

Why French fund depositaries are best placed in servicing AIFs and AIFMs?

AIFMD will impose a new model across the European Union

May 2013



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1. Foreword

Financial services firms are facing significant regulatory change, with the adoption and development of a number of regulations, at both European and national levels. The Asset Management industry is central to many of these changes, and the implementation of the AIFM directive is a key opportunity to reevaluate existing organizational issues, strategy and business models.

Some public authorities identified Asset Managers as partly responsible for amplifying the 2008 crisis. This in turn has resulted in new rules and regulations which will severely impact Asset Management (cf. AIFMD). Some initiatives are expected to improve the industry, by giving all actors the opportunity to operate under a safer framework. For example, the obligation to appoint a depositary for all Managers of Alternative Investment Funds (mostly hedge fund (HF) and private equity (PE) firms) is, in many ways, a step forward for the protection of investors.

Against that backdrop, in November 2012, **AFTI (the Association of French Securities Professionals, including depositaries and asset servicers)** considered it appropriate, with the assistance of **PwC**, to reflect on the role of French depositaries, in the context of the implementation of AIFMD. AFTI concluded that the time had come for a comprehensive promotion of the French depositary bank model, to demonstrate their long standing history of servicing the Asset Management industry.

There is a widespread acknowledgement that the AIFMD took the French regulatory framework as a source of inspiration. Consequently, it is indisputable that the “gap” to adapting to the new environment for French depositaries is much lower than in any other Member State. French depositaries are therefore keen to promote their service offering to Asset Managers across Europe, and are convinced that they are particularly well placed in the new AIFMD environment.

We are delighted to present this brochure which summarizes the work of all the French depositaries that participated in the working group (see the Appendix for the composition). We would also like to take this opportunity to thank them for the quality of the discussion held and for the work undertaken. We trust this will be valuable when building on the skills and expertise of the French industry.

Karima Lachgar

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2. Introduction

The custody “à la française” anticipated the European initiative

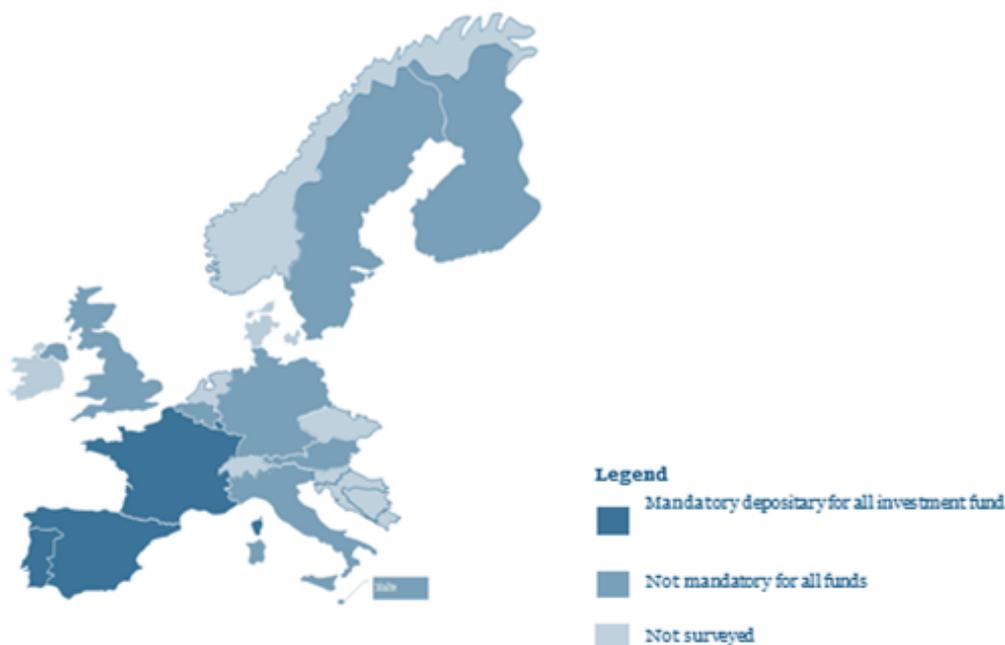
EU regulation seeks to **segregate cash and assets** from the Asset Manager’s own assets in order to reduce operational and legal risks, and, in particular, fraud; the depositary acts as a second level of control, independently ensuring compliance with local applicable regulations.

