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Friday, 23 September 2016

Dear Sir/ Madam,

Re: ESMA Call for Evidence Asset Segregation and Custody Services ('Call for Evidence')

Deutsche Bank (DB) welcomes the opportunity to provide comments on the above Call for Evidence.

After careful consideration of how best to protect client assets through the custody chain, DB views the optimal solution to be for ESMA to mandate Option 4, but to allow for flexibility where law, regulation and market practices demand otherwise. In our experience of providing custody service in a broad range of markets, segregation (whether through individual or omnibus accounts) alone cannot guarantee the recovery and return of assets in insolvency and it is not seen as a factor that determines the timing or speed of recovery or return of assets.

Importantly, a mandated asset segregation model that deviates from Option 4 (where AIFs, UCITS and other assets are held in omnibus accounts and pooled with assets from different depositaries) through Options 1, 2 or other options, may result in detrimental unintended consequences without enhancing investor protection. These include:

- New barriers that will prevent clients from investing in certain markets;
- Additional operational complexities, risk and cost;
- Significant impact on the securities lending business, as triparty collateral management service providers rely on the ability to use internalised settlement using omnibus account structures and books and records segregation. Without the ability to transfer ownership on a books and records basis between their clients, triparty agents would effectively cease to be able to operate efficiently on behalf of Alternative Investment Funds (AIFs) and Undertakings for Collective Investment in Transferable Securities (UCITS).

We have set out below details of four custody account structures we use in DB. These illustrate the robust processes that are currently in place to ensure traceability throughout the custody chain. Taking these points into account, we would question whether Options 1, 2 and others identified by ESMA would produce a proportionate regime.

On questions pertaining to CSDs in this Call for Evidence, it is our view that CSDs should be regulated under the CSDR, rather than AIFMD and UCITS V, which is specific to AIF and UCITS entities. That said, DB believes there are a number of elements to be considered to make a balanced decision, in particular to the allocation of liability for intermediaries involved in custody of AIF and UCITS assets.

Additional confidential supporting material will be provided directly to ESMA. Please do not hesitate to let us know if you have any questions about these points or would like to discuss further.

Yours sincerely,

Matt Holmes
Global Head of Regulatory Policy

Q1: 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:

a) please describe – with the use of a chart/diagram – at least three levels of account-keeping in your custody chain, as follows:

i) the first level should be the level of the AIF/UCITS-appointed depositary,

ii) the second level should be the level of a third party delegate of the depositary, and

iii) 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.

Deutsche Bank mainly operates four custody account structure models. The differences between the four models arise from the specific role that DB is performing for the AIFs and UCITS.

DB's four models are:

- Global Prime Finance ("GPF") - where DB performs the function of a Prime Broker
- Agency Securities Lending ("ASL") - where DB functions as a securities lending agent
- Custody and Clearing ("C&C") – where DB acts as a Delegate of the Depositary (sub-custodian) and
- Fund Services ("FS") - where DB acts as Fund Administrator and Depositary.

The GPF and ASL models are essentially identical whilst other models have a number of differences.

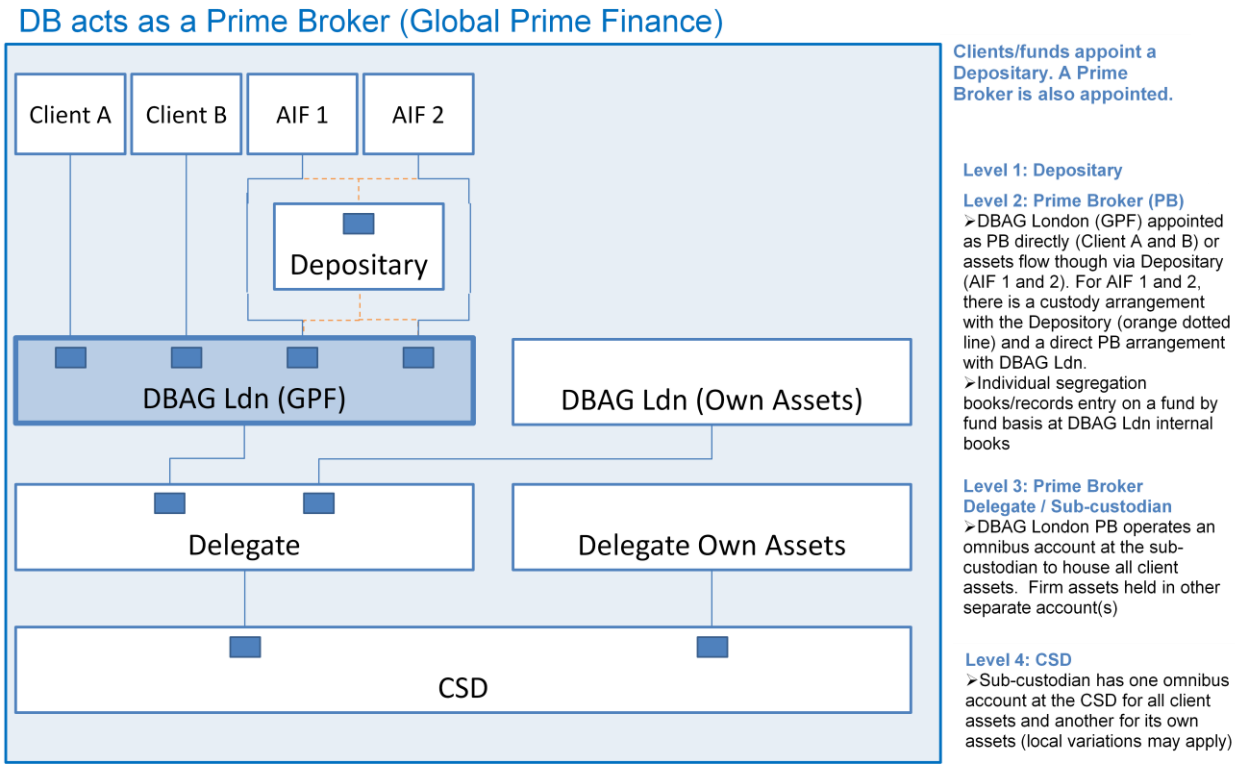
Custody accounts at each level of the custody chain allow for segregation and the scope of records at each level is different:

- Segregation at the level of the depositary: Assets are recorded in a separate account in the depositary in the name of a fund. The assets of a particular fund are segregated from the proprietary assets of the depositary, and from the Depositary's other client assets. The depositary records reflect a fund's rights to securities.

- Segregation at the level of the sub-custodian: Assets are recorded in a separate client account at the sub-custodian in the name of a depositary (or in the case of Prime Brokerage, in the name of the 'Prime Broker-client assets'). The client assets of a particular depositary are segregated from the own assets of the depositary and those of the sub-custodian, and from the assets of other clients of the sub-custodian. The records of the sub-custodian confirm a depositary's rights to securities in its capacity as the depositary (not as their owner). If this sub-custodian (Level 2) further delegates to another sub-custodian (Level 3), the records at the latter sub-custodian would confirm the Level 2 sub-custodian's rights to the securities. As above, when further delegating assets it should be noted that custody of financial securities is not 'delegated' in the same form as with tangible assets i.e.: art. Here the records of both intermediaries will continue to exist in parallel (see page 4 for more detail).

- Segregation at the level of the CSDs: Assets are recorded in a separate client account opened in the CSD in the name of a sub-custodian. The client assets of a particular sub-custodian are segregated from the own assets of the sub-custodian, the CSD, and from the assets of other clients of the CSD.

NB:
Omnibus accounts- assets of different funds held in one account.
Individual accounts: assets of one fund held in an account separately from the assets of other funds.



For DB's Global Prime Finance business, clients appoint a Prime Broker and/or a Depositary. At Level 2, DB is either directly appointed as Prime Broker (Client A and B, funds not regulated by AIFMD/UCITS who have no requirement for a depositary) or assets flow via the Depositary (AIF 1 and AIF 2). For AIF 1 and 2, there is a custody arrangement with the Depositary as well as a direct Prime Broker relationship with DB (orange dotted line). At this level, client accounts are individually segregated and opened for all clients in DB's internal books and records. Note that in general, Prime Brokers do not custody assets for UCITS funds.

When DB as a Prime Broker delegates assets to a sub-custodian/delegate, client omnibus accounts are operated at the sub-custodian level to hold all client assets. A separate account will also be opened at the sub-custodian to hold DB's own proprietary assets. Most trading activity takes place in markets that use this structure. Some markets such as South America, Asia and Africa occasionally require individually segregated client accounts even at the sub-custodian level that are operated by the Prime Broker on behalf of the client. But in this scenario, DB would not be able to offer the full range of PB services to the client.

The sub-custodian then maintains one omnibus account at a CSD, for all the sub-custodian's client assets and another for the sub-custodian's own assets. There can be variations to this at CSD level in different jurisdictions.

Q1b(iii) Reuse of assets: In DB's Prime Brokerage business, reuse of client assets is permitted subject to certain restrictions set out in the prime brokerage agreement ("PBA"), however no sub-custodian or CSD is ever permitted to reuse client's assets at lower levels of the custodial chain. On occasion individual clients may request additional restrictions on reuse of assets at the PB level in accordance with their investment strategy.

