

Irish Funds Industry Association’s Response to European Securities and Markets Authority’s Consultation Paper “ESMA’s draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive”.

Introduction

The Irish Funds Industry Association (IFIA) is the industry association for the international investment fund community in Ireland, representing the custodians, administrators, managers, transfer agents and professional advisory firms involved in the international fund services industry in Ireland. As the leading centre for alternative investment funds (AIFs), Ireland services over 40% of all hedge fund assets globally, with EUR 210 billion of assets in Irish domiciled non-UCITS funds, EUR 158 billion of which is in “qualifying investor funds” (QIFs) regulated by the Central Bank of Ireland (CBI) as of July 2011. Accordingly, all developments in the alternative investment arena are of particular importance to the Irish industry. The IFIA welcomes both the publication of, and the opportunity to comment on, ESMA’s Consultation Paper (ESMA/2011/209) setting out its proposals for the advice to the European Commission on possible implementing measures for the Alternative Investment Fund Managers Directive (AIFMD). Below are our responses to the questions posed in the Consultation Paper and other general comments on the content of the Consultation Paper. All responses and questions refer to the numbering used in the Consultation Paper.

III Article 3 exemptions		
No.	Question	Response
1	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?	This does not seem problematic.
2	Do you think there is merit in ESMA specifying a single date, for example 31 December 2011 for the calculation of the threshold?	No. ESMA should not specify a date but should leave it to the alternative investment fund manager (AIFM) to determine.
3	Do you consider that using the annual net	The net asset value (NAV) is an appropriate

III Article 3 exemptions		
No.	Question	Response
	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.	measure for determining the level of assets under management (AUM) as AUM are understood by the market and investors alike to be measured on a net basis. Introducing a gross exposure or leverage measure will only lead to confusion. The requirement in the text of the AIFMD (Article 3(2)(a)) of including in the AUM figures “<i>any assets acquired through leverage</i>” is met by a NAV calculation as this necessarily reflects the value of any assets acquired through leverage. There may be other appropriate measures for other types of AIF and the AIFM should be able to determine this at its discretion provided that there is full disclosure of the method used in calculating this.
4	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?	Where total AUM exceed the threshold on a temporary basis (e.g., high levels of market volatility, unusual investor inflows or outflows).
5	Do you agree that AIFs which are exempt under Article 61 of the Directive should be included when calculating the threshold?	No. Exempted AIFs should not be included in the threshold calculation.
Additional comments In Section III.I, paragraph 12 of the Consultation Paper, the preference is for Option 2 whereby, in a fund of funds scenario, the AIFM has the option to either include all cross-holdings in underlying AIFs for the threshold calculation or perform a look through calculation.		

No.	Question	Response
6	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. The gross exposure should not be used. AUM are understood by the industry and investors to represent a net figure and the value of any assets acquired through the use of leverage would be reflected in the NAV. Introducing an additional measure such as gross exposure would lead to confusion and inconsistency in the application of the threshold.
7	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?	Please see the response to question 6 above. As with any assets acquired through the use of leverage, the value of any foreign exchange or interest rate hedging positions would necessarily be reflected in the NAV of the relevant AIF.
8	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?	No. There should be no reference to gross exposure or leverage. The total value of AUM should refer only to NAV or another generally recognised measure of AUM calculation. In particular, the method of calculation of gross exposure referred to in Box 2 (as set out in Box 95) is unclear and very likely to lead to significant and material confusion amongst managers and investors alike. As stated above, NAV is generally recognised in the marketplace as the appropriate measure of AUM.

IV. General operating conditions

No.	Question	Response
9	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?	No. It is difficult to see how the risk referred to (i.e., the risk that an appointed external valuer improperly values assets or calculates units / share prices) could be covered in the manner contemplated by the draft rules - either by additional own funds or insurance. Article 19(10) of the AIFMD provides that the external valuer shall be liable to the AIFM for any losses suffered by the AIFM as a result of the external valuer's negligence or intentional failure to perform its tasks. Therefore, the proper manner for this risk to be covered is by ensuring that the AIFM is able to recover on behalf of investors any loss suffered as a result of an improper valuation.

No.	Question	Response
		Typically, this is achieved by way of indemnification or equivalent provisions in a contract between the AIFM/AIF and the external valuer. Furthermore, Article 19(5) requires that the external valuer <i>inter alia</i> provide “<i>sufficient professional guarantees</i>”. It appears to be a disproportionate requirement that the AIFM itself provide cover for this risk when the AIFMD contemplates in a number of provisions that there be separate protections in place against this risk.
10	Please note that the term ‘relevant income’ used in Box 8 includes performance fees received. Do you consider this as feasible and practicable?	We believe that that Option 1, i.e., the additional own funds requirement for liability risk be calculated on the value of the portfolios of AIF managed by the AIFM is the appropriate approach rather than Option 2, i.e., the own funds requirement being calculated based on a combination of the value of the portfolios managed and a percentage of the “<i>relevant income</i>” of the AIFM. The former Option is easier to calculate and is directly linked to the risk involved: the greater the assets under management, the greater the potential quantum of investor claims. Linking the own funds requirement to the level of income of the AIFM bears little or no relation to the risk involved - high performance fees do not necessarily equate to higher risk - and in any event an investor would typically only be able to sue for the actual loss it has suffered. The loss suffered should equate to the size of that investor’s holding in the AIF, determined by reference to the initial capital amount invested and / or a NAV figure; it is difficult to see how a court could award compensation determined by reference to the level of performance fees paid. Furthermore, an own funds requirement based on the fee stream of the AIFM may deter AIFM from growing their businesses and achieving performance targets - both of which would be detrimental to the AIF industry in Europe and those it employs. Bearing in mind the industry’s fundamental objection to the Option 2, we would point out that including performance fees received as part of relevant income may mean that the own funds maintained by AIFM will change materially

No.	Question	Response
		from year to year (depending on whether performance benchmarks are exceeded) even though the risk in the AIF may have remained relatively constant.
11	Please note that the term ‘relevant income’ used in Box 8 does not include the sum of commission and fees payable in relation to collective portfolio management activities. Do you consider this as practicable or should additional own funds requirements rather be based on income including such commissions and fees (‘gross income’)?	It needs to be clarified here what is meant by “ <i>commission and fees payable in relation to collective portfolio management</i> ”. This could be broadly construed, even to include investment management fees which cannot be the intention. If it relates to matters such as subscription fees, contingent deferred sales charges, distribution fees and the like, then these amounts are not linked to remuneration for investment management <i>per se</i> and so cannot be said to be linked to the risks associated with the core activities of the AIFM.
12	Please provide empirical evidence for liability risk figures, consequent own funds calculation and the implication of the two suggested methods for your business. When suggesting different number, please provide evidence for this suggestion.	Intentionally left blank.
13	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?	Intentionally left blank.
14	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?	We consider this period to be acceptable. Bearing in mind that in a number of jurisdictions the statutory limitation periods for bringing claims for loss, in particular claims in tort, are limited to 3 years from the date of the cause of action, a look back period in excess of 5 years seems to us to be disproportionate.
15	Would you consider it more appropriate to set lower minimum amounts for	Intentionally left blank.

No.	Question	Response
	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 AIFs 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.	
Additional comments As a general comment, we would note that the concept of having an additional own funds requirement or the requirement to maintain professional indemnity insurance is not appropriate in the context of internally managed AIF. The doctrine of “reflective loss” in common law jurisdictions refers to losses of individual shareholders that are inseparable from general losses of the company. The rule against recovery of reflective loss states that there should be no double recovery, so a shareholder can only bring a derivative action for losses of the company, and may not allege she has suffered a loss in her personal capacity for a personal right. In other words, if any investor suffers a loss to his/her investment in an AIF, the investor should not be able to sue the company for that loss. Instead, it is the company which should seek to recover on the investor’s behalf. All investors should participate in any recovery <i>pro rata</i> to the size of their investment in the AIF. There is also the practical difficulty with an internally-managed AIF maintaining additional own-funds. Are these to form part of the AIF or segregated from it? If the latter, this will operate as an additional charge on investors in internally-managed AIF who will only receive the performance of their subscribed amount net of the own-funds amount withheld. It is difficult to see why an internally-managed AIF should be maintaining professional indemnity insurance given that the only services it provides are to its shareholders. We would like to clarify/confirm the identity of the AIFM within a self-managed fund structure. If the AIFM is the AIF itself, we would be keen for further clarity to be provided on the ability of the AIF to rely upon its service providers to comply with its obligations (e.g., capital requirements) and also would be grateful for confirmation that director's liability insurance can take the place of professional indemnity insurance in such structures. In relation to the obligation, in paragraph 2 of Box 2, of AIFMs to calculate leverage using the gross method of calculating the exposure of the AIF as set out in Box 95, gross leverage does not measure, and is poorly correlated with, the risk of a portfolio for the end investor, or the systemic risk that an AIF poses. Leverage is only one of many helpful measures of risk of a portfolio. Taken alone, or with undue significance placed upon it, any one risk measure can be misleading and dangerous for regulators and investors. In particular, given the method used by many AIFMs to achieve best execution for AIF and other clients (i.e., essentially netting of swap positions, as opposed to cancelling of existing positions to take out brand new swaps) the gross basis of measuring leverage may produce a misleading and potentially extremely inflated leverage number for many AIF. We are concerned that, given the requirement to disclose this number in the prospectus, this will potentially mislead (and unnecessarily frighten) investors. Furthermore, agreeing a maximum limit on this basis would also be problematic.		

No.	Question	Response
16	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?	No, we think the term " <i>business plan</i> " might be confusing, particularly given its application in the context of UCITS funds, and would suggest using another term such as "investment proposal".
17	Do you agree with Option 1 or Option 2 in Box 19? Please provide reasons for your view.	Option 1 provided that such preferential terms may be made known upon request to all other investors in an AIF.
18	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?	None. However, we respectfully submit that the advice does not give sufficient weight to the nature, scale and complexity of the relevant AIFM and AIF. We suggest that ESMA should highlight that the types of safeguards which should be put in place must be tailored to the circumstances. For instance, the risk management function employed by an internally managed AIF may differ materially from that employed by an AIFM which has a range of sizeable and complex AIF under management.
19	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 additional proportionality criteria should be included when competent authorities are making their assessment of functional and hierarchical independence in accordance with the proposed advice and in consideration of the safeguards listed?	Smaller AIFM and internally managed AIF would certainly have the most difficulty in demonstrating independence due to lack of resources and the cost prohibitions in establishing an independent risk management function. ESMA should consider key factors like the AIFM's / internally managed AIF's AUM, revenue and if the positions the relevant AIFs invest in would, of themselves, contribute to systemic risk. Perhaps ESMA might consider converging with the United States Securities and Exchange Commission's (SEC) Private Fund Reporting Requirements, which takes into account the above proportionality factors.
20	It has been suggested that special	We do not agree that use of special

