

September 13th , 2011

ESMA Consultation Paper on Possible Implementing Measures under the AIFMD

AFTI – FBF Contribution

Response to be addressed to submitted online via ESMA's website (www.esma.europa.eu)

Deadline for sending the response: 13 September 2011

I- PRESENTATION OF THE ASSOCIATIONS

L'Association Française des Professionnels des Titres ("AFTI") is the French association representing the post-trade industry.

All 100 members of AFTI are players in the securities market and back office functions: banks, investment firms, market infrastructures, issuers, in France and more generally in Europe.

The French Banking Federation ("FBF") represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, *i.e.* more than 500 commercial, cooperative and mutual banks. They employ 500,000 people in France and around the world, and serve 48 million customers.

In its submission, the response of **AFTI-FBF** (hereafter "The Associations") to the ESMA consultation will focus on the depositary issues, with additional comments on the delegation.

II- KEY MESSAGES

The Associations welcome the opportunity to contribute to the ESMA Consultation Paper on possible implementing measures of the Alternative Investment Fund Managers Directive.

The Associations share the objectives stated in the proposed ESMA advice:

- Striking the appropriate balance between the AIFM Directive objectives of ensuring a high level of investor protection while refraining from putting unjustified liabilities on the fund depositaries at the expense of the stability and the growth of the banking and fund industries.
- Propose implementing measures that are not unduly costly compared to alternatives measures that would also ensure the achievements of the objectives of the AIFM Directive.
- Clarifying and ultimately contributing to the **harmonisation of the fund depositaries duties and liabilities in the context of EU regulated funds**.

Consequently, when clarifying the duties of the fund depositary, The Associations expect the implementing measures to take into account the following over-arching principles with regard to:

a) the organisation and the accountability at the level of the different stakeholders:

- Recognition of the **accountability of the first level of controls** performed by the AIFM (or the AIF) *i.e.* no requirement for duplication of tasks and controls already carried out at the first level,
- **Proportionality of controls** performed by the depositary based on the characteristics of the AIF and its environment,
- Compliance with the **contractual arrangements** between the depositary and the AIFM (or the AIF),

b) the definition of the liability regime applicable to the depositary :

- **The scope of “assets held in custody”** should be clearly defined. In this respect “option 2” of the advice, amended for further clarification, should be retained
- Depositary should not be put in a position where it **would interfere with the** management decision and responsibilities,
- Loss of assets should be recognized as **a component of the investment risk** and should be borne in proportion by all actors, including the assets managers and the investors,
- A clear recognition that due diligences duties imposed on the depositary **cannot go beyond the custodian tasks** performed by its delegates,
 - In this respect, The Associations regret that ESMA did not choose to develop a comprehensive template of evaluation, selection, review and monitoring. Such a template would have been a key element for the clarification of the duties of the depositary, the European harmonization of the function and the resolution of conflicts.
- Fund depositaries **cannot be requested to provide legal** certainty on arrangements and procedures, **including segregation**, that pertain to national legal systems,
- Fund depositaries **cannot be requested to compensate** for, or substitute, local regulators /supervisors that are in charge of the sound functioning of the financial and banking system.
- Harmonized implementation and interpretation should be achieved throughout the EU. In this context complexity (e.g; “3 steps” rationale) seem unadvisable.

Some of the proposed advices included in this consultation have raised major concerns within the depositary bank community.

This is particularly true with respect to the issue of the insolvency of sub-custodians, as **insolvency related events of a sub-custodian to the Depositary should be considered an external** event since it is beyond the possibility to foresee a situation of insolvency, whatever the nature of the “due diligences”

Making the European bank depositary community liable for the insolvency of sub-custodians would put a major, and unjustified, risk to the banking stability in Europe, at a moment when markets are experiencing difficult times

The Associations urge ESMA to further develop the concept of proportionality in the advice in order to avoid the situation where depositories would be assimilated as an insurer for the fund industry.

The Associations trust that ESMA will find value in this contribution and remain at its entire disposal should ESMA need further comments or details.

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III- Detailed contribution to the public consultation

A. DELEGATION

Box 65

Objective Reasons

Option 1

~~The AIFM must be able to justify its entire delegation structure with objective reasons; to comply with this the AIFM should be able to demonstrate that the delegation is done for the purpose of a more efficient conduct of the AIFM's management of the AIF.~~

Option 2

Objective reasons for delegating tasks include but are not limited to:

- optimising of business functions and processes;
- cost saving;
- expertise of the delegate in administration/ specific markets/ investments;
- access of the delegate to global trading capabilities.

Q24: Do you prefer Option 1 or Option 2 in Box 65? Please provide reasons for your view.

THE ASSOCIATIONS CONTRIBUTION

The Associations support Option 2. We are of the opinion that the list of objective reasons should not be exhaustive.

We also recommend that the entity that calculates the NAV, acting as delegate of the AIFM, be compliant with a minimum European standard, namely:

- to be compliant with an accounting chart defined by a regulator,
- to be controlled by auditors of the Funds on a regular basis (statements for stock portfolio and of the NAV per unit, certifications of the annual accounts),
- to be compliant with the professional national rules of conduct organising the missions of the entity that calculates the NAV and its relations with the management company, including exchange of information between the entity that carries out the calculation of the NAV and the management company.

B. Depositories

Appointment of a depositary

1 Contract evidencing the appointment of a depositary

1.1 Particulars of the contract appointing the depositary

1.2 ESMA's justification for not providing a model agreement

THE ASSOCIATIONS CONTRIBUTION

The Associations agree with ESMA proposed advice. A model agreement does not appear to be necessary, provided that all particulars referred to in box 74 are included in the contract.

Duties of the depositary

Depositary functions

1 Depositary functions pursuant to §7 – Cash monitoring

1.1 Cash flow monitoring

THE ASSOCIATIONS CONTRIBUTION – Amendments to Box 75

Box 75

Cash Monitoring – general information requirements

The AIFM should ensure the depositary is provided, upon commencement of its duties and on an ongoing basis, with all relevant information it needs to comply with its obligations pursuant to Article 21 (7) including by third parties and particularly that:

- the depositary is informed, upon its appointment, of all existing cash accounts opened in the name of the AIF, or in the name of the AIFM acting on behalf of the AIF;
- the depositary is informed prior to the effective opening of any new cash account by the AIF or the AIFM acting on behalf of the AIF;
- the depositary is provided with all information related to the cash accounts opened at a third party entity, directly from those third parties in order for the depositary to have access to all information regarding the AIF's cash accounts and have a clear overview of all the AIF's cash flows.

Where the depositary does not receive **timely and accurate** this information, the AIFM will have been deemed not to have satisfied the requirements of Article 21 of the directive **and the depositary shall be discharged from any liability so long as it has exercised its responsibilities on the basis of the information made available to it.**

THE ASSOCIATIONS CONTRIBUTION

ESMA's advice in relation to article 21 rightly reaffirmed the importance for the depositary to receive all the necessary information on a timely and accurate manner from the various parties involved in the management and administration of the AIF in order to perform its supervision duties. On that basis, the Associations suggest that when those requirements have not been met, the depositary shall be discharged from its responsibilities and liabilities.

THE ASSOCIATIONS CONTRIBUTION – Please see our amendments to Box 76 in Q. 29

Box 76

Proper monitoring of all AIF's cash flows

Option 1

The depositary should act as a central hub to ensure an effective and proper monitoring of all cash movements and in particular, it should:

1. ensure the cash belonging to the AIF is booked in an account opened at the depositary; or
2. where cash accounts are opened at a third party entity:
 - (a) ensure those accounts are only opened with entities referred to in Article 18 (1) (a) to (c) of Directive 2006/73/EC or another entity of the same nature in the relevant market where cash accounts are required as defined in §2 of Box 77 (Ensuring the AIF's cash is properly booked)
 - (b) mirror the transactions of those cash accounts into a position keeping system and make periodic reconciliations between the cash accounts statements and the information stemming from the AIF's accounting records
 - (c) ensure the AIFM has taken appropriate measures to send all instructions simultaneously to the third party and the depositary

Option 2

To ensure the AIF's cash flows are properly monitored, the depositary should at least:

1. ensure that cash accounts opened at a third party are only opened with entities referred to in Article 18 (1) (a) to (c) of Directive 2006/73/EC or another entity of the same nature in the relevant market where cash accounts are required as defined in §2 of Box 77 (Ensuring the AIF's cash is properly booked);
2. ensure there are proper procedures to reconcile all cash flow movements and verify that they are performed at an appropriate interval;
3. ensure appropriate procedures are implemented to identify on a timely basis significant cash flows and in particular those which could be inconsistent with the AIF's operations;
4. review periodically the adequacy of those procedures including through a full review of the reconciliation process at least once a year;

5. monitor on an ongoing basis the outcomes and actions taken as a result of those procedures and alert the AIFM if an anomaly has not been rectified without undue delay.

THE ASSOCIATIONS CONTRIBUTION

The Associations strongly support option 2 in box 76, for the reasons highlighted in its response to question 29 (please see amendments to Box 76 in Q.29)

Notwithstanding the oversight duties in relation to the compliance with the applicable national law or AIF articles of incorporation, it should be recognized that the depositary should not be held responsible for identifying any “inconsistent” transactions with the AIF’s operations as this identification should be the primary responsibility of the AIF .

1.3 Conditions for ensuring the AIF’s cash is properly booked

Q25: How difficult would it be to comply with a requirement by which the general operating account and the subscription / redemption account would have to be opened at the depositary? Would that be feasible?

THE ASSOCIATIONS CONTRIBUTION

Should the requirement laid down in Q 25 be imposed, this would raise major difficulties.

- This would cause significant operational difficulty and would appear unnecessary.

- It could have a damaging impact on distribution channels and would therefore increase costs.

In our opinion, the current arrangements enable the AIF accounts to be promptly credited with subscriptions monies.

- We do not see any added value in disrupting administrative channels that best suit the distribution procedures.