Q1f ECON model used: DB's Prime Brokerage business enters into prime brokerage agreements with clients under which DBAG London branch ("DBL") will hold all assets of a client on trust for clients. Under this arrangement, DBL becomes the legal owner of the client's assets, and the client (beneficiary of the trust) has an equitable interest in the assets subject to the trust. In the event of an insolvency of DBL, the trust model makes the client better protected as a matter of English law with an omnibus client account at the level of DBL. This trust model is market standard for UK prime brokers. DB recognises that the level of protection afforded under this trust model which governs the

relationship between it and its clients is complicated by custody chains in which DBL appoints other separate legal entities i.e.: overseas sub-custodians to hold the assets of DBL clients. In these custody chains, sub-custodians appointed by DBL hold assets according to the basic models identified in the ECON briefing note. Unlike Prime Brokers, sub-custodians (and also CSD's) do not hold DB's client assets on trust and, in an insolvency of a sub-custodian (and/or CSD), the distribution of assets held by those legal entities would be determined by local insolvency law without regard to the contractual position and trust established between DBL and its clients. In the event of insolvency in the custody chain, DBL would seek recovery of the assets belonging to clients (in its capacity as the trustee),

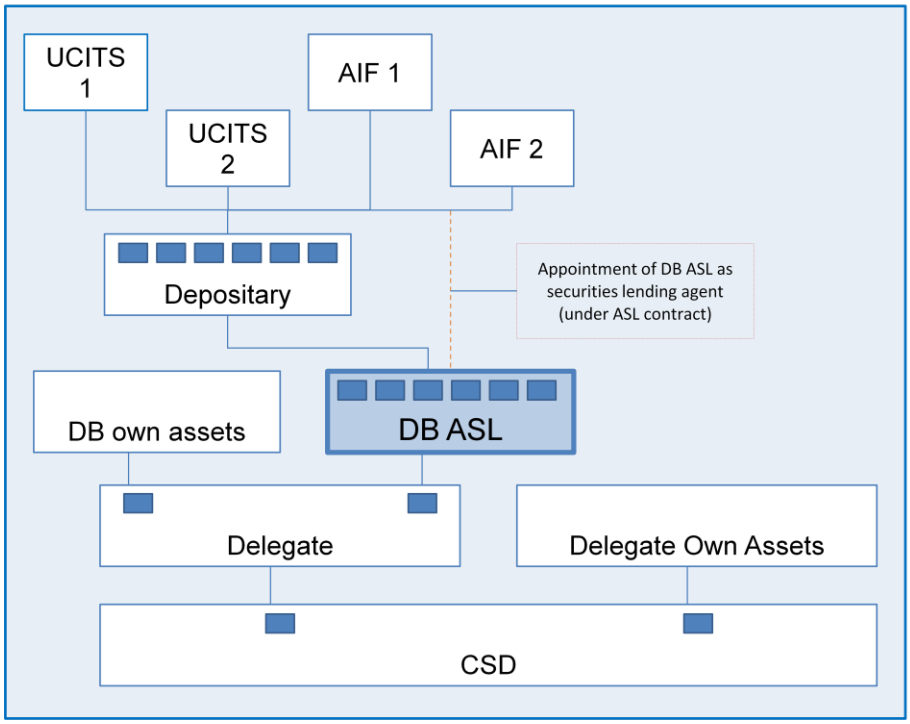
Q1g Naming conventions: DB's Prime Brokerage business provides access to a global network of approximately 70 markets in which DBL appoints sub-custodians. These sub-custodians are typically instructed to open an omnibus account on their books and records to hold all of DBL's client's assets unless local law, regulation and/or market practice require otherwise. At the sub-custodial level, the omnibus account is generally opened in the name of DBL and is labelled as a "DBL – client account" or similar. Each sub-custodian generally opens an omnibus account with a CSD to hold all of the sub-custodian's client's assets. At the CSD level, the omnibus account is generally opened in the name of the sub-custodian and is labelled as a "Sub-custodian – client account". Occasionally, accounts may be opened specifically in the name of the fund (individual segregation) at the sub-custodial level, but this is quite rare. It can be done following a specific client request or mandatory in light of market practice in the applicable local jurisdiction. However, in that instance, it would mean that DBL would not be able to offer the full range of prime brokerage services to that client.

General comment on all models:

It is important to note that when appointing a delegate for the custody of intangible assets (such as financial instruments), the appointing entity always continues to maintain records to the securities. This is unlike the custody of a tangible object such as art for example, which can only be in custody with one service provider at any point in time. Custody records of intermediaries for financial instruments continue to exist in parallel and in this sense, there is no replacement of services providers. To the contrary, the records of each of the intermediaries have a different scope (with different information captured, such as: clients, rights to the assets etc), and thus they are irreplaceable and not interchangeable.

There are two further issues that could be raised by the contractual relationship between the intermediaries and the impact of records held on that basis. The first is with regards to the ability of a sub-custodian to recognise the rights of funds to securities when held with them through an account opened for the depositary. A sub-custodian is able to keep records on rights to securities of its immediate clients only and without a direct contractual relationship between the fund and the sub-custodian – there is no legal basis for a sub-custodian to recognise these rights. As a contractual relationship is maintained between the sub-custodian and its client (the depositary), the depositary instructs the sub-custodian about which accounts to open and which assets need to be held in these accounts. To open up individual accounts, the sub-custodian will have to rely on the information provided by its client (the Depositary) and the sub-custodian has no control over the choice of the asset segregation structures, nor can it verify the accuracy of such information. The second issue would be additional aspects to address on KYC and AML being performed by intermediaries in the custody chain without having a direct contractual relationship with the fund or being able to source this information directly from the fund.

DB acts as Securities Lending Agent (ASL)



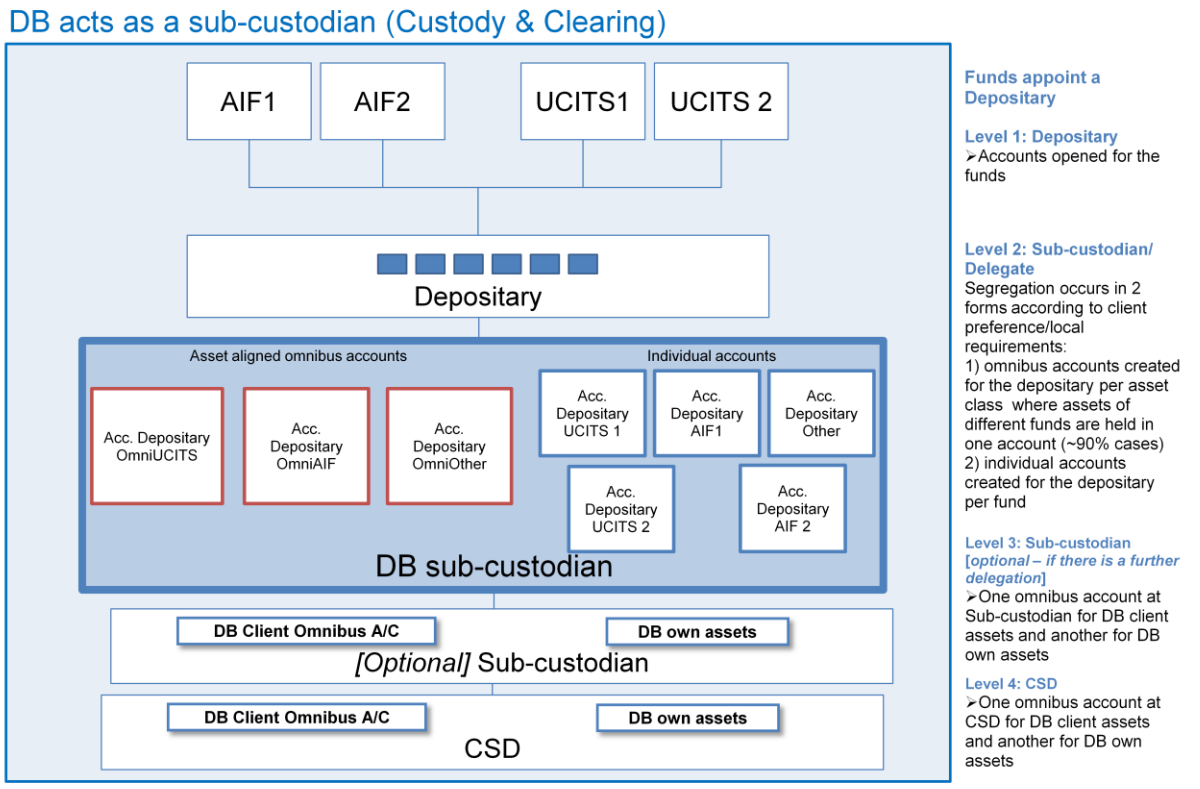
When DB acts as a Securities Lending Agent, DB ASL is appointed as a delegate in Level 2 for the safekeeping of the assets related to ASL programmes (i.e.: DB ASL is appointed as ASL by the fund and as a sub-custodian by the depositary of the funds). Assets are individually segregated on DB ASL books and records on a fund-by-fund basis and reported to the clients (the funds) and their Depositaries daily. At level 3, where DB ASL appoints a delegate, the delegate opens omnibus accounts in the name of DB ASL to hold the assets of different depositaries and their funds (i.e.: with UCITS, AIF and other clients' securities pooled together). Any proprietary assets of DB would be held in a separate account at the Delegate of DB ASL.

The delegate of DB ASL then maintains one omnibus account at a CSD, for all the sub-custodian's client assets and another for the sub-custodian's own assets. There can be variations to this at CSD level in different jurisdictions.

Q1b(iii)Reuse of assets: Client assets are held in omnibus accounts at the delegate of ASL, with UCITS, AIF and other ASL clients' securities pooled together. These omnibus accounts are identified as containing client assets and these securities are not pledged towards any credit line – there is no reuse / re-hypothecation allowed.

Q1c Level of custody chain when omnibus accounts are used/essential: Individually segregated accounts are maintained in ASL internal books and records. The use of omnibus accounts from ASL's delegate level onwards is essential to enable efficient lending and the associated management of collateral. Since triparty collateral service providers rely on the ability to use omnibus account structures and transferring ownership on a books and records basis between their clients, they would effectively cease to be able to operate on behalf of AIF/UCITS funds if individual segregation beyond the level of their own books and records was required.

