

CESR's call for evidence – Implementing measures on the Alternative Investment Fund Managers Directive

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

ADEPO welcomes and takes a positive view of the opportunity and specific content of the document and appreciates the usefulness of this call for evidence. 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 call for evidence 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.

III Part II: Depositary (Article 21)

In developing its advice, CESR should take into account that one of the legislative objectives of the AIFMD is to foster a common understanding and harmonised interpretation among the Member States of the functions and duties of the depositary. To that end, the provisions in the AIFMD clarify the general principles applicable to the depositary functions and liability regime, while providing for an extensive set of level 2 measures to further specify the depositary duties and conditions for performing its tasks.

To achieve this objective, CESR should consider the appropriate level of detail of its advice. It should also be noted that during a period of four years certain EU entities could be permitted to provide depositary services on a cross-border basis. To ensure the smooth functioning of such an 'AIF depositary passport', the level 2 provisions should further clarify and specify what has been introduced in the AIFMD as 'principles' set forth in the relevant provisions of Commission Directive 2006/73/EC.

In its advice, CESR should also take into account: the legal structure of the AIF and in particular whether the AIF is of the closed-ended or open-ended type with respect to depositary functions pursuant to Article 21(6); and specificities of various types of assets to be safe-kept by the depositary pursuant to Article 21(7). In addressing the issue of the scope of financial instruments that can be held in custody, CESR should take into account the upcoming Securities Law Directive with a view to ensuring consistency between the two directives.

III.1. Issue 11 – Contract evidencing appointment of the depositary

I. Scope of the Commission's implementing powers

"15. The Commission shall adopt by means of delegated acts, in accordance with Article 54,

*and subject to the conditions laid down in Articles 55 and 56, measures specifying:
(a) the particulars that need to be included in the standard agreement as referred to in paragraph 2;...*"

II. Level 1 text

2. *The appointment of the depositary shall be evidenced by a contract in writing. The contract shall, among others, regulate the flow of information deemed necessary to allow the depositary 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.*

III. Questions

1 CESR 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, CESR should take into account the consistency with the respective requirements in the UCITS Directive.

Future legislation should be consistent with solutions envisaged in article 30 and seq of Directive 2010/43/EU, and the standard agreement should therefore include elements covering at least the following aspects:

- Confidentiality and anti-money laundering,
- Appointment of third parties: Clause requiring the management company to include in the agreement with the counterparties/prime brokers the latter obligations to:
 - i) Send information to the depositary about the transactions, positions and any other information (i.e. financial transactions) affecting them.
 - ii) Provide the depositary with any additional information demanded by it.
- Governing Law and Jurisdiction.
- Expenses and Liabilities.
- Units commercialization procedure.
- Proper instructions.
- Exchange of information (with reference to the AIFM obligation to provide any information requested by the depositary)
- Amendment and Termination.

Finally, we want to indicate that we are not completely convinced of the need of these “standards” agreements, since the very wide range of alternative funds make difficult to reach common standards.

2 CESR is encouraged to provide the Commission, if possible, with a draft model agreement.

III.2. Issue 12 - General criteria for assessing equivalence of the effective prudential regulation and supervision of third countries

I. Scope of the Commission's implementing powers

5. (...) *The Commission shall adopt, by means of delegated acts in accordance with Article 54 and subject to the conditions laid down in Articles 55 and 56, measures specifying the criteria for assessing that the prudential regulation and supervision of third countries are to the same effect as the provisions laid down in European law and are effectively enforced, as referred to in point (ii) of this paragraph 5. On the basis of the criteria referred to in third subparagraph, the Commission shall adopt, in accordance with the procedure referred to in Article 57(2), implementing measures, stating that prudential regulation and supervision of a third country are to the same effect as the provisions laid down in European Union law and are effectively enforced.*

II. Level 1 text

"5. *The depositary shall be located as follows: [...]*

(b) For non-EU AIF, the depositary shall be established in the third country where the AIF is established, or in the home Member State of the AIFM managing the AIF, or, as the case may be, in the Member State of reference of the AIFM managing the AIF.

Without prejudice to the requirements set forth in paragraph 3, the appointment of a depositary established in a third country shall at all times be subject to the following conditions:

[...]

