BEAMA AIFMD FAQ

The information provided in this document is provided for reference only and does not constitute legal advice. All content is believed to be fair and accurate however, this does not dispense you from seeking legal advice relating to any particular case.

The FSMA, i.e., the Belgian National Competent Authority for financial markets and financial conduct, has been so kind to review a previous version of this document and add punctual comments. Those comments are included in this version.

Any question relating to the AIFMD topic can be addressed to the BEAMA team (ag@febelfin.be). Reports of inaccuracy in this document are also more than welcomed.

1. General:

Q1 : Are single-investor AIFs in or out of scope of the AIFMD?

ESMA answered this question in its Guidelines on key concepts of the AIFMD[1] (published 24 May 2013). The fact that there is one single investor in an AIF is not sufficient to exclude it from the scope of the Directive. There should be a legally enforceable restriction to raise capital from just one investor. This means that the fund statuses (or the management rules) must state that units can only be held by one single investor. Funds that do not meet this condition are therefore considered raising capital from "a number of investors" and are thus in scope.

2. Transitory period:

Q2: Should I obtain the AIFM passport before 22 July 2014 to continue exercising my activities or is introducing an agreement request to the FSMA sufficient?

Your demand has to be introduced by 22 July 2014 but you are not required to receive your agreement by that date.

However the fact you are submitting an application obviously means that you have to be 100% AIFMD-compliant at that time.

[1] http://www.esma.europa.eu/system/files/2013-600_final_report_on_guidelines_on_key_concepts_of_the_aifmd_0.pdf

Q3: AIFMD has not been transposed yet in Belgian Law, however this has been done in my Member State and I am now an authorized AIFM. Can I come to Belgium and market my AIF's to professional investors?

Yes the FSMA is able to receive and handle notifications from other national competent authorities; this is based on the direct application of the Directive. You can therefore proceed to the placement of your AIF units in Belgium (if you respect the conditions of the Belgian non-public offer regime).

More information concerning the transitory period can be found in a specific Q&A that has been published by the FSMA, see question 15 of that document in particular[2].

3. Depositaries:

Q4: So, who should be the depositary of my AIF?

Art. 21 §3 of the AIFMD 2011/61/EU Directive is pretty straightforward,your depositary should be:

- A EU credit institution authorised according to 2006/48/EC
- An investment firm that provide the depositary service according to Annex I, Section B of the MiFID Directive (2004/39/EC) and subject to the same capital requirements as credit institutions according to Directive 2006/49/EC and authorised as to 2004/39/EC.
- A prudentially regulated and supervised institution that is eligible as a custodian for UCITS funds, see Art. 23 §3 of 2009/65/EC.

For Non-EU AIFs the depositary may also a credit institution or an investment firm located outside of the EU provided it is subject to an effective prudential regulation producing the same effects as EU Laws provided conditions set at article 21(6) are met.

In addition, Member States may allow that, in relation to AIFs which have no redemption rights exercisable during the period of 5 years from the date of the initial investments and which, in accordance with their core investment policy, generally do not invest in assets that must be held in custody in accordance with point (a) of paragraph 8 (Art. 21 2011/61/UE) or generally invest in issuers or non- listed companies in order to potentially acquire control over such companies in accordance with Article 26, another type of depositary be appointed.

Belgium has the intention to implement this possibility and will regulate those special depositaries through an ad-hoc Royal Decree. The FSMA confirms that it is intended that those should be entities

[2] http://www.fsma.be/~/media/Files/fsmafiles/circ/en/2013/fsma_2013_11.ashx

such as notaries, lawyers, real estate registrars as long as they respect the specific conditions introduced for this status.

Q5: Where should the depositary of my AIF located?

For Belgian AIF, it should be located in Belgium and for other Member States' AIF, in that Member State (Art. 21 §5 a)).

