European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken

EACB comments on ESMA's draft technical advice on possible implementing measures of the Alternative Investment Fund Managers Directive (AIFMD)

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The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4.200 locally operating banks and 63.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 160 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 50 million members and 750.000 employees and have a total average market share of about 20%.

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General Remarks

The members of the European Association of Cooperative Banks (EACB) are pleased to comment on ESMA's draft technical advice on possible implementing measures of the Alternative Investment Fund Managers Directive (Ref.: ESMA 2011/209) of July 2011.

The EACB welcomes the realistic and balanced approach that was taken by the European Union in its implementation of the AIFM Level 1 Directive which was published in June of this year. We believe that it can pave the way to ensure the strengthening of investor protection, the bolstering of stability in the financial markets and to uphold Europe as an attractive financial centre for Alternative Investment Funds.

While providing clearer and more harmonised definitions for all participants in the Alternative Investment Fund's value chain, we believe that the upcoming Level 2 implementing measures should not deviate from the original level 1 objectives. This rings especially true for the duties of AIF depositaries, which provide invaluable services to its funds by safekeeping and overseeing its assets.

European Co-operative Banks are most affected by the AIFM Directive and its implementing measures through its depositary services which they provide for a large number of European and non-European Alternative Investment. For this very reason our position paper will focus solely on the parts regarding depositaries and its duties and obligations (questions 25 through 54).

The aim of the Level 2 measures to strengthen accountability and investor protection is invaluable, but we nevertheless believe that some measures contemplated in this consultation paper by ESMA will shift this strengthened accountability solely towards the depositary function in the value chain and neglect that this accountability should be borne proportionately by all AIF contributors; may this be the investment funds, investment managers, transfer agents, administrators or supervisory authorities.

This shift is most discernible in the proposed measures for cash & securities transaction mirroring (questions 25 to 31) through the depositary as well as secondary-level checks (questions 35 to 45) that could shift the liability away from the AIFM towards the depositary bank by replacing the current market practise of risk-based and periodical reviews by constant & perpetual monitoring. We are of the opinion that the proposals would introduce additional layers of administration and controls which would result in increased costs – borne by the investor – with no real added value to his protection.

With regards to the depositary's liability regime, EACB welcomes ESMA's clarification of loss of a financial instrument and generally agrees with its three-step-approach to defining such a loss. We are nevertheless very concerned about the distinction of "internal/external events" (questions 47 through 52) in case of a loss and believe that ESMA's proposals go beyond the intention of the Level 1 directive. If "external event[s]

beyond reasonable control [of the depositary]" are not further clarified, then depositaries might be responsible for a default of a sub-custodian, effectively making the depositary strictly liable for all acts and omissions of any sub-custodian – even when having acted with all proper care and due diligence.

We are simply of the opinion that the depositaries should only be made responsible for instances within its level of control, such as losses caused by either own failure or negligence. What goes beyond its reasonable control, such as misjudgements in other parts of the value chain or shortcomings in the regulatory and legal environments, should not be made its responsibility.

We share ESMA's belief of investor protection, but encourage the European Securities and Markets Authority to strike a reasonable and workable balance between investor security and strengthened accountability of an AIF. Ultimately, this balance should be borne proportionately by all participants of the AIF.

List of questions

V. DEPOSITARIES

V.III. Depositary functions

1.3 Conditions for ensuring the AIF's cash is properly booked

Q25: How difficult would it be to comply with a requirement by which the general operating account and the subscription / redemption account would have to be opened at the depositary? Would that be feasible?

We do not believe it proportional to hold all accounts in the same depositary, as it would force investors to make subscription orders and payments only in the depositary bank.

Current market practices already ensure that the AIF's accounts are credited/debited with subscription/redemption monies in a correct and timely manner. If such a requirement were to be imposed on the depositary, we fear that current well-working administrative channels would have to be completely redesigned, which would lead to unnecessary costs to the value chain without adding additional value to the investor.