No.	Question	Response
	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?	arrangements such as gates and side pockets should be considered only in exceptional circumstances where the liquidity management process has failed. We recommend that such arrangements should be considered as essential liquidity management tools and it would be inimical to the interests of investors were an AIFM or AIF prevented from using every liquidity management tool at its disposal to preserve value and manage the assets of the fund, irrespective of whether “ <i>exceptional circumstances</i> ” prevail or not. The key point here is that there should be adequate disclosure of such liquidity management tools in the prospectus or other offering document and the circumstances in which such tools may be employed. Discretion should be left to the AIFM / AIF to determine these disclosures and investors will then be adequately on notice of the circumstances in which they may be relevant.
21	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?	Liquidity conditions are subject to change, and therefore liquidity management should involve flexible arrangements. As a consequence, we encourage the adoption of a principles based approach, rather than a more prescriptive approach. The risk of impacting the fair treatment of investors can be ameliorated by putting appropriate procedures and communication protocols in place.
22	Do you agree with ESMA’s proposed advice in relation to the alignment of investment strategy, liquidity profile and redemption policy?	We agree that investors should be able to redeem their investments in accordance with the AIF’s redemption policy, which should cover conditions for redemption in both normal and exceptional circumstances, and in a manner consistent with the fair treatment of investors, capturing the use of gates, suspensions and side-pockets.
23	Should a requirement for complaints handling be included for situations where an individual portfolio manager invests in	No. As ESMA states itself in the explanatory text at paragraph 26, the AIFMD regulates the marketing to professional investors and not

No.	Question	Response
	an AIF on behalf of a retail client?	retail investors. The AIFMD provides for the ability of individual Member States to permit the marketing of AIF to retail investors in their territory and, as part of that regime, should be able to determine the necessity or otherwise of requiring a complaints handling procedure.
Additional comments In relation to the recording of subscriptions and redemption orders, which is addressed at Box 53 and paragraph 24, the AIFM is required to ensure that AIF subscriptions and redemptions are recorded. While the points (a) – (k) in Box 53 are captured by the administrator (albeit in differing systems or workflow methods) and are retrievable, it is not typically recorded on the share register or investor accounting system. Specifically, points (b) – (e) in Box 53 may not be entered into the investor accounting system whereas the remaining points would be. These requirements have been implemented under the UCITS Directive which sets out the information that should be firstly recorded on receipt of a subscription or redemption order and secondly displayed on the contract note that is issued to an investor following execution of the order. The implementation of these requirements presents a significant change to current market practice and consequently raises challenges in terms of systems and the operating model of the funds industry. We would suggest that several of the requirements, which stem from Directive 2004/39/EC on markets in financial instruments (MiFID), are more appropriate to brokerage transactions rather than in an investment funds context. For example, the requirements to record the date and time of receipt of the order on the confirmation issued to an investor is more appropriate to situations where the notion of “<i>best execution</i>” can be applied, for instance where pricing and intra-day trading takes place on a secondary market, whereas it is the dealing deadline, as outlined in the prospectus, that is relevant to investors in collective investment schemes. Likewise, the subscription and redemption price for each unit would not be known at the time of receipt of the order and will only be recorded once the NAV per unit has been issued, in keeping with the forward pricing methodology typically applied by collective investment schemes. This price is then applied to the order and reflected on the contract note issued to the investor. The provisions must be flexible to take into account the diverse nature of the AIF.		

Section IV.VIII. Possible Implementing Measures on Valuation

Additional Comments

The IFIA welcomes ESMA's clarification in the explanatory text at paragraph 24 that a third party which calculates the NAV on the basis of values or prices obtained from other sources shall not be considered external valuer. It is the essential feature of the valuer's activity that the valuer determines the valuations. In other words, persons calculating the NAV without determining the valuation are not to be considered valuers.

In order to reflect this idea more clearly, paragraph 24 could be amended as follows:

"A third party which carries out the calculation of the net asset value for an AIF is not considered to be an external valuer for the purposes of Article 19 of the Directive, so long as this entity does not determine final valuations for individual assets (...)."

Furthermore, in order to avoid a different interpretation by competent authorities in the future we suggest that this clarification should be included directly into the text of Box 60.

Section IV.IX. Possible Implementing Measures on Delegation

No.	Question	Response
24	Do you prefer Option 1 or Option 2 in Box 65? Please provide reasons for your view.	Option 1 is strongly preferred as this is principles-based approach rather than Option 2 which sets out an indicative list of four " <i>objective reasons</i> " for delegating tasks. While the latter is expressed as being non-exhaustive (" <i>include but are not limited to</i> "), there is the danger that these specific grounds will be interpreted as the principal grounds justifying the delegation of tasks. This risks not taking account of the individual circumstances which may not corresponding with one of these four grounds in which delegation is for the purpose of the more efficient management of the AIF.

Additional Comments

This section does not provide much in the way of guidance on delegation arrangements employed by internally-managed AIF. It would be helpful if, in the same manner as self-managed UCITS, guidance was provided on the requirements applicable to such delegation arrangements.

No.	Question	Response
V. Depositary		
25	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 AIFMD text explicitly provides for cash accounts to be opened with authorised entities different from the depositary and in the relevant market where cash accounts are required to be maintained. Such accounts are needed to facilitate the AIFs' investment activities as well as distribution activities. Imposing a requirement that both subscription/redemption accounts and investment related accounts must be opened with the depositary in one given jurisdiction for all investment and distribution settings would be detrimental to the AIF and thereby ultimately to the investor. In Ireland, it would be typical for the AIF's subscription/redemption account to be opened by the AIF's/AIFM's delegate, the administrator. Certain administrators have an omnibus account holding all subscription/redemption monies which is then moved to the custodian account. Alternatively, certain administrators have separate subscription/redemption accounts for each client/fund. At all times proper segregation is ensured with fund monies being kept separate from administrator funds. There are also cases where an AIFM has multiple funds with different depositaries. Such AIFMs may have only one pooled subscription/redemption account with a credit institution. It would be operationally complex if AIFMs were to be required to open subscription/redemption accounts at each individual depositary. It could have a damaging impact on distribution channels and could increase costs. The proposed depositary oversight of subscriptions advice by ESMA as set out in paragraph 16 on page 151 is as follows: • ensure there is an appropriate reconciliation performed between the subscription orders in the AIF's register and the subscription proceeds received; • ensure there is an appropriate reconciliation performed between the number of units / shares issued and the subscription proceeds received; and • check (regularly) the consistency

No.	Question	Response
		between the total number of units / shares in the AIF's accounting records and the total number of outstanding units / shares in the AIF's register. It would not appear essential for the subscription/redemption account to be opened at the depositary and this would cause significant operational difficulty. In line with the Level 1 text, we would recommend having the flexibility to allow the administrator to open such accounts along with the AIF and the AIFM.
26	At what frequency is the reconciliation of cash flows performed in practice? Is there a distinction to be made depending on the type of assets in which the AIF invests?	Typically for a daily dealing fund, where the depositary is satisfied that all reconciliation controls are in place and working, it would review reconciliations on a periodic basis. The suggestion by ESMA that depositaries review daily priced AIF on a weekly basis would not conform to market practice. Typically, there is no distinction made as to the type of assets that the AIF invests in for the purpose of this review but would be more dependent on the valuation frequency of the AIF and the nature, scale and complexity of the AIF.
27	Are there any practical problems with the requirement to refer to Article 18 of MiFID?	We do not foresee any practical problems with the reference to Article 18 of Commission Directive 2006/73/EC and note that for any entity established in a relevant 3 rd country that it should be considered " <i>of the same nature</i> " as those entities referred to in Article 18(1)(b) of Commission Directive 2006/73/EC if it is a credit institution subject to prudential regulation and supervision to the same effect as the provisions laid down in EU law and we note that this includes central banks and any bank authorised in a third country.
28	Does the advice present any particular difficulty regarding accounts opened at prime brokers?	Typically, sufficient reporting is received from the prime brokers (PB) to enable timely cash reconciliations to be reviewed by the depositary on a periodic basis. It is important to note that the depositary will be relying on the PB or the AIFM to present sufficient documentation to it to demonstrate that " <i>cash accounts opened at a</i>

No.	Question	Response
		<i>third party are only opened with entities referred to in Article 18 (1) (a)-(c) of Directive 2006/73/EC or another entity of the same nature in the relevant market where cash accounts are required as defined in paragraph 2 of Box 77 in the Consultation Paper (Ensuring the AIF's cash is properly booked)"</i> as the depositary will not have access to that information.
29	Do you prefer option 1 or option 2 in Box 76? Please provide reasons for your view.	The IFIA strongly advocates adopting the approach set out in Option 2 as it allows the depositary to focus on adequate supervision and monitoring of transactions. More importantly, Option 1, in particular its requirement to “mirror” certain transactions, would not only be costly but also operationally challenging and add unnecessary layers of administration without any apparent benefit to the investor in the AIF. We question the appropriateness of the depositary ensuring appropriate procedures are implemented to identify on a timely basis significant cash flows and in particular those which could be inconsistent with the AIF's operations. The depositary does not consider it appropriate to be tasked with this specific oversight duty and the depositary's role should be “to ensure that appropriate procedures are implemented <u>by the AIFM</u> to identify.....” [suggested amendment underlined]
30	What would be the estimated costs related to the implementation of option 1 or option 2 of Box 76?	It is not possible to quantify costs but it is evident that if Option 1 was chosen, this would involve employing more people to perform the tasks as set out, in particular mirroring the transactions of those cash accounts into a position-keeping system and making periodic reconciliations between the cash accounts and the AIF's accounting records (see below). As a general comment, the proposals introduce unnecessary additional layers of administration and controls which are not to the benefit of the investor and increase costs. Option 2 requires strong oversight of the entire process and is less resource intensive while achieving the same level of protection. Moreover, it is substantially in line with current best practice and additional cost should therefore be limited.

