|  |
| --- |
| 15 July 2016 |

|  |
| --- |
| Reply form for the Call for Evidence  Asset Segregation and Custody Services |
|  |

|  |
| --- |
| Date: 15 July 2016 |

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the Call for Evidence Asset Segregation and Custody Services (ASCS), published on the ESMA website.

*Instructions*

Please note that, in order to facilitate the analysis of the responses, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

* use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
* do not remove the tags of type <ESMA\_QUESTION\_CE\_ASCS\_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
* if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

* if they respond to the question stated;
* contain a clear rationale, including on any related costs and benefits; and
* describe any alternatives that ESMA should consider

**Naming protocol**

In order to facilitate the handling of stakeholders’ responses, please save your document using the following format:

ESMA\_CE\_ASCS\_NAMEOFCOMPANY\_NAMEOFDOCUMENT.

E.g. if the respondent were XXXX, the name of the reply form would be:

ESMA\_CE\_ASCS\_XXXX\_REPLYFORM or

ESMA\_CE\_ASCS\_XXXX\_ANNEX1

***Deadline***

Responses must reach us by **23 September 2016.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input/Consultations’.

***Publication of responses***

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

***Data protection***

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the headings ‘Legal notice’ and ‘Data protection’.

# Introduction

Please make your introductory comments below, if any:

<ESMA\_COMMENT\_CE\_ASCS\_1>

AFTI, “Association Française des Professionnels des Titres”, is the leading association representing the post-trade businesses in France and Europe. AFTI represents through its 99 members a wide range of activities: market infrastructures, custodians, account-keepers and depositaries, issuer services, reporting and data management services with staff 28,000 people in Europe of which 16,000 in France. Our members account for 26 % of the European custody activity with 55,600 billion € in safekeeping and 25 to 30% of the European fund asset servicing sector (namely depositaries and fund administrators). The French market infrastructures main figures are 29 millions of settlements ( CSD) and 186 millions of operations cleared in 2014 (CCP).

AFTI members provide trustee/depositary service in lot of countries, among them France, Spain, The Netherlands,UK,Germany,Italy,Luxembourg,Ireland,Jersey,Guernsey,Isle of Man , Switzerland, Belgium, Colombia, Hong Kong, Singapore, etc. For France, assets under depositary represent more than Eur 2,500 billion, and for UE, more than 12,630 billion.

AFTI members welcome this consultation paper on both segregation requirements and custody services under the AIFM and UCITS V directives. AFTI has a great interest in the questions raised in this paper as final ESMA conclusions will significantly impact AFTI members ‘activities as both depositaries for EU investment funds and global custodians.

As previously answered to the previous consultation paper issued in December 2014, AFTI supports the Option 1 for segregation requirements for all reasons mentioned below. In addition AFTI is of the opinion that a clear distinction between the concept of “issuer” CSD and “investor” CSD should be made when referring to the questions around the delegation of custody. This clarification is key from an investor protection perspective and should also ensure level-playing field between entities in the similar types of activities.

* Transparency as a mean to anticipate occurrence of insolvency :

Further to the Madoff case and the Lehman Brothers bankruptcy, one of the main objectives of the AIFM and UCITS V directives was to increase the protection of investor’s assets in order to restore investors’ confidence in the investment fund industry.

AIFMD and UCITSV have introduced a specific custody regime for collective investment funds with regards to (i) the strict liability regime of the depositary for assets held in custody and (ii) the obligations to take necessary actions in case of custody risk, ideally before a delegate or a sub-delegate goes bankrupt.

To that end, AIFMD and UCITS V require transparency on the custody chain as mitigating custody risks is essential in the interest of asset managers, investors and financial markets, given the amounts at stake, the importance of reputational risks and the need to keep investor’s confidence. Segregation is a cornerstone for investor protection and trust in the role of the depositary in the wider financial sector:

* Article 21 of AIFMD and Article 22a of UCITS V state that a delegate of a depositary “segregates the assets of the depositary’s clients from its own assets and from the assets of the depositary in such a way that they can at any time be clearly identified as belonging to clients of a particular depositary”. Clarity from ESMA will enable depositaries to have a clear legal basis to require compliance with the segregation rules by their delegates.
* Segregation requirements ~~in~~ under Article 99 of the AIFMD Level 2 text and Article 16 of the UCITS V Directive Level 2 text are to be implemented by delegates and sub-delegates of the depositary’s custody function. They do not only introduce~~d~~ protection in the case of bankruptcy of delegates/sub-delegates, but also provide the depositary with a look-through view of assets whatever the level of delegation of custody toassist with the monitoring of custody risks (e.g. risks of fraud, misuse of assets) and the transfer of assets to back-up delegates when they are at risk of becoming bankrupt.

AFTI is of the opinion that to avoid any regulatory arbitrage, these obligations should be enforced on a similar harmonized way.

* Need for clarity with regards segregation obligations

In ESMA’s consultation paper published in December 2014, only option 1, 2 and 5 were assessed by ESMA as being compliant with the segregation rules. Unfortunately, no guideline was issued to clarify which option should be implemented by depositaries further to the ESMA consultation.

AFTI is of the opinion that, contrary to option 2, option 1 enables the depositary via its delegates reporting and procedures, to have the proper assurance that the assets recorded at the depositary level on behalf of the investment funds are actually those recorded at the last level of the custody chain ensuring that no misuse or loss of assets has occurred along the custody chain by providing transparency at every level of delegation. Moreover, option 1 enables the depositary to request an immediate transfer of the assets to another back up delegate when, in the depositary’s opinion, risk-related considerations at the level of a delegate or sub-delegate necessitate the implementation of a contingency plan. Thus option 1~~,~~ strikes the right balance by providing appropriate level of transparency to the depositary, enabling it to monitor its delegates appropriately whilst at the same time only requiring a limited increase of number of accounts.

Due to lacking clear segregation rules, difficulties have been encountered by depositaries for effective implementation of option 1 with prime-brokers and tri-party collateral managers. These delegates resist the implementation of option 1, arguing cost and operational reasonswhen they hold securities in custody for which they are not directly registered with issuer CSDs (and therefore use themselves delegates).

AFTI members believe that option1 can also be implemented by tri-party collateral managers and prime-brokers. With regards tri-party collateral managers, it is important to keep in mind that the proportion of the total assets held by the EU investment funds and received under tri-party collateral arrangements is less than 1% (see our calculation in Response to Question 14). Moreover some tri-collateral managers have reduced the impact of option 1 implementation by reducing their number of delegates, which also reduces the complexity and the risk of default in the Depositary custody chain. This is an indirect positive outcome of option 1 implementation for AIFs and UCITS’ depositaries and investors.~~;~~

Prime-brokers are not affected differently than depositary by segregation requirements with regards their custody network and no special treatment regarding these requirement would be justified. Moreover prime brokers are affected by AIFMD/UCITS V segregation requirements only with regards unencumbered securities they hold in custody and which can be transferred to depositaries.

* Need for clarity as regards the dual role of CSDs

In addition, it is our experience that “investor CSDs” have challenged any qualification as depositaries’ delegates and consequently insist they ~~are~~ should not be subject to the segregation requirements introduced by AI~~D~~FMD and UCITS V.