It is worth noting that these requirements have been implemented by the French depositaries for more than twenty years. Indeed, some say the final European regulation of depositaries (enshrined in AIFMD and expected in the UCITS V directive) validated the French approach to depositary regulation at a pan-European level.

Prior to AIFMD, it is interesting to consider the adoption of mandatory fund depositary requirements across Europe (See the map below).

French depositaries’ current clients include non-French UCITS managers; this client base is likely to extend to foreign alternative Asset Managers who will make use of the AIFMD cross-border opportunities.

Fund depositaries in the “pre-AIFMD” environment:

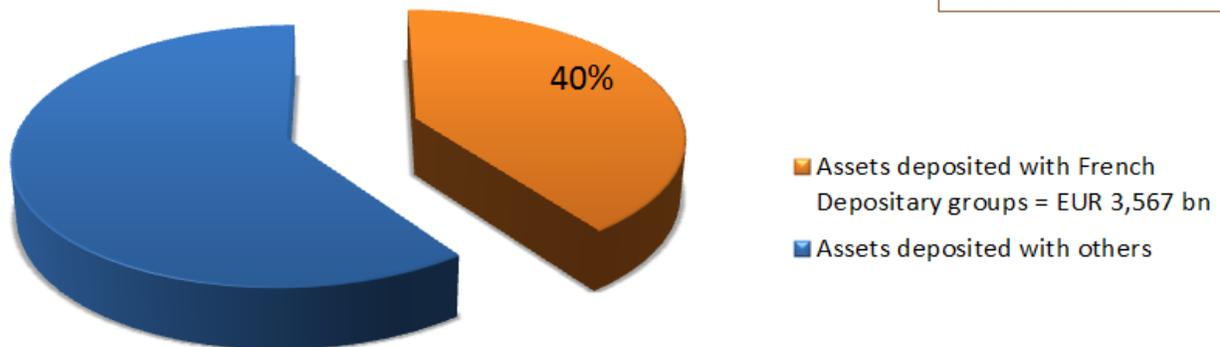


Source: PwC analysis – February 2013

3. French depositaries, what we are

We are global and major actors in the asset servicing industry.

French depositary groups market shares in Europe (December 2012)



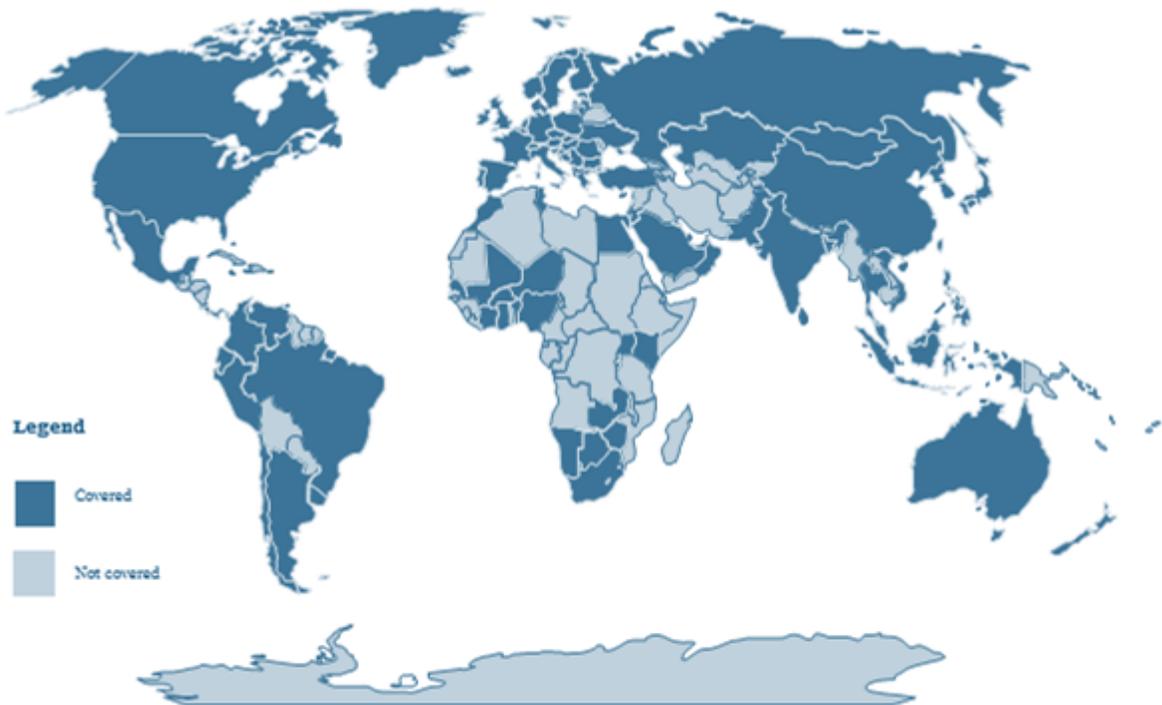
Total of Net Assets for European Investment Funds (UCITS and non UCITS) = EUR 8, 944 Billion

