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ESMA
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FRANCE

(submitted via ESMA website)

Re: GUIDELINES ON ASSET SEGREGATION UNDER THE AIFMD – CONSULTATION PAPER (ESMA/2014/1326)

Introduction

BNY Mellon is a global investments company dedicated to helping its clients manage and service their financial assets throughout the investment lifecycle. As one of the world's largest investment services and investment management firms, BNY Mellon welcomes the opportunity to respond to the ESMA Consultation Paper (*ESMA/2014/1326*) in respect of Guidelines on Asset Segregation under the AIFMD.

BNY Mellon operates in Europe through: (i) branches of The Bank of New York Mellon (a New York incorporated financial institution) and (ii) directly established and duly authorised subsidiaries established in several EU jurisdictions and branches of those entities operating in most of the core EU member states. It provides services to clients and end-users of financial services globally. It is accordingly keenly interested to ensure financial markets operate fairly and consistently globally and that common standards ensure playing fields are kept level.

In Europe, BNY Mellon is represented as a triparty collateral manager, depositary, delegate (ie, custodian), CSD and asset manager. As a group, BNY Mellon represents various types of market participants at various levels in the chain of custody. Therefore BNY Mellon has a strong interest in this Consultation Paper.

Our Approach to Responding to this Consultation

In responding to this Consultation Paper, we have worked closely with the Association of Global Custodians ("AGC") (whose response we endorse), together with other industry associations such as the Bundesverband Investment und Asset Management e.V. ("BVI").

In our view, the AGC response provides a very useful explanation of the role of the depositary and custodian, and how the chain of custody operates in the general context and under AIFMD.

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In this response, we refer to the implications of the extent of the segregation obligation for **collateral management services**, as this is a particular component of BNY Mellon's business activities in which we are very active but in which there is no single industry association equivalent to the AGC. Therefore, it is important that this response focuses on this area of activity, but this should be taken as consistent with the points that we and others make about custody services.

Executive Summary

All five options should be available to market participants, and in particular, Options 3 and 4 should be available to market participants. All five options achieve investor protection, which should be the overriding objective of the guidelines.

Options 1 and 2 do not increase investor protection from a legal perspective, and increase operational risks and costs. They should remain available, but their use should not be mandatory.

If ESMA will not permit Options 3 and 4 at a general level, then there should be a specific treatment (supported by any required exemptions) to enable Options 3 and 4 to be used for collateral management arrangements, as a public policy objective. Otherwise the triparty collateral management model will revert to a bilateral collateral model, which would introduce inherent risks and costs for no substantive benefit. We believe that the removal of Options 3 and 4 would have a significant negative impact on liquidity and funding, which would be contrary to EU policy generally (we expand on this in the detail of our response).

General Comments

BNY Mellon makes the following general comments in regard to this consultation paper, as this supports the approach we have taken in responding to the specific questions asked by ESMA.

Firstly, Article 99 of AIFMR should be interpreted and applied to ensure the objective of the AIFMD segregation requirements, i.e., **investor protection**. Achieving investor protection should be the overriding objective of these guidelines.

Secondly, the two segregation options proposed by ESMA (Options 1 and 2) do not increase nor enhance investor protection (in comparison with Options 3 and 4). Therefore requiring Options 1 or 2 (and excluding the other options) does not advance the investor protection objective of AIFMD. On this basis, we believe that ESMA should <u>not</u> have discarded Options 3 and 4, and therefore the guidelines should make it clear that Options 3 and 4 remain available for use under AIFMD.

Thirdly, there is no additional protection against loss of client assets on an insolvency of the delegate achieved by segregation of AIF assets from non-AIF assets. In other words, the distinction between AIF assets and non-AIF assets is an artificial one, for the purposes of insolvency law. As insolvency law will not grant additional protection for AIF assets compared with non-AIF assets, there is no benefit from imposing AIF/non-AIF segregation throughout a chain of custody.

Fourthly, the two segregation options proposed by ESMA (Options 1 and 2) result in the introduction of additional operational risk for investors, reduced efficiency and increased costs. In particular:

- a proliferation of client asset accounts under AIFMD demonstrably leads to a significant increase in day-to-day operational/settlement risk for the depositary, the delegate and its local-subcustodian (and ultimately the investor) – because there is more complexity in the holding chain; and

- a multiplicity of accounts inevitably creates significantly more complexity and delay on an insolvency of a delegate with respect to release of client assets.