Furthermore, today's systems already ensure the reconciliation of subscription/ redemption amounts and we therefore believe that the location of the accounts should be left flexible enough to accommodate the diversified nature of AIFs.

Q26: At what frequency is the reconciliation of cash flows performed in practice? Is there a distinction to be made depending on the type of assets in which the AIF invests?

The reconciliation of cash flows is dependent on the type of AIF and is performed at each calculation of the NAV by the administrator on a periodic basis in accordance with its own risks analysis. The depositary verifies the reconciliation performed by the administrator. If reconciliations of cash flows had to be performed by depositaries, this would result in over-burdening and cause large expenses in order to develop new organisational and IT-systems. Huge investments into these new systems would be necessary irrespective of its frequency.

There is no distinction made on the type of assets in which the AIF invests and we do not believe it feasible or prudent to introduce such a rationale.

Q27: Are there any practical problems with the requirement to refer to Article 18 of MiFID?

We do not foresee any practical problems with the reference to Article 18 of MiFID, as any entity established in a relevant 3rd country considered "of the same nature" as those entities referred to in Article 18 (1)(b) of Commission Directive 2006/73/EC and being a

credit institution are subject to prudential regulation and supervision as under existing EU law.

Q28: Does the advice present any particular difficulty regarding accounts opened at prime brokers?

We are of the opinion that cash account opened at a prime broker would lead to difficulties regarding the monitoring of cash flows: currently, information on cash flows provided by prime brokers to the depositary may not be sufficient in all cases and prime broker are not liable vis-à-vis the unit-holders.

The AIFM should therefore have the obligation to require the Prime Broker to transmit all information to the depositary in order to allow him to perform its control (see our answer to question 29 below). The obligation should apply to securities, derivatives and cash. Moreover, in our view, the Prime Broker should have to fulfil the conditions of Article 18 of the Directive 2006/73/EC and the AIFM should have to ensure that the Prime Broker has satisfied its obligation.

Q29: Do you prefer option 1 or option 2 in Box 76? Please provide reasons for your view.

We strongly prefer option 2 with regards to the proper monitoring of all AIF's cash flows over option 1. Option 1 would seemingly alleviate the AIFM of its liability to properly monitor its cash flows and shift this liability towards the depositary bank by replacing the currently practised risk-based and periodical review by constant & perpetual cash monitoring. As a side note we would like to remark that cash flow reconciliations (both UCITS and AIF) are performed on an ex-post basis and that the introduction of an ex-ante concept in point c of Option 1 seems to us unfeasible from a business standpoint.

We believe option 2 to be a much more realistic approach requiring only secondary level control by the depositary bank. Regarding this option we would like to highlight the following points:

- The Depositary duties refer to periodic checking of the reconciliation processes and findings.
- The suggested verification frequency in point 9 (p. 150) does not take into account the nature, scale and complexity of the AIF, or the volume of transactions. The verification frequency should be tailored towards these attributes and not towards the reconciliation frequency of the AIFM.
- The notion of "full review of the reconciliation process" needs to be more accurately defined. We are of the opinion that the depositary should review the reconciliation process' findings on a yearly basis, at a minimum. The scope of the review includes the administrator and the third parties' positions. The reconciliation process itself may be reviewed according to a different schedule.

Q30: What would be the estimated costs related to the implementation of option 1 or option 2 of Box 76?

The adoption of option 1 would lead to high additional cost with very little real added value, as a complete change of the existing operating model would be required. In order to meet the option 1 requirements, depositaries would need

- to duplicate part of the middle office and valuation function, therefore doubling the valuation costs and
- to implement new system architectures (including substantial IT investments) and increase the number of depositary staff

It is challenging to quantify those additional costs, but as a minimum this would involve employing a larger number of people to perform the required tasks – in particular mirroring the transactions of those cash accounts into a position keeping system and making periodic reconciliations between the cash accounts and the AIF's accounting records (see our answer to question 31). We have not received enough representative data for the whole European Market, but have been informed that costs for these new systems would be estimated to be significant in all markets, with a relative higher burden in smaller European markets.

