

## THE ASSOCIATION OF GLOBAL CUSTODIANS

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### Via Electronic Transmission

Richard Stobo  
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European Securities and Markets Authority

### Re: AIFMD Implementation Issues

Dear Mr. Stobo:

I am pleased to have the opportunity to contact you today on behalf of the Association of Global Custodians (AGC). Established in 1996, the Association of Global Custodians is a group of 11 financial institutions that provide securities safekeeping services and asset-servicing functions to primarily institutional cross-border investors worldwide. Members' custody activities cover, on average, 87 jurisdictions. Members and their affiliates maintain nearly 13,000 offices globally, employing over 1.1 million people. The members of the AGC include many of the leading global custodians and fund depositaries in Europe, and we have been actively engaged to help our members to implement the Alternative Investment Fund Managers Directive (AIFMD).

We understand that ESMA, in efforts to ensure smooth implementation and consistency of the AIFMD across EU Member States, is working on Q&As, as well as continuing its work with national competent authorities.

The members of the AGC are working diligently to implement the new rules by July 2013 deadline, but it is apparent that there are challenges for all parts of the industry to adjust operating models within the very tight timeframe. As you will be aware, global custodians, in their capacity as fund depositaries, are significantly impacted in a number of ways by the AIFMD. One of the challenges that has come into focus is continuing insufficient clarity in the interpretation of some aspects of the legislation. This creates uncertainty about how requirements are to be met. There are also continuing tensions between the requirements of the directive and operational and market practices, not all of which are within the control of depositaries. We consequently seek clarity as to how the requirements of the AIFMD can be appropriately applied. We set out some of these issues below posed in the form of a Q&A document on which we seek ESMA's view.

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### **Question: Which circumstances permit a discharge of liability through contract to a prime broker appointed as depositary's sub-custodian?**

AGC Interpretation: We are of the view that when an AIFM's investment strategy depends directly on the provision of certain services by a prime broker, the AIFM's use of prime brokers on this basis, together with their acknowledgement and consent on behalf of the AIF to "transfer the liability", should satisfy the required "objective reason" for discharge, as this would be in the interest of the end investor to allow the AIF(M) to achieve its described investment strategy in the most efficient and transparent way.

[Reasoning: We are aware that law firms and others are offering divergent interpretations regarding contractual discharge of liability by which a depositary might "transfer" its liability to a third party such as a prime broker to whom the custody function is deemed "delegated" under the Directive. This creates uncertainty and difficulties in our implementation plans. As ESMA will be aware, it is the AIF(M), not the depositary, that selects a prime broker for services such as the provision of financing, collateral management, specifically tailored asset servicing services and other services not provided by traditional depositaries.]

### **Question: Which methods are acceptable to meet the cash monitoring challenges where accounts are already reconciled by an entity independent of the AIFM?**

AGC Interpretation: The depositary could conduct ex post monitoring of cash accounts through review of the independent reconciliation process that is already in place or a monitoring of flows using, where they exist and are deemed appropriate by the depositary, administrators' processes.

[Reasoning: Client cash accounts at clearing firms and brokers fall within scope of the cash monitoring function of the depositary. Global custodians acting as depositaries find this a significant challenge, as it is not practical for a depositary to perform an independent daily reconciliation of all cash flows in cash margin and/or collateral accounts. This would require inefficient duplication of the role of the administrator and associated data flows.]

### **Question: How far down the distribution chain is the depositary to reconcile subscription flows?**

AGC Interpretation: We interpret that the depositary cash monitoring duty should be limited to valid and accepted orders and related cash flows due to the AIFs.

[Reasoning: Subscription orders and cash flows move up the distribution chain in an unsynchronized fashion and with different aggregations. It is always the transfer agent's task to reconcile these flows and validate the subscription orders on behalf of the AIF(M). Without this affirmation by the transfer agent, the AIF would not issue units against those flows and consequently not own the cash.]

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**Question: Within the cash monitoring duties of a depositary, what is the meaning of end-of-day?**

AGC Interpretation: the regulation is a European regulation therefore end-of-day is assumed by AGC to be "close of business" European time. Any U.S. or Latin American activity will be captured on the following day.

[Reasoning: Cash Statements usually can be retrieved only once the market is closed for the day, hence reconciliation activity can only be started when the respective statements have been received. As some of the AIFs maintain funds in currencies traded in different time zones, the actual end-of-day of the depositary might be earlier than the end-of-day of the payment system the currency is held with, e.g., Americas vs. Europe.]

**Question: Will the placement of securities with ICSDs / CSDs / CCPs not be considered as a delegation irrespective of the capacity in which they act?**

AGC Interpretation: In principle, yes: we believe that the Commission has been consistent and clear in explaining that CSDs, ICSDs and CCPs are not intended to be treated as delegates of the depositary for the purposes of the AIFMD and Regulation.

[Reasoning: We are aware of differences in interpretation between parts of the industry and potentially also among Member States. The source of these differences is the lack of precision in the legislative text (at Article 21.11 of the Level 1 text): we believe it is important that the Commission's expressed intent be made clear in order to avoid these differences.]

**Question/Issue: The determination as to whether holdings in Collective Investment Schemes are to be recorded in the name of the depositary (or its nominee) or the AIF (or the AIFM on behalf of the AIF).**

AGC Interpretation: Unless required otherwise by local law, the decision whether to register in the name of the AIF(M) or the depositary (or its nominee) should be left to the agreement of the AIF(M) and the depositary and subject to relevant considerations such as the legal structure of the underlying fund.

[Reasoning: The decision as to how such investments should be recorded depends on legal, risk, practical and other factors, which vary depending on circumstances and structure of a particular investment.]

**Question: How does ESMA intend to cater for the extremely short timeframe for AIFMD and Regulation implementation given the late publication of the final Level 2 text?**

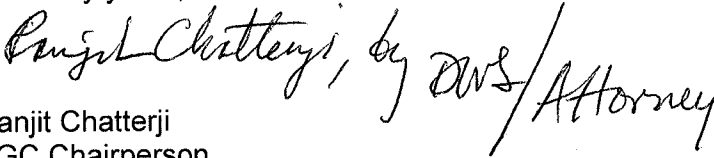
AGC Interpretation: ESMA should recognise the implementation difficulties faced by the industry – and should address how the time available in the transition timeline may best be used with these difficulties in mind.

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Collectively and individually, we are working towards solutions to the above-noted issues. We believe that we have some constructive ideas and that it would be useful to discuss them with you. Although we understand the burdens on you of the current regulatory agenda, we hope you agree that it would be helpful to discuss some of these issues so that we might offer some useful thoughts as ESMA moves towards finalising the rules and producing its FAQs.

Sincerely yours,

  
Ranjit Chatterji  
AGC Chairperson

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