No.	Question	Response
31	What would be the estimated costs related to the implementation of cash mirroring as required under option 1 of Box 76?	Currently, for all custody positions it holds on behalf of an AIF, the depositary maintains a record. For all assets that cannot be held by depositary, these positions are recorded by the administrator in the records of the AIF. The administrator or custodian prepares periodic reconciliations of these positions with the third party bank and the depositary would oversee these reconciliations on a periodic basis. If at any time the depositary wishes to obtain a full list of third party cash held by the AIF it would request such information from the administrator. The suggestion that the depositary should “mirror” the transactions of the cash accounts held with third parties that are already being accounted for by the administrator is completely unnecessary duplication and will involve increased costs to AIF shareholders, to cover additional headcount and system enhancement costs without increasing the level of investor protection.
32	Do you prefer option 1 or option 2 in Box 78? Please provide reasons for your view.	We prefer Option 2 with an additional suggestion as set out below: Box 78 Option 2 <i>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 <u>and that the financial instruments are held in custody by the depositary within its sub-custody network.</u></i> <i>Additionally, financial instruments which can be <u>are</u> physically delivered <u>in accordance with standard market practice</u> to the depositary should be held in custody.</i> <i>Financial instruments that are directly registered with the issuer itself or its agent (e.g. a registrar or a transfer agent) <u>directly or indirectly</u> in the name of the AIF</i>

No.	Question	Response
		<u>or the depositary or its agent on behalf of one or more clients</u> should not be <u>considered to be</u> held in custody unless <u>the bearer instruments have been</u> they can be physically delivered to the depositary, <u>in line with standard market practice.</u> This Option is preferred because it recognises the practical complications that arise where ownership of and rights in financial instruments are determined via mechanisms providing for a level of legal certainty following dvp/rvp settlement and use of securities depositaries. In addition, financial instruments that are directly registered with the issuer itself or its agent (e.g., a registrar or a transfer agent) directly or indirectly in the name of the AIF or the depositary or its agent on behalf of one or more AIF are not considered to be held in custody unless they are physically delivered to the depositary. We believe that this addition is important to consider as financial instruments may be held directly with the issuer itself or its agent in the name of the depositary or its sub-custodian/agent and the depositary does not select the issuer or the registrar/transfer agent. A parallel can be drawn with CSD or settlement systems as referred to in explanatory text of Box 80 of the Consultation Paper. The last bullet point of explanatory note paragraph 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

No.	Question	Response
		<i>assets</i> ” since the depositary’s cash monitoring and other obligations separately arise pursuant to Article 21(7) of the AIFMD.
33	Under current market practice, which kinds of financial instrument are held in custody (according to current interpretations of this notion) in the various Member States?	The approach commonly understood in Ireland is set out above.
34	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?	See “Additional Comments”, point 5 below.
35	How do you see the delegation of safekeeping duties other than custody tasks operating in practice?	In the alternative funds environment, when asset classes may vary widely with significant onward impact on the way in which a depositary may carry out its responsibilities, it is crucial that the AIFMD be flexible enough to allow depositaries to draw on third parties where necessary. We would envisage that the depositary should be permitted to delegate its record-keeping and verification obligations to a third party under the terms of its contract evidencing the appointment of the depositary. It is also important to recognise that the depositary will not always appoint a third party who has control and maintains day-to-day records of the underlying asset: third parties may include an affiliate or delegate of the AIFM, or a professional service provider such as a law firm, notary or property manager, the valuer, the administrator or the prime broker. In these cases, it is the responsibility of the AIFM to ensure that the depositary has appropriate and timely access to records and documentary evidence held or controlled by the third party.
36	Could you elaborate on the difference notably in terms of control by the depositary when the assets are registered directly with an issuer or a registrar (i) in	There is not a significant difference in terms of control when assets are registered in any of the formats outlined in the question. The key control is focused on the parties than can

No.	Question	Response
	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?	instruct the movement of the assets. For assets under the control of the depositary this will be its authorised signatories or those of its authorised agents/delegates.
37	To what extent would it be possible / desirable to require prime brokers to provide daily reports as requested under the current FSA rules?	In our opinion it is desirable that prime brokers provide daily reporting on the status of their client assets and client money. This information should be available online for depositaries to access as required. In practice, UK-based prime brokers are currently obliged to provide this information and it would be beneficial to have this standard of reporting in place for all prime brokers contracted to provide prime broker services to AIFs.
38	What would be the estimated costs related to the implementation of option 1 or option 2 of Box 8? Please provide an estimate of the costs and benefits related to the requirement for the depositary to mirror all transactions in a position keeping record?	The preference for depositaries is that administrator's records are the primary record for assets not held by the depositary. Indeed, paragraph 5, page 173 of the Consultation Paper gives scope for the delegation of record-keeping tasks by the depositary. In addition, the reconciliation procedures employed by the administrator, in respect of assets not held by the depositary, would be overseen to ensure an appropriate control environment exists to record and verify the AIF's assets and that the depositary reviews such reconciliations on a regular basis. On this basis, it is felt that imposing a requirement on a depositary to mirror all transactions would not increase the control environment for the AIF. The benefits of a full mirroring exercise are questionable and would direct resources away from the primary oversight and verification responsibilities of the depositary. The costs of Option 2 would be very significant and would impose unwarranted additional costs on the depositary without an equivalent increase in shareholder protection. Option 1 (ii) imposes additional costs from a headcount / resource perspective. As noted, the preference of depositaries is for oversight of the administrator's reconciliation process as

No.	Question	Response
		opposed to the requirement to receive documentary evidence for each transaction. The costs associated with this Option would also be significant and would detract from the depositary's oversight role.
39	To what extent does / should the depositary look at underlying assets to verify ownership over the assets?	The IFIA believes that in order to fulfil its duty to verify the ownership of the assets of the AIF and to adequately protect the interests of AIF's investors, the depositary should be required to apply a "look-through approach" to the entire AIF's asset structure, i.e., that the depositary must look through any intermediary entity controlled (directly or indirectly) by the AIF which is interposed between the AIF and its target investments. This requirement is obviously of particular relevance for AIFs which are making substantial use of intermediary entities, such as AIFs investing in real estate through an SPV, private equity and other multi-layered structures such as fund of funds or master-feeder funds. Control is the important aspect and the extent of the look-through to underlying assets should be determined by this. Where the AIF does not control the investment, it should be considered a "<i>portfolio investment</i>". By way of example, quite often feeder funds will have non-controlling interests in a master fund. In this example, we do not consider it practicable or necessary to perform look through checks to the individual investments of the master fund. It is important to adopt a pragmatic approach to verification taking into account the different types of assets. We believe that if the depositary is required to do more than rely on documentary evidence regarding ownership, it will be the subject of an open-ended obligation with unacceptable resource and legal implications. Legal and ownership structures can vary tremendously, especially as regards private equity and real estate. Therefore, the depositary should be able to rely on legal opinions or appropriate documentary evidence without incurring associated liability.
40	To what extent do you expect the advice on oversight will impact the depositary's	As mentioned above, we support the general oversight requirements as set out in Box 82 as

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	relationship with funds, managers and their service providers? Is there a need for additional clarity in that regard?	well as with the additional clarifications as set out in Box 83 of the Consultation Paper. However, as mentioned above, in Box 82, “<i>potential irregularities</i>” are undefined and as such could be far-reaching. It would appear that this puts the onus on the depositary to identify potential irregularities which also is subject to wide interpretation. This needs to be clarified that the depositary oversight duty is to monitor the AIF in accordance with its investment restrictions and AIF rules and offering documents. We suggest that the definition of irregularities is limited to those considered in UCITS IV (Commission Directive 2010/44/EC). As set out above, paragraph 62, page 169, introduces the idea that the depositary should check whether “<i>the AIF’s investments are consistent with its investment strategy [...] to ensure it does not breach its investment restrictions.</i>” While a depositary should and does check to “<i>ensure</i>” that investment restrictions are not violated, we believe that introducing an obligation for a depositary to ensure that investments “<i>are consistent with its investment strategy</i>” would not be possible to meet, especially in certain asset classes such as real estate, and would involve an unacceptable level of subjectivity in the execution of the depositary function. Generally, the same provisions with regard to oversight have been included in the AIFMD as those set out in the UCITS Directive. Therefore, in order to discharge its oversight function, the depositary must be provided with all of the relevant information. As the depositary will be performing this oversight on parties which it does not have a contractual relationship with, the AIFM must have the contractual authority to require such third parties (e.g., administrator / external valuer) to facilitate the oversight process. It should also be clarified that the depositary does not review the actual performance of the service provider, instead ensuring the adequacy of their procedures. Review of performance of the service provider, for example through the use of KPIs, is the responsibility of the AIF/M. The use of risk assessment by the depositary would be a standard approach but is not

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		currently a requirement under the UCITS Directive. As above, the various service providers must be required to provide the relevant information to the depositary in order for this initial risk assessment to be carried out. It would also be useful to have guidance in this area. Additional clarity should confirm that the various parties will be required to do what is necessary to enable the depositary to perform its oversight. There also needs to be clarity on which entities we are referring to as “<i>service providers</i>” which will be subject to the oversight of the depositary, e.g., clarification that it is sufficient for the depositary to oversee the delegate of the AIFM, the administrator, for example rather than the AIFM itself.
41	Could potential conflicts of interest arise when the depositary is designated to issue shares of the AIF?	Yes. There could be situations where a conflict of interest could arise where the depositary is designated to issue shares of the AIF. This should be addressed by ensuring that there are appropriate Chinese walls in place together with a functional and a hierarchical separation. It would not be usual in Ireland for the depositary to issue shares but we understand that it may be more common in other jurisdictions.
42	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 oversight is completed through undertaking a number of oversight functions which can be summarised below. (a) onsite visit to the transfer agent – walkthrough of all process and controls in the live environment; and (b) sample testing of shareholder activity to ensure it adheres to the fund documentation (e.g., deadlines, dealing frequency, minimums etc.). Onsite visit to the transfer agent: This is completed usually yearly by the

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		depository. In advance of the inspection the depository may pick a sample of AIFs, clients, processes or control that it wishes to see as part of this onsite review. This sample could be determined by a new client take on, increase of transfer agent errors in relation to a particular area/process. The areas that the depository will include in this review would typically be: • receipt of investor subscription instructions and processing is completed within the deadlines specified in the prospectus; • subscriptions are processed at the correct price and accurately entered into the transfer agent system; • that subscriptions received adhere to the AIF prospectus limits and restrictions; • payment of dividends to shareholder and that there is a procedure in place to identify any unclaimed dividends; • reporting of investor instructions to the AIF administrator and total balances; • the end goal is to issue a report to the transfer agent noting any recommendations/observations. We attach our IFIA Guidance Paper 3 (Appendix I) which gives direction as to the type of work currently undertaken in this area.
43	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?	It would be practically impossible for the depository to meet this obligation and in our view, this obligation should not be imposed on the depository. It may be possible for other parties to the AIF such as the transfer agent to meet such an obligation if it was imposed.
44	With regards to the depository's duties related to the carrying out of the AIFM's	We would view the scope of the duties as set out in Box 85 to be appropriate and as

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	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.	following industry practice. The depositary should be satisfied that there is a system in place to monitor compliance with investment restrictions, the AIF documents and applicable law. We would not agree that the depositary should check that investments are consistent with the AIF's investment strategy, as this would involve an unacceptable level of subjectivity in the execution of the depositary function. The duty of the AIFM is to ensure that the investment strategy is followed and complied with in all material respects. Lastly, the current wording relating to the depositary's obligation to verify the AIFM's compliance with "<i>applicable law and regulation</i>" goes beyond what is foreseen by the Level 1 Directive. Depositaries can reasonably be expected to consider the law in the jurisdiction of the AIF, but cannot be held responsible for compliance with all "<i>applicable law</i>" that may affect the global activities of an AIF. Accordingly, Box 85, point 1 should have "<i>applicable national law</i>" as the test, as included in the Level 1 Directive.
45	Do you prefer option 1 or option 2 in Box 86? Please give reasons for your view.	We prefer Option 1 in Box 86. In discharging its obligations the depositary will generally carry out oversight on certain areas including: (a) reviewing timeliness of receipt of investment trades by the administrator; (b) failed trades at sub-custodians; (c) outstanding receivable controls and procedures in relation to items included in the NAV; (d) cash and asset reconciliations; and (e) receipt of income from investments /subscriptions. There is no evidence that additional requirements are necessary.
46	What alternative or additional measures to	We do not believe that segregation is an issue

