

Depository Banks in XENTIS

Monitoring Duties and Enhanced Service Offering



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INTRODUCTION

On 7th October 2015, the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin) published Circular 08/2015 (WA) on the duties and obligations of the depositary banks pursuant to Chapter 1 Section 3 of the German Capital Investment Code (Kapitalanlagegesetzbuch – KAGB). The new depositary circular replaces the circular 6/2010 (WA) on custodian bank tasks and duties (custodian circular). With the entry into force of the depositary circular, as of 4th April 2016, the currently 40 authorised depositary banks in Germany are required to increase their control function towards investment companies. Depositary banks are assigned a special role for the protection of investors, both in the German Capital Investment Code and in the depositary circular. In order to fulfil this role, along with organisational provisions, depositary banks have to execute controls on unit value calculation, collaterals for securities loans, investment limits and principles, remuneration and reimbursement as well as market conformity.

Moreover, the services offered by the depositary banks should include flexible reporting that meets prevailing market and client requirements. XENTIS covers the regulatory as well as the client and market requirements.

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MODEL OPTIONS

To comply with their monitoring duties in accordance with the BaFin statements, the depositary banks are offered two model options or a combination of both:

MODEL 1: SYSTEM ACCESS TO XENTIS AT INVESTMENT COMPANIES

External system access necessitates user licences and a suitable technical infrastructure. The authorisation concept of XENTIS allows investment companies to define both the extent of the data access and the functional rights through a user profile specifically tailored to the respective depositary bank. XENTIS is accessible to external parties using client virtualisation technologies such as Citrix Metaframe.

MODEL 2: XENTIS AS AN IN-HOUSE SYSTEM FOR DEPOSITARY BANKS

If a depositary bank chooses the in-house solution, the investment company's positions should be mirrored in XENTIS and administered using shadow accounting. Two options exist for the import of the investment data:

- a) When importing the movements of the original fund assets, the transactions are made available via an interface and mapped in XENTIS using definable transaction types. The extraction and preparation of data are performed using the Financial Analysis Language (FINAL). Simple queries and mathematical correlations can thus be formulated and presented in all commonly used formats, including FundsXML. This type of display enables the exact replication of positions and the corresponding movement history. Deviations may occur if some transactions are not delivered, hence the position information in the system requires continuous reconciliation with the original fund assets.
- b) The considerable effort described above can be minimised through direct transfer of the fund position data. Position history is not lost as the previous position deliveries are not overwritten; synthetic delta transactions are generated for each new data entry instead.

The model 1 seems to reduce the administrative and financial effort for depositary banks at short term. However, if the control functions according to model 1 are exercised at several investment companies, the associated effort increases considerably. In this case, the model 2, with the standardisation of the different processes of several investment companies in a unique system, represents the more advantageous option. In addition, if controlling procedures need to be performed at a qualitatively high level (as often required by investors), this can only be achieved by using a high performance in-house software solution. Depositary banks are thus able to guarantee a neutral and independent evaluation of the investment companies – which can only be in the interest of the investor. Among other things, verification on the management fees, including performance-dependent fees incurred by investment companies, are to be mentioned in this context.

XENTIS FUNCTIONS FOR DEPOSITARY BANKS

UNIT VALUE CALCULATION

A processing cycle describes a specific workflow of successive tasks during which the Net Asset Value and consequent unit value of a fund, including relevant tax key figures, is calculated based on a daily cash flow statement. Approval steps manage the execution of processing steps and can be undertaken at any point in the processing cycle. Processing steps perform a set function in the cycle. These include investment compliance checks and fee accruals as well as checking the prices applied for fund valuation and monitoring the current share value for deviations from the previous day or a benchmark. The level (main class fund, sub class fund, portfolio) on which the individual processing steps are performed can be defined for each

processing step, thereby ensuring a review of all fund types, including the aforementioned multi class funds.

RECONCILIATION

In addition to the automated matching of orders, transactions and payments, data such as nominal amounts, cost, booking and market values, prices and FX rates, key figures, financial account balances and securities master data can be reconciled. Third party/system records can be received in all formats. Internal positions can be reconciled with external ones, as can multiple external positions with one another. Any occurring discrepancies are displayed. If transactions are processed too late or not at all, (and thus not included in the position reconciliation), they must be localised immediately along with other sources of error. It is therefore possible to drill down from the position reconciliation overview to a specific deviation analysis, or to call up a context-sensitive menu to access relevant master, price and event data source tables. A central blotter with monitoring and immediate notification functions can be set up for all reconciliation procedures. Notifications appear after import of the external data to be reconciled, if reconciliation errors occur, or if matching was not performed/completed within a specified time period. The exception handling follows definable workflows.

