

Non-official English translation from the French original

COMMISSION FOR THE SUPERVISION
OF THE FINANCIAL SECTOR

Luxembourg, 5 September 2008

To all specialised investment funds and their
depositories

CSSF CIRCULAR 08/372

Concerns: Rules of conduct applicable to the depository of a specialised investment fund adopting alternative investment strategies, in cases where such fund makes use of the services of a prime broker

Ladies and Gentlemen,

This circular applies more specifically to any specialised investment fund (hereafter “SIF”) which, within the context of the use of derivative products or the implementation of alternative investment strategies, makes use, according to market practice, of the services of a prime broker.

For illustrative purposes, the role of the prime broker generally consists in rendering the following services to the SIF:

- safekeeping of the assets of the SIF;
- execution of transactions and netting operations for account of the SIF;
- intervention in the context of margin deposits;
- implementation of credit lines for debt financing;
- participation in the context of securities lending, borrowing or repurchase transactions.

It is, depending on the legal form of the SIF, the competent management body of a SIF organised in a corporate form or the management company of a SIF organised as a *fonds commun de placement*, that is responsible for the choice of the prime broker, its official appointment by the conclusion of a prime broker agreement and the determination of its functions and responsibilities.

According to the provisions of the law of 13 February 2007, the custody of the assets of any SIF has to be entrusted to a depository. This requirement is of general application, in that it concerns all SIFs regardless of their legal form or their investment policy.

The concept of custody, as it is used to specify the duty of the depository, must be understood in the sense of “supervision”. In the context of this circular, the duty of “supervision” is fulfilled if the provisions set out in sections 1 and 2 hereafter are complied with.

Since the prime broker intervenes in the safekeeping of the assets of the SIF and since the prime broker needs to interact with the depository in relation to the services rendered by the prime broker, in the context of the safekeeping of the assets of the SIF, it is necessary that the depository accepts the choice of the prime broker made by the SIF pursuant to the conditions described hereafter. Indeed, the depository of a SIF needs to organise its relationship with the SIF and the prime broker in a manner such that it may accomplish its monitoring duty over the assets of the SIF.

This circular aims at highlighting the rules of conduct which shall enable the depository of a SIF using the services of a prime broker to perform its duty of supervision in compliance with the provisions of the law of 13 February 2007.

1. Acceptance of the choice of the prime broker by the depository

The depository must accept the choice of the prime broker made by the SIF, since the depository must organise its relationship with the SIF and the prime broker in such a way that the depository is able to perform its duty of supervision of the assets.

For the depository, the acceptance of the choice of the prime broker made by the SIF is limited to ensuring that the prime broker meets the following selection criteria:

- The prime broker is a financial institution subject to the control of a supervisory authority of a State with a supervisory regime recognised to be equivalent to that provided by Community law.
- The prime broker is a recognised financial institution specialised in these types of operations.

2. Organisation of the relationship between the depository and the prime broker

The depository must ensure to organise its relationship with the prime broker in such a way that the depository is in a position to know the composition of the assets of the SIF.

In order to allow the depository to exercise in an adequate manner its duty of supervision as described in this circular, the depository must be assured to have a right to access information on the composition of the assets of the SIF entrusted to the prime broker. Such right to information may either result from adequate instructions given by the SIF to the prime broker within the framework of the prime brokerage agreement concluded between the SIF and the prime broker or from a specific right to information resulting from a direct contractual relationship between the depository and the prime broker.

On this basis, the depository must be in a position to obtain at any time information from the prime broker on the composition and the value of the assets of the SIF entrusted to the prime broker.

The depository must also be vested with a right of intervention regarding the assets of the SIF entrusted to the prime broker of which it may make use in cases it considers that it is no longer in a position to exercise its duty of supervision. This right of intervention may either result from adequate instructions given by the SIF to the prime broker within the framework of the prime brokerage agreement concluded between the SIF and the prime broker or from a right of intervention resulting from a direct contractual relationship between the depository and the prime broker.

The depository does not need to be informed with which correspondents the prime broker holds the assets of the SIF.

3. Additional duties of the depository

The law of 13 February 2007 provides that the depository carries out all operations concerning day-to-day administration of the assets of the *fonds commun de placement*. This means that the depository is in particular responsible for the collection of dividends, interests and proceeds of matured securities, the exercise of options and, in general, for any other operation concerning the day-to-day administration of the securities and liquid assets making up the fund. To the extent that the depository entrusts a prime broker with the safekeeping of the assets, the prime broker may contractually be vested with the material execution of these operations concerning day-to-day administration.

4. Information to investors

The sales documents of the SIF using the services of a prime broker must contain an adequate description of the involvement of the prime broker and the possible risks connected therewith, including the counterparty risk.