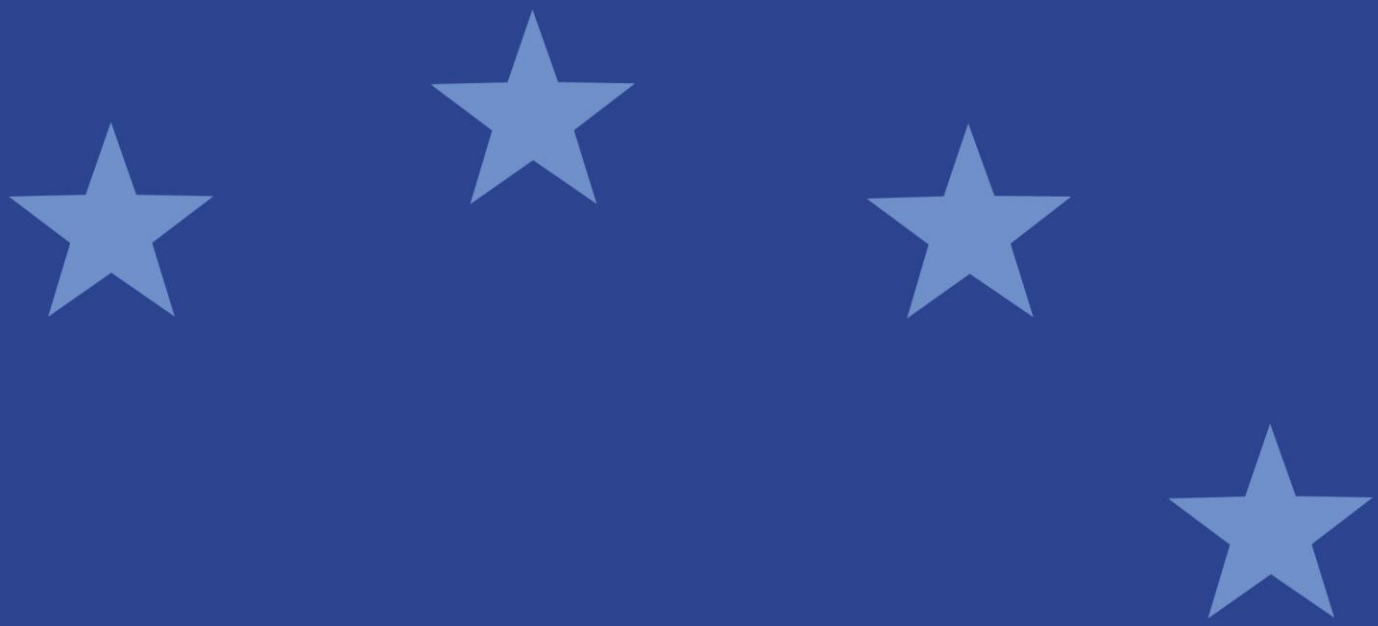
esma European Securities and Markets Authority

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>
The Irish Funds Industry Association ("Irish Funds") is the representative body of the international investment funds community in Ireland, representing the depositaries, administrators, managers, transfer agents, fund promoters and professional advisory firms involved in the international fund services industry in Ireland. Ireland is a leading centre for the domiciling, administration, and provision of depositary services to collective investment schemes. As of June 2016, there were 6,286 Irish domiciled UCITS and AIFs with €1.9 trillion in assets under custody (Source: Central Bank of Ireland). This represents over 14% of all European investment fund assets (Source: EFAMA Q2 2016). Irish domiciled funds are distributed to investors in over 70 countries across the globe and invest extensively in every region of the globe (Source: Monterey Ireland Fund Encyclopaedia 2015). ESMA's consultations on asset segregation are therefore of particular relevance and significance for the international funds industry operating in Ireland.

Irish Funds responded to ESMA's original consultation on asset segregation dated December 2014 and welcomes the fact that in recognition of the complexities and significant difficulties arising from potential asset segregation options, ESMA has decided to undertake a call for evidence on this subject. We wish to emphasise that while we agree with ESMA's stated objective to ensure that the interests of UCITS/AIF investors are protected in the event of an insolvency, the uniform application of greater physical account segregation is not necessary to achieve this. In the case of an insolvency of a delegate, greater asset segregation would not enhance the speed of return of assets, due to the nature of insolvency law and practices.

On the other hand, the account multiplier effect from greater asset segregation will lead to increased operational complexity, increased risk of error and a higher rate of settlement failure. This, combined with the attendant increase in account reconciliations and oversight will have a knock on impact on cost which will ultimately impact on the investor. The use of omnibus accounts is recognised under AIFMD, UCITS and under IOSCO's Standards for the Custody of CIS Assets as appropriate and the law and market practice in many developed markets has evolved to support their existence, as a safer and more efficient way to hold and settle assets. In other jurisdictions, where it is deemed necessary under legal advice to further physically segregate UCITS or AIF assets, the depositary will ensure that these arrangements are in place in line with its legal obligations to the fund and the investors, acting in their best interests. We therefore urge ESMA to refrain from mandating a uniform model requiring greater physical asset segregation and to take into account the different nature and structure of other markets globally and the protections afforded in those markets, which make further physical segregation unnecessary.

Ultimately, the depositary is held liable for loss of financial instruments held in custody in the event that the segregation requirements are not met and the depositary also has a responsibility to continually assess the local segregation arrangements to ensure that the risk of loss is minimised. From our perspective this should be the starting point when developing the guidelines, combined with the depositary's duty to always act in the best interests of the shareholders. Taking this approach, the final segregation guidelines need to provide sufficient flexibility to allow for the most appropriate arrangements to be put in place dependent on the local legal, regulatory and operational environment.
<ESMA_COMMENT_CE_ASCS_1>

Q1: Please describe the model of asset segregation (including through the use of 'omnibus accounts') in your custody chain/the custody chain of the funds that you manage. Please explain what motivates your choice of asset segregation at each level (e.g. investor demand, local requirements, tax reasons).

In your description, please take into account the following:

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

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

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

   iii) **the 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>
Answer to Question 1(a):

[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.

