

European Services and Markets Authority  
103 Rue de Grenelle  
75007 Paris

September 13, 2011

**Re:** Consultation paper on ESMA's draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive.

Ladies and gentlemen,

RBC Dexia Investor Services welcomes the opportunity to comment on the proposed implementing measures in relation to the Alternative Fund Managers Directive, as set out in your consultation paper dated July 2011.

Equally-owned by RBC and Dexia, the company ranks among the world's top 10 global custodians with USD 3.0 trillion in client assets under administration. In Europe, we are among the leading third-party service providers for alternative funds and UCITS funds in all the major European financial centres.

Please find our responses below. We have focused only on those questions in which we have a special interest and did not take positions on all the issues comprised in the consultation paper.

We stand ready to engage in further dialogue with you or to submit more detailed responses if you would find that helpful. If you have any questions, please contact Jean-Michel Loehr on (+352 26 05 42 40).

Sincerely yours,

RBC Dexia Investor Services Bank

Jean Michel LOEHR  
Chief Industry and Government Relations.



D'Arcy CHADWICK  
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## Chapter III.II: influences of leverage on the assets under management

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

We do not consider that the provisions made by ESMA would cause any difficulties in particular.

For start-up situations, however, there might indeed be some peculiarities. An AIFM's initial threshold calculation should be based at the close of the first financial year which, for the first time at least, will not necessarily occur after a 12-month period as some countries may grant an extension for the first financial year-end.

Depending on the investment policy (e.g. fund of funds), the underlying investments may not always have audited accounts at their disposal when the AIFM should proceed to the threshold calculation. It should therefore be permitted to also rely on un-audited figures, if needs be.

In general, we would advocate the use of simple and practical solutions relying on existing figures (i.e. reports or latest available NAV calculations) for the sake of industry costs and the ease of control.

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

No. This would create bottle-necks for AIFs, AIFMs, valuers and other service providers active in administration services. In our view, the result of specifying a single date for threshold calculation would be that each AIF would use this as their financial year-end date. They would do this to avoid undertaking separate calculations for year-end and threshold during the year and could therefore create substantial logistical and resource problems for the financial services industry.

In our view, AIFs should be permitted to calculate the threshold at their own convenience. As a general principle, the date when the NAV of the AIF is calculated should determine the threshold, rather than the threshold date determining the date of the NAV calculation.

Forcing AIFs to use single date may further create timing problems at an investor level, if and when the investments in the AIF need to be consolidated by the investor.

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

In our view, an annual net asset value calculation is suitable for open-ended funds but not for closed-ended funds, as also recognized by ESMA under point 7 in the introduction. To our mind, it should be left at the discretion of the AIFM governing bodies to determine which methodology to deploy in the case of closed-ended structures. This methodology should be based on industry associations best practice recommendations.



## Chapter IV.II (Box 13): selection and appointment of counterparties and prime brokers

RBC Dexia suggests that the text provided in Box 13 be expanded to include specific contractual provisions between the counterparty or prime broker and the AIFM requiring the counterparty or prime broker to provide the information that the depositary requires to comply with its supervisory obligations.

Counterparties and prime brokers used by an AIFM will be required to provide the AIFM or the Depositary with all transaction information. Therefore, the contract of appointment with the counterparty or prime broker as delegate of the AIFM should contain a provision that they must provide such information to the Depositary so that the Depositary may discharge its supervisory duties. This provision should be similar to the provision contemplated in Box 75 in respect of information required to be provided in connection with cash accounts in Box 75 so that the Depositary can discharge its cash monitoring duties.

It is the opinion of RBC Dexia that the role and the duties of a prime broker versus the Depositary should be clearly defined by ESMA and we refer to our explanations to question 32 and the *"definition of financial instruments to be held in custody"*.

## Chapter IV.VI : possible implementing measures on investments in securitisation positions

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

We agree with the case-by-case review by the competent authorities of the home Member State of the AIFM, proportionality principle and safeguards requirements (a) to (f). We suggest there should be two complementary safeguards on the adequacy of the team expertise/competence and risk solution/system used, ensuring sufficient means will be given to the risk management function as well as spreadsheet solutions.

Further guidance for each alternative asset class would be desirable because different options may be appropriate for Hedge Funds, owing to their strategies and the instruments they use, as opposed to listed securities, OTC derivatives and fund of hedge funds.