(ii) in the third country where the depositary is established depositaries are subject to effective prudential regulation (including minimum capital requirements) and supervision which are to the same effect as the provisions laid down in European Union law and which are effectively enforced;"

III. Questions

1. CESR is requested to advise the Commission on the criteria for assessing whether the prudential regulation and supervision applicable to a depositary established in a third country with respect to its depositary duties are to the same effect as the provisions laid down in European law. In this regard, CESR is invited to take into account at least whether the depositary:

- is subject to specific capital requirements for the safe-keeping of assets.
- is subject to supervision on an ongoing basis.
- provides sufficient financial and professional guarantees to be able to effectively pursue its business as a depositary and meet the commitments inherent to that function.
- is subject to rules as stringent as those laid down in Article 21 AIFMD

We consider the institutions subject to the Capital Requirements Directive 2006/48/EC (which includes credit institutions and investment firms) are the most suitable entities to fulfil AIF depositary requirements. On top of the regulatory control, external auditors should verify the assets on a recurrent basis.

2. CESR is requested to advise the Commission specifying the criteria for assessing that prudential regulation and supervision of a third country applicable to the AIF depositary with respect to its depositary duties established in a third country is to be considered as effectively enforced. Inter alia, CESR should take into account whether the depositary is subject to the oversight of a public authority, meaning that, at least:
- the authority has the power to request information from the depositary
 - the authority has the power to intervene with respect to, and sanction, the depositary

The existence of the two mentioned powers is clearly necessary and both should also be used in a standing form.

In our opinion, supervisors should also ensure the transparency of the depositary.

III.3. Issue 13 – Depositary functions

I. Scope of the Commission's implementing powers

15. *The Commission shall adopt by means of delegated acts, in accordance with Article 54, and subject to the conditions laid down in Articles 55 and 56, measures specifying:*

[...]

(c) the conditions for performing the depositary functions pursuant to paragraphs 6, 7 and 8, 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 7; 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 7 the financial instruments issued in a nominative form and registered with an issuer or a registrar;

ISSUE 13.1 – DEPOSITARY FUNCTIONS PURSUANT TO PARAGRAPH 6

II. Level 1 text *"6. 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 as long as 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 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. In case 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."*

III. Questions

1. CESR is requested to advise the Commission on the conditions for performing the depositary functions pursuant to Article 21(6). CESR is requested to specify conditions for the depositary to ensure that:

-the AIF's cash flows are properly monitored;

This liquidity should be held by the depositary in a regular cash account. Moreover, depositaries should be the only entitled to open all kind of AIF accounts (including deposits).

As soon as liquidity is transferred into collateral or deposited in another institution, it falls outside the scope of the depositaries custody duties.

The regulation should include information obligations affecting the depositary and restrictions to the destinations of transfers coming from the counterparties. The depositary should be directly informed by the counterparty about any payments in favour of the AIFM, and such payments should only be charged in the AIF account opened in the depositary (taking into account common practices on this issue in respect of cross border payments requiring a correspondent bank)

In relation with the ordered payments, the AIFM should previously and adequately justify them before the depositary.

Moreover the settlement of the financial transactions (even off market ones) should normally be done by the depositaries, carrying out the instructions of the management company. In any case, the depositary should be capable of verifying the correctness of the settlement processes.

-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.

It would be recommendable identifying just one AIF account in the depositary receiving all the subscriptions. Unit holders (or the distributor) should directly transfer to such account the amount/s of the subscriptions. Depositaries should not be liable for any consequences arising from third parties (e.g. transfer agents) involved in the subscription or redemptions of shares or units.

-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.

Applicable rules should impose segregation requirements so as to protect the AIF's assets from being lost, not only of the depositary's own assets but also of the assets held on behalf of its clients.

Depositaries should implement the internal controls necessary to guarantee the necessary account segregation in order to clearly assure that in no case depositary's own cash is kept in the same accounts opened in the name of AIF.

In its advice, CESR 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.

ADEPO considers that it is not required to make any distinction in this function according to the legal nature of the AIF and, in particular, whether the AIF is of the closed-ended or open-ended type. The duties performed by the depositary are of the same nature in all cases.

2. CESR 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.

At least the following conditions should be met:

- The entity is subject to a local prudential regulation and supervision that is enforced by the competent authority of the country where it is established,
- The entity complies with international rules which are also transposed at the European level (e.g. Basel III for rules relating to capital requirements and money laundry prevention GAFI recommendations),
- The entity is able to produce a reporting indicating for the cash accounts opened in its books the balance and the movements of these accounts on a regular basis and at any request by the depositary.

