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Consultation paper on the UCITS Depository Function and on the UCITS managers 'remuneration AFTI & FBF Contribution

The Association Française des Professionnels des Titres ("AFTI") is the leading association in France and within the European Union representing the post-trade industry. AFTI has over more than 100 members, all actors in the securities market and back office businesses: banks, investment firms, market infrastructures, issuers. Please note that response of AFTI & FBF to the European Commission consultation expresses views on **the depository functions issues only**.

The French Banking Federation ("FBF") represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, i.e. more than 500 commercial, cooperative and mutual banks. They employ 500,000 people in France and around the world, and serve 48 million customers.

I- Key messages

AFTI & FBF welcome the initiatives taken by the European Commission and shares the Commission's objective to achieve a clarification of the duties and of the liability regime of UCITS depository.

AFTI & FBF welcome the significant positive steps forward that the AIFM Directive brought to these issues and expects a consistency of the future legislation applicable to the European funds (UCITS and AIF) as far as the depository's duties and liability regime are concerned.

More specifically, AFTI & FBF reaffirm that a full alignment between the AIFM Directive and the UCITS Directive is needed as far as the definition of the sake-keeping duties of the depository and the scope of the assets to be included in the depository's custody duties are concerned.

There is a wide consensus that the depository's liability regime should be clarified, harmonized and proportionate to the depository's duties and to the risks the depositories can monitor.

However, AFTI & FBF are of the opinion that this objective cannot be achieved if the sole concept of *force majeure* is retained to discharge the depository from its obligation to return financial instruments held in custody in case of loss of assets. Therefore, AFTI & FBF expect that the UCITS regulation will consider and retain the AIFM Directive proposed legislation for a harmonized definition of "events where the loss of assets can be considered to be a result of an external event beyond the control of the depository reasonable control.

Last, AFTI & FBF are of the opinion that the issue of financial instruments issued in a nominative form and/or registered with an issuer or a registrar shall not be included in the scope of the custody duties as the depositary does not select the issuer or the registrar of these financial instruments. In addition, the issuer or the registrar may not be a regulated entity, therefore imposed onto the depositary that does not maintain any contractual relationship with. This specific case should be addressed by the future legislation, notably to ensure that ownership rights of the UCITS are recognized and undisputable whatever the local legislation or the recording method used by the issuer or its registrar.

II. Detailed response

A. Depositary's duties

1. Safe-keeping

Box 1

It is necessary to define what activities and responsibilities are related to the notion of "safe-keeping" of assets.

AFTI & FBF strongly support a clarification of the safekeeping function of the assets by the fund depositary.

The mapping recently issued by CESR on the UCITS depositary function confirmed that one of the **key priorities in this clarification objective is the implementation of a European harmonized definition of the safekeeping functions** that should be part of level 1 of the future legislation.

The second key aspect is a need for a clear and undisputable description of the tasks to be performed by the fund depositary when performing the safe-keeping of the assets of the fund. This should result in the clarification of the liability regime of the depositary.

AFTI & FBF strongly advocate a regulatory approach for UCITS funds that is consistent with the AIFM Directive approach (i.e. clarifying the different duties of the depositary according to the different asset classes invested in by the UCITS).

Box 2

It is envisaged to complete articles 22 and 32 of the UCITS Directive, in a way which is consistent with the approach in the AIFM Directive, in order to:

Distinguish safekeeping duties between (1) custody duties relating to financial instruments (such as securities) that can be held in custody by the depositary and (2) asset monitoring duties relating to the remaining types of assets. A reference to the custody of physical assets, such as real estate or commodities, is not necessary because such assets are currently not eligible for holding within a UCITS portfolio;

Supplement the requirements on custody duties with a segregation requirement, so that any financial instruments on the depositary's book held for a UCITS can be distinguished from the depositary's own assets and at all times be identified as belonging to that UCITS; such a requirement would confer an additional layer of protection for investors should the depositary default;

Equip the depositary with a view over all the assets of the UCITS, cash included. The directive should more explicitly make clear that no cash account associated with the funds' transactions can be opened outside of the depositary's acknowledgement, with a view to avoiding the possibility of fraudulent cash transfers;

Introduce new implementing measures in the mentioned Articles defining detailed conditions for performing depositary monitoring and custody functions, including (i) the type of financial instruments that shall be included in the scope of the depositary's custody duties; (ii) the conditions under which the depositary may exercise its custody duties over financial instruments registered with a central security depositary; and (iii) the conditions under which the depositary shall monitor financial instruments issued in a nominative form and registered with an issuer or a registrar.

