CD/AP/SJ- 2809/Div. – 31.01.2011

Interest representative register number:
5975679180-97

Mr Ugo Bassi
Head of Unit
G4 Asset Management Unit
Financial Services Policy and Financial Markets
DG Internal Market
European Commission
200 rue de la Loi
1049 Bruxelles
BELGIQUE

Consultation paper on the UCITS depositary function and on the UCITS managers' remuneration

Dear Mr Bassi,

The Association Française de la Gestion financière (AFG)[1] is grateful for the opportunity to comment on the Commission Services' consultation paper on the UCITS depositary function and on the UCITS managers' remuneration.

[1] The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. Our members include 413 management companies. They are entrepreneurial or belong to French or foreign banking or insurance groups. AFG members manage 2,600 billion euros in the field of investment management, making in particular the French industry the leader in Europe in terms of financial management location for collective investments (with over 1,300 billion euros managed from France, i.e. 20% of all EU assets managed in the form of investment funds), wherever the funds are domiciled in the EU, and second at worldwide level after the US. In the field of collective investment, our industry includes – beside UCITS – employee savings schemes and products such as regulated hedge funds/funds of hedge funds, private equity funds, real estate funds and socially responsible investment. AFG is of course an active member of the European Fund and Investment Management Association

*
**

1. UCITS DEPOSITARIES

General comments

Although faster and in practice more convenient for those in charge of drafting and negotiating the UCITS Directive, a mere replication of the depositary provisions of the Directive of the European Parliament and of the Council on Alternative Investment Fund Managers (the AIFMD) would not be appropriate. Indeed, some specific provisions will have to be introduced for UCITS depositaries – in particular as UCITS investors addressed through fund passporting may be retail investors (and not only professional investors as for the AIF passport): the issue of retail investor protection through depositaries is crucial.

In addition, we would like to recall that another European legislative file, the proposal for a Securities Law Directive, might have a huge – negative or positive - impact on the final legal safety applicable to fund depositaries and investors. As some notions are potentially shared, as envisaged today by the European Commission, by the draft SLD and the depositary provisions of AIFMD and UCITS Directive, such as 'safekeeping' for instance, we deeply request G4 Unit to be closely associated to the work carried out by the other Unit in charge of SLD.

Otherwise, all the efforts deployed by G4 – and by European institutions later on in the negotiation phase of UCITS V – might be without effect if some basic and crucial concepts are dealt elsewhere, in particular through the SLD.

From another perspective, and if finally the European Commission is able to set up a sound and safe regime for UCITS depositaries, we think that therefore there would not be any reasonable justification for keeping management companies in the scope of ICSD as the financial net offered by depositaries through UCITS V would guarantee in any case the appropriate protection for investors.

*
**

Detailed comments

A .Depositary's duties

1. Safe-keeping (p.8)

Box 1
It is necessary to define what activities and responsibilities are related to the notion of "safe-keeping" of assets.

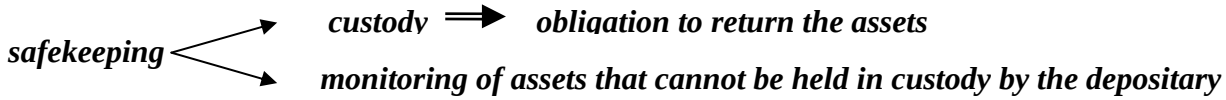
(EFAMA) and of the European Federation for Retirement Provision (EFRP). AFG is also an active member of the International Investment Funds Association (IIFA).

AFG agrees that the notion of "safe-keeping" of assets should be precisely defined at level 1. Indeed, we had understood that following Lehman and Madoff cases, the notions of "custody" and "safekeeping" – which are crucial from a legal certainty and safety perspective - would have to be urgently clarified. It was not done as such in AIFM. We very much hope that it will be done in UCITS V. Let's recall that such notions are still interpreted differently in different Member States today and are part of the difficulty for investors to get their money back from – supposedly safe – UCITS funds impacted by Madoff in at least two Member States other than France.

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;

AFG supports the Commission's proposal to distinguish safekeeping duties between custody duties relating to assets that can be held in custody by the depositary and monitoring duties relating to the remaining types of assets.



