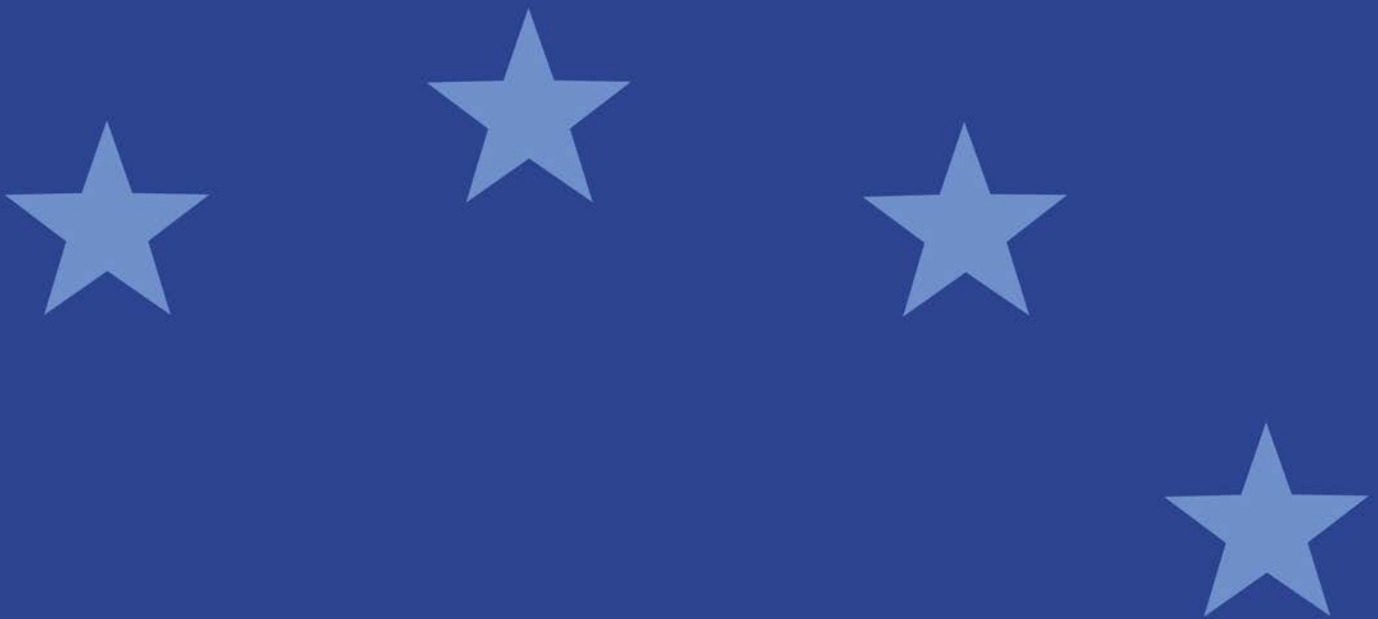




European Securities and
Markets Authority

Reply form for the Technical Advice the on delegated acts re- quired by the UCITS V Directive



26 September 2014



European Securities and
Markets Authority

Date: 26 September 2014



Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Consultation Paper - ESMA's technical advice to the European Commission on delegated acts required by the UCITS V Directive, published on the ESMA website ([here](#)).

Instructions

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, please follow the instructions described below:

- II. use this form and send your responses in Word format;
- III. do not remove the tags of type < ESMA_UCITS_QUESTION_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- IV. if you do not have a response to a question, do not delete it and leave the text "TYPE YOUR TEXT HERE" between the tags.

Responses are most helpful:

Q1: if they respond to the question stated;

Q2: contain a clear rationale, including on any related costs and benefits; and

Q3: describe any alternatives that ESMA should consider

Given the breadth of issues covered, ESMA expects and encourages respondents to specially answer those questions relevant to their business, interest and experience.

To help you navigate this document more easily, bookmarks are available in "Navigation Pane" for Word 2010 and in "Document Map" for Word 2007.

Responses must reach us 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 end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that 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 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 'Disclaimer'.



III. Advice on the insolvency protection of UCITS assets when delegating safekeeping (Art. 22a(3)(e)¹ and 26b(e) UCITS V)

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?

<ESMA_UCITS_QUESTION_1>

Yes. While segregation should not be an aim by itself, ALFI agrees that it is of importance in relation to insolvency protection where the objective is that a third party takes all necessary steps to ensure that in the event of an insolvency all UCITS assets held by this third party are unavailable for distribution among, or realisation for the benefit of creditors of this third party.

<ESMA_UCITS_QUESTION_1>

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?

<ESMA_UCITS_QUESTION_2>

Yes it should protect all assets in custody with a 'third party'.

