

Luxembourg, 13 September 2011

To ESMA

Re: Consultation Paper: Implementing measures on the Alternative Investment Fund Managers Directive (the "Consultation")

Introduction

ALFI represents the Luxembourg investment management and fund industry. It counts among its membership asset management groups from various horizons and a large variety of service providers.

According to the latest CSSF (Commission de Surveillance du Secteur Financier) figures, on 31 July 2011, there are 3,795 undertakings for collective investment in Luxembourg (UCITS and non-UCITS), representing 13,210 active compartments and a total, in terms of net asset value ("NAV"), of EUR 2.189,665 billion.

In the non-UCITS fund arena, two types of fund are included in the CSSF statistics, namely the UCI Part II funds (629 funds, NAV EUR 210 billion) and the SIF funds (1,305 funds, NAV EUR 226 billion).

While these funds do include significant numbers of the traditional alternative investment segments, namely hedge funds ("HF"), private equity funds ("PE") and real estate funds ("RE"), one should note that a substantial part of these figures also represent UCITS like funds, i.e. money market or securities investment funds, which do not need the benefit of the passport and therefore opt for a non-UCITS form.

Luxembourg also supports a wide variety of other investment strategies in its funds, including (but not limited to) microfinance, socially responsible investment, commodities, infrastructure, carbon credits, renewable energy, islamic finance, wine, art, timber, agriculture, distressed debt, shipping, aircraft leasing, etc. In addition, the SICAR venture capital/private equity regime and some non-regulated legal arrangements under Luxembourg corporate law may also partly fall under the scope of the AIFMD.

The present comments should be read in conjunction with our previous ALFI Papers sent to ESMA on 13 January 2011 and 22 February 2011, and our various submissions to the ESMA AIFMD Taskforces.

We thank ESMA for the opportunity to participate in this Consultation and for their consideration of our comments.

Response to the consultation

We have carefully considered all the proposed advice, explanatory text, questions and annexes contained in the Consultation.

In summary, we would like to highlight the following key points:

- **Directive for depositary regime**

ALFI would like to take the occasion of the present response to stress once again the importance of having the level 2 provisions relating to depositary adopted by way of a directive and not by way of a regulation.

The directive is indeed the unique EU legislative instrument which will enable the member states to consider when transposing the directive, the broad range of funds and of funds managers acting on their own territory, and the specificities of their own market practices.

- **Prime broker**

With respect to the provisions on prime brokers and in order to avoid any discussions when applying those provisions, ALFI strongly recommends ESMA to confirm that in the event of appointment of a prime broker, all the assets received by such prime broker will be considered as “other assets” subject to recordkeeping obligations by the depositary and not subject to custody obligations.

- **Level 2 provisions should not go beyond the Level 1 text**

We have identified some points in the Consultation where the suggested advice from ESMA goes beyond the level 1 text (see our comments on Box 6, Box 23, Box 24, Q23, Q29, Box 84, Box 85, Q44, Box 90). Given that the scope of the advice to be delivered by the EU Commission is determined and restricted by the Level 1 text, we believe that the present consultation should not exceed the level 1 provisions.

- **Alignment with UCIT and Proportionality**

For consistency and efficiency, we recommend ESMA to align the AIFM provisions on risk, liquidity management and delegation with the UCITS framework.

We also welcome the fact that ESMA has confirmed its willingness to introduce proportionality. Both the Consultation and our responses recognise that due the variety of funds (type, size, specificities...), the one size fits all approach is not appropriate.

We would be pleased to answer any questions that ESMA should have on the present ALFI submission, or to arrange for further discussions with subject-matter-experts from relevant member firms.

III. Article 3 Scope – Exemptions.

III.I. Identification of the portfolio of AIF under management by a particular AIFM and calculation of the value of assets under management

Box 1 Calculation of the total value of assets under management

ALFI notes and appreciates the considerable work done by ESMA in order to determine the most appropriate way to calculate the value of the assets under management, however, we believe that the solution proposed by ESMA should not be too complex. We recommend adopting a pragmatic approach, with a calculation method that is easy to use and to control.

Q1: Does the requirement that net asset value prices for underlying AIFs must be produced within 12 months of the threshold calculation cause any difficulty for AIFMs, particularly those in start-up situations?

In principle, requiring AIFM's to include NAV's that are not more than 12 months old in their threshold AUM calculation does not raise any difficulties, as all Luxembourg funds do calculate a NAV and produce financial reports at least annually and must publish or make these reports available to investors within six months (at the latest) from the end of the period to which they relate.

However, there are a number of start-up issues that should be taken into consideration:

- There should be flexibility in the AIFM's start-up phase. Luxembourg law provides an option for new companies to have an extended first financial period of up to 18 months (i.e., the annual accounts will have to be approved within 18 months). Hence we recommend that the AIFM's initial threshold calculation date should be set at the end of the first financial period. Thereafter, relying on the audited annual accounts, the threshold calculation may be completed within 6 months of the financial year-end.
- In respect of AIFs which are in a start-up situation (i.e., launched during the 12 month period preceding the threshold calculation date), this requirement may be problematic, particularly for AIFs which invest in illiquid assets (e.g., real estate assets where the valuation is carried out annually) and which benefit from an extended accounting period for their first fiscal year). In that case, the "asset values" in respect of these AIFs may not be finalised within twelve months of the threshold calculation date. Accordingly, AIFMs should therefore be permitted to rely on unaudited estimates for start-up AIFs during their first fiscal period.
- For some funds, the periodic update of the financial statements and NAV may be based on valuations of underlying assets prepared at an earlier date, for example property funds or funds of funds. Nevertheless, AIFMs should be allowed to use the NAVs as calculated for the threshold calculation.

The reference in Box 1 to the *"total value of the assets under management [...] calculated [...] using the latest available net asset value calculation [...]"* is misleading. Whether or not an AIFM is exempted under article 3 of the AIFMD is based on the level of *"assets under management"*. This concept can be different from the *"net asset value"* of the AIFs. This is recognised by ESMA inter alia under point 7. of Section III.I. of the consultation paper: *"For [closed-ended funds], the net asset value may not be relevant or calculated with sufficient frequency and perhaps other methods could be used, such as acquisition costs of assets held, or commitments less realisations at cost for private equity and venture capital"*. Therefore, we suggest that all references to *"net asset value calculations"* in the ESMA recommendations relating to the calculation of value of assets under management be replaced by *"asset value calculations"*. See also our response to Q3 below.

Q2: Do you think there is merit in ESMA specifying a single date, for example 31 December 2011 for the calculation of the threshold?

No.

An AIFM may manage several AIFs located in various jurisdictions with potentially different accounting periods and should be able to decide which date is the most appropriate to calculate the threshold taking into account the AIFs under management. Setting a single reference date in an international environment could carry significant additional (and disproportionate) costs for the industry (and hence, ultimately, investors) and could create an administrative bottle neck.

Q3: Do you consider that using the annual net asset value calculation is an appropriate measure for all types of AIF, for example private equity or real estate? If you disagree with this proposal please specify an alternative approach.

Using the “*net asset value calculation*” is not an appropriate measure for all types of AIFs. This is recognised by ESMA under items 4 to 7 of Section III.I of the consultation paper.

The approach should be different depending on whether the relevant AIF is closed-ended or open-ended. So far as traditional unlimited-term open-ended AIFs are concerned, we agree with ESMA on the “net asset test”, subject to our comments on the questions below relating to leverage, valuation of assets, cross-holdings and “threshold-crossing”. It is (we believe) widely recognised that reference to “assets under management” is equivalent to the gross asset value of these AIFs, namely:

- market value of AIF assets, or the fair value of those assets where market value is unavailable, calculated on a gross basis, i.e., without deducting liabilities, such as accrued fees and expenses or the amount of any borrowing (as per US Dodd-Frank rules).

For closed-ended funds, we share ESMA’s view under item 7. of Section III.I of the consultation paper. The “net asset value” is frequently not relevant, or may be fundamentally different among different closed-ended AIFs investing in different asset types. Therefore, we believe that it should be the responsibility of the AIFM to justify the most appropriate method of asset valuation in respect of each of the (closed-ended) AIFs that it manages. In particular, the following calculation methods may be appropriate for closed-ended AIFs (particularly private equity/venture capital and real estate funds):

- gross market value, as per open-ended funds, or
- acquisition costs of assets less realization costs and permanent write-offs, subject to adjustments for leverage (as to which, see ALFI responses on leverage Section VI. “*Article 4.1 - Possible Implementing Measures on Methods for Calculating the Leverage of an AIF and the Methods for Calculating the Exposure of an AIF*”); or
- capital contributed and not repaid, subject to adjustments for leverage.

Q4: Can you provide examples of situations identified by the AIFM in monitoring the total value of assets under management which would and would not necessitate a recalculation of the threshold?

- In respect of a closed-ended AIF that invests or commits to invest its funds during a limited investment period, the AIFM should be entitled to cease monitoring the threshold as from the end of that AIF’s investment period if, on such date, the AIFM is below the relevant threshold and exempted from the AIFMD requirements. The relevant AIF asset value would therefore be set and remain set at the value achieved at the end of the investment period. This is because the relevant AIF will have entered into its divestment period and therefore the “assets under management” will decrease rather than increase. An obligation to monitor that type of AIF’s assets under management would be disproportionate in our view.

- For an AIFM that is subject to the AIFMD requirements, to cease monitoring the threshold in respect of that AIF if, at some point in time after the end of the relevant AIF investment period, the AIFM falls below the threshold and opts to become exempted from the AIFMD requirements.

For the avoidance of doubt, this does not exempt the AIFM to continue monitoring the "total assets under management" in respect of such other AIFs which it manages but only provides for the ability of the AIFM to set a fixed "asset under management value" in respect of certain closed-ended AIFs at a certain point in time.

Q5: Do you agree that AIFs which are exempt under Article 61 of the Directive should be included when calculating the threshold?

No.

An AIFM managing only "exempt AIFs" will not be subject to the AIFMD requirements and the "assets under management" test would not be applicable.

We do not see any reason why "exempt AIFs" assets should be treated differently depending on whether the relevant AIFM is managing only "exempt AIFs" or managing a mix of "exempt AIFs" and "non-exempt AIFs". This is not consistent with article 61 of the AIFMD and would risk discriminatory treatment between those two categories of AIFM.

III.II. Influences of leverage on the assets under management

Box 2 Calculation of Leverage

Q6: Do you agree that AIFMs should include the gross exposure in the calculation of the value of assets under management when the gross exposure is higher than the AIF's net asset value?

No comment for the moment.

Q7: Do you consider that valid foreign exchange and interest rate hedging positions should be excluded when taking into account leverage for the purposes of calculating the total value of assets under management?

This is the same approach as used under UCITS. However the purpose of the rules under UCITS is different. Since AIFM will need to assess the value of an asset, hedging arrangements that are an integral part of the asset should therefore be included.

Q8: Do you consider that the proposed requirements for calculating the total value of assets under management set out in Boxes 1 and 2 are clear? Will this approach produce accurate results?

Under Box 1, point 1, second bullet point, the sentence "*UCITS for which the AIFM acts as the designated management company under the UCITS Directive are not included for purposes of the threshold calculation*" should be reworded for clarification purposes as follows:

"Assets of UCITS are not included for purposes of the threshold calculation".

III.III. Content of the obligation to register with national competent authorities and suitable mechanisms for gathering information

Box 3 Information to be provided as part of registration

The quarterly updating obligation may prove burdensome for smaller AIFM, the scope of information being rather limited, changes may possibly not be that frequent.

III.IV. Opt-in procedure

Box 4 Opt-in Procedures

The procedure should allow some flexibility and should be proportionate to the size of the AIFM.

Box 5 AIFMs falling below the threshold

ALFI: No comment.

IV. General operating conditions

IV.I. Possible Implementing Measures on Additional Own Funds and Professional Indemnity Insurance

BOX 6 Risks from Professional Negligence

Under current market practice, many separate insurance categories are covered in this list of risks, which extend far beyond the Professional Negligence requirement laid down in Level 1:

- Professional Negligence
- Crime/Fraud liabilities
- Directors & Officers cover
- Business Interruption cover

Any insurance policy will be limited by events such as force majeure and other policy conditions such as disclosure of material facts prior to arrangement, and policy coverage amounts negotiated for individual policies. Such cover availability varies widely across Member States, and may not be available at all in certain markets, or at a reasonable cost.

While it may be desirable for AIFM to provide for these risks, ALFI believes that the Level 2 provisions should not exceed the scope of Level 1 and should not make this mandatory.

Q9: The risk to be covered according to paragraph 2 (b)(iv) of Box 6 (the improper valuation) would also include valuation performed by an appointed external valuer. Do you consider this as feasible and practicable?

The responsibilities of the independent valuer will typically vary depending on the scope of their contractual engagements with the AIFM.

In particular, when independent valuers are appointed for an external review of the valuation performed internally by the AIFM, their responsibilities would typically be more limited.

In practice, the liabilities borne by independent valuers are generally defined contractually and subject to a limitation by means of a maximum monetary amount or a multiple of the fees agreed between the independent valuer and the AIFM.

If the AIFMD seeks to impose an unlimited liability on independent valuers, except for gross negligence, ALFI believes that this would likely result in a significant reduction in the number of valuers willing to support AIFMs, and a significant increase in the fees charged by the remaining valuers.

Therefore, it may be appropriate for risks to be covered according to §2 (b) (iv) of Box 6 to also include valuation performed by an external valuer, especially in asset classes where an established valuation profession does not exist, or where it is not common for external valuers to carry their own professional indemnity insurance. Professional valuers in real estate, for example, will hold their own professional indemnity insurance, and thus including such requirements in the AIFM's own insurance requirements will double the coverage and cost.

BOX 7-8 Quantitative Requirements Additional Own Funds

We strongly support the option 1 in Box 8 point 1 (0.01% of the value of the portfolios of AIF managed by the AIFM) with the cap on own funds set at EUR10 million, as this is consistent with the UCITS approach. Many of ALFI's members manage both UCITS and AIF, and a consistent method would be highly preferable.

Q10-Q12: See comments in Box 7-8

Q13: Do you see a practical need to allow for the 'Advanced Measurement Approach' outlined in Directive 2006/48/EC as an optional framework for the AIFM?

No. We believe that the second option in Box 8 point 1 is complicated and not necessarily useful.

Q14: Paragraph 4 of Box 8 provides that the competent authority of the AIFM may authorise the AIFM to lower the percentage if the AIFM can demonstrate that the lower amount adequately covers the liabilities based on historical loss data of five years. Do you consider this five-year period as appropriate or should the period be extended?

No. A five year period is appropriate.

BOX 9 Professional Indemnity Insurance

No comment for the moment.

