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| 15 July 2016 |

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

The Association of the Luxembourg Fund Industry (ALFI) is the representative body of the Luxembourg investment fund community. Created in 1988, the Association today represents over 1300 Luxembourg domiciled investment funds, asset management companies and a wide range of service providers such as custodian banks, fund administrators, transfer agents, distributors, legal firms, consultants, tax experts, auditors and accountants, specialist IT providers and communication companies. The Luxembourg Fund Industry is the largest fund domicile in Europe and a worldwide leader in cross-border distribution of funds. Luxembourg-domiciled investment structures are distributed on a global basis in more than 70 countries with a particular focus on Europe, Asia, Latin America and the Middle East.

**General remarks**

ALFI welcomes the opportunity to respond to ESMA’s Call for Evidence on asset segregation and custody services and we wish to reiterate that we consider that segregation should not be an aim by itself but it is a way to enhance the protection of ‘custodiable’ financial instruments in case of insolvency of the depositary or its sub-custodians. This can be effectively achieved by using segregated accounts or omnibus account structure which are commonly recognised as an effective method of protecting end investors *(please refer to our response to the ESMA consultation paper on Guidelines on asset segregation under the AIFMD of December 2014 (ESMA/2014/1326)*). Segregation between a depositary’s proprietary assets and its customer’s assets by way of separate accounts as well as at the levels below between delegate’s proprietary assets, depositary’s proprietary assets and customer assets is generally regarded as an efficient way of protecting the customer’s assets against depositary and/or delegate insolvency. This can be effectively achieved by using segregated accounts and/or omnibus structures which are commonly recognised as an effective method of protecting end investor’s interests.

ESMA’s policy goal of guaranteeing the protection of UCITS/AIF fund assets from the insolvency of a third-party delegate is sufficiently guaranteed via separate book-keeping in the accounts of the delegating depositary institution. Larger pools of securities in omnibus accounts would also facilitate the use of tri-party collateral management agreements, as well as broader market liquidity.

Therefore, of the opinion that:

* the custodian chain model below the level of the depositary may vary and in many markets there is no choice. The model chosen should be the one that best protects client assets in accordance with local law and practice;
* the account holding structure in a given market is amongst others driven by a combination of local settlement and safekeeping practices;
* the primary concern for Depositaries is to ensure segregation of its clients’ assets (i.e. the assets owned by AIFs and UCITS it services) from the proprietary assets of the participants in the custodial chain;
* depositaries ensure that assets are identified through the custodial chain in a manner that best protects and ensures the speediest return of assets in the event of an insolvency.

As to the second key aspect of our response we would like to stress that we are not aware that additional segregation provides any additional legal protection in case of insolvency and even physically segregated individual accounts do not guarantee the return of assets in an insolvency scenario. We are also not aware of any evidence regarding the assertion that subdivision of existing omnibus accounts by AIF, UCITS or depositary (or a combination of same) may expedite a return of assets. Furthermore, as noted above, additional segregation does not result in increased investor protection. In the case of a sub-custodian insolvency, there will be no legal or practical advantage for investors depending on whether assets are being held in segregated accounts by global custodian/depositary or in one comingled account for all global custodians/depositaries. The level of protection will be the same.

Moreover, ALFI is concerned by the uncertainty with regard to the treatment of CSD and the potential mismatch regarding liability standards between depositaries and their delegates on the one hand and, on the other hand, CSDs.

For the industry to operate on a level playing field, ALFI is of the view that clarifications need to be made to recognise the dual role CSDs can play as either “issuer” or “investor” CSDs. However, ALFI also notes that relying solely on the “issuer” CSD / “investor” CSD distinction might be problematic (*please refer to our answer to question 29*).

We regret that the time allowed to respond to the Call for Evidence has been extremely short. Our response will therefore unfortunately not be able to address some of the questions to the extent their relevance would deserve.

Finally, we support the submissions of the European Fund and Asset Management Association (EFAMA) and of the European Trustee & Depositary Forum (ETDF).

<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>

Q1 a): The attached chart describes the typical set ups in relation to safe-keeping services for financial instruments provided by a Luxembourg Depositary to several investment funds which are AIF or UCITS.

One model is that a Depositary (first level in our chart) provides custody services nationally and appoints a ‘Global Sub-Custodian’ (second level lower side of our chart) that provides custody servicesinternationally for multiple markets through one service agreement. The financial instruments are ultimately held by national CSD (third level, lower side in our chart).