<ESMA_UCITS_QUESTION_2>

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

<ESMA_UCITS_QUESTION_3>

Additional measures might be considered but this depends very much on the specific circumstances and should be left to the good faith appreciation of the depositary and any third party appointed by the depositary as its delegate.

In any case, it is important to note that the risk of loss of assets in insolvency proceedings by a third party cannot be completely alleviated.

As pointed out by IOSCO, we would like to remind ESMA that the ultimate regulatory and market risk of each domestic securities market remains and is beyond the control of the depositary. As IOSCO stresses, *“where assets are held in foreign jurisdictions, there may be specific country risks that should be taken into account, e.g. the effectiveness of the local regulatory regime, whether a judgement can be enforced*

¹ Article 22a(3)(d) in the text of UCITS V published in the Official Journal.



effectively and other factors that make it difficult to repatriate CIS assets² – factors for which clearly ALFI believes the depositary as well as any appointed third party have no influence on.

Hence, this is an element to be taken into account by the management company/ investment company in its investment decision process. In this respect, communication/ cooperation between depositaries and their management companies/ investment companies, including an appropriate escalation procedure, is of paramount importance.

<ESMA_UCITS_QUESTION_3>

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

<ESMA_UCITS_QUESTION_4>

ALFI agrees on the importance of a careful analysis of the protection of assets in case of insolvency. As a preliminary comment, ALFI would like to stress that the Directive itself is not directly applicable to delegates (third parties appointed by the depositary) and hence the directive cannot create directly obligations for delegates. The obligations of delegates derive from the contractual framework with the depositary. This is notably true where the delegate/ third party is established in a non EU jurisdiction. Therefore it is the depositary who must appreciate and ascertain that the contractual framework caters for this adequately.

Consequently any steps that may be useful (e.g. obtaining independent legal advice) should be taken either at delegate or depositary level. There is no added value if the steps are taken at both levels.

Further, the specific steps to be taken should be left to the reasonable discretion of the depositary. Indeed, the situation of each depositary may be different in nature, e.g. for depositaries using a proprietary network vs. depositaries appointed third party sub-custodians. Therefore, specific means such as the obtaining of a legal advice from independent legal counsel should be recommended but not prescribed, where – depending on the circumstances – the assessment of the depositary’s internal legal services may be an alternative.

With respect to the reference to IOSCO recommendations under section 24.2 of ESMA’s consultation paper, ALFI would like to indicate that this recommendation is probably not entirely relevant in the context of UCITS. First, this recommendation can only apply to assets under custody which are under the control of the depositary. Second, based on article 22. (7), the depositary as well as any third party which it appoints, shall not re-use assets under custody.

² IOSCO Consultation Report: Principles regarding the Custody of Collective Investment Schemes’ Assets, Chapter 3, Paragraph 38.



<ESMA_UCITS_QUESTION_4>

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?

<ESMA_UCITS_QUESTION_5>

Yes there are many difficulties such as:

- Insolvency regimes are based on legal concepts which are not necessarily comparable in nature and whose assessment may prove difficult;
- Legal regimes do not always warrant the actual enforcement before the courts;
- The evaluation of the insolvency regimes may vary between legal advisers as this may be subject to interpretation;
- Quality legal advice might not always be available in all jurisdictions to the extent needed in this context;
- Independent legal advice is not necessarily more desirable, especially where in-house legal advice is available, notably for depositaries which have a local presence in the markets at stake;
- Finally, a legal advice is only valid as on its issuance and may not foresee future developments which may be sudden.

<ESMA_UCITS_QUESTION_5>

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.

<ESMA_UCITS_QUESTION_6>

There will be material additional costs, which may, or may not, depending on the level of assets for a particular project, be significant, e.g. for a depositary servicing for the first time a new fund investing in frontier markets. Further, the additional costs may not necessarily be commensurate with the additional level of protection.

<ESMA_UCITS_QUESTION_6>

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

<ESMA_UCITS_QUESTION_7>

At first sight, we do not see further steps, but this should be left to the appreciation of the depositary.



<ESMA_UCITS_QUESTION_7>

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?

<ESMA_UCITS_QUESTION_8>

At first sight, we do not see specific considerations and ALFI agrees further that sub-delegates should be substantially subject to the same regime. However, a proportionality element should come into consideration. In this context, please note for the sake of completeness that in many countries, financial instruments are ultimately safekept by national CSDs. These are not sub-delegates and are not subject to the same regime.

<ESMA_UCITS_QUESTION_8>

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

<ESMA_UCITS_QUESTION_9>

ALFI generally agrees with the recommended steps, with the exception of the eventual need for diversification (Principle 3, 3rd paragraph, fourth bullet point, page 12).

