

New challenges. New solutions

Investment Trust Companies

Care and control of clients' investments: the regulatory net widens

One result of the recent financial crisis was the extension of the European regulatory framework to a wider number of investment vehicles through the Alternative Investment Fund Managers Directive ('AIFMD'), which is now enshrined in European law and will eventually be reflected in the domestic legislation of each of the Member States. For the purposes of the Directive, quoted UK investment trust companies are regarded as 'alternative investment funds' and, subject to size thresholds, will require the appointment of a depositary. The purpose of this paper is to provide an overview of the additional protections afforded to investors and the impact on the operating model for investment companies as a result of this change in the UK.

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Where have we come from?

In the UK, a regulatory oversight regime covering open ended collective investment schemes (unit trusts and OEICs, often referred to collectively as mutual funds) has been in place since regulations were published under the Financial Services Act in 1988. Under direct supervision by the Financial Services Authority, the funds industry is now operating within a framework which is both well understood and delivering a high level of protection to underlying investors. Driven at a headline level by the UCITS legislation in Europe, similar regulatory regimes are in place for most of the EU Member States.

The role of the Depositary

For open ended funds, primary fiduciary responsibility to investors lies with the fund manager. However, underpinning this is the requirement that an independent depositary is appointed with direct responsibility for:

- Safekeeping the fund assets (the custody function)
- Overseeing certain activities of the fund manager or their delegates (eg. investment advisers, fund accountants, transfer agents), including:
 - review of the investment portfolio against relevant restrictions
 - monitoring of borrowing and liquidity
 - periodic validation of the net asset value and pricing procedures
 - sample testing transactions with investors
 - ensuring timely production of the Report & Accounts and payment of distributions
 - review of controls and procedures through onsite visits

In discharging the detailed responsibilities defined in the regulations, there is a requirement placed on the depositary to act in the best interests of investors.

In broad terms, the AIFMD extends these types of activities, with some modification, to cover all ‘alternative investment funds’, including investment trust companies.

J.P. Morgan provides depositary services through its Trust & Fiduciary Services Team, which acts in a fiduciary capacity for collective investment schemes across Europe. J.P. Morgan Trustee & Depositary Company Limited and our European affiliates are leading providers in Dublin, Frankfurt, Jersey, Luxembourg and the UK, and have a growing presence in Belgium, Denmark, Finland, Norway, Sweden and Switzerland.

Our Trust & Fiduciary business has grown significantly over the past 10 years. When we take our UK business and that of our affiliates in Europe into account, in 1997 we provided services to 554 funds with a value of around \$70 billion. Today, those figures have risen to over 2000 funds with a value in excess of \$1 trillion – making J.P. Morgan the largest provider in terms of assets in the European market. With the increasing influence of Europe on financial services legislation, our extensive pan European experience is therefore becoming increasingly valuable in the context of eventual implementation in the UK.

Key Features and Benefits

| Feature | Benefits |
|---|---|
| Partnering with Clients | <p>Trust & Fiduciary Services works:</p> <ul style="list-style-type: none"> • In partnership with clients to ensure that fund assets are securely kept and properly serviced, that the various schemes are managed in accordance with the local regulations, and that the interests of investors are protected • To provide assistance to its clients on technical matters |
| Experienced and Client-Focused Staff | <ul style="list-style-type: none"> • Our team includes experienced professionals with many years of industry knowledge who know this business and their clients |
| Independent Structure | <ul style="list-style-type: none"> • In the U.K., authorisation from the FSA is contingent upon the Trustee & Depositary Company acting as an independent entity and ensuring that potential conflicts of interest with other elements of J.P. Morgan or others are properly managed. This ensures strong focus on the discharge of our fiduciary responsibilities to investors |
| Technical Support | <ul style="list-style-type: none"> • In addition to our experienced client teams, we have a team of technical experts from the wider organisation with skills in all the various aspects of fund services and transaction processing |

Highlights

- Specific assistance to clients on an individual basis
- Comprehensive monitoring programmes, both “desktop” checks and, where appropriate, site visits to the asset management company, or its respective agents
- J.P. Morgan Trust & Fiduciary works with clients, industry associations, policy makers and regulators to ensure that its services comply with industry best practices

The role of the Custodian

Whilst the depository has the statutory responsibility for safekeeping fund assets, in practice the task is often delegated to a specialist global custodian in the UK, often from within the same corporate group, whose activities include:

- Custody
- Appointment and management of subcustodians
- Trade settlement
- Collection of income
- Corporate actions
- Tax reclaims
- Proxy voting

The day-to-day operating model is based on direct interface with the fund manager.

J.P. Morgan offers one of the largest and most experienced custody services teams in the industry, and provides uniform high quality servicing of assets through a wide

network of J.P. Morgan branches, affiliates and subcustodians. J.P. Morgan has the industry's most geographically diversified and experienced network management team with professionals located throughout the world actively engaged in servicing \$15.9 trillion of assets, managing 100 markets and 100 subcustodial relationships and providing extensive market information to clients. Through both onsite visits and ongoing communications, each network manager fosters local relationships not only with core market participants (such as stock exchanges, depositories and regulators), but also with leading brokers, registrars and central banks. For J.P. Morgan's clients, this expertise translates into comprehensive market intelligence and products that support clients in their risk assessment of markets and helps in identifying solutions for mitigating such risks.

Our network and risk management teams' structure and protocols have served us well over time. During the recent market

turbulence, our 'business as usual' processes were highly effective in enabling us to quickly identify and report potential concerns and to mitigate risks across our network.

Conclusion

J.P. Morgan continues to monitor the progress of the AIFMD and the implications of any changes as its requirements become embedded in domestic legislation. We are also focusing specifically on refining our depository and custody services with the aim of providing reliable and practical support to a wide range of investment vehicles captured by the AIFMD, with particular regard to their legal structures and operating models. This is in addition to the existing range of services that J.P. Morgan already offers to investment companies, including fund administration and company secretarial support.

If you have any queries on the content of this document or the progress of the AIFMD, please contact:

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