3.1. We are international credit institutions

The **first key issue is** that French depositaries are global players in the asset servicing world – we are located in 37 countries. We are large, robust banking groups which enjoy a worldwide presence, enabling them to service the investment management industry on a large scale (see the map below).

Indeed, we have the skills, experience and resources to serve Asset Managers in a multi-jurisdictional environment as we already operate under multiple regulatory frameworks (in Europe and further afield).

International direct locations of the French depositaries (37 countries)



Source: AFTI - May 2013

We are clearly well equipped to help our global clients (management companies and/or investment funds) to develop **cross-border distribution strategies**.

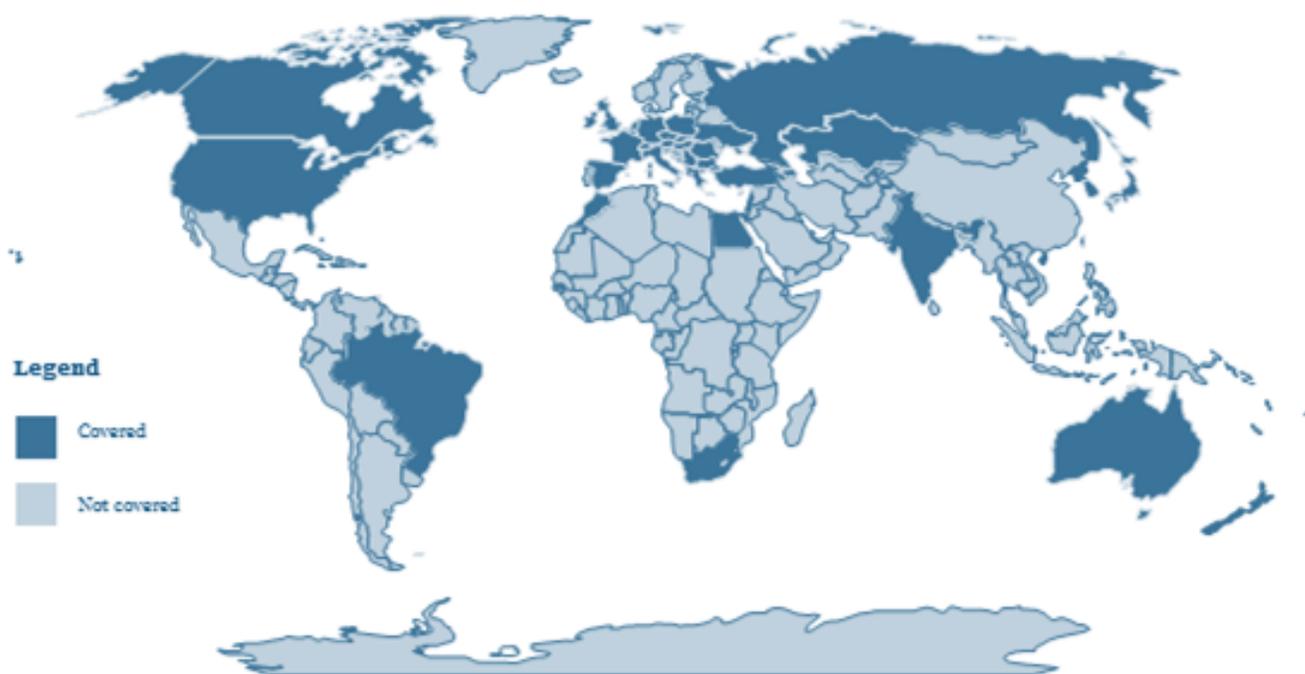
3.2. We are robust

A **second key issue** is that all major French depositaries are part of robust banking groups. The largest French global custodians are subsidiaries of banking groups identified by the Financial Stability Board as **systemically important financial institutions** (SIFIs). These groups are subject to specific regulatory and supervisory requirements.