We fear that the proposals introduce unnecessary additional layers of administration and controls which are not to the benefit of the investor and only result in increased costs.

On the other hand we believe that the implementation of option 2 is able to achieve similar results without substantial additional costs and is therefore clearly preferable.

Q31: What would be the estimated costs related to the implementation of cash mirroring as required under option 1 of Box 76?

Mirroring all transactions on a depositary record would be onerous for AIFs with large trading volumes and such mirroring would be prone to error and require additional reconciliation, without providing any additional protection over the processes outlined in Option 2. Since AIFM and AIF already perform this duty and are already supervised and regulated by their local financial authorities, such duplication would not provide any real added value, as it is unlikely that it would allow the detection of any actual discrepancies.

2.1 Definition of the financial instruments that should be held in custody

Q32: Do you prefer option 1 or option 2 in Box 78? Please provide reasons for your view.

First of all, we welcome ESMA's approach to differentiate between the different types of financial instruments as defined in Annex I, section C of Directive 2004/39/EC, as not all financial instruments can be treated in the same manner.

Given the two possible approaches we deem that option 1 defines a too narrow scope of interpretation of financial instruments held in custody which then would ultimately trigger the depositary's liability regime to replace the instrument in case of loss.

We therefore would prefer option 2, as the depositary might – in certain cases and with certain instruments – be unable to verify the existence and location of the assets and to

retrieve them at any given time through the application of effective operational process and controls.

Q33: Under current market practice, which kinds of financial instrument are held in custody (according to current interpretations of this notion) in the various Member States?

The financial instruments currently held in custody include transferable securities, money market instruments or units of collective investment undertakings, both foreign and domestic. Derivatives or physical assets are not assets held in custody. Option 2 in Box 78 retains both concepts of 1) the nature of assets and 2) the registration maintained in a regulated settlement system, which is in line with market practices.

Q34: How easy is it in practice to differentiate the types of collateral defined in the Collateral Directive (title transfer / security transfer)? Is there a need for further clarification of option 2 in Box 79?

The differentiation of the types of collateral defined in the Collateral Directive is not easy since this requires an analysis of the collateral agreement and of the parties' intention (i.e. title transfer financial collateral arrangements, security financial collateral arrangements). This is the reason why we view option 2 as the appropriate option that best suit all circumstances.

2.2 Conditions applicable to the depositary when performing its safekeeping duties on each category of assets

Q35: How do you see the delegation of safekeeping duties other than custody tasks operating in practice?

The delegation of safekeeping duties (i.e. delegation of Prime Brokerage intervention, delegation of record-keeping duties to be performed by the Prime Brokers) is difficult to operate in practice. The depositary would be required to ensure the financial instruments are properly registered in segregated accounts in order to be identified at all times as belonging to the AIF (Box 80, p. 159). The global market practices do not permit segregated accounts everywhere because of the way local markets are organised from a legal and organisational viewpoint. The depositary would further be obliged to exercise due care in relation to the financial instruments held in custody to ensure a high level of protection. This obligation also affects other depositaries in the depositary chain. Other depositaries outside EU do not necessarily accept this when such an obligation is not required in their own local legislation. Therefore depositaries cannot be deemed to give legal certainty on the effects of segregation which goes beyond its reach of control.

Depositaries are furthermore required to assess the custody risks related to settlement systems and inform the AIFM of any material risk identified. We believe that this is not feasible in practice and would ask ESMA for further clarification.

Q36: Could you elaborate on the differences notably in terms of control by the depositary when the assets are registered directly with an issuer or a registrar (i) in the name of the AIF directly, (ii) in the name of the depositary on behalf

of the AIF and (iii) in the name of the depositary on behalf of a group of unidentified clients?

