



European Securities and  
Markets Authority

# Consultation Paper

**Guidelines on asset segregation under the AIFMD**



## Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

1. respond to the question stated;
2. indicate the specific question to which the comment relates;
3. contain a clear rationale; and
4. describe any alternatives ESMA should consider.

ESMA will consider all comments received by **30 January 2015**.

All contributions should be submitted using the [reply form](#), and uploaded on [www.esma.europa.eu](http://www.esma.europa.eu) under the heading 'Your input - Consultations'.

### Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. 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 not to disclose the response 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](http://www.esma.europa.eu) under the heading [Legal Notice](#).

### Who should read this paper

This document will be of interest to (i) depositaries of alternative investment funds and their delegates (including prime brokers and collateral managers) and their trade associations, (ii) alternative investment funds managers and their trade associations, as well as (iii) institutional and retail investors investing into such funds and their associations.

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# 1 Executive Summary

## Reasons for publication

With a view to ensuring a common, uniform and consistent application of the rules on depositaries under the AIFMD and its implementing measures, ESMA has decided to develop guidelines on the AIFMD asset segregation requirements. In this consultation paper, ESMA is seeking feedback from external stakeholders on its proposal for those guidelines.

## Contents

This consultation paper sets out ESMA's proposals for possible guidelines regarding the asset segregation requirements in case of delegation of safe-keeping duties by the appointed depositary of an AIF. Section 2 explains the background to ESMA proposals. Section 3 describes the rules on asset segregation set out under the AIFMD Level 1 and 2. Section 4 sets out our proposal on the guidance on the asset segregation requirements in case of delegation of safe-keeping duties. This proposal is spelled out in two different possible options on which ESMA is seeking feedback from respondents to this consultation. Annex I provides for the summary of questions while Annex II includes the cost-benefit analysis. Annex III contains the full text of the draft guidelines.

## Next Steps

ESMA will consider the feedback it receives to this consultation with a view to finalising the guidelines and publishing a final report in Q2 2015.

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## 2 Background

1. Directive 2011/61/EU (AIFMD) puts in place a comprehensive framework for the regulation of alternative investment fund managers within Europe. The extensive requirements with which AIFMs must comply are designed to ensure that AIFs can be managed and sold on a cross-border basis.
2. Since the adoption of the AIFMD, ESMA has produced a range of material relating to the application of the Directive (including technical advice to the European Commission, guidelines, regulatory technical standards and Q&As).
3. In particular, on 11 November 2011 ESMA delivered its technical advice to the European Commission relating, inter alia, to the depositary rules under the AIFMD.<sup>1</sup> Based on this advice, the European Commission adopted the Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (Level 2 Regulation).
4. In order to promote common supervisory approaches and practices in the application of the AIFMD and its implementing measures, ESMA further developed a Q&A under Article 29(2) of the ESMA Regulation<sup>2</sup> on the application of the AIFMD.<sup>3</sup> This Q&A clarifies some of the depositary provisions under the AIFMD regime, including matters such as the depositary's cash monitoring duties, the delegation of tasks by the depositary and the scope of the custody duties.
5. Additional clarifications on the depositary provisions are included in the European Commission Q&A on AIFMD.<sup>4</sup>
6. The depositary provisions – and, in particular, those on asset segregation – are a key aspect of the AIFMD framework and are aimed at improving investor protection. ESMA sees merit in further fostering convergence among supervisors across Europe on these provisions. Therefore, with a view to ensuring a common, uniform and consistent application of the rules on depositaries under the AIFMD and its implementing measures, ESMA has decided to consult on a proposal for guidelines on the AIFMD asset segregation requirements.
7. While the guidelines are of most immediate relevance to depositaries of AIFs (and their delegates), and the AIFMD (both the Level 1 Directive and the Level 2 Regulation) clearly sets out rules for the depositary to comply with, the depositary is not necessarily subject to authorisation under the AIFMD. Taking into account that it is the AIFM which is

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<sup>1</sup> ESMA's technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive (ESMA/2011/379), available at [http://www.esma.europa.eu/system/files/2011\\_379.pdf](http://www.esma.europa.eu/system/files/2011_379.pdf).

<sup>2</sup> Regulation (EU) No 1095/2010.

<sup>3</sup> The latest version of the Q&A at the time of publication of this report is dated 30 September 2014 and available at [http://www.esma.europa.eu/system/files/2014-1194\\_qa\\_on\\_aifmd.pdf](http://www.esma.europa.eu/system/files/2014-1194_qa_on_aifmd.pdf).

<sup>4</sup> <http://ec.europa.eu/yqol/index.cfm?fuseaction=legislation.show&lid=9>.

ultimately responsible for the compliance with the AIFMD rules (see recital 11 of the Level 1 Directive), ESMA considers it appropriate to apply the proposed guidelines to AIFMs, depositaries of AIFs and competent authorities.