AFTI & FBF strongly support the Commission's objective to complete articles 22 and 32 of the UCITS Directive at level 1 in a way which is consistent with the approach in the AIFM Directive's provisions related to safekeeping duties.

AFTI & FBF fully agree with the European Commission proposal to provide implementing measures to specify for each type of safekeeping duties the scope and the list of the financial instruments concerned.

Safekeeping duties of the fund depositary

As a matter of principle, AFTI & FBF agree that the revision of the UCITS provisions should recognise two different types of duties within the safe-keeping functions, i.e. custody duties and asset monitoring duties.

1/ Custody

Custody duties should apply to the classes of assets which fulfil relevant criteria to make the restitution obligation applicable in case of loss of assets.

These assets are the financial instruments that are safe-kept all along a chain of intermediaries in a way that gives insurance to the fund depositary, at any time, about their existence, their location and its rights of disposition and retrieval.

That implies that the financial instruments held in custody should be at the same time (cumulative criteria):

- **free of any lien** that qualifies for a transfer of ownership and/or re-hypothecation of the assets;
- **subject to regulated central reconciliation procedures (in CSDs)**, performed independently from the issuer in order to ensure the integrity of the financial instruments issuances;

- **transferable with all their rights and effects;**
- **safe-kept by third parties selected by the depositary** according to its own due diligence criteria.

Therefore the financial instruments in the scope of the custody duty are all the financial instruments referred to in points 1 and 2 in annex I, section C of Directive 2004/39/CE and the ETF, i.e. the securities that:

- Are registered in a central security depository (CSD) performing the so-called notary function (i.e. these securities that are not registered with the issuer itself or its agent - a registrar or a transfer agent).
- And are not subject to any collateral agreement or re-used with the agreement of the management company.

Conversely, financial instruments that are excluded from the above-mentioned scope are, namely:

- All financial contracts (including lending, borrowing, derivative listed and OTC instruments). These instruments are financial contracts which cannot be registered into securities accounts;
- Financial instruments (including units and shares of collective investment schemes) issued in a nominative form or registered with the issuer or a registrar (see below for rationale);
- All financial instruments used as collateral or re-used following the agreement of the management company.

Specific case of the financial instruments registered with an issuer of its agent (registrar):

As a matter of principle, in order to be included in the scope of custody, the assets should be registered in a way that ensures the integrity of the issuance (existence of the security).

CSD (central securities depositories) core function is to ensure this integrity through ongoing supervision, international best practices and disclosed market rules. Where financial instruments are registered with the issuers themselves or their agents (registrars), the depositary only maintain in its records the positions held in the books of the issuer or its agent. Accordingly, assets are not recorded as such in the books of the depositary but in the books of the issuer or its agent.

In addition, these financial instruments may be subject to operational risks (errors, fraud, misappropriation), linked to their modalities of their registration, undetectable through normal market practices as issuers and/or registrars differ in their practices and applicable regulations (financial instruments may be registered in the name of the fund, or of the intermediary (i.e. a nominee which, in most cases, is the depositary on behalf of the fund).

Lastly, issuers (and/or registrars) are not selected by the depositary that does not maintain any contractual relationship with them. For all these reasons, it is essential that these assets are excluded from the scope of assets in custody **and included in the assets subject to asset monitoring duties** (maintenance of a record of the positions held in the books of the issuer or of its agent).