Firstly, we would like to point out that whether an omnibus account or further segregated account is opened in a particular market is driven by local legal opinions / legal analyses which are obtained by depositaries/global custodians and/or their delegates which indicate which structure is appropriate to protect such assets from the insolvency of a delegate in a particular market. It is only when there is no legal requirement to indicate that omnibus accounts are not appropriate that other considerations may apply as set out below (such as operational efficiency and risk considerations).

We would refer ESMA to the Irish Funds response to the ESMA Consultation Paper - Guidelines on asset segregation under the AIFMD, dated 30 January 2015, attached for ease of reference. In our response we provided a diagrammatic representation of each of the 5 Options outlined in the Consultation Paper.

Models predominantly employed by Members of Irish Funds are Options 4 and 5, depicted below. You will note that there is no difference in either model at Level 1 or above. Global Custodians and Prime Brokers are, without exception, in a position to maintain books and records at the level of the AIF or UCITS, or at sub-fund level if relevant.

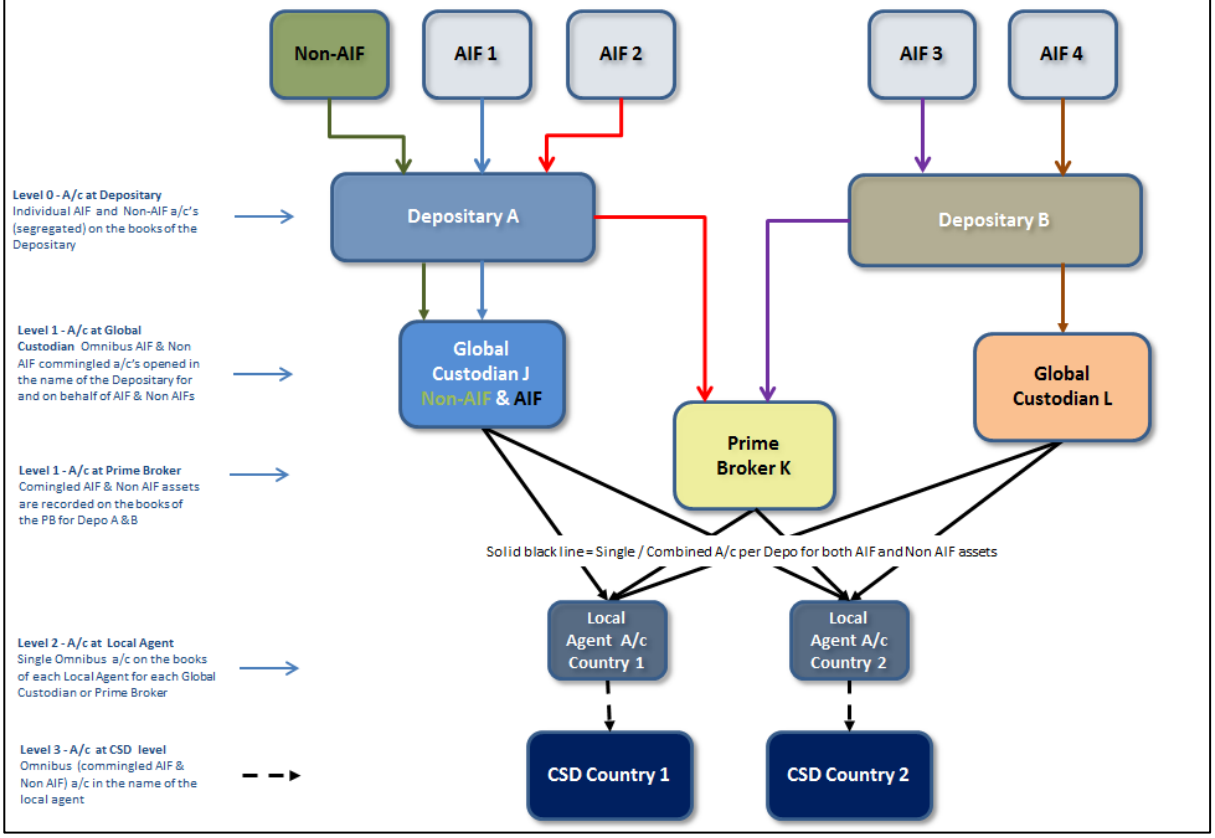
The motive for choosing any custodian chain model below Level 1 is not singular and in many markets there is no choice. The structure below Level 1 is driven by a combination of local settlement and safekeeping practices in the specific market concerned, systemic and reporting capabilities of local agent (Level 2) and CSDs (Level 3) and the local legal/regulatory requirement that has evolved over time to support the established market practices.