(i) With a view to enhance the protection offered to retail investors, we propose that, in the revised "UCITS V Directive", the assets "held in custody" are defined, as :

"all the assets that can be:
- ***for materialised securities, held by the depositary,***
- ***and for the other assets, registered in an account open in the name of the custodian (for example a nominee account) on behalf of clients (hence the necessity of segregating the accounts)."***

Regarding the treatment of restitution of cash, we think that, as a general principle, it is crucial to guarantee that UCITS investors benefit from the restitution of <u>all</u> UCITS assets held in custody, <u>including the cash</u> - as cash is part of UCITS assets - and not only the financial instruments. <u>We think that as soon as cash is held by the depositary, it should be restituable - as for securities. There is no reason to make a different treatment for such cash as compared to such securities. There is currently a legal uncertainty on the restitution of cash, and this legal uncertainty should be repealed.</u>

- ***First, UCITS are offered to retail investors, and retail investors need a higher degree of protection as compared to AIF investors.***

- ***Second, in practice, managers are market participants which act on behalf of such investors: they must be able to bring some comfort to retail investors on their guarantee regarding restitution of assets (which once again include cash).***

- ***Third, regarding fongibility, both cash and securities are fongible, as today securities are very largely dematerialised and therefore as fongible as cash.***

- ***Fourth, in practice, for instance when the dividend of a bond is paid, we don't see why the day before the payment the whole bond would be potentially restituable while once the dividend payment is done, such a cash payment would not be restituable. Otherwise it would mean a fluctuation in time on the degree of restitution for a security depending on when you look at it.***

We of course understand that in the case where assets cannot be held by the depositary, or when the management company decides to deposit cash elsewhere than within the depositary, such an obligation of restitution by the depositary seems impossible.

But conversely, we consider that one solution to increase the possibility of restitution of assets – including cash – would be to explicitly mention cash as part of the assets which can be held in custody by the depositary – based on the definition of "assets held in custody" proposed right above and except for the two limitations mentioned in the paragraph right above.

If the Commission can find an alternative way to increase at the same level the possibility of restitution of assets - including cash - to UCITS investors, we are of course open to assess such an alternative proposal.

(ii) Furthermore, the notion of 'monitoring' should be also defined.

(iii) In addition, we think that depositaries should all register in their books the same types of assets, regardless of the Member State where they are located, in order to ensure that the obligations attached to these instruments are harmonised throughout the EU.

This harmonisation is crucial as it would ensure the same level of safety for investors throughout the EU, in particular as UCITS are both passported and marketed to retail investors - which need more protection than professional investors.

(iv) We also are of the opinion that the obligation to return the assets should apply to any asset held in custody belonging to the UCITS and registered in the depositary's name, as well as to any asset physically held by the depositary. In particular, the obligation to return the assets should apply to the cash – which is an asset - held in accounts open with the depositary itself. Indeed, we appreciate that the depository can only have monitoring duties relating to the cash held in accounts open with other institutions.

(v) Last, we would like to stress that custody duties also include the reconciliation of assets held in the sub-custodian network.

(vi) Regarding the definition of the asset monitoring duties, we suggest to using the wording of the AIFMD (Article 21.7.b of the text adopted by the Council on 27 October 2010) by setting two cumulative duties:

- ***first, for all assets of the AIF which cannot be held in custody, the depositary should verify the ownership of the AIF, or, as the case may be, the AIFM acting on behalf of the AIF, of such assets and should maintain a record of those assets for which it is satisfied that the AIF, or, as the case may be, the AIFM acting on behalf of the AIF, holds the ownership of such assets;***

- ***second, for such assets, the depositary should keep this record up to date, after receiving the information from the AIF (or AIFM).***

- 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;

The ultimate aim of segregation is to ensure the maximum level of safety for retail investors.

In particular, in the case of UCITS, such segregation would ensure:

- ***to keep the flexibility of the management of the whole asset portfolio of the funds by the Management Company, by guaranteeing the Management Company that at any time all assets (including cash) are identified and can therefore be sold and replaced by other assets bought on markets;***

- ***to keep the guarantee of transferring at any time the fund assets (including cash) to another depositary or custodian in case of bankruptcy of this depositary/custodian.***

For instance, in the case of the Banque Pallas Stern bankruptcy in France in the 1990s, such segregation allowed for a prompt transfer of all UCITS assets towards another custodian, without having to wait for the final settlement of the bankruptcy. It was in practice an efficient way to keep UCITS investors' interests on board.