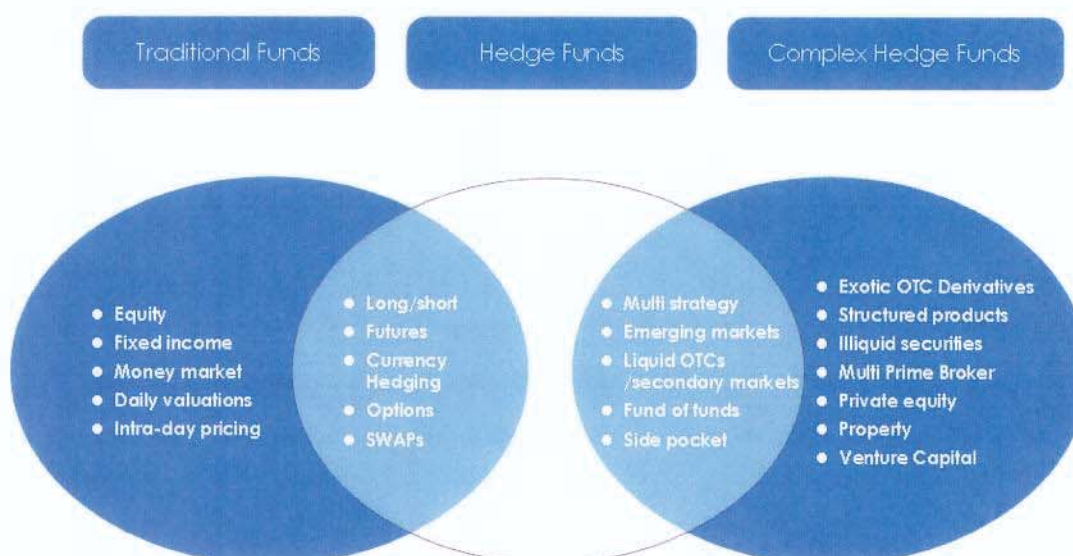
Conversely, the limitations of the AIFMD's proposed safeguards appear obvious for private equity and real estate structures. Gaining access to timely and independent market data or establishing the reliability of the valuation supplied for illiquid assets will be challenging for risk managers because of the limited frequency of the valuation exercise. We believe the risk management function should check the competence and reputation of the entities (third-party real estate valuation agent/committee, external auditors) who are wholly or partially engaged to provide the valuation of illiquid assets to ensure sufficient independence in the valuation process. These risk management duties should start from the election of the above entities and be accompanied by an appropriate frequency.

Larger-scale asset managers will generally have the necessary infrastructure in place to meet independent compliance requirements and ensure that third party providers are able to quantify and validate the risk manager's procedures. We believe it is important that data produced by a third party provider is done so transparently and follows strict guidelines. Further, we seek clarification on the types of documentation and the duties of the third party provider in undertaking this process, which may vary by asset-type.

We note that it is mandatory for each asset management company to have a risk management regime independent of daily trading decisions. However, smaller asset management houses may lack the resources and infrastructure to achieve this. Under these circumstances, the asset manager may be required to rely on a third-party provider. In our view the third-party provider should produce the necessary data and provide it to the Management Company for consideration, the Management Company should then have the sole responsibility for acting upon it.

**Q19: ESMA would like to know which types of AIFM will have the 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.**

The diagram below highlights the rising levels of complexity within alternative asset classes in relation to their independent risk management function.



Traditional funds are categorized as the most simple with regards to oversight, pricing and liquidity. The most complex "Alpha" asset classes will be less liquid and create more difficulties for valuation and with transparency requirements.

In our view, the underlying asset-type determines the transparency and risk management functions. We anticipate particular difficulties will be faced by real estate, private equity and private placement funds, whose assets tend to be more illiquid. We recommend that attention is paid to the appropriate profile level of those conducting risk management duties. Risk appraisers must possess adequate specialist skill sets. The independence of risk management functions would additionally be impacted by the size and numbers of a particular firm. Regardless of the size of the investment manager, we acknowledge that robust and independent structures to validate the management of risk are required regardless of long-only or alternative investments.

In relation to the additional proportionality criteria that should be included, in our view the following three factors should also be taken into account. **(1)** The level of risk management which is outsourced by the asset manager; **(2)** the risk management data sources and data systems, to ensure they are transparent and there is not a "black box" arrangement; and **(3)** the underlying asset class-type.



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

#### **Gates**

We do not agree with the concept that gates should only be considered in exceptional circumstances. Gates should be permitted so long as the conditions of their use are clearly communicated to potential investors in the AIF documentation. For example, gates are necessary to help the fund manager manage liquidity in the event of a large unforeseen redemption. Gates are also relevant for illiquid strategies as they avoid fire-selling processes that ultimately penalize investors remaining in the AIF. It is important to remember that certain institutional investors do not have daily liquidity requirements and might be ready to invest part of their money in illiquid strategies (private equity, loans, real estate, and special situations, distressed and high-yield hedge funds strategies) to generate extra-returns. Clearly stating the rules in the AIF documentation by describing the gating process allows investors to know the terms and potential redemption constraints.

#### **Side-pockets**

We concur that side-pockets should be managed in exceptional circumstances. Side-pockets benefit existing unit holders by separating assets that have become illiquid because of exceptional circumstances, such as default. New investors would not participate or receive proceeds in the event side pocket asset returns are realized. Side pocket accounts resemble single asset private equity funds. The potential use of side pockets needs to be clearly communicated to all investors in the AIF documentation.

When managing "gating" and "side-pocket" processes, it will be important that the AIF, AIFM or appointed service provider is able to segregate the investors affected, allowing equality between new subscriptions and those investors with side pocket positions.

**Q21: AIFMs which manage AIFs which are not closed-ended (whether leveraged or not) are required to consider and put into effect any necessary tools and arrangements to manage such liquidity risks. ESMA's advice in relation to the use of tools and Art85 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?**

We agree with the case-by-case review by the competent authorities of the home Member State of the AIFM, to ensure when the fund is launched that the liquidity arrangements proposed by the AIFM is proportionate to the liquidity profile.

We also agree that a proper liquidity disclosure to investors must enable the client base to clearly understand the liquidity approach an AIF intends to take, the rationale and the mechanisms applied.

While the ultimate goal of these arrangements is the fair treatment of all investors, the practical modalities of their application in exceptional circumstances may remain critical. The normal and exceptional circumstances which trigger the various arrangements must be disclosed in the AIF documentation. Moreover, the AIF documentation disclosure should also specify the communication process that applies in the case of such an event. In addition to investors' information we recommend the AIFM should inform its home Member State Authority and provide

(1) the quantitative and qualification reasons pertaining to such an arrangement and (2) details of the frequency of review.