The other model is that the Depositary - instead of appoint one Global Sub-Custodian - appoints a Sub-Custodian (second level in the upper side of our chart) for each relevant market. Again, ultimately the financial instruments are held by a national CSD (third level, upper side, in our chart). Depending on the requirements of the relevant market, the accounts with the Sub-Custodian are segregated accounts (upper left side in our chart) or omnibus accounts (upper right side in our chart).

Own assets and customer assets are of course segregated at each level. We believe this to be a common denominating international standard that should apply (and be seen to apply) by the depositary bank at each layer of the custody chain that they employ.

A combination between Global Sub-Custodians, e.g. for a certain region, and individually appointed Sub-Custodians can be encountered as well. Also the three levels are a somehow simplified view where in reality there are often more than three levels.

In parallel to the accounts, records are kept at each level. Such records permit to follow and establish the entitlement of each investment fund throughout the whole chain of custody, sub-custody, CSD.

In terms of entitlement, the investment fund would be able to claim at level 1 a given financial instrument from the depositary. At level 2 it is the depositary who can claim against the Sub-Custodian or the Global Sub-Custodian, as the case may be. At level 3 it is then the (Global) Sub-Custodian who can claim against the CSD.

In case of dispute the investment fund must obviously be in a position to adduce conclusive proof of the entitlement against the depositary and then the depositary against the (Global) Sub-Custodian and finally the (Global) Sub-Custodian against the CSD. Such proof takes typically the form of records and hence proper record keeping and re-conciliations are of such paramount importance.

Accounts are of a relatively lesser importance in this respect. To provide an imagined example: An investment fund can establish proof to be entitled to a given financial instrument, then the depositary must normally provide such financial instrument, regardless of whether such financial instrument is or is not in the financial instruments account of such investment fund. The same is true vice versa. The fact that a given financial instrument is in a given account does not necessarily mean that the relevant investment fund is entitled to such financial instrument. It can be in such account by error.

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*First Level*

At the depositary level, a separate account is opened for each investment fund and each sub-fund so as to solidify the segregation of assets and liabilities between investment funds and sub-funds. The creditors of a given investment fund or sub-fund can only seize the account corresponding to such investment fund or sub-fund. The record keeping follows the same logic. A key task of the depositary is to ensure that there is a constant accuracy of the records of entitlements and holdings per investment fund or sub-fund. To this end, the depositary bank must understand the structure of the custody chain down to investor CSD and execute its DDV obligations accordingly in order to understand the risks at each level.

*Second Level*

At the second level in the custody chain the depositary will typically open at least three accounts, namely one omnibus account for own financial instruments, one omnibus account for UCITS and/or AIF financial instruments and one omnibus account for the financial instruments of other customers. Only for the good order, the (Global Sub-Custodian) must of course separate own transferable financial instruments from the above referenced accounts.

In terms of entitlement, the creditors of the (Global) Sub-Custodian can potentially get hold of the (Global) Sub-Custodian own financial instruments but typically not of the other financial instruments. Similarly, the creditors of the depositary can potentially get hold of the own financial instruments of the depositary but not of the other ones. The investment funds and their creditors can, however, not directly claim against the (Global) Sub-Custodian and get hold of the financial instruments on the omnibus accounts opened for UCITS and/or AIF and the omnibus accounts for other customers. They have to claim against the depositary who then in turn must claim against the (Global) Sub-Custodian. Consequently it is of lesser importance whether separate omnibus accounts are opened for UCITS, AIF and other customers. For a variety of reasons thought the market practice appears to be to have at least separate accounts for UCITS and AIF (collective asset management) on the one hand and other customers on the other hand.

As already mentioned there may be a Global Sub-Custodian or a country specific Sub-Custodian at level 2 or a mixture, depending on the circumstances and preferences.

*Third level*

As of this level all along the chain down to the CSD the prevailing standard is segregation between own assets and customer assets *( for further details, please refer to page 9 – Level 3 and Level 4)*.

Q. 1b.). As outlined above at the first level the norm is to open segregated account for each investment fund or sub-fund and hence omnibus accounts are not the entry point.

Omnibus accounts are often used for a variety of good reasons at the levels below but own assets and customer assets are segregated as described.

