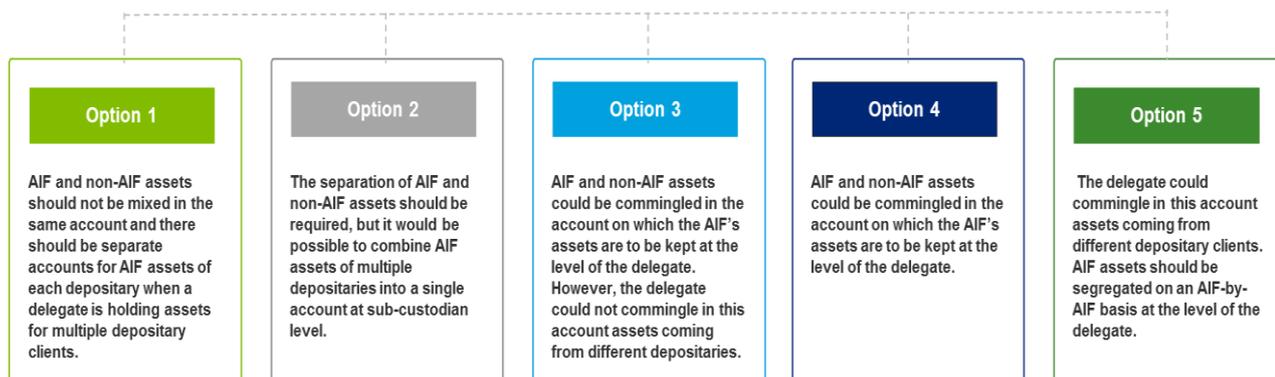


## Responses to ESMA's Consultation on Guidelines on Asset Segregation under the AIFMD



On 1 December 2014 ESMA published a Consultation on Guidelines on Asset Segregation under the AIFMD (the Consultation Paper).

In it, ESMA proposed five options for the segregation of assets by a sub-depositary, in circumstances where an AIF's depositary had outsourced the custody of the AIF's assets. The five options are summarised in the chart [below]. We reviewed the Consultation Paper in our [December newsletter](#). In brief, ESMA proposed that the first two options in the Consultation Paper were preferable, and that the remaining three should be discarded.



## Background

The first option requires the sub-depositary to hold AIF and non-AIF assets in separate accounts, with separate accounts for the AIF assets of each depositary when a delegate is holding assets for multiple depositary clients. The second option mandates the separation of AIF and non-AIF assets, but allows the combination of AIF assets of multiple depositaries into a single account at sub-custodian level. The diagrams [overleaf] illustrate both options.

The deadline for receipt of responses was 30 January 2015, and ESMA has now published some of the responses to the Consultation Paper. We have reviewed the responses submitted by the Irish Funds Industry Association (IFIA), the Alternative Investment Management Association (AIMA) and the European Fund and Asset Management Association (EFAMA) and summarise them below.

AIMA were strongly of the opinion that Option 4 was more appropriate than either Options 1 or 2. They considered that Options 1 and 2 would incur significant additional operating costs, which would ultimately be passed on to investors. Another possible consequence of Options 1 and 2 according to AIMA was the restructuring of depositaries and prime brokers, which could result in fewer participants acting as sub-depositaries or prime-brokers, which they considered would be a poor result for investors.

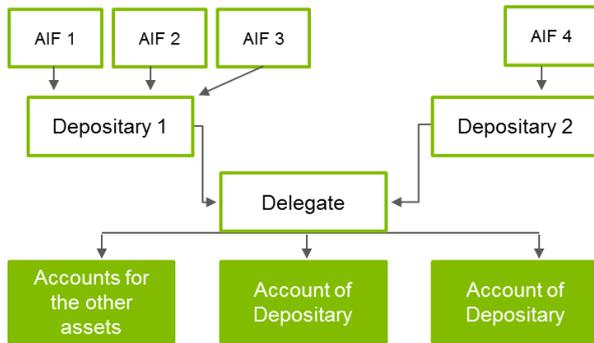
They argued that Option 4 was similar to the current prime-brokerage model, and that it complies with the text of both AIFMD and the Level 2 Regulations, as these only require the assets to be identifiable from records and books.

The IFIA also considered that neither Options 1 nor 2 were optimal and that both options would lead to a 'dramatic increase in the cost and complexity of the system due to the extrapolation of accounts and associated reconciliations', without necessarily enhancing investor protection. In their view, investor protection would be better achieved by focusing on maintaining proper records and

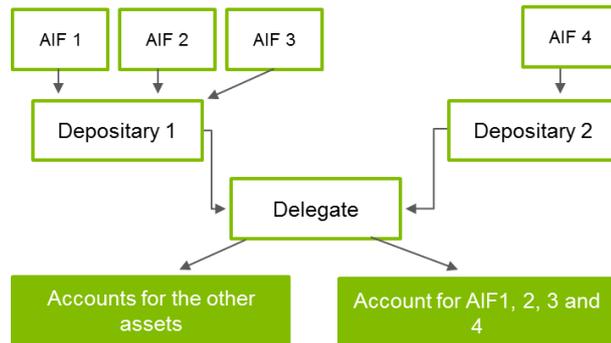
reconciliations at each stage of the custody chain to ensure that AIF assets are always readily identifiable. They noted that such record keeping and 'accounting segregation' was already established in most developed financial jurisdictions and is relied upon as an effective means of identifying asset ownership. They considered that Option 4 achieved the overall policy objective of investor protection while also complying with the regulatory requirements. However, if Options 1 and 2 were the only available options, they would prefer Option 2 as long as ESMA provided further clarity to ensure consistency.

The EFAMA response had some parallels to the IFIA response. According to the EFAMA, neither Option 1 nor 2 were optimal in achieving the aim of investor protection, and 'registration of individual assets in separate accounts' would guarantee asset protection equally well. Moreover, they considered that commingling of AIF and non-AIF assets at the level of delegate would not be an obstacle to maintaining a 'high standard of investor protection where the depositary and its delegates maintain robust processes, procedures and associated controls to: distinguish all records of an AIF's financial instruments; monitor the settlement cycle of the transactions of financial instruments, and reconcile the assets'. EFAMA's preference would be for Option 2 to be amended whereby the depositary segregates/maintains record-keeping of AIFs' accounts in its books and ensures that its delegate at the first level of the custody chain segregates the assets of the depositary's clients from its own assets and from the depositary's own assets. Failing that, they would prefer Option 4. If forced to choose between Options 1 and 2, EFAMA would choose Option 2.

### Option 1



### Option 2



### Next steps

ESMA are reviewing the feedback received and will publish finalised guidelines in Q2 2015. It will be interesting to see whether the weight of industry opposition to Options 1 and 2 and preference for Option 4 causes them to re-consider their proposals.

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