For third countries AIF, there are 3 options (Art. 21 §5 b))
-In the Member State of the AIF's manager.
-In the reference Member State of the AIFM (for AIF managed by 3rd countries AIFM)
-In the third country where the AIF is established provided that all conditions under Art. 21 §6 are met.

Q6: Should non-EU AIFs marketed in Belgium now appoint such a depositary?

No, they benefit of a "period of grace" until at least 2015 or 2018.

Indeed as passport is not yet available for non-EU AIF(M)s, member states may permit marketing of those AIF to professional investors on their territory only (i.e. this will mean non-public offer in Belgium). This is according to Art. 36 and 42 of 2011/61/EU that respectively regulate marketing of non-EU AIF managed by an EU AIFM and non-EU AIF managed by a non-EU AIFM.

Art. 36(1) a) states that EU-AIFMs managing non EU-AIFs should obtain the AIFM agreement and therefore comply with all AIFMD requirements except for Art. 21 (for the managed non-EU AIFs). Art. 36 also states that article 21 (7), (8) and (9) of the Directive apply (see Question 7).

Art. 42 §1 a) states that the non-EU AIFs managed by non-EU AIFM should only comply with Art. 22, 23 and 24 in addition to Art. 26 to 30 where applicable.

Finally art 36(1) b) and c) and art. 42(1) b) and c) also apply in those cases: that is appropriate cooperation agreement and non-figuration on non-cooperative FATF countries list.

As reminded by the FSMA, it is the AIFM's role to demonstrate that art. 36 and 42 are fulfilled.

Q7: What is the role of my depositary?

The role of the depositary under AIFMD consists in 3 main tasks:

Art. 21 §7 gives the depositary a cash monitoring function.

Art. 21 §8 defines the safe-keeping of the AIF assets function.

Art. 21 §9 defines different oversight duties to be performed by the depositary.

Q8: What cash flows should the depositary monitor?

It is important to stress that the depository should monitor **all cashflows** of AIFs for which it has been appointed as depositary. This includes cash flows taking place on any account of the AIF, not only on those opened with the depositary.

This is why Art. 85 and 86 of Regulation 231/2013 impose that the AIFM provides the depositary with all the necessary information to perform its tasks. This includes any information about all accounts opened in name of the AIF or the AIFM acting on behalf of the AIF.

More in depth, Art. 86 of Regulation 231/2013 defines the different tasks relating to this monitoring:

-Check that all cash flows are deposited on accounts at entities listed in Art. 18 §1 a), b) or c) of Directive 2006/73/EC (that is central banks, credit institutions, …)
-Implement procedure to reconcile all cash movements on a daily basis
-Identify significant cash flows and in particular those inconsistent with the AIF's usual operations.

Q9: Art. 89 §3 and Art. 90 §5 AIFMD respectively introduce a look-through obligation regarding safe-keeping obligation and recording and verification of ownership for assets held by financial or legal structures established by the AIF. Does the look-through apply for cash monitoring of accounts held in name of such structures?

No, there is no obligation to monitor those cash accounts.

In addition, keep in mind that the obligations under Art. 89(3) and 90(5) of Regulation 231/2013 do not apply for funds of funds and master-feeder structures provided those underlying funds have a regulated depositary performing those functions.

As a general rule, no structure can be created in the sole objective of avoiding the AIFMD requirements (a structure only owning the AIF cash accounts for example).

Q10: In order to delegate its safe-keeping functions, the depositary must ensure a number of conditions are satisfied (cf. art. 21 §11 a) b) c) and d)). Condition b) (i.e. the objective reason) is subject to diverse interpretation, what are common views regarding this?

First, one must be aware that objective reason for a delegation can be a different matter from the question of an objective reason for a discharge of liability (as to art. 21 §13 AIFMD).