3. CESR 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.

ISSUE 13.2 – DEPOSITARY FUNCTIONS PURSUANT TO PARAGRAPH 7

II. Level 1 text

7. *"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 AIF in accordance with 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."

III. Questions

CESR 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(7), namely (i) the financial instruments⁸ 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;

We should distinguish between:

a) Instruments that can be "physically delivered", these having very little importance in Spain.

b) Instruments that can be registered in the depositary's book:

- Listed securities. In Spain these instruments are registered through a "two levels" 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.

-Non listed securities represented through a book entry system (with a "single level").

-Units of collective investments vehicles acquired through platforms like Fundsettle EOC.

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: o 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,; o 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/EC9), 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.

Most financial instruments which can be held in custody are finally those which are registered with a CSD, either directly or through a chain of intermediaries, in this scenario:

- The CSD and the various intermediaries (i.e., participant entity at the relevant CSD) should all be regulated entities .
- The depositary is in most cases able to choose the intermediaries selected for the holding of financial instruments according to stringent criteria which ensure that these entities have the appropriate expertise and provides all the financial and professional guarantees to carry out their duties,
- The depositary carries out periodic reviews on the sub-custodian network to validate that they keep to apply these criteria on an ongoing basis.

With regard to the segregation of assets, the following rules should be complied with:

- Specific accounts are opened in the name of the AIF in the books of the depositary to book the AIF's assets and separate them from assets held by the depositary on its own account and by other investors,
- Where a depositary uses a sub-custodian, the segregation of the assets is effective when the depositary's own assets are segregated from the ones of its clients. In the books of the sub-custodian, the depositary will open one account where the assets held by the depositary on its own account are recorded and one or several other accounts where the assets of the depositary's clients are registered. There is no need to have one account per AIF in the books of the sub-custodian.
- This principle is to be replicated all along the intermediaries chain whether several intermediaries are used
- This principle also applies for the accounts opened in the CSD's books where the assets are ultimately registered.

2. CESR 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 7(b), namely all assets that cannot or are not to be kept in custody by the depositary pursuant to Article 7(a):

We should distinguish between:

a) Financial instruments:

- Units of collective investment vehicles, held with a register (managed or not by the manager).
- Derivative contracts.
- Shares and other instruments issued in a nominative form or registered by the issuer itself or a register.
- Structured products.
- Cash placed on deposit with other entity.

b) Non financial assets:

- commodities,
- real estate,

- pieces of fine art,
- material goods.

-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.

In those cases where the assets cannot be kept in custody by the depositary, it can only keep an inventory (through a 'mirror record' or a 'position keeping' record) so as to have an overview of all the assets of the fund.

As depositaries may experience difficulties in getting access to accurate and up-to-date information in a timely manner (for example the confirmation of derivative transactions), AIFM should be liable for providing the depositary with the accurate information.

8 As specified in annex I section C of Directive 2004/39/EC

9 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

3. To that end, CESR 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

It is a registration in the depositary's books that reflects the fund's right of ownership of the asset. Therefore, in those cases where the assets can not be kept in custody by the depositary, it can not guarantee the AIF's ownership of such assets.

The depositary should just verify (but never should guarantee) the ownership of the assets when they are acquired by the fund. This can only be done if the depositary is informed (with accurate and up-to-date information in a timely manner) about this acquisition by the AIF. To that end, the depositary role will consist in the implementation of those mechanisms and procedures which grants its participation and monitoring of the assets acquisition process. This participation must also grant that the property and free disposal of the assets, in the name of the AIF. Finally, disposal of the AIF's assets shall be done with the depositary's consent and authorization.

Moreover, it would be convenient this information generally could be confirmed by an external source of information, which can be the counterparty of the transaction or an agent acting on behalf of the counterparty. The depositary thus makes a reconciliation to check the main characteristics of the asset (in terms of value, quantity; date of acquisition...).

These verifications should be sufficient to check the ownership of the assets.

In Spain, real estate mutual funds legislation specifically obliges to the depositaries to monitor acquisitions and disposals of the assets. The managers also have to provide information on a quarterly basis.

- 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.

