

# **ZENTRALER KREDITAUSSCHUSS**

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**Comments on**

**WORKING DOCUMENT OF THE COMMISSION SERVICES  
(DG MARKET)  
CONSULTATION PAPER ON THE UCITS DEPOSITARY  
FUNCTION**

**14 September 2009**

**Question 1)**

**Do you agree that the safe-keeping (and administration) duties of depositaries should be clarified?**

We share the European Commission's opinion that the UCITS regulatory model is a success story for European harmonisation and regulation which has earned the label UCITS worldwide acclaim in the international capital market. We are convinced that the current supervisory and safe-keeping duties of depositaries are part and parcel of UCITS's success story. During the accomplishment of their tasks, German depository banks offer a high service level to capital investment firms and investors. Hence, basically, as far as German law is concerned, we see no need for regulatory action. After all, there is already the most far-reaching legal certainty when it comes to the obligations incumbent upon depositaries. However, standardisation of the depository banking business may be meaningful in view of the further expansion of the European single market. Based on the foregoing, this exercise should be linked to the European passport for depository banks. German depository banks are liable for their services pursuant to the general terms of liability for securities safe-keeping. We should like to point out that any plans for standardisation in this field would go well beyond the area of depository banking and would affect the general custody business. This means that a securities services sector would be affected that is far beyond the scope which has been laid out in DG Market's working document. This aspect should be taken into account during all deliberations on the European depository banking business.

**Question 2)**

**Do you agree these duties should be clarified for each class of assets eligible to the UCITS portfolio?**

In our view, the securities services of safe-keeping and control can be described and covered in a general form. The main difference results less from the type of the fund titles but rather more from the type of domestic or non-domestic safe-keeping, for instance by subcustodians.

**Question 3)**

**Are there any other appropriate approaches?**

Please cf. our answer under question number 2.

**Question 4)**

**Do you agree to a common horizontal and functional approach of the custody duties on the listed financial instruments, to be applied to UCITS depositaries?**

There is no definition as to which kind of approach this refers to. Should this refer to a “same business-same rules approach” then we fundamentally subscribe to this approach under the proviso that the depositary banking business (to the extent that it is being conducted by credit institutions) will be compared in a corresponding manner and will be subject to the same regulation. Any horizontal equal treatment can only relate to services which are functionally equal and which are being rendered within the same regulatory framework. Depositaries which do not qualify as a credit institution enjoy a cost advantage that leads to competitive distortion.

**Question 5)**

**Is there some specificity that may be applicable to the custody functions of a UCITS depositary that should be taken into account?**

Funds as contemplated by the Directive (UCITS) may indeed be deemed as especially trustworthy in the market, yet the creation of *sui generis* rules for the safekeeping of UCITS which do not result from the depositary’s supervisory function should absolutely be avoided. From the point of view of the investor, there should be no first and second class regime for UCITS funds on the one hand and individual assets on the other hand. This would be exactly the opposite of the “level playing field” notion, i.e. one of the most fundamental tenets underlying European capital markets legislation.

**Question 6)**

**Do you agree that the existing supervisory duties of the UCITS depositary should be clarified?**

Please cf. our answer under question number 1.

**Question 7)**

**If so, what clarification do you suggest?**

**Question 8)**

**To what extent does the list of supervisory duties need to be extended?**

We feel there is no need for any extension of the scope of the existing supervisory duties. Should there be any plans to extend the obligations incumbent upon depositaries, then this would inevitably have to be preceded by a cost-benefit analysis.

**Question 9)**

**Do you agree that the 'only one depositary' requirement should be clarified?**

We feel that this requirement is evident.

**Question 10)**

**Do you think that the risks related to improper performance have been correctly identified?**

Yes, we do.

**Question 11)**

**Do you foresee other situations where a risk associated with improper performance of the depositary duties might materialise?**

No, we do not foresee any such situations.

**Question 12)**

**Do you agree that safeguards against the risk associated with the improper performance of depositary duties, such as requiring that UCITS assets be segregated from the depositary's and sub-custodian's assets, should be introduced?**

We feel that the mentioned requirements are a matter of course. This has been an integral part of the European *acquis communautaire* for banks ever since the Investment Services Directive came into force.

**Question 13)**

**Do you agree there should be a general clarification of the liability regime applicable to the UCITS depositary in cases of improper performance of custody duties?**

The liability regime is largely based on national civil law. Hence, this would imply the goal of a long-term harmonisation of civil law across the whole of Europe. Should the European Commission wish to pursue this goal, then the European Commission should be aware of the magnitude of such an undertaking. As has been mentioned above, we object to a differentiation on the basis of the nature of the assets held for safe-keeping (special purpose assets for funds or individual assets). In this context, we should furthermore like to point out that there are comprehensive efforts aimed at a global and European harmonisation of the custody law. Any amendment to the existing regime should therefore be geared towards the EU Commission's ongoing other deliberations.

**Question 14)**

**What adjustments to the liability regime associated to the custody duties of the UCITS depositary would be appropriate and under what conditions?**

The current liability regime for depositary banks already corresponds to a high standard. The depositary bank is fully liable for careful selection of the non-domestic subcustodian. Any liability beyond this for wrongdoings committed by the subcustodian would lead to huge insurance-type costs and would not be economically feasible. We feel that the reversal of the burden of proof envisaged for depositary banks under the AIFM Directive is inconsistent with the way in which European law has been applied until now. In other words: The liability regime needs to be based on evidence of negligence, fraud or failure.

