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**Commission consultation on the UCITS depository function
and on the UCITS managers' remuneration**

Euroclear response

We are pleased to be given the opportunity to offer Euroclear's¹ views on the Commission's consultation paper on UCITS. Euroclear is registered on the European Commission's register of interest representatives - ID number 88290282308-75.

As a provider of market infrastructure services related to securities settlement and custody (Central Securities Depository), our comments focus on the topic of UCITS depositories, their delegation of the safekeeping function and the liability in case of loss of securities.

General remarks

We welcome the Commission's recognition that there are several Commission initiatives that are related to or have an impact on the issue of UCITS depositories. We would like to stress that it is important that all these measures are coherent and that they do not represent different or overlapping requirements for the same function, i.e. safekeeping of securities assets.

In this respect, we would like to highlight the following:

- The Commission's plans for the forthcoming Directive on legal certainty of securities holding and transactions (Securities Law Directive) foresees that all providers of securities accounts will be regulated, thereby aiming at increasing the safety and soundness of holding securities through account providers. We

¹ The Euroclear group is the world's leading provider of domestic and cross-border settlement and related services for bond, equity, fund and derivative transactions. User owned and user governed, the group comprises the international central securities depository Euroclear Bank, based in Brussels, as well as the national central securities depositories (CSDs) Euroclear Belgium, Euroclear France, Euroclear Nederland, Euroclear UK & Ireland and NCSD, the CSD for Finland and Sweden..



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believe that – in the case of book-entry securities - the “safekeeping” function of UCITS depositaries can be considered identical to the provision of securities accounts by the fund depositary to the fund. The status of account provider that is foreseen in the frame SLD and is planned to be regulated through MiFID² will therefore also need to be applicable to UCITS depositaries and the sub-custodians to which they delegate the safekeeping of securities. A revision to the UCITS Directive’s provisions on depositaries would need to take into account the planned MiFID requirements for account providers³ and avoid any overlapping or incoherent requirements.

- While Central Securities Depositaries (CSDs) do not act as fund depositaries themselves, the vast majority of listed and non-listed securities are issued into, and held through, a CSD. A fund depositary will hold a fund’s securities assets either:
 - Directly with the CSD, by keeping a securities account in the CSD. In practice, if the fund depositary wishes to hold securities directly in a CSD, it has no effective choice as in most cases a security has only one CSD;
 - Indirectly by maintaining a securities account with an agent (acting as sub-custodian) which in turn keeps a securities account with another agent (sub-custodian) or with the CSD.

A revision to the UCITS Directive’s provisions on depositaries needs to take into account the specific role of CSDs and the fact that these CSDs will be subject to their own specific legislation which is being prepared by the Commission.

- In the AIFM Directive, article 21 §10 on delegation of depositary functions recognises the specific role of CSDs by stating that the deposit of securities into a Securities Settlement System as designated by the Settlement Finality Directive (Directive 98/26/EC) is not considered as a delegation. We believe that the same clause should be foreseen in the revision of the UCITS Directive.

² Please refer to Commission consultation document on the Legislation on legal certainty of securities holdings and dispositions section 21 “Account provider status”.

³ In particular, Section 3 of MiFID implementing Directive 2006/73/EC on safeguarding of clients assets foresees requirements with regard to safekeeping client financial instruments and funds, and how these are deposited.



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Box 1&2 – Safekeeping

With regard to safekeeping of securities, a difference could be made between securities that are kept in book-entry form in securities accounts (either because securities are dematerialised or immobilised) and securities that are available in physical form (physical certificates) and are not safe kept in securities accounts. It is our view that most (if not all) securities that will be kept for UCITS funds will be in book-entry form.

On the definition of “safekeeping”, we believe reference should be made to services provided by “account providers” that will be defined in the frame of the upcoming SLD and the CSD legislation. These initiatives should define rules applicable to all types of account providers regardless of the type of investor on behalf of which securities are kept; i.e. the same level of protection should be offered for securities holdings on behalf of UCITS, AIFs, retail or other investors.

Box 5 – Delegation of the depositary’s tasks

We would like to point out that fund depositaries often delegate the safekeeping of securities to agents/sub-custodians, even in an EU context. For securities in book-entry form, this delegation takes the form of opening a securities account with one or more sub-custodians. In annex, we have included an example of how fund depositaries may delegate the securities holdings, and how the segregations of funds’ assets will generally be implemented.

It may happen that a fund depositary deposits some of the fund’s securities directly in a CSD, in which case there is no delegation (cfr AIFMD article 21 §10).

Unfortunately, CSDs are not in a position to be able to quantify what proportion of the securities that are under deposit at the CSD are held for the account of a UCITS fund depositary directly or for the account of sub-custodians to which UCITS fund depositaries have delegated safekeeping.

Box 7&8 – Depositary liability in case of loss of assets (by the depositary or its sub-custodian)

We are concerned about the fact that a fund depositary would need to return lost securities “with no delay” in case of bankruptcy or negligence of a sub-custodian to which safekeeping is delegated.