Arguably the above two points actually reduce, rather than enhance, investor protection.

From a legal perspective, the omnibus account structure is recognised as an effective method of protecting end investors, and full segregation throughout the custody chain does not provide additional protection for the end investor. This is because the omnibus account structure is recognised by various legal systems as a set of enforceable property rights. The utility of requiring the maintenance of segregated positions throughout the custody chain has been comprehensively rejected, including in the report of the Task Force on Adaptation to Cross-CSD Settlement in T2S.

We would also note that there are inconsistencies in the Consultation Paper between the text description of the various options, and the diagrams presented for Options 1 and 2. This has resulted in considerable confusion among various readers of the Consultation Paper regarding what each Option actually means in practice. This may mean that responses to the Consultation Paper are approaching the issues from a different starting point.

Collateral Management

Our view is that proposals in regard to asset segregation need to be carefully designed and implemented so that they do not prevent effective collateral management. Any restrictions (intended or unintended) on the use and management of collateral would contradict the broad public policy objective of the use of collateral to reduce risk in the financial system.

European policy makers support the use of collateral as part of the post-financial-crisis recovery path. This is evident in significant components of the EU legislative framework such as CRD IV, CSDR and EMIR, which require or encourage the provision of collateral as an effective risk mitigation tool.

Collateral management is systemically important. Collateral management plays a vital role in the post-financial-crisis economy by reducing risk in the financial system and increasing liquidity. It also enables additional income for funds, which is of benefit to their investors.

We would emphasise that the business models of triparty collateral manager and securities lending agent are very different from core custody services.

In particular, collateral management is an environment where beneficial ownership of collateral changes frequently (including intra-day) as part of a dynamic process, whereas custody tends to involve beneficial ownership of securities changing less frequently (ie, held for longer periods). This market difference is fundamental in understanding the impact of requiring segregation along the chain of custody in the context of collateral management.

In our view, ESMA's Options 1 and 2 require extensive segregation along the chain of custody. In essence, a requirement of extensive segregation along the chain of custody does not work effectively in a business model where there are frequent changes of beneficial ownership at the investor level.

Such a requirement would force the triparty collateral market to operate on a bilateral basis, which would increase various risks (e.g., settlement risk, counterparty risk, operational risk), reduce liquidity, and reduce the opportunity for funds to generate additional income in relation to their securities.

A key advantage of the omnibus account structure is the principle of *data uniqueness*. In any situation where segregated accounts are used, it is necessary for the relevant data to be stored and maintained in multiple locations (ie, at each intermediary level). In a triparty collateral management model, in which data at the end investor level is changing frequently, it would be impossible for market infrastructure (with settlement cycles and other obligations) to keep up with frequent changes of collateral at the end investor level if a fully segregated account structure is required.

We do not support any approach that prevents or restricts the use of omnibus accounts at sub-custodian level. BNY Mellon segregates per client in our own books and records. We strongly recommend that (rather than requiring segregated accounts to be used at various levels in the chain of custody) ESMA takes a permissive approach, whereby it is *possible* for such segregated accounts to be used, but without requiring their use.

As referred to in the penultimate paragraph under General Comments above, the omnibus account structure is recognised from a legal perspective.

Restricting the choice to Options 1 and 2 is inconsistent with overall European policy objectives of encouraging economic growth. A key aspect of encouraging economic growth is to ensure that markets are liquid, capital is able to move to where it is most needed, and collateral is used to reduce risk in the financial system. Options 3 and 4 are needed to achieve this.

In **Annex 2**, we provide a diagram that demonstrates the triparty collateral management account structure used by BNY Mellon.

Responses to Specific Questions

BNY Mellon is responding to ESMA using ESMA's "Form to Reply" document, which we are submitting online. However, for convenience, our responses to questions are also contained in this document in **Annex 1** below.

BNY Mellon looks forward to further engagement with ESMA on AIFMD Asset Segregation.

Veronica Iommi
EMEA Head of Public Policy
Office of Public Policy and Regulatory Affairs
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BNY Mellon

ANNEX 1 – Responses to Specific Questions

Q1: Which of the two identified options do you prefer?

If the choice is limited to a choice between Option 1 and Option 2 (we believe this is a false choice), then BNY Mellon prefers Option 2.

Option 2 provides the same level of investor protection as Option 1 (therefore we disagree with the view that Option 1 increases investor protection, compared to Option 2).