Therefore, the highest level of segregation should be followed.

For instance, in many countries across the world today, the segregation of assets – including cash – is done both at individual level and until the last layer of sub-custodian: it is technically possible, and it was required by regulators. Such a list of countries includes China, Brazil, Chile, India, Korea, Taiwan for instance. Some of these countries have a significant fund industry as you know. Considering that investment funds' assets in some non EU countries may be identified and returned at individual level, it would be paradoxical if Europe did not require a similar level of safety – knowing that the international promotion of the "UCITS brand" is largely based on its level of safety for investors.

Of course, we could ask for such segregation at individual level, fund by fund. But we also understand that it might generate too big changes for depositaries in Europe.

Our proposal is therefore to get only a segregation in three parts for all assets (including cash) at the level of the depositary and of sub-custodians (i.e. own account, UCITS omnibus account and other clients' omnibus account). In practice, it would mean that the depositary opens an omnibus account dedicated to UCITS assets at the level of its sub-custodians, that is technically possible today.

Such an approach in three parts would ensure that in case of bankruptcy of the relevant depositary or sub-custodian, all assets belonging to UCITS funds could be moved promptly to another custodian/sub-custodian, without having to wait for the final settlement of the relevant bankruptcy. It would therefore bring two significant guarantees:
- keeping all UCITS assets intact, for the benefit of UCITS investors
- keeping all UCITS assets accessible by the relevant Management Company, in order to continue managing the whole UCITS assets' portfolio as if there had not been any bankruptcy, and therefore ensuring keeping the optimal performance of the relevant UCITS.

- Equip the depositary with a view over all the assets of the UCITS, cash included. 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;

We support the Commission's proposal to equip the depositary with a view over all the assets of the UCITS, cash included, and to explicit that no cash account associated with the funds' transactions can be opened outside of the depositary's acknowledgement .

- 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.

We support the Commission's proposal to introduce implementing measures detailing the conditions for performing depositary monitoring and custody functions, based on the implementing measures that are being designed for the AIFMD.

In order to harmonise throughout the Union the obligation to return the assets, we believe that a provision in the UCITS Directive should explicitly require depositaries to return the assets held in custody including the cash held in accounts open with it in any case (except in case of an event which is 'unpredictable', cannot be overcome and is external to the related player) without any reference to local legislation: otherwise, the whole provision might be void in its practical effects and far from being applied in a harmonised manner – which would create a high lack of safety knowing that UCITS funds can be passported, including to retail investors. Besides, there is no clear requirement for restitution of the

cash by the depositary in the AIFMD; however, we think that such requirement should be introduced in the UCITS Directive in order to ensure a high level of investor protection.

2. Oversight functions (p.10)

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).

We support the Commission's proposal to align the oversight duties related to UCITS with a corporate form on those to be performed in respect to UCITS with a common fund form. Indeed, as retail investors are not able to differentiate between the legal form of a common fund unit and a corporate type fund share, such alignment is obviously needed.

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.

AFG supports the introduction of implementing measures that will clarify further the scope of each listed supervisory duty.

However, we would like to recall that the calculation of the Net Asset Value of the UCITS is not the responsibility of the depositary but of the management company as per Annex II letter c of the Directive:

"Functions included in the activity of collective portfolio management:

(c) valuation and pricing (including tax returns)"

In the same way, the maintenance of unit-holder register and unit issues and redemptions are responsibilities of the management company.

3. Delegation of the depositary's tasks (p.11)

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.

AFG believes that the obligation of information of the relevant management company/UCITS should be made explicitly compulsory when the UCITS depositary decides to delegate the custody of the relevant assets.

However, we do not think that it would be relevant to disclose the existence of such a sub-depositary network to investors. Indeed, the KIID already mentions the potential risks attached to the depositary. Providing more information on depositaries would be meaningless for retail investors and would create a burden for management companies by generating a nearly permanent updating of the KIID, each time the network members are changed.