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In practice, as the fund's securities holdings will be segregated from the own securities of the fund depositary or the sub-custodian, the securities will remain protected from the bankruptcy of such entity. They will however not be available immediately as the bankruptcy proceedings will take time to unwind and securities will be rendered some time after the bankruptcy. Requesting the fund depositary to return the securities "with no delay" may require this entity to buy securities on the market thereby taking on a market risk on the value of such securities between the time of the buy-in and the time when securities are released from the bankruptcy proceedings. If securities cannot be found on the market, the fund depositary would need to compensate the fund in cash and will also take a market risk on the value of the securities which it will need to sell later on.

A crucial policy question is therefore which entity (the fund depositary, or the fund and the fund investors) should be taking the market risk in the case of loss of securities due to bankruptcy or negligence of a sub-custodian. It can be argued that – when a fund depositary has followed strict selection and due diligence criteria for its sub-custodians – it should not be subject to the liability and the related market risk.

As pointed out before, we believe the UCITS revision should be coherent with AIFMD article 21 §10 that states that the deposit of securities into a Securities Settlement System as designated by the Settlement Finality Directive (Directive 98/26/EC) is not considered as a delegation of safekeeping by the fund depositary.

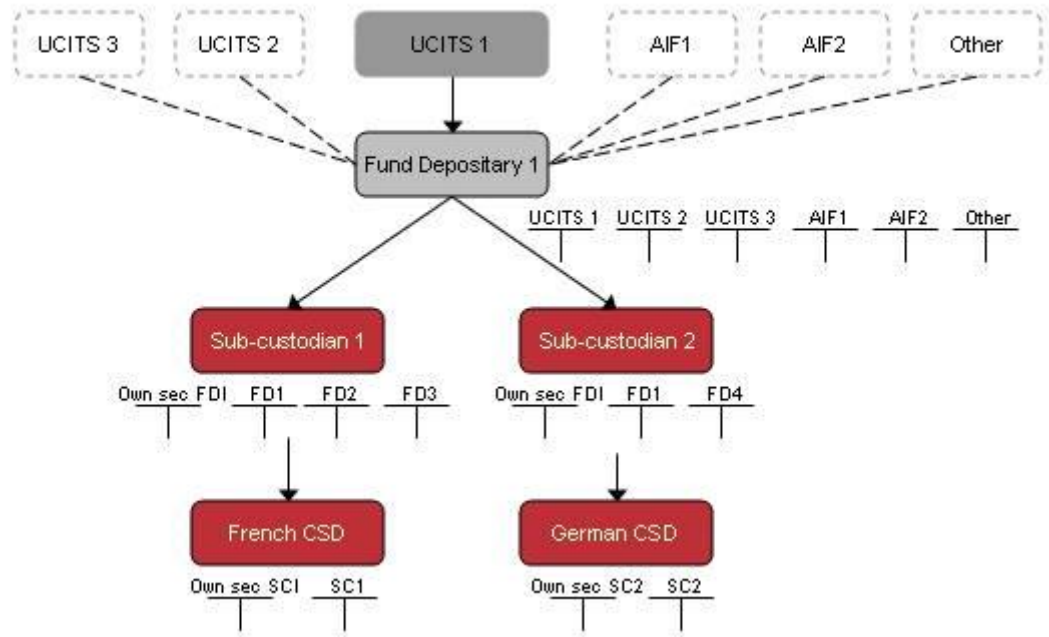
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ANNEX – illustration of typical holding pattern of fund assets (securities) using omnibus accounts (simplified)

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UCITS1 invests in French and German equities.

UCITS1 appoints Fund Depository 1 (FD1) as its depository

FD1 is also fund depository for UCITS2 and UCITS3, and for Alternative Investment Fund (AIF)1 and AIF2. It is also a depository for 1 non-fund investor. In its own books, FD1 keeps separate securities accounts for UCITS1, UCITS2, UCITS3, AIF1, AIF2 and the non-fund investor. FD1 can identify at all times which securities are held for each of these customers.

FD1 uses Sub-custodian 1 (SC1) for the French equities and Sub-custodian 2 (SC2) for the German equities.

FD1 opens **two** securities accounts with SC1:

- one to keep its own assets
- one to keep the assets of its customers (UCITS1, UCITS2, UCITS3, AIF1, AIF2 and the non-fund investor): all assets are pooled into one securities account: SC1 does not/should not know the underlying customers and cannot/should not distinguish which securities are held on behalf of which underlying client, cannot/should not distinguish which securities are held on behalf of UCITS or AIFs.

FD1 opens two securities accounts with SC2 (same account set up)

SC1 is also the sub-custodian of FD2 and FD3. In its own books, SC1 keeps separate securities accounts for FD1, FD2 and FD3. SC1 can identify at all times which securities are held for each of its customers.

SC1 keeps **two** securities accounts in the French Central Securities Depository:



- one to keep its own assets
- one to keep the assets of its customers (FD1, FD2, FD3): all assets are pooled in one securities account in the CSD. The CSD does not/should not know SC1's underlying customers and cannot/should not distinguish which securities are held on behalf of which customer, cannot/should not distinguish which assets are held on behalf of UCITS, AIFs or FDs.

SC2 has similar account set-up as SC1 but keeps securities with the German Central Securities Depository.

Note: account segregations are in line with MiFID requirements which require that client assets be segregated from own assets.

UCITS1 appoints FD1, FD1 "delegates" safekeeping to SC1 and SC2; SC1 and SC2 deposit securities in the relevant CSD (no delegation).

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