In a Q&A published on its website[3], the Central Bank of Ireland provides some advice regarding to this issues. It notably states that:

[3] http://www.centralbank.ie/regulation/industry-sectors/funds/Documents/QandA%20AIFMD%2016%20MAY%202013%20FINAL.pdf

"Whether an appropriate objective reason for delegation and/or discharge of liability exists depends on the particular nature of each entity's business model, which is not only particular to it but may also vary over time. It is a matter for depositaries to judge this in the first instance and to keep the matter under review. Given the importance of this matter it would be prudent that the analysis and ongoing review should be documented and approved at least at a senior managerial level within the depositary. It may also be appropriate to have the matter approved at Board level."

Also, we would like to remind that delegations of functions of an AIFM are also subject to a similar objective reason condition. Some criteria to judge of this matter are provided in Art. 76 of Regulation 231/2013.

Q11: Is a delegation of the cash monitoring function allowed?

No, only tasks under art. 21 §8 AIFMD (i.e. sake-keeping of assets) can be delegated to third parties.

Q12: To what extent can a depositary rely on cash reconciliation processes that are performed by third parties (e.g. by the administrative agent of the AIF)?

This can be a difficult point. Once again, we wish to remind that cash monitoring cannot be delegated.

However the FSMA seems to agree with the following practice:

The depositary could agree with the administrative agent to perform ex-post control of the reconciliation processes and results of the tasks performed by the agent. The depositary could also agree to rely on the information flows from the administrative agents to perform its own monitoring.

However, it is important that the liability for this remains on the depositary at any time. Should anything go wrong, the depositary would remain the only liable person.

In addition, the FSMA wishes to remind that for public Belgian AIFs, some administrative tasks and depositary tasks cannot be performed by the same entity. This condition is set in article 42, §1, 5e of the Law of 3 August 2012, this article will also be contained in the future Belgian AIFM law.

Q13: What does the safe-keeping of assets consist in?

It is important to distinguish between two types of instruments:

1) Financial instruments that can be held in custody

2) Other assets

The first category includes instruments that can physically be delivered to the custodian (art. 88 §3 Regulation 231/2013), and transferable securities that can be registered in an account in name of the depositary.

Other assets are non-financial instruments that cannot be delivered to the depositary (real-estate, infrastructure, …) and financial instruments that cannot be registered in name of the depositary. That is for example instruments registered directly in name of the AIF with the issuer (e.g. private equity).

For the first type of assets the depositary must: (Art. 89 Regulation 231/2013)

-Properly register and record them on segregated accounts. This can be done by delegates.
-Reconciliate the depositary books and those of its delegates.
-Verify the ownership right
-Keep the instruments with due care in a way that minimizes risk loss or diminution.

For other assets, the depositary's duties consist in: (see Art. 90 Regulation 231/2013)

-verifying that the AIF (or the AIFM acting on behalf of the AIF) have effective ownership of the assets.
-maintaining an up-to-date record of all those assets

Q14: What about collaterals: does the depositary also have to safe-keep those assets?

The FSMA recommends that we follow a simple rule of thumb to answer this question: as long as the property of those collaterals remains that of the AIF, the assets have to be safe-kept by the depositary or its delegates even if transferred to a third party. But, as soon as the property of those assets is transferred away from the AIF, the assets become other assets.

Indeed, recital 100 of Regulation 231/2013 states that "Provided that the conditions on which financial instruments are to be held in custody are fulfilled, financial instruments which are provided as collateral to a third party or are provided by a third party for the benefit of the AIF have to be held in custody too by the depositary itself or by a third party to whom custody functions are delegated as long as they are owned by the AIF or the AIFM acting on behalf of the AIF"

In addition the Summary of the Commission's Impact Assessment of the Delegated Act[4] states the following:

"The proposed approach deviates from ESMA to the extent that AIF assets may not be excluded from the scope of custody simply because they are subject of a security interest collateral arrangement. Therefore, should an AIF provide its assets as collateral to a collateral taker, the

[4] http://ec.europa.eu/internal_market/investment/docs/20121219-directive/ia-resume_en.pdf

AIFMD requires that these assets remain in custody – except if the AIF transfers ownership of the collateralised assets to the collateral taker (title transfer collateral arrangement)."