COLLATERAL MANAGEMENT

Technical requirements and frequently changing guidelines can be easily implemented and made available system-wide with a standard rule language using XENTIS business rules. Key figures as well as relative and absolute tolerance values can be defined in the reconciliation processes described above. Collateral management, market conformity and investment compliance checks are also performed using business rules.

The depositary circular differentiates in undertakings for collective investment in transferable securities (UCITS) and alternative investment funds (AIF) as well as assets that can or cannot be held in custody. As for assets that cannot be held in custody, which include non-securitised receivables from derivatives, securities loans and repurchase agreements in terms of UCITS, the depositary bank shall keep an inventory in accordance with standard accounting principles. In XENTIS, these and all other asset classes can also be included in collateral management. According to the depositary circular, collateral management is to be used explicitly to oversee that the amount of collaterals transferred for securities loans is sufficient. Authorised users in XENTIS are informed when under-hedging occurs due to a gain in value of the lent securities or a loss in value of the provided collaterals. As a consequence, they can take appropriate actions.

MARKET CONFORMITY CHECK

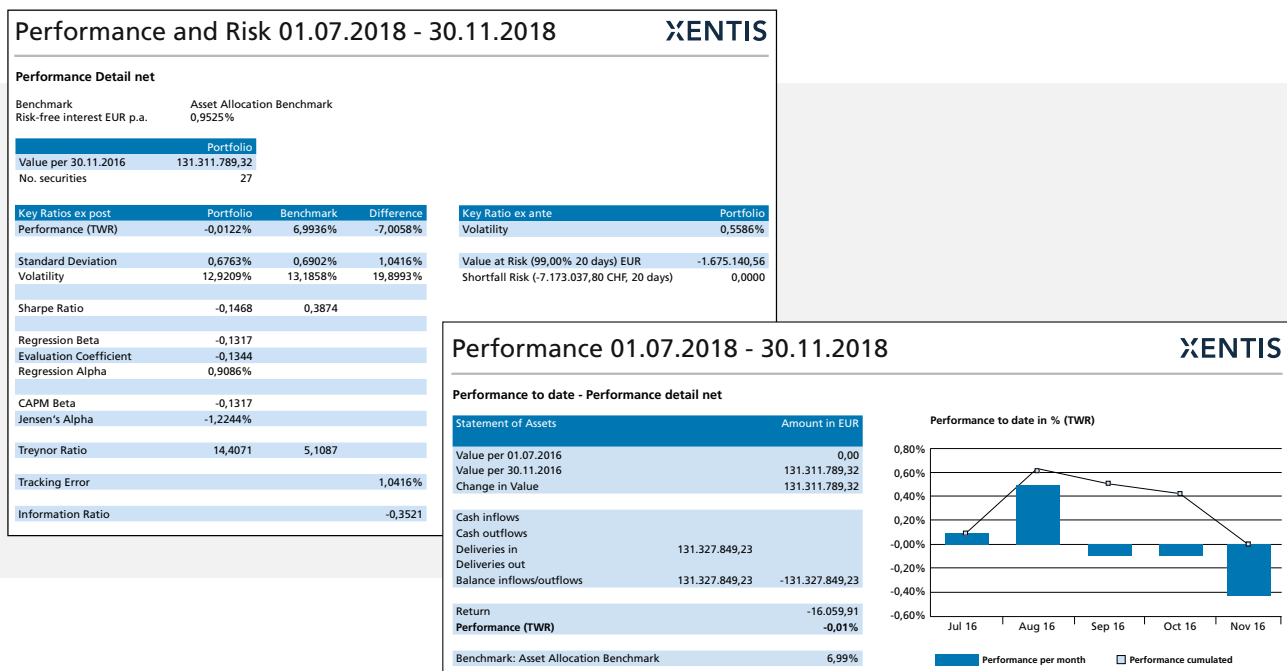
The same is true for the market conformity check if, when acquiring assets, the cost price or FX rate surpasses the current price/rate or if the sell transaction is not executed at least at the current rate. When tradable prices are missing, theoretical valuation models can be used to determine the fair value. The check of the criteria defined by business rules (for instance, relative or absolute thresholds for different financial instruments) is executed as a stand-alone process on a transaction basis in the course of automated job processing as soon as all the prices/rates relevant for the check are available.