The following would be considered as valid methods in order to verify the ownership of the transactions/positions over assets of this kind: the agreements, confirmations and originals issued by the counterparty/entity carrying the registry(external sources). In case of receiving them by fax/e-mail, just in case the document comes directly from the issuer. Moreover it would be considered valid all the information over assets/operations in name of the AIF, obtained through SWIFT messages or web access to the entity's registry.

After the acquisition of the assets, the depositary has to be informed by the AIF and by any relevant external sources of information about any modification relating to the assets held by the fund. This obligation needs to be mentioned in the agreement appointing the depositary, as these flows of information are crucial to enable the depositary to perform its duties. They need to be described appropriately by specifying their nature, their way of transmission and in which circumstances they need to be transmitted to the depositary.

Additionally, the depositary can send some requests to the AIF and/or to the external sources of information to make sure that the record of assets is kept updated. This can be done according to a frequency which is specified in the agreement. The AIF and the external sources of information have the obligation to respond to these requests.

4. In its advice, CESR 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.

The depositary should:

- Oversee the adequacy of the arrangement to assure that these transactions comply with the legislation and internal rules.
- Be involved in their settlement, according to the instructions of the AIFM.
- When the arrangement involves transfer of legal title to the AIF, collateral should be under the depositary's custody.
- Receive accurate and up-to-date information in a timely manner from the AIFM.
- On top of this, assets transferred into collateral in agreements that involve transfer of legal title to the financial instruments should fall outside the scope of the depositaries custody duties.

It should be clarified that the depositary may contractually discharge its custody liability over those assets object of securities loans or other collateral agreements, in accordance with the Directive, if:

- (i) the fund rules or articles of association of the AIF concerned expressly allow for such discharge
- (ii) the investor of the relevant AIF have been duly informed of this discharge
- (iii) the AIF or the AIFM on behalf of the AIF instructs the relevant transfer to the depositary
- (iv) there is a written contract between the depositary and the AIF which expressly allows such a

discharge

(v) there is a written contract between the depositary and the third party that explicitly transfer the liability to the third party

ISSUE 13.3 – DEPOSITARY FUNCTIONS PURSUANT TO PARAGRAPH 8

II. Level 1 text

8. In addition to the tasks referred to in paragraph 6 and 7, the depositary shall:

- (a) ensure that the sale, issue, re-purchase, redemption and cancellation of shares or units 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 and the AIF rules or instruments of incorporation and 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.

III. Questions

1. CESR is requested to advise the Commission on the conditions the depositary must comply with in order to fulfill its duties pursuant to Article 21(8). 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.

ADEPO thinks that a high degree of harmonization of these functions is very convenient. Furthermore legislation should avoid situations where depositaries merely replicate the tasks already done by the manager. We are of the opinion that the current list of supervisory duties mentioned is satisfactory and should not be to be extended by local authorities.

Responding to the specific questions:

(a), (b) and (e): through the verification of the AIFM procedures.

(a): Through periodic verification of samples.

(b): Comparing the NAV evolution vs benchmark. For real estate funds, checking that independent appraisals are done before acquisitions /disposals of the assets and once per year and the monthly NAV to take account of the last appraisal.

(c): In those cases in which the liquidation of the assets contracted should be carried out despite there is a conflict with the legislation or the prospectus, it will be done in order to avoid a greater damage to the unit holders.

(d): Monitoring the operations and payments/charges compromises.

Any failures detected by the depositary with regards to the task listed above should be communicated to the AIFM in order to be amended and, if such failures are not amended or in the case of high failure, will be also communicated by the depositary to the Supervisor, without delay.

Finally, we are of the opinion that the expression "shall ensure" could not to be interpreted in the same way across Members States, so we believe that the term should be clarified.

III.4. Issue 14 – Due diligence

I. Scope of the Commission's implementing powers

15. The Commission shall adopt by means of delegated acts, in accordance with Article 54, and subject to the conditions laid down in Articles 55 and 56, measures specifying:

[...]

(d) the due diligence duties of depositaries pursuant to paragraph 10 (c);

II. Level 1 text

10. The depositary may not delegate to third parties any of its functions as described in this Article, other than those referred to in paragraph 7. The depositary may only delegate to third party the functions referred to in paragraph 7, provided that:

[...]

(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 shall keep 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;

III. Questions

1. CESR 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(10), 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.

