



Guernsey Financial
Services Commission

**EU’S ALTERNATIVE INVESTMENT
FUND MANAGERS DIRECTIVE
 (“AIFMD”)**

**GUIDANCE NOTES – GUERNSEY DEPOSITARY
REQUIREMENTS UNDER ARTICLE 36 OF AIFMD**

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Glossary of Terms

AIFMD	Directive 2011/61/EU on Alternative Investment Fund Managers
AIFM	Alternative Investment Fund Manager
AIF	Alternative Investment Fund
Directive 2006/73/EC	Directive 2006/73/EC of the European Parliament and of the Council of 10 August 2006 (referred to as “MiFID Implementing Directive”)
EEA	European Economic Area
ESMA	European Securities and Markets Authority
EU	European Union
Guernsey Depository	A person licensed for custody under Categories 1 and/or 2 controlled investment business under the POI Law, and is carrying out one or all of the depository duties referred to in Articles 21(7), (8) and (9) of AIFMD to a non-EEA AIF, with an EEA AIFM.
Level 2 Regulations	Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositories, leverage, transparency and supervision
the “POI Law”	The Protection of Investors (Bailiwick of Guernsey) Law, 1987, as amended

Interpretation

Unless the context otherwise requires, the terms expressed in these guidance notes have the same meaning as they have in AIFMD. Furthermore, any guidance issued by ESMA may be used by the Commission to interpret the obligations created by these guidance notes.

Purpose

The purpose of this document is to provide guidance on how Article 36 of AIFMD applies to the Bailiwick of Guernsey’s existing regulatory regime for collective investment schemes. The Commission will take this document into account when assessing a licensee’s compliance with the Minimum Criteria for Licensing under the POI Law.

1: Executive Summary

1.1 EEA Requirements

AIFMD is a European Directive that seeks to regulate the non-UCITs fund sector, including hedge funds, private equity funds and real estate funds. All AIFMs established in the EEA¹, whether they manage EEA or non-EEA AIFs are subject to AIFMD. AIFMD also governs the managing and marketing in the EEA of AIFs managed by an AIFM established outside the EEA. It is important to note that a non-EEA AIFM marketing a non-EEA AIF outside of the EEA and a non-EEA fund which does not market to EEA investors and which invests in EEA securities do not come within the scope of AIFMD. For the avoidance of doubt, AIFMD covers all funds other than UCITs Funds. Therefore, for the purposes of AIFMD, all Guernsey regulated funds which are marketed into the EEA fall within the definition of an AIF.

AIFMD entered into force on 21 July 2011 and EEA Member States were required to implement AIFMD in local laws by 22 July 2013. However, it is important to note that some EEA Member States, such as the United Kingdom have inserted transitional provisions into their regulatory regimes, which in the case of the United Kingdom have been extended to include third country (non-EEA Member States) AIFMs.

Under Article 36 of AIFMD an EEA AIFM may market to professional investors, units or shares of non-EEA AIF so long as it ensures that one or more entities are appointed to carry out the depositary duties referred to in Article 21(7), (8) and (9) of AIFMD. The EEA AIFM shall not perform those functions. The Commission does not consider that Guernsey Depositaries need to opt in to comply with The AIFMD Rules, 2013 made under the POI Law to provide such a service. It is considered that Guernsey Depositaries can provide these services on a contractual basis with the EEA AIFM. Although Guernsey Depositaries are not required to opt in to comply with The AIFMD Rules, 2013, the Commission will expect Guernsey Depositaries to follow this guidance, which is predominantly based on AIFMD and the Level 2 Regulations.

1.2 Guernsey Requirements

For many years the Guernsey regulatory regime has had a requirement for a locally licensed Designated Custodian/Trustee under the POI Law, to be appointed to an authorised or registered open-ended collective investment scheme, and this Designated Custodian/Trustee would provide safe custody and trustee oversight, where applicable. The exception to this requirement is when the scheme is operating under the Commission's Flexible Hedge Fund Policy. Notwithstanding the requirements under Article 36 of AIFMD, rules, regulations and guidance made under the POI Law, and in particular, the Incorrect Pricing of Authorised Collective Investment Schemes – Guidance Note on Correction and Compensation, will still apply to designated managers and designated custodians of open-ended collective investment schemes authorised/registered under the POI Law, unless derogations have been granted by the Commission, such as those catered for under the Flexible Hedge Fund Policy.

