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VIA ELECTRONIC SUBMISSION

The European Securities and Markets Authority
www.esma.europa.eu
c/o: "Consultations"

RE: Association Comments on ESMA's Consultation paper, "Draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive in relation to supervision and third countries", 23 August 2011 - ESMA 2011/270

We herewith submit on behalf of the members of the Association of Global Custodians ("Association" or "AGC")[1] comments in response to the Consultation Paper issued on 23 August 2011 ("Consultation") by the European Securities and Markets Authority ("ESMA"). The Association appreciates the opportunity to provide members' views and recommendations.

Members' comments below address Article 21(6) of the Alternative Investment Fund Managers Directive (the "Directive" or "AIFMD") and Part IV of the Consultation (Depositary (Article 21(6)). In particular, members' comments address the seven "assessment criteria" set out in Box 2 of the Consultation and the accompanying Explanatory Text (pages 10 -12 of the Consultation). The comments include recommended changes to the text of, and certain emphases in, the Consultation proposals.

Association members appreciate the value of appropriate regulation surrounding custody and fund services, including in respect of cross-border servicing in a global context, and fully support the objectives of the Directive to protect investors and prevent undue systemic risk. Members therefore wish to note aspects of the proposals that may require emphasis on

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[1] The Association is an informal group of eleven global banking institutions, listed on the letterhead above, with affiliates and branches in many countries that provide custody services and related securities asset-servicing functions to cross-border institutional investors around the globe. Association Members participate actively in European Union securities markets by, among other things, employing collectively more than 210 subcustodians in the 27 EU jurisdictions to assist in holding in custody well in excess of 15 Trillion EUR assets and by providing depositary services to well in excess of 18, 000 EU based funds.

flexibility in implementation, and we note elements of custody law and regulation outside the European Union that invite contract-based methods for achieving principled equivalence.

General Comments.

- Article 21(6), sub-paragraph b), of the Directive provides that non-EU depositaries may act as depositary of non-EU AIFs wishing to benefit from the new AIFMD EU passport regime available beginning 2015 provided that "***the depositary is subject to effective prudential regulation, including minimum capital requirements, and supervision which have the same effect as Union law and are effectively enforced***".

The phrase "same effect" may imply a greater degree of sameness than the phrase "similar to", and AGC members are of the view that the only way practically feasible to achieve workable equivalence is to approach the objective from a pure investor point of view. The question is whether "subject to effective prudential regulation" in article 21 (6), sub-paragraph b), should be construed as requiring that the home domicile regulation be reshaped to meet a strict equivalence test, or can a principled equivalence be achieved by contractual arrangements. Principled equivalence, which is clearly the more sensible approach, would need to be established and assessed on a case-by-case basis, depositary-by-depositary. However, such case-by-case equivalence arguably might not fit the proposed administrative scope noted in explanatory note 7, which refers to the European Commission issuing **decisions declaring given countries *"equivalent"***. In members' view therefore, as further described below, ESMA's advice should recognize legal and regulatory regimes as capable of equivalence which allow the parties to agree contractually to legal protections that have the same effect as Union law.

In addition to considering whether a particular third country is "equivalent", ESMA should be mindful of other measures that can be employed to facilitate investor protection, which can be incorporated into ESMA's proposed criteria (described more specifically below). The ability to achieve investor protection through contractual measures agreed between market participants is already well known and employed widely in European Union law. For example, Chapter V of Commission Directive 2010/43/EU of 1 July 2010 sets out detailed particulars of the standard agreement between a depositary and a management company. In the United Kingdom, the client fund segregation rules of Article 16 of Commission MiFID Directive 2006/73/EC of 10 August 2006 are implemented via the Financial Service Authority's CASS Rule 7.8, in which the bank holding an investment firm's client bank account must provide written acknowledgement to the investment firm that all money standing to the credit of the account is held by the firm as trustee and that the bank is not entitled to combine the account with any other account or to exercise any right of set-off or counterclaim against money in that account in respect of any sum owed to it on any other account of the firm. Contractual undertakings by service providers outside the direct scope of European Union law and regulation are therefore seen as important tools in providing for effective protection of investors.

Specific Comments on ESMA's Proposed Criteria.

- ***Box 2 criterion a: The depositary should be subject to authorisation and on-going supervision by an independent competent authority with adequate resources to fulfil its tasks***.

Reference in explanatory note 5 to Part II "*Regulator*" of the International Organization of Securities Commissions (IOSCO) Objective and Principles for Securities Regulation as well as the Basel Core Principles for assessment of independent authority is generally welcomed. This approach will mean that this criterion is not restricted to depositary oversight regimes that necessarily "match" the EU framework.

