

Best practice guidelines for depositary banks in relation to the safekeeping of assets from UCITS funds held through the traditional custody network

The purpose of the following is to provide general principles and "best practice" guidelines applicable to the Depositary Bank in relation to the safekeeping aspects of assets that are held by sub-custodians either through the standard custody network of the depositary or through the client directed / imposed sub-custodians.

1. Appointment and monitoring of the sub-custodian (local Agents)

As a general principal, the selection process, appointment and monitoring of the sub-custodian in relation to the safekeeping of these assets held inside the traditional sub-custody network remains the responsibility of the Luxembourg Depositary Bank which is as well the Custodian Bank in Luxembourg.

The Depositary Bank performs proper due diligence on those sub-custodians through an assessment process including, but not limited to, the examination of: the legal framework (in case of default, fraud, bankruptcy, ...), the regulatory framework (regulatory principles, supervisory body, regulation existing in relation to liability,...), the political environment (stability,...); credit worthiness, the management and the operational infrastructure; staffing and expertise of the operation; custody volume capacity; sophisticated technology/communications; financial strength; internal control and related risk management infrastructure; external linkages to settlement and registration processes, depositaries, exchanges and clearing entities; income processing, corporate actions and proxy voting capabilities; contingency plans; results of external/internal audits; insurance coverage; etc...

This initial due diligence should be supplemented by ongoing monitoring to ensure that the sub-custodians remain appropriate.

2. Account structure and segregation of assets at the counterparty

The sub-custodian either operates an omnibus client account structure or operates segregated custody accounts for each client as per the provisions of local regulations of each jurisdiction. In case of omnibus accounts maintained at sub-custody level, the depositary has to ensure segregation at fund/sub-fund level within its systems. At sub-custody level the assets should also be “ring-fenced” and held separately from the sub-custodian’s accounts and (non-cash) assets.

In no circumstances proprietary assets of sub-custodian should be co-mingled in its books with the custody client assets to ensure that ownership on the client assets can be easily evidenced and therefore claimed.

As a general principle, the security account with the sub-custodian would ideally be opened on behalf of the Bank with express reference to the relevant client. In some markets (e.g. India) there are possibilities that the assets are registered directly in the name of the client with no reference to the custodian .

Cash related assets held by the fund/sub-fund with the Luxembourg depositary bank are not subject to segregation rules due to the nature of these assets and fall under the counterparty risk of the Luxembourg depositary bank.

3. Re-hypothecation of assets

Re-hypothecation of assets, where authorised by regulation applicable to the Fund and the sub-custodian, should be specifically disclosed and governed, including necessary reporting requirements, in a provision of the sub-custody contract and, as the case may be, in the Fund’s prospectus.

4. Periodic reconciliation and audit confirmation

Depositary Bank’s records of holdings are reconciled to statements of holdings from the local sub-custodians at least monthly. Differences are identified, investigated and resolved on a timely basis.



Book/records from the depositary associated with a SAS70 report or similar control report is provided.

5. Disclosure in the Fund's Prospectus

Sub-custodians are generally not disclosed in the Fund's prospectus. For market directed sub-custodians a disclosure in the prospectus highlighting the specific risks of the market could be recommended.



Best practice guidelines for depositary banks in relation to the safekeeping of assets from UCITS funds NOT held through the traditional custody network

The purpose of the following is to provide general principles and “best practice” guidelines applicable to the Depositary Bank in relation to the safekeeping aspects of assets that are not held through the traditional custody network, due to the nature of those investments (namely but not limited to derivatives, third party foreign exchange and deposits, investments into target funds not eligible through the traditional clearing systems, repurchase agreements and lending transactions...).

1. Appointment and monitoring of the counterparties

With the enlargement of the notion of eligible investments under the UCITS Directive, a broad range of asset classes are now dealt through and held by third parties, directly selected and/or appointed by Board of Directors of the Fund or the Management Company, which are not and often cannot be part of the Depositary's global network. In this context, Depositaries cannot be liable for the selection of these third parties and ultimately the counterparty risk associated to them. On that basis, the selection process, appointment and monitoring of the counterparties in relation to the safekeeping of these assets held outside the traditional custody network remains the responsibility of the Board of Directors of the Fund or the Management Company.

The Fund should provide the Depositary Bank with a duly signed list of authorised counterparties and make available the relevant information supporting its due diligence process in the selection and ongoing monitoring of those counterparties. The Depositary shall comply with its general obligation of supervision by:

- a) Ensuring that the board of the Fund or its Management Company has adequate procedures in place with respect to the selection and the monitoring of those third parties,
- b) Implementing checks on financial resources, competence and reputation of the counterparty,
- c) Reconciling records (at least on balances) periodically. Differences are identified, investigated and resolved on a timely basis.

Notwithstanding the above, the Depositary Bank would not engage a validation process for counterparties that play a passive and administrative role (e.g. Transfer agent of a target fund or Registrar for a Private Equity investment). The Depositary Bank may decide to be part of the contractual agreement but this is not a prerequisite. However, it should receive from the Board of Directors and related counterparties concerned all the necessary information in order to perform its supervision duties. Finally, the scope and frequency of reviews should be commensurate with the risk attached to the counterparty in charge of the safe-keeping of the assets.

2. Account structure and segregation of assets at the counterparty

It is acknowledged as general principle that third parties should segregate the assets held on behalf of their clients from their own and ensure that the accounts holding the assets of the Fund (including collateral) should be opened in the name of the Fund (or the sub-Fund in case of an umbrella structure) or in the name of the Depositary Bank in favour of the Fund. One would also expect a power of attorney to be granted to the Depositary in order to give it direct access to the assets. The Depositary Bank would be looking to receive an attestation or affirmation letter from the Board of Directors of the Fund or Management Company that, at the level of the counterparty (and where applicable its sub-custodians), there is an effective segregation of assets. Alternatively, the Depositary Bank will send a questionnaire to the counterparty, by which it obtains evidence.



3. Re-hypothecation of assets

Re-hypothecation of assets, where authorised by regulation, should be subject to specific disclosure into the Fund prospectus and the Board of Directors of the Fund or Management Company should ensure that safeguards are in place to ensure that the safety and liquidity of the assets subject to the re-hypothecation are not compromised. It is important to mention that in case of re-hypothecation, a direct intervention from the Depositary on the assets will not be possible.

4. Additional considerations

The contractual documentation and related service level agreements to be signed by the relevant parties should include specific arrangements supporting the provision of all the necessary information (e.g. legal documentation, statements, summary of activity...) to the Depositary in order to fulfill its supervisory duties. In the context of the annual certification of the accounts by the independent auditors, assets held by those third parties will not be included on the official custody confirmation but the Depositary Bank will make the results of its controls available to the auditors.