Description of custody duties

Custody duties encompass:

- maintenance of its records and accounts in a way that ensures its accuracy, and in particular its correspondence to the financial instruments with the asset of the UCITS,
- segregation of the assets (AFTI & FBF response on segregation hereafter),
- conduct of, on a regular basis, reconciliations between its internal accounts and records and those of any third parties by whom those assets are held,
- introduction of adequate organizational arrangements in order to mitigate the risk of the loss, or of the loss of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence,
- exercise with all due skill, care and diligence of the selection, appointment and periodic review of the third party and of the arrangements for the holding and safekeeping of those financial instruments held in custody. In particular, the depositary should take into account the expertise and market reputation of the third party as well as any legal requirements or market practices related to the holding of those financial instruments that could adversely affect clients' rights.

2 Asset monitoring duties relating to the remaining scope of assets

All financial instruments which are excluded from the scope of the custody as mentioned above should be subject to asset monitoring duties.

Asset monitoring duties should include:

- the maintenance by the depositary of a record of all assets belonging to the fund.
- The verification by the depositary of the ownership of the assets by the fund,

These duties are performed by the depositary through:

- a periodic review by the depositary of the existing procedures in place in the management Company (reconciliation procedure of the management company records with the external evidences of ownership);
- a periodic reconciliation of the management company records with the depositary records, to be performed by the UCITS (the findings of which being communicated, without delay, to the depositary).

The description of the nature of the information flows to be communicated by the management company to the depositary should be included in the agreement evidencing the appointment of the depositary. The obligation of information to the depositary lies on the management company of the UCITS.

3. Segregation requirement relating to custody function

AFTI & FBF agree with the proposal to provide for a segregation requirement. This requirement should specify that depositaries shall segregate assets in their books so as to be able to identify assets held for one client from assets of another and from their own assets.

Intermediaries in the custody chain shall equally be required to segregate their client assets from their own assets. This requirement is considered to be the main ring-fencing procedure. However, any measures addressing the question of segregation below the level of the depositary need to take into account the legal and operational way in which assets are currently held in the international custodial system and the cost implications of making any changes to the existing situation.

Below the depositary, however, assets are generally mixed with those of all other client assets and held in an “omnibus client” account. Indeed, full segregation throughout the sub-custody chain by designation of each individual client at each level would not add clear benefits in terms of security of the assets and may not be acceptable under local law in the jurisdiction in which the third party is located.

AFTI & FBF suggest that the Commission (or another designated European institution) establishes a list of EU Members States and/or parties where segregation obligation is both applicable and enforceable. For all other jurisdictions outside the EU, the depositary may rely on regular certifications issued by the sub-custodians, its external or **internal auditors or third parties such as independent counsels**.

4. Cash accounts of the UCITS

4.1. View on all the assets of the fund, cash included

AFTI & FBF support the European Commission’s proposal to require the depositary’s acknowledgement for any cash account opened outside its own books. AFTI & FBF, however, insist on the fact that this condition cannot be understood as the appropriate tool to prevent fraudulent cash transfers. Indeed, fraudulent transfers can only be detected through procedures and ex-ante verifications within the management company that instructs the cash transfers on behalf of the fund.

External cash account providers should communicate, and where requested, confirm to the asset management company and to the depositary the specifics related to all account details, balances, transactions, collateral arrangements, deposits, and compliance to the local regulation applicable to cash accounts.

This level of information from the asset management company and the cash account providers to the depositary is required in order to properly discharge the oversight functions of the depositary

The UCITS by-laws should expressly authorize the opening of cash accounts with third parties, and provide for the adequate disclosure as per the specific related risks.

4.2 Regime of the cash accounts

A distinction is to be made between:

1- Cash accounts opened in the depositary’s books

The cash account keeping function are performed by the depositary in accordance with applicable national banking regulations.

2- Cash accounts opened by the fund (or the management company, on behalf of the fund) with external account providers.

In this case, the assets are in the scope of the assets monitoring functions of the depositary. The depositary should not be liable in case of loss of assets related to these cash accounts.

4.3 Duties of the depositary for external cash accounts

The depositary should verify that the management company on behalf of the UCITS, has set up procedures and controls with regards to :

- the opening of the account and the management of the cash flows including:
 - o the verification of the appropriate license of the third party,
 - o the existence and the communication of statements of accounts.
- the compliance of a segregation between the cash belonging to each fund and the cash belonging to the asset management company ,
- the reconciliation of the account balances with the assets of the UCITS ,
- the compliance by the fund with of the counterparty limits, including cash held by third parties that are not protected by protection schemes or similar arrangements.