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	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.	in relation to assets held with sub-custodians. When a depositary appoints a sub-custodian it will take the appropriate steps, such as consulting with regulatory authorities and other relevant parties, to ensure that assets are segregated in compliance with the requirements of local market practice and regulation. The depositary satisfies itself when conducting due diligence that assets are segregated in line with the market. The choice to use a particular type of account, segregated or omnibus, is driven by the market and the needs of the investment manager in accessing that market. Assets held in omnibus accounts are segregated by the records on the depositary’s system, which ensure at all times that depositary can identify client assets. We do not believe that further segregation measures would bring additional benefits and may even increase operational risk due to the number of accounts that would be needed to operate such a model. It may be worth noting that under Rule 17f-5 of the Investment Company Act of 1940 in the United States regulated banks are not permitted to hold assets in a market that does not recognise insolvency law. Finally and importantly, cash is in most cases not by its nature capable of segregation. Client cash is ultimately maintained subject to standard principles of banking law. In the event of insolvency, the client would typically be an unsecured creditor of the depositary or its delegate.
47	What are the estimated costs and consequences related to the liability regime as set out in the proposed advice? What could be the implications of the depositary’s liability regime with regard to prudential regulation, in particular capital charges?	The estimated cost is extremely difficult to quantify. It depends on many factors (e.g., the number of intra-group sub-custodians within the depositary’s group; the value of funds held in emerging markets versus more established markets; the current political situation in a particular market; and its implications on the financial markets). In the worse case scenario the level of costs could equal the total value of assets held in custody. It is conceivable that the liability regime

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		proposed could lead to depositaries only using affiliated sub-custodians which in turn could result in constriction of markets available to the AIF/M. While in the past it was thought that depositaries may shy away from emerging markets in this regard, it is now conceivable given current financial turmoil that established markets such as France, Spain and Italy may be deemed too risky for depositaries. Insolvency risk is also a factor here in that the depositary appears to have an open ended responsibility as this is not viewed as an external risk.
48	Please provide a typology of events which could be qualified as a loss in accordance with the suggested definition in Box 90.	We do not believe it would be helpful to provide a typology of events, our preference is for a principal based approach. A list by its very nature is restrictive and it is impossible to properly capture all events. A list of certain events is included in relation to fraud in Box 90. It appears that the onus to extend the depositary liability to, for example, accounting fraud is over and above what could be considered an event beyond its reasonable control.
49	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?	With regards to the general definition of “external”, ESMA suggests that “<i>an event should be deemed ‘external’ if it did not occur as a result of an act or omission of the depositary or its sub-custodian where the financial instruments were held in custody</i>”. In our view, “external” should be interpreted in a strict way, i.e., as everything that is not related to the depositary or any of its affiliates and therefore outside of its reasonable control. Following this rationale, if at the end of the sub-custodian insolvency proceedings, assets are determined to be lost, the following events/situations should be considered external by nature and therefore exclude the depositary’s liability: • where the law of the country in which the assets were held does not recognise the effects of segregation; or • where the assets are lost, as the result of an act or an omission of a sub-

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		custodian. This is based on the experience that clients' assets may have been used just before the sub-custodian's insolvency in a final attempt to avoid the bankruptcy. The insolvency prevents the sub-custodian from returning the assets to the depositary despite the provisions laid down in the agreement entered into between the depositary and the sub-custodian. In addition, it is outside the depositary's reasonable control to prevent such a use of assets in the situation around a sub-custodian's insolvency. Holding the depositary liable for such loss of assets would therefore be inappropriate. We agree that the fact that local legislation may not recognise the effects of the segregation requirements imposed by the AIFMD should be considered "<i>external</i>". We are of the view that if this is identified as part of the depositary's due diligence obligations and the depositary has notified of the AIFM of this risk and the AIFM instructs the depositary to continue to hold the asset in that market, the depositary has satisfied the "<i>reasonable efforts</i>" requirement and should avoid liability. Providing for this as an "<i>external event</i>" is helpful in that it would establish expectations and lead to a greater understanding in the market that not all ways of holding interests in financial instruments through the chain of custody is controllable by the depositary. It is recommended however that the reference to local legislation not recognising the "<i>effects of segregation</i>" be extended to "courts and regulatory bodies".
50	Are there other events which should specifically be defined/presumed as 'external'?	Our preference is for a rules- and principles-based definition for "<i>external</i>" events. It is not possible to properly enumerate all possible scenarios nor would this be of benefit to the investors. Essentially it depends on the facts and circumstances of the case and how a reasonable depositary responds to those facts and circumstances. We suggest the following amendment to Box 91:

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		Box 91 <i>The event which led to the loss did not occur as a result of an improper act or omission of the depositary or one of its sub-custodians to meet its obligations.</i> Whilst it is not possible to produce a complete list of events that are external, the following are examples of certain events that are considered to meet this definition: • act of God, explosion, fire, accident, lightning, outbreak of war, armed conflict, act of any government of authority, power failure, failure of telecommunications lines; • failure of settlement system, central securities depositary or exchange; • terms or conditions imposed by post-market infrastructure (including both Central Securities Depositories (“CSD”) and payment systems); • risk resulting from investment decisions taken by the AIFM; • default or insolvency of any counterparty or broker; • fraud committed by an employee of any counterparty, broker, sub-custodian, settlement system, registrar, issuer or other third party; • use of a prime broker which has been appointed by the AIFM (subject to the depositary’s approval of the appointment and the depositary’s general duty of supervision); • securities holdings recorded by an agent of the issuer, such as a transfer agent or registrar; and • certain market conditions or events, including currency restrictions, sovereign default and the expropriation of assets.
51	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	The types of event used in page 184, paragraph 27 assist. Regarding operational failures, it would appear

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	reasonable control' be further clarified to address those concerns?	appropriate that operational failures outside of the direct control of the depositary should not be included as an internal event. The concept of considering " <i>direct control</i> " may be more appropriate. The standard of negligence or intentional failure to perform has to be respected and in that regard, the level of liability the depositary would be expected to undertake, it makes more sense to refer to entities that are " <i>controlled</i> " by the depositary as " <i>internal</i> " because it is reasonable to premise a test based on those activities, entities and personnel that are actually capable of being " <i>controlled</i> " by the depositary.
52	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 anticipate that a contractual transfer of liability will be very difficult to implement in practice for the following reasons: • it is unlikely that sub-custodians will accept a transfer of liability which will result in stricter liability standards than those applicable to them under local liability rules. In addition, they risk facing multiple direct claims from AIFs save where the depositary acts as a coordinator; and • for a given sub-custodian it will be difficult to operate under two regimes in parallel: the transfer of liability regime for AIFs and standard regime for non-AIFs or for AIFs who reject the transfer of liability. In case of a liability trigger event, the situation will entail significant administrative complexity, as it will first need to be established which AIF are entitled to claim under the transfer of liability regime and which funds remain subject to standard regime. In other words, contractual transfer of liability is regarded to be of limited value in terms of depositary risk mitigation. The IFIA remains very concerned there is no realistic prospect of utilising the "<i>transfer of liability</i>" provision in practice due to significant legal confusion. To provide an example, under common law principles of "subrogation", where a claimant lacks privity with the "third party" (such as a sub-custodian) against whom

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		rights would be asserted, the claimant typically would be required to assert his or her claim in the name of the party (e.g., the depositary) who is in privity with the third-party. In the UK, however, the Contracts (Rights of Third Parties) Act 1999 reformed the common law concept requiring privity. Among other things, the Act allows third parties who are not party to a contract to enforce terms of the contract that benefit them in some way, or which the contract allows them to enforce. It also grants them access to a range of remedies if the terms of the contract are breached. The Act also limits the ways in which a contract can be changed without the permission of an involved third party. The problem is this is a law of one jurisdiction that envisages invoking that law in the relevant contract. Even if they did exist, it would not be possible to invoke laws of jurisdictions where AIFs or investors are located in contracts with every sub-custodian for each individual AIF. Therefore, it does not seem possible to implement a “one-size-fits-all” theory of liability on legal systems throughout the world which may not recognise such a new concept with respect to which there is no precedent in the law. Similarly, we are uncertain how an AIF might assert rights directly against the third party under all legal regimes. As a result, this condition as written will make contractual discharge from liability insupportable and – most likely - effectively unavailable. The above in turn raises significant concerns about systemic risk unless that concern can be successfully addressed in some other way, such as by ensuring that the other avenue for discharge from liability (“<i>external events beyond the reasonable control of the depositary</i>”) is broad enough to prevent that risk from becoming untenable. For this reason we remain very concerned about sub-custodians being considered “<i>internal</i>” such that “<i>external events</i>” cannot be used as a basis for discharge from liability. The net result, in effect, is strict liability for depositaries even where every effort is taken to select, supervise and monitor the sub-custodian with utmost care.

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53	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?	Assuming Option 2 is chosen in Box 78, the IFIA believes that this framework is workable in the context of private equity funds because private equity shares would be considered “ <i>other assets</i> ” falling under Article 21(8)(b) of the AIFMD and subject to the depositary’s duty of oversight.
54	Is there a need for further tailoring of the requirements set out in the draft advice to take into account the different types of AIF? What amendments should be made?	The advice needs to be specific regarding how assets held with prime brokers will be treated as well as the supervision requirements that a depositary must discharge in relation to assets held with a prime broker. Without specifically addressing this matter, different practices will emerge within and throughout European jurisdictions.
Additional comments - The IFIA supports ESMA’s view that in the context of the appointment of the depositary, the development of a model agreement would be inappropriate. The IFIA welcomes the approach suggested by ESMA consisting in defining the particulars to be included in the depositary agreement by reference to the corresponding requirements under the existing UCITS legal framework, subject to a limited number of adaptations to take into account the specificities of AIFs (in particular, the fact that they are authorised to invest in a wider range of assets) and the additional requirements contained in the Level 1 Directive. Concerning the particulars to be included in the agreement, it would be useful for the avoidance of any doubt to amend item 2 in Box 74 so as to read “<i>A description of the type of assets that will fall within the scope of the depositary’s safekeeping and oversight functions (...)</i>”. - We strongly support the inclusion of the requirement for the AIFM to provide the depositary with all required information in the general information requirements in the context of the depositary’s cash monitoring obligations. The IFIA generally agrees with the set of requirements as set out in Box 75. However, it is unclear whether the depositary would be exonerated from liability in situations where the AIFM failed to provide timely and accurate information. In our view, the last sentence of Box 75 should be interpreted in such a way that if the AIFM does not satisfy the requirements, the depositary cannot exercise its duties and should therefore be exonerated from its liability. - Regarding Box 76, ESMA’s draft advice suggests two options with Option 1 having the depositary act as a central hub to ensure an effective and proper monitoring of all cash movements and Option 2 setting out minimum requirements for the depositary to meet its monitoring obligations (see also question 29 of the Consultation Paper). The IFIA strongly advocates the approach as set out in Option 2 as it allows the depositary to focus on adequate supervision and monitoring of transactions. - In Article 21(8) of the AIFMD, the AIFMD differentiates between “<i>assets to be held in custody</i>” and “<i>other assets</i>” which are subject to the depositary’s record keeping duties. It is		