Option 2 would reduce the number of accounts that are required to be maintained (compared to Option 1), and would therefore be more operationally efficient and less costly to operate.

Given that there would be the same level of investor protection but with greater efficiency and lower cost, we would prefer Option 2 over Option 1. However, Option 1 should remain available for those parties which choose to adopt that option.

BNY Mellon's view is that all five options should be available to market participants, and in particular, Options 3 and 4 should be available to market participants.

The underlying assumptions of the ESMA CBA are incorrect

BNY Mellon believes that limiting this to a choice between Options 1 and 2 is the incorrect approach to take, for the reasons outlined in our general comments, and for the reasons given below.

All five options should be available to market participants, and in particular, Options 3 and 4 should be available to market participants.

In particular, we would strongly critique the underlying assumptions in the CBA which seem to have influenced ESMA's decision-making in regard to the preferred options.

In the ESMA CBA, the benefits of the five options, from the investor protection standpoint, are described as follows:

Option	ESMA's Qualitative Description in the CBA
5	"This option provides for the **highest** level of investor protection …"
1	"This option provides for a **high** standard in terms of investor protection …"
2	"This option provides for a **significant** level of investor protection …"
3	"This option provides for a **lower** level of investor protection …"
4	"This option provides for the **lowest** level of investor protection …"

From an investor protection standpoint, the reasoning given for the level of investor protection is linked to the extent of segregation required. Therefore the CBA assumes that there is a *correlation* between the extent of segregation and the level of investor protection. Based on this reasoning, ESMA has presented the above options on the basis of a continuum and formed the view that Options 1 and 2 represent the acceptable options available to market participants.

This is indeed a fallacy, because it is incorrect that the extent of segregation influences the extent of investor protection. We discuss this below under Legal Arguments.

Due to the incorrect underlying assumptions above, this has resulted in only two options being presented (the "either-or fallacy"), when in reality, all five options presented by ESMA should be available to market participants. Unfortunately, the use of incorrect assumptions impacts upon the overall conclusions reached in the Consultation Paper.

There are inconsistencies in the Consultation Paper between the text description of the various options, and the diagrams presented for Options 1 and 2. This has resulted in considerable confusion among various readers of the Consultation Paper regarding what each Option actually means in practice. This may mean that responses to the Consultation Paper are approaching the issues from a different starting point.

Furthermore, there are no diagrams presented for Options 3, 4 or 5 (which are essential in order to understand the distinction between the options).

The diagrams presented for Options 1 and 2 do not cover multiple levels in the chain of custody, and therefore do not properly visualise the effect of requiring multiple accounts in a longer chain of custody. The diagrams are therefore not realistic in this context, as they are far too simplistic.

To illustrate the impact of the proposals on account structure, please see **Annex 2**, where we compare (by way of diagrams and descriptions) Option 1 and Option 3 at various levels in a chain of custody. This clearly demonstrates the exponential increase in the number of accounts under Option 1 in comparison with Option 3.

Legal Arguments

In our view, the concern in regard to the use of omnibus accounts rather than segregated accounts arises out of a misunderstanding of, and failure to distinguish between, personal or contractual rights on the one hand, versus property (or "in rem") rights on the other hand.

This distinction is important. Where personal rights are involved, the cause of action is against the other party, and as such, the ability to take effective action depends on the solvency of the other party. If the other party is insolvent, then the first party is an unsecured creditor in relation to the other party and the success of the first party's claim will depend on the extent to which the other party has unencumbered assets.

Where property rights are involved, the cause of action is against the asset, and such rights tend to be effective against all comers. As such, the property rights are enforceable, regardless of the status of any intermediary or counterparty holding the asset.

This is consistent with the internationally recognised concept of **PRIMA** (**Pl**ace of the **R**elevant **I**nter**m**ediary **A**ccount). PRIMA recognises that at each level in the chain of custody, each person in the chain ("A") has a directly enforceable property right against the next person in the chain ("B") (ie, A can enforce against B, B can enforce against C, etc); and the only person who can directly enforce a property right against B is A, and against C is B, etc.

This maintains a consistent set of property rights throughout the chain, and prevents any attempts by one party to gain an unfair advantage by “leapfrogging” (ie, trying to enforce property rights directly against further levels in the chain rather than the immediate level).

PRIMA – the place of the relevant intermediary account (ie, where that account is kept) – determines the relevant jurisdiction for the purpose of the property law that applies at that level of the chain. The fact that there are potentially a number of legal jurisdictions involved in the chain of custody does not matter, as all such jurisdictions will ultimately recognise the enforcement of property rights by the person at the immediate level (although of course the technical details of the property rights and enforcement of such rights will differ from jurisdiction to jurisdiction).