Q15: Would you consider it more appropriate to set lower minimum amounts for single claims, but higher amounts for claims in aggregate per year for AIFs with many investors (e.g. requiring paragraph 2 of Box 9 only for AIF with fewer than 30 investors)? Where there are more than 30 investors, the amount in paragraph 3 (b) would be increased e.g. to €3.5 m, while for more than 100 investors, the amount in paragraph 3 (b) would be increased e.g. to €4 m.

It may be more appropriate to set a lower minimum amount for claims in aggregate since the mutualisation of several claims statistically leads to lower risk.

IV.II. Article 12 - General Principles

Box 10 Duty to act in the best interests of the AIF or the investors of the AIF and the integrity of the market

No comment for the moment.

Box 11 Due Diligence requirements

No comment for the moment.

Q16: Paragraphs 4 and 5 of Box 11 set out additional due diligence requirements with which AIFMs must comply when investing on behalf of AIFs in specific types of asset, e.g. real estate or partnership interests. In this context, paragraph 4(a) requires AIFMs to set out a 'business plan'. Do you agree with the term 'business plan' or should another term be used?

Yes, the term "business plan" is frequently used in real estate and private equity funds, although formal plans are not necessarily prepared in all funds or in all investment cases, especially where the investment strategy is to buy and hold the asset for the medium to long term. In view of a proportionate impact, item 4(a) should be qualified with "... *business plan, if appropriate to the specific investment* ..."

Box 12 Reporting obligations in respect of execution of subscription and redemption orders

No comment for the moment.

Box 13 Selection and appointment of counterparties and prime brokers

Many AIFM already today base their selection and appointment process on recommendations of industry associations that have worked on extensive questionnaires and established best practices and recommendations for ongoing monitoring of counterparties and prime brokers. Such criteria should be sufficient for initial selection and ongoing monitoring.

ALFI proposes that the text in Box 13 be more detailed in relation to the requirements that counterparties and prime brokers need to comply with during the whole duration of their appointment, as follows:

“AIFMs should perform due diligence before appointing a counterparty or prime broker which is similar to that carried out by the depositary on its sub-custodians, and when appointing counterparties, the AIFM should ensure that the depositary receives from the counterparties automatically or upon demand such information as the depositary may require in order to discharge its duties and obligations of safekeeping and oversight.”

Finally, ALFI would also invite ESMA to enlarge in Box 13 point 3 the scope of eligible counterparties to include:

- clearing brokers for exchange traded derivatives
- cash correspondents
- counterparties for time deposits, and
- counterparties for securities lending transactions.

Prime Brokers

A prime broker will normally receive practically all assets of an AIF for which he is appointed.

ESMA should:

- confirm that assets placed with the prime broker will be classified as *“other assets”*, subject to the record-keeping obligations of the depositary.
- ensure that the prime broker is not considered as prime custodian of the AIF, and is not viewed as a sub-custodian to the Depositary when holding assets as collateral. The prime broker should be required to accept custodial liability on any collateral they hold that has not been subject to re-use.
- set minimum required qualifications of prime brokers appointed by the AIFM, who should be subject to similar requirements as for any third party where cash accounts are opened, i.e. entities referred to in Article 18 (1) (a) to (c) of the Directive 2006/73/EC or another entity of the same nature in the relevant market where the prime broker is located, or
- clarify that in case of the appointment of a prime broker, Box 76 does not apply to Depositaries.
- oblige the AIFM, when appointing counterparties and prime brokers with similar duties as described in Box 75/76, to provide such information or cause that such information be provided to the Depositary, as needed to discharge its duties of cash monitoring, verification of ownership and recordkeeping.

In order to ensure a level playing field, as the appointment of a depositary needs to provide transparency on possible re-use of assets, (see Box 74 clause 8), in case of re-use of the AIF's assets by a prime broker, ESMA should require equivalent disclosure of such re-use and inherent risks in the prospectus.

Level 2 should make provision for consequences of the AIFM being deemed not to have satisfied the requirements in Box 13 (sanctions) but also with regard to the particulars of the contract (section 1.1. / Box 74) in relation to actions the depositary could take within an appropriate timeframe in the event the AIFM is in non-compliance with its obligations.

Box 14 Execution of decisions to deal on behalf of the managed AIF

Non-application of some provisions to private equity / real estate, included under Explanatory text 21, should be added to box 14.

Box 15 Placing orders to deal on behalf of AIFs with other entities for execution

Non-application of some provisions to private equity / real estate, included under Explanatory text 24, should be added to box 15.

Box 16 Handling of orders – general principles

Non-application of some provisions to private equity / real estate, included under Explanatory text 25, should be added to box 16.

Box 17 Aggregation and allocation of trading order

Non-application of some provisions to private equity / real estate, included under Explanatory text 27, should be added to box 17.

Box 18 Inducements

From the feedback received from our members, it appears that some UCITS managers intend to become authorised to act as an AIFM. Consequently, the AIFMD inducement regime should be the same as the one applicable to UCITS today.

Moreover, we believe that these provisions should not apply to marketing.

Box 19 Fair treatment by an AIFM

Q17: Do you agree with Option 1 or Option 2 in Box 19? Please provide reasons for your view.

Option 2, which may be preferred for investor protection purposes, does however create legal uncertainty. ALFI believes that Option 1 should be retained, with the following change as it is a definition, not a description of a process:

“Fair treatment by an AIFM means that no investor may obtain a preferential treatment that has an overall material disadvantage to other investors.”

IV.III. Possible Implementing Measures on Conflicts of Interest

Box 20 Types of conflicts of interest between the various actors as referred to in Article 14(1)

A definition of “*client*” is not included in the directive. To avoid any misunderstanding, we suggest replacing this with “*any other contractual party*”.

- Distinct interest: The wording “*distinct interest*” suggests situations where the objectives of the AIFM and those of the investors are not fully aligned. Such situation however does not automatically imply a conflict of interest. Similarly, one could argue that “distinct” by definition means that there must be a negative effect, otherwise the interests would have been identical.

- In order to avoid discussions about distinct and opposite interest, we suggest to rephrase as follows:
“... or of a transaction carried out on behalf of the AIF or any other contractual party, which favours an outcome that is at the expense of the AIF or its investors”

Comments on the explanatory notes:

We understand that the examples presented in the explanatory notes are of illustrative nature only and are not to be considered as an exhaustive list of possible conflicts of interests. Some of the examples are disputable in certain situations (e.g. a fund extension may make sense in lots of situations and is most of the time in the best interest of the investors).

Options:

We welcome the decision of ESMA to implement Option 1 as well as to define provisions on how conflicts of interests must be identified and handled.

Box 21 Conflicts of interest policy

“...circumstances of which the AIFM is or should be aware may give rise to a conflict of interest...”. The wording which has been chosen is rather generic and will potentially be applicable to many different situations. However, we think that a procedure on conflicts of interests needs to list situations where a conflict of interest CAN arise and not only situations where a conflict of interest is obvious. In the day to day operations the AIFM will have to do an assessment whether there has been any potential conflict of interest and how it has been managed.

We therefore think that the wording is appropriate at the level of the procedure. However, we suggest deleting the words *“may arise”* in Box 23, point 1. Indeed, it may be extremely cumbersome to document all situations where a conflict of interest may have existed when as a matter of fact there was none. The documentation should be limited to explaining how real conflicts have been managed.

Box 22 Independence in conflicts management

No comment for the moment.

Box 23 Record keeping of activities giving rise to detrimental conflicts of interest and way of disclosure of conflicts of interest

- **1.** We consider that *“may arise”* is too wide. It could lead to providing a list of theoretical risks that it would not necessarily be relevant. Producing such a long list could even be counterproductive in terms of relevant information to disclose to shareholders.
- **2 (a).** This condition (disclosure of conflict of interest pursuant to Article 14(1) of the AIFM Directive) is not expressly provided for in the Level 1 provisions and it should therefore not be included in Level 2. We do not think it is necessary that investors be informed of (i) identification of conflicts of interest and (ii) procedures to be followed and measures to be adopted to manage conflicts of interest.
- **2(b).** This condition is not required by the UCITS IV Directive and AIFM Directive level 1. In addition, the AIFM Directive Level 1 (article 14(1)) requires that an AIF Manager identifies such conflicts of interest, but does not mention conflicts of interest arising between the delegate or sub-delegate and the AIF Manager. Instead, we propose that AIF Manager should contractually ensure that the sub-delegate establishes, implements and maintains a conflict of interest policy. Then, this requirement may be imposed by the manager to sub-delegate in the delegation contracts.
- **3.** The objective of the paragraph 3 is to be clarified: does it address any kind of information available to investors (in this case we would suggest to disclose such point in a separate box in the transparency section) or should it be read in conjunction with point 2 of box 23 only (conflict of interest)?

- We believe that the requirements under 3a) to 3c) are only relevant for retail investors, as professional investors have access to the internet. In addition, this option is not permitted by UCITS IV, except for KIID and prospectus (i.e. Articles 156 and 162 of the law of 17th December 2010 concerning undertakings for collective investment). Indeed, it is expected that managers convey such information via a website.
- **3 (a).** This provision seems inappropriate since the fact that an investor has a regular access to the internet is implied from paragraph 3 (b).
- Finally, we believe it would be preferable to clarify the meaning of "*specially consent*" specifying that consent can be given in writing, by recorded telephone, in a physical meeting, or through a website for example (i.e. *ALFI UCITS IV implementation project, Key Investor Information document, Q&A, Issue 08, 1st June 2011*)

Box 24 Strategies for the exercise of voting rights

We do not favour Level 2 measures on strategies for the exercise of voting rights for the following reasons:

- They are not covered in the Level 1 Directive; they should not, therefore, be covered by Level 2 measures.
- While we support the implementation of voting policies and the link between governance and the investment process, we believe that some AIFMs will find these provisions costly, and sometimes impossible, to implement in practice and furthermore, they may create an unnecessary compliance risk for AIFMs.
- Such provisions should not be covered by legislative measures but rather by industry guidelines (such as EFAMA's *Code for External Governance*¹. EFAMA says 'The code is "principles" based in that it relies upon good judgment rather than prescription. As such, the recommendations recognize that the "best" approach for many issues depends on the circumstances.
- Requiring voting rights to be exercised to the exclusive benefit of the AIF **AND its investors** requires the AIFM to know the interests of investors; AIFMs cannot know the individual interests of a large number of investors, and should not know them, in order to avoid any potential conflicts of interest between the AIF and its investors. For example, an AIFM might face a potential conflict of interest if it were aware that one of its investors had an interest in the election to the Board of a candidate who was not the best one for a position.
- Requiring action to be taken on when and how to exercise ANY voting rights may create a disproportionate burden on AIFMs. AIFMs with AIFs with a large numbers of small holdings may not be able to handle the burden on officers and administration.
- Requiring details of actions taken to be made available to the investors, without requiring them to keep such information private, may in some cases require disclosure of sensitive information which could create reputational damage for the investee company or the AIF – e.g. in cases of one-to-one engagement with an investee company by the AIFM on governance issues (e.g. in private equity funds).

If, in spite of our reservations, these provisions were to be kept, the proportionality principle should be applied. We would suggest the following wording:

Strategies for the exercise of voting rights

AIFM should develop adequate and effective strategies for determining when and how any voting rights held in the managed portfolios are to be exercised, to the exclusive benefit of the AIF.

The strategies should be proportionate to the nature, scale and complexity of the AIFM and the AIF.

¹ EFAMA Code for External Governance: Principles for Exercise of Ownership Rights in Investee Companies, April 2011

The strategy referred to in paragraph 1 should determine measures and procedures for:

- *ensuring that the exercise of voting rights is in accordance with the investment objectives and policy of the relevant AIF;*
- *preventing or managing any conflicts of interest arising from the exercise of voting rights.*

A summary description of the strategies and information on the exercise of voting rights on the basis of those strategies shall be made available to investors on request.

If the current wording of Box 24 were to be kept despite our reservations, to avoid any doubt, in 2(a) “*relevant*” and “*corporate actions*” should be defined.

IV.IV. Article 15 - Risk Management

Within the consultation paper, ESMA applies different terms for management bodies, i.e., Senior Management, AIFM governing body and supervisory function. In its current approach, ESMA often refers to the AIFM’s governing body as the venue for performing certain tasks. Within the UCITS, the role of Senior Management is more emphasized. It may be helpful to realign the roles and responsibilities of Senior Management and the Board of Directors for AIFMD with UCITS. For many tasks, Senior Management of the AIFM may be a more appropriate body than the Board of Directors of the AIF.

Box 25 Permanent Risk Management Function

ALFI generally agrees with ESMA’s approach to reflect general Risk Management governance requirements as outlined in UCITS IV within AIFMD. On the other hand, it remains important to highlight the overarching principle of proportionality for setting up a permanent risk function, which might be different for PE, RE or HF industries.

Nevertheless, some of the proposed specifications of AIFMD go well beyond current UCITS IV requirements. We strongly urge ESMA to reconsider the comments made concerning those aspects.

Box 26 Risk Management Policy

We welcome the fact that ESMA has expressly reiterated the aspect of proportionality in relation to the establishment of a risk management policy by an AIFM. However, we point out the use of the wording ‘separate risk management function’ whereas the UCITS framework uses ‘independent risk management function’. We prefer to have the same wording as UCITS as the Risk Management must be independent and a way to monitor the independence will be the independence of the function.

Box 27 Assessment, monitoring and review of the risk management policy

No comment for the moment.

Box 28 Measurement and Management of Risk

For consistency, we prefer to retain the UCITS wording regarding the identification of risks which the AIF may be exposed to. Within the UCITS framework, only those risks that directly affect the UCITS materially are to be taken into consideration. We therefore propose to delete from Box 28 the part “*including those sources of risk the AIFM incurs on behalf of the AIF*”.

On point 3.a), we propose to remove the following part “*on the basis of sound and reliable data*”.

On point 3.b), we understand “*model-based forecasts and estimates*” may include models used by research teams of AIFMs to select the securities for their strategy. We are of the opinion that the review of such models are out of scope of the Risk Management function. Instead, the Risk Management function must ensure that back-testing of models used by the front-office have been performed.

Box 30 Functional and Hierarchical Separation of the Risk Management Function

We suggest that the separation of function should extend up to “*Senior Management of the AIFM*”, rather than referring to the governing body.

Q18: ESMA has provided advice as to the safeguards that it considers AIFM may apply so as to achieve the objective of an independent risk management function. What additional safeguards should AIFM employ and will there be any specific difficulties applying the safeguards for specific types of AIFM?

We believe that additional safeguards will be unnecessary.

