

**ESMA'S DRAFT TECHNICAL ADVICE TO THE EUROPEAN
COMMISSION ON POSSIBLE IMPLEMENTING MEASURES OF THE
ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE**

**AGRUPACIÓN ESPAÑOLA DE INSTITUCIONES DE INVERSIÓN
COLECTIVA Y FONDOS DE PENSIONES (ADEPO) COMMENTS**

ADEPO welcomes and takes a positive view of the opportunity and specific content of the document and appreciates the usefulness of this CONSULTATION. ADEPO is a Spanish association of mutual and pension funds depositaries, currently formed by BBVA, BANCO POPULAR, BANCO SABADELL, BANCO SANTANDER, BNP-PARIBAS, CECA, CAJA MADRID, DEXIA Y LA CAIXA.

This CONSULTATION is particularly important since a considerable number of questions was left open at level 1. We hope that our input will be useful for ESMA and will contribute to the correctness and fairness of the future secondary legislation.

**V 7.4 AIFMD WG – DEPOSITORIES
AIFM – Level II rules**

Article 21 of the AIFMD sets out an extensive set of requirements on the depositaries of AIFs. In line with the implementing measures foreseen in that article, the draft advice in this area covers the following elements:

- i. Appointment of the depositary
- ii. The depositary's duties
- iii. The depositary's liability regime

Appointment of a depositary

1. In line with the request from the Commission, the draft advice on this point sets out ESMA's proposals on the content of the contract evidencing the appointment of the depositary, which must at least regulate the flow of information necessary to enable the depositary to perform its

functions. The particulars required in the contract to be signed between the depositary and the management company in the UCITS Directive was taken as a starting point with a view to ensuring consistency across the industry.

2. Due to the very diverse nature of the entities subject to the Directive, it has not been considered appropriate to develop a model agreement. This is also in line with the approach taken in CESR's advice on the UCITS IV Directive in relation to depositaries.

Duties of the depositary

The depositary has two primary functions: to safekeep the AIF's assets and to oversee its compliance with the AIF's rules and instruments of incorporation and with applicable law and regulation. The Directive further assigns the depositary with a requirement to ensure the AIF's cash flows are properly monitored.

Safekeeping

The duty to safekeep consists either of custody or of record keeping, depending on the type of asset. In line with the Commission's request, the draft advice addresses the types of financial instrument which should be included in the scope of the depositary's custody functions and the conditions upon which the depositary can fulfil its obligation to safekeep the assets. The 'other assets' subject to the recordkeeping obligation are then defined as all assets not covered by custody. The advice sets out a number of different options in this area, each of which has potentially different consequences for the scope of the custody duty.

Oversight function

The AIFMD contains the same provisions regarding the depositary's oversight functions as those set out in the UCITS Directive. However, in light of the differences in interpretation of the five oversight duties of a depositary across Member States, the draft advice aims to clarify each task.

Cash monitoring

The draft advice considers the depositary's cash monitoring function as a general requirement to have a full overview of all cash movements of the AIF which should be read alongside its oversight duties. The advice acknowledges that an AIF may have cash accounts at various entities outside the depositary; as such, the aim is to have a strong requirement on the AIFM to ensure the depositary has access to all information related to each cash account opened at a third party.

The draft advice sets out two options regarding the tasks which would be expected of a depositary when implementing its cash monitoring obligations. One option would be to consider the depositary as a central hub where all information related to the AIF's cash flows is centralised, recorded and reconciled in order to ensure an effective and proper monitoring of all cash flows. The second option identified would require the depositary to ensure there are procedures in place to appropriately monitor the AIF's cash flows and that they are effectively implemented and periodically reviewed. In particular, the depositary would be required to look into the reconciliation procedure and monitor that remedial action is taken without undue delay whenever a discrepancy is identified.

Under its cash monitoring function, the depositary is also required to ensure that payments made by investors upon subscription have been received by the AIF. ESMA has put forward advice with a view to clarifying that the depositary is not expected to interfere with the distribution channels of the AIF but simply to verify the information at the level of the AIF's register.

Due diligence duties

Article 21(11) of the Directive provides significant detail as to the conditions to be met for the depositary to be able to delegate any of its safekeeping functions. ESMA has been asked to provide further guidance in relation to the specific tasks the depositary would be expected to carry out in order to comply with its due diligence duties and, if possible, to provide a template of evaluation, selection, review and monitoring criteria to be considered. The advice focuses on what the depositary is expected to do when delegating custody tasks given the potentially significant implications for the AIF and its investors.

Segregation

The third party to which the depositary wishes to delegate custody tasks must segregate the assets belonging to the depositary's clients from its own assets and from assets of the depositary in such a way that they can at all times be clearly identified as belonging to clients of a particular depositary. The Commission has asked ESMA to clarify what the specific requirements should be to make sure the subcustodian effectively meets that obligation. The draft advice is based on Article 16 of the MiFID implementing Directive (2006/73/EC), adapted to reflect that sub-custodians may, as the AIFMD acknowledges, use 'omnibus accounts'.

Depository liability

The depository's liability regime is a central issue of the AIFMD. The advice aims to strike the appropriate balance between the Directive's objective of ensuring a high level of investor protection while refraining from placing the entire responsibility on depositaries. With this objective in mind, the proposed advice attempts to provide clear definitions of what would constitute: (i) the loss of a financial instrument; (ii) an external event beyond the reasonable control of a depository, the consequences of which would have been unavoidable despite reasonable efforts; and (iii) the objective reason which could enable a depository to discharge its responsibility by transferring it to a sub-custodian.

VI Appointment of a depository

1. The AIFMD requires every AIFM to ensure that, for each AIF it manages, a single depository has been appointed, appointment which must be formalised in a written contract regulating at least the flow of information necessary to enable the depository to perform its functions. The European Commission has asked ESMA to provide guidance on the content of such a contract and to the extent possible to provide a model agreement.
2. In order to define the elements which should be required in the written agreement evidencing the appointment of the depository, ESMA has used the particulars required in the contract to be signed between the depository and the management company in the UCITS framework as a starting point with a view to ensure consistency across the industry. ESMA has then suggested some amendments or new provisions to take into account the specificities of AIFs.
3. For instance, the contract will need to include provisions on the depository's liability and the conditions under which it may transfer its liability to a sub-custodian²¹, on the possibility to re-use the assets it has been entrusted with, or a description of the type of assets it will have to safekeep, given that unlike for UCITS there is no harmonisation as to the type of assets in which an AIF can invest and the AIFMD covers an extremely wide spectrum of funds.
4. Precisely because the Directive regulates AIFM which manage very different types of funds, ESMA suggests not elaborating a model agreement and provides a detailed explanation of the reasons why it has not considered that an appropriate means to improve harmonisation or investor protection.

1 Contract evidencing the appointment of a depository***Scope of the Commission's implementing powers***

The Commission shall adopt by means of delegated acts, in accordance with Article 56, and subject to the conditions laid down in Articles 57 and 58, measures specifying: (a) the particulars that need to be included in the standard agreement as referred to in paragraph 2;...