3.3. We are global players

The **third key issue** is that we have a proven **sub-custody network** covering virtually all financial markets in the world, thus fulfilling the usual demands of Asset Managers. Additionally, we may build on our international presence and consider additional markets if our clients expressed an interest in investing there.

A worldwide custody network (96 countries)



Source: AFTI-May2013

4. What we offer

4.1. We already serve a broad international client base

French depositaries' clients today are mostly alternative Asset Managers (HFs, RE funds, and PE firms) based in France, UCITS managers and foreign managers who utilise a passporting facility. This client base is likely to grow as foreign alternative Asset Managers make use of one of the AIFMD cross-border opportunities, such as:

- 1- A fund established in a Member State may be managed from any other Member State by virtue of the **AIFMD management company passport**;
- 2- French depositaries may be appointed for funds not domiciled in France (subject to the opt-in of AIFMD provision of Art 61-5 (the so called "Malta Clause"), by which member states may allow the AIFM to select and appoint a depositary from a country different from that of the AIF;
- 3- Cross border master/feeder structures. There is an incentive to appoint a depositary within the same group for practical and operational reasons for both the master and the feeder(s);
- 4- From 2015, non-EU AIFMs will be eligible to use the product passport and select French depositaries.

For these reasons, the implementation of AIFMD is viewed by French depositaries as a new opportunity to expand our operations cross-border. In particular, provision 61-5 in AIFMD may be regarded as a precursor to a depositary passport in future EU legislation.

4.2. We are dedicated to meeting our clients' needs regarding the mandatory duties that must be performed

We have been carrying out our services in an AIFMD-like environment for more than 20 years. We have always been operating in a **safe, legal and regulated environment**. Indeed, French Asset Management and depositary regulation is rated as one of the most, if not the most demanding. The role of French depositaries is recognised by local regulators as a stability factor for the investment industry. This offers a clear advantage to investors who may, for instance, rely on the data and information processed by the French asset servicing industry.

Consequently, the AIFMD is not expected to be transformational for us, as it is largely in line with all the range of services already provided:

- i) **safekeeping** (custody and record-keeping);
- ii) **oversight functions**;
- iii) **cash monitoring**, as some cash monitoring duties were already embedded in depositary duties in France, whereas it is viewed as unprecedented in many other EU jurisdictions.

While Article 21 of the AIFMD may have taken inspiration from current French depositary regulation, the French depositary's liability regime is, in some aspects, actually stricter than the AIFMD provisions. This is why we have developed a very structured and documented approach to serve our clients; the quality offered when performing our duties is directly linked to this existing strict liability regime from our domestic regulatory environment.

Indeed, all funds (whether regulated by or registered with the French securities markets regulator) must have a depositary. As a consequence, we have been developing our broad expertise irrespective of the strategy pursued by AIFs (e.g. whether retail AIFs, HFs, PE, RE). For example, we are ready to serve as depositary for structures/entities (e.g. forest funds) which are current unregulated, but which are going to be captured within AIFMD regulatory framework. The French national regulator estimates there to be up to 400 such entities.

Good processes already exist, and we have put in place procedures governing our relationship with third-party sub-custodians. We already ensure good record keeping and some cash monitoring functions, and intend to leverage on the harmonization brought in by AIFMD, notably in the relationship between depositary and prime broker.

Moreover, French depositaries operate in all major countries and benefit from close connections to national regulators in many markets. This proves to be valuable for Asset Managers with cross-border activities (fund domicile and/or fund distribution), facing multiple regulatory environments. This is also crucial, for instance, to PE or RE managers in European countries where there is no current depositary appointment obligation.

This will be key to managers who intend to undertake business in France, as regulation is being streamlined (e.g. legal range of investment funds is being simplified and complimented by a French "limited partnership" structure). We are committed to providing our clients with the best market practices in line with **international standards**. We also take into account our clients' demands in customised service level agreements (SLAs).