This confirms the stated approach.

Q15: Are shares in target funds considered as financial instruments held in custody?

In accordance with article 21 (8) of 2011/61/UE and article 88 of Regulation 231/2013, the answer to this question depends on who is officially registered with the fund's Transfer Agent (TA).

If the AIF or the AIFM on its behalf is registered with the TA, then those shares will be considered as "other assets" and the depositary shall only perform ownership verification tasks.

However if the shares are directly registered in name of the depositary either directly or in name of the AIF, the shares will indeed be considered as held in custody?

Q16: Can you give me more concrete examples of "other assets"?

In addition to art. 21 (8) a) of 2011/61/UE and art. 88 of Regulation 231/2013 defining those assets, ESMA has redacted a list of such instruments in its technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive, we provide you with the appropriated extract. Please pay extra attention to derivatives.

"In accordance with the above definition, financial instruments which would fall under the 'other assets' category would include but not be limited to:

- physical assets that do not qualify as financial instruments or cannot be physically delivered to the depositary;
- financial contracts (e.g. derivatives other than those embedded in transferable securities for the purposes of article 21(8)(a));
- all financial instruments, including units and shares of collective investment schemes, issued in a nominative form or registered directly with the issuer or through a registrar acting on behalf of the issuer, in the name of the AIF, provided that they cannot be physically delivered to the depositary or they are not registered or held in an account directly or indirectly in the name of the depositary;
- cash deposits;
- investments in privately-held companies and interests in partnerships."

Q17: What is the obligation of segregation and how is this effectively implemented?

Providing an answer to this question is not very easy as views still differ on how this concept has to be interpreted.

However BEAMA can provide you, on an informal basis, with practices that seem more and more widely accepted.

At first level, the depositary should maintain separated accounts for every AIF so that it can immediately identify the assets of every client AIF. AIF assets should of course be segregated from the depositary's own assets and from assets held for the depositary's other clients.

At delegate-level, the assets should be separated in 3 different pools: (Art. 99 §1 a Regulation 231/2013)

-Delegate institution's own assets.
-Assets held for AIFs.
-Assets held for all other clients of the institution (e.g. UCITS funds)

Recital (40) of the AIFMD permits the use of omnibus accounts at delegate level:

"A third party to whom the safe-keeping of assets is delegated should be able to maintain a common segregated account for multiple AIFs, a so-called 'omnibus account'".

Q18: Is cash also subject to the segregation requirement?

Yes, it is.
Art. 21 §7, 2 AIFMD clearly states that:

"Where the cash accounts are opened in the name of the depositary acting on behalf of the AIF, no cash of the entity referred to in the first subparagraph and none of the depositary's own cash shall be booked on such accounts"

Q19: Can a depositary also perform valuation tasks for an AIF?

Yes provided it has functionally and hierarchically separated the performance of those tasks from those depositary tasks (See AIFMD art. 19 §4, 2°).

The FSMA communicates that hierarchical separation should go as far as possible as to end-persons to whom those two separated units report. In addition, potential conflict of interest have to be identified, managed and properly disclosed to investors. Also, for Belgian public AIF, the depositary cannot perform certain administrative tasks (such as valuation of assets), see question 12 for more explanation relating to this.

Q20: AIFMD introduces a strict liability regime in case of loss of assets by the depositary, is the depositary also liable for a loss of "other assets"?

No unless the loss results from the depositary's negligent or intentional failure to properly fulfil its obligations under AIFMD (see art 21 (12) AIFMD). The burden of proof for such events does not lie on the depositary in contrary for loss of assets held in custody.

Q21: Under what circumstances is a depositary exempted from returning lost instruments?

This happens only if the depositary is able to demonstrate that all the conditions of Art. 101 §1 of Regulation 231/2013 are met. Those conditions can be summarized as follows:

-The event must be external (events happening within delegates are NOT considered external)
-The event is beyond the reasonable control of the depositary.
-The event could not have been avoided with reasonable efforts.

