

THE LONG VIEW

CRAIG BORTHWICK
AIFMD: offshore funds and depositary requirements



“AN AIFM NEEDS TO ENSURE ONE OR MORE ENTITIES OTHER THAN THE AIFM ARE APPOINTED TO CARRY OUT THE FOLLOWING ‘DEPOSITARY’ FUNCTIONS”

Full scope depositary requirements do not apply to EEA AIFMs managing non-EEA ‘offshore’ funds. Instead, if the offshore fund is being marketed in the EEA under the private placement regime, AIFMD article 36 requires that a ‘depositary-lite’ regime will apply (at a minimum).

1. KEY REQUIREMENTS: DEPOSITARY-LITE

Under the depositary-lite regime, an AIFM needs to ensure that one or more entities other than the AIFM are appointed to carry out the following ‘depositary’ functions: (i) cash monitoring; (ii) safekeeping of financial instruments in custody; (iii) safekeeping of other assets and (iv) oversight.

1.1 Cash monitoring: A depositary appointed to carry out this function is required to ensure that the fund’s cash flows are monitored. This includes ensuring that payments made by investors have been received and that the fund’s cash has been recorded in cash accounts.

1.2 Safekeeping financial instruments: A depositary must hold in custody all of the fund’s assets that can be physically delivered. It must also hold in custody assets, which cannot be physically delivered but that are capable of being registered or held

in an account directly or indirectly in the name of the fund. The depositary must hold these assets in segregated accounts.

1.3 Safekeeping of other assets: For assets not capable of being held in custody (including re-hypothecated assets), a depositary must verify the fund’s ownership of them and maintain a record of the assets.

1.4 Oversight: This includes ensuring that subscriptions and redemptions of interests in the fund and the valuation of such interests are carried out in accordance with the constitutional documentation of the fund and any applicable law.

2. PRACTICAL ASPECTS OF COMPLIANCE

2.1 Service Providers: It is typical for the fund’s administrator to perform the cash monitoring function and for the prime broker to perform the safekeeping function. The oversight function is a new requirement and consideration will need to be had as to who should perform this function. This would likely be the prime broker, the administrator or a new third-party provider.

2.2 Service agreements: It is likely that amendments will need to be made to certain service agreements to ensure the proper performance of the depositary-lite functions provided for in AIFMD.

In respect of the depositary functions already carried out by the fund’s administrator or prime broker, it is recommended that existing service agreements be carefully checked to ensure that they provide for the specific requirements under AIFMD. In respect of the performance of the oversight function, amendments will need to be made to existing service agreements or a new agreement will need to be entered into depending on whom is appointed.

2.2 AIFM regulatory obligations: It is typical for the fund to appoint its prime broker and administrator directly and the AIFM would not normally be a contractual party. However, the AIFM is now under a regulatory obligation to ensure that one or more entities are appointed to carry out the depositary functions for the fund.

To fulfil its regulatory obligations, the AIFM may wish to have a contractual relationship in place with the entity or entities appointed. This will also serve to provide the AIFM contractual recourse to the extent that the depositary does not perform.

There is still some debate as to the best way to structure this contractual arrangement: (i) the AIFM assumes direct contractual responsibility for the performance of the depositary functions and thereafter delegates them to the depositaries – although this is not recommended; (ii) the AIFM enters into a tripartite agreement with the fund and each appointed depositary in respect of the depositary functions and thereafter delegates these functions to the depositaries (this is not recommended as most AIFMs would normally want to avoid taking on direct contractual responsibility to the fund for the depositary’s liability) and (iii) the fund appoints each depositary directly (the status quo) and the AIFM enters into side letters with regard to the performance of the functions by each depositary. ■

CRAIG BORTHWICK is an associate within the Financial Services department at Dechert.

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