

Public consultation on the review of the alternative investment fund managers directive (AIFMD)

Deutsche Börse Group

January 29, 2021

– Response to question 35.1 based on the response given to question 35 –

This document includes our detailed response to question 35.1. in relation to our response given to question 35 of the consultation on the AIFMD review.

Question 35. Should the investor CSDs be treated as delegates of the depositary?

– No

Question 35.1 Please explain your answer to question 35, providing concrete examples and suggesting improvements to the current rules and presenting benefits and disadvantages as well as costs:

According to AIFMD and UCITS V “securities settlements” or respectively “services specified by the Settlement Finality Directive” should “not be considered a delegation of custody functions”. This view makes sense as CSDs do not act as fund depositories.

CSDs and fund depositary banks are structurally different in that they play a different role and serve different purposes. The main regulatory objective of the depositary bank is to act in the best interest of the fund investor. The main role of a CSD is to mitigate the risks of failure of a market participant (including depositary banks) and to absorb settlement risk. This feature is enabled through Settlement Finality (provided by recognised Securities Settlement Systems (SSS)) and is ensured through the provision of a secure Delivery-versus-Payment Mechanism. CSDs have a very low-risk profile, are subject to very stringent regulatory requirements (prudential- and FMI-related), and central bank oversight (as CSD by the CSDR designated competent authority and as SSS by the EU relevant national central bank). Moreover, CSDs are subject to a very robust risk management system based on the CPMI-IOSCO Principles (PFMIs). This most stringent level of supervisory requirements is not imposed nor met by most fund depositories.

The CSDR is specifically tailored to the CSD's Financial Markets Infrastructure nature. CSDR provides a vast set of harmonised rules for all EU-authorized CSDs to adequately protect the assets of all CSD participants and their clients, including fund depositaries. Legislation hereby recognises (1) that the fund depositary has neither control, nor power to influence the highly regulated service provision of a CSD and (2) CSDR is the relevant framework to maximize protection of assets held in a CSD and through a "CSD link" (a link between two CSDs). CSD links as per CSDR are subject to the competent authorities' supervision and annual review (each link being covered by legal opinions reviewed annually, which is not the case for funds depositary banks). CSD links are in scope of additional notification/authorisation under CSDR, i.e. assessed by the regulators, and new links shall be notified to the competent authority after authorisation. If conditions are not satisfactory, the competent regulator may request to discontinue the links. Hence, the duties defined in the Article 98 AIFMD, level 2, are not comparable with those applicable to CSDs, as defined in article 48 CSDR and 40, 41, 84 - 86 RTS 2017/392. Furthermore, though the depositary banks must assess the legal framework, the scope of that assessment is more limited and is not notified to the regulator.

Each year the CSD links are subject to a review by the regulators (articles 40/41/84 RTS 2017/392), as subject to the annual reporting. For depositary banks subject to AIFMD there is indeed an annual review but there is no regular reporting to the regulator. AIFMD as well as UCITS V present the reality of the SSS in a properly functioning securities market, provided that a CSD, as operator of an SSS, cannot be considered a delegate for custody services. This exempts the fund depositary banks from being subject to the strict liability regime when they hold their assets with a CSD.

To consider that CSDs must comply with the delegation rules applying to fund depositary banks under AIFMD and UCITS V may eventually result in requests for contractual transfer of liability for loss of assets to the CSD. Such exposure could disincentivise CSDs to act as Investor CSD (i.e. as necessary connectors between EU markets and beyond), notably for T2S-purposes, resulting in low cross-CSD settlement volumes and decline in the use of low-risk FMIs. Moreover, CSDs could be faced with increased complexity for reconciliation of securities transfers by increasing the number of necessary realignments.

The provision of "custody" services is a basic element for a CSD (as an operator of an SSS) in the delivery of its core services. CSDs cannot make a distinction between different types of custody as they operate one single environment. To avoid regulatory discrepancies, we believe it is advisable to take into consideration the CSDR regulatory context. Any interpretation of a regulation that has the ability to affect the services provided by CSDs, including the liability regime of EU CSDs, should be principally based on considerations which correspond to the CSDs' very own profile and services, and therefore suggest moving the discussion to identify and address any concern on the liability regime of the EU CSDs into the review of the CSDR regulation.

In addition, we would like to raise a concern on the potential operational difficulties that would arise in case AIFMD/UCITS delegation rules would apply to Investor CSDs (e.g., segregation and reconciliation duties).

In this regard, rather than applying UCITS/AIFMD operational/safekeeping delegation rules to Investor CSDs, we want to point to the level playing field concern brought forward in the context of global custodians. The application of UCITS/AIFMD operational or safekeeping delegation rules to Investor CSDs would lead to differences in regulatory treatment, and also entail changes to the Issuer CSDs operational setup under CSDR.

From a practical perspective this would mean that CSDs would need to set up and follow two different and separate operational regimes: 1) the existing general regime under CSDR for CSD services on all instruments, and 2) another regime resulting from the AIFMD/UCITS delegation rules for Funds for Investor CSDs as delegates of a UCITS/IFM depositary bank. With reference to the latter, CSDs would face regulatory uncertainty, as the proposed AIFMD/UCITS V regime would conflict with CSDR, which is the CSD's primary framework. Therefore, it might be worth considering the other way around: applying CSDR like rules to global custodians.