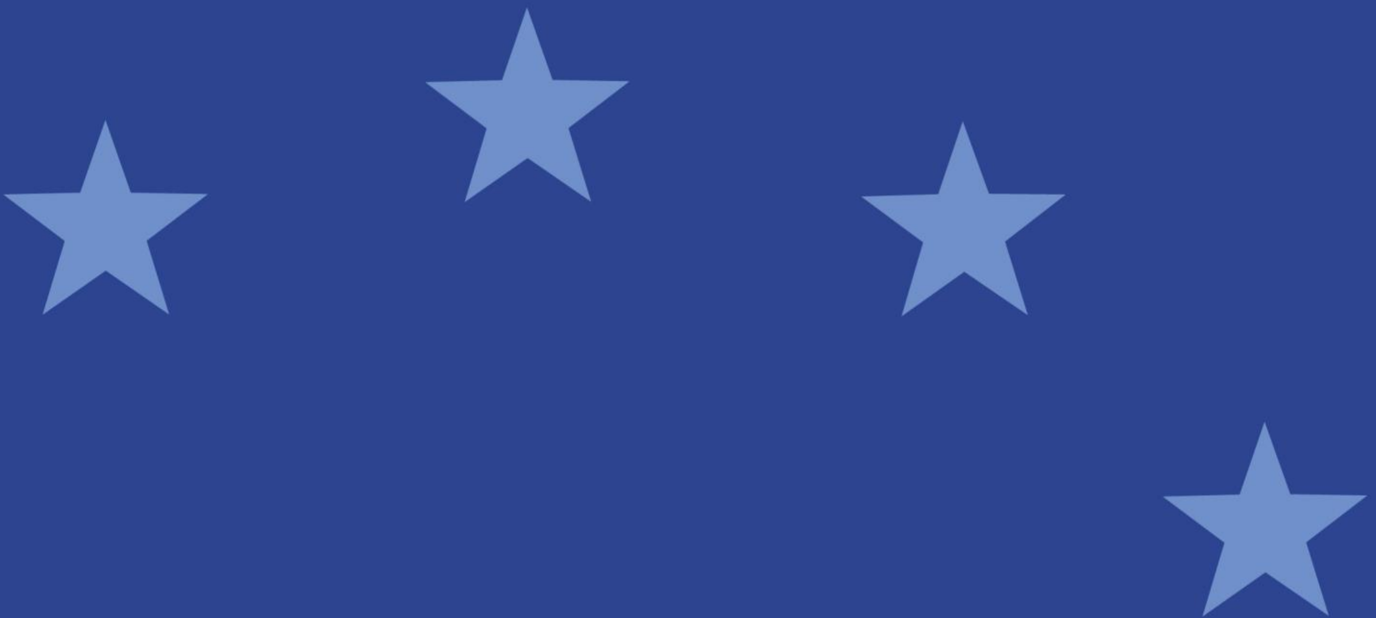
Reply form for the Call for Evidence Asset Segregation and Custody Services



15 July 2016

European Securities and Markets Authority

Date: 15 July 2016

Responding to this paper

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

Instructions

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

- use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
- do not remove the tags of type <ESMA_QUESTION_CE_ASCS_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

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

Naming protocol

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

ESMA_CE_ASCS_NAMEOFCOMPANY_NAMEOFDOCUMENT.

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

ESMA_CE_ASCS_XXXX_REPLYFORM or

ESMA_CE_ASCS_XXXX_ANNEX1

Deadline

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

All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input/Consultations’.

Publication of responses

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

Data protection

Information on data protection can be found at www.esma.europa.eu under the headings 'Legal notice' and 'Data protection'.

Introduction

Please make your introductory comments below, if any:

<ESMA_COMMENT_CE_ASCS_1>
IMMFA represents the institutional money market fund ("MMF") industry that sponsors and promotes funds based on providing a constant Net Asset Value per share to investors. All IMMFA members' funds are UCITS, although it is possible that new entrants to the market could use the AIF structure in future. All but one are domiciled in Luxembourg and the Republic of Ireland (there is one UK fund). Total funds under management as at 9 September 2016 amounted to €576 billion.

