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L.N. 114 of 2016

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INVESTMENT SERVICES ACT (CAP. 370)

Investment Services Act (Custodians of Collective Investment Schemes) Regulations, 2016

IN exercise of the powers conferred by article 12 of the Investment Services Act, the Minister for Finance, acting on the advice of the Malta Financial Services Authority, has made the following regulations:-

Part 1

Preliminary

Citation and scope.

1. (1) The title of these regulations is the Investment Services Act (Custodians of Collective Investment Schemes) Regulations, 2016.

(2) The objective of these regulations is in part to transpose the following:

(a) Articles 22, 22a, 23, 24, 25, 26 and 26a of the UCITS Directive; and

(b) Articles 19(4) second sub-paragraph, 21 and 61(5) of the AIFMD.

(3) These regulations shall be applicable to custodians of all collective investment schemes.

Interpretation.

2. (1) In these regulations, unless the context otherwise requires:

Cap. 370.

"the Act" shall mean the Investment Services Act;

"AIFMD" means Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers, as may be amended from time to time;

"alternative investment fund" or "AIF" means a collective investment scheme, including the subfunds thereof, which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors, and which does not qualify as a UCITS Scheme in terms of the UCITS Directive;

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"alternative investment fund manager" or "AIFM" means a legal person whose regular business is the management of one or more AIFs;

"Category 2 Investment Services Licence" shall have the same meaning as that provided in the Investment Services Act (Licence and other fees) Regulations; S.L. 370.03

"collective investment scheme" or "scheme" shall have the same meaning as that provided in the Act; Cap. 370.

"the competent authority" means the Malta Financial Services Authority established by the Malta Financial Services Authority Act; Cap. 330.

"custodian" means a licence holder in possession of a Category 4a or 4b investment services licence, as the context requires, issued in terms of the Act; Cap. 370.

"Directive 2013/36/EU" means Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC as may be amended from time to time and includes any implementing measures that have been or may be issued thereunder;

"Directive 2010/43/EC" means Commission Directive 2010/43/EC of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company as may be amended from time to time and includes any implementing measures that have been or may be issued thereunder;

"Directive 2006/73/EC" means Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive as may be amended from time to time and includes any implementing measures that have been or may be issued thereunder;

"financial instrument" means a financial instrument as specified in Section C of Annex I to Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments;

"Investment Services Rules" means the Rules issued by the competent authority pursuant to the provisions of the Act; Cap. 370.

"Maltese UCITS" means:

(a) an investment company, a partnership *en commandite* or a limited partnership with its registered office and head office situated in Malta and licensed in terms of the Act; or Cap. 370.

(b) where the UCITS is constituted as a common fund, a UCITS domiciled in Malta in terms of the Investment Services Act (Contractual Funds) Regulations and licensed in terms of the Act; or S.L. 370.16 Cap. 370.

(c) where the UCITS is established as a unit trust, a unit trust whose proper law is the law of Malta;

"management body" shall mean the body with the ultimate decision-making authority in a management company or fund manager, investment company or custodian, comprising the supervisory and the managerial functions, or only the managerial function if the two functions are separated;

"Regulation (EU) No. 231/2013" shall mean 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, depositaries, leverage, transparency and supervision;

"UCITS" means undertakings for collective investment in transferable securities in terms of the UCITS Directive as defined herein;

"UCITS Directive" means Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast), as amended by Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014;

"UCITS management company" means a management company authorised by a European regulatory authority or the competent authority and the regular business of which is the management of UCITS.

(2) Words and expressions which are also used in the Act shall have the same meaning as in the Act. Cap. 370.

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Part 2

General requirements applicable to custodians of collective investment schemes

Applicability of Part 2.

3. This Part shall apply to custodians of all collective investment schemes.

Requirement of a licence.

Cap. 370.

4. (1) The custodian of a collective investment scheme shall be in possession of a valid Category 4a or 4b Investment Services Licence issued in terms of the Act.

(2) A Category 4a Investment Services Licence Holder shall be eligible to act as custodian to all types of collective investment schemes.

(3) A Category 4b Investment Services Licence Holder shall be eligible to act as custodian in specific instances as prescribed in Part 4.

Written contract.

5. (1) The collective investment scheme or the fund manager on behalf of the scheme shall ensure that a custodian is appointed.

(2) The appointment of the custodian of a collective investment scheme pursuant to sub-regulation (1) shall be evidenced by a written contract also referred to as the custody agreement.

(3) The custody agreement shall, *inter alia*, regulate the flow of information deemed to be necessary to allow the custodian to perform its functions for the scheme for which it has been appointed as custodian in accordance with these regulations.

Custodian's fees.

6. (1) The custodian shall have the right to charge fees to the scheme and to be reimbursed for expenses in accordance with the terms and conditions of the custody agreement referred to in regulation 5.

(2) The custodian may, if authorised to do so by the terms and conditions of the custody agreement, exercise a right of retention over the assets of the scheme held under its control, to the extent of any lawfully due but unpaid fees and expenses, until such fees and expenses are paid.

Termination of the custody agreement.

7. (1) Without prejudice to any requirements as may be prescribed by the competent authority, a custody agreement may be terminated by the scheme, by the fund manager, by the custodian or by order of the competent authority:

Provided that the fund manager may terminate the custody agreement in the case where it is a party to the agreement and it has been granted termination rights.

(2) The custodian shall proceed with the conveyance of the assets held for the scheme as stipulated in the custody agreement or as instructed by the scheme.

Termination of custody.

8. (1) The termination of the appointment of the custodian in accordance with the provisions of regulation 7 shall only come into force following the lapse of a transitional period of three months from the date of the notification to terminate the custody agreement, within which the scheme or the fund manager on behalf of the scheme is to appoint another custodian:

Provided that the three-month transitional period shall not apply in the instances where the custody agreement includes clauses which provide for its immediate termination.

(2) At any time prior to the expiration of the transitional period, the custodian and the scheme or the fund manager on behalf of the scheme may, by agreement, extend the transitional period.

(3) Where the scheme, the fund manager on behalf of the scheme or the custodian serves notice to terminate the appointment of the custodian, it shall simultaneously notify the competent authority of the intended termination of the appointment of the custodian and of the transitional period specified in sub-regulation (1).

(4) In the case where following the lapse of the transitional period, the scheme, or the fund manager on behalf of the scheme, fails to find a replacement for the outgoing custodian, the scheme, or the fund manager on behalf of the scheme shall immediately notify the competent authority.

(5) Following an assessment of the case, the outgoing custodian shall, in accordance with the directions given by the competent authority, provide the monitoring, safekeeping and oversight functions as the case may be in relation to the assets of the scheme:

Provided that, having regard to the circumstances of the case, the competent authority may also order the suspension of the collective investment scheme licence or the liquidation and winding up of the scheme.

Replacement of the custodian.

9. The constitutional documents of the scheme shall lay down the conditions for the replacement of the custodian as well as rules to

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ensure the protection of unit-holders in the event of such replacement.

Insolvency of the custodian.