2. Oversight functions

Box 3

It is envisaged to achieve a higher degree of consistency in the oversight duties to be performed by UCITS depositaries: the oversight duties related to UCITS with a corporate form should be aligned with those to be performed in respect to UCITS with a common fund form (article 22).

AFTI & FBF agree with the objective to achieve a replication of the oversight duties related to UCITS with a corporate form with those to be performed in respect to UCITS with a common fund form. Indeed, as retail investors are not able to differentiate between the legal form of a common fund unit and a corporate type fund share, such alignment appears to be appropriate.

Box 4

It is envisaged to introduce implementing measures that will clarify further the scope of each listed supervisory duty, for example the methodology to be used for the calculation of the Net Asset Value of the UCITS.

AFTI & FBF support the European Commission proposal to bring some clarification on supervisory duties of the UCITS depositary through implementing measures. This would enhance transparency and further harmonisation at the European level.

In particular, it should be specified that supervisory duties of the depositary should be performed on an ex- post basis.

In AFTI & FBF perspective, supervisory duties of the depositary are two-fold:

- Oversight function of the investment decisions taken by the management company in order to verify their compliance against the fund applicable regulations and contractual obligations (as described in the prospectus) ;
- Verification that the management company has put in place the appropriate procedures in order to calculate the Net Asset Value (NAV) -in accordance with the fund regulation and contractual obligations- and to check the NAV calculation process (please note that , as per Annex II of the UCITS IV Directive, the management company is responsible of the NAV calculation and that Article 22.3 of the Directive 2009/65/EC provides that the depositary should “ensure that the value of units is calculated in accordance with the law and the fund rules”.)

These tasks are performed **independently** and carried out in addition of, but **not in duplication of, controls and procedures put in place by the management company.**

In this context, supervisory duties of the depositary should be performed on an **ex-post basis** in accordance with the proportionality principle. AFTI & FBF would see some benefit in specifying these principles in the level 1 of the future UCITS legislation

As per the calculation of the NAV of a UCITS fund, AFTI & AFTI would see some benefit in clarifying this provision with the objective to specify that the depositary tasks does not impose neither “re-calculating” nor validating the NAV and that this control does not exonerate the management company to perform its duties. The proposed regulation, however, should take the appropriate steps in order to clarify and harmonize the duties of the depositary to ensure that the NAV has been properly calculated/validated by the management company.

Regarding the **Commission proposal to harmonise the methodology to be used for the calculation of the NAV.** AFTI & FBF are of the opinion that it should be part of the fund contractual obligations and national laws. AFTI & FBF, however, reaffirm as the duties of the depositary should be harmonized, differences in methodologies may not cause differences in the nature of the depositaries duties

3. Delegation of the depositary’s tasks

Box 5

It is envisaged to restrict more explicitly the delegation of the depositary task to the safekeeping duties and that the conditions and requirements upon which a UCITS depositary may entrust its safekeeping duties to a third party should be aligned with those under the AIFM Directive.³²

It is also envisaged to require additional information for UCITS investors be published (for example in the prospectus) where a network of sub-custodians is to be used. Such information would specify the risk that such a sub-depository network might fail or default, and how this risk can be dealt with.

Finally, implementing measures are envisaged in order to detail the depository's initial and on going due diligence duties, including those that apply to the selection and appointment of a sub-custodian.

Delegation

AFTI & FBF support the European Commission proposal to restrict the delegation to the safekeeping function. AFTI & FBF agree that only the safekeeping function (custody duties and asset monitoring duties relating to the remaining types of assets) could be delegated to a third party in order to avoid the depository to act as a letter-box entity.

AFTI & FBF are of the opinion that more clarification should be given to the concept of delegation. Indeed, the Directive should clearly mention that the delegation concept is limited to the circumstances where the depository, selects third parties within its safekeeping duties. When the selection of the actors (e.g. a registrar, a collateral agent or an external entity where cash accounts are opened in the name of the fund), does not fall into the remit of the depositories duties, the depository may not be considered as liable in case of a loss resulting from this actor.