Q1g Naming conventions: The ASL business names accounts within their books and records either as the AIF/UCITS Client [*AIF/UCITS umbrella fund name*] together with the underlying fund [*sub-fund name*] with or without the Depositary name. The specific naming convention is agreed with each Depositary. The omnibus accounts operated are named Deutsche Bank AG Client account (or similar i.e.: Deutsche Bank AG Client / Deutsche Bank AG Client Clearing / Deutsche Bank AG Client Collateral).



For DB's Custody and Clearing business, at level 2 when DB is appointed and acting as a delegate for the Depositary, a separate omnibus account by each type of client asset (AIFs, UCITS, other assets) is maintained in DB books and records for each client Depositary, segregated from assets of other clients of the sub-custodian. Whilst this structure is used 90% of the time for operational efficiency and when costs and speed aid market entry (see Q11 for more detail), DB opens individual accounts for funds in the name of each Depositary on an exceptional basis upon request by a client. Where DB as sub-custodian further delegates assets to another sub-custodian and at the CSD level, one omnibus account is generally maintained for all DB client assets and any proprietary assets of DB are held in a separate account. All activity is supported by daily reconciliation and client reporting.

Q1b(iii)Reuse of assets: Reuse of assets is highly restricted. Systematic controls are in place to ringfence UCITS and AIF assets in DB's risk system on a client basis and are therefore flagged as exempt from re-use or from any entitlement DB may have in order to mitigate risk in the event of the client being overdrawn or in default.

Q1c Level of custody chain when omnibus accounts are used/essential: See paragraph 1 above.

Q1f ECON model: DB's models will vary from one jurisdiction to another (DB provides securities services and participants of CSDs in approximately 30 locations of which 13 are European domiciled CSDs) and this correlates with the varying global models as described in the ECON study.

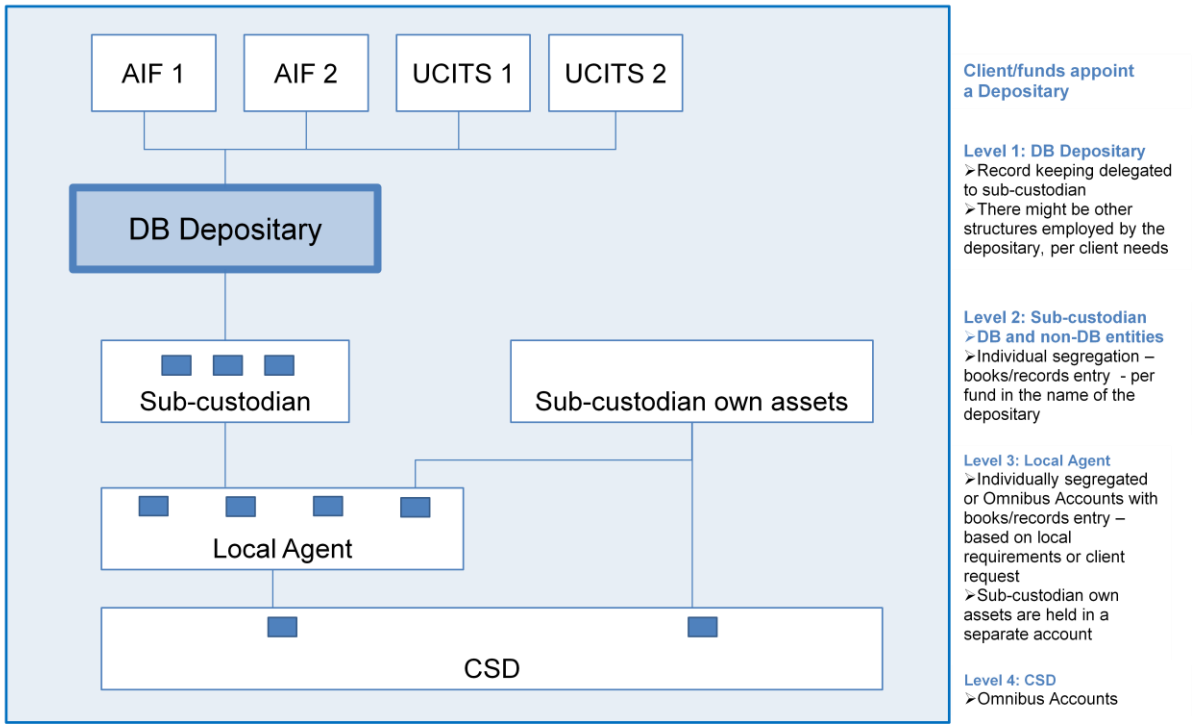
Q1g Naming conventions: Accounts are in the name of the Depositary, marked as: depositary's name/ [own account(or client's account or AIF clients or UCITS clients)]

At the CSD or with C&C delegate (Level 3 sub-custodian), the account opened for DB would be:

- "Deutsche Bank AG MMA A/C (where MMA stands for multi market agreement – which is the indication that this is an account to hold client assets)

- "Deutsche Bank AG MMA Re: Client_____" - where the clients request DB to open an account specifically for it and their specific business

DB acts as a Depositary (Fund Services)



In DB's Funds Services business, at level 1 where DB acts as a Depositary, an individually segregated model is enforced on the first level of sub-custodian that DB appoints as its Delegate (Level 2). This sub-custodian opens accounts for each fund (the depositary's client) in its internal books. Record keeping is delegated to the sub-custodian. The sub-custodian then appoints a local agent as its delegate. At the local agent level (level 3), two structures are possible which depend on market practice & local requirements, where either i) the local agent opens an individual account in the name for each fund; or ii) the local agent opens an omnibus account in the name of the sub-custodian for all types of client assets held by this sub-custodian (e.g. UCITS, AIFs, assets of other clients). If any, the proprietary assets of DB as the depositary are held in a separate account at the sub-custodian.

Q1b(iii)Reuse of assets: As with the Custody and Clearing business**,** reuse of assets is highly restricted in Fund Services. Systematic controls are in place to ringfence UCITS and AIF assets in DB's risk system on a client/Depositary basis and are therefore flagged as exempt from re-use or from any entitlement DB may have to mitigate risk in the event of the client/Depositary being overdrawn or in default.

Q1c Level of custody chain where omnibus accounts are used/essential: When DB acts as a Depositary (in Fund Services), an individually segregated model is enforced on the first level of sub-custodian that DB appoints as its Delegate and after this level omnibus accounts or individually segregated accounts are used based on local requirements or client request.

Q1g Naming conventions: As above, when DB acts as a Depositary, an individually segregated model is enforced on the first level of sub-custodian that DB appoints as its Delegate (Level 2). This sub-custodian opens accounts for each fund (the depositary's client) in the name of the funds in its internal books. When the sub-custodian appoints a local agent, two structures are possible at this level, which depends on the market practice & local requirements. As in Q1a, the local agent either i) opens an individually segregated account in the name of the depositary for each fund, or ii) an omnibus account for all types of client assets held by such depositary (e.g. UCITS, AIFs, assets of other clients). At the CSD Level, one omnibus account is maintained for all DB assets in the name of DBAG.

b) if you use 'omnibus accounts' (i.e. accounts, in which the assets of different end investors are commingled, rather than ea**c**h 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:

i) an explanation including at which level of the chain you use them;

ii) 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);

iii) 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

iv) the number or percentage of 'omnibus accounts' versus 'separate accounts' in your custody chain.

For answers to i), ii), iii) and iv), please refer to the answer to Q1a.

c) 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)?

Please refer to the answer to Q1a.

d) 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.

At each level of delegation, the model used can evolve. At the start of the custody chain (at the depositary level) Option 5 is utilised (where the assets are held in individual accounts) but from level 2 delegates onto CSDs as seen in the enclosed diagrams, Option 4 is broadly used.

e) 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).

Across all DB businesses, we distinguish between AIF, UCITS and other assets only on a books and records basis – please refer to the enclosed diagrams. For all other purposes, they are treated in the same way.

f) According to a Briefing Note[1] published by ECON in 2011, there are five basic models for holding securities with an intermediary: the trust model[2], the security entitlement model[3], the undivided property model[4], the pooled property model[5] and the transparent model[6]. 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:

i) What securities holding model do you use?

ii) Is such model the market standard in your jurisdiction?

iii) 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.

[1] http://www.europarl.europa.eu/document/activities/cont/201106/20110606ATT20781/20110606ATT20781EN.pdf
[2] See pages 14-15 of the Briefing Note.
[3] See page 16 of the Briefing Note.
[4] See page 17 of the Briefing Note.
[5] See page 18 of the Briefing Note.
[6] See page 19 of the Briefing Note.

iv) Does the model you refer to under f) 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.

g) 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.

For f) and g) please refer to the answer in Q1a.

Q2: 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?

As the specific form of asset segregation does not guarantee the return of assets in an insolvency scenario in many jurisdictions, other actions are taken to protect client assets (outlined below). DB recognises that, in the event of the insolvency of a sub-custodian, or the national CSD of which the sub-custodian is a participant, it will be the local insolvency law of the relevant jurisdiction that determines the distribution of property held by the sub-custodian and CSD.

