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Response to CESR Call for Evidence on Implementing Measures for the Alternative Investment Fund Managers Directive

Key Points

- The EBF believes that the implementing measures might best be delivered in two sets, including both a Directive and a Regulation for different aspects of the AIFMD.
- At the occasion of the call for evidence, the Federation makes a number of remarks in respect of valuation and in respect of depositary rules. Regarding depositary rules, the remarks concern the definition of the depositary functions and the issues relating to the depositary's liability regime. Regarding valuation, the EBF draws attention to certain specificities in local regulation to be considered when designing the implementing measures.
- As regards the depositary functions and more specifically the custody rules, it must be recognised that the depositary does not have effective means of control for certain types of assets, which should be excluded from depositaries' custody duties.
- National law currently diverges significantly in respect of depositary functions pursuant to paragraph 8. The EBF believes that the implementing measures should not impose any new measures which would force Member States to make far-reaching changes to the existing national law in this respect.
- Regarding the assessment of equivalence of third country regulation, the EBF suggests that applicable functions and liability rules should form the most important criteria in respect of depositary rules.
- As regards the liability regime, the loss of financial instruments should be clarified to exclude the cases where assets are temporarily unavailable and where there is a loss in the value of the assets. In addition, the EBF agrees that ESMA should provide a non-exhaustive list of external events beyond the reasonable control of the depositary.

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Related documents: CESR Call for Evidence: <http://www.cesr.eu/popup2.php?id=7318>

Responses to CESR's Questions

1. Which categories of investment manager and investment fund will fall within the scope of the Alternative Investment Fund Managers in your jurisdiction? Please provide a brief description of the main characteristics of these entities (investment strategies pursued, underlying assets, use of leverage, redemption policy etc).

The scope of the AIFMD is extremely broad, in covering all non-UCITS type funds. The EBF leaves it to the investment funds industry to describe in detail the different types of funds that are concerned. However, from its specific perspective the EBF notes that the wide range and diversity of funds covered has important implications for meaningful regulation. Please cf. our below more detailed remarks in respect of depositary regulation.

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

EBF members believe that it might be necessary to make use of both tools for the implementing measures. The desirable consistency of regulations in respect of, notably, the calculation of leverage, transparency rules, and possibly supervision, would best be achieved through a Regulation, whereas issues dealing with authorisation would better be addressed in a Directive.

3. Can you identify useful sources of data and statistical evidence from which CESR could benefit in the preparation of its advice?

The EBF cannot provide any statistical data that would be relevant in this context.

Comments on the Commission's Questions: Part I – General provisions, authorisation and operating - Valuation (Article 19)

The European Banking Federation takes interest in the Alternative Investment Fund Managers Directive from a range of perspectives including that of investors in funds, lenders to funds, and distributors. Its most significant interest however is from the perspective of depositaries. At the occasion of the current consultation, the EBF would therefore like to submit some comments on the Commission's questions to CESR in respect of depositary regulation and in respect of valuation.

- The EBF observes that while Article 19 refers to the "valuation" of the assets, paragraph 2 of the same provision refers to the "calculation of the net asset value" (NAV). European banks would therefore find it helpful that the relationship between the valuation of assets and the calculation of the NAV be clarified in the implementing measures. In particular, it could be clarified whether these two activities are seen to be necessarily linked and consequently inseparable.

- In this context, the EBF encourages CESR to be mindful of legal specificities in some Member States when designing the AIFMD implementing measures. For example, while in most Member States the depositary only has a supervisory duty on the calculation of the net asset value (NAV), in Italy the depositary may also carry out NAV calculation itself. This is as opposed to asset valuation, which may be carried out by the fund manager or may be outsourced to a third party.

Comments on the Commission's Questions: Part II – Depositary (Article 21)

- Generally, the EBF notes that the depositary's functions for AIFMD funds are the same as those for UCITS funds. The EBF would therefore encourage the **greatest possible degree of consistency between applicable regulations under the two Directives**.
- This includes notably the **standard contract on the appointment of the depositary** and the requirements for information to be exchanged between the AIFM and the depositary. The EBF believes that the **requirements in respect of the standard contract should remain relatively general**, in view of the large number of funds and respective assets to be covered. Similarly, the EBF does **not believe that a model agreement would be necessary or helpful**. Instead, within the general framework suggested above the parties should remain free to shape the agreements in the most meaningful way for each type of AIF, also taking account of applicable national law.
- In respect of **third country equivalence and the criteria to assess regulation and supervision in respect of depositaries**, it is important to ensure that investors receive the same level of protection under non-EU AIF as for EU AIF. To this effect, European banks consider that it will be necessary to set out clear conditions, some of which are already included in the Commission's request for technical advice to CESR. Generally, the EBF considers that the **most important aspect in the consideration of equivalence should be that of the functions to be carried out by the depositary and its liability** in the case of the loss of assets. In addition, ongoing supervision of the fund by the respective competent authorities should be supplemented by the requirement for at least annual **external audits**.
- In respect of depositary functions pursuant to paragraph 7 of Article 21, i.e. **custody duties**, the EBF notes that the scope of financial instruments to be held in custody as defined in the Level 1 text is very wide. In the view of European banks, the **scope should be restricted to those financial instruments:**
 - **which can be registered in a financial instrument account, and**
 - **for which the depositary is capable to verify their existence and location and to retrieve them at any time with the help of effective operational processes and controls.**
 - As a result, the EBF considers that the financial instruments that can be held in custody are - in addition to physical instruments held by the depositary - those for which the issuer has registered its securities in a CSD. This is only the case where:

