

# Undertakings for collective investment in transferable securities (UCITS): depositary functions, remuneration policies and sanctions

2012/0168(COD) - 03/07/2012 - Legislative proposal

**PURPOSE:** to improve investors' confidence in undertakings of collective investment in transferable securities (UCITS).

**PROPOSED ACT:** Directive of the European Parliament and of the Council.

**BACKGROUND:** since the UCITS Directive was adopted in 1985, the rules relating to depositaries in the Directive have remained unchanged. These rules consist of a number of generic principles **setting out the duties of depositaries**. The Directive makes reference to national laws in respect of the precise contours of these duties. This leaves considerable scope for diverging interpretations regarding the scope of a depositary's duties and the liability for the negligent performance thereof.

As a result, **different approaches have developed across the European Union**, leading to UCITS investors facing uneven levels of protection in different jurisdictions. The potential consequences of national divergences in the liability standard came to the fore following the Lehman Brothers bankruptcy and the Madoff fraud. **The Madoff case** raised several important issues in relation to UCITS funds particularly regarding the precise conditions under which a depositary acting on behalf of a UCITS fund can delegate safekeeping of assets to a sub-custodian. The Madoff case also raises the issue of conflicts of interest.

The Commission considers it necessary to amend [Directive 2009/65/EC](#) in order to take into account market developments and the experiences of market participants and supervisors gathered so far, in particular to address discrepancies between national provisions in respect of depositaries' duties and liability, remuneration policy and sanctions.

This proposal forms part of a wider **legislative package** dedicated to rebuilding consumer trust in financial markets. The package has two other parts:

- the first is [an extensive overhaul of the Insurance Mediation Directive 2002/92/EC](#) to ensure a high level of protection when buying insurance products;
- the second part is [a proposal for a regulation on key information documents](#) on investment products, aiming at improving transparency in the investment market for retail investors.

**IMPACT ASSESSMENT:** the impact assessment focused on five issues. Its main conclusions are as follows:

1. **Eligibility to act as a depositary:** both credit institutions and regulated investment firms provide sufficient guarantees in terms of prudential regulation, capital requirements and effective supervision to act as UCITS depositaries. Other institutions (such as law firms, notaries) are not deemed to provide these guarantees and would have, if they wished to act as UCITS depositaries, to transform themselves into regulated investment firms. As most UCITS depositaries are already credit institutions or regulated investment firms, the impact of the chosen option would thus only concern a small minority of unlicensed service providers.

2. **Delegation of custody:** the delegation of custody should be governed by rules on diligence in selecting an appointing a sub-custodian, and on the ongoing monitoring of the activities of the sub-custodian.
3. **Liability:** a 'strict liability' standard obliging depositaries to return instruments lost in custody irrespective of fault or negligence is both conducive to ensuring a high level of investor protection and to achieving a uniform standard across the EU.
4. **Remuneration:** the proposal envisages introducing a requirement for the UCITS management company to implement remuneration policy that is consistent with sound risk management of the UCITS fund and complies with minimum remuneration principles.
5. **Sanctions:** the policy choice is to achieve minimum harmonisation of the sanctions regime. This regime would apply to a catalogue of breaches of main investor protection safeguards in the UCITS Directive.

LEGAL BASIS: Article 53(1) of the Treaty on the Functioning of the European Union.

CONTENT: the proposal aims to amend Directive 2009/65/EC on UCITS as regards depositary functions, remuneration policies and sanctions. The main points of the proposal are as follows:

**Rules on depositaries' duties:** in relation to the depositary's core safekeeping and oversight duties, the draft proposes to amend the UCITS Directive in the following manner:

- **appointment of a single depositary** for each UCITS fund in order to ensure that one fund cannot have several depositaries. The appointment of a depositary shall be evidenced by written contract;
- **making uniform a list of oversight duties of depositaries** of UCITS established in a contractual form and UCITS established in a corporate form. These duties involve: (i) verifying compliance with applicable rules when UCITS shares are sold, issued, re-purchased, redeemed and cancelled; (ii) verifying that any consideration is remitted to it within the usual time limits; (iii) verifying that the investment company's income is applied in accordance with its instruments of incorporation, ensuring that the value of units in a UCITS is calculated in accordance with the applicable national law and the fund rules; (iv) and carrying out instructions of the management or investment company;
- detailed provisions on **cash monitoring** in order to equip the depositary with a view over all the assets of the UCITS, cash included. The proposal also ensures that no cash account associated with the funds' transactions shall be opened without the depositary's knowledge. The aim is to avoid the possibility of fraudulent cash transfers. This paragraph also introduces 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 can at all times be identified as belonging to that UCITS;
- introduction of a distinction between (a) **custodial duties** relating to financial instruments that can be held in custody by the depositary and (b) **verification** of the ownership duties relating to the remaining types of assets;
- introduction of a series of customary provisions on **professional conduct**, the avoidance of and the management of conflicts of interest.

**Rules on delegation:**

- the proposal defines the conditions in which the depositary's safekeeping duties can be delegated to a sub-custodian (the conditions upon which a UCITS depositary may entrust its safekeeping duties to a third party are aligned with those applicable under the Alternative Investment Fund Management Directive).

#### **Rules on eligibility to act as a UCITS custodian:**

- introduction of an exhaustive list of entities that are eligible to act as depositaries. The policy choice is to only allow credit institutions and investment firms to act as UCITS depositaries.

#### **Rules on liability:**

- clarification of the UCITS depositary's liability in case of the loss of a financial instrument that is held in custody. Where a financial instrument held in custody is lost, the UCITS depositary shall be under the obligation to return a financial instrument 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 where the depositary can prove that the loss is due to an 'external event beyond its reasonable control';
- the depositary's liability is not affected by the fact that it has entrusted to a third party all or some of its custody tasks. As a result, the depositary is obliged to return instruments held in custody that are lost, **even if the loss was incurred by the sub-custodian**.

#### **Redress:**

- alignment of the rights of investors in both corporate and contractual UCITS so that they 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.

#### **Remuneration:**

- the proposal reflects current policy on remuneration of senior management, risk takers and those who exercise control functions. These principles should also apply to those that manage a UCITS fund, be it managed in the form of an investment company or in the form of a management company.

#### **Access to telephone and data records:**

- competent authorities will be able to require existing telephone and existing data traffic records held by a telecommunication operator or by a UCITS, a management company, an investment company or a depositary, where a reasonable suspicion exists that such records related to the subject-matter of the inspection may be relevant to prove a breach of the provisions of the UCITS Directive.

#### **Sanctions and measures:**

- a common approach to the main breaches of the UCITS Directive. The proposal sets out a list of the main breaches. It also lays down the administrative sanctions and measures that the competent authorities should be empowered to apply in case of the main breaches.

**BUDGETARY IMPLICATIONS:** the proposal has no implications for the EU budget.

**DELEGATED ACTS:** the proposal contains provisions empowering the Commission to adopt delegated acts in accordance with Article 290 of the Treaty on the Functioning of the EU.