- When contracting subdepositaries, the depositary should issue a report over each sub-depositary using omnibus accounts: over its regulatory requirements, solvency and audit requirements, credit rating, legal and operational risks, periodic supervision by the competent regulator, and appropriate segregation of assets.

- All 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.

2. CESR is encouraged to develop a comprehensive template of evaluation, selection, review and monitoring criteria to be considered by the depositary while exercising its due diligence duties under Article 21(10).

III.5. Issue 15 – The segregation obligation

I. Scope of the Commission's implementing powers

15. The Commission shall adopt by means of delegated acts, in accordance with Article 54, and subject to the conditions laid down in Articles 55 and 56, measures specifying:

[...]

(e) the segregation obligation set forth in paragraph 10 (d) (iv)

II. Level 1 text

10. The depositary may not delegate to third parties any of its functions as described in this Article, other than those referred to in paragraph 7. The depositary may only delegate to third parties the functions referred to in paragraph 7, provided that:

[...]

(d) the depositary has ensured that the third party fulfils the following conditions and on an ongoing basis ensures that it will remain to fulfil such conditions during the performance of the tasks delegated to it:

[...]

*(iv) it 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 given depositary
any time be clearly identified as belonging to clients of a given depositary;*

III. Questions

1. CESR 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 fulfils the conditions referred to in Article 21(10)(d)(iv).

Sub-custodians should meet at any time the requirements set out in articles 16 and 17 of the Commission Directive 2006/73/EC implementing MIFID. See also response to Issue 13.1 above.

As we stated before, rules should impose segregation requirements so as to protect the AIF's assets from being lost, not only of the depositary's own assets but also of the assets held on behalf of its clients.

III.6. Issue 16 – Loss of financial instruments

I. Scope of the Commission's implementing powers

15. The Commission shall adopt by means of delegated acts, in accordance with Article 54, and subject to the conditions laid down in Articles 55 and 56, measures specifying: [...]

(f) the conditions and circumstances under which financial instruments held in custody shall be considered as lost;

II. Level 1 text

11. *The depositary shall be liable to the AIF, or, as the case may be, to the investors of the AIF, for the loss by the depositary, or as the case may be, a third party to whom the custody has been delegated, of financial instruments held in custody according to point (a) of paragraph 7. 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, as the case may be, 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.*

III. Questions

1. CESR is requested to advise the Commission on the conditions and circumstances under which financial instruments held in custody pursuant paragraph 7(a) shall be considered as "lost" according to Article 21(11). In its advice, CESR 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.

ADEPO considers that the loss of a financial instrument should not be assumed simply because the assets of the AIF are not immediately available for the investors. Legally speaking, a financial instrument should be considered as permanently lost only where at least one of the following conditions occurs:

- the financial instrument does no longer exist or did never exist,
- the rights over the financial instruments were suspended or terminated.

Under these conditions, a financial instrument cannot be deemed as lost if:

- it is temporarily unavailable as a result of legal and/or regulatory proceedings. This typically happens in the case of a sub-custodian's insolvency. Provided that the assets were correctly segregated before, the depositary will get them back entirely but only after the insolvency procedure will be finalised,
- there is a loss in the market value of the financial instrument. The loss of value of a financial instrument results from a pure market risk taken by the AIF. As a consequence the depositary cannot bear that risk.

In any case, the loss should be declared by a judicial or regulatory authority which acknowledges that the financial instruments have been definitively lost.

This issue is also considered in the draft Securities Law Directive (SLD). Therefore any solution finally adopted in the AIFMD implementing legislation should be in line with the final version of the SLD.

2. In its advice, CESR 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, CESR 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.

As examples, we can mention these types of losses:

- Loss or destruction of “physical” financial instruments.
- Instrument sold or transferred to other holder without order from the AIFM (specially when the “third party”holder is acting with “good faith”).
- The instrument is de-registered because finally it is not received.
- The instrument is de-registered because the AIFM instructions were not sent and there is not *force majeure*.
- Legal deprivation (not temporally) of the core rights/faculties inherent to the financial instrument due to Civil Law reasons.
- Situations under which legal capability to dispose of the instrument has been lost in a permanent/long standing fashion.

