

Paris, 18th January 2011

Response of
Societe Generale Securities Services
to the CESR's Call for evidence
on Implementing Measures on the Alternative
Investment fund Managers Directive ("AIFMD")

Response to be addressed to submitted online via ESMA's website (www.esma.europa.eu)

Deadline for sending the response: 14 January 2011

1 PRESENTATION OF SOCIETE GENERALE SECURITIES SERVICES

Societe Generale Securities Services (SGSS), established in 28 locations in four continents with more than 4500 employees, offers a full range of securities services in:

- Execution, clearing, delivery and settlement
- Securities back-office outsourcing services
- Custody, trustee, transfer agent, fund and portfolio administration
- Employee Share

Societe Generale Securities Services currently ranks 6th worldwide custodian and 2nd European custodian with €2,906 billion of assets under custody. Societe Generale Securities Services provides custody & trustee services for 3,100 funds and the valuation of 4,815 funds, representing assets under administration of around €423 billion. Societe Generale Securities Services also ranks among the European leaders in stock option management.

2 PREAMBLE

Societe Generale Securities Services welcomes the opportunity to contribute to the CESR/ESMA Call for evidence on implementing measures on the alternative investment fund managers' directive ("AIFMD").

In its submission, the response of SGSS to the CESR/ESMA call for evidence will focus on: valuator and depositary functions.

Due to the limited period available for the response some detailed comments may not be as comprehensive as expected.

In these circumstances, SGSS would be happy to provide additional detail on any of the issues considered below and impacting the depositary/valuator functions.

3 DETAILED RESPONSE (TO SPECIFIC ISSUES)

I. VALUATION

II.9. Issue 9 - Article 19 Valuation

CESR is invited to advise the Commission on:

1. The criteria concerning the procedures for the proper valuation of the assets and the calculation of the net asset value per share or unit to be used by competent authorities in assessing whether an AIFM complies with its obligations under Article 19(1) and Article 19(3).

CESR is invited to consider how these procedures should be differentiated to reflect the diverse characteristics of the assets in which an AIF may invest.

1. The following factors are the key points which guarantee a proper valuation of the assets:

- Compliance with accounting regulations and practices established by the relevant regulatory authority of the AIF
- Certification of the annual accounts and, where applicable, other regulatory periodic reports issued by the external auditors
- Compliance with the provisions of industry good practices (eg: AFTI Charter) that define the valuation rules of the assets and the rules for the net asset value establishment. These practices should prevent market timing.

2. As an illustration, in France :

The AIFs comply with Standard Accounting Practices as provided for in the national regulations. These standards provide for assets valuation procedures which prevent market timing. In addition, AIFs are audited and certified by statutory external auditors.

SGSS applies a professional Charter of the valuator's good practices (see attachment) drafted by AFTI. The Charter's main purpose is to communicate about the fund administration services, the control procedures, the traceability of the operations, the transparency of the process.

In particular, the Charter states that the fund administrator should, in all circumstances:

- Have access to a data management information system and to procedures adapted to the assets invested in by the Management Company;
- Use data management information in accordance with the rules defined by the Management Company;
- Have permanent and reliable resources in order to identify and to process the corporate actions;
- Ensure that the accounting rules applicable to the NAV calculation comply with the agreements in place with the asset management company.

2. The type of specific professional guarantees an external valuer should be required to provide so as to allow the AIFM to fulfill its obligations under Article 19(5). CESR is asked to consider the impact of the required guarantees on the availability of external valuers to the AIFM industry.

The external valuers should, notably, be in a position:

- to have permanent and reliable material and technical means and resources adapted to the assets used by the Management Companies;
- to rely on employees with a good level of professional expertise;

- to rely on an internal control system adapted to the asset used by the Management Companies.

Professional's guarantees may be envisaged as a part of the contractual arrangements between the AIFM and the valuer.

3. The frequency of valuation carried out by open-ended funds that can be considered appropriate to the assets held by the fund and its issuance and redemption frequency. In particular, CESR is invited to consider how the appropriate frequency of valuation should be assessed for funds investing in different types of assets and with different issuance and redemption frequencies, taking into account different (and varying) degrees of market liquidity. CESR is invited to take account of the fact that such valuations shall in any case be performed at least once a year.