We advocate for a clear distinction between the «issuer CSD” concept (i.e. the CSD where the initial issuance of the securities is recorded) and the “investor CSD” concept (i.e. a CSD that provides custody services in relation to securities initially issued in another CSD and for which the investor CSD acts in a capacity similar to a global custodian) to get this critical issue solved.

It should be clarified that issuer CSDs are not delegate /sub-delegate of the depositary as opposed to investor CSDs. Ideally this distinction should be introduced in the relevant articles of both the UCITS and AIFM directives and their associated delegated regulations, and should not be addressed only in the recitals. Although Recital 21 in the UCITS V directive is, in our view, quite useful in providing clarity and addressing this issue, it is challenged from ~~not~~ legal enforceability perspective and therefore further clarification in both Directives is necessary. Appropriate language is provided in ESMA report RTS 2015/1457, page 15.

In addition ~~l~~inks between CSDs, direct or indirect, do~~es~~ not bring any additional legal safety and guarantee that could justify a distinct regime in favor of Investor CSDs versus global custodians. What is at stake is much more the maintenance of the integrity of clients’ positions than the technical monitoring of settlement instructions.

~~I~~t is also worth noting that should an investor CSD open new accounts at the issuer CSD (which is not the case under AIFMD~~/~~ and UCITS V segregation requirements), the T2S Users Detailed Functional Specifications (UDFS) do not mention any restriction with regards to the number of accounts opened at an issuer CSD by an investor CSD. T2S is designated to accommodate high volumes as regards volumes of transactions, number of participants and settlement information.

As far as others markets are concerned, there may be some jurisdictions where the registration of securities as an issuer CSD is only possible via opening an account at a given intermediary which cannot be selected by the depository. Any final approach from ESMA should consider the distinction between such mandatory market arrangements and CSDs offering similar services to custodians.

<ESMA\_COMMENT\_CE\_ASCS\_1>

1. **Please describe the model of asset segregation (including through the use of ‘omnibus accounts’) in your custody chain/the custody chain of the funds that you manage. Please explain what motivates your choice of asset segregation at each level (e.g. investor demand, local requirements, tax reasons).**

**In your description, please take into account the following:**

1. **please describe – with the use of a chart/diagram – at least three levels of account-keeping in your custody chain, as follows:**
2. **the first level should be the level of the AIF/UCITS-appointed depositary,**
3. **the second level should be the level of a third party delegate of the depositary, and**
4. **the second level should be the level of a third party delegate of the depositary, and**
5. **the third level should be the level of a sub-delegate of the third party delegate or the CSD, where applicable.**

**You may wish to add further levels of accounts, depending on your custody chain.**

1. **if you use ‘omnibus accounts’ (i.e. accounts, in which the assets of different end investors are commingled, rather than each individual investor’s assets being held in a separate account) at any level of the custody chain, please provide, in as clear and detailed a manner as possible:**
2. **an explanation including at which level of the chain you use them;**
3. **a description of the features of these accounts (e.g. whose assets are held in them, who holds title to those assets or is considered to be the end investor, etc. - e.g. AIF, UCITS, other clients, depositaries or their third party delegates);**
4. **an explanation on how any restriction on reuse of the assets applying to the funds (AIF/UCITS) which you have in custody/manage (e.g. the restriction under Article 22(7) of the UCITS Directive) is respected, when they are held in an omnibus account at a given level; and**
5. **the number or percentage of ‘omnibus accounts’ versus ‘separate accounts’ in your custody chain.**
6. **if you do not use ‘omnibus accounts’, please specify why and how far down the chain it is possible for you not to use them (i.e. whether this works in all situations or, if it is necessary to use ‘omnibus accounts’ at some level of the custody chain, at which level)?**
7. **in the chart/diagram to be provided under a), if applicable, please refer to the five options in the table under Q22 below and specify if your model matches or closely matches with any of the models described therein.**
8. **if your model makes any distinction between AIF and UCITS assets, please highlight the difference between the two in the chart/diagram to be provided under a).**
9. **According to a Briefing Note[[1]](#footnote-2) published by ECON in 2011, there are five basic models for holding securities with an intermediary: the trust model**[[2]](#footnote-3)**, the security entitlement model**[[3]](#footnote-4)**, the undivided property model**[[4]](#footnote-5)**, the pooled property model**[[5]](#footnote-6) **and the transparent model**[[6]](#footnote-7)**. ESMA is interested in gathering evidence on whether there may be any link between certain securities holding models and certain asset segregation models. Therefore, ESMA invites stakeholders to provide input to the following questions:**
10. **What securities holding model do you use?**
11. **Is such model the market standard in your jurisdiction?**
12. **Is the market standard model in your jurisdiction one of the five mentioned above, or a different one? If a different one, please provide details.**
13. **Does the model you refer to under f) i) require a particular way of segregating assets or omnibus accounts at one of the levels referred to at letter a) above? If yes, please specify.**
14. **Please explain the naming conventions (i.e. in whose name is the account opened) applied to the accounts with the delegates/sub-delegates of the depositary in the model described under answers to questions a) to e) above. Please also specify if there are instances where the accounts with the immediate delegate of the depositary are opened in the name of the funds.**

<ESMA\_QUESTION\_CE\_ASCS\_1>

.

As a preliminary remark, as mentioned in recital 21 of the UCITS V Directive, an issuer CSD is not a delegate /sub-delegate of the depositary for the purposes of the AIFM~~D~~ and UCITS Directives. AFTI members require that the issuer CSD segregates its own assets (or its delegate/sub-delegate’ assets) from the assets of its clients (or its delegate/sub-delegate’s clients) in a nominee omnibus account. This minimum segregation level is the one imposed by MIFID in the EU.

All securities held in custody for investment funds are recorded at thedepositary level (level 1 according to ESMA definition) in an individual AIF/UCITS securities account in the name of each AIF/UCITS.

AFTI members require (in compliance with requirements of AIFMD level2 text -Article 99- and UCITSV level 2 –Article 16- ) that their delegates (level 2 according to ESMA definition) to open the following accounts at their level:

* + A nominee omnibus account in the name of the AFTI member acting on behalf of AIFs,
  + A nominee omnibus account in the name of the AFTI member acting on behalf of UCITS ,
  + A nominee omnibus account in the name of the AFTI member acting on behalf of its other clients,
  + An account in the name of the AFTI member to record its own assets.

This set-up does not apply when a prime broker has been appointed as delegate of the depositary~~,~~ at the request of the investment fund, as the individual accounts of the AIFs/UCITS are opened directly in the Prime Broker books. This set up and associated questions related to the prime-broker’s delegates will be further developed in our response to Q14 of the present call for evidence.