Disclosure to investors

AFTI & FBF agree with the proposal to disclose information to investors on the potential existence of a sub-custodian network and on the risks associated. Such a disclosure would contribute to strengthen transparency *vis-à-vis* the investors. In this respect, AFTI & FBF are of the opinion that inserting **a standardized disclosure wording in the KIID** is appropriate and sufficient.

For practical reasons, this information should refer to the nature of the risks linked to the recourse to a sub-custodian network only and not envisage an exhaustive description of the network. Further disclosure would indeed be of no value for the investors and prove very difficult and expensive to deliver as sub-custodian networks do undergo frequent modifications.

Due Diligence

AFTI & FBF agree with the objective to detail on-going due diligences and strongly supports in this view **a strict alignment between the provisions of the AIFM and UCITS Directives.** **Therefore** AFTI & FBF are of the opinion that the provisions, as laid down in the level 1 of the AIFM Directive, are detailed enough and should be inserted in the level 1 text of the UCITS V Directive.

In this respect implementing measures to further detail the depositories due diligence duties may not be advisable.

B. UCITS depository liability regime

1. Improper performance

Box 6

It is envisaged that the depositary liability regime might be clarified in case of a UCITS suffering losses as a result of a depositary's negligence or intentional failure to perform its duties.

AFTI & FBF support the Commission's proposal to clarify the depositary liability regime in case of a UCITS suffering losses as a result of a depositary's negligence or intentional failure to perform its duties. This principle should be aligned with the provisions of the AIFM Directive.

Box 7

It is envisaged to clarify the UCITS depositary liability regime in case of loss of assets. Accordingly, the UCITS depositary shall be under the obligation to return the financial instruments of the identical type or of the corresponding amount to the UCITS. No further discharge of liability in case of loss of assets is envisaged, except in case of force majeure. Implementing measures should be introduced, as necessary, to clarify all necessary underlying technical aspects, for example to identify the circumstances under which assets may be lost.

AFTI & FBF support the European Commission proposal to clarify the liability regime of the depositary in case of loss of assets.

Nevertheless, in order to achieve this objective, the following issues should be clarified:

- the scope of the assets under the obligation of restitution in case of loss of these assets,
- the definition of loss (including the measures that could be taken in case of temporary unavailability of the assets),
- the circumstances when the depositary should be discharged of its obligation to return assets in custody, further to a loss of those assets.

A) the scope of the restitution obligation in case of loss of assets

It is essential to bear in mind, that from a depositary perspective, the safekeeping function differs according to the nature of the assets and not according to the legal nature of the fund (i.e. AIF or UCITS fund). Therefore, the Commission approach for UCITS should be aligned with the one retained in the AIFM Directive which makes a clear distinction between assets in custody (where the restitution obligation may apply, provided that all applicable conditions are met) and assets subject to the asset monitoring function.

Indeed, the obligation of restitution in case of loss should apply only to assets held in custody, i.e. when the financial instruments are safe-kept all along a chain of

intermediaries in a way that gives insurance to the depositary at any time about their existence, their location and the right of disposition and retrieval on them. (see above)

For all other financial instruments which are safe-kept by the depositary, the liability regime should be limited to the negligence of the intentional failure of the depositary to perform its duties in accordance with the Directive.

B) The concept of loss of assets should be clarified

As a matter of principle, AFTI & FBF expect that the future legislation does not make possible any misinterpretation on the meaning of the concept of “loss” and reaffirms the objective of a full harmonisation at the European level.

As mentioned above, the “loss of a financial instrument” should only cover **a loss in relation with financial instruments held in custody.**

Legally speaking a loss of assets affecting a UCITS is a result of the following circumstances:

- the **financial instrument does not longer exist** (without any relation to a decision of the issuer or its agent),
- the **rights** of the AIF over the financial instrument **have been suspended or terminated.**

Consequently, **temporary unavailability of financial instruments cannot per se qualify for a loss.** From the AFTI & FBF perspective, a clear distinction should be done between a temporary unavailability of an asset (i.e. an asset is blocked for a certain period of time, due to e.g. bankruptcy proceedings or governmental measures) with a definitive “loss” (due to e.g. embezzlement or fraud).