We support the Commission's proposal to introduce implementing measures 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.

In addition, AFG members clearly think that the auditor should specify in its report that the depositary complied in practice with its obligations in line with Directive provisions, in particular in terms of due diligence.

*
**

B .UCITS depositary liability regime

1. Improper performance (p.12)

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.

AFG supports the Commission's proposal to clarify the depositary liability regime in case of a UCITS suffering losses as a result of a depositary's negligence or intentional failure to perform its duties.

2. UCITS depositary specific liability in case of loss of assets (p.12)

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.

AFG agrees that there should be no further discharge of liability in case of loss of assets, except in case of an event which is 'unpredictable', cannot be overcome and is external to the related player and provided the depositary has completed all the necessary due diligence.

In the AIFMD, only two of these three criteria have been kept, and only partially.

First, the criterion of 'unpredictability' of the event is missing in the provision included in the AIFMD.

Second, the current AIFMD exemption is too wide,as it would leave – in the case of UCITS – too much latitude to the relevant depositary to demonstrate that the loss has arisen as a result of an external event 'beyond its reasonable control', the consequences of which would have been unavoidable 'despite all reasonable efforts to the contrary'.

We therefore urge the Commission to narrow this exemption by both adding this complementary cumulative criterion of 'unpredictability' and repealing such references to 'reasonable control' and 'reasonable efforts', in order to create a scope of exemptions as objective as possible – knowing once again that the level of safety for retail investors, and for funds which are allowed for passporting, should be higher than for AIFs which are more dedicated to professional investors (at least the AIF passport is only applicable towards professional investors).

3. The scope of the UCITS depositary liability when assets are lost by a sub custodian (p.13)

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".

AFG agrees that the rule should be maintained 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. It also supports the Commission's proposal to clarify the fact that if assets are lost, the UCITS depositary has the general obligation to return financial instruments of the identical type or of the corresponding amount to the UCITS with no delay.

4. Burden of the proof (p.15)

Box 9

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

AFG strongly supports the Commission's proposal to clarify that the depositary should carry the burden of demonstrating that it has duly performed its duties.

5. Rights of UCITS holders action against the UCITS depositary (p.15)

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.

AFG agrees that the rights of both share- and unit-holders should be aligned regarding claims relating to the liabilities of depositaries.

However, the majority of our members are of the opinion that, as the management company has the duty to act in the best interest of investors, it should be trusted to take the relevant action vis-à-vis the depositary if necessary. In other words, investors should primarily invoke claims relating to the liabilities of depositaries indirectly through the management company. This way all investors are treated fairly, which would not be the case if investors could act directly, thus favouring the most informed and wealthy investors. Only in case the management company does not take the relevant action and cannot prove that they took action, should investors be allowed to invoke such claims directly.

*

**

C .Eligibility criteria

1. Eligibility criteria (p.16)

Box 11

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

AFG members think that the scope of eligible entities agreed as depositaries should be limited for UCITS funds to credit institutions and investment firms only, as UCITS funds may be passported to retail clients which cannot by themselves assess the risk associated to

depositaries. As soon as a type of eligible entity, beyond the mere credit institutions and investment firms, would be recognised in one country and not in another, the legal safety associated to UCITS depositaries will not be the same from one Member State to another in spite of being allowed for passporting. In addition, knowing that UCITS assets are restricted financial assets – contrary to AIF assets for instance, which may be non-financial assets and for which there might be a legitimate reason to authorise non-financial entities to be AIF depositaries – the extension of eligible entities beyond credit institutions and investment firms is therefore not acceptable. In addition, limiting the scope of entities eligible as UCITS depositaries to credit institutions and investment firms would facilitate the segregation of cash in their accounts, as such entities are already able to set such a segregation. Such limitation will improve the trademark/concept of UCITS funds and will increase the confidence of investors based in Europe or outside Europe

2.Location of the depositary (passport issues) (p.16)

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.

We support the Commission's proposal to introduce a provision 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, once the three following conditions are fulfilled:

- ***The law of reference should be the law of the Member State where the fund is domiciled;***
- ***The depositary has a local representative in the country where the fund is domiciled;***
- ***A real harmonisation of depositary status, duties and responsibility will have been achieved in practice.***

*
**

D. Supervision issues

1. Supervision by national regulators (p.17)

Box 13

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.

