

AIFMD – Assets other than financial instruments held in custody

Directive 2011/61/EU on Alternative Fund Managers (AIFMD) includes a number of ownership verification and record keeping requirements for assets of alternative investment funds (AIFs) which are not financial instruments held in custody by a depositary ("other assets").

The types of evidence that could be used to verify ownership will vary considerably for different types of assets and across different jurisdictions. Changes to prevailing market practice may also affect the types of evidence available to verify ownership.

Safekeeping of "other assets"

Depositaries are under a responsibility to ensure the safekeeping of all assets of an AIF. However, the AIFMD draws a key distinction between financial instruments held in custody and "other assets" and safekeeping obligations differ accordingly.

"Other assets" include non-financial assets (real estate, infrastructure and commodities), derivatives and other financial contracts, financial instruments which are not registered in the name of the depositary, cash deposits, investments in privately held companies and interests in partnerships.

The safekeeping obligations applicable to "other assets" require a depositary to:

1. verify the AIF's ownership of all assets that are not financial instruments held in custody by the depositary; and

2. maintain an accurate record of those assets which have been verified as belonging to an AIF.

Ownership verification

The requirement for depositaries to verify the ownership of assets belonging to the AIF includes cases where the AIF holds beneficial title to an asset as well as cases where the AIF holds legal title to an asset.

Since depositaries may not have possession of the AIF's "other assets", it will be necessary for depositaries to obtain the relevant information either directly from the AIF or its manager (AIFM) or from other sources.

Obligation on AIFM to provide information

The AIFM is required to provide, and to ensure that any relevant third parties provide, the depositary with all relevant information that it needs to conduct its ownership verification procedures. It also requires the AIFM to ensure that all instructions and relevant information relating to the AIF's assets are sent to the depositary.

The types of information and documentation that the depositary may rely upon when conducting its ownership verification exercise will

Key issues

- Depositaries must verify the ownership of all assets that are not financial instruments held in custody and maintain an accurate and up-to-date record of those assets which have been verified as belonging to an AIF.
- Depositaries must verify that the AIFM has and implements procedures to ensure the correct registration of "other assets" and reconciliation of the depositary's records against those of the AIFM.
- Depositaries are not subject to the same liability regime as for financial instruments held in custody but will be liable for loss caused by the negligent or intentional failure to properly fulfil their obligations under the AIFMD.

vary according to the type of asset and jurisdiction.

Requirement for depositaries to possess information

A depositary is required to possess sufficient and reliable information for it to be satisfied of the AIF's ownership right to the relevant asset.

Depositaries are also under an obligation to have access to the information and documents that it needs without undue delay. The concept of "undue delay" is not defined in the AIFMD and is likely to vary depending on the type of asset concerned. For example, this may depend on how long it takes to register title in respect of a particular type of asset.

Record keeping

Depositaries are required to maintain records of assets which are not financial instruments held in custody and for which it is satisfied that the AIF owns.

In particular, a depositary must:

- register in its record assets that it is satisfied the AIF owns, including the notional amount of such assets; and
- be able to provide, at any time, a comprehensive and up-to-date inventory of the AIF's assets, including their notional amounts.

Depositaries must ensure that records reflect any changes in ownership of such assets and any corporate actions arising from these assets that result in the issue of financial instruments.

A depositary's ability to carry out its record keeping obligations is dependent on it: (a) having knowledge of such events; and (b) receiving appropriate documentation and/or information from the AIF, AIFM or third parties, which constitutes evidence of ownership.

Therefore, the depositary is required to put in place procedures to ensure that the depositary is informed of any assignment, transfer, exchange or delivery of the AIF's assets. In general, the measures required by the AIFMD are ex-post procedures, rather than ex-ante controls.

Delegation

A depositary may either keep its own record of "other assets" which it is satisfied that the AIF owns or it may choose to rely on the records kept by the fund administrator.

If a depositary wishes to delegate its record keeping obligations to a third party, it should check whether there is any local regulation or legislation which may prohibit it from delegating its record keeping obligations to a particular entity (e.g. to the AIFM).

Even where there is no prohibition on delegation, depositaries should ensure that it identifies and manages any risks appropriately; including any conflicts of interest or procedural deficiencies which mean there that the administrator's records may not be fully up-to-date.

A depositary should also ensure that it complies with any applicable outsourcing requirements when delegating record keeping obligations.

Monitoring of AIFM's procedures

Depositaries are required to ensure that the AIFM has and implements appropriate procedures to:

- verify that the assets acquired by the AIF are appropriately registered in the name of the AIF or AIFM; and
- check the consistency between the AIFM's records and the assets for which the depositary is satisfied that the AIF or the AIFM acting on behalf of the AIF holds the ownership.

The AIFM should also provide the depositary with information to enable it to perform its own verification or reconciliation between its records and those of the AIFM.

Escalation procedures

A depositary is required to set up and maintain an escalation procedure for situations where an anomaly in ownership details is detected including notification of the AIFM and of the competent authorities if the situation cannot be clarified and, as the case may be, or corrected.

Liability for loss

With respect to depositaries' safekeeping obligations outlined above, depositaries are not subject to the same liability for loss of financial instruments held in custody.

Rather, when performing safekeeping obligations in respect of assets which are not financial instruments held in custody, depositaries will only be liable to the AIF or its investors for losses suffered by them as a result of the depositary's negligent or intentional failure to properly fulfil its obligations under the AIFMD.

This briefing paper is part of a series of five papers which summarise key issues that the AGC has been considering in relation to the AIFMD