As already stated, quality is not seen as an option for French depositaries but rather a mindset. We have noticed that our clients are more and more demanding of customised solutions in order to differentiate from the competition. We are keen to promote partnerships with our customers and to guarantee reactive and adapted service.

We can rely on our Association: **AFTI**.

French depositaries benefit from the influence and recognition of a Post-Trade Association, which acts as an active contributor to the regulatory debate, both in France and the EU.

AFTI publishes Depositary codes of good conduct, guides for external valuers and fund administrator best practice (see below). AFTI may provide templates of contracts to be entered between depositaries and Asset Managers; this contractual expertise is largely viewed as reinforcing the legal safety of the contractual relationship between service providers and their clients.

France is one of the largest European domiciles and servicing locations for UCITS and AIFs investment funds. In this respect, AFTI periodically evaluates the opportunity to provide best practices whose aim it is to focus on asset servicers and Asset Managers and on their needs and expectations towards the Asset Management industry and products.

AFTI guides reflect the general consensus of discussions with Asset Management professionals. These tools improve the transparency and demonstrate commitment to high standards of market practices.

AFTI publishes and regularly updates a wide range of standards and contract templates that allow Asset Managers to manage better their relationship with all other counterparties involved in the life of the funds (e.g. depositary, fund administrator, external valuator, transfer agent). Where relevant, this documentation is available in English.

Appointment of a single depositary

- Code of good conduct of the depositary
- Template for the mandatory written contract to be concluded between the depositary and the Asset Manager (being updated to incorporate the last developments for AIFs) – drafted jointly with AFG
- Template for the mandatory contract for the exchange of information between the depositary of the master UCITS and the depositary of the feeder UCITS

Under process in the context of AIFMD implementation:

- Guide to sound practices for the daily relationship between the depositary and the Asset Manager of real estate funds (drafted jointly with AFG and ASPIM)
- Guide to sound practices for the daily relationship between the depositary and the Asset Manager of private equity funds (drafted jointly with AFIC)

Redemption and Subscription of UCITS

- Charter of good professional practices for the treatment of UCITS subscription/redemption orders

NAV calculation

- Charter of good professional practices for Fund Administrators

Independent valuation

- Charter of good professional practices for External Valuers

4.3. Beyond our regulated role and duties, we offer additional services to our clients

We have developed a robust offer of innovative solutions, using of the expertise acquired while discharging our regulated duties.

We (directly or an entity of our group) have developed high-standard services which include:

1. Collateral administration, OTC derivatives administration (in line with EMIR and Solvency II regulations):

French depositaries and asset servicers service the entire OTC derivatives portfolio for all classes of instruments. This includes interfacing with counterparties and ensuring the execution of collateral agreements, portfolio reconciliation calculation of net exposure and margin calls per counterparty, and ensuring the collateral payments. Whenever necessary, depositaries provide support in the case of a dispute.

2. Clearing member services with regards to listed derivatives:

Listed derivatives are already subject to clearing and compensation requirements. Depositaries may act as a clearing member between the CCP and the Asset Managers and/or the investment fund using the listed derivatives.

3. External valuation (e.g. OTC derivatives):

French depositaries perform the collection and reconciliation of counterparties and independent providers' prices; the production of exception reports together with a list of the different pricing sources, with the objective of providing full transparency on valuation models and the market data used. We comply with all the required standards with respect to the prevention and the management of conflict of interests.

4. Fund administration / Net Asset Value (NAV) calculation:

French asset servicers offer accounting services, and legal and fiscal reporting. NAV calculations, including NAV dissemination to the market, are parts of the core services provided to the Asset Management industry.

5. Risk management:

We perform the identification and generation of metrics, the prioritisation including risk mitigation tools. This includes VaR calculation (according the regulation) and stress testing.

6. Reporting

French depositaries already provide many services regarding tax, investors and regulatory reporting. In particular, as we serve an international client base, France-based depositaries have significant experience in this range of services.

4. Banking services

This includes financing and associated services such as securities lending, foreign exchange transactions and payments.