Q22: Is the depositary liable in case of loss of an instrument because of the insolvency of a sub-custodian?

Yes, conditions of Art. 101 §1 of Regulation 231/2013 are not deemed to be met in case of the insolvency of a sub-custodian. In principle, appropriate segregation should ensure that the assets under custody can be returned and transferred to another custodian. Assets should not be considered lost and the depositary liable from the beginning of the insolvency procedure. It is only when it is established that these assets have been permanently lost (Art. 100 Regulation 231/2013) that the depositary will have to return a financial instrument of identical type or the corresponding amount to the AIF (Art. 21 §12 AIFMD). Also, as explained in the summary of the Commission's impact assessment of the delegated Acts, in the event of insolvency of a sub-custodian, operational failures by the latter (e.g. failure to implement the segregation requirement) would not be an "external event".

In the case where segregation of assets is not recognized in the legislation of a third country, recital 118 of Regulation 231/2013 states that this is indeed to be considered as an external event. However this does not mean that the discharge of liability is automatic in that case. Indeed, the depositary must still demonstrate that conditions of article 101(1) c) of Regulation 231/2013 have been fulfilled (and therefore art. 99(2) of that Regulation).

That article states that "Where a depositary has delegated its custody functions to a third party in accordance with Article 21(11) of Directive 2011/61/EU, the monitoring of the third party's compliance with its segregation obligations shall ensure that the financial instruments belonging to its clients are protected from any insolvency of that third party. If, according to the applicable law, including in particular the law relating to property or insolvency, the requirements laid down in paragraph 1 are not sufficient to achieve that objective, **the depositary shall assess what additional arrangements are to be made in order to minimise the risk of loss and maintain an adequate standard of protection.**" The depositary must therefore have demonstrated that those steps have been taken in order to achieve the discharge. In addition conditions of art. 21(14) of AIFM Directive have to be met.

Some other examples of external events include nationalisation of the issuer, embargoes, wars, … (see Art 101 §2 Regulation 231/2013).

Q23: Are CSDs / CCPs[5] considered as delegate of the depositary? In other words, is the depositary liable in case of loss of instruments by a CSD/CCP ?

This question is touchy and remains subject to various interpretations. Variation of interpretations is to be found among member states.

ESMA's comment on page 184 of its technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive stating that "[…], ESMA believes that the event of, for instance, a market closure or of a technical failure at the level of the Central Securities Depositary or any other settlement system should be considered 'external'" reinforces this interpretation. The FSMA reminds us that the external event condition is necessary but not sufficient for the discharge of liability. The additional conditions stated at art. 21(12) of 2011/61/EU have to be met, that is that the external event was beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.

However in its compromise position on UCITS V dated 2 December 2013[6], the European Council added some precision concerning this topic for the new UCITS depositary regime. BEAMA believes this new approach comes from the impulse of the European Commission and might indicate a new approach also in the AIFMD context. The text of the Council is the following:

"When a Central Securities Depositary (CSD), as defined in Article 2 (1)(1) of CSDR, or a third-country CSD provides the services of: (i) initial recording of securities in a book-entry system through initial crediting; (ii) providing and maintaining securities accounts at the top tier level; and (iii) operating a securities settlement system, as specified in Section A of the Annex to CSDR, the provision of those services by this CSD with respect to the securities of the UCITS that are initially recorded in a book-entry system through initial crediting by this CSD should not be considered a delegation of custody functions. However, entrusting the custody of securities of the UCITS to a CSD, as defined in Article 2(1)(1) of CSDR, or to a third country CSD should be considered a delegation of custody function."

Furthermore, the FSMA refers to the Commission Staff working Document which states that all financial instruments which could be registered with the issuer or its registrar or held in an account, directly or indirectly in the name of the depositary would be considered as instruments to be held in custody. As a consequence, the FSMA states that instruments deposited in custody with a CSD remain under the custodian's responsibility.