Q19: ESMA would like to know which types of AIFM will have most difficulty in demonstrating that they have an independent risk management function? Specifically what proportionality criteria should be included when competent authorities are making their assessment of functional and hierarchal independence in accordance with the proposed advice and in consideration of the safeguards listed?

Small AIFM who may only manage a single or small number of AIFs may nevertheless exceed the AUM thresholds and thus be subject to AIFMD. In the case of private equity or real estate, it is not uncommon for a small, tightly integrated team to manage all aspects of an AIF jointly, and such groups may struggle to separate functions entirely, given their limited scale.

ALFI believes that this question should be left to local regulators discretion as they are best suited to make an assessment of the means and resources available in individual firms, and at a later stage, based on experience harmonize minimum requirements through national rules.

IV.V. Possible Implementing Measures on Liquidity Management

The specific requirements in terms of liquidity management and policy proposed by ESMA are more detailed and prescriptive for AIFMD than for UCITS. In that respect we suggest that application of proportionality is going to be essential to ensure that a sound liquidity risk management process is applied to the heterogeneous universe of AIF.

Box 31 Liquidity Management Definitions

No comment for the moment.

Box 32 Liquidity Management Policies and Procedures

We appreciate the exception applied to unleveraged closed-ended funds.

A challenge still remains for the bigger population of leveraged closed-ended funds and open ended funds.

The last sentence of point 13 of the explanatory text (page 80) is confusing. We believe that it was maybe intended to make reference to “*paragraph 1 of Box 33*” (instead of 32).

3b) We anticipate difficulties in accurately assessing the profile of end investors given the distribution structures for some AIF.

3c) We propose adding UCITS within the exceptions in the last paragraph of this article as UCITS have their own regulatory requirements to ensure that redemptions can be paid.

3g) We propose removing the reference to “*the AIFMs incentive to invest in illiquid assets*” and to replace the paragraph instead by explanatory text 24:

“AIFMs which manage AIFs which are not closed-ended are also required to identify, manage and monitor conflicts of interest arising between investors wishing to redeem their investments and those investors wishing to maintain their investments in the portfolio and, where appropriate considering the nature, scale and complexity of the AIF, implement and maintain adequate limits on liquidity consistent with the redemption policy of the AIF.”

Box 33 Liquidity Management Limits and Stress Tests

We welcome the clarification that it may not be possible to conduct stress tests on a qualitative basis, when reliable quantitative data is not available, or not appropriate.

Box 34 Alignment of investment strategy, liquidity profile and redemption policy

No comment for the moment.

Q20: It has been suggested that special arrangements such as gates and side pockets should be considered only in exceptional circumstances where the liquidity management process has failed. Do you agree with this hypothesis or do you believe that these may form part of normal liquidity management in relation to some AIFs?

We believe that practices such as gates and side pockets are not unusual for AIFs, and should not necessarily be considered “*exceptional circumstances*”, especially where these practices are disclosed in the Fund documentation. It is not unusual for AIFs (in particular HF and PE) to issue “side pockets” for illiquid investments in the interest of investors’ protection.

Q21: AIFMs which manage AIFs which are not closed ended (whether leveraged or not) are required to consider and put into effect any necessary tools and arrangements to manage such liquidity risks. ESMA’s advice in relation to the use of tools and arrangements in both normal and exceptional circumstances combines a principles based approach with disclosure. Will this approach cause difficulties in practice which could impact the fair treatment of investors?

No issue foreseen for the moment.

Q22: Do you agree with ESMA’s proposed advice in relation to the alignment of investment strategy, liquidity profile and redemption policy?

No comment for the moment.

IV.VI. Possible Implementing Measures on Investment in Securitisation Positions

ESMA should ensure that the AIFM has an obligation to provide (and to procure that relevant third parties, such as the securitization vehicle, provide) prior to, and during the life of, the investment, such information as the depositary may require in order to discharge its Oversight Duties. This is missing and must be added where appropriate.

This is true mutatis mutandis in relation to UCITS Management Companies.

Box 35 Requirements for retained interest

No comment for the moment.

Box 36 Requirements for sponsors and originator credit institutions

No comment for the moment.

Box 37 Requirements for transparency and disclosure of retention

No comment for the moment.

Box 38 Requirements for risk and liquidity management

No comment for the moment.

Box 39 Requirements for monitoring procedures

No comment for the moment.

Box 40 Requirements for stress tests

No comment for the moment.

Box 41 Requirements for formal policies, procedures and reporting

No comment for the moment.

Box 42 Introduction of new underlying exposures to existing securitisations

Box 43 Investments by UCITS

No comment for the moment.

IV.VII. Possible Implementing Measures on Organisational Requirements

Box 44 General requirements on procedures and organization

No comment for the moment.

Box 45 Resources

No comment for the moment.

Box 46 Electronic Data Processing

No comment for the moment.

Box 47 Accounting procedures

We understand that “B.1 paragraph 4” should read “*Box 44 paragraph 4*”.

It would be appropriate to insert a reference to the proportionality principle (nature, scale and complexity of the business) under point 2.

Box 48 Control by senior management and supervisory function

No comment for the moment.

Box 49 Permanent compliance function

We note the reference in Box 48 2(d) to the possibility of an external party providing part or all of this function. We believe that it would be appropriate to include this possibility in Box 49, by amending item 2 as follows

“2. AIFM should ensure that a permanent and effective compliance function is established and maintained, on an internal or external basis, which”

Box 50 Permanent internal audit function

As per our comments for Box 49, an external provider supporting internal audit functions should be allowed, as such arrangements already exist in practice.

Box 51 Personal transactions

No comment for the moment.

Box 52 Recording of portfolio transactions

No comment for the moment.

Box 53 Recording of subscription and redemption orders

No comment for the moment.

Box 54 Recordkeeping requirements

No comment for the moment.

Q23: Should a requirement for complaints handling be included for situations where an individual portfolio manager invests in an AIF on behalf of a retail client?

There should be no distinction between treatments of retail investors' complaints whether they invest into a UCITS or an AIF.

At present, UCITS complaints handling is subject to rules established at national level.

The AIFMD only addresses marketing to professional investors. Retail investor's issues are intended to be dealt with at national level, with national regulators addressing any complaints handling requirement. The Directive did not introduce harmonising provisions for retail investors at Level 1, and thus these should not be added at Level 2.

IV.VIII. Possible Implementing Measures on Valuation

Box 55 Policies and procedures for the valuation of the assets of the AIF

Explanatory text paragraphs 10 and 24 are essential for a proper understanding of the "*valuation*" function compared to the "*net asset value calculation*" function.

Explanatory note n°10 states the following:

"In line with the UCITS approach (Article 9 UCITS Level 2) the provisions of Box 48 set out the roles and responsibilities of the senior management and the supervisory function (if any). In this respect paragraph 2(b) of Box 48 lists the responsibility of the senior management to either approve or oversee the approval of the investment strategies for each managed AIF. When the AIF is constituted under the law of contract and has no legal personality, the first alternative is applicable, i.e. the senior management of the AIFM approves the investment strategies. When the AIF is constituted under statute, has a legal personality and has appointed an AIFM, the second alternative is applicable."

Explanatory note n°24 states the following:

"In line with the UCITS approach (Article 15 UCITS Level 2) Box 53 requires AIFM to ensure that AIF subscription and, where relevant, redemption orders are recorded. The provisions are based on the relevant UCITS provisions (Article 15 UCITS Level 2) taking into account the diversity of types of AIF. Some of the terms used in the UCITS provisions are not suitable for specific types of AIF e.g. for private equity AIF there is no subscription price for each unit but rather a commitment to invest. Therefore, the term 'amount of capital committed and paid' was included."

These paragraphs should become part of Box 55.

Box 56 Models used to value assets.

We ask ESMA to clarify that the use of commonly accepted pricing tools such as “Bloomberg valuation tools” used by, e.g., administrators for the valuation of certain instruments like Interest Rate Swaps are not regarded as a model in the sense of Box 56.

Box 57 Consistent application of the valuation methodologies

Ideally, a valuation methodology should be applied consistently over time to a specific AIF (except for circumstances covered in Box 58 – periodic review of valuation methodologies) but there may be other reasons related to varied investment strategies, different types of assets, time zones and different external valuers which make requirements for consistency across all AIF managed by the same AIFM impractical or unnecessary. An example would be where an AIFM manages a closed-ended and an open-ended AIF with the same strategy, assets etc. or where the focus of one AIF is to return regular distributions to investors while the focus of another AIF is to reinvest and produce capital gains to investors.

Box 59 Review of individual values

It is too burdensome to require that the AIFM documents its assessment of the appropriateness and fairness of the individual values of all assets, especially for funds trading financial instruments with frequent (daily) net asset value calculations. The AIFM should ensure that there are procedures in place at the administrator for appropriate and fair pricing of financial instruments. The AIFM has to be able to rely on a delegate which meets the requirements of having sufficient resources, being of sufficiently good repute and being sufficiently experienced, without having to duplicate part of the work. At most, a reasonableness check with appropriate follow up in case a price movement would be considered unreasonable should be adequate.

We suggest deleting the second and third sentence of paragraph 1.

Box 60 Calculation of net asset value per unit or share

The Level 1 provision, i.e. art. 19, paragraph 11(c), only requires that the Commission adopt measures specifying the frequency of valuation carried out by open-ended AIFs. Calculating a net asset value requires valuation (even if this would only be assessing whether the last determined value is still fair and proper as per Box 62, 2) or pricing of assets. ESMA seems to specify this for all AIFs, including closed-ended.

For certain closed-ended structures where all investors contribute new capital in the same proportion as of their holdings and at a fixed price in accordance with the fund documentation, calculating a net asset value to determine the number of shares or units to be issued is not necessary and only results in extra costs and complications.

Explanatory note n° 22 is correct but it leaves unresolved who appoints the third party which performs the administration functions. In a corporate structure, this would be the board of directors. However, in the case that the board of directors appoints the administrator, it is not logical that the AIFM is responsible for the net asset value calculation (Art. 19-10).

Explanatory note n°22 states the following:

“22. The AIFM, in addition to performing portfolio management and/or risk management, may also carry out administration functions for the AIF as set out in Annex I, this includes the calculation of the net asset

value. Alternatively a third party can be appointed to perform the administration functions including the calculation of the net asset value.”

We believe that note 24 (third party administrators are not external valuers) should be added to box 60 for clarification of an important issue.

Box 61 Professional guarantees

No comment for the moment.

Box 62 Frequency of valuation carried out by open-ended funds

No comment for the moment.

IV.IX. Possible Implementing Measures on Delegation

Box 63 Delegation

We note that the Level 2 delegation requirements are more detailed and stringent than for UCITS. We question whether this is appropriate and/or necessary.

We agree that the requirements of Article 20 shall apply only for critical or important functions that are delegated. However, Box 63 doesn't only refer to the term "functions" but as well includes the concept of "tasks".

We believe that supportive tasks that assist the AIFM in fulfilling some of its functions should not be considered as a delegation of critical or important functions for the purpose of Article 20.

For example, an AIFM may receive information from a third party to be used for risk analysis purposes by the AIFM (e.g., VaR calculation for an AIF). It is essential that an AIFM could continue to receive support and assistance for some tasks from specialized partners, which do not necessarily have to be authorized for the purpose of asset management, to avoid building non scalable specialized teams that would drastically impact the cost structure and the proper organization of the AIFM.

Box 64 General principles

It is important to clarify that this Box only applies to the situation where the AIFM itself delegates one of its functions to third parties.

If the AIFM is only contracted to perform portfolio and risk management, the governing body of the AIF may delegate to third parties and would thus be the party to have the legal instruction and termination rights.

Box 64, (f): We agree that the AIFM shall make provisions to ensure continuity and quality of delegated tasks in cases of a termination of delegation.

Our understanding is that the AIFM will have to ensure, only in case of a planned termination of delegation, that the transfer of the delegated tasks to another third party or the insourcing of the function within the AIFM is properly managed to ensure continuity and quality of the delegated task. It is worthwhile to clarify that the AIFM does not need to put in place a set of procedures to ensure continuity and quality in case of termination of a delegation if the AIFM is not planning to terminate such any delegate.

Box 65 Objective reasons

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

ALFI believes that Options 1 and 2 can best be combined, as the interpretation of “*more efficient conduct*” may differ. Examples of objective reasons as provided in Option 2 provide guidance as to how to interpret “*more efficient conduct*”.

Box 66 Sufficient resources and experience and sufficiently good repute of the delegate

We feel that it is too onerous for an AIFM to comply with paragraph 4 of Box 66 as it would not be possible for them to know with absolute certainty that there are no negative records. We would suggest reversing the standard of proof so that the persons conducting the business are “not of sufficiently good repute” if the AIFM has actual knowledge of relevant criminal offences, judicial proceedings or administrative sanctions, having undertaken reasonable checks. In addition, we believe that the wording of explanatory text 29 should be included in the main Box wording for all jurisdictions (including non-EU) where repute is assessed by supervisory authorities. Please see the suggested wording below:

“4. The persons who effectively conduct the business of the delegate should be considered to be of sufficiently good repute if either:

- a. the delegate is authorised for the purpose of the delegated tasks and the criterion “good repute” of the delegate has been reviewed by the relevant supervisory authority within the authorisation procedure; this criterion should be assumed as satisfied unless evident facts speak against it.*
- b. the AIFM, acting in good faith and having carried out reasonable checks, has no knowledge of the relevant person having any Negative Records relevant both for the assessment of good repute and of the proper performance of the delegated tasks. “Negative Records” means records of significant criminal offences, judicial proceedings or administrative sanctions in the jurisdiction where the delegated tasks are to be performed and that the AIFM reasonably believes to be relevant to the delegated tasks.”*

Box 67 Institutions considered to be authorised

Article 20(1) (d) of the AIFM Directive specifically allows authorised portfolio management companies to undertake delegated acts so long as cooperation between regulators is assured. It is not appropriate to limit the definition of “authorised or registered for the purpose of asset management and subject to supervision” to those that are authorised under the AIFM Directive. Level 1 does not limit the requirement of authorisation to EU, therefore, entities registered and supervised as required by Art 21 (1)(c) of AIFM Directive should include those entities authorised under the laws of third countries that have signed cooperation agreements with the relevant Member States.

Please amend the third bullet point in Box 67(1) to ensure that this is consistent with Level 1 as per the above.

Box 71 Criteria to be taken into account when considering whether a delegation/ sub-delegation would result in a material conflict of interest with the AIFM or the investors of the AIF; and for ensuring that portfolio or risk management tasks haven been functionally and hierarchically separated from any other potentially conflicting tasks within the delegate/ sub-delegate; and that potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF

Point 2: It is essential that proportionality aspects are taken into consideration as suggested in the text below point 2(d).

