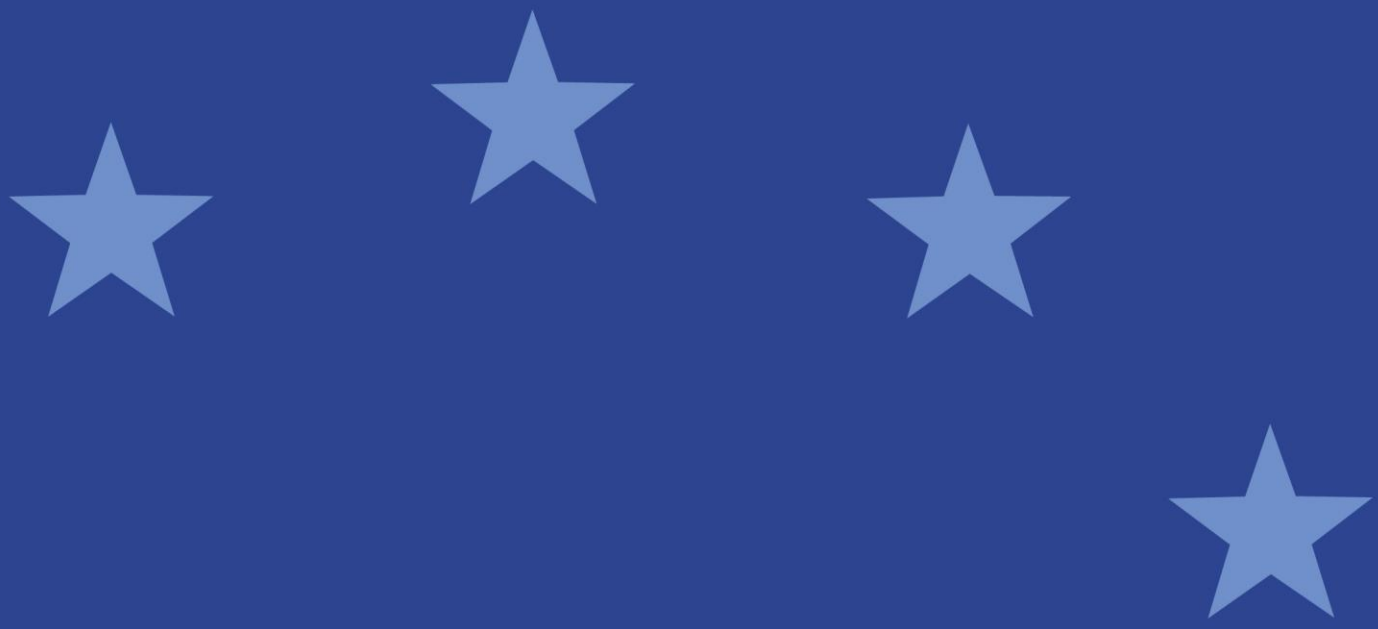
esma European Securities and Markets Authority

Reply form for the Technical Advice the on delegated acts required 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:

i. use this form and send your responses in Word format;

ii. 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

iii. 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:

i. if they respond to the question stated;

ii. contain a clear rationale, including on any related costs and benefits; and

iii. 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)

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?

<ESMA_UCITS_QUESTION_1>
Better Finance, the European Federation of Financial Services Users, is the pan-European organization advocating for the rights of individual shareholders, retail investors and other financial services users.

First of all, we would like to acknowledge the importance of this Consultation for Better Finance since UCITS are one of the most important retail investment products for investors. In general, Better Finance is in favour of reducing risks that are not directly linked to the assets themselves. To that end a sound and safe depositary regime indeed constitutes one of the key components to achieve high level of protection.

Generally, Better Finance strongly supports the clarification and harmonization of UCITS depositaries' tasks and liability across Member States as well as the alignment of the UCITS V requirements with the more attractive ones of the AIFMD. Protection of client assets is highly important for investors since the risk to the client becomes most acute when the firm is not in a position to compensate him/ her for losses because of its own insolvency.

Better Finance therefore considers that the depositary's liability regime including an effective insolvency ring-fence is indispensable for UCITS V. We welcome the fact that unit-holders in UCITS may invoke the liability of the depositary directly (or indirectly through the management / investment company in certain circumstances). We furthermore strongly support the proposal for the inversion of the burden of proof from the investor to the depositary to be taken into account also for UCITS unit-holders.

We therefore, in general, agree with the proposal outlined in Q1.

On a more general level, we would like to comment as well on the fact that ESMA should provide more user-friendly consultation formats that:

- Are written in plain English if/when ESMA is looking for responses from NGOs representing individual investors, consumers and civil society in general;
- Devote some room to general comments;
- And allow collaborative work, since Better Finance, for example, is using working groups composed by experts from their member associations to respond to Public consultations. The current ESMA formatting forbids collaborative work as it does not allow using the review or edit mode of the word processor.

<ESMA_UCITS_QUESTION_1>

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?