Percentages of AFTI member assets under option 1 segregation rule are:

* 100% at the first level of delegation,
* More than 90% at the second level of delegation due to difficulties encountered with investor CSDs, tri-party collateral managers and prime-brokers. As long as the segregation rules will not be clarified it is very difficult to convince some investor CSDs, tri-party collateral and prime-brokers that their current set-up is not compliant :
* Investors CSDs do not view themselves as depositaries’ delegates, and will only accept to require their sub-delegate to open the following nominee omnibus accounts to record :
  + assets belonging to the investor CSD acting on behalf its clients ,
  + assets belonging to the investor CSD belonging to it-self.
* Tri-party collateral managers, which are not International CSDs, open a nominee individual or omnibus account /record in the name of the AFTI member acting on behalf it(s) client(s) in their books. Based on the reports or files provided by the tri-party collateral manager the assets are booked in a custody account at the AFTI member (being level 1 according to ESMA definition) in the name of the AIF/UCITS. Tri-party collateral managers, which are delegates of the AFTI member at the level 2 according to ESMA definition, comply with option 1 only when they hold securities directly registered in accounts at the issuer CSD. Arguing cost or internal technical reasons and without clarification of segregation rules, when they use sub-delegates in their own custody chain, the tri-part collateral managersonly require their delegates to open the following nominee accounts:
  + assets belonging to the tri-party collateral manager acting on behalf its clients,
  + assets belonging to the tri-party collateral manager itself.
* When, at the request of the investment fund, a prime-broker has been appointed, an individual record in the name of the AIF is opened in the Prime-broker books .On the basis of the report provided by the Prime Broker and according to Article 91 of AIFMD, the AFTI member keeps a record of assets held by the prime-broker in the name of the AIF/UCIT: those assets can be recalled if necessary. Prime Brokers , which are delegates of the AFTI member at the level 1, comply with option 1 only when they hold securities directly registered in their name with the issuer CSD .Without clarification of segregation rules , prime-brokers use sub-delegates in their own custody chain, theyonly require they delegates to open the following nominee omnibus accounts to record :
  + assets belonging to the prime\_ broker acting on behalf its clients ,
  + assets belonging to the prime-broker itself.

Non-reuse of assets is checked by the depositary via procedures, reporting and controls on site at the delegate, to check that:

* the reconciliation process with the sub-delegate or the Issuer CSD includes all delegate clients’ assets,
* controls have been implemented at the delegate so that clients’ asset settlement instruction do not offset each other.

When a sub-delegate is appointed only option 1 enables the depositary to check that the assets recorded at the depositary level on behalf of the investment funds are actually those recorded at the last level of the custody chain and are part of the assets that are recorded at the issuer CSD as belonging the custodian’s clients.

AFTI members provide today depositary services in several European Countries (France, Germany, Ireland, Luxembourg, UK, Italy, Spain, Netherlands, etc.) and use the standard market holding model in such jurisdiction.

The custody chain can be represented by the chart in the Annex file attached.

<ESMA\_QUESTION\_CE\_ASCS\_1>

1. **Please explain how, under the framework you have described in your response to Q1, the assets of the AIF/UCITS are protected against the insolvency of any of the parties involved in the custody chain (depositary, delegate, sub-delegate, – including prime broker – CSD) and – in case of use of ‘omnibus accounts’ – of their other clients whose assets are also held in this same account. In particular, what happens if a party, whose assets are held in another party’s ‘omnibus account’, becomes insolvent? Does this place at any disadvantage the other parties using the omnibus account who are not in default?**

<ESMA\_QUESTION\_CE\_ASCS\_2>

AFTI members use omnibus accounts along their custody chain provided they have ascertained that that the nominee concept is recognised at the delegate/sub-delegate level. Subject to local law, nominee omnibus accounts are protected in case of bankruptcy of delegates/sub-delegate. These accounts do not record assets belonging to those delegates/sub-delegates as they are recorded in a separate account.

AFTI members use option 1, as far as it is possible (i.e. when implementation is not denied by its delegates), to avoid its assets being commingled with the assets of another custodian ‘clients. This segregation makes it possible for the depositary to check the accuracy of the rights all along the custody chain, and avoids the effect of any discrepancies affecting the record of ownership rights of other third-party’s clients.

Should AFTI members or their delegates/sub-delegates go bankrupt the assets of a given UCITS/AIFS, subject to applicable insolvency law, are protected as they are not recorded as part of the own assets of the AFTI member or those of its delegates/sub-delegates. Therefore these assets of the UCITS/AIFS are not available for distribution to their creditors in the event of their insolvency.

The quantity of securities returned to an AIF or a UCITS fund in a situation where the depositary has declared bankruptcy would depend on:

* the actual enforcement of insolvency law applicable to the delegates/sub-delegates,
* the quantity returned by the delegate/sub-delegate. This will also depend on the accuracy and traceability of the quantity of securities recorded at the delegate/sub-delegate level as belonging to the AFTI member’ clients and on the total quantity recorded at the issuer CSD as belonging to the delegate’s clients (or to the sub-delegate ‘s clients).

<ESMA\_QUESTION\_CE\_ASCS\_2>

1. **Please describe the differences (if any) between ‘omnibus accounts’ (i.e. books and records segregation) and separate accounts in terms of return of the assets from the account in a scenario of potential insolvency or insolvency. In particular, please indicate whether the assets may be transferred to the depositary or another delegate more easily and/or quickly under a particular insolvency regime from either of the two types of account and explain why. If possible and relevant, please (i) distinguish among the various jurisdictions of which you have knowledge and (ii) explain whether a specific type of account may have an impact on the timeline for the aforementioned transfer of assets or, more generally, on the order of events in a scenario of potential insolvency or insolvency.**

<ESMA\_QUESTION\_CE\_ASCS\_3>

We are not aware of countries where the type of accounts (omnibus accounts under the nominee concept or segregated accounts in the name of the end investors) has an impact on the ability to return assets in the event of an insolvency or potential insolvency, provided those accounts or records are recognised as segregating assets of clients as opposed to assets of the custodian. We are not aware that a type of client’s account, either omnibus or separate may affect the timeline for transfer of assets.

The insolvency of a delegate/sub-delegate may be dealt with in accordance with the law of the jurisdiction where the securities are located. Different jurisdictions have different insolvency regimes and the timeline for recovery against an insolvent estate will depend on the administrator proceedings.

However, the quantity of assets to be transferred must have been determined and justified by accurate records before a transfer of assets take place. Option 1 ensures that this necessary step of accurate recordkeeping has already been performed on an ongoing basis, at all the levels of the custody chain.

When, in the depositary’s opinion, risk-related considerations at the level of a delegate or sub-delegate require an immediate transfer of the assets to a replacement delegate, option 1 is the more efficient ~~best~~ as it enables the depositary to remove from its custody chain any delegates/sub-delegates likely to become insolvent with ease and speed.