In the particular circumstances where an AIF has or expects to apply a NAV suspension, this should be notified to fund investors, particularly to those investors having already submitted a redemption order pending to the end of the notice period.

In our view, the potential application of any liquidity arrangement requires the AIFM to have proper capabilities to monitor (under normal and exceptional circumstances and based on appropriate quantitative or qualitative measures) the liquidity of the AIF compared with the liquidity arrangements disclosed in the AIF documentation.

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

We agree with the case-by-case review by the competent authorities of the home Member State of the AIFM, to ensure at fund launch that the redemption policy defined aligns with the liquidity/illiquidity nature of the underlying asset class(es).

We propose replacing in the alignment approach the investment strategy by the asset class type. A long-short fund with physical shorts may have a totally different profile than a long-short fund trading derivatives.

## Chapter IV.VII: possible implementing measures on organisational requirements

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

If an individual portfolio manager is investing money for a retail client (who would be itself a non-qualifying investor), it is the individual portfolio manager's exclusive responsibility to deal with its clients according to its agreement with the client and subject to applicable national law. Neither the AIF, AIFM, the depositary or any other entity involved in the daily administration of an AIF should have to perform monitoring duties on this, as (1) this is primarily an exclusive relationship between the individual portfolio manager and its client and (2) depending on the method of subscription (disclosed or undisclosed), it may be impossible to identify the claiming person as an investor in the AIF.

Only in cases where the individual portfolio manager would be officially appointed as distributor of the AIF, the AIF and/or the AIFM would from a mere commercial point of view anyhow be obliged to react and collaborate with the distributor to solve the issue.

## Chapter IV.IX: Possible implementing measures on delegation

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

In our view, Option 1 is the most suitable as it is aligned to UCITS legislation, is more principle-based and does not specify the "objective reasons" that must be met before delegation occurs. The list outlined in Option 2 contains pertinent issues, but the language in Option 1 allows the AIFM greater leeway in interpreting the circumstances under which delegation is appropriate for a more efficient conduct of business depending on its own business models and the service offer available.



## Chapter V.I (Box 74): appointment of a depositary

RBC Dexia welcomes ESMA's addition in Box 74 of certain requirements which must be reflected in an agreement for the appointment of a depositary. We also share ESMA's view that it is more appropriate to outline the required elements of this contract rather than attempt to develop a model agreement.

The required description of eligible assets will, in addition to limiting an AIF's investments in predefined asset classes, also permit the depositary to establish appropriate procedures and controls in respect of those asset classes so that the depositary can comply with its safekeeping and oversight duties. We think that this principle should be extended further so that the contract must specify the geographic markets in which the AIF is authorised to invest. This would mean that the AIFM would be required to go through the contractual amendment process to add a new market. Requiring that market additions go through the contractual amendment process would allow the depositary sufficient time to evaluate the procedures of the AIFM for additional geographic markets, to open the required accounts in that additional market and to implement, if necessary, the conditions for a transfer of liability.

In addition, we ask ESMA to consider allowing operational or administrative details (e.g. names of contact persons, escalation procedures, account numbers, etc.) to be specified in a document different than the depositary agreement. This would align AIFMD with the requirements of UCITS in Article 37 of Directive 2010/43. It is market practice as of today that the legal terms are defined in the depositary agreement and that operational details are defined in an *"operating memorandum"* or a *"service level agreement"*. The latter documents are regularly changed during a year (e.g. change of contact person, change of organisation, new service, new report, etc.) and do not require a full legal validation process or submission to the regulator in the context of the documentation of the AIFM.

RBC Dexia welcomes the observation of ESMA in Item 10 of Chapter V.I. that early termination of an appointment may be the depositary's ultimate recourse if the depositary is not satisfied that the assets are properly protected, or where the AIF/AIFM does not comply with the depositary's advice regarding custody risk or with its duties under the agreement or the AIFMD. However, we assume that ESMA does not intend to allow the depositary to simply cease its services without a replacement depositary having been appointed. At the same time, a depositary should not be required to continue providing services once a reasonable termination period has expired. Therefore, we recommend that the contract be required to specify that the AIFM must appoint a successor depositary after the expiration of the termination notice and, if a successor depositary has not been appointed after a reasonable period, the depositary should be entitled to withdraw thus leading to an automatic liquidation of the AIF. Without this additional contractual provision, the depositary would not be able to effectively terminate the contract.

It would also be unjustified and unfair to keep depositaries liable for losses that might occur in the period between the depositary's notification of such a breach or risk and the actual termination of the agreement. We invite ESMA to consider recommending that the depositary, by notifying the AIFM and the competent authorities of the breach or risk, will be deemed to have put the AIFM on notice that failure to remedy the breach or risk will have the effect of altering the custody obligations from Art. 21.7(a) (Custody) to Art. 27.1 (b) (Recordkeeping) of the AIFMD, with a corresponding change in liability standard. This solution would allow for an orderly change of depositary in the best interest of the investors without unduly penalizing the depositary for having fulfilled its duties. Failure to alter the depositary liability standard applicable during this period would cause depositaries to cease providing any services to funds in such a position, harming investors and possibly creating systemic risk. In the light of the above it is recommended that ESMA adds clarification to this in its advice.



Finally, in regards to the requirement and ability of the depositary to enquire into the conduct of the AIFM, we assume that this requirement is subject to proportionality and that a depositary will be able to rely on the supervision to which an AIFM is already subject. We understand that in certain circumstances, the depositary may need to investigate an AIFM in more depth, but we assume that in the normal course of business, the depositary will be able to rely on the supervision of the AIFM in its home country.