The typical chain of entitlement is for example investment fund/sub-fund – depositary, depositary –Global Sub-Custodian, Global Sub-Custodian - Sub-Custodian and finally Sub-Custodian – CSD. From this it results as well that, whatever the account structure, the record keeping is paramount because ultimately it determines the entitlements to the specific financial instruments.

This being said, the account structure model in a given market is in particular driven by a combination of local settlement and safekeeping practices in the specific market concerned, systemic and reporting capabilities of the local agent and CSDs and the local regulatory requirement and established market practices.

Q. 1c) Please find an answer in the previous section; the general approach is to use omnibus account throughout the custody chain, unless required otherwise by a given jurisdiction or required for practical purposes such as tax reporting. In any case, from our point of view, what prevails from the perspective of protecting fund’ assets is that records of entitlements are maintained accurately and timely.

CSD links as described and regulated under article 48 of Regulation 909/2014 (CSDR) – either direct, indirect or relayed – are established on the basis of omnibus accounts in order to ensure maximum efficiency whilst delivering the norms of asset protection afforded under the same legislation and their founding legal acts or basis in their domestic market. This level of asset protection regardless of the type of link is afforded to all CSD participants – not just depositary banks or other FMIs holding securities on behalf of AIFs (UCITS).

1d) As mentioned above, the account structure model in a given market is in particular driven by a combination of local settlement and safekeeping practices in the specific market concerned, systemic and reporting capabilities of the local agent and CSDs and the local regulatory requirement and established market practices and finally it is also subject to clients’ needs.

1e) From an operational perspective, both types of funds are largely managed according to the same, or very similar, custody structure. Indeed, a UCITS or an AIF buying an equity share, are acquiring the same instruments, and this through the same channels. Acquiring such instruments impose, in both cases, to maintain the same types of recording or processing. This applies unless the assets justify a specific treatment or are for any (regulatory) reasons excluded from the reach of a type of fund.

1f) Since the vast majority of financial instruments is not kept in custody in Luxembourg but elsewhere, this may not be very relevant.

The choice for omnibus accounts in level 2 and below is less driven by these considerations than by reasons of operational certainty and efficiency, cost, ease of quick repatriation and similar considerations.

<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>

See above. As long as own financial instruments and customer financial instruments are properly segregated by accounts and records, there should be protection of the investor against creditors of the custodian at each level. The fact that financial instruments of several customers are commingled in one omnibus account does normally not entail a direct entitlement of a customer to the financial instruments on such omnibus account but the customer must claim against the depositary who then must obtain the financial instruments from the omnibus account.

Consequently if such customer becomes e.g. insolvent, the bankruptcy receiver must claim against the depositary and the customers whose financial instruments are commingled at the level of the omnibus account are not concerned.

The fact that omnibus accounts are already used since a very long time and in a quite general manner and not limited to investment funds without – to the best of our knowledge – major failings despite a number of very important insolvencies appears to confirm these findings in reality. The overall rule of law in each jurisdiction (where securities are held cross border) provides the basis for the enforceability of the “claim” (/right of the holder) on the holding at the next level of the custody chain.

<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>

In line with our response to the ESMA consultation paper on Guidelines on asset segregation under the AIFMD of December 2014 (ESMA/2014/1326) we consider that segregation should not be an aim by itself but it is a way to enhance the protection of ‘custodiable’ financial instruments in case of insolvency of the depositary or its sub-custodians. This can be effectively achieved by using segregated accounts or omnibus account structure which are commonly recognised as an effective method of protecting end investors when taken in the context of the legal and regulatory framework in which they operate.

Segregation between a depositary’s proprietary assets and its customer’s assets by way of separate accounts as well as at the levels below between delegate’s proprietary assets, depositary’s proprietary assets and customer assets is generally regarded as an efficient way of protecting the customer’s assets against depositary and/or delegate insolvency. This can be effectively achieved by using segregated accounts and/or omnibus structures which are commonly recognised as an effective method of protecting end investor’s interests.

We believe that there are no material differences 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. Moreover, asset segregation is not the key factor in determining the recoverability of assets in the event of the sub-delegate’s insolvency.

In our view, if a party whose assets are held in another person’s omnibus account becomes insolvent, this in itself would not disadvantage the position of solvent parties whose assets are in the same omnibus account. The position of the insolvent party post-insolvency should not be any stronger than it would have been prior to the liquidation i.e. it would not have a claim on assets to which it would not have been entitled prior to the insolvency.