<ESMA\_QUESTION\_CE\_ASCS\_3>

1. **Should you consider that asset segregation pursuant to options 1 and 2 of the CP does not provide any additional protection to the existing arrangements you described in your response to Q1 in case of insolvency, and that these arrangements provide adequate investor protection, please explain which aspects of the regime contribute to meeting the policy objective through measures including:**
2. **effective reconciliation,**
3. **traceability (e.g. books and records), or**
4. **any other means (e.g. legal mechanisms).**

**Please justify your response and provide details on what any of the means under i) to iii) consist of.**

<ESMA\_QUESTION\_CE\_ASCS\_4>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CE\_ASCS\_4>

1. **In the chart below (option 1 of the CP), AIF 1 would only have recourse against Depositary 1 under the PRIMA concept.**
2. **In the event of, for instance, a default of Depositary 2, would separate accounts at the level of the Delegate make it easier for Depositary 1 to enforce the rights in respect of the assets held in the account on its behalf against the Delegate?**

****

1. **In the event of the default of the Delegate, would separate accounts at the level of the Delegate make it easier for Depositary 1 and Depositary 2 to enforce their rights in respect of the assets held in the account on their behalf against the Delegate or its liquidators?**

<ESMA\_QUESTION\_CE\_ASCS\_5>

Whatever the level in a custody chain, the enforcement of the ownership rights of a client (or of a client of the custodian ’s client) relies on accurate recordings of how client assets are held at both the custodian’s and at client’s level, which need to be reconciled on a regular and frequent basis.

Under option 1 depositary 1‘s clients ownership is established via records and detailed allocation of settlement instructions, without being affected by any difficulty in the establishment of depositary 2s’ clients ownership. In particular option 1 prevents any uncontrolled use of assets of depositary1’s AIFs to settle transactions (in the event of short sale or failed trade) of depositary2’s AIFs.

<ESMA\_QUESTION\_CE\_ASCS\_5>

1. **Many respondents to the CP argued that, in an insolvency scenario, imposing a model where investors have individual accounts throughout the custody chain would not necessarily provide any particular benefit over the use of IT book segregation in an omnibus account (i.e. books and records instead of separate accounts). Please explain how the level of protection indicated in the policy objective at the start of this paper can be achieved through the use of omnibus accounts. Please also:**
2. **describe how segregation in books and records would ensure the aforementioned investor protection;**
3. **provide an example of how such books and records are used in insolvency proceedings to trace and return client securities when omnibus accounts are used; and**
4. **explain how the above-mentioned segregation in books and records would address any of the risks of ‘omnibus accounts’ mentioned in recent IOSCO work[[7]](#footnote-8).**

<ESMA\_QUESTION\_CE\_ASCS\_6>

<ESMA\_QUESTION\_CE\_ASCS\_6>

1. **Please describe the impact of settlement process and account structures on the different levels through the custody chain in the case of**

* **Cross-border investments**

1. **Through CSD Links**
2. **In relation to cross-border investments through CSD links, what are the functions of an investor CSD[[8]](#footnote-9)?**
3. **Through T2S**

* **Prime broker services**
* **Tri-party collateral management / securities lending.**

<ESMA\_QUESTION\_CE\_ASCS\_7>

* With regards to cross-border investments and the impacts on CSD links , we would like to get clarified that issuerCSDs are not delegate /sub-delegate of the depositary as stated in Recital 12 of the UCITS V directive. Consequently issuer CSDS are not subject to AIFMD/UCITS segregation requirements. At the issuer CSD level, the only applicable segregation requirement is a distinction between the own assets of the custodian, which is the last level of the custody chain, and this custodian clients’ assets. Consequently AIFMD/ UCITS V segregation requirements do not affect the number of accounts opened at an issuer CSD by an investor CSD. It has the same impact ~~s~~ as when the investor CSD opens new accounts for a given client or open accounts for new clients .In addition it is interesting to note that, should an investor CSD open new accounts at the issuer CSD, which is not the case, the T2S Users Detailed Functional Specifications (UDFS) do not mention any restriction with regards to the number of accounts opened at an issuer CSD by an investor CSD. T2S is designated to accommodate high volumes as regards volumes of transactions, number of participants and settlement information.
* Regarding prime-brokers and tri-party collateral managers, they are not affected by segregation requirements when they hold securities directly registered in their name at the issuer CSD. They are only impacted by asset segregation requirements when they use delegates. Currently they only require they delegates to open the following nominee accounts:
  + assets belonging to the prime broker/ tri-party collateral manager acting on behalf its clients ,
  + assets belonging to the prime-broker/ tri-party collateral manager it-self

<ESMA\_QUESTION\_CE\_ASCS\_7>

1. **It has been argued that each time a new end investor or new AIF or UCITS is added as a customer, instead of one new account being created, many new accounts would need to be created at multiple levels in the chain of custody. If you agree with this statement, please provide further details of how this would work in practice.**

<ESMA\_QUESTION\_CE\_ASCS\_8>

Options, from 1 to 5 (which requires individual account segregation), should not be assimilated and therefore lead to confusion.

This statement is true for option 5 only that is based on individual segregation (by end investor) all along the custody chain. To comply with option 5, each time a new investment fund is added as a customer, the Depositary is expected to open a new account (at level 2 according to ESMA definition) per delegate and per country where the investment fund invests. Depending of the length of the custody chain, each sub-delegate should then open itself a specific account at lower level (3 and above) until reaching the local issuer CSD. It is important to note, that several countries in the world impose segregation per final investor at issuer level and as such all custodian/depositary have to operate under option 5 for those countries. This does not prevent AIFs and UCITS from investing in such countries. However, option 5 was discarded by ESMA itself in its CP after a costs/ benefits assessment.

When option 1 was implemented for the first time by AFTI Members, the number of new accounts (at level 2 or beyond) to be opened was dependent on the already existing set-up, the number of issuers CSD involved, and the number of delegates. Due to these factors and specific cases (Tax and clients requirements), it is not possible to simulate with a single formula the increase in accounts required to comply with option 1. Nevertheless the following rules are applicable:

* When the custody chain has ~~2~~ two levels (the depositary is directly registered with issuer CSD) are they are not deemed being delegates under AIFMD or UCITS V no new accounts need to be opened at issuers CSD are they are not deemed being delegates under AIFMD or UCITS V.
* When the custody chain has 3 levels (i.e. the Depositary appoints a delegate which is directly registered with the issuer CSD): only 2 new omnibus accounts need to be opened at the delegate one for AIFs and one for UCITS funds in order not to longer commingle such assets with other depositary’s clients not being AIFs or UCITS funds. No further segregation is to be implemented by the delegate as the next level is the issuer CSD (which is not a delegates under AIFMD or UCITSV).
* When the custody chain has 4 levels (i.e. the Depositary appoints a delegate which in turn appoints a sub-delegate directly registered with the issuer CSD), only two additional omnibus accounts- at the sub-delegate level (level 3) - need~~s~~ to be opened, as compared to the previous set-up. No further segregation at level 4 to be implemented by the sub-delegate as the next level is the issuer CSD (which is nota delegate~~s~~ under AIFMD or UCITSV).

As an illustration let ’s consider a scenario where AIFs and UCITS of a given depositary have invested in 25 countries, assuming that the depositary is directly registered with 15 issuer CSDs and it has appointed 10 delegates being themselves directly registered with the relevant issuer CSD, with 1 existing accounts for all the clients at delegate’s level. The conversion under Option 1 of this network would only add: 15+10\*2=35 accounts

Therefore implementation of Option 1 by the industry is fully manageable, would generate a limited increase of accounts at delegates/sub-delegates. Option 1 is also an incentive to shorten the custody chain leading to increased efficiency of the settlement process and reduced risks for investors and depositary with regards to the safety of assets.

