

CD/SJ/PYB/JA/LD –10.10.2012

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

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.

\*

\*\*

**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

Page 3

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

AFG 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*

Proposed modification of 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.

AFG 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.*

AFG 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 are not deprived from potentially rewarding investment opportunities.

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 it could understand the need for an adjustment relating to letter (e). However, in order to remove our concerns regarding the creation of legal uncertainty, we propose to reword conditions (a) and (b).

*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.*

AFG 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;*

AFG 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 understand properly 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.***

\*

\*\*

**AFG comments on the proposed provisions on remunerations**

General comments on remunerations

The proposed provisions on remunerations are a copy-paste of the AIFMD provisions on remunerations. However, there are huge differences between UCITS and AIFs, especially on their respective risk profiles. As a consequence, some provisions of the UCITS V proposal as currently drafted seem inadequate for UCITS management companies.

AFG comments on article 14 a

Usually, UCITS have a performance indexed on public benchmarks (MSCI, Euro Stoxx, S&Ps…). These benchmarks measure the variation of various markets with various asset classes and geographical zones. Only a small part of UCITS can be classified as absolute return funds.

Benchmarked UCITS have different risk profiles linked to their asset class or geographical zone. Their asset manager is not “encouraged” to take some risk, it is just the asset class that is more or less risky. Emerging markets stocks will be by nature more risky than European stocks. But it is not at the asset manager’s discretion to invest or not on emerging markets if the fund he/she manages is an emerging market fund.

Thus, remuneration policies usually have no material impact on the risk profiles of UCITS. It is very important that UCITS V remuneration provisions take UCITS risk profile into account and that the principle of proportionality is applied.

AFG comments on article 14b

f) A RemCo does not always exist. The words “*in case such a committee exists*” should be added.

*The remuneration of the senior officers in the risk management and compliance functions is directly overseen by the remuneration committee* ***in case such a committee exists.***

h) “*the assessment of performance is set in a multi-year framework appropriate to life-cycle of the UCITS*”

The terms “life cycle” and “redemption policy” are not appropriate. UCITS are totally liquid, open-ended and they do not have a limited life cycle. Decisions taken by UCITS managers have immediate and direct consequences on the UCITS performance. Except in exceptional situations, there is no delayed impact on the risk profile of the fund. Thus, the delayed payment of bonuses has very little impact on the UCITS’ risk profile.

m) An asset manager usually manages several UCITS. Clarifications would therefore be required with regards to payments in funds shares.

We believe that it would be useful to enlarge the range of tools that could replace payments in fund shares. We therefore propose amending the Commission’s wording as follows:

*A substantial portion and in any event at least 50% of any variable remuneration consists of:*

* *units of the UCITS concerned;*
* *equivalent ownership interest;*
* *share linked instruments*
* *equivalent non-cash instruments; or*
* ***any other remuneration system that takes into account over time the level of risk of the investments made****.*

\*

\*\*

**AFG comments on the proposed provisions on sanctions**

General comments on sanctions

We understand that the Commission aims at a harmonisation of the measures and sanctions applicable in the different Member States. We fully support this objective and as a principle and in particular believe that the implementation of administrative measures and sanctions defined at European level should be compulsory in all Member States and should not be at the Member States’ discretion, as is considered in some of the proposals by some Member States in the context of the MIFID review. Indeed, it would make no sense to specify which administrative measures and sanctions should apply and then leave it up to the Member States to decide whether to implement them or not.

We believe that these measures and sanctions, in particular pecuniary sanctions, should be at least as strict as those currently applying in France. Indeed, France has a long and positive track record of measures and sanctions that covers several decades.

In France, applicable sanctions are the following (Article L621-15):

*a) Pour les personnes mentionnées aux 1° à 8°,11°,12°,15° à 17° du II de* [*l'article L. 621-9,*](file:///C:\Users\delfrayssic\AppData\Local\Microsoft\Windows\Temporary%20Internet%20Files\Content.Outlook\RAQL5YVL\affichCodeArticle.do;jsessionid=26E2E8179E4ABF614FAC71D507C3699D.tpdjo03v_1?cidTexte=LEGITEXT000006072026&idArticle=LEGIARTI000006660297&dateTexte=&categorieLien=cid) *l'avertissement, le blâme, l'interdiction à titre temporaire ou définitif de l'exercice de tout ou partie des services fournis, la radiation du registre mentionné à* [*l'article L. 546-1*](file:///C:\Users\delfrayssic\AppData\Local\Microsoft\Windows\Temporary%20Internet%20Files\Content.Outlook\RAQL5YVL\affichCodeArticle.do;jsessionid=26E2E8179E4ABF614FAC71D507C3699D.tpdjo03v_1?cidTexte=LEGITEXT000006072026&idArticle=LEGIARTI000022954075&dateTexte=&categorieLien=cid) *; la commission des sanctions peut prononcer soit à la place, soit en sus de ces sanctions une sanction pécuniaire dont le montant ne peut être supérieur à 100 millions d'euros ou au décuple du montant des profits éventuellement réalisés ; les sommes sont versées au fonds de garantie auquel est affiliée la personne sanctionnée ou, à défaut, au Trésor public ;*