<ESMA_UCITS_QUESTION_2>
Asset segregation is a fundamental duty for all depositaries and must be preserved along the chain when the depositary delegates its obligations to a third party. We agree that the level of segregation foreseen

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

under Art. 22a(3)(d) should protect UCITS assets from claims by creditors of an insolvent third party but would like to suggest additional measures. See our answer to Q3.
<ESMA_UCITS_QUESTION_2>

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

<ESMA_UCITS_QUESTION_3>
An additional means to protect UCITS assets from third party claims could be based on the measure implemented by the German legislator in sec. 72 of the Capital Investment Act (KAGB) for UCITS funds. According to this measure, depositaries are required to use a blocked custody account for funds' assets (and a blocked bank account for cash belonging to the fund) so that a clear identification of beneficial ownership is made possible.

<ESMA_UCITS_QUESTION_3>

Q4: 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>
Investors should not be put at a disadvantage just because an intermediary places clients' assets with a third party outside the EU. Therefore we deem the additional measures proposed by ESMA to be necessary in order to provide for a similar standard also in cases where third parties located outside the EU are involved. We furthermore welcome the fact that ESMA took into account certain principles from IOSCO's Recommendations Regarding the Protection of Client Assets. We would however contend that these Recommendations, especially principles 1-3 should not be restricted to principle 3, guidance no. 2, as proposed by ESMA. Instead, principles 1 to 3 should be considered as a minimum standard and not as mere guidance - as far as applicable and not yet covered by the Directive.
Furthermore we point to the fact that UCITS V explicitly allows third parties to maintain omnibus accounts for multiple UCITS. Such omnibus accounts have the disadvantage of not protecting clients from the default of other clients. This distinction, however, may become significant when a firm defaults because of losses arising on a particular client's account. We therefore suggest for ESMA to develop guidance on this issue as well.
<ESMA_UCITS_QUESTION_4>

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?

<ESMA_UCITS_QUESTION_5>
Verifying the applicable insolvency regime might be difficult especially in cases where various jurisdictions are involved along the chain of intermediaries. Such a potential difficulty on the side of the depositary should, however, not lead to detrimental policies for the end-investor who is very likely not to even be aware of which insolvency regime, under which jurisdiction, may be applicable.
When information regarding the legal environment provided by a third party located outside the Union is not accurate, not up-to-date or incomplete, questions regarding the liability of the depositary may arise. Here, clarification from ESMA would be welcomed.
<ESMA_UCITS_QUESTION_5>

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.

<ESMA_UCITS_QUESTION_6>
This is not applicable as regards our constituency, but we understand that the decision to use a sub-custodian outside of the EU is the decision and responsibility of the prime custodian and of the investment firm that contracts with it. Therefore they must bear the cost of such a choice. In any case it is a part of good governance for a financial company handling financial instruments owned by other legal or physical persons, to obtain qualified legal advice on the applicable insolvency regime. Such an obligation should not come as a surprise to financial companies.

<ESMA_UCITS_QUESTION_6>

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

<ESMA_UCITS_QUESTION_7>
The third party should be required to ensure that all standards applicable to the third party are maintained by any sub-delegate further down the chain.
<ESMA_UCITS_QUESTION_7>

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?

<ESMA_UCITS_QUESTION_8>
Better Finance believes such further sub-delegation should be forbidden for UCITS funds sold to individual investors, since:
1/ It would make the tracking of the entity responsible for failure very complex;
2/ Better Finance does not believe retail UCITS portfolios should be as complex as to justify a third (or more) step of sub-delegation of custody. We would advise ESMA to request solid proofs / evidence from any respondent who would claim the contrary.
We however acknowledge that such a ban may be beyond the powers of ESMA. At the very least, choosing to allow a second (or more) step of sub delegation should be duly justified and documented by the investment firm when contracting with the prime depositary.
<ESMA_UCITS_QUESTION_8>

Q9: 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>
We agree. However we are wondering why ESMA did not extend its question to the cases where it does not consider it necessary for the third party/depositary to obtain independent advice (see recital 32 of the consultation paper). ESMA proposes that whenever independent legal advice obtained by the third party is made available to the depositary (and vice versa) there is no need to require for the depositary (and, inversely, the third party) to obtain equivalent legal advice confirming the recognition of the segregation of assets by the applicable insolvency laws. We consider that detailed clarification is needed to ascertain whether this proposal is feasible and whether there should not be an ultimate obligation for one party to provide for such independent legal advice. Furthermore, clarification would be needed in case two conflicting legal advices from the depositary and the third party would exist, and which consequences this could have for the liability regime
<ESMA_UCITS_QUESTION_9>

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.

<ESMA_UCITS_QUESTION_10>
See our reply to Q6
<ESMA_UCITS_QUESTION_10>

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

<ESMA_UCITS_QUESTION_11>
TYPE YOUR TEXT HERE
<ESMA_UCITS_QUESTION_11>

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?

