CONSULTATION ON CARRYING OUT DEPOSITARY DUTIES IN ACCORDANCE WITH ARTICLE 36 OF THE AIFMD – CONSULTATION PAPER CP 78

We note the point made by the Central Bank of Ireland ("Central Bank") in CP 78 and Q ID 1021 of its recent Q & A "If an Irish entity proposes to provide the safe-keeping duties set out in Article 21(8) it must have authorisation to provide "custodial operations involving the safe-keeping and administration of investment instruments" under the Investment Intermediaries Act 1995 and that this includes assets referred to in both Article 21(8)(a) and (b)."

However, it is important to recognise that AIFMD and the AIFMD Level 2 Regulations ("Regulations") refer to two different types of assets in this context (namely financial instruments held in custody and other assets) and sets out separate obligations and criteria in relation to the "safe-keeping" of each of these assets types.

Recital 37 of AIFMD makes this point and states:

"The depositary should be responsible…for the safe-keeping of the assets of the AIF, including the holding in custody of financial instruments that can be registered in a financial instruments account opened in the depositary's books and all financial instruments that can be physically delivered to the depositary, *and for the verification of ownership of all other assets by the AIF or the AIFM on behalf of the AIF* (our emphasis)."

Article 21(8)(b) of AIFMD states:

(b) for other assets:
(i) the depositary shall verify the ownership of the AIF or the AIFM acting on behalf of the AIF of such assets and shall maintain a record of those assets for which it is satisfied that the AIF or the AIFM acting on behalf of the AIF holds the ownership of such assets;
(ii) the assessment whether the AIF or the AIFM acting on behalf of the AIF holds the ownership shall be based on information or documents provided by the AIF or the AIFM and, where available, on external evidence;
(iii) the depositary shall keep its record up-to-date.

Recital (111) of the Regulations state:

(111) When delegating safe-keeping functions related to other assets according to Directive 2011/61/EU, delegation is likely to concern administrative functions in most cases.

Article 90(2) of the Regulations sets out in detail the obligations of an entity undertaking the "safe-keeping" of other assets. These are described as the "Safekeeping duties regarding *ownership verification and record keeping*" (our emphasis)

Nowhere in the AIFMD or the Regulations does it stipulate that the entity providing Article 21(8)(b) services should register other assets in an account directly or indirectly in the name of the depositary or have physical custody of the other assets. Indeed, in most instances this will be practically impossible due to the nature of the assets and hence the duties in respect of other assets are limited to ownership verification and record keeping in recognition of this fact.

This is in contrast to the provisions of AIFMD relating to financial instruments which make it clear that such need to be entrusted to a depositary for safekeeping and subject to a strict liability regime

Further, as the Central Bank points out in its Q & A, Article 36(1) of AIFMD does not set out eligibility criteria for entities providing these services and the Central Bank requirements for such entities to have authorisation to provide "custodial operations involving the safe-keeping and administration of investment instruments" under the Investment Intermediaries Act 1995 goes beyond what is required in the AIFMD itself as it totally fails to distinguish between financial instruments and other assets.

It is the case that fund administrators currently carry out ownership verification and record keeping as part of the reconciliation process which is fundamental to the calculation of the net asset value of a fund. They do this today even where they are not authorised to provide "custodial operations involving the safe-keeping and administration of investment instruments" Accordingly, it follows that a fund administrator is the service provider with the most experience and proven capability to provide this service without the need for any additional authorisation.

Given that there is no physical custody requirement for other assets and no requirement for other assets to be registered in the name of a depositary in either AIFMD or the Regulations, there is no traditional "safekeeping" of other Assets. It therefore seems overly burdensome that a licensed fund administrator should need additional authorisation to provide Article 21(8)(b) safe keeping services, particularly as the processes required by AIFMD and the Regulations are already embedded in the reconciliation process that supports the calculation of net asset value by a fund administrator under its existing authorisation

We also note the Central Bank's proposal in relation to Fund Administrator's providing both Article 21(7) and Article 21(9) services under the depositary-lite regime provided for by Article 36(1). We do agree that the Article 21(9) oversight duties should be undertaken by a separate legal entity other than the fund administrator. This will ensure that the fund administrator does not face insurmountable conflicts of interests where it is effectively overseeing itself.

However, we disagree with the Central Bank's proposal in the context of the provision of Article 21(7) cash flow monitoring services. We believe that, as with the verification and record keeping of other assets, fund administrators already provide this service. Where a fund administrator is calculating the NAV of a fund under its existing authorisation it is required to reconcile all positions and the cash balances of all accounts to be able to fulfill this obligation. The cash flow monitoring envisioned under Article 21(7) simply sets out a more prescriptive approach to the function already being applied in the calculation of the net asset value by fund administrators.

As we have explained above, we agree that conflicts of interests can arise where the fund administrator is acting in both an Article 21(9) oversight role and an Article 21(7) cash flow monitoring role but we do not believe these conflicts arise where a separate legal entity is engaged to perform the Article 21(9) oversight function and thus the provision of the services is properly segregated.

We believe that an open architecture approach is favoured by the hedge fund administration industry and is ultimately in the interests of investors as this allows the AIFM to use their existing service providers with the minimum of cost impact and operational disruption.

It is also important to emphasis that the timeframe allotted for responses to this CP is simply too long. This matter need to be addressed more quickly as most AIFMs are already in the process of varying their permissions in their home jurisdictions. In this process they need to be able to explain to their regulators exactly how they are complying with the local implementing legislation which requires them to identify the service providers involved and detailing the services being provided by each.