Q26: At what frequency is the reconciliation of cash flows performed in practice? Is there a distinction to be made depending on the type of assets in which the AIF invests?

THE ASSOCIATIONS CONTRIBUTION

The reconciliation of cash flows is performed at each calculation of the NAV by the AIF, by its own means or by delegation (fund administration).

On a periodic basis, in accordance with its own risks analysis, the verification of the reconciliation performed by the AIF/AIFM is included in the Program of controls performed by the depositary.

There is no distinction to be made depending on the type of assets in which the AIF invests.

Q27: Are there any practical problems with the requirement to refer to Article 18 of MiFID?

THE ASSOCIATIONS CONTRIBUTION

We do not foresee any practical problems with the reference to Article 18 of MiFID.

With regard to any entity established in a relevant 3rd country, it should be considered 'of the same nature' as those entities referred to in Article 18 (1)(b) of Commission Directive 2006/73/EC if it is a credit institution and subject to prudential regulation and supervision to the same effect as the provisions laid down in EU legislation.

Q28: Does the advice present any particular difficulty regarding accounts opened at prime brokers?

THE ASSOCIATIONS CONTRIBUTION

The AIFM should have the obligation to require the Prime Broker to transmit all information to the depositary in order to allow him to perform its control (ref. Q. 29). This obligation should apply to all instruments (securities, derivatives and cash).

Moreover, in our view, the Prime Broker should have to fulfil the conditions of Article 18 of the Directive 2006/73/EC (point 18) and the AIFM should have to ensure that the Prime Broker has satisfied its obligation.

Q29: Do you prefer option 1 or option 2 in Box 76? Please provide reasons for your view.

THE ASSOCIATIONS CONTRIBUTION

1. The Associations do not support Option 1.

The depositary's duties regarding the monitoring of the AIF's cash flows are performed on an ex-post basis. This contradicts c) of Option 1 that introduces an ex-ante concept.

Moreover, the requirements set in c) imply a "blocking action" from the depositary which could lead to some notable delay in carrying out the operation and could be detrimental to the unit-holders. (and interfere with asset management acts and decisions).

Point 8 of the explanatory text associated to option 1 reads that: 'the depositary could intervene immediately if it considers the cash flows inappropriate.' This would require the depositary to achieve a real time monitoring of all cash transactions, and also to review the reason for all transactions (trade, deposit with credit institution, expense payment and potentially free cash transfer) to determine whether there are potentially inappropriate. In these circumstances, the depositary would be turned into a fund manager middle-officer. The cost in terms of infrastructure and resources to meet this requirement would be very high, similar to the cost of an ex-ante authorization regime by the depositary and would be very high as stated in the ESMA's impact assessment (page 308).

2. The Associations support Option 2 (more realistic) with some amendments (see below)

Option 2 rightly refers to secondary level controls. Indeed, the depositary carries out a secondary level of control as the AIF/ AIFM are responsible for primary levels of control. The importance of first levels of control should be reaffirmed as it is the first, and priority point of control in the whole chain of operations and controls.

Nevertheless:

- We are of the opinion that the depositary's duties are to be limited to check the periodic reconciliation.

- When the depositary carries out the task associated to the custody, the market practice is that a general account is opened in the books of the depositary. Indeed carrying out custodial tasks such as the processing of settlement and of corporate actions for the AIF's assets.

Conversely, opening of cash accounts with third parties for operations on derivatives and/or for activities related to real estate funds (administrator of real estate) requires the opening by the AIF of a cash account outside the custodian's books. In these circumstances whenever cash accounts are opened in the name of the AIF with a third party, the corresponding assets are subject to the provisions for "other assets" (please see further comments in this contribution).

- Point 9 of the explanatory text suggests that if the reconciliations are performed daily, then the depositary would be expected to perform its verifications on a weekly basis. **The suggested verification frequency does not take into account the nature, scale and complexity of the AIF, or the volume of transactions.** Normally, the fund administrator would complete daily reconciliations for a daily valued fund, but the transactions may be minimal, and thus weekly verification by the depositary would not be cost effective.

- The notion of "full review of the reconciliation process" appears to be unclear. We understand that the depositary has to check that all of the relevant cash accounts opened in the name of the AIF and held at third parties are included in the scope of the reconciliation process.

Therefore the Associations suggest the following amendments to Box 76:

Box 76

Proper monitoring of all AIF's cash flows

Option 1

~~The depositary should act as a central hub to ensure an effective and proper monitoring of all cash movements and in particular, it should:~~

~~1. ensure the cash belonging to the AIF is booked in an account opened at the depositary; or~~

~~2. where cash accounts are opened at a third party entity:~~

~~(a) ensure those accounts are only opened with entities referred to in Article 18 (1) (a) to (c) of Directive 2006/73/EC or another entity of the same nature in the relevant market where cash accounts are required as defined in §2 of Box 77 (Ensuring the AIF's cash is properly booked)~~

~~(b) mirror the transactions of those cash accounts into a position keeping system and make periodic reconciliations between the cash accounts statements and the information stemming from the AIF's accounting records~~

~~(c) ensure the AIFM has taken appropriate measures to send all instructions simultaneously to the third party and the depositary~~

Option 2

To ensure the AIF's cash flows are properly monitored, the depositary should at least:

1. ensure that the cash belonging to the AIF is booked in an account opened at the depositary when it carries out

the custody of financial instruments; and

2. ensure that cash accounts opened at a third party are only opened with entities referred to in Article 18 (1) (a) to (c) of Directive 2006/73/EC or another entity of the same nature in the relevant market where cash accounts are required as defined in §2 of Box 77 (Ensuring the AIF's cash is properly booked);

2. ensure there are proper procedures at AIFM to reconcile all cash flow movements and verify that they are performed at an appropriate interval;

3. ensure there are appropriate procedures at AIFM which define the frequency of reconciliation process, the materiality of unresolved amounts, in particular those which could be inconsistent with the AIF's, and an "alert " mechanism if an anomaly has not been rectified without undue operations;

4. review periodically the adequacy of those procedures including through a full review of the reconciliation process and in particular check that the relevant cash accounts opened in the name of the AIF are included in the reconciliation process at least once a year;

When performing its monitoring tasks the depositary should take into account the nature, the size and the complexity of the AIF as well as the volume of transactions.

Q30: What would be the estimated costs related to the implementation of option 1 or option 2 of Box 76?

THE ASSOCIATIONS CONTRIBUTION

The Associations are of the opinion that Option 1 would lead to a complete change of operating model and to very high additional cost but no added value. Meeting the requirements of Option 1 would lead the depositary to:

- I. duplicate a part of the middle office function and of the valuation function, and duplicate the valuation costs (the depositary would perform valuation tasks)
- II. modify the relationship with the fund manager,
- III. implement a new system architecture and increase the number of depositary staff,
- IV. an additional running cost widely over than 100% of the current cost for AIFs with a high number of cash movements.

Moreover, Option 1 would require substantial IT evolutions after an implementation phase that cannot be quantified at this stage.

It is not possible to quantify costs but it seems that, would option 1 be retained, this would involve requiring to additional resources to perform the tasks as envisaged, in particular mirroring (ie: posting of each individual transaction) the transactions from the cash accounts into a position keeping system and performing, the periodic reconciliations between the cash accounts and the AIF's accounting records (see below).

As a general comment, the proposals introduce unnecessary additional layers of administration and controls which are not to the benefit of the investor but are only likely to cause additional costs.

The Associations are of the opinion that Option 2 should not generate additional costs.

Q31: What would be the estimated costs related to the implementation of cash mirroring as required under option 1 of Box 76?

THE ASSOCIATIONS CONTRIBUTION

Mirroring all transactions on a depositary record would be onerous for AIFs with large trading volumes and such mirroring would be prone to error and require additional reconciliation, without providing any additional protection over the processes outlined in Option 2.

The cost in term of infrastructure and resources to meet this requirement would be very high, similar to the cost of an ex-ante control procedure scheme, and would be very high as stated in the ESMA's impact assessment (page 308).

Option 2 requires strong oversight of the entire process and is less resource intensive while achieving the same level of protection. Moreover, it is in line with current best practice and additional cost should therefore be contained.

2 Depositary functions pursuant to §8 – Safe-keeping duties

2.1 Definition of the financial instruments that should be held in custody

Q32: Do you prefer option 1 or option 2 in Box 78? Please provide reasons for your view.

THE ASSOCIATIONS CONTRIBUTION

The Associations' preference is for option 2 (subject to the comments below)

Option 1 is not acceptable as it could cause the scope of assets in custody to go far beyond the duties of the depository.

There is indeed no direct link between the registration and the qualification for assets in custody. This is explicitly acknowledged in ESMA advice (please refer to explanatory text 10: "ESMA recommends clarifying that maintaining a record could mean registering the assets in its name in the first instance or...").

Registration of assets with registers that are neither selected nor delegates of the depository but in most cases a consequence of an investment decision made by the AIF (or the AIFM) cannot give ground for these assets to qualify for assets in custody (e.g.: registrars commonly used for shares in unit trusts).

In order to promote and protect investments and financial stability in Europe, the European banking system should not be exposed and made liable for weaker or less regulated financial markets outside the EU. We therefore suggest to restrict the settlement systems to those designated in Directive 98/26/EC.

The Associations suggest to retain option 2 with the following amendments to Box 78:

Box 78

Definition of financial instruments to be held in custody – Article 21 (8) (a)

Pursuant to Article 21 (8) (a), financial instruments belonging to the AIF should be included in the scope, of the depository's custody function when they meet all the criteria defined below:

1. they are transferable securities, money market instruments or units of collective investment undertakings – as listed in Annex I, section C of Directive 2004/39/EC **and the depository or its sub custodian is the registered holder of the financial instruments or the depository or its sub custodian is the only registered holder of the assets whether on a client by client basis or according to an "omnibus "account scheme).**
2. they are not provided as collateral in accordance with the provisions set out in Box 79 **(they have not been transferred out of the depository's book, and their ownership right has not been transferred to a third party) ;** and

Option 1

- ~~3. they are registered or held in an account directly or indirectly in the name of the depository.~~

Option 2

3. they are financial instruments with respect to which the depository may itself or through its sub-custodian instruct the transfer of title or an interest therein by means of a book-entry on a register **subject to regulated central reconciliation procedures and** maintained by a settlement system **which acts directly for the issuer or its**

agent. This settlement system is one of the European settlement system as designated by Directive 98/26/EC

Additionally, financial instruments which **are** ~~can be~~ physically delivered to the depositary should be held in custody.

