



31 March 2009

Mr Carlo Comporti
Secretary General
The Committee of European Securities Regulators
11-13 Avenue de Friedland
75008 Paris
France

Dear Mr Comporti

CESR Call for Evidence on Possible implementing Measures Concerning the Future UCITS Directive

The Depository and Trustee Association (DATA) represents all depositaries and trustees of UK-based authorised unit trusts and open-ended investment companies. At the end of July 2008, the members of DATA were responsible for safeguarding £425.2 billion of funds under management

DATA welcomes CESR's work in order to further develop the UCITS IV legislation. However, we do not believe that there is any value in introducing detailed rules at level 2. We understand that a separate consultation is underway for section 2 - KID. Our comments are therefore in relation to sections 1 and 3 only.¹

We look forward to hearing from you in due course.

Yours sincerely

Kevin Tomlin
DATA Chairman

¹ CESR advice on technical issues relating to Key Information Document (KID) disclosures for UCITS

Responses to questions from the call for evidence

1.2.1. Prudential rules and conflict of interest (Article 12)

The requirements of article 12 are met in the UK by general prudential rules and the SYSC handbook which are aligned with MiFID. We do not believe that level 2 measures would be necessary provided that CESR is satisfied that each Member State has similar rules in place.

1.2.2. Rules of conduct including conflict of interests (Article 14)

As above.

1.2.3. Measures to be taken by a depositary of a UCITS managed by a management company or an investment company situated in another Member State (Articles 23 and 33).

- 1) Advise the Commission on the specific conditions that a depositary must meet to fulfil its duties regarding a UCITS managed by a management company situated in another country.**

The conditions to be met by a depositary should not change, regardless of where the management company is situated.

One of the primary responsibilities of a depositary is to protect the interests of the unitholders (Article 25). Article 22 of the UCITS Directive sets out the specific obligations of a depositary and this has been primarily adopted in the UK via COLL 6.6.4 / 6.6.12.

One important question which needs to be considered is - have the rules in each Member State been implemented consistently with regard to the depositaries responsibilities? For example - UK rules in COLL 6.3.6.3 include some specific guidelines on what a depositary needs to do in the UK when considering the valuation of a fund.

In light of this, we note the mapping being undertaken by CESR regarding the implementation of depositary obligations imposed by the UCITS Directive and the appropriateness of the existing regulatory framework.

If we assume identical implementation of depositary responsibilities across Member States this drastically simplifies the depositary requirements to protect investors, as a standard agreement could be implemented without a need or regard to different regulatory requirements between Member States.

Without identical implementation, the depositary would need to be aware of how/if the rules or laws would differ from jurisdiction to jurisdiction and how these requirements could be satisfied. This knowledge would need to cover areas such as pricing, safe custody arrangements, dealing and income/distribution rules. This could also lead to variances in the oversight costs involved. A depositary would also need to consider whether on-site visits will be made and have access to all appropriate records. Nevertheless, we believe that any particular conditions that need to be included in a standard agreement should be outlined in Level 3 guidance.

However, we recognise that, for a variety of reasons, identical implementation is unlikely to be achievable in the short term.

We believe that the law that should be applied is that which is applicable to the UCITS and its depositary.

We do not believe that investment companies should be treated differently to common funds.

2) Advise the Commission on standard arrangements between the depositary and management company and identify the particulars of the agreement between them that are required under Articles 23(6)² and 33(6)³ and the regulation of the flow of information deemed necessary to allow the depositary to discharge its duties.

Currently, where a depositary and a Management Company are both situated in the UK, arrangements between a depositary and a management company are contained within a depositary agreement⁴. These may differ slightly between Depositary Companies but in essence, although not exhaustive, should make provision for at least the following:

- An interpretation of the terms used i.e. definition of the terms used within the agreement;
- Effective date of appointment of the depositary;
- Rights over Scheme Property;
- The ability for the Depositary to carry out its regulatory duties under the terms of the agreement and the Regulatory Rules of the fund (in the UK this is FSMA, Trust Deeds/OEIC Regulations, and COLL)⁵;
- The ability for the Depositary to act on authorised instructions from the Management Company;
- Conflicts of interest and a promise on the part of the depositary to act solely in the interests of the unitholders;
- The depositary's role in receiving, holding and distributing income on behalf of the fund;
- A right to terminate the agreement with an agreed period of notice;
- *Force majeure*;
- Details of the governing law and jurisdiction applicable to the agreement.