### 3 AIFMD rules on asset segregation

8. The AIFMD requires AIFMs to ensure that, for each AIF they manage, a single depositary is appointed in accordance with the provisions of Article 21 of the Directive. Article 21(8) of the AIFMD provides that

*The assets of the AIF or the AIFM acting on behalf of the AIF shall be entrusted to the depositary for safe-keeping, as follows:*

*(a) for financial instruments that can be held in custody:*

- (i) the depositary shall hold in custody all 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;*
- (ii) for that purpose, the depositary shall ensure that all those financial instruments that can be registered in a financial instruments account opened in the depositary's books are registered in the depositary's books within segregated accounts in accordance with the principles set out in Article 16 of Directive 2006/73/EC, opened in the name of the AIF or the AIFM acting on behalf of the AIF, so that they can be clearly identified as belonging to the AIF in accordance with the applicable law at all times;*

*(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.*

9. According to Article 21(11), second sub-paragraph of the AIFMD,

*The depositary may delegate to third parties the functions referred to in paragraph 8 subject to the following conditions:*

[...]

*(d) the depositary ensures that the third party meets the following conditions at all times during the performance of the tasks delegated to it:*

[...]

*(iii) the third party segregates the assets of the depositary's clients from its own assets and from the assets of the depositary in such a way that they can at any time be clearly identified as belonging to clients of a particular depositary; [...]*

10. Recital 40 of the AIFMD provides for the following in case of delegation of the safe-keeping duties to a third party:

*A third party to whom the safe-keeping of assets is delegated should be able to maintain a common segregated account for multiple AIFs, a so-called 'omnibus account'.*

11. Article 21(17) of the AIFMD mandated the Commission to adopt, by means of delegated acts, measures specifying, inter alia, the segregation obligation pursuant to point (d)(iii) of paragraph 11 of Article 21.

12. Article 99(1) of the Level 2 Regulation sets out the relevant rules specifying the segregation obligation and states that

*Where safekeeping functions have been delegated wholly or partly to a third party, a depositary shall ensure that the third party, to whom safe-keeping functions are delegated pursuant to Article 21(11) of Directive 2011/61/EU, acts in accordance with the segregation obligation laid down in point (iii) of Article 21(11)(d) of Directive 2011/61/EU by verifying that the third party:*

*(a) keeps such records and accounts as are necessary to enable it at any time and without delay to distinguish assets of the depositary's AIF clients from its own assets, assets of its other clients, assets held by the depositary for its own account and assets held for clients of the depositary which are not AIFs; [...]*

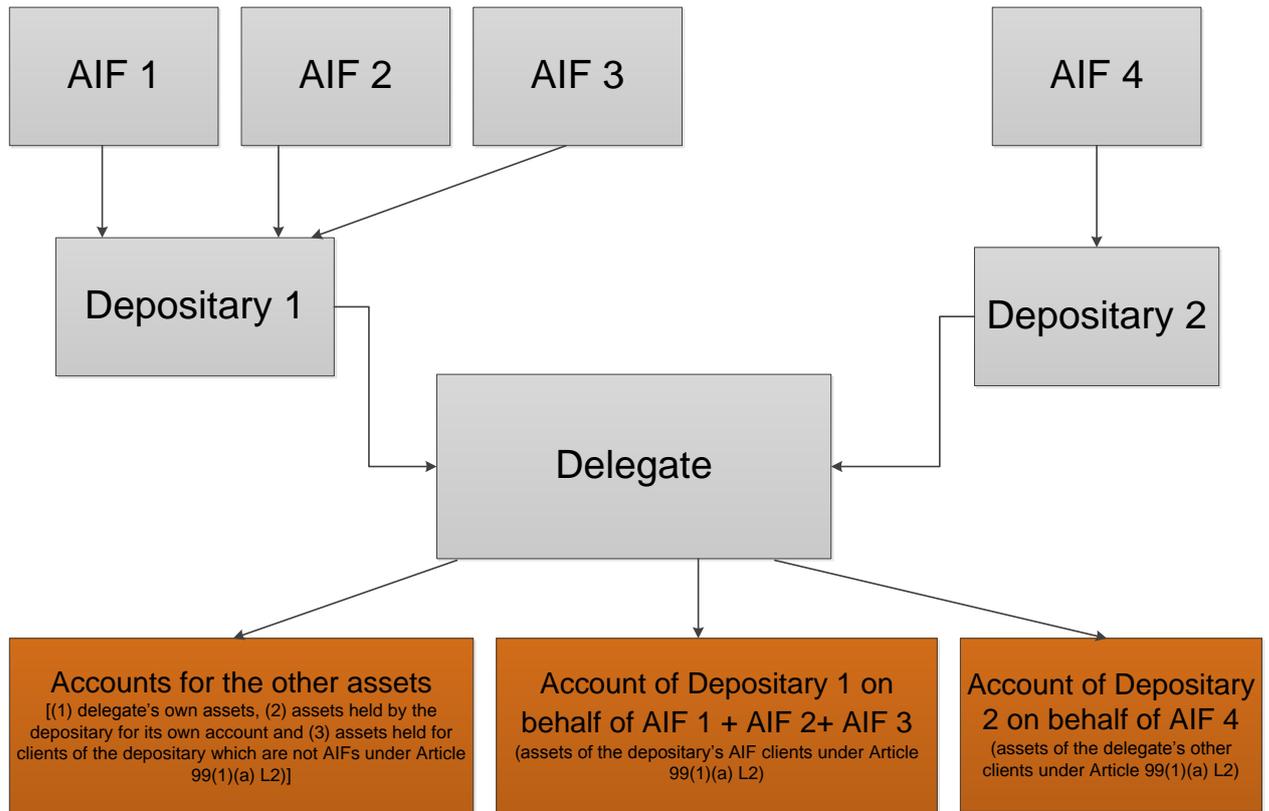
## **4 Asset segregation in case of delegation of safe-keeping duties**

13. According to Article 21(8)(a)(ii) of the AIFMD, when the depositary does not delegate the safe-keeping of those financial instruments that can be registered in a financial instruments account opened in the depositary's books to a third party, the segregation requirements set out in Article 16 of Directive 2006/73/EC apply at the level of the depositary.

