

The role played by depositaries

There has been more focus on depositaries recently as a result of Cayman's new Private Funds Law and the FCA's decision to look into decisions taken by the depositary at Woodford Investment Management.

It is usually only when something goes wrong that the role depositaries play in fund governance gets any coverage in the media. That is what happened now that the FCA has launched an enquiry into the role played by the Northern Trust, the depositary for Woodford Investment Management. In particular the FCA is looking at Northern Trust in relation to the events that led to the gating of the Woodford Equity Income fund last June.

Northern Trust was supposed to have been overseeing the work done by Link, Woodford's ACD. This includes ensuring that are following the rules with regard to pricing, dealing, borrowing restrictions and portfolio valuation.

The point of the FCA's investigation is to find out what Northern Trust did in terms of its oversight of Woodford Investment Management. Did it, for example, challenge Link as Woodford was building-up illiquid holdings in his funds, which breached the FCA's 10% limit on unquoted stocks? It will also want to know how much Northern Trust knew about Woodford listing of illiquid companies on the Channel Islands Stock Exchange. There are understood to also be concerns with the accuracy of daily pricing of unlisted holdings.



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It is worth pointing that if Northern Trust didn't perform its oversight role properly that it could find itself the target of some lawsuits. It has deep pockets. And whilst disgruntled investors will continue to take action against Link they would likely have another entity, with more resources, to go after as well.

News of the FCA's investigation into Northern Trust's oversight role in the Woodford affair comes at approximately the same time as Cayman's new Private Funds law, which came into effect on August 7. The provisions in the new law have been covered a number of times in The NED but not the association with AIFMD that INDOS Financial has made.

Bill Prew, CEO of INDOS, has said that some of the new requirements

in Cayman are based on similar rules within AIFMD, which are required to be performed by a fund depositary. These include: implementation of appropriate and consistent valuation procedures; arranging custody of custodial assets; verification of ownership and title of all other assets; and the monitoring cash flows including the checking of cash accounts and receive of investor contributions. These functions have to be carried out independently of the investment management process and conflicts of interest need to be identified and disclosed to investors.

It is quite likely that managers of many Cayman funds will outsource this job to third party depositaries like INDOS. 'Quite some industry achievement for over 12,000 funds to register for

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the first time in the Cayman Islands under the new Private Funds Law. We now expect managers to turn their attention to how they will comply with the new operating conditions ... with regulatory focus being on non-EU managers initially given many EU managers will already de facto comply through existing depositary arrangements in place', says Bill Prew.

There are three core duties of depositaries: safe-keeping of assets, cash flow monitoring and various oversight functions such as of the NAV and complying with the investment mandate.

In the past Bill Prew has made the point that the the Weaving Capital disaster would have been avoided if the AIFMD's depositary requirements had been in place back then. 'Whilst AIFMD may not have prevented the collapse of Weaving Capital, there is no doubt an independent FCA regulated depositary would have detected the irregularities and taken appropriate action to blow the whistle long before the eventual collapse,'



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says Bill Prew. Weaving's funds were domiciled in Cayman.

Many entities performing the depositary function are also doing service provider work for the fund, such as administration. Concern has been expressed in the past that some of those in this position do not take their responsibilities as depositary seriously enough and so it becomes another 'tick the box' type function.

In some respects, there maybe similarities to role played by large fund governance firms here, those

who provide individuals for board positions whilst, at the same time, offering a range of complementary services to managers such as risk and compliance. In the case of the depositary and the global fund governance firm there is a danger that the oversight function becomes another routine function just to be ticked off.

Will that be what happens in Cayman following the new requirements in its Private Funds Law? Only time will tell. ■

The new monthly publication from IFI Global

The Briefing Report

Measuring ESG's impact on the fund industry

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