The level 2 of AIFM should only provide general criteria and not a fixed frequency for each open-ended type of funds. The criteria to take into consideration to determine the AIF valuation frequency are:

- the fair value of the assets, and
- the nature and the liquidity of all the assets in the AIF, and,
- The valuation periodicities of the main assets in the portfolio (for example the valuation of a building is not changing every month)

The Level 2 should specify that the frequency should be a deterrent to potential market timing practices.

As a matter of principle, the fund valuation frequency should be detailed in the fund rules/funds by-laws.

II. DEPOSITARY

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

1. CESR is requested to advise the Commission on the necessary particulars to be found in the standard agreement evidencing the appointment of the depositary. In its advice, CESR should take into account the consistency with the respective requirements in the UCITS Directive.

SGSS is of the opinion that the main purpose of the standard agreement, besides evidencing the appointment of the depositary should be to provide for appropriate exchanges of information that enable the depositary to discharge its duties.

In addition, whenever possible, consistency between the UCITS legislation and the AIFM implementing measures should be achieved in order to avoid unnecessary additional costs and diverging interpretations.

Consequently, SGSS suggests

- To align the AIFM provisions to the provisions of the UCITS IV Directive with regards to the appointment of the depositary (article 23 paragraphs 5 and article 33 paragraph 5 of the Directive 2009/65 and article 30 of the Directive 2010/43). In particular, the agreement should provide for:
 - (a) the transmission by the AIFM of all information allowing the depositary to perform its safe-keeping duties for all types of asset pertaining to the AIF;
 - (b) the transmission by the depositary of relevant information, including a description of the means and procedures related to the exercise of any rights attached to financial instruments, and the means and procedures applied in order to allow the AIFM and the AIF to have timely and accurate access to information in relation to the accounts of the AIF;
 - (c) a right of access and information to the depositary in relation with its oversight duties (assessment of AIFM and AIF organizational arrangements, procedures, internal control organization, ...), including the right of on-site visits by the depositary;
 - (d) a sufficient information should be provided to the AIFM so that it can review the performance of the depositary in respect of the depositary's contractual obligations;
 - (e) the obligation of information when the AIFM envisages to modify the fund rules or the prospectus of the AIF, and that these modifications require information to, or prior agreement from, the depositary.
- Due to the assets and the specific transaction, the arrangement should also provide for:
 - (a) the transmission by the AIFM of all information allowing the depositary to perform its duties in relation with rules that regard subscription, redemption, issue, cancellation and repurchase of units.
 - (b) the obligations concerning the information of the parties and their compliance with the regulations related to the prevention of money laundering and the financing of terrorism, where applicable.

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

SGSS is of the opinion that issuing a model agreement would not be appropriate.

Indeed, no model contract appears to be fit to accommodate to the diversity of situations, legislations and all types of assets that can be invested in by the AIF.

What actually matters is that, whatever the final format of the contract, its provisions cover adequately the items referred to in issue 11-point 1.

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

1. CESR is requested to advise the Commission on the criteria for assessing whether the prudential regulation and supervision applicable to a depositary established in a third country with respect to its depositary duties are to the same effect as the provisions laid down in European law.

In this regard, CESR is invited to take into account at least whether the depositary:

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

SGSS agrees that the criteria proposed by the CESR would contribute to the application of equivalent rules in terms of prudential regulation and supervision in third countries. They should ensure a level playing field in all circumstances, including in the case of investment in non-EU AIFs.

Ongoing supervision by the competent authorities of the third country where the fund is domiciled should be complemented by an independent external audit review, on an annual basis.

The most relevant criteria in terms of equivalence should refer to the definition of the functions to be performed by the depositary (safe keeping and oversight) and to its level of liability in case of loss as defined in Article 21 of the AIFM Directive.

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

- the authority has the power to request information from the depositary
- the authority has the power to intervene with respect to, and sanction, the depositary

SGSS agrees that the relevant public authority should have the power to request information and to intervene or sanction the depositary.

SGSS is of the opinion that, as a prerequisite, this public authority should be granted the effective authority to explicitly license (authorize) the depositary to perform its functions for non EU AIFs that might be distributed in the European Union.

III.3. Issue 13 – Depositary functions

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

- the AIF's cash flows are properly monitored;
- all payments made by or on behalf of investors upon the subscription of shares or units of - an AIF have been received and booked in one or more cash accounts opened in the name of the AIF or in the name of the AIFM acting on behalf of the AIF or in the name of the depositary acting on behalf of the AIF at an entity referred to in Article 18 (1) (a) to (c) of Commission Directive 2006/73/EC in accordance with the principles set forth in Article 16 of Commission Directive 2006/73/EC.
- where cash accounts are opened in the name of the depositary acting on behalf of the AIF, none of the depositary's own cash is kept in the same accounts.