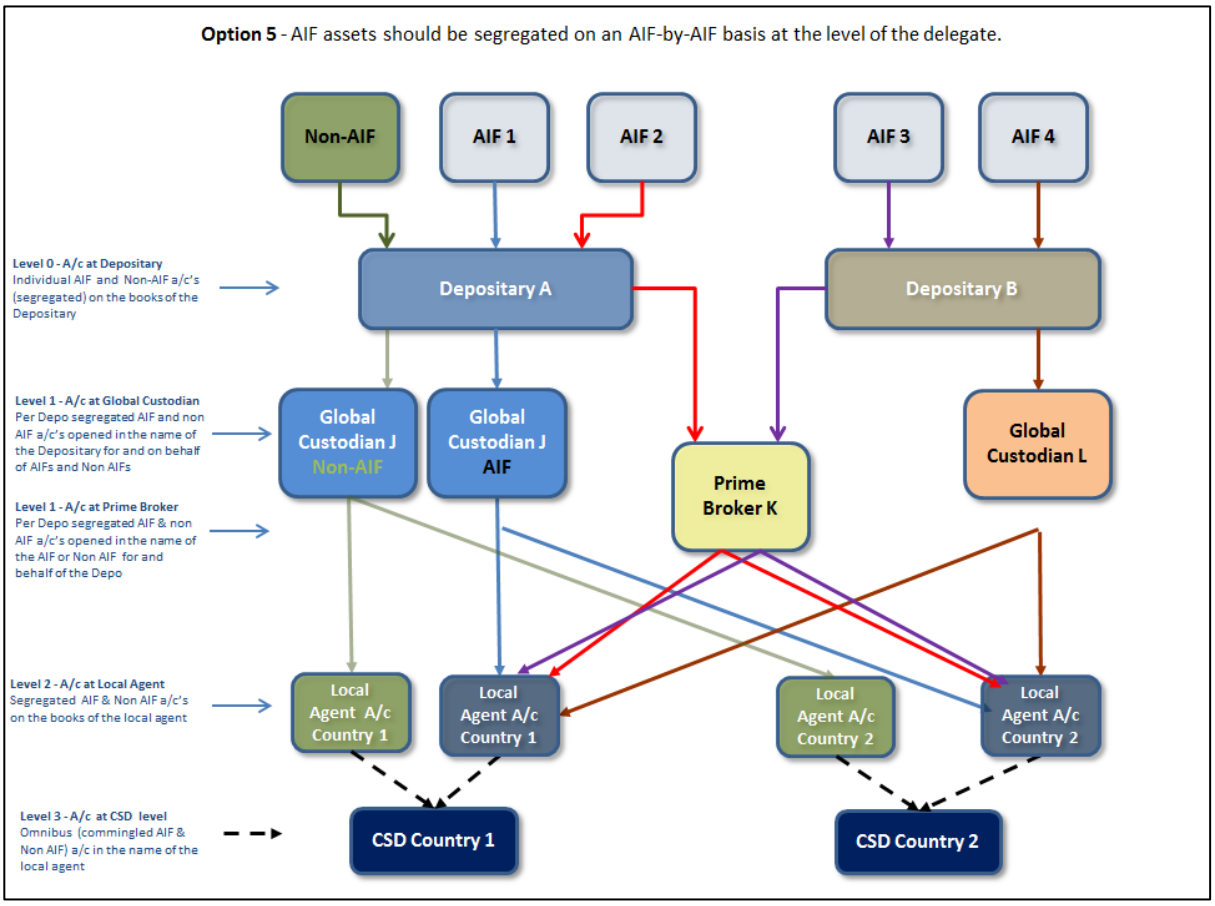
The primary concern for depositaries is to ensure segregation of its clients' assets (i.e. the assets owned by AIFS and UCITS it services) from the proprietary assets of the participants in the custodial chains depicted in the Options, having regard to a number of factors, not least local law and practice as it relates to determination of ownership in the local market with reference to account structures, naming conventions and registration requirements in that market. From the perspective of the depositary the optimum model therefore, particularly given the enhanced liability it has assumed for loss of assets under the UCITS Directive and AIFMD, is the model that best protects client assets in accordance with local practice for a particular market.

In several cases, and particularly in developing markets, the model employed is Option 5 or a close variant on this, where local requirements dictate that accounts must be maintained at Level 2 in the name of the ultimate beneficial owner (i.e. UCITS/AIF or depositary on behalf of UCITS/AIF or variant of same). In certain other markets, the use of omnibus accounts at Level 2 is a legal and regulatory requirement, for example in certain countries where specific requirements are imposed on account set-up for foreign investors (e.g. Finland, Greece, Malta and Turkey).

In markets where the use of Option 4 or 5 is optional, and where there are no additional legal protections to be gained for end-investors by sub-division of existing omnibus Level 2 accounts maintained for each Level 1 Global Custodian, other factors must be considered. Many of these have already been outlined in our original response, namely increased operational risks and costs (transaction costs, legal costs, system development (all Levels in the chain), human resources etc.); increased settlement complexity and risk of failure; disruption of existing securities lending and collateral models for derivatives and repurchase contracts and medium term market disruption.

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.





Answer to Question 1(b)(i):

As noted above in response to Q1 (i), and only where omnibus accounts are employed in the custodian chain, they are employed at Level 2 and Level 3, i.e. books and records maintained by Global Custodian or Prime Broker with its local agent reflecting assets of all clients of the Global Custodian or Prime Broker (Level 2), and the local agents' accounts with the CSD (Level 3).

Answer to Question 1(b)(ii):

Legal ownership is normally determined by reference to the party registered as owner by the CSD in the local market, but is ultimately dependent on applicable law in each market. Beneficial ownership is determined by reference to books, records and contracts throughout the chain (it would normally be the AIF, UCITS or the depositary on behalf of the AIF or UCITS or variant of same).

The local agent maintains an omnibus account in the Central Securities Depositary ("CSD") for that market. Financial instruments of the AIF are held in the omnibus account maintained by the local agent at the CSD, registered in their name comingled with financial instruments belonging to all clients of that local agent.

Each local agent reconciles the records of financial instruments it maintains on its books for its clients, typically one omnibus account for each global-custodian or prime broker, to the omnibus account it maintains at the CSD where the financial instruments of all its clients are held.

The global custodian or prime broker will in turn maintain a record of financial instruments for each AIF client of the depositary, one account opened in the name of the AIF or AIFM on behalf of the AIF for each AIF

client. The global custodian or prime broker will reconcile its records across those AIF accounts to the omnibus account it maintains with the local agent, whose account records only those assets of the clients of the global custodian or prime broker.
As part of the due diligence process, the depositary oversees the record keeping and reconciliation processes of its delegates using the practices summarised below:

Regulatory Obligation	**Practices Employed (Where global custodians and prime brokers are used)**	**Practices Employed(where the depositary delegates custody of assets directly to local agents)**
1) Recording/Identification of Financial Instruments	- Delegated to global custodian	- Account opening/naming - Trade capture - Failed trade reporting and rectification - Corporate actions/income collection - Effecting reconciliations - Regular monitoring and oversight of agents employed
2) Record Accuracy	- Oversight of global custodian / prime broker asset servicing practices - Failed trade reporting - Reporting of reconciliation breaks - Regular monitoring and oversight of reconciliation practices through the custodial chain	- As above
3) Reconciliation	- Obtain evidence of reconciliations performed by global custodians/ prime brokers	- Perform reconciliations to local agent records directly - Onsite inspections. Oversight of reconciliations performed by local agents to CSD

	- Onsite inspections. Oversight of reconciliations performed through the custodial chain - Reporting of reconciliation breaks - Materiality and aged analysis / escalation	- Reporting of reconciliation breaks - Materiality and aged analysis / escalation
4) Due Care and 5) Organisational Arrangements	- Initial due diligence and ongoing monitoring through reporting and onsite inspections	- As per practices Employed where global custodians and prime brokers are used
6) Custodial Risks	- Credit rating monitoring - Monitoring of press releases and market surveys - Assessment of risk identification and reporting capabilities - Receipt of SEC Rule 17f5, 17f7 or similar legal opinions	- As per practices Employed where global custodians and prime brokers are used
7) Ownership rights	- Record of account structures and naming conventions - Record of registration methodologies - Oversight of reconciliation process through the custodial chain	- As per practices Employed where global custodians and prime brokers are used