*b) Pour les personnes physiques placées sous l'autorité ou agissant pour le compte de l'une des personnes mentionnées aux 1° à 8°,11°,12°,15° à 17° du II de l'article L. 621-9, l'avertissement, le blâme, le retrait temporaire ou définitif de la carte professionnelle, l'interdiction à titre temporaire ou définitif de l'exercice de tout ou partie des activités ; la commission des sanctions peut prononcer soit à la place, soit en sus de ces sanctions une sanction pécuniaire dont le montant ne peut être supérieur à 15 millions d'euros ou au décuple du montant des profits éventuellement réalisés en cas de pratiques mentionnées aux c et d du II ou à 300 000 euros ou au quintuple des profits éventuellement réalisés dans les autres cas ; les sommes sont versées au fonds de garantie auquel est affiliée la personne morale sous l'autorité ou pour le compte de qui agit la personne sanctionnée ou, à défaut, au Trésor public ;*

*c) Pour les personnes autres que l'une des personnes mentionnées au II de l'article L. 621-9, auteurs des faits mentionnés aux c et d du II, une sanction pécuniaire dont le montant ne peut être supérieur à 100 millions d'euros ou au décuple du montant des profits éventuellement réalisés ; les sommes sont versées au Trésor public.*

Furthermore, the French regime explicitly specifies that the principle of proportionality should be applied to the above mentioned sanctions:

*Le montant de la sanction doit être fixé en fonction de la gravité des manquements commis et en relation avec les avantages ou les profits éventuellement tirés de ces manquements.*

As a principle, we believe that a direct link should be avoided as far as possible between the sanction and the detriment caused to investors.

Furthermore, we ask that these sanctions do not target management companies only but also the other players in the value chain (e.g. depositaries).

Detailed comments on sanctions

AFG comments on article 99a

The wording of paragraph 2 seems imprecise and confusing. Indeed, it does not seem clear whether all the listed sanctions should apply to one breach. In addition, the sanctions might not be proportionate to the relevant breach.

We therefore suggest rewording as follows:

*Member States shall ensure that in ~~all~~ cases referred to in paragraph 1, the administrative sanctions and measures that may be applied ~~include at least~~* ***are in*** *the following* ***non exhaustive list and that the proportionality principle described in article 99 paragraph 1 is applied***

The wording in French seems particularly confusing and will have to be amended. Indeed, the translation of “may” into “soient” is not accurate.

*Les États membres veillent à ce que dans tous les cas visés au paragraphe 1, les sanctions et les mesures administratives applicables ~~soient~~* ***sont tirées de la liste non exhaustive ci-dessous*** *~~au moins les suivantes~~* ***et à ce que le principe de proportionnalité décrit à l’article 99 paragraphe 1 est appliqué***

AFG comments on article 99c paragraph 2

The mere guidance by ESMA on the measures and sanctions and their amounts should not infringe on the Member States’ remit. Indeed, national judges should be able to set the measures or sanctions and their amounts at their own discretion - although the Directive may set maximum amounts, depending on their appreciation of the case and applying the principle of proportionality.

AFG comments on article 99e

The reporting to ESMA by the AMF of measures or sanctions in the view of a publication by ESMA in an annual report should not allow the making of databases. The protection of such data should be ensured, for example by laying down technical standards and limiting its use by search engines. For example, the French data protection authority (CNIL) limits the use of databases: e.g. there is no technical possibility to extract personal data from legal texts.

Moreover, the reporting to ESMA should only be done when the measures or sanctions are final, after the expiry of the delay for appeal in front of national courts. Indeed, any reputational damage caused might be difficult to fix in case an appeal later lifts the relevant measure or sanction.

\*

\*\*

Would you need any further information, please feel free to contact our Head of International Affairs Division, Stéphane Janin, at +33 1 44 94 94 04 ([s.janin@afg.asso.fr](mailto:s.janin@afg.asso.fr)), our Deputy Head of International Affairs Division, Carine Delfrayssi, at + 33 1 44 94 96 58 ([c.delfrayssi@afg.asso.fr](mailto:c.delfrayssi@afg.asso.fr)) or myself at +33 1 44 94 94 29 ([p.bollon@afg.asso.fr](mailto:p.bollon@afg.asso.fr)).

Sincerely yours,

Pierre Bollon