Similarly, in case of loss of value which is a pure market risk, the depositary cannot bear the liability. In this respect, these types of loss should be clearly excluded from the definition of loss of assets.

AFTI & FBF also believe that only **a judiciary decision authority** should determine the loss of financial Instruments, the date of occurrence of the loss, and if applicable, the corresponding amount.

AFTI & FBF suggest that implementing measures should be introduced in order to cater for the circumstances of temporary unavailability of financial instruments in order to preserve investor interests. In such a case, the management company, or when applicable, the fund itself, may, in accordance with the regulation of the fund, adopt transitional measures and procedures (such as the amendment to the NAV calculation rules, the suspension of subscription/redemption rights or the creation of side pockets) in order to orderly preserve the investors interests in exceptional circumstances.

Implementing measures should also further detail the nature of the assets to be returned and the modalities of the restitution obligation.

C) The circumstances when the depository should be discharged from the obligation of restitution of lost assets

Regarding the liability regime of the depository, **AFTI & FBF do not support** the European Commission proposal to strictly limit the possibility of discharge to *force majeure*, as this legal concept is not harmonised at European level and is subject to the definitions provided by national laws or interpretations of the national courts.

AFTI & FBF are of the opinion that the approach adopted by the European Commission should rather ensure that the liability regime is fully harmonised at the European level in the level 1 text. In this respect AFTI & FBF recommend to have a similar approach as the one adopted in the **AIFM Directive** with identification of external events which are beyond the reasonable control of the depository. From a depository 's perspective, there is no differences between the functions performed by the depository whatever the type of the fund (AIF or UCITS) as they are dependent on the nature of the financial instrument invested in by the fund.

Indeed, in spite of due diligence performed by the depository in selecting and monitoring its sub-custodians, the depository cannot eliminate risks in relation to:

- Investments which are made in non-mature financial markets (e.g. weak centralized infrastructures, absence or limited legal effects of the segregation obligation) or in unstable political environments, or in markets with limited availability of sub-custodian services appropriate for selection,
- The organization and the effectiveness of the oversight of the local financial systems by the local competent authorities, over the financial infrastructures and the regulated actors. In this respect, prevention and punishment of fraud appear to be clearly within the remit of the local relevant (including administrative and judiciary) authorities.
Indeed, no due diligence process over third parties can be superior to on-going local regulatory supervision, local regulators and overseers being, by nature, the strongest authority and having been granted the highest capacity to perform their duties,
- The local and international systemic crises affecting the financial markets,
- The local and international political crisis and events.

AFTI & FBF are therefore of the opinion that it is advisable to establish a non-exhaustive list of events where the loss of assets can be considered to be the result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.

That list should contain, as a minimum, the following types of events:

• **Events linked to local market conditions**

- Insolvency of a sub custodian notwithstanding the fulfillment of the depository's duties (ie due diligence obligations)
- Market closures
- Widespread defaults (systemic/domino effect in one of more markets)
- Effect of political/ judiciary acts and decisions

- **Events linked to markets infrastructures deficiencies**
 - Failure, outage, and fraud
 - Local market rules imposing liens and/or reversals

3. The scope of the UCITS depositary liability when assets are lost by a sub custodian

Box 8

As already provided under art. 22 and art. 32 of the UCITS directive, it is envisaged to maintain the rule according to which the depositary's liability is not affected if it has entrusted to a third party all or some of its safekeeping tasks. As a result, the depositary faces the same level of liability, should the UCITS assets be lost by a sub-custodian. Moreover, it is envisaged that the legislative proposal should clarify the fact that if assets are lost, the UCITS depositary liability regime has the general obligation to return the financial instruments of the identical type or of the corresponding amount to the UCITS with no delay.

As mentioned above, no further discharge of liability (either regulatory or contractual) in case of loss of assets by a sub custodian shall be envisaged, except in case of "force majeure".

A) Liability principle

AFTI & FBF support the proposal to maintain the rule according to which the depositary's liability is not affected if it has entrusted to a third party all or some of **its safekeeping functions**.