In any insolvency scenario, the key requirement is that the assets are clearly identifiable as belonging to the AIF/UCITS. This is ensured by having a link from the books and records of the depositary, which will maintain separate accounts for each AIF/UCITS, through omnibus accounts with sub-custodians to the position held at the CSD. Without such a link, it would not be possible for the various parties in the chain to reconcile their respective records.

The ability to distinguish between clients’ interests where separate accounts are opened may initially assist in identification; however it is unlikely to lead to greater ease of speed in the return of assets on an insolvency due to a number of factors, including the following:

* the differences in insolvency law and practice in the relevant jurisdictions at the various levels of the custodial chain;
* problems involved in unravelling securities lending and other derivative contracts to which the assets may be subject;
* resolving the security claims and interests (including liens) of the various parties throughout the custodial chain.

In addition, we are of the view that separate accounts would be likely to lead ultimately to greater difficulty in record reconciliation and risk of error without any additional legal protection. It would also have a significant impact upon cost which would outweigh any benefits to separate accounts (see below). Finally we do believe that the choice between ‘omnibus accounts’ (i.e. books and records segregation) and separate accounts does not alter the insolvency risk.

<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>

Individual client accounts and omnibus client accounts held at the level of its delegates are reconciled with the depositary’s own records on a daily basis. Discrepancies are escalated within a quick turnaround time and tracked through to resolution; these standards can be implemented and reviewed by a depositary bank via a Service Level Agreement (‘SLA’) with its provider in order to deliver reconciliation (or confirmation of securities holdings in the system where finality is given) results as market practice or rules permit. In case of insolvency proceeding, daily effective reconciliations are fundamental for the traceability of client’s assets throughout the custody chain when books and records are used.

<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?**

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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>

Q.5a.) Referring to the chart above, our understanding is that Depositary 1 would not be impacted by the default of Depositary 2. The account structure will not give rise to different rights or impeach some of the depositary 1 clients’ rights to enforce theirs. What is key, in this scenario, as in others, is that records of entitlements are accurate and up-to-date, so that a liquidator is able to allocate the assets to the right “entity”. The default of Depositary 2 would only affect its own assets held by the Delegate (proprietary assets of the Depositary 2) as securities that are allocated *do not form part of property* of ‘Intermediary’, but are allocated to the *rights* of account holder, irrespective if it is an omnibus account or an individual separated clients account.

5b.) As a general remark, securities that are allocated do not form part of property of Delegate, but are allocated to the rights of Depositary 1 and 2 clients (the ‘account holders’). Therefore, we believe that the failure of the delegate will not impact the depositary 1 (or 2) clients holdings as long as the jurisdiction is recognising that there is a separation between own assets and clients assets. As such, those assets do not form part of the property of the delegate and are not available for distribution among or realisation for the benefit of creditors of the delegate (*see also Art 25 (2) UNIDROIT CONVENTION ON SUBSTANTIVE RULES FOR INTERMEDIATED SECURITIES*).

<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>

The principal objective of a depositary is to effectively manage the risk and safety of its client’s assets. Across the custody chain proper segregation is maintained between the proprietary assets of the depositary and its delegates throughout the custody chain from client’s own assets. When client’s assets are identifiable and safe through the chain with the use of books and records and provided that reconciliations are conducted in a timely and accurate way, such segregation would ensure investor protection.

In the event of an insolvency of a delegate, the Insolvency Practitioner would undertake a full reconciliation of delegate records to the records held at the level of the depositary and it must undertake a number of controls on any right over the assets, before is able to return these assets. There is no evidence that assets which are held on segregated client accounts instead of omnibus client accounts would make any material difference to the speed at which the assets are recovered from the delegates.

<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**
* **Through CSD Links**
* **In relation to cross-border investments through CSD links, what are the functions of an investor CSD[[8]](#footnote-9)?**
* **Through T2S**
* **Prime broker services**
* **Tri-party collateral management / securities lending.**

<ESMA\_QUESTION\_CE\_ASCS\_7>

While the scope and complexity of this question exceeds this call for evidence, in summary it is fair to say that multiplication of accounts is detrimental to efficient and secure operations and settlement as well as economies of scale and therefore better cost management without an apparent added advantage. The market infrastructure such as CSD links, T2S as well as prime broker services and securities lending are based on standardisation and pooling transactions together into “blocks” as to reduce the number of operations so as to gain efficiency and reduce cost.

