



Frankfurt am Main,
31 August 2012

BVI's Position Paper on the Commission's Proposal for a Directive of the European Parliament and of the Council amending the Directive 2009/65/EC (UCITS V)

BVI¹ welcomes the Commission's proposal for amending the UCITS Directive on rules relating to UCITS depositaries and UCITS managers' remuneration as an important initiative for enhancing investor protection and strengthening investors' confidence in UCITS.

I. UCITS depositary function and investor protection

1. Key messages

We share the Commission's view that the requirements relating to UCITS depositaries are crucial within the UCITS framework for the purpose of ensuring a high level of investor protection. Therefore, we are fully committed to supporting the Commission's efforts towards further improvements of the UCITS depositary regime.

Against this background, would like to emphasise the following points:

1.1 Rules on depositaries' duties

We welcome the Commission's proposal to implement precise rules on depositaries' duties, in particular concerning the definition of safe-keeping. A differentiation between custody duties and asset monitoring duties is a meaningful step towards a common understanding of the safe-keeping function.

Moreover, we greatly appreciate the request on Member States to ensure that in the event of insolvency of the depositary UCITS assets held in custody are unavailable for distribution among or realisation for the benefit of creditors of the depositary.

¹ BVI represents the interests of the German investment fund and asset management industry. BVI's offices are located in Berlin, Brussels and Frankfurt. Its 82 members currently handle assets in excess of EUR 1.8 trillion in both investment funds and mandates by managing directly or indirectly the capital of 50 million private clients in 21 million households. BVI's ID number in the EU register of interest representatives is 96816064173-47. For more information, please visit www.bvi.de.

1.2 Rules on delegation

We are strongly in favour of enhancing the UCITS requirements for delegation of the safe-keeping function to third parties. In this regard, we support the Commission's proposal for a new Article 22(7) which is broadly based on the corresponding AIFMD provision.

Nonetheless, we think that it might be too strict to require as an absolute precondition of delegation in terms of the custody function that UCITS assets must be unavailable for distribution or realisation in the event of insolvency of the sub-custodian (cf. Article 22(7) third subparagraph (e)). This would effectively mean that no sub-custody of UCITS assets might take place in countries where the effects of asset segregation are not recognised for insolvency purposes. Depending on the local requirements on custody, this might lead to a factual inability of UCITS to invest in certain markets only as a result of deficiencies in national insolvency regimes.

In our opinion, delegation of the custody function should be still permissible in these circumstances provided that the law of a third country requires appointment of a local sub-custodian and UCITS investors are duly informed of the conditions of the sub-custody as well as the associated risks. To account for this possibility, the scope of application of Article 22(7) fourth paragraph should be extended accordingly. In addition, the depositary should be under the obligation to take further protective measures in order to minimise the risk of loss to a reasonable extent. This might especially encompass enhanced monitoring of financial soundness or measures which according to the local law are capable of rendering the assets "insolvency-proof".

1.3 Rules on liability

We fully support the new liability rules for UCITS depositaries as proposed in Article 24. In particular, we clearly see the need for further enhancing the liability standards of the AIFMD by not allowing for any kind of contractual liability discharge. UCITS are per definition retail products aimed in general for mass public distribution. In contrast to professional clients who often negotiate the terms of their investment directly with the fund manager, the average UCITS investor is not capable of adequately capturing and responding to the higher risks associated with a liability discharge and hence, requires a higher level of protection.

2. Further comments

In addition to these key issues, we would like to address the following points which are rather of a technical nature:

2.1 Reuse of fund assets

The Commission's proposal does not contain a provision equivalent to Article 21(10) third subparagraph of the AIFMD according to which the UCITS assets shall not be re-used by the depositary without the prior consent of the AIF or the AIFM. In these circumstances, it is unclear whether reuse of fund assets under the UCITS Directive shall be generally allowed (which would run counter to the AIFMD standards) or generally prohibited (which would be inconsistent with the freedom of contract). An absolute ban on the asset reuse appears not reasonable as it would potentially also prevent the depositary to reuse cash held on UCITS accounts. Therefore, in order to ensure proper balance between investor protection and viability of investments, we recommend transposing the above mentioned AIFMD standard into the UCITS V text.

