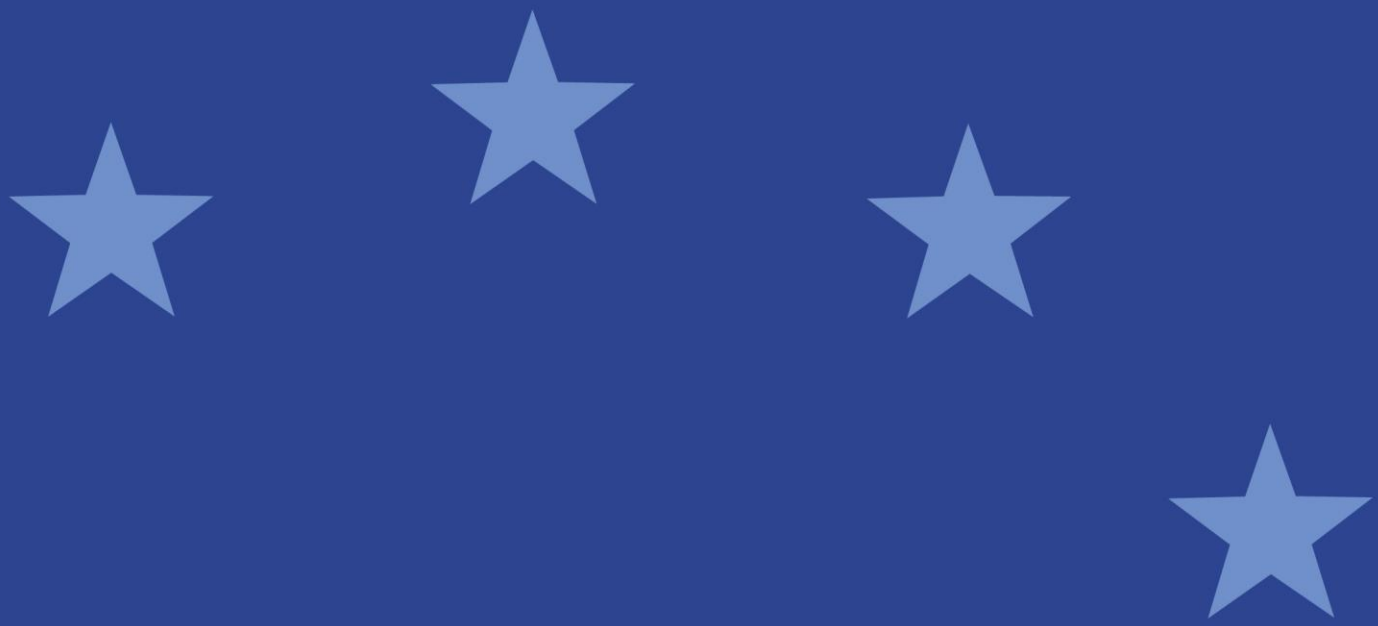
esma European Securities and Markets Authority

Consultation Paper

ESMA's technical advice to the European Commission on delegated acts required by the UCITS V Directive



26 September 2014 | ESMA/2014/1183

European Securities and Markets Authority

Date: 26 September 2014
ESMA/2014/1183

Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

- indicate the specific question to which the comment relates and respond to the question stated;
- contain a clear rationale, clearly stating the costs and benefits; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **24 October 2014**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading 'Legal Notice'.

Who should read this paper

This document will be of interest to depositaries (including their delegates) of UCITS funds and their trade associations, asset management companies managing UCITS funds and their trade associations, as well as institutional and retail investors investing into such funds and their associations.

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Acronyms used

AIFMD	Alternative Investment Fund Managers Directive (2011/61/EU)
ESMA	European Securities and Markets Authority
IOSCO	International Organization of Securities Commissions
NCA	National Competent Authority
UCITS	Undertaking for Collective Investment in Transferable Securities
UCITS Directive	Directive 2009/65/EC
UCITS V	Directive 2014/91/EU

I. Executive Summary

Reasons for publication

On 3 July 2014 ESMA received a provisional request from the European Commission for technical advice on the content of two of the delegated acts on depositaries required by UCITS V. In this consultation paper, ESMA is seeking feedback from external stakeholders on the draft advice on those delegated acts.

Contents

This consultation paper sets out ESMA's proposals for possible implementing measures regarding the issues identified in the European Commission's request. Section II explains the background to ESMA proposals. The formal proposals for advice are contained in the boxes in Annex IV to the paper, while further commentary and explanation is provided in Sections III and IV.

Advice on the insolvency protection of UCITS assets when delegating safekeeping (Section III)

UCITS V provides that, when the custody functions are delegated by the depositary to a third party, such a third party shall take "*all necessary steps to ensure that 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*". The European Commission is empowered to adopt delegated acts specifying the steps to be taken by the third party pursuant to these provisions. This section of the consultation paper proposes measures, arrangements and tasks for the third party to which custody is delegated as well as measures to be put in place by the depositary.

Advice on the independence requirement (Section IV)

UCITS V states that "*In carrying out their respective functions, the management company* [and the investment company] *and the depositary shall act* [...] *independently and solely in the interest of the UCITS and the investors of the UCITS*". The European Commission is empowered to adopt delegated acts specifying the conditions for fulfilling this independence requirement. This section of the consultation paper identifies two types of link between the management company/investment company and the depositary which may jeopardise their independence. These are (a) the common management/supervision and (b) the cross-shareholdings between these entities.

Next steps

ESMA will consider the feedback it receives to this consultation with a view to submitting the technical advice to the European Commission by the end of November 2014.

II. Background

II.I. UCITS V

1. At its plenary session on 15 April 2014, the European Parliament adopted the text of UCITS V [T7-0355/2014]. Following the legal revision of the text, on 28 August 2014 UCITS V was published in the Official Journal of the European Union.[1] The changes introduced to the UCITS Directive relate to depositary issues, remuneration and sanctions. UCITS V came into force on 17 September 2014; Member States must adopt and publish the laws and regulations necessary to comply with the Directive by 18 March 2016.

II.II. Delegated acts under UCITS V

2. UCITS V provides for several empowerments for the Commission to adopt delegated acts relating to the new depositary requirements. These requirements are meant to broadly align the provisions of the UCITS Directive with those of the AIFMD in terms of rules on depositaries' duties, delegation, eligibility to act as custodian and liability. As a consequence, the empowerments for the Commission to adopt delegated acts on depositaries under UCITS V are largely equivalent to the ones that were foreseen by the AIFMD and for which ESMA provided its technical advice to the Commission in 2011.[2]

3. However, UCITS V includes two empowerments to adopt delegated acts that were not covered by the AIFMD depositary rules. These relate to the provisions of the Directive on (i) the insolvency protection of UCITS assets when the depositary delegates safekeeping duties to a third party and (ii) the requirement for the management company and depositary to act independently.

II.III. The provisional request to ESMA for technical advice

4. On 3 July 2014, ESMA received a provisional request for advice from the Commission (see Annex II). The request relates to the two empowerments mentioned above and is based on the text that was adopted by the European Parliament in April. For this reason throughout this document reference is made to the numbering and the content of the UCITS V articles in the text adopted by the European Parliament. References to the numbering of the articles in the text published in the Official Journal are made in the footnotes, whenever these differ from the ones in the text adopted by the European Parliament.

5. The Commission asked ESMA to deliver its advice by 15 October 2014. In light of this tight deadline, ESMA moved quickly to consider the key issues and engage with key stakeholders, including via a roundtable of external stakeholders on 29 July.

6. The need to organise a public consultation on the draft advice, in line with ESMA consultation practices, means that ESMA will deliver its advice after the deadline set by the Commission. It is expected that the final advice will be sent to the Commission by the end of November of this year.

[1] OJ L 257, 28.8.2014, p. 186.
[2] ESMA's technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive (ESMA/2011/379), available at: http://www.esma.europa.eu/system/files/2011_379.pdf.

7. For these reasons the consultation period for this consultation paper is only four weeks, which is shorter than the three months ESMA would normally aim for when dealing with significant issues such as those covered in the Commission's request.

III. Advice on the insolvency protection of UCITS assets when delegating safekeeping (Art. 22a(3)(e)[3] and 26b(e) UCITS V)

III.I. Level 1 provisions

8. Article 1(4) of UCITS V replaces Article 22 of the UCITS Directive so that the text of Article 22(5) of the UCITS Directive reads as follows:

The assets of the UCITS shall be entrusted to the depositary for safe-keeping as follows:

(a) for financial instruments that may be held in custody, the depositary shall:

(i) hold in custody all financial instruments that may be registered in a financial instruments account opened in the depositary's books and all financial instruments that can be physically delivered to the depositary;

(ii) ensure that 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;

(b) for other assets the depositary shall:

(i) verify the ownership of the UCITS or the management company acting on behalf of the UCITS of such assets by assessing whether the UCITS or the management company acting on behalf of the UCITS holds the ownership based on information or documents provided by the UCITS or the management company and, where available, on external evidence;

(ii) maintain a record of those assets for which it is satisfied that the UCITS or the management company acting on behalf of the UCITS holds the ownership and keep that record up-to-date.

9. Article 1(5) of UCITS V inserts a new Article 22a in the text of the UCITS Directive. Article 22a(3) of the UCITS Directive provides that

The functions referred to in Article 22(5) may be delegated by the depositary only to a third party which at all times during the performance of the tasks delegated to it:

[…]

[3] Article 22a(3)(d) in the text of UCITS V published in the Official Journal.

(e) takes all necessary steps to ensure that 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; [...]

10. Article 1(10) of UCITS V inserts a new Article 26b in the text of the UCITS Directive. According to such article,

The Commission shall be empowered to adopt delegated acts [...] *specifying:*

[...]

(e) the steps to be taken by the third party pursuant to point (e) of Article 22a (3); [...]

III.II. Scope of the mandate given to ESMA by the Commission

11. The Commission asks ESMA to provide advice on what are the necessary steps to be taken to ensure that 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.

12. The Commission further details its request by asking ESMA:

i) to specify the steps to be taken in the form of a non-exhaustive list of the measures, arrangements and tasks that the third party to which custody is delegated should put in place and perform on on-ongoing basis in order to ensure that the UCITS assets are protected from distribution among or realisation for the benefit of creditors of the third party. These measures, arrangements and tasks must take into account the legal framework of the country in which the third party operates, notably that country's insolvency laws and relevant jurisprudence.

ii) to specify the measures that the depositary should put in place ex-ante to ensure that the third party fulfils its obligations and how the depositary should ensure that the required level of protection is respected at all the times.

III.III. Proposed advice

III.III.I. Structure of the advice

13. According to the request received from the Commission, the areas to be covered in the ESMA advice relate to the two different actors involved in the custody of UCITS assets in case of delegation of safe-keeping duties and are as follows:

a) Third party to which custody is delegated:

- ESMA is asked to develop a non-exhaustive list of measures, arrangements and tasks to be put in place and performed on an ongoing basis.

b) Depositary:

- ESMA is asked to specify:

i) the measures that the depositary should put in place ex-ante to ensure that the third party fulfils its obligations, and

ii) how the depositary should ensure that the required level of protection is respected at all the times.

III.III.II. Measures, arrangements and tasks for the third party to which custody is delegated

14. In order to provide an answer to the first part of the Commission's request, it seems appropriate to clarify the link between the requirement under Article 22a(3)(e) of the UCITS Directive and the requirement to segregate the UCITS' assets under Article 22a(3)(d).[4] Indeed, the latter provisions foresee that "*The functions referred to in Article 22(5) may be delegated by the depositary only to a third party which at all times during the performance of the tasks delegated to it:* [...] *(d) segregates the assets of the clients of the depositary from its own assets and from the assets of the depositary in such a way that they can at any time be clearly identified as belonging to clients of a particular depositary;*".

15. ESMA is of the view that there is a natural link between the provisions of Article 22a(3)(d) and 22a(3)(e) of the UCITS Directive. Indeed, ensuring that – in the event of insolvency of the third party – the UCITS' assets are unavailable for the benefit of creditors of the third party ultimately implies ensuring that the assets of the UCITS held by the third party do not have to form part of the third party's estate under the insolvency proceedings. The segregation foreseen under Article 22a(3)(d) of the UCITS Directive is intended to ensure that the assets held by the third party are "*unavailable for distribution among or for the realisation for the benefit of*" its creditors since they would be identified solely as the assets of the UCITS in the case of insolvency proceedings.

16. In other words, ESMA considers that segregation greatly supports the policy objective that UCITS assets would be unavailable for distribution to the creditors of an insolvent third-party delegate of a depositary.

Q1: Do you agree that the steps to be taken by the third party are ultimately intended to ensure that the level of segregation foreseen under 22a(3)(d) of the UCITS Directive is recognised in the context of an insolvency proceeding involving the third party?

Q2: Do you consider that the level of segregation foreseen under Art 22a(3)(d) of the UCITS Directive should protect UCITS assets from claims by creditors of an insolvent third party which had been delegated the safekeeping of the assets by the UCITS' depositary?

Q3: Are there other measures which could also help achieve this objective?

Third party which is located in a jurisdiction outside the Union

17. Based on this approach, ESMA considers that the basic requirement for the third party should be to make all reasonable efforts, including the receipt of independent legal advice, to verify that the applicable insolvency laws and jurisprudence recognise the segregation of the UCITS' assets from the third party's own assets and from the assets of the depositary, in line with the requirements of

[4] Article 22a(3)(c) in the text of UCITS V published in the Official Journal.

Article 22a(3)(d) of the UCITS Directive, as it will be further implemented by the delegated acts foreseen under Article 26b(1)(d) of the UCITS Directive. Moreover, it should be verified that the UCITS' segregated assets do not form part of the third party's estate in case of insolvency and are unavailable for distribution among or realisation for the benefit of creditors of the third party.

18. The requirement should be established only for cases where the applicable insolvency laws and jurisprudence are those of a jurisdiction outside the European Union. Indeed, insolvency laws inside the European Union are expected to provide that the assets of a UCITS cannot be distributed to the creditors of a third party located in the European Union in case of its insolvency. This is based on the provisions of Article 22(8) of UCITS V which provides that: "*Member States shall ensure that in the event of insolvency of the depositary and/or any third party located in the Union to whom custody of UCITS assets has been delegated, the assets of a UCITS held in custody are unavailable for distribution among or realisation for the benefit of creditors of such depositary and/or such third party*" (emphasis added).