<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>

Every time there is a new AIF or UCITS at first level, the depository is setting up a new account for the recordkeeping of this new entity in their system. Replicating additional new accounts at further levels of the custody chain would result in many new accounts and would increase risks, operational complexity and upfront and ongoing costs regarding the opening and maintenance of multiple accounts held at the level of the delegates which unnecessarily challenges structures designed to support T2S. Please also refer to our answer to question 9.

<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>

From an efficiency standpoint the multiplication of accounts at the different intermediaries in the custody chain would inevitably imply greater operational risks. All operational risks need to be capital allocated. In addition, setting up a very high number of accounts requires significant set-up and maintenance costs over a long period of time. Likewise, all participants in the custody chain would need to process a far greater amount of settlement instructions and reconciliations.

For example, if full segregation is requested, global custodians would most probably open segregated accounts with their local sub-custodians as opposed to using omnibus, direct T2S-type links direct to the CSDs.

* Omnibus account structures are critical for the efficient functioning of internalised settlements. Key advantages of omnibus accounts that it allows for internalised (or net) settlement, especially with respect to the competitive nature; clients could "settle" across the books of an account provider instead of using the CSD.
* If each clients' holding is held in a separate account with an upper-tier intermediary "internalised settlement" is impossible, since an account provider acting as lower-tier intermediary needs to process a transfer from a selling investor client to a buying investor client by means of external instructions to the upper-tier intermediary.
* By contrast, if an omnibus account is used, and the ordinary processing algorithms permit, an account provider would not need to issue any external instructions to settle such a transfer.
* Internalised settlement can reduce the cost of transfers and improve service levels (e.g., by offering "transfer finality" at an earlier moment than if settlement occurs at a higher tier intermediary).

By removing the benefits that the use of omnibus accounts brings to the industry, there would also be the consequence to compromise the benefits that the T2S project aimed to introduce. Going ahead, the different depositaries, will not be able to rely in the single access to T2S for the settlement of the assets of the fund (requiring segregation), and would then need to establish direct access to the markets where they intend to settle.

Finally, an increase of accounts would reduce the efficiency of dealing block trades, result in less efficient reconciliations and in multiplication of trades and orders (*inter alia*, also to support daily securities lending or EPM activities), thereby increasing the potential for false or erroneous account bookings and entries.

<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>

Please see answer to question 9.

<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>

From an association level, it is always difficult to supply specific figures. The benefits of implementing Option 1 do not meet ESMA’s policy objective to provide a framework with stronger asset protection and is in contradiction with the objectives of the Capital Markets Union (‘CMU’).

<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>

Not at first sight. We do not see any additional advantage which is not already covered in your responses to the other questions above.

<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>

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<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>

Overall, the issues that option 1 would create are largely the same for items a) and b) although the underlying rationales of the trade are different. Option one will notably have for consequence to affect medium to small size asset managers and UCITS funds that rely heavily on liquidity management as a tool for maximising returns, these would include MMFs. As the pool of assets they have with one of these counterparties is limited, the possibilities to use some collateral for any arrangements would only be suboptimal.

In addition, the option one presents one limitation, as the agent will be in the impossibility to supply collateral in time. As these 2 alternatives are used in the context of liquidity management, a timely access to available liquidity and collateral is of prime importance, which de facto discredits less optimal solutions.

Further, the complexity of management will be increased (numerous accounts instead of one omnibus) which would slower the process and negatively impact economy of scales.

Concretely, should a fully segregated approach be introduced, reconciliation will have to be done at each layer. It means that transaction under option 1 will have to be replicated at each layer of the custody chain. This is currently not necessarily the case as regards book records, where a bulk approach can currently be retained and tailored at each layer needs. A process that is both flexible and robust enough under most risk free market conditions.

By changing the existing prime brokerage arrangements to meet option 1, executing brokers would likely be required to handle a significantly larger number of Standard Settlement Instructions (‘SSIs’) compared to a single omnibus SSI for each market as per today. This will naturally increase the operational complexity (for both executing brokers and prime brokers) that will lead to an inevitable increase in the error rate. Such errors can result in failed trades with the potential for buy-in’s, additional cost and even regulatory sanctions in certain markets. Should the trades not fail, they will be initially unmatched, causing unnecessary additional work to resolve. The technical complexity in the changes required to be made by the prime brokers will not only increase operational risk but most likely end up with the costs of such changes being passed on to their clients, i.e. the investors of the funds.[[10]](#footnote-11)

Finally, we believe that Option 1 bears a significant downside potential in harming the liquidity of European markets to the advantage of non-EU ones, while reducing available securities loan pools to the detriment of UCITS/AIF investors. This, at a time when the essential tenets of CMU should be embraced and applied.