In the case of a closed-ended authorised or registered scheme, providing that there is full disclosure of the provisions that are in place to ensure the assets of a scheme are adequately safeguarded, the

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Although a European Union directive, AIFMD is also to be implemented by Iceland, Liechtenstein and Norway (the three EEA members that are not also members of the EU)

Commission will give consideration to the appointment of a custodian/trustee that is either domiciled or not domiciled in the Bailiwick of Guernsey.

2: Guidance

2.1 Commission's Expectations

Article 36 of AIFMD requires an AIFM to appoint one or more entities to carry out the depositary duties of cash monitoring, safekeeping of assets and share dealing oversight. The Commission does not consider that it can give detailed guidance on Article 36 of AIFMD, as it covers a wide variety of fund structures and interpretation of the requirements by financial services supervisors is likely to differ across the EEA. However, in order to define its oversight programs and procedures, it is the Commission's expectation that the Guernsey Depositary should undertake, at the time of its appointment, an initial assessment of the risks associated with the nature, scope and complexity of the AIF's strategy and the organisation of the AIFM. From this initial assessment and applying a risk based approach, the depositary shall decide on the level of due diligence it needs to implement and the number of periodic controls it needs to undertake to meet the requirements of Article 21(7), (8) and (9) of AIFMD and the underlying Level 2 Regulations, as detailed below. It is the Commission's expectation that this initial assessment be documented in writing and be kept under regular review. The Commission will review these assessments as part of its impact and risk based on-site visit regime.

2.2 Cash Monitoring

Level 1: Article 21(7) of AIFMD

The depositary shall in general ensure that the AIF's cash flows are properly monitored, and shall in particular ensure that all payments made by or on behalf of investors upon the subscription of units or shares of an AIF have been received and that all cash of the AIF has been booked in cash accounts opened in the name of the AIF or in the name of the AIFM acting on behalf of the AIF or in the name of the depositary acting on behalf of the AIF at an entity referred to in points (a), (b) and (c) of Article 18(1) of Directive 2006/73/EC, or another entity of the same nature, in the relevant market where cash accounts are required provided that such entity is subject to effective prudential regulation and supervision which have the same effect as Union law and are effectively enforced and in accordance with the principles set out in Article 16 of Directive 2006/73/EC.

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.

Level 2 Regulations: Article 85

1. Where a cash account is maintained or opened at an entity referred to in Article 21(7) of AIFMD in the name of the AIF, in the name of the AIFM acting on behalf of the AIF or in the name of the depositary acting on behalf of the AIF, an AIFM shall ensure that the depositary is provided, upon commencement of its duties and on an ongoing basis, with all relevant information it needs to comply with its obligations.
2. In order to have access to all information regarding the AIF's cash accounts and have a clear overview of all the AIF's cash flows, a depositary shall at least:

- (a) be informed, upon its appointment, of all existing cash accounts opened in the name of the AIF, or in the name of the AIFM acting on behalf of the AIF;
- (b) be informed at the opening of any new cash account by the AIF or by the AIFM acting on behalf of the AIF;
- (c) be provided with all information related to the cash accounts opened at a third party entity, directly by those third parties.