	- Due diligence /Network Management	

In order to ensure that AIF and UCITS assets are adequately safeguarded, depositaries put various measures in place for the purpose of providing client protection when using global custodians/delegates. In particular, the depositary:

- conducts an extensive due diligence process before appointing a global custodian/delegate. This process includes on-site visits to assess the global custodians/delegates' controls and reconciliation systems. This exercise is repeated on an annual basis;
- undertakes regular reconciliations of the custodian records against those held by the fund administrator;
- has full and continuous access to the global custodian's/delegate's records via on-line portals or other similar means. Contractual requirements are generally imposed on such delegates to provide the depositary with relevant access and documentation; and
- requires that delegates comply with all relevant domestic client asset protection requirements (such as CASS in the UK) or other equivalent EU provisions/applicable law to which such delegates are subject.

As part of depositary's due diligence, it checks that the settlement of trades, corporate actions and reconciliation processes employed by a custodian are reflective of their books and records at a local account level in the custodial chain. This provides the depositary with comfort that there are robust processes in place to evidence that the records at the global custody fund level are an accurate reflection of assets held in the local market accounts.

In addition, many of the third party custodians used by depositaries are large financial institutions based in the EU, which are themselves subject to domestic client asset protection regimes or other equivalent regulatory provisions that provide additional protection and do not prescribe a level of segregation equivalent to Options 1 and 2 in the Consultation.

Answer to Question 1(b)(iii):

Rehypothecation by parties in the custodial chain is prohibited for a UCITS by contract, both between the UCITS and depositary and through the custodial chain, although it is normal for a depositary or its agents to take a security interest in fund assets to secure any obligations the UCITS (or AIF) may have to the depositary or its agents. The adherence to parties in the custody chain to this prohibition on rehypothecation is monitored by the depositary through its monitoring and reconciliation processes as set out in the response directly above.

For AIFs the investment strategy of the AIF determines the need for receipt of financing from a prime broker, and the appointed prime broker in turn may rehypothecate assets of the AIF up to a certain percentage value of financing extended to the AIF, agreed by contract and disclosed in the AIF prospectus.

The value of assets that a Prime Broker may rehypothecate is determined by reference to its books and records for the AIF at Level 1. Prime Brokers employ systems and procedures to carry out daily mark to market valuations of assets rehypothecated (and financing extended) to ensure percentage limits are not exceeded. Any excess rehypothecation that has occurred through market movement is rectified by a return of rehypothecated securities to the AIF. Rehypothecation levels are typically monitored by AIFMs and depositaries on a daily basis to ensure compliance with any limits.

Where the prime broker utilises omnibus accounts for its client base at Level 2, it performs reconciliations between its Level 1 transactions across its client base and the transactions at Level 2, to mitigate the risk of excess rehypothecation. Should more granular levels of segregation be imposed at Level 2 accounts, the

number of transactions and reconciliations required will increase exponentially, thereby further increasing cost and operational risk.

Answer to Question 1(b)(iv):

Members of Irish Funds consider this to be commercially sensitive and proprietary information. Irish Funds is not therefore in a position to collate this data across our membership. Where members decide to respond to the Call for Evidence directly they may be in position to provide this data.

Answer to Question 1(c):

As noted above in response to Q1(a), Omnibus accounts are never used at Level 0 or Level 1 in the custody chain. Their use at Level 2 or below is dependent primarily on local market requirements and practice in the first instance. Where it is not required to use either omnibus or segregated accounts at Level 2 or below, and where omnibus accounts are currently employed, it may be possible to sub-divide omnibus accounts to the level of a particular depositary and/or its clients (AIF/UCITS). It is not something Irish Funds would support however given the lack of any obvious benefit or additional protections to end investors when compared to the additional costs, risks and market disruption such a course of action would cause.

Answer to Question 1(d):

Options 4 and 5 are those that most closely match the models employed by the majority of our members, depending on the level of segregation required in the local market (please refer to response to Q1 (i) above).

In respect of model 4), at the level of the immediate delegate of the depositary and as noted above in response to Q1 (iv) (c), accounts are always segregated at the level of the AIF or UCITS (or sub-fund level if relevant). Omnibus level segregation will only be employed at level 2 or below.

Answer to Question 1(e):

Whether assets belong to an AIF or a UCITS has no impact on the determination of the model employed. As noted above in response to Q1(iii), the investment strategy of an AIF may require the appointment of a prime broker as a custodial delegate of the depositary. The position of depositaries is the same whether a global custodian or prime broker is appointed, the most important and critical consideration being that assets are segregated from all parties through the custodial chain in a manner that best protects and ensures the speediest return of assets in the event of an insolvency in the custodial chain. This may necessitate the use of omnibus accounts at Level 2, having regard for local market practice and legal frameworks that have evolved to support those practices.

We do not believe there is any evidence to support the assertion that sub-division of existing segregated omnibus accounts by AIF, UCITS or depositary (or a combination of same) may expedite a return of assets. In theory, it may facilitate speedier identification of the ultimate beneficial owner (being UCITS or AIF). In practice, exponentially increasing the number accounts in the custodial chain will increase risk of settlement failure and/or reconciliation breaks through the chain and may therefore have a counterproductive impact to that intended.

Answer to Question 1(f):

Irish Funds supports the position outlined in the response by the Association of Global Custodians European Focus Committee ("AGC"). As set out in the AGC response, depositaries are not in a position to employ a particular securities holding model through a cross-border chain of custody. For domestic holdings, this is possible, as the model employed will be a function of local law (for example, an Irish depositary/custodian holding Irish securities will do so as a bare trustee under Irish law). As set out in the AGC the position for cross-border holdings is more complicated and we support the detailed AGC response in this regard.

Answer to Question 1(g):

There is no definitive naming convention employed by all depositaries. Typically, the naming convention is chosen to demonstrate that the assets in the account belong to the client of the account holder (for example *abc depositary for the account of xyz UCITS or AIF*), to ensure assets are protected from the creditors of the account holder.