Financial instruments that are directly **(in the name of the AIF)** registered with the issuer itself or its agent (e.g. a registrar or a transfer agent) should not be held in custody unless they **are** ~~can be~~ physically delivered to the depositary. Further, financial instruments which comply with the definition set out above will remain in custody when the depositary is entitled to re-use them whether that right has been exercised or not. Where the financial instruments have been provided by the AIF or the AIFM acting on behalf of the AIF to a third party under a temporary lending agreement, they will no longer be held in custody by the depositary and fall under the definition of 'other assets' in accordance with Article 21 (8) (b).

~~In the context of Option 1, where the financial instruments are registered directly with the issuer or its agent making the depositary the only registered owner on behalf of one or more unidentified clients, the financial instruments should be held in custody. However, such financial instruments should not be held in custody if the depositary is clearly identified in the register as acting on behalf of the AIF and thus the AIF is clearly identified as the owner of the financial instruments.~~

All financial instruments that do not comply with the above definition should be considered as 'other assets' under the meaning of the AIFMD Article 21 (8) (b) and be subject to record keeping duties.

Q33: Under current market practice, which kinds of financial instrument are held in custody (according to current interpretations of this notion) in the various Member States?

THE ASSOCIATIONS CONTRIBUTION

These financial instruments are transferable securities, money market instruments or units of collective investment undertakings in bearer form, as listed in Annex I, section C of Directive 2004/39/EC (derivatives excluded)

These financial instruments, in bearer form, are subject to mandatory registration in a regulated CSD and are registered with an account opened in the name of the depositary itself.

This is therefore consistency with the proposal for a definition, as amended by the Associations in Box 78.

Note that, in France, the custodian bank is not recognized as the owner of the financial instruments.

THE ASSOCIATIONS CONTRIBUTION – Amendments to Box 79

Box 79

Treatment of collateral – Article 21 (8) (a)

Financial instruments provided as collateral should not be held in custody if they are provided:

Option 1

~~under a title transfer financial collateral arrangement as defined in Directive 2002/47/EC on financial collateral arrangements~~

Option 2

under a title transfer financial collateral arrangement or under a security financial collateral arrangement by which the control over / possession of the financial instruments within the meaning of Article 2 (2) of Directive 2002/47/EC on financial collateral arrangements is transferred away from the AIF or the depositary to the collateral taker or a person acting on its behalf. Therefore financial instruments that have been provided as collateral should not be in custody except in the following case

- they have not been transferred out of the depositary's book, and
- their ownership right has not been transferred to a third party, and
- they cannot be re-used by a third party which is not the depositary.

Option 3

~~under a financial collateral arrangement as defined in Directive 2002/47/EC on financial collateral arrangements~~

THE ASSOCIATIONS CONTRIBUTION

We prefer Option 2 .but it should be clarified that financial instruments that have been provided as collateral should not be in custody except in the following case :

- they have not been transferred out of the depositary's book, and
- their ownership right has not been transferred to a third party, and
- they cannot be re-used by a third party which is not the depositary.

Financial instruments provided as collateral (taken by AIF or given by AIF) are NOT held in custody if they have been transferred out of the depositary's book.

In these circumstances, Financial Instruments transferred to a third party, and belonging to the fund (no transfer of ownership). are subject to the depositary recordkeeping duties

Q34: How easy is it in practice to differentiate the types of collateral defined in the Collateral Directive (title transfer / security transfer)? Is there a need for further clarification of option 2 in Box 79?

THE ASSOCIATIONS CONTRIBUTION

The differentiation of the types of collateral defined in the Collateral Directive is not easy since this requires an analysis of the collateral agreement and of the parties' intention.

In this context, Option 2 appears to be the appropriate.

2.2 Conditions applicable to the depositary when performing its safekeeping duties on each category of assets

THE ASSOCIATIONS CONTRIBUTION – Amendments to Box 80

Box 80

Safekeeping duties related to financial instruments that can be held in custody

1. To comply with its obligations pursuant to Article 21 (8) (a), the depositary should be required to at least:

(a) Ensure the financial instruments are properly registered in segregated accounts in order to be identified at all times as belonging to the AIF

(b) Exercise due care in relation to the financial instruments held in custody to ensure a high level of protection

(c) Assess and monitor all relevant custody risks. ~~In particular, depositaries should be required to assess the custody risks related to settlement systems and inform the AIFM of any material~~ **change in the market practices risk identified.**

2. Where the depositary has delegated its custody functions, the depositary would remain subject to the requirements of §1 (c) and would further have to ensure the third party (hereafter referred to as the 'sub-custodian') complies with §1 (b) as well as with the segregation obligations set out in Box 16.

THE ASSOCIATIONS CONTRIBUTION

The Associations are of the opinion that the depositary cannot be required to "...assess and monitor all relevant custody risks...", and especially not those custody risks "...related to settlement systems and inform the AIFM of any material risk identified."

The Associations recommend therefore to amend point 1 (c) : the depositary shall inform the AIF or the AIFM acting on behalf of the AIF of any **material change** in the markets it holds AIF's assets in custody.

Q35: How do you see the delegation of safekeeping duties other than custody tasks operating in practice?

THE ASSOCIATIONS CONTRIBUTION

In practice, we envisage few delegation schemes for safekeeping duties other than custody tasks with the exception of, in the context of Prime Brokerage intervention, of the delegation of record-keeping duties to the Prime Brokers.

Q36: Could you elaborate on the differences notably in terms of control by the depositary when the assets are registered directly with an issuer or a registrar (i) in the name of the AIF directly, (ii) in the name of the depositary on behalf of the AIF and (iii) in the name of the depositary on behalf of a group of unidentified clients?

THE ASSOCIATIONS CONTRIBUTION

- When the assets are directly registered in the name of the AIF, the depositary should be provided by the AIF with an unquestionable document (e.g; statement of assets under custody) with regards to the acquisition/sale. There is no account relationship between the depositary and the issuer.

A functional relationship, however, may be set up between the depositary and the issuer, whereby the depositary can be granted exclusive authority to give instructions on the account opened in the name of the AIF (or the AIFM).

- When the assets are registered in the name of the depositary on behalf of the AIF (i.e. in the form of depositary/AIF or depositary /AIFM).

- When the assets are registered in the name of the depositary on behalf of a group of unidentified clients (= omnibus account): same comment as above: The depositary reconciles its positions with the transfer agents.

37: To what extent would it be possible / desirable to require prime brokers to provide daily reports as requested under the current FSA rules?

THE ASSOCIATIONS CONTRIBUTION

A daily information (including re-used assets) provided by the Prime Broker to the depositary is desirable. Assets of the fund with the Prime Broker should be clearly identified and segregated.

Q38: What would be the estimated costs related to the implementation of option 1 or option 2 of Box 8? Please provide an estimate of the costs and benefits related to the requirement for the depositary to mirror all transactions in a position keeping record?

THE ASSOCIATIONS CONTRIBUTION

- Option 1 with some amendments is preferable.

- The Associations do not support option 2 which would lead to a complete change of operating model and to very high additional costs but no real added value. Meeting the requirements of option 2 would lead the depositary:

- i. to duplicate part of the clearer or of the prime broker activity ,
- ii. to modify the relationship with fund manager,
- iii. to implement a new system architecture with additional resources
- iv. to an additional running cost widely over than 100% of the current cost for AIFs with large trading volume on listed derivatives or on assets provided as collateral.

Mirroring all transactions with option 2, in particular trade on listed derivatives or trades on assets provided as collateral to a Prime broker, on a depositary record would be onerous for AIF with large trading volume and such mirroring would be prone to error and require additional reconciliations, without providing any additional protection over the processes outlined in option 1.

The depositary should be in the position to comply, at a reasonable cost, with its obligation to provide at any time a comprehensive and up to date inventory of the AIF assets.

Therefore, it should be clarified that for listed derivatives and for transactions related to assets provided in collateral, **the depositary can discharge its assets monitoring duties by receiving and storing the clearing broker statement mentioning the transactions and positions.**

Therefore the Associations suggest the following amendments:

Box 81

Safekeeping duties related to 'other assets' – Ownership verification and record keeping

The AIFM should ensure the depositary is provided, upon commencement of its duties and on an ongoing basis, with all relevant information it needs to comply with its obligations pursuant to Article 21 (8) (b) including by third parties. **The AIFM is responsible for any negligence of not providing to the depositary in due time – or not giving access to the depositary- with all relevant information needed from the AIFM or a third party appointed by the AIF.**

To comply with its obligations pursuant to Article 21 (8) (b), the depositary should be required to at least:

1. Ensure it has timely access to all relevant information it needs to perform its ownership verification and record keeping duties, including from third parties (e.g. prime brokers).
2. Ensure that it possesses sufficient and reliable information for it to be satisfied of the AIF's ownership right or of the ownership right of the AIFM acting on behalf of the AIF over the assets.
3. Maintain a record of those assets for which it is satisfied the AIF or the AIFM acting on behalf of the AIF holds the ownership of those assets.

In order to comply with that obligation, the depositary should be required to:

(a) register, on behalf of the AIF, assets in its name or in the name of its delegate; or

(b) ensure, where assets are registered directly in the name of the AIF or the AIFM, or physically held by the AIF or the AIFM, it is able to provide at any time a comprehensive and up to date inventory of the AIF's assets [positions](#).