V.I. Appointment of a depositary

We believe that a primary assumption should be established that no look-through should normally be required where the AIF is holding ordinary securities of a listed company, securities of an unlisted operating company or shares or units of other AIFs (i.e. a fund of funds), as described in the investment policy of the AIF.

However, in order to fulfil its supervisory duties over an AIF's assets (meaning the assets which are described as target investments in the AIF's investment policy), the depositary may be required to look through an intermediate entity controlled (directly or indirectly) by the AIF which is interposed between the AIF and the target investments, where such entities are ancillary to the investment policy.

This means that cash accounts opened by such intermediary entities may fall within scope of the depositary supervisory duties as if they were cash accounts opened by the AIF directly, and that the ownership of the intermediate entities may form part of the verification and recordkeeping activities. This is particularly relevant for AIFs investing in real estate which make substantial use of intermediary entities (for local legal reasons, non-recourse financing or many other legitimate purposes).

As the question of intermediary entities may have a significant impact on the operating cost of the AIF depending on the investment policy, ALFI believes that the exact scope of the depositary duties in terms of intermediate entities should be assessed on a case-by-case basis by the competent authorities using a risk-based approach.

ALFI recommends that these assumptions be confirmed by Level 2 measures, to enhance the level playing field sought by Level 1 measures in relation to depositary duties.

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.

Due to the nature and complexity of different AIFs, we support the intention to define overall principles and not to proceed to the prescription of a model agreement.

In addition to the required description of asset classes, ESMA should require a description of geographic markets, as this will affect any possible discharge or transfer of liability.

In Box 74, for the sake of transparency, ALFI recommends to amend point 2 to read *"A description of the types of assets and geographic markets that will fall within the scope of the depositary's safekeeping duties and oversight function ..."*

With respect to the point 14 of Box 74, we believe that those details could be set out in the agreement or in a service level agreement or similar document.

ALFI notes the explanation in Explanatory text #10 of Chapter V.I., that clarifies that early termination of an appointment may be the only ultimate remedy for the depositary if the AIFM does not respect the advice on custody risk received from the depositary or does otherwise not comply with its duties (e.g. missing collaboration, lack of information, etc.) under the agreement or the AIFMD (as implemented in local law).

Early termination of a contract may raise more than one issue both at the AIFM level and of course at the depositary level. It cannot be good policy that the depositary - once a reasonable termination period has expired – is forced to continue in its functions with the same duties and liabilities. Therefore ALFI recommends adding a maximum period of time of 2 months after which the AIFM must have appointed a new depositary after the expiration of the termination notice. ESMA should also define the duties and responsibilities of the exiting depositary during such period. ESMA should also define procedures in case no replacement depositary has been appointed at the end of such period, and specify consequences for the AIFM.

However, another option exists: the depositary could notify the AIFM and the competent authorities of the breach, and put the AIFM on notice that non-repair will change the custody obligations from art.21.8 (a) (Custody) to art.21.8 (b) (Recordkeeping), with a corresponding change in liability standard. This would provide an interim solution, which provides more time for an orderly change of depositary.

ALFI recommends the use of similar wording for Items 6 and 7 in Box 74, to provide for reciprocity and to align the duties as much as possible.

Finally, ALFI considers that it is not under normal circumstances the role of the depositary to oversee the AIFM's conduct of business, but rather that of the competent authorities. Accordingly, the second last paragraph of Box 74 should be amended as follows:

... the procedures by which the depositary, in respect of its duties has the ability to enquire into the administration of the AIF ...”

V.II. Duties of the depositary

V.III. Depositary functions

1 Depositary functions pursuant to §7 – Cash monitoring

Box 75 Cash Monitoring – general information requirements

Box 76 Proper monitoring of all AIF's cash flows

Box 77 Ensuring the AIF's cash is properly booked

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

The Level 1 directive expressly retains the possibility that cash accounts be opened with entities different from the depositary and hence Level 2 measures should not require that cash accounts be opened at the depositary (for general operations, subscription/redemption, or other purposes). While a requirement that subscriptions and redemptions settle on a depositary account is likely to ease the depositary's monitoring of settlement processes, such requirements may prove challenging to deploy in reality because of separate transfer agent processes and different distribution channels.

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?

We are unable to provide a meaningful frequency figure.

It is difficult to justify a supervisory process that would not involve a minimum monthly reconciliation of cash flows.

Daily reconciliation of cash flows for subscriptions and redemptions by transfer agents has become a standard for daily traded funds. However, this is not done by depositaries today.

The frequency for reconciliation of operating accounts, and subscription/redemption accounts in infrequently traded funds, is in general done monthly or quarterly on an ex-post basis, by administrators or transfer agents.

ALFI would therefore strongly recommend separating requirements for reconciliation of shareholder register activities, of other operating accounts, and of assets and account balances falling either under the depositary's recordkeeping duties or oversight duties.

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

We have not identified any practical problem.

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

Providing Option 2 of Box 76 (oversight of other parties' records and procedures) is retained, we see no particular difficulty to implement the advice regarding cash accounts opened at prime brokers. The depositary should, however, make a distinction between cash held by the primer broker (i) as margin (or otherwise as collateral) or (ii) as ordinary deposits.

As a matter of principle, only cash held as ordinary deposits with the prime broker should fall within scope of the depositary's recordkeeping duties.

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

Imposing Option 1 (Central Hub/Mirroring) on all AIFs will in most instances go well beyond AIFMD Article 21.7 requirements, with a relatively low added value (see answer to Q30, below).

In the absence of a Level 1 provision allowing delegation of the duties set forth in AIFMD Article 21.7, a depositary would be forced to mirror all transactions internally with no possibility to delegate to third party service providers.

ALFI proposes Option 2 (Due Diligence) should be retained as the minimum standard, allowing depositories to opt for Option 1 in specific cases.

Explanatory text 9 (page 150) alludes to weekly checks for daily reconciled AIFs, even though the wording immediately before leaves the depository to produce its own procedures. For the sake of clarity, ALFI would like the example to be withdrawn as some market participants could then expect the Depository to carry out weekly monitoring of cash flows but also for all other oversight duties. Depositories should be free to opt for a periodicity for each duty it needs to undertake, bearing in mind that monthly monitoring for daily funds seems to be appropriate with regard to the depository's second level of control.

Q30/Q31: What would be the estimated costs related to the implementation of option 1 or option 2 of Box 76? / What would be the estimated costs related to the implementation of cash mirroring as required under option 1 of Box 76?

Full and exhaustive mirroring of all externally managed cash transactions would potentially entail substantial investment costs as well as cost for running the process on a daily basis as cash transactions occur independently of NAV calculations or fund dealing windows.

Costs incurred would include the building and maintenance of control teams capable of receiving and interpreting available cash reports provided by third parties under option 2.

While the estimates as to cost depend on a variety of factors, including the type of AIF, its investment strategy, the number of accounts as well as the number and quality of the counterparties, they will likely include costs of:

- designing and developing (or adapting/acquiring) a “position-keeping system” capable of capturing, storing, reconciling and adequately reporting on multiple accounts;
- designing and developing file formats and communication protocols for electronic capture of movements with each counterparty. Sensible accommodation would be required for those third-party entities not equipped with automated communications capabilities. For example, certain communications mechanisms - such as SWIFT – are utilised by many but not by all entities globally: it is likely to be difficult to force such entities to adapt their core message handling systems;
- chasing or inputting certain files manually, failing or pending agreement on electronic exchanges in the required formats;
- daily verification and chasing of data files and “quality control” of these files;
- “quality control” of data loading into the “position-keeping system”;
- enquiring and correcting technical errors detected at the data-loading stage (chasing, files, re-sending, missing data, etc.); and
- producing output files and reports and building a functional team analysing these reports, etc.

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

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)

(Recommended Revisions Marked)

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

3. 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~~ **have been** 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~~ **bearer instruments have been** physically delivered to the depositary. Further, financial instruments which comply with the definition set out above will remain in custody when the depositary **takes a security interest in them** or 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.

ALFI favours legal certainty in order to more clearly delineate rights and responsibilities as between depositaries and AIFs (including the investors). The only sensible regime is a clear *a contrario* approach by which assets falls within the scope of Art. 21.8(a) or Art. 21.8(b). For this reason, A prefers Option 2 as it suggests a definitional framework that is clear, reflects current reality and is relatively easily employed over time as market infrastructure evolves.

In the context of financial instruments, this *contrario* approach is an appropriate mechanism for allocating the depositary's responsibilities – and liability – for the following reasons:

For purposes of identifying where the depositary's obligations arise under Article 21(8)(a), ALFI continues to believe it is important to distinguish:

(a) financial instruments which are held in "nominee name" with a settlement system (CSDs, ICSDs) by a depositary/custodian or a nominee company

Versus

(b) financial instruments such as units of a fund not traded on a regulated market or private equity shares that are merely registered in nominee name directly with an issuer (which are usually inscribed in a register by a registrar or transfer agent appointed by the issuer or its agent).

Where the depositary/custodian is the participant in the settlement system:

- Rights and obligations of ultimate owners of securities are addressed via the "participation" agreement or "rules" of the CSD, which often have the force of law (e.g., DTC Rules under New York law).
- Securities are registered in a regulated settlement system (CSDs and ICSDs) that provide for the conditions necessary for the shares to be considered "held in custody" under the directive. These conditions include providing for certainty of transfer of ownership arising from "delivery versus payment/receipt versus payment" ("DVP/RVP") on settlement of the relevant transaction, which the depositary/custodian effectively controls via its participant account at the CSD/ICSD (either directly or indirectly via the sub-custodian). This in turn provides assurance as to when customers (such as AIFs) become entitled to ownership of the relevant securities. The forthcoming Securities Law Directive is clearly relevant to providing a more uniform approach within the EU.
- The custody agreement with the depositary/custodian sets out the conditions (and rights) surrounding these shares: the AIF's rights to the relevant financial instruments are made subject to the rules of the CSD, for example.

Where the financial instruments are merely "registered in the nominee name" of the depositary/custodian or its subsidiary nominee company:

- In the case of funds or securities (such as private equity shares or interests in limited partnerships) not traded on a regulated market, there is no participation agreement (like there is with a CSD) linking the depositary/custodian to the registrar or transfer agent. Instructions to invest in such financial instruments involve an instruction to deliver cash "free of delivery" (unlike a CSD setting, where investments are legally effected by settling on a "DVP/RVP" basis).
- The choice of investment, including relevant due diligence, is carried out by the AIFM.
- The client of the depositary/custodian (the AIF or AIFM on behalf of the AIF) typically discusses all aspects of possible investment with the issuer (who is the fund or private equity investment into which the AIF or the AIFM on behalf of the AIF is considering investing) and then – if it prefers not to make the investment itself directly - might instruct the depositary/custodian to make the investment on its behalf by filling out the necessary subscription documents: the subscription documents would indicate that the depositary/custodian or its subsidiary nominee company is the registered owner, usually "for the benefit of ("FBO") underlying client". The client may or may not be named. The depositary/custodian's records would not normally indicate such investments as being "held in custody" per se."
- As a result of the above, such financial instruments – those not involving a recognised settlement system – should not be considered "held in custody" subject to restitution liability under Art. 21.8(a): it is untenable to expect depositaries incur this kind of liability where they lack the kind of infrastructure and recognised rules afforded by recognised settlement systems (i.e., certainty of settlement and effective transfer of legal title extending to participants).

Both private equity shares and interests in funds may be invested in without use of a depositary/custodian's or its subsidiary's nominee name. It is common for such investments to be held "directly" (i.e., in the name of the AIF) as well. In some cases, this is necessitated by the legal structure of the target investment or other factors. If "Option 1" is selected, it seems likely that all such holdings will migrate to a "direct" approach if depositaries are to avoid taking unwarranted risk that they cannot control.

- In respect of the following:

"... financial instruments which can be physically delivered to the depositary should be held in custody" (emph. added)"

the text should be revised slightly (as recommended as marked in Box 78) so that it does not **require** interests in funds to be "certificated" or physically issued simply because this is possible. Not all shares and other financial instruments should be required to be "physical" simply because this is allowed under the AIF's rules. There are many potential reasons why this would not be desirable, including costs associated with printing and maintaining certificates, increased risk of error and continuation of the EU's prudential policy goal of reducing fraud risk associated with bearer certificates.

- In respect of the following proposal that financial instruments should still be treated as being held in custody where the depositary re-uses them,

"... 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",

this should be revised. If re-hypothecation could result in title transfer, the suggested approach would be inconsistent with the proposed rule in Box 79 (allowing title transfer collateral to be treated as being "no longer held in custody" by the depositary).

- Finally, the last bullet point of Explanatory Note no. 29 refers to "cash deposits with a third party" as "financial instruments" which would fall under the "other assets" category. This bullet point should be deleted because cash is not considered a "financial instrument" within the meaning of MiFID. There is no need to include cash within the definition of "other assets" since the depositary's cash monitoring and other obligations separately arise pursuant to Art. 21.7

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

Under Option 1 (registered in the name of the Depositary), ESMA should consider:

- the role of CSDs in an intermediated holding chain
- financial instruments which are held in "nominee name" with a settlement system (CSDs, ICSDs) by a custodian or its subsidiary nominee company;
- financial instruments such as units of a fund not traded on a regulated market or private equity shares that are merely registered in nominee name directly with an issuer (usually on a register maintained by a registrar or transfer agent), where the transfer agent is not appointed by the Depositary.

ESMA must also accommodate the model of the "direct holding markets" where the account is only indirectly held at a financial intermediary and the depositary/custodian is registered with the CSD. Other direct holding markets go even beyond this practice and open the securities account and register the positions directly in the name of the investor/final beneficiary.

ALFI supports Option 2 (financial instruments held in a settlement system), provided that the financial instruments are held in custody by the depositary within its sub-custody network. If financial instruments are held by counterparty other than the depositary, e.g. a prime broker, as instructed by the AIFM, they should not be included in this section, but should be regarded as "other assets".

On that specific point, we would appreciate if ESMA could confirm our view.

It should be kept in mind that both private equity shares and interests in underlying funds may be invested in without use of a custodian's or subsidiary's nominee name. It is common for such investments to be held "directly" (i.e., in the name of the AIF) as well. In some cases, this is necessitated by the legal structure of the target investment or other factors. If "Option 1" is selected, it seems likely that all such holdings will migrate to a "direct" approach if depositaries are to avoid taking unwarranted risk that they cannot control.

While some financial instruments "may" be issued in physical form, in most cases they are not, and issuance of bearer instruments is currently being discouraged in most markets. Financial instruments in physical form should only be eligible for safekeeping by the Depositary if they can be opposed (in case of physical/material loss) under the laws of the country of issuance and replaced by new instruments/securities in bearer or registered form.