19. The applicable insolvency laws and jurisprudence of a jurisdiction outside the European Union may set out the conditions under which it can be considered that the UCITS' assets are segregated and unavailable for distribution or realisation. The third party should ensure that the relevant conditions foreseen by these laws are met both at the moment of the conclusion of the delegation agreement with the depositary and on an ongoing basis for the entire duration of the delegation.

20. It may happen that, during the life of the delegation agreement with the third party, the conditions required by the applicable insolvency laws and jurisprudence are no longer met or are amended due to legislative modifications. In such circumstances, the third party should take action in order to ensure that the requirements of Article 22a(3)(e) of the UCITS Directive are fulfilled on an ongoing basis. To that extent, it seems reasonable to require the third party to immediately inform the depositary of the fact that the relevant conditions are no longer met or the applicable insolvency laws and jurisprudence have changed.

Third party which is located in a jurisdiction inside or outside the Union

21. In order to ensure that the depositary receives a first-hand confirmation on the relevant insolvency regime to which the UCITS assets are linked, the third party should adequately inform the depositary about the applicable rules and conditions.

22. Moreover, in developing this part of the advice, ESMA took into specific account the recent Recommendations Regarding the Protection of Client Assets issued by IOSCO in January 2014 (the "IOSCO Recommendations").[5] The IOSCO Recommendations seek to help regulators improve the supervision of intermediaries holding client assets by clarifying the roles of the intermediary and the regulator in protecting those assets. In particular, they set out guidance for cases where an intermediary places client assets with third parties, where the intermediary should reconcile the client's accounts and records with those of the third party.

23. ESMA considers that some of the principles set out in the IOSCO Recommendations are relevant also for specifying the requirements of Article 22a(3)(e) of the UCITS Directive. The relevant principles are the following ones:

[5] Available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD436.pdf.

Principle 1 – An intermediary should maintain accurate and up-to-date records and accounts of client assets that readily establish the precise nature, amount, location and ownership status of client assets and the clients for whom the client assets are held. The records should also be maintained in such a way that they may be used as an audit trail.

Principle 2 – An intermediary should provide a statement to each client on a regular basis detailing the client assets held for or on behalf of such client.

Principle 3 – An intermediary should maintain appropriate arrangements to safeguard the clients' rights in client assets and minimise the risk of loss and misuse.

24. The IOSCO Recommendations also set out guidance on the means of implementation of each of the principles. The element of guidance that appears more relevant for the purpose of the present advice is the following one mentioned under Principle 3:

[…]

2. *An intermediary should also analyse how certain actions or decisions could materially change the status of the client asset and/or complicate return of the client asset (e.g., if the exercise of a right of re-use or enforcement of a pledge results in a different party succeeding to rights in the client asset). An intermediary may build this understanding through in-house analysis as well as through consultation with professional advisors (i.e., law firms or accountancy firms).* […]

25. ESMA considers that the measures suggested in the above guidance may be relevant to the extent that the reuse of UCITS assets is authorised under Article 22(7) of the UCITS Directive.[6]

26. ESMA proposes to include the above mentioned principles in the requirements to be imposed on the third party to which the safe-keeping of the UCITS' assets is delegated.

Q4: Do you agree with the steps to be taken by the third party as identified above? If not, please explain the reasons.

Q5: Do you consider that there are any specific difficulties that may arise in verifying the applicable insolvency regime that makes the proposed rules difficult to be complied with? In particular, do you consider the requirement for the third party located in a jurisdiction outside the Union to obtain independent legal advice could give rise to specific issues?

Q6: Do you expect a significant increase in terms of costs that would be faced by the third party delegated entities located in jurisdictions outside the Union in order

[6] Article 22(7) of the UCITS Directive provides the following (emphasis added): "*The assets held in custody by the depositary shall not be reused by the depositary or by any third party to whom the custody function has been delegated for their own account. Reuse comprises any transaction of assets held in custody including, but not limited to, transferring, pledging, selling and lending. The assets held in custody by the depositary are only allowed to be reused provided that the reuse of the assets is executed for the account of the UCITS, the depositary is carrying out the instructions of the management company on behalf of the UCITS, the reuse is for the benefit of the UCITS and the interest of the unit-holders and the transaction is covered by high quality and liquid collateral received by the UCITS under a title transfer arrangement. The market value of the collateral at all times has to amount to at least the market value of the reused assets plus a premium*".

to obtain independent legal advice on the applicable insolvency regime? If yes, please provide any available data and/or estimation.

Q7: Would you suggest requiring the third party to take any further steps which are not foreseen in the draft advice?

Q8: Should any specific consideration be given to the scenario where the third party further sub-delegates the safe-keeping of the UCITS' assets in accordance with Article 22a(3), last sub-paragraph of the UCITS Directive (as inserted by UCITS V)? Should the third party take any additional/different steps or measures in this case?

III.III.III. Measures to be put in place by the depositary

27. The role of the depositary is also important for the purpose of ensuring compliance with the requirements of Article 22a(3)(e) of the UCITS Directive.

28. As for the measures to be put in place ex-ante by the depositary, the IOSCO Recommendations provide for some useful principles that ESMA deems appropriate to take into account in its advice. These are as follows:

Principle 3 – An intermediary should maintain appropriate arrangements to safeguard the clients' rights in client assets and minimise the risk of loss and misuse.

Means of implementation

[…]

3. *Where client assets are placed with a third party (whether in the same jurisdiction or in a foreign jurisdiction and whether an unrelated or affiliated party), the intermediary should exercise all due skill, care and diligence in the selection and appointment (where applicable), and periodic review of the third party and of the arrangements for safeguarding the client assets, and should consider:*

   - *The legal requirements or market practices related to the holding of client assets that could adversely affect clients' rights during business as usual and in the event of resolution or insolvency of the intermediary or the third party;*
   - *The financial condition, expertise and market reputation of the third party;*
   - *Protection or lack thereof attendant upon the regulatory status of the third party; and*
   - *The need for diversification and mitigation of risks, where appropriate, by placing client assets with more than one third party.*

4. *Where an intermediary places client assets with a third party, the intermediary should, to the extent necessary to achieve compliance with applicable domestic requirements, understand the material effects of the contractual provisions governing that arrangement on the clients' rights in respect of such client assets, including how those contractual provisions would*

operate in the jurisdiction where such assets are held, including in the event of the resolution or insolvency of the intermediary, the third party or both.

[…]

29. ESMA proposes to incorporate some of these principles in the measures to be adopted ex-ante by the depositary.

30. As for the measures to ensure that the required level of protection is respected all the times, ESMA believes that the following provisions of the IOSCO Recommendations are relevant:

Principle 4 – Where an intermediary places or deposits client assets in a foreign jurisdiction, the intermediary should understand and take into account the foreign regime to the extent necessary to achieve compliance with applicable domestic requirements.

Means of implementation

To the extent the home regime imposes requirements on an intermediary that places or deposits client assets in a foreign jurisdiction, the intermediary may face challenges in ensuring its compliance with such domestic requirements. Accordingly, the intermediary should have sufficient knowledge of the domestic as well as foreign regimes where it places client assets to the extent necessary to ensure such compliance. This means that the intermediary has the responsibility to understand the client asset protection regimes and arrangements in every jurisdiction (including its home jurisdiction) in which client assets are kept, to the extent necessary to ensure compliance with the domestic requirements.

31. Moreover, in case the third party is located outside the Union, ESMA considers appropriate to also require the depositary to ensure that there are contractual provisions allowing the termination of the agreement with the third party without undue delay in case the applicable insolvency laws and jurisprudence of a jurisdiction outside the European Union no longer guarantee the segregation of the UCITS assets in the event of insolvency of the third party or the conditions set out under these laws are no longer fulfilled. In such a case, the depositary should immediately inform the management company/investment company of the situation. However, ESMA considers that the mere provision of information to the investment company or the management company on behalf of the UCITS should not change the nature of the assets held by the third party which should continue to be held in custody.

Q9: Do you agree with the steps to be taken by the depositary as identified above? If not, please explain the reasons.

Q10: Do you expect any significant one-off and ongoing compliance costs for depositaries in order to take the steps identified above? If yes, please provide any available data and/or estimation.

Q11: Would you suggest requiring the depositary to take any further steps which are not foreseen in the draft advice?

Q12: Which measures do you think should be taken by the depositary and/or the investment company/management company in the best interest of the investors once the depositary has informed the investment company or the management

company on behalf of the UCITS that the segregation of the UCITS' assets in the event of insolvency of the third party is no longer guaranteed in a given jurisdiction located outside the Union? Would the transfer of the relevant UCITS' assets held by the third party in a non-EU jurisdiction to another (EU or non-EU) jurisdiction which recognises the segregation of the UCITS' assets in the event of insolvency of the third party/depositary be a possible measure?

III.III.IV. Cases where it may not be necessary for the third party/depositary to obtain an independent legal advice

32. ESMA is of the view that whenever the independent legal advice obtained by the third party is made available to the depositary or the independent legal advice obtained by the depositary is made available to the third party, there is no need to require the other party to obtain an equivalent independent legal advice confirming that the applicable insolvency laws and jurisprudence recognise the segregation of the UCITS' assets from the third party's own assets and from the assets of the depositary. Indeed, in such a case the policy objective of obtaining a confirmation of the rules applicable to the UCITS assets is achieved by one of the two parties (the third party or the depositary) and should be valid and reliable for the other one as well.

33. However, this does not exempt the third party nor the depositary from performing the residual 'reasonable efforts' required of each of them (see paragraph 1(a)(i) and paragraph 2(b)(i) of the draft advice).

Draft advice:

1. In case of delegation of the functions referred to in Article 22(5) of Directive 2009/65/EC, in order to ensure that in the event of insolvency of the third party, assets of a UCITS held by this third party in custody are unavailable for distribution among or realisation for the benefit of creditors of the third party, the third party shall take steps including, but not limited to, the following:

   (a) whenever the applicable insolvency laws and jurisprudence are those of a jurisdiction located outside the Union,

      (i) make all reasonable efforts, including the receipt of independent legal advice, to verify that the applicable insolvency laws and jurisprudence:

         – recognise the segregation of the UCITS' assets from the third party's own assets and from the assets of the depositary, in line with the requirements of Article 22a(3)(d) of Directive 2009/65/EC[7], as further implemented by [the delegated acts foreseen under Article 26b(1)(d) of the UCITS Directive]; and

         – recognise that the UCITS' segregated assets do not form part of the third party's estate in case of insolvency and are unavailable for distribution among or realisation for the benefit of creditors of the third party;

      (ii) ensure that the conditions set out in the applicable insolvency laws and

[7] Article 22a(3)(c) in the text of UCITS V published in the Official Journal.

jurisprudence to consider that the UCITS' assets are segregated and unavailable for distribution or realisation, as referred to under point (i), are met at the moment of the conclusion of the delegation agreement with the depositary and on an ongoing basis for the entire duration of the delegation;

(iii) immediately inform the depositary in case any of the conditions mentioned under (ii) is no longer met;

(b) whichever jurisdiction – inside or outside the Union – the applicable insolvency laws and jurisprudence relate to,

(i) inform the depositary about the applicable insolvency laws and jurisprudence and the relevant conditions that apply;

(ii) maintain accurate and up-to-date records and accounts of UCITS' assets that readily establish the precise nature, amount, location and ownership status of those assets. The records should also be maintained in such a way that they may be used as an audit trail;

(iii) provide a statement to each depositary on a regular basis detailing the UCITS' assets held for or on behalf of such depositary; and

(iv) maintain appropriate arrangements to safeguard the UCITS' rights in its assets and minimise the risk of loss and misuse. In particular, the third party shall analyse how certain actions or decisions could materially change the status of the UCITS' assets and/or complicate return of the UCITS' assets, such as if the exercise of a right of re-use or enforcement of a pledge – to the extent that this is authorised under Article 22(7) of Directive 2009/65/EC – results in a different party succeeding to rights in the UCITS' assets;

2. In case of delegation of the functions referred to in Article 22(5) of Directive 2009/65/EC, in order to ensure that in the event of insolvency of the third party, assets of a UCITS held by this third party in custody are unavailable for distribution among or realisation for the benefit of creditors of the third party, the depositary delegating the functions to a third party shall adopt the following measures:

(a) in all cases, consider the following elements in the selection and appointment of the third party:

– the legal requirements or market practices related to the holding of client assets that could adversely affect UCITS' rights during business as usual and in the event of insolvency of the third party;

– the financial condition, expertise and market reputation of the third party; and

– protection or lack thereof attendant upon the regulatory status of the third party;

(b) in case the third party is located outside the Union,

(i) make all reasonable efforts, including the receipt of independent legal advice, to understand the material effects of the contractual provisions governing the arrangement with the third party on the UCITS' rights in respect of its assets, including how those contractual provisions would operate in the jurisdiction where such assets are held, including in the event of insolvency of the third party to which the depositary has delegated safekeeping duties;

(ii) ensure that there are contractual provisions in its agreement with the third party allowing the termination of such agreement without undue delay in case the applicable insolvency laws and jurisprudence no longer guarantee the segregation of the UCITS' assets in the event of insolvency of the third party or the conditions set out under these laws and jurisprudence are no longer fulfilled; and

(iii) in case the depositary becomes aware that the applicable insolvency laws and jurisprudence no longer guarantee the segregation of the UCITS' assets in the event of insolvency of the third party or the conditions set out under these laws and jurisprudence are no longer fulfilled, immediately inform the investment company or the management company on behalf of the UCITS of such a situation. The mere provision of information to the investment company or the management company on behalf of the UCITS shall not change the nature of the assets held by the third party, which shall continue to be held in custody.

3. Whenever the independent legal advice referred to under point (a)(i) of paragraph 1 is made available by the third party to the depositary, the latter shall be absolved of the obligation to obtain independent legal advice set out under point (b)(i) of paragraph 2.

4. Whenever the independent legal advice referred to under point (b)(i) of paragraph 2 is made available by the depositary to the third party, the latter shall be absolved of the obligation to obtain independent legal advice set out under point (a)(i) of paragraph 1, provided that the relevant independent legal advice obtained by the depositary covers all the elements mentioned under point (a)(i) of paragraph 1.

IV. Advice on the independence requirement (Art. 25(2) and 26(b)(h) UCITS V)

IV.I. Level 1 provisions

34. Article 1(8) of UCITS V replaces Article 25 of the UCITS Directive so that the text of Article 25(2) of the UCITS Directive reads as follows:

In carrying out their respective functions, the management company and the depositary shall act honestly, fairly, professionally, independently and solely in the interest of the UCITS and the investors of the UCITS. In carrying out their respective functions, the investment company and the depositary shall act honestly, fairly, professionally, independently and solely in the interest of the investors of the UCITS.