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		absolutely essential that the definition of financial instruments which can be held in custody by the depositary (as distinct from “<i>all other assets</i>”) and therefore where a more rigorous standard of liability applies, is completely unambiguous. In Box 78 for the definition of assets that should be held in custody, the first Option contemplates a definition by which all financial instruments registered or held in an account directly or indirectly in the name of the depositary through a subsidiary or a sub-custodian would be considered as instruments to be held in custody. The second Option proposes referring to the use of settlement systems to define what financial instruments should be held in custody. The IFIA favours Option 2 with some additional wording as set out below, as it is in line with our view that only assets over which the depositary has control and is able to retrieve if necessary should be required to be held in custody. With regards to the “<i>other assets</i>”, we support the suggested a <i>contrario</i> approach as it avoids interpretation difficulties and allows for a clear distinction.
5.	An important question is the treatment of collateral. Given the different circumstances in which collateral is exchanged (e.g., prime broker, securities lending, collateralisation of OTC transactions), it is important that the duties and responsibilities of the depositary in this context are clearly defined. The Consultation Paper contains three options in Box 79 as to when collateral should not be held in custody. The first only sets out that collateral provided under title transfer collateral arrangements should not be held in custody. Option 2 is broader by adding security financial collateral arrangements by which the control over/possession of the financial instruments is transferred away from the AIF or the depositary to the collateral taker or a person acting on its behalf. The third Option suggests that collateral provided under a financial collateral arrangement should not be held in custody. In our view, the third Option is to be preferred as it represents a more pragmatic approach. Option 2 on the other hand does not appear desirable because of the complexity and lack of certainty around determining the requisites for possession and control under the Financial Collateral Directive. Option 1 is not acceptable because it would require an analysis of whether title is deemed to transfer under applicable law or not and, if so, under what circumstances and therefore unworkable. Another key point is that the Consultation Paper indicates that any definition of Financial Collateral Arrangements will need to be compliant with the Financial Collateral Directive (FCD), which is not a requirement under the Level 1 Directive. This could be important as the FCD does not apply to non-financial collateral, such as real estate.	
6.	The IFIA would like to understand why only title transfer financial collateral arrangements (FCA) are mentioned as “<i>other assets</i>” in paragraph 29 of the explanatory text on page 157 if an AIF no longer owns assets either because of a title transfer FCA or under a repo agreement (referred to in paragraph 34, page 159), why should they be included in “<i>other assets</i>” where depositaries have to verify ownership? In addition, the IFIA feels it is important that it is clarified by ESMA how it expects both encumbered and unencumbered assets are treated with regards to Box 78, 79 and 80, specifically in respect of assets held by the prime broker.	
7.	The safekeeping duties that will apply to financial instruments to be held in custody as set out in Box 80 seem appropriate and are, as mentioned above, in line with current industry best practice. However, the IFIA would welcome further clarifications on the requirement under point (c) of Box 80 to “<i>assess and monitor all relevant custody risks. In particular, depositaries should be required to assess the custody risks related to settlement systems and inform the AIFM of any material risk identified.</i>” Currently, certain depositaries provide their clients with regular information and overviews of the markets they are invested in. This	

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		includes assessments of perceived and potential risks in these markets. The requirement as set out in Box 80 however was not contemplated in the AIFMD and goes beyond what is current best market practice, especially by establishing a legal obligation for the depositary to inform the AIFM of any material risk identified. In light of the stringent depositary liability it has to be taken into account that, as recently seen in the context of the political developments in Northern Africa, such risks can materialise without any previous signs or indications and at very short notice, this could have unintended consequences for the depositary as it is unclear whether in such situations it would have failed to perform its safekeeping duties. We would therefore recommend changing the wording of Box 80 in the following way:
		Box 80 <i>Safekeeping duties related to financial instruments that can be held in custody</i> 1. <i>To comply with its obligations pursuant to Article 21 (8) (a), the depositary should be required to at least:</i> (a) <i>Ensure the financial instruments are properly registered in segregated accounts in order to be identified at all times as belonging to the AIF</i> (b) <i>Exercise due care in relation to the financial instruments held in custody to ensure a high level of protection</i> (c) <u>Ensure that appropriate processes are in place to</u> <i>assess and monitor all relevant custody risks. In particular, depositaries should be required to assess the custody risks related to settlement systems and inform the AIFM of any material risk identified <u>as appropriate and within a reasonable timeframe.</u></i>
	8.	Assets that fall into the “<i>other assets</i>” category will be subject to the depositary’s record keeping obligations which include the requirement for the depositary to undertake an ownership verification of these assets. In determining the obligations of the Depositary it is important that sufficient guidance is given on what constitutes “<i>sufficient and reliable information</i>” to verify ownership. Further detailed guidance on this point at Level 3 is necessary and we would therefore support ESMA developing guidelines in this respect as referenced in paragraph 37 of the ESMA’s Explanatory Notes. It should also be considered to place a regulatory requirement upon the AIFM, as part of its investment decision making process, to satisfy itself of ownership. The AIFM should be under a regulatory obligation to provide evidence of ownership to the depositary. This should not simply be left to contract. We note that paragraph 5, page 173 states that a depositary can delegate its record-keeping tasks. With regards to the specific requirements that the depositary will have to fulfil to meet its duties, ESMA proposes two options in Box 81. Option 1 on the one hand requires the depositary to ensure that there are procedures in place so that assets so registered cannot be assigned, transferred, exchanged or delivered without the depositary or its delegate having been informed of such transactions or to have access to documentary evidence of each transaction from the relevant third party on a timely basis. Option 2 on the other hand requires the depositary to ‘<i>mirror</i>’ all transactions in a position keeping record. The IFIA strongly advocates Option 1 as it is much more pragmatic and acknowledges that the “<i>other assets</i>” may not be controllable by depositaries. Mirroring of transactions as suggested under Option 2 however is not desirable as set out previously. Whilst the IFIA therefore supports Option 1 set out in Box 81, we believe that some minor amendments are required. In order for the depositary to comply, at a reasonable cost, with its

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	obligation to provide at any time a comprehensive and up to date inventory of the AIF's assets, we would therefore recommend the following wording in Box 81:	
	Box 81 Safekeeping duties related to 'other assets' – Ownership verification and record keeping To that end, the depositary should: Option 1 (i) ensure there are procedures in place so that assets so registered cannot be assigned, transferred, exchanged or delivered without the depositary or its delegate having been informed of such transactions; or (ii) have access to documentary evidence of each transaction from the a relevant third party on a timely basis; Option 2 mirror all transactions in a position keeping record In the context of § (b) the AIFM should be required to ensure that the relevant third party provides the depositary with certificates or other documentary evidence of ownership every time there is a sale / acquisition or a corporate action and at least once a year. In any event, the depositary should ensure that the AIFM has and implements appropriate procedures to verify that the assets acquired by the AIF it manages are appropriately registered in the name of the AIF or in the name of the AIFM on behalf of the AIF, and to check consistency between the positions in its records and the assets for which the depositary is satisfied the AIF or the AIFM acting on behalf of the AIF holds the ownership. Additional requirement if Option 2 is retained in Box 78 with regard to the definition of financial instruments to be held in custody In the context of § (a), the depositary should ensure the AIF, its investors or the AIFM acting on behalf of the AIF, are able to exercise their rights if a problem arises that affects assets for which the depositary or its delegate is the registered owner either by clearly identifying the AIF as the ultimate owner of the assets or, where the depositary or its delegate is the only registered owner of the assets on behalf of a group of one or more unidentified clients, by taking appropriate actions to ensure the AIF's ownership right is recognised by the relevant parties. Where a legal action is required, the costs related to such an action would have to be borne by the AIF, the AIFM or as the case may be the AIF investors. 4. The depositary should set up and implement an escalation process for situations where an anomaly is detected (e.g., to notify the AIFM and if the situation cannot be clarified / corrected, alert the competent authority).	
9.	With regard to the suggested general requirements under the depositary's oversight duties, the IFIA agrees with ESMA's overall view that the depositary should set up procedures and processes which are proportionate to the estimated risks. We are also generally supportive that there is recognition that oversight is on generally on an <i>ex post</i> basis and involves verification of processes and procedures. However, we would propose to add a statement in the last paragraph of Box 82 to allow the depositary to perform on site visits and/or rely on other information such as internal/external accountants/auditor control reports and internal/external audit reports in order to build an efficient oversight function. Procedures and process reviews are reviewed by the AIF's internal and external auditors. Moreover, the review by the depositary is in any case superfluous if the depositary and any related group service providers use their own system for fund accounting and investment restriction controls. Alternatively, the depositary could verify and review SAS 70 reports and internal	

No.	Question	Response
	audit reports provided by the AIFM instead of performing on site visits. Where depositary uses its own systems to perform the tasks outlined in Article 21(9) a-e of the AIFMD, additional oversight tasks regarding the performance/processes of the AIFM should not be required.	
		Box 82 <i>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 <u>and/or review internal/external audit reports, independent accountants controls reports and statements (e.g., SAS 70)</u> 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.</i>
10.	When it comes to the depositary's oversight duties related to the valuation of shares as set out in Box 84, the IFIA would like to highlight some concerns and recommend a limited number of changes. In our view, ESMA's recommendations in Box 84 go well beyond the requirements of the AIFMD without adding meaningfully to investor protection. Article 21(9)(b) of the AIFMD requires the depositary to "...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..."	In Box 82, "potential irregularities" are undefined and as such could be far reaching. It would appear that this puts the onus on the depositary to identify potential irregularities which also is subject to wide interpretation. This needs to be clarified that the depositary oversight duty is to monitor the AIF in accordance with its investment restrictions and fund documentation. We suggest that the definition of irregularities is limited to those considered in UCITS IV (Commission Directive 2010/44/EC). Included in paragraph 56, page 167, we are concerned with the statement that if "[...] <i>an AIF has defined in its rules that it is not be distributed to a certain category of investors (e.g. citizens of a certain country for tax purposes for example, the depositary would be required to ensure that no units/shares are sold by any unitholder/shareholder to such an investor.</i>" In our view this goes well beyond the requirements of Article 21 AIFMD and is not workable. Paragraph 62, page 169, introduces the idea that the depositary should check whether "<i>the AIF's investments are consistent with its investment strategy [...] to ensure it does not breach its investment restrictions.</i>" While a depositary might sensibly seek to "ensure" that investment restrictions are not violated, an obligation for a depositary to ensure that a real estate fund's investments "<i>are consistent with its investment strategy</i>" would not be possible to meet in most cases and would involve an unacceptable level of subjectivity in the execution of the depositary function. We believe that this goes beyond the Level 1 Directive, Article 21(9)(c), which states that the depositary shall "<i>carry out the instructions of the AIFM, unless they conflict with the applicable national law or the AIF rules or instruments of incorporation</i>". The terms "<i>applicable national law</i>" and "<i>AIF rules or instruments of incorporation</i>" are used throughout clause 9 of Article 21. The prospectus/investment strategy or objective would not be included in that definition and we would ask that monitoring be limited to those areas, for the reasons stated above earlier.