Extract from Level 1 Directive

2. The appointment of the depository shall be evidenced by a written contract. The contract shall, inter alia, regulate the flow of information deemed necessary to allow the depository to perform its functions for

the AIF for which it has been appointed as depositary, as set out in this Directive and in other relevant laws, regulations or administrative provisions.

European Commission's Request for Advice to ESMA

1. ESMA is requested to advise the Commission on the necessary particulars to be found in the standard agreement evidencing the appointment of the depositary. In its advice, ESMA should take into account the consistency with the respective requirements in the UCITS Directive.
2. ESMA is encouraged to provide the Commission, if possible, with a draft model agreement.

1.1 Particulars of the contract appointing the depositary

Box 74

Particulars to be included in the written agreement evidencing the appointment of a single depositary and regulating the flow of information deemed necessary to allow the depositary to perform its functions pursuant to Article 21 (2) of the AIFMD.

The depositary on the one hand and the AIFM and / or the AIF on the other hand shall draw up a written agreement setting out the rights and obligations of the parties to the contract.

This agreement should include at least the following elements:

1. A description of the services to be provided by the depositary and the procedures to be adopted for each type of asset in which the AIF may invest and which may be entrusted to the depositary;
2. A description of the types of assets that will fall within the scope of the depositary's function which should be consistent with the information provided in the AIF rules, instruments of incorporation and offering documents, regarding the assets in which the AIF may invest;
3. A statement that the depositary's liability shall not be affected by any delegation of its custody functions unless it has discharged itself of its liability in accordance with the requirements of Article 21 (13) or (14); and where applicable, the conditions under which the AIF or the AIFM may allow the depositary to transfer its liability to a sub-custodian including the objective reasons that could support that transfer;
4. The period of validity, and the conditions for amendment and termination of the contract; and, if applicable, the procedures by which the depositary should send all relevant information to its successor;
5. The confidentiality obligations applicable to the parties in accordance with prevailing laws and regulations; these obligations should not impair the ability of Member States competent authorities to have access to the relevant documents and information;
6. The means and procedures by which the depositary will transmit to the AIFM or the AIF all relevant information that the latter needs to perform its duties including the exercise of any rights attached to assets, and in order to allow the AIFM and the AIF to have a timely and accurate situation of the accounts of the AIF. The details of such means and procedures should be described in this agreement or set out in the service level agreement or similar document;
7. The means and procedures by which the AIFM will ensure the depositary has access to all the information it needs to fulfil its duties, including the process by which the depositary will receive

information from other parties appointed by the AIF or the AIFM;

8. Information regarding the possibility for the depositary or a sub-custodian to re-use the assets it was entrusted with or not and where relevant the conditions related to the potential re-use;
9. The procedures to be followed when a modification to the AIF rules, instruments of incorporation or offering documents is being considered, detailing the situations in which the depositary should be informed, or where a prior agreement from the depositary is needed to proceed with the modification;
10. All necessary information that needs to be exchanged between the AIF, the AIFM and the depositary related to the sale, subscription, redemption, issue, cancellation and re-purchase of units or shares of the AIF;
11. Where the parties to the contract envisage appointing third parties to carry out their respective duties, an undertaking to provide, on a regular basis, details of any third parties appointed; and upon request, information on the criteria used to select the third party and the steps taken to monitor the activities carried out by the selected third party;
12. All information regarding the tasks and responsibilities in respect of obligations relating to anti-money laundering and combating the financing of terrorism;
13. Information on all cash accounts opened in the name of the AIF or in the name of the AIFM on behalf of the AIF and procedures by which the depositary will be informed prior to the effective opening of any new account opened in the name of the AIF or in the name of the AIFM on behalf of the AIF;
14. Details regarding the depositary's escalation procedure(s), including the identification of the persons to be contacted within the AIF and / or the AIFM by the depositary when it launches such a procedure.

Subject to national law, there shall be no obligation to enter into a specific written agreement for each AIF; it shall be possible for the AIFM and the depositary to enter into a framework agreement listing the AIF managed by that AIFM to which it applies.

The parties may agree to transmit part or all of this information electronically. Proper recording of such information shall be ensured.

The agreement shall include the procedures by which the depositary, in respect of its duties has the ability to enquire into the conduct of the AIFM and / or the AIF and to assess the quality of information transmitted including by way of on-site visits. It shall also include a provision regarding the possibilities and procedures for the review of the depositary by the AIFM and / or the AIF in respect of the depositary's contractual obligations.

The law applicable to the agreement shall be specified.

ADEPO has –in general terms- a positive opinion of the text prepared by ESMA on this issue. The goal of drafting a text based on the requirements defined in chapter V (articles 30-37) of Directive 2010/43/EC implementing Directive 2009/65/EC (the UCITS Directive) but –at the same time- taking into account the specificities of AIFs, has clearly been achieved. Nevertheless, we have the following remarks we would like to be considered.

1. The list of particulars to be included in the written agreement should be wide enough to match the very broad range of types of AIF. Although the framework Directive clearly refers to a “standard agreement”, a high level of flexibility in the list of particulars to include in the agreement should be very useful.
2. In the final version of the advice (Box 74), the position of points 1 and 2 should be swapped. Effectively, and as the explanatory text explicitly recognises (point 8), the “tasks the depositary will need to perform... depend on the type of assets it is entrusted” and consequently the “type of assets” should precede the “description of services to be provided” in the list of elements to be included in the agreement.
3. The details of the “means and procedures by which the AIFM will ensure the depositary has access to all the information it needs” (Box 74.7) could be described not only in the standard agreement but as well in a service level agreement (SLA). ESMA draft advice only contemplates this possibility for the information to be provided by the depositary to the AIFM (Box 74.6), departing from the solution envisaged in article 37 of Directive 2010/43/EC, which enables to rely on the SLA not only with respect to the information (details of means and procedures for its transmission) to be provided by the depositary but as well with respect to the information to be received by the depositary. We do not see any justification for maintaining different solutions on this subject.
4. Although in the first bullet point of section 10th of the explanatory note, “termination of the contract” is explicitly mentioned as one of the items amended “in comparison with the UCITS requirements”, suggesting for a more elaborated text of the contracts in this regard, the wording of Box 74.4 is actually very succinct and clearly insufficient.

In our opinion the following elements should be mentioned:

- “The conditions which are necessary to facilitate transition to another depositary”. This item is specifically mentioned in article 33.c) of Directive 2010/43/CE and it has a wider scope than “the procedures by which the depositary should send all the relevant information to its successor” only aspect contemplated in the current ESMA text.
- How the transfer of liability between the two depositaries works in this scenario.

5. Regarding section 13th, it is worth noting that information on cash accounts should not only be provided when they are opened, but it also should be provided while they are operational. Consequently, in the written agreements frequency and type of information to be provided to the depositaries should be specifically contemplated.

6. Finally, and in order to be consistent with our position on the meaning of the expression “objective reason to contract a discharge of liability” (see below, V.IV.3), the sentence “including the

objective reasons that could support the transfer” should be deleted from the end of paragraph 3 in Box 74.