The fact that property rights are only directly enforceable at the immediate level in the chain of custody has the following practical consequences:

- End investors (eg, AIFs) do not have direct claims against any specific property held beyond the immediate level, and therefore from an AIF’s perspective, it is irrelevant whether the subsequent intermediaries have a separate account containing AIF assets only, or there are only records distinguishing AIF assets from non-AIF assets.

- Use of omnibus accounts which are not split according to AIF and non-AIF assets reduces operational and structural complexity and thereby reduces costs and the risk of operational error.

We would strongly recommend that rather than requiring segregated accounts to be used at various levels in the chain of custody, that ESMA take a permissive approach, whereby it is possible for such accounts to be used, but without requiring their use.

This should provide sufficient flexibility to cater for various jurisdictions around the world (some of which may require segregated accounts as a matter of local law) and for situations where all parties wish to use a segregated account structure for whatever reason. It would also recognise the utility and flexibility of the omnibus model, which has broad legal recognition, fully recognises and respects property rights, and is an essential feature for collateral management.

It is clear from the above analysis that requiring segregation at various levels along the chain of custody, instead of enabling the use of omnibus accounts, does not provide additional protection for the end investor from a legal perspective. Although segregated accounts are mandatory in some jurisdictions, and relevant parties may freely choose to use a segregated account structure for other purposes, its use should not be mandatory under AIFMD.

Q2: Would you suggest any alternative option which is compatible with the AIFMD and its implementing measures? If yes, please provide details.

All five options are compatible with AIFMD and its implementing measures, because they **all achieve the objective of investor protection**. This is because, when moving between each level in the chain of custody, it is clear what each party's property rights are under the PRIMA concept. Therefore all five options should be available to market participants. **In particular, Options 3 and 4 should be available to market participants.**

The reasoning is set out in our response to Question 1.

<u>AIFMD / AIFMR Text</u>

Furthermore, AIFMR 99(1) provides that "a depositary shall ensure that the third party acts in accordance with the segregation obligation laid down in [AIFMD Article 21(11)(d)(iii)] by verifying that the third party … keeps such records and accounts as are necessary to enable it at any time and without delay to distinguish the assets of the depositary's AIF clients from … assets held for clients of the depositary which are not AIFs".

The proper reading of the above sentence is that "keep such records and accounts as are necessary" should be read flexibly so as to enable such record(s) and/or account(s) to be required to be kept only if necessary to achieve segregation. Therefore it should not be expected that a multitude of segregated accounts should be required, and indeed AIFMD Recital (40) acknowledges the use of omnibus account structures.

Also, it is the depositary that is the party who must be able – at any time and without delay – to distinguish the assets of its AIF clients from its non-AIF clients. The depositary would in practice distinguish the assets as between *every* client, in the depositary's own books and records.

This interpretation is key to understanding how the overall objective of investor protection is achieved – depositaries must ensure that delegates keep and maintain the records and accounts that are necessary, and the depositary must ensure that regular reconciliations are performed. The depositary must ensure that each delegate imposes the same requirements at the following level of the chain of custody, such that there is a fully-reconciled chain of custody and that any breaks in the chain are identified and resolved.

On this basis, all five options, including Options 3 and 4, are fully effective from an AIFMD perspective, and in particular achieve the policy objective of investor protection.

Q3: Do you have knowledge of the impact that each of the two options identified would have on your business in terms of restructuring of existing delegation arrangements in Europe and third countries? Please quantify the one-off and ongoing costs as well as the types of costs for each of the two options or any alternative option that you may prefer.

<u>Custody</u>

<u>Costs</u>

If Option 1 and/or Option 2 are adopted as the only available options, then this will have a significant impact on custody-related activity. **All such costs would ultimately be borne by end investors.**

The costs would be significant, both in terms of one-off and ongoing costs.

Examples of **one-off costs** in moving to Options 1 and/or 2 only, would include:

- IT rebuild or enhancements to cater for a much higher number of accounts and transactions within the chain of custody.
- Contractual renegotiations to cater for the new models.