## Chapter V.III: depositary functions

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

While a requirement that subscriptions and redemptions settle in a depositary account might be seen as easing the depositary's duty to monitor settlement processes, such a requirement may prove challenging in reality because of separate transfer agent processes and different distribution channels.

The AIFM directive expressly recognizes that cash accounts be opened with authorized entities different from the depositary and in the relevant market where cash accounts are required, given that AIF's, like other UCI's, operate in various geographies and currencies. Cash accounts are needed to service the investment and are needed as well as for the distribution side of the activity. Imposing one central account with the depositary in one given jurisdiction for all investment and distribution situations would be detrimental to the AIF.

There are numerous situations which justify an account outside the depositary, as for example:

- domestic accounts in local currency might be required by local markets
- depositories (i) may not be market makers in all currencies, (ii) may have insufficient volumes in certain currencies or (iii) may decide not to offer deposits or foreign exchange transactions in certain currencies for risk exposure purposes or for other internal considerations and thus not be a position to offer coverage or competitive prices or account remuneration to the fund
- local accounts in the country and currency of the domicile of the investor may be required for distribution purposes by local regulations or otherwise justified for cost reasons (less expensive local cash payments versus international transfers/foreign exchange).

**Q26: At what frequency is the reconciliation of cash flows performed in practice? Is there a distinction to be made depending on the type of assets in which the AIF invests?**

In practice there are different levels of reconciliations that, depending on their nature, may be handled differently, while recognizing that there is no uniform practice:

- the reconciliations done by the depositary or the AIFM or its administrator between their records and the external party where the AIF holds an account. (In this case, the frequency should be proportionate to the type of activity, trading frequency and movement volumes. For high volumes of activity, the target should be daily reconciliations, taking into account the technical possibilities of the counterparty, (e.g.) to reconcile via SWIFT or to deliver electronic files in an adequate format.)
- the reconciliation between the depositary and its cash correspondents for the cash accounts opened with the depositary or with third parties in the depositary's name (daily)



- the reconciliation between the depository and the entity centralizing the subscription flows (at trading frequency)

For the reconciliations not performed by the depository itself (e.g., by the AIF's administrator, or by a global custodian who is not the depository) the depository should be supposed to verify application of procedures by the third party party with adequate frequency. We would consider monthly as a reasonable frequency for such verifications

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

No practical problem has been identified.

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

To the extent that Option 2 of Box 76 is retained, we see no particular difficulty to implement the advice regarding cash accounts opened at prime brokers.

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

We clearly identify option 2 as being in the best interest of all involved parties as it allows sufficient flexibility to leverage existing processes and operating models adapted to the type of AIF and choice of providers.

By allowing the depository to rely on verified processes, cash statements and reconciliation reports issued by various parties, the depository may concentrate its expert resources on directly accessible reports and focus on controls and risk assessment, rather than having to spend substantial efforts and recurrent resources on managing the mere mirroring task.

Option 2 is thus the most efficient both from a cost, but more importantly also from a timing and risk monitoring, perspective.

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

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

Option 2 is principally in line with best practice as currently applied. Additional cost should be limited and consist in a one-off review aiming at adapting and documenting the current processes in line with the described requirements and recurrently assuring a regular and duly documented review and escalation process. No major IT investments should be required in this scenario.

Under Option 1, full and exhaustive mirroring of all externally managed cash transactions would potentially entail substantial investment costs as well as costs for running the process on a daily basis as cash transaction occur independently from NAV calculations or AIF dealing windows.

Those costs would have to be incurred to bring the depository's control teams at a functional level equivalent to that of functional experts interpreting available cash reports directly received from third parties under Option 2.

While the cost may be difficult to assess as it depends on the type of AIF, its investment strategy, the number of accounts as well as the number and quality of the counterparties, the costs will consist of:

- designing and developing ( or adapting / acquiring) a "position keeping system" able to capture, store, reconcile and adequately report on the multiples accounts
- designing and developing with each counterparty the file format and communication protocol for electronic capture of movements. Sensible efforts would be required for those entities not equipped to report on widely used standards such as Swift or if core message handling systems needed to be adapted
- chasing or inputting certain files manually, failing or pending agreement on electronic exchanges in the required formats
- daily verification and chasing of data files and quality control of those files
- quality control of data loading onto the "position keeping system"
- cost of enquiring and correcting technical errors detected at that stage (chasing, files, resending, missing data)
- producing the output files and reports and building a functional team analyzing those reports that would go far beyond the reception in different formats of available and externally produced statements and reports and the regular verification of those reports as outlined in Option 2.

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

RBC Dexia is a member of "The Association of Global Custodians" and contributed to the answer of the association to ESMA. We consider the explanations given by the AGC as expressing our own opinion. As a result, we believe that Option 2 is the only viable option because it provides for legal certainty by adopting a clear *contrario* approach by which assets fall within the scope of Art. 21.8(a) or Art. 21.8(b). Option 2 suggests a definitional framework that is clear, reflects current reality – especially where financial instruments are not held via recognized settlement systems – and is relatively easily employed over time as market infrastructure evolves.

In line with our comments to Box 13, we would like to urge ESMA to clarify – as for collateral arrangements in Box 79 – the situation that If financial instruments are held by another counterparty than the depositary, e.g. a prime broker, as instructed by the AIFM, they should not be included in this section, but should be regarded as "other assets".

We also seek clarification in regards to the depositary's use of nominee accounts whether in the name of a number of unidentified AIF or identified AIFs. It is highly recommended that given the different scenarios set out in detail by the AGC, these situations should be handled the same way.