V.II. Duties of the depositary

According to the AIFMD and in line with the UCITS framework, the depositary has two primary functions: to safekeep the AIF's assets and to oversee its compliance with the AIF rules and instruments of incorporation and with applicable law and regulation. The Directive further assigns the depositary with a requirement to ensure the AIF's cash flows are properly monitored.

Cash Monitoring

ESMA has considered the depositary's cash monitoring function as a general requirement to have a full overview of all cash movements of the AIF which should be read along with its oversight duties. ESMA has acknowledged that an AIF may have cash accounts at various entities outside the depositary and therefore defined a pre-requisite for the AIFM to ensure the depositary has access to all information related to each cash account opened at a third party.

Further ESMA is consulting on two options to specify the tasks which would be expected of a depositary when implementing its cash monitoring obligations. One option would be to consider the depositary as a central hub where all information related to the AIF's cash flows is centralised, recorded and reconciled in order to ensure an effective and proper monitoring of all cash flows. The second option contemplated would require the depositary to ensure there are procedures in place to appropriately monitor the AIF's cash flows and that they are effectively implemented and periodically reviewed. The depositary would in particular be required to look into the reconciliation procedure and monitor that remedial action is taken without undue delay whenever a discrepancy is identified.

Under its cash monitoring function, the depositary is also required to ensure that payments made by investors upon their subscription have been received by the AIF. ESMA acknowledges the need for clarification in relation to the scope of such a requirement and has therefore put forward an advice with a view to clarifying that the depositary is not expected to interfere with the distribution channels of the AIF but simply to verify the information at the level of the AIF's register.

Lastly, the depositary is responsible to ensure the AIF's cash is properly booked which ESMA takes to mean that cash accounts have only been opened with entities authorised under Article 18 (1) (a) to (c) of MiFID or any bank or credit institution in the non EU countries where the AIF has had to open an account in relation to an investment decision.

Safekeeping

The depositary is responsible for safekeeping the AIF's assets. Depending on the type of assets, they are to be either held in custody – as is the case for financial instruments which can be registered in a financial instruments account or can be physically delivered to the depositary in line with Article 21 (8) (a) - or in record keeping. ESMA has been asked to provide advice on the type of financial instruments which should be included in the scope of the depositary's custody functions and on the conditions upon which the depositary can fulfil its obligation to safekeep the assets.

ESMA has suggested setting out a clear definition of the financial instruments to be held in custody and adopting an *contrario* approach to define the 'other assets' as referred to in Article 21 (8) (b) which shall

be subject to record keeping. Such a definition is a key element of the implementing measures regarding Article 21 since it conditions the scope of the depositary's custody functions and consequently the scope of its liability. Therefore ESMA is consulting on various options to seek industry input on the workability of the definition elaborated and its potential consequences.

As a first step of the definition, there is a consensus within ESMA to define financial instruments as transferable securities, money market instruments and units of collective investment undertakings in reference to the first items of Annex 1, Section C of Directive 2004/39/EC. Further ESMA considers that should be held in custody those financial instruments that the depositary is in a position to instruct the transfer of. Two options are put forward to translate that. One would be to consider that all financial instruments registered or held directly or indirectly in the name of the depositary should be in custody. The second considers that custody should be limited to financial instruments with respect to which the depositary can instruct the transfer of title by means of a book entry on a register maintained by a settlement system as defined in Directive 98/26/EC or a similar non European securities settlement system. The last component of the definition concerns financial instruments provided as collateral. ESMA is consulting on three different options regarding collateral.

As to what is specifically expected of a depositary to comply with its custody function, ESMA considers the depositary should ensure the financial instruments are properly segregated in its books and where relevant in those of its sub-custodians, are subject to due care and protection and should assess and monitor relevant custody risks

With regard to the depositary's record keeping function which applies to all other assets (i.e. which do not comply with the definition of financial instruments to be held in custody), the AIFMD imposes two obligations on the depositary. The first one is to verify the ownership of the AIF / AIFM of such assets and the second is to maintain a record of those assets for which it is satisfied the AIF / AIFM holds the ownership. ESMA recommends clarifying that maintaining a record could mean registering the assets in its name in the first instance or where the assets are registered in the name of the AIF or in the name of the AIFM acting on behalf of the AIF, to ensure it is able at any time to provide a comprehensive and up to date inventory of all the AIF's assets. To enable the depositary to meet that requirement, ESMA has specifically imposed an obligation on the AIFM to ensure the depositary has access to all relevant information it needs including from third parties (e.g., administrators, prime brokers, etc.) to ensure it can fulfil its obligations. ESMA is consulting on two options to reflect the means by which the depositary can ensure it is able to provide such an inventory. It can either rely on information provided to it by the AIF / AIFM or third parties on a timely basis or it can mirror every transaction in a position keeping system.

Oversight function

The AIFMD contains the same provisions regarding the depositary's oversight functions as those required under the UCITS Directive. However, in light of the major differences in interpretation of the five oversight duties of a depositary across Member States, ESMA has decided to provide a draft advice which suggests clarifications on each task.

Furthermore ESMA recommends defining general principles applicable to the depositary's oversight function. ESMA suggests for example that the depositary should assess, upon its appointment, the risks associated with the nature scale and complexity of the AIF and set up appropriate procedures. It also recommends that it should perform ex post verifications of procedures which are under the responsibility of the AIF, the AIFM or a third party. ESMA suggests that, when appointed as a third party to perform

duties it has to oversee as AIF's depositary, the depositary must manage potential conflicts of interest as required by Article 21 (10). The proposed advice finally sets out a general requirement for the depositary to set up and implement an escalation procedure for all instances where it detects a potential irregularity while conducting its oversight procedures.

Due diligence duties

Article 21 (11) provides significant detail as to the conditions to be met for the depositary to be able to delegate any of its safekeeping functions. ESMA has been asked to provide further guidance in relation to the specific tasks the depositary would be expected to carry out in order to comply with its due diligence duties and if possible to provide a template of evaluation, selection, review and monitoring criteria to be considered.

ESMA suggests focusing mainly on the tasks to be implemented when delegating custody since that is where the implications can be material for the AIF and its investors. In its proposed advice, ESMA has highlighted the main steps the depositary should go through when appointing a sub-custodian and during its ongoing monitoring. The requirements have been based on the best market practices and with a view to ensuring the depositary takes into consideration all elements relevant to the consequences of the insolvency of the sub-custodian. ESMA has also assumed that, in light of its liability, the depositary would have a sufficiently strong incentive to take all appropriate measures to ensure the financial instruments will be subject to a high level of protection and care.

Segregation

One of the conditions the third party to which the depositary wishes to delegate custody tasks to must comply with on an ongoing basis is the requirement to segregate the assets belonging to the depositary's clients from its own assets and from assets of the depositary in such a way that they can at all times be clearly identified as belonging to clients of a particular depositary. The Commission has asked ESMA to clarify what the specific requirements should be to make sure the sub-custodian effectively meets that obligation.

ESMA has based its advice on Article 16 of Directive 2006/73/EC and has adapted the text to reflect that this requirement is to be met by sub-custodians for which the Directive acknowledges they can use 'omnibus accounts'. It has also been refined to address the specific concern this requirement is supposed to mitigate i.e. the consequences of the insolvency of the sub-custodian.