Examples of **ongoing costs** would include:

- Account opening fees – more accounts required, therefore account opening fees would be higher overall. Account opening fees cover regulatory checks (e.g., AML/KYC) and IT set-up/connectivity testing, the costs of which would increase in a segregated environment.
- Account maintenance fees – more accounts required, therefore account maintenance fees would be higher overall.
- Transaction fees – the more segregated the account set-up is, then there will be more external settlement transactions (including the use of external settlement and messaging infrastructure), as segregation reduces the ability for internalisation of settlement.
- Reconciliation costs – an increased number of accounts will require more work to reconcile all the accounts along the chain. Furthermore, the structure is more likely to result in a higher number of "reconciliation breaks" which will need to be resolved.

In terms of core depositary and core custody functions, it would be necessary for the industry to adopt a new account structure. The number of accounts required would expand exponentially, requiring a significant IT rebuild or enhancements.

Furthermore, the ongoing costs are likely to be significant. Each time there is a new end investor or new AIF, then instead of one new account being created, many new accounts will need to be created at multiple levels in the chain of custody.

In the AIFMD context in which investors ultimately invest in third countries, the chain of custody may involve multiple levels such as the end investor, the AIF, the depositary, the global custodian, the local sub-custodian and the CSD.

The diagrams presented in the Consultation Paper do not cover multiple levels in the chain of custody, and therefore do not properly visualise the effect of requiring multiple accounts in a longer chain of custody. The diagrams are therefore not realistic in this context, as they are far too simplistic.

To illustrate the impact of the proposals on account structure, please see **Annex 2**, where we compare (by way of diagrams and descriptions) Option 1 and Option 3 at various levels in a chain of custody. This clearly shows the exponential increase in the number of accounts under Option 1 in comparison with Option 3.

Contractual renegotiations would be required at various levels of the chain of custody, and so the one-off transition costs would likely be significant. Contractual renegotiations may be difficult, especially for delegates in third countries which do not have a similar regulatory regime (see Third Country Impacts below).

Third Country Impacts

In particular, requiring the use of Options 1 and/or 2 may not be acceptable to third country sub-custodians who do not have similar requirements in their own jurisdiction. The requiring of Options 1 and/or 2 in a particular market may have the practical effect of closing off that market to EU investors. We do not think this is in the interests of EU investors.

This impact would apply both for established and emerging markets. Established markets such as the United States, which has a long-standing SEC “17f-5” rule focused on investor protection, may question the rationale of moving to a segregated account structure. It would not be a desirable outcome for EU investors if they were unable to access the U.S. markets because the U.S. refuses to follow the Options 1 and/or 2 model. For emerging markets, it is important that unnecessary costs are not imposed on those markets, so that they can be viewed as a potentially viable investment opportunity for AIFs and their EU investors.

Similarly, the increased costs of operating this model in the EU jurisdictions may have the effect of reducing investor returns, and non-EU investors may therefore choose to invest in other markets. We believe that this would be inconsistent with the European Union’s growth and jobs agenda, which is a top European policy priority.

Triparty Collateral Management

In regard to triparty collateral management, if Options 1 and/or 2 are adopted as the only available options, then collateral management will move to a bilateral model (and the AIF and counterparty would need to move collateral and funding directly between themselves at the market level).

This is because triparty collateral managers would no longer be able to service AIFs under a segregated custody model.

We refer to the implications of this in our answer to Question 4.

Q4: Do you see merit in foreseeing a specific treatment for certain types of arrangement (e.g. collateral management arrangements)? If yes, please specify how your proposal would ensure compliance with the relevant requirements of the AIFMD and Level 2 Regulation.

The basis of our reasoning is that all five options should be made available to market participants, as they all achieve the outcome of investor protection.

If ESMA agrees with our reasoning, then there would not be any need for specific treatment for collateral management arrangements, as such arrangements would be treated consistently with the rest of the market. It is highly likely that collateral managers would continue with their current approach which comes closest to Options 3 and/or 4 (depending on the exact operating model to be adopted by a collateral manager).

If, however, ESMA was not minded to do this, and to require the use of Option 1 and/or Option 2 as a general rule, then we would strongly recommend that ESMA adopt a specific treatment (including specific exemptions) for collateral management arrangements, to enable the use of Options 3 and 4.

This is in order to support the triparty collateral management model as a public policy objective. We describe the differential characteristics of the business model and the public policy objectives in our General Comments. European policy makers support the use of collateral as part of the post-financial-crisis recovery path. This is evident in significant components of the EU legislative framework such as CRD IV, CSDR and EMIR, which require or encourage the provision of collateral as an effective risk mitigation tool. Failure to allow the use of Options 3 and 4 would be inconsistent with the policy objectives of the above-referenced legislation.