Actions taken to protect client assets across DB include:

- Maintaining accurate books and records that will enable them at any time and without delay, to distinguish property held for one client from property held for any other client, and from DB's own property.
    - Maintaining all books and records necessary to give a complete record of all property held -whether by the sub-custodian or another third party- and of all actions taken by it or with respect to any property under the sub-custody agreement. Includes information reasonably requested by DB or required to comply with applicable reporting requirements.
- Procuring insolvency opinions from legal counsel in each jurisdiction to assess the legal and custody risk in each AIFMD market, including, for AIFs, an assessment of protection afforded by segregation under Article 98(3)(c) of the AIFMD Level 2 Regulations.
- Carrying out due diligence
    - Carrying out additional due diligence on risky markets on a regular basis.
    - Performing due diligence on sub-custodians and CSD's on appointment and periodically thereafter.
- Performing daily reconciliations of property balances recorded in the books and records of DB to sub-custodians and CSD's.
- Identifying a fallback sub-custodian in certain jurisdictions in the event of insolvency of a particular sub-custodian (not always possible in all markets).
- Appointing sub-custodians with contractual terms that require them:
    - To act in accordance with applicable local law and regulation including requirements relating to segregation and maintaining accurate books and records.
    - In relation to accounts opened for DB clients, to name any accounts opened in the sub-custodian's books and records in a way that indicates any property credited to the account is held as agent for the benefit of DB's clients and does not belong to DB.
    - To hold securities belonging to DB and DB clients separately from the sub-custodian's own property; to hold DB's own securities separately from securities belonging to DB's clients; and, at all times in accordance with Article 99 of the AIFMD Level 2 Regulation to record, in its own books and records, the entitlement of DB or DB's clients (including AIF and non-AIF clients) to property held by the sub-custodian or under the sub-custodian's control.

- To promptly register registrable securities in the name of DB, its nominees or its clients (in the case of client securities) as agreed in writing or in accordance with instructions.
- In relation to assets held by a Securities Settlement System (CSD), to procure that:
    - The property of clients of the sub-custodian and the sub-custodian's own property are held in separate accounts or, if not possible under the rules or practice of the Securities Settlement System, in another manner as required by local law or market practice and provided that the sub-custodian gives DB prior notice of the manner in which the property will be held.
    - The Securities Settlement System accepts instructions in relation to the property only from the sub-custodian.

There are additional actions that are taken in some businesses. Actions Prime Brokerage for example would also take include:

- Holding property belonging to DB clients under the terms of an English Law trust under which: the trustee is Deutsche Bank AG-London Branch which is the legal owner of the property; and the client which holds beneficial interest.
- Limiting AIFMD clients to approved markets only, where the risk of loss of a financial instrument held in custody is deemed to be minimal by the Prime Broker and where the sub-custodian complies with the delegation criteria under AIFMD.
- Establishing and maintaining an internal AIFMD risk committee to monitor all markets where AIF clients hold financial instruments in custody.
- Maintaining an overview of all assets held by AIF funds in each market daily for risk management purposes.
- Not using any CSD, clearing agency, sub-custodian or agent (other than a CSD) in the performance of its services under the prime brokerage agreement, or otherwise delegate any of its functions or powers, without the prior written consent of DB.

Q3: 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.

DB believes that in the event of insolvency of a sub-custodian, there would be little or no difference in terms of timing, speed of return or ease of identification of assets between an individually segregated client account and an omnibus client account where accurate and robust books and records are maintained. A number of factors are responsible to determining the return of assets, including: the operation of insolvency law within a jurisdiction, the scale and complexity of the business of sub-custodian (client numbers, product and service lines, geographical locations and group relationships), and the factors leading to the appointment of an insolvency practitioner.

As highlighted in Q1, it is arguable whether account segregation would fully satisfy the AIFMD policy objective of investor and client asset protection in Options 1 and 2 as insolvency rules in many jurisdictions do not support the view that individual segregation of assets guarantees their protection in insolvency. In some jurisdictions segregation appears to be a dispositive factor (a factor which brings about final settlement) when defined and mandated by national law and/or regulation. On the other hand, in other jurisdictions it is only a contributory factor only and must work with other factors such as the operation of law, registration of legal title and traceability of ownership through books and records as maintained through the custody chain to protect the assets. From our experience it is clear that there is no single factor, common to all jurisdictions in which we have appointed sub-custodians, that guarantees protection of client assets in the event of insolvency. Diversity in insolvency regime/securities law legislation across Europe means that diverse and sometimes conflicting national laws can potentially be a barrier to the transfer/reimbursement of assets in an insolvency scenario. In some markets settlement is halted or client assets are frozen immediately, whilst in other markets it

does not. The custodial structure for the relevant market should always match the accompanying insolvency opinion to provide the best level of protection for the client in that market.

In Greece for example, securities traded through ATHEX (equities) are required to be individually segregated throughout the custody chain and also at the CSD. However in the event of an insolvency of the sub custodian or CSD, this segregation practice is not the dispositive factor in relation to protecting client assets, registration is. Conversely, for Greek government debt, traded through the Bank of Greece settlement system (BOGS), it is not possible to open individually segregated accounts all the way through the system. In fact, accounts may only be opened at the sub-custodian level (i.e.: all clients of the sub-custodian are pooled in an omnibus account in accordance with local law which is a far lower level of segregation vs. Greek equities). In the event of an insolvency of the sub-custodian however, this (lesser) level of segregation is deemed to be dispositive and would protect clients.

The process that takes place in an insolvency scenario to identify and return assets and the impact of the form of account segregation is broadly as follows.

- The risk of insolvency of a sub-custodian and CSD is assessed (under Articles 89 (1) (e) of the AIFMD Level 2 regulation. When appointing a third party to whom safekeeping functions are delegated, Article 98 (2) (a) also requires an assessment of the regulatory and legal frameworks to enable a depositary to determine the potential implication of an insolvency of a third party for the assets and rights of an AIF.
- In the case of DB, assessment of custody risk has involved seeking specialist legal opinions for each jurisdiction in which it offers custody services to clients and has appointed a sub-custodian. The legal opinions are on insolvency of a sub-custodian and CSD within the particular jurisdiction. This allows for an informed response and corrective action to put in place required protective measures.

- We understand that, the key responsibility of an insolvency practitioner generally is to map-out all creditor claims of an insolvent sub-custodian (or CSD) and to identify the assets available to satisfy those claims and to realise assets for cash for the benefit of all creditors. A fundamental principle is that assets (and liabilities) not owned by the insolvent custodian do not form part of the insolvent estate.

- In this regard, strict segregation is required between the proprietary assets of the sub-custodian and the assets of the sub-custodian clients. Segregation will be achieved through: book entries that clearly identifies and delineates between proprietary and client assets and a system of controls that ensures that each of proprietary and client assets can be only be used for properly authorised purposes. Segregation will work to ensure that the integrity of the pool of client assets is maintained on an ongoing basis and therefore available to clients of a sub-custodian in the event of insolvency (and verified by ongoing daily or other periodic reconciliations).

- In insolvency, asset identification will include indentifying and distinguishing between the segregated sub-custodian's proprietary assets (available to meet claims of the creditors of an insolvent sub-custodian) and the property of the clients of the sub-custodian. In this case, regardless of whether client assets are held by a sub-custodian in individually segregated accounts or collectively in omnibus accounts, what is of primary importance is that client assets are and can be clearly identified and therefore separated from the estate of the insolvent custodian and the claims of its creditors.

- Once client assets have been identified and separated from the insolvent estate of sub-custodian, factors that will contribute to the timely return of client assets will be: the accuracy of books and records maintained by the sub-custodian, the clients of the sub-custodian (which will include daily or other periodic reconciliation) and through the custody chain which will enable traceability through the different levels of the custody chain; and registration and/or recording of legal title under the local law of the insolvent sub-custodian.

It should be noted that as long as all accounts are set up correctly with robust books and records, transfer of assets would not create an issue in Option 4 as it requires the

Depositary's own assets to be held in a different account at the delegate and the delegate's assets to be held in a different account to client assets delegated to it. It is also important that the custodial structure in the relevant market is set up to afford the best protection as a matter of local law (i.e.: English law "trust model"). Under other laws this may require physical AIF-by-AIF client accounts.

Please also refer to the answer to Q19.

Q4: 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:

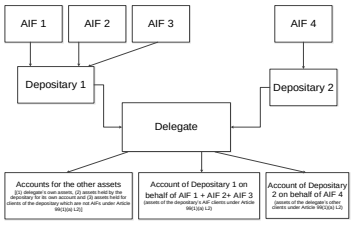
i) effective reconciliation,
ii) traceability (e.g. books and records), or
iii) any other means (e.g. legal mechanisms).

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

Please refer to the answers to Q2 and Q3. Q2 highlights the measures DB takes to ensure protection of client property against insolvency events and furthering the objectives of investor protection. These include measures around reconciliation and therefore traceability of assets and legal mechanisms. Q3 sets out DB's view that there is little or no difference in timing, speed of return and identification of assets in insolvency when using an individual or omnibus account structure. It also includes a detailed study on insolvency process and how traceability can be achieved by maintaining robust books and records and with effective reconciliation through the chain of custody.

Q5: In the chart below (option 1 of the CP), AIF 1 would only have recourse against Depositary 1 under the PRIMA concept.

a) 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?



No there would be no difference. This is because for Depositary 1 it will be business as usual and only Depositary 2's accounts down the chain would be impacted. With robust books and records down the chain of custody, there should be no difference. The insolvency administrator appointed for Depositary 2 would provide the Delegate with a list of AIF4's assets, establish competing claims, and return the residual amount back to them. Depositary 1 and its assets would be unhindered and available as normal.

b) 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?

No, there is no difference. If the delegate was to become insolvent, Depositary 1 and 2 would collate their lists of assets, send to the delegate's administrator and request back assets regardless of whether AIF's were comingled from different depositaries in the same account or separately held. This is because with robust books and records, the administrator would be able to trace the asset location and identify ownership and return them.

Q6: 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:

a) describe how segregation in books and records would ensure the aforementioned investor protection;

b) 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

c) 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].