V.III. Depositary functions

1 Depositary functions pursuant to §7 – Cash monitoring

Scope of the Commission's implementing powers

The Commission shall adopt by means of delegated acts, in accordance with Article 56, and subject to the conditions laid down in Articles 57 and 58, measures specifying:

[...]

(c) the conditions for performing the depositary functions pursuant to paragraphs 7, 8 and 9

Extract from Level 1 Directive

'7. The depositary shall in general ensure that the AIF's cash flows are properly monitored, and shall in particular ensure that all payments made by or on behalf of investors upon the subscription of shares or

units of an AIF have been received and that all cash of the AIF has been booked in one or more cash accounts opened in the name of the AIF or in the name of the AIFM acting on behalf of the AIF or in the name of the depositary acting on behalf of the AIF at an entity referred to in Article 18 (1) (a) to (c) of Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European

Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, or an other entity of the same nature as the entity referred to in Article 18 (1) (a) to (c) of that Commission Directive 2006/73/EC in the relevant market where cash accounts are required provided that such entity is subject to effective prudential regulation and supervision of the same effect as the provisions laid down in European Union law and which are effectively being enforced, and in accordance with the principles set forth in Article 16 of Commission Directive 2006/73/EC

Where the cash accounts are opened in the name of the depositary acting on behalf of the AIF, no cash of the entity referred to in the first subparagraph and none of the depositary's own cash shall be booked on such accounts.'

European Commission's Request for Advice to ESMA

1. ESMA is requested to advise the Commission on the conditions for performing the depositary functions pursuant to Article 21(7). ESMA is requested to specify conditions for the depositary to ensure that:
 - the AIF's cash flows are properly monitored;
 - all payments made by or on behalf of investors upon the subscription of shares or units of an AIF have been received and booked in one or more cash accounts opened in the name of the AIF or in the name of the AIFM acting on behalf of the AIF or in the name of the depositary acting on behalf of the AIF at an entity referred to in Article 18 (1) (a) to (c) of Commission Directive 2006/73/EC in accordance with the principles set forth in Article 16 of Commission Directive 2006/73/EC.
 - where cash accounts are opened in the name of the depositary acting on behalf of the AIF, none of the depositary's own cash is kept in the same accounts. In its advice, ESMA should take into account the legal structure of the AIF and in particular whether the AIF is of the closed-ended or open-ended type.
2. ESMA is requested to advise the Commission on the conditions applicable in order to assess whether:
 - an entity can be considered to be of the same nature as the entity referred to in Article 18 (1) (a) to (c) of Commission Directive 2006/73/EC, in the relevant non-EU market where opening cash accounts on behalf of the AIF are required;
 - such an entity is subject to effective prudential regulation and supervision to the same effect as the provisions laid down in European Union law and which is effectively enforced.
3. ESMA is requested to advise the Commission on the conditions applicable in order to determine what shall be considered as the relevant market where cash accounts are required.

1.1 Cash flow monitoring

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 this information, the AIFM will have been deemed not to have satisfied the requirements of Article 21 of the directive.

ADEPO agrees with the text with a single comment to add: in the last paragraph, the last sentence should be completed by the following text: "and the depositary shall be discharged from liability so long as it has exercised its responsibilities on the basis of the information made available to it."

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:

- (a) ensure the cash belonging to the AIF is booked in an account opened at the depositary; or
- (b) where cash accounts are opened at a third party entity:
- (c) 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)
- (d) 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
- (e) 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:

- (f) 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);

- (g) ensure there are proper procedures to reconcile all cash flow movements and verify that they are performed at an appropriate interval;
- (h) 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;
- (i) review periodically the adequacy of those procedures including through a full review of the reconciliation process at least once a year;
- (j) monitor on an ongoing and anomaly basis the outcomes and actions taken as a result of those procedures and alert the AIFM if has not been rectified without undue delay.

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

Box 77

Ensuring the AIF's cash is properly booked

The depositary should be required to:

1. ensure that the AIFM complies on an ongoing basis with the requirements of Article 16 of Directive 2006/73/EC in relation to cash and in particular where cash accounts are opened at a third party entity in the name of the depositary acting on behalf of the AIF, take the necessary steps to ensure the AIF's cash is booked in one or more cash accounts distinct from the accounts where the cash belonging to the depositary or belonging to the third party are booked
2. ensure the AIF's cash is booked in one or more cash accounts opened at an entity referred to in Article 18 (1) (a) to (c) of Directive 2006/73/EC or at a bank or a credit institution of the non EU country in which the AIFM / AIF has been compelled to open a cash account in relation to an investment decision

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?

ADEPO considers that it is feasible to comply with the requirement of having both accounts (general operating and subscription/redemption ones) at the depositary. Notwithstanding that, ADEPO acknowledges that imposing this requirement throughout the UE can be excessive, creating unnecessary burdens and technical difficulties for depositaries working in a different way.

What is really important in any scenario is that the depositary can receive timely and accurate information of cash flows, including information from any third party where the cash account is opened.

Moreover, in the specific case of cash transfers (different to investments/disinvestments) between different accounts opened in different entities, it could be a better option that said transfers be carried out via the depositary's account and/or with the depositary's express approval.

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?

Typically for a daily dealing fund, where the depositary is satisfied that all reconciliation controls are in place and working, it would review reconciliations on a periodic basis. The suggestion by ESMA that depositaries review daily priced funds on a weekly basis is too strict, and ADEPO thinks that doing it on a monthly basis is sufficient. Typically, there is no distinction made as to the type of assets that the fund invests in for the purpose of this review but it would be more dependent on the valuation frequency of the fund.

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

ADEPO does not foresee any practical problems with the requirement to refer to Article 18 of MIFID.

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

Primebrokers should provide enough information to enable –in any case- timely reconciliations to be reviewed by the depositary on a periodic basis (on a monthly basis or even less, taking into account the frequency of NAV calculation).
As we said above (Q25) any cash transfers between different entities should be carried out by the depositary and/or with its approval.

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

ADEPO prefers option 2 although it realizes that option 1 is safer. It would be clearly excessive to impose option 1 as the only one admissible throughout the UE. 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.

But even in the case of choosing option 2, wherever the depositary carries out the task associated to the custody, a general account should be 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 requires the opening by the AIF of a cash account in the custodian's books

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

It is not possible to quantify costs but it is clear that option1 is more expensive.

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

A compulsory change of model, with the implementation of cash mirroring by depositaries who nowadays operate in a different way, could be highly expensive and burdensome for them.

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

Scope of the Commission's implementing powers

The Commission shall adopt by means of delegated acts, in accordance with Article 56, and subject to the conditions laid down in Articles 57 and 58, measures specifying:

[...]