To that end, the depositary should:

Option 1

(i) ensure there are procedures in place so that assets so registered cannot be assigned, transferred, exchanged or delivered without the depositary or its delegate having been informed of such transactions; or

(ii) have access to documentary evidence of each transaction [and position](#) from the relevant third party on a timely basis; or

[\(iii\) receive and store relevant electronic data flow from the relevant third party on a timely basis.](#)

Option 2

~~mirror all transactions in a position keeping record~~

In the context of § (b) the AIFM should be required to ensure that the relevant third party provides the depositary with certificates or other documentary evidence or [relevant electronic data flows](#) every time there is a sale / acquisition or a corporate action and at least once a year.

In any event, the depositary should ensure that the AIFM has and implements appropriate procedures to verify that the assets acquired by the AIF it manages are appropriately registered in the name of the AIF or in the name of the AIFM on behalf of the AIF, and to check consistency between the positions in its records and the assets for which the depositary is satisfied the AIF or the AIFM acting on behalf of the AIF holds the ownership.

Q39: To what extent does / should the depositary look at underlying assets to verify ownership over the assets?

THE ASSOCIATIONS CONTRIBUTION

[In our opinion ESMA advice appears to lack clarity when referring to "underlying assets" in this context.](#)

[- If it means, for instance, the assets underlying a collective investment scheme into which the AIF invests \(transparency level\), then clearly the depositary should not be required to look at these. In this context, It should be reaffirmed that the ownership of the underlying assets is of relevance for the calculation of the NAV of the AIF and is not part of the asset monitoring duties](#)

[- If the issue is to reach to the *level* of due diligence a depositary should carry out in order to verify ownership of non-custody assets held *directly* by the AIF \(Record-keeping level\), it is our opinion that it is not advisable to be too prescriptive about this. In its record-keeping duties the depositary is provided by the AIFM with elements documenting the ownership.](#)

[Given the extended nature of the assets classes eligible for investment, the AIF \(or the AIFM\) should set the appropriate verification procedure. The AIF \(or AIFM\), should establish and maintain a procedure whereby it is established what should be accepted as a valid title of ownership for each type of assets. The depositary should ensure that the AIFM \(or AIF\) procedures are in place, and through periodic reviews, review that these procedures are complied with.](#)

3 Depositary functions pursuant to §9 – Oversight duties

THE ASSOCIATIONS CONTRIBUTION (please see our amendments to Box 82 in Q.40)

Box 82

Oversight duties – general requirements

At the time of its appointment, the depositary should assess the risks associated with the nature, scale and complexity of the AIF's strategy and the AIFM's organisation in order to define oversight procedures which are proportionate to the AIF and the assets in which it invests. Such procedures should be regularly updated.

To comply with its oversight duties, the depositary is expected to perform *ex post* controls and verifications of processes and procedures that are under the responsibility of the AIFM, the AIF or an appointed third party. The depositary should in all circumstances ensure a procedure exists, is appropriate, implemented and frequently reviewed.

The depositary is required to establish a clear and comprehensive escalation procedure to deal with situations where potential irregularities are detected in the course of its oversight duties, the details of which should be made available to the competent authorities upon request.

The AIFM should ensure the depositary is provided, upon commencement of its duties and on an on going basis, with all relevant information it needs to comply with its obligations pursuant to Article 21 (9) including by third parties and particularly that the depositary is able to perform on-site visits of its own premises and any service provider appointed by the AIF or the AIFM (e.g. Administrator, external valuer) to ensure the adequacy and relevance of the procedures in place.

(a) Oversight duties related to subscriptions / redemptions

THE ASSOCIATIONS CONTRIBUTION – Amendments to Box 83

Box 83

Clarifications of the depositary's oversight duties

Duties related to subscriptions / redemptions (a)

The oversight duties of the depositary do not include "secondary" market transactions (i.e. sale or repurchase of shares and units).

To fulfil its duties pursuant to Article 21 (9) (a), the depositary should be required to:

1. ensure that the AIF, the AIFM or the designated entity has and implements an appropriate procedure to :
 - (a) reconcile
 - the subscription / redemption orders with the subscription proceeds / redemptions paid, and
 - the number of units or shares issued / cancelled with the subscription proceeds received / redemptions paid by the AIF
 - (b) verify on a regular basis that the reconciliation procedure is appropriate.

To that end, the depositary should in particular regularly check the consistency between the total number of units or shares in the AIF's accounts and the total number of outstanding shares or units that appear in the AIF's register. The frequency of the controls performed by the depositary depends upon the nature, the scale and the

complexity of the AIF and on the frequency of the AIF's calculation of the units or shares of the AIF .

2.ensure and regularly check the compliance of the procedures regarding the sale, issue, repurchase, redemption and cancellation of shares or units of the AIF with the applicable national law and the AIF rules and / or instruments of incorporation and verify that these procedures are effectively implemented **(PLEASE SEE THE ASSOCIATIONS COMMENTS ON THIS SECTION)**

~~The frequency of the depositary's checks should be proportionate to the frequency of subscription and redemptions.~~

THE ASSOCIATIONS CONTRIBUTION

Point 2 of Box 83 should be clarified.

The oversight duties of the depositary cannot include "secondary" market transactions (i.e. sale or repurchase of shares and units)

The oversight duties should apply to the compliance of the procedures at the level of AIF, AIFM or the designated entity only. The depositary has no view or access to the distribution channels.

The Associations support point 54 of the explanatory text. AIFM and UCITS requirements on oversight duties should be aligned. We expect the implementing measures to achieve this goal.

(b) Oversight duties related to the valuation of shares or units of the AIF

THE ASSOCIATIONS CONTRIBUTION – Amendments to Box 84

Box 84

Clarifications of the depositary's oversight duties

Duties related to the valuation of shares / units (b)

~~1. The depositary should verify on an on-going basis that appropriate and consistent procedures are established for the valuation of the assets of the AIF in compliance with the requirements of Article 19 and its implementing measures and the AIF rules and instruments of incorporation.~~

2. The depositary should ensure that the valuation policies and procedures **for the calculation of the value of the units or shares of the AIF** are effectively implemented and periodically reviewed.

3. The depositary's procedures should be proportionate to the nature, scale and complexity of the AIF and conducted at a frequency consistent with the frequency of the **AIF's internal procedures with regards the calculation of the value of the units or shares of the AIF** ~~valuation policy~~ as defined in Article 19 and its implementing measures.

4. Where the depositary considers the calculation of the value of the shares or units of the AIF has not been performed in compliance with applicable law or the AIF rules or the provisions of Article 19, it should notify the AIFM and ensure timely remedial action has been taken in the best interest of the AIF's investors.

~~5. Where applicable, the depositary should be required to check that an external valuer has been appointed in accordance with the provisions of Article 19 of the AIFMD and its implementing measures.~~

THE ASSOCIATIONS CONTRIBUTION

With respect to Box 84, the Associations consider that ESMA's advice and explanatory text imposes more duties on the depositary than laid down in the Level 1 text. The Level 1 Article 21.9(b) requires that the depositary *"...ensure that the value of the units or shares of the AIF are calculated in accordance with the applicable national law, the AIF rules or instruments of incorporation and the procedures laid down in Article 19...".* This does not require the depositary to directly oversee the valuation of assets. Accordingly, the Associations believe that paragraph 1 of Box 84 should be deleted.

For the avoidance of confusion, the Associations suggest to amend points 2 and 3. As the depositary is not required to oversee the valuations of assets or the decision to appoint an external valuer, the Associations also believe that point 5 should be deleted. The decision over internal or external valuation is the responsibility of the AIFM, and the AIFM must ensure compliance with the requirements of Article 19 in this regard.

In the explanatory text number 58, the Associations believe that the depositary should be expected *"... to take reasonable steps to ensure that the procedures for the calculation of the value of the units or shares of the AIF are appropriate ..."*.

The sentence *"When setting up its oversight procedures, the depositary should ensure that it has a clear understanding of the valuation methodologies used by the AIFM or the external valuer to value the assets of the fund."* should be deleted, as this is beyond the direct remit of the depositary.

(c) Oversight duties relating to the carrying out of the AIFM's instructions

THE ASSOCIATIONS CONTRIBUTION (Please see our amendments to Box 85 in Q. 44)

Box 85

Clarifications of the depositary's oversight duties

Duties related to the carrying out of the AIFM's instructions (c)

To fulfil its obligation pursuant to Article 21 (9) (c), the depositary should be required to:

1. Set up and implement appropriate procedures to verify the compliance of the AIF / AIFM with applicable law and regulation as well as with the AIF's rules and instruments of incorporation. In particular, the depositary should monitor compliance of the AIF with investment restrictions and leverage limits defined in the AIF's offering documents. Those procedures should be proportionate to the nature, scale and complexity of the AIF.
2. Set up and implement an escalation procedure where the AIF has breached one of the limits or restrictions referred to under §1.

(d) Oversight duties relating to the timely settlement of the transactions

THE ASSOCIATIONS CONTRIBUTION – Amendments to Box 86

Box 86

Clarifications of the depositary's oversight duties

Duties related to the timely settlement of transactions (d)

Option 1

No additional requirement

Option 2

~~To fulfil its obligation pursuant to Article 21(9)(d), the depositary should be required to set up a procedure to detect any situation where the consideration is not remitted to the AIF within the usual time limits, notify the AIFM and where the situation has not been remedied, request the restitution of the financial instruments from the counterparty where possible.~~

~~Where the transactions do not take place on a regulated market, the usual time limits should be assessed with regard to the conditions attached to the transactions (OTC derivative contracts, investments in real estate assets or in privately held companies)~~

THE ASSOCIATIONS CONTRIBUTION

The Associations support Option 1.

The current arrangements, processes and market practices allow for a timely settlement of transactions and the identification of possible fails or anomalies by the AIFM (middle office functions, accounting functions) and the clearing and settlement service providers (custodians).