10. In the event of insolvency of the custodian and, or of any third party located in any Member State or EEA State to which custody of assets has been delegated, the assets of the scheme held in custody shall not be available for distribution among, or realisation for the benefit of, the creditors of such a custodian and, or such third party.

Assets held by the custodian constitute a distinct patrimony.

11. (1) A custodian holding assets of a scheme in custody shall hold such assets solely for and on behalf of and in the interest of the scheme and its investors.

Cap. 16.

(2) Notwithstanding the provisions of article 1894 of the Civil Code, the assets held by the custodian shall be deemed to constitute a distinct patrimony, separate from that belonging to the custodian and from that of other collective investment schemes, the assets of whom are also held by the custodian.

Cap. 16.

(3) Except as expressly provided in the custody agreement entered into between the custodian and the scheme or the fund manager on behalf of the scheme and notwithstanding the provisions of the Civil Code, the control of assets of the scheme, shall not give or be deemed or construed to give to the custodian any rights over such assets nor shall it create any form of loan between the custodian and the scheme and this notwithstanding the nature of the assets or the rights or obligations of the custodian in relation to the assets.

Scheme enjoys right of ownership in assets.

12. (1) The scheme whose assets are held by a custodian enjoys a right of ownership in such assets notwithstanding that they may be registered in the name and title of or are otherwise vested in the custodian.

(2) The records, accounts and other statements held or issued by the custodian shall, saving any proof to the contrary, constitute evidence of their contents and of the right of ownership of the scheme as provided in terms of sub-regulation (1).

Assets held under control not subject to the rights of creditors of the custodian.

13. (1) The creditors of the custodian shall have no claim or right of action on or against the assets held by the custodian for and on behalf of the scheme and such assets shall not be affected in any manner by the provisions of laws and regulations in force regulating the insolvency or bankruptcy of the custodian.

(2) In the event of any such insolvency or bankruptcy or related order or resolution, or in the event that the competent authority so requires, the custodian or any administrator or receiver or other officer appointed to represent it by any court or otherwise, shall

on demand of any scheme or of the competent authority, immediately transfer the control, possession and title of all assets held by or in the name of the custodian on behalf of the scheme to another custodian or to such other person as may be instructed by the scheme or by the competent authority.

(3) In the event that any assets held by the custodian are, at the request of any creditor of the custodian, made subject to any precautionary or executive act or warrant granted by any Court in terms of the Code of Organization and Civil Procedure, the scheme on whose behalf such assets are being held or the competent authority may, by application to the Court, request the release of the assets from such act or warrant and the Court shall on production of evidence, as it may deem fit, accede to the application without delay.

Cap. 12.

Applicability of the Duty on Documents and Transfers Act.

14. (1) The delivery of the assets of a scheme to a custodian and from a custodian to a scheme or another custodian for the purpose of these regulations shall not be deemed to constitute a chargeable transfer for the purposes of the Duty on Documents and Transfers Act and for the purposes of article 5(1) of the Income Tax Act, where the delivery of such assets does not constitute a change in the beneficial owner of the assets.

Cap. 364.

Cap. 123.

(2) For the purposes of this regulation, beneficial owner means a person who is the real owner of, or who is otherwise beneficially entitled to, the assets held by the custodian, as is provided in regulation 12.

Part 3

Requirements applicable to custodians of UCITS

Applicability of Part 3.

15. (1) This Part shall apply exclusively to custodians of UCITS.

(2) The custodian of a Maltese UCITS shall also be guided by the provisions prescribed in the Investment Services Rules for Investment Services Providers applicable to custodians.

Appointment of the custodian.

16. (1) The UCITS management company shall ensure that a single custodian is appointed for each UCITS it manages.

(2) Where the scheme is a self-managed UCITS, it shall ensure that a custodian is appointed.

Eligibility criteria.

17. (1) The custodian of a Maltese UCITS shall have an established place of business in Malta.

(2) The following entities shall be eligible to provide custody

services to a UCITS:

(a) a national central bank;

(b) a credit institution authorised in accordance with Directive 2013/36/EU and in possession of a licence issued in terms of the Banking Act; Cap. 371.

(c) a branch established in Malta of a credit institution authorised in a Member State or EEA State;

(d) a company incorporated in Malta, which is wholly owned by a credit institution, provided that the liabilities of the company are guaranteed by the credit institution, and the credit institution is either a Maltese credit institution or a credit institution established in an EU Member State or an EEA State and authorised in accordance with Directive 2013/36/EU:

Provided that the entity referred to in this paragraph (d) shall be required to have a minimum of one director who is resident in Malta on its board of directors;

(e) an investment firm or branch of an investment firm established in a Member State or EEA State other than Malta subject to capital adequacy requirements in accordance with Directive 2013/36/EU and Regulation (EU) No 575/2013 including capital requirements for operational risks and authorised in accordance with Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments and which also provides the ancillary service of safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management in accordance with point (1) of Section B of Annex I of Directive 2004/39/EC:

Provided that such investment firms shall in any case have own funds not less than the amount of initial capital referred to in Article 28(2) of Directive 2013/36/EU:

Provided further that the entity referred to in this paragraph (e) shall be required to have a minimum of one director who is resident in Malta on its board of directors.

(3) The entities referred to in sub-regulation (2) shall be in possession of a Category 4a Investment Services Licence issued in terms of the Act. Cap. 370.

(4) An entity which is referred to in sub-regulation (2)(c), (d) and (e) shall be subject to prudential regulation and ongoing supervision and shall satisfy the following minimum requirements:

(a) it shall have the infrastructure necessary to keep in custody financial instruments that can be registered in a financial instruments account opened in the custodian's books;

(b) it shall establish adequate policies and procedures sufficient to ensure compliance of the entity, including its managers and employees, with its obligations in terms of these regulations;

(c) it shall have sound administrative and accounting procedures, internal control mechanisms, effective procedures for risk assessment and effective control and safeguard arrangements for information processing systems;

(d) it shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest;

(e) it shall arrange for records to be kept of all services, activities and transactions that it undertakes, which shall be sufficient to enable the competent authority to fulfil its supervisory tasks and to perform the enforcement actions provided for in these regulations as well as in the applicable Investment Services Rules;

(f) it shall take reasonable steps to ensure continuity and regularity in the performance of its custodian functions by employing appropriate and proportionate systems, resources and procedures including to perform its custody activities;

(g) all members of the management body and the senior management of the said entity shall at all times be of sufficiently good repute and possess sufficient knowledge, skills and experience;

(h) the management body of the said entity shall possess adequate collective knowledge, skills and experience to be able to understand the custodian's activities, including the main risks; and

(i) each member of the management body and senior management shall act with honesty and integrity.

(5) UCITS or UCITS management companies acting on behalf

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of the UCITS they manage which, prior to 18 March 2016, appointed as custodian an institution that did not meet the requirements prescribed in sub-regulations (2) and (4), shall, by 18 March 2018, appoint a custodian that meets the said requirements.

Conflicts of interest.

18. (1) No company shall act as both UCITS management company and custodian.