Similarly at Level 2, a global custodian will name its accounts with its local agents in a manner that protects the assets in that account from the creditors of the global custodian, having regard for local practice or requirements. This may be for example in the name of the global custodian for the account of its client or clients, or where required in the name of the ultimate beneficial owner, should local market requirements necessitate this.

<ESMA_QUESTION_CE_ASCS_1>

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?

<ESMA_QUESTION_CE_ASCS_2>
A depositary authorised in Ireland to perform fund depositary services is required to be an Irish credit institution, an Irish branch of an EU credit institution or an Irish company authorised under the Investment Intermediaries Act 1995. Irish law recognises the concept of client assets (e.g. assets of UCITS and AIF clients) being held in trust and therefore if an Irish depositary or its Irish sub-custodian becomes insolvent, assets held in trust will not form part of the estate of the Irish depositary/Irish sub-custodian.

Most "custody" assets of Irish funds are held, however, through the depositary's global custodian based outside Ireland, or a sub-custodial network based outside Ireland, pursuant to the provisions on delegation under the UCITS and AIFM Directives.

The books and records of the global custodian (the first delegation level) will show separate accounts in the name of the depositary for:

- the depositary's own proprietary assets (if applicable);
- each of the clients of the depositary (segregated accounts in the name of the depositary and each client).

These assets will be segregated from the global custodian's proprietary assets and that of its other clients.

The books and records of the global custodian's sub-delegate (second delegation level) will show accounts in the name of:

- the global custodian (first delegation level) for that global custodian's proprietary assets;
- the clients of the global custodian (omnibus account);

- the sub-delegate's other clients (omnibus where the clients are other global custodians on behalf of their clients and segregated accounts where the sub-custodian has a direct relationship (first delegation level) with the client;
- the sub-delegate's own proprietary assets.

Insolvency of depositary

If the depositary becomes insolvent, client assets held in the name of the client or the depositary on behalf of the client will not form part of the insolvent estate of the depositary.

The liquidator will reconcile the depositary's client books and records against the accounts held at the global custodian in the name of each of the clients of the depositary, and also reconcile the depositary's account containing proprietary assets with the depositary's own record of its proprietary assets.

The liquidator would also reconcile the omnibus accounts in the name of the global custodian at the level of its sub-custodians with the records of the global custodian to ensure that there was a match of holdings at the sub-custodians with those of the global custodian in aggregate, for each client of the global custodian.

Insolvency of global custodian

If the global custodian (first delegation level) becomes insolvent, its client assets (i.e. the client assets of the depositary) should not form part of the insolvent estate of the global custodian. The liquidator would reconcile the statements held by the depositary for each of its clients, with the records of the global custodian. The liquidator would also reconcile the records of the global custodian with the records of the sub-delegate to ensure a match of holdings across the entire chain from the sub-delegate, through the insolvent global custodian's records and then onto the depositary's records (if these are separate from the global custodian). The books of the global custodian, (the first delegation level) will show an account in the name of the depositary for:

- the depositary's own proprietary assets, if applicable.
- each of the clients of the depositary, (segregated accounts in the name of the depositary and each client), as well as segregated accounts for all other clients of the global custodian.

The books of the sub-delegate (second delegation level) will show accounts in the name of the:

- global custodian (first delegation level) for the global custodian's proprietary assets (if any);
- clients of the global custodian;
- the sub-delegate's other clients;
- the sub-delegate's own proprietary assets.

Insolvency of sub-delegate

If the sub-delegate becomes insolvent, its client assets (i.e. the assets of the global custodian) should not form part of the sub-delegate's insolvent estate.

The books of the sub-delegate will show an account in the name of the global custodian for:

- the global custodian's own proprietary assets (if applicable);
- the clients' of the global custodian in an omnibus account.
- The books of the sub-delegate will also show accounts in the name of the:
- the sub-delegate's other clients;
- the sub-delegate's own proprietary assets.

Insolvency of Other Party

In our view, if a party whose assets are held in another person's omnibus becomes insolvent, this of itself would not disadvantage the position of solvent parties whose assets are in the same omnibus account. The position of the insolvent party post-insolvency should not be any stronger than it would have been prior to the liquidation i.e. it would not have a claim on assets to which it would not have been entitled prior to the insolvency. The assets of the insolvent client will be recorded in the books and records of the depositary/global custodian separate from those of other clients and these should be capable of being reconciled with the statements of assets that have been issued to the insolvent client. The estate of the insolvent client would not have a legitimate claim over the assets beneficially owned by other clients held in an omnibus account along with those of the insolvent client.

We also support the AGC response to this question.
<ESMA_QUESTION_CE_ASCS_2>

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>
Under Irish law, there would be no difference, in principle, between omnibus accounts and separate accounts in terms of the return of assets in an insolvency situation. At the end of our response to Question 2 above, we indicated that the estate of an insolvent client whose assets are held in an omnibus account would have no claim on the assets of other clients held in that omnibus account, and to substantiate that position, the books and records of the relevant depositary/delegate should be capable of reconciliation against the statements of assets issued to the insolvent client. Obviously, the ability to distinguish between clients' interests where separate accounts are opened may initially assist in identification; however it is unlikely to lead to greater ease of speed in the return of assets on transfer to another delegate on insolvency due to a number of factors, including the following:

- the differences in insolvency law and practice in the relevant jurisdictions at the various levels of the custodial chain;
- problems involved in unravelling securities lending and other derivative contracts to which the assets may be subject;
- resolving the security claims and interests (including liens) of the various parties throughout the custodial chain.

In addition, the proliferation of accounts would be likely to lead ultimately to greater difficulty in record reconciliation and risk of error. It would also have a significant impact upon cost which would outweigh any benefits to separate accounts.

We also support the AGC response to this question.
<ESMA_QUESTION_CE_ASCS_3>

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>
To answer this question it may be helpful to examine the start of the ownership chain. It is unavoidable that the right of an AIF to a security will not be reflected in an omnibus account at the CSD. It follows that the AIF's right to those securities is dependent upon the controls and processes of the sub-custodian to reconcile its records with those of the CSD. The use of separate accounts by the sub-custodian clearly does not strengthen that reconciliation process as there would never be a one to one relationship between the positions per the CSD and the account structure used by the sub-custodian. Once we accept that the very first link in the ownership chain starting at the CSD operates satisfactorily without separate accounts at the CSD, it follows that the same principles can be applied equally effectively throughout the custody chain.

i) effective reconciliation,

Depositaries and sub-custodians have developed highly effective automated reconciliations which operate equally effectively with either omnibus or separate accounts. Please see response to question 1 b (ii). Accordingly, where possible those reconciliations are performed via SWIFT messaging.

ii) traceability (e.g. books and records), or

It is sufficient that separate accounts per AIF are maintained by the depositary. Those balances can be linked, through a reconciliation process, to the balances held by the sub-custodians with the CSDs.

iii) *any other means (e.g. legal mechanisms).*

The account structure used does not change the legal relationship of any of the parties in the custody chain, nor does it give AIF any additional legal rights.

