



European Association of Co-operative Banks  
Groupement Européen des Banques Coopératives  
Europäische Vereinigung der Genossenschaftsbanken



Brussels, 29 October 2012

AS/B15/12-177

## European Association of Co-operative Banks comments on the

### European Commission's Proposal for a Directive

*amending Directive 2009/65/EC on the  
coordination of laws, regulations and  
administrative provisions relating to  
undertakings for collective investment in  
transferable securities (UCITS) as regards  
depository functions, remuneration policies  
and sanctions*

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The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4.000 locally operating banks and 63.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 181 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 51 million members and 750.000 employees and have a total average market share of about 20%.

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*The voice of 4.000 local and retail banks, 51 million members, 181 million customers*

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The European Association of Co-operative Banks (EACB) welcomes the Commission's Proposal on UCITS' depositaries to unify the already existing, but nationally diverging legal regimes currently in place in the Member States.

### **Convergence between AIFMD & UCITS**

Looking at the limited scope of the UCITS V, the EACB strongly believes that the central aim of this Proposal should be the convergence of rules and regulations of the heightened depositary standards which were adopted for non-UCITS funds in 2011 through the Alternative Investment Fund Managers Directive (AIFMD).

## **I. Depositary liability regime**

### **Discharge of Liability (Art. 22 para. 7)**

The most important issue where this convergence is clearly missing relates to the depositary's liability in case of a loss of financial instrument belonging to a UCITS fund. AIFMD deals with the issue of loss as follows: A depositary is, naturally, responsible for the safekeeping of the UCITS' financial assets, unless the asset manager discharges it of its liability when delegating its custody functions to a third party under certain circumstances (Article 21 para. 13 of AIFMD). However, Article 24 para. 7 of the UCITS Proposal holds the depositary liable at all times for the return of instruments held in custody, without the possibility to discharge liability by contract. This results in a much stricter liability standard under UCITS than AIFMD, as the only way for a depositary not to return a financial instrument of the identical type is to prove an "external event beyond its reasonable control".

As a result, the depositary would always be obliged to return instruments held in custody that are lost, even if the loss occurred with the sub-custodian. We strongly believe that depositaries must not be held liable for events related to the sub-custodian, in particular where the local insolvency law does not allow the return of the assets lost in case of the insolvency of the sub-custodian. Leaving aside cases of negligence or intentional failure to perform its duties, this would transform depositaries in de-facto insurers against different legal regimes, in particular insolvency law, where sub-custodians have to be used to provide safekeeping services to UCITS funds. We believe that such a liability regime could even inject further systemic risk into the financial system in case of a bankruptcy of a large custodian bank which will have a severe contagion effect on all connected depositaries. We therefore strongly believe that the possibility of contractual discharge of liability, as foreseen in the AIFMD, should be preserved and the Directive should not go beyond the already working compromise that has been found for the AIFMD.

### **Alternative**

In the current form the depositary has no absolute veto power over such investment decision and may be required to appoint a local sub-custodian even in circumstances where it has raised concerns in relation to local custody providers. This resulting strict risk liability regime for depositaries could severely limit investment possibilities of UCITS funds' investors. In order to provide a satisfactory level of investor protection as intended we could imagine a requirement to inform the fund' investor beforehand about



possible segregation issues in countries where sub-custodians are established. By following this alternative, it remains possible for investors to invest in new developing markets.

### **Conditions for the Appointment of a Delegate (Art. 22 para. 7 lit. e)**

The second issue about missing convergence can be found in Article 22 para. 7 which sets out the circumstances in which custody and safekeeping functions can be delegated by a depositary to a third party. These are almost equivalent to the AIFM requirements<sup>1</sup>, except for one new addition in the form of lit. e<sup>2</sup>.

It requires the depositary to determine that all assets entrusted in custody are, whatever the circumstances, left outside of delegate estate in case of bankruptcy of the delegate. The addition is unclear and potentially of far reaching consequences. This additional requirement, indeed, may suggest that the depositary is requested to determine ex-ante the outcome of the legal proceedings of a specific bankruptcy case. How the insolvency laws might apply, depending on the circumstances surrounding any insolvency and the manner in which the third party has dealt with the assets entrusted to it.

This "insurance" will lead to severe limitations on the choice of UCITS investments for funds since depositaries will be reluctant to offer custody services in most foreign legal environments. We therefore strongly suggest alignment with AIFMD by deleting lit. e.

### **II. Protection of cash deposited with a Depositary (Art. 22 para. 6)**

The fifth paragraph under point 2.1 of the explanatory memorandum<sup>3</sup> clearly states that cash is considered as a type of asset, which obliges depositaries to have arrangements in place ensuring that cash deposits are protected against claims of creditors (in case of bankruptcy). We want to stress that because of the nature of a credit institution – deposited cash is used for the credit and lending business of the bank – this kind of protection cannot be achieved. As a consequence credit institutions will be unable to fulfil the requirements arising from Art. 22 para. 6. We therefore strongly suggest to clearly indicate that cash is outside the scope of Art. 22 para. 6.

### **III. Requirements to be an Eligible Depositary (Art. 23)**

The current Proposal stipulates that only a credit institution<sup>4</sup> or investment firm<sup>5</sup> should be eligible to act as a depositary to a UCITS which will narrow down the currently permitted types of depositaries. We support the Commission's desire to exclude unregulated and low capitalised entities from being authorised to perform or pursue depositaries' activities in the EU.

<sup>1</sup> AIFM Directive 2011/61/EU, Article 21 para. 11

<sup>2</sup> Art. 22 para. 7 lit. e: "in the event of the insolvency of the third party, securities held by the third party for UCITS are unavailable for distribution among or realisation for the benefit of creditors of the third party."

<sup>3</sup> Section "2.1. Rules on depositaries' duties" on page 7, paragraph 5 states: "Article 22(4) contains detailed provisions on cash monitoring. This paragraph intends to equip the depositary with a view over all the assets of the UCITS, **cash included**. [...]"

<sup>4</sup> Credit institutions as authorised in accordance with Directive 2006/48/EC

<sup>5</sup> Investment firms as authorised under Directive 2004/39/EC ("MiFID")



## Contact

The EACB trusts that its comments will be taken into consideration. Should there be any need for further information any questions on this paper, please contact:

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