A depositary shall not carry out activities with regard to the UCITS or the management company on behalf of the UCITS that may create conflicts of interest between the UCITS, the investors in the

UCITS, the management company and itself, unless the depositary has functionally and hierarchically separated the performance of its depositary tasks from its other potentially conflicting tasks, and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the UCITS.

35. Article 1(10) of UCITS V inserts a new Article 26b in the text of the UCITS Directive. According to such article,

The Commission shall be empowered to adopt delegated acts [...] *specifying:*

[...]

(h) the conditions for fulfilling the independence requirement referred to in Article 25(2).

IV.II. Scope of the mandate given to ESMA by the Commission

36. The Commission requests ESMA to provide advice on what are the necessary conditions and criteria, at a minimum in relation to areas such as corporate and group governance, structure, organisation and internal processes, so that each of the entities referred to in Article 25(2) can be deemed to act independently in carrying out their respective functions.

IV.III. Proposed advice

IV.III.I. Structure and content of the advice

37. Article 25(2) of the UCITS Directive (as amended by UCITS V) sets out the general independence requirement for the management company (or the investment company, where it has not designated a management company) and the depositary in carrying out their respective functions.

38. ESMA considers that the empowerment under Article 26b of the UCITS Directive for the Commission to specify the conditions for fulfilling this independence requirement only relates to the independence of:

(i) the management company/investment company from the depositary, and

(j) the depositary from the management company/investment company.

39. Given that the said empowerment relates to provisions included under Chapter IV of the UCITS Directive (Obligations regarding the depositary), ESMA is of the view that such empowerment does not relate to the independence of the management company/investment company and the depositary in general (i.e. it only relates to the links between these entities).

40. Indeed, a wider mandate on the independence of the management company/investment company in isolation would risk overlapping with the provisions in other chapters of the UCITS Directive[8]

[8] Chapter III – Obligations regarding management companies (in particular, Section 3 – Operating conditions) and Chapter V – Obligations regarding investment companies (in particular, Section 2 – Operating conditions).

and the related empowerments for delegated acts.[9] For this reason the scope of this part of the advice is limited to the independence as described above under paragraph 38.

IV.III.II. Conditions and criteria for the management company/investment company and the depositary to act independently

41. ESMA considers that the independence of the management company/investment company and the depositary (together, the "Relevant Entities"), may be jeopardised by the existence of certain links between these parties.

42. The following categories of links have been identified for these purposes:

a) common management/supervision; and

b) cross-shareholdings/group inclusion.

43. The draft advice has been drafted on the basis that both categories of links should always be addressed, but in the case of cross shareholdings/group inclusion it sets out two options for consultation (see paragraphs 53 to 64 below).

Q13: Do you agree with the identified links that may jeopardise the independence of the Relevant Entities? If not, please explain the reasons.

Q14: Do you consider that any additional links should be taken into account such as, for instance, the existence of any contractual commitment or other relationship which would affect the independence of the Relevant Entities? If yes, please provide details.

Q15: Do you consider that the cumulative presence of all or some of the identified links is necessary to jeopardise the independence of the Relevant Entities or the presence of any of these links is sufficient to determine a lack of independence?

a) <u>Common management/supervision</u>

44. ESMA considers that the independence would be lost if any of the Relevant Entities, by means of executive power or supervision, could control the action of the other.

45. Therefore, the management bodies of the Relevant Entities should be kept separate. For the purpose of the present advice, 'management body' shall have the same meaning as defined under Article 2(1) of the UCITS Directive (added by UCITS V).[10]

[9] The relevant delegated acts were adopted by the Commission through the Commission Directive 2010/43/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company.

[10] Management body is defined as "*the body with ultimate decision making authority in a management company, investment company or depositary, comprising the supervisory and the managerial functions, or only the managerial function if the two functions are separated. Where, according to national law, the management company investment company or depositary has in place different bodies with specific functions, the requirements of this Directive directed at the "management body" or the "management body in its supervisory function" shall also or instead apply to those members of other bodies of the management company to whom the applicable national law assigns the respective responsibility*".

46. In case the management body of the Relevant Entities is not in charge of the supervisory functions, appropriate limitations should be introduced to the possibility for members of the body in charge of the supervisory functions of one of the Relevant Entities to also be members of the management body, the body in charge of the supervisory functions or employees of the other Relevant Entity.

47. The separation of the management bodies of the Relevant Entities could be ensured by various means:

    i. A first option could be to prohibit any member of the management body of one of the Relevant Entities from also being a member of the management body or employee of the other Relevant Entity.

    ii. A second option could be to provide that those members of the management body of one of the Relevant Entities who are also members of the management body or employees of the other Relevant Entity have limits in their decision-making capacity in the latter Relevant Entity.

    iii. A third option could be to prohibit any member of the management body of one of the Relevant Entities from having a direct or indirect shareholding of more than a given percentage of the votes at a general meeting of the other Relevant Entity.

48. ESMA saw merit in consulting on the first option only. The first option provides for the most clear and straightforward rule which would have the advantage of providing for the highest degree of protection for the investors of the UCITS as it would ensure no interference of members of the management body of the management company/investment company with the management body of the depositary and vice versa.

49. In this respect, the second option has the disadvantage of providing less certainty to the extent that it might prove difficult to determine the limits to be imposed to the decision-making capacity of the members of the management body and, therefore, it may be difficult for supervisors to supervise the appropriate application of the rule.

50. As for the third option, ESMA is of the view that the shareholding which is the most relevant is the one hold at the level of the management company/investment company and depositary and not at the level of the members of their management bodies. Since specific consideration is given to the shareholding at the level of the management company/investment company and depositary under section b) below, ESMA decided not to consult on this option.

51. For the above mentioned cases where the management body of the Relevant Entities is not in charge of the supervisory functions, ESMA proposes to set a cap of one third for the proportion of members of the body in charge of the supervisory functions of one of the Relevant Entities who may also be members of the management body, the body in charge of the supervisory functions or employees of the other Relevant Entity.

52. The reason for introducing a less stringent rule for the members of the body in charge of the supervisory functions is linked to the structure of those entities which have a dual structure (i.e. the body in charge of the supervisory functions is different from the body in charge of the managerial functions). Indeed, these entities would also have a separate body in charge of the managerial functions to which the more stringent rules on the common management would apply. Therefore,

ESMA considers that there is less of a need for stringent rules on the independence of the supervisory functions as strong safeguards should already be in place at the level of the body in charge of the managerial functions.

Q16: Do you agree with the proposed option to ensure the separation of the management bodies/bodies in charge of the supervisory functions of the Relevant Entities?

Do you have any alternative options to suggest, taking into account those identified under paragraph 47?

Q17: Do you consider that the cap of one third of members of the body in charge of the supervisory functions of one of the Relevant Entities to also be members of the management body, the body in charge of the supervisory functions or employees of the other Relevant Entity is appropriate? Would you suggest any alternative percentage? If yes, please provide the reasons why.

Q18: Do you have knowledge of any restructuring in the composition of the management bodies/bodies in charge of the supervisory functions of any Relevant Entities that would be triggered by the identified option? If yes, please provide data and an estimation of the one-off and ongoing costs that would be incurred.

b) Cross-shareholdings/group inclusion

53. ESMA considers that it must be analysed whether the independence of the Relevant Entities can be prejudiced if either of them could control the other by means of shareholders' votes. Another scenario that could jeopardise the independence of the Relevant Entities is where both of them are part of the same group.

54. It is necessary to define criteria to determine when this would happen.

55. A first option could be to refer to the notion of 'qualifying holding' in the UCITS Directive and consider that the Relevant Entities are not independent whenever they are linked by such a qualifying holding.

56. Article 2(1)(j) of the UCITS Directive defines the notion of 'qualifying holding' as follows:

'qualifying holding' means a direct or indirect holding in a management company which represents 10 % or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the management company in which that holding subsists;

57. In addition, the same threshold could be used in reverse, providing that where the management company has 10% or more of the capital/voting rights of the depositary the Relevant Entities are also not independent.

58. ESMA is of the view that it is important not only to consider the situation where the Relevant Entities are linked by a cross-shareholding, but also the situation where they are part of the same group. For this purpose, it is proposed to include in the criteria whether the Relevant Entities are included in the same group for the purposes of consolidated accounts, as defined in Directive

2013/34/EU or in accordance with recognised international accounting rules. Article 2(11) of Directive 2013/34/EU defines the notion of group as '*a parent undertaking and all its subsidiary undertakings*'.

59. A second option could be to provide that in case the Relevant Entities are (a) linked by a qualifying holding or (b) part of the same group, some specific governance and organizational arrangements and measure should be put in place to ensure that the independence of the Relevant Entities is preserved.

60. These measures and arrangements could include, as a minimum, the obligation to:

    (i) put in place conflicts of interest policies to avoid conflicts of interest arising from the shareholding or group structure; and

    (ii) justify the choice of the depositary to investors upon request.

61. Moreover, in case the Relevant Entities are part of the same group, it could be appropriate to have a certain percentage of independent members of the management body of the management company/investment company and depositary. The concept of independence within the group should be understood as requiring that the independent directors should not be member of the management body or the body in charge of the supervisory function nor employees of any of the undertakings within the group.

62. ESMA recognises that the introduction of a rule as foreseen under the first option described above might have a substantive impact on the existing shareholding structures of management companies/investment companies and depositaries in Europe. Indeed, the mapping carried out by ESMA among the NCAs (see Annex III to the present consultation paper for more details on the mapping) evidenced that a considerable amount of management companies/investment companies and depositaries might be impacted by the rules set out under the first option.

63. However, in order to assess whether this impact (and the related costs) might be outweighed by the higher investor protection standards that could be achieved through a stricter rule on cross-shareholdings, ESMA decided to consult on both the first and the second option and, in order to make its final deliberations on the basis of a full set of information, would welcome responses to this consultation paper which are as precise as possible when describing the impact of that the first option might have on the existing structures.

64. ESMA considers that, in any event, the management company/investment company should be required to put in place a robust decision-making process for choosing the depositary based on objective pre-defined criteria and meet the exclusive interest of the UCITS.

Q19: Which of the two identified options do you prefer? Would you suggest any alternative option? If yes, please provide details.

Q20: Under the second option, do you consider that it would be appropriate to require that – whenever the Relevant Entities are part of the same group – at least one third of the members of the management body of the management company/investment company and depositary should be independent? Would you suggest any alternative percentage? If yes, please provide the reasons why.

Q21: Do you agree that the concept of independence should be understood as requiring that independent directors should not be member of the management body or the body in charge of the supervisory function nor employees of any of the undertakings within the group?

Q22: Do you have knowledge of the impact that each of the two options identified would have in terms of restructuring the shareholding of any Relevant Entities or finding alternative service providers? If yes, please provide data and an estimation of the one-off and ongoing costs that would be incurred.

Draft advice:

In order to fulfil the independence requirement referred to in Article 25(2) of Directive 2009/65/EC, the following requirements shall be complied with:

[Common management/supervision]

(a) no member of the management body of the management company/investment company shall be a member of the management body of the depositary;

(b) no member of the management body of the management company/investment company shall be an employee of the depositary and no member of the management body of the depositary shall be an employee of the management company/investment company;

(c) where the management body of the management company/investment company is not in charge of the supervisory functions, no more than [one third] of the members of the body in charge of the supervisory functions of the management company/investment company shall be a member of the management body, the body in charge of the supervisory functions or an employee of the depositary;

(d) where the management body of the depositary is not in charge of the supervisory functions, no more than [one third] of the members of the body in charge of the supervisory functions of the depositary shall be a member of the management body, the body in charge of the supervisory functions or an employee of the management company/investment company;

[Cross-shareholdings]

OPTION 1

(e) the management company/investment company shall put in place a robust decision-making process for choosing the depositary which shall be based on objective pre-defined criteria and meet the exclusive interest of the UCITS;

(f) the management company/investment company shall not have a direct or indirect holding in the depositary which represents 10 % or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the depositary in which that holding subsists; and

(g) the depositary shall not have a direct or indirect holding in the management

company/investment company which represents 10 % or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the management company/investment company in which that holding subsists.

(h) the management company/investment company and the depositary shall not be included in the same group for the purposes of consolidated accounts, as defined in Article 2(11) of Directive 2013/34/EU or in accordance with recognised international accounting rules,

OPTION 2

(e) the management company/investment company shall put in place a robust decision-making process for choosing the depositary which shall be based on objective pre-defined criteria and meet the exclusive interest of the UCITS;

(f) in case any of the following situations arise:

- the depositary has a direct or indirect holding in the management company/investment company which represents 10 % or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the management company/investment company in which that holding subsists; or

- the management company/investment company has a direct or indirect holding in the depositary which represents 10 % or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the depositary in which that holding subsists; or

- the management company/investment company and the depositary are included in the same group for the purposes of consolidated accounts, as defined in Directive 2013/34/EU or in accordance with recognised international accounting rules,

at least the following arrangements shall be put in place:

(i) all reasonable steps to avoid conflicts of interest arising from the shareholding or group structure shall be taken and, when they cannot be avoided, conflicts of interest shall be identified, managed and monitored and, where applicable, disclosed, in order to prevent them from adversely affecting the interests of the UCITS and their investors;

and

(ii) the choice of the depositary shall be justified to investors upon request;

(g) in case the management company/investment company and the depositary are included in the same group for the purposes of consolidated accounts, as defined in Directive 2013/34/EU or in accordance with recognised international accounting rules, at least the

following additional arrangements shall be put in place:

(i) at least [one third] of the members of the management body of the management company/investment company and the depositary shall be independent, in the sense that they shall not be members of the management body or the body in charge of the supervisory function nor employees of any of the undertakings within the group;

(ii) where the management body of the management company/investment company and the depositary is not in charge of the supervisory functions, at least [one third] of the members of the body in charge of the supervisory function shall be independent, in the sense that they shall not be members of the management body or the body in charge of the supervisory function nor employees of any of the undertakings within the group.

Annex I

Summary of questions

Q1: Do you agree that the steps to be taken by the third party are ultimately intended to ensure that the level of segregation foreseen under 22a(3)(d) of the UCITS Directive is recognised in the context of an insolvency proceeding involving the third party?

Q2: Do you consider that the level of segregation foreseen under Art 22a(3)(d) of the UCITS Directive should protect UCITS assets from claims by creditors of an insolvent third party which had been delegated the safekeeping of the assets by the UCITS' depositary?