Moreover, with regard to the assets not held in custody (derivatives, non listed securities real estate..), and due to the non-standard nature of those transactions, the Associations are of the opinion that the responsibility of assessing the usual time limits should not be transferred to the depositary and should remain with the contracting parties of the transaction.

We therefore do not think that Option 2 is feasible for assets not held in custody.

(e) Oversight duties relating to the AIF's income distribution

THE ASSOCIATIONS CONTRIBUTION – Amendments to Box 87

Box 87

Clarifications of the depositary's oversight duties

Duties related to the AIF's income distribution (e)

To fulfil its obligation pursuant to Article 21(9)(e), the depositary should be required to:

1. Ensure the net income calculation **once declared by the AIFM** is applied in accordance with the AIF rules, instruments of incorporation and applicable national law

2. Ensure appropriate measures are taken **by the AIF** where the AIF's auditors have expressed reserves on the annual financial statements. **This obligation , however , is subject to the compliance by the AIF (or the AIFM) of the obligation to promptly and accurately inform the depositary of all reserves. (PLEASE SEE THE ASSOCIATIONS COMMENTS ON THIS SECTION)**

~~3. Check the completeness and accuracy of dividend payments and where relevant of the carried interest, (PLEASE SEE THE ASSOCIATIONS COMMENTS ON THIS SECTION)~~

THE ASSOCIATIONS CONTRIBUTION

Paragraph 1: The calculation of the net income is part of the portfolio management and accounting processes, and therefore under the responsibility of the AIF (or the AIFM). The depositary cannot be requested to be part of these processes as it would duplicate the entire accounting process for all fund transactions (debits and credits). Such a process does not seem to be feasible, would interfere inappropriately with management discretion and, would bring about significant duplicated tasks and higher costs. The Associations suggest to paragraph 1 in box 87 as follows: *"Ensure that net income, **once declared by the AIFM**, is applied ..."*

Paragraph 2 : The depositary cannot be requested to review all financial reports This requirement is acceptable under the sole condition that the AIF/AIFM is required to provide the depositary with all information on possible reserves expressed on the annual financial statements. Indeed, the contractual relationship is between the AIF/AIFM and the external auditor and the reserves are expressed to the benefit to the AIF/AIFM who has the primary to cure them.

In this context, the AIF/AIFM should inform the depositary of all possible reserves and the depositary and assess the actions undertaken by the AIF/AIFM.

Paragraph 3: It is our opinion that the requirement set out in this sub-section, are part of the external auditor duties and obligations.

Q40: To what extent do you expect the advice on oversight will impact the depositary's relationship with funds, managers and their service providers? Is there a need for additional clarity in that regard?

THE ASSOCIATIONS CONTRIBUTION

The Associations support the proposal to introduce principle-based implementing measures with regard to oversight duties.

The Associations also welcome the right level of depositary duties which remain proportional in relation to the duties of the other involved parties. It would like to underline its belief that level 1 does not impose the obligation on the depositary to undertake primary verification of every matter described in Article 21 (9). We would like to stress that the depositary does not perform first levels of control (operational and internal control) that are performed at AIF/AIFM level). The depositary performs secondary level controls. Therefore the depositary should neither substitute nor replicate the controls performed internally by the AIF/AIFM.

The proposed advice will create benefits for the reason that it enhances the orderly harmonized cooperation between the depositary and the AIFM or the AIF in relation to clearly establishing all the relevant information / communications flows, which is essential for an adequate investors' protection.

According to the general requirements as described in Box 82, the Associations understand that the oversight function as performed by the depositary should take into consideration the risks associated with the nature, scale and complexity of the AIF's strategy and the AIFM's organisation and essentially consist of assessing the control

procedures and environment at the AIFM, the AIF or appointed third party.

Provided the principles listed below are followed, the Associations do not believe that the advice on oversight duties will materially impact the depositary's relationships with AIFMs, AIF and third party providers:

- i) The scope of the oversight duties does not include the review of the whole organization and processes of the AIFM/AIF but is limited to the processes and procedures of the AIFM in relation to its obligations pursuant to article 21(9)
- ii) Objective of added value for all oversight duties and controls;
- iii) Ex-post basis controls;
- iv) No prevailing means of controls (samples, assessment of procedures, on site-visits...) should be designated in the level 2 text, In order to allow the use of the best appropriate. In particular the depositary should perform on-site visits only when it estimates it is necessary.
- v) Compliance with an escalation process;
- vi) Proportionality of controls;
- vii) Compliance with the contractual relationship between the depositary and the AIF/AIFM;
- viii) Absence of duplication with duties and controls performed at primary level;
- ix) Alignment with UCITS regulation.

Therefore the Associations suggest the following amendments to Box 82:

Box 82

Oversight duties – general requirements

At the time of its appointment, the depositary should assess the risks associated with the nature, scale and complexity of the AIF's strategy and the AIFM's organisation in order to define oversight procedures which are proportionate to the AIF and the assets in which it invests. Such procedures should be regularly updated.

To comply with its oversight duties, the depositary is expected to perform *ex post* controls and verifications of processes and procedures **in relation to its obligations pursuant to article 21(9)** that are under the responsibility of the AIFM, the AIF or an appointed third party. The depositary should in all circumstances ensure a procedure exists, is appropriate, implemented and ~~frequently~~ reviewed on a regular basis.

The depositary is required to establish a clear and comprehensive escalation procedure to deal with situations where potential irregularities are detected in the course of its oversight duties, the details of which should be made available to the competent authorities upon request.

The AIFM should ensure the depositary is provided, upon commencement of its duties and on an ongoing basis, with all relevant information it needs to comply with its obligations pursuant to Article 21 (9) **the outcome of the AIF/AIFM's monitoring on the actual and ongoing performance of the processes and procedures** including by third parties and particularly:

- that the depositary receives the risk management procedures describing how the AIF/AIFM will exercise its supervision duties in that regards, the information made by the independent assessment of the AIF/AIFM and its service provider on their control environment, the reserves on the AIF's auditor expressed on the annual financial statements, the outcome of the controls and calculation performed by the AIF/AIFM 's internal control and risk management function.
- that the depositary, when it estimates it is necessary, is able to perform on-site visits of its own premises and any service provider appointed by the AIF or the AIFM (e.g. Administrator, external valuer) to ensure the adequacy and relevance of the procedures in place.

Q41: Could potential conflicts of interest arise when the depositary is designated to issue shares of the AIF?

THE ASSOCIATIONS CONTRIBUTION

As a general duty, the depositary is required to be organised in such a way that allows proper identification and mitigation of all potential conflicts of interest (operational, functional and hierarchical segregation of functions)

Q42: As regards the requirement for the depositary to ensure the sale, issue, repurchase, redemption and cancellation of shares or units of the AIF is compliant with, the applicable national law and the AIF rules and / or instruments of incorporation, what is the current practice with respect to the reconciliation of subscription orders with subscription proceeds?

THE ASSOCIATIONS CONTRIBUTION

Please refer to the comments to Box 83, including our comments to explanatory text, paragraph 54.

Q43: Regarding the requirement set out in §2 of Box 83 corresponding to Article 21 (9) ,(a) and the assumption that the requirement may extend beyond the sales of units or shares by the AIF or the AIFM, how could industry practitioners meet that obligation?

THE ASSOCIATIONS CONTRIBUTION

Please refer to the response to question 42.

Q44: With regards to the depositary's duties related to the carrying out of the AIFM's instructions, do you consider the scope of the duties set out in paragraph 1 of Box 85 to be appropriate? Please provide reasons for your view.

THE ASSOCIATIONS CONTRIBUTION

The duties set out in Box 85 are part of regulatory and statutory controls. They are performed on an ex-post basis.

Regarding Box 85 the Associations find it important to keep in mind that the responsibility for implementing an effective and sound risk management process remains the responsibility of the AIF (or AIFM on behalf of the AIF).

According to the general requirements as described in Box 82, the Associations understand that the oversight function as performed by the depositary should mainly consist of assessing the control procedures and environment at the AIFM, the AIF or appointed third party.

The Associations are of the opinion that point 1 goes beyond the level 1 provisions. Level 1 text which refers to the incorporation document (not offering documents, i.e. the prospectus that may change without the depositary being informed). Furthermore in that regards, the reference to laws and regulations goes a little bit further than the Directive which refers to "national law", the difference may be tiny, but legally speaking it may not be the same. As the intent of this EU legislation is to promote harmonisation at EU level, we would recommend ESMA to limit its scope to EU rules.

Therefore the Associations suggest the following amendments to Box 85:

Box 85

Clarifications of the depositary's oversight duties

Duties related to the carrying out of the AIFM's instructions (c)

To fulfil its obligation pursuant to Article 21 (9) (c), the depositary should be required to

1. Set up and implement appropriate procedures to verify the compliance of the AIF / AIFM with applicable [national](#) laws and regulations as well as with the AIF's rules and instruments of incorporation. In particular, the depositary should monitor compliance of the AIF with investment restrictions and leverage limits ~~defined in the AIF's offering documents~~. Those procedures should be proportionate to the nature, scale and complexity of the AIF.
2. Set up and implement an escalation procedure where the AIF has breached one of the limits or restrictions referred to under §1.

Q45: Do you prefer option 1 or option 2 in Box 86? Please give reasons for your view.

THE ASSOCIATIONS CONTRIBUTION

[Please refer to the Associations comments to Box 86.](#)

[Option 1 is preferable.](#)

Section 2 Due diligence duties

THE ASSOCIATIONS CONTRIBUTION – Amendments to Box 88

Box 88

Due Diligence Requirements

1. When the depositary delegates any of its safekeeping functions, it should implement an appropriate, documented and regularly reviewed due diligence process in the selection and ongoing monitoring of the delegate.