We support the Commission's proposal to harmonise the national supervisors' scope of competencies.

2. Supervision by auditors (p.18)

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.

We believe that the certification should apply to all the assets that the depositary holds in safekeeping i.e. all the assets it either holds in custody or monitors.

As explained in our comment on box 5, AFG members clearly think that the auditor should specify in its report that the depositary complied in practice with its obligations in line with Directive provisions, in particular in terms of due diligence.

*
**

E. Other issues

1. Derogation from the obligation of UCITS to appoint a depositary (p.18)

Box 15
It is suggested to delete articles 32 (4) and 32 (5) of the UCITS Directive n°2009/65/EC.

We support the Commission's proposal to remove the derogation from the obligation of UCITS to appoint a depositary.

2. Single depositary rule (p.19)

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).

We support the Commission's proposal to clarify the requirement for a single depositary per UCITS and align the Directive on the AIFMD (article 21.1) as follows:

"For each UCITS it manages, the management company shall ensure that a single depositary is appointed".

We would also like to reassert that the depositary should be allowed to delegate its safekeeping duties only and should always assume its supervisory duties.

3. Organisational requirements and rules of conduct (p.20)

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.

We support the Commission's proposal to introduce for UCITS depositaries similar rules of conduct as in the AIFM. More generally, we support the introduction of implementing measures in order to encourage a higher degree of harmonisation and consistency between the UCITS directive and AIFMD.

4. Exchange of information with competent authorities (p.21)

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.

AFG members support the Commission's proposals as described in box 18.

5. The contract between the depositary and the UCITS manager (p.22)

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 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.

AFG believes that there should be a written contract between the management company and the depositary regardless whether the management and the fund are located in the same Member State.

However, we do not think that the format of this written contract should be itself imposed by European legislation. As for the level 2 implementing measures of UCITS IV, in the context of the management company passport, the UCITS V Directive should only identify a list of mandatory items to be included in such contract.

*
**

We do not think that additional measures are required to reflect the objective of maintaining a high level of investors' confidence, as the level of protection that will be obtained through the Commission's proposals as amended with AFG suggestions will be sufficient.

*
**

2. UCITS MANAGERS' REMUNERATION POLICIES

2.3 Need for a remuneration policy for UCITS managers

Following the G20 Decisions and EU initiatives to support financial stability, we understand the willingness of the Commission to take into account compensation practices in the asset management industry. Of course, we fully agree with the statement of the consultation paper: "*The UCITS asset management sector was not one of the root causes of the financial crisis*". We recommend the Commission to draw all the consequences of this preliminary analysis in order to define and apply tailored and proportionate remunerations principles in the asset management sector. Indeed one of the strong differences between the UCITS sector and other financial activities is that by nature, the management company does not take risks affecting its own balance sheet and its assets.

We stress that no evidence supports the general comment "*New products and techniques making UCITS more vulnerable*". Indeed, until now there has been no case of default or bankruptcy of UCITS funds due to the remuneration policies or practices of the management companies.

The argument about the level playing field is quite specious: because AIFMD is, unduly according to us, a copy-paste of CRD III, the same framework would have to be adopted for UCITS in order to ensure that all asset management companies are covered. It's especially the case concerning the alleged risk of "regulatory arbitrage": assuming there would have no rules on remuneration policies for the UCITS sector, it would be highly unlikely that management companies, for this only reason, transfer their activities from AIF to UCITS funds, mainly because the UCITS sector as a whole remains one of the most regulated activities of the financial sector, with stringent rules on risk management (*cf. infra*). Moreover, the consultation paper seems to forget that management companies are not all subsidiaries of banks. In France, on 590 asset management companies, 410 are independent from financial groups and many of the others part of insurance or international asset management groups.

Against this background, it is envisaged that the UCITS Directive should be adapted to

include requirements on sound remuneration principles for UCITS managers. Furthermore, these requirements should be consistent with those proposed for the managers of AIFs as well as for banks and investment firms. A harmonised approach to remuneration policy would entail similar (though not necessarily identical) principles for all relevant entities. This would not only create a level playing field, but it would also lessen costs of compliance as compared with maintaining different standards.