5. Support functions for cross-border fund distribution irrespective of the operating model (Central Securities Depository vs. Transfer Agent):

We can enhance Asset Managers' distribution. French asset servicers fully take advantage of the international fund distribution environment and opportunities in UCITS IV.

6. And many other services such as middle office, post-execution trade management, data recording and maintenance, regulatory watch ...

For instance, we offer services such as drafting the fund prospectus directly in English and elaborating the Key Investor Information Document in French since this document is mandatory for all funds offered to non professional investors.

5. Why we are better than “light” depositaries

It is important to consider the differences between credit and non-credit institution’s depositary models, although undoubtedly credit institution depositaries can be viewed as a superior model. Firstly, the fact that French depositaries are credit institutions ensures financial robustness and resilience (subject to very demanding capital requirements). Secondly, credit institutions may provide one-stop shopping services, with a large geographic coverage. Thirdly, credit institutions are well-organised and implement robust policies, processes and tools, and offer an invaluable expertise.

French credit institution depositaries also offer highly competitive pricing as we have developed a sound and lasting financial model.

How could non-credit institution depositaries restore lost assets without a robust financial basis? What about one-stop shopping services when dealing with small, local players? For example, non-credit institutions may not provide financing services, although these are crucial to Asset Managers. Moreover, they do not benefit from the same standards or expertise/experience needed to deliver high-quality services.

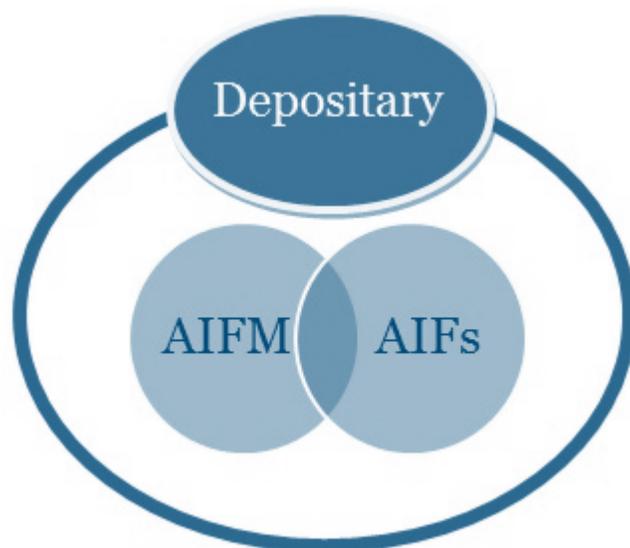
6. We may either replace other service providers or facilitate our functioning

The AIFMD requires the appointment of a depositary but remains silent about other service providers. There are, however, some operational requirements that may lead to firms partnering with other service providers in order to address the needs of Asset Managers. Therefore, the Directive authorises a depositary to offer additional services (e.g. NAV calculation, independent valuation, prime brokerage, cash financing), subject to the appropriate management of possible conflict of interests.

The Asset Manager may select between various organisational models: bundled (the depositary performs the mandatory duties and all other additional services) or unbundled (the depositary and a network of service providers for all other services).

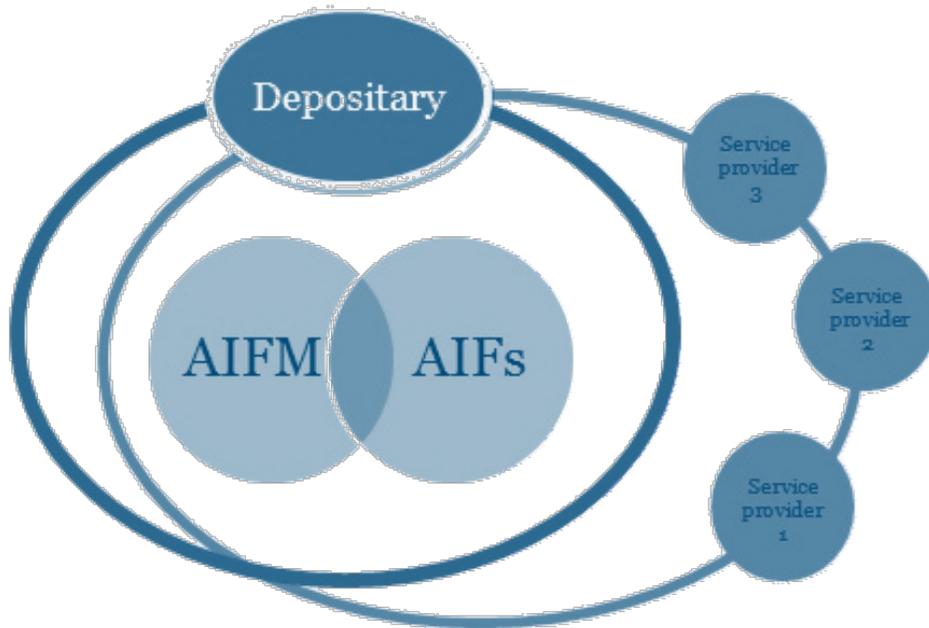
- ***Scenario 1 – bundled (one-stop shopping):***