14. When the safe-keeping duties are delegated to a third party, the asset segregation requirements under Article 21(11)(d) of the AIFMD and Article 99(1)(a) of the Level 2 Regulation apply at the level of the third party. As regards the segregation of assets in case of further delegation, Level 1 imposes the same requirements. Questions have

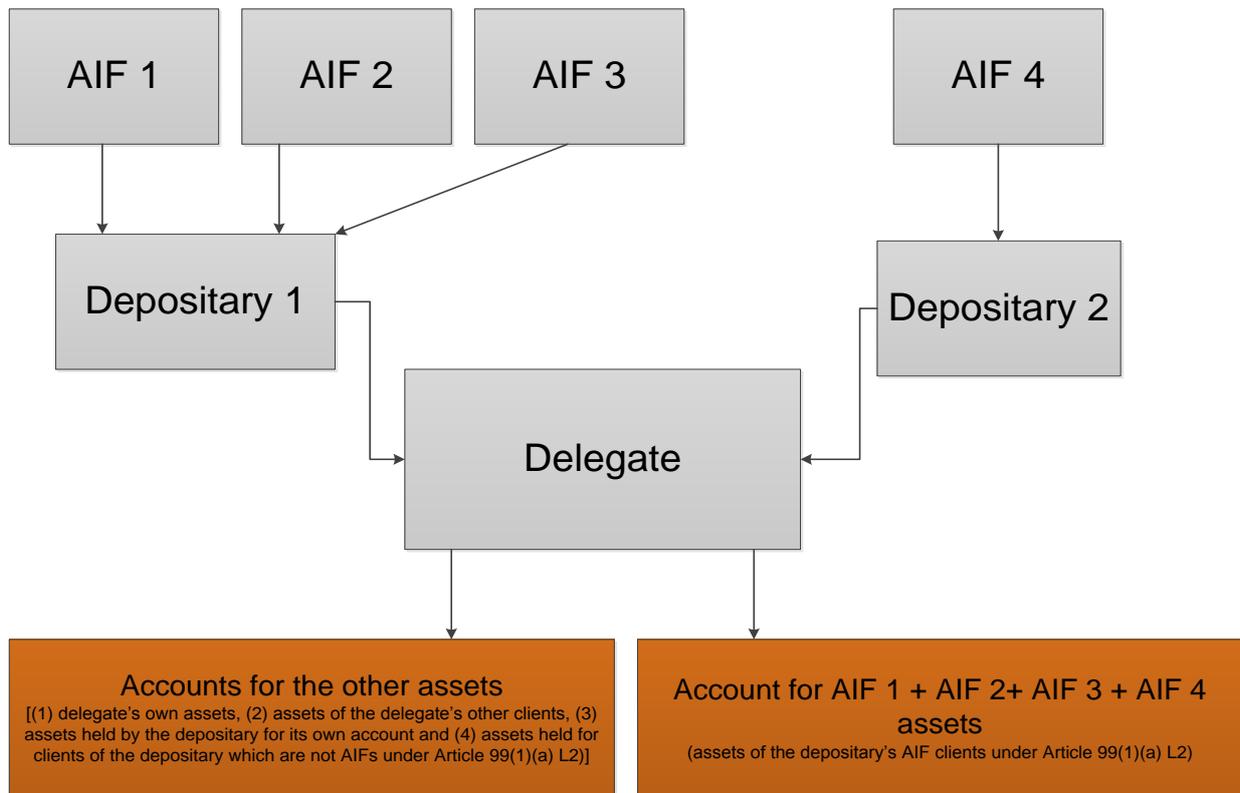
arisen in relation to the practical application of the required segregation at the level of the delegated third party (or sub-delegate).

15. ESMA considers that the segregation requirement under Article 99(1)(a) of the Level 2 Regulation implies that the third party has to distinguish assets of AIF clients from (1) its own assets, (2) the assets of any other client of the third party, (3) the assets belonging to the depository itself as well as (4) the assets belonging to clients of the depository which are not AIFs.
16. This means that the account where the AIF's assets are to be kept at the level of the delegated third party can only comprise assets of the AIF for which the safe-keeping has been delegated to the third party and assets of other AIFs. Non-AIF assets cannot be included in such an account.
17. This is confirmed by the provisions of recital 40 of the AIFMD which recognises that the delegated third party can hold an account for multiple AIFs.
18. However, questions have arisen as to whether the assets which can be held in such an account are only those coming from the same delegating depository or, alternatively, whether the omnibus account can hold assets for AIF clients coming from different delegating depositories.
19. Two alternative options are foreseen in the proposed guidelines on this point.
20. Under the first option, the account on which the AIF's assets are to be kept by the delegated third party may only comprise assets of the AIF and assets of other AIFs of the same delegating depository. Assets of AIFs of other depositories would be considered as assets of the third party's "other clients" for the purpose of Article 99(1)(a) of the Level 2 Regulation.
21. The chart below illustrates the level of segregation described under this first option.