ALFI recommends an addition to Box 78 paragraph 2 as follows:

"Additionally, financial instruments, which have been physically delivered to the depositary should be held in custody, provided that under the laws of the country of issuance, a stop can be placed on these financial instruments (in case of physical/material loss) and that they can be replaced by new instruments/securities in bearer or registered form"

Similarly, Explanatory text 29 should be amended as follows:

"all financial instruments, including units and shares of collective investment schemes, issued in a nominative form or registered directly with the issuer or through a registrar acting on behalf of the issuer, in the name of the AIF, provided that they have not been physically delivered to the depositary"

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?

Transferable securities, money market instruments or units of collective investment undertakings – as listed in Annex I, section C of Directive 2004/39/EC, regardless of their legal form, which can be held in safekeeping or securities accounts such as stocks and bonds, be they domestic or foreign in any freely convertible currency, and for which the depositary can arrange the settlement of any purchases and sales and deliver the assets.

Generally, depositaries accept only those assets for safekeeping if they can collect information on and income from such assets (dividends in the case of stocks/equities and coupons (interest payments) in the case of bonds) and administer related tax withholding documents and foreign tax reclamation, administer voluntary and involuntary corporate actions, provide information on the securities and their issuers such as annual general meetings and related proxies.

Units and shares of collective investment schemes, issued in a nominative form or registered directly with the issuer or through a registrar acting on behalf of the issuer, private equity securities, privately negotiated loans and real estate investments should not be considered as being held in custody.

Box 79 Treatment of collateral – Article 21 (8) (a)

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

The general terms and conditions of financial institutions normally foresee “general pledges” on clients’ assets to cover any liabilities or debt. This general pledge should not be considered as collateral granted by the AIF to the depositary or as a general authorization for the re-use of assets.

Unless the contractual arrangements entered into by the parties set forth the type of arrangement (title transfer vs. security transfer), in practice the alternatives in different legal systems in perfecting the claim in respect of the book-entry of the financial collateral, which may involve the depositary or third parties as collateral agents (which may act as financial collateral managers) creates confusion as regards the dispossession of the collateral. Under option 1, the duties and obligations of the depositary would therefore remain unclear.

Option 2 avoids some confusion as it is clearly stated that notwithstanding the type of financial collateral agreed, to the extent that it is transferred out of the depositary’s books falls out of the scope of the custody obligations. However, the depositary would still have to examine each individual collateral arrangement to determine if it meets the criteria for Option 2.

For this reason, we prefer Option 3, as this allows the Depositary to establish a consistent procedure across all types of collateral arrangements.

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

To avoid any confusion with the term ‘registration’, which has specific meaning in various custody settings, ALFI recommends to reword Box 80 point 1 (a) to read

“ensure the financial instruments are properly recorded in segregated accounts...”

ALFI believes that under Box 80 point 1 (c), the depositary cannot sensibly “... *assess and monitor all relevant custody risks...*”, and especially not those custody risks “...*related to settlement systems and inform the AIFM of any material risk identified.*”

ALFI recommends amending point 1 (c) so as to clarify that the depositary “... *will inform the AIFM of market practices and any material changes for custody and settlement in the various countries in which it is required to safe keep the assets of the AIF.*”

Box 81 Safekeeping duties related to ‘other assets’ – Ownership verification and record keeping

We believe that several issues arise from Box 81.

We consider that Option 1 (Procedures/Third-party evidence) is preferable, primarily since it respects more closely current market practice.

However, Item 3(a) in Box 81 (*the depositary registers assets in its name*), while providing obvious control benefits, will be unworkable if Option 1 of box 78 is retained (*assets registered in the name of the depositary are automatically held in custody*).

ALFI believes that Item 3 should not distinguish between 3(a) (registered in the depositary's name) and 3(b) (held directly by the AIF). Both options have a valid place in alternative funds in different situations.

ALFI considers that imposing Option 2 (mirror all transactions) will inevitably lead to duplication of work and delay, without bringing commensurate benefits to investors.

ALFI believes that it is beneficial to require documentary evidence upon every acquisition or sale of a significant asset, and upon every significant corporate action. This requirement should however be proportionate and should be required only for assets that have a significant impact on the investment portfolio. Ancillary assets, such as fixtures and fittings in a property, would not be material in this regard.

ALFI proposes that Box 81 Item 3 be amended as follows:

“3. Maintain a record of those assets of material importance for which within a reasonable timeframe it is satisfied the AIF or the AIFM acting on behalf of the AIF holds the ownership of those assets. The depositary should be required to ensure that it is able to provide within a reasonable timeframe a comprehensive and up to date inventory of the AIF’s material assets.

To that end, the depositary should:

- (i) ensure there are procedures in place so that assets of material importance cannot be assigned, transferred, exchanged or delivered without the depositary or its delegate having been informed of such transactions; and*
- (ii) have access to documentary evidence of each transaction of material importance from the relevant third party on a timely basis”*

It is not common industry practice to renew legal, real estate title or corporate certification on an annual basis, as such documentation is not easily or quickly attainable in many countries, and may require legal counsel to carry out further investigations. ALFI believes that a depositary should be allowed to adopt a risk-based approach to such documentation, to focus primarily on significant transactions and to agree a rolling multi-year assessment programme of documentation and proceeds with refreshes where appropriate.

ALFI proposes that Box 81 last paragraph be amended as follows:

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 on an ongoing basis as often is deemed necessary by the depositary to reduce the risk of unauthorised changes in ownership.

Assurance about the existence and effectiveness of procedures and controls is frequently provided by third-party assurance reports, such as SAS 70. ALFI proposes to add to Box 81:

“Where relevant third-party legal, technical or assurance reports exist, the AIF or the AIFM should ensure that the depositary receives a copy on a timely basis.

This provision should also be added to the section on depositary oversight.

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

We consider that the Depositary can only assume responsibilities when it is in a position to receive relevant information, including from third parties.

In Luxembourg, which currently requires depositaries for real estate funds, current market practice is for depositaries to generally execute their duties without reliance on external third parties. However, given the extension of the depositary duty envisaged under AIFMD, ALFI believes that a variety of third parties may now be explicitly used or referred to including:

- Notaries,
- Lawyers,

- Property managers,
- Domiciliation agents,
- External accountants,
- Affiliates of the AIFM,
- Title insurers,
- Auditors and
- Lending banks

In current practice, such entities will be engaged by the AIFM as a service provider (not a delegate) and will not be a delegate of the depositary, despite holding the original documents related to title and detailed records of assets, and being responsible for providing any updates to ownership status. In the future, depositaries will need to continue to rely on their services and information indirectly via their relationship with the AIFM, to provide local support for the safekeeping process.

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?

We think it may be useful to describe the various situations to which a fund may be confronted without inviting ESMA to limit any one of these options, as each has its rightful place in the spectrum of AIF operations. These include:

- assets may be registered directly with a registrar in the name of the AIF directly. This is common practice in real estate funds and private equity funds. The depositary must rely on its contract with the AIF to receive the necessary information about statements, corporate actions and transactions. In some cases, the registrar may refuse to recognise the standing of the depositary in requesting information directly on the status of the assets, requiring the depositary to make any such requests via the AIFM. The depositary is not generally in the instruction chain and may learn about transactions and cash proceeds significantly after a transaction has taken place. It also addresses other concerns related to ultimate liability for environmental or civil responsibility that usually attaches to registered property title, which a depositary will not normally accept, contractual warranties which promise specific performance by the contracting party or where local legal or tax regulations require local entities to be the registered owner of property.
- assets may be registered in the name of the depositary, on behalf of a specific AIF. This is common in fund of real estate or private equity funds investments. This allows the depositary to control the execution of the investment and to specify the mailing address and bank accounts that must be used in relation to the assets. At the same time, the underlying registrar is notified that the depositary is acting as an agent of the AIF, which assists in segregating assets from the depositary's proprietary assets and between the depositary's clients.
- assets may be registered in the name of the depositary in an 'omnibus' registration with the registrar. This is more common in fund of securities funds, where larger volumes of transactions are made on behalf of a number of clients into liquid fund platforms, and provides control and segregation from proprietary assets, while offering greater efficiency and automation, which can lower transaction costs for all investors.

In some jurisdictions, if a depositary wants to receive information on financial instruments or take appropriate measures upon them, it can be extremely difficult if the account is not opened in the name of the depositary itself (even if on behalf of the AIF). Depositaries understand that this situation may present legal/fiscal risks but it has until now proven to be the most reliable option and is in the interest of AIF investors. However, if registration in the depositary's name will mean that certain investments, including those into other AIFs, are brought into the custody liability when they would not otherwise be in custody, we anticipate that depositaries will refuse to offer this service.

It is agreed that registration of the assets in the name of the depositary on behalf of the AIF should not preclude the AIF from receiving relevant information or to exercise its rights in relation to such assets, indirectly via the depositary if necessary.

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

We do not have a specific comment on the FSA rules, but do hold the view that the prime broker should be required to provide relevant statements of transactions at an appropriate frequency or, binding statements of holdings to enable the Depositary to perform its oversight and record keeping function so as to have a full overview on the assets and the cash movements of the AIF.

Daily reports should be available on line for depositaries to access as required.

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?

Consistent with previous discussions, ALFI prefers Option 1 as it assesses the options in the following way:

For Option 1: While prior notification of the existence of cash accounts on appointment and the opening of new cash accounts is already best practice for Luxembourg domiciled funds, the ability to enforce such practices are practically in the control of the AIFM. The depositary has limited ability to detect such accounts, and must rely on the AIFM to declare any new accounts, explain their purpose and arrange access for the depositary for monitoring.

ALFI does not identify significant additional costs in Luxembourg for setting up procedures to receive information about the existence of cash accounts, as this is currently required.

However, if depositaries are required to perform some form of counterparty identification, creditworthiness check or KYC process, this will create additional effort and risk, with additional costs.

The significant cost driver will be the level of monitoring that is required, and ALFI refers you to our answer above on reconciliation. It is impossible to quantify the cost of the different approaches given the very diverse nature of funds.

Monitoring of month-end balances rather than daily cash flows appears to be the best available tool from a cost/benefit perspective.

For Option 2: ALFI regards the mirroring option to entail a significant duplication of administrative and/or third party controls and recordkeeping. In order to create and reconcile the mirrored transactions, the depositary will need to perform controls to ensure the reliability of these records. This will likely lead to adding administration costs to the depositary cost, which is basically a doubling of effort and thus of cost. This option will also entail significant automation, which will incur considerable systems costs.

The estimation of these costs depends on a variety of factors, including the type of AIF, its investment strategy, the number of accounts as well as the number and quality of the counterparties, however, they will likely include costs of:

- designing and developing (or adapting/acquiring) a “position-keeping system” capable of capturing, storing, reconciling and adequately reporting on multiple accounts;
- cost of designing and developing file formats and communication protocols for electronic capture of movements with each counterparty. Sensible accommodation would be required for those third-party entities not equipped with automated communications capabilities. For example, certain communications mechanisms - such as SWIFT – are utilised by many but not by all entities globally: it is likely to be difficult to force such entities to adapt their core message handling systems;

- chasing or inputting certain files manually, failing or pending agreement on electronic exchanges in the required formats;
- daily verification and chasing of data files and “quality control” of these files;
- “quality control” of data loading into the “position-keeping system”;
- enquiring and correcting technical errors detected at the data-loading stage (chasing, files, re-sending, missing data, etc.); and
- producing output files and reports and building a functional team analysing these reports, etc.

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

We believe that a primary assumption should be established that no look-through should normally be required where the AIF is holding ordinary securities of a listed company, securities of an unlisted operating company or shares or units of other AIFs (i.e. a fund of funds), as described in the investment policy of the AIF.

However, in order to fulfil its supervisory duties over an AIF’s assets (meaning the assets which are described as target investments in the AIF’s investment policy), the depositary may be required to look through an intermediate entity controlled (directly or indirectly) by the AIF which is interposed between the AIF and the target investments, where such entities are ancillary to the investment policy .

This means that cash accounts opened by such intermediary entities may fall within scope of the depositary supervisory duties as if they were cash accounts opened by the AIF directly, and that the ownership of the intermediate entities may form part of the verification and recordkeeping activities. This is particularly relevant for AIFs investing in real estate which make substantial use of intermediary entities (for local legal reasons, non-recourse financing or many other legitimate purposes).

As the question of intermediary entities may have a significant impact on the operating cost of the AIF depending on the investment policy, ALFI believes that the exact scope of the depositary duties in terms of intermediate entities should be assessed on a case-by-case basis by the competent authorities using a risk-based approach.

ALFI recommends that these assumptions be confirmed by Level 2 measures, to enhance the level playing field sought by Level 1 measures in relation to depositary duties.

Real Estate and Private Equity funds are not the only multi-layered structures in use. Other examples exist in the fund of funds area and in master-feeder structures.

In line with the procedures as set out in Box 81, the duty of the depositary is limited to verifying ownership of “*other assets*”. Accordingly the primary and most reliable basis is by receiving documentary evidence from the AIFM of the ownership of the assets (either direct ownership or through intermediate entities) in a language accessible to all participants.

In an escalation approach, depositaries should be allowed:

- to refer to copies of documents submitted by the AIFM, then
- to inspect original documents themselves, and then
- if needed, to rely on the external expertise of lawyers, notaries and other professionals.
- where available, depositaries may also refer to contracts to purchase and/or land registry extracts. In certain jurisdictions (e.g. UK), such reports take the form of a standardised “certificate of title” from a law firm. Such certificates focus on summarising material issues relating to title, and in particular identifying any risk elements.
- finally, depositaries may wish to check on a regular basis that AIFM have adequate procedures at their level to verify ownership process.

ALFI believes that not all activity or assets at portfolio level should fall under this duty (e.g. leases, developments, capital expenditure, fixtures and assets ancillary to real estate. etc.), and that competent

authorities should be given discretion to consider alternatives when the nature of the assets demands this.

In conclusion, ALFI believes it is desirable, for consistency between varying national legal regimes, to rely on contractual controls as established between the fund manager, the fund and the depositary.

3 Depositary functions pursuant to §9 – Oversight duties

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 Duties related to subscriptions / redemptions (a)

With respect to point 2 of Box 83, the depositary should not be required to confirm the eligibility of an investor, as this would duplicate the efforts of the investor and the AIFM.

Box 84 Duties related to the valuation of shares / units (b)

In Box 84, the text imposes more duties on the depositary than laid down in Level 1. The Level 1 Article 21.9(b) requires that the depositary *"...ensure that the value of the units or shares of the AIF are calculated in accordance with the applicable national law, the AIF rules or instruments of incorporation and the procedures laid down in Article 19..."*.

This does not require the depositary to directly oversee the valuation of assets. Accordingly, ALFI believes that item #1 of Box 84 should be deleted.