III.7. Issue 17 - External events beyond reasonable control

I. Scope of the Commission's implementing powers

15. *The Commission shall adopt by means of delegated acts, in accordance with Article 54, and subject to the conditions laid down in Articles 55 and 56, 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 11;

II. Level 1 text

11. *The depositary shall be liable to the AIF, or, as the case may be, to the investors of the AIF, for the loss by the depositary, or as the case may be, a third party to whom the custody has been delegated, of financial instruments held in custody according to point (a) of paragraph 7. 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, as the case may be, 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*

III. Questions

1. CESR is requested to advise the Commission on conditions and circumstances for events to be considered as:

- external,
- going beyond reasonable control, and
- having consequences which would have been unavoidable despite all reasonable efforts to the contrary.

Although the conditions are quite stringent in the Directive itself, they should not be implemented/interpreted in a way impeding any possibility of discharge.

2. If possible, CESR 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. CESR is encouraged to consider the appropriate form (e.g. guidelines) of such a list.

- Issuer bankruptcy or default.
- Depository 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 Depository 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 depository 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 depository.

III.8. Issue 18 – Objective reason to contract a discharge

I. Scope of the Commission's implementing powers

15. *The Commission shall adopt by means of delegated acts, in accordance with Article 54, and subject to the conditions laid down in Articles 55 and 56, measures specifying: [...]*
(h) the conditions and circumstances under which there is an objective reason to contract a discharge pursuant to paragraph 12.

II. Level 1 text

12. *The depository's liability shall not be affected by any delegation referred to in paragraph 10.*

However, in case of a loss of financial instruments held in custody by a third party pursuant to paragraph 10, provided that there is a written contract between the depository and the AIF, or, as the case may be, the AIFM acting on behalf of the AIF, which expressly allows such a discharge under the explicit condition precedent of the existence of a written contract in accordance with point (i) below and which establishes the objective reason to

contract such a discharge, the depositary can discharge itself of its liability if it can prove:

- (i) that all requirements for the delegation of its custody tasks, as set forth in paragraph 10 (a) to (d), are met, and*
- (ii) that there is a written contract between the depositary and the third party that explicitly transfers the liability of the depositary to that third party and makes it possible for the AIF, or as the case may be, 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.*

III. Questions

1 CESR 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(12).

Discharge of liability could have an “objective” reason wherever given the specific nature/features of the assets entrusted to the sub-custodians and despite the depositary meeting all the legal requirements that article 21.12 lays down, the latter can only have a very reduce control on said assets. (i.e. prime broker)

We would like to emphasize how difficult in practice will be to activate this solution. Although the latter is clearly envisaged in the Directive, it will be extremely difficult to convince any subcustodians to enter into these agreements.

2 In its advice, CESR 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 (12).

Cases where reuse of the assets is allowed.

Additional section of the Call for evidence paper that might be of potential interest

Additional CESR Questions

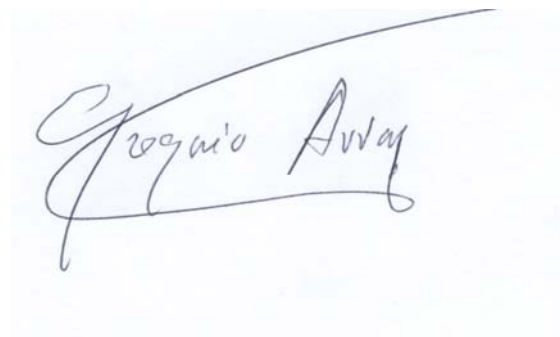
Choice of legislative instrument

Once CESR/ESMA has submitted its advice on the implementing measures, the Commission will have to decide which type(s) of legislative instrument would be appropriate for the level 2 measures. The choice is likely to be between directives – which require transposition at national level – and regulations, which are directly applicable on market participants without any national transposition. Regulations can be considered as promoting harmonisation across EU Member States (MS), while directives leave a greater amount of discretion to MS in their application. CESR may express an opinion on this in its advice to the Commission.

Question for the call for evidence

1. Among the topics that will be covered by the implementing measures, which do you consider would be most appropriately adopted in the form of regulations or directives? Please explain your choice.

We do not have a fully decided opinion on this, but the Directive seems to be preferable due to the importance of the liability issues, with a clear linkage with Civil Law, not yet harmonized.

A handwritten signature in blue ink, reading "Gregorio Arranz". The signature is written in a cursive style with a long horizontal stroke extending from the end.

Gregorio Arranz ADEPO Secretary General