

**CUSTODY BUSINESS:
KEY REGULATORY CONSIDERATIONS
FOR BANKS**

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Overview

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2. Ongoing Regulatory Requirements
3. AIFMD
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1. Authorisation Requirement

- Investment Services Licence in terms of Article 3 of Investment Services Act
- Category 4a Investment Services Licence – Full Depo
- Category 4b Investment Services Licence – Depo Lite
- Services limited to custody and oversight
- For execution services + Category 2 Investment Services Licence
- Custody Services are not passportable in the EU

1. Authorisation Requirement

- Category 4a: Licence Holders authorised to act as trustees or custodians of all types of Collective Investment Schemes.
- Category 4 b: Licence Holders authorised to act:
 - a. as custodians of AIFs which have no redemption rights exercisable during the five year period from the date of initial investment and which generally do not invest in assets that must be held in custody in terms of the Investment Services Rules.
 - b. as custodians to non EU-AIFs marketed in the EU without a passport in terms of Article 36 of the AIFMD.

2. Ongoing Regulatory Requirements

- Subject to Part BIV of the Investment Services Rules for Investment Services Providers
- Notification requirements
- MFSA prior consent requirements
- Compliance and AML Function
- Risk Management Function
- Segregation of assets

2. Ongoing Regulatory Requirements

- Reconciliation of clients' assets and clients' money
- No additional capital requirements for custodians that are also credit institutions
- Audited accounts, management letter and auditors' report to MFSA within 4 months from year end
- Nature of services provided to a Fund client depend on type of Fund

3. AIFMD

- Article 21 of the AIFMD and Chapter IV [Articles 83 to 102] of the AIFMR set out the requirements applicable to the custodian of an AIF.
- Single custodian to be appointed in respect of each AIF.
- The appointment of the custodian to be evidenced by written contract.
- The contract to regulate the flow of information deemed necessary to allow the custodian to perform its functions for the AIF.
- The custodian must be based in the same domicile as the AIF...Malta opted for the 4 year exemption until 2017.

3. AIFMD

- Custodian responsible for:
 - Cash flow monitoring [Article 21(7)]
 - Safekeeping of assets [Article 21(8)(a)]
 - Verification of Ownership and Record keeping [Article 21(8)(b)]
 - Oversight over the sale, issue, re-purchase, redemption and cancellation of units [Article 21(9)(a)]
 - Oversight over the calculation of the net asset value [Article 21(9)(b)]

3. AIFMD

- Responsible for:
 - Ensuring that instructions of the AIFM do not conflict with national law and AIF's instruments of incorporation [Article 21(9)(c)]
 - Oversight over the settlement process and that in transactions involving the AIF's assets any consideration is remitted to the AIF within the usual time limits [Article 21(9)(d)];
 - Oversight over the investment process to ensure that AIF's income is applied in accordance with the applicable national law and the AIF's instruments of incorporation [Article 21(9)(e)]

3. AIFMD

- The custodian shall not delegate to third parties its functions save for the safekeeping function referred to in Article 21(8) [Article 21(11)].
- The custodian shall be liable to the AIF or to the investors of the AIF, for the loss by the custodian or a third party to whom the custody of financial instruments held in custody in accordance with Article 21(8)(a) has been delegated. The custodian shall not be liable if it can prove that the loss was the result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary [Article 21(12)].

3. AIFMD

- The custodian shall also be liable to the AIF, or to the investors of the AIF, for all other losses suffered by them as a result of the custodian's negligent or intentional failure to properly fulfil its obligations pursuant to the AIFMD [Article 21(12)].
- In some instances the custodian may discharge its liability for loss of assets [Article 21(13)].

4. UCITS IV

- Chapter IV and Section 3 of Chapter V of the UCITS Directive sets out the requirements applicable to the custodian of a UCITS Fund.
- Single custodian to be appointed in respect of each UCITS Fund.
- The appointment of the custodian to be evidenced by written contract.
- The contract to regulate the flow of information deemed necessary to allow the custodian to perform its functions for the UCITS.
- The custodian must be based in the same domicile as the UCITS Fund.

4. UCITS IV

- Custodian responsible for:
 - Safekeeping of assets [Article 22(1)/ Article 32(1)]
 - Oversight over the sale, issue, re-purchase, redemption and cancellation of units [Article 22(3)(a)/ Article 32(3)(a)]
 - Oversight over the calculation of the net asset value [Article 22(3)(b)/ Article 32(3)(b)]
 - Ensure that instructions of the AIFM do no conflict with national law and AIF's instrument of incorporation [Article 22(3)(c)/ Article 32(3)(c)]

4. UCITS IV

- Responsible for:
 - Oversight over the settlement process and that in transactions involving the UCITS's assets any consideration is remitted to the AIF within the usual time limits [Article 22(3)(d)/ Article 32(3)(d)];
 - Oversight over the investment process to ensure that UCITS's income is applied in accordance with the applicable national law and the AIF's instruments of incorporation [Article 22(3)(e)/ Article 32(3)(e)]

4. UCITS IV

- The custodian shall, in accordance with the national law of the UCITS's home Member State, be liable to the UCITS and the unit-holders for any loss suffered by them as a result of its unjustifiable failure to perform its obligations, or its improper performance of them [Article 24/ Article 34].
- Under UCITS V (March, 2016), liability provisions will be aligned to the provisions in the AIFMD with the exception of the “discharge of liability for lost assets to sub-custodians” provisions.

5. Fund Structures

- Maltese AIF (EU AIFM) – Full AIFMD
- Maltese AIF (Non EU AIFM) – safekeeping only
- Maltese UCITS – Full UCITS
- Maltese Self Managed Deminimis AIF – safekeeping only
- Non EU AIF (EU AIFM) - Article 36 – Depo Lite

6. Concluding Remarks

- Volumes based business
- Revenue generator – other services (fx, financing, brokerage)
- Detailed oversight / monitoring processes
- Liability for loss of assets (AIFMD related structures)
- Safekeeping of “other assets” might be tricky
- Due Diligence on sub-custodians is key

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