Level 2 Regulations: Article 86

A depositary shall ensure effective and proper monitoring of the AIF's cash flows and in particular it shall at least:

- (a) ensure that all cash of the AIF is booked in accounts opened with entities referred to in points (a), (b) and (c) of Article 18(1) of Directive 2006/73/EC in the relevant markets where cash accounts are required for the purposes of the AIF's operations and which are subject to prudential regulation and supervision that has the same effect as Union law, is effectively enforced and is in accordance with the principles laid down in Article 16 of Directive 2006/73/EC;
- (b) implement effective and proper procedures to reconcile all cash flow movements and perform such reconciliations on a daily basis or, in case of infrequent cash movements, when such cash flow movements occur;
- (c) implement appropriate procedures to identify at the close of business day significant cash flows and in particular those which could be inconsistent with the AIF's operations;
- (d) review periodically the adequacy of those procedures including through a full review of the reconciliation process at least once a year and ensuring that the cash accounts opened in the name of the AIF, in the name of the AIFM acting on behalf of the AIF or in the name of the depositary acting on behalf of the AIF are included in the reconciliation process;
- (e) monitor on an ongoing basis the outcomes of the reconciliations and actions taken as a result of any discrepancies identified by the reconciliation procedures and notify the AIFM if an irregularity has not been rectified without undue delay and also the competent authorities if the situation cannot be clarified and, as the case may be, or corrected;
- (f) check the consistency of its own records of cash positions with those of the AIFM. The AIFM shall ensure that all instructions and information related to a cash account opened with a third party are sent to the depositary, so that the depositary is able to perform its own reconciliation procedure.

Level 2 Regulations: Article 87

An AIFM shall ensure that the depositary is provided with information about payments made by or on behalf of investors upon the subscription of units or shares of an AIF at the close of each business day when the AIFM, the AIF or a party acting on behalf of it, such as a transfer agent receives such payments or an order from the investor. The AIFM shall ensure that the depositary receives all other relevant information it needs to make sure that the payments are then booked in cash accounts opened

in the name of the AIF or in the name of the AIFM acting on behalf of the AIF or in the name of the depositary in accordance with the provisions of Article 21(7) of AIFMD.

2.3 Safekeeping of Assets

Level 1: Article 21(8) of AIFMD

The assets of the AIF or the AIFM acting on behalf of the AIF shall be entrusted to the depositary for safe-keeping, as follows:

- (a) for financial instruments that can be held in custody:
 - (i) the depositary shall hold in custody all financial instruments that can be registered in a financial instruments account opened in the depositary's books and all financial instruments that can be physically delivered to the depositary;
 - (ii) for that purpose, the depositary shall ensure that all those financial instruments that can be registered in a financial instruments account opened in the depositary's books are registered in the depositary's books within segregated accounts in accordance with the principles set out in Article 16 of Directive 2006/73/EC, opened in the name of the AIF or the AIFM acting on behalf of the AIF, so that they can be clearly identified as belonging to the AIF in accordance with the applicable law at all times;
- (b) for other assets:
 - (i) the depositary shall verify the ownership of the AIF or the AIFM acting on behalf of the AIF of such assets and shall maintain a record of those assets for which it is satisfied that the AIF or the AIFM acting on behalf of the AIF holds the ownership of such assets;
 - (ii) the assessment whether the AIF or the AIFM acting on behalf of the AIF holds the ownership shall be based on information or documents provided by the AIF or the AIFM and, where available, on external evidence;
 - (iii) the depositary shall keep its record up-to-date.

Level 2 Regulations: Article 88

1. Financial instruments belonging to the AIF or to the AIFM acting on behalf of the AIF which are not able to be physically delivered to the depositary shall be included in the scope of the custody duties of the depositary where all of the following requirements are met:
 - (a) they are transferable securities including those which embed derivatives as referred to in the last subparagraph of Article 51(3) of Directive 2009/65/EC and Article 10 of Commission Directive 2007/16/EC (1), money market instruments or units of collective investment undertakings;
 - (b) they are capable of being registered or held in an account directly or indirectly in the name of the depositary.

2. Financial instruments which, in accordance with applicable national law, are only directly registered in the name of the AIF with the issuer itself or its agent, such as a registrar or a transfer agent, shall not be held in custody.
3. Financial instruments belonging to the AIF or the AIFM acting on behalf of the AIF which are able to be physically delivered to the depositary shall always be included in the scope of the custody duties of the depositary.