(i) When the assets are directly registered in the name of the AIF, the depositary should be provided by the AIF with an unquestionable document with regards to the acquisition/sale. There is no relationship between the depositary and the issuer. A functional relationship, however, may be set up between the depositary and the issuer, whereby the depositary can be granted exclusive authority to give instructions on the account opened in the name of the AIF (or the AIFM).

(ii) When the assets are registered in the name of the depositary on behalf of the AIF (i.e. in the form of depositary/AIF or depositary /AIFM), the depositary reconciles its positions with the transfer agents.

(iii) When the assets are registered in the name of the depositary on behalf of a group of unidentified clients (omnibus account), the above processes apply.

Q37: To what extent would it be possible / desirable to require prime brokers to provide daily reports as requested under the current FSA rules?

Daily reports provided by the prime broker are desirable for the depositary. Assets of the fund with the prime broker should also be clearly identified and segregated.

Q38: What would be the estimated costs related to the implementation of option 1 or option 2 of Box 81? Please provide an estimate of the costs and benefits related to the requirement for the depositary to mirror all transactions in a position keeping record?

With regards to Box 81, we clearly favour option 1, as we believe it to be more than sufficient to ensure the safekeeping of assets and prevent loss for the investor. Option 2 would create a very similar situation with regards to costs as mirroring all cash movements (see question 31) and would lead to a complete change of the existing operating model and therefore to very high additional costs but no real added value for the investor.

We believe that the depositary should be in the position to comply, at a reasonable cost, with its obligation to provide at any time a comprehensive and up to date inventory of the AIF's assets. Therefore, it should be clarified that for listed derivatives and for transactions related to assets provided in collateral, the depositary can discharge its assets monitoring duties by receiving and storing the clearing broker statements including the transactions and the positions.

Q39: To what extent does / should the depositary look at underlying assets to verify ownership over the assets?

Some clarification on the definition of "underlying asset" seems to be necessary to avoid confusion.

If "underlying assets" refers to, for instance, the assets underlying a collective investment scheme into which the AIF invests (transparency level), then clearly the depositary should not be required to look at these.

If the question is instead referring to the level of due diligence a depositary should carry out in order to verify ownership of non-custody assets held directly by the AIF (Record-keeping level), then it is inadvisable to be too prescriptive about this. In its record-keeping duties the depositary is depending on the AIFM with regards to the documentation of the ownership. If, however, ESMA were to nonetheless pursue such a prescriptive approach, we are of the opinion that a precise and comprehensive list of actions/documents should be set out by ESMA as a requirement to verify the ownership of each specific asset class.

V. 3 Depositary functions pursuant to §9 – Oversight duties

Q40: To what extent do you expect the advice on oversight will impact the depositary's relationship with funds, managers and their service providers? Is there a need for additional clarity in that regard?

The oversight duties of the depositary recommended by ESMA are very extensive. This could be problematic, since the corresponding duties of the AIFM are missing (e.g. in order to fulfil its oversight duties, the depositary must be granted rights to access and control the systems of the AIFM). Another point is the costs of these oversight duties (and the need for more professionals, IT etc.). Performing depositary services could become very expensive.

We see the need for further clarification by ESMA, as there should be specific provisions which describe how the depositary can execute his oversight duties respectively by getting access to the relevant information and records. For example the AIF (or the AIFM acting on behalf of the AIF) could be obliged to provide a SAS70-report or equivalent. We would welcome to see these specific provisions to be aligned to the following principles:

- Objective of added value for all oversight duties and controls
- Ex-post basis controls
- Compliance with an escalation process
- Proportionality of controls
- Compliance with the contractual relationship between the depositary and the AIF/AIFM
- Absence of mandatory duplication with duties and controls performed at primary level
- Alignment with UCITS regulation

Q41: Could potential conflicts of interest arise when the depositary is designated to issue shares of the AIF?