**Q33: Under current market practice, which kinds of financial instrument are held in custody (according to current interpretations of this notion) in the various Member States?**

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

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

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

We think that Option 3, with a small drafting change, would be the best option, giving all depositaries across Europe and in different jurisdictions the possibility to treat collateral arrangements in a generally consistent way. It also avoids the need for the depositary to analyse the legal effect of each individual collateral arrangement.

We suggest adding a small change in the introductory portion so that it provides, "Financial instruments provided as collateral **shall not be regarded as held in custody if and when they are provided...**". Otherwise, there may be ambiguity which could lead to the interpretation that assets that are pledged as collateral should be taken out of custody; i.e., placed with a third-party collateral agent, which is not always the case. We do believe that this is the intention of this provision and as such recommend this change.

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

In the alternative funds environment, where 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 AIFM directive and the Level 2 advice remain flexible enough to allow depositaries to draw on third parties where necessary expertise and support that does not exist in-house.

However, it is also important to recognise that it is not always the depositary appointing a third party. 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 appointed and selected by the AIFM. 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.

In the future, depositaries will need to be able to continue to rely on their services and information indirectly through their relationship with the AIFM, to provide local support for the safekeeping process.

**Q36: Could you elaborate on the differences notably in terms of control by the depositary when the assets are registered directly with an issuer or a registrar (i) in the name of the AIF directly, (ii) in the name of the depositary on behalf of the AIF and (iii) in the name of the depositary on behalf of a group of unidentified clients?**

As mentioned above, assets of all kinds – including MiFID financial instruments (such as private equity shares and interests in underlying funds) – may be invested in with or without use of a depositary's or its subsidiary's "nominee" name.

With respect to (iii) above, assets held in the "name of the depositary on behalf of a group of unidentified clients" is effected through use of "nominee account" or "nominee name". In certain circumstances, an omnibus account may be used which only reflects this "nominee" name (often the depositary or custodian itself) and does not reflect the underlying beneficial owner. Although the books of the registrar/transfer agent do not segregate among positions of beneficial owners, the intermediary (the depositary) would have segregated these positions in compliance with its own record-keeping responsibilities (e.g., in compliance with client asset rules that separately apply to it).

Registering ownership of a financial instrument or other asset in nominee name may serve a variety of purposes but registering in nominee name does not – in itself – mean that the share or other asset is held in "custody" in the sense of depositary responsibilities envisioned in AIFMD under Article 21.8(a). Registering an asset in the name of a depositary may provide for additional "control" but may not provide the degree of "control" implied in Article 21.8(a) as discussed above. Moreover, it is not always possible to register assets in the name of a depositary. Direct investment may be required by the legal structure of the target investment or other factors such as for limited partnerships. For other structures – especially open-end funds with significant distribution – "nominee" or "indirect" structures are often used for purposes relating to the chain of distribution and other factors. Omnibus accounts are commonly utilised for this reason.

As a result, all three methods of investment described above are quite common. For this reason, we strongly urge ESMA to recommend an approach that encompasses all three approaches described in Question 36.

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

RBC Dexia understands the consultation and the definition of Box 78 that **(1)** a Prime broker should not be viewed as a sub-custodian of the depositary when it has been appointed directly by the AIFM or AIF and holding assets or collateral of an AIF and that **(2)** the assets that are with a prime broker are to be considered as "other assets", in which circumstances the depositary has only oversight duties and no safekeeping duties.

Under this assumption, the depositary has to comply with a number of duties that require the prime broker to provide detailed information to the depositary and therefore in any case should the prime brokers be required to provide daily statements of transactions or, at least, binding statements of holdings to enable the depositary to perform its oversight and record keeping function so as to have a full overview on the assets and the cash movements of the AIF at any time. It is therefore recommend aligning the reporting obligation of a prime broker to stringent reporting requirements like the FSA rules.

It should as well be required by the AIF or the AIFM to urge the prime broker to deliver the reporting to the depositary in a form acceptable and requested by the depositary, to enable the depositary for AIFs with high trading frequency to proceed as much as possible to automated checks.



**Q38: 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?**

Option 1 is in line with best practice as currently applied. Additional cost would be relatively limited and consist of a one-off review aiming at adapting and documenting the current processes in line with the described requirements and recurrently assuring a regular and duly documented review and escalation process. It is not expected that major IT investments would be required in this scenario.

We regard the mirroring requirements in Option 2 to entail a significant duplication of administrative and/or third-party recordkeeping. By creating and reconciling the mirrored transactions, the depositary will be performing controls to ensure the reliability of these records. This will likely lead to adding administration costs to the depositary cost, which is basically a doubling of costs.

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

It is important to recognize the wide variety of forms and locations "other assets" might take. Given this variety, the form, availability and reliability of records which evidence ownership in these assets will vary widely as well. The depositary's ability to validate ownership of assets is dependent on external factors that are effectively beyond its control (and instead within the control of the fund manager). For example, while the depositary may obtain title certificates (or copies thereof) in relation to real property, depositaries are not in a position to be able to "verify" ownership unconditionally, since "ownership" in relation to non-securities investments is dependent on a number of external factors and risks which are not necessarily patent on the face of title certificates or other documentary evidence.

For this reason, the depositary should be able to discharge its responsibilities under Article 21.7(b) by relying on reasonably reliable evidence provided by the AIFM or its delegate, such as lawyers' legal opinions in the respective jurisdiction, or confirmation provided by the AIFM or other advisors.

As the depositary will have to rely upon representations of third parties, which it is not in a position to verify with absolute certainty, it is essential to establish a basis for determining when the depositary has discharged its responsibility, which can apply across all relevant asset classes and having regard to the nature and type of evidence which is available to the depositary.