22. Under the second option, a delegated third party holding assets for multiple depository clients would not be required to have separate accounts for the AIF assets of each of the delegating depositories.

23. The chart below illustrates the level of segregation described under this second option.



24. It should be noted that the charts above only reflect the AIFMD requirements and are without prejudice to any additional segregation requirements stemming from any other European or national legislation.

**Q1: Which of the two identified options do you prefer?**

**Q2: Would you suggest any alternative option which is compatible with the AIFMD and its implementing measures? If yes, please provide details.**

**Q3: Do you have knowledge of the impact that each of the two options identified would have on your business in terms of restructuring of existing delegation arrangements in Europe and third countries? Please quantify the one-off and ongoing costs as well as the type of costs for each of the two options or any alternative option that you may prefer.**

**Q4: Do you see merit in foreseeing a specific treatment for certain types of arrangement (e.g. collateral management arrangements)? If yes, please specify how your proposal would ensure compliance with the relevant requirements of the AIFMD and Level 2 Regulation.**

## **5 Annexes**

### **5.1 Annex I**

#### **Summary of questions**

**Q1: Which of the two identified options do you prefer?**

**Q2: Would you suggest any alternative option which is compatible with the AIFMD and its implementing measures? If yes, please provide details.**

**Q3: Do you have knowledge of the impact that each of the two options identified would have on your business in terms of restructuring of existing delegation arrangements in Europe and third countries? Please quantify the one-off and ongoing costs as well as the type of costs for each of the two options or any alternative option that you may prefer.**

**Q4: Do you see merit in foreseeing a specific treatment for certain types of arrangement (e.g. collateral management arrangements)? If yes, please specify how your proposal would ensure compliance with the relevant requirements of the AIFMD and Level 2 Regulation.**

**Q5: Do you agree with ESMA's approach to discarding the third, fourth and fifth options described in Section 5 of the CBA? if not please provide data and information that support your view.**

## 5.2 Annex II

### Cost-benefit analysis

#### 1. Introduction

1. The AIFMD and its implementing measures set out a comprehensive framework for the regulation of alternative investment fund managers within Europe. In particular, this framework consists of a harmonised set of rules regulating the provision of depositary services to alternative investment funds (AIFs).
2. One of the key elements of the depositary rules relates to the requirement to entrust the assets of the AIF or the AIFM acting on behalf of the AIF to a depositary for safe-keeping, according to the provisions of Article 21(8) of the AIFMD.<sup>5</sup> The safe-keeping functions may be delegated by the depositary to third parties provided that certain specific conditions are met. One of these conditions is that the depositary shall ensure the third party segregates the assets of the depositary's clients from its own assets and from the assets of the depositary in such a way that they can at any time be clearly identified as belonging to clients of a particular depositary.<sup>6</sup>
3. This segregation obligation was further specified by the Commission's Level 2 Regulation which requires the depositary who delegates the safe-keeping functions to a third party to verify that the third party "*keeps such records and accounts as are necessary to enable it at any time and without delay to distinguish assets of the depositary's AIF clients from its own assets, assets of its other clients, assets held by the depositary for its own account and assets held for clients of the depositary which are not AIFs*" (Article 99(1)(a) of the Level 2 Regulation).

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<sup>5</sup> Article 21(8) of the AIFMD provides that "*The assets of the AIF or the AIFM acting on behalf of the AIF shall be entrusted to the depositary for safe-keeping, as follows:*

(a) *for financial instruments that can be held in custody:*

(i) *the depositary shall hold in custody all 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;*

(ii) *for that purpose, the depositary shall ensure that all those financial instruments that can be registered in a financial instruments account opened in the depositary's books are registered in the depositary's books within segregated accounts in accordance with the principles set out in Article 16 of Directive 2006/73/EC, opened in the name of the AIF or the AIFM acting on behalf of the AIF, so that they can be clearly identified as belonging to the AIF in accordance with the applicable law at all times;*

(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*".

<sup>6</sup> Article 21(11)(d)(iii) of the AIFMD.

4. Given the central role of asset segregation rules in ensuring a proper application of the depositary regime – which is aimed at improving investor protection – ESMA sees merit in developing guidelines under Article 16 of Regulation (EU) No 1095/2010 to ensure that these rules are commonly, uniformly and consistently applied across Europe by the relevant competent authorities and market participants. This will avoid the establishment of an un-level playing field by the different positions taken at national level on the application of these rules.
5. In preparing this consultation paper, ESMA consulted with the Consultative Working Group (CWG) of ESMA's Investment Management Standing Committee (IMSC) on the various possible approaches on asset segregation under the AIFMD. The input provided by the CWG was useful for the purpose of this cost-benefit analysis (CBA) as it allowed, inter alia, views to be gathered on the various approaches that may be envisaged when applying the relevant AIFMD provisions.
6. This CBA was done internally by ESMA and is qualitative in nature. ESMA does not have comprehensive data on the level of segregation put in place by delegates of depositaries of AIFs, nor on the precise level of costs that would be incurred should the guidelines provided by ESMA differ from the current practice put in place in the various European and non-European jurisdictions where the safe-keeping of AIFs' assets may be delegated. However, ad hoc questions have been introduced in the main body of the consultation paper in order to elicit market participants' input on the quantitative impact of the proposals. Should relevant data be received through the consultation process, ESMA will take it into account when finalising its guidelines and will include it in the cost-benefit analysis accompanying the final report.