Q3: Are there other measures which could also help achieve this objective?

Q4: Do you agree with the steps to be taken by the third party as identified above? If not, please explain the reasons.

Q5: Do you consider that there are any specific difficulties that may arise in verifying the applicable insolvency regime that makes the proposed rules difficult to be complied with? In particular, do you consider the requirement for the third party located in a jurisdiction outside the Union to obtain independent legal advice could give rise to specific issues?

Q6: Do you expect a significant increase in terms of costs that would be faced by the third party delegated entities located in jurisdictions outside the Union in order to obtain independent legal advice on the applicable insolvency regime? If yes, please provide any available data and/or estimation.

Q7: Would you suggest requiring the third party to take any further steps which are not foreseen in the draft advice?

Q8: Should any specific consideration be given to the scenario where the third party further sub-delegates the safe-keeping of the UCITS' assets in accordance with Article 22a(3), last sub-paragraph of the UCITS Directive (as inserted by UCITS V)? Should the third party take any additional/different steps or measures in this case?

Q9: Do you agree with the steps to be taken by the depositary as identified above? If not, please explain the reasons.

Q10: Do you expect any significant one-off and ongoing compliance costs for depositaries in order to take the steps identified above? If yes, please provide any available data and/or estimation.

Q11: Would you suggest requiring the depositary to take any further steps which are not foreseen in the draft advice?

Q12: Which measures do you think should be taken by the depositary and/or the investment company/management company in the best interest of the investors

once the depositary has informed the investment company or the management company on behalf of the UCITS that the segregation of the UCITS' assets in the event of insolvency of the third party is no longer guaranteed in a given jurisdiction located outside the Union? Would the transfer of the relevant UCITS' assets held by the third party in a non-EU jurisdiction to another (EU or non-EU) jurisdiction which recognises the segregation of the UCITS' assets in the event of insolvency of the third party/depositary be a possible measure?

Q13: Do you agree with the identified links that may jeopardise the independence of the Relevant Entities? If not, please explain the reasons.

Q14: Do you consider that any additional links should be taken into account such as, for instance, the existence of any contractual commitment or other relationship which would affect the independence of the Relevant Entities? If yes, please provide details.

Q15: Do you consider that the cumulative presence of all or some of the identified links is necessary to jeopardise the independence of the Relevant Entities or the presence of any of these links is sufficient to determine a lack of independence?

Q16: Do you agree with the proposed option to ensure the separation of the management bodies/bodies in charge of the supervisory functions of the Relevant Entities?

Do you have any alternative options to suggest, taking into account those identified under paragraph 47?

Q17: Do you consider that the cap of one third of members of the body in charge of the supervisory functions of one of the Relevant Entities to also be members of the management body, the body in charge of the supervisory functions or employees of the other Relevant Entity is appropriate? Would you suggest any alternative percentage? If yes, please provide the reasons why.

Q18: Do you have knowledge of any restructuring in the composition of the management bodies/bodies in charge of the supervisory functions of any Relevant Entities that would be triggered by the identified option? If yes, please provide data and an estimation of the one-off and ongoing costs that would be incurred.

Q19: Which of the two identified options do you prefer? Would you suggest any alternative option? If yes, please provide details.

Q20: Under the second option, do you consider that it would be appropriate to require that – whenever the Relevant Entities are part of the same group – at least one third of the members of the management body of the management company/investment company and depositary should be independent? Would you suggest any alternative percentage? If yes, please provide the reasons why.

Q21: Do you agree that the concept of independence should be understood as requiring that independent directors should not be member of the management

body or the body in charge of the supervisory function nor employees of any of the undertakings within the group?

Q22: Do you have knowledge of the impact that each of the two options identified would have in terms of restructuring the shareholding of any Relevant Entities or finding alternative service providers? If yes, please provide data and an estimation of the one-off and ongoing costs that would be incurred.

Q23: Do you agree with ESMA's approach to discard the second and third options described above?

Annex II

Commission mandate to provide technical advice

Mr Steven Maijoor

Chairman

European Securities and Markets Authority

103 rue de Grenelle

75007 Paris
France

Subject: Provisional request to ESMA for technical advice on delegated acts required by the UCITS V Directive

Dear Mr. Maijoor,

The services of the European Commission request the advice of ESMA on two implementing measures covering UCITS depositaries that are required by the soon-to-be-adopted Directive amending UCITS Directive ('UCITS V'). Most of the substantive rules and delegated acts in UCITS V are identical to those contained in the AIFMD. The present request therefore focuses on two empowerments not present in the AIFMD: (1) insolvency protection of UCITS assets when custody of those assets is delegated to third parties and (2) the independence of the UCITS depositary.

The present request for advice is based on the text adopted by the European Parliament at its plenary session on 15 April 2014 [T7-0355/2014]. While the Commission's services do not anticipate further changes in substance, the process of legal revision may result in drafting amendments and, as the case may be, the renumbering of articles. The Commission's services will keep ESMA fully informed of any such developments.

It is the Commission's established practice to adopt the delegated acts well before the end of the transition period. This would allow Member States sufficient time for transposition of the directive itself. Taking into account that Member States are obliged to transpose UCITS V not later than 18 months after entry into force, the Commission's services therefore request ESMA to deliver its advice by **15 October 2014**. An indicative timetable of all procedural steps is attached in Annex II.

In accordance with the principles of Better Regulation, the Commission, in preparing its delegated acts, is required to prepare a detailed **impact assessment.** As well as providing advice on the content of the delegated acts, ESMA is therefore requested to underpin its advice by first identifying a range of policy options and then undertaking an assessment of the costs and benefits of each option. The results of this assessment should be submitted alongside the advice.

The **technical advice** provided by ESMA to the Commission should not take the form of a legal text. However, ESMA should provide the Commission with a structured text accompanied by detailed explanations for the advice given.

The services of the Commission will, after transmission to ESMA, publish this provisional request for advice and any updated versions on the DG Internal Market and Services website.

Yours sincerely,

Jonathan FAULL

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c.c.: O. Guersent, P. Dejmek, B. Dumont (Cab), C. Hughes (COMM), P. Pearson, MARKT List G4

Annex I: Empowerments for Level 2 measures to be elaborated by ESMA

1. Insolvency protection of UCITS assets when delegating safekeeping

Article 22a(3) requires, inter alia, that the third party to which custody of UCITS assets has been delegated " *(e) takes all necessary steps to ensure that 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*".

Article 26b empowers the Commission to adopt delegated acts specifying, among others: "*(e) the steps to be taken by the third party pursuant to point (e) of Article 22a(3)".*

ESMA is requested to advise the Commission on what necessary steps should be taken to ensure that in the event of insolvency of the third party, assets of a UCITS held in custody by the third party are unavailable for distribution among or realisation for the benefit of creditors of the third party.

ESMA is requested to specify those steps in the form of a non-exhaustive list of the measures, arrangements and tasks that the third party to which custody is delegated should put in place and perform on on-going basis in order to ensure that the UCITS assets are protected from distribution among or realisation for the benefit of creditors of the third party. These measures, arrangements and tasks must take into account the legal framework of the country in which the third party operates, notably that country's insolvency laws and relevant jurisprudence.

ESMA is also requested to specify the measures that the depositary should put in place ex-ante to ensure that the third party fulfils its obligations and how the depositary should ensure that the required level of protection is respected all the times.

2. Independence requirement

Second sub-paragraph of Article 25(2) requires that "*In carrying out their respective functions, the management company and the depositary shall act honestly, fairly, professionally, independently and solely in the interest of the UCITS and the investors of the UCITS. In carrying out their respective functions, the investment company and the depositary shall act honestly, fairly, professionally, independently and solely in the interest of the investors of the UCITS.*"

Article 26b empowers the Commission to adopt delegated acts specifying, among others: *"(h) the conditions for fulfilling the independence requirement referred to in Article 25(2).*"

ESMA is requested to advise the Commission on what are the necessary conditions and criteria, at a minimum in relation to areas such as corporate and group governance, structure, organisation and internal processes, so that each of the entities referred in Article 25(2) can be deemed to act independently in carrying out their respective functions.

Annex II: Indicative timetable for UCITSV Directive transposition and Level 2 work

Date	Milestones
Jun 2014	Request for advice
Jul 2014	
Aug 2014	
Sep 2014	UCITS V enters into force
Oct 2014	ESMA advice
Nov 2014	
Dec 2014	COM working documents: Draft L2 + IA
Jan 2014	ISC
Feb 2015	Translation
Mar 2015	Consultation with ESC
Apr 2015	Adoption of L2 measures
Jul 2015	End of period for EP and Council to object to Level 2 measures,
…	
Feb 2016	End of the transposition period of the UCITS V Directive

Annex III

Cost-benefit analysis

1. Introduction

1. On 3 July 2014, ESMA received a provisional request for advice from the Commission (see Annex II). The request relates to certain of the delegated acts foreseen under UCITS V. It recalls that in accordance with the principles of Better Regulation, in preparing its delegated acts, the Commission is required to prepare a detailed impact assessment. The Commission therefore asks ESMA to identify a range of policy options and then undertake an assessment of the costs and benefits of each option.

2. The delegated acts foreseen by UCITS V relate to the some of the new depositary provisions introduced by this Directive. The delegated acts covered by the request for advice are a subset of those which the Commission is empowered to adopt under UCITS V. Specifically, they are the ones relating to:

    i) the necessary steps to be taken to ensure that 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 (Article 22a(3) and 26b(e) UCITS V); and

    ii) the conditions for fulfilling the independence requirement applying to the management company/investment company and the depositary (Article 25(2) and 26(b)(h) UCITS V).

3. Therefore, the present draft cost-benefit analysis (Draft CBA) is limited to the above-mentioned delegated acts for which the advice from ESMA was sought by the Commission.

4. In preparing this Draft CBA (and the consultation paper in general), ESMA consulted with the Consultative Working Group (CWG) of ESMA's Investment Management Standing Committee (IMSC). Moreover, ESMA organised a roundtable on 29 July 2014 in order to gather input from market participants on the relevant matters. The experts attending the roundtable were drawn from among UCITS managers, depositaries, prime brokers, consumer representatives and insolvency law experts (the latter, for the part of the advice relating to item i) under paragraph 2 above). The roundtable was also attended by representatives from national competent authorities.

5. The input provided by the CWG and stakeholders who attended the roundtable was useful for the purpose of this Draft CBA as it allowed, inter alia, to provide some evidence on the factors that could be viewed as significant for determining the protection afforded to assets in the event of the insolvency of the third party in different jurisdictions.

6. For the purposes of this Draft CBA ESMA carried out a mapping exercise among national competent authorities (NCAs) to identify the provisions that already exist at national level on the two topics to be covered by the advice (see section 4 below).

7. The nature of the Draft CBA is mostly qualitative. However, ad hoc questions have been introduced in the main body of the consultation paper in order to elicit market participants' input on the quantitative impact of the proposals foreseen herein. Should relevant data be received through the

consultation process, ESMA will take it into account when finalising its advice to the Commission and will include it in the cost-benefit analysis accompanying the final advice.

2. Identification of the necessary steps for the insolvency protection of UCITS assets when delegating safekeeping

8. The fact that assets of a UCITS held by a third party in custody are unavailable for distribution among or realisation for the benefit of creditors of the third party in case of insolvency of this third party is one of the key regulatory issues of UCITS V, because it is one of the main aspects of the investor protection framework put in place to learn from the Madoff experience, as well as one of the pillars upon which is based the possibility for UCITS to invest in a wide range of jurisdictions.

9. Therefore, the Commission asked ESMA i) to provide advice on what are the necessary steps to be taken in the form of a non-exhaustive list of the measures, arrangements and tasks that the third party to which custody is delegated should put in place and perform on on-ongoing basis in order to ensure that the UCITS assets are protected from distribution among or realisation for the benefit of creditors of the third party, and ii) to specify the measures that the depositary should put in place ex-ante to ensure that the third party fulfils its obligations.

Baseline scenario

10. The baseline scenario should therefore be understood for this cost-benefit analysis as the application of the requirements in the Level 1 Directive (i.e. the provisions of Article 22a(3) of UCITS V) without any further specification. This would leave discretion to UCITS management companies, depositaries and national competent authorities to determine the necessary steps that shall be taken to ensure that in the event of insolvency of a 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. This could clearly lead to a lack of harmonisation in the application of the provisions of the Level 1 UCITS Directive across the UCITS investment industry on a very sensitive issue.

11. Indeed, uncertainty on the above-mentioned steps considered as being necessary and on the measures to be taken by the depositary and third party could lead to a situation where some Member States would adopt stricter rules than others on these two issues, leading to greater uncertainty for investors of UCITS in the different Member States who would not know to what extent the assets of the UCITS they invest in are protected. For instance, a depositary could be considered as failing to meet the above-mentioned requirements in one Member State whereas the same depositary would be considered to meet these requirements in another Member State and therefore be allowed to safeguard the assets of a UCITS. This would be particularly problematic in the context of the EU passport of the UCITS Directive.

Technical option

12. The draft technical advice aims to promote the objectives of the Level 1 Directive by clarifying the scope of application of certain of the UCITS V provisions. This should contribute to the creation of a level playing field across Member States, which will help ensure that the risks tackled by the UCITS management/ investment company are done so in a harmonised way and there is reduced scope for regulatory arbitrage which could hamper the key objectives of the Level 1 Directive.

13. In order to address the problem and comply with the objectives identified above, ESMA not only considered the idea of providing clarifications on the criteria which may be extracted from the Level 1 provisions, but also identified in this consultation paper some topics for which additional guidance could be beneficial for the purposes of a harmonised application of the UCITS Directive. These topics are as follows:

    i) ESMA developed a non-exhaustive list of measures, arrangements and tasks to be put in place and performed on an ongoing basis by the third party to which custody is delegated. In this regard, ESMA considered that segregation greatly supports the policy objective that UCITS assets would be unavailable for distribution to the creditors of an insolvent third-party delegate of a depository. ESMA considered, therefore, that the basic requirement for the third party (which is located in a jurisdiction outside the Union) should be to make all reasonable efforts, including the receipt of independent legal advice, to verify that the applicable insolvency laws and jurisprudence recognise the segregation of the UCITS' assets from the third party's own assets and from the assets of the depositary. In developing this part of the advice, ESMA took into specific account the recent Recommendations Regarding the Protection of Client Assets issued by IOSCO in January 2014.

    ii) ESMA also specified the measures that the depositary should put in place ex-ante to ensure that the third party fulfils its obligations, and how the depositary should ensure that the required level of protection is respected at all times. ESMA proposed to incorporate some of the above-mentioned IOSCO principles in the measures to be adopted ex-ante by the depositary. Moreover, ESMA considered appropriate to require the depositary to ensure that there are contractual provisions allowing the termination of the agreement with the third party in case the applicable insolvency laws and jurisprudence of a jurisdiction outside the European Union no longer guarantee the segregation of the UCITS assets in the event of insolvency of the third party or the conditions set out under these laws are no longer fulfilled.