[5] CSD: Central Security Depository / CCP: Central Clearing Counterparty

[6] Available via the following link:
http://register.consilium.europa.eu/doc/srv?l=EN&t=PDF&gc=true&sc=false&f=ST%2017095%202013%20INIT&r=http%3A%2F%2Fregister.consilium.europa.eu%2Fpd%2Fen%2F13%2Fst17%2Fst17095.en13.pdf

Q24: Is it still possible for a depositary to cap its financial liability?

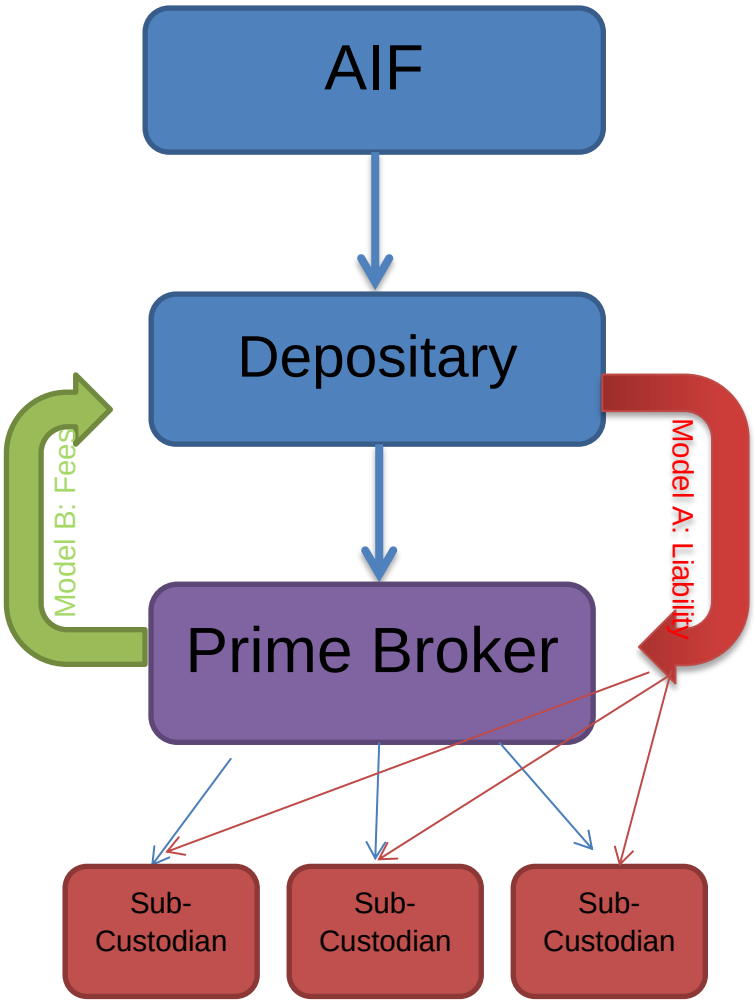
No, the AIFMD does not foresee such a possibility, any contract between a fund and a custodian that contains such a provision is not AIFMD compliant should be amended as soon as possible.

The only possible discharges of liability are those foreseen under art. 21 (12), (13) and (14) of the AIFMD.

Q25: What prime brokerage models are still possible under AIFMD?

The answer to this question is not clear yet but several models have been imagined, we will provide you with schemes of two prominent ones:

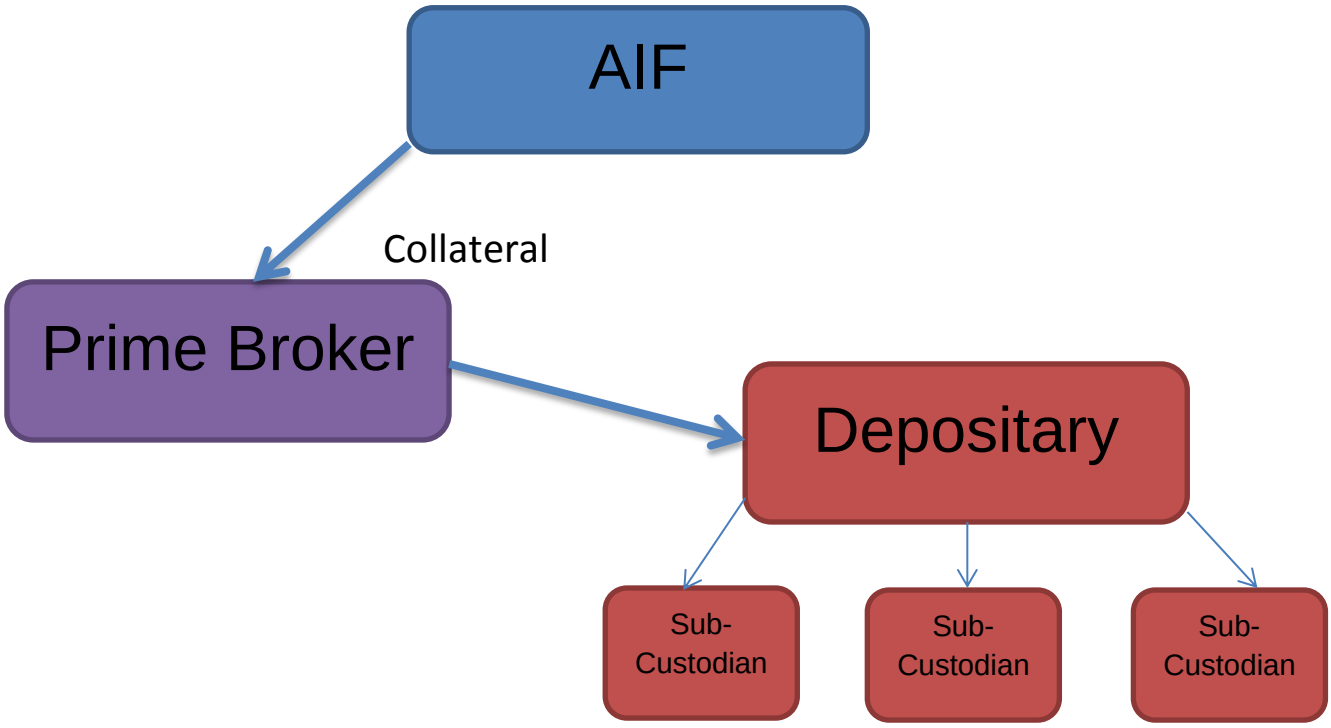
First:



This model includes 2 sub-scenarios, the AIF appoints a Prime Broker which then becomes a delegate of the depositary. All assets remain within the sphere of the Prime Broker and its sub-custodian network. Under scenario A, the liability is transferred to the Prime Broker and potentially to its sub-custodians. The question of the objective reason for delegations and other related conditions (see Art. 21 §11 2°) has however to be answered.

Under model B: liability is not transferred to the Prime Broker but remains with the depositary. In contrary to model A, the depositary perceives a fee from the PB, this is to compensate for the risk borne by the Depositary.

Second:



Under this model, the AIF appoints its prime broker independently from the depositary. Investment instructions are then given to the Prime Broker and the AIF passes collateral onto the PM for those instructions. Then, all assets are transferred from the PM to the depositary's network on a daily basis. In this model, all assets are under the depositary's safe-keeping duty but the AIF remains exposed to the prime broker until the assets are passed to the depositary. In addition, this model requires multiple settlement instructions, which might prove inefficient.

Please note that:

- To appoint the PM as a sub-custodian, the depositary must ensure that the requirements for delegations are met (see notably question 9)
- The PM can belong to the entity as the depositary if it has hierarchically and functionally separated its PM functions from its depositary functions. And, all potential conflicts of interests have been managed, monitored and eventually disclosed to the investors of the AIF

BEAMA – 09/01/2014