(2) A scheme which is in possession of a collective investment scheme licence issued in terms of the Act shall not act as custodian. Cap. 370.

(3) In carrying out their respective functions, the UCITS management company and the custodian shall act honestly, fairly, professionally, independently and solely in the interests of the UCITS and the investors of the UCITS.

(4) A custodian shall not carry out activities with regard to the UCITS or the UCITS management company on behalf of the UCITS, that may create conflicts of interest between the UCITS, the investors in the UCITS, the UCITS management company and itself, unless the custodian has functionally and hierarchically separated the performance of its custodian tasks from its other potentially conflicting tasks, and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the UCITS.

Oversight function.

19. The custodian shall:

(a) ensure that the sale, issue, repurchase, redemption and cancellation of units of the UCITS are carried out in accordance with the requirements prescribed by the competent authority, if any, applicable to the UCITS and with the constitutional documents of the UCITS;

(b) ensure that the value of the units of the UCITS is calculated in accordance with the provisions of the constitutional documents of the UCITS;

(c) carry out the instructions of the UCITS management company or the UCITS, unless they conflict with the requirements prescribed by the competent authority, if any, applicable to the UCITS and with the constitutional documents of the UCITS;

(d) ensure that in transactions involving the assets of the UCITS, any consideration is remitted to the UCITS within the usual time limits;

(e) ensure that the income of the UCITS is applied in accordance with the constitutional documents of the UCITS.

Monitoring of cash flows function.

20. (1) The custodian shall ensure that the cash flows of the UCITS are properly monitored and, in particular, that all payments made by or on behalf of investors upon the subscription of units of the UCITS have been received.

(2) The custodian shall ensure that all cash of the UCITS has been booked in cash accounts that are:

(a) opened in the name of the UCITS, the UCITS management company acting on behalf of the UCITS, or the custodian acting on behalf of the UCITS;

(b) opened at one of the following entities:

(i) a central bank;

(ii) a credit institution authorised in accordance with Directive 2013/36/EU; or

(iii) a bank authorised in a third country;

(c) maintained in accordance with the principles set out in Article 16 of Directive 2006/73/EC.

(3) Where the cash accounts are opened in the name of the custodian acting on behalf of the UCITS, no cash of the entity referred to in sub-regulation (2)(b) and none of the own cash of the custodian shall be booked on such accounts.

Safekeeping function.

21. (1) The assets of the UCITS shall be entrusted to the custodian for safekeeping as follows:

(a) for financial instruments that may be held in custody, the custodian shall:

(i) hold in custody all financial instruments that may be registered in a financial instruments account opened in the custodian's books and all financial instruments that can be physically delivered to the custodian;

(ii) ensure that all financial instruments that can be registered in a financial instruments account opened in the custodian's books are registered in the custodian'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 UCITS or the UCITS management company acting on behalf of the UCITS, so that they can be clearly identified as belonging to the UCITS in accordance with the applicable law at all times;

(b) for other assets, the custodian shall:

(i) verify the ownership by the UCITS or by the UCITS management company acting on behalf of the UCITS of such assets by assessing whether the UCITS or the UCITS management company acting on behalf of the UCITS holds the ownership based on information or documents provided by the UCITS or by the UCITS management company and, where available, on external evidence; and

(ii) maintain a record of those assets for which it is satisfied that the UCITS or the UCITS management company acting on behalf of the UCITS holds ownership and keep that record up to date.

(2) The custodian shall, on a regular basis, provide the UCITS management company or the UCITS with a comprehensive inventory of all the assets of the UCITS.

Reuse of assets held in custody.

22. (1) The assets held in custody by the custodian shall not be reused by the custodian, or by any third party to which the custody function has been delegated, for their own account except where:

(a) the reuse of the assets is executed for the account of the UCITS;

(b) the custodian is carrying the instructions of the UCITS management company on behalf of the UCITS;

(c) the reuse is for the benefit of the UCITS and in the interest of the unit holders;

(d) the transaction is covered by high-quality and liquid collateral received by the UCITS under a title transfer arrangement:

Provided that the use of the term "reuse" in this regulation shall comprise any transaction of assets held in custody including, but not limited to, transferring, pledging, selling and lending.

(2) The market value of the collateral shall, at all times,

amount to at least the market value of the reused assets plus a premium.

Delegation.

23. (1) The custodian shall not delegate to third parties the functions referred to in regulations 19 and 20.

(2) The custodian may delegate to third parties the functions referred to in regulation 21(1) only where:

(a) the tasks are not delegated with the intention of avoiding the requirements prescribed in these regulations and in the applicable Investment Services Rules;

(b) the custodian can demonstrate that there is an objective reason for delegation; and

(c) the custodian has exercised due skill, care and diligence in the selection and appointment of any third party to whom it intends to delegate parts of its tasks, and continues to exercise all due skill, care and diligence in the periodic review and ongoing monitoring of any third party to which it has delegated parts of its tasks and of the arrangements of the third party in respect of the matters delegated to it.

(3) The functions referred to in regulation 21(1), may be delegated by the custodian to a third party only where that third party at all times during the performance of the tasks delegated to it:

(a) has structures and expertise that are adequate and proportionate to the nature and complexity of the assets of the UCITS or the UCITS management company acting on behalf of the UCITS which have been entrusted to it;

(b) for the custody tasks referred to in regulation 21(1)(a), is subject to:

(i) effective prudential regulation, including minimum capital requirements and supervision in the jurisdiction concerned; and

(ii) an external periodic audit to ensure that the financial instruments are in its possession;

(c) segregates the assets of the clients of the custodian from its own assets and from the assets of the custodian in such a way that they can, at any time, be clearly identified as belonging to clients of a particular custodian;

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(d) takes all necessary steps to ensure that in the event of insolvency of the third party, assets of a UCITS held by the third party in custody are unavailable for distribution among, or realisation for the benefit of, creditors of the third party; and

(e) complies with the general obligations and prohibitions prescribed in regulations 5, 21(1), 18 and 22.

(4) Notwithstanding the provisions of sub-regulation (3)(b)(i), where the law of a third country requires that certain financial instruments be held in custody by a local entity and no local entities satisfy the delegation requirements laid down in that point, the custodian may delegate its functions to such a local entity only to the extent required by the law of that third country, only for as long as there are no local entities that satisfy the delegation requirements and only where:

(a) the investors of the relevant UCITS are duly informed, prior to their investment, of the fact that such a delegation is required due to legal constraints in the law of the third country, of the circumstances justifying the delegation and of the risks involved in such a delegation;

(b) the UCITS, or the UCITS management company on behalf of the UCITS, has instructed the custodian to delegate the custody of such financial instruments to such a local entity.

(5) The third party may in turn sub-delegate the functions referred to in sub-regulation (3) subject to the same requirements. In such a case, the provisions of regulation 24(4) shall apply *mutatis mutandis* to the relevant parties.

(6) For the purposes of this regulation, the provision of services as specified by Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems, by securities settlement systems as designated for the purposes of that Directive or the provision of similar services by third-country securities settlement systems shall not be considered to be a delegation of custody functions.