Level 2 Regulations: Article 89

1. In order to comply with the obligations laid down in point (a) of Article 21(8) of AIFMD with respect to financial instruments to be held in custody, a depositary shall ensure at least that:
 - (a) the financial instruments are properly registered in accordance with Article 21(8)(a)(ii) of AIFMD;
 - (b) records and segregated accounts are maintained in a way that ensures their accuracy, and in particular record the correspondence with the financial instruments and cash held for AIFs;
 - (c) reconciliations are conducted on a regular basis between the depositary's internal accounts and records and those of any third party to whom custody functions are delegated in accordance with Article 21(11) of AIFMD;
 - (d) due care is exercised in relation to the financial instruments held in custody in order to ensure a high standard of investor protection;
 - (e) all relevant custody risks throughout the custody chain are assessed and monitored and the AIFM is informed of any material risk identified;
 - (f) adequate organisational arrangements are introduced to minimise the risk of loss or diminution of the financial instruments, or of rights in connection with those financial instruments as a result of fraud, poor administration, inadequate registering or negligence;
 - (g) the AIF's ownership right or the ownership right of the AIFM acting on behalf of the AIF over the assets is verified.
2. Where a depositary has delegated its custody functions to a third party in accordance with Article 21(11) of AIFMD, it shall remain subject to the requirements of points (b) to (e) of paragraph 1 of this Article. It shall also ensure that the third party complies with the requirements of points (b) to (g) of paragraph 1 of this Article and the segregation obligations laid down in Article 99.
3. A depositary's safe-keeping duties as referred to in paragraphs 1 and 2 shall apply on a look-through basis to underlying assets held by financial and, as the case may be, or legal structures controlled directly or indirectly by the AIF or the AIFM acting on behalf of the AIF.

The requirement referred to in the first subparagraph shall not apply to fund of funds structures or master-feeder structures where the underlying funds have a depositary which keeps in custody the assets of these funds.

Level 2 Regulations: Article 90

1. An AIFM shall provide the depositary, upon commencement of its duties and on an ongoing basis, with all relevant information the depositary needs in order to comply with its obligations pursuant to point (b) of Article 21(8) of AIFMD, and ensure that the depositary is provided with all relevant information by third parties.
2. In order to comply with the obligations referred to in point (b) of Article 21(8) of AIFMD, a depositary shall at least:
 - (a) have access without undue delay to all relevant information it needs in order to perform its ownership verification and record-keeping duties, including relevant information to be provided to the depositary by third parties;
 - (b) possess sufficient and reliable information for it to be satisfied of the AIF's ownership right or of the ownership right of the AIFM acting on behalf of the AIF over the assets;
 - (c) maintain a record of those assets for which it is satisfied that the AIF or the AIFM acting on behalf of the AIF holds the ownership. In order to comply with this obligation, the depositary shall:
 - i. register in its record, in the name of the AIF, assets, including their respective notional amounts, for which it is satisfied that the AIF or the AIFM acting on behalf of the AIF holds the ownership;
 - ii. be able to provide at any time a comprehensive and up-to-date inventory of the AIF's assets, including their respective notional amounts.

For the purpose of point (c)(ii) of paragraph 2, the depositary shall ensure that there are procedures in place so that registered assets cannot be assigned, transferred, exchanged or delivered without the depositary or its delegate having been informed of such transactions and the depositary shall have access without undue delay to documentary evidence of each transaction and position from the relevant third party. The AIFM shall ensure that the relevant third party provides the depositary without undue delay with certificates or other documentary evidence every time there is a sale or acquisition of assets or a corporate action resulting in the issue of financial instruments and at least once a year.

3. In any event, a depositary shall ensure that the AIFM has and implements appropriate procedures to verify that the assets acquired by the AIF it manages are appropriately registered in the name of the AIF or in the name of the AIFM acting on behalf of the AIF, and to check the consistency between the positions in 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 shall ensure that all instructions and relevant information related to the AIF's assets are sent to the depositary, so that the depositary is able to perform its own verification or reconciliation procedure.

