
Appendix B

Benchmarking on Hedge Fund Prime Brokerage Regulations in onshore jurisdictions

- Ireland
- Hong Kong
- Spain
- France

Regime	Regulation of Prime Brokerage
Ireland	<p>The focus of the framework for regulation of prime brokers contained in Guidance Note 2/00 is to facilitate trading strategies by permitting increased exposure to counterparty and to speed up approval process. The key features of the frame work are as follows:</p> <ul style="list-style-type: none">• IFSRA will not formally review prime broker documentation provided that the fund's legal advisers confirm that the documentation incorporates the provisions of the guidance notes;• For professional investor schemes assets passed as collateral shall not exceed 140 per cent of the level of the funds' indebtedness to the prime broker• In the case of qualified investor funds there is no limit on the extent to which assets may be passed to the prime broker subject to full disclosure in the prospectus• Prime brokerage agreement must incorporate a procedure to mark positions to market daily, in order to meet the exposure requirements on an ongoing basis.

	<ul style="list-style-type: none"> • The prime broker must agree to return the same or equivalent securities to the fund and the agreement must incorporate a legally enforceable right of set-off for the fund. • The prime broker may take a charge over the assets where he is appointed as a sub custodian but the assets must be held in segregated custody and be clearly identifiable as assets of the fund.
Hong Kong	<p>Hong Kong has put in place a regime for domiciliation of Hedge Funds. Section 8.7 of the Hong Kong Code on Mutual Funds and Trusts, which specifically deals with Hedge Funds contains the following provision on the Prime Broker:</p> <ul style="list-style-type: none"> • The Prime Broker must be a substantial financial institution subject to prudential regulatory supervision. • where assets of the scheme are charged to the Prime Broker for financing purposes, such assets must not at any time exceed the level of the scheme's indebtedness to the Prime Broker. • Where assets of the scheme may be used as collateral or security for financing to be provided by the Prime Broker, disclosure must be made in the offering document of the risks associated with the collateralisation, for example, foreclosure or re-hypothecation of these assets by the Prime Broker and any consequential impact to the scheme and its investors. • The assets charged to the Prime Broker must remain in a segregated custody account, in the name or held to the order of the trustee/custodian. • The scheme's offering document must disclose the profile of the Prime Broker and its relationship with the scheme. • Apart from the profile of the Prime Broker, the offering document must disclose the role of the Prime Broker in relation to the Hedge Fund, whether the Prime Broker is subject to any regulatory supervision, and if so , a brief description of its license status in the relevant jurisdiction. Where appropriate disclosure of the risks relating to any conflicts of interest between the Prime Broker and the scheme has to be made in the offering document.

	<ul style="list-style-type: none">• Hong Kong permits such funds to be marketed to retail investors.
Spain	<p>Spanish Collective Investment Institutions Draft Regulation issued in November 2005 introduces regulation of hedge funds and funds of hedge funds which promotes the setting up of Spanish domiciled hedge funds. The regime regulates management companies of hedge funds and contains detailed information disclosure requirements. Two new structures are permitted under the regulations: Free Investment Funds (FIF) with a minimum investment of Euros 50,000 and with practically no restrictions in terms of eligible assets and diversification rules; and Fund of Free Investment Funds (FoFIF) which are Fund of Hedge Fund.</p> <p>The regime contains specific regulations in respect of prime brokerage by establishing the following controls:</p> <ul style="list-style-type: none">• Disclosure obligations concerning the prime broker and its solvency in order to ensure that information is provided about the creditworthiness of the entity appointed as Prime Broker;• Prime broker's obligation to enter into any sub-custody agreements with the fund's custodian when the prime broker is permitted to use the assets. The entering into this agreement must be disclosed in the prospectus.• Prime Broker's obligation to provide the management company and the custodian with information regarding the assets guaranteed and the amount of the financial obligations guaranteed.• To ensure that investors are informed about the fund's counterparty risk towards the Prime Broker for the assets provided as collateral, the draft establishes the obligation to indicate in the prospectus the maximum fair value that may represent the collateralised assets in relation to the obligations secured by the fund as well as the current fair market value of the assets subject to guarantee in relation to the obligations of the fund in respect of the guarantee's beneficiary. Likewise, the periodic information provided by the fund must indicate the current market value of the assets covered by the guarantee in relation to the obligations of the fund towards the guarantee's benefit.

	<ul style="list-style-type: none"> • According to the Draft legislation, in order to provide an additional mechanism to protect investors in the event of the Prime Broker's insolvency, the fund may terminate the collateral agreement entered into with the Prime Broker and proceed with the close-out netting of any payment obligations. The ability of the Fund to terminate any collateral arrangement will not be limited in the event of the broker's insolvency. <p><i>[Information source: AIMA Journal, Spring 2006]</i></p>
France	<p>France has put in place a regime for the regulation of prime brokerage. A Prime Broker appointed by an OPCVM (French onshore hedge fund) must be authorised to provide investment services in France pursuant to the Investment Services Directive 19993 or otherwise. In September 2005, the first international prime broker was appointed in respect of a French on-shore Fund following implementation of Decree No. 2005-875 of July 2005.</p> <p>The key documents that the regulator requires from a prime broker are the Compliance Letter and the prime brokerage agreement. The following are some of the mandatory elements of a prime brokerage relationship with an OPCVM:</p> <ul style="list-style-type: none"> • cash balances must be subject to the protections conferred by the Client Money Rules; • restrictions in respect of the types/volume of assets of the OPCVM that are permitted to be hypothecated by the prime broker; • collateral arrangements are subject to the requirements of a code; and • rights of the OPCVM to terminate the prime brokerage relationship and effect rights of set off in an insolvency of the prime broker. <p><i>[Information source: AIMA Journal, Spring 2006]</i></p>
Commentary	<ol style="list-style-type: none"> 1. Having reviewed the prime broker agreements issued by the 3 prime brokers in the United Kingdom, the provisions of the standard agreements would not meet the requirements of the onshore regimes reviewed without modification. This seems to confirm that international prime brokerage agreements are often adopted to suit

	<p>regulatory requirements in the relevant market</p> <p>2. The ceilings provided by Ireland (140%) and Hong Kong (100%) in respect of amount of assets that may be the subject of collateral by the prime broker offers a possible policy option for the DFSA in addressing undue exposure and asset safety concerns.</p>
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