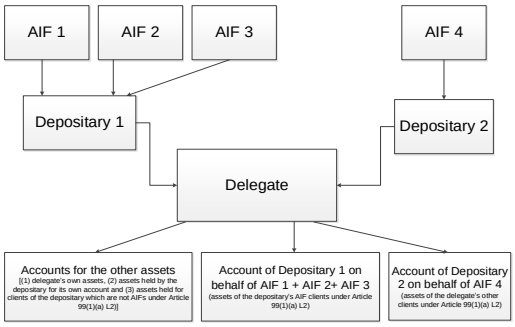
We support the AGC response to this question. The model typically operated by appointed global custodians, is one where they open segregated accounts in their books in the name of each client of the depositary. In addition, they open an omnibus account at each of their local sub-custodians worldwide classified as a client omnibus account. They aggregate all client assets in those client omnibus accounts and instruct movements to and from the client's segregated accounts in their books and corresponding movements at

the sub-custodian from the client omnibus account, according to authorised instructions from the investment manager.

Each day, they reconcile the sub-custodian omnibus client accounts with their own records of aggregated client holdings and resolve discrepancies, normally within 24 hours. Such daily reconciliations provide the traceability and assurance that the client's assets are accurately recorded throughout the custody chain.
<ESMA_QUESTION_CE_ASCS_4>

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?

<ESMA_QUESTION_CE_ASCS_5>
A default of Depositary 2 would not have any impact on AIFs 1 to 3 or Depositary 1.

Depositary 1 and 2's rights are dependent upon the terms of their sub-custodian agreements with the Delegate and the local insolvency laws. Those rights do not change whether separate accounts or omnibus

accounts are used. In terms of speed of return of assets please note the letter on the Lehman insolvency from PwC as appended.

<ESMA_QUESTION_CE_ASCS_5>

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>
The two key objectives are:

1. "***clearly identifiable as belonging to the AIF/UCITS***" – There is a logical link all the way from the books and records of the depositary, which will maintain separate accounts for each AIF, through omnibus accounts with sub-custodians to the position held at the CSD that will establish the assets belonging to each AIF. It is self-evident in that without such a link, it would not be possible for the various parties in the chain to reconcile their respective records.

2. "***avoiding the ownership of the assets being called into question in case of the insolvency***" – The ownership of the assets at each point of the custody chain is determined by the contractual relationship between the two parties at that point in the chain. A UCITS/AIF has no contractual claim against a sub-custodian and consequently the use of separate accounts for each UCITS/AIF cannot influence any questions regarding ownership.

[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).

It should be pointed out that any separate accounts maintained by a sub-custodian has no evidentiary value in showing those securities are owned by that UCITS or AIF. The sub-custodian has not verified that the UCITS or AIF owns those assets; it has simply allocated securities on the instruction of the depositary.

Answer to Question 6(a)

There is a logical link all the way from the books and records of the depositary/delegate of the depositary as appropriate, which will maintain separate accounts for each AIF, through omnibus accounts with sub-custodians to the position held at the CSD that will establish the assets belonging to each AIF.

Please note response to question 1 b (ii).

Furthermore, it should be noted that:

- Financial instruments are held at CSDs not with depositaries or their delegates / sub-custodians or global custodians. In the custody chain (account providers) provide access to the (account holders).

- Therefore all recording keeping throughout the chain reconciles back to the CSD ultimately and the custody chain is a essentially a recording keeping and reconciliation process.

- Local delegates/ sub-custodians may maintain omnibus or segregated client records or accounts. This will be based on the factors previously outlined, legal operational efficiency etc. Creating unnecessary additional records only serves to delay account opening processes, create costs and make the reconciliation process more complicated.

- Global custodians maintain client by client segregated books and records.

- In all levels of the custody chain - client and proprietary assets are segregated.

- As set out elsewhere in our responses, the depositaries monitor their delegates and the robustness of their reconciliation processes etc.

Therefore, if a local delegate/ sub-custodian is holding 100 securities for a global custodian the global custodian will reconcile back to its records and the local delegate/ sub-custodian to the CSD. Each delegate will have contractual and legal requirements to maintain accurate records. Naturally, it is easier to perform reconciliations throughout the chain when the number of accounts and records are reduced as opposed to being increased for example if Options 1 and / or 2 in the CP were mandated.

We are not aware of member depositaries or their delegates 'losing financial instruments' as the above process works in multiple markets with multiple delegates as the key issue is to ensure that securities are 'ring-fenced from the insolvency of the delegate' and this is achieved via assessment of any local law insolvency requirements.

Depositaries monitor for fraud, unusual transactions and reconciliation processes. Where there is a fraud or error (i.e. client error with incorrect account instructions) this is traceable to the relevant fund account and is not impacted by segregation / omnibus account structures. However, the omnibus structures provide numerous benefits i.e. in respect of corporate actions, operational efficiencies and cost saving.

The creation of numerous unnecessary segregated accounts and records would mean that the reconciliation process and oversight process would become unduly complicated with no clear benefit to underlying funds.

Indeed the fraud checks would become more challenging across dramatically increased accounts and records throughout the chain with multiple reconciliation breaks thereby draining resources with no increased fraud detection capabilities.

Separately, it should be noted that there are substantial differences between triparty collateral custody models and global custody services. For example, in respect of collateral management, the beneficial ownership of collateral changes frequently, even intra-day, and it would be challenging/impossible/risky to accurately update multiple records and accounts throughout the chain. Again this would also make fraud detection or unusual account activity more challenging to reconcile by causing delays and complications.

Answer to Question 6(b)

All that is required in insolvency proceedings of a sub-custodian, is to identify the securities that the sub-custodian holds on behalf of the depositary. The ownership by the respective funds is not relevant for that purpose.