The funds offer cash management services, effectively intermediating between investors and issuers in the money markets (prime and government), as well as providing risk diversification away from direct deposit taking by banks. Typically the investor profile includes institutions such as corporations, investment firms including banks, pension funds, charities, local authorities and other public bodies.

The assets in the funds comprise money market instruments, term deposits, eligible securitisations including asset backed commercial paper and the use of reverse repo.
We are therefore particularly concerned about the impact of the various custody models on tri-party reverse repo. Use of reverse repo is a crucial tool for managing liquidity in MMF, allowing the funds to be able to meet potential client redemptions in the portfolio.

We currently estimate that between 10-15% of money market assets are invested in reverse repo (although this figure fluctuates over time). Within IMMFA money market funds (which are denominated in euros, sterling and dollars) this gives an estimated amount of USD60 billion (combined equivalent). The vast majority of this supply will be in tri-party repo, where the collateral is government and government guaranteed securities.

If the option of tri-party repo were to be removed the industry would have to move the balance into bilaterally traded repo, time deposits or direct holding of government securities, each of which would present significant challenges:

- Bilaterally traded repo increases settlement risk to an unacceptable level, due to the inflexible nature of the delivery of the collateral. It is not uncommon for a counterparty to be "failed", meaning they cannot deliver the specified collateral and causing the trade to fail outright or be netted off, which creates an unsecured position. Furthermore, the diversification of collateral received is significantly reduced within the bilateral model and is more operationally cumbersome, creating an inherent risk. The availability of supply is also smaller, creating illiquidity later in the day.

- The Basel III LCR regulation has made the balance sheet availability of time deposits inflexible and availability markedly limited. Relying on time deposits would be no substitute for tri-party repo, which has a more forgiving treatment due to its high quality collateralised nature. Reliance on time deposits would also reduce the ability of the funds to accept large and unplanned flows from investors.

- Direct Government securities are an invaluable source of daily liquidity, however reliance on them to replace the use of tri-party repo has three implications:
    i. Supply challenges – arising from the Bill/ Bond issuance profile and MMF restrictions, and regulatory backdrop requiring financial institutions to hold high levels of high quality/ government assets;
    ii. Wasted supply – there are more market participants willing to repo out their Government holdings than to sell them;

iii. Fund metric impacts – Bill issuance is typically in 1 month (30 day), 3 month (90 day), 6 month (180 day) tenors. Short Term MMFs have a WAM restriction of 60 days, which thus constrains MMF ability to hold paper >60 day, particularly if this replaces overnight holdings.

In parallel, the liquidity requirements within the forthcoming EU Money Market Fund Regulation will require money market funds to hold increased levels of overnight and short-term liquidity. Depending on the outcome of final negotiations, the rules on eligible assets for liquidity purposes could force funds into a very substantial reliance upon reverse repo to meet the requirements. Even if the final outcome is more balanced, the money market funds will still have substantial reliance on reverse repo to support the daily management of eligible assets. To make tri-party repo arrangements impossible at the same time would severely hamper the industry - and step in the way of what the Commission is trying to achieve.

We anticipate that the custodians to the funds will provide you with full details in respect of the various segregation models in use. For our part, we wish to confirm that our industry has a significant interest in the consultation too, particularly in relation to tri-party repo, and would be affected by any option ultimately selected. We have answered those of your questions that are directly relevant.

Given the stated objective of the MMF, which is to preserve capital, custody of the assets will always be a hugely important issue for the industry. Assets held in the funds have to be of very high quality, and the mechanisms used to hold and access assets must work seamlessly. But it is worth stating here that although the absolute security of the assets is a paramount concern, so too is the speed and efficiency with which assets may be acquired, sold and transferred.

In short, we flag the importance of tri-party collateral management to the MMF industry, state our support for Option 4 and note that:

- Option 4 provides a sufficient level of investor protection and is the only option that maintains the policy and industry benefits arising from tri-party collateral management;
- By contrast Option 3 does **not** increase investor protection to a level above Option 4, but would cause damage to tri-party collateral management;
- Implementing either Option 1 or 2 would not increase investor protection to a level above Option 4, but would mean that tri-party collateral management would no longer be available.