In accordance with Article 21(8) of AIFMD and Article 22a UCITS rules, assets are clearly identifiable in books and records which will allow the Depositary to further identify assets on a client level. Robust operational controls (due diligence, operational efficiency, strong control frameworks, scalable and efficient technology) ensure that the books and records, supported by daily reconciliation, distinguish proprietary assets from client assets. In the event of the default of the custodian the client assets are separate to the defaulted party's estate.

See answer to Q1 for more detail on segregation maintained at each level of a custody chain.

Q7: 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]?
  - Through T2S
- Prime broker services
- Tri-party collateral management / securities lending.

Omnibus accounts are operationally more efficient, faster to operate and cheaper to maintain. To move away from this model would make Europe more expensive to operate in, operationally

[7] See paragraphs 29 and 30 of the Standards for the Custody of Collective Investment Schemes' Assets – Final Report (FR25/2015): "*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).

[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).

inefficient, could be subject to settlement delays (T+2 settlement in 2 business days after a transaction, may not even be achievable) and could deter investors.

The benefit of omnibus account structures, at sub-custodian / CSD-participant level is to enable cross-border settlement:

- The use of omnibus accounts which reduce congestion and operational complexity facilitates cross border flows, which aligns with the European Commission's T2S Strategy to enable borderless, real-time settlement;
- There are economies of scale as omnibus structures reduce the need for multiple accounts impede the seamless flow of securities and collateral cross border;
- It provides a quick route to market for new investors to the European eco-system; and
- It also increases the mobility of liquidity i.e.: T2S auto-collateralisation is dependent on omnibus accounts.

As highlighted in Q1, from an agency securities lending point of view, since triparty collateral service providers rely on the ability to use omnibus account structures and transferring ownership on a books and records basis between their clients, they would effectively cease to be able to operate on behalf of UCITS/AIF funds if segregation beyond the level of their own books and records is required. As widespread users of triparty for collateralisation of loans and cash collateral reinvestment (via triparty reverse repo), the need for segregation will have a significant impact on securities lenders, including Depositaries and third-party lending agents.

DB's third-party lending model utilises a clearing account structure whereby Depositary's securities are held in DB ASL's omnibus client account (as outlined in Q1) where loans can be bulked together across multiple AIFs/UCITS/ /other clients. This enables DB ASL to utilise many smaller funds which would otherwise be too small for borrowers of securities to approve as counterparties and also to maintain full control / oversight of the settlement process (ensuring that there is no under-collateralisation).

Segregation of accounts beyond the Depositary level (or beyond the Delegate level in DB's model) will result in smaller UCITS/AIFs becoming ineligible for participation in agency securities lending programmes (borrowers require the economies of scale facilitated by lending agents), resulting in loss of revenue to their investors. Although a small number of large funds may be supported in a segregated account model, the complexity of dealing with such structures, in comparison to the omnibus models which will still exist for non-UCITS/AIFs, will limit their participation in any lending activities; the fee they are paid for any given security will likely be lower than that paid to more 'straight-forward' lenders and the overall returns to their investors will be reduced to compensate.

This is addressed from a Prime Brokerage perspective in Q14.

Q8: 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.

Please find an illustration below of the number of additional accounts that would need to be opened at each level of the custodial chain if Option 1 was mandated vs. Option 4.

The example uses the following inputs for each level in the chain:
10 depositaries
10 level 1 sub-custodians (each servicing 10 depositaries)
1 level 2 sub- custodian
1 CSD

<table>
<tr><th></th><th>Option 4</th><th>Option 1</th></tr>
<tr><td>At the depositary</td><td>x number of funds at each depositary</td><td>x number of funds at each depositary</td></tr>
<tr><td>At the level 1 sub-custodian</td><td><u>Per depositary</u>
<table><tr><td>Account for AIFs
1 account x 1 depositary</td><td>1</td></tr><tr><td>Account for UCITS
1 account x 1 depositary</td><td>1</td></tr><tr><td>Account for other assets
1 account x 1 depositary</td><td>1</td></tr><tr><td>Total Accounts</td><td>3</td></tr></table><u>For ten depositaries</u>
<table><tr><td>Account for AIFs
1 account x 10 depositaries</td><td>10</td></tr><tr><td>Account for UCITS
1 account x 10 depositaries</td><td>10</td></tr><tr><td>Account for other assets
1 account x 10 depositaries</td><td>10</td></tr><tr><td>Total Accounts</td><td>30</td></tr></table>Plus x*accounts for assets of other x*clients of level 1 sub-custodians</td><td><u>Per depositary</u>
<table><tr><td>Account for AIFs
1 account x 1 depositary</td><td>1</td></tr><tr><td>Account for UCITS
1 account x 1 depositary</td><td>1</td></tr><tr><td>Account for other assets
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1 account x 10 depositaries</td><td>10</td></tr><tr><td>Account for UCITS
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1 account x 10 depositaries</td><td>10</td></tr><tr><td>Total Accounts</td><td>30</td></tr></table>Plus x*accounts for assets of other x*clients of level 1 sub-custodians</td></tr>
<tr><td>At level 1 sub-custodian (PB)</td><td>x number of funds at the Prime Broker with separate accounts on a fund by fund basis opened on its internal books and records</td><td>x number of funds at the Prime Broker with separate accounts on a fund by fund basis opened on its internal books and records</td></tr>
<tr><td>At the level 2 sub-custodian & at the CSD level</td><td><u>One x level 1 sub-custodian (servicing ten depositaries)</u>
<table><tr><td>Omnibus account for AIFs/UCITS/other assets of all depositaries
1 account x 1 sub-custodian</td><td>1</td></tr><tr><td>Total Accounts</td><td>1</td></tr></table><u>Ten x level 1 sub-custodians</u>
<table><tr><td>Omnibus accounts for AIFs/UCITS/other assets of all depositaries
1 account x 10 sub-custodians</td><td>10</td></tr><tr><td>Total Accounts</td><td>10</td></tr></table></td><td><u>One x level 1 sub-custodian (servicing ten depositaries)</u>
<table><tr><td>Account for AIFs
1 account x 10 depositary</td><td>10</td></tr><tr><td>Account for UCITS
1 account x 10 depositary</td><td>10</td></tr><tr><td>Account for other assets (assets of other clients of level 1 sub-custodian and other assets of the depositaries)
1 account x 1 sub-custodian</td><td>1</td></tr><tr><td>Total Accounts</td><td>21</td></tr></table><u>Ten x level 1 sub-custodians (each servicing ten depositaries)</u>
<table><tr><td>Account for AIFs
1 account x 10 sub-custodians x 10 depositaries</td><td>100</td></tr><tr><td>Account for UCITS
1 account x 10 sub-custodians x 10 depositaries</td><td>100</td></tr><tr><td>Account for other assets (assets of other clients of level 1 sub-custodian and other assets of the depositaries)
1 account x 10 sub-custodians</td><td>10</td></tr><tr><td>Total Accounts</td><td>210</td></tr></table></td></tr>
</table>

On the basis of our understanding, to use Option 4 would result in 10 accounts being opened at a level 2 sub-custodian or CSD vs. 210 accounts being opened using Option 1. The number of the accounts to manage for the level 1 sub-custodian would be even greater if they need to access more markets, as the same structures at level 2 would need to be replicated for each market.

If Option 1 was mandated, then a large AIFMD client operating in 50 markets would have to initiate a significant number of asset transfers out of the omnibus account for that market into smaller depositary specific omnibus accounts. AIFs would not want this as mandating such a huge transfer of assets across global markets will inevitably lead to confusion, complexity and operational cost which would likely be charged back to the clients.

For options other than Option 4, in addition to the requirement to create new accounts at multiple levels in the chain of custody, there will also be an impact to the entry of an existing fund into a new market. There will be delay due to the requirement to open a new account in the name of the specific fund at the CSD – rather than being able to use the existing omnibus account as is the case today. This may negatively impact the ability of the fund to trade as it wishes. The alternative is for the fund to open an account at the CSD in every country in which it may trade in the future, in order to be ready when it wishes to enter a market. However, maintaining such accounts will incur account opening & maintenance fees.

Q9: 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)?

Building on the illustration of the number of additional accounts that would be required in Q8, efficiency will be directly impacted as netting would be not be feasible in most instances.

From an agency securities lending point of view, efficiency would be impacted as each additional account introduces a new set of instructions and increases the risk of settlement failure (compared with DB's current operating model which consolidates all client holdings via one clearing account). The risk of fails could be greater with individual account segregation in agency securities lending programmes due to the short settlement cycle (T+1 or same day); this will likely lead to lower utilisation of UCITS/AIF clients in agency securities lending programmes, but may also lead to funds withdrawing from lending if they do experience fails.

From a netting perspective, since triparty collateral service providers rely on the ability to use omnibus account structures and transferring ownership on a books and records basis between their clients, they would effectively cease to be able to operate on behalf of UCITS/AIF funds if segregation beyond the level of their own books and records is required.

From a Custody and Clearing perspective, a proliferation of accounts would be operationally burdensome and would incur a cost at each stage of the custody lifecycle - which ultimately would be borne by the investor. Again, this could impact the desirability and affordability of investing in Europe. When considering segregation and the increased number of accounts obvious negative factors are outlined below with more detail and indication of cost impacts in Q11.