<ESMA\_QUESTION\_CE\_ASCS\_8>

1. **If the number of accounts were increased, what effect would it have on the efficiency of settlement operations (e.g. the ability to net off transactions)?**

<ESMA\_QUESTION\_CE\_ASCS\_9>

Existing securities settlement arrangements and systems have been designed and implemented in order to accommodate and support large volumes with many actors servicing millions of clients and accounts. Efficiency will not be affected by an increase of accounts prompted by segregation requirements.

After having implemented option 1 since 2014, we have not noticed any changes in the efficiency of our settlement process. Neither our market STP (Straight Trough Processing) rate, neither our Failed/Late settlement rate have increased.

On client side, and post securities migration due to changes in their SSI (Standard Settlement Instructions) in markets where we have delegates, we have not been advised of particular difficulties resulting from option1 implementation by delegates.

<ESMA\_QUESTION\_CE\_ASCS\_9>

1. **Many respondents to the CP argued that option 1 in the CP would prevent asset managers from:**
2. **executing block trades; and**
3. **benefiting from internalised settlements (settling across the account provider’s own books rather than the books of the sub-delegate).**

**If you agree with the statements under a) or b), please explain the relevant issue.**

<ESMA\_QUESTION\_CE\_ASCS\_10>

We disagree with these statements.

a/ block trades:

Settlement of block trades is possible only when the have the same common following characteristics:

* + (Operation type – buy or sell –,
  + trade date,
  + settlement date, securities,
  + counterparty …
  + same depositary
  + same existing SSI (no tax or other segregation needs)

Such existing technical requirements already exclude de facto block trades from ~~on~~ mandatory segregated markets (under option 5 setup) and any commingling between end investors (clients, AIFs, UCITS …) having different tax status which is often the case.

Option 1 effectively introduces a new requirement linked to the change of SSI due to segregation between AIFs, UCITS and other clients. In such cases, the Asset manager will have to “split” its original commingled settlement in 1 or 2 additional settlements depending of the number or “investor type” involved in the block. Although we have no statistics to provide on such cases, the number of settlements has not significantly increased due to implementation of option 1.

b/ internalised settlements

We do not see significant impacts.

<ESMA\_QUESTION\_CE\_ASCS\_10>

1. **Many CP respondents indicated that the costs associated with option 1 are very significant. Please provide further data on quantifying the cost impact (including one-off and on-going) of option 1 on AIFs/UCITS (and their shareholders), depositaries, global custodians, prime brokers, delegates, their clients and the different markets?**

<ESMA\_QUESTION\_CE\_ASCS\_11>

Costs to implement option 1 were not significant for AFTI members neither as depositaries nor as delegates of other depositaries. With regards the impact on the settlement activity AFTI members do not noticed any significant impacts neither on the efficiency of the settlement process -( in term of costs, straight through processing rate, or clients’ satisfaction) nor on the efficiency of the reconciliation process. This is mostly due to the fact that settlement and reconciliation processes are highly automatized and standardized. An increase in volumes (still to be demonstrated) only generate very low marginal costs.

To conclude option 1 implementation does not generate ~~very~~ significant costs neither for depositaries nor for clients or ~~for~~ investors. By the way, competition on the depositary UE market also mitigates the potential surge of such costs.

<ESMA\_QUESTION\_CE\_ASCS\_11>

1. **Are there any advantages of using omnibus accounts not covered in your responses to other questions?**

<ESMA\_QUESTION\_CE\_ASCS\_12>

Option 1, strikes the right balance by providing appropriate transparency to the depositary enabling it to monitor its delegates while no imposing an obligation to segregate by investment funds all along the custody chain. Omnibus accounts should be maintained. We expect guidance from ESMA for the implementation of model (s) providing the depositaries with appropriate legal empowerment to demand proper organisation/ information from their delegates linked to the strict liability regime for assets in custody.

<ESMA\_QUESTION\_CE\_ASCS\_12>

1. **Please consider the case where a third-party delegate or sub-delegate in the custody chain also acts as a clearing member under EMIR. What would be the impact (if any) of the interaction between the approaches described under each of the options in the table under Q22 below and the choices provided for under Article 39 (2) and (3) of EMIR[[9]](#footnote-10) (including if this may raise any operational difficulties)? Should you consider that there is any impact, please explain why.**

<ESMA\_QUESTION\_CE\_ASCS\_13>

We do not see any impact.

<ESMA\_QUESTION\_CE\_ASCS\_13>

1. **Please describe the functioning of the following arrangements and clarify the operational reasons why, and the extent to which, the segregation requirements under option 1 would affect them:**
2. **tri-party collateral management arrangements;**
3. **prime brokerage arrangements.**

<ESMA\_QUESTION\_CE\_ASCS\_14>

Below are described how tri-party collateral management arrangements and prime brokerage arrangements could be affected and to what extent

i) Tri-party collateral managers

It is essential to understand what proportion of the total assets held in custody by the EU investment funds and posted as collateral are received under tri-party collateral arrangements. The below calculation demonstrates this proportion to be less than 1% currently.

In June 2015 the total net assets value of EU investments funds (UCITS and AIFs) represented

12, 632€billion (Source EFAMA).

In June 2015 the global securities lending market was ~~is~~ estimated at 1,800 billion€. EU lenders represent **1/3** of this market. Securities on loan by Mutual/retail funds represented **18%** and non-cash collateral received represented between 60% and 90% of the collateral received (we will assume it represented 75%) (Source ISLA).

According to a public paper on ICMA website (authored by Richard Comotto): “In Europe, the outstanding value of tri-party repos managed by the top four agents is about EUR 1.3 trillion (June 2014). In the US, tri-party stands at some USD 1.6 trillion (November 2014). Although the two markets are similar in value, tri-party repo is relatively much more important in the US, where it is estimated to represent 60% or more of the overall repo market. In Europe, tri-party repo is only about 10% of the market.”

We use the following calculation to assess what proportion of the total assets held by the EU investment funds represented the securities held in custody under tri-party collateral arrangements in June 2015 (assuming tri-party repo in Europe represented 10% as in 2014):

((1800/3)\*0,18\*0,75\*0,10)/12632 = 0,06%

Below are described the reasons and to which extent the segregation requirements would affect:

* The tri-party collateral management arrangements,
* Prime brokerage arrangements.

They are currently four major tri-party collateral managers operating in the in EU market.

Two of them are acting as International CSD. Our understanding is that in the countries where these International CSD are directly registered with issuer CSDs, they are not affected whatsoever by segregation requirements whatever the option. In countries where they appoint delegates, should they decide to comply with option1, they would have to segregate AIFs and UCITS assets by depositary at their delegate’s level. However, this situation if not frequent as in these countries there are very few issuers of securities eligible as collateral received by the funds.

