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**AFG comments on the European Commission proposal UCITS V – depositaries**

The European Commission published a legislative proposal early July 2012 with a view to increase the protection of investors that invest in UCITS funds. AFG welcomes this proposal.

The Commission proposal covers 3 topics: depositaries, remunerations and sanctions. We wish that the scope of this proposal remains limited to these 3 topics in order to be finalised as soon as possible and thus reduce the period when the rules applying to UCITS depositaries differ from those applying to AIF depositaries.

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**AFG comments on the proposed provisions on depositaries**

General comments on depositaries

In general, we strongly support the Commission proposal to reinforce the role and responsibility of the UCITS depositary beyond those of the AIF depositary. Indeed, the UCITS cross border passport aims at both professional and retail investors, whereas the AIFM passport aims at professional investors only. This explains why we believe that an increased protection is required for UCITS investors.

Furthermore, it should be ensured that, where level 2 measures are provided for in the AIFMD, they are at least also provided for in the UCITS Directive in order to make the AIFMD the basis of the UCIST V directive. It could even be considered to include some AIFM level 2 measures in the UCITS level 1 directive in order to reinforce them, UCITS targeting mainly retail investors who will require a higher level of protection and therefore a safer legal regime.

Detailed comments on depositaries

Comments on explanatory text page 3

We would like to recall that it would not make sense to extend investor compensation schemes to cover funds. Indeed, the depositary’s obligation to return the assets will ensure that the assets benefit from the appropriate level of protection.

Comments on article 22 (point 1 page 20)

We support the obligation to appoint a single depositary as this will allow the depositary to have a global view of all the assets of the UCITS.

*An investment company and, for each of the common funds it manages, a management company shall ensure that a single depositary is appointed*

Comments on article 22 (point 5 page 21)

We support the obligation to segregate assets that are held in custody that will allow to distinguish the depositary’s assets, the clients’ assets and the funds’ assets. Indeed, Asset segregation is a fundamental requirement for security vis a vis creditors.

*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 UCITS or the management company acting on behalf of the UCITS, so that they can be clearly identified as belonging to the UCITS in accordance with the applicable law at all times*

However, we would like to highlight that this segregation obligation should in our opinion cover the assets of funds whatever their type and not specifically the assets of UCITS funds: there should be a global common account gathering all funds’ assets e.g. UCITS, AIFs, EuSEFs. If not, this would imply a multiplication of accounts, when for example the depositary holds in custody assets of UCITS and assets of AIFs.

Comments on article 22 (point 6 page 21)

We strongly support the obligation of unavailability of assets proposed by the Commission. Indeed, in case of default of the depositary, it will ensure a higher level of investor protection against the depositary’s creditors.

*Member States shall ensure that in the event of insolvency of the depositary, assets of a UCITS held by the depositary in custody are unavailable for distribution among or realisation for the benefit of creditors of the depositary.*

Comments on article 22 (point 7 (d) page 22)

We would like to highlight the need for consistency between the UCITS and AIFM directives, both at level 1 and level 2, in particular regarding the obligation of segregation of the assets applying to sub-custodians.

Comments on article 22 (point 7 (e) page 22)

As a general principle, we believe that **the requirement relating to the unavailability of the assets of the UCITS kept in custody should apply both at depositary and sub-custodian levels** in order to ensure the appropriate level of protection of the assets.

We therefore propose to leave article 22 – point 7 (e) unchanged as follows:

*In the event of insolvency of the third party, assets of a UCITS held by the third party in custody are unavailable for distribution among or realisation for the benefit of creditors of the third party.*

Proposed modification of Article 22 - point 7 page 22

However, **an adjustment is needed** for non EU countries **where the national law requires a local sub custodian** but does not ensure such unavailability so that UCITS funds and their investors are not deprived from potentially rewarding investment opportunities – provided of course that investors and asset managers are informed thereof.

Therefore, as the Commission acknowledges the need for an adjustment relating to letter (b) on the prudential framework where the national law requires a local sub custodian, we believe that an additional adjustment could be introduced relating to letter (e). In addition, we propose to reword conditions (a) and (b) so as to require that any additional potential risk is disclosed to investors in the KIID and that depositaries inform asset managers that custody has been delegated to such an entity.

*Notwithstanding point****s*** *(b)* ***and (e)*** *of the third subparagraph where the law of the third country required that certain financial instruments be held in custody by a local entity and no local entities satisfy the delegation requirements laid down in ~~that~~* ***these*** *point****s****, the depositary may delegate its functions to such a local entity only to the extent required by the law of the third country and only for as long as there are no local entities that satisfy the delegation requirements, and only where:*

*a) the investors of the relevant UCITS are duly informed ~~that such delegation is required due to legal constraints in the law of the third country and of the circumstances justifying the delegation, prior to investment~~* ***of any additional potential risk as a component of the operational risk disclosed in the KIID****;*

*b) the UCITS, or the management company on behalf of the UCITS, ~~have instructed~~* ***has been informed that*** *the depositary ~~to~~* ***has*** *delegate****d*** *the custody of such financial instruments to such a local entity.*

Comments on article 23 (point 2 page 23)

We support the limitation of the types of entities eligible as depositaries as this will ensure a higher protection of the assets.

*The depositary shall be:*

*(a) a credit institution authorised in accordance with Directive 2006/48/EC;*

*(b) an investment firm, subject to capital adequacy requirements in accordance with Article 20(1) of Directive 2006/49/EC including capital requirements for operational risks and authorised in accordance with Directive 2004/39/EC and which also provides the ancillary service of safe-keeping and administration of financial instruments for the account of clients in accordance with point (1) of Section B of Annex I to Directive 2004/39/EC; such investment firms shall in any case have own funds not less than the amount of initial capital referred to in Article 9 of Directive 2006/49/EC;*

Comments on article 24 (points 2, 3 et 4 page 24)

**We support the prohibition for depositaries to contractually discharge their responsibility**, as retail investors might not properly understand the potential consequences of such a discharge.

*2. The liability of the depositary shall not be affected by any delegation referred to in Article 22(7).*

*3. The liability of the depositary referred to in paragraph 1 shall not be excluded or limited by agreement.*

*4. Any agreement that contravenes the provision of paragraph 3 shall be void.*

Proposed modification of the Annex

We believe that such information is legitimate and useful. However, we do not believe that requesting such disclosure to be made in the prospectus of the UCITS is appropriate as it would raise significant practical and operational challenges. Indeed, sub custodian networks may change quite often over time (for example, the geographical investment regions may change over the life of the UCITS) and it would be burdensome and costly to update the prospectus accordingly.

We therefore propose removing this requirement and replacing it by an obligation based on article 23 (f) of the AIFMD, as follows, which would for example allow to disclose such information on a website:

***Management companies shall for each of the UCITS that they manage make available to investors in accordance with the UCITS rules or instruments of incorporation, a description of any safe-keeping functions delegated by the depositary, the identification of the delegates and any conflicts of interest that may arise from such delegations, as well as any material changes thereof.***

Additional modifications proposed by AFG

**We request that the prohibition to re-use the assets of the UCITS without prior consent of the manager be explicit** - as is the case in the AIFMD (cf. article 21 paragraph 10). This would ensure a clarification of the applicable regime and its harmonisation at EU level.

We therefore propose to add the following provisions:

***The assets safekept by the depositary shall not be reused by the depositary without the prior consent of the UCITS or the management company acting on behalf of the UCITS****.*

***The sub-custodian does not make use of the assets without the prior consent of the UCITS or the management company acting on behalf of the UCITS and prior notification to the depositary.***