<ESMA_UCITS_QUESTION_12>
The assets can be held along a chain of depositaries between the UCITS and the depositary in the issuing country. The more members in the chain, and the more countries involved, the higher the risk of something going wrong. It is of the utmost importance to the clients of the UCITS that the chain of depositaries is kept as short as possible and that the UCITS has ensured the best possible degree of guarantee.
<ESMA_UCITS_QUESTION_12>

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

Q13: 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>
Yes we agree, if cross-shareholdings are understood as also including indirect holdings.
<ESMA_UCITS_QUESTION_13>

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.

<ESMA_UCITS_QUESTION_14>
We consider that contractual commitments also (e.g. the provision of other services provided by the depositary to the management company) could potentially jeopardise their independence and should therefore also be taken into account.
<ESMA_UCITS_QUESTION_14>

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?

<ESMA_UCITS_QUESTION_15>
The presence of just any one of the links described could be sufficient to impair independence.
<ESMA_UCITS_QUESTION_15>

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?

<ESMA_UCITS_QUESTION_16>
Yes, we strongly agree with ESMA's assessment that option one in recital 47 provides for the most clear and straightforward rule with the highest degree of protection for UCITS investors.

<ESMA_UCITS_QUESTION_16>

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.

<ESMA_UCITS_QUESTION_17>
When legislation provides that different functions must be carried out by different legal bodies, the intention normally is for these functions to be carried out by bodies independent of each other so that one of the bodies is supervising or guaranteeing the activities of other bodies.
We find it important to ascertain the independence and integrity of the different legal bodies when legislation prescribes that functions must be divided between different legal bodies.
Consequently we find it important to ensure the separation of the management bodies/supervisory bodies within one legal body (company) and to ensure the separation of the management bodies/bodies in charge of the supervisory functions of the Relevant Entities. The clearest solution would be option i in paragraph 47. Option ii would be extremely cumbersome in daily life and option iii is not relevant because the shares will normally be owned by the companies.

We could support the cap of one third in Q 17; but unfortunately the situation that should be covered by the cap of one third is not described in recital 51 in a sufficiently clear and straightforward manner. If it should be understood that ESMA considers that a maximum of one third of the supervisory board of a Relevant Entity (i.e. the depositary) may be represented on the management or supervisory board of another Relevant Entity (e.g. the management company). Thus described, we consider this cap to be appropriate.

<ESMA_UCITS_QUESTION_17>

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.

<ESMA_UCITS_QUESTION_18>
TYPE YOUR TEXT HERE
<ESMA_UCITS_QUESTION_18>

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

<ESMA_UCITS_QUESTION_19>

Independence of management/investment company and the depositary is a key element of UCITS V and – as the Madoff case demonstrated negatively - one of the main pillars of investor protection. The independence of a depositary in particular, is necessary because it acts both as a supervisor of a UCITS fund as well as a custodian over the fund's assets. From the investors' point of view we therefore certainly prefer the first option as it provides for the clearest and most straightforward way to address the issue of conflicts of interest and would ensure the highest standard of investor protection.

The mapping exercise – according to ESMA – has shown that the first option might have "a substantial impact on the existing shareholding structures of management companies/investment companies and depositaries in Europe" (recital 62) and "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 qualified holding or are part of the same group" (recital 39 of Annex III). Better Finance, however, has concerns regarding the significance of this mapping exercise. Based on the net assets, the Member State with by far the largest UCITS industry is Luxemburg, followed by Ireland, France and the UK. Together, these Member States cover more than 75% of net assets of the European UCITS Industry, according to EFAMA (for details see http://www.efama.org/Publications/Statistics/Quarterly/Quarterly%20Statistical%20Reports/140902_QuarterlyStatisticalReleaseQ22014Final.pdf). According to the mapping exercise, only 14% of the existing Luxemburg UCITS structures would be impacted if option 1 would be implemented, and the UK already has comparable regulation. Information on Ireland regarding the potential impact is not provided. The conclusions drawn regarding the impact on costs need to be read in this context.
From the investors' point of view, the second option proposed by ESMA would only be the second best choice. Taking into account that implementation of the second option would also entail an additional cost burden for the industry and weighing this against the benefits investors would obtain under the first option we suggest that ESMA (when deciding which option to implement) also takes into account the difference in costs between implementing option one or two as well as the market share of Member States with regard to the UCITS net assets.<ESMA_UCITS_QUESTION_19>

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.

<ESMA_UCITS_QUESTION_20>
This would be the minimum requirement if option two were to be chosen.
<ESMA_UCITS_QUESTION_20>

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?

<ESMA_UCITS_QUESTION_21>
Under option 2, we agree.
<ESMA_UCITS_QUESTION_21>

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.

<ESMA_UCITS_QUESTION_22>
TYPE YOUR TEXT HERE
<ESMA_UCITS_QUESTION_22>

Annex III

Cost-benefit analysis

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

<ESMA_UCITS_QUESTION_23>
Yes we agree since we consider the first option as providing the highest level of investor protection, see our comment to Q16.
<ESMA_UCITS_QUESTION_23>