Two of them are commercial banks providing also custody and depositary services in Europe, having developed a specific expertise on tri-party collateral management. To the contrary to the two Investor CSDs providing comparable services, they are not directly registered with the issuer CSD in all countries where are located the issuers of securities received as collateral by investment funds. Therefore implementing any segregation between clients and investment funds at their delegates’ levels will force them to send settlement instructions to their delegates. This could affect the efficiency of their business model. However, this could be mitigated by reducing the number of countries with delegates and being registered with the issuer CSDs.

In conclusion tri-party collateral managers may be affected by segregation requirements depending on their custody network. However, some of them have already reduced the impact though a reduction of their delegates.

ii) Prime brokers

Regarding assets held in safekeeping by prime-brokers, a distinction should be made between.

* Unencumbered securities that belong to the AIFs/ UCITS and therefore are held in custody.
* Re-hypothecated securities: assets being transferred (with tittle transfer) to the prime broker under collateral arrangements: these assets are no longer under custody. Whatever the segregation option, those securities must be segregated from the prime-broker’s own assets.

Prime-brokers are not affected differently than depositary by segregation requirements with regards their custody network and no special arrangement /permission regarding segregation requirement would be justified. Moreover they are only affected by AIFMD/UCITS V segregation requirements with regards to unencumbered securities they hold in custody which they can transfer to the depositary.

<ESMA\_QUESTION\_CE\_ASCS\_14>

1. **Are you able to source any data on quantifying the additional costs and market impact for prime brokers and/or collateral managers as a result of implementing option 1?**

<ESMA\_QUESTION\_CE\_ASCS\_15>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CE\_ASCS\_15>

1. **Many respondents to the CP argued that the requirements under option 1 would trigger ‘legal certainty risk’ and ‘attendant operational risk’ in relation to collateral management. Should you agree with these statements, please specify what precisely you understand by “legal certainty risk and “attendant operational risk”. How could those risks be mitigated?**

<ESMA\_QUESTION\_CE\_ASCS\_16>

We do not share this view and have not identified such consequences further to the implementation of option 1.

<ESMA\_QUESTION\_CE\_ASCS\_16>

1. **Could adaptations to IT systems help to face the challenges that option 1 represents in relation to collateral management? If so, please explain how, if possible indicating the costs and timescales of the work that would be needed.**

<ESMA\_QUESTION\_CE\_ASCS\_17>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CE\_ASCS\_17>

1. **Have you identified any operational (or other) challenges in terms of the impact of the requirements under option 1 of the CP for the functioning and efficiency of T2S? If your answer is yes, please explain in detail.**

<ESMA\_QUESTION\_CE\_ASCS\_18>

We are not aware of any challenges under option 1 for the functioning and efficiency of T2S:

* Option 1 does not affect the links between investor CSDs and issuer CSDs. Issuer CSDs are not delegate /sub-delegate of the depositary. Consequently they are not subject to AIFMD/UCITS segregation requirements. At the issuer CSD level the only segregation required is a distinction between the own assets of the custodian and the assets held on behalf its clients. Consequently AIDMD/ UCITSV segregation requirements do not affect the number of accounts opened at an issuer CSD by an investor CSD. It would merely have the same impacts as when the investor CSD opens new accounts for a given client or open accounts for new clients.
* In addition should an investor CSD open new accounts at the issuer CSD, the T2S Users Detailed Functional Specifications (UDFS) do not mention any restriction with regards to the number of accounts opened at an issuer CSD by an investor CSD as the Option1 segregation requirements do not apply to Issuer CSDs , which are not delegate-or sub-delegate of the depositary.

T2S is designated to accommodate high volumes as regards volume of transactions, number of participants and settlement information.

<ESMA\_QUESTION\_CE\_ASCS\_18>

1. **Many respondents to the CP argued that AIFs risk being shut out of key markets due to the following:**
2. **the mismatch that will arise between local jurisdiction securities ownership rules and the mandated level of segregation required under option 1 in the CP; and/or**
3. **the requirement in certain countries to hold omnibus accounts across multiple depositaries, as is the case for certain stock exchanges.**

**If you agree with the above statement, please explain your concern with reference to specific jurisdictions and/or stock exchanges and the relevant requirements.**

<ESMA\_QUESTION\_CE\_ASCS\_19>

We have not encountered yet any specific issue, with respect to the implementation of option 1, relating to the location of the delegate, within or outside the EU.

1. should specific regulations prohibit explicitly segregation corresponding to option 1, specific guidance could be provided by ESMA on a case-by-case basis
2. if in a given third country the registration of securities at an issuer CSD is only possible via opening an account at a given intermediary which cannot be selected by the depositary , ESMA should consider the distinction between such mandatory market arrangements and non-mandatory arrangements with investor CSDs or intermediaries.

<ESMA\_QUESTION\_CE\_ASCS\_19>

1. **Should you/the funds that you manage comply with option 1 in the CP, please provide details on if and how you apply the requirements under this option when delegating safe-keeping duties to third parties outside the EU.**

<ESMA\_QUESTION\_CE\_ASCS\_20>

See response to Q1.

<ESMA\_QUESTION\_CE\_ASCS\_20>

1. **Many respondents to the CP argued that, given that many delegated third parties are located outside of the EU, option 1 of the CP could lead to higher fees charged by the delegated parties. Are you able to source any data on the potential higher fees charged by the delegated parties outside the EU as a result of implementing option 1?**

<ESMA\_QUESTION\_CE\_ASCS\_21>

No significant additional fees have been charged by AFTI members delegates outside the EU.

As they have implemented option1 in XX markets where they are not directly registered with the issuer CSDs such implementation may be considered as representative for the purpose of this call for evidence in term of market fees practices.

<ESMA\_QUESTION\_CE\_ASCS\_21>

1. **How would you compare and contrast the five options in the cost-benefit analysis (CBA) of the CP in terms of achieving the policy objective described in the above introduction? In your opinion, does any one of the options offer a better solution for achieving this aim, and if so, how? In answering to these questions, please refer to the table below which is copied from the CBA of the CP and adds the sub-delegate level.**

**Please note that as the present call for evidence is intended to cover asset segregation requirements for both AIFs and UCITS, with regard to the latter any reference in the table below to ‘AIF’ should also be read as ‘UCITS’, i.e. when applied to UCITS, references to ‘AIF’ should be read as ‘UCITS’ and references to ‘non-AIF’ should be read as ‘non-UCITS’.**

|  |  |
| --- | --- |
| **Option 1** | AIF and non-AIF assets should not be mixed in the same account and there should be separate accounts for AIF assets of each depositary when a delegate is holding assets for multiple depositary clients.  When the delegate appoints a sub-delegate, this should hold separate accounts for AIF assets of each depositary and should not mix in the same account non-AIF assets of that depositary or AIF assets coming from different depositaries. |
| **Option 2** | The separation of AIF and non-AIF assets should be required, but it would be possible to combine AIF assets of multiple depositaries into a single account at delegate or sub-delegate level. |
| **Option 3** | AIF and non-AIF assets could be commingled in the account on which the AIF’s assets are to be kept at the level of the delegate. However, the delegate could not commingle in this account assets coming from different depositaries.  When the delegate appoints a sub-delegate, this should hold separate accounts for assets coming from different depositaries. However, AIF and non-AIF assets could be commingled in the account of a given depositary in which the AIF’s assets are to be kept at the level of the sub-delegate. |
| **Option 4** | AIF and non-AIF assets could be commingled in the account on which the AIF’s assets are to be kept at the level of the delegate. The delegate could commingle in this account assets coming from different depositary clients.  When the delegate appoints a sub-delegate, this could commingle in the same account AIF and non-AIF assets and assets coming from different depositaries and the delegates’ clients (but should not be mixed with the delegate’s or depositaries’ own assets). |
| **Option 5** | AIF assets should be segregated on an AIF-by-AIF basis at the level of the delegate or sub- delegate. |