The restitution obligation, however, as mentioned above (see our response for Box 7) should be restricted to the cases where there is a loss of a financial instrument which is held in custody (as opposed to the assets subject to asset monitoring duties only), following a judiciary decision which has qualified the event as a loss, and provided that the loss is not the result of an external event beyond the reasonable control of the depositary.

B) No delay

AFTI & FBF are of the opinion that the proposal to return the assets to the fund **with no delay would be at best, difficult to enforce and at worst, could create unintended adverse effects**.

Indeed, in all circumstances, a minimum delay is required due to legal and technical constraints resulting from local market practices and/or legal frameworks. These constraints should be taken into account when defining the liability regime. AFTI & FBF therefore favour the language retained in the AIFM Directive. It is our view that the obligation to return the assets "without undue delay" better reflects the operational constraints imposed to the depositary.

C) Force majeure

AFTI & FBF are strongly opposed to *force majeure* as the sole case envisaged for a discharge of the responsibility of the depositary, in case of loss of assets (please see Point C of the response to Box 7).

4. Burden of the Proof

Box 9

It is envisaged to clarify that the depositary should carry the burden of demonstrating that it has duly performed its duties.

AFTI & FBF are of the opinion that the reversal of the burden of proof proposed by the European Commission is inappropriate even if we acknowledge that this concept has been adopted in the AIFM Directive.

5. Rights of UCITS holders action against the UCITS depositary

Box 10

It is suggested to align the rights of UCITS investors, so that both share- and unit-holders are able to invoke claims relating to the liabilities of depositaries, either directly or indirectly (through the management company), depending on the legal nature of the relationship between the depositary, the management company and the unit-holders.

Finally, implementing measures should also be introduced in order to encourage a high degree of harmonisation, for example to detail the conditions and procedures under which shareholders may directly use their rights towards a UCITS depositary.

AFTI & FBF agree that the rights of both share- and unit-holders should be aligned as regards claims relating to the liabilities of depositaries.

AFTI & FBF are also of the opinion that, since the management company has the duty to act in the best interest of the investors, it is its duty to take the relevant action vis-à-vis the depositary if necessary. Therefore, investors should primarily invoke claims relating to the liabilities of depositaries indirectly through the management company.

1. Eligibility criteria

Box 11

It is suggested to introduce an exhaustive list of entities that should UCITS depositaries, aligned with the AIFM Directive list. Such credit institutions authorised MiFID firms which also provide safe-keeping and administration of financial instruments, depositary institutions (by means of a grandfathering clause).

AFTI & FBF do not agree with the approach retained in the AIFM Directive.

AFTI & FBF are of the opinion that the scope of eligible entities agreed as depositaries for UCITS **should be limited to EU credit institutions or investment firms** for which head office and central administration are in the UCITS home Member State. Appropriate Investors protection should rely on supervised and regulated entities with a sufficient level of regulatory capital that may comply with their obligations in case of loss of a financial instrument held in custody.

In addition limitation of the eligibility would ensure a full European harmonisation on this aspect.

2. Location of the depositary (passport issues)

Box 12

It is envisaged that a provision is introduced into the UCITS Directive creating a commitment to assess and re-examine the need to address depositary passport issues, to be undertaken a few years after the new UCITS depositary framework has come into force.

As a matter of principle, it is essential that the introduction of a depositary passport does not create an unlevel playing field between European Member States and jeopardize the objective of European harmonisation pursued by the Commission initiatives.

Therefore, AFTI & FBF suggest that any reference to a provision creating a commitment to assess and re-examine the need to address depositary passport issues should be subject to the actual enforcement of a full European harmonisation of the depositary duties and liability regime.

D. Supervision issues

1. Supervision by national regulators (p.17)

Box 13

Differences between national supervisors' scope of competencies lead to an uneven supervisory framework, suggesting that such competences might be better harmonised. In the Commission's view, this remains a key issue to be addressed in order to fully achieve due levels of harmonisation in practice for the depositary function at the Community level.

AFTI & FBF support the Commission's proposal to harmonise the national supervisors' scope of competencies.