(c) the conditions for performing the depositary functions pursuant to paragraphs 7, 8 and 9, including:

- the type of financial instruments that shall be included in the scope of the depositary's custody duties according to point (a) of paragraph 8;*
- the conditions upon which the depositary may exercise its custody duties over financial instruments registered with a central depositary;*
- and the conditions upon which the depositary shall safe keep according to point (b) of paragraph 8 the financial instruments issued in a nominative form and registered with an issuer or a registrar;*

Extract from Level 1 Directive

8. 'The assets of the AIF, or, as the case may be, the AIFM acting on behalf of the AIF, shall be entrusted to the depositary for safe-keeping, as follows:

(a) *Financial instruments that can be held in custody*

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

(ii) For this purpose, the depositary shall ensure that all those financial instruments that can be registered in a financial instruments account opened in the depositary's books, are registered in the depositary's books within segregated accounts in accordance with the principles set forth in Article 16 of Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, opened in the name of the AIF or, as the case may be, the AIFM acting on behalf of the AIF, so that they can at all times be clearly identified as belonging to the AIF in accordance with the applicable law.

(b) *Other assets*

(i) For all other assets of the AIF, the depositary shall verify the ownership of the AIF, or, as the case may be, the AIFM acting on behalf of the AIF, of such assets and shall maintain a record of those assets for which it is satisfied that the AIF, or, as the case may be, the AIFM acting on behalf of the AIF, holds the ownership of such assets;

(ii) The assessment whether the AIF, or, as the case may be, the AIFM acting on behalf of the AIF, holds the ownership shall be based on information or documents provided by the AIF or the AIFM and, where available, on external evidence;

(iii) The depositary shall keep this record up to date.'

European Commission's Request for Advice to ESMA

1. ESMA is requested to advise the Commission on:
 - the type of financial instruments that shall be included in the scope of the depositary's custody duties as referred to in point (a) of Article 21(8), namely (i) the financial instruments that can be registered in a financial instruments account opened in the name of the AIF in the depositary's books, and (ii) the financial instruments that can be 'physically' delivered to the depositary;
 - the conditions applicable to the depositary when exercising its safekeeping custody duties for such financial instruments, taking into account the specificities of the various types of financial instruments and where applicable their registration with a central depositary, including but not limited to:
 - the conditions upon which such financial instruments shall be registered in a financial instruments accounts opened in the depositary's books opened in the name of the AIF or, as the case may be, the AIFM acting on behalf of the AIF,;
 - the conditions upon which such financial instruments shall be deemed (i) to be appropriately segregated in accordance with the principles set forth in Article 16 of Commission Directive 2006/73/EC), and (ii) to be clearly identified at all times as belonging to the AIF, in accordance with the applicable law; and what shall be considered as the applicable law.
- a. ESMA is requested to advise the Commission on:
 - the type of 'other assets' with respect to which the depositary shall exercise its safekeeping duties pursuant to paragraph 8(b), namely all assets that cannot or are not to be kept in custody by the depositary pursuant paragraph to Article 8(a);
 - the conditions applicable to the depositary when exercising its safekeeping duties over such 'other assets', taking into account the specificities of the various types of asset, including but not limited to financial instruments issued in a 'nominative' form, financial instruments registered with an issuer or a registrar, other financial instruments and other types of assets.
- b. To that end, ESMA is requested to advise the Commission on:
 - the conditions upon which the depositary shall verify the ownership of the AIF or the AIFM on behalf of the AIF of such assets;
 - the information, documents and evidence upon which a depositary may rely in order to be satisfied that the AIF or the AIFM on behalf of the AIF holds the ownership of such assets, and the means by which such information shall be made available to the depositary;
 - the conditions upon which the depositary shall maintain a record of these assets, including but not limited to the type of information to be recorded according to the various specificities of these assets; and the conditions upon which such records shall be kept updated.
- c. In its advice, ESMA should also consider the circumstances where assets belonging to the AIF, are subject to temporary lending or repurchase arrangements or any type of arrangements under which financial instruments may be re-used or provided as collateral by the AIF or AIFM on behalf of the AIF, whether or not such arrangements involve transfer of legal title to the financial instruments, and advise on the conditions applicable to the depositary to perform its safekeeping duties accordingly.

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

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 depositary'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;
2. they are not provided as collateral in accordance with the provisions set out in Box 79; and

Option 1

3. they are registered or held in an account directly or indirectly in the name of the depositary.

Option 2

4. they are financial instruments with respect to which the depositary 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 maintained by a settlement system as designated by Directive 98/26/EC or a similar non-European securities settlement system which acts directly for the issuer or its agent.

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

Financial instruments that are directly registered with the issuer itself or its agent (e.g. a registrar or a transfer agent) in the name of the AIF should not be held in custody unless they 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.

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

ADEPO prefers option 2 for being more accurate and conforming to European legislation(Directive 98/26/EC).

It is worth to mentioning that in Spain, securities are registered through a "two level" system, the Central Registry managed by IBERCLEAR (Spanish CSD, as first level), which keeps the securities

balances of the participants entities, and a detailed registry managed by the participants entities (second level) where securities are listed by holder's name. In this scenario depositaries can be members or not of the system and any future legislation should not prevent this local feature. In any case, the depositary or its delegate(i.e .if the depositary is not direct member of the system)should be the registered holder of the financial instruments.

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?

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

- the depositary is able to verify the existence and location of the assets and to retrieve them at any time, through the application of effective operational process and controls.
- when needed the depositary has selected the entity which holds the assets “(sub-custody network”).

In Spain,financial instruments that can be physically delivered are of little relevance.

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

Option 3

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

We prefer Option 3 for being the most comprehensive.

Indeed financial instruments provided as collateral are not held in custody if they have been transferred out of the depositary's book through any enforceable arrangement. In these circumstances, when the FI assets are with a third party, the depositary's duty is limited to recordkeeping.

Financial instruments that have been provided as collateral are not in custody except if (cumulative conditions) :

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

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?

ADEPO believes that the differentiation of the types of collateral defined in the corresponding Directive is not easy at all and demands a thorough analysis –legal and technical- of each agreement.

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

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 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-custodian²³') complies with §1 (b) as well as with the segregation obligations set out in Box 16.

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.

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.

To that end, the depositary should:

Option 1

- (a) 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
- (b) (ii) have access to documentary evidence of each transaction 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 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.

Additional requirement if Option 2 is retained in Box 78 with regard to the definition of financial instruments to be held in custody

In the context of § (a), the depositary should ensure the AIF, its investors or the AIFM acting on behalf of the AIF, are able to exercise their rights if a problem arises that affects assets for which the depositary or its delegate is the registered owner either by clearly identifying the AIF as the ultimate owner of the assets or, where the depositary or its delegate is the only registered owner of the assets on behalf of a group of one or more unidentified clients, by taking appropriate actions to ensure the AIF's ownership right is recognised by the relevant parties. Where a legal action is required, the costs related to such an action would have to be borne by the AIF, the AIFM or as the case may be the AIF investors.

4. The depositary should set up and implement an escalation process for situations where an anomaly is detected (e.g. to notify the AIFM and if the situation cannot be clarified / corrected, alert the competent authority).

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

ADEPO has not precise information on this point, but anyway we agree with ESMA draft advice and delegation of safekeeping duties should be permitted.

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?

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

- 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), a mandate is given to the depositary by the AIF in order to allow him to instruct directly the issuer. The depositary reconciles its positions with the transfer agent *when exits*.