In its advice, CESR should take into account the legal structure of the AIF and in particular whether the AIF is of the closed-ended or open-ended type.

When taking in consideration monitoring of cash flows, the following principles should be reaffirmed:

- Control procedures described further have proved to be sufficient and proportionate to ensure the monitoring of AIF's cash flows.
- Because of the high number of cash flows involved in the AIF industry, it is unrealistic to require the depositary to check every cash movement for every AIF.
- Banking regulation which currently regulates cash deposit accounts which is a banking activity..

a) Monitoring of the AIF's cash flows

SGSS does not see any rationale for any differential treatments according to the legal structure of the AIF.

SGSS is of the opinion that the tasks and responsibilities of the depositary differ depending upon the location of the cash accounts of the AIF - i.e. opened with the depositary itself or with another entity (cash account provider) appointed by the AIFM - and, in the later case, whether the cash account is opened in the name of the AIF (or AIFM), or in the name of the depositary.

Indeed, when cash belonging to the AIF is maintained with cash account providers others than the depositary itself, all relevant information is to be provided by the AIF, or the AIFM, to the depositary. The depositary may in no circumstance be held liable for any misrepresentation, misappropriation or loss related to these assets.

1. Depositary tasks when cash accounts are in the books of the depositary :

In this case, the depositary should ensure the maintenance of the AIF's cash accounts according to applicable banking laws where the account is located.

2. Depositary tasks when the cash accounts are opened in the books of third parties and opened in the name of the AIF (or the AIFM)

In this case:

- the depositary should verify that the AIFM has set up procedures and controls with regards to :
 - o the opening of the account and the management of the cash flows including:
 - the verification of the appropriate license of the third party
 - the existence and the communication of statements of accounts
 - o the compliance of a segregation between the cash belonging to each AIF and the cash belonging to the AIFM
 - o The reconciliation of the account balances with the assets of the AIF
 - o The compliance by the AIF of the counterparty limits, including cash held by third parties that are not protected by protection schemes or similar arrangements

The AIF by-laws should expressly authorize the opening of cash accounts with third parties, defines the counterparty limits, and provide for the adequate disclosure as per the specific related risks

- The AIFM should communicate to the depositary the details of all accounts and cash account providers of the AIF.

Cash account providers should communicate, and when requested, confirm to the AIFM and to the depositary the specifics related to all account details, balances, transactions, collateral arrangements, deposits, and compliance to the local regulation applicable to cash accounts.

This level of information from the AIFM and the cash account providers to the depositary is required in order to properly discharge oversight functions

3- Duties of the depositary when cash accounts are maintained in the books of third parties and opened in the name of the depositary on behalf of the AIF

The obligation imposed by the Directive is not feasible since cash is fungible asset. If cash is held on an account opened in the name of the depositary, it will not be possible in case of the depositary's failure to make a distinction between cash belonging to the depositary and cash belonging to the fund because cash held in an account opened in the name of the depositary will be considered as belonging to the depositary.

The segregation between cash held by the fund and cash held by the depositary on its own account is actually ensured by the internal follow-up-system as applied by the depositary in its own accounting structure.

b) Payment/Reception of the subscription of shares or units

It is the opinion of SGSS that the depositary duties should be limited to, on an ex-post basis:

- checking the periodic global reconciliations made by the AIFM, and ;

- checking the unresolved amounts (in the reconciliations) related to subscription or redemption.

These controls as currently performed by the depositary have proved to be efficient enough to validate that cash movements relating to subscriptions are effectively and timely credited to the cash accounts of the funds.

Other duties are inefficient if the payment and the reception of the subscription or the redemption are not made within the cash account opened in the books of the depositary.

2. CESR is requested to advise the Commission on the conditions applicable in order to assess whether:

- an entity can be considered to be of the same nature as the entity referred to in Article 18 (1) (a) to (c) of Commission Directive 2006/73/EC, in the relevant non-EU market where opening cash accounts on behalf of the AIF are required;
- such an entity is subject to effective prudential regulation and supervision to the same effect as the provisions laid down in European Union law and which is effectively enforced.

SGSS agrees that the conditions applicable should provide for the same effect as for the provisions laid down in the European Union law.