To place assets with several sub-custodians in a given jurisdiction is not a suitable risk mitigating measure. On the contrary this introduces unwarranted complication and complexity.

Further, only for the good order, the depositary cannot "ensure compliance with domestic measures". The depositary can only provide for adequate provisions in its contractual framework with the sub-custodians and monitor compliance and take, if need be, remedial action.

<ESMA_UCITS_QUESTION_9>

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.

<ESMA_UCITS_QUESTION_10>

Material additional costs will occur and depend on the specific situation. It should be left to the reasonable discretion of the depositary which exact measures are to be taken so as to procure that the costs for additional measures are commensurate with the additional protection offered.

<ESMA_UCITS_QUESTION_10>

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

<ESMA_UCITS_QUESTION_11>

Not at first sight and this should be left to the discretion of the depositary who is best situated to appreciate whether further steps may enhance the protection of assets.

<ESMA_UCITS_QUESTION_11>

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?

<ESMA_UCITS_QUESTION_12>

A transfer of assets to another jurisdiction as suggested above is not a realistic protective measure. First of all this will typically not be feasible at all (e.g. the assets are ultimately held by a local CSD of which only local sub-custodians can be members) or at least not be feasible within the short delays required (a transfer of assets even within the same jurisdiction needs a certain time). Secondly, the assets are likely to be ultimately held in any case in the original jurisdiction because this will be required in order to trade the assets. Thirdly, the sub-custodian in the other jurisdiction will simply not be able and willing to safe-keep assets of another jurisdiction.

In fact the measures the depositary can take are limited to the escalation procedure whereby the depositary would bring the issue to the attention of the management company / self managed investment company. It is then up to the management company / self managed investment company to decide whether or not it is in the best interest of the investors to maintain the relevant investments. The issue may have to be escalated to the attention of the competent authorities of the fund and management company.

Ultimately, the depositary will have no other choice than to terminate the depositary contract with the fund. The management company / self managed investment company should then and until the new depositary has been appointed and the fund assets have been transferred to the new depositary be under a duty to take appropriate risk mitigating steps and in particular to abstain from actions that would increase the risk.



<ESMA_UCITS_QUESTION_12>

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

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

<ESMA_UCITS_QUESTION_13>

No, we disagree with ESMA's analysis. We do not agree with the identified links that may jeopardise the independence of the Relevant Entities. We are concerned that the outright prohibition of cross-shareholdings/group inclusion ('Option 1'), goes beyond the policy objectives and the legal basis of the UCITS V directive. We are convinced that proposing recommendations based only on this will not achieve the final policy objective of higher investor protection but may rather lead to disproportionate costs and have a detrimental and negative effect on the existing shareholding structures of management companies and depositaries in Europe (see our answer to Q15, Q18 and Q22 below).

Many financial groups (universal banks), amongst them the largest, have developed asset management and depositary bank businesses which represent today a significant share of the global market of depositaries of UCITS.

The outright prohibition of cross-shareholding as foreseen in Option 1 is also inadvisable as this would imply the separation of a large number of entities, in several Member States with a significant share of the UCITS market such as France, Germany, Luxembourg, Belgium, Denmark, Sweden and Italy. In the absence of a proven market failure and as the UCITS regulatory framework provides investors with a greater level of protection we strongly believe that this long established market practice should not be restricted by any level – 2 measures.

Finally, the prohibition of cross-shareholdings could lead banking groups to either dispose of their management companies or their depositary divisions. This would entail a significant re-structuring of the financial industry across a number of Member States and within a relatively short period of time. We fear that the disposal of any such companies or businesses under such a time constraint and on a large scale will necessarily be made at prices which would not reflect the true market value of such entities. It is even feared that some entities or businesses at sale would not find any buyer or alternatively that it may prompt non-EU groups to get an entry in the European market at dumped prices.

Thus we urge ESMA to propose final recommendations that are strictly proportionate and that meet the policy objectives to be achieved. Indeed, the principle of proportionality is intended to ensure that regulatory measures go no further than is required to achieve a set objective, which is to ensure that both the management company and the depositary have specific safeguards against conflicts of interest to allow for the independent performance of their activities. This is the reason why we strongly disagree with the cross-

shareholdings/group inclusion as identified links which may jeopardise the independence of the Relevant Entities where an adequate conflict of interest policy is in place.

In particular, it should not be forgotten that Article 25(2) states that “In carrying out their respective functions, the management company and the depositary shall act independently [...]”.