Liability of the custodian.

24. (1) The custodian shall be liable to the UCITS and to the unit-holders of the UCITS for loss by the custodian or a third party to whom the custody of financial instruments held in custody in accordance with regulation 21(1)(a) has been delegated.

(2) In the case of loss of a financial instrument held in custody, the custodian shall return a financial instrument of an identical type or

the corresponding amount to the UCITS or the UCITS management company acting on behalf of the UCITS without undue delay:

Provided that the custodian shall not be liable if it can prove that the loss has arisen as a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.

(3) The custodian shall also be liable to the UCITS and to the investors of the UCITS for all other losses suffered by them as a result of the custodian's negligent or intentional failure to properly fulfil its obligations pursuant to the provisions of the Act, these regulations and the applicable Investment Services Rules.

Cap. 370.

(4) The liability of the custodian referred to in sub-regulations (1) to (3) shall not be affected by any delegation as referred to in regulation 23.

(5) The liability of the custodian referred to in sub-regulations (1) to (3) shall not be excluded or limited by agreement.

(6) Any agreement that contravenes the provisions of sub-regulation (5) shall be void.

(7) Unit-holders in the UCITS may invoke the liability of the custodian directly or indirectly through the UCITS management company or the UCITS itself provided that this does not lead to a duplication of redress or to unequal treatment of the unit-holders.

Reporting obligations of the custodian.

25. (1) The custodian shall, on request, make available to the competent authority all information which it has obtained while performing its duties and that may be necessary for the competent authority or for the European regulatory authorities of the UCITS or the UCITS management company.

(2) Where the UCITS or the UCITS management company are established in a Member State or EEA State, other than Malta, the competent authority shall without delay share the information received with the European regulatory authority of the UCITS and the UCITS management company.

Part 4

Custodians of AIFs

Custodians of AIFs.

26. The custodian of a Maltese AIF shall be either a Category 4a or a Category 4b Licence Holder as prescribed in Parts 4a and 4b.

Part 4a

Requirements applicable to custodians of AIFs - Category 4a

Applicability of Part 4a.

27. (1) This Part shall apply solely to custodians in possession of a Category 4a Investment Services Licence which provide custody services to the following:

(a) Maltese AIFs which are managed by an AIFM; or

(b) Maltese self-managed AIFs.

(2) A Category 4a Investment Services Licence Holder shall also be guided by the provisions prescribed in the Investment Services Rules for Investment Services Providers applicable to custodians.

Appointment of the custodian.

28. The AIFM shall ensure that a custodian is appointed for each AIF it manages:

Provided that where the scheme is a self-managed AIF, it shall appoint a custodian.

Eligibility criteria.

29. (1) The custodian of a Maltese AIF shall have an established place of business in Malta:

Provided that in the case of a non-EU AIF which is managed by a Maltese AIFM, the custodian may be either established in Malta or be established in the third country where the non-EU AIF is established:

Provided further that the competent authority may allow a credit institution authorised in accordance with Directive 2013/36/EU and established in a Member State or EEA State other than Malta to be appointed as custodian to an AIF the units or shares of which are marketed to professional investors until 22 July 2017.

Cap. 370.

(2) The following entities shall be eligible to hold a Category 4a Investment Services Licence issued in terms of the Act and to provide custody services to all AIFs:

(a) a credit institution authorised in accordance with Directive 2013/36/EU and in possession of a licence issued in terms of the Banking Act;

Cap. 371.

(b) a branch established in Malta of a credit institution authorised in a Member State or EEA State;

(c) a branch established in Malta of an overseas credit

institution which is subject to prudential requirements at least equivalent to the requirements applicable to Maltese credit institutions;

(d) a company incorporated in Malta, which is wholly owned by a credit institution, provided that the liabilities of the company are guaranteed by the credit institution, and the credit institution is either a Maltese credit institution or a credit institution established in a Member State or EEA State and authorised in accordance with Directive 2013/36/EU:

Provided that in such a case, the custodian shall be required to have a minimum of one director on its board of directors who is resident in Malta;

(e) a company incorporated in Malta which is wholly owned by a Maltese or foreign institution or company which is deemed by the competent authority to be an institution or company which provides unit-holders with protection equivalent to that provided by a custodian fulfilling the requirements prescribed in paragraphs (a), (b), (c) or (d) and provided the liabilities of the company acting as custodian are guaranteed by the institution or company and the institution or company has paid-up share capital of five million euro (€5,000,000) or its equivalent in foreign currency:

Provided that, in such a case, the custodian shall be required to have a minimum of one director on its board of directors who is resident in Malta;

(f) an investment firm or branch of an investment firm established in another Member State or EEA State subject to capital adequacy requirements in accordance with Directive 2013/36/EU and Regulation (EU) 575/2013 including capital requirements for operational risks and authorised in accordance with Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and which also provides the ancillary service of safekeeping and administration of financial instruments for the account of clients in accordance with point (1) of Section B of Annex I of Directive 2004/39/EC:

Provided that such investment firms shall in any case have own funds not less than the amount of initial capital referred to in Article 28(2) of Directive 2013/36/EU.

Conflicts of interest.

30. (1) In order to avoid conflicts of interest between the

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custodian, the AIFM and, or the AIF and, or its investors:

(a) the AIFM shall not be licensed to act as custodian;

(b) a prime broker acting as counterparty to an AIF shall not act as custodian for that AIF unless it has functionally and hierarchically separated the performance of its functions as custodian from its tasks as prime broker and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF:

Provided that delegation by the custodian to such prime broker of its custody tasks in accordance with regulation 34 is allowed if the relevant conditions are met; and

(c) the custodian shall not be appointed as external valuer of the AIF, unless it has functionally and hierarchically separated the performance of its functions as custodian from its tasks as external valuer and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF.

(2) In the context of their respective roles, the custodian and the AIFM shall act honestly, fairly, professional, independently and in the interests of the AIF and the investors of the AIF.

(3) The custodian shall not carry out any activities with regard to the AIF or the AIFM on behalf of the AIF that may create conflicts of interest between the AIF, the investors in the AIF, the AIFM and itself, unless the custodian has functionally and hierarchically separated its tasks as custodian from its other potentially conflicting tasks and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF.

Monitoring of cash flows.

31. (1) The custodian shall in general ensure that the AIF's cash flows are properly monitored.

(2) The custodian shall in particular ensure that all payments made by or on behalf of the investors upon subscription of units of an AIF have been received and that all the 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 custodian acting on behalf of the AIF with any one of the following entities:

(a) a central bank;

(b) a credit institution authorised in accordance with

Directive 2013/36/EU;

(c) a bank authorised in a third country; or

(d) another entity of the same nature in the relevant market where cash accounts are required provided such entity is subject to effective prudential supervision which has the same effect as Union law and is effectively enforced in accordance with the principles set out in Article 16 of Directive 2006/73/EC.

(3) Where the cash accounts are opened in the name of the custodian acting on behalf of the AIF, no cash of the entity referred to in sub-regulation (2) and none of the custodian's own cash shall be booked on such accounts.