<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>

Due to the short timeframe we would like to refer ESMA to the individual response of our members.

<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>

In our view, the major issue concerns the operational risk. For collateral management, flows of transactions should be smooth and efficient, and, regarding collateral, the combination of assets through pooling delivers the most desired outcomes. As previously mentioned, the option 1 will create costs and delays and will potentially trigger operational risks, as there will be an increased number of transactions to perform and to replicate at the various layers. Indeed, in the numerous replications there is a risk of fail, notably settlement fail, which will entail potential legal risks and significant allocation of risk capital, costs and systemic disruption.

It is to be underlined that a segregated model does not entail any benefits in terms of investor protection and legal certainty. On the contrary, it can even have detrimental effects considering that the operational risks are outweighing any potential benefits. Finally, it also risks excluding smaller accounts from using the tools offered to optimise the management of funds, where such tools are allowed.

<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>

No, not necessarily – IT-enhancements are not a panacea solution. More complex IT-structures create a risk on their own. The drawbacks of implementing new IT options are so important (time efficiency, operational risks, general efficiency) that even by adapting the systems it won’t overcome all potential problems before all stakeholders across the globe have upgraded their own. Furthermore, under option 1, if IT is to be adapted, the processes will have to be amended and the settlement will have to be processed in the market. As a consequence, one will face much more complex processes where the instructions would have to be instructed much earlier in the chain and replicated throughout at each layer. This would mean that each layer will have to develop fully identical IT systems, as it will not only be applied by a sub-custodian. This is not only applicable in the EU, but anywhere where collateral may be used or reused.

<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>

Several preliminary remarks are necessary when exploring the impacts of option 1 on T2S. Firstly, the development of CSD links (and where CSD-CSD links are assessed by the ECB for their robustness in order to meet the criteria for executing settlement related to Eurosystem monetary operations), encouraged amongst others by T2S, has resulted in more widespread availability of omnibus accounts at CSDs. Secondly, by design T2S operates with omnibus accounts. For the few, so called direct markets, linked to T2S, there is an intermediary structure that has been put in place to regroup segregated accounts into an omnibus structure, which is then linked to T2S. This process goes back and forth in T2S and the local market. If option1 is pursued, it will place all the operators in a similar situation, which is conceptually neither desirable nor efficiently manageable.

T2S is currently in a migration phase across the different markets, which once completed will be followed by a “stabilisation” period. These phases have to be completed prior to the introduction of changes. Therefore, the first window that will be opened to accommodate the option 1 for the fund industry onto T2S will not be prior to 2022. As such, forcing the introduction of the option 1 today, will, in this respect, correspond to put the carts before the horses and it will add risk for the different counterparties.

Furthermore, we would note that the objective of individual account segregation according to the proposed Option 1 appears to be misaligned with the objectives of the Central Securities Depositaries Regulation (CSDR) and Target 2 Securities (T2S). Where the latter initiatives’ main objectives are to increase the safety and efficiency of securities settlement and settlement infrastructures, Option 1 would jeopardize these by impeding settlement at an earlier moment as a result of the increased operational complexity associated with the proliferation of accounts and standard settlement instructions (“SSIs”), likely to provoke frequent settlement failures and delays. With the penalties for settlement failures envisaged under Article 7 of the CSDR, this is likely to result in additional costs for market participants to the detriment of their clients. For the reasons described above, omnibus accounts for CSD links must be preserved. CSDs are uniquely regulated as financial market infrastructures in the custody chain.

Finally, conceptually T2S was created with the policy objective to support growth across MS markets in a secure environment (by relying on central bank money), so that large transaction volumes can easily move from one Member State to another. Thus, if we opt for segregated accounts, we fear that, this would disrupt the process and reduce speed.

<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>

In reality, the option 1 approach is so incompatible with the market practices in some countries that to be enforced, it will require, at least, a special treatment.

Special treatment means additional complexity for the intermediary and additional costs. If the option 1 was providing outstanding benefits for the different stakeholders the option could have been envisaged, but in the present scenario, it only introduces burden and complexity to be replicated along the custody chain for little, if no benefit at all. This is barely acceptable within the EU because all stakeholders are under the same regime, but it is even more detrimental if it is exported to third countries as then, it becomes fully unviable.