(a) When appointing a sub-custodian, the depositary should roll out a due diligence process which aims to ensure that entrusting financial instruments to a sub-custodian provides an adequate level of protection. Such a process should include at least the following steps:

(i) assess the regulatory and legal framework (including country risk, custody risk, enforceability of contractual agreements). ~~This assessment should particularly enable the depositary to determine the potential implication of the insolvency of the sub-custodian~~

(ii) assess whether the sub-custodian's practice, procedures and internal controls are adequate to ensure the financial instruments will be subject to reasonable care

(iii) assess whether the sub-custodian's financial strength and renown are consistent with the delegated tasks. This assessment shall be based on information provided by the potential sub-custodian as well as third party data and information where available

(iv) ensure the sub-custodian has the operational and technological capabilities to perform the delegated custody tasks with a satisfactory degree of protection and security

(b) The depositary should perform ongoing monitoring to ensure the sub-custodian continues to comply with the criteria defined under §1 and the conditions laid out in Article 21 (11) (d), and at least:

(i) monitor the sub-custodian's performance and its compliance with the depositary's standards

(ii) ensure it exercises reasonable care, prudence and diligence in the performance of its custody tasks and particularly that it effectively segregates the financial instruments assets ~~in line with the requirements set out in Box 16~~ between 1) its assets and the assets of its clients 2) the assets held by the depositary for its own account and the assets of the depositary's clients.

(iii) review the custody risks associated with the decision to entrust the assets to that entity ~~and promptly notify the AIF or AIFM of any change in these risks~~. This assessment should be based on information provided by the sub-custodian as well as third party data and information where available. During market turmoil or where a risk has been identified, the frequency and the scope of the review should be increased

2. The depositary should design contingency plans for each market in which it appoints a delegate to perform safekeeping duties. Such a contingency plan may include the identification of an alternative provider, if any.

3. The depositary shall ~~take such measures, including terminating the contract, if the depositary assesses that the sub-custodian no longer complies with the requirements and this situation cannot be cured in a reasonable period of time~~ terminate the contract in the best interest of the AIF and its investors ~~where the delegate no longer complies with the requirements~~.

THE ASSOCIATIONS CONTRIBUTION

The Associations regret that ESMA does not support the development of a comprehensive template of evaluation. Indeed, parameters, topics to be checked on sub-custodians and guidelines could be useful. Although this would be further adapted by all depositaries, this would encourage best professional practices and limit room for interpretations when assessing the relevance, or the absence of due diligence task

We support the distinction made in ESMA's advice between delegation of custody of financial instruments in respect of which the custody obligation applies (i.e. on the delegates selected by the depositary only) and safe-keeping of other assets.

Hereafter our comments in relation to Box 88:

- Paragraph 1(a) (i): the requirement on the assessment of the regulatory and legal framework including custody risk seems to be not advisable. Indeed, it is not the role of the depositary to assess the legal framework of the effects of the segregation (see our comments in Box 89). The risk of a loss of assets, linked to factors other than direct custodial functions is a component of the investment risk and, therefore, should be assessed by the AIFM (or the AIF) when deciding to invest in a given market .(please see also our comments to Q46)
- Paragraph 1 (b) (ii): Cross-reference to Box 16 should not apply in this context. Indeed, financial instruments

are not registered in the account of the AIFs at the sub-custodian's level. Such a requirement would cause a major additional costs and operational burden and will not bring any further protection (please refer to Box 89 on segregation and section "Delegation")

- Paragraph 1 (b) (iii): the depositary's obligation under paragraph (b)(iii) should essentially be to confirm the assessments carried out under (a)(i) and (a)(iii). Conversely, the requirement to notify any change of the custody risk to the AIF/AIFM appears to be not advisable and possibly unlawful. Any change identified by the depositary should be assessed and may bring about, or not, decisions made by the depositary with respect to its relation with the sub-custodian. The AIF/AIFM may be informed of these decisions but this information should in no case be mandatory since the dissemination of information or decision to third parties with regards to custody risk of a given market/given entity may qualify as a breach of a confidentiality obligation and market abuse regulation and may induce systemic consequences in the market .
- Paragraph 2: should be deleted as paragraph 1 (as amended according to the Associations comments) appears to be sufficient. Indeed, the on-going due diligences and procedures enable to identify alternatives wherever available in a timely manner.
- Paragraph 3: The termination of sub-custody agreement should not be mandatory. Indeed this may not in every case, when practicable, be in the AIF/AIFM' best interests. As an alternative, we would suggest that the depositary be required to "take such measures, including terminating the contract, as are in the best interest of the AIF and its investors, provided that:
 - the depositary has assessed in good faith, the pros and cons of the measures to be taken, and
 - the sub-custodian no longer complies with the requirements and
 - this situation cannot be cured in a reasonable period of time".

Section 3 Segregation

THE ASSOCIATIONS CONTRIBUTION – Amendments to Box 89

Box 89

Segregation obligation for third parties to which depositaries have delegated part or all of their ~~safekeeping~~ custody functions (based on Article 16 of Directive 2006/73/EC implementing the MiFID Directive)

1. Where ~~safekeeping~~ custody functions have been delegated partly or totally to a third party, the depositary must ensure that the third party acts in accordance with the segregation obligation pursuant to Article 21(11) (d) (iii) by verifying that the third party has put in place arrangements that are compliant with the following requirements:

(a) to keep such records and accounts as are necessary to enable it at any time and without delay to distinguish assets held in custody ~~safe kept~~ for the depositary on behalf of its clients from (1) its own assets and the assets of its clients and (2) the assets held by the depositary for its own account and the assets held for the depositary's clients ~~from assets held for any other client (including assets belonging to the depositary itself)~~

(b) to maintain records and accounts in a way that ensures their accuracy, and in particular their correspondence to the assets held in custody ~~safe kept~~ for the depositary's clients;

(c) to conduct, on a regular basis, reconciliations between its internal accounts and records and those of any sub-delegate by whom those assets are safe kept;

(d) to take the necessary steps to ensure that any financial instruments belonging to the depositary's clients entrusted to a sub-delegate are identifiable separately from (1) the financial instruments belonging to the sub-delegate and the assets of its clients (2) the assets held by the depositary for its own account and the assets held

~~for the depositary's clients, by means of differently titled accounts on the books of the sub-delegate or other equivalent measures that achieve the same level of protection;~~

~~(e) to take the necessary steps to ensure that cash belonging to the depositary's clients deposited in a central bank, a credit institution or a bank authorised in a third country is held in an account or accounts identified separately from any accounts used to hold cash belonging to the third party or where relevant the sub-delegate~~

~~2. Where the depositary has delegated its custody functions, monitoring the sub-custodian's compliance with its segregation obligations should ensure the financial instruments belonging to its clients are protected from the event of insolvency of that sub-custodian. If, for reasons of the applicable law, including in particular the law relating to property or insolvency, the requirements described in §1 are not sufficient to reach that objective, the depositary should assess what additional arrangements could be made in order to minimise the risk of loss and maintain an adequate level of protection.~~

~~3. The requirements in §1 and §2 should apply mutatis mutandis when the third party has decided to delegate part or all of its tasks to a sub-delegate as foreseen in Article 21 (11).~~

THE ASSOCIATIONS CONTRIBUTION

- We welcome explanatory text paragraph 4 that clarifies it is not required to segregate assets on a fund by fund basis, and that the proposed wording allows the use of omnibus accounts for depositary clients' assets by sub-custodians as per current prevailing market practice, that prove to be both efficient and safe (*please our comments to box 88*)
- With respect to paragraph a) we suggest to amend the proposed wording in order to clarify the conditions for segregation: in this respect "to distinguish assets between 1) its own assets and the assets of its clients and between 2) the assets held by their clients for their own account and for their own clients".
- With respect to paragraph d) a common wording should be used for a) and d) indeed what matters is that at all level of the custody chain there is a segregation between 1) its own assets and the assets of its clients and between 2) the assets held by their clients for their own account and for their own clients".
- With regards to the level of protection, please refer to Q.46.
- With respect to paragraph 1 e) we are of the opinion that e) should be deleted. Indeed, cash is recognised as fungible assets and should not be subject to segregation. Such a requirement would cause a major additional costs and operational burden, whilst the cash assets represent the slightest portion of the assets of the AIF. Indeed, cash assets are a residual part of the assets since alternative financial instruments into the obligation of segregation are available and widely used.
- Paragraph 2 should be deleted. Protection of the financial instruments from the event of insolvency of the sub-custodian is subject to the local law recognising the full effects of the segregation. The depositary could not be requested to review and analyse national legislations with regard to insolvency procedure and **go beyond the duties** referred to in paragraph 1 (amended as per the Associations comments). Indeed, Segregation procedures should be viewed as a presumption of protection of the assets held in custody and deemed to be sufficient in this context. In addition, it should be recognized that not all national legislations provide for segregation obligations and any segregation at the 3rd party level (as provided for in Level 1) may not have any legal effects with regard of the protection of assets. Please refer to our comments to Q. 46
- With respect to explanatory text paragraph 5, the Associations are of the opinion that segregation

obligations CANNOT apply to assets in recordkeeping. By definition assets held in recordkeeping are either assets held with a third party custodian that is not a sub-contractor of the depositary, or assets held directly with the issuer or its agent, none of which having been selected by the depositary.

Consequently, no due diligence duty should bear on the depositary as per the internal organisation and quality of such third party. The Associations strongly reject the concept of any duty to monitor the eligibility, whatever the circumstances, of such party. It is our view that this issue is a perfect illustration of what could be a “non custodial” component of the custody risk.

Nevertheless, the Associations recognise that the depositary has an obligation to ensure that the AIF/AIFM has put in place the necessary due diligences procedures with respect to such third party as regards their own sub custodians, where applicable (e.g. prime brokers, selected by the AIFM, with arrangements of delegation),

In addition, it is should be recognised that in some circumstances, these third parties (e.g. prime brokers) may not be in the position to comply with the segregation obligations.

Should these circumstances exist the AIF/AIFM should have an obligation to report and disclose this situation in the documentation available to the investors.