<ESMA\_QUESTION\_CE\_ASCS\_22>

In ESMA consultation paper published in December 2014 only options 1, 2 and 5 were assessed as compliant. However, option 5 was discarded by ESMA itself following a costs/ benefits assessment. We do not believe that option 5, which relies on individual account, provide additional legal investor’s protection as compared to option 1, provided that omnibus accounts are used only when the nominee concept is recognized by the regulation applicable to delegates/sub-delegates;

We believe that, contrary to Option 2, Option 1 enables the depositary via its delegates reporting and procedures, to have the proper assurance that the assets recorded at the depositary level on behalf of the investment funds are actually those recorded at the last level of the custody chain so that no misuse or loss of assets has occurred along the custody chain. Moreover, option 1 enables the depositary to request an immediate transfer of the assets to another party when, in the depositary’s opinion, risk-related considerations at the level of a delegate or sub-delegate request the implementation of its contingency plan. Arrangements under other options would be more hazardous.

Option 1, strikes the right balance by providing appropriate transparency to the depositary to monitor properly its delegates without having the constraint to open a new account at the delegate/sub-delegate for each investment funds.

Difficulties encountered by tri-party collateral managers and prime-brokers are not insurmountable:

* Some tri-party collateral managers have reduced the impact of option 1 implementation by reducing the number of their delegates, which also reduces the complexity and the risk of default in the Depositary custody chain. This is an indirect positive outcome of option 1 implementation for AIFs and UCITS’ depositaries and investors. It is also important to keep in mind that the proportion of the total assets held by the EU investment funds representing the securities received under tri-party collateral arrangements is less than 1% ( 0,2% in 2015 - see our calculation in Response to Question 14).
* Prime-brokers are only affected by AIFMD/UCITS V segregation requirements with regards to unencumbered securities they hold in custody (which can be transferred to depositaries). Prime-brokers are not affected differently than depositaries by segregation requirements and no special treatment regarding segregation requirements would be justified.

<ESMA\_QUESTION\_CE\_ASCS\_22>

1. **Articles 38(3) and (4) of the CSDR state that a CSD shall offer its participants the choice between:**

* **‘omnibus client segregation’ at the CSD level (holding in one securities account the securities that belong to different clients of that participant);**
* **‘individual client segregation’ at the CSD level (segregating the securities of any of the participant’s clients, if and as required by the participant).**

**In addition, under Article 38 (5) of CSDR, a participant shall offer its clients at least the choice between omnibus client segregation and individual client segregation and inform them of the costs and risks associated with each option[[10]](#footnote-11).**

* **Do you consider that a regime similar to the one under Article 38 of the CSDR but applied throughout the custody chain (according to which the manager of AIFs/UCITS, on behalf of their investors, informs the depositary of the level of asset segregation it wishes to apply throughout the custody chain to each individual AIF/UCITS, after having duly assessed the risks and costs associated with the different options) would achieve the policy objective described in the above introduction? Please explain why and, if the answer is yes, how.**
* **Applying a regime similar to the one under Article 38 of the CSDR to the AIF/UCITS framework would mean that the fund investors would have the choice to invest in a given fund or not, after having been made aware – through appropriate disclosures – of the level of asset segregation that the managers of AIFs/UCITS had chosen and the related costs. However, investors would not have the opportunity to participate in the choice of the level of asset segregation as such a choice would have to be made by the manager for each individual fund as a whole (i.e. it would not be possible to have different levels of segregation for the investors in the same fund). Do you consider that this could raise any concern in terms of investor protection or could any concern be alleviated through appropriate disclosures? Please explain the reasons for your answer.**
* **Please comment on any implications of such a regime for the account related provisions under Article 39 of EMIR.**

<ESMA\_QUESTION\_CE\_ASCS\_23>

On the first question, we do not consider that a regime similar to the one under article 38 applied to AIFs and UCITS would achieve the policy objective described in the introduction, i.e. to provide an EU framework with strong client asset protection, especially in insolvency, for the safe-keeping of assets which are, in accordance with both UCITS and AIFM Directives, required to be held in custody. In an insolvency situation, the insolvency administrator needs to identify clearly and with certainty which assets fall within the insolvency estate, i.e. which assets “belong to” the insolvent intermediary (irrelevant of the detailed legal ownership regime that is applicable). Only those assets are available for distribution among the insolvent intermediary’s creditors.

CSDR is applicable to EU countries and as such not recognized by CSDs in non-UE countries. In most countries if it is already possible for a CSD participant to open several accounts at CSD level, few of them are ready to accept individual segregation that could lead to thousands of accounts per participant.

If in practice the asset manager has the choice of level of segregation, it is likely that the assets of some funds will be subjects to minimum segregation requirements all along the custody chain. This would be detrimental to the investor’s protection. AIFMD and UCITS V have introduced a specific custody regime for collective investment funds in particular the strict liability regime applicable to the depositary. This regime is associated due diligence and segregation requirements which must enable depositary to alert the asset manager in case of custody risks and take necessary actions, including the transfer of assets to a back-up delegate before a delegate or a sub-delegate goes bankrupt.

In addition operational incidents and costs will increase, as a given depositary and a given asset manager would have to manage different set-up (in particular different SSIs) for investments funds investing in the same country. This will lead to an increase of costs which finally will be born by the end-investors.

Depositaries need the appropriate empowerment by the regulation to demand proper information and access to information regarding the investment funds’ assets from their delegates /sub-delegates and so to monitor efficiently custody risks. The regime must provide the depositary with transparency, which means that assets are segregated by depositary whatever the number of levels of delegation in the custody chain. This model avoids the restriction imposed by confidentiality rules and enables the depositary to perform its controls and to require for an immediate transfer of assets if necessary.

<ESMA\_QUESTION\_CE\_ASCS\_23>

1. **Please describe any alternative regime which, in your view, would achieve the policy objective described in the above introduction.**

<ESMA\_QUESTION\_CE\_ASCS\_24>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CE\_ASCS\_24>

1. **Do you see a need for detailing and further clarifying the concept of “custody” for the purposes of the AIFMD and UCITS Directive?**

<ESMA\_QUESTION\_CE\_ASCS\_25>

No. Article 88 of AIFMD level 2 text and Article 12 of UCITS V level 2 text specify that securities held in custody are those capable of being registered or held in an account directly or indirectly in the name of the depositary, contrary to securities directly registered in the name of the AIF or of the UCITS with the issuer itself or its agent, which shall not be held in custody. Therefore it is clear that the notary service and central maintenance service which relate to the registration of an issuance does not relate to the custody function.