No.	Question	Response
		Different from ESMA’s recommendations, the depositary is hence not required to directly “oversee” the valuation of the AIF’s assets. Accordingly, we recommend the deletion of item no. 1 of Box 84. Furthermore, we would advocate further clarification regarding the allocation of responsibilities in the valuation process and would therefore recommend the following amendments to item no. 2 of Box 84 as follows: <i>“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.”</i> In addition, item no. 3 should be amended to replace “valuation policy” with “policy for the calculation of the value of the units or shares of the AIF”. As the depositary is not required to oversee the valuations of assets or the decision to appoint an external valuer, item no. 5 should also be deleted. The decision as to whether to utilize an “internal” versus “external” valuer is the responsibility of the AIFM, and the AIFM must ensure compliance with the valuation and delegation requirements as set out in Article 19 and 20 of the AIFMD. The IFIA would therefore recommend the following wording for Box 84:
	Clarifications of the depositary’s oversight duties Duties related to the valuation of shares / units (b) The depositary should verify on an on-going basis that appropriate and consistent procedures are established for the valuation of the assets of the AIF in compliance with the requirements of Article 19 and its implementing measures and the AIF rules and instruments of incorporation. - The depositary should ensure that the valuation policies and procedures for the calculation of the value of the units or shares of the AIF are calculated, are effectively implemented and periodically reviewed. - The depositary’s procedures should be proportionate to the nature, scale and complexity of the AIF and conducted at a frequency consistent with the frequency of the AIF’s valuation policy policy for the calculation of the value of the units or shares of the AIF as defined in Article 19 and its implementing measures. - Where the depositary considers the calculation of the value of the shares or units of the AIF has not been performed in compliance with applicable law or the AIF rules or the provisions of Article 19, it should notify the AIFM and ensure timely remedial action has been taken in the best interest of the AIF’s investors. Where applicable, the depositary should be required to check that an external valuer has been appointed in accordance with the provisions of Article 19 of the AIFMD and its implementing measures.	Box 84
11.	Furthermore, in light of ESMA’s considerations in the explanatory notes in paragraph 58, the IFIA believes that the depositary should be expected to take <i>reasonable</i> steps, instead of “appropriate” steps to ensure that the procedures for the calculation of the value of the units or shares of the AIF are appropriate. Lastly, we would recommend the deletion of 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” in this section as this is outside the direct remit of the depositary.	

No.	Question	Response
12.	Box 87 sets out ESMA's suggested measures as regards the depositary's oversight duties related to the AIF's income distribution. In line with the depositary industry's view, the IFIA notes that these duties 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. In addition, point two in Box 87 suggests requiring the depositary to ensure that appropriate measures are taken where the AIF's auditors have expressed reserves on the annual financial statements. In our view, this goes beyond the oversight duties that the depositary could and should be required to perform. In the case of such concerns, it should be the duty of the auditor and ultimately the relevant competent authorities to ensure that appropriate actions are taken by the AIFM. The IFIA therefore recommends amending Box 87 as follows:	Box 87 Clarifications of the depositary's oversight duties Duties related to the AIF's income distribution (e) <i>To fulfil its obligation pursuant to Article 21(9)(e), the depositary should be required to:</i> 1. <i>Ensure the net income calculation, once declared by the AIFM, is applied in accordance with the AIF rules, instruments of incorporation and applicable national law</i> 2. <i>Ensure appropriate measures are taken where the AIF's auditors have expressed reserves on the annual financial statements</i> 3. <i>Check the completeness and accuracy of dividend payments and where relevant of the carried interest</i>
13.	Regarding due diligence, we welcome that in its draft advice, ESMA is proposing a series of principles that are based on such best market practice. The one point where we would recommend changes to ESMA's draft advice is under point 5 in Box 88. There, ESMA suggests that the depositary shall terminate the contract in the best interest of the AIF and its investors where its delegate no longer complies with the requirements. This approach seems too rigid to us. Instead, we would suggest a multi-stage process which would first allow the depositary to require its delegate to undertake appropriate remedial measures before, as the <i>ultima ratio</i>, having to terminate the contract if the non-compliance of the delegate with the requirements continues. This would allow for a more flexible and workable process that takes into account the operational realities around changing the sub-custodian.	14. In Box 88, 1 (a) (iv) use of the word "ensure" is inconsistent with assessment requirement in other three sub-points of (a), we suggest that "assess" is more consistent with the depositary's requirements in relation to operational and technological capabilities. Section b (iii) Custody risks, as drafted, is very broad – and we would need clarification on the type of specific risks that need to be highlighted to the AIF or AIFM. We feel that this requirement changes the responsibility from the AIF/M to the depositary to be aware and disclose specific custody risks in markets where the AIF/M is investing. Ultimately this requirement appears to shift some of the market assessment requirements and related investment consideration process from the AIF/M to the depositary which we feel is not appropriate given that the AIF/M is making the investment decision. 15. Ensuring the proper segregation of clients' assets is one of the main elements in a depositary's selection and monitoring process of its sub-custodians and plays a key role in the protection of investors' assets and interests. We agree with the importance attributed to

No.	Question	Response
		segregation and support the suggested implementing measures as set out in Box 89. In particular, we welcome and strongly support the explicit recognition of the validity of the use of <i>omnibus accounts</i> given their widespread use in the industry. Assets held in <i>omnibus accounts</i> are segregated by the records on the depositary's system, which ensure at all times that depositary can identify client assets. In relation to Box 89, 1(b), a second (or third or fourth) party in the sub-custody chain will not distinguish between each individual client of a depositary bank through its own books and records. That is performed by the depositary. As a result, such parties in the custody chain could not comply with the requirement that they ensure that their books and records have a "<i>correspondence to the assets safe kept for the depositary's clients</i>". We believe it would be reasonable to delete the last phrase of Box 89,1(b) so that it refers only to "<i>maintain records and accounts in a way that ensures their accuracy</i>". This acknowledges the different obligations that lie on parties throughout the custody chain.
		Box 89 <i>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)</i> <i>1. Where safekeeping functions have been delegated partly or totally to a third party, the depositary must ensure that the third party acts in accordance with the segregation obligation pursuant to Article 21 (11) (d) (iii) by verifying that the third party has put in place arrangements that are compliant with the following requirements:</i> <i>a) to keep such records and accounts as are necessary to enable it at any time and without delay to distinguish assets safekept for the depositary on behalf of its clients from its own assets and from assets held for any other client (including assets belonging to the depositary itself);</i> <i>b) to maintain records and accounts in a way that ensures their accuracy; and in particular their correspondence to the assets safekept for the depositary's clients;</i>

No.	Question	Response
16.	Section V.IV - The depositary's liability regime In Box 90, ESMA sets out its proposed definition of loss of assets which, amongst others, suggests that an asset can be lost in one of the following three situations: • where the financial instruments no longer exist or never did; • where the financial instruments exist but the AIF has lost its right of ownership over them; or • where the AIF still holds the ownership right but cannot dispose of the financial instruments. In this context, we welcome ESMA's recognition, as stated in the explanatory notes, that a financial instrument should only be considered lost if the AIF has been permanently deprived of its right of beneficial ownership or is unable to dispose of them on a permanent basis. Also, we support ESMA's acknowledgement that any intentional transfer of ownership by the AIF or the AIFM acting on behalf of the fund to a third party (e.g., prime broker or collateral agent) should not be considered as a "loss". However, it is disappointing to note that instances of fraud which has taken place within the depositary's network or one of its sub-custodians, the depositary would be held liable. Fraud is practically impossible to uncover even with the best control environments in place and may go uncovered for years. Whilst good due diligence procedures and oversight may mitigate its occurrence, we feel this should be regarded as an external event. Similarly, the IFIA would recommend clarifying that in case of loss resulting from a fraud within the (external) sub-custodian whereby the financial instruments have either never existed or have never been attributed to the AIF as a result of a falsified evidence of title, it is not the responsibility of the depositary to return the assets. Furthermore, whilst we would have preferred that sub-custodian insolvency is considered an external event beyond the depositary's reasonable control, the regulatory framework for sub-custodian insolvency as proposed by ESMA seems workable. We support that in the case of sub-custodian insolvency, assets will not be considered lost until the end of the insolvency proceedings. However, ESMA's proposal, as set out in the explanatory notes, that it should be up to the AIFM to determine whether the financial instruments are lost causes concern as in situations such as the Lehman Brothers Europe failure; this could lead to significant legal disputes before the insolvency proceedings have even been finalised. The IFIA believe that the decision to determine a loss should be left to relevant third parties and ultimately, as suggested, to the courts where there is a disagreement between the AIFM and the depositary.	17. As set out in Box 91, point 1, "<i>the event which led to the loss did not occur as a result of an act or omission of the Depositary or one of its sub custodians to meet its obligations</i>" leads to the following concerns: (i) if an act or omission which was proper led to the loss, then it is inequitable to hold the depositary liable. The standard of negligent or intentional failure to perform obligations has to be respected. Otherwise, Level 2 creates a standard which is different than Level 1; and (ii) the act or omission may only be part of a chain of events. If the depositary's act or omission was not the "<i>proximate cause</i>" of the loss, then it would be inequitable to hold them solely liable for the loss. Therefore we would suggest the following amendment: <i>"The event which led to the loss did not occur as a result of an improper act or omission of the depositary or one of its sub-custodians to meet its obligations."</i> Regarding paragraph 29, page 184 of the Explanatory paragraph, we remain very concerned

No.	Question	Response
		about the assumption that any acts and omissions of any appointed sub-custodian are automatically deemed to be “<i>internal events</i>” and hence there may be no ability for depositaries to be discharged from liability for “<i>events</i>” occurring at sub-custodians unless the contractual discharge requirement suggested in Box 92 is satisfied, which we believe is highly unlikely. In our view, the only sensible way of providing a means of discharge from liability is if events occurring at sub-custodians are not always deemed “<i>internal</i>” so that “<i>external events</i>” occurring at sub-custodians can be a basis for discharge from liability. Otherwise, the net result, in effect, is strict liability for depositaries even where every effort is taken to select, supervise and monitor the sub-custodian with utmost care. We believe that it would be reasonable for the depositary to be exonerated from liability provided it can prove that it fulfilled the segregation and due-diligence requirements as set down in the AIFMD and 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 of the depositary in respect to its duties above in relation to the delegation of custody. We do not think that Article 21(12) requires or supports such an interpretation of the word “<i>external</i>”. This issue is of such fundamental importance that such an interpretation could be considered to be a <i>de facto</i> amendment of the Level 1 text, which would go beyond ESMA's mandate to provide the Commission with technical guidance. If ESMA's proposed interpretation of the word “<i>external</i>” is taken forward and accepted by the Commission, not only would this in our view be contrary to the Level 1 text, but the practical result is likely to be highly counterproductive. Capital costs to depositaries would increase significantly. Those costs, which will probably be uninsurable and would inevitably be ultimately borne by the AIF and investors in the AIF, in order for any depositary's business model to be sustainable.
18.	The IFIA notes that point 3 in Box 91 requires that as a condition for the depositary to not be liable, it needs to prove that “<i>rigorous and comprehensive due diligences could not have prevented the loss</i>”. In our view, this seems to introduce a different due diligence standard different to what is being required under the due diligence and oversight sections of ESMA’s draft advice. We would therefore recommend replacing “<i>rigorous and comprehensive</i>” with “<i>the exercise of reasonable efforts</i>”.	
19.	The draft advice suggests that in situations where the depositary believes that given increasing risks in a market the only appropriate action is to dispose of the financial instruments, it must duly inform the AIFM, who must instruct the depositary in writing whether to continue holding the financial instruments or to dispose them. If the depositary is instructed to continue holding the assets, any such instruction must be reported to the competent authorities and the AIF’s investors. Where the depositary having notified the AIFM several times remains concerned that the level of protection of the financial instruments is not sufficient, it should notify the competent authorities and assess whether to request the authorisation to transfer its liability to a sub-custodian or ultimately consider terminating the contract. The depositary’s ultimate recourse is to put an end to its contract with the AIF/AIFM provided the AIF is given a period of time to find another depositary. The depositary’s ultimate recourse is to put an end to its contract with the AIF/AIFM provided the AIF is given a period of time to find another depositary.	
		These proposals cause significant concerns within the industry and we have serious reservations about their workability. More importantly, it would leave the depositary with unlimited and strict liability.
		Firstly, the IFIA rejects the concept of the depositary having a legal obligation of informing the AIFM of general risks building up in a market. Depositaries provide their clients with regular information and overviews of the markets they are invested in as such information becomes available, including assessments of perceived and potential custody risks in these