As a general duty, the depositary is required to have an organisational set-up that identifies and mitigates all potential conflicts of interest (operational, functional and hierarchical segregation of functions). We therefore believe that this set-up prevents any potential conflicts of interest.

Q42: As regards the requirement for the depositary to ensure the sale, issue, repurchase, redemption and cancellation of shares or units of the AIF is compliant with the applicable national law and the AIF rules and / or instruments of incorporation, what is the current practice with respect to the reconciliation of subscription orders with subscription proceeds?

With regards to the oversight duties, we believe that point 2 of Box 83 needs further clarification. Indeed, the oversight duties of the depositary cannot include "secondary" market transactions (i.e. sale or repurchase of shares and units). The oversight duties should apply to the compliance of the procedures at the level of AIF, AIFM or the designated entity only. In our view it would be more than sufficient for depositaries to control the processes of the AIFM, for example, once a year.

In addition we support point 54 of the explanatory text. AIFM and UCITS requirements on oversights duties should be aligned. We expect the implementing measures to achieve this goal.

Q43: Regarding the requirement set out in §2 of Box 83 corresponding to Article 21 (9) (a) and the assumption that the requirement may extend beyond the sales of units or shares by the AIF or the AIFM, how could industry practitioners meet that obligation?

The obligations could be met (at higher than current costs), if the depositary receives access to the relevant information and records of the AIF (or the AIFM acting on behalf of the AIF) or a third party provider. ESMA should include in the provisions, that

- a third party is also obliged to provide the information and records to the depositary;
- the AIF (or the AIFM acting on behalf of the AIF) has to provide independent audit reports about his control/risk environment (e.g. SAS70-reports or equivalent)
- the AIF (or the AIFM acting on behalf of the AIF) and the third party have to allow on-site visits of the depositary respectively his Internal Audit for verification purposes

Q44: With regards to the depositary's duties related to the carrying out of the AIFM's instructions, do you consider the scope of the duties set out in paragraph 1 of Box 85 to be appropriate? Please provide reasons for your view.

We believe that an effective risk management process remains the responsibility of the AIF/AIFM. The depositary's duties should therefore consist of assessing the control procedures and environment at the AIF/AIFM which should be performed on an ex-post basis. In order to promote harmonisation at EU level, we would prefer that point 1 would refer to national laws and regulations.

Q45: Do you prefer option 1 or option 2 in Box 86? Please give reasons for your view.

We believe option 1 to be preferable. The current arrangements, processes and market practices allow for a timely settlement of transactions and the identification of possible

failings or anomalies. In the latter case, the depositary takes the necessary steps to inform the AIF/AIFM and request its instructions. We therefore do not think that Option 2 will bring any additional added value and safety to the current arrangements.

V. Section 2: Due diligence duties

We tend to agree with ESMA's requirements, as the proposals and its risk-based approach are already standard market practice. We would nonetheless suggest the development of a comprehensive template of evaluation with parameters and guidelines to be checked against sub-custodians in order to prove proper due diligence. This would further foster best professional practices and limit room for interpretations when assessing the relevance, or the absence of due diligence by a depositary in case of loss of a financial instrument held in custody.

V. Section 3: Segregation

Q46: What alternative or additional measures to segregation could be put in place to ensure the assets are 'insolvency-proof' when the effects of segregation requirements which would be imposed pursuant to this advice are not recognised in a specific market? What specific safeguards do depositaries currently put in place when holding assets in jurisdictions that do not recognise effects of segregation? In which countries would this be the case? Please specify the estimated percentage of assets in custody that could be concerned.

Generally speaking, it is complicated to ensure the assets are "insolvency proof" if the assets are not directly registered in the name of the owner (end investor) at the level of local securities account. The issue should therefore not be limited to neither the segregation, whose implementation may differ according to the different markets and regulations, nor on any alternative or additional measures (such as specific safeguards put in place by the depositaries in jurisdictions which do not recognise effects of segregation). The issue is and remains the effect of the segregation in case of insolvency of a sub-custodian, on the assets that the sub-custodian holds for the benefits of its customers.