- 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 but more complex at an operational level since the information is not individualised (e.g. calculation of performance fees and equalization factor)

Q37: To what extent would it be possible / desirable to require prime brokers to provide daily reports as requested under the current FSA rules?

According to Spanish legislation prime brokers have to provide periodic information to the depositary and ADEPO does not object having to comply with this obligation daily.

Q38: What would be the estimated costs related to the implementation of option 1 or option 2 of Box 81? 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?

ADEPO prefers option 1, since option 2 could be very expensive and excessively complex. The latter is more evident on listed derivatives (not held in custody) or trades on assets provided as collateral to prime brokers, where a depositary record would be very onerous for AIF with large volume of trading and prone to error.

Within option 1, and in the case of the mentioned listed derivatives (not held in custody) or trades on asset provided as collateral, the depositary could comply with its monitoring duties receiving and storing the clearing broker statements including the transactions and positions.

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

ADEPO thinks that the depositary should accept the information provided by the manager without a need to reviewing it.

3 Depositary functions pursuant to §9 – Oversight duties

Scope of the Commission's implementing powers

The Commission shall adopt by means of delegated acts, in accordance with Article 56, and subject to the conditions laid down in Articles 57 and 58, measures specifying:

[...] (c) the conditions for performing the depositary functions pursuant to paragraphs 7, 8 and 9

Extract from Level 1 Directive

9. In addition to the tasks referred to in paragraph 7 and 8, the depositary shall:

- (a) ensure that the sale, issue, re-purchase, redemption and cancellation of units or shares of the AIF are carried out in accordance with the applicable national law and the AIF rules or instruments of incorporation;*

- (b) ensure that the value of the shares or units of the AIF is calculated in accordance with the applicable national law, the AIF rules or instruments of incorporation and the procedures laid down in Article 19;*
- (c) carry out the instructions of the AIFM, unless they conflict with the applicable national law or the AIF rules or instruments of incorporation;*
- (d) ensure that in transactions involving the AIF's assets any consideration is remitted to the AIF within the usual time limits;*
- (e) ensure that an AIF's income is applied in accordance with the applicable national law and the AIF rules or instruments of incorporation.*

European Commission's Request for Advice to ESMA

1. ESMA is requested to advise the Commission on the conditions the depositary must comply with in order to fulfil its duties pursuant to Article 21(9). The advice shall include all necessary elements specifying the depositary control duties when inter alia verifying the compliance of instructions of the AIFM with the applicable national law or the AIF rules or instruments of incorporation, or when ensuring that the value of the shares or units of the AIF is calculated in accordance with the applicable national law and the AIF rules or instruments of incorporation and procedures laid down in Article 19.

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 ongoing 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.

Box 83

Clarifications of the depositary's oversight duties

Duties related to subscriptions / redemptions (a)

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

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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
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.

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

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-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 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 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.

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.

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)

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 is applied in accordance with the AIF rules, instruments of incorporation and applicable national law
2. Ensure appropriate measures are taken where the AIF's auditors have expressed reserves on the annual financial statements
3. Check the completeness and accuracy of dividend payments and where relevant of the carried interest

ADEPO, in general terms, has a positive opinion of this part of the draft. ADEPO has always defended that a rather high degree of harmonization of the oversight duties is necessary.

As the draft sets out, the scope of this function should be adapted to the risk profile of the AIF and its strategy.

Equally, as the document mentions, ex-post controls of processes implemented by the AIFM should be the general rule, and reliance on samples and benchmarks should also be normal practises(eg with the calculation of NAV).

By no means depositaries should confine themselves to replicate the task already done by the managers.

Moreover ADEPO wants to stress that depositaries could also rely on third-party assurance reports such as SAS 70 to be satisfied of the suitability of procedures and controls implemented by FIA.

Finally, and as regard the contents of Box 87.3, the depositaries oversight duty should not be interpreted as an obligation to revise the calculation of the net income or dividend already done by the manager.

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?

ADEPO is of the view that the text will have a positive impact and does not think that additional clarity is needed.

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

In Spain depositaries are not the entities designated to issue shares of the AIF, so we have not practical experience on this.

In any case, under the AIFMD requirements, these entities will have to maintain and operate effective organizational and administrative arrangements with a view to taking all reasonable steps designed to identify, prevent, manage and monitor conflicts of interest in order to prevent them from adversely affecting the interests of the AIFs and their investors.

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?

In Spain subscriptions and redemptions are done with the intervention of depositaries.

Notwithstanding that, ADEPO does not object at all a different kind of practice based on a periodic monitoring by the depositaries of the appropriateness and update of the reconciliation procedures of the managers (subscription orders with subscriptions proceeds). The review of the effectiveness of these procedures should be performed ex-post and based on samples.

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?

ADEPO thinks that depositaries could meet that obligation by getting access to the relevant information and records of the AIFM, the AIF or the third party provider. In line with the requirements of Box 83, the depositary will ensure that procedures are implemented, reviewed and updated on a periodic basis, it will also undertake post-checks to ensure that the procedures are effectively implemented.

The oversight should be limited in any case to primary market transactions.

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.

ADEPO agrees with ESMA position.

In Spain escalation procedures are not only agreed between depositaries and managers since their main features are directly contemplated in the legislation as well.

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

ADEPO prefers option 2 in order to clarify a duty that the Directive unequivocally imposes on depositaries. Clarity in this field will make tasks more straightforward for depositaries. Moreover ESMA text represents an adequate position.

Section 2 Due diligence duties

Scope of the Commission's implementing powers

The Commission shall adopt by means of delegated acts, in accordance with Article 56, and subject to the conditions laid down in Articles 57 and 58, measures specifying: [...] (d) the due diligence duties of depositaries pursuant to paragraph 11 (c);

Extract from Level 1 Directive

11. The depositary shall not delegate to third parties its functions as described in this Article, save for those referred to in paragraph 8. The depositary may delegate to third party the functions referred to in paragraph 8, subject to the following conditions: [...]

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

European Commission's Request for Advice to ESMA

1. ESMA is requested to advise the Commission on the duties the depositary has to carry out in exercising its due diligence duties pursuant to Article 21(11), namely:
 - procedures for the selection and the appointment of any third party to whom it wants to delegate parts of its tasks; and
 - procedures for the periodic review and ongoing monitoring of that third party and of the arrangements of that third party in respect of the matters delegated to it.
2. ESMA is encouraged to develop a comprehensive template of evaluation, selection, review and monitoring criteria to be considered

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
 - (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 terminate the contract in the best interest of the AIF and its investors where the delegate no longer complies with the requirements.

ADEPO regrets that ESMA did not choose the option to develop a comprehensive template of evaluation, selection, review and monitoring criterias. Such a template would definitely help clarifying the duties of the depositary, provide for documented evidences and be instrumental to achieve an European harmonisation.

Notwithstanding that, proposals made by ESMA for formulating the due diligence duties of depositories when they appoint a sub-custodian appear generally appropriate. The envisaged requirements for the selection and ongoing monitoring process are largely in line with current market practice. Categorisation

of depositaries' due diligence duties into “**selection**” and “**ongoing monitoring**” also appears generally appropriate.