2. Supervision by auditors (p.18)

Box 14

The introduction of a requirement for an annual certification of the assets held in custody by the depositary would clarify the true existence of such entrusted assets. This annual

certification could be performed by the depositary's auditors. Details related to any such requirement might need to be further defined in implementing measures or technical standards as appropriate.

AFTI & FBF support the European Commission proposal to introduce an annual certification performed by an external auditor. The certification should consist in verifying that the depositary complies with its duties as defined in the Directive and that the depositary has established, maintained and implemented procedures compliant with the legal framework.

This certification, however, should not impose an obligation on the depositary to check that its sub-custodians have obtained a similar certification as this certification is not required outside the EU and therefore may not be available at the sub-custodian level.

E. Other issues

1. Derogation from the obligation of UCITS to appoint a depositary

Box 15

It is suggested to delete articles 32 (4) and 32 (5) of the UCITS Directive n°2009/65/EC.

AFTI & FBF support the Commission's proposal to remove the derogation from the obligation of UCITS to appoint a depositary.

2. Single depositary rule

Box 16

It is suggested that the requirement for a single depositary per UCITS should be clarified (without prejudice to Article 113(2) of the UCITS Directive n°2009/65/EC).

AFTI & FBF support the Commission's proposal to clarify the requirement for a single depositary per UCITS and alignment of the provisions of the UCITS Directive and AIFM Directive.

The appointment of a single depositary is a key measure to enhance the investor protection as it would allow the depositary to have a complete view on all the assets invested in by the UCITS fund.

3. Organisational requirements and rules of conduct

Box 17

It is suggested to:

- *Introduce for UCITS depositaries similar rules of conduct as in the AIFM Directive, in addition to the already existing rules stated in the article 22 and 32 of the UCITS Directive;*

- *Introduce implementing measures in order to encourage a higher degree of harmonisation and consistency between the organisational requirements applicable to all functions of the UCITS depositary (safekeeping as well as oversight) and, where appropriate, the existing MiFID requirements.*

AFTI & FBF are of opinion that the rules of conduct and organisational requirements are already specified in existing regulations.

Where the depositary is a credit institution, the applicable legislative framework is the national and European banking regulations (Directive 2006/48/EC) and MIFID (Directive 2004/39/EC) applies in case where the depositary is an investment firm.

4. Exchange of information with competent authorities

Box 18

It is suggested to amend existing requirements concerning the disclose of information to the competent authorities, on their request, in such a way that any information, obtained by a depositary while carrying out its duties, should be made available to its competent authorities if such information may be necessary for these authorities.

Implementing measures should also be introduced in order to, for example to detail the conditions and procedures under which UCITS depositaries shall exchange information with their supervisors.

AFTI & FBF support the Commission's proposals to transmit information obtained by the depositary while carrying out its duties to the competent authorities, upon their request.

Concerning the **conditions and the procedures** under which UCITS depositaries shall exchange information with their supervisors, the provisions would take into account the fact that supervisory (oversight) functions need flexibility (samples, review of process etc). Therefore, AFTI & FBF suggest that these provisions should provide for an obligation of information to the regulators for significant breaches and/or anomalies, without establishing specific thresholds

5. The contract between the depositary and the UCITS manager

Box 19

It is suggested that the requirements set out in Article 23(5) and Article 33(5) of the UCITS Directive and their corresponding implementing measures should also apply to a situation where the management company home Member State is also a UCITS home Member State. It appears opportune to require the UCITS depositary to follow conduct of business rules which would oblige a depositary to act honestly, fairly, professionally, independently and in the interest of the UCITS and investors of the UCITS. Furthermore, the depositary should be required to establish appropriate policy for identification, management, monitoring and

disclosure of the conflict of interests which may arise when a depositary carries out activities with regard to the UCITS.

AFTI & FBF agree that there should be a written contract between the management company and the depositary regardless whether the management and the fund are located in the same Member State or not.

However, AFTI & FBF do not think that the format of this contract should be imposed by the European legislation. As for the implementing measures on the UCITS IV Directive, in the context of the management company passport, the UCITS V Directive should only identify a list of mandatory items to be included in such a contract.