## **2. Problem identification**

7. The issues covered in the present consultation paper were already analysed by the European Commission when carrying out its impact assessment on the delegated acts on the depositary rules. Therefore, there is no need to provide for any additional problem identification in the present CBA.
8. In particular, Annex 7 of the Impact Assessment accompanying the Level 2 Regulation<sup>7</sup> provided for the following on the delegated acts to be adopted to specify the segregation obligation pursuant to point (d)(iii) of paragraph 11 of Article 21:

### ***Issue 15 – The segregation obligation***

#### ***Article 21, paragraph 10; implementing powers, Article 21, paragraph 15:***

*The depositary may only delegate to third parties provided that, among others, the depositary has ensured that the third party segregates the assets of the depositary's clients from its own assets and from the assets of the depositary in such a way that*

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<sup>7</sup> SWD(2012) 386 final, available at [http://ec.europa.eu/internal\\_market/investment/docs/20121219-directive/ia\\_en.pdf](http://ec.europa.eu/internal_market/investment/docs/20121219-directive/ia_en.pdf).

*they can at any time be clearly identified as belonging to clients of a given depositary and that it complies with this requirement on an ongoing basis. The third party may, in turn, sub-delegate those functions subject to the same requirements.*

*Delegated acts should specify this segregation obligation.*

### **Assessment of IA need**

*Similar rules exist already in MiFID. As there is no obvious reason to deviate substantially from those, there is also no need for a detailed IA. As regards the segregation of assets in case of further delegation, Level 1 imposes the same requirements. In such a case, the delegate of the third party would therefore need to segregate the assets of the third party's clients from its own assets and from the assets of the third party in such a way that they can at any time be clearly identified as belonging to clients of a particular third party.*

*This provides for a clear rule without any obvious substantive alternative option. While one could consider either to impose stronger obligation (e.g. to require individual segregation of assets of depositary's clients) or to impose less strict obligation (e.g. assets would not need to be identified as belonging to clients of a particular third party) but such options would not be consistent with Level 1 that only allows further delegation under the same conditions.*

### **3. Policy objective**

9. The AIFMD asset segregation rules are intended to protect the interest of the AIF investors by ensuring that the assets of the AIF are not exposed to events (such as bankruptcy) which may affect the third party to whom the safekeeping of its assets may be delegated by the depositary or any other third party (e.g. other clients of the delegated third party). These rules should be applied consistently across Europe.

### **4. Baseline scenario**

10. The AIFMD and the Level 2 Regulation set out detailed rules on asset segregation requirements whenever the safe-keeping of the AIF assets is delegated to a third party.
11. The practical application of these rules ultimately depends on the interpretation of Article 21(11)(d)(iii) of the AIFMD and the related implementing measures (Article 99(1)(a) of the Level 2 Regulation).
12. The baseline scenario is, therefore, not to produce any further guidance on the interpretation and proper application of these rules. This would leave discretion to AIFMs, depositaries, delegated third parties and national competent authorities to determine the level of segregation required by the relevant rules. This could clearly lead to a lack of harmonisation in the application of the provisions of the AIFMD on a very important investor protection issue.

13. Indeed, uncertainty on the level of segregation required under the above-mentioned AIFMD rules could lead to a situation where some national competent authorities would apply a stricter approach than others, leading to greater uncertainty for investors of AIFs in the different Member States who would not know to what extent the assets of the AIFs in which they invest are protected. For instance, a third party delegate of a depositary could be considered as failing to meet the above-mentioned requirements in one Member State whereas the same third party would be considered to meet these requirements in another Member State. This would be particularly problematic in the context of the EU passport under the AIFMD.

## 5. Technical options

14. The following options were identified and analysed by ESMA to address the policy objective referred to above and provide guidance on the application of the rules under Article 21(11)(d)(iii) of the AIFMD and Article 99(1)(a) of the Level 2 Regulation.

15. In identifying the options set out below and choosing the preferred ones, ESMA was guided by the relevant AIFMD and Level 2 Regulation rules and the fact that the proposed guidelines are intended to ensure a consistent interpretation and application of these rules only, without imposing any additional requirements beyond what is already foreseen in the relevant legislative texts.