14. In the light of this approach, ESMA decided to carry out a preliminary mapping of (i) existing provisions in this area in the different jurisdictions and (ii) the potential impact that the ESMA technical advice may have. Details on the outcome of the mapping are set out under section 4 below, while a summary of the mapping on the potential impact of the advice are set out under the following paragraphs.

The likely economic impacts

15. On the basis of this mapping exercise, the impact of the draft technical advice should not be material in most of the Member States.

Costs

16. The proposed approach is unlikely to lead to significant additional costs to the extent that it provides clarifications on the Level 1 provisions and do not impose additional obligations beyond those already set by UCITS V on firms whose compliance has to be supervised, except the receipt of independent legal advice, that is required for the third party to which custody is delegated outside the Union and for the depositary. Most NCAs confirmed that the proposed approach would not lead to significant additional costs from a supervisory perspective, but that it may lead to some

additional costs for market participants. They added they were unable to quantify these costs at this stage.

17. One NCA was of the opinion that the amount of these costs will depend on the level of comfort (and hence the level of liability) that the independent law firms will be requested to provide under the different legal opinions to be delivered and may vary substantially between the different markets/agreements. This same NCA was of the opinion that with respect to depositaries, the collection of such independent legal advice in relation to all contracts with third parties to whom the custody of assets has been delegated entails a substantial work load which varies depending on the number of delegates a given depositary has appointed.

18. The same NCA said they considered that the proposed measures in relation to insolvency protection would involve substantive additional costs/issues from a supervisory perspective, given the requirement to monitor compliance with such proposed measures in relation to a potentially significant number of third party delegates of the depositaries in that NCA's jurisdiction.

Benefits

19. The expected benefits of the proposed approach are that it minimises the risk of inconsistencies and regulatory arbitrage in the application of UCITS V while harmonizing the industrial processes of depositaries and third parties to which custody is delegated in the different parts of the world by partly aligning the EU legislative framework with the IOSCO principles.

20. In the Feedback Statement – Summary of Responses to UCITS Depositaries Consultation Paper (2009), which is under Annex 2 of the Impact Assessment accompanying the UCITS V Proposal (pages 60 and ff.)[11], the answers to the Commission's consultation evidenced some issues that are relevant to the draft technical advice. These are as follows:

"*Given these circumstances, respondents stressed that depositaries face unavoidable operational and legal constraints associated with local rules applying to the custody of securities:*

- There are, for example, cases where a fund is investing in certain jurisdictions (for example in emerging markets). Investments in emerging market can imply that it is the fund's strategy to deliberately take on the additional risks that arise due to the poor local post-market infrastructure (for example, there may be no segregation requirements and insolvency protection rules may not exist) or high political uncertainties (for example, nationalisation of assets). These risks could lead to the loss of the fund's assets;

- There can also be, for example, cases where local rules do not impose any segregation requirements so as to protect the fund's assets from being lost;

- Sometimes, even if assets are duly segregated, insolvency rules do not allow for the assets to be immediately identified, isolated and returned to their beneficial owner.

There is therefore a risk, if the sub-custodian goes bankrupt, that the fund's assets will only be identified, isolated and returned to their owners, once insolvency proceedings are completed. This can take months or even years".

[11] SWD(2012) 185 final, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012SC0185&from=EN.

21. The benefits of the present technical option are therefore also to standardize the operational processes that the depositaries will set up to face such local rules applying to the custody of services and, as a consequence, to increase the protection of UCITS investors.

3. Identification of the conditions to be fulfilled by the management company/investment company to be considered independent

22. The independence of the management company/investment company and the depositary is one of the key regulatory issues of UCITS V, because it is one of the main aspects of the investor protection framework put in place to learn from the Madoff fraud.

23. Therefore, the Commission asked ESMA to provide advice on what are the necessary conditions and criteria, at a minimum in relation to areas such as corporate and group governance, structure, organisation and internal processes, so that each of the entities referred to in Article 25(2) (management company/investment company and the depositary) can be deemed to act independently in carrying out their respective functions.

Baseline scenario

24. The baseline scenario should therefore be understood for this cost-benefit analysis as the application of the requirements in the Level 1 Directive (i.e. the provisions of Articles 25(2) of UCITS V) without any further specification. This would leave discretion to UCITS management companies, depositaries and NCAs to assess whether UCITS management companies and depositaries act independently in carrying out their respective functions. This could clearly lead to a lack of harmonisation in the application of the provisions of the Level 1 UCITS Directive across the UCITS investment industry.

25. Indeed, some Member States could consider that a specific depositary / management company acts independently in carrying out its functions whereas the same depositary / management company would not be considered to meet these requirements in another Member State and therefore not be allowed to safeguard the assets of a UCITS. This would be particularly problematic in the context of the EU passport of the UCITS Directive.

Technical options

26. The technical advice aims to promote the objectives of the Level 1 Directive by clarifying the scope of application of certain of the UCITS V provisions. This should contribute to the creation of a level playing field across Member States, which will help ensure that the risks tackled by the UCITS management/ investment company / depositary are done so in a harmonised way and there is reduced scope for regulatory arbitrage which could hamper the key objectives of the Level 1 Directive.

27. In order to address the problem and comply with the objectives identified above, ESMA not only considered the idea of providing clarifications on the criteria which may be extracted from the Level 1 provisions, but also identified in the consultation paper some topics for which additional guidance could be beneficial for the purposes of a harmonised application of the UCITS.

28. ESMA considered that the independence of the management company/investment company, on one side, and the depositary, on the other (together, the “Relevant Entities”), may be jeopardised by

the existence of certain links between these parties, and that the following categories of links can be identified for these purposes:

c) common management/supervision; and

d) cross-shareholdings.

29. In relation to a) (common management/supervision), ESMA considered that the independence would be lost if any of the Relevant Entities, by means of executive power or supervision, could control the action of the other.

30. The separation of the management bodies of the Relevant Entities could be ensured by various means:

i. A first option could be to prohibit any member of the management body of one of the Relevant Entities from also being a member of the management body or employee of the other Relevant Entity.

ii. A second option could be to provide that those members of the management body of one of the Relevant Entities who are also members of the management body or employees of the other Relevant Entity have limits in their decision-making capacity in the latter Relevant Entity.

iii. A third option could be to prohibit any member of the management body of one of the Relevant Entities from having a direct or indirect shareholding of more than a given percentage of the votes at a general meeting of the other Relevant Entity.

31. The first option provides for the most clear and straightforward rule which would have the advantage of providing for the highest degree of protection for the investors of the UCITS. The second option has the disadvantage of providing less certainty to the extent that it might prove difficult to determine the limits to be imposed to the decision-making capacity of the members of the management body and, therefore, it may be difficult for supervisors to supervise the appropriate application of the rule. The third option risks establishing a prohibition which is unnecessary as the shareholding which is likely to be the most relevant is the one held at the level of the management company/investment company and depositary and not at the level of the members of their management bodies. Therefore, ESMA saw merit in consulting on the first option only as from a preliminary analysis the other two seemed to be clearly sub-optimal.

Q23: Do you agree with ESMA's approach to discard the second and third options described above?

32. In relation to b) (cross-shareholdings), ESMA considered that a first option could be to refer to the notion of 'qualifying holding' in the UCITS Directive and consider that the Relevant Entities are not independent whenever they are linked by such a qualifying holding or are part of the same group. A second option could be to provide that in case the Relevant Entities are (i) linked by a qualifying holding or (ii) part of the same group, some specific governance and organizational arrangements and measures should be put in place to ensure that the independence of the Relevant Entities is preserved.

33. ESMA saw merit in consulting on both options to assess the impact that each of the proposed rules may have on the existing shareholding structures in Europe and make its final deliberations on this aspect on the basis of a full set of information.

34. In the light of this approach, ESMA decided to carry out a preliminary mapping of (i) existing provisions on the present topic in the different member States and (ii) the potential impact that the ESMA technical advice may have. Details on the outcome of the mapping are set out under section 4 below, while a summary of the mapping on the potential impact of the advice are set out under the following paragraphs.

The likely economic impacts

35. On the basis of this mapping exercise, the impact of the proposed rules on common management/supervision should be limited in most Member States.

36. As for the proposed rules on cross-shareholdings, the mapping exercise evidenced that the impact of the first option could be a significant restructuring of different parts of the depositary industry in most of the Member States. The second option is likely to lead to additional costs for stakeholders, but there is some uncertainty on the amount of such costs.

Costs

37. The proposed approach on the common management/supervision is likely to lead to limited additional costs for stakeholders to the extent that it will imply some restructuring in the composition of the management bodies of some of the existing Relevant Entities in the EU asset management sector, and to the extent that existing similar national measures are not applicable in all the jurisdictions.

38. However, one NCA considers that the proposed measures would involve substantive additional costs from a supervisory perspective given the need to (i) ensure that any UCITS structures that are not currently in compliance with the new rules will need to reorganise so to be compliant and (ii) the need to monitor compliance with the new regime for all structures going forward. Furthermore, this NCA considers that in any scenario where the management company of a UCITS and the depositary of that UCITS are not located in the same jurisdiction, this approach would require that specific measures, regarding the cooperation between NCAs in relation to verifying that the conditions under said option are properly fulfilled, are put in place. The same NCA also considers that the restructuring implied by this approach would entail substantive costs for market participants.

39. The approach on cross-shareholdings (first option) is likely to lead to substantive additional costs to the extent that it would imply the separation of a large number of entities which are currently linked by a qualifying holding or are part of the same group.

40. These entities account for a significant share of the global market of depositaries of UCITS. The mapping exercise conducted by ESMA shows that rules on limitations on cross-shareholdings for the Relevant Entities indeed do not exist at the moment in Europe, except in the UK and Slovenia. This mapping exercise also shows that it is quite common in most Member States for management companies and depositaries to have either a common parent undertaking or a cross-shareholding. These are examples of the situation in some European jurisdictions, as revealed by the mapping exercise:

- Germany: more than half of German management companies and depositaries have either a common parent undertaking or a cross-shareholding.

- Hungary: there are 34 management companies of which 13 companies belong to some financial group.

- Croatia: it is frequent that the credit institution that acts as a depositary for UCITS funds is a shareholder of the management company that manages UCITS funds. This ownership structure appears in approximately 25% of management companies.

- Denmark: there are 14 Danish management companies, 6 of which would be affected by the requirements under this option.

- Luxembourg: 14% of the existing UCITS structures will be impacted.

- Sweden: it is roughly estimated that 40% of the actors in the industry (management companies and depositaries) have a cross-shareholding.

- Malta: 16 out of 69 Maltese UCITS funds (including sub-funds) appoint a manager which is a subsidiary of the custodian.

- Estonia: the market of depositary services is very concentrated due to its size and a large part of this market is in the hands of 2-3 participants who belong to the same group or are direct owners of also the larger management companies.

- Belgium: approximately 50% of the Belgian management companies would be affected by the requirement not be linked by a qualifying holding with the depositary or not to be part of the same group of the depositary.

- France: out of the 30 depositaries that are active in France on the UCITS segment, 27 provide safekeeping services to UCITS managed by a management company displaying a shareholding link of 10% or above (of share capital or voting rights) with the depositary, or belonging to the same group, and would therefore be affected by the ban foreseen in this option. In terms of assets under management (AuM), 62% of the total UCITS AuM in France would need to be transferred to another depositary, because they are currently safe-kept by a depositary displaying a shareholding link of 10% or above with the management company, or belonging to the same group.

41. Implementing this option would not entail many additional costs from a supervisory perspective, but might imply material additional costs for market participants because significant changes would have to be made to the structure of the companies, or different depositaries should be appointed. The mapping exercise conducted by ESMA also shows that NCAs find it very difficult to quantify these costs accurately. The input from stakeholders will be therefore a key element in this evaluation.

42. One NCA also considers that in addition to the cost aspect, the supervisory costs would further be increased due to the fact that market participants might face practical issues when adapting the structure of their management body to the new requirements, such as a difficulty to reorganise their shareholder base (e.g. finding "new" shareholders) in compliance with the new requirements. Such difficulty can be a material difficulty for the different UCITS management company structures taken

individually and would be even more material if such a requirement were to apply to UCITS collectively.

43. The proposed approach under the second option on cross-shareholdings is also likely to lead to additional costs to the extent that it would imply the setting-up of some specific governance and organizational arrangements for entities which are currently linked by a qualifying holding or belong to the same group. The mapping exercise conducted by ESMA shows that most of the NCAs do not expect any material supervisory costs arising from this option, but find it very difficult to quantify the amount of these costs for market participants. However, overall it seems that the likely costs for market participants implied by this second option would be less significant than those implied by the first one.

Benefits

44. The expected benefits of the proposed approach on common management/supervision and cross-shareholdings are that it minimises the risk of inconsistencies in the application of UCITS V. Moreover, by prohibiting a certain level of cross-participation in the Relevant Entities' shareholding the first option on cross-shareholdings would ensure a more radical structural independence of the Relevant Entities and, consequently, is expected to set higher standards in terms of investor protection by, for instance, reducing the risk of conflicts of interests between the Relevant Entities that could harm the investors' interests.

4. Outcome of the mapping exercise

45. The outcome of the mapping exercise conducted by ESMA among the NCAs on the two aspects covered by the draft technical advice is set out below.

Mapping Exercise – Necessary steps for the insolvency protection of UCITS assets when delegating safekeeping

Question: Does your national legislation/supervisory practice requires third parties to whom the custody of UCITS assets is delegated to take any steps to ensure that in the event of insolvency of the third party, assets of the UCITS held by the third party in custody are unavailable for distribution among or realisation for the benefit of creditors of the third party? If yes, please specify which ones.

Germany

The custody of assets by a German custodian is governed by the German Safe Custody Act. Article 4 of the German Safe Custody Act restricts German custodian's assertion of rights of lien and retention rights and safeguards the right for segregation in the case of insolvency.