Safekeeping function.

32. (1) The assets of the AIF or the AIFM acting on behalf of the AIF shall be entrusted to the custodian for safekeeping as follows:

(a) for financial instruments that can be held in custody:

(i) the custodian shall hold in custody all financial instruments that can be registered in a financial instruments account opened in the custodian's books and all financial instruments that can be physically delivered to the custodian;

(ii) for that purpose, the custodian shall ensure that all those financial instruments that can be registered in a financial instruments account opened in the custodian's books are registered in the custodian'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 custodian 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 custodian shall keep its records up-to-date.

(2) The custodian shall not reuse the assets referred to in sub-regulation (1) without the prior consent of the AIF or the AIFM acting on behalf of the AIF.

Oversight function.

33. In addition to the tasks referred to in regulations 31 and 32(1), the custodian 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 provisions of the Act, the Rules and regulations issued thereunder, and the fund rules or instruments of incorporation; Cap. 370.

(b) ensure that the value of the units or shares of the AIF is calculated in accordance with the provisions of the Act, the Rules and regulations issued thereunder, the fund rules or instruments of incorporation and the valuation procedures as outlined in the applicable Investment Services Rules; Cap. 370.

(c) carry out the instructions of the AIFM, unless they conflict with the provisions of the Act, the Rules and regulations issued thereunder, the AIF's fund rules or instruments of incorporation; Cap. 370.

(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 the AIF's income is applied in accordance with the provisions of the Act, the Rules and regulations issued thereunder and the fund rules or instruments of incorporation. Cap. 370.

Delegation.

34. (1) The custodian shall not delegate to third parties its functions as described in this Part save for those referred to in regulation 32(1).

(2) The custodian may delegate to third parties the functions referred to in regulation 32(1) subject to the following conditions:

(a) the tasks are not delegated with the intention of avoiding the requirements prescribed in the Act, the Rules and regulations issued thereunder; Cap. 370.

(b) the custodian can demonstrate that there is an objective reason for the delegation;

(c) the custodian has exercised all due skill, care and diligence in the selection and the appointment of any third party to whom it wants to delegate parts of its tasks, and keeps exercising all due skill, care and diligence in the periodic review and ongoing monitoring of any third party to whom it has delegated parts of its tasks and of the arrangements of the third party in respect of the matters delegated to it; and

(d) the custodian ensures that the third party meets the following conditions at all times during the performance of the tasks delegated to it:

(i) the third party has the structures and the expertise that are adequate and proportionate to the nature and the complexity of the assets of the AIF or the AIFM acting on behalf of the AIF which have been entrusted to it;

(ii) for custody tasks referred to in regulation 32(1)(a), the third party is subject to effective prudential regulation, including minimum capital requirements, and supervision in the jurisdiction concerned and the third party is subject to an external periodic audit to ensure that the financial instruments are in its possession:

Provided that where the law of a third country requires that certain instruments be held in custody by a local entity and no local entities satisfy the delegation requirements prescribed above, the custodian may delegate its functions to such a local entity only to the extent required by the law of the third country and only for as long as there are no local entities that satisfy the delegation requirements subject to the following requirements:

(a) the investors of the relevant AIF must be duly informed that such delegation is required due to legal constrains in the law of the third country and of the circumstances justifying the delegation, prior to their investment; and

(b) the AIF, or the AIFM on behalf of the AIF, must instruct the depositary to delegate the custody of such financial instruments to such local entity;

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(iii) the third party segregates the assets of the custodian's clients from its own asses and from the assets of the custodian in such a way that they can at any time be clearly identified as belonging to clients of a particular custodian;

(iv) the third party does not make use of the assets without the prior consent of the AIF or the AIFM acting on behalf of the AIF and prior notification to the custodian;

(v) the third party complies with the general obligations and the prohibitions set out in regulation 30(2) and (3) and regulation 32(1) and (3).

(3) The third party may, in turn, sub-delegate those functions, subject to the same requirements prescribed in the above sub-regulations. In such a case, regulation 36 shall apply *mutatis mutandis* to the relevant parties.

(4) For the purposes of this regulation, the provision of services as specified by Directive 98/26/EC by securities settlement systems as designated for the purposes of said Directive or the provision of similar services by third country securities settlement systems shall not be considered a delegation of its custody functions.

Liability of the custodian.

35. (1) The custodian shall be liable to the AIF or to the investors of the AIF, for the loss by the custodian or a third party to whom the custody of financial instruments held in custody in accordance with regulation 32(1)(a) has been delegated.

(2) In the case of such a loss of financial instruments held in custody, the custodian shall return a financial instrument of identical type or the corresponding amount to the AIF or the AIFM acting on behalf of the AIF without undue delay. The custodian shall not be liable if it can prove that the loss has arisen as a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.

(3) The custodian shall also be liable to the AIF, or to the investors of the AIF, for all other losses suffered by them as a result of the custodian's negligent or intentional failure to properly fulfil its obligations pursuant to the provisions of the Act, the regulations and the Rules issued thereunder.

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(4) Liability to the investors of the AIF may be invoked directly or indirectly through the AIFM, depending on the legal nature of the relationship between the custodian, the AIFM and the

investors.

Discharge of liability.

36. (1) The custodian's liability shall not be affected by any delegation referred to in regulation 34.

(2) Notwithstanding the generality of sub-regulation (1), in the case of a loss of financial instruments held in custody by a third party pursuant to regulation 34, the custodian may discharge itself of liability if it can prove that:

(a) all requirements for the delegation of its custody tasks set out in regulation 34 are met;

(b) a written agreement between the custodian and the third party expressly transfers the liability of the custodian to that third party and makes it possible for the AIF or the AIFM acting on behalf of the AIF to make a claim against the third party in respect of the loss of financial instruments or for the custodian to make such a claim on their behalf; and

(c) a custody agreement between the custodian and the AIF or the AIFM acting on behalf of the AIF expressly allows a discharge of the custodian's liability and establishes the objective reason to contract such a discharge.

(3) Where the law of a third country requires that certain financial instruments are held in custody by a local entity and there are no local entities that satisfy the delegation requirements prescribed in regulation 34(2)(d)(ii), the depositary can discharge itself of liability provided that the following conditions are met:

(a) the rules or instruments of incorporation of the AIF concerned expressly allow for such a discharge under the conditions prescribed in this sub-regulation;

(b) the investors of the relevant AIF have been duly informed of that discharge and of the circumstances justifying the discharge prior to their investment;

(c) the AIF or the AIFM on behalf of the AIF instructed the depositary to delegate the custody of such financial instruments to a local entity;

(d) there is a custody agreement between the custodian and the AIF or the AIFM acting on behalf of the AIF which expressly allows such a discharge; and

(e) there is a written agreement between the custodian

and the third party that expressly transfers the liability of the custodian to that local entity and makes it possible for the AIF or the AIFM acting on behalf of the AIF to make a claim against that local entity in respect of the loss of financial instruments or for the custodian to make such a claim on their behalf.