<b>Policy Objective</b>	The AIFMD asset segregation rules are intended to protect the interest of the AIF's investors by ensuring that the assets of the AIF are not exposed to events (such as bankruptcy) which may affect the third party to whom the safekeeping of its assets may be delegated by the depositary or any other third party (e.g. other clients of the delegated third party). These rules should be applied consistently across Europe.
<b>Option 1</b>	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.
<b>Option 2</b>	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 sub-custodian level.
<b>Option 3</b>	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.
<b>Option 4</b>	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.
<b>Option 5</b>	AIF assets should be segregated on an AIF-by-AIF basis at the level of the delegate.
<b>Preferred Options</b>	<p>ESMA decided to consult on options 1 and 2 and discarded options 3, 4 and 5. ESMA felt that options 3 and 4 were sub-optimal as they would have provided a clearly lower level of investor protection given that they would have allowed a higher level of commingling of the assets of AIFs which might frustrate the recovery of assets in the event of a bankruptcy of a depositary or sub-depositary.</p> <p>Option 5 was discarded, as the marginal benefit of the additional level of segregation (compared to Options 1 and 2) in terms of an expeditious return of assets in the event of the bankruptcy of a depositary or sub-depositary does not seem likely to exceed the marginal cost of this level of segregation.</p> <p>Furthermore, options 3-5 do not seem to be compatible with the provisions of the AIFMD and its implementing measures (the latter judgement having been based, inter alia, on the provisions of the Impact Assessment accompanying the Level 2 Regulation<sup>8</sup>).</p>

**Q5: Do you agree with ESMA’s approach to discarding the third, fourth and fifth options described in Section 5 of the CBA? If not please provide data and information that support your view.**

**6. Assessment of the impact of the various options**

<b>Option 1</b>	<b>Qualitative description</b>
<i>Benefits</i>	This option provides for a high standard in terms of investor protection as it ensures the strictest level of segregation by prohibiting assets other than AIFs assets coming from the same depositary to be commingled. This would limit the exposure of the AIF investors to the risk of the bankruptcy of third parties (such as other depositaries or non-AIF entities). This risk seems to be relevant to stakeholders as some of the answers to the Commission consultation on hedge funds evidenced the

<sup>8</sup> See the text quoted under paragraph 8 above.

	<p>following: “[...] some respondents insist that the assets of the fund should be segregated from those of the prime broker. If not, the interests of the former are exposed to the risk of the bankruptcy of the latter”.<sup>9</sup> More recently, the risks linked to the commingling of funds’ assets with other assets were also highlighted by IOSCO as follows:</p> <p>“26. 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 (unless CIS assets are held in a permissible “omnibus account”). There is also a risk that CIS assets may be misused by the custodian (e.g. to settle the liabilities of another client).</p> <p>27. 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”.<sup>10</sup></p>
<p><b>Costs to regulator:</b></p> <ul style="list-style-type: none"> <li>- One-off</li> <li>- Ongoing</li> </ul>	<p>The one-off and ongoing costs to the regulator should be limited (or non-existent) to the extent that this option provides clarifications on the existing provisions of the AIFMD and Level 2 Regulation and do not impose additional obligations on firms whose compliance has to be supervised. Some limited one-off costs might be incurred in case the relevant regulator followed a different interpretation of the relevant legislative provisions and would have to adapt its supervisory practices to the interpretation set out under this option.</p>
<p><b>Compliance costs</b></p> <ul style="list-style-type: none"> <li>- One-off</li> <li>- Ongoing</li> </ul>	<p>The one-off and ongoing impact on firms in terms of costs should be limited (or non-existent) if the relevant firms/national supervisor have followed an interpretation of the relevant European legislative provisions which is already in line with this option. Indeed, in such a case the relevant segregation requirement should have already been implemented following the expiry of the AIFMD transposition and transitional periods. Moreover, the level of segregation required under this option is similar to the one already existing under MiFID, as recognised by the Commission in its Impact Assessment accompanying the Level 2 Regulation.<sup>11</sup></p>

<sup>9</sup> See Annex VIII to the Impact Assessment accompanying the AIFMD proposal, SEC(2009) 576, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52009SC0576&from=EN>.

<sup>10</sup> Consultation Report on Principles regarding the Custody of Collective Investment Schemes’ Assets (CR07/2014), October 2014, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD454.pdf>.

<sup>11</sup> See the text quoted under paragraph 8 above.

	For firms that have followed a different interpretation of the relevant provisions of the AIFMD and Level 2 Regulation this option may require the implementation of a much higher degree of segregation of accounts at the sub-custodian level and the related costs (e.g. for the opening and keeping of additional accounts) may be substantial (in particular if non-AIF assets were being commingled with AIF assets or if AIF assets from different depositaries were being commingled in the same account).
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Option 2	Qualitative description
<i>Benefits</i>	This option provides for a significant level of investor protection as it prohibits a delegate from commingling the AIF and non-AIF assets in the same account. This would help avoid any risk of cross-contamination of the AIF assets in case an event affects the non-AIF assets (e.g. AIF assets would not risk being frozen in case the non-AIF assets fall under an insolvency proceeding). However, the AIF assets would be exposed to the events affecting the assets delegated by other depositaries which could be held in the same account. In this regard, this option ensures a level of investor protection which is lower than under option 1.
<i>Costs to regulator:</i> <ul style="list-style-type: none"> <li>- <i>One-off</i></li> <li>- <i>Ongoing</i></li> </ul>	These should be equivalent to those set out above under option 1.
<i>Compliance costs</i> <ul style="list-style-type: none"> <li>- <i>One-off</i></li> <li>- <i>Ongoing</i></li> </ul>	These should be similar to those set out above under option 1. The only difference should be that for firms that have followed a different interpretation of the relevant provisions of the AIFMD and Level 2 Regulation this option may require the implementation of a higher degree of segregation of accounts at the sub-custodian level (but such segregation is less than that envisaged under option 1). Therefore, while the related costs (e.g. for the opening and keeping of additional accounts) may still be substantial (in particular if non-AIF assets were commingled with AIF assets), they should be less significant than the ones that could be faced under option 1.