In the light of Level 1 provisions, ESMA should bear in mind that the requirement to act independently does not coincide with requiring the “structural” independence of the Relevant Entities. *This functional independence may be achieved in a variety of ways provided each is appropriate to the broader regulatory framework of the relevant jurisdiction. Functional independence as a minimum requirement is to be distinguished from a structural or “legal independence”. According to principle 25 of the IOSCO Principles, it is not mandatory for the custodian and the responsible entity to be legally separate entities or for the custodian and the responsible entity to not have common shareholders or directors, although it is open to the regulatory regime to prohibit or restrict this.*

*A functional separation, however, necessarily implies a hierarchical separation, which will involve assessing where key decisions are taken.*³

In this sense, and to avoid the risk that the future relative delegated acts reach beyond the Level 1 text, the conditions and criteria for fulfilling the independent action requirement mentioned therein should not be construed as ones requiring profound changes in corporate and group governance, structure, organization and internal processes, and shareholder links. Rather, the focus of ESMA’s advice to the Commission in this regard should be made on conduct rules and possible sanctions, aiming at identifying, managing and disclosing eventual conflicts of interest to investors.

We would therefore strongly advocate that the wording of Option 2 should be revised. ESMA should concentrate all its impetus on the following two sub-paragraphs regarding the necessary arrangements to be put in place by the Relevant Entities:

- (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; (...).

Finally, we believe that ESMA should not give any indications as regards to the composition of the management body of the management company/investment company and the depositary. As outlined in detail

³ IOSCO Consultation Report: Principles regarding the Custody of Collective Investment Schemes’ Assets, Principle 4 Paragraph 59.

above, the provision requiring the Relevant Entities to “act independently” should not be interpreted as requiring more “structural” or far-reaching independence requirements for the Relevant Entities. We therefore, suggest in addition to the removal of ‘one third’ requirement to remove the last paragraph (g) of Option 2 in the draft advice.

<ESMA_UCITS_QUESTION_13>

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.

<ESMA_UCITS_QUESTION_14>

We do not consider that any additional links should be taken into account. We rather believe it is more important to focus on the robustness of the group as a whole and the (‘anti-’) conflict of interests policies that it has put in place as required by other regulations. In addition it is likely that a regulation may not draw an exhaustive list of all cases. We would therefore propose to concentrate on the principles.

<ESMA_UCITS_QUESTION_14>

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?

<ESMA_UCITS_QUESTION_15>

We are strongly opposed to the cross-shareholdings/group inclusion links as it cannot pre determine a lack of independence of the Relevant Entities. Potential conflicts are mitigated by means of functional and hierarchical separation of performance of the depositary function (tasks) from other potential conflicting tasks. Furthermore, whenever potential conflicts of interests are identified they are managed, monitored and adequately disclosed to unitholders via the prospectus of the UCITS or by other means.

<ESMA_UCITS_QUESTION_15>

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?

<ESMA_UCITS_QUESTION_16>

No, we partly disagree. As a general remark we would like to emphasis that the integrated business model/universal bank organisation model has proven in the past its robustness and resilience. It should be acknowledged that universal banks bring benefits in terms of client service and more broadly that activi-

ties such as asset management usefully contribute to the financing of the economy. Against this background, the established and proven European universal banking model should not be jeopardized by the proposed independence requirements. However, we believe that already now supervisory practices are in place which ensure independence between the management company, investment company on one side and the depositary on the other side. In line with the approach taken by the Commission de Surveillance du Secteur Financier ('CSSF') we suggest as *an alternative to the first option that the management body of one of the Relevant Entities should not be predominantly composed of representatives from member(s) of the management body or employee(s) of the other Relevant Entity.*

<ESMA_UCITS_QUESTION_16>

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.

<ESMA_UCITS_QUESTION_17>

Please refer to our answer to question 13 and 16.

<ESMA_UCITS_QUESTION_17>

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.

<ESMA_UCITS_QUESTION_18>

Please refer to our answers to question 13 and question 22.

<ESMA_UCITS_QUESTION_18>

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

<ESMA_UCITS_QUESTION_19>

For the reasons mentioned above and below, we find that the first option is not a valid option. Option 1 potentially would have adverse consequence such as increasing the costs, concentration and consolidation of depositaries and management companies and consequently increase systemic risk (for more details please refer to our answer to question 22). In addition, the principle of proportionality is intended to ensure that regulatory measures go no further than is required to achieve a policy objective, which is to ensure that both the management company and the depositary have specific and robust safeguards against conflicts of interest to allow for the independent performance of their activities. Although we have a clear

preference for Option 2 we believe that ESMA's proposal should not intervene in governance issues relating to group structure, organisation, internal processes and shareholder links. Option 2 provides for a more balanced approach to ensure the Relevant Entities act independently. However, the reference to the composition of the management body of the management company/investment company and the depositary in case the Relevant Entities are included in the same group should be removed. For more detailed comments, please also refer to our answer to Question 13.