<ESMA\_QUESTION\_CE\_ASCS\_25>

1. **If your answer to Q25 is yes, should the concept of “custody” of financial instruments include the provision of any of the following services for the purpose of the AIFMD and UCITS Directive:**

* **initial recording of securities in a book-entry system (‘notary service’);**
* **providing and maintaining securities accounts at the top tier level (‘central maintenance service’)**[[11]](#footnote-12)**;**
* **maintaining or operating securities accounts in relation to the settlement service;**
* **having any kind of access to the assets of the AIF/UCITS; or**
* **having any access to the accounts where the assets of the AIF/UCITS are booked with the right to pledge and transfer those assets from those accounts to any other party?**

<ESMA\_QUESTION\_CE\_ASCS\_26>

Notary service and central maintenance service clearly do not relate to the custody function performed by the depositary, as clarified in Recital 21 of UCITS V. We advocate for a clear distinction between the “issuer CSD” concept (i.e. the CSD where the initial issuance of the securities is recorded) and the “investor CSD” concept (i.e. a CSD that provides custody services in relation to securities initially issued in another CSD and for which the investor CSD acts in a capacity similar to a global custodian).

It should be clarified that issuer CSDs are not delegates /sub-delegates of the depositary as opposed to investor CSDs. Ideally this distinction should be introduced in the relevant articles of both the UCITS and AIFMD directives and its associated delegated regulation and not only be addressed in the recitals. Although Recital 21 of the UCITS V Directive is quite useful in providing clarity and addressing this issue, it is challenged from a legal enforceability perspective and therefore further clarification is necessary. Appropriate language is provided in ESMA report RTS 2015/1457, page 15.

<ESMA\_QUESTION\_CE\_ASCS\_26>

1. **If your answer to Q25 is yes, would you include any other services in the concept of “custody” of financial instruments for the purpose of the AIFMD and UCITS Directive? If your answer is yes, please list and describe precisely the services that should be included.**

<ESMA\_QUESTION\_CE\_ASCS\_27>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_CE\_ASCS\_27>

1. **Please explain how, in your views, “custody” services interact with “safe-keeping” services, in particular those referred to under Article 21(8) of the AIFMD (as well as Article 89 of the AIFMD Level 2[[12]](#footnote-13)) and Article 22(5) of the UCITS Directive (as well as Article 13 of the UCITS V Level 2[[13]](#footnote-14)).**

<ESMA\_QUESTION\_CE\_ASCS\_28>

Custody cannot be performed for all assets owned by an investment fund. it only relates to financial instrument that are capable of being registered directly or indirectly in the name of the depositary and financial instruments that can be delivered to the depositary .There is a specific process for each type of assets (e.g., on-financial assets such as commodities, unlisted debt, derivatives) and those process do not overlap.

<ESMA\_QUESTION\_CE\_ASCS\_28>

1. **If you consider that the provision by a CSD of any of the core services (i.e. services mentioned under Section A of the Annex to the CSDR) or ancillary services (i.e. services provided in accordance with Section B or Section C of the Annex to the CSDR) should not result in the CSD being considered as a delegate within the meaning of Article 21(11) of the AIFMD and Article 22a of the UCITS Directive, please list the specific services and explain the reasons why.**

<ESMA\_QUESTION\_CE\_ASCS\_29>

It should be clarified that issuer CSDs are not delegate /sub-delegate of the depositary as opposed to investor CSDs. Ideally this distinction should be introduced in the relevant articles of both the UCITS and AIFMD directives and its associated regulation and not only be addressed in the recitals. Although Recital 21 of UCITS V is, in our view, useful as it is intended to provide clarity and address this issue, it is not legally enforceable and therefore further clarification in the main body of the Directives or its associated regulation is necessary. Appropriate language is provided in ESMA report RTS 2015/1457, page 15.

<ESMA\_QUESTION\_CE\_ASCS\_29>

1. <http://www.europarl.europa.eu/document/activities/cont/201106/20110606ATT20781/20110606ATT20781EN.pdf> [↑](#footnote-ref-2)
2. See pages 14-15 of the Briefing Note. [↑](#footnote-ref-3)
3. See page 16 of the Briefing Note. [↑](#footnote-ref-4)
4. See page 17 of the Briefing Note. [↑](#footnote-ref-5)
5. See page 18 of the Briefing Note. [↑](#footnote-ref-6)
6. See page 19 of the Briefing Note. [↑](#footnote-ref-7)
7. See paragraphs 29 and 30 of the [Standards for the Custody of Collective Investment Schemes’ Assets – Final Report (FR25/2015)](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD512.pdf): “*Depending on the operational framework in the jurisdiction, there is a risk that CIS assets in the custodian’s care can become co-mingled with (i) assets of the responsible entity; (ii) assets of the custodian; or (iii) the assets of other clients of the custodian (although it should be noted that CIS assets may be held in a permissible "omnibus account"). The consequences of these risks could result in the ownership of the assets being called into question in the event of misuse or insolvency of the custodian, which may create difficulties differentiating ownership of the assets*”. The positive and negative aspects of omnibus accounts are also mentioned on page 11 of the IOSCO [Survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets – Final Report (FR05/11)](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD351.pdf). [↑](#footnote-ref-8)
8. According to Article 1(g) of the ESMA draft technical standards under CSDR (ESMA/2015/1457/Annex II), ‘investor CSD’ means a CSD that is a participant in the securities settlement system operated by another CSD or that uses an intermediary that is a participant in the securities settlement system operated by another CSD in relation to a securities issue (available at [www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1457\_-\_annex\_ii\_-\_csdr\_ts\_on\_csd\_requirements\_and\_internalised\_settlement.pdf](http://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1457_-_annex_ii_-_csdr_ts_on_csd_requirements_and_internalised_settlement.pdf)). [↑](#footnote-ref-9)
9. Article 39(2) and (3) of EMIR states the following: “*2. A CCP shall offer to keep separate records and accounts enabling each clearing member to distinguish in accounts with the CCP the assets and positions of that clearing member from those held for the accounts of its clients (‘omnibus client segregation’). 3. A CCP shall offer to keep separate records and accounts enabling each clearing member to distinguish in accounts with the CCP the assets and positions held for the account of a client from those held for the account of other clients (‘individual client segregation’). Upon request, the CCP shall offer clearing members the possibility to open more accounts in their own name or for the account of their clients*”. [↑](#footnote-ref-10)
10. However, under Article 38(5) of the CSDR a CSD and its participant shall provide individual clients segregation for citizens and residents of, and legal persons established in, a Member State where required under the national law under which the securities are constituted as it stands at 17 September 2014. [↑](#footnote-ref-11)
11. These services are part of the core services of central securities depositories under Section A, point 2 of the Annex to Regulation (EU) No 909/2014 (“CSDR”). [↑](#footnote-ref-12)
12. Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012. [↑](#footnote-ref-13)
13. Commission Delegated Regulation (EU) 2016/438 of 17 December 2015. [↑](#footnote-ref-14)