for all other assets, the depositary must verify whether the AIF or the AIFM (acting on behalf of the AIF) holds the ownership of those assets, based on internal and external evidence, and maintain a record of those assets.

Delegation

The depositary is permitted to delegate the safekeeping duties set out in Article 21(8), but not any of its other functions, provided that:

- (a) the depositary can demonstrate that there is an objective reason for the delegation;
- (b) the purpose of the delegation is not to avoid the requirements of the AIFMD;
- (c) the depositary has exercised all due skill, care and diligence in the selection, appointment, ongoing review and monitoring of any delegate; and
- (d) the depositary ensures on an ongoing basis that its delegate meets certain specified standards related to structures, expertise, prudential regulation and supervision, segregation of assets and rehypothecation.



The delegate may sub-delegate the safekeeping functions delegated to it, provided however that the conditions set out in (a) to (d) directly above shall apply to any such sub-delegation accordingly.

Oversight (Article 21(9))

The depositary is responsible for ensuring that:

- (i) the sale, issue, repurchase, redemption and cancellation of shares in the AIF are carried out in accordance with the AIF's constitutional documents and applicable law;
- (ii) the value of the AIF's shares is calculated in accordance with the AIF's constitutional documents and applicable law;
- (iii) consideration in respect of any transactions involving the AIF's assets is remitted within the usual time limits; and
- (iv) the AIF's income is applied in accordance with the AIF's constitutional documents and applicable law.

Rehypothecation

The depositary is not permitted to reuse or rehypothecate the AIF's assets in its custody without the prior consent of the AIF or the AIFM (acting on behalf of the AIF). This consent is usually set out in the depositary agreement entered into between the AIF and/or the AIFM (as applicable) and the depositary.

Depositary Agreement

There must be a written agreement appointing the depositary and the specific provisions which must be included in this agreement are set out in Article 83 of the AIFMD Level 2 Regulations. The depositary can be appointed by the AIF or the AIFM, but as the AIFM is responsible for ensuring that the depositary is appointed in accordance with the AIFMD, then it is sensible to assume that the AIFM will be a counterparty to the agreement regardless of whether the depositary is in fact appointed by the AIF.

Liability of depositary

The depositary is strictly liable for the loss of any financial instruments held in custody by it or any delegate and is responsible for returning a financial instrument of identical type or the corresponding amount to the AIF without delay. However, the depositary shall not be liable if it can prove that the loss has arisen as a result of an "external event beyond its control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary". The Level 2 Regulations clarify that such an external event may be deemed to be fulfilled in the following circumstances:

- (i) natural events beyond human control or influence;
- (ii) the adoption of any law, decree, regulation, decision or order by any government or governmental body; or
- (iii) war, riots or other major upheavals.

The depositary will also be liable for all other losses suffered by the AIF or its investors as a result of the depositary's negligent or intentional failure to fulfil its obligations as depositary under the AIFMD.

Delegation of liability

As mentioned above, the depositary's strict liability shall not be affected by any delegation; however, the depositary may discharge or contract itself out of such liability if:

- (a) it has complied with all the prescribed obligations in the AIFMD relating to delegation (as set out under 'Delegation' above);
- (b) the contract between the depositary and the relevant sub-custodian expressly transfers the liability from the depositary to the sub-custodian and allows for the AIF (or AIFM, acting on behalf of the AIF) to make a claim against that sub-custodian in respect of the relevant loss;



- (c) the contract between the depositary and the AIF and/or the AIFM (as applicable) expressly allows a discharge of the depositary's liability; and
- (d) there is an objective reason for the delegation.

Further to (d) above, the objective reason(s) for contracting out liability must be limited to precise circumstances and be consistent with the depositary's policies and decisions and must be established each time the depositary intends to discharge itself of liability.

Finally, where the law of a third country requires that certain assets are held in custody by a local entity and there are no local entities that satisfy the delegation requirements, the depositary can again discharge itself of liability, provided that:

- (a) the AIF's constitutional documents expressly allow for a discharge in such circumstances;
- (b) the contract between the depositary and the AIF and/or the AIFM (as applicable) expressly allows such a discharge of the depositary's liability; and
- (c) investors have been given prior notice of the discharge and its justification.

Notification to FCA

An AIFM is required to disclose details of its depositary arrangements to the FCA on application for authorisation as an AIFM. The FCA has confirmed that an application for authorisation can be submitted before all arrangements are finalised, provided that there is sufficient time for those arrangements to be concluded before the anticipated date of authorisation.

The provisions in the FCA Handbook relating to depositaries under the AIFMD can be found at FUND 3.11: <https://www.handbook.fca.org.uk/handbook/FUND/3/11.html>

**This document is for general guidance only. It does not constitute advice
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42 Brook Street, London W1K 5DB +44 20 7585 1406

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