For the avoidance of confusion, ALFI also proposes to amend:

- item #2 as follows: *"The depositary should ensure that the policies and procedures for the calculation of the value of the units or shares of the AIF are effectively implemented and periodically reviewed."*
- Item #3 should also be amended to replace *"valuation policy"* with *"policy for the calculation of the value of the units or shares of the AIF"*.

The decision over internal or external valuation is the responsibility of the AIFM, and the AIFM must ensure compliance with the requirements of Article 19 in this regard. As the depositary is not required to oversee the valuations of assets or the decision to appoint an external valuer, ALFI also believes that item #5 should be deleted.

In explanatory text #58, ALFI believes that the depositary should be expected “... to take reasonable steps to ensure that the procedures for the calculation of the value of the units or shares of the AIF are appropriate ...”.

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

Box 85 Duties related to the carrying out of the AIFM’s instructions (c)

In box 85, point 1 goes beyond Level 1. Depositaries can reasonably be expected to consider the law in the jurisdiction of the AIF, but cannot be held responsible for compliance with all “*applicable law*” that may affect the global activities of an AIF. Accordingly, Box 85 point 1 should have “*applicable national law*” as the test, as included in Level 1.

Furthermore, ESMA has extended the source of compliance monitoring to include restrictions in “*offering documents*”, while Level 1 refers to “*the AIFs rules and instruments of incorporation*”. We consider this extension is unwarranted and should be returned to the Level 1 text.

Box 86 Duties related to the timely settlement of transactions (d)

Option 1 is preferred.

Box 87 Duties related to the AIF’s income distribution (e)

A depositary’s oversight duties related to the AIF’s income distribution can only be interpreted as an obligation to oversee the allocation of a distribution to investors according to the rules of the AIF, once a decision has been made by the AIFM to distribute.

Distributions take many forms and are usually declared after the AIFM has decided on their working capital requirements and other strategic issues. Reasons for distributions may include, for example, income, capital gains, and a return of capital or repayment of a shareholder loan.

Under Box 87 (1) calculation of the net income for fund operations would require the depositary to enquire into the portfolio management decisions regarding available cash, and possibly to duplicate the entire accounting process for all fund debits and credits to ensure their correct calculation under AIF rules, instruments of incorporation and applicable national law. This would not be possible in most cases, may interfere unreasonably with management discretion or in any event would only be possible by incurring significant duplication and thus higher costs.

ALFI proposes to amend item #1 in box 87 as follows:

*“Ensure that net income, **once declared by the AIFM**, is applied ...”*

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?

ALFI supports the proposal to introduce principle-based implementing measures with regard to oversight duties, which will result in an adequate harmonization of duties across the European Member States. ALFI welcomes the right level of depositary duties which remain proportional in relation to the duties of other parties involved in AIFs. The proposed advice will be beneficial through enhancing orderly cooperation between the depositary and the AIFM and clearly establishing all the relevant information and communications flows.

ALFI does not believe that the advice on oversight duties will materially impact the depositary's relationships with AIFMs, AIF and third party providers.

According to the general requirements as described in Box 82, ALFI understands that the oversight function as performed by the depositary should take into consideration the risks associated with the nature, scale and complexity of the AIF's strategy and the AIFM's organisation and essentially consist in assessing the control procedures and environment at the AIFM, the AIF or appointed third party. ALFI broadly supports this approach but would like to make the following observations and comments:

- ALFI recommends that the risk management procedures as filed by the AIFM should include specific provisions on operational risks and the information (SAS70, KPI/KRI's) that will be made available in a timely manner to the depositary to fulfil its oversight duties.
- to ensure a level playing field and consistency amongst service providers (administrators, custodian, risk managers...), ESMA may consider imposing an independent assessment of their control environment (e.g. SAS 70 or equivalent), as is common in the depositary industry.
- in order for the depositary to discharge its responsibilities, "ex post verifications" should be limited to review of the adequacy of procedures and escalation of any gaps or issues as highlighted by the review. Consequently, the depositary should not be required to monitor actual and ongoing performance of service providers (review of KPI/KRI's) as this should remain the responsibility of the AIFM.
- as the AIFM remains ultimately responsible for ensuring that an effective and sound control environment has been implemented at the level of the AIF, any issues identified by the depositary in the course of its oversight duties should be reported to the AIFM, who should be responsible for any further escalation and resolution.
- the written agreement between the AIFM and the depositary should contain an obligation for the AIFM to provide or ensure that the AIFM or any third party appointed by the AIFM provides all necessary timely information as required by the depositary in performance of its oversight duties.
- in Luxembourg, these oversight duties are required currently for UCITS (law of 2010 Part 1) and 2010 Part 2 funds. However, they are not required for Specialised Investment Funds or SICARS. As such, ALFI foresees additional costs associated with the extension of the five oversight duties to all AIFs.

The principle-based approach properly clarifies the scope of each listed oversight duty and provides the necessary flexibility for depositaries so that they are in a position to undertake verifications and checks of administrative functions in the context of AIFs. Therefore, ALFI does not believe that there is need for additional clarity.

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

No, as long there is a proper segregation between the transfer agent function in charge of issuing the shares and the depositary bank department in charge of the oversight of the fund operations.

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

The Depositary ensures, on a periodic basis, that the AIFM or the designated entity (transfer agent) has appropriate procedures to reconcile subscription orders with subscriptions proceeds, and that the procedures are reviewed on a regular basis and updated if necessary. The review of the effectiveness of these procedures should be performed ex-post based on samples, and may be satisfied by third-party assurance reports such as SAS70's.

In addition, the Depositary, where deemed necessary, may conduct additional ex-post verifications based on information provided by the designated entity such as exceptions reports, key performance indicators, key risks indicators, etc. All these reviews are performed based on aggregated numbers as provided by the transfer agent and not based on individual shareholder transactions.

The Depositary's review of procedures should not necessarily be correlated to the frequency of subscription and redemptions. For accounting purposes, a further reconciliation between transfer agent and fund accountant must be done to ensure consistency between the total number of units or shares in the AIF's accounts and the total number of outstanding shares or units that appear in the AIF's register. The frequency of these accounting controls should be proportionate to the frequency of subscription and redemptions and defined at the time of appointment. It does not therefore seem beneficial to require the depositary to duplicate this reconciliation, and ALFI proposes to delete the last paragraph of Box 83 point 1.

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

The scope of the review, as currently performed by the depositary, already includes not only subscriptions but also other types of shareholders related transactions, such as redemptions, switches etc.

To complete its oversight duty, the depositary should have the ability to leverage existing independent assessments of the control environment (e.g. SAS 70) or conduct on-site visits at the AIFM, the AIF or the third party provider for the purpose of reviewing procedures and verifying the quality of information, by way of sample checks.

The depositary oversight in relation to Article 21 (9) (a) should be limited to the primary market only. Shares or Units negotiated on a secondary market should be excluded from the scope of this oversight.

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

The responsibility for implementing an effective and sound risk management process remains with the AIFM. According to Box 82, ALFI understands that the oversight function as performed by the depositary should mainly consist in assessing the control procedures and environment at the AIFM, the AIF or appointed third party.

ALFI believes that duties in box 85 should follow the same principles i.e. assessment of the control environment in place and sample reviews. On that basis, the depositary could also rely on controls performed by the investment manager or any third party in charge of the compliance/risk monitoring. Combined with an initial due diligence over the investment management, including site visits if deemed necessary, the depositary will be in a position to discharge its oversight duty.

In box 85, point 1 goes beyond Level 1. Depositaries can reasonably be expected to consider the law in the jurisdiction of the AIF, but cannot be held responsible for compliance with all "*applicable law*" that may affect the global activities of an AIF. Accordingly, Box 85 point 1 should have "*applicable national law*" as the test, as included in Level 1.

Furthermore, ESMA has extended the source of compliance monitoring to include restrictions in "*offering documents*", while Level 1 refers to "*the AIFs rules and instruments of incorporation*". We consider this extension is unwarranted and should be returned to the Level 1 text.

Finally, we would welcome some fundamental points of the explanatory text to be included in box 85, such as the information that compliance consists of ex post verification.

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

Option 2 is preferred, as this clarifies that for transactions that take place outside a regulated market, transaction settlement is frequently individually negotiated and thus expectations of timeliness are contractual.

Similar to other oversight duties, the depositary should be able to rely on its assessment of the existing control environment at the AIF, AIFM and/or a third party provider to discharge its responsibilities. Those control procedures should include assets and cash reconciliations, past due receivables and payables etc.

V.III Section 2 - Due Diligence Duties

Box 88 Due Diligence Requirements

We welcome the list of key elements of due diligence, which will harmonise European Depositary practices, but still allow Depositaries to develop individual solutions.

The reference to Box 16 (Handling of Orders) in Box 88 1 (b) (ii), does not appear relevant.

It does not seem to be clear enough to what extent should the contingency plans apply: the replacement of a delegate for safekeeping only or more exhaustive, depending on the type of AIF and the investments in these markets.

V.III Section 3 - Segregation

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)

The segregation criteria proposed in Box 89 seem adequate and reasonable. ALFI has the following comments:

- Corresponding to current market practice, segregation of assets does not require segregation on a fund by fund basis; this allows continued use of omnibus accounts for assets at sub-custodians.
- Corresponding to current market practice, segregation of cash is limited to segregation from cash of third parties or the sub-delegate of the depositary. Further segregation requirements at sub-delegate level would not add protection to cash holdings in case of insolvency of the sub-delegate, and would thus offer no further investor protection (neither in the EU nor outside the EU).
- The extension of segregation requirements from financial instruments to *other assets* may not be practicable given the various types of other assets. If such extension were to be retained, it would be preferable to add it to the rules in an explanatory note (note 5), for legal certainty purposes.
- The duty to ensure segregation of other assets should at any rate be limited to cases where the depositary has appointed the delegate. In order to have a harmonized set of investor protection measures, the AIFM should have identical duties when it appoints another delegate directly for such assets, such as a prime broker.

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.

It is difficult to prepare a negative inventory of concerned jurisdictions based on the published list of "equivalent jurisdictions". Such a list would need to be continually updated, due to changing legislation. The segregation of financial instruments is a professional obligation across OECD countries' legislation.

By contrast, investments by AIFs in other instruments in various frontier markets bear a higher risk of pooling and are more exposed to insolvency risks. This is more relevant to the AIF's risk management policy and procedures/framework than to the depositary's liability and the latter's obligation to segregate assets for enhanced ownership and investor protection.

V.IV. The depositary's liability regime

1 Loss of financial instruments

Box 90 Definition of loss

Depositaries cannot be made liable for events outside their sphere of control and influence. The AIFMD Level 1 is clear on this with reference to *"the loss by the depositary or a third party to whom the custody of financial instruments ... has been delegated"*. Box 90 seems to go beyond Level 1, and hence should be clarified appropriately by adding at the end of paragraph 1. *"due to a wrongful action or omission of the depositary"*

Ownership in a financial instrument that has never existed, notably in case of falsified evidence of title etc. cannot be lost. *"or never existed"* must be deleted in paragraph 1 a). Such risks are inter-related with investment risks, and should not be transferred to the depositary, who will have limited power to influence or control such fraud; thus they are prime facie "external".

ALFI cannot agree that *"all conditions described in §1 should be deemed to be met"* in all such cases. To provide two examples: if the issuer the financial instruments of which are held in custody has never existed (due to fraud etc.) or has never validly issued the financial instruments (due to fraud etc.), this is certainly not a loss *"by the depositary"*. In the case of falsified bearer instruments, the depositary's liability must be limited, as is the case today, to the return of the falsified bearer instruments, not to making good their purported financial value.

There is need for further clarification of the requirement of the *"notification of investors"*. What will the rule be in case of a dispute whether there has been a loss and/or whether such loss is covered by the liability exemption of an "external event"?

We do not see how the depositary can *"determine"* in case of a sub-depositary's insolvency whether all or parts of the assets are *"lost"*. This is ultimately a matter for the competent courts to decide and not for the depositary.

We agree that the board of directors of the AIF or AIFM has to play a key role in the determination of whether an asset is lost or not; however, we believe that the decision remains ultimately the competence of the local jurisdictions where the assets are held. There is a myriad of circumstances that could lead to the permanent loss of the assets (e.g. settlement system rules, market infrastructure deficiencies, local market conditions, appointment of counterparties by the AIFM, investment decision of the AIF...) and the interpretations, especially when driven by national law, could potentially diverge from one country to another.

2 External events beyond reasonable control

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.

ALFI submits the following comments in relation to Box 91:

- It appears counter-intuitive to assert that *“the small percentage of the assets [that] may be lost due to the disruption in the entity’s activities in relation to its default”* are not *“external events”*. ALFI very much believes the contrary, as such risks are inter-related with investment risks, and should not be transferred to the depositary, who will have limited power to influence or control such frictional costs; thus they are prime facie *“external”*.
- ALFI understands that each of the three conditions must be met for the depositary to discharge its liability and not to be held liable for the loss of financial instruments. ALFI considers that the long-standing distinction between *“obligation of means”* and *“obligation of results”* should apply to the depositary when demonstrating fulfilment of the three conditions. The nature of the relevant duties permits only an *“obligation of means”*.
- ALFI considers that the requirement under 3 (c) where it has to be demonstrated that the due diligence performed by the depositary encompassed assessment of *“potential external events which it believes present a significant risk of loss of a financial instruments (...)”* could, as currently worded, risk creating an impractical duty on the depositary.
- Clarification should be given on the definition of *“potential external events”* which could reasonably be assessed by the depositary, as all *“potential external events”* is open-ended and by nature some preventive or mitigating action may simply not be possible.
- It should be clarified that the act or omission of the sub-custodian should be considered as an external event with respect to the depositary if it did not occur as a result of a wrongful act or omission by the depositary in respect its delegation duties. The two other conditions would also have to be met in order to exculpate the depositary. We therefore do not agree with the assertion that an accounting error or an operational failure at the sub-custodian is to be considered as an internal event triggering the depositary’s obligation of restitution.
- as regards the circumstances where the depositary believes that the only appropriate action to prevent a loss of financial instruments is to require disposal, the escalation procedures set forth under Explanatory text #38 and #39 are too cumbersome to apply in real life. Under such extreme situations as outlined, a balance should be established between a decision to dispose of the financial instruments (which is an AIFMs portfolio management decision) and the prompt action requested by the depositary to safeguard financial instruments.
- ALFI notes the explanation in Explanatory text #10 of Chapter V.I., that clarifies that early termination of an appointment may be the only ultimate remedy for the depositary if the AIFM does not respect the advice on custody risk received from the depositary or does otherwise not comply with its duties (e.g. missing collaboration, lack of information, etc.) under the agreement or the AIFMD (as implemented in local law).