2.2. Enforcement of liability claims (Article 24(5))

The wording in Article 24(5) seems to suggest that liability may be invoked directly or indirectly through the management company at the investor's choice. However, in the Explanatory Memorandum to the proposal, the Commission clearly recognises that the means of asserting the liability claim depend "on the legal nature of the relationship between the depositary, the management company and the unit-holders"². This interdependence has been reflected in both the corresponding AIFMD provision in Article 21(15) and the current UCITS standard of Article 24 second subparagraph. Hence, we believe that it should also be acknowledged in the text of Article 24(5).

2.3. Disclosure of delegated safe-keeping functions (Annex I point 2.2.)

This new disclosure requirement is based upon Article 23(1)(f) AIFMD. The important difference is, however, that the AIFMD provision makes no stipulation as to the means of disclosure, whereas the Commission's proposal for UCITS V requires the information to be included in the fund prospectus. Given that operations of many UCITS require a global network of sub-custodians the identity of which may change on a common basis, we fear that this requirement might be challenging in practice and prompt frequent modifications of sale prospectuses. For this reason, we deem it appropriate to include in the prospectus a reference to other sources where investors may obtain the relevant information concerning the sub-custody of assets.

² Section 2.5. of the Explanatory Memorandum to the Commission's proposal.

II. Remuneration

We appreciate the Commission's proposal to introduce new rules on remuneration policies for UCITS managers. However, we would like to submit the following remarks:

1. Disclosure

While in favour of consistency between UCITS and AIFM Directives in terms of principles, we consider that a full alignment of UCITS provisions with the AIFMD remuneration rules as regards disclosure would be not appropriate. **In particular, Article 69(3) of the Commission's proposal is disproportionate for UCITS and should be deleted.**

The Commission is now proposing external disclosure. The UCITS management company shall be required to disclose the amount of remuneration for the financial year with appropriate detail in the annual report of individual UCITS. This proposal differs from the Commission's position in the consultation paper on the UCITS managers' remuneration³. The consultation paper still envisaged internal transparency for staff members to whom the remuneration policy applies.

Initial point for establishing remuneration policies and disclosure to investors are the Financial Stability Forum (FSF) Principles for Sound Compensation Practices⁴. These principles are intended to apply to significant financial institutions, but they are especially critical for large, systemically important firms. UCITS managements companies are not systemically important market participants and the UCITS asset management sector was not one of the root causes of the financial crisis (cf. the Commission's consultation on UCITS V, page 26). The Commission also endorses this viewpoint in its recommendation on the remuneration policies in the financial services sector⁵. According to this recommendation, a risk-focused remuneration policy which is consistent with effective risk management and does not entail excessive risk exposure should be adopted (cf. recital 12 of the recommendation).

A further criterion for distinguishing UCITS from AIF and the business models prevailing in the banking and investment banking sector is the strict product regulation with fund-specific investment restrictions and risk limits. Therefore, in correspondence with the risk-focused approach of the FSF and the Commissions' recommendation, the internal transparency of remuneration principles should be deemed sufficient for UCITS.

³ dated 14 December 2010, MARKT/G4 D (2010) 950800.

⁴ dated 2 April 2009, cf. http://www.financialstabilityboard.org/publications/r_0904b.pdf.

⁵ dated 30 April 2009 (2009/384/EC).

2. Consistency with requirements for credit institutions

The approach proposed in Article 14a(4) that EBA should assist ESMA in the elaboration of remuneration guidelines is correct in principle. However, the assumption of ensuring consistency with requirements for credit institutions and investment firms appears too far-reaching. The guidelines for credit institutions are intended to apply to significant financial institutions and systemically important firms. In contrast, UCITS management companies are barely relevant in the systemic context (see above). Moreover, the business model of credit institutions fundamentally differs from UCITS management which takes place within clearly defined boundaries in terms of allowable investments and legitimate levels of market risk. Thus, minor – or even major – differences should be allowable between the remuneration policies of UCITS management companies and credit institutions. The remuneration guidelines for UCITS managers should be rather aligned with the corresponding guidelines for AIFM which are currently in preparation by ESMA.