INVESTMENT COMPLIANCE

XENTIS Investment Compliance fulfills all prerequisites for the contractual and statutory investment limit checks. The intuitive handling of its limit rule definition interface requires only minimal technical knowledge from the users. As a further convenience, predefined compliance rule sets are available for several countries such as Germany, Luxembourg, Switzerland, and Singapore. Internal investment limits for indirect investments often require a look-through which enables, for instance, a fund certificate or structured product to be decomposed into its individual components that are then assigned to the respective asset classes. The procedure for assigning derivative positions in terms of hedging and netting is the same. In addition, the

simple or qualified approach is to be followed in the market risk assessment according to the depositary circular. The respective application is determined by the derivatives used and by the risk profile resulting from the investment strategy of the fund. XENTIS supports both approaches and can therefore also test the 200 percent limit required by the qualified approach in the course of a Value at Risk calculation. The pre- and post-trade checks encompass active limit violations by the user and passive limit violations due to price fluctuations, as well as limit violations caused by missing master data. Prices, valuations, master data, etc. can all be accessed directly from the utilisation analysis screen. The entire internal process of the depositary bank for the management of limit breaches is processed via a workflow. Each step can be saved in the database with comments – this allows the reproduction (tracking) of changes at any time.

Fig. 1
Performance- and
Risk Reporting



FEE CALCULATION

The XENTIS fee module provides users with optimum support in fee model administration by means of predefined functional components and configurable business rules. System structures are required, that combine complexity and flexibility with user-friendliness and offer scope for any future developments. The fee module is based on a modular design concept allowing the combination of an arbitrary number of individual partial calculations with different algorithms. The functionality includes various calculation methods, nested and interdependent sub models, a simulation mode for model testing and detailed calculation verification. The fee module, in fact, comprises two sub modules: a basic module and a performance fee module. The basic module serves to design calculation models which are depending on the asset structure. The performance fee module extends the basic functionality with profit-related remuneration models, which enable calculations depending on the fund or portfolio performance as well as the benchmark performance, hurdle rate and high water mark.

Fee models for any category, such as management and global fees as well as audit, transaction and publication costs, etc. referred to in the depositary circular, are either defined as individual or global models. Depending on the object, individual models are entered on the mandate, portfolio, fund, segment, main or sub class fund, or investor and consolidation mandate administrative levels, whereas global models are created independent of the object and subsequently allocated to an administrative level. The fully integrated fee module has the distinct advantage of directly accessing the XENTIS data universe. Therefore, interface breaks and

redundant data management are avoided. The result is an integrated processing without delays.

REPORTING

Clients of depositary banks increasingly request detailed and stringent reporting. On the basis of legal requirements, XENTIS not only provides and validates the reporting data, but it also performs advanced calculations and produces the information output in a specific layout. The flexible reporting structures are a prerequisite to preconfigure individual client requirements such as consolidations of fund and direct mandates. Further, the components of a report folder such as content, language, period, cycle, format, etc. can be customised. The integrated XENTIS high-end reporting suite is based on FINAL data extracts and satisfies superior requirements in terms of complex table layouts, graphics and style elements.

The standard reporting comprises transaction and position lists, account balances and movements, cash-flow projections, cost and fee analyses as well as the presentation of the asset allocation. Risk and compliance reports illustrate the key figures of market and concentration risks and also enlarge on the individual investment compliance checks. Furthermore, results of market scenarios and stress tests as well as Value at Risk calculations can be visualised. Performance reports display gross and net performance and risk-adjusted key figures, as well as attribution and contribution ratios (**Fig. 1**). Individual reporting mainly comprises statutory directives. XENTIS covers the manifold reporting requirements of larger companies that are obliged to perform parallel accounting in accordance with national and international reporting standards as well as those of financial service providers, for whom the Solvability notifications (CRD IV) are essential, and those of Insurance companies that request an integrated insurance reporting for all capital investments in accordance with the Solvency II directives.

CONCLUSION

With the introduction of the depositary circular, the monitoring duties of depositary banks towards investment companies have once again increased. Should depositary banks opt for model 2, XENTIS offers all technical and functional options to fulfil these obligations. Moreover, with XENTIS, depositary banks can enhance their service offering for their clients.



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