<ESMA_COMMENT_CE_ASCS_1>

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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 – <u>with the use of a chart/diagram</u> – 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 second level should be the level of a third party delegate of the depositary, and

iv) 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.

b) if you use 'omnibus accounts' (i.e. accounts, in which the assets of different end investors are commingled, rather than each individual investor's assets being held in a separate account) at any level of the custody chain, please provide, in as clear and detailed a manner as possible:

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.

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)?

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.**

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).**

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.**

   iv) **Does the model you refer to under f) i) require a particular way of segregating assets or omnibus accounts at one of the levels referred to at letter a) above? If yes, please specify.**

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.**

<ESMA_QUESTION_CE_ASCS_1>
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[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.

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?

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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.

<ESMA_QUESTION_CE_ASCS_3>
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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.

<ESMA_QUESTION_CE_ASCS_4>
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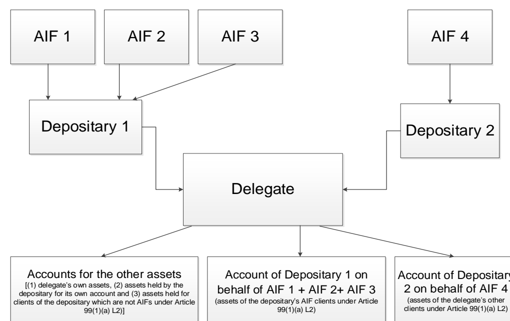
Q5: In the chart below (option 1 of the CP), AIF 1 would only have recourse against Depositary 1 under the PRIMA concept.

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?



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?

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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].

<ESMA_QUESTION_CE_ASCS_6>
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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]?**

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[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).

  - **Through T2S**

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

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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.

<ESMA_QUESTION_CE_ASCS_8>
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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)?

<ESMA_QUESTION_CE_ASCS_9>
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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.

<ESMA_QUESTION_CE_ASCS_10>
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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, global custodians, prime brokers, delegates, their clients and the different markets?

<ESMA_QUESTION_CE_ASCS_11>
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Q12: Are there any advantages of using omnibus accounts not covered in your responses to other questions?

<ESMA_QUESTION_CE_ASCS_12>
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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.

<ESMA_QUESTION_CE_ASCS_13>
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[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*".

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<ESMA_QUESTION_CE_ASCS_13>

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;

b) prime brokerage arrangements.

<ESMA_QUESTION_CE_ASCS_14>

For money market funds ("MMF"), segregating UCITS assets at the sub-custodian level will prevent efficient collateral management, which could fatally impair the effective operation of the funds. For speed, certainty and efficiency, collateral flows for these funds have to occur at the books and records level rather than at the market level. Moving them to the sub-custodian level will introduce significant timing challenges. Since the CNAV money market funds provide same day settlement to clients, any lengthening of the physical segregation model through the custodial chain will make this much more difficult, if not impossible, to achieve.

Moreover the funds would become unattractive counterparties to the reverse repo markets as collateral posted to a UCITS will have to be delivered into a segregated account at the sub-custodian level, meaning that collateral movements will take place at the sub-custodian (and market) level. This does not work for borrowers, who typically will optimise and substitute collateral many times a day. Substitution and optimisation of collateral at the sub-custodian level is not generally possible intraday since it becomes the subject of "physical" movements in the local markets.

The consequence of UCITS (and AIF) cash not being available to the reverse repo markets are grave:

1. It would have a substantial effect on market liquidity, since UCITS MMF are sizeable participants in the market.
2. In addition, should the forthcoming Money Market Fund Regulation come into effect reflecting existing proposed text, the inability to use the reverse repo markets would cause the CNAV Government MMF to cease to function (since they are constrained from holding government securities in their liquidity count and must instead use the reverse repo markets) and would also put considerable strain on the Low Volatility NAV MMF as well. Indeed, all MMF would be affected in this way, Variable NAV MMF too.