As Article 4 German Safe Custody Act does not apply to foreign custodians a comparable protection of the assets held by a foreign sub-custodian is provided by the "Third Party Declaration". The foreign sub-custodian has to sign a declaration before his involvement confirming the following:

- The foreign sub-custodian has taken due note that the assets which are held in custody and shall in future be held in custody belong to the custodian's customer;
- If the custodial services agreement provides for any lien or other rights with regard to assets in respect to any accounts, the custodian may assert any security interest lien, right of retention or any similar rights with respect to the assets held in custody only for such claims as may arise from the purchase, administration and safe custody of these assets. Nothing in this declaration will be

deemed to give the custodian greater rights than may be specified in the custodial services agreement if the rights provided there are less than the rights described herein. The custodian will immediately advise the foreign sub-custodian if a third party levies an attachment upon or takes other measures of compulsory execution in respect of these assets; and
- Without consent of the custodian the sub-custodian is not entitled to entrust a third party with the effective safe custody of such assets or to transfer them to another country.

This three point declaration serve as protection against insolvency of the foreign sub-custodian because he undertakes to provide to the German custodian bank trust property that, in case of insolvency, shall establish preferential rights to the insolvent's estate, the existence of which, however, is subject to the respective foreign law.

UK

In the case of the UK domiciled funds, and a UK depositary, overall, for third parties carrying out custody activity (as sub-custodians for the UK depository) outside the UK, there are no *direct* UK rules that require the third party to ensure that assets are not available for general creditors of the third party, etc – the rules require the UK depositary in its role as custodian to ensure that the third party's arrangements ensure this, etc.

If the third party is carrying out the custody activity in the UK, it is subject to full UK client asset protection rules, which do require that steps are taken to ensure assets are unavailable for distribution among or realisation for the benefit of creditors of the third party (Rules references: See the UK FCA's Handbook CASS 6 (custody rules) chapter, in particular, CASS 6.3).

Should the depositary then use sub-custodians, the depositary must;

i) (CASS 6.3.1) exercise all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements for the holding and safekeeping of the fund's assets and;
ii) (CASS 6.3.1) take the necessary steps to ensure that any client's safe custody assets deposited with a third party, in accordance with this rule are identifiable separately from the applicable assets belonging to the firm and from the applicable assets belonging to that third party, by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection; and
iii) (CASS 6.3.4R); (1) A firm must only deposit safe custody assets with a third party in a jurisdiction which specifically regulates and supervises the safekeeping of safe custody assets for the account of another person with a third party who is subject to such regulation (2) A firm must not deposit safe custody assets held on behalf of a client with a third party in a country that is not an EEA State (third country) and which does not regulate the holding and safekeeping of safe custody assets for the account of another person unless:
(a) the nature of the safe custody assets or of the investment services connected with those safe custody assets requires them to be deposited with a third party in that third country; or
(b) the safe custody assets are held on behalf of a professional client and the client requests the firm in writing to deposit them with a third party in that third country.

Croatia

Croatian Act on UCITS funds, Part Nine – Depositary, Article 226 (Delegation of depositary's duties to third parties) stipulates that, when delegating custody of UCITS assets to a third party, the depositary shall prove that the third party fulfils for the duration of the delegation agreement the following requirements:

- it has an internal organisation and experience necessary and appropriate for the nature and complexity of the assets of the investment fund which have been entrusted to it for safe-keeping in accordance with the provisions of Article 215 of this Act;

- the third party is the person which is subject to prudential supervision in accordance with the provisions of applicable law (including the capital requirements) in respect of delegation of the custody activities referred to in Article 215, point 1 of this Act
- it separates the clients' assets from its own assets so that it is possible to clearly and accurately identify and determine at any time which assets belong to the clients of that depositary;
- it shall not freely use the assets entrusted for safe-keeping without approval of the management company and prior notification of the depositary;
- it complies with the obligations and prohibitions referred to in Articles 216 and 217 of this Act.

More generally, Article 218. paragraph 5) stipulates that asset of a UCITS fund referred to in the Article 217, paragraph 1, points 1 and 3 of Act (financial instrument placed in custody and other assets) shall not become part of the depositary or sub-custodian assets or of liquidation or bankruptcy estate and shall neither be subject to enforcement proceedings in connection with claims against the depositary or sub-custodian.

Romania

The Romanian legal framework does not explicitly requires third parties to whom the custody of UCITS assets is delegated to take any steps to ensure that in the event of insolvency of the third party, assets of the UCITS held by the third party in custody are unavailable for distribution among or realisation for the benefit of creditors of the third party

However, the Government Emergency Ordinance no. 32/2012 (art. 54 (3) – (5)) and ASF Regulation no 9/2014 (art. 68) provides that in case of delegation of safekeeping to a third party (sub-depositaries), the same regime applicable to depositaries applies to third parties (i.e. including the provisions related to unavailability in case of third party insolvency).

Government Emergency Ordinance no. 32/2012

"Art. 54 – [...] (3) The depositary in art. 52 paragraph (1) may transfer to a third party, as sub-depository, the safekeeping of a part of an O.P.C.V.M.' assets, according to the regulations issued by C.N.V.M.

(4) The activities delegated to third parties, pursuant to the provisions in paragraph (3), are carried out in compliance with the same regime applicable to the depositary.

(5) The depositary's obligations referred to in paragraph (3) shall not be affected by the fact that it entrusted to a third party all or a part of the assets kept in custody."

ASF Regulation no 9/2014

„Art. 68 -The UCITS assets cannot be subject to forced sale proceedings initiated by the depositary's creditors, cannot be foreclosed or pledged by these and cannot be sold in order to meet the claims of creditors in the event of bankruptcy by the depositary."

France

No such requirements exist in French law / supervisory practice. This can be explained by the fact that both French law (art. L. 214-10 II of the *code monétaire et financier*) and the AMF General Rules (art. 323-14.) make it clear that the depositary of a UCITS retains full liability in case the custody functions are delegated to a third party.

Austria

According to Art. 2 para 2 Investment Funds Act 2011 (InvFG 2011) *"… in Austria, a UCITS can only be set up as assets in accordance with article 46 divided into equal units evidenced by securities and jointly owned by the unit-holders."*

Art. 46 (1) InvFG 2011: *"A UCITS in the form of assets as referred to in article 2 para 2 has no legal personality of its own; it is broken down into equal units evidenced in transferable securities (unit certificates). The unit certificates are financial instruments (article 1 no 6 letter c Wertpapieraufsichtsgesetz 2007 (Securities Supervision Act of 2007)); they evidence jointly owned shares in the assets of the UCITS and the unitholders' rights against the management company and against the depositary bank. …"*

The custody of shares is regulated by the Austrian Custody Act (Depotgesetz), which provides different contractual possibilities to hold shares in custody. Those contractual possibilities which are in accordance with the InvFG 2011 always lead to the consequence that in case of an insolvency of the depositary bank (or a delegate of it) according to Art. 44 of the Federal Insolvency Act (Insolvenzordnung) unit holders as owners may segregate the above mentioned units from the rest of the assets of the depositary bank. The same applies to delegates of the depositary bank.

This principle does not apply for bank balances which are held by the depositary for the management company.

Italy

The Banca d'Italia regulation on asset management (Regulation of 8.5.2012, Title V, Chapter 8, Section 2) requires delegate third parties to register the assets each UCITS in an account in the name of the depositary, specifying that such assets belong to the UCITS fund.

Sweden

In Sweden one can only delegate the custody of foreign instruments to a third party. Such arrangement shall not release the depositary from its liabilities, hence an incentive for the depositary to ensure the protection of the assets. The depositary has the responsibility to act in the best interest of the unit-holders and the segregation of the UCITS' assets from the third party's own assets must be verified.

Malta

National legislation/ MFSA supervisory practice does not require steps to be taken by the delegate sub-custodian but imposes upon the depositary the ultimate responsibility for any functions delegated, including the custody of all the assets of any scheme.

"The custodian shall take custody of all the assets of any scheme and shall safeguard such assets and the interests of the scheme and of the holders of units or participants in the scheme."[12]

"The custodian shall be liable for any loss or prejudice suffered by the manager, the scheme or the holders of units or participants in the scheme due to the custodian's fraud, wilful default or negligence including the unjustifiable failure to perform in whole or in part the custodian's obligations arising under these regulations, the terms and conditions of the agreement appointing the custodian, the deed or other instrument establishing or regulating the scheme, the conditions of the collective investment

[12] Investment Services Act (Control of Assets) Regulations, 1998, Regulation 16(1).

scheme licence which may be held by the scheme, the conditions of any investment services licence or such other requirements as may be laid down by the competent authority."[13]

In this respect, the depositary is responsible to ensure that assets held under control constitute a distinct patrimony, separate from that belonging to it and from that of other customers.

"Notwithstanding anything stated in article 1894 of the Civil Code or in the agreement entered into between the subject person and the customer or the fact that a customer's assets held under the control of a subject person are registered in the name and title of or are otherwise vested in the subject person, such assets shall be deemed to constitute a distinct patrimony, separate from that belonging to the subject person and from that of other customers the assets of whom are also held under the control of the subject person."[14]

The assets held under its control are also not subject to the rights of its creditors.

"The creditors of a subject person shall have no claim or right of action on or against the assets held under the control of the subject person for and on behalf of and in the interest of any customer and such assets shall not be affected in any manner by the provisions of laws and regulations in force regulating the insolvency or bankruptcy of the subject person."[15]

However, these latter provisions are not extended to delegates of the depositary.

Estonia

There is no clear requirement as set out in the question in the current Estonian legislation, however it may be indirectly derived from the segregation requirement of depositaries that this requirement may transfer to third party sub-depositaries as it is the depositary's responsibility and duty.

Slovenia

There is no explicit requirement apart from the requirement that at least equal level of protection of investors in an investment fund to the level of protection in the case where the custody service is directly performed by the depositary has to be ensured.[16]

Belgium

The Belgian legislation does not require the delegated third party to take any of the steps mentioned in the question.

As a general rule, in case a depositary has delegated safekeeping of any assets to a third party, the depositary remains fully responsible for these assets. The articles of incorporation of the investment company and the depositary may not in any way limit or exclude this responsibility of the depositary.

[13] Investment Services Act (Control of Assets) Regulations, 1998, Regulation 19(1).
[14] Investment Services Act (Control of Assets) Regulations, 1998, Regulation 3.
[15] Investment Services Act (Control of Assets) Regulations, 1998, Regulation 5.
[16] Nevertheless, it should be noted that there are no provisions which would grant any special status to the assets held by the depositary (bank) on behalf of the investment fund in case of insolvency procedure. In such case, the investment fund is considered equal to any other creditor of the insolvent depositary (i.e. there is no right of exclusion on such assets on behalf of the investment fund).

In the specific case of a UCITS that is managed by a management company from another Member State, the depositary and the management company must conclude an agreement in which they provide that on a regular basis information will be exchanged on the delegated third party and, upon request, information will be provided on the criteria for the selection of the delegated third party, as well as a declaration that depositary remains fully responsible for these assets in case he has delegated safekeeping of any assets to a third party.

Luxembourg

Neither the Luxembourg legislation (or regulatory framework), nor the supervisory practice of the CSSF currently provide for specific rules/requirements applicable to the third party, which require such third party to take any steps to ensure that in the event of insolvency of that third party, assets of the UCITS held by the third party in custody are unavailable for distribution among or realisation for the benefit of creditors of the third party. The currently applicable rules require the depositary of a Luxembourg UCITS to monitor on an ex ante and on-going basis that the segregation requirements at the third-party level are satisfactory.

Denmark

The national legislation does not require the third party to take any steps as mentioned in the question. If the depository has delegated safekeeping of any assets to a third party, the depository remains responsible for these assets. That gives the depository an incentive to ensure that the assets are protected against the third party's bankruptcy. At the same time it lets the depository decide how to conduct its business.

Finland

The national legislation may only cover entities acting in the jurisdiction, otherwise the national legislation remains silent regarding third parties. However, the entities need to take into consideration the domestic legislation – even in the case they use services of third parties in other jurisdictions – in order to cope with the requirements they are due to fulfil. Therefore, the domestic legislation is indirectly effecting third party relations.

The Act on Common Funds 29.1.1999/48, Chapter 5, Section 33 states the following: 'The assets of a common fund shall be kept with one custodian. A custodian may use organisations specialised in custodian services under the supervision of the Financial Supervision Authority or a corresponding foreign authority to assist it in its duties'.

Chapter 5 Section 31 subsection 2 states that: 'The assets of a common fund shall be kept separate from the assets of the custodian and the assets of other customers and common funds as well as kept in reliable manner. The assets of a common fund may not be distrained for a debt of the custodian'.

Ireland

Conditions imposed by the Central Bank of Ireland on depositaries of UCITS include the following:

17. The trustee (depositary) must:

(i) ensure that there is legal separation of non-cash assets held under custody and that such assets are held on a fiduciary basis. In jurisdictions where fiduciary duties are not recognised the trustee must ensure that the legal entitlement of the UCITS to the assets is assured;

(ii) maintain appropriate internal control systems to ensure that records clearly identify the nature and amount of all assets under custody, the ownership of each asset and where documents of title to that asset are located.

Where the trustee utilises the services of a sub-custodian the trustee must ensure that these standards are maintained by the sub-custodian.

18. Where the trustee utilises the services of a global sub-custodian the trustee must ensure that:

(i) the non-cash assets are held on a fiduciary basis by the global sub-custodian's network of custodial agents. This should be confirmed by those agents on a regular basis. In jurisdictions where fiduciary duties are not recognised the trustee must ensure that the legal entitlement of the scheme to the assets is assured;

(ii) the trustee must maintain records of the location and amounts of all securities held by each of the custodial agents;

(iii) the relationship between the trustee and the global sub-custodian should be set out in a formal contract between the two entities.

Hungary

Under national law there is no specific requirement as described in the question.

Cyprus

Under national law there is no specific requirement as described in the question.

Lithuania

There are no specific provisions regarding the protection of assets held at sub-custodian level, except those stated in Article 31(2) of Law on Collective Investment Undertakings stating that a depositary's liability shall not be affected by the fact that it may have entrusted all or part of its functions to other depositaries.

Mapping Exercise – Independency of the management company/investment company, and the depositary

Question: Does your national legislation/supervisory practice foresees any conditions to ensure that the management company/investment company and the depositary act independently in carrying out their respective functions? If yes, please provide details, including reference to the relevant provisions.