The third country impacts also relate to prime brokers in the US (SIPA Rules) and amongst others potentially the excess to mainland China, depending on the qualification of CSDs.

<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>

As trade association, we are not able to answer conclusively as it depends on each specific set up. Therefore, we refer ESMA to the individual replies of our Members.

<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>

At our level it is difficult to assess the cost since they depend on the structure of each of the stakeholder. However, for sure, applying option 1 will add complexity, regulatory constraints and new risks. Non-EU markets may not find/understand the commercial incentives to pursue or set up specific models to accommodate the specific EU demands. Moreover, we refer ESMA to the individual replies of our Members.

<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>

Option 4 would be most preferable Option. Our members consider that option 4 offers the best mix of protection and efficiency, provided that as stated across our response there is an accurate and timely booking of records and entitlement at each intermediary in the chain for its clients. CSDs as operators of SSSs and that are identified separately in AIFMD should be permitted to maintain CSD links (both direct and indirect) on an omnibus basis.

However, this does not mean that other models should be discarded. Indeed, there may exist circumstances under which other alternative options may have some merits. Other alternatives can have merits for specific reasons like local legal constraints, the fund manager demand (commercial basis) or specificities of the assets. The choice of a certain custodian chain model may vary from market to market. It is driven by a combination of local settlement and safekeeping practices in the specific market concerned, systemic and reporting capabilities of local agent and CSDs and the local legal/regulatory requirement that has evolved over time to support the established market practices.

Overall, mature markets have come to the conclusion that the best mix to ensure both protection of investors and efficiency is to rely on omnibus structures, segregating own assets from clients’ assets. With today’s technology, booking of records could be timely and accurate, and serves as satisfying the traceability of assets foreseen under an option 1 model.

<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:**
2. **‘omnibus client segregation’ at the CSD level (holding in one securities account the securities that belong to different clients of that participant);**
3. **‘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[[11]](#footnote-12).**

1. **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.**
2. **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.**
3. **Please comment on any implications of such a regime for the account related provisions under Article 39 of EMIR.**

<ESMA\_QUESTION\_CE\_ASCS\_23>

a) We believe that ESMA’s suggested approach goes well beyond what is required by the UCITS V and AIFMD Directives and the Delegated Regulation which require a segregation in the books of the depositary, the depositary's delegate and sub-delegates of such delegate.

Moreover, it seems debateable whether such an approach would be appropriate, given the fact that depositaries are responsible for the choice of the sub-custody network. We also believe that such an approach is likely to be complex and onerous for a depositary to administer, because a depositary would need to maintain systems capable of setting up both omnibus and individual accounts with all of its sub-custodians, and to maintain records and systems reflecting the different approach chosen for each fund (even where funds have the same manager), and the same would apply to sub-custodians and all other intermediaries through which the assets are held even though such entities have no direct relationship with the manager or the funds. Adding the concept of choice in this instance for the investor creates uncertainty and additional unnecessary legal work in apportioning liability and obligations.

b) We are not certain how this will work in practice. In order to make this workable we believe that the choice between omnibus vs. individual account segregation and their related trade-offs need to be explained to investors in any pre-contractual documents (e.g. KID/ PRIIPS KID)), taking into account all relevant factors (e.g. choice of a tri-party vs. a bilateral collateral manager, insolvency protection in non-EU jurisdictions, a summary description of the sub-custody network, related risks, and appropriate risk warnings etc.). Finally, we believe that the concept of choice will result in a default option being considered and implemented as a de facto mandatory obligation resulting in market distortions and commercial expediency which will be to the detriment of the secure running of the market and its structures.

<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>

As explained above, we clearly favours option 4. This being said, one might wonder if a prescriptive regime is desirable, a principle based approach leaving room for natural adaptations that will arise due to market and technical developments could be preferable.

<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>

There is no need to further clarify the concept of “custody” in the AIFMD and UCITS Directive. The meaning of "custody" of financial instruments in both AIFMD and UCITS V is sufficiently clear. It refers to the holding of financial instruments (whether directly or indirectly through intermediaries), whereas "safekeeping" is a broader term, used to mean both the function of providing custody of financial instruments, and the function of verifying ownership of assets which are not financial instruments. This may be seen from the wording of Art 21(8) AIFMD, in which the first lines refer to "safe-keeping" which is then sub-divided into the depositary's obligation to "hold in custody all financial instruments" in 21(8)(a) AIFMD, and the depositary's obligation "verify the ownership of the AIF" in 21(8)(b) AIFMD. The wording in UCITS V, Art 22(5) is similar, and the same terms are used in a similar manner throughout the AIFMD and UCITS V Level 2 legislation.