<ESMA_QUESTION_CE_ASCS_14>

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?

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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?

<ESMA_QUESTION_CE_ASCS_16>
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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.

<ESMA_QUESTION_CE_ASCS_17>
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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.

<ESMA_QUESTION_CE_ASCS_18>
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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.

<ESMA_QUESTION_CE_ASCS_19>
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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.

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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?

<ESMA_QUESTION_CE_ASCS_21>
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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.

<ESMA_QUESTION_CE_ASCS_22>
All five options outlined above achieve the high level policy objective of investor protection, though arguably not all achieve the goal of expediting asset recovery in the event of insolvency in the custody chain.

Option 4 both provides a sufficient level of investor protection and is the only option that maintains the policy benefits arising from tri-party collateral management.

Option 3 does not increase investor protection above Option 4, and would cause some damage to tri-party collateral management.

Options 1 and 2 would mean that tri-party collateral management would no longer be available, with a significant negative impact on liquidity and funding as mentioned in our response to Q14. Furthermore, Options 1 and 2 do not increase investor protection but do increase operational risks and costs.

Mandating Option 5 would also mean that tri-party collateral management would no longer be available. We note that this was already ruled out by ESMA in its Consultation Paper.

It is essential that the individual market regulators and funds understand that if segregation becomes mandatory down to the sub-custodian/CSD level, the consequences for the money market fund ("MMF") and wider UCITS industry will be seriously adverse.

We remain concerned that, notwithstanding the markets' response and the sincere doubts expressed by various national Competent Authorities, there is a still potential for segregation to be mandated for UCITS assets at the sub-custodian level in the custody chain. This is despite the reality that, for MMF, the change would impair the ability of the funds to function now and in the future.

With collateral inventory fragmented across multiple sub-accounts, the efficiency loss for MMFs and the markets would be huge.

<ESMA_QUESTION_CE_ASCS_22>

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

[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.

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.

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.**

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

<ESMA_QUESTION_CE_ASCS_23>
Yes. We believe that such a regime, which is effectively Option 4 in the ESMA Consultation Paper, would contribute to achieving the policy objective described in the introduction.

Introducing new requirements based on the principles of the regime set out in CSDR Article 38 to replace the existing requirements under AIFMD and UCITS V for segregation up the chain of custody (such as, for example, Options 1 and 2 from the Consultation Paper) would be a helpful and positive step. The Article 38 CSDR regime importantly helps to maximise choice for market participants, such as our members, and offers transparency over the implications of choice, which is helpful also for the investors in our members' funds.

We understand that the proposed CSDR Article 38 regime could in theory apply with respect to the accounts provided by all entities in the custody chain, excluding the depositary (which is the last intermediary in the custody chain), for which the existing AIFMD and UCITS V segregation rules would apply.

We note that any implementation of an Article 38 regime must take into account non-European securities. Depositary banks may not be able to offer a full choice of account structures up the custody chain with respect to those parts of the custody chain that are located outside of the European Union. Non-EU CSDs and account providers do not fall under European law and may be constrained by their own system capabilities and national regulatory obligations. Any application of the Article 38 regime should not have the unintended consequence of preventing UCITS from investing in certain categories of non-EU securities, as depositaries are unable to fulfil their Article 38 regime obligations for those particular securities.

<ESMA_QUESTION_CE_ASCS_23>

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

<ESMA_QUESTION_CE_ASCS_24>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_ASCS_24>

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

<ESMA_QUESTION_CE_ASCS_25>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CE_ASCS_25>

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');

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

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

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

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?

<ESMA_QUESTION_CE_ASCS_26>
TYPE YOUR TEXT HERE

[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").

<ESMA_QUESTION_CE_ASCS_26>

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.

<ESMA_QUESTION_CE_ASCS_27>
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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]).

<ESMA_QUESTION_CE_ASCS_28>
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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.

<ESMA_QUESTION_CE_ASCS_29>
TYPE YOUR TEXT HERE
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[12] Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012.
[13] Commission Delegated Regulation (EU) 2016/438 of 17 December 2015.