- Impact to the Investor/impact to the Depositary:
  - Would require greater operational self sufficiency with regards to: funding, inventory management, operational capacity and enhanced systems to ensure efficient and timely settlement (of paramount importance with the segregation provisions of CSDR Article 38).
- Increased Cost derived from:
  - Cost of opening and servicing additional custody accounts this would impact all actors in the custody lifecycle
  - Increased reconciliation demands throughout the custody chain
  - Increased client reporting (more accounts to report on)
  - Operational efficiency enables volume compressions and reduces transaction costs which the investors benefit from
- Decreased Operational Efficiency derived from:

- Increased accounts will amount to increased settlement instruction volume and complexity which in turn will increase settlement mis-matching that will lead to delayed settlement and reduced settlement and liquidity efficiency.
- In addition, settlement of corporate actions across multiple segregated accounts will be more difficult.
- Inability to net - flow that was once internalised would need to settle at the CSD, more flow, more instructions with diverse standard settlement instructions (SSIs) to be matched timely and in accordance with CSDR
- Reduced settlement efficiency increases operational and reputational risk and will also add extra complexity to the CSDR Settlement Efficiency provisions which will ultimately add to greater costs in transacting in Europe
- It needs to be seen if static data repositories be able to cope with a very large onset of new accounts
- Increased reconciliations throughout the custody chain will be exposed to the risk of operational error
- Reduces the flow of liquidity which will have issuer and market impact

- Increased KYC on-boarding burden. With strong focus on AFC / AML measures there would be significant delays in implementing / bringing clients onboard and would require a change in naming conventions to support.

From a settlement perspective, the amount of messages which will flow through various systems would increase as settlements which could have been internalised previously would have to be sent for external settlement going forward due to the inability to net internally. Overall the introduction of full segregation will have an impact on headcount and will increase risks of processing settlement instructions and corporate actions, making enhanced automation and enhanced supervisory mechanisms necessary.

Whilst the harmonisation efforts on settlement processes and corporate actions in Europe are adding considerable value, its implementation remains a slow process. Within T2S as one example, not all CSDs are making full use of the harmonised platform and will join T2S with reduced functionality. It is unclear whether the T2S platform will be equipped to handle millions of additional accounts should Option 1 be mandated, and this may impact the functional performance of T2S. We understand that markets which have an individually segregated model domestically are joining T2S explicitly with a so called “layered model” (only bringing omnibus accounts to the T2S platform and leaving the individual accounts in the domestic market). We believe that by making the individual segregated model mandatory it will increase cost in the market.

Q10: Many respondents to the CP argued that option 1 in the CP would prevent asset managers from:

a) executing block trades; and

b) 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.

We agree that Option 1 could prevent block trading – especially for managers that manage AIF and non AIF funds. Trades in this scenario could not be bulked as they would need to settle into different accounts. This would negatively impact best execution, increase the risk of failed trades and ultimately reduce settlement efficiency. These costs and risks are likely to have to be borne by underlying investors. In agency securities lending programmes, where the omnibus structure (at the level of the ASL DB delegate) allows multiple participants to be included in one transaction - the ‘bulking’ only works because the counterpart can book one transaction. The omnibus structure (at the level of the ASL DB delegate) facilitates the reallocation of participants within a loan during the loan’s lifetime and individually segregated accounts at the level of the ASL DB delegate do not allow this and again increases settlement risk. In the latter case, (individually segregated accounts at the level of the ASL DB delegate) the onus would be on the borrower to return securities to the correct account (from potentially many hundreds) rather than allowing the lending agent to execute a reallocation internally.

For more detail on internalised settlements being restricted, please refer to the answer to Q9.

Q11: 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, prime brokers, delegates, their clients and the different markets?

From a prime brokerage perspective, Option 1 would require instructions to be issued to sub-custodians to open a substantial number of new accounts which will add complexity and cost to the operations of sub-custodian's. The current prime brokerage business model does not involve charges for clients for custody services but with a far greater number of accounts being opened, the sub-custodian could pass these costs onto the prime broker who would start charging clients directly for custody. Although it is difficult to quantify precisely these additional costs, the impact may be sufficient to reduce the overall competitiveness of regulated funds (AIFs/UCITS) when compared to out of scope funds.

From a Custody and Clearing perspective, looking at the markets that have already a high segregation of accounts requirements (i.e.: Baltic and Nordics), it would appear that full segregation would lead to higher costs from an operational maintenance perspective, but there is also a lengthy account opening process.

When DB is acting as the Depositary, the change to a fully segregated model at local agent & CSD level will not increase the direct costs of the Depositary associated with its oversight function. However, increased costs to the funds (and therefore their investors) are anticipated indirectly via increased sub-custodian and/or CSD fees as an example and could be passed onto the fund as part of the Depositary fee. Examples of these indirect costs could be:

1. Account Reconciliation: Many reconciliation processes are automated so an increase in accounts may not directly lead to increased reconciliation costs (not including running costs associated with these systems), but it will increase the number of breaks that will need to be investigated through the chain of intermediaries. This is often a manual process which would require an increase of 2-3 full time employees for each sub-custodian for account setup and additional controls to ensure the breaks are resolved as efficiently as possible with limited impact to the investor. There will also be additional costs for further automation.

2. Separate settlement instructions required to be submitted to the CSD for each account will directly increase processing & operational costs.

3. There will be a large impact on Corporate Actions processing:

    - Announcement Capture and Notification: increase in SWIFT traffic and messaging costs as outbound messages would need to be sent on a 1:1 basis rather than like in the current omnibus structure where messages can be sent for each account (see example below). Cost increases here are unknown as these are likely to be obtained within SWIFT IT messaging fees. An increase in headcount would be required to review any free text on the inbound message. Increased messaging may also mean a delay in sending the information through the chain of intermediaries to the end investor. Additional costs are likely to be passed back to the end investor. It is difficult to quantify the increase of messages, however the following example may be of some assistance:

        - Approximately 4 SWIFT messages go out for each corporate action with every message containing various updates - all received on one omnibus account;
        - The omnibus account has 20 underlying clients, all of which have 100 sub-accounts. Therefore under Option 1 there would be 2,000 segregated accounts;
        - The impact would be: approximately 8,000 SWIFT messages for each corporate action inbound from the CSD. All of which require reviewing as part of the due diligence process. Additionally, approximately 8,000 SWIFT messages for each corporate action have to be sent to the underlying clients.

    - Corporate Action Elections (inbound and outbound): Due to the variations in each market for elective corporate actions segregation would potentially increase the operational risk within

the elective space. The process can be manual in some CSDs, resulting in increased controls being required and operational risk. Due to risks associated with increased accounts, in some markets this may have an impact to the deadline which is set by the custodians within the transaction chain as operations areas would require more time to process elections - especially at the CSD where the number of accounts may increase from one to 100+ for each client.

- Proxy: with the exception of market instructions, further account segregation would greatly increase the number of instructions that are required, to be sent to the CSDs. In some markets participants need to lodge instructions by a paper form for each segregated account. Electronic voting will also be for each segregated account which in turn increases vendor costs where ever third parties are utilised, and in addition physical attendance would increase the Power of Attorney (POA) requirements.

4. Settlements: In the markets where full segregation is not required the sub-custodians perform thousands of internal settlements each month. The more segregation is required, the less internal settlements could be done. This means more costs for the Depositary as well for the sub-custodians themselves. Also, more external settlement instructions would trigger more SWIFT traffic and the SWIFT costs resulting in around 25% more settlement costs.

5. Billing**:** If the number of accounts with sub-custodian increases, reconciliation efforts will increase as the sub-custodians will receive an invoice for each client account level & will be required to manage the client billing process. If the monthly invoices would need to be sent for every sub-account, their number would increase significantly in the segregated accounts model structure.

Costs highlighted will be incremental to each other.

Q12: Are there any advantages of using omnibus accounts not covered in your responses to other questions?

An additional advantage of an omnibus account set up is the time-to-market component which can be vital to some fund managers. Providing appropriate documentation once as part of the onboarding at the Depositary would be much more preferable to undergoing multiple KYC and AML processes at each level of the custody chain.

Therefore in an omnibus set up, an AIF/UCITS is able to start its business as soon as the accounts at the Depositary and the Prime Broker are opened instead of having to wait until the accounts have been opened throughout the custody chain, lengthening the on-boarding process by weeks (some CSDs still take 4-6 weeks to open one additional account).

Q13: 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] (including if this may raise any operational difficulties)? Should you consider that there is any impact, please explain why.

More mandated segregation at the clearing level might give the CCP fewer assets to net. Therefore the anticipated reduction in credit risk that the CCP wants to achieve, might not be possible and could lead to an increase in the CCP risk models and subsequent increased margin requirements, etc.

Q14: 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:

a) tri-party collateral management arrangements;

[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*".

b) prime brokerage arrangements.

In terms of triparty collateral management arrangements, please refer to the answer to Q7.

In the context of prime brokerage, if Option 1 were to be mandated, this could potentially have a significant impact in all markets in which DB's PB operates. Potential required actions might include:

- A full assessment, in relation to all global markets in which custody services are offered, of the impact of the mandated changes to include:
  - Capacity of sub-custodians (and/or CSD's) to provide mandated account structures.
  - Contractual terms in custody agreements and client prime brokerage agreements.
  - Client disclosures, such as client reporting.
  - Internal control systems, operational procedures and IT systems.
  - Custody model economics (potentially changed cost and revenue profiles).
  - At a more strategic level, approach going forward and custody offering.

  This will have to be conducted across all markets to accommodate jurisdictional differences especially outside the EU – for example, some markets already operate AIF-by-AIF account structures (Option 5 of the December CP).