No.	Question	Response
		markets and reports on changing infrastructural conditions. However, it is not the depositary's responsibility to provide the AIFM with information on other, more general risks in a market. The monitoring of such risks should be the AIFM's obligation as part of its governing body responsibilities and is ultimately part of market risk attached to an investment. Secondly, the assumption that the sub-custodian will be willing and accept to take over the depositary's liability following the depositary's warning is unrealistic. Thirdly, if the depositary is terminating an agreement because the AIFM chooses not to act upon its advice, it is unlikely that the AIFM will find another depositary willing to take on the AIF. Also, such a transfer of assets requires a certain period of time during the depositary would still be liable for the loss of assets until the transfer is completed. Furthermore, the suggested measures are very likely to create moral hazard for the AIFM as it could assume that independent from market developments and its own investment decisions, the depositary will have to return the assets without undue delay. The suggested measures are therefore contradicting the stated objective of striking the right balance between investor protection and depositary liability and therefore need to be substantially changed. In a situation where a depositary believes that the only appropriate action is to dispose of the financial instruments and it informs the AIFM, if the AIFM disregards this advice, the only remaining appropriate actions are escalating to the AIF's governing body and, if this does not address the issue to the depositary's satisfaction, notifying the AIFM's competent authority. Such actions should operate to ensure the depositary is discharged of its liability. The AIFM and/or the AIF's governing body should be required to consider the depositary's views. If the AIFM and/or the AIF's governing body nevertheless decide to retain the investments, this should be seen as an investment decision and, unless the AIFM has acted negligently, liability in the event of a loss rests with the AIF. ESMA should consider requiring AIFMs to address these possibilities in disclosures to investors pursuant to Article 23(1)(d) of the AIFMD, thus providing for informed decisions by investors.
20.	The last issue that ESMA considers as part of its draft advice in the context of depositary liability is the contractual discharge of liability to a sub-custodian. Of the two Options suggested, Option 2 is much preferred, since it preserves freedom of contract. However, we feel that it would be useful to outline by way of example the types of situation that would be deemed to qualify for a discharge of liability as is the case in Box 65 where the objective reasons for the AIFM are set out.	

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

No.	Question	Response
55	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?	Intentionally left blank.
56	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?	Intentionally left blank.
57	Is further clarification needed in relation to the treatment of contingent liabilities or credit-based instruments?	Intentionally left blank.
58	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?	Intentionally left blank.
59	Which of the three options in Box 99 do you prefer? Please provide reasons for your view.	Intentionally left blank.
60	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?	We do not believe that leverage created at the level of an AIF-controlled entity is relevant except where this would contribute to the leverage at the level of the AIF. We believe that the primary concern here should be transparency for AIF investors so that they can determine the maximum potential loss their investment in the AIF might incur due to leverage. Therefore, as long as the AIF-controlled entity is a limited liability company

		or subject to an arrangement whereby recourse to the AIF is limited to the amount of capital it has paid or is committed (even if uncalled) in respect of the underlying entity, this should not add to the leverage levels of the AIF. The terms of the AIFMD are limited to regulating the AIF under management by the AIFM and it seems to be extending the scope of the AIFMD to consider leverage generated through companies or other issuers which are not themselves AIF.
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VII. Possible Implementing Measures on Limits to Leverage or Other Restrictions on the Management of AIF

No.	Question	Response
61	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.	Intentionally left blank.
62	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?	Intentionally left blank.
63	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?	Intentionally left blank.
64	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 suggest that the provisions of the FSA Remuneration Code, including the exemptions for Tier 4 firms, should be used as a basis for any rules applicable to AIFM.
65	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?	Intentionally left blank.

66	Do you agree with ESMA's proposed definition of special arrangements? What would this not capture?	Yes, although we disagree that redemption gates should be considered to be special arrangements as they typically apply with equal effect to all investors.
67	Which option for periodic disclosure of risk profile under Box 107 do you support? Please provide reasons for your view.	Option 1, because it will allow the professional investor to quickly and easily assess meaningful information. We suggest that the wording of Option 1 be amended to refer to " <i>material</i> " risks.
68	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.	No.
69	Do you agree with the proposed frequency of disclosure? If not, please provide alternative suggestions.	No, we believe that the frequency of disclosure as proposed is unduly onerous. We suggest that the template as described be required annually, within 4 months of the end of the period. We also suggest that an abridged balance sheet summary be required semi-annually within 2 months of the period end.
70	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.	We are not in a position to assess costs until we understand the required frequency and deadline.
71	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?	No. See our response to question 69 above.
72	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	Intentionally left blank.

	to prepare such an assessment?	
Additional Comments: We are concerned that there is no requirement in the guidelines for competent authorities to take into account the impact on the clients when deciding whether to intervene to limit the amount of leverage within any AIF. In particular if, as a result, an AIFM was forced to reduce leverage in AIFs without allowing clients sufficient time to provide extra capital, clients' protection against movements in interest rates and inflation expectations would also be reduced. This could leave pension schemes exposed to adverse movements in interest rates and inflation; the very situation they were using the AIFs to avoid. If rates were to fall post the leverage reduction, for example, this would lead to a deterioration in the funding level and make it harder for a pension scheme to meet its pension promise.		

APPENDIX I



GUIDANCE PAPER 3

Trustee Duties as set out in applicable regulations

Irish domiciled collective investment schemes authorised as either UCITS or Non UCITS ('NU') (herein after referred to as the "Fund"), require the appointment of a Trustee / Custodian (herein after referred to as "Trustee"). The Trustee is required to fulfill duties outlined in UCITS 4 and NU 7. Duties 1 – 7 cannot be delegated by the Trustee to a third party and these duties must be carried out in the state. The focus of this paper is on these seven duties. The remaining duties pertain largely to the responsibilities of the Trustee in relation to the appointment of sub-custodians. Guidance in relation to these duties is set out in the IFIA Guidance note 1 "Safekeeping of Fund Assets".

The Manager of a Unit Trust or Common Contractual Fund or the Board of Directors of an Investment Company has the primary responsibility for ensuring that the Fund is managed in accordance with the fund documentation and the Regulations. These parties may delegate the management functions to various service providers ("delegates"). The Trustee is independent of the Manager/the Board and has an oversight responsibility in relation to the fund complying with the fund constitutional documentation and applicable regulations in accordance with its duties.

While the relevant notices include the duties of the Trustee they do not include detail on how such duties are to be discharged. This is at the discretion of the individual Trustee.

It is generally accepted that such duties will have been discharged if the Trustee is satisfied that sufficient procedures and controls exist within the Investment Company/Manager or its appointed delegates e.g. Fund Administrator. To discharge these duties, the Trustee will need to establish through periodic assessment and oversight procedures that the fund is being managed in accordance with the applicable regulations and the Fund's constitutional documentation.

Oversight Procedures

The Trustee carries out its oversight function on a historic, post trade basis, following the finalisation of the Net Asset Value by the Fund Administrator. The Trustee may achieve this through undertaking a number of oversight procedures which will include some or all of the following:

- On-site inspections of the Fund Administration
- On-site inspections of the Transfer Agent
- Review of Procedural documentation where provided
- Sample walk-through testing
- Oversight of compliance with the Fund's investment restrictions and borrowing powers in the Regulations and the Fund's constitutional documentation
- Obtaining Representations / Confirmations
- Oversight of Reconciliations
- Oversight of the calculation of NAV
- Oversight of the share/unit holder register
- Review of Management Information reports being used by senior management of the Administrator.

Use of Independent Reports

The Trustee may also take into account other independently prepared reports, such as Internal audit reports, External audit findings or SAS 70 reports, in making its assessment of the control environment of the Administrator / Manager.

Reliance on Representations

For certain areas it may be necessary to rely on representations from the Manager / Investment Manager or Administrator where it is not possible for the Trustee to confirm such information independently. In such circumstances the Trustee will assess its ability to rely on such representations based on the reputation and standing of the Manager / Investment Manager or Administrator.

Frequency

The frequency with which oversight work is completed is at the discretion of the Trustee and should be based on its assessment of the control environment in place and by reference to issues identified during previous reviews. The Trustee will refer to breaches and pricing error logs as a summary indicator of the types of issues arising in the overall management of a Fund.

An onsite inspection of the Fund Administrator and/or Transfer Agent within the financial year may be deemed appropriate; however other oversight and review

procedures carried out by the Trustee may reduce the frequency of and the level of detail covered in the onsite inspections.

The IFIA has issued an information note for Trustees in relation to On-Site Inspections of Fund Administrators and Transfer Agents which provides guidance to the Trustee for onsite inspections.

Investment and Borrowing Restriction Reviews

Reviews of Investment restrictions and borrowing power are carried out on an historical basis ie post trade basis and are typically carried out monthly by the Trustee; however, they may be carried out less frequently having regard to the complexity and valuation frequency of the funds in question.

New Funds Set Ups

The Trustee should give consideration to the timing of oversight in the case of new fund launches.

Escalation of Unresolved Issues

If issues are identified as a result of the Trustee's oversight of the Fund and such issues are not resolved to the satisfaction of the Trustee within a reasonable timeframe such issues may be escalated to the Manager/Board of Directors for their attention. The Trustee should consider whether an unresolved matter needs to be reported to the share/unit holders in the annual accounts. If the Trustee deems the matter to be material, the Trustee will act in accordance with its responsibilities in this regard. Please refer for further details to Trustee Duty 7 as outlined in this paper.

Summary

The discussion of each duty on subsequent pages of this paper includes areas that the Trustee may wish to take into account in discharging their oversight responsibilities. This is a guide and not an exhaustive list. Trustees will perform their duties taking into account a number of factors including but not limited to the risk profile of the fund, the frequency of the NAV, the loss events/error experience of the Fund and the Trustee's experience of the controls in place in relation to the overall management of the Fund over a period of time.

The Central Bank has set out the same responsibilities for the Trustee of a UCITS fund (Notice 4) and a Non-UCITS fund (Notice 7).