Early termination of a contract may raise more than one issue both at the AIFM level and of course at the depositary level. It cannot be good policy that the depositary - once a reasonable termination period has expired – is forced to continue in its functions with the same duties and

liabilities. Therefore ALFI recommends adding a maximum period of time of 2 months after which the AIFM must have appointed a new depositary after the expiration of the termination notice. ESMA should also define the duties and responsibilities of the exiting depositary during such period. ESMA should also define procedures in case no replacement depositary has been appointed at the end of such period, and specify consequences for the AIFM.

However, another option exists: the depositary could notify the AIFM and the competent authorities of the breach, and put the AIFM on notice that non-repair will change the custody obligations from art.21.8(a) (Custody) to art.21.8 (b) (Recordkeeping), with a corresponding change in liability standard. This would provide an interim solution, which provides more time for an orderly change of depositary.

3 Objective reason to contract a discharge

Box 92 Objective reasons for the depositary to contract a discharge

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?

Given the specific nature of such information ALFI is not able to provide such estimates, as this may lead to discussions around pricing and fees which are prohibited from a competitive standpoint at industry level.

ALFI invites ESMA to consider proxies such as:

- those provided by EFAMA in the ICSD scheme where the cost of guaranteeing UCITS funds for retail investors was evaluated to be close to € 30 billion,
- the cost of fund director insurance across various Member States
- additional bank regulatory capital that will be required for European Depositaries under Basle II if this liability is held to be a 'bank guarantee' (which normally carries a 100% capital charge).

To calculate the costs of the enhanced liability scheme, it would be necessary to estimate:

- the proportion of in-group vs. external sub-custody assets, which varies significantly from bank to bank,
- the likely counterparty exposure and
- the likelihood of insolvency, fraud or other "internalised" risks, in 230 different countries.

If recent real worst-case scenarios are to be considered, that may be improbable but nevertheless occur (market closures, currency collapses, large scale nationalisations, large scale systemic breakdowns, concerns over some EU member states, the US rating downgrade etc.) the level of cost may come close to the totality of the assets kept in custody.

ALFI considers that the depositaries are not and cannot be insurers of last resort.

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

We agree with the principle and rules based approach laid down in Box 90. A typology is can only be a non-exhaustive list that is unlikely to add further clarity.

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?

We see this as a helpful clarification in dealing with the uncertainty associated with the effectiveness of various countries' approach to segregation. While this may be a relevant "custody risk" for a depositary to alert an AIFM to, it is in essence an investment risk associated with a particular market that the depositary cannot influence, and thus should properly be treated as "external".

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

We note the following types of "external" events that should be included:

- operational failures outside the sphere of influence of the depositary and its network,
- 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?

We refer to our comments above on the sphere of influence and the need to clarify that the relevant due diligence and similar obligations are "obligation of means".

We also would like to draw ESMA's attention to the fact that 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 depositaries 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?

We prefer Option 2.

Option 1 is not of a nature to provide required legal certainty. Indeed the fact that it would be up to the depositary to demonstrate that it had "*no other option*" or that it has "*agreed ... it is in the best interest*" is likely to give rise to subsequent legal challenges with all the ensuing complications and time delays; this contradicts the aims of the AIFMD to foster clear and transparent rules.

Current market practice is that depositaries organize their network through affiliates and third party sub-custodians, in order to provide efficient sub-custody services, based on criteria including market presence, legal, technical and economic grounds.

It is not possible to assume widely that sub-custodians, even when they are affiliates of the depositary, will be willing to accept a transfer of liability. Today, many sub-custodians already argue that their contractual arrangements are entered into with the depositary and not with the underlying clients of the depositary and under such grounds they are not willing to directly handle claims from AIFM in case of loss of financial instruments.

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

Nothing in theory should prevent non-bank depositaries from acting as depositary for financial instruments, provided that they:

- appoint a custody bank as sub-custodian to provide the practical functions for custody and settlement of financial instruments, and
- establish cash accounts under their control at appropriate banks,

For private equity and / or real estate assets, non-bank depositaries should be able to provide the requisite ownership verification, recordkeeping and oversight functions directly, or via sub-custodians.

However, in order to establish a level playing field and to ensure similar levels of investor protection, any non-bank depositary should be subject to equivalent requirements regarding authorisation, ongoing supervision, capital, resources, procedures, systems, experience and fit & proper conduct that applies to bank depositaries.

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

We believe that, while the salient points relate more to the specific class of assets, i.e. certain financial instruments, than the type of AIF, it may be appropriate to account for inherent specificities arising from fund types (open vs. closed etc.) in relation to the “beyond reasonable control” requirement. Indeed what is reasonable for a more traditional AIF may not be reasonable for an AIF engaged in intra-day-trading.

Where relevant, it is preferable to have specifics relating to private equities / real estate funds in separate boxes or stated in each applicable box rather than just the explanatory text.

VI. Article 4.1 - Possible Implementing Measures on Methods for Calculating the Leverage of an AIF and the Methods for Calculating the Exposure of an AIF

Box 93 General Provisions on Calculating the Exposure of an AIF

No comment for the moment.

Box 94 Exposure Related Definitions

No comment for the moment.

Box 95 Gross Method of Calculating the Exposure of the AIF

No comment for the moment.

Box 96 Commitment Method of Calculating the Exposure of an AIF

No comment for the moment.

Box 97 Advanced Method of Calculating the Exposure of an AIF

No comment for the moment.

Box 98 Methods of Increasing the Exposure of an AIF

No comment for the moment.

Box 99 Exposures involving third party legal structures

No comment for the moment.

Q55: ESMA has set out a list of methods by which an AIF may increase its exposure. Are there any additional methods which should be included?

ALFI believes that the population of AIFs is significantly more heterogeneous than UCITS.

ALFI understands that the leverage calculation methods included (Gross and Commitment) are intended to ensure consistency across all AIFs in order to give investors and regulators transparency in a harmonized manner. However, we support a flexible approach to the additional 'Advanced' calculation method, which should be available with appropriate justification to calculate leverage for specific AIFs in a more relevant fashion.

It is our understanding that the UCITS standards to calculate exposure under the "Sum of Notional" and the Commitment method as defined in particular by CESR paper 10-788 are consistent with the Gross Method and Commitment approach as detailed in the ESMA Consultation paper. However, we are of the opinion that the operational burden to calculate two or three leverage figures in parallel may lead to additional costs for AIFMs which may be passed through to investors.

For clarity, the AIFM should nominate their proposed method in their fund documentation, which will provide an opportunity for the national regulator to intervene if the chosen method is not appropriate.

Q56: ESMA has aimed to set out a robust framework for the calculation of exposure while allowing flexibility to take account of the wide variety of AIFs. Should any additional specificities be included within the Advanced Method to assist in its application?

ALFI welcomes the possibility to use an 'Advanced method' to calculate the leverage of specific AIFs. We understand that an AIFM can set an AIF's leverage limit based on any one of the three approaches outlined by ESMA.

For real estate funds, the main measure used for leverage is the so-called LTV (Loan to Value) ratio. It should remain possible to use the LTV ratio as a measure for leverage, i.e., as a method under the Advanced approach.

Q57: Is further clarification needed in relation to the treatment of contingent liabilities or credit-based instruments?

No further clarification required.

Q58: Do you agree that when an AIFM calculates the exposure according to the gross method as described in Box 95, cash and cash-equivalent positions which provide a return at the risk-free rate and are held in the base currency of the AIF should be excluded?

We agree that any cash and cash-equivalent positions should be excluded.

Q59: Which of the three options in Box 99 do you prefer? Please provide reasons for your view.

We have not a single preference to any of the named options.

We believe that a primary assumption should be established that no look-through should normally be required where the AIF is holding ordinary securities of a listed company, securities of an unlisted operating company or shares or units of other AIFs (i.e. a fund of funds), as described in the investment policy of the AIF.

Nevertheless, we agree that a look-through to any financial and/or legal structure that involves third parties controlled by the AIF shall only be required in limited circumstances, e.g., as outlined in Option 3.

Q60: Notwithstanding the wording of recital 78 of the Directive, do you consider that leverage at the level of a third party financial or legal structure controlled by the AIF should always be included in the calculation of the leverage of the AIF?

ALFI supports a reasonable approach in defining what leverage at the level of third party financial or legal structures has to be included in the leverage calculation by the AIF.

We do not see any general requirement to include leverage at the level of those third party structures in the leverage calculation of the AIF.

VII. Possible Implementing Measures on Limits to Leverage or Other Restrictions on the Management of AIF

Box 100 Principles specifying the circumstances under which competent authorities will exercise the powers to impose leverage limits or other restrictions on AIFM

No comment for the moment.

Q61: Do you agree with ESMA's advice on the circumstances and criteria to guide competent authorities in undertaking an assessment of the extent to which they should impose limits to the leverage than an AIFM may employ or other restrictions on the management of AIF to ensure the stability and integrity of the financial system? If not, what additional circumstances and criteria should be considered and what should be the timing of such measures? Please provide reasons for your view.

We would propose to reflect both the potential overall implication of the communication (and implementation) of restrictions on the stability and integrity of financial markets as well as the potential different implications on the heterogeneous set-up of the alternative industry and fund types.

Q62: What additional factors should be taken into account in determining the timing of measures to limit leverage or other restrictions on the management of AIF before these are employed by competent authorities?

When determining the timing of such measures it is of importance that the competent authorities take into consideration the impacts of its measures on overall financial stability as well as the best interests of investors by allowing a reasonable time to reduce positions without compromising the financial system and/or the structure of the AIF.

VIII. Transparency Requirements

VIII.I. Possible Implementing Measures on Annual Reporting

Box 101 Annual Report Definitions

We agree with the proposed definition in general. However, we note that the information provided to investors may influence their decisions, but not their ability to exercise their rights. We propose to simplify the wording as follows:

***‘Material change’** (for the purposes of Article 22(2) (d) and with reference to Article 23, where appropriate) means changes in information if there is a substantial likelihood that a reasonable investor, becoming aware of such information, would reconsider its investment in the AIF or such information would otherwise be likely to prejudice the interests of one or more investors in the AIF.*

Box 102 General Principles for the Annual Report

The General Principles raise an important point of corporate governance. The preparation and publication of the Annual Financial Statements is currently the direct responsibility of those in charge of the corporate governance of the AIF when the AIF is set up as separate legal entity.

By making this a legal requirement of the AIFM, this text may be considered to dilute that responsibility, or to confuse the roles of the two. This may be further exacerbated when the AIFM and the AIF are established in different countries that would have a different interpretation of the Article 22 (1) in relation to the responsibility of the AIFM vis-à-vis of the annual report. The alternative interpretation is to focus on the words *“make available”* and see in them a general obligation to ensure the distribution, although this is also directly a responsibility of the Board. A statement of clarification as to the Board’s ultimate responsibility, or not if that is the intention, should be included.

Box 103 Reporting Material Changes for the Annual Report

ALFI: We welcome the last sentence of the paragraph 4. We would suggest clarifying that the medium by which the information is made available could be a website as foreseen in the box 23, point 3, as follows:

"Where such information has already been provided to existing and potential investors, a summary may be provided with a reference to the medium in which or where that information has been made available. If the medium used is a website, the requirements foreseen under box 23, point 3 should be met."

Box 104 Primary Financial Statements required under Article 22 (2) (a) and (b) of Directive 2011/61/EU - Content and Format of the Balance Sheet (or Statement of Assets and Liabilities)

We welcome the fact that ESMA has retained Option 1. Whilst we understand that the box does not aim to include an exhaustive list of the annual report captions, we suggest including separate captions for key features of the industry, i.e. performance fees and derivatives position (when applicable).

Box 105 Content and Format of the Report on Activities for the Financial Year

We welcome the clarification provided by the second sentence of Explanatory text #24 & the whole of #25. We would suggest including these sentences in box 105.

We would also recommend clarifying that if the AIF discloses conflict of interest in its management report (as usually required by national rules/laws), it would satisfy the obligations foreseen under box 23 (point 2 and 3) as well as point 6 of box 106. We propose the following:

"Box 105

Content and Format of the Report on Activities for the Financial Year

In accordance with Article 22(2) (c) of Directive 2011/61/EU AIFM shall, for each of the EU AIF it manages and for each AIF it markets in the Union or in a member state territory only, make available a report on the activities of the financial year, or, where applicable, the activities of the relevant financial period within the annual report (which may be in the form of the Directors or Investment Managers' Report), which shall contain at least the following elements:

- *an overview of investment activities during the year or period, and an overview of the AIF's portfolio at year-end or period end;*
- *an overview of AIF performance over the year or period;*
- *material changes in the information listed in Article 23 of the Directive not already presented in the financial statements.*
- *conflict of interest pursuant to article 14 (2) of the directive and*
- *remuneration disclosure as required under box 106 (when appropriate).*

The report shall include a fair and balanced review of the activities and performance of the AIF, containing also a description of the principal risks and investment or economic uncertainties that the AIF may face. It should not disclose proprietary information on portfolio companies.

To the extent necessary for an understanding of the AIF's investment activities or its performance, the analysis shall include both financial and, where applicable according to the AIF type, non-financial key performance indicators relevant to that AIF.

The information provided in the report should be consistent with national rules where the AIF is established."

Box 106 Content and Format of Remuneration Disclosure

See responses to question 64.

Q63: Do you agree with the approach in relation to the format and content of the financial statements and the annual report? Will this cause issues for particular GAAPs?

The approach to the format and content of the Financial Statements will not cause issues for any of the accounting principles, and GAAPs etc. used in Luxembourg.

It is important to clarify the intended role of the AIFMD in the preparation of the Financial Statements vis-à-vis those in charge of the governance of the AIF and specify whether this is an intended deviation from accepted and existing Corporate Governance.

Q64: In general, do you agree with the approach presented by ESMA in relation to remuneration? Will this cause issues for any particular types of AIF and how much cost is it likely to add to the annual report process?

We welcome the flexibility foreseen in Box 106 relating to disclosure of remuneration either at the level of the AIFM or at the level of the AIF.

When AIF are incorporated as a separate legal entity, those responsible for the financial statements of the AIF will be those in charge of the corporate governance of the AIF. They may differ from the management of the AIFM. In this case, they are likely not to have direct access to AIFM records and thus not to be in a position to take responsibility and ownership for such disclosures.

Moreover, the auditor of the AIF may not have direct access to the books of the AIFM in order to audit such disclosure.

We therefore suggest clarifying that the disclosure on remuneration would be a separate statement of the annual report, i.e. separate from the financial statements and not subject to the audit report.