As most French depositaries are **credit institutions**; we may combine the three main services (depositary, banking – including prime brokerage services – and **all other fund asset services**) that Asset Managers and/or investment funds may require. We have long been regulated in such a way that we are used to properly and satisfactorily managing potential conflicts of interest.



- **Scenario 2 – unbundled (multi-providers):**

Where the fund manager selects different fund service providers for the three above-mentioned functions, we have the required tools and skills to facilitate the necessary interactions between the **different service providers**.



In conclusion, the depositary can facilitate whatever organisation an Asset Manager opts for, whether a unique service provider or various specialised service providers. Indeed, French depositaries may either act as highly competitive service providers, or may be complementary and even conduct the interactions between the Asset Manager and all other service providers selected and appointed to service the fund assets.

7. Conclusion

One of the main regulatory themes witnessed in Europe in the aftermath of the 2008 crisis is that depositaries have become the central players for investor protection, sound functioning of investment fund markets and mitigation of Asset Managers' operational and legal risks.

The AIFMD should not be regarded as a constraint, but rather as a source of opportunities, synergies and harmonisation, especially for the French depositaries.

As discussed, provisions regarding depositaries in the directive were inspired by the existing French regulatory framework. Indeed, the French depositary model has a longstanding experience in servicing actors in the Asset Management industry, with an extensive sub-custody network covering foreign financial markets.

Furthermore, the introduction of product and Asset Manager passports represents a great opportunity for French depositaries who already serve a large international client base. The main French depositaries are true global players in the custody world while the French regulatory model also covers additional services such as external valuation, fund administration, risk management and reporting.

We can thus be regarded as AIFMD-ready. We may therefore start servicing AIFs and the first approved AIFMs as of July 22, 2013.

Beyond AIFMD, We are committed to developing cross-border strategies for the benefit of our global clients. We enjoy a long and valuable experience in proposing flexible, and tailored, options in order to enhance the Asset Manager's experience.

French depositaries play a key role in the Asset Management industry. Our scale, expertise and commitment are keys to responding to the needs of the demanding Asset Management environment.

8. Appendix

Composition of the working group

Members

	First name	Family name	Company
Mr	Serge	BALATRE	Société Générale Securities Services
Ms	Michèle	BESSE	Société Générale Securities Services
Mrs	Marie-Catherine	DEMOLIN	RBC Investor Services
Mr	Etienne	DENIAU	Société Générale Securities Services
Ms	Florence	DWYER	BNP Securities Services
Ms	Carine	ECHELARD	CACEIS Bank
Mr	Jean Marc	EYSSAUTIER	CACEIS
Ms	Laurence	FHIMA	Société Générale Securities Services
Mrs	Karine	FORTI	State Street Bank
Mrs	Frédérique	HOUZE	Statestreet Bank
Ms	Anne	LANDIER-JUGLAR	CACEIS
Mr	Philippe	LEGRAND	RBC Investor Services
Mr	Pierre	MAUCHAMPS	RBC Investor Services
Ms	Anita	METZGER	BNP Securities Services
Mr	Bruno	NOYON	State Street Bank
Mr	Raphaël	REMOND	States Street Bank

Chairmen

	First name	Family name	Company
Ms	Karima	LACHGAR	AFTI
Mr	Patrice	BERGÉ-VINCENT	PwC France

Secretary

	First name	Family name	Company
Mr	Fahdi	EL YOUNSI	PwC France
Mr	Youssef	ATFI	PwC France