These rules state that the Trustee must:

1. Ensure that the sale, issue, repurchase, redemption and cancellation of units affected by or on behalf of a unit trust, a common contractual fund or an investment company are carried out in accordance with the Regulations and in accordance with the trust deed, the deed of constitution or memorandum and articles of association.
2. Ensure that the value of units is calculated in accordance with the Regulations and the trust deed of a unit trust, the deed of constitution of a common contractual fund and the articles of association of an investment company.
3. Carry out the instructions of the management company unless they conflict with the Regulations, the trust deed or the deed of constitution. The trustee must carry out the instructions of the investment company unless they conflict with the Regulations or the memorandum and articles of association.
4. Ensure that in transactions involving a unit trust's, a common contractual fund's or an investment company's assets, any consideration is remitted to it within time limits which are acceptable market practice in the context of a particular transaction.
5. Ensure that a unit trust's, a common contractual fund's or an investment company's income is applied in accordance with the Regulations, the trust deed, the deed of constitution or memorandum and articles of association.
6. Enquire into the conduct of the management company or the investment company in each annual accounting period and report thereon to the share/unit holders.
7. The trustee must notify the Central Bank promptly of any material breach of the Regulations, conditions imposed by the Central Bank or provisions of the prospectus with regard to a unit trust, common contractual fund or investment company.

TRUSTEE DUTY 1

To ensure registration is carried out correctly

UCITS 4 (1) and NU 7 (1) require the following:

“The Trustee must ensure that the sale, issue, repurchase, redemption and cancellation of units affected by or on behalf of a unit trust, a common contractual fund or investment company are carried out in accordance with the Regulations and in accordance with the trust deed, the deed of constitution or memorandum and articles of association.”

The manner in which the Trustee discharges its responsibility and the frequency of any oversight work is at the discretion of the Trustee and is not prescribed by the Central Bank. The Trustee may consider some or all of the following areas in considering whether the registration is in line with fund documentation:

- Subscription and redemption trade processing (e.g. in accordance with the Fund’s constitutional documentation)
- Controls and procedures surrounding investor documentation and processing
- Controls and procedures surrounding distribution payments
- Unit/share reconciliation;
- Investor Complaints Log
- Transfer Agent Error Logs
- Trades received after dealing deadlines
- Transfer Agent’s outstanding cash receipt report together with the unit/share dealing process, and related controls and procedures.

The Trustee’s procedures to assess the above areas may wish to make use of some or all of the oversight procedures outlined at the commencement of this paper.

TRUSTEE DUTY 2

To Ensure the NAV is calculated correctly

UCITS 4 (2) and NU 7 (2), requires the following:

“The Trustee must ensure that the value of units is calculated in accordance with the Regulations and the trust deed of a unit trust, the deed of constitution of a common contractual fund and the articles of association of an investment company.”

The manner in which the Trustee discharges its responsibility and the frequency of any oversight work is at the discretion of the Trustee and is not prescribed by the Central Bank. The Trustee may consider some or all of the following areas in considering whether the NAV is calculated correctly in line with fund documentation:

- Valuation Policy (compliance with prospectus)
- Trade Capture Process
- Expense Process
- NAV Errors Log
- Cash and Stock Reconciliations from Accounting to Custody records
- Income Capture and Completeness
- Outstanding Payables and Receivables
- Performance fee verification (e.g. calculation and methodology in accordance with the Prospectus)
- Income distribution to unit/share holders

The Trustee may wish to make use of some or all of the oversight procedures outlined at the commencement of this paper in their procedures used to assess the above areas.

IFIA Guidance Paper 6 provides guidance to the Administrators, the Manager/Board and the Trustee in respect of material NAV errors on Funds, their recording, reporting, correction and compensation. The Trustee should receive an error report on a material error which will detail how the error occurred and measures to ensure that a re-occurrence is prevented.

TRUSTEE DUTY 3

To carry out the instructions of the Management Company/Investment Company, unless they conflict with the law or the fund rules.

UCITS 4 (3) and NU 7 (3) states the following:

“The Trustee must carry out the instructions of the management company unless they conflict with the Regulations or the trust deed or the deed of constitution. The Trustee must carry out the instructions of the investment company unless they conflict with the Regulations or the memorandum and articles of association.”

The manner in which the Trustee discharges its responsibility and the frequency of any oversight work is at the discretion of the Trustee. Industry practice is that this duty is discharged when the Trustee is satisfied that there is a system in place to ensure any investment or borrowing breach, or other conflict, arising from an instruction to the trustee, is identified and rectified in compliance with the applicable regulations and the memorandum and articles of association/trust deed.

The following points are noted:

1. Under contract, the Trustee is obliged to settle the trades advised by the investment manager/advisor on a timely basis.
2. Industry practice is that investment trades are not reviewed by Trustee on a pre-trade settlement basis.
3. In general, the oversight procedures for other instructions of the Management Company / Investment Company are not carried out in advance of payment. The Trustee will only act on cash payments instructions from the custody accounts on receipt of authorised instructions.
4. Investment restrictions and borrowing power reviews are normally carried out monthly by the Trustee however they may be carried out less frequently having regard to the complexity and valuation frequency of the Fund in question.

The Trustee may wish to make use of some or all of the oversight procedures outlined at the commencement of this paper in their procedures used to assess the above areas.

TRUSTEE DUTY 4

To ensure consideration is remitted within acceptable time limits

According to Notice UCITS 4 (4) and NU 7 (4) , the Trustee:

“The Trustee must ensure that in transactions involving the unit trust’s, a common contractual fund’s or investment company’s assets, any consideration is remitted to it within time limits which are acceptable market practice in the context of a particular transaction.”

The manner in which the Trustee discharges its responsibility and the frequency of any oversight work is at the discretion of the Trustee but the Trustee may wish to take account of some or all of the following areas:

- Timeliness of receipt of investment trades by the Administrator
- Failed trades
- Outstanding receivable controls and procedures in relation to items included in the NAV
- Dividend / Corporate Action procedures and entitlements
- Cash and asset reconciliations
- Receipt of consideration for subscriptions

The Trustee may wish to make use of some or all of the oversight procedures outlined at the commencement of this paper in their procedures used to assess the above areas.

TRUSTEE DUTY 5

To ensure income is applied in accordance with applicable regulations and/or the fund constitutional documentation.

UCITS 4 (5) and NU 7 (5) requires the following:

“The Trustee must ensure that a unit trust’s, a common contractual fund’s or investment company’s income is applied in accordance with the Regulations, the trust deed, the deed of constitution or memorandum and articles of association.”

The manner in which the Trustee discharges its responsibility and the frequency of any oversight work is at the discretion of the Trustee and is not prescribed by the Central Bank. The Trustee may consider some or all of the following areas in considering if the income is applied in accordance with the Regulations.

- Income is accounted for in the NAV in line with fund documentation
- Completeness and accuracy of dividend accruals and receipts
- Completeness and accuracy of corporate event accruals and receipts
- Interest receivables in the NAV calculation

The Trustee in reviewing income components of the NAV will do so on a sample test basis. The Trustee may wish to make use of some or all of the oversight procedures outlined at the commencement of this paper in their procedures used to assess the above areas.

TRUSTEE DUTY 6

To issue a Trustee Report in each accounting period

UCITS 4 (6) and Non UCITS 7 (6) requires the following:

“The Trustee must enquire into the conduct of the management company or the investment company in each annual accounting period and report thereon to the unit holders.”

IFIA Paper 2, “Trustee Report” provides detailed guidance to the Trustee on the preparation of the Trustee report.

TRUSTEE DUTY 7

To ensure that material matters are reported to the Central Bank

UCITS 4 (7) and Non UCITS 7 (7) require the following:

“The Trustee must notify the Central Bank promptly of any material breach of the Regulations, conditions imposed by the Central Bank or provisions of the prospectus with regard to a unit trust, common contractual fund or investment company.

Where an error or breach is noted by the Trustee or brought to the attention of the Trustee and deemed material by the Trustee, the duty requires the Trustee to ensure that the Central Bank (CB) is notified of such material breach or error.

Reporting

The CB recognises that in addition to the Trustee, there are other parties who have responsibility to report material matters to the CB. These include the Board of Directors, the Management Company or indeed their delegates e.g. the Investment Manager or Administrator. It may be appropriate for any of these parties to make the report. The duty of the Trustee is to ensure that a report is actually made to the CB when a material breach/error arises rather than the Trustee necessarily making the report. However, it would be appropriate, where the Trustee is not the party submitting the report, for the Trustee to acknowledge to the CB that the Trustee is aware that the breach/error has been reported to the CB.

The format and content of a report may vary. The CB does not provide a reporting template or require reports in a standardised form.

Reporting promptly

A report should be made to the CB as soon as possible within a reasonable timeframe. The CB understands that it may take some time to collate the relevant information. Where appropriate given the significance of the matter, consideration should be given to advising the CB by phone in the first instance of the existence of a material issue giving a broad outline of the detail, followed by the written report.

Material

The materiality of a particular matter is subjective; therefore, a range of interpretations can be applied. In the context of breach reporting, materiality is not a term which has been defined, unlike the terms advertent and inadvertent, which are defined in the industry guidance papers.

Industry guidance on what constitutes materiality for the purposes of reporting is set out below. This is guidance to provide assistance in determining what matters to report; however this list below is not exhaustive and the Trustee retains discretion in this regard.

Material breaches of the Regulations:

Consideration should be given to the following when determining the materiality of a matter, including a material pricing error, for reporting purposes. This does not purport to be an exhaustive list but an illustrative guide for Trustees on some of the matters to be considered:

- Any breach or series of investment regulatory or prospectus breaches which causes the Trustee to have significant concerns about the overall management of the fund
- Any errors or series of errors which causes the Trustee to have significant concerns about the overall control environment in which the Fund is managed, the NAV is produced or the shareholder register is updated/maintained.
- Nature and circumstance of the breach or error. For example an inadvertent breach or immaterial NAV error may be deemed material for reporting purposes depending on the nature and circumstances of the breach or error
- Action or inaction of the responsible party eg Investment Manager, Custodian, Administrator in addressing the breach or error
- Length of time the breach or error is outstanding without resolution
- Recurring nature of the error or breach
- An advertent breach or material NAV error may be deemed material for reporting purposes if the impact to the fund and/or the unit/shareholders is greater than 50bp of the NAV. In determining whether it is appropriate to report the breach or error, consideration would be given to factors such as whether and at what level compensation was paid, the circumstance of the error and an assessment of the overall control environment.

Material breaches of the provisions of the Prospectus:

In relation to material breaches of the provisions of the prospectus, it is recognised by the CB that the focus of the Trustee review is on monitoring compliance with the investment and borrowing restrictions of the fund. However should other matters of a material nature come to the attention of the Trustee during the course of its review these would be reportable in line with this section.

Breach of the Conditions imposed:

Where the fund has been granted a specific derogation by the CB and the provisions or conditions of the derogation have been breached and this comes to the attention of the Trustee, the Trustee should ensure that such a breach is reported

Notwithstanding the guidance provided above on materiality, it is important to note that the Trustee retains discretion at all times to report or to ensure others report

breaches of the Regulations, conditions imposed by the Central Bank or provisions of the prospectus which the trustee deems material given the particular circumstances of the CIS and the breach in question.

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Updated May 2011