In addition to these general comments, we strongly support EFAMA argumentation on the need to take into account the fundamental differences between the business model of the asset management industry and the banking and investment banking sector:

- UCITS managers act as principals, managing the assets of the UCITS on the UCITS behalf in the UCITS name. The UCITS assets are segregated from the own assets of the asset manager and from other clients' assets, separately accounted for and held by an independent depositary.

- Therefore, the business model of the UCITS managers revolves around the management of third party assets which are segregated. There is no dealing on own account performed by the UCITS manager. Managing the UCITS assets does not affect the assets of the UCITS manager.

- As UCITS managers by definition do not take risk against their balance sheet but instead manage UCITS assets, remuneration structures in the asset management industry should not have as main objective the limitation of risk taking. Instead rules for the asset management industry need to address the specific issues arising out of the activities of the asset managers. Existing regulatory provisions on remuneration policy for UCITS management companies take this business model into account and address conflicts of interest instead of effective risk management. They provide that the remuneration policy of a UCITS management company has to align the interests of the UCITS Management company with the interests of the UCITS it manages (Article 14 of Directive 2009/65/EC).

Furthermore, the current regulatory and legal framework limits the risk the UCITS manager may take for each UCITS:

- The risks which may be taken by the UCITS manager on behalf of the UCITS are regulated within the regulation applicable to the UCITS. The current investment restrictions contained in the existing directive provide a sufficient regulatory framework to limit excessive risk-taking. This will still be the case with the use of sophisticated financial techniques as the related risk is duly monitored by specific procedures. The recently revised UCITS framework places significant limits on the degree and nature of the risk that a UCITS may take on.

- Furthermore, for each UCITS, the risks are detailed in its investment policy, investment strategy and investment restrictions as described in its prospectus and fund rules or articles of incorporation which are established at the outset of the UCITS and made available to investors and potential investors. The UCITS manager may not diverge from the investment policy and restrictions without prior consent by the investors.

- The level of risk is part of the features of each UCITS and is a key component of the diversity of the products offered by the industry. An additional set of rules intending to limit the risk would lead to a reduction of the diversity of products available to the investors and consequently would decrease the success of the UCITS.

- The risk management framework which exists within the UCITS regime, together with the controls and monitoring that is performed should be sufficient to ensure that undue levels of risk to such third party assets are not accepted.

Rather than to "*entail similar (though not necessarily identical) principles for all relevant entities*", it's essential to define a framework tailored to UCITS sector.

2.4 Suggested changes in the UCITS Directive

2.4.1. Focus on effective risk taking and prevention of conflict of interests

It is suggested that remuneration policies for UCITS managers should be designed to:

- Promote sound and effective risk management, and discourage any risk-taking which is inconsistent with the risk profiles, fund rules of instruments of incorporation of the managed UCITS;

- Prevent conflicts of interest;

- Ensure the protection of the interests of clients and investors in the course of collective portfolio management activities and other services provided.

In order to follow the same general orientations and principles in the financial sector, we call the attention of the Commission that in AIFMD and CRD III Directive, the remuneration scheme is designed to "avoid conflicts of interest" and not to "prevent" them.

We have a major concern about the introduction of the general notion of "the protection of the interests of clients and investors" in this area. It's essential to stick at the initial approach according which the remuneration policy promotes sound and effective risk management and does not encourage excessive risk-taking. To our knowledge, "the protection of the interests of clients and investors" is not used in AIFMD as a basis to establish and apply a remuneration policy. It would be harmful to replace, in the UCITS sector, a systemic risk management approach by a so large and ambiguous consumer protection approach.

2.4.2. Scope of application – to whom requirements should apply

It is suggested that in the case of UCITS managers, remuneration policies should apply to those categories of staff whose professional activities may have a material impact on the risk profile of a managed UCITS, in particular to senior management

including a board of directors, persons carrying out supervisory functions or the permanent risk management function, and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management

In the same way, it's important not to define too extensively the scope of application. In particular, the wording of this box seems to be wider than in AIFMD. Furthermore, it's crucial to stress again that the exercise has to be driven only by the notion of risk management. It's the responsibility of each company to identify the members of staff, concerned by a potential impact on the risk profile of the fund. A priori, this would lead to exclude, in most cases, the sales managers.