Members believe that the Advice should recognize -- and take into account -- that in some jurisdictions supervision and regulation of fund portfolio custody can involve multiple "supervisory" and "regulatory" authorities. In the United States, for example, substantive standards care and liability for custodial activities are dictated by a mix of state-level commercial law, state property law and federal regulation. At the federal level, primary standards for selection and oversight of fund custodians and subcustodians are set for investment companies by the Securities and Exchange Commission under US securities laws, while compliance examinations over funds' custody operations – largely the operations of banks -- are carried out by various banking supervisors, including the Treasury Department and the Federal Reserve. As a very practical matter, the structure of this legislative/regulatory regime – like that in place in other jurisdictions beyond the EU – will complicate the application of "equivalence" tests and principles, though the extent of rigor and discipline embedded in the regulation and oversight of US banks engaged in global custody activities cannot be questioned.

- ***Box 2 criterion b: The local regulatory framework should set out criteria for the eligibility to act as depositary that are equivalent to those set out for the access to the business of credit institution or investment firm.***

It is not clear whether the term "local" means the domicile jurisdiction of the depositary or the domicile of the non-EU AIF or both.

- ***Box 2 criterion c: The capital requirements imposed in the third country should be equivalent to those applicable in the EU to a credit institution or an investment firm.***

Most of the major third country financial centres like Hong Kong, Singapore and Zurich are members of the Basel Committee. In addition, the British Virgin Islands, Bahamas, Guernsey, Jersey and the Cayman Islands have implemented the Basel principles in their regulation. It is not known today how many third countries are capable of applying the Capital Adequacy Ratio Directive IV. Accordingly, in view of the evolving and uneven global work on capital requirements, how will the test for equivalence regarding capital be computed?

The AGC also recommends revising this criterion to address those non-EU depositaries that may be considered equivalent to those that are described in Article 21(3), sub-paragraph C)

(i.e., depositaries that are considered appropriately regulated and supervised which are neither credit institutions nor investment firms)[2].

- **Box 2 criterion d:** ***The operating conditions are equivalent to those set out for credit institutions or investment firms within the EU depending on the nature of the entity.***;

The term "operating conditions" and its application for purposes of an equivalence test is unclear. As a simple illustration, the operating conditions imposed on credit institutions and investment firms pursuant to Directive 2004/39/EC (MiFID) and its implementing texts may differ depending on the individual EU Member State.

- ***Box 2 criterion e: The requirement on the performance of the specific duties as non-EU AIF depositary established in the third country regulatory framework are equivalent to those applicable to those provided for Article 21 (8) to (15) and in the relevant implementing provisions.***

Members believe strongly that the reference to "*regulatory framework*" should be removed (or restated) because the current wording implies the need for third countries to revise their legislation, and many third countries are already so highly regulated (e.g. the USA) that such a revision exercise is practically unrealistic and may be seen as impairing or interfering with aspects of the third country regime. ESMA's advice should emphasize what is important -- that non-EU AIFs and their investors should benefit from basically the same legal protections as an EU AIF -- while leaving each third country the freedom to establish equivalence by its own means or by legal means practically possible. Members thus believe that the equivalence test should focus on the result and not on a specific means to achieve equivalence. Indeed, instead of trying to replicate the EU framework in third countries, which will be largely infeasible, it would be preferable to enable equivalence via a legal regime that allows the depositary and the AIF to establish similar requirements on a contractual basis. The existence of contractual provisions having an effect equivalent to the requirements of EU law could be a pre-condition for the non-EU AIF to benefit from the new AIFMD EU passport regime.

- ***Box 2 criterion f: The local regulatory framework provides for the application of sufficiently dissuasive sanctions in cases of violations by the depositary.***

This advice is welcomed, so long as strict equivalence of EU enforcement provisions is not required. Although the current wording appropriately implies flexibility in the means used to achieve dissuasive sanctions, it is not clear which element of which regulatory regime is referred to "*in case of violations*" by the depositary. Does this criterion refer to violations of the EU AIFMD (and if so how is this feasible) or of the third countries' regulatory framework? If the

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[2] "...another category of institution that is subject to prudential regulation and ongoing supervision and which, on 21 July 2011, falls within the categories of institution determined by Member States to be eligible to be a depositary under Article 23(3) of Directive 2009/65/EC."

latter, (which members believe would be inappropriate), does this suggest that revisions and adjustments would need to be made to the third countries' regulatory framework?

- ***Box 2 criterion g: The liability to the investors of the AIF can be invoked directly or indirectly through the AIFM, depending on the legal nature of the relationship between the depositary, the AIFM and the investors.***

This criterion is already covered under e. Article 21(15) and should therefore be removed entirely.

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Association members appreciate the opportunity to provide their collective views on the Consultation and strongly encourage ESMA to take the foregoing comments fully into account in its revisions. If the Association can provide further information, please contact the undersigned as an initial matter.

Sincerely yours on behalf of the Association,

Dan W. Schneider
Baker & McKenzie LLP
Counsel and Secretariat to the Association