4. A depositary shall set up and implement an escalation procedure for situations where an anomaly 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.
5. A depositary's safe-keeping duties referred to in paragraphs 1 to 4 shall apply on a look-through basis to underlying assets held by financial and, as the case may be, or legal structures established by the AIF or by the AIFM acting on behalf of the AIF for the purposes of investing in the underlying assets and which are controlled directly or indirectly by the AIF or by the AIFM acting on behalf of the AIF.

The requirement referred to in the first subparagraph shall not apply to fund of funds structures and master-feeder structures where the underlying funds have a depositary which provides ownership verification and record-keeping functions for this fund's assets.

2.4 Share Dealing Oversight

Level 1: Article 21(9) of AIFMD

In addition to the tasks referred to in 21 (7) and (8) set out in sections 2.2 and 2.3 above, the depositary shall:

- (a) ensure that the sale, issue, re-purchase, redemption and cancellation of units or shares of the AIF are carried out in accordance with the applicable national law and the AIF rules or instruments of incorporation;
- (b) ensure that the value of the units or shares of the AIF is calculated in accordance with the applicable national law, the AIF rules or instruments of incorporation and the procedures laid down in Article 19;
- (c) carry out the instructions of the AIFM, unless they conflict with the applicable national law or the AIF rules or instruments of incorporation;
- (d) ensure that in transactions involving the AIF's assets any consideration is remitted to the AIF within the usual time limits;
- (e) ensure that an AIF's income is applied in accordance with the applicable national law and the AIF rules or instruments of incorporation.

Level 2 Regulations: Article 92

1. At the time of its appointment, the depositary shall assess the risks associated with the nature, scale and complexity of the AIF's strategy and the AIFM's organisation in order to devise oversight procedures which are appropriate to the AIF and the assets in which it invests and which are then implemented and applied. Such procedures shall be regularly updated.
2. In performing its oversight duties under Article 21(9) of AIFMD, a depositary shall perform *ex-post* controls and verifications of processes and procedures that are under the responsibility of the AIFM, the AIF or an appointed third party. The depositary shall in all circumstances ensure that an appropriate verification and reconciliation procedure exists which is implemented and applied and frequently reviewed. The AIFM shall ensure that all

instructions related to the AIF's assets and operations are sent to the depositary, so that the depositary is able to perform its own verification or reconciliation procedure.

3. A depositary shall establish a clear and comprehensive escalation procedure to deal with situations where potential irregularities are detected in the course of its oversight duties, the details of which shall be made available to the competent authorities of the AIFM upon request.
4. An AIFM shall provide the depositary, upon commencement of its duties and on an ongoing basis, with all relevant information it needs in order to comply with its obligations pursuant to Article 21(9) of AIFMD including information to be provided to the depositary by third parties. The AIFM shall particularly ensure that the depositary is able to have access to the books and perform on-site visits on premises of the AIFM and of those of any service provider appointed by the AIF or the AIFM, such as administrators or external valuers and, as the case may be, or to review reports and statements of recognised external certifications by qualified independent auditors or other experts in order to ensure the adequacy and relevance of the procedures in place.

Level 2 Regulations: Article 93

In order to comply with point (a) of Article 21(9) of AIFMD the depositary shall meet the following requirements:

1. The depositary shall ensure that the AIF, the AIFM or the designated entity has established, implements and applies an appropriate and consistent procedure to:
 - i. reconcile the subscription orders with the subscription proceeds, and the number of units or shares issued with the subscription proceeds received by the AIF;
 - ii. reconcile the redemption orders with the redemptions paid, and the number of units or shares cancelled with the redemptions paid by the AIF;
 - iii. verify on a regular basis that the reconciliation procedure is appropriate.

For the purpose of points (i), (ii) and (iii), the depositary shall in particular regularly check the consistency between the total number of units or shares in the AIF's accounts and the total number of outstanding shares or units that appear in the AIF's register.

2. A depositary shall ensure and regularly check that the procedures regarding the sale, issue, repurchase, redemption and cancellation of shares or units of the AIF comply with the applicable national law and with the AIF rules or instruments of incorporation and verify that these procedures are effectively implemented.
3. The frequency of the depositary's checks shall be consistent with the frequency of subscriptions and redemptions.

