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Commission consultation paper on UCITS depository function

Euroclear response

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 Euroclear group includes the International Central Securities Depository (ICSD) Euroclear Bank, based in Brussels, as well as the national Central Securities Depositories (CSDs) Euroclear Belgium, Euroclear Finland, Euroclear France, Euroclear Nederland, Euroclear Sweden and Euroclear UK & Ireland. The total value of securities transactions settled by the Euroclear group is around €560 trillion per annum, while assets held for clients are valued at more than €18 trillion.

We are pleased to be given the opportunity to provide our views on the Commission's consultation paper on the UCITS Depository Function. In short, we believe that the consultation has been drafted without due consideration of the role of (I)CSDs, with whom the underlying securities assets of a fund are in general ultimately held. (I)CSDs do not act as fund depositaries themselves. We believe that an amendment of the UCITS directive along the lines of the currently AIFM proposals (article 17) could have a significant impact on the operation of financial markets and the role of the settlement infrastructure in supporting those markets.

Please note that this note specifically focuses on issues related to a (I)CSD's functions and responsibilities. We concur with most of the comments made by trade associations such as the European Securities Services Forum (ESSF), the International Securities Services Association (ISSA), the European Banking Federation (EBF) and Febelfin, specifically those comments that relate to the liability of a fund depository with regard to its sub-custody network.

The fund depository's safe-keeping duties

With regard to the consultation's views on the safe-keeping duties of fund depositaries (1.A.), we would like to clarify the role of (I)CSDs, their regulatory status, and the way services of sub-custodians and (I)CSDs are used by depositaries:



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- The vast majority of listed and non-listed securities are issued into, and held through, a (I)CSD. The fund depositary will hold the fund's securities assets either:
 - By maintaining a securities account directly with the CSD of issuance (which is usually referred to as the "Issuer CSD"),
 - Indirectly by maintaining a securities account with an agent such as a custodian, sub-custodian, an International CSD (like Euroclear Bank, for example) or, less frequently, another CSD (generally referred to as "Investor" CSD) that has in turn an account with the Issuer CSD. Such an Investor CSD then performs a role that is very comparable to that of a sub-custodian¹.

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 of issuance.

- (I)CSDs are typically the entities in which securities are established in book-entry form, even if the underlying securities exist in physical form. In the latter case, securities are said to be "immobilised" and they can circulate in book-entry form in the chain of CSDs, custodians and sub-custodians.
- CSDs are very rarely credit institutions, since their very nature as providers of settlement infrastructure means that they are structured in a way to minimise risk wherever possible, making their risk of default very remote. The current AIFM proposal that fund depositaries, if they "delegate", can only do so to other depositaries which in turn have to be credit institutions does therefore, seem impracticable. We do not believe that the purpose is to prevent depositaries from "using" the services of (I)CSD, which would be unworkable, given the central infrastructure role played by (I)CSDs.
- On the topic of "delegation", we believe that a difference needs to be made between a fund depositary
 - (a) **appointing** a sub-custodian or **using** the services of a (I)CSD. We do not view this as "delegation" because the sub-custodian/CSD does not deliver services directly to the fund; rather, the sub-custodian/CSD performs its

¹ Please note that it is one of the purposes of the Code of Conduct on Clearing and Settlement and also of the ECB's T2S settlement service (to be launched in 2013) that CSDs create links, and become Investor CSDs, thereby taking a role of securities intermediary.



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functions in its own name towards the depositary and has no contact with the fund at all; and

- (b) **delegating** to a third party some obligations of the depositary whereby that third party acts in the name, and on behalf, of the depositary directly towards the fund.

Segregation of UCITS assets

We would appreciate clarification on the segregation requirements that are referred to in the consultation document (II.A.1.) and the related question 12. It is unclear to us if this requirement would mean that each UCITS' securities assets are to be segregated across the whole holding chain, i.e. up to the level of the CSD. This would be an important change in today's practices which could reduce efficiency and increase costs.

The Depositary's liability – impact on CSDs

As CSDs are part of the holding chain of securities assets held by a fund depositary, we would like to point out a potential indirect impact of the current AIFM proposal of paragraph 5 of Article 17 on CSDs: when an (I)CSD starts developing Investor CSD services (as expected under the Code of Conduct's Access and Interoperability Agreement¹), it would bear a higher liability cost for its links with other CSDs which could make the link economically uninteresting (although we recognise that the default risk of a CSD is very small). We believe that such increased cost would be running against the generalised call for more interoperability between market infrastructures as advocated by MiFID and the Code of Conduct.

Moreover, we do not believe that there is any reason why a depositary acting for a fund should be subject to more stringent liability rules than if it were acting for a direct investor. In general, we believe that the liability of fund depositaries should be defined in such a way that the costs of providing depositary services and the impact on the economics of the fund itself and the fees paid by its end-investors are not unreasonably increased.

We would appreciate discussing these issues further with you if you would find that helpful.



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