More specifically, effective local supervision should be in place and enforced, entities should be subject to and comply with prudential international standards (such as "Basel 3" standards). Reporting requirements and procedures applicable to the account providers should be satisfactory.

3. CESR is requested to advise the Commission on the conditions applicable in order to determine what shall be considered as the relevant market where cash accounts are required.

SGSS would appreciate further explanation about the objective pursued by CESR with respect to this issue before commenting on this question.

ISSUE 13.2 – DEPOSITARY FUNCTIONS PURSUANT TO PARAGRAPH 7

1. CESR is requested to advise the Commission on:

- the type of financial instruments that shall be included in the scope of the depositary's custody duties as referred to in point (a) of Article 21(7), namely (i) the financial instruments that can be registered in a financial instruments account opened in the name of the AIF in the depositary's books, and (ii) the financial instruments that can be "physically" delivered to the depositary;
- the conditions applicable to the depositary when exercising its safekeeping custody duties for such financial instruments, taking into account the specificities of the various types of financial instruments and where applicable their registration with a central depositary, including but not limited to:
 - o the conditions upon which such financial instruments shall be registered in a financial instruments accounts opened in the depositary's books opened in the name of the AIF or, as the case may be, the AIFM acting on behalf of the AIF,

o the conditions upon which such financial instruments shall be deemed (i) to be appropriately segregated in accordance with the principles set forth in Article 16 of Commission Directive 2006/73/EC), and (ii) to be clearly identified at all times as belonging to the AIF, in accordance with the applicable law; and what shall be considered as the applicable law.

As a matter of principle, all financial instruments that shall be included in the scope of the depositary's duties as referred to in point (a) of Article 21(7) are financial instruments as described in point 1 and 2 in annex I, section C of directive 2004/39/CE and the ETF shares, (hereafter "the securities"). These securities should comply with the following conditions:

- the financial instruments are safe kept all along a chain of intermediaries, in a way that gives insurance to the depositary, at any time, about their existence, their location and its rights of disposition and retrieval.

That implies that the securities should be:

- free of any lien,
- subject to regulated central reconciliation procedures (registered with a central securities depository – CSD-), performed independently from the issuer in order to ensure the integrity of the financial instruments issuances,
- Transferable with all their rights and effects,
- Safe-kept by third parties selected by the depositary according to its own due diligence criteria.

Therefore, the financial instruments that can be included in the above-mentioned scope are the securities (Equities, Bonds and ETF) that:

- are not subject to a partial or full transfer of ownership and to any re-use (re-hypothecation) of the financial instruments,
- are registered in a CSD performing the so-called notary function (ie these securities that are not registered with the issuer itself or its agent - a registrar or a transfer agent).

Conversely financial instruments that are excluded from the above-mentioned scope are, namely:

- Physical instruments not held by the depositary and its sub-custodians,
- All financial contracts (including lending, borrowing, derivatives instruments, listed and OTC). These instruments are financial contracts which cannot be registered into securities accounts,
- Units and shares of collective investment schemes issued in a nominative form or registered with the issuer or a registrar,
- All other securities issued in a nominative form or registered with and issuer or a registrar,
- All financial instruments used as collateral which do not remain in an account open in the books of the depositary.

The securities that can be "physically" delivered to the depositary can be transferred in a physical (certificate) form of title only. These securities are safe kept in a vault only and not in an account.

As far that the conditions applicable to the Depositary are concerned, level 1 provisions In the AIFM Directive appear to be appropriate and sufficient in their nature and scope.

2. CESR is requested to advise the Commission on:

- the type of "other assets" with respect to which the depositary shall exercise its safekeeping duties pursuant to paragraph 7(b), namely all assets that cannot or are not to be kept in custody by the depositary pursuant paragraph to Article 7(a);

All financial instruments which are not in the scope of the custody as referred in point (a) of Article 21(7) should be subject to safekeeping duties pursuant to paragraph 7(b).

In addition all assets which are not financial instruments are also part of the "other assets". Main categories can be described as follows:

- Commodities,
- Receivables,
- Real estate properties,
- Pieces of fine arts,
- Material goods.

It is relevant to precise that level 1 excludes cash from the safekeeping of the assets (nor in custody or record keeping)

- the conditions applicable to the depositary when exercising its safekeeping duties over such "other assets", taking into account the specificities of the various types of asset, including but not limited to financial instruments issued in a 'nominative' form, financial instruments registered with an issuer or a registrar, other financial instruments and other types of assets.