With regard to selection, a distinction should be made between general risk (e.g. country risk) and specific risk associated with the individual sub-custodian. Whilst general risk involves basic risk associated with the country of deposit, specific risk that may arise from the sub-custodian's business activity is individual risk that can be mitigated by selecting a different sub-custodian.

As regards the review during the business relationship, ADEPO welcomes the risk-based approach proposed by ESMA. In case the risk is not based on the sub-custodian itself but on general risks (e. g. political risks), the relevant authority and the AIFM should be informed, so as the AIFM can take the appropriate steps to adapt its investment strategy accordingly. In case the AIFM does not react adequately, the depositary should be discharged from its liability.

On a separate note, the sub-depositaries should provide a specific auditing of the operating procedures of its activities of the custody of assets belonging to third parties by an external independent auditor and according to internationally accepted rules and standards of auditing (for example, SAS 70 certification (Statements on Auditor Standards)).

Periodically (at least monthly) the depositary should also verify the positions in the delegated entities.

Any change of internal procedures or local regulation applicable to the segregation of assets should be immediately reported by the sub-custodian.

Section 3 Segregation

Scope of the Commission's implementing powers

The Commission shall adopt by means of delegated acts, in accordance with Article 56, and subject to the conditions laid down in Articles 57 and 58, measures specifying: (e) the segregation obligation set forth in paragraph 11 (d) (iii)

Extract from Level 1 Directive

11. The depositary may not delegate to third parties any of its functions as described in this Article, other than those referred to in paragraph 8.

The depositary may only delegate to third parties the functions referred to in paragraph 8, provided that:

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

[...]

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

European Commission's Request for Advice to ESMA

1. ESMA is requested to advise the Commission on criteria to be satisfied to comply with the segregation obligation whereby the depositary shall ensure on an ongoing basis that the third party fulfills the conditions referred to in Article 21(11)(d)(iii).

Box 89**Segregation obligation for third parties to which depositaries have delegated part or all of their safekeeping functions (based on Article 16 of Directive 2006/73/EC implementing the MiFID Directive)**

1. Where safekeeping 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 safekept for the depositary on behalf of its clients from its own assets and 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 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 safekept;
 - (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 the financial instruments belonging to the sub-delegate, 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).

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.

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

V.IV. The depositary's liability regime

1 Loss of financial instruments

Scope of the Commission's implementing powers

The Commission shall adopt by means of delegated acts, in accordance with Article 56, and subject to the conditions laid down in Articles 57 and 58, measures specifying:

[...]

(a) the conditions and circumstances subject to which financial instruments held in custody are to be considered as lost;

Extract from Level 1 Directive

12. The depositary shall be liable to the AIF, or to the investors of the AIF, for the loss by the depositary or a third party to whom the custody of financial instruments held in custody according to point (a) of paragraph 8 has been delegated.

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

European Commission's Request for Advice to ESMA

1. ESMA is requested to advise the Commission on the conditions and circumstances under which financial instruments held in custody pursuant paragraph 8(a) shall be considered as 'lost' according to Article 21(12). In its advice, ESMA should take into account the various legal rights attached to the financial instruments depending, for example, on the legal concepts ('ius ad rem' vs. 'ius in personam') used in the jurisdiction where they have been issued and any legal restrictions applicable to the place where they are kept in (sub-) custody.

2. In its advice, ESMA should specify circumstances when such financial instrument should be considered permanently 'lost', to be distinguished from circumstances when such financial instruments should be considered temporarily 'unavailable' (held up or frozen).

To that end, ESMA shall consider inter alia the following circumstances:

- Insolvency of, and other administrative proceedings against, a sub-custodian;
- Legal or political changes in the country where financial instruments are held in sub custody;
- Actions of authorities imposing restrictions on securities markets;
- Risks involved through the use of settlement systems; and
- Any other circumstances which may prevent the AIF from using or disposing of its assets that are kept in custody by a depositary or a sub custodian.

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.

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 is 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.

ADEPO agrees in general terms with the definition of loss envisaged in this Box.

2 External events beyond reasonable control

Scope of the Commission's implementing powers

The Commission shall adopt by means of delegated acts, in accordance with Article 56, and subject to the conditions laid down in Articles 57 and 58, measures specifying:

[...]

(g) what is to be understood by external events beyond reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary pursuant to paragraph 12;

Extract from Level 1 Directive

12. The depositary shall be liable to the AIF or to the investors of the AIF, for the loss by the depositary, or a third party to whom the custody of financial instruments held in custody according to point (a) of paragraph 8 has been delegated.

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

European Commission's Request for Advice to ESMA

1. ESMA is requested to advise the Commission on the conditions and circumstances for events to be considered as:
 - (i) external;
 - (ii) going beyond reasonable control, and;
 - (iii) having consequences which would have been unavoidable despite all reasonable efforts to the contrary.
2. If possible, ESMA is requested to advise the Commission on a non-exhaustive list of events where the loss of assets can be considered to be a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary. ESMA is encouraged to consider the appropriate form (e.g. guidelines) of such a list.

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 event which led to the loss did not occur as a result of an act or omission of the depositary or one of its sub-custodians to meet its obligations
2. The event which led to the loss was beyond its reasonable control, i.e. it could not have prevented its occurrence by reasonable efforts

3. Despite rigorous and comprehensive due diligences it could not have prevented the loss. 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.

ADEPO main concern refers to the concept of "insolvency of a sub-custodian" that the document adopts.

ADEPO strongly disagrees that events related to the insolvency of a sub-custodian should be considered as "internal" events if:

- despite appropriate due diligences performed by the depositary insolvency can not 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, as everything that is not related to the depositary or any of its affiliates. Indeed, the use of the wording 'Beyond its reasonable control' implies a reduced scope compared to the notion of external. Thus, given that 'beyond the reasonable control' implies a broader scope than 'external', an event should be deemed 'external' as soon as it is beyond the reasonable control of the depositary.

Following this rationale, the insolvency of a sub-custodian is an external event by nature which may prevent a depositary to get back the assets entrusted to a sub-custodian:

- where the law of the country where the assets were held does not recognise the effects of segregation; or
- where the assets are lost, as the result of an act or an omission of a sub-custodian. Indeed experience has shown that client's assets may have been used just before insolvency in a desperate attempt to avoid the bankruptcy. The insolvency prevents the sub-custodian from returning the assets to the depositary despite the provisions laid down in the agreement entered into between the depositary and the sub-custodian.

Nevertheless, ADEPO agrees 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 as "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 really significant. Although the total amount of assets entrusted by a depositary to external sub-custodians may represent a small percentage of the total assets of the funds entrusted to it as a depositary, it may represent an amount of assets relevant.

In a worst case scenario, and given the amount of assets to return, even if split between several sub-custodians, any increase of 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.

Assuming in all cases that an event should be deemed 'internal' if it did occur as the result of an act or an omission of the sub-custodians of the depositary:

- would not be neither in the interest of the fund industry nor in the depositary's other clients interest,
- 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.

