



UCITS:
DEPOSITARY FUNCTION AND MANAGERS'
REMUNERATION
(EC Consultation)

BEUC POSITION PAPER

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Ref.: X/2011/007 - 31/01/11

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Summary

BEUC welcomes the consultation issued by the Commission services on the UCITS depositary function and on the UCITS manager's remuneration.

BEUC supports reducing risks that are not directly linked to the asset itself. The risk linked to variations of assets' value is completely normal; other risks (or their impact) like fraud, inaccurate information, mismanagement, negligence, default of investment firm etc. should be minimized. In this regard, the safe-keeping and oversight functions of the depositary are crucial.

BEUC fully supports the Commission Services when writing "It is clear that the level of protection for UCITS should not go below the standard applied for the AIF and that the large retail based of UCITS investors should be provided with the necessary guaranty for them to place their confidence in UCITS."

BEUC generally agrees with the proposed measures, more specifically with the recommendation that the UCITS depositary should be responsible for the loss of assets in case of failure of a sub-custodian.

BEUC is concerned about the conflicts of interests existing between UCITS managers and UCITS depositaries belonging to the same group. If that is the case, it will always be difficult for the depositary's staff to exert its oversight function and take measures against the UCITS manager.

GENERAL REMARKS

BEUC welcomes the consultation issued by the Commission services on the UCITS depositary function and on the UCITS manager's remuneration.

UCITS are one of the most important retail investment products for consumers. UCITS regulation comprises provisions that are important to retail investors such as diversification of assets, pre-contractual information (prospectus agreement, KIID), periodic information, and depositary functions.

It makes the UCITS framework the best way for most retail investors to invest in products presenting some risks.

BEUC supports reducing risks that are not directly linked to the asset itself. The risk linked to variations of assets' value is completely normal; other risks (or their impact) like fraud, bad information, mismanagement, negligence, default of investment firm etc. should be minimized. In this regard, the safe-keeping and oversight functions of the depositary are crucial.

BEUC fully supports the Commission Services when writing "It is clear that the level of protection for UCITS should not go below the standard applied for the AIF and that the large retail based of UCITS investors should be provided with the necessary guaranty for them to place their confidence in UCITS."

ANALYSIS OF THE CONSULTATION DOCUMENT

1. UCITS Depositaries

1.A. Depositary's duties

1.A.1. Safe-keeping

Box 1

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

As mentioned by the Commission in its document, the Madoff fraud and the Lehman default have demonstrated that the differences and inconsistencies in the rules applicable to the depositaries have created legal and technical uncertainties that may be detrimental to the UCITS holders and their confidence in this important retail investment product.

Box 2

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

- Distinguish safekeeping duties between (1) custody duties relating to financial instruments (such as securities) that can be held in custody by the depositary and (2) asset monitoring duties relating to the remaining types of assets. A reference to the custody of physical assets, such as real estate or commodities, is not necessary because such assets are currently not eligible for holding within a UCITS portfolio.
- Supplement the requirements on custody duties with a segregation requirement, so that any financial instruments on the depositary's book held for a UCITS can be distinguished from the depositary's own assets and at all times be identified as belonging to that UCITS; such a requirement would confer an additional layer of protection for investors should the depositary default;
- Equip the depositary with a view over all the assets of the UCITS, cash included.²⁸ The directive should more explicitly make clear that no cash account associated with the funds' transactions can be opened outside of the depositary's acknowledgement, with a view to avoiding the possibility of fraudulent cash transfers;
- Introduce new implementing measures in the mentioned Articles defining detailed conditions for performing depositary monitoring and custody functions, including (i) the type of financial instruments that shall be included in the scope of the depositary's custody duties; (ii) the conditions under which the depositary may exercise its custody duties over financial instruments registered with a central security depositary; and (iii) the conditions under which the depositary shall monitor financial instruments issued in a nominative form and registered with an issuer or a registrar.

BEUC agrees with the suggestion to make the UCITS directive consistent with the approach of the AIFMD regarding the provisions mentioned in box 2.

The segregation requirement should also be applied when the depositary delegates its custodian functions on a sub-custodian.

1.A.2. Oversight functions

Box 3

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

Box 4

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

BEUC agrees with the suggestions mentioned by the Commission in boxes 3 and 4.

1.A.3. Delegation of the depositary's tasks

Box 5

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

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

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

BEUC considers that only safe-keeping duties could be entrusted to a third party. Retail investors generally don't have the knowledge to understand and evaluate the risk linked to using a network of sub-custodians. He/she is not the one who chooses the sub-custodian and he/she cannot assess if the choice made by the depositary is the best solution. Technical information on the risk is not of great help for the retail investor.

BEUC considers that the risks linked to the sub-custodian network have to be supported by the depositary. If the risks are too high to be supported by the depositary, the investment in that particular asset that needs a sub-custodian should be reconsidered by the UCITS manager.

The due diligence duty when appointing a sub-custodian on an ongoing basis is necessary. The due diligence will be quite more efficiently performed if it protects the depositary firm than if it is to protect the unit holder.

1. B. UCITS depositary liability regime

1. B.1. Improper performance

Box 6

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

BEUC agrees with the measure suggested in box 6.