1. The AIFM needs to reconcile his records with the depositary record on a on going basis. On the other way, the depositary has to wait to be certain of the ownership before recording the information received to the AIFM (level 1 provision provides the depositary shall maintain a record of those assets for **which it is satisfied that** the AIF holds the ownership of such asset). In this case, it will be a large period between the negotiation and its recording (for example the time to obtain the record of the signed copy of the swap contract). SGSS proposes two types of records :
 - a. The first one is temporally
 - b. The second when the depositary is satisfied that the AIF holds the ownership of the assets

The temporary record must be considered as out of the scope of the safekeeping.

2. As per the depositary safe-keeping functions over the other assets, SGSS is of the opinion that:

Ownership of other assets should be ascertained through

- a. a periodic review of the existing procedures in place in the AIFM with regards to the
 - i. the acquisition of the ownership
 - ii. the reconciliation procedure of the AIFM records with the external evidences of ownership on ongoing basis
 - iii. the information on the transaction sent to the depositary
- b. a periodic reconciliation of the AIFM records with the depositary records to be performed by the AIF (the findings of which being communicated, without delay, to the depositary)

3. The obligation of information to the depositary lies on the AIF, or AIFM, acting on behalf of the AIF.

The description of the nature of the information flow to be communicated by the AIF (or AIFM) to the depositary should be included into the provisions of the agreement evidencing the appointment of the depositary.

4. For the purpose of the administration of securities, the national law of the depositary shall apply.

3. To that end, CESR is requested to advise the Commission on:

- the conditions upon which the depositary shall verify the ownership of the AIF or the AIFM on behalf of the AIF of such assets;
- the information, documents and evidence upon which a depositary may rely in order to be satisfied that the AIF or the AIFM on behalf of the AIF holds the ownership of such assets, and the means by which such information shall be made available to the depositary.
- the conditions upon which the depositary shall maintain a record of these assets, including but not limited to the type of information to be recorded according to the various specificities of these assets; and the conditions upon which such records shall be kept updated

Please refer to response above.

In the course of its periodic reviews of the procedures, the depositary should be satisfied with the reconciliation procedures in place in the AIF (or the AIFM).

Such procedures shall include the existence and the nature of the proof of evidence (eg certifications from issuers and third parties), the frequency of the reconciliation procedure, the nature and the justifications for discrepancies ...).

Assessment of the depositary reviews, should be represented to the AIF (or to the AIFM) and to the relevant regulatory authority if the problem persist.

- the conditions upon which the depositary shall maintain a record of these assets, including but not limited to the type of information to be recorded according to the various specificities of these assets; and the conditions upon which such records shall be kept updated.

4. In its advice, CESR should also consider the circumstances where assets belonging to the AIF, are subject to temporary lending or repurchase arrangements or any type of arrangements under which financial instruments may be re-used or provided as collateral by the AIF or AIFM on behalf of the AIF, whether or not such arrangements involve transfer of legal title to the financial instruments, and advise on the conditions applicable to the depositary to perform its safekeeping duties accordingly.

As a matter of principle, the depositary should not be held responsible for the loss of any assets given in collateral by the AIF unless the assets remain with the depositary.

The financial instruments subject to temporary lending or repurchase agreements or to any type of arrangements under which they can be re-used or provided as collateral, SGSS believes that in that case the depositary will not be able to perform its custody function unless the financial instruments remain in its books. Indeed where financial instruments are not held in the depositary's books, the depositary will not be able to control where they are and how they are used by the counterparty.

When the financial instrument do not remain in the books of the depositary **i)** is not be in a position to perform its custody duties and, **ii)** in no circumstance this case can qualify for a delegation of the custody function as the counterparty or the collateral manager is selected by the AIF (or the AIFM acting on behalf of the AIF). No restitution obligation for the depositary with respect to the financial instruments subject to such arrangements may therefore be envisaged

Nevertheless, in order for the depositary to properly fulfill its duties with regards to these financial instruments, the depositary will require information from the AIF (or the AIFM acting on behalf of the AIF). The AIF (or the AIFM acting on behalf of the AIF) is responsible for the proper delivery and accuracy of the information. Said information is to be described in the contract between the depositary and the AIFM.