2.4.3. Proportionate application of sound remuneration principles

It is suggested that UCITS managers should be given similar flexibility, so that they could apply the principles of sound remuneration policy in a manner proportionate to their size, internal organization as well as the nature, scale and complexity of the activities carried out by the UCITS manager and the managed UCITS.

We fully share the view that the proportionality principle is a key point to define the general framework of the remuneration policies for UCITS managers. It implies that each management company has a great flexibility to set up all the components of its remuneration policy, in accordance with the general principles established for the sector. The application of this principle may also lead to the neutralization of some requirements. In a manner tailored to asset management activities, we could refer to the analysis made in the recent CEBS guidelines on the proportionality principle.

2.4.4. Governance issues: elaboration, review and disclosure of the remuneration policy

Taking into account the recommendations mentioned above, rooted in the principles of good governance, it is suggested to include the following requirements for UCITS managers in relation to the internal organization and procedures:

- The management body in its supervisory function should adopt the general principles of the remuneration policy and be responsible for the implementation and periodical review of these principles;

- The permanent compliance function should review, at least annually, how the remuneration policy is implemented and whether its implementation complies with the general principles of the remuneration policy

- A remuneration committee should be established where it is justified by the size of a UCITS managers and a UCITS it manages ("significant size" criterion), their internal organization and the nature, scope and the complexity

of their activities. The role of the remuneration committee would be to exercise an independent judgment on remuneration policies and practices;

- The principles of the remuneration policy should be accessible to staff members to whom they apply.

Following our previous comments, this area is typically designed to a sound application of the proportionality principle, especially for small-medium size companies. In particular, at the implementation level, it will be necessary to have a special focus on the significant size criterion (in terms of AUM? of members of staff? etc.) for the remuneration committee.

Notwithstanding the fact that the permanent compliance function has to be involved in the implementation of the remuneration policy, we disagree with the role devoted to them in the review of this policy. This review remains the responsibility of the management body.

2.4.5. Elements of the remuneration structure

It is suggested that principles relating to remuneration structures should be adapted so as to take into account UCITS managers' business models. They should address the following elements:

- Criteria for calculating compensation for different categories of staff in cases where remuneration is performance-related, including the time element in assessing the performance;

- Rules for guaranteed variable remuneration (which might be allowed only in the context of hiring new staff, and should be limited in time);

- Rules for fixed and variable components of total remuneration (restrictions on variable remuneration, deferral of a portion of variable remuneration etc.);

- Rules on pension benefits;

- Rules for payments related to the early termination of contract.

We support the insertion of principles on the items mentioned in this box instead of detailed rules. Also in this area, the proportionality principle has to be fully applied (*cf. our comments on 2.4.3*). It's the responsibility of the management company to adapt each item to the nature, complexity, risk profile of the fund.

Moreover, we call the attention of the Commission on the risks and potential negative effects of a general obligation to pay a portion of the remuneration in units or shares of the fund: it could be counterproductive in terms of alignment of the interests of the managers and the investors; it could be also detrimental to the owners or shareholders in some small-medium size companies.

***

1. Comments on the suggestions included in this Consultation Paper concerning the remuneration policy for UCITS management or investment companies are welcome.

   In particular:

   a) Do you agree that to maintain a level playing field in the financial services sector, remuneration policy for UCITS management or investment companies should broadly follow similar rules contained in the AIFM Directive or CRD III, so as to ensure a consistent approach to remuneration policy across all financial sectors? If not, please explain and justify your views.

   b) Do you agree that the proposed approach to the regulation of remuneration policy for UCITS managers includes all requirements that should be covered? Can you identify any other options or approaches that might be more effective?

   c) Do you consider certain requirements more important than others?

   d) Do you believe that certain principles, or elements of these, are not suitable for UCITS managers or not appropriately tailored? If so, please suggest alternative ways of tailoring the general principles.

   Please justify or explain your answer and provide supportive evidence.