Examples have been delivered by "The Association of Global Custodians" to ESMA in which RBC Dexia is a member. We consider those as sufficient but if desired by ESMA will be delighted to reproduce this and provide further explanations.

**Q40: To what extent do you expect the advice on oversight will impact the depositary's relationship with funds, managers and their service providers? Is there a need for additional clarity in that regard?**

RBC Dexia supports the proposal to introduce principle-based implementing measures with regard to oversight duties, which will result in an adequate harmonization of duties across the European Member States, which is important for RBC Dexia as service provider to UCITS on a pan-European basis.

The second level controls do not systematically require the depositary to re-perform tasks which are performed by another responsible party in the AIFM / AIF value chain, but instead require

depositories, in order to discharge their duties, to ensure that adequate procedures are in place and to undertake ex post controls on a sample basis during the assessment of the controls environment.

RBC Dexia does not believe that the advice on oversight duties will materially impact its depositary relationships with AIFMs, AIF and third party providers. The proposed advice will create benefits for the reason that it enhances the orderly harmonized cooperation between the depositary and the AIFM or the AIF by clearly establishing all the relevant information/communications flows, which are essential for an adequate investor protection.

We also welcome the initiative of ESMA that the depositary agreement shall contain an obligation for the AIFM or AIF to provide or ensure any third party appointed by the AIFM or AIF provides all necessary information that permits the depositary to perform its oversight duties, in compliance with Article 21 (9) of the AIFMD.

The principle-based approach properly clarifies the scope of each listed oversight duty and provides the necessary flexibility for depositaries so that they are in a position to undertake verifications and checks of management functions in the context of alternative investment funds. Therefore, we do not believe that there is a need for additional clarity in that regard. However, it would be useful for ESMA to clarify the requirements to which an AIFM is subject when selecting, monitoring and instructing a delegate compared to the oversight requirements applicable to a depositary in relation to the delegates of the AIFM.

Nevertheless, we foresee additional costs associated with **(1)** the extension of the oversight duties to depositaries, at the initial acceptance of a mandate or if the AIFM decides to change its business model and **(2)** the requirement of a depositary to follow-up on audit findings in the annual financial statement about the distribution of the AIF's income, which carries a risk of generating conflict between the AIFM and the depositary if their interpretations differ.

We wish to point out that the general oversight procedures, referred in paragraph 1 of Box 82, should be reviewed on a regular basis and updated when necessary, rather than regularly updated.

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

This question needs to be seen in relation with regulation applicable in the member states. In Luxembourg a depositary is not mandated to issue shares or units of the AIF. In Luxembourg, only the AIFM, the AIF or a third party provider (authorized transfer agent) is designated to issue shares or units of the AIF. This avoids possible conflicts of interest.

In situations in which the depositary is also the transfer agent for the AIF, potential conflicts of interest could arise, especially in light of the depositary's oversight role in respect of AIF units/shares, set out in Article 21.9.

The provisions of AIFMD Level 1 include measures to limit conflicts of interest, which require that the depositary: *"has functionally and hierarchically separated the performance of its depositary functions from its tasks as [prime broker/external valuer/etc] and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF"*. Similar provisions are contained in Article 20.2(b), covering delegation.

RBC Dexia believes these provisions – and any additional provisions – that may be applicable under local regulation to the depositary as credit institution are sufficient to manage such any potential conflicts of interest.



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

Current practice of a depositary is that on a periodic basis, the depositary ensures that the AIF, the AIFM or the designated entity (transfer agent) has appropriate procedures in place to reconcile the subscription orders with the subscriptions proceeds, applies these procedures and reviews the procedures on a regular basis and if necessary updates them.

Where deemed appropriate, the depositary may conduct ex-post verifications based on information provided by the designated entity such as exceptions reports, Key Performance Indicators, Key Risks Indicators.

In this respect, the depositary undertakes specific verifications of the performance of the AIFM, AIF or third party provider (transfer agent) for the purpose of reviewing procedures and methodologies, including sample checks based on aggregated numbers and not on individual transactions (unless there is a doubt).

Regarding the depositary's control duties, amongst which the checks for consistency between the total number of units or shares in the AIF's accounts and the total number of outstanding shares or units that appear in the AIF's register, we agree that the frequency of these controls should be proportionate to the frequency of subscription and redemptions and defined at the time of the appointment.

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

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

RBC Dexia believes that the review of a depositary should remain proportional and rely on the availability of procedures, the control environment and sample checks. Eligibility for entry into an AIF is usually defined on a contractual basis, and that the responsibility lies primarily with the investor to respect such rules of the AIF in this regard. Responsibility for disclosures and conditions of investment lie primarily with the promoter/distributor.

If an extension of this requirement is envisaged, depositaries could meet that obligation only by getting access to all information and records of the AIFM, the AIF or the third party provider. In line with the requirements of Box 83, the depositary would have to ensure that procedures are implemented, reviewed and updated on a periodic basis and undertake post-checks to ensure that the procedures are effectively implemented, conduct on-site visits at the AIFM, the AIF or the third party provider for the purpose of reviewing procedures and verifying the quality of information transmitted by way of sample checks.

Extending such an obligation to other parties than those directly involved in the administration of the AIF would require the depositary to engage in controls which are not possible. Besides the inherent cost this will generate, it will require the depositary to intervene in areas where it does not have expertise (e.g. market and asset management) or where the information will be difficult to obtain (e.g. in a situation where the depositary and the transfer agent are not within the same country). Such extension would therefore in the view of RBC Dexia only generate additional cost but not produce specific value or additional protection for the investor.