Level 2 Regulations: Article 94

1. In order to comply with point (b) of Article 21(9) of AIFMD the depositary shall:
 - (a) verify on an ongoing basis that appropriate and consistent procedures are established and applied for the valuation of the assets of the AIF in compliance with Article 19 of

- AIFMD and its implementing measures and with the AIF rules and instruments of incorporation; and
- (b) ensure that the valuation policies and procedures are effectively implemented and periodically reviewed.
2. A depositary's procedures shall be conducted at a frequency consistent with the frequency of the AIF's valuation policy as defined in Article 19 of AIFMD and its implementing measures.
 3. Where a depositary considers that the calculation of the value of the shares or units of the AIF has not been performed in compliance with applicable law or the AIF rules or with Article 19 of AIFMD, it shall notify the AIFM and, as the case may be, or the AIF and ensure that timely remedial action is taken in the best interest of the investors in the AIF.
 4. Where an external valuer has been appointed, a depositary shall check that the external valuer's appointment is in accordance with Article 19 of AIFMD and its implementing measures.

Level 2 Regulations: Article 95

In order to comply with point (c) of Article 21(9) of AIFMD the depositary shall at least:

- (a) set up and implement appropriate procedures to verify that the AIF and AIFM comply with applicable laws and regulations and with the AIF's rules and instruments of incorporation. In particular, the depositary shall monitor the AIF's compliance with investment restrictions and leverage limits set in the AIF's offering documents. Those procedures shall be proportionate to the nature, scale and complexity of the AIF;
- (b) set up and implement an escalation procedure where the AIF has breached one of the limits or restrictions referred to in point (a).

Level 2 Regulations: Article 96

1. In order to comply with point (d) of Article 21(9) of AIFMD the depositary shall set up a procedure to detect any situation where a consideration related to the operations involving the assets of the AIF or of the AIFM acting on behalf of the AIF is not remitted to the AIF within the usual time limits, notify the AIFM and, where the situation has not been remedied, request the restitution of the financial instruments from the counterparty where possible.
2. Where transactions do not take place on a regulated market, the usual time limits shall be assessed with regard to the conditions attached to the transactions (OTC derivative contracts or investments in real estate assets or in privately held companies).

Level 2 Regulations: Article 97

1. In order to comply with point (e) of Article 21(9) of AIFMD the depositary shall:
 - (a) ensure that the net income calculation, once declared by the AIFM, is applied in accordance with the AIF rules, instruments of incorporation and applicable national law;

- (b) ensure that appropriate measures are taken where the AIF's auditors have expressed reserves on the annual financial statements. The AIF or the AIFM acting on behalf of the AIF shall provide the depositary with all information on reserves expressed on the financial statements; and
 - (c) check the completeness and accuracy of dividend payments, once they are declared by the AIFM, and, where relevant, of the carried interest.
2. Where a depositary considers that the income calculation has not been performed in compliance with applicable law or with the AIF rules or instruments of incorporation, it shall notify the AIFM and, as the case may be, or the AIF and ensure that timely remedial action has been taken in the best interest of the AIF's investors.

3: Notifications to the Commission

At the time of its appointment, a Guernsey Depositary shall give written notification forthwith to the Commission of the fact, and the date, it commenced the provision of depositary services to a non-EEA AIF with an EEA-AIFM, pursuant to Article 36 of AIFMD. As part of this notification procedure, the Guernsey Depositary shall also submit an executed copy of the depositary agreement between it and the EEA AIFM. The Commission will review any service level agreements put in place as a result of Article 36 of AIFMD as part of its impact and risk based on-site visit regime.

Please note, in the case of an authorised or registered open ended collective investment scheme, under Section 8(5) of the POI Law, an authorisation/registration must name the designated custodian/trustee. It remains the Commission's expectation in respect of Class A, B or Q authorised and registered open-ended collective investment schemes that a change of designated custodian/trustee should not occur until the Commission has varied the authorisation to ensure that the provisions of the aforementioned Section 8(5) are met. The Commission's website details the information/documentation required to vary the authorisation/registration of a collective investment scheme.