VIII.II. Possible Implementing Measures on Disclosure to Investors

Box 107 Periodic Disclosure to Investors

Our comments to the specific sections are as follows:

Percentage of Assets Subject to Special Arrangements

Special arrangements apply to a varying degree to different type of funds and will rarely apply for closed funds. We therefore suggest :

“For the purposes of Article 23(4) (a) of Directive 2011/61/EU the percentage of assets subject to special arrangements, where they exist, as defined in Box 31 (Liquidity Management Definitions) shall be calculated as the net value of those assets subject to special arrangements, divided by the net asset value of the AIF concerned.”

Furthermore, we believe that funds with no periodic redemption rights should only be required to disclose information relating to paragraphs 1, 2 and 3 in the initial disclosure to investors and not be required to do so periodically.

Assets which are subject to special arrangements, such as assets transferred to a side pocket, will be valued at a price which may be significantly different than fair value, and as a result thereof be valued on a different basis than the AIF as a whole. We therefore consider that the *“ratio of a percentage of assets subject to special arrangements, divided by the net asset of the value of the AIF concerned”* may be

misleading (*), and should therefore be supplemented with some narrative information to inform the investor on the relevance of this ratio. An overview (of the nature and the characteristics) of special arrangements, and the valuation methodology and amounts concerned, may therefore provide a more accurate view to the investors. This information is currently requested in paragraph 3. We would recommend that this disclosure request be presented in paragraph 1 providing the reader all necessary information to understand the ratio. We would further suggest changing the title from *“Percentage of Assets Subject to Special Arrangements”* to *“Description of Assets Subject to Special Arrangements”*.

(*) For instance, it is a market recognized practice to value certain pocketed assets such as company/funds in trouble at zero when the potential outcome is unknown and very uncertain (for instance, the so-called “Madoff funds”). Mathematical calculation would lead to a “misleading” 0 % of assets subject to special arrangements.

New arrangements for managing the liquidity of the AIF

We suggest the following addition in paragraph 4

“AIFM shall take the necessary measures to immediately notify investors where they activate gates...”

This implies an “obligation of means” instead of “obligation of results” whereby the AIFM needs to be able to demonstrate that they have taken the necessary steps to notify the investors.

Risk profile of the AIF

The wording of the first sentence which require the AIFM to disclose the current risk profile of each AIF raises an assumption that the risk profile of each AIF can be measured, which is not necessarily the case. We may therefore suggest to adding *“in a quantitative and/or qualitative way, whichever is deemed to be the most appropriate”*.

We prefer option 1 (principle based) rather than option 2 (too prescriptive and not necessarily relevant for all alternative sectors).

Risk management systems employed by the AIF

We consider the required information in the second part of paragraph 5 to be onerous (as the description of the techniques, tools and arrangements may lead to very long disclosure requirements, in particular for umbrella structures, as tools and techniques may differ from one sub-fund to the other) and not necessarily of immediate interest to all investors. We suggest therefore the second part of the paragraph to be amended as follows, i.e.: *“and the AIFMs shall make available to investors on request the techniques, tools and arrangements it employs to manage these risks”*.

Box 108 Regular Disclosure to Investors

We note that in broad terms the content of Box 108 is in line with UCITS regulations, which will facilitate the reporting for AIFM's who also manage UCITS. We note one exception, however, whereby the directive refers to the disclosure of the total amount of leverage, whereas for UCITS reference is made to disclosure of the “leverage level”, whereby the information may be based on the average level of the leverage effects observed (and followed) during a period.

We suggest also making reference to the possibility to calculate the total leverage on the basis of the average level of the leverage effects observed (and followed) during a period. Paragraph 4 of Box 108 could therefore be amended as follows: *“The average amount of leverage employed by an AIFM...”*

Q65: Does ESMA's proposed approach in relation to the disclosure of 1) new arrangements for managing liquidity and 2) the risk profile impose additional liability obligations on the AIFM?

We consider that the requirement of adequate disclosure on liquidity as well as risk profile and risk management systems is very relevant for some specific type of funds such as Hedge Funds. However

this could possibly generate undue additional obligations for other types of funds such as closed-ended private equity funds which would rarely be subject to special arrangements.

We would suggest adding in the first sentence in paragraph 1 of Box 108 :

'For the purposes of Article 23(4) (a) of Directive 2011/61/EU the percentage of assets subject to special arrangements, where they exist, as defined in Box 31 (Liquidity Management Definitions) shall be calculated as the net value of those assets subject to special arrangements, divided by the net asset value of the AIF concerned.'

In addition, we suggest the following addition in paragraph 4 of Box 107:

'AIFM shall take necessary measures to immediately notify investors where they activate gates....'

This implies an "obligation of means": instead of "obligation of results" whereby the AIFM needs to be able to demonstrate that they have taken the necessary steps to notify the investors.'

Q66: Do you agree with ESMA's proposed definition of special arrangements? What would this not capture?

We agree with ESMA's definition of special arrangements as defined in Box 31, and the consideration that this should not include the suspension of an AIF.

In Explanatory text 9, last bullet of Box 20, the term "*special arrangements*" is used in the context of side letters whereby the AIFM grants investors redemption rights on preferential terms. We suggest, in order to avoid confusion, that the term "special arrangements" would not be used in the context of side letters.

Q67: Which option for periodic disclosure of risk profile under Box 107 do you support?

We prefer Option 1 (principle based) rather than Option 2 (too prescriptive and not necessarily relevant for alternative sectors).

Q68: Do you think ESMA should be more specific on the how the risk management system should be disclosed to investors? If yes, please provide suggestions.

Given the different types and natures of AIF falling under the scope of the AIFMD, we do not propose to be more specific on how the risk management system should be disclosed to investors, as it would then be more difficult to achieve a harmonised disclosure requirement. We suggest however that the disclosure of the risk management system be subject to the general principle of proportionality and this should take into account the different assets and types of AIF. We have a preference for the provision of information of a qualitative nature as opposed to a quantitative nature.

We thus consider that the required information in the second part of paragraph 10 of Box 107 to be onerous and not necessarily of an immediate interest to all investors. We suggest therefore the second part of the paragraph to be amended as follows:

"AIFMs shall provide an overview of the procedures employed to assess and manage the most relevant risks to which each AIF it manages is exposed."

VIII.III. Possible Implementing Measures on Reporting to Competent Authorities

Box 109 Format and Content of Reporting to Competent Authorities

As AIFMD foresees reporting, at the level of the AIFM, of information coming from AIF's managed in various jurisdictions, we welcome a proposed reporting template as detailed under Appendix 5 in order to harmonise the reporting process. Regarding the content of the pro-forma in Appendix 5, we have the following comments:

- The purpose of the information required and thus how it would contribute to the objective of identifying systemic risks is not always/immediately clear to us and we wonder how the competent authorities will be able to exploit such reporting.
- Guidance should be given on whether the reporting should be done at the level of AIF's or of their sub funds.
- As the lay out and content derives from the IOSCO work on reporting for hedge funds, most of the information required might not be relevant for other alternative funds, such as private equity or real estate. **Moreover, it is important to bear in mind that, given the broad definition of an AIF as per the directive, a significant proportion of AIF's will not pursue alternative strategies but will be plain-vanilla funds investing only in long position over listed securities that had not opted for the UCITS status.** Most of the disclosure require under the pro-forma are not relevant for these unleveraged funds. Imposing these onerous reporting requirements to types of funds when not relevant will not be in line with the "proportionality" principle.
- We would welcome a "decision tree" approach whereby the responses given to initial questions on the strategy, leverage and size would trigger a tailored report. This approach would reconcile the legitimate concern of ESMA to establish the tools for adequate supervision, flexibility requested by the European Commission and efficiency objectives of the funds industry.
- Page 422, section 1 : under the proposed format, the funds that do not pursue an alternative strategy, which can be very numerous as mentioned above, will be mingled in an "other funds" category including as well infrastructure and commodity funds as well as an "other" category. We wonder whether it makes sense to mix funds with such different profiles. Moreover, we note that there is no category for ETF's.
- Page 423 and 424, individual exposures per categories of instruments: we believe that a category of cash and cash equivalent (for money market funds) should be added as well as a category "other assets" under point c) real assets (for assets such as art, wine,...).
- Page 423: we wonder why the G10 bonds are split per maturity and not the Non-G10 bonds (what is the purpose of this information?). We would also suggest considering the distinction between "investment grade" and "non-investment grade" similarly as for the corporate bonds, as we do not understand the relevance of the distinction between G-10 and Non G-10.
- Page 425: typical deal size: the type of information required should be clarified.
- Page 425, point 4, value of turnover: formula for calculating turnover should be defined to order to allow consistency in the reporting. Turnover on money market instruments and derivative is usually not relevant information as it is a direct consequence of the roll forward of short term positions. We suggest removing these from the reporting.
- Page 426, section 1, 4, c): we assume that there is a typo and we should read "other assets" rather than "other funds"?
- Page 426, section 2, point 6: if the fund is distributed through intermediaries (for instance, retail funds, feeders, funds of funds...), this information will not necessarily be accessible and the AIFM may not be in a position to report.

- Page 427, section 2: AIFM should not be required to disclose “expected” return and risk profiles to regulators. Such disclosures would be pure conjecture.
- Page 427, section 3, point 9: the category “*infrastructure fund*” mentioned here is not included as a category per se under question 1. As this section focus on typical “*hedge fund*” risks, all funds categories other than hedge funds (for instance the unleveraged funds invested in listed securities as mentioned above) should be exempted from this section. Indeed, expected return cannot be assessed upfront for traditional funds taking long positions on markets as returns will largely derive from beta.
- Page 429, section c) liquidity profile is not relevant for closed-end funds. They should be exempted from this reporting.
- Page 431, 18, i): if the fund is distributed through intermediaries (for instance, retail funds, funds sold through feeders, funds of funds, structures...), this information will not necessarily be accessible and the AIFM may not be in a position to report.
- Page 434: the category “*other funds of funds*” will mix up alternative and non-alternative strategies. Will this information be useful?

Box 110 Use of Leverage on a ‘Substantial Basis’

Points 2 c) to f) are really judgmental and subjective. We therefore question whether the proposed definition will lead to a consistent approach to leverage. Moreover, we believe that to perform the assessment required under the points d) to f), the AIFM would have to consider consolidated information on the markets and information about investees/counterparties that are not under its control or accessible to him. These points create an obligation that is difficult to discharge effectively.

Q69: Do you agree with the proposed frequency of disclosure? If not, please provide alternative suggestions.

Whilst frequency and timing may be adequate for strategies trading in liquid financial instruments (i.e. certain hedge fund strategies), it is impractical (and irrelevant) for strategies holding long term assets (private equity, real estate, funds of funds).

Quarterly reporting is inconsistent with the requirement to calculate the net asset value at least once a year (article 19, 2.).

Q70: What costs do you expect completion of the reporting template to incur, both initially and on an ongoing basis? Please provide a detailed analysis of cost and other implications for different sizes and types of fund.

Costs will vary significantly depending on the nature of strategies, the number of funds, their domicile and the number of different systems from which the information will have to be aggregated. Whilst difficult to precisely quantify within such short timeframe, costs seem disproportionate for the closed-end structures and small unleveraged funds invested in listed securities where the risks are limited as these do not present systemic risks. We would urge ESMA to consider the proportionality principle as regards to the information to be reported and to carefully balance the cost to produce the information versus how this information will be used in order to identify systemic risks, as these additional costs could damage the competitiveness of the European AIF industry versus the rest of the world.

Q71: Do you agree with the proposed reporting deadline i.e. information to be provided to the competent authorities one month after the end of the reporting period?

The deadline one month after year end is impractical for certain structures (PE/RE invested through subsidiaries, funds of funds...) which typically take 3-4 months to produce financial statements and inconsistent with the 30 days mentioned in the explanatory text. We would suggest an annual reporting

for those closed end funds calculating net asset value yearly and their managers (or the managers predominantly involved in such strategies), which takes account of the legal deadlines for financial reporting (e.g. 4 months for SICARS and 6 months for other Luxembourg funds.)

Q72: Does ESMA's proposed advice in relation to the assessment of whether leverage is employed on a substantial basis provide sufficient clarity to AIFMs to enable them to prepare such an assessment?

Points 2 c) to f) are really judgmental and subjective. We therefore wonder whether the proposed definition will lead to a consistent approach to leverage. Moreover, we believe that to perform the assessment required under the points d) to f), the AIFM would have to consider consolidated information on the markets and information about investees/counterparties that are not under its control or accessible to him. These points create an obligation that is difficult to discharge effectively.

TABLE OF CONTENT

III. Article 3 Scope – Exemptions.....	3
III.I. Identification of the portfolio of AIF under management by a particular AIFM and calculation of the value of assets under management.....	3
III.II. Influences of leverage on the assets under management.....	5
III.III. Content of the obligation to register with national competent authorities and suitable mechanisms for gathering information	6
III.IV. Opt-in procedure	6
IV. General operating conditions	6
IV.I. Possible Implementing Measures on Additional Own Funds and Professional Indemnity Insurance	6
IV.II. Article 12 - General Principles	8
IV.III. Possible Implementing Measures on Conflicts of Interest	10
IV.IV. Article 15 - Risk Management	13
IV.V. Possible Implementing Measures on Liquidity Management	14
IV.VI. Possible Implementing Measures on Investment in Securitisation Positions.....	16
IV.VII. Possible Implementing Measures on Organisational Requirements	17
IV.VIII. Possible Implementing Measures on Valuation	18
IV.IX. Possible Implementing Measures on Delegation	20
V.I. Appointment of a depositary.....	22
V.II. Duties of the depositary	23
V.III. Depositary functions.....	23
1 Depositary functions pursuant to §7 – Cash monitoring.....	23
2 Depositary functions pursuant to §8 – Safe-keeping duties.....	26
2.1 Definition of the financial instruments that should be held in custody	26
2.2 Conditions applicable to the depositary when performing its safekeeping duties on each category of assets	30
3 Depositary functions pursuant to §9 – Oversight duties	35
V.III Section 2 - Due Diligence Duties.....	39
V.III Section 3 - Segregation	39
V.IV. The depositary's liability regime	40
1 Loss of financial instruments	40
2 External events beyond reasonable control	41

3	Objective reason to contract a discharge	42
VI.	Article 4.1 - Possible Implementing Measures on Methods for Calculating the Leverage of an AIF and the Methods for Calculating the Exposure of an AIF	44
VII.	Possible Implementing Measures on Limits to Leverage or Other Restrictions on the Management of AIF.....	46
VIII.	Transparency Requirements.....	47
VIII.I.	Possible Implementing Measures on Annual Reporting	47
VIII.II.	Possible Implementing Measures on Disclosure to Investors	49
VIII.III.	Possible Implementing Measures on Reporting to Competent Authorities	52