ISSUE 13.3 – DEPOSITARY FUNCTIONS PURSUANT TO PARAGRAPH 8

1. CESR is requested to advise the Commission on the conditions the depositary must comply with in order to fulfill its duties pursuant to Article 21(8). The advice shall include all necessary elements specifying the depositary control duties when inter alia verifying the compliance of instructions of the AIFM with the applicable national law or the AIF rules or instruments of incorporation, or when ensuring that the value of the shares or units of the AIF is calculated in accordance with the applicable national law and the AIF rules or instruments of incorporation and procedures laid down in Article 19.

According to SGSS, it is essential to bear in mind that the proposed implementations measures should acknowledge the fact that different operating models for the depositaries coexist in the EU when fulfilling their duties.

Indeed, level 1 provisions read that these functions are to be performed in accordance with national laws.

Therefore, implementing measures should not result in new provisions that would impose rules which are not consistent with existing national regimes.

For instance, the French model relies on ex-post controls of NAVs. The controls, according to an annual program, do consist in the review and the appraisal of the internal procedures of the AIFM, and in the appraisal of data and information resulting from internal verifications performed by the AIFM itself

While, in contrast, other models (e.g. Italy, Germany) follow different patterns.

Therefore, the proposed implementation measures should follow the following principles:

- A risk-based approach that implies proportionality when fulfilling the duties;

- An efficiency approach that implies that :
 1. The depositary does not replicate works and processes done by others. In particular the depositary, when the applicable national legislation does not require the depositary to process calculations of NAVs, should not be induced to “recalculate” the NAVs. Conversely, should these tasks be included in the depositary’ duties that should be taken into account and limit the scope and the nature of other tasks and controls to be performed by the depositary
 2. These functions are to be performed on ex-post basis as they are always carried out by the depositary, in addition to the controls already performed by the AIF itself or the AIFM.

It is therefore essential that, in the proposed legislation, neither a prevailing, nor a forbidden, procedure for controls (samples, assessment of procedures, on site due diligence...) is designated.

III.4. Issue 14 – Due diligence

1. CESR is requested to advise the Commission on the duties the depositary has to carry out in exercising its due diligence duties pursuant to Article 21(10), namely:

- procedures for the selection and the appointment of any third party to whom it wants to delegate parts of its tasks; and
- procedures for the periodic review and ongoing monitoring of that third party and of the arrangements of that third party in respect of the matters delegated to it.

SGSS is of the opinion that the description of the due diligence duties to be performed by the depositary as provided for in the level 1 text of the Directive (Art 21.10.d) appears to be already very detailed as it provides for a large number of conditions to be fulfilled by a third party.

SGSS agrees that the depositary should establish, implement and maintain internal procedures referring to:

- the selection and appointment of a sub-custodian,
- the periodic review and ongoing monitoring of this sub-custodian.

Therefore, SGSS is of the opinion that there is no need to introduce additional due diligence duties in the level 2 text if the internal procedures; established, implemented and maintained by the depositary procedures do provide for:

- regular market reviews ;
- the verification of :
 - o the existence of contractual arrangements for assets in custody with the third party, and in particular, arrangements applicable to the obligation of segregation of assets,
 - o all others dispositions provided for in art 21.10 (d).
- the appraisal of:
 - o the means and organization of the third party to perform the delegated tasks, including its internal reconciliation procedures,
 - o the sufficient good repute and experience of the third party.
 - o The financial soundness (appraised through internal/external rating procedures) of the third party/

In addition, the procedures should take into account the proportionality principle of controls and the specificities of the market where a third party is located. Accordingly, the procedures may provide for different means to conduct due diligence processes (eg: questionnaires, visits in situ, third parties assistance and services...).

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

SGSS is of the opinion that, given the diversity of countries that may comprise the depositary's sub-custodian network, any regulatory template should be limited to the principles mentioned above.

III.5. Issue 15 – The segregation obligation

1. CESR is requested to advise the Commission on criteria to be satisfied to comply with the segregation obligation whereby the depositary shall ensure on an ongoing basis that the third party fulfils the conditions referred to in Article 21(10)(d)(iv).

Current market practices already require segregation of securities on behalf of the fund, where possible under current market practice.

There are, however, limitations in some typically less developed markets or in some legal environments. These limitations should be reflected with appropriate level of disclosure to investors.

Any standards addressing the question of segregation below the level of the depositary need to take into account the legal and operational realities of the way in which assets are currently held in the international custodial system and the cost implications of making any changes to that.