On a separate note, ADEPO also disagrees with the way the expression "appropriate action" (as the third requirement to meet in order to allow the depositary to discharge its liability) is explained in the document (paragraphs 38 and 39)

Effectively, in a situation where a depositary believes that the only appropriate action is to dispose of the financial instruments and it informs the AIFM, if the AIFM disregards this advice, the only remaining appropriate action is that of notifying the AIFM's competent authority. Such notification to the AIFM's competent authority should be sufficient to discharge the depositary of its liability as it will have made all reasonable efforts. It should not be unreasonable to expect the competent authority to have a responsibility to ensure that the AIFM is acting in a manner that is not going to cause investor detriment or potentially create greater systemic risk. The AIFM should also be under a direct duty to demonstrate that it is not acting negligently. The above approach also recognises the

fact that it is the AIFM who has responsibility for portfolio management and who ultimately makes the decision whether or not to act upon the alert from the depositary.

The process outlined in these paragraphs would not work in practice and would leave a depositary with open-ended liability until such time as it is able to terminate the contract in respect of something it has made all reasonable efforts to address. The paragraphs indicate too that the AIF is to be given a period of time to find another depositary. If a depositary is terminating an agreement because the AIFM chooses not to act upon its advice, how likely is it that the AIFM will find another depositary willing to take on the AIF? We question also whether it would be in the interests of AIF investors to effectively force their depositary into terminating its contract as a means of discharging its liability.

ADEPO firmly defends that in a situation where a depositary assesses that the only appropriate action is to dispose of the financial instruments and it informs the AIFM, if the AIFM disregards this advice, the only remaining appropriate action is that of notifying the AIFM's competent authority. Such notification to AIFM's competent authority should always discharge the depositary of its liability.

3 Objective reason to contract a discharge

Scope of the Commission's implementing powers

The Commission shall adopt by means of delegated acts, in accordance with Article 56, and subject to the conditions laid down in Articles 57 and 58, measures specifying:

[...]

(h) the conditions and circumstances under which there is an objective reason to contract a discharge pursuant to paragraph 13.

Extract from Level 1 Directive

The depositary's liability shall not be affected by any delegation referred to in paragraph 11.

Notwithstanding the first subparagraph of this paragraph, in case of a loss of financial instruments held in custody by a third party pursuant to paragraph 11, the depositary may discharge itself of liability if it can prove that:

(a) all requirements for the delegation of its custody tasks set out in the second subparagraph of paragraph 11 are met;

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

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

European Commission's Request for Advice to ESMA

1. ESMA is requested to advise the Commission on the conditions and circumstances under which there is an objective reason for the depositary to contract a discharge pursuant to Article 21(13).

2. In its advice, ESMA is encouraged to provide an indicative list of scenarios that are to be considered as being objective reasons for the contractual discharge referred to in Article 21 (13).

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.

ADEPO has a clear preference for option 2. In order to allow the depositary to prove there is an objective reason to contractually discharge itself of its liability it is enough to demonstrate that AIFM (or the AIF) and the depositary have explicitly agreed through a written contract that the depositary can discharge its responsibility. We would welcome so far a broad definition of “objective reasons”.

Additionally option 1 refers to “best interest of the AIF and its investors”. This notion remains very broad and in some situations challenging to establish.

As a matter of fact, the AIFMD contemplates a very demanding range of conditions and requirements for the discharge of the depositary’s liability. In this context, an additional requirement obliging depositaries to “positively” prove there is an objective reason to contract a discharge could make this discharge almost impossible to achieve in practise.

Finally, we fully agree with the consideration that –as explanatory note 45 remarks- the transfer of liability can intervene all along the custody chain.

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?

We are sure that depositary’s cost will increase, as under this regime depositaries are somehow assimilated to insurance companies. Moreover, this will also imply that many entities may choose not to provide custody services to AIF.

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

- Issuer bankruptcy or default.
- Depositary bankruptcy.
- Political or legal changes in the country in which the instruments are deposited.
- Restrictions to the securities markets imposed by the Supervisors.
- Loss occurred in/caused by the Central Securities Depository.
- Eventualities in the Depositary that impedes it giving instructions and, as a result, the instrument is lost or cancelled.
- Cases of natural catastrophes.
- Wars, riots and any uncontrolled social events.
- Third party (mainly sub-custodians) fraudulent bankruptcy, occurred despite all the reasonable measures adopted by the depositary to avoid its consequences.
- Assets belonging to the AIF and subject to temporary lending or repurchase arrangements, which have been lost by the prime broker, when outside of the scope of custody of the depositary.
- Cases of mis-delivery or misappropriation.
- Shares which have been improperly issued have to be cancelled by a company.
- Expropriation by national authority.

From a different angle and regarding specifically “securities”, final solutions to be adopted by the future Securities Law Directive should also be taken into account.

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?

ADEPO is clearly in favour of the suggestion.

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

All types of operational failures outside the sphere of influence of the depositary and its network are typically “external” events and the same goes for claims of third parties to be the true legal owner of a financial instrument.

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?

Most of the players active in the security servicing business do operate on platforms or use tools qualified as market standard that are owned or operated by third parties under service contract and/or software license (e.g. SWIFT messaging system, infrastructure used by clearing houses...). It is commercially impossible for the end-users of these tools to transfer their liability onto those service / IT infrastructure providers. Whereas the fact that depositories do monitor the performance of those systems, we still believe that the depositary should not be held responsible in case of error or failure of those systems.

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?

ADEPO, although it is clearly respectful of the Directive, it is also very skeptical on the functioning of the system specifically envisaged in order to transfer the liability. In practice, it is going to be really difficult for the depositories to reach "negotiated" agreements with their sub-custodians in this respect. For us, the adopted solution is perhaps the most negative part of the Directive.

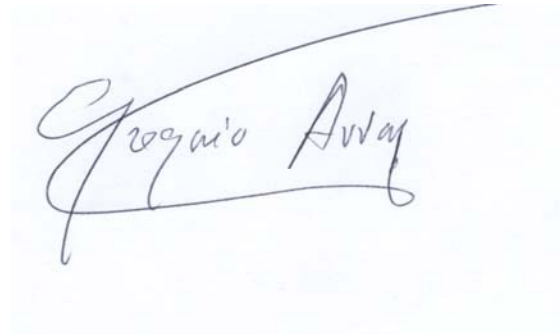
The solution would be more workable when the sub-custodian only if the subcustodian is inside the depositary group.

Q53: Is the framework set out in the draft advice considered workable for non-bank depositories 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?

Although we think it would be workable, in Spain we have not any empirical evidence on this.

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?

ADEPO deems that a further tailoring of the requirements could be more appropriate , mainly with regard to private equity and real estate funds. A further specification of the concept “beyond reasonable control” is also necessary as what is reasonable for “traditional” AIF could not be reasonable for more “sophisticated” ones.

A handwritten signature in dark ink, reading "Gregorio Arranz". The signature is written in a cursive style with a large, sweeping initial 'G' and a long horizontal line extending from the end of the name.

13-09-2011

Gregorio Arranz ADEPO Secretary General