At this juncture, we should like to point out that, to date, the AIFM Directive is but a draft and that at least at the present point in time the provisions thereunder are not yet applicable law.

**Question 15)**

**Do you agree that the conditions upon which the UCITS depositary shall be able to delegate its duties to a third party should be clarified?**

The definition of the term “delegation” lacks concision. We should like to point out that depositary banks – and our entire response in the present Consultation Paper is exclusively limited to the latter – constitute credit institutions which are subject to the most stringent supervision. Regulation also affects the outsourcing of functions which is regulated in a corresponding manner. The depositary bank remains potentially liable for fulfilment of the outsourced services. The case is different when a subcustodian is selected (cf. above): Here, the depositary bank can only be blamed for selection fault. In view of the limited influence and control possibilities in worldwide safekeeping for depositary banks, a comprehensive assumption of liability for third-party mistakes made by subcustodians would not be feasible. Hence, also in future it needs to remain possible to limit subcustody liability to the careful selection and monitoring of the subcustodian. However, we would like to endorse the need for harmonised requirements with regard to the quality of eligible subcustodians.

One possible result of such an extension of the liability could be that in view of the extended liability regime, depositary banks will have to refuse safe-keeping for certain fund assets and that in the final analysis this would result in a limitation of the investment choice for asset

managers. This can be neither in the interest of the investor nor in the interest of a flexible capital market with a global orientation.

**Question 16)**

**Under which conditions should the depositary be allowed to delegate the performance of its duties to a third party?**

Please cf. our answer under question number 15.

**Question 17)**

**Do you agree that the depositary should be subject to additional on-going due diligence requirements when delegating the performance of its duties to a third party?**

The depositary shall be liable for outsourced functions (c.f. also our answer to question number 15); any additional encumbrance for outsourcing is therefore unnecessary.

**Question 18)**

**Do you share the Commission services approach to reviewing the ICSD, to allow UCITS to benefit from a compensation scheme where the depositary defaults?**

We feel that an extension of the investor compensation scheme to include UCITS and depositary banks would be inconsistent with the underlying philosophy of the system. The fund assets are separately safe-kept by the depositary bank and available for a potential default of the AIFM or the depositary bank. Furthermore, to the extent described in the Consultation Paper, the depositary bank shall be liable for breaches of its functions. We see no further need for action with regard to the differentiated German system of deposit protection and/or bank protection scheme. We therefore object to any additional inclusion of depositary banks under the investor compensation scheme.

**Question 19)**

**Do you agree that UCITS holders should also benefit from compensation if their custodian defaults and these assets are lost?**

Please cf. our answer under question number 18.

**Question 20)**

**Do you agree that the general organisation requirements that are applicable to a UCITS depositary should be clarified?**

Please cf. our answer under question number 1.

**Question 21)**

**If so, to what extent?**

n/a

**Question 22)**

**Do you agree that requirements on conflicts of interest applicable to UCITS depositaries should be clarified?**

We should like to point out that depositary banks – and our entire answer is exclusively geared to the latter - are credit institutions that are subject to the most stringent supervision. Corresponding conflicts of interests are therefore already regulated in the form of compliance provisions and these are being respected. The provisions under MiFID would make organisational provisions beyond this redundant, provided that the function of a depositary bank shall, henceforth, only be the prerogative of banks.

**Question 23)**

**If so, to what extent?**

n/a

**Question 24)**

**Do you agree that there is a need for clarifying the type of institutions that should be eligible to act as UCITS depositaries?**

Yes, only credit institutions should be eligible to act as a depositary bank. This is due to the fact that, in order to ensure the highest possible level of investor protection, these institutions are subject to corresponding prudential supervision and regulation.

**Question 25)**

**Do you agree that only institutions subject to the CDR should be eligible to act as UCITS depositaries?**

Yes, we do agree.

**Question 26)**

**If not, which types of institutions should be eligible to act as UCITS depositaries, and why?**

n/a

**Question 27)**

**Do you agree that additional auditing requirements should be imposed, such as an annual certification of the depositary's accounts by independent auditors?**

No, we do not agree. A bank's depositary activity is already subject to in-depth and detailed annual reviews by independent auditors meaning that an additional "certification" in this context is redundant.

**Question 28)**

**Do you agree that UCITS depositaries should be subject to a specific 'depository' approval by national regulators?**

At present, this is already an established standard market practice in Germany.

**Question 29)**

**Do you believe that there is need to promote further harmonisation of the supervision and cooperation by European regulators of depository activities? What are your views on the creation of an EU passport for UCITS depositaries?**

As has already been pointed out above, for the sake of maintaining a level playing field, we are in favour of the EU passport for depository banks only under the proviso that such entities qualify as credit institutions. In terms of the harmonisation of the single market, we do indeed perceive a need for such an EU passport. The introduction of such a passport would only be consistent. After all, already today and in the absence of red tape, the fund can become active in a cross-border context and in future (under UCITS IV), the same will be possible for the management by virtue of a passport.

**Question 30)**

**As far as the UCITS portfolio and UCITS units or shares are concerned, do you agree that their value should be assessed by an independent valuator?**

No, we do not agree. Already today, this forms part of the remit of depository banks.

**Question 31)**

**If so, what should be the applicable conditions for an entity to be eligible to act as an UCITS Valuator?**

n/a