Triparty collateral management is a highly specialised function performed by independent third party institutional service providers to help clients mitigate risks and challenges posed by the client's trading/financing activity.

In **Annex 2**, we provide a diagram that demonstrates the triparty collateral management account structure used by BNY Mellon.

Failure to allow the use of Options 3 and 4, or to provide specific treatment for collateral management arrangements, would result in the use of bilateral collateral arrangements. Triparty collateral management would no longer be viable if only Options 1 and/or 2 were permitted.

Bilateral collateral arrangements introduce inherent risks and costs, for no substantive benefit. We describe this in more detail below. The dynamic real-time intra-day allocations and substitutions that happen within the triparty environment to minimise client risk and optimise performance will not be able to occur.

A segregated model for AIFs will result in overall increased costs and risks for AIFs, and reduce liquidity in the market. Liquidity is vital to ensure that economic capital is allocated efficiently, in order to facilitate the economic growth agenda of the European Union.

The consequences of a bilateral model include:

- Settlement risk, as collateral movements would now need to be settled as market trades (rather than book entry movements)

- Counterparty exposure risk during settlement windows
- Increased operational risk as the AIF and counterparty manage their own trades and movements
- Increased expense for funds including additional support staff and specialised technology
- A potential reduction in the number of participants willing to trade with AIFs, given an inefficient bilateral settlement model and potentially limited collateral schedule
- Exposure to commercial bank settlement risk
- Increased trade dispute risk and resolution
- Limited collateral eligibility schedules in the absence of the sophistication of collateral management systems
- Reduced opportunity for AIFs (and their investors) to benefit from additional income in relation to their securities.

We would also refer ESMA to the Bank of International Settlements (Committee on Payments and Markets Infrastructures) publication "Developments in collateral management services", which was published in September 2014. This publication provides a useful overview of the role and importance of collateral management services since the financial crisis of 2008, including some key market benefits on a global basis.

Q5: Do you agree with ESMA's approach to discarding the third, fourth and fifth options described in Section 5 of the CBA? If not, please provide data and information that support your view.

BNY Mellon strongly disagrees with the discarding of Options 3 and 4. BNY Mellon also disagrees with the discarding of Option 5.

<u>Options 3 and 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*)</u>

BNY Mellon strongly disagrees with the discarding of Options 3 and 4, as we believe that these Options would comply with AIFMD (please see our answer to question 2).

Therefore we disagree with the view in the CBA that these Options do not seem to be compatible with the provisions of the AIFMD and its implementing measures. They are compatible and achieve the objective of investor protection.

<u>Option 5 (*AIF Assets should be segregated on an AIF-by-AIF basis at the level of the delegate*)</u>

BNY Mellon disagrees with the discarding of Option 5, as we believe that this Option would comply with AIFMD (please see our answer to question 2).

Therefore we disagree with the view in the CBA that this Option does not seem to be compatible with the provisions of the AIFMD and its implementing measures.

We note ESMA's view that "the marginal benefit of the additional level of segregation [in Option 5] in terms of an expeditious return of assets in the event of the bankruptcy of a depositary or sub-depositary does not seem likely to exceed the marginal cost of this level of segregation".

BNY Mellon agrees with ESMA's implicit conclusion that the costs exceed the benefits, but our view is that there is **no** benefit (rather than a marginal benefit) of the additional level of segregation.

Furthermore, our view is that the marginal cost of this level of segregation is in practice, likely to be substantial.

We also disagree with ESMA's view that "[Option 5] provides for the highest level of investor protection." This is not correct from an operational and legal perspective, for the reasons set out in our answer to Question 1.

Although Option 5 is not a preferred option from BNY Mellon's perspective, our view is that it should remain available to those who may wish to use it and where it is operationally feasible to do so.

Furthermore, in some jurisdictions (particularly those which do not recognise the omnibus account structure, or require the end investor to be identified at each level), it may be the only available option. If this option was excluded by ESMA, then an unintended consequence may be that certain jurisdictions would no longer be available to AIFs. Therefore Option 5 should be retained as an option, but its use should not be required.

ANNEX 2 – Diagrams

Please refer to following five pages [contained in separate PDF attachment]:

- Option 3 Description
- Option 3 Diagram
- Option 1 Description
- Option 1 Diagram
- Triparty Collateral Management Model