Reporting obligations of the custodian.

37. (1) The custodian shall make available to the competent authority, on request, all information which it has obtained while performing its duties and that may be necessary in relation to the AIFM or the AIF.

(2) Where the AIF or the AIFM are established in a Member State or EEA State other than Malta, the competent authority shall without delay share the information received with the European regulatory authority of the AIF or AIFM.

Part 4b

Requirements applicable to custodians of AIFs - Category 4b

Applicability of Part 4b.

38. (1) This Part shall apply solely to custodians in possession of a Category 4b Investment Services Licence and which provide custody services to the following types of AIFs:

(a) AIFs which are managed by a Maltese or EU AIFM or are self-managed AIFs and which have no redemption rights exercisable during the period of five years from the date of the initial investments and which, in accordance with their core investment policy, generally do not invest in assets that must be held in custody in accordance with regulation 32(1)(a) or which generally invest in issuers or non-listed companies in order to acquire control of such companies in accordance with the provisions of the applicable Investment Services Rules; or

(b) third country AIFs which are marketed in Malta by a Maltese or EU AIFM in terms of regulation 7 of the Investment Services Act (Alternative Investment Fund Manager) (Third Country) Regulations. S.L. 370.24

(2) A Category 4b Investment Services Licence Holder shall also be guided by the rules prescribed in Part B IV of the Investment Services Rules for Investment Services Providers applicable to custodians.

Appointment of the custodian.

39. The AIFM shall ensure that a custodian in possession of either a Category 4a or a Category 4b Investment Services Licence is appointed to act as custodian to AIFs referred to in regulation 38(1) which are managed by the AIFM.

Eligibility criteria.

40. The following entities shall be eligible to apply for and obtain a Category 4b Investment Services Licence:

(a) an Investment Services Licence Holder in possession of a Category 2 Investment Services Licence issued in terms of the Act:

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Provided that UCITS management companies and AIFMs shall not be included in the list of eligible entities;

(b) Recognised fund administrators in possession of a Recognition Certificate issued in terms of article 9A of the Act.

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Applicability of Part 4a to custodians providing custody services to AIFs prescribed in regulation 38(1)(a).

41. A Category 4b Investment Services Licence Holder which provides custody services to AIFs referred to in regulation 38(1)(a) shall, in addition to the regulations prescribed in Part 2 applicable to custodians of all collective investment schemes, also be regulated by regulations 30 to 37 of Part 4a.

Applicability of Part 4a to custodians providing custody services to AIFs prescribed in regulation 38(1)(b).

42. (1) A Category 4b Investment Services Licence Holder which provides custody services to AIFs referred to in regulation 38(1)(b) shall, in addition to the regulations prescribed in Part 2 applicable to custodians of all collective investment schemes, also be regulated by regulations 30(2), 31, 32(1), 33 and 37 of Part 4a:

Provided that one or more entities may be appointed to carry out the functions referred to in regulations 31, 32(1) and 33.

(2) A Category 4b Investment Services Licence Holder as referred to in sub-regulation (1) shall also comply with regulations 43 and 44.

Liability of the custodian.

43. (1) A 4b Investment Services Licence Holder which provides custody services to the AIFs referred to regulation 38(1)(b) shall be liable for any loss or prejudice suffered by the AIFM, the AIF or the investors of the AIF due to the custodian's fraud, wilful default or negligence, including the unjustifiable failure to perform in whole or in part its obligations pursuant to:

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(a) the provisions of the Act, the regulations and the Rules issued thereunder;

(b) the custody agreement appointing the custodian;

(c) any other requirements prescribed by the competent authority.

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(2) A Category 4b Investment Services Licence Holder as referred to in sub-regulation (1) shall not be liable for any loss or prejudice suffered by the AIF or the unit-holders of the AIF as a result of the acts or omissions of the AIFM, except where and to the extent that the custodian has failed to perform its functions and duties in terms of the provisions of the Act, the regulations and the Rules issued thereunder: Cap. 370.

Provided that the term "custodian" shall be deemed to include such third party to whom functions, duties or assets may be delegated or entrusted in terms of regulation 44.

(3) Liability to the investors of the AIF may be invoked directly or indirectly through the AIFM, depending on the legal nature of the relationship between the custodian, the AIFM and the unit-holders.

Delegation of functions by the custodian to third parties.

44. (1) A 4b Investment Services Licence Holder which provides custody services to the AIFs referred to regulation 38(1)(b) may delegate to third parties in whole or in part the functions referred to in regulations 31 to 33 subject to the following conditions:

(a) the tasks are not delegated with the intention of circumventing the provisions of the Act or the regulations and the Rules issued thereunder; Cap. 370.

(b) the custodian has exercised all due skill, care and diligence in the selection and the appointment of any third party to whom it wants to delegate its tasks, and keeps exercising all due skill, care and diligence in the periodic review and ongoing monitoring of any third party to whom it has delegated its tasks and of the arrangements of the third party in respect of the matters delegated to it; and

(c) the custodian ensures that the third party meets the following conditions at all times during the performance of the tasks delegated to it:

(i) the third party has structures and the expertise that are adequate and proportionate to the nature and complexity of the assets of the AIF or the AIFM acting on behalf of the AIF which have been entrusted to it;

(ii) as far as the custody tasks referred to in regulation 32(1)(a) are concerned, the third party is subject to effective prudential regulation, including minimum capital requirements and supervision in the jurisdiction concerned and the third party is subject to an external

periodic audit to ensure that the financial statements are in its possession:

Provided that where the law of a third country requires that certain instruments be held in custody by a local entity and no local entities satisfy the delegation requirements prescribed above, the custodian may delegate its functions to such a local entity only to the extent required by the law of the third country and only for as long as there are no local entities that satisfy the delegation requirements subject to the following requirements:

(a) the investors of the relevant AIF must be duly informed that such delegation is required due to legal constraints in the law of the third country and of the circumstances justifying the delegation, prior to their investment; and

(b) the AIF or the AIFM on behalf of the AIF shall instruct the custodian to delegate the custody of such financial instruments to such local entity:

Provided further that the third party may in turn sub-delegate those functions subject to the same requirements;

(iii) the third party segregates the assets of the custodian's clients from its own assets and from the assets of the custodian in such a way that they can at any time be clearly identified as belonging to the clients of a particular custodian;

(iv) the third party does not make use of the assets without the prior consent of the AIF or the AIFM acting on behalf of the AIF and prior notification to the custodian; and

(v) the third party complies with the general obligations and prohibitions prescribed in regulations 30(2) and (3), 31 to 33.

(2) The provision of services as specified by Directive 98/26/EC by securities settlement systems as designated for the purposes of that Directive or the provision of similar services by third country securities settlement systems shall not be considered a delegation of the custodian's functions.

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Part 5

Requirements applicable to custodians of collective investment schemes other than UCITS and AIFs

Applicability of Part 5.