Q46: What alternative or additional measures to segregation could be put in place to ensure the assets are ‘insolvency-proof’ when the effects of segregation requirements which would be imposed pursuant to this advice are not recognised in a specific market? What specific safeguards do depositaries currently put in place when holding assets in jurisdictions that do not recognise effects of segregation? In which countries would this be the case? Please specify the estimated percentage of assets in custody that could be concerned.

THE ASSOCIATIONS CONTRIBUTION

In our view, the issue should not be limited to neither the segregation, whose implementation may differ according to the different markets and regulations, nor on any alternative or additional measures. The issue is and remains the effect of the segregation in case of insolvency of a sub-custodian, on the assets that the sub-custodian holds for the benefits of its customers.

Whatever the circumstances, since the local legislations and the local court decisions prevail in all disputes, no third party such as the depositary can be requested to ensure that the effect of the segregation or any other measures (although we do not see what could be these measures) is such that the assets held by a sub-custodian for the benefits of its customers are protected from an insolvency of the sub-custodian.

Indeed, the present ESMA advice acknowledges this circumstance (please ref to explanatory paragraph 32): since it confirms that the event of insolvency would qualify as an external event.

With this above qualification, the Associations support the principle of the requirement for a segregation, since, wherever recognised by the local legislation that should be seen as a satisfactory compromise in order to reasonably limit the risks of exposure of the clients assets to the bankruptcy of a sub custodian.

The Associations suggest that this legal risk, a component of the investment risk, is disclosed by the AIF (or the AIFM) to the investors as it is very unlikely that AIF, or the AIFM, would renounce to invest on the sole ground of this risk.

The depositary’s liability regime

1 Loss of financial instruments

THE ASSOCIATIONS CONTRIBUTION- Amendments to Box 90

Box 90

Definition of loss

1. Financial instruments held in custody by the depositary or, as the case may be, by a sub-custodian should be considered 'lost' within the meaning of Article 21 (12) if one of the following conditions is met:

- (a) a stated right of ownership is uncovered to be unfounded because it either ceases to exist or never existed;
- (b) the AIF has been permanently deprived of its right of ownership over the financial instruments;
- (c) the AIF is permanently unable to directly or indirectly dispose of the financial instruments.

2. The assessment of the loss of financial instruments must follow a documented process readily available to competent authorities and lead to the notification of investors in a durable medium taking into account the materiality of the loss.

Where an AIF is permanently deprived of its right of ownership in respect of a particular instrument, but this instrument is substituted by or converted into another financial instrument or instruments, for example in situations where shares are cancelled and replaced by the issue of new shares in a company reorganisation, this is not considered to be an example of the loss of financial instruments held in custody.

Equally, any default on the part of the issuer is part of the investment risk and cannot qualify for a loss of financial instruments as defined in this section (ADDITION SUGGESTED FOR CLARIFICATION PURPOSES)

In case of insolvency of a sub-custodian, financial instruments should be considered 'lost' as soon as one of the conditions set out in §1 is met with certainty and at the latest, at the end of the insolvency proceedings. To that end, the AIFM should monitor closely the proceedings to determine whether all or part of the financial instruments entrusted to the sub-custodian are effectively lost.

In case of a fraud whereby the financial instruments have never existed or have never been attributed to the AIF (e.g., as a result of a falsified evidence of title, accounting fraud, etc.), all conditions described in §1 should be deemed to be met.

THE ASSOCIATIONS CONTRIBUTION

The Associations agree with the definition of loss set out in Box 90, provided that the definition of the financial instruments held in custody (box 78) is amended as suggested by the Associations.

Should a different wording be retained for box 78, the assets should not be deemed to be lost, unless the loss is caused by the depositary's failure or negligence.

2 External events beyond reasonable control

THE ASSOCIATIONS CONTRIBUTION – Amendments to Box 91

Box 91

Definition of ‘external event beyond the depositary’s reasonable control, the consequences of which were unavoidable despite all reasonable efforts to the contrary’

The depositary will not be liable for the loss of financial instruments held in custody by itself or by a sub-custodian if it can demonstrate that all the following conditions are met:

1. the depositary has performed rigorous due diligences and the event which led to the loss did not occur as a result of an act or omission of the depositary
2. the event which led to the loss did not occur as a result of an act or omission of one of its sub-custodians to meet its obligations
3. the event which led to the loss was beyond its reasonable control, i.e. it could not have prevented its occurrence by reasonable efforts
4. in accordance with the national regulations and contractual arrangements with sub-custodian the depositary could not have prevented the loss

Conditions 2,3 and 4 are deemed to be met in case of insolvency of a sub-custodian.

~~Subject to requirements of §1 and §2 being fulfilled, the depositary or the sub-custodian could be regarded as having made reasonable efforts to avoid a loss of a financial instrument held in custody if it can prove that it has taken all of the following actions:~~

~~(a) it has ensured that it has the structures and expertise that are adequate and proportionate to the nature and complexity of the assets of the AIF, to identify in a timely manner and monitor on an ongoing basis any external events which it considers may result in a loss of a financial instrument held in custody~~

~~(b) it has reviewed on an ongoing basis whether any of the events it has identified under point (a) present a significant risk of loss of a financial instrument held in custody~~

~~(c) where it has identified actual or potential external events which it believes present a significant risk of loss of a financial instrument held in custody, it has taken appropriate actions, if any, to prevent or mitigate the loss of financial instruments held in custody~~

The above described conditions will apply to the delegate when the depositary has contractually transferred its liability to a sub-custodian.

THE ASSOCIATIONS CONTRIBUTION

General comments

1. Analysis of the definition of « external event »

The Associations are of the opinion that ESMA’s draft advice on the definition of “external event” goes beyond Level 1 text.

The interpretation that appears to have been taken of Article 21(12) of Level 1 text is that the acts and omissions of any appointed sub-custodian are automatically deemed not to be "external events". The effect of that is that the depositary is strictly liable for all acts and omissions of any sub-custodian.

There is nothing in Article 21(12) that requires or, in the Associations' view, even supports such an interpretation of the word "external".

If ESMA's proposed interpretation of the word "external" is taken forward and accepted by the Commission, not only would this in the Associations' view be contrary to the Level 1 text, but the practical result is likely to be highly counter-productive. Capital costs to depositaries would increase significantly. Those costs, which will probably be uninsurable and would inevitably, be ultimately borne by the AIF and investors in the AIF, in order for any depositary's business model to be sustainable.

"Despite rigorous due diligences, it could not have prevented the risk": The Associations suggest to clarify that due diligences should be limited to aspects and circumstances pertaining to the custodial functions (and NOT to all possible other events such as political and natural events and disasters that should remain within the remit of the responsibilities of the AIF (or AIFM))

ESMA has identified three types of events:

- Acts of State or Acts of God
- Events related to the insolvency of a sub-custodian
- Other events including operational failures, fraud at the level of Central Security Depositary, Settlement System, Market (issuers, sellers,....) ...

The Associations agree with ESMA that the first and the third types of event should be considered as "external" event and welcomes the fact that ESMA considers that the depositary has not to return the assets in case a depositary has gone bankrupt and the national insolvency laws do not recognize the effects of the segregation of the assets.

The Associations, however, strongly disagree that the other event resulting in a loss of the AIF's assets that are related to the insolvency of a sub-custodian should be considered as an "internal" event:

- despite appropriate due diligences performed by the depositary insolvency cannot be predicted sufficiently in advance to make it possible for the depositary to take appropriate action; and
- insolvency laws overrule any contractual arrangements that would link a depositary and its sub-custodian.

'External' should be interpreted in a strict way, and refer to events that are not related to the depositary or any of its affiliates.

- The insolvency of a sub-custodian is an external event by nature which may prevent a depositary getting back the assets entrusted to a sub-custodian despite rigorous due diligences performed by the depositary
- Indeed past experience demonstrated that client's assets may have been used before insolvency in a desperate attempt to avoid bankruptcy
- The bankruptcy of the sub-custodian, that overrules the agreement between the sub-custodian and the depositary, prevents the sub-custodian from returning the assets to the depositary as it would have not been the case, if the sub-custodian had not been insolvent. Indeed, according to the provisions laid down in the agreement entered into between the depositary and the sub-custodian the sub-custodian has to return the assets.
- A loss of assets is not the result of the sole fraud of the sub-custodian but is the result of both the fraud (or negligence) and of the insolvency of the sub-custodian therefore, in this case, the loss of asset should be considered as an **'external event beyond the depositary's reasonable control, the consequences of which were unavoidable despite all reasonable efforts to the contrary'**

The Associations agree, however, that the depositary should have the obligation to ensure proper representation of its clients' interests in the insolvency procedure.

Should insolvency of sub-custodians not qualify for an “external event” the level of liability that depositaries would have to assume would be beyond their financial capacity.

Indeed the amounts of assets involved are significant (in practice most of the assets held in custody and of a different “citizenship” than the citizenship of the Depositary)

In a worst case scenario and given the amount of assets held in custody, even if split between several sub-custodians, a liability regime not excluding the “external” nature of the insolvency of a sub custodian, would have a major impact on capital requirements without any certainty with regard to the actual level of risks which appears to be very difficult to measure. It is our opinion that any major default would, in fine, have a major financial impact on a depositary. It is our opinion that this could be very material to depositaries and increase the systemic risks in the financial system.

Other consequences:

- It would not be neither in the interest of the fund industry nor in the depositary's other clients interest ,
- It would lead to a concentration of the activity and of the systemic risk within a small number of global custodians that are direct members of CSD/ICSD.

The Associations are of the opinion that, as long as it has fulfilled its duties, a depositary cannot assume, directly or indirectly, the financial consequences of an investment decision taken by an AIFM.

Qualifying events related to a sub-custodian as internal would go against such assumption.

A situation where a sub-custodian becomes insolvent following a fraud would cause the depositary to face exceptional financial consequences since it would have to return the financial instruments held in custody which have been lost without any recourse to the sub-custodian since the latter is insolvent.