UK

The requirement for the fund manager and depositary to be independent persons appears in legislation; the FCA Handbook includes guidance on how we interpret this requirement, which can be found in COLL 6.9.2G to 6.9.5G at: http://fshandbook.info/FS/html/FCA/COLL/6/9

Independence of depositaries and scheme operators

COLL 6.9.2
(1) Regulation 15(8)(f) of the *OEIC Regulations* (Requirements for authorisation) requires independence between the *depositary*, the *ICVC (investment company with variable capital*) and the *ICVC's directors*, as does section 243(4) of the *Act* (Authorisation orders) for the *trustee* and *manager* of an *AUT (authorised unit trust scheme*), and section 261D(4) of the *Act* (Authorisation orders) for the *depositary* and *authorised fund manager* of an *ACS (authorised contractual scheme*). COLL 6.9.3 G to COLL 6.9.5 G give the *FCA's* view of the meaning of independence of these relationships. An *ICVC,* its *directors and depositary* or a *manager* and a *trustee* of an *AUT* or an *authorised fund manager* and *depositary* of an *ACS*[2] are referred to as "relevant parties" in this *guidance*.

(2) There are at least three possible kinds of links between the relevant parties:
(a) *directors* in common;

(b) cross-shareholdings; and

(c) contractual commitments.

(3) If any of these links exist between the relevant parties, the *FCA* will have regard to COLL 6.9.3 G to COLL 6.9.5 G in determining whether there is independence.

Independence: influence by directors

COLL 6.9.3
(1) Independence is likely to be lost if, by means of executive power, either relevant party could control the action of the other.

(2) The board of one relevant party should not be able to exercise effective control of the board of another relevant party. Arrangements which might indicate this situation include quorum provisions and reservations of decision-making capacity of certain *directors*.

(3) For an *AUT* or *ACS*, the *FCA* would interpret the concept of *directors* in common to include any *directors* of associates of one relevant party who are simultaneously *directors* of the other relevant party.

(4) For an *ICVC*, independence would not be met if:
(a) a *director* of the *ICVC* or any *associate* of the *director* is a *director*, an employee, or both of the *depositary*; or

(b) a *director* of an *ICVC*:
(i) has a direct or indirect shareholding for investment purposes of more than 0.5% of the votes at a general meeting or a meeting of *holders* of the class of *share* concerned of the *depositary* of that *ICVC*; or

(ii) has any other relationship with the *depositary* which might reasonably be expected to give rise to a potential conflict of interest.

Independence: influence by shareholding COLL 6.9.4

Independence is likely to be lost if either of the relevant parties could control the actions of the other by means of shareholders' votes. The *FCA* considers this would happen if any shareholding by one relevant party and their respective *associates* in the other exceeds 15% of the voting *share* capital, either in a single *share* class or several *share* classes. The *FCA* would be willing, however, to look at cross-shareholdings exceeding 15% on a case-by-case basis to consider if there were exceptional grounds for concluding that independence was safeguarded by other means.

Independence: contractual commitments

COLL 6.9.5
The *FCA* would encourage relevant parties to consult it in advance about its view on the consequences of any intended contractual commitment or relationship which could affect independence, whether directly or indirectly.

Italy

According to the Italian legislation, more specifically, article 35-*decies* of Legislative decree No. 58 of 24 February 1998 (*Consolidated Law on Finance*), asset management companies must be organised in a manner which ensures the minimizing of risks of "conflicts of interests". Secondary regulation on conflict of interests is established in the *joint Regulation Bank of Italy – Consob on the organization and procedures of intermediaries providing investment services or collective investment management services* and is in line with the UCITS and AIFMD framework.

Bank of Italy's supervisory provisions on powers of direction and coordination of the parent company of a banking group in respect of the asset management company belonging to the group provides for rules which aim at ensuring the independence of the investment policies of the asset management companies included in a banking group. The purpose is to ensure that the parent undertaking's power of direction and coordination on the subsidiary-asset management companies does not undermine investors' interests.

These provisions focus on the following principles:
- it should be ensured the independence of the asset management company: i) in the development of the investment products (also from the influence of the distribution network); ii) in the definition of procedures and strategies; iii) in the exercise of the voting rights related to the securities in which the funds invest; iv) in the investment policy, including when it manages assets assigned by the parent company; v) in the appointment of the depositary;
- also in case of integrated organizational structures of the banking group, the asset management company should maintain a full management autonomy;
- the parent company should ensure that the subsidiary-asset management company should implement the best practices concerning corporate governance (i.e. composition of bodies, level of competence of members, balance between executive and non-executive directors).

Bank of Italy's *Regulation on collective asset management of 8 May 2012* also limits the possibility of interlocking management between manager and depositary: the asset management company can not confer the task of depositary to institution whose key-roles (i.e. senior manager, directors) are played by the same people who are in charge with the management of the asset management company.

Cyprus

The legal requirement is that the same entity cannot act as management company and depositary. In case the depositary and management company are part of the same group, the internal policy of the Cypriot competent authority establishes the functional independence of those entities.

Germany

The requirements of option 1 of the CP on the independency in terms of common management / supervision are applicable under the current German law, but there is no requirement on the independency in terms of cross-shareholdings such as those mentioned in the CP.

France

Provisions on the independency of the management company/investment company and the depositary are included in the *Code monetaire et financier*.

Article L214-9 of this Code provides that UCITS, their depositaries and management companies shall act independently and that the management company and the depositary shall not be the same company.

Croatia

Croatian Act on open-ended investment funds with public offering (UCITS funds) contains provisions on independence requirements.

Management company shall not be permitted to have shares or holdings in the depositary (Article 32. paragraph 2). The respective businesses of the depositary and the management company may not be interconnected in organisational terms and the same employees may not be involved in these business activities.

Management company shall not be permitted to have shares or holdings in the entity to which the depositary has delegated the activities referred to in Article 217 (safe-keeping of the assets) (Article 32. paragraph 3).

No entity shall act as both management company and depositary (Article 213. paragraph 6).

In addition, the safe-keeping and administration business and other activities performed for the management company shall be separated, in organisational terms, from other activities of the depositary in accordance with the law regulating the establishment and functioning of credit institutions (Article 218. paragraph 1).

Finland

The Act on Common Funds 29.1.1999/48 Chapter 4 Section 26 subsections 1 and 2 provides that:

"A management company shall carry out common-fund activity independently and with care and expertise and in the best interests of the common fund and its unitholders. The management company shall treat its unitholders equally in its activity.

In its common-fund activity and in organising its business structures , the management company shall aim at avoiding situations involving conflicts of interests and, should they occur, ensure that the common funds managed by it, their uniholders and the other customers of the management company are treated equally."

Some specific provisions are related to the board of Directors (Chapter 2 Section 8 of the aforementioned Act):

"The Board of Directors of a management company shall comprise at least three members. The unitholders shall elect at least one third of the members of the Board of Directors in the manner provided for in the Articles of Association of the management company. A member of the Board of Directors of the management company elected by the unitholders may not
1. be employed by the management company or the custodian;
2. exercise control in the management company as referred to in Chapter 1 section 5 of the Accounting Act (1336/1997) or a representative thereof; nor
3. a member of the Board of Directors or the Board of Supervisors of another management company or custodian."

Some specific provisions are related to the potential conflicts of interest (Chapter 4 Section 26 b third subsection of the aforementioned Act):

"The Custodian of a common fund or another organisation whose interest may be in conflict with the interests of the management company or the unit holders may not be used as a representative in attending to the duties relating to the management of a common fund. An agreement on the transfer of liability of the management company to a third party shall be void. A representative shall be governed by the provisions of Section 133, subsection 1"

There are also some more general provisions on the independence requirements (Chapter 5 Section 31 subsection 2 and 3 of the aforementioned Act):

"The assets of a common fund shall be kept separate from the assets of the custodian and the assets of other customers and common funds as well as kept in reliable manner. The assets of a common fund may not be distrained for a debt of the custodian."

"The custodian shall carry out its duties independently for the benefit of the unitholders."

Luxembourg

The legislation/supervisory practice in place tends to ensure independence between the management/investment company and the depositary by way of (i) requirements to act independently, (ii) conflicts of interests provisions, (iii) rules in relation to delegation and (iv) specific organisational aspects laid down in CSSF Circular 12/546.

Under this Circular, any provisions applicable to a management company are applicable, *mutatis mutandis* to any self-managed UCITS that has not designated a management company).

Specific provisions are further provided for under CSSF Circular 14/587 on Provisions applicable to credit institutions acting as UCITS depositary subject to Part I of the law of the 17 December 2010 relating to undertakings for collective investment and to all UCITS, where appropriate, represented by their management company. This Circular mirrors the rules applicable to management companies/self-managed UCITS under the CSSF Circular 12/546 on independence requirements at the level of the rules applicable to Luxembourg UCITS depositary banks. The provisions of this recently published Circular 14/587 are nevertheless binding only as of 1 January 2016.

(i) Requirements to act independently

Article 20 of the Law of 17 December 2010 relating to undertakings for collective investment provides that: "*In the context of their respective roles, the management company and the depositary shall act*

independently and solely in the interest of the "unitholders"." – this provision is applicable to common funds managed by management companies.

Article 37 of the Law of 17 December 2010 relating to undertakings for collective investment: "*In carrying out its role as depositary, the depositary shall act solely in the interests of the unitholders*" – this provision is applicable to UCITS constituted by statute (investment companies).

(ii) Conflicts of interests

Those rules are mainly laid down under article 20 to 22 of the CSSF Regulation 10-04[17]

Article 20 CSSF Regulation 10-04 provides that: "*Conflicts of interest policy 1. Management companies shall establish, implement and maintain an effective conflicts of interest policy. That policy shall be set out in writing and shall be appropriate to the size and organisation of the management company and the nature, scale and complexity of its business. Where the management company is a member of a group, the policy shall also take into account any circumstances of which the company is or should be aware which may give rise to a conflict of interest resulting from the structure and business activities of other members of the group.*".

Article 21 CSSF Regulation 10-04 provides that: "*Independence in conflicts management 1. The procedures and measures provided for in Article 20, paragraph (2), point b) of this Regulation shall be designed to ensure that relevant persons engaged in different business activities involving a conflict of interest carry on those activities at a level of independence appropriate to the size and activities of the management company and of the group to which it belongs and to the materiality of the risk of damage to the interests of clients.*".

(iii) Specific rules on delegation – prohibition to delegate to the depositary

Article 110 of the Law of 17 December 2010 relating to undertakings for collective investment provides that: "*(1) Management companies are authorised to delegate to third parties, for the purpose of a more efficient conduct of their business, the power to carry out on their behalf one or more of their functions. In that case, all of the following preconditions shall be complied with:… e) a mandate with regard to the core function of investment management shall not be given to the depositary or to any other undertaking whose interests may conflict with those of the management company or the unitholders*;".

(iv) Specific organisational set-ups under CSSF Circular 12/546[18]

Under section 2.1., penultimate paragraph, the following provision is being provided for: "*In the case where the depositary bank has a direct or indirect qualifying holding in a management company, the management company must identify the conflicts of interest which could result from this holding and has to strive to avoid them in accordance with the procedures provided for in the conflicts of interest policy of the management company.".*

Section 4.1. penultimate paragraph of the same CSSF Circular 12/546 further spells out the following requirement: "*Insofar as every management company must have solid governance arrangements, its shareholders must take this principle into account when composing the board of directors of the management company. Thus, for example, when a bank is a shareholder of a management company and when this bank assumes the function of depositary bank of one or more funds managed by the management company, it must be ensured that the board of directors of the management company is not predominately composed of representatives of the business line "depositary bank". In addition, in the case of a SICAV having appointed a management company, it is recommended that the board of directors of the two entities is not predominantly composed of the same persons.*".

[17] http://www.cssf.lu/fileadmin/files/Lois_reglements/Legislation/RG_CSSF/RCSSF_No10-04_eng.pdf
[18] http://www.cssf.lu/fileadmin/files/Lois_reglements/Circulaires/Hors_blanchiment_terrorisme/cssf12_546.pdf

Section 4.2. penultimate paragraph of the same CSSF Circular 12/546 further provides for the following: "*The principle of independence of the management company from the depositary prevents the conducting officer from being employed by the depositary of a UCITS which the management company manages.*".

Hungary

There is no specific provision under national law.

Denmark

The management company and the depositary must be two separate legal entities. They may belong to the same group.

Romania

Article 55 of Government Emergency Ordinance no. 32/2012 state that:
" *(1) A company may not simultaneously fulfil the functions of an AMC and of a depositary.*
(2) AMC and the depositary shall act independently from one another and to the exclusive interest of equity titles holders."

Regulation 9/2014 also includes certain requirements/incompatibilities for members of management body/directors of AMC vis-a- vis management body/directors of the depositary (Art. 23 para (1) letter d) point. 2 and letter e)):

d) *Besides the conditions set out in indent (c), the members of Board of Directors/Board of Supervisors of the AMC shall cumulatively meet the following conditions: […]*
2. *they shall not be members of the Board of Directors/Board of Supervisors or managers/members of Management Board of another AMC, investment company or of a credit institution which functions as a depository for one of the UCI managed, shall not be members of the Board of Directors/Board of Supervisors of an investment firm which has concluded a financial intermediation contract with the AMC and shall not be employed or have any direct or indirect contractual relationship with another AMC or investment company;*
[…]
e) The managers/members of the Management Board of an AMC, as well as the persons who replace them shall meet the conditions set out in indent c) and d) point 1-6 and 7 and shall have a minimum experience of three years in the investment management field or in the field of capital markets.

Art. 60 (3) also provides that *"Where the UCITS depositary is part of the same financial group with AMC, the managers/members of the Management Board who manage the depositary activity within the credit institution are not allowed to simultaneously manage the brokerage activity which can be provided as investment firm – custodian agent."*

Austria

The Investment Funds Act 2011 (InvFG 2011) states basic principles: The depositary shall carry out the instructions of the management company, unless they conflict with the provisions of this federal act or the fund rules (Art. 40 para 3 Investment Funds Act 2011 – InvFG 2011). Art. 44 para 2 InvFG 2011 restates this principle for the depositary, i.e.: *"In carrying out its role, the depositary bank must act independently and solely in the interest of the unit-holders."*

In addition Art. 6 para 2 number 8 InvFG 2011 states "*neither a director nor any member of the depositary's supervisory board is a member of the supervisory board of the management company*".

Furthermore Art. 6 para 2 number 9 InvFG 2011 states *"the director or an employee holding a power of attorney (Prokurist) of the management company is neither a manager nor a member of the supervisory board nor an employee of the depositary holding a power of attorney"*.