In particular full segregation on a client by client basis throughout the custody chain would be impossible to achieve in practice. At depositary level, depositaries that are subject to MiFID are required to segregate assets so as to be able to identify assets held for one client from assets of another and from the depositary's own assets.

Intermediaries in the custody chain are equally usually required to segregate their client assets from their own assets. This requirement is considered to be the main ring-fencing procedure.

Below the depositary, however, assets are generally mixed with those of all other client assets and held in an "omnibus client" account. Indeed, full segregation throughout the sub-custody chain by designation of each individual client at each level would be impossible to achieve in practice, would not add clear benefits in terms of security of the assets and may not be possible under local law in the jurisdiction in which the third party is located.

SGSS suggests that the Commission (or another designated European institution) establishes a list of EU Members States and/or parties where segregation obligation is both applicable and enforceable. For all other jurisdictions outside the EU, the depositary may rely

on regular certifications issued the sub custodians, its external or internal auditors or third parties such as independent counsels.

The agreement between the depositary and the third party should include the segregation obligation. Especially that agreement should provide for the obligation of segregation between the client assets and the own assets of the third party and for the obligation to inform the depositary whenever any change of internal procedures or local regulation regarding segregation and custody regulation/arrangements occur.

III.6. Issue 16 – Loss of financial instruments

1. CESR is requested to advise the Commission on the conditions and circumstances under which financial instruments held in custody pursuant paragraph 7(a) shall be considered as "lost" according to Article 21(11). In its advice, CESR should take into account the various legal rights attached to the financial instruments depending, for example, on the legal concepts ('*ius ad rem*' vs. '*ius in personam*') used in the jurisdiction where they have been issued and any legal restrictions applicable to the place where they are kept in (sub-) custody.

Firstly, as a matter of principle, SGSS expects that the future legislation does not lead to any misinterpretation on the meaning of the concept of "loss".

Indeed, a "loss of a financial instrument" **should cover the material loss only**; and not, in any circumstance, the loss of value which is a pure market risk for which the depositary cannot bear the liability. In this respect, the loss of value should be clearly excluded from the definition of loss of assets.

Legally speaking a material loss affecting the AIF is a result of the following circumstances:

- the financial instrument does not longer exist (without any relation to a decision of the issuer or its agent)
- the rights of the AIF over the financial instrument had been suspended or terminated.

Secondly, **unavailability of financial instruments cannot *per se* qualify for a loss**. From the SGSS perspective, a clear distinction should be done between assets which are "**temporary unavailable**" (i.e. an asset is blocked for a certain period of time, due to e.g. bankruptcy proceedings or governmental measures) and asset "**permanently unavailable**" (due to e.g. embezzlement or fraud).

Thirdly, only **a judiciary decision authority should be given the capacity to confirm the loss** of financial Instruments.

In its advice, CESR should specify circumstances when such financial instrument should be considered permanently "lost", to be distinguished from circumstances when such financial instruments should be considered temporarily "unavailable" (held up or frozen).

To that end, CESR shall consider inter alia the following circumstances:

- Insolvency of, and other administrative proceedings against, a sub-custodian; it's not temporarily lost, this case is a case of external events beyond reasonable control;
- Legal or political changes in the country where financial instruments are held in sub-custody; it's not temporarily lost, this case is a case of external events beyond reasonable control;

- Actions of authorities imposing restrictions on securities markets; it's not temporarily lost, this case is a case of external events beyond reasonable control;
- Risks involved through the use of settlement systems; and it's not temporarily lost, this case is a case of external events beyond reasonable control;
- Any other circumstances which may prevent the AIF from using or disposing of its assets that are kept in custody by a depositary or a sub custodian.

When determining that a the conditions for loss are met the decision may take into account *inter alia* the following circumstances

- Insolvency of, and other administrative proceedings against, a sub-custodian;
- Legal or political changes in the country where financial instruments are held in sub custody;
- Actions of authorities imposing restrictions on securities markets;
- Risks involved through the use of settlement systems;
- Any other circumstances which may prevent the AIF from using or disposing of its assets that are kept in custody by a depositary or a sub custodian.

None of the above circumstances, however, qualify as a loss of financial instrument *per se*.

The above circumstances may qualify for a loss only when the disappearance of the assets can be evidenced, and thus excluding any possibility that these circumstances may qualify for a temporary unavailability of the assets.