- Based on the outcome of impact assessment:
  - Amended custody agreements may need to be negotiated executed, as well as client prime brokerage agreements and client disclosures.
  - Design, test, execution and implementation of new and changed control systems, operational procedures and IT systems, as required.
  - Setting-up of new account structures to include:
    - Issue new instructions to all sub-custodians to open a specific depositary account for each AIF/UCITS/other client.
    - Issue instructions both internally and externally to sub-custodians for book entry transfers of assets of AIFMD clients into the newly established accounts; execute internal book entry asset transfer instructions; and completion of comprehensive internal and external reconciliations with sub-custodians of book entry transfers.
    - Initially, sub-custodians we have appointed would have to ensure that the asset transfers set out above are, if required under local law and regulation, are matched at the CSD level.
  - Managing changed operational risk arising from greater complexity through the custody chain including:
    - Increased number of failed trades owing to more and complex account structures increasing the potential for error.
    - New and additional account reconciliations and break resolution.
    - Capacity constraints within operational process could be reached especially in the processing of corporate actions.
    - Rehypothecation, which benefits clients by allowing them to provide their own assets for collateral against their borrowing requirements, would be impacted as highlighted in Q1. the transaction costs of such arrangements would go up as would the opportunity to rehypothecate. Two outcomes are possible: i) increased costs of borrowing which would passed back to the AIF eating into fund performance and/or ii) an increase in the amount of assets a fund would make available to be rehypothecated in order to partially offset such increased costs.
  - Withdrawal from markets as required.
    - Some markets in which we currently operate would potentially be rendered out-of-scope as sub-custodians in those markets would not, under local domestic legal and regulatory framework or market practice, be able to offer and operate an account structure compliant with Option 1
    - More broadly, the key question to be resolved will be how to provide continued uninterrupted access to established key markets, such as the US, for AIF and UCITS investors.

Q15: 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?

Please refer to the answer to Q11 and Q14.

Q16: 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?

With regard to legal certainty risk, Option 1 would increase the number and complexity of account structures. It would take longer for relevant parties to clearly identify and enforce their property rights.

In relation to attendant operational risk, whenever there is a change in settlement arrangements, including new accounts to open/settle with/reconcile to, there is the potential for increased errors. Increased numbers of accounts means there is an increased risk that transactions can be posted to incorrect accounts or to issue settlement instructions etc. to incorrect accounts.

Although the control and mitigation of such risks is, in part, the responsibility of a custodian, there would also be an impact on the asset manager and brokers who are responsible for issuing and executing instructions. DB will continue to support initiatives to strengthen regulation in order to provide better protection for investors, but any changes should be proportionate to the benefits and increasing operational risk with limited benefits would be at odds with best market practice and what regulation should be aiming to do.

Q17: 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.

Please refer to the answer to Q11.

Q18: 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.

T2S needs to allow CSDs to provide its participants with the possibility to use large numbers of accounts for individual client segregation as in CSDR Article 38, which places this obligation on CSDs. A CSD is considered an 'issuer CSD' of a given security if the initial issuance of this security was deposited with this CSD. An 'investor CSD' allows its clients to hold securities in its books which were issued by another CSD (issuer CSD). If investor CSDs in a custody chain are located on T2S and considered delegates (under obligation to segregate) and there are more than one investor CSDs in a custody chain i.e.: a so called "relayed link", then there is the possibility of a performance impact on the functioning of T2S.

This technical impact arises out of the fact that the full account structure for AIF/UCITS holdings in the books of the first investor CSD on T2S will need to be replicated in the books of all other investor CSDs in the custody chain before reaching the issuer CSD. Such replication will involve not only opening up the relevant inter-CSD accounts on T2S, but also opening up the appropriate mirror accounts on T2S.

It is difficult to provide an estimate of the size of the technical impact on T2S on the opening, maintenance and use of these additional accounts (and mirror accounts). Even if the technical impacts on T2S of segregation requirements placed on AIF and UCITS assets are limited, it is important to consider the consequences for T2S if these segregation requirements are generalised so that they apply to assets held on behalf of all types of investor.

If a view is taken that additional segregation requirements through the chain of custody give further protection to holders of UCITS and AIF, then there is a significant possibility that authorities will in due course take the view that all categories of investor should benefit from these additional protections. Segregation up the chain for a part of a custody chain that is located on T2S involves opening up additional technical accounts on a common IT infrastructure. Opening up these additional technical accounts gives no apparent additional protections, but it does very clearly create the possibility for additional cost and complexity, with a reduction in the efficiency and capabilities of the IT infrastructure.

Q19: Many respondents to the CP argued that AIFs risk being shut out of key markets due to the following:

a) 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

b) 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.

Yes, DB is in full agreement with this statement. Some markets, as set out in Q14, already operate AIF-by-AIF accounts (Option 5) so Option 1 would weaken the level of protection afforded to the client. Furthermore this model would naturally lead to Prime Brokers concentrating relationships with key Depositaries to reduce account proliferation and would increase concentration risk. It would also increase the relative attractiveness of trading synthetically via contracts for difference or similar investments due to cost, efficiency and access to leverage. Further, all DB custody contract documentation will have to be amended across c.70 jurisdictions with increased cost potentially being passed onto the AIF/UCITS clients as applicable.

In jurisdictions where there is more segregation than Option 4, i.e.: Kuwait and Taiwan, Option 5 is the norm with individual segregation through the chain of custody due to law, regulation or market practice. A wholesale move to Option 1 could cause issues where markets are not be able to accommodate the shift for infrastructure reasons, or where AIF/UCITS clients cannot invest due to segregation being less than currently mandated by local laws. As a further example, omnibus account structures are market practice in the US and moving away from Option 4 would require a fundamental alteration to custodial structures in the US market. If the custodians in the US were unable to make this adjustment, AIF/UCITS clients would be unable to hold their assets in that jurisdiction.

From an agency lending perspective – if further segregation was mandated at the level of ASL delegates, this might also have a negative effect for accessing the markets for AIFs and UCITS as in the answer to Q1 and Q7.

Please also refer to the example provided in the answer to Q3 on the Greek equity market (individual segregation) rules vs. debt market (omnibus segregation) rules.

Q20: 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.

A fully segregated model (individual accounts throughout the custody chain) is used by DB is in the Custody and Clearing business on an exceptional basis (10% of the time) driven by client request or local requirements in the United Arab Emirates, Kingdom of Saudi Arabia and Pakistan as a few examples. In these markets, DB holds AIF and UCITS assets on behalf of some Depositary clients (DB acts as sub-custodian) and does not delegate this function any further – DB in this case is the last intermediary before the CSD. At the CSD level in these markets, accounts are also opened on a beneficial owner basis; each beneficial owner (i.e.: each underlying client of our Depositary client) has their own UIN – Unique Investor Number (or equivalent term in the local market).

Q21: 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?

It is difficult to estimate, with any precision, the impact of change on the costs of sub-custody service across a custody network, as some sub-custodians have not had to segregate according to Option 1 thus far. The impact of service pricing will depend on the impact of changes on the economics of the sub-custody business model and the appetite of sub-custodians to pass on any increased cost in the

context of individual commercial offerings. This would need to be multiplied across 70 markets for the Prime Brokerage business for example, and for 10 to 15 Depositaries and the scale becomes more clear. As mentioned previously, Prime Brokers typically do not charge AIF clients for account opening or general custody services but significant changes to the costs incurred may result in new charges passed to AIFs.

Please also refer to the cost analysis in Q11 – which will have to be replicated by each of the delegates in the chain should the segregated model be mandated.

Q22: 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.

The optimal solution would be for ESMA to mandate Option 4, but to allow for flexibility where law, regulation and market practices demand otherwise. Any mandated asset segregation model that

deviates from Option 4 (allowing AIFs, UCITS and other assets to be held in the same omnibus account and pools assets from different depositaries) via Option 1 or 2 or other options, could lead to unintended consequences such as barriers for clients to invest in certain markets, certain key businesses no longer being viable as well as operational complexities, risk and additional cost without enhancing protection for client assets.

The policy objective is to provide the safest level of access to global markets for clients. This will be achieved by analysing the market practice and accompanying insolvency opinion for that market with a view to setting up the custodial structure in line with the insolvency opinion in order to achieve the highest level of protection on insolvency for the client.

Please also refer to the answer to Q1 and 19.

Q23: Articles 38(3) and (4) of the CSDR state that a CSD shall offer its participants the choice between:

i) 'omnibus client segregation' at the CSD level (holding in one securities account the securities that belong to different clients of that participant);

ii) 'individual client segregation' at the CSD level (segregating the securities of any of the participant's clients, if and as required by the participant).

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

a) 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.

No. Experts are appointed and legal advice is sought for each individual market to determine what the appropriate model is to ensure full investor protection in the case of insolvency. It is not a fund managers' expertise to decide which account structure is best for any given market. We note however, that clients can have specific views on which sub-custodian should be appointed in specific markets.

b) 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.

No, this would not achieve the policy objective. An investor of a fund buys into the strategy of a fund and evaluates risks involved in the investment. Additional segregation – as outlined earlier in the response – is irrelevant for the purposes of guaranteeing asset recovery in insolvency in many jurisdictions, and providing the investor with this information could conversely suggest to the investor that a risk exists where none is.

c) Please comment on any implications of such a regime for the account related provisions under Article 39 of EMIR.

[10] However, under Article 38(5) of the CSDR a CSD and its participant shall provide individual clients segregation for citizens and residents of, and legal persons established in, a Member State where required under the national law under which the securities are constituted as it stands at 17 September 2014.

As the evidence provided by EMIR implementation shows, there has been very limited take up of the opportunity for segregated clearing and margin accounts throughout the industry despite having the legal right to segregate. DB would expect the same to occur with the suggested change in models. DB's clear preference is for Option 4 to be implemented or to allow flexibility to operate as per local laws at present (whether omnibus or individual account segregation). Timely reconciliation of assets from a books and records perspective is of paramount importance and Option 4 is the market standard whilst other options can increase inaccuracy and time required for reconciliation.

Q24: Please describe any alternative regime which, in your view, would achieve the policy objective described in the above introduction.

Please refer to the answer to Q22.

Q25: Do you see a need for detailing and further clarifying the concept of "custody" for the purposes of the AIFMD and UCITS Directive?