Finally, the Associations are concerned that AIFMs may choose to invest in countries with less secure internal infrastructure, safe in the knowledge that the depositary will be liable for any losses.

The Associations do not believe that the burden of such risks should be placed on depositaries.

2. Analysis of Definition of the due diligence to be performed by the depositary

The Associations are of the opinion that the wording used in Box 91 lacks clarity. As such it opens the way for diverging implementation in EU Members States that would prevent full harmonisation.

The Associations are of the opinion that situations as described in point 38 and 39 (above) go far beyond the role and mission of the depositary.

The proposed advice should not bring about circumstances whereby the depositary would have to carry out acts or take decisions that fall into the AIF/AIFM scope of duties/liability. In addition, the advice should recognize that sub-custodians are regulated entities in their jurisdictions. In this respect a third party such as the depositary cannot be requested to, and made liable for, supplement supervisory duties.

It is our opinion that imposing a requirement of "rigorous and comprehensive due diligence" does not reflect the Level 1 text and could be read as requesting the depositary to go far beyond "reasonable efforts". The word "comprehensive", in particular, could be understood as requiring the depositary to do all-encompassing due diligence, covering as wide a range of theoretical possibilities as may be conceived, regardless of how reasonable it might be to do so.

The Associations do NOT support the rationale (following the third condition) whereby the depositary could be regarded as having made reasonable efforts to avoid a loss. Indeed, the requirements set out in a), b) and c) go far

beyond the role and mission of the depositary.

Therefore, the Associations recommend a rewording for “the law of the country where the instruments are held in custody does not recognise the effects of the segregation requirements” as described by ESMA for identifying where instruments may be lost following the bankruptcy of a sub-custodian.

As discussed previously (see response to Q46) the concept of “effects of the segregation” needs a clear definition. The Associations suggest: “Full protection of the property rights on the financial instruments held in custody by the custodian, to the benefit of clients in case of insolvency of this custodian.

Any other definition may be misleading and open the way for diverging interpretation.

3 Objective reason to contract a discharge

THE ASSOCIATIONS CONTRIBUTION – Amendments to Box 92

Box 92

Objective reasons for the depositary to contract a discharge

The depositary will be deemed to have an objective reason to contractually discharge itself of its liability in accordance with the requirements set forth in Article 21 (13) if it can demonstrate that:

Option 1

- ~~1. it had no other option but to delegate its custody duties to a third party (e.g. as a result of legal constraints); or~~
- ~~2. it has agreed with the AIF or as the case may be the AIFM through a written agreement that it is in the best interest of the AIF and its investors to delegate such duties (e.g. if the delegate is in a country where the depositary does not operate).~~

Option 2

Where the AIF or, as the case may be, the AIFM and the depositary have explicitly agreed through a written contract that the depositary can discharge its responsibility, it should be considered that the requirement to have an objective reason is fulfilled (PLEASE SEE FURTHER COMMENTS) .

THE ASSOCIATIONS CONTRIBUTION

The Associations support Option 2. Option 2 is more likely to cover all circumstances in which the AIFM and the depositary might, quite properly, agree that the depositary ought to be able to discharge its liability.

An objective reason, however, could be envisaged. This reason could be “when an investment or an investment strategy may be qualify for “unusual” risk (e.g; country risk; weak market infrastructures, selection by the AIF, or the AIFM of a AIFM, Of A PRIME BROKER or of a CUSTODIAN that do not meet the DEPOSITARY’s criteria for selection and proper monitoring.

Q47: What are the estimated costs and consequences related to the liability regime as set out in the proposed advice? What could be the implications of the depositary's liability regime with regard to prudential regulation, in particular capital charges?

THE ASSOCIATIONS CONTRIBUTION

The Associations are of the opinion that it is difficult to estimate costs and consequences related to the liability regime proposed in the ESMA advice.

Should insolvency of sub-custodians not qualify for an "external event" the level of liability imposed on the depositaries is likely to be beyond their financial capacity. Indeed the amounts of assets involved are significant.

In a worst case scenario and given the amount of assets to return, even if split between several sub-custodians, any increase in the regular capital requirements, of which the amount depends on the frequency of occurrence of such event (very hard to determine), would not be sufficient to avoid a major financial impact on a depositary and would consequently increase the systemic risks.

Q48: Please provide a typology of events which could be qualified as a loss in accordance with the suggested definition in Box 90.

THE ASSOCIATIONS CONTRIBUTION

Below are suggested events (non exhaustive list) that follow the current draft definition of "loss" proposed by ESMA in Box 90:

(a) A stated right of ownership is uncovered to be unfounded because it either ceases to exist or never existed:

- Fraud resulting in the permanent loss of the financial instrument

(b) the AIF has been permanently deprived of its right of ownership over the financial instruments:

- Nationalisation of the issuer – the financial instruments of the issuer are nationalised, expropriated or are otherwise required to be transferred to any governmental agency, authority or entity.

(c) the AIF is permanently unable to directly or indirectly dispose of the financial instruments:

- Change in relevant law – e.g. due to the adoption of or change in any applicable law or regulation (including tax laws) it becomes illegal to hold, acquire or dispose of the financial instruments.
- In some cases, government action may result in "loss" – for example, where a government (or governmental institution or agency) has taken action which has had the effect of permanently and irretrievably preventing the transfer, sale or other disposition of the financial instruments.
- In some cases, national or international embargoes (i.e., a government (or government institution or agency) or an international organisation has announced a trade embargo affecting the ability to transfer, sell or dispose of the financial instruments) may be sufficiently permanent that the financial instruments can be considered "lost".
- Liquidation, dissolution or winding up of issuer – but, as ESMA rightly recognises, only where it becomes certain during (or at the end of) the insolvency process that the financial instruments are

permanently and irretrievably lost.

Q49: Do you see any difficulty with the suggestion to consider as an external event the fact that local legislation may not recognise the effects of the segregation requirements imposed by the AIFMD?

THE ASSOCIATIONS CONTRIBUTION

- We do not see any difficulty with the suggestion to consider as an external event the fact that local legislation may not recognise the effects of the segregation requirement, provided that the notion of "effects of the segregation" is defined clearly (please refer to the Associations comments to the section "external event...").

- The Associations strongly support this proposal, and considers that matters relating to local legislation are inherently "external". Local law and local courts decisions are, by definition, entirely outside the control or influence of the depository. Further, changes in local legislation are also inherently unpredictable. The Associations cannot see any justification for any matter pertaining to local law/court decisions to be treated as an "internal" event.

Q50: Are there other events which should specifically be defined/presumed as 'external'?

THE ASSOCIATIONS CONTRIBUTION

Set out below is a non-exhaustive list of examples of other events which should be presumed 'external':

- Any event, the occurrence of which might reasonably be considered to be part of the general risk of investing].
- Liquidation, dissolution or winding up of issuer.
- National or international embargoes.
- Nationalization, strikes, devaluations or fluctuations, seizure, expropriation or other government actions, or other similar action by any governmental authority, de facto or de jure; or enactment, promulgation, imposition or enforcement by any such governmental authority of currency restrictions, exchange controls, levies or other charges affecting the financial instruments.
- Breakdown, failure, malfunction, error or interruption in the transmission of information caused by any machines, utilities or telecommunications systems.
- Errors, Failures and event of insolvency of a register maintained by a settlement system as designated by Directive 98/26/EC, or a similar non European securities settlement subsystem which acts directly for the issuer or its agent
- Any order or regulation of any banking or securities industry including changes in market rules and market conditions affecting the orderly execution or settlement of financial instruments transactions or affecting the value of financial instruments.
- Acts of war, terrorism, insurrection or revolution.

Q51: What type of event would be difficult to qualify as either 'internal' or 'external' with regard to the proposed advice? How could the 'external event beyond reasonable control' be further clarified to address those concerns?

THE ASSOCIATIONS CONTRIBUTION

See responses above

Q52: To what extent do you believe the transfer of liability will / could be implemented in practice? Why? Do you intend to make use of that provision? What are the main difficulties that you foresee? Would it make a difference when the sub-custodian is inside the depositary's group or outside its group?

THE ASSOCIATIONS CONTRIBUTION

The transfer is feasible provided that the sub-custodians (and their local jurisdictions) accept that the AIF (or the AIFM) may directly place a claim with regard to assets in custody.

Most of the sub-custodians, however, when domiciled outside the EU, might be reluctant or prevented by their own legislation to be subject to an EU regulation with regard to the transfer of liability .

Hence, discharging the depositary implies that the depositary will be able to limit its duty of restitution and indemnification in case of loss to the amounts that the depositary has been able to recover from the sub custodian by exercising its contractual recourse against the latter. Doing so, the depositary would be able to authorize its client to represent him and act on its behalf vis à vis the sub-custodian.

The depositary should have the capacity to transfer its liability either within or outside its group.

Q53: Is the framework set out in the draft advice considered workable for non-bank depositaries which would be appointed for funds investing mainly in private equity or physical real estate assets in line with the exemption provided for in Article 21? Why? What amendments should be made?

THE ASSOCIATIONS CONTRIBUTION

The Associations are of the opinion that the framework set out in the draft advice must be implemented in non-bank depositaries. It is important to ensure a level playing field in the EU and for the third countries between all the depositaries.

Q54: Is there a need for further tailoring of the requirements set out in the draft advice to take into account the different types of AIF? What amendments should be made?

THE ASSOCIATIONS CONTRIBUTION

For the time being there are different models which co-exist in the EU and within EU Member States depending :

- the type of investment fund (UCITS like funds, Real estate fund, Private equity fund) and the national law applicable to them (in particular in case of investment restrictions for tax matter purpose),
- the type of assets these funds invest in (listed/ non listed, in which way these underlying assets are regulated) ;

Consequently-the principles laid down at the level 2 text should remain generic enough to be applicable to these different types of fund .The full harmonization of rules which is a legitimate and ultimate objective will require

further levels of European text and cannot be achieved at this current implementation measures level.