<ESMA_UCITS_QUESTION_19>

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.

<ESMA_UCITS_QUESTION_20>

We disagree. First of all we do not believe that it is necessary to impose a strict percentage. We believe it even more important that high standards of corporate governance are applied at all times. Particular emphasis should be put on the fact that the Board of Directors /management body should have good professional standing and appropriate experience and ensure that it is collectively competent to fulfill its responsibilities. In doing so consideration should be given to the inclusion in the Board of one or more members that are, in the opinion of the Board, independent.

Furthermore, it is important to note that all members of the Board of as well the depositary as the management company are under the obligation to always act fairly and independently in the best interest of the investors, regardless whether they are 'independent directors' or not. For more detailed information we would like to refer you to the ALFI Code of Conduct for Luxembourg Investment Funds.

Finally, we believe that ESMA should consider to introduce a principle of proportionality. The principle of proportionality is intended to ensure that regulatory measures go no further than is required to achieve a set objective, which is to ensure that both the management company and the depositary have specific safeguards against conflicts of interest to allow for the independent performance of its activities.

<ESMA_UCITS_QUESTION_20>

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?

<ESMA_UCITS_QUESTION_21>

No we disagree, notably the proposal lacks clear definition of the management level of reference and does not take into account the existing different organisational models of financial institutions across Europe. The governance structure of the management company and/or of the investment company shall provide for independent oversight of the management company and of fund operations through entities that can take different forms (i.e. auditor, depositary or a number of independent directors on the Board). Such entities can either be independent of management, shareholders of the management company and service providers, or be related parties.

In order to provide effective independent oversight and fulfil their fiduciary duty to protect investors' interests, related parties shall take all necessary measures to minimize conflicts of interest and **maintain a functional and hierarchical separation of group entities**. The independent oversight shall ensure that the management company and/or the investment company respect applicable rules, contractual obligations and duties and protect the interests of investors.

Therefore, the concept of independence should not exclude members of the management body nor employees of undertakings of the group that are **functionally and hierarchically separated from management company and/or investment company and depositary function**.

<ESMA_UCITS_QUESTION_21>

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.

<ESMA_UCITS_QUESTION_22>

The prohibition of cross shareholding, as envisaged in option 1 (“the management company company/investment company shall not be included in the same group...”) may, if retained by ESMA, lead to the following consequences, all significantly detrimental to the investors:

- The choice of Option 1 could have the adverse consequence of increasing the costs of the products for the end investors, as for most actors having to be integrated or for a management company to move all assets to a depositary not being part of the same Group, could prove to be very expensive to match the current standards adopted in terms of workflows and information mechanisms which are possible in the integrated models.
- European-based diversified financial groups with a depositary arm will be compelled to limit their operations in asset management, thus depriving the market of a substantial part of the range of products available for investment for the retail market.



- European-based diversified financial groups with an asset management arm will exit the depositary sector. Depositary service offering in the European Union will therefore be reduced, be limited to fewer players, and is likely to be offered by banks somewhat away from the asset industry constraints.
- This may lead to a significant restructuring of the UCITS universe (e.g. merger, closing, transfer) with significant follow-up costs related to changes of prospectus, KIID, shift of depositary or management company, etc.

Option 1 would entail huge costs and a complete transformation of the existing models with a chance to put at risk and to weaken the overall sector. These costs would ultimately be borne by UCITS investors with no added benefits in terms of protection given the absence of proven market failure.

In terms of assets under management ('AuM') please find below our own estimate of the percentage of AuM that would need to be transferred to another depositary and the number of potentially impacted management companies and depositaries:

- 39.54% of the Luxembourg UCITS;
- 30.66 % of the UCITS AuM in Luxemburg (equally to € 755 484 million AuM);
- 39 Management Companies and 32 Depositaries.

But these costs would go far beyond the costs of transfer since option 1 would, in our view contradict, without any compelling grounds, the freedom of enterprise in the European financial industry and lead to a far reaching market restructuring detrimental to:

- 1) The employment in the financing sector,
- 2) The financing of the economy,
- 3) The stability and safety of the whole UCITS model,
- 4) The stability of the banking sector.

<ESMA_UCITS_QUESTION_22>

Annex III

Cost-benefit analysis

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

<ESMA_UCITS_QUESTION_23>

Yes, we agree with ESMA to discard the second and third option.

<ESMA_UCITS_QUESTION_23>