Option 3	Qualitative description
<p><i>Benefits</i></p>	<p>This option provides for a lower level of investor protection as it allows a delegate to commingle the AIF and non-AIF assets in the same account. However, the prohibition on commingling in the same account assets coming from different depositary clients would still help avoid any risk of cross-contamination of the AIF assets in case an event affects the other depositary clients (e.g. AIF assets would not risk being frozen in case the other depositaries go bankrupt). In this regard, this option ensures a level of investor protection which is lower than under option 1 and also appears lower than under option 2.</p>
<p><i>Costs to regulator:</i></p> <ul style="list-style-type: none"> <li>- <i>One-off</i></li> <li>- <i>Ongoing</i></li> </ul>	<p>These should be equivalent to those set out above under option 1.</p>
<p><i>Compliance costs</i></p> <ul style="list-style-type: none"> <li>- <i>One-off</i></li> <li>- <i>Ongoing</i></li> </ul>	<p>These should be similar to those set out above under option 1. The only difference should be that for firms that have followed a different interpretation of the relevant provisions of the AIFMD and Level 2 Regulation this option may require the implementation of a higher degree of segregation of accounts at the sub-custodian level (but such segregation is less than that envisaged under option 1). Therefore, while the related costs may still be substantial (in particular if AIF assets from different depositaries were commingled in the same account), they should be less significant than the ones that could be faced under option 1.</p>

Option 4	Qualitative description
<p><i>Benefits</i></p>	<p>This option provides for the lowest level of investor protection as it allows a delegate to commingle both (i) AIF and non-AIF assets and (ii) assets coming from different depositary clients in the same account whilst keeping these assets separate from the assets of the depositary</p> <p>It would have the benefit of requiring no structural changes to those firms which currently do not provide for any segregation at the level of the delegate.</p>

<p><i>Costs to regulator:</i></p> <ul style="list-style-type: none"> <li>- <i>One-off</i></li> <li>- <i>Ongoing</i></li> </ul>	<p>These should be equivalent to those set out above under option 1.</p>
<p><i>Compliance costs</i></p> <ul style="list-style-type: none"> <li>- <i>One-off</i></li> <li>- <i>Ongoing</i></li> </ul>	<p>There should be no compliance costs linked to this option. Indeed, firms currently implementing any sort of asset segregation in the accounts held at the delegate level would be permitted to continue such segregation. Firms not following any kind of segregation at the delegate level would be allowed to continue doing so.</p>

Option 5	Qualitative description
<i>Benefits</i>	This option provides for the highest level of investor protection as it requires segregation AIF-by-AIF at the level of the delegate.
<p><i>Costs to regulator:</i></p> <ul style="list-style-type: none"> <li>- <i>One-off</i></li> <li>- <i>Ongoing</i></li> </ul>	The costs to regulators, both one-off and ongoing, may be significant to the extent that this option would require supervision of a stricter approach to segregation that is not in line with the general interpretation of the AIFMD Level 1 and 2 requirements at present (in particular given the reference to ‘omnibus accounts’ in recital 40 of the Level 1).
<p><i>Compliance costs</i></p> <ul style="list-style-type: none"> <li>- <i>One-off</i></li> <li>- <i>Ongoing</i></li> </ul>	Compliance costs for firms may be significant to the extent that this approach would require a much higher degree of segregation of accounts at the sub-custodian level than is currently in place.

## **5.3 Annex III**

### **Draft guidelines**

#### **1 Scope**

##### **Who?**

1. These guidelines apply to AIFMs, depositaries of AIFs and competent authorities.

##### **What?**

2. These guidelines apply in relation to Article 21(11)(d) of Directive 2011/61/EU and Article 99(1)(a) of Commission Delegated Regulation (EU) No 231/2013.

##### **When?**

3. These guidelines apply from two months after the date of publication by ESMA.

#### **2 Definitions**

4. Terms used in the Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010<sup>12</sup> (AIFMD) and in the Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision<sup>13</sup>, have the same meaning in these guidelines.

#### **3 Purpose**

5. The purpose of these guidelines is to ensure common, uniform and consistent application of the provisions in Article 21(11)(d) of Directive 2011/61/EU and Article 99(1)(a) of Commission Delegated Regulation (EU) No 231/2013. In particular, they provide guidance on the segregation requirements foreseen therein.

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<sup>12</sup> OJ L 174, 1.7.2011, p. 1.

<sup>13</sup> OJ L 83, 22.3.2013, p.1.

## 4 Compliance and reporting obligations

### 4.1 Status of the guidelines

6. This document contains guidelines issued under Article 16 of the ESMA Regulation. In accordance with Article 16(3) of the ESMA Regulation competent authorities and financial market participants must make every effort to comply with guidelines and recommendations.
7. Competent authorities to whom the guidelines apply should comply by incorporating them into their supervisory practices, including where particular guidelines within the document are directed primarily at financial market participants.