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

RBC Dexia considers the scope of the duties set out in paragraph 1 of Box 85 to be appropriate. The explanatory notes confirm that the depositary is only required to set up a procedure to verify on an ex-post basis the compliance of the AIF with applicable law and regulation, and the AIF rules and constitutional documents. The responsibility for implementing an effective and sound risk management process remains with the AIFM. RBC Dexia understands (see Box 82) that the oversight function as performed by the depositary should mainly consist in assessing the control procedures and environment at the AIFM, the AIF or appointed third party.

Taking into consideration the complexity of the investment policy of the AIF, such as investment rules at the AIF level but also at the level of the underlying investments and the availability of information, the depositary should also be authorized to rely on controls performed by a specialised third party in charge of the compliance/risk monitoring for the AIF.

Combined with an initial due diligence over the investment management, including on-site visits if deemed necessary, the depositary will be in a position to validly discharge its oversight duty.

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

RBC Dexia believes that no additional clarification is needed for this oversight duty and prefers Option 1 as it allows adapting to the variety of situations that may occur depending on the type of AIF and investment strategies.

Common practice is that depositaries (or their appointed global custodians) are already closely monitoring the settlement process for the financial instruments held in custody and provide adequate reporting to their clients. Based on commercial terms, global custodians would regularly offer contractual settlement to their clients for certain types of securities, thus limiting the risk of late payments for the fund. This issue is consequently largely addressed by the industry and does not need further clarification.

Applying Option 2 to "Other assets" may create fundamental problems within asset classes such as real estate, venture capital, private equity or other less frequent trading alternative asset classes, as the spectrum of possible requirements, delays, partial settlements, etc. may not be defined. Such transactions take often place outside a regulated market, transaction and settlement is frequently individually negotiated and thus expectations of timeliness are contractual.

Any additional clarification might interfere in the applied market practice.

**Q46: What alternative or additional measures to segregation could be put in place to ensure the assets are 'insolvency-proof' when the effects of segregation requirements which would be imposed pursuant to this advice are not recognised in a specific market? What specific safeguards do depositaries currently put in place when holding assets in jurisdictions that do not recognise effects of segregation? In which countries would this be the case? Please specify the estimated percentage of assets in custody that could be concerned.**

It would be impossible to prepare an inventory of such jurisdictions given legal uncertainties relating to insolvency legislation and the frequency of change in insolvency law and regulation



At most, all that can be reasonably expected is for the depositary to seek clarification or confirmation as to the conditions under which assets are held, but sub-custodians will not be placed to provide certainty as to legal effect in this regard.

**Q47: What are the estimated costs and consequences related to the liability regime as set out in the proposed advice? What could be the implications of the depositary's liability regime with regard to prudential regulation, in particular capital charges?**

RBC Dexia is of the opinion that industry associations are better placed to collect representative data of their member and to communicate this on an aggregate basis.

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

RBC Dexia does not favour typology as non-exhaustive list and agrees with the principle based approach laid down in Box 90.

**Q49: Do you see any difficulty with the suggestion to consider as an external event the fact that local legislation may not recognise the effects of the segregation requirements imposed by the AIFMD?**

We welcome the clarification by ESMA that if local legislation does not recognise the effects of segregation, this will be considered as external event.

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

RBC Dexia would like to reiterate at this stage that "external event" is relevant only to the discussion of "*financial instrument to be held in custody*" and not for "*assets in record keeping*". RBC Dexia is further concerned about the last sentence in Explanation Note 29, stating that the depositary being liable in case of fraud at the level of one of its sub-custodians. This case is referred to in recital 44 to Level 1 where only the example of fraud resulting out of an "internal" employee (i.e. an employee of the depositary) is given and not the case of an external employee as it would be the case with a sub-custodian. Consequently, RBC Dexia strongly believes depositaries should only be held responsible in case of fraud of their own employees and not the employees of their sub-custodians, which they may not control and which is by definition unpredictable. As a result the fraud of any person that is not an employee of the depositary should be considered as "external" for the depositary, as the remaining criteria leaves sufficient room to determine if the depositary could have avoided the fraud or not.

**Q51: What type of event would be difficult to qualify as either 'internal' or 'external' with regard to the proposed advice? How could the 'external event beyond reasonable control' be further clarified to address those concerns?**

We strongly believe that professional investors as well as the AIFM should appreciate the risks they are taking when investing in certain asset classes or markets. These risks should be fully and clearly disclosed to them. As the depositary is not involved in the distribution of an AIF, it should not be the intention of ESMA to require a depositary, in using "*reasonable efforts to avoid a loss*", to educate the investors and the AIFM about all potential risks. Such risks and their disclosure should clearly be considered as "external" to the depositary.

As already stated in our comment to Box 74, the consultations allow the depositary very limited circumstances to discharge its liability where the depositary has raised concerns and the AIFM does not react. The ultimate possibility in such case is to terminate the agreement. Even then, the



depository may not be released unless it is clarified that the liability standard applicable to "financial instrument to be held in custody" can be altered in these circumstances. We would invite ESMA to consider clarifying this point so that where a depository, after having alerted the AIF / AIFM, the regulator and the investors of a risk or breach, terminates the appointment, the notification of such risk shall be considered as an "external event" for the depository, provided that the risk or breach does not result from the depository's own breach of its obligations.