Answer to Question 6(c)

The IOSCO Final Report (FR25/2015) on Standards for the Custody of Collective Investment Schemes Assets (the "IOSCO Report") refers to omnibus accounts under "Chapter 3 – Key risks around the custody of CIS assets" and the heading "Risk of co-mingling / misuse of CIS assets / segregation". As this IOSCO Report shows, the use of properly controlled omnibus accounts does not increase the risks associated with co-mingling or segregation.

The risk of misuse of assets, exists whether the CIS is in an omnibus or segregated account throughout the custody chain. In respect of fraud and the Madoff case, the risks of loss in that scenario are exactly the same across omnibus and segregated accounts. Madoff had authority to move assets from client accounts whether they were classified as omnibus or segregated accounts.

Most importantly, we note that the IOSCO Report does not make a recommendation in respect of segregating CIS assets other than the industry standard of segregating proprietary assets from clients' assets, which is normal commercial practice.

<ESMA_QUESTION_CE_ASCS_6>

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]?**

[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 partici-

- **Through T2S**

- **Prime broker services**

- **Tri-party collateral management / securities lending.**

<ESMA_QUESTION_CE_ASCS_7>
Irish Funds supports the AGC and AFME responses to this question.

<ESMA_QUESTION_CE_ASCS_7>

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>
Irish Funds supports the AGC and AFME responses to this question.

<ESMA_QUESTION_CE_ASCS_8>

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>
Irish Funds supports the AGC and AFME responses to this question.

<ESMA_QUESTION_CE_ASCS_9>

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

pant 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).

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>
Irish Funds supports the AGC and AFME responses to this question.

<ESMA_QUESTION_CE_ASCS_10>

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>
Irish Funds supports the AGC and AFME responses to this question.

<ESMA_QUESTION_CE_ASCS_11>

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

<ESMA_QUESTION_CE_ASCS_12>
Irish Funds supports the AGC and AFME responses to this question.

<ESMA_QUESTION_CE_ASCS_12>

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>
Irish Funds supports the AGC and AFME responses to this question.

<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>
Irish Funds supports the AGC and AFME responses to this question.

<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?

<ESMA_QUESTION_CE_ASCS_15>
Irish Funds supports the AGC and AFME responses to this question.

<ESMA_QUESTION_CE_ASCS_15>

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

[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*".

understand by "legal certainty risk and "attendant operational risk". How could those risks be mitigated?

<ESMA_QUESTION_CE_ASCS_16>
Irish Funds supports the AGC and AFME responses to this question.

<ESMA_QUESTION_CE_ASCS_16>

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>
Irish Funds supports the AGC and AFME responses to this question.

<ESMA_QUESTION_CE_ASCS_17>

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>
Irish Funds supports the AGC and AFME responses to this question.

<ESMA_QUESTION_CE_ASCS_18>

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>

Yes, we believe enforcement of Option 1 would negatively impact on AIF and UCITS strategies in jurisdictions that operate local customer protection rules, for example the U.S. SEC's (customer protection rule) 15 C 33. The requirement to segregate fund assets in a manner that is not compatible with established local practice will preclude funds from being able to avail of certain investment strategies, notwithstanding the fact that the protections afforded to investors exceed those based solely on segregation alone.

In the context of the Shanghai-Hong Kong Stock Connect programme, if HKSCC were considered a delegate, any segregation requirements imposed on delegates would apply. As we have previously outlined to ESMA, HKSCC is not prepared to identify in its books and records accounts of underlying account holders other than those of direct participants. This raises the obvious concern that if imposed segregation requirements cannot be complied with, investors in UCITS and AIFs would not be able to access the China A-share market under such an interoperability arrangement.

In the case funds investing in China A shares through the Shanghai-Hong Kong Stock Connect programme, notably those depositaries supporting the enhanced model through the Special Segregated Accounts ("SPSA") structure, Option 1 would give rise to operational challenges linking omnibus accounts between China's clearing house, ChinaClear and Hong Kong's clearing house, CCASS.
<ESMA_QUESTION_CE_ASCS_19>

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.

<ESMA_QUESTION_CE_ASCS_20>
As noted in our response to Question 1, the majority of our members employ Options 4 and/ or 5 from the CP, as dictated by local market practice and in accordance with applicable local law opinions.

It is our understanding that it would not be currently possible to employ Option 1 for AIFs that appoint prime brokers for financing arrangements or for UCITS /AIFs which utilise BNY Mellon for triparty collateral arrangements.

In this regard, we would draw your attention to previous responses above; however, we understand that the additional layers of segregation in Options 1 and 2 do not add to investor protection or a speedier return of assets. We would also reiterate the increased operational risk, costs and broader issues noted above in previous responses that this added layer of complexity would introduce.

Securities accounting opening requests in local markets are initiated by the depositary, or the global sub custodian. Requests are sent to each sub-custodian, governed by the terms and conditions of the sub custody agreement. In markets where segregated accounts are not supported, financial instruments are held at central securities depositories (CSDs), such as the Depository Trust Company (DTC) or international central securities depositories (ICSDs) such as Euroclear, are held in omnibus accounts per the non-negotiable terms of these facilities.

<ESMA_QUESTION_CE_ASCS_20>

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>
Account opening fees, maintenance costs etc. are subject to the negotiating power and commercial arrangements between each agent bank and its sub delegates. It is difficult therefore to quantify what the potential costs would be not least, the push back from local delegates on the additional administrative tasks associated. <ESMA_QUESTION_CE_ASCS_21>

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>
Irish Funds supports the AGC and AFME responses to this question.
<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].

[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.

a) **Do you consider that a regime similar to the one under Article 38 of the CSDR but applied throughout the custody chain (according to which the manager of AIFs/UCITS, on behalf of their investors, informs the depositary of the level of asset segregation it wishes to apply throughout the custody chain to each individual AIF/UCITS, after having duly assessed the risks and costs associated with the different options) would achieve the policy objective described in the above introduction? Please explain why and, if the answer is yes, how.**

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>
Irish Funds supports the AGC and AFME responses to this question.