In order to preserve the investor interests, in case of temporary unavailability of the assets of the AIF , it could be put in place exceptional and provisional measures, to be determined by the AIF (or the AIFM) in compliance with applicable regulations (eg: amendments to NAV calculation rules, temporary suspension of subscription /redemption rights, side pocket...).

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

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

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

2. If possible, CESR is requested to advise the Commission on a non-exhaustive list of events where the loss of assets can be considered to be a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary. CESR is encouraged to consider the appropriate form (e.g. guidelines) of such a list.

When drafting its advice, CESR should bear in mind that although depositaries comply on an permanent basis with the AIFM provisions and more specifically with those laid by Art 21 paragraph 10 that aim at mitigating risks related to safekeeping :

1. Safekeeping arrangements are a consequence of investment decisions made by the AIFM (and ultimately by the investors) that may generate specific incremental risk factors that the depositary cannot monitor.
 Practical cases are: investments in non mature financial markets (eg weak centralized infrastructures, absence, or limited effects, of the segregation obligation), in unstable political environments, in markets with limited availability of sub custodian services appropriate for selection.
2. Compliance with these obligations cannot, in any circumstance, eliminate risks in relation to:
 - o The organization and the effectiveness of the oversight of the local financial systems by the local competent authorities, over the financial infrastructures and the regulated actors. In this respect, prevention and punishment of fraud appears to be clearly within the remit of the relevant authorities including administrative and judiciary organizations.
 Indeed, no due diligence process over 1/3 parties can be superior to ongoing local regulatory supervision, local regulators and overseers being, by nature, the strongest authority and having been granted the highest capacity to discharge their duties
 - o The local and international systemic crises affecting the financial markets.
 - o The local and international political crisis and events.

SGSS is therefore of the opinion that is advisable to establish a need for a non-exhaustive list of events where the loss of assets can be considered to be a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.

That list should contain, as a minimum, the following events:

- **Linked to local market conditions**
 - o Market closures
 - o Widespread defaults (systemic/domino effect in one of more markets)
 - o Effect of political/ judiciary acts and decisions
 - o Insolvency of a sub custodian notwithstanding the fulfillment of the depositary's duties (ie due diligence obligations)
- **Linked to markets infrastructures deficiencies**
 - o Failure, outage, and fraud
 - o Local market rules imposing liens and/or reversals

Additional comment

When responding to issue 17, SGSS refers to its comments to issue 13.2 and more precisely to its recommendation as per the financial instruments that shall be included in the scope of the depositary's duties as referred to in point (a) of article 21 7, ie:

- Physical instruments not held by the depositary and its sub-custodians;
- All financial contracts (including lending, borrowing, derivatives instruments, listed and OTC). These instruments are financial contracts which cannot be registered into securities accounts;
- Units and shares of collective investment schemes issued in a nominative form or registered with the issuer or a registrar;
- All other securities issued in a nominative form or registered with an issuer or a registrar;

- All financial instruments used as collateral or that are transferred to a counterparty for a potential re-use.

Therefore, there is no need to advise on a list of external event affecting the other types of assets

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

1. CESR is requested to advise the Commission on the conditions and circumstances under which there is an objective reason for the depositary to contract a discharge pursuant to Article 21(12).
2. In its advice, CESR is encouraged to provide an indicative list of scenarios that are to be considered as being objective reasons for the contractual discharge referred to in Article 21 (12).

Conditions and circumstances leading to contract a discharge may be of very diverse natures, but in all cases result from investment decisions made by the AIFM which can interfere in the ability of the depositary to discharge its duties appropriately. These circumstances may be of an *inter alia*, legal (unsatisfactory legal environment), economical (unsatisfactory conditions), operational, nature.

Consequently, the purpose of the requirement for an “objective reason” for discharge is not clear to SGSS. In any event, SGSS is of the opinion that the existence of a contract evidencing the agreement of the two parties (the depositary and the AIF) to assess that there is a need to contract a discharge pursuant to Art 21(12) should be deemed sufficient and should not require additional and unnecessary formalization.

III. FORM OF IMPLEMENTING MEASURES: DIRECTIVE OR REGULATION

SGSS considers that the implementing measures, at least insofar as they concern depositary/valuation issues, should take the form of a directive. Given that the majority of implementing measures relating to depositaries and valuation are closely linked to the law of contract, liability and property, all of which are issues for the national law of each Member State, implementing measures must take account of such national laws and must therefore be carried out at the national level.

* * *