**Q52: To what extent do you believe the transfer of liability will/could be implemented in practice? Why? Do you intend to make use of that provision? What are the main difficulties that you foresee? Would it make a difference when the sub-custodian is inside the depository's group or outside its group?**

It is current market practice that, in order to provide efficient sub-custody services, depositories organize their network through affiliates and more frequently through third party sub-custodians based on criteria such as market presence and legal, technical and economical grounds. It is further very common that some sub-custodians used may be affiliated with a global custodian who is directly competing with the depository for global custody mandates.

It is not possible to assume that sub-custodians, in particular when they are not affiliates of the depository, would accept a transfer of liability and accept duties and liability standards that might go beyond their local regulatory requirements. If they were to do so, it might come at an onerous cost to investors. This is particularly true in markets where choice and quality of sub-custodians may be limited.

It is in the AIFM and their investors' best interest if the depository can select the best sub custodian from a reputational, financial strength and technical standards point of view in each market, and not necessarily the sub-custodian who is willing to accept a transfer of liability.

It would be highly counterproductive to have other criteria, such as price or acceptance of liability, dictate the choice at the detriment of quality. This would also create competitive distortion between depositories with a proprietary network and those using a third party network, potentially leading to systemic risk and less competition.

It is also incorrect to consider that using a proprietary network guarantees consistently high quality services, as the latter will depend on size, market share, experience, and quality of local management that may heavily influence the quality and operational risks factor on a country by country basis. Better quality and risk protection may be achieved through a third party network selected independently for reasons of quality and technical criteria alone, which is constantly reviewed.

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

Given that the kind of assets concerned, namely certain types of financial instruments, are the same regardless of whether the AIF is a private equity or real estate fund, we do not see good reasons for amendments. However, we question whether non-bank depositories are well placed and well equipped to act as custodian for financial instruments in the first place.

Any provision requiring cash accounts (e.g. distribution, income distribution) to be "held at the depository" will be unworkable for non-banks and will require them to collaborate with credit institutions.



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

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

Generally speaking, it is the specific class of assets, i.e. certain financial instruments, that is relevant rather than the type of AIF. However, it may be appropriate to account for certain specificities inherent in certain fund types in order to define the "beyond the reasonable control" requirement. Indeed what is reasonable for a more traditional AIF may not be reasonable for an AIF engaged in intra-day-trading.

## Chapter VI: possible implementing measures on methods for the calculation of leverage

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

We have nothing to add to the existing methods.

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

No.

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

We indeed seek further clarification on the credit underlying component and treatment of instruments such as Credit Default Swaps, Credit-linked notes, asset-backed securities, and also options pertaining to them.

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

We agree in principle. The maturity of a position does not guarantee that there is no exposure. It seems dangerous to liken "cash equivalent" with short maturity investment: a position with a three-month time to maturity can bear a high risk. "Cash equivalent" could be defined with a restrictive list. If not, we think that it would be acceptable to exclude cash positions, but cash equivalent positions should be included.

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

Option three. In our view, the financial risk is more important than the overall legal structure. In case of a default, the fund does not have to pay back more than the initial investment, so the leverage should not be included in the overall consolidation process. Option three clearly defines the case where the AIF has no obligation towards the third party legal structure.

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

Please see response to Q59 above.

## Chapter VIII: transparency requirements

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

AIFMs should follow local GAAPs, so we do not expect any problems. In any case IFRS is used for AIF reporting, which is more detailed than Luxembourg GAAPs.

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

The answer seems clear as any additional information to be included in an official document (i.e. annual report) automatically triggers an additional layer of responsibility in regards to accuracy and completeness. In addition, the prospectuses and by-laws may also need to be amended so as to inform investors about any new information that is obtained.

This being said, we understand the usefulness of the proposed disclosures although they will create additional costs at the expense of AIFs or their managers.

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

While we do not contest the definition of special arrangements and agree that suspensions should be excluded, it might be helpful to define guiding principles of what is not considered a "special arrangement" so as to promote a harmonized application across the industry.

**Q67: Which option for periodic disclosure of risk profile under Box 107 do you support? Please provide reasons for your view.**

Our preference is Option 2 because it includes stress testing and is more robust regime. In our view it is not too onerous, in principle, to include stress test results since this should be part of the risk management process of an AIF.

However, we are also aware that stress testing will not be appropriate for every type of fund, particularly those with physical assets. For example, it would not be applicable to the majority of



real estate funds because there is insufficient data to process stress-testing unless the fund invests in a single jurisdiction or in a market where relevant sector indexes are available whereas most real estate funds have a pan-European, continental or even global reach. As such, we propose stress testing with exceptions allowed for certain specific cases to be granted upon file submission to local supervisory authorities.

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

Yes. Next to the investment strategy, we believe it is most important to explain to investors the fund risk profile, namely the material risks to which the portfolio is exposed as well as the leverage and liquidity levels. Describing the risk management system per se would be secondary. Understandable language should be used, in line with the plain language requirement for UCITS IV key investor information. We consider a separate document unnecessary and instead recommend that the details be included within the fund prospectus. Additionally, investors should not be overwhelmed with information about systems and methodologies, but rather be informed of the variables to which their investments are exposed, such as strategy, objectives, risk and past performance.

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

Yes.

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

Given the wide variety of possible investments, coupled with a necessary conversion period, we would favour a three months period.

Indeed, the AIFM Directive requires many AIFMs to apply significant changes in processing, organization and set-up. This will be a huge effort for the AIFMs and the concerned service providers.

If deemed necessary the proposed 3-month period could be shortened (for example by 1 month) after an initial transition period which should not extend beyond a three-year period.

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

We agree with the list of criteria provided in Box 110 and ESMA's recommendation to measure leverage on an ongoing basis. We would further suggest monitoring leverage levels against the predicted/target amount of leverage.