45. (1) Custodians of collective investment schemes which are not AIFs as defined in terms of the AIFMD or UCITS shall be regulated by the regulations prescribed in Part 2 together with the regulations prescribed in this Part:

Provided that for the purposes of this Part, the term "collective investment scheme" shall be understood as referring to collective investment schemes which are licensed as non-UCITS retail schemes and Professional Investor Funds established in terms of the Act and in terms of the Rules issued thereunder both of which are not managed by an AIFM falling within the scope of the AIFMD.

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(2) The custodian of a collective investment scheme as referred to in sub-regulation (1) shall also be guided by the rules prescribed in the applicable Investment Services Rules.

Appointment of the custodian.

46. (1) The scheme or the fund manager on behalf of the scheme which is licensed as a non-UCITS retail scheme or as a Professional Investor Fund targeting Experienced Investors shall appoint as custodian an entity which is in possession of a Category 4a Investment Services Licence.

(2) The scheme, or the fund manager on behalf of a scheme which is licensed as a Professional Investor Fund targeting Qualifying or Extraordinary Investors, may appoint as custodian an entity which is in possession of a Category 4a or Category 4b Investment Services Licence:

Provided that such scheme may alternatively provide for other safekeeping arrangements as accepted by the competent authority:

Provided further that a custodian which is appointed to provide custody services as provided in sub-regulation (2) shall be required to comply with the applicable provisions of this Part.

Eligibility criteria.

47. (1) The custodian of a non-UCITS retail scheme shall have an established place of business in Malta.

(2) Where a scheme which is licensed as a Professional Investor Funds appoints a custodian holding a Category 4a Investment Services Licence, such custodian shall be:

(a) an entity having an established place of business in Malta;

(b) an entity constituted in a Member State or EEA State other than Malta providing the services of custodian to collective investment schemes;

(c) an entity constituted outside Malta and operating from outside Malta providing the services of a custodian to collective investment schemes, where the competent authority is satisfied that such entity is of sufficient standing and repute and having the business organisation, systems, experience and expertise deemed necessary for it to act as custodian.

(3) The following entities shall be eligible to hold a Category 4a Investment Services Licence issued in terms of the Act and to provide custody services to the collective investment schemes referred to in sub-regulations (1) and (2):

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(a) a credit institution authorised in accordance with Directive 2013/36/EU and in possession of a licence issued in terms of the Banking Act;

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(b) a branch established in Malta of a credit institution authorised in a Member State or EEA State;

(c) a branch established in Malta of an overseas credit institution which is subject to prudential requirements at least equivalent to the requirements applicable to Maltese credit institutions;

(d) a company incorporated in Malta, which is wholly owned by a credit institution, provided that the liabilities of the company are guaranteed by the credit institution and the credit institution is either a Maltese credit institution or a credit institution established in a Member State or EEA State and authorised in accordance with Directive 2013/36/EU:

Provided that, in such a case, the custodian shall be required to have a minimum of one director on its board of directors who is resident in Malta;

(e) a company incorporated in Malta which is wholly owned by a Maltese or foreign institution or company which is deemed by the competent authority to be an institution or company which provides unit-holders with protection equivalent to that provided by a custodian fulfilling the requirements of paragraphs (a), (b), (c) or (d) and provided the

liabilities of the company acting as custodian are guaranteed by the institution or company and the institution or company has paid-up share capital of five million euro (€5,000,000) or its equivalent in foreign currency; or

(f) an investment firm in Malta or branch of an investment firm established in a Member State or EEA State other than Malta, subject to capital adequacy requirements in accordance with Directive 2013/36/EU and Regulation (EU) 575/2013 including capital requirements for operational risks and authorised in accordance with Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and which also provides the ancillary service of safekeeping and administration of financial instruments for the account of clients, including custody and related services such as cash/collateral management in accordance with point (1) of Section B of Annex I of Directive 2004/39/EC:

Provided that such investment firms shall in any case have own funds not less than the amount of initial capital referred to in Article 28(2) of Directive 2013/36/EU.

Applicability of Part 4a to custodians providing custody services to non-UCITS Retail Schemes.

48. A Category 4a Investment Services Licence Holder which provides custody services to a non-UCITS retail collective investment scheme shall also comply with regulations 30 to 36:

Provided that, for the purposes of this Part, references in regulations 30 to 36 to "AIFM" and "AIF" shall be construed to refer to the "fund manager or management company" and the "non-UCITS Retail Scheme" respectively.

Applicability of Part 4a to Professional Investor Funds marketed to Experienced Investors.

49. A Category 4a Investment Services Licence Holder which provides custody services to a Professional Investor Fund which is marketed to Experienced Investors, shall also comply with regulations 30 to 36:

Provided that, for the purposes of this Part, reference in regulations 30 to 36 to "AIFM" and "AIF" shall be construed to refer to the "fund manager or management company" and the "Professional Investor Fund marketed to Experienced Investors" respectively.

Professional Investor Funds marketed to Qualifying and Extraordinary Investors.

50. A Professional Investor Fund which is marketed to Qualifying or Extraordinary Investors may appoint one or more entities in possession of a Category 4a or Category 4b Investment Services Licence to provide safekeeping of the assets of the scheme and such entities shall ensure compliance with regulations 51 to 58.

Functions and duties of the custodian.

51. (1) The scheme or the fund manager on behalf of the scheme shall appoint a custodian. The scheme or the fund manager on behalf of the scheme shall entrust the assets of the scheme to the custodian for safekeeping in the interests of the scheme and in the interests of the unit-holders thereof.

(2) The custodian shall carry out such functions and duties as shall be required in accordance with these regulations, the terms of the custody agreement entered into with the scheme, the conditions of the custodian's investment services licence and such other requirements as may be laid down by the competent authority. The terms of the custody agreement shall distinguish between financial instruments that can be held in custody and other assets.

(3) The custodian shall maintain proper and adequate records and accounts of the assets of all the schemes with which it has entered into a custody agreement. The records and accounts shall identify the schemes to which such assets belong and shall clearly indicate that the assets of every scheme are separate and distinct from the assets belonging to the custodian and from the assets of other schemes with which the custodian has entered into a custody agreement.

(4) The records and accounts shall, upon due notice being given by the custodian, indicate the instances where any pledge or other right over assets has been given by the respective schemes to any third parties and where any order by any Court has been made in connection with such assets.

(5) The custodian entrusted with the safekeeping of the assets belonging to a scheme shall, to every extent reasonably possible, segregate in a proper manner the assets of each scheme from the assets belonging to the custodian and from the assets of other schemes:

Provided that the custodian may, with the written consent of the scheme and in accordance with the terms and conditions of the custody agreement entered into with the scheme, the conditions of any investment services licence and such other requirements as may be prescribed by the competent authority and without prejudice to the scheme's right of ownership over the assets held under control, place and keep such assets in a common pool of identical assets or otherwise deposit them in a clients' or common account.

(6) The custodian shall make appropriate arrangements for the protection of assets held and shall ensure that such assets are placed under adequate systems to safeguard them from damage, misappropriation or other loss and which permit the delivery of such

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assets only in accordance with the terms and conditions of the custody agreement entered into with the scheme.