Whatever the circumstances, since the local legislations and the local court decisions prevail in all disputes, no third party such as the depositary can be requested to ensure that the effect of the segregation or any other measures is such that the assets held by a sub-custodian for the benefits of its customers are fully protected from an insolvency of the sub-custodian.

V.IV. The depositary's liability regime

Q47: What are the estimated costs and consequences related to the liability regime as set out in the proposed advice? What could be the implications of the

depositary's liability regime with regard to prudential regulation, in particular capital charges?

It is difficult to estimate the costs and consequences related to the liability regime as set out in the ESMA advice. But it is clear that costs for depositary services will most certainly increase due to

- the complexity of depositary services and its much tighter liability regime.
- the new tasks which have to be performed by the depositary as proposed by ESMA

These costs increases will have to be borne by the AIF, and ultimately by the investor.

Q48: Please provide a typology of events which could be qualified as a loss in accordance with the suggested definition in Box 90.

In general we welcome the clarification of loss and tend to agree with the definition of loss in Box 90 given that certain types of financial instruments (such as OTC derivatives or physical assets) are not part of the depositary's liability scheme. As explained in question 32, the depositary is unable with these types of instruments to verify the existence and location of the assets and to retrieve them at any given time through the application of effective operational process and controls.

Below is a non-exhaustive list of events that follow the current draft definition of "loss" proposed by ESMA in Box 90:

(a) stated right of ownership is uncovered to be unfounded because it either ceases to exist or never existed:
    - Fraud resulting in the permanent loss of the financial instrument

(b) the AIF has been permanently deprived of its right of ownership over the financial instruments:
    - Nationalisation of the issuer – the financial instruments of the issuer are nationalised, expropriated or are otherwise required to be transferred to any governmental agency, authority or entity.

(c) the AIF is permanently unable to directly or indirectly dispose of the financial instruments:
    - Change in relevant law – e.g. due to the adoption of or change in any applicable law or regulation (including tax laws) it becomes illegal to hold, acquire or dispose of the financial instruments.
    - In some cases, government action may result in "loss" – for example, where a government (or governmental institution or agency) has taken action which has had the effect of permanently and irretrievably preventing the transfer, sale or other disposition of the financial instruments.
    - In some cases, national or international embargoes (i.e., a government (or government institution or agency) or an international organisation has announced a trade embargo affecting the ability to transfer, sell or dispose of the financial instruments) may be sufficiently permanent that the financial instruments can be considered "lost".

- Liquidation, dissolution or winding up of issuer – but, as ESMA rightly recognises, only where it becomes certain during (or at the end of) the insolvency process that the financial instruments are permanently and irretrievably lost.

Q49: Do you see any difficulty with the suggestion to consider as an external event the fact that local legislation may not recognise the effects of the segregation requirements imposed by the AIFMD?

We do not see any difficulty with the suggestion to consider as an external event the fact that local legislation may not recognise the effects of the segregation requirement – provided that the notion of "effects of the segregation" is defined clearly.

We strongly support this proposal, and consider that matters relating to local legislation are inherently "external". Local law and local courts decisions are, by definition, entirely outside the control or influence of the depositary and should therefore be considered as market risks. Changes in local legislation are inherently unpredictable for the depositary. It would therefore be more beneficial to inform investors of this risk, as it is not feasible for a depositary to bear the market risk and the risk of the depositary chain.

Looking at the liability regime as a whole, we would like to add that the envisaged liability regime would lead to a situation where depositaries will reconsider whether they are willing to accept these risks as well as the increased costs and go on operating in the business. The outcome of this debate could be that a substantially smaller amount of depositary service providers might remain in the future.

Q50: Are there other events which should specifically be defined/presumed as 'external'?