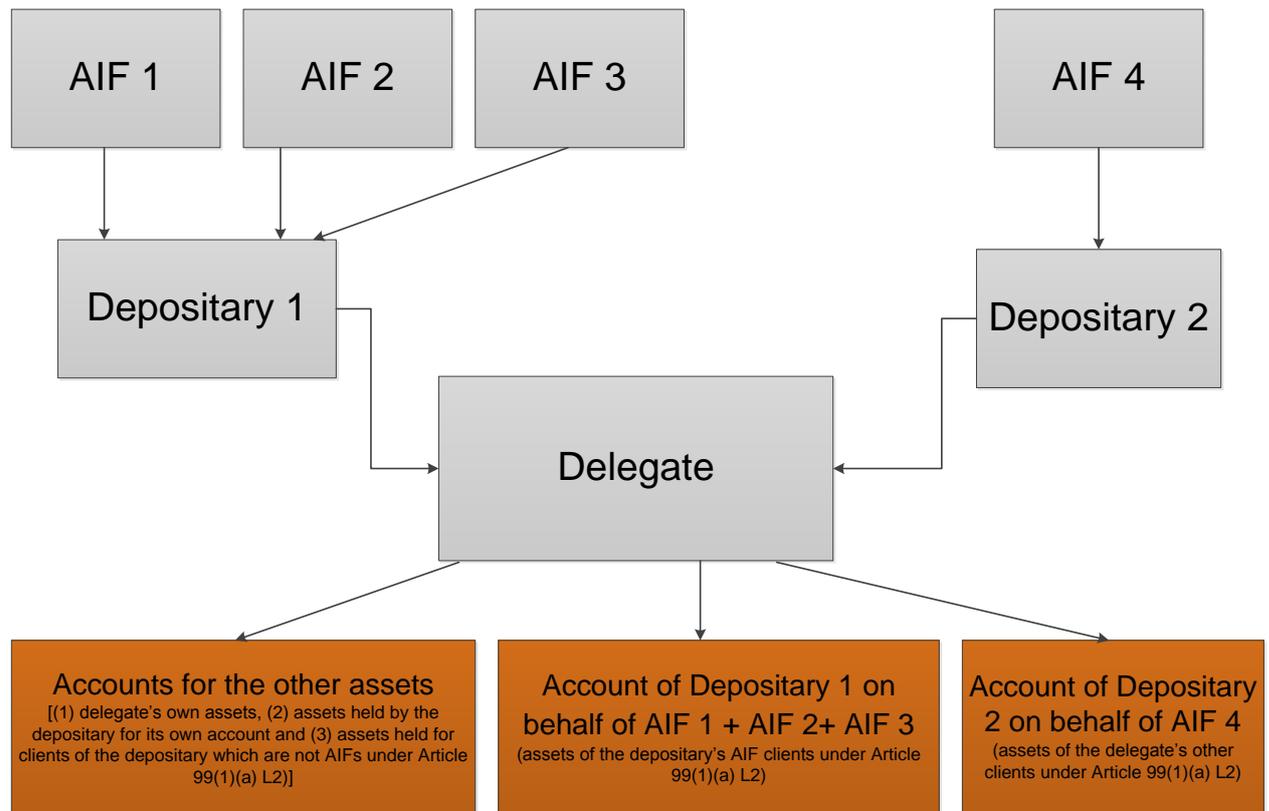
### 4.2 Reporting requirements

8. Competent authorities to which these guidelines apply must notify ESMA whether they comply or intend to comply with the guidelines, with reasons for non-compliance, within two months of the date of publication by ESMA. In the absence of a response by this deadline, competent authorities will be considered as non-compliant. A template for notifications is available from the ESMA website.
9. AIFMs and depositaries of AIFs are not required to report to ESMA whether they comply with these guidelines.

## 5 Guidelines on asset segregation under the AIFMD

### OPTION 1

10. When safe-keeping duties are delegated to a third party (including a prime broker or a collateral manager), the account on which the AIF's assets are to be kept at the level of the delegated third party (or sub-delegate) should only comprise assets of the AIF and assets of other AIFs of the same depositary.
11. Non-AIF assets should not be included in the account on which the AIFs assets are kept at the level of the delegated third party (or sub-delegate). Assets of other AIFs of other depositaries equally should be held in a separate account.
12. The chart below illustrates the level of segregation described above. It should be noted that the chart only reflects the requirements of the AIFMD and Level 2 Regulation and is without prejudice to any additional segregation requirement stemming from any other European or national legislation.



## **OPTION 2**

10. When safe-keeping duties are delegated to a delegate (including a prime broker or a collateral manager), the account on which the AIF's assets are to be kept at the level of the delegated third party (or sub-delegate) should only comprise assets of the AIF and assets of other AIFs.
11. Non-AIF assets should not be included in the account on which the AIFs assets are kept at the level of the delegated third party (or sub-delegate). However, the account on which the AIFs assets are kept may include assets from AIFs of different depositaries.
12. The chart below illustrates the level of segregation described above. It should be noted that the chart only reflects the requirements of the AIFMD and Level 2 Regulation and is without prejudice to any additional segregation requirement stemming from any other European or national legislation.