2. Are there any additional changes than those suggested in this Consultation Paper that should be introduced as regards remuneration policy for asset managers? Please justify or explain your answer and provide objective data to support it.

3. Please provide us with any evidence you may have on the likely scale and nature of impacts that the suggested rules on remuneration policy may create for UCITS managers and other stakeholders.

We reiterate all arguments and comments raised below. In particular, we stress again the need (i) to fully take into account the fundamental differences between the business model of the asset management industry and the other financial activities, (ii) to stick at the risk management approach adopted by the G20 and not to enlarge the initiative to other considerations (such as the general notion of "the protection of the interests of clients and investors", etc.), (iii) to accept an entire application of the proportionality principle on each item of the remuneration policy, especially those concerning remuneration structure.

In particular, we repeat our concern about a possible obligation to pay a portion of the remuneration in shares or units of the fund.

*
**

3. OTHER PROVISIONS WHICH HAVE TO BE REVISED

AFG would like to take the opportunity of the consultation published by the Commission to highlight the **crucial need for reviewing some specific other areas of the Directive**, in addition to the two topics dealt with in this paper (i.e. depositaries and remunerations).

We are aware that the aim of UCITS V is not to reopen the whole Directive, as such a reopening might slow down the process of revision of the Directive.

However, some points must be revised in our view:

1) **Some provisions of the UCITS III Directive**, untouched by UCITS IV, need to be "cleaned up" in order **to better reflect the reality of the asset management industry**.

   - For example, article 12.2 letter b of the directive requires management companies to participate to an investor compensation scheme. However, such an obligation does not seem to make sense for companies that are prohibited by their national law to hold the assets of their clients, especially as the account holders ("teneurs de compte") of these assets are already under the obligation to participate to such a scheme. As a consequence, the UCITS directive imposes a duplicated participation that relates to the same assets. The obligation to participate to an investor compensation scheme should therefore only apply to management companies that do hold their clients' assets.

   - We would also like to highlight that the adoption of the UCITS IV directive (level 1) and its translation into the different languages of the Member States did not solve all the issues that arose during the transposition of the UCITS III directive into the Member States' national law:

      - For instance, some definitions are still missing in the UCITS IV directive, which lead to its provisions being interpreted in different ways by the national authorities of the Member States. For instance, the concept of "fund of funds" is not precisely defined at European level and needs to be clarified in order to ensure a higher level of harmonisation throughout the EU.

         - For example, the French regulator defines a fund of funds as a fund that invests more than 10% of its assets in underlying UCITS, even though the UCITS directive allows investing in underlying UCITS, as in any other asset eligible in the portfolio of a UCITS, up to 100% of the portfolio.

         - Furthermore, the KIID introduced by the UCITS IV directive sets specific obligations (in particular relating to the disclosure of charges) for funds that invest a "significant" portion of their assets in underlying

2) Some provisions of the UCITS III Directive, untouched by UCITS IV, **need to be updated if we want to make them consistent with other pieces of European legislation adopted after the adoption of UCITS III.**

- In particular, the definition of a number of concepts should be updated in line with MIFID. For example, MIFID uses the concept of "financial instruments" and "regulated markets" while the UCITS III directive still refers to "transferable securities" and "regulated markets". Investment advice is now treated by MIFID as an "investment service"; as a consequence, it might be confusing that it is considered as a "non-core service" in the UCITS directive.

- The scope of activities allowed for UCITS Management Companies should include the possibility of "reception and transmission of orders in relation to one or more financial instruments". As AIFMs may be allowed to provide for such reception and transmission of orders (article 6 paragraph 4 of the AIFMD), we don't see why UCITS Management Companies could not be allowed to provide for the same service – otherwise, it would not ensure a level playing field between the two types of management companies.

- More largely, the content of the AIFMD provisions will certainly require some adjustments of the UCITS IV directive.

*

**

If you need any further information, please do not hesitate to contact myself at +33 1 44 94 94 29 (p.bollon@afg.asso.fr), our Head of International Affairs Division, Stéphane Janin, at +33 1 44 94 94 04 (s.janin@afg.asso.fr), or our Deputy Head of International Affairs Division, Carine Delfrayssi, at +33 1 44 94 96 58.

Sincerely Yours,

Pierre Bollon