Sweden

The depositary shall conduct independently of the management company and in exclusively in the common interest of the unit holders. The management company and the depositary may belong to the same group, given the existence of Chinese walls between the companies. Independency between the management company and the depositary is also ensured through legislative provisions relating to conflict of interest.

Malta

National legislation/ MFSA Rules provide that a depositary shall act independently of the manager and the management of the scheme and solely in the interest of the scheme and its investors.

"In the exercise of its functions and duties and responsibilities, the custodian shall act independently of the manager and of the management of the scheme and solely in the interest of the holders of units or participants in the scheme and of the scheme itself."[19]

Moreover, one cannot act as a member of the board of the scheme or else as an officer of the manager while at the same time being involved in a similar position with the depositary unless expressly authorised by the MFSA.

"Except as may be authorised by the competent authority, a person shall not act as a member of the board of directors or similar organ or as an officer responsible for the administration and management of the manager and at the same time hold a similar position with the custodian entrusted with the custody of the assets of any scheme managed by the manager."[20]

In terms of independence from the manager of a scheme the MFSA Rules additionally provide that should there be any possibility that the required independence is brought into question, this shall be declared to the MFSA immediately.

"The Licence Holder shall be a separate person from the Manager of a Scheme for which it acts as Custodian, and shall act independently of each other and solely in the interests of the Unit Holders. Since independence may be compromised in a variety of ways, any facts, relationships, arrangements, or circumstances which may at any stage bring that independence into question shall be declared to the MFSA as soon as the Licence Holder becomes aware of any such matter."[21]

Estonia

Article 94 of the Estonian Investment Fund Act establishes the general requirement of independent activity for the depositary. It is also established that the depositary must act in the best interests of the fund and its shareholders or unit-holders.

[19] Investment Services Act (Control of Assets) Regulations, 1998, Regulation 17.
[20] Investment Services Act (Control of Assets) Regulations, 1998, Regulation 18.
[21] Investment Services Rules for Investment Services Providers, SLC 3.01.

Slovenia

The relevant provisions are Articles 179 and 180 of Investment Fund and Management Companies Act.

Article 179

The relevant provisions of the Investment Funds and Management Companies Act state that a management company and depositary must act independently and in a way to ensure the largest possible benefit to holders of investment funds' investment coupons or to holders of shares of investment companies. A depositary and a management company are authorised to enforce claims and objections on behalf of a mutual fund or an investment company in all court procedures and procedures involving other government authorities dealing with an investment fund's rights, liabilities or assets. In case of conflicting actions, those more favourable for the investment fund in question are valid.

Article 180

Currently there are restrictions imposed on a custodian with regard to its deals and investments.[22] A management company and the party related to the management company may not in its own name and for its own account and for the account of the investment fund it manages enter into transactions comprising the purchase or sale or other business, the object of which is investments of investment funds managed by the management company, with a depositary providing depositary services for its funds and the parties related to this custodian. A depositary and its related parties are not allowed to acquire investment coupons or shares of an investment fund on whose behalf they provide depositary services.

There is an exception for the transactions concluded on organised markets, if the parties to the transactions are not known or could not be known to each other at the time of transaction.

A natural person, who manages the depositary's assets, cannot at the same time provide depositary services.

A depositary shall adopt the rules of procedure which regulate restrictions on the transfer of information among the different parties referring to the assets of an investment fund and curb possible conflicts of interest, which might arise during the provision of the depositary services for an investment fund with regard to the other services and activities and the depositary's assets as well as with regard to the capital relation of the depositary to other persons and the ownership structure of the custodian.

Depositary's investments and operations, the object of which is investment of the investment funds, for which the custodian provides the custodian services, are reported to the Slovenian competent authority.

Belgium

The Belgian rules on UCITS stipulate that the management company and the depositary must act independently and in the sole interest of the participants in the UCITS. In particular, the Belgian rules laid down in the Law of 3 August 2012 and the Royal Decree of 12 November 2012 provide:

- Specific organisational rules, according to which (i) the management company and the depositary shall be two separate legal entities, but may belong to the same group; (ii) the depositary shall not

[22] The Article 180 of Investment Funds and Management Companies Act, stipulating the described arrangements, is currently under revision.

be a member of the management body (those responsible for the day to day management) of the management company/investment company; and (iii) the members of the board of directors of the investment company/management company who have been appointed on the recommendation of the depositary (of the said investment firm or of the UCITS-fund that designated the management company), may not serve among those responsible for the day-to-day management of either the investment company/or the management company in question.

- Conflict of interest provisions, which oblige management companies, investment companies and the depositary to take measures to avoid/manage conflicts of interest and to inform on these measures.

- Rules in relation to delegation: the core function of portfolio management and some other administrative tasks, such as the bookkeeping and the valuation of the portfolio, shall not be delegated to the depositary.

Ireland

In addition to the requirements in the UCITS Directive for management companies and depositaries to act independently and solely in the interests of unitholders and for relationships with group entities to be addressed under the management company conflicts of interest policy, conditions imposed by the Central Bank of Ireland prohibit the board of directors of the UCITS management company from having directors in common with the board of the trustee.

The supervisory practice of the Central Bank of Ireland is focused on the effectiveness of the corporate governance framework and structures of management companies and depositaries, to ensure that each company has sufficient autonomy to ensure independent decision making.

Lithuania

The requirements aimed at ensuring independence of the depositary and of the management company are set out in Article 34 of Law on Collective investment Undertakings. No depositary shall act both as a management company or an investment company, except in case provided for in Article 33 of this Law – i.e. where the right of a management company to manage a collective investment undertaking is suspended or expires and management of a collective investment undertaking is not delegated to another management company, the management of a collective investment undertaking shall be temporarily (up to 3 months) taken over by a depositary that has all rights and duties of the management company.

According to Article 34(2) of Law on Collective Investment Undertakings, managers of a management company or an investment company, except for the supervisory board members, and employees may not be the managers or employees of a depositary to which the safe-keeping of assets comprising an investment fund managed by that company or assets held by an investment company is entrusted, whose functions are directly linked to activities of a depositary.

Moreover, managers of a depositary, to which the safe-keeping of assets comprising an investment fund managed by that company or assets held by an investment company is entrusted, whose functions are directly linked to activities of a depositary may constitute not more than half of members of the supervisory board of a management company or an investment company managing that investment fund. Employees of a depositary, to which the safe-keeping of assets comprising an investment fund managed by that company or assets held by an investment company is entrusted, whose functions are directly linked to

activities of a depositary, may not be members of the supervisory board of a management company or an investment company managing that investment fund (Article 34(3) of Law on Collective Investment Undertakings).

Annex IV

Draft technical advice

I. Advice on the insolvency protection of UCITS assets when delegating safekeeping (Art. 22a(3)(e) and 26b(e) UCITS V)

1. In case of delegation of the functions referred to in Article 22(5) of Directive 2009/65/EC, in order to ensure that in the event of insolvency of the third party, assets of a UCITS held by this third party in custody are unavailable for distribution among or realisation for the benefit of creditors of the third party, the third party shall take steps including, but not limited to, the following:

   (a) whenever the applicable insolvency laws and jurisprudence are those of a jurisdiction located outside the Union,

      (i) make all reasonable efforts, including the receipt of independent legal advice, to verify that the applicable insolvency laws and jurisprudence:

         – recognise the segregation of the UCITS' assets from the third party's own assets and from the assets of the depositary, in line with the requirements of Article 22a(3)(d) of Directive 2009/65/EC[23], as further implemented by [the delegated acts foreseen under Article 26b(1)(d) of the UCITS Directive]; and

         – recognise that the UCITS' segregated assets do not form part of the third party's estate in case of insolvency and are unavailable for distribution among or realisation for the benefit of creditors of the third party;

      (ii) ensure that the conditions set out in the applicable insolvency laws and jurisprudence to consider that the UCITS' assets are segregated and unavailable for distribution or realisation, as referred to under point (i), are met at the moment of the conclusion of the delegation agreement with the depositary and on an ongoing basis for the entire duration of the delegation;

      (iii) immediately inform the depositary in case any of the conditions mentioned under (ii) is no longer met;

   (b) whichever jurisdiction – inside or outside the Union – the applicable insolvency laws and jurisprudence relate to,

      (i) inform the depositary about the applicable insolvency laws and jurisprudence and the relevant conditions that apply;

      (ii) maintain accurate and up-to-date records and accounts of UCITS' assets that

[23] Article 22a(3)(c) in the text of UCITS V published in the Official Journal.

readily establish the precise nature, amount, location and ownership status of those assets. The records should also be maintained in such a way that they may be used as an audit trail;

(iii) provide a statement to each depositary on a regular basis detailing the UCITS' assets held for or on behalf of such depositary; and

(iv) maintain appropriate arrangements to safeguard the UCITS' rights in its assets and minimise the risk of loss and misuse. In particular, the third party shall analyse how certain actions or decisions could materially change the status of the UCITS' assets and/or complicate return of the UCITS' assets, such as if the exercise of a right of re-use or enforcement of a pledge – to the extent that this is authorised under Article 22(7) of Directive 2009/65/EC – results in a different party succeeding to rights in the UCITS' assets;

2. In case of delegation of the functions referred to in Article 22(5) of Directive 2009/65/EC, in order to ensure that in the event of insolvency of the third party, assets of a UCITS held by this third party in custody are unavailable for distribution among or realisation for the benefit of creditors of the third party, the depositary delegating the functions to a third party shall adopt the following measures:

(a) in all cases, consider the following elements in the selection and appointment of the third party:

- the legal requirements or market practices related to the holding of client assets that could adversely affect UCITS' rights during business as usual and in the event of insolvency of the third party;
- the financial condition, expertise and market reputation of the third party; and
- protection or lack thereof attendant upon the regulatory status of the third party;

(b) in case the third party is located outside the Union,

(i) make all reasonable efforts, including the receipt of independent legal advice, to understand the material effects of the contractual provisions governing the arrangement with the third party on the UCITS' rights in respect of its assets, including how those contractual provisions would operate in the jurisdiction where such assets are held, including in the event of insolvency of the third party to which the depositary has delegated safekeeping duties;

(ii) ensure that there are contractual provisions in its agreement with the third party allowing the termination of such agreement without undue delay in case the applicable insolvency laws and jurisprudence no longer guarantee the segregation of the UCITS' assets in the event of insolvency of the third party or the conditions set out under these laws and jurisprudence are no longer fulfilled; and

(iii) in case the depositary becomes aware that the applicable insolvency laws and jurisprudence no longer guarantee the segregation of the UCITS' assets in the event of insolvency of the third party or the conditions set out under these laws and jurisprudence are no longer fulfilled, immediately inform the investment company or the management company on behalf of the UCITS of such a situation. The mere provision of information to the investment company or the management company on behalf of the UCITS shall not change the nature of the assets held by the third party, which shall continue to be held in custody.

3. Whenever the independent legal advice referred to under point (a)(i) of paragraph 1 is made available by the third party to the depositary, the latter shall be absolved of the obligation to obtain independent legal advice set out under point (b)(i) of paragraph 2.

4. Whenever the independent legal advice referred to under point (b)(i) of paragraph 2 is made available by the depositary to the third party, the latter shall be absolved of the obligation to obtain independent legal advice set out under point (a)(i) of paragraph 1, provided that the relevant independent legal advice obtained by the depositary covers all the elements mentioned under point (a)(i) of paragraph 1.

II. Advice on the independence requirement (Art. 25(2) and 26(b)(h) UCITS V)

In order to fulfil the independence requirement referred to in Article 25(2) of Directive 2009/65/EC, the following requirements shall be complied with:

[Common management/supervision]

(a) no member of the management body of the management company/investment company shall be a member of the management body of the depositary;

(b) no member of the management body of the management company/investment company shall be an employee of the depositary and no member of the management body of the depositary shall be an employee of the management company/investment company;

(c) where the management body of the management company/investment company is not in charge of the supervisory functions, no more than [one third] of the members of the body in charge of the supervisory functions of the management company/investment company shall be a member of the management body, the body in charge of the supervisory functions or an employee of the depositary;

(d) where the management body of the depositary is not in charge of the supervisory functions, no more than [one third] of the members of the body in charge of the supervisory functions of the depositary shall be a member of the management body, the body in charge of the supervisory functions or an employee of the management company/investment company;

[Cross-shareholdings]

OPTION 1

(e) the management company/investment company shall put in place a robust decision-making process for choosing the depositary which shall be based on objective pre-defined criteria and meet the exclusive interest of the UCITS;

(f) the management company/investment company shall not have a direct or indirect holding in the depositary which represents 10 % or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the depositary in which that holding subsists; and

(g) the depositary shall not have a direct or indirect holding in the management company/investment company which represents 10 % or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the management company/investment company in which that holding subsists.

(h) the management company/investment company and the depositary shall not be included in the same group for the purposes of consolidated accounts, as defined in Article 2(11) of Directive 2013/34/EU or in accordance with recognised international accounting rules,

OPTION 2

(e) the management company/investment company shall put in place a robust decision-making process for choosing the depositary which shall be based on objective pre-defined criteria and meet the exclusive interest of the UCITS;

(f) in case any of the following situations arise:

- the depositary has a direct or indirect holding in the management company/investment company which represents 10 % or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the management company/investment company in which that holding subsists; or

- the management company/investment company has a direct or indirect holding in the depositary which represents 10 % or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the depositary in which that holding subsists; or

- the management company/investment company and the depositary are included in the same group for the purposes of consolidated accounts, as defined in Directive 2013/34/EU or in accordance with recognised international accounting rules,

at least the following arrangements shall be put in place:

(i) all reasonable steps to avoid conflicts of interest arising from the shareholding or group structure shall be taken and, when they cannot be avoided, conflicts of

interest shall be identified, managed and monitored and, where applicable, disclosed, in order to prevent them from adversely affecting the interests of the UCITS and their investors;

and

(ii) the choice of the depositary shall be justified to investors upon request;

(g) in case the management company/investment company and the depositary are included in the same group for the purposes of consolidated accounts, as defined in Directive 2013/34/EU or in accordance with recognised international accounting rules, at least the following additional arrangements shall be put in place:

(i) at least [one third] of the members of the management body of the management company/investment company and the depositary shall be independent, in the sense that they shall not be members of the management body or the body in charge of the supervisory function nor employees of any of the undertakings within the group;

(ii) where the management body of the management company/investment company and the depositary is not in charge of the supervisory functions, at least [one third] of the members of the body in charge of the supervisory function shall be independent, in the sense that they shall not be members of the management body or the body in charge of the supervisory function nor employees of any of the undertakings within the group.