<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:**
2. **initial recording of securities in a book-entry system (‘notary service’);**
3. **providing and maintaining securities accounts at the top tier level (‘central maintenance service’)**[[12]](#footnote-13)**;**
4. **maintaining or operating securities accounts in relation to the settlement service;**
5. **having any kind of access to the assets of the AIF/UCITS; or**
6. **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>

N/A

<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>

N/A

<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[[13]](#footnote-14)) and Article 22(5) of the UCITS Directive (as well as Article 13 of the UCITS V Level 2[[14]](#footnote-15)).**

<ESMA\_QUESTION\_CE\_ASCS\_28>

We think that both regulations do offer satisfactory definitions of these concepts. Please refer to our answer to question 25.

<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>

First of all, we would like to acknowledge and highlight that CSDs are a crucial component of the overall market infrastructure and vital for the functioning of the market.

Under CSDR, CSDs are allowed to provide additional banking-type ancillary services relating to settlement such as collateral management, securities lending, enhanced asset servicing, etc. (see Annex B to CSDR). Many of the latter services are also offered by UCITS/AIF depositaries and their third party delegates.

By offering identical services both compete on unequal terms due to the fact that CSDs are exempted under EU regulation from the strict liability requirements which UCITS/AIF depositaries are intended to comply with under their respective Directives.

At the present, AIFMD clearly states that CSDs, as operators of Security Settlement Systems (“SSS”), are outside the scope of Article 21 (11) which applies to third-party delegates.

The uncertainty relates to the reading of the UCITS Directive in respect of Recital 21 of the same legislation and the ESMA Q&A issued on 1 October 2015 in respect of the AIFMD. It is ambiguous in respect of the dual roles that CSDs can play, either as issuer CSDs or investor CSDs. Two fundamental questions arise:

1. Should CSDs be considered “third parties to whom custody is delegated” and if so, would these include all CSDs or just certain CSDs – such as CSDs maintaining certain types of links to provide access to securities held at other CSDs?
2. If there is a loss of securities by a CSD (or a third-party within its network), should such loss be considered due to “external events”?[[15]](#footnote-16)

We also noted that there is a potential mismatch regarding liability standards between depositaries and their delegates on the one hand and, on the other hand, CSDs.

For the industry to operate on a level playing field, ALFI is of the view that clarifications need to be made to recognise the dual role CSDs can play as either “issuer” or “investor” CSDs. However, ALFI also notes that relying solely on the “issuer” CSD / “investor” CSD distinction might be problematic. We are concerned that the “investor” CSD definition might capture some CSDs which should not be treated as delegates, such as CSDs that provide access to other CSDs using direct links between SSS entities. Those linked CSDs should be classified as market infrastructure and not as delegates[[16]](#footnote-17). Finally, CSDs that provide access to other CSDs using links that are intermediated by entities that are not Securities Settlement Systems should be classified as falling within the scope of depositary delegation arrangements under the UCITS/AIFM Directives. In light of these considerations we would call for a comprehensive impact assessment followed by amendments to the relevant Directives.

<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. Please also refer to the AFME response to ESMA’s consultation paper on Guidelines on asset segregation under the AIFMD of December 2014 (ESMA/2014/1326). [↑](#footnote-ref-11)
11. 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-12)
12. 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-13)
13. Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012. [↑](#footnote-ref-14)
14. Commission Delegated Regulation (EU) 2016/438 of 17 December 2015. [↑](#footnote-ref-15)
15. See also letter send by the Association of Global Custodoans, dated 4th April 2016. [↑](#footnote-ref-16)
16. Examples: Target2Securities (T2S), Shanghai-Hong Kong Stock Connect programme, as operated jointly by the Hong Kong Securities Clearing Company Limited (HKSCC) and China Clear. Article 7 of the China Securities Regulatory Commission (CSRC) Stock Connect Rules mandates both China Clear and HKSCC to perform their functions effectively as joint CSDs, together acting as a “top tier level” CSD function as described under Recital (21) of the “UCITS V” Directive. [↑](#footnote-ref-17)