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- all intermediaries used all along the chain are regulated entities (including the CSD),
- third parties are selected by the depositary according to its own due diligence criteria.

In addition, there can be no custody duties where the assets' ownership has been transferred to another counterparty, nor where the assets have been transferred to a counterparty for their potential re-use. In such a case the depositary has no more effective control over the assets.

- Importantly, this would mean to **exclude** from the depositary's custody duties:
 - Physical instruments not held by the depositary,
 - Derivative instruments, which cannot be registered in a CSD,
 - Units and shares of funds issued in a nominative form or registered with an issuer or a registrar,
 - Similarly, all financial instruments issued in a nominative form or registered with an issuer or a registrar,
 - All financial instruments associated with the use of collateral, whether or not such arrangements involve a transfer of legal title to the financial instruments.

All these financial instruments are to be considered "other" assets, together with assets which are not financial instruments, e.g. receivables, commodities, real estate, pieces of fine art, material goods.

- Regarding depositary safe-keeping functions for other assets, the EBF considers that the depositary should receive, from the management company or third parties, information/documentation regarding the ownership of assets. The depositary must also be informed about any modification relating to the ownership of these assets to be able to maintain an up-dated record. Otherwise, the depositary could not be held liable for any incorrect information relating to these assets. The EBF recommends that the appropriate corresponding flows of information to the depositary are set out in the agreement evidencing the appointment of the depositary.
- Regarding **depositary functions** pursuant to paragraph 8, the basic legal text requires that depositary functions be performed in accordance with applicable national law, thereby acknowledging the current significant differences in national law. The European banking industry considers that the **implementing measures should not impose any new measures** that would compel some Member States to modify to a significant extent the national law in this respect. Whilst a certain degree of harmonisation at EU level is seen to be desirable, depositary functions should be defined on the basis of a number of principles, including notably:
 - The principle of proportionality in fulfilling its duties;
 - The principle of efficiency, meaning that the depositary should not replicate any work that has already been carried out and that it should have flexibility in its means of control;
 - The principle of *a posteriori* controls.

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- The EBF considers that the loss of financial instruments is limited to the case where the depositary has been definitively dispossessed of the financial instruments, i.e. these will not be recoverable at any time. Therefore, the following cases should not be considered a loss of financial instruments:
 - Assets are temporarily unavailable,
 - There is a loss in the value of the financial instruments.
- Regarding external events beyond the reasonable control of the depositary, the EBF wishes to remind that financial instruments in nominative form or held with the issuer or with registrars, as well as financial instruments held as collateral, are excluded from the scope of custody. Therefore, any circumstance leading to a loss of these assets is to be considered an external event beyond the reasonable control of the depositary. In addition, the EBF considers that circumstances where the depositary is not able to effectively control the assets of the fund in spite of all duties attached to the custody function can be summarised in two main categories of events:
 - investment decisions made by the AIF or the AIFM acting on behalf of the AIF which prevent the depositary from having effective control over the assets,
 - events which are not predictable by nature, despite all controls performed by the depositary in respect of its custody duties.
- It would be helpful for ESMA to provide a non-exhaustive list of events which would be considered to lie beyond the reasonable control of the depositary, in line with the basic legal act. This list should, at a minimum and by way of example, contain the following cases:
 - Failure of a sub-custodian resulting from
 - Its insolvency,
 - Fraud beyond the depositary's duties of supervision.
 - Local market conditions:
 - Settlement failure in non delivery-versus-payment markets,
 - Market closures,
 - Widespread defaults (domino effect),
 - Result of political/ judicial decisions.
 - Market infrastructure deficiencies:
 - Failure, outage and fraud,
 - Local market rules imposing liens and/or reversals.
- The EBF also believes that the implementing measures should include a non-exhaustive list with examples for the reasons for the contractual discharge of liability. This should include the case where the use of a sub-custodian is in the interest of the AIF and its investors.