EPFSF Lunch Discussion

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"Alternative Investment Funds"

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- ## Introduction

Ladies and gentlemen,

Initially, I should like to take this opportunity to thank you for having been given the opportunity to speak today on this very important topic. As you may be aware, Deutsche Bank is involved in a number of business lines that would be affected by the AIFM directive. Examples are asset management but also as a result of being a service provider to the alternative asset management industry (in our capacity as prime broker, custodian, fund administrator, etc).

I personally work in the Trust & Securities Services division which provides, among other things, depository, fund administrator and valuation services. Within the context of our various roles here, we currently administer in total some EUR 7 trillion of assets. As an important player in the market, we have a keen self-interest in ensuring that the industry operates in a fair and adequately regulated environment. As such, Deutsche Bank shares the directive's objectives, such as appropriate authorisation, reducing systemic risk and increased transparency. Today's event provides us with an excellent opportunity to verify that these objectives are met in a cost-effective manner by supporting the dialogue between the industry and legislators and clarifying any open issues.

- ## Challenges going forward

The industry has recently highlighted a number of key critical issues that need further investigation. Having just returned from a business trip, I would like to highlight three broad themes raised by clients (and this is by no means a complete list):

- Custodians are concerned about the proposed liability regime, the additional risks that this may introduce and how this can be managed. In particular, the proposal via which a custodian would de-facto take on the role of a guarantor for the investment decisions of its clients (in the case of a loss of securities under circumstances outside the control of the depository) raises questions in terms of the moral hazards.
- Asset managers from smaller domiciles are concerned that they may not be able to appoint depository banks in other EU jurisdictions in those cases where larger banks potentially do not wish to act in such capacity locally.
- Foreign fund managers are unsure how other jurisdictions will respond to this legislation i.e. what does this specifically mean for managers in the US who do not dispose of an EU presence; what would happen to their distribution networks in Europe should the directive be passed as is?

Let me address the above three points:

- **Depositary liability**

Being liable for the delivery of services is not per se a problem. This becomes clear by looking at the existing contractual arrangements we have in place with our custody clients. In the event of a loss of securities we would, for example, be required to inform the client and would be liable to the extent that the loss is the result of an act or omission in breach of an agreement or negligence on the part of Deutsche Bank. Industry best practice is that any such liability is limited according to the standard of “Reasonable care and diligence”. Put in simply terms, depositories are expected to act in accordance with what can be required of an organisation of a similar size, also as regards asset volumes, assets under custody, client base, expertise, technical capabilities, etc. Hence, there is a clear recognition that a depository cannot be held liable for consequences beyond its control - this needs be maintained going forward.

But why is this important? A rather simplistic example would be to consider the following:

A depository and its client may have agreed that the client will send instructions to its provider via a secure electronic network and the provider is able to process the respective instructions on day ‘x’ if these are received before a certain time (e.g. 16:00 hrs CET). Why should the depository be held liable if the client decides to send an instruction via fax (manual processing) or after the deadline? Increasing the liability regime beyond the duty of reasonable care and diligence could actually increase systemic risk since only very few organisations would be able to assume this risk thereby reducing the universe of available providers.

- **Delegation/Sub-Delegation/Valuation**

The questions on delegation and sub-delegation apply to both depository and asset management services. Without allowing the delegation and sub-delegation of tasks to non-EU-registered entities, the industry could not facilitate investments outside the EU and profit from international management expertise. Why, for example, would we wish to preclude the possibility of benefiting from the expertise of fund managers located in Asia for investments in the region? Overly strict restrictions could furthermore affect jobs in numerous locations, including France, the UK and Germany. For example, it would make it impossible to uphold the German Master KAG concept. Furthermore, the rules should be proportional. An independent valuator is not always necessary for better investor protection. Moreover, daily valuation is impossible for some funds e.g. real estate.

- **Marketing restrictions and leverage**

Improving investor protection is an important goal but the marketing restrictions for third country funds should be reconsidered since they limit investor choice. In principle, there is not a “one size fits all” answer. This also applies to leverage limits. They do not give a sufficient proxy for risk (it is also a question of asset quality, liquidity etc) whereby the risk framework is better served, in my opinion, through more transparency towards the competent authority.

- **Conclusion**

The directive is most certainly a step in the right direction as it can assist in to raising the bar for the industry. Having a dialogue on the concerns brought up by the industry may help make the regulation more effective. I look forward to the discussion and thank you for your attention.