We strongly disagree that events related to the insolvency of a sub-custodian should be considered as "internal" events despite appropriate due diligences performed by the depositary. Insolvency cannot, by definition, be predicted in advance to make it possible for the depositary to take appropriate actions. AIFMs may choose to invest in countries with less secure internal infrastructures, weaker custodians or uncertain regulatory and legal environments, safe in the knowledge that the depositary will be liable for any losses. We do not believe that the burden of such risks should be placed on depositaries.

Furthermore, set out below is a non-exhaustive list of examples of other events which should be presumed 'external':

- Any event, the occurrence of which might reasonably be considered to be part of the general risk of investing.
- Liquidation, dissolution or winding up of issuer.
- National or international embargoes.
- Nationalization, strikes, devaluations or fluctuations, seizure, expropriation or other government actions, or other similar action by any governmental authority, de facto or de jure; or enactment, promulgation, imposition or enforcement by any such governmental authority of currency restrictions, exchange controls, levies or other charges affecting the financial instruments.

- Breakdown, failure, malfunction, error or interruption in the transmission of information caused by any machines, utilities or telecommunications systems.
- Any order or regulation of any banking or securities industry including changes in market rules and market conditions affecting the orderly execution or settlement of financial instruments transactions or affecting the value of financial instruments.
- Acts of war, terrorism, insurrection or revolution.

Q51: What type of event would be difficult to qualify as either 'internal' or 'external' with regard to the proposed advice? How could the 'external event beyond reasonable control' be further clarified to address those concerns?

We generally agree with ESMA's Three-Step-Approach to defining loss, but are nevertheless opposed to ESMA's general approach towards the definition of "external event". In our opinion it goes beyond the intention of the Level 1 text and if the proposed interpretation of the word "external" is taken forward, the practical result are likely to be highly counter-productive. The effect would be that the depositary is strictly liable for all acts and omissions of any sub-custodian. Capital costs for depositaries would increase significantly. These costs would probably be uninsurable and would inevitably have to be borne by the AIF investors, in order for any depositary's business model to be sustainable.

On the same line, we would like to argue that "external event[s] beyond reasonable control" should be further clarified in order to exonerate the depositary of its liability in case of having performed proper due diligence (see our remarks on due diligence on page 11) within its possible and reasonable means, as the proposed advice should not bring about circumstances whereby the depositary would have to make act or decision that fall into the AIF/AIFM scope of duties/liability. In addition the advice should recognize that sub-custodians are regulated entities in their jurisdictions. In this respect a third party such as the depositary cannot be requested to, and made liable for, supplement local supervisory entities.

Q52: To what extent do you believe the transfer of liability will / could be implemented in practice? Why? Do you intend to make use of that provision? What are the main difficulties that you foresee? Would it make a difference when the sub-custodian is inside the depositary's group or outside its group?

We would like to imagine that the transfer of liability would be used, but are doubtful of the feasibility of this measure, as these transfers are difficult to be implemented in practice. For a sub-custodian concerned by the transfer it is not prudent to accept such a transfer, as most of the sub-custodians based outside of the EU would not accept to be subject to an EU regulation with regard to the transfer of liability.

Q53: Is the framework set out in the draft advice considered workable for non-bank depositaries which would be appointed for funds investing mainly in private equity or physical real estate assets in line with the exemption provided for in Article 21? Why? What amendments should be made?

The framework set out in the draft advice must also be implemented in non-bank depositaries. It is important to ensure a level playing field in the EU and for the third countries between all the depositaries.

Q54: Is there a need for further tailoring of the requirements set out in the draft advice to take into account the different types of AIF? What amendments should be made?

The more diversified nature (compared to UCITS) of AIFs has to be taken into account, but this further tailoring should not be achieved by sacrificing the ultimate goal of harmonisation.

Contact

The EACB trusts that its comments will be taken into account. For further information or questions on this paper, please contact:

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