Yes. As highlighted in DB's response to the European Commission's Call for Evidence on regulatory framework for financial services in January 2016, there is no common definition or single set of standards of custody and safekeeping of assets in EU legislation. At the moment, a variety of market participants provide custody services including Central Securities Depositaries (CSDs), traditional custodians, brokers, asset managers and prime brokers but all under different regulatory frameworks. SFTR, CSDR, UCITS, AIFMD, EMIR, and MiFID all contain inconsistent requirements for custodians. A harmonised EU definition and single set of standards would be beneficial and ensure greater investor protection.

The scope of the term custody for financial instruments should be differentiated from the custody of other assets (such as precious metals, art, wine etc.) Custody services consist of all of the below mentioned services, and, as applicable to the non-tangible securities, is done at each level of the intermediaries (depositaries, sub-custodians and CSDs).

From a functional point of view DB believes that custody is broader than the pure safekeeping of securities and should include the following activities:

1. Securities Account: the infrastructure for the maintenance of securities accounts (CSDs, depositaries and custodians offer these services)
2. Safekeeping: securities held in a securities account (CSDs, Depositaries and custodians offer these services)
3. Record keeping: recording rights of clients to securities
    - Settlement Services: crediting/debiting of securities based on the client instruction , or triggered by corporate actions, and keep the respective records of securities
    - Registering other rights to securities, e.g. pledge and other encumbrances (provided mainly by the custodians, however some of the CSDs can also provide such services)
4. Collecting information related to securities recorded in the securities accounts and provide information on the securities and their issuers (such as annual general meetings and related proxies) to the clients
5. Processing of corporate actions with regards to the securities in the custody account including any value added services.

To consider whether or not a delegation of custody functions has taken place, the above functions 1-3 are essential. Where the custodians provide services 4-5, but without parallel performance of 1-3, it should not be considered as delegation. Indeed AIFMD and UCITS support this by not allowing delegation of any custody service other than the "safekeeping" of the assets.

Clarification from ESMA in the difference between the terms 'custody' and 'safekeeping' would be welcome as they are seen to be used interchangeably. As the term "custody" is being used for services which are exempt and which are captured by delegation requirements – it appears that defining the term "custody" won't take away the confusion. To address the uncertainty, the

terminology used to describe the services captured by the delegation and those exempt from it - should be differentiated. There is also uncertainty as to the criteria for the exemption from delegation requirements, which could relate to the services provided, the purpose for the services being provided or by whom these services are provided. UCITS and AIFMD should be aligned and core services provided by CSD's listed under CSDR should be expressly excluded.

Q26: 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:

a) initial recording of securities in a book-entry system ('notary service');

No. This task is described in CSDR as one of the core activities of a CSD. Due to the fact that it has a specific purpose, this is an exclusive service provided to the new issuances only by the Issuer CSD or/and common depositaries.

It should be also added further that such services exercised by the Issuer CSD should not be considered as delegation of custody function for that reason

Where however the CSD is not the issuer CSD for certain securities but connects to the CSD (similar as any other CSD Participant) then we believe that provision of such services is not possible.

b) providing and maintaining securities accounts at the top tier level ('central maintenance service')[11];

No. This task is described in CSDR and one of the core activities of a CSD. As long as it involves opening of the accounts, safekeeping and records keeping in such accounts – this is a custody service (for further detail, please refer to the answer to Q25). However, due to the fact that it has a unique status – top tier accounts can only be operated at the level of the Issuer CSDs - it should not be considered as delegation. A CSD participant (local sub-custodian) would in this situation utilise the same account type at a given Issuer CSD as an Investor CSD linked to it. Here the Investor CSD and local sub-custodian compete for the same client base albeit at an uneven playing field. The participant in the investor CSD has then made a commercial decision to delegate the safekeeping and settlement services to the Investor CSD rather than the local sub-custodian.

c) maintaining or operating securities accounts in relation to the settlement service;

This is one of the custody services that all players in the chain perform. However it should be noted that the "securities accounts" might be operated /maintained at different tiers in the custody chain in parallel:

- Issuer CSDs operate top tier accounts
- Investor CSDs and Issuer CSD Participants operate second tier accounts
- Investor CSD Participants and Issuer CSD Participants Clients operate third tier accounts

It would be helpful if ESMA could clarify the different levels of the custody chain and how they interact with each other.

d) having any kind of access to the assets of the AIF/UCITS; or

It is not clear what type of access is meant here. There might be different legal arrangements made by a client and authorising different people to have access to its assets, without these entities providing custody services. Access to the assets can be granted on the basis of power of attorney, or through the appointment of the securities lending agent. Even if securities lending agent has access to the client's assets – the service is to facilitate the lending of the assets belonging to the client (which is based on the respective contractual arrangement), and as a such it does not provide the safekeeping of securities itself even though the same legal entity might be appointed as a sub-custodian of such securities.

[11] These services are part of the core services of central securities depositories under Section A, point 2 of the Annex to Regulation (EU) No 909/2014 ("CSDR").

Thus, without providing safekeeping services, an access to the assets of the AIF/UCITS should not be considered custody. Custody of securities itself should be differentiated from the rights to access these securities, or the purpose of why the securities are being accessed, e.g. certain access rights granted to the securities lending agent.

e) 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?

No. Regarding the access in this case please also refer to the response to (d) above. In addition, it is important to differentiate custody as reflecting the encumbrance over securities (pledge) from the actions that legally create pledge. While some of the market participants might have legal right to enter into contracts that would legally create the pledge of client assets (as well as having access to client accounts for that purposes), this does not per se represent custody services.

Q27: 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.

Q28: Please explain how, in your views, "custody" services interact with "safe-keeping" services, in particular those referred to under Article 21(8) of the AIFMD (as well as Article 89 of the AIFMD Level 2[12]) and Article 22(5) of the UCITS Directive (as well as Article 13 of the UCITS V Level 2[13]).

For Q27 and Q28, please refer to the answer to Q25.

Q29: 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.

DB's view is that CSDs should be regulated under the CSDR, rather than AIFMD and UCITS V which is specific to AIF and UCITS entities. The CSDR is the best place to impose strict liability and a high standard of investor protection. This should level the playing field for global custodians but without creating uncertainty on the issuer / investor CSD distinction.

Irrespective of the decision of how to treat CSDs going forward, in the interest of investor asset protection, there would need to be clarification on what would happen if a CSD lost some of the securities that have been entrusted to it. Neither, in the main CSDR text nor in the draft CSDR RTS is there a specific provision regarding the level of liability CSDs should assume for the loss of securities caused by them or by a third-party within their custody networks. This contrasts with the strict and high level of liability that Depositaries are required to assume under UCITS V and the AIFMD. In most cases, there is no alternative to providing access to securities maintained at CSDs: the depositary therefore would have to assume liability for a loss caused by another party over which it has no control, and for which there is no alternative. This mismatch in liability standards creates risk both for depositary banks and for the UCITS / AIFs themselves to the extent depositaries are required to absorb risk inappropriately. This mismatch in liability standards therefore has no prudential justification especially as on some areas there is a competitive aspect to this. The logic of CSDR is that CSDs - in carrying out their function of providing for safekeeping of securities – are to be held to the highest possible standards. Accordingly, CSDs should be held to a high level of responsibility for the services they provide and be required to be held appropriately accountable. As a result, and if CSDs lose assets that have been entrusted to them, they should be obliged to take the same strict liability as the depositaries under UCITS and AIFMD for the restitution and should have sufficient insurance coverage to cater for such hopefully rare scenarios.

In order to support ESMA in its decision making process please see the below summary of potential consequences identified:

[12] Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012.
[13] Commission Delegated Regulation (EU) 2016/438 of 17 December 2015.

A) Where CSDs are exempt from the delegation requirements in general:
   - Reduces the liability of the depositaries – If exempt from delegation requirements, the CSDs would not be liable for their actions. This doesn't take away the risk of loss of the assets with the CSDs though and neither the depositary nor the CSD would pay for them.
   - Competition considerations: There could be an uneven playing field for sub-custodians when CSDs provide the same services as custodians. Where a CSD is exempt from delegation requirements while it provides the same services as sub-custodians - CSDs would be competing with the sub-custodians, but they would have unfair advantages driven by legal requirements. Also, related to the point above, depositaries would be in an advantageous position using CSDs rather than sub-custodians to reduce liability.
   - Reduces the due-diligence costs of the depositaries: Whilst performance of the due diligence aims to protect assets, if CSDs are outside the scope of such requirements this would not serve the best interests of the investors (funds).
   - It takes away the need for CSDs to comply with eligibility criteria (which provide more protection for assets). Whilst CSDs do not have to comply with the eligibility criteria, being out of scope for this requirement would not serve the best interests of the investors (funds).
   - It takes away the need for a CSD to comply with segregation requirements (which reduces cost and operational risks). It can put the CSDs in a more advantageous position vs. sub-custodians, who will have to comply with the segregation requirements and bear all costs and risks associated with it (competition consideration).

B) Where CSDs that are not Issuer CSDs are subject to delegation requirements:
   - This would create a level playing field for sub-custodians and CSD where the latter performs the same services when competing with sub-custodians.
   - Increases the complexity of the legal implementation, i.e.: would require distinction on a functional or even transactional level as CSDs can be Issuer or Investor CSD at the same time.
   - Liability of the depositaries will increase – as it would cover losses caused by the CSDs.
   - Depending on the model of segregation mandated by ESMA, there could be a negative impact on the agency securities lending business as discussed in the response (provided that the use of such CSD is necessary for ASL programme, which isn't always the case) with increased costs and operational risks.
   - Increases due-diligence costs of the depositaries, but would improve asset protection.
   - For sub-custodians there would be higher costs for doing business in third countries (costs for legal opinion is usually covered by sub-custodians) and additional contractual costs (for documenting contracts with CSDs).