<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>
Irish Funds supports the AGC and AFME responses to this question.
<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>
Yes, a common definition of custody across all relevant legislation such as AIFMD, UCITS V and CSDR would be beneficial to provide clarity in the marketplace. This definition needs to recognise the different elements of a custody service as well as the different providers including custodians, prime brokers, collateral managers, CSDs acting in an issuer CSD capacity, CSDs acting in an investor CSD capacity and financial market infrastructure interoperability arrangements. This should all be considered with overriding focus on transparency, consistency and investor protection. Furthermore, it is essential that any efforts towards establishing a common definition of custody should be consistent with global operating models, given the global nature of investment fund and securities markets. We therefore would encourage further consideration of these topics through fora such as IOSCO.

We also support the AGC response to this question.
<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>
No – In addition, a), b) and c) as stated describe attributes that are unique to central securities depositories. We support the AGC response to this question.
<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.

[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_27>
We support the AGC response to this question.

<ESMA_QUESTION_CE_ASCS_27>

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>
For the purposes of the legislation referenced above, the term 'custody' sets out how and where the fund assets are held. 'Safekeeping' sets out the obligations imposed on a depositary to ensure that ownership of the assets is verified and that through the depositary's decision-making and due diligence process, suitable third party/ies are selected to hold the fund assets in segregated accounts in custody and thereafter the depositary will perform regular monitoring and oversight of the parties selected and of the fund assets held in custody.
<ESMA_QUESTION_CE_ASCS_28>

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>

Certain CSDs (namely those offering ancillary services under a banking license) are competing with UCITS/AIF depositaries and their third party delegates by offering identical services, and these are being offered on unequal terms due to the fact that such CSDs are exempted under EU regulation from the strict liability requirements which UCITS/AIF depositaries are intended to comply with under their respective Directives.

Whereas under the AIFM Directive, CSDs, as operators of SSS, are outside the scope of the relevant provisions applying to third-party delegates, Recital (21) of the UCITS Directive contemplates circumstances where "entrusting the custody of securities of the UCITS to any CSD, or to any third-country CSD should be considered to be a delegation of custody functions".

Certain CSDs become interposed as third-party agents in the custody holding chain by providing custody in relation to securities that are initially issued in another CSD, while offering a range of ancillary services in

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

direct competition with those offered by UCITS/AIF funds' depositaries. These "investor CSDs" are domiciled in local jurisdictions where they operate an SSS, but only for a limited number of securities (either local securities or Eurobonds) and for which they also provide notary and/or central maintenance services. In this capacity, they qualify as an "issuer" CSD, but for these few securities only.

For the industry to operate on a level playing field, Irish Funds is on the view that clarifications need to be made to recognise the different roles that CSDs can play. While CSDs may be classified as either "investor" or "issuer" CSDs that relying solely on the issuer CSD / investor CSD distinction can be problematic and concerns have arisen that the "investor CSD" category may capture some CSDs which should not be regarded as delegates. CSDs that provide access to other CSDs using links that are intermediated by entities that are not Securities Settlement Systems (SSS) should be classified as falling within the scope of depositary delegation arrangements. However, CSDs which are providing access to other CSDs using direct links under interoperability arrangements between SSS entities should be classified as infrastructure and not as delegation arrangements.

Examples would include the Target2Securities arrangements for greater cross-border settlement efficient in Europe, introduced by the ECB and the Shanghai-Hong Kong Stock Connect programme operated jointly by the Hong Kong Securities Clearing Company Limited (HKSCC) and ChinaClear. Article 7 of the China Securities Regulatory Commission (CSRC) Stock Connect Rules mandates both ChinaClear and HKSCC to perform their functions effectively as joint CSDs, together acting as a "top tier level" CSD function as described under Recital 21 of the UCITS Directive.

Furthermore, there is concern that careful consideration should be given to the impact of any segregation requirement that would apply to CSDs if they are considered "delegates" due to the increasing use of financial market infrastructure (FMI) interoperability arrangements throughout the world and which are expected to grow significantly.

Further clarity as to the circumstances in which a loss of assets by a CSD could be considered an "external event" would be beneficial. We do see some merit in the introduction of such a clarification, at least in circumstances where the depositary has no choice in the selection of the CSD, would avoid a result whereby the depositary is forced to underwrite risks beyond its control. However, in order to avoid the dilution of the protection afforded to UCITS and AIFs under the current regime, we believe that this clarification should be accompanied by steps to impose the UCITS V / AIFMD standard of care on CSDs directly where they hold financial instruments in custody on behalf of a UCITS or AIF.

If the industry is required to engage with CSDs in order to re-negotiate putative "non-negotiable" terms of participation and other relevant arrangements, lack of clarity will inhibit chances of success as questions of interpretation inevitably arise. CSDs in many cases will continue to insist that requirements of UCITS V and AIFMD do not apply to them as operators of SSSs and as FMIs subject to the CSD Regulation. In this context, it is relevant to note that members of Irish Funds have received independent legal advice to the effect that the last sentence of Recital 21 of UCITS V is inoperative, as by itself it cannot change the substance of the main text. In support of this view is the argument that if the intention of the main UCITS V text had been for some CSDs to be treated as delegates, then there would have had to be a formal assessment of the impact of such a policy choice; as there is no such impact assessment, then this is a strong indication that there was no such policy intention.

A second important consideration is that this discussion is not primarily a discussion about safety in sub-custody chains. By placing a restitution obligation on depositaries, AIFMD and UCITS V require depositaries to meet a very high standard with respect to safety in sub-custody chains; CSDR places similar requirements on CSDs with relation to CSD to CSD links.

From the perspective of Irish Funds, this discussion is principally a discussion about ensuring clarity in regulatory obligations, and in minimising complexity and uncertainty with respect to contractual discussions and operational procedures.

In light of these considerations, Irish Funds is of the view that further clarity is needed in relation to the treatment of CSDs and given the complexities involved, an impact assessment an impact assessment may

be beneficial in relation to any changes being contemplated. Over the shorter term, a clarification that CSDs are not generally to be treated as delegates would be beneficial. However, the level playing field concern needs to be addressed as a matter of serious market concern. Irish Funds is aware that the topic of whether CSDs are delegates does give rise to concerns about competition (as, for example, there is a common perception that the use of investor CSDs grants an exemption from the restitution obligation of a depositary) and about safety in the custody chain. Irish Funds believes that these are important concerns that may be dealt with in other pieces of legislation.
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