(7) Where it is not reasonably possible for the custodian to carry out any of the duties specified in these regulations due to the nature of the assets and of the custody agreement, the said duties may be varied with the written consent of the scheme and in accordance with the terms and conditions of the custody agreement entered into with the scheme, the conditions of the investment services licence and such other requirements as may be prescribed by the competent authority.

(8) The custodian shall carry out monitoring, oversight, administrative and such other functions where applicable in accordance with the terms and conditions of the custody agreement.

Use of clearing, settlement and de-materialised systems and settlement risk.

52. (1) Where reasonably required by the nature of the assets and of the arrangements whereby the custody function is to be exercised, a custodian may, with the written consent of the scheme and in accordance with the terms and conditions of the custody agreement entered into with the scheme, the conditions of any investment services licence and such other requirements as may be laid down by the competent authority, make use of any market clearing system, settlement system, dematerialised book entry system, centralised custodial depository or similar system for the purpose of the control of assets in terms of these regulations.

(2) Such systems as are provided for in sub-regulation (1) may also be used to effect all transactions including conveyance, assignment, transfer, transmission and pledging of assets held in custody by the custodian and the law of the country in which the system is maintained shall apply to the validity of such transactions, notwithstanding the provisions of any other law.

(3) The custody agreement with the scheme shall clearly define the extent of liability of the custodian for any losses that may be incurred by the scheme as a result of the use of such systems.

Independence of the custodian from the management of the collective investment scheme.

53. In the exercise of its functions, duties and responsibilities, the custodian shall act independently of the fund manager and of the management of the scheme and solely in the interest of the unit holders and of the scheme itself:

Provided that the custodian shall act upon the instructions of the manager and the manager shall act upon the instructions of the custodian to the extent required by the conditions of any investment services licence, such other requirements as may be prescribed by the competent authority, and the conditions of the scheme's constitutional

documents.

Administration and management of the fund manager and custodian.

54. Except as may be authorised by the competent authority, a person shall not act as member of the board of directors or similar organ or as an officer responsible for the administration and management of the manager acting on behalf of the scheme and at the same time hold a similar position with the custodian entrusted with the safekeeping of the assets of any scheme managed by the manager.

Liability of the custodian.

55. (1) The custodian shall be liable for any loss or prejudice suffered by the scheme or the unit-holders due to the custodian's fraud, wilful default or negligence including the unjustifiable failure to perform in whole or in part the custodian's obligations arising pursuant to:

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(a) the provisions of the Act, these regulations and the Rules issued under the Act;

(b) the terms and conditions of the custody agreement appointing the custodian;

(c) the conditions of any investment services licence; or

(d) such other requirements as may be prescribed by the competent authority.

(2) The custodian shall not be liable for any loss or prejudice suffered by the scheme or by the unit holders as a result of the acts or omission of the fund manager except where and to the extent that the custodian has failed to perform its functions and duties in terms of regulation 51.

(3) For the purposes of this regulation, "custodian" includes such other sub-custodian to whom functions, duties or assets may be delegated or entrusted in terms of regulation 56.

Delegation of function by the custodian to a sub-custodian.

56. (1) The custodian may, with the consent of the scheme or the fund manager acting on behalf of the scheme, delegate all or part of the functions and duties referred to in regulation 51 to a sub-custodian, and may also entrust or deposit all or part of the assets of the scheme held in custody with such sub-custodian.

(2) The liability of the custodian for its own acts or omissions pursuant to regulation 55 shall not be affected or reduced as a result of the custodian delegating functions and duties or entrusting all or part of the assets of the scheme to a sub-custodian.

(3) Where the custodian delegates or entrusts functions, duties

or assets in terms of sub-regulation (1) to a person who is either a group company or is the fund manager or associate of the fund manager, without prejudice to the liability of such person, the custodian shall be liable for any loss or prejudice suffered by the scheme or the unit-holders as a result of the acts, omissions or insolvency of such person:

Provided that the custodian may not delegate to the fund manager acting on behalf of the scheme any function of oversight in respect of the fund manager or any function of custody of the assets, nor may the custodian delegate to an associate of the fund manager any function of oversight in respect of such entity.

(4) Where the custodian delegates or entrusts functions, duties or assets in terms of sub-regulation (1) to a person which is not a group company nor the fund manager acting on behalf of the scheme nor associate of the fund manager, without prejudice to the liability of such person, the custodian shall be liable for any loss or prejudice suffered by the fund manager, the scheme or the unit-holders as a result of the acts or omissions of such person unless the custodian can prove that such person was and remains qualified and competent to carry out the functions and duties delegated to it and that the custodian exercised reasonable care to oversee that the functions and duties delegated were undertaken by such person competently.

(5) The liability of the custodian pursuant to sub-regulations (3) and (4) may be varied or reduced with the written consent of the scheme or the fund manager acting on behalf of the scheme, and in accordance with the terms and conditions of the written custody agreement appointing the custodian, the deed or other instrument establishing and regulating the scheme, the conditions of the collective investment scheme licence which may be held by the scheme, the conditions of any investment services licence and such other requirements as may be prescribed by the competent authority:

Provided that the custodian discloses fully to the scheme or the fund manager acting on behalf of the scheme, any risks that may be associated with the nature of the custody arrangements, and that the agreement appointing the custodian shall clearly define the extent of liability of the custodian. Any such risks shall also be fully disclosed to the unit-holders in the scheme.

(6) For the purposes of this regulation, "associate" in relation to the fund manager means a body corporate which forms part of the same group of companies as the fund manager acting on behalf of the scheme.

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(7) For the purposes of this regulation, "group company" in relation to the custodian, means any body corporate which is the custodian's subsidiary or parent company, or a subsidiary of the custodian's parent company; and the terms "parent" and "subsidiary" shall be construed in accordance with article 2(2) of the Companies Act.

Cap. 386.

Reporting obligations of the custodian.

57. The custodian of a collective investment scheme which is licensed as a non-UCITS Retail Scheme or a Professional Investor Fund shall make available to the competent authority, on request, all information which it has obtained while performing its duties and that may be necessary for the competent authority of the fund manager or the scheme.

Part 6

Transitional arrangements

Transitional arrangements.

58. (1) Non-UCITS retail schemes and Professional Investor Funds targeting Experienced Investors or management companies on behalf of such schemes, which on the date of publication of these regulations appointed, as custodian, an entity which did not meet the requirements prescribed in Part 5, shall have a transitional period of eighteen months within which to comply with these regulations. This eighteen-month transitional period shall commence to run from the date of the coming into force of these regulations and shall expire within eighteen months thereafter.

(2) Professional Investor Funds targeting Qualifying Investors or Extraordinary Investors or managers on behalf of such schemes, which on the date of the coming into force of these regulations appointed, as custodian, an entity which did not meet the requirements prescribed in Part 5 hereof, shall have a transitional period of eighteen months within which to comply with these regulations. This eighteen-month transitional period shall commence to run from the date of the coming into force of these regulations and shall expire within eighteen months thereafter.

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