1. B.2. UCITS depositary specific liability in case of loss of assets

Box 7

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

BEUC agrees with the measure suggested in box 7.

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

Box 8

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

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

BEUC agrees with the recommendation that the UCITS depositary should be responsible for the loss of assets in case of failure of a sub-custodian.

As mentioned above, BEUC considers that the risks linked to the sub-custodian network have to be supported by the depositary. If the risks are too high to be supported by the depositary, the investment in that particular asset that needs a sub-custodian should be reconsidered by the UCITS manager.

Allowing for a contractual possibility for the depositary to be discharged of its liability or even introducing an automatic discharge of responsibility where assets are kept by sub-custodian are not acceptable for retail investors.

To avoid divergent or extensive national interpretations, the “force majeure” exception should be harmonised, preferably with some examples.

1. B.4. Burden of proof

Box 9

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

If the Depositary is liable for all assets loss except in case of “force majeure”, there is no need to have specific provision about the burden of proof for the safe-keeping duty of the depositary.

For the supervisory duty, BEUC agrees that the AIFMD provision inverting the burden of proof should be extended to the UCITS Directive. This is a key requirement as – due to the high technicality - retail investors have a huge disadvantage when problems occur.

1. B.5. Rights of UCITS holders’ action against the UCITS depositary

Box 10

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

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

BEUC agrees with the measure suggested in box 10.

1. C. Eligibility criteria

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Box 11

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

BEUC agrees with the suggestion made in box 11.

However, existing UCITS depositary institutions which are neither credit institutions nor authorised MiFID firms and also provide the ancillary service of safe-keeping and administration of financial instruments should adopt one of the eligible entities type. We would prefer it if there was no grandfathering but in any case there should be a time limit of 2 years for the grandfathering clause.

1. C.2. Location of the depositary (passport issues)

Box 12

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

BEUC has no strong opinion about this suggestion.

1. D. Supervision issues

1. D.1. Supervision by national regulators

Box 12

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

BEUC agrees with the suggestion to harmonise the scope of national supervisors' competencies.

1. D.2. Supervision by auditors

Box 14

The introduction of a requirement for an annual certification of the assets held in custody by the depositary would clarify the true existence of such entrusted assets. This annual certification could be performed by the depositary's auditors. Details related to any such requirement might need to be further defined in implementing measures or technical standards as appropriate.

Due to the importance of the depositary's functions in the framework of protecting the retail investor BEUC considers that the assets held in custody should be certified by the depositary's auditor. That measure could also improve the confidence in the UCITS brand.

1. E. Other issues

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

Box 15

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

BEUC has no strong opinion about this suggestion.

1. E.2. Single depositary rule

Box 16

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

BEUC has no strong opinion about this suggestion.

1. E.3. Organisational requirements and rules of conduct

Box 17

It is suggested to:

- Introduce for UCITS depositaries similar rules of conduct as in the AIFM Directive, in addition to the already existing rules stated in the article 22 and 32 of the UCITS Directive;
- Introduce implementing measures in order to encourage a higher degree of harmonisation and consistency between the organisational requirements applicable to all functions of the UCITS depositary (safekeeping as well as oversight) and, where appropriate, the existing MiFID requirements.

BEUC is concerned about the conflicts of interests existing between UCITS managers and UCITS depositaries belonging to the same group. If that is the case, it will always be difficult for the depositary's staff to exert its oversight function and take measures against the UCITS manager. Chinese walls don't offer enough guarantee when both manager and depositary serve the same shareholders, or even have same directors.

1. E.4. Exchange of information with competent authorities

Box 18

It is suggested to amend existing requirements concerning the disclose of information to the competent authorities, on their request, in such a way that any information, obtained by a depositary while carrying out its duties, should be made available to its competent authorities if such information may be necessary for these authorities. Implementing measures should also be introduced in order to, for example to detail the conditions and procedures under which UCITS depositaries shall exchange information with their supervisors.

BEUC agrees with the measure suggested in box 18.

1. E.5. The contract between the depositary and the UCITS manager

Box 19

It is suggested that the requirements set out in Article 23(5) and Article 33(5) of the UCITS Directive and their corresponding implementing measures should also apply to a situation where the management company home Member State is also a UCITS home Member State.

It appears opportune to require the UCITS depositary to follow conduct of business rules 23 which would oblige a depositary to act honestly, fairly, professionally, independently and in the interest of the UCITS and investors of the UCITS. Furthermore, the depositary should be required to establish appropriate policy for identification, management, monitoring and disclosure of the conflict of interests which may arise when a depositary carries out activities with regard to the UCITS.

BEUC agrees with the mandatory written agreement between the UCITS manager and its depositary.

As mentioned under box 17, BEUC is concerned about the conflicts of interests existing between UCITS managers and UCITS depositary belonging to the same group. It seems illusory that they could really act independently as suggested when they serve the same shareholders. In the first place, conflicts of interests should be prevented, disclosure remains the last choice.

2. UCITS MANAGERS' REMUNERATION POLICIES

BEUC staff in general agrees with the suggested changes in the UCITS directive regarding managers' remuneration (see hereunder), but currently, we don't have specific remark or suggestion to add to the Commission suggestions.

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