² Article 23(6) "The Commission may adopt implementing measures on the measures to be taken by a depositary in order to fulfill its duties regarding a UCITS managed by a management company situated in another Member State, including the particulars that need to be included in the standard agreements to be used by the depositary and the management company as referred to in paragraph 4. Those measures, designed to amend non-essential elements of this Directive by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 112(2)."

³ Article 33(6) "The Commission may adopt implementing measures on the measures to be taken by a depositary in order to fulfill its duties regarding a UCITS managed by a management company situated in another Member State, including the particulars that need to be included in the standard agreements to be used by the depositary and the management company referred to in paragraph 4. Those measures, designed to amend non-essential elements of this Directive by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 112(2)."

⁴ Trustees of unit trusts do not have an equivalent to the Depositary agreement as the contractual arrangements are set out in the trust deed.

⁵ The Financial Services and Markets Act 2000, the OEIC Regulations 2001 and the FSA Collective Investment Schemes Sourcebook (COLL).

The fourth bullet point above (covering regulatory duties) would incorporate the scenarios mentioned by the Commission regarding a request for information on investment activities, composition of the assets invested in, calculation of the value of units, continuing compliance with the risk profile of the UCITS/fund rules/prospectus rules and other disclosure documentation.

Another important requirement to include would be guaranteed timely access to the books and records of the fund, whether by means of IT systems or paper based documentation. It should also be possible to be able to undertake on-site visits where this was considered necessary, although a confidentiality clause would also need to be agreed.

It might be more appropriate to look at the actual contents of the depositary agreement as part of Level 3, rather than including it as part of any additional Level 2 Directive or Regulation, as practice may differ between depositaries in different Member States.

3) Consider the need to regulate through level 2 measures the law applicable to the agreement in order to remove legal uncertainty (whether the agreement should be governed by law of UCITS home Member State, management company home Member State or of any other Member State).

We believe that the law adopted by the Management Company should be the law applicable to the domicile of the Depositary/fund.

1.2.4 – Risk Management

1 What should be the conditions that govern risk management processes that can be employed by management/investment companies?

Establish the criteria that competent authorities should take into account when determining whether the risk management process employed by the management company is adequate for monitoring and measuring at any time the risk of a position and its contribution to the overall risk profile of the portfolio.

The recent market events have shown that all manner of risk management and mitigation have been tested within UCITS (and other funds). It is therefore pleasing to note that the vast majority of UCITS have “weathered” and continue to “weather” the unprecedented “climate” experienced. Nevertheless, the introduction of the management company passport and the continuing move to a single market necessitates a harmonised approach for many aspects in the operation of a UCITS. We therefore welcome the Commission’s proposals to strengthen and harmonise Members States’ approach to risk management, not just at the level of the management company and the UCITS, but also at regulator level i.e. how the regulator of each Member State monitors and reacts to risk management and sets out appropriate regulatory limits.

a) to advise on the categories of material risks that are relevant for UCITS (the identification of types of risks that should be addressed).

Whilst the CESR Risk Management Principles Advice states that a manager must consider the material risks attributable to the UCITS, we do not believe that providing an exhaustive, or detailed, list at level 2 will be of any benefit. Risks of historically low importance have, in some circumstances, become material and may, perhaps, reduce to a lesser importance in the future. The dynamic nature of the markets and of funds will continually introduce new risks which will need to be dealt with quickly and not be subject to lengthy negotiations.

We recommend CESR considers these matters by way of separate consultation and to aim to introduce level 3 guidelines, if appropriate.

b) to advise on principles governing the identification of the particular material risks relevant for a particular UCITS related to each portfolio position and their contribution to the overall risk profile of the portfolio,

As CESR has acknowledged in the Call for Evidence, the advice of February 2009⁶ (which was consulted on in August 2008) suggests risk management principles covering governance and organisation, identification and measurement of risks, management of risks, monitoring and reporting. We believe that this advice provides enough detail to advise the Commission on whether level 2 provisions are necessary.

c) to advise, to the extent possible, on requirements concerning risk measurement methods, such as the conditions for the use of different methodologies in relation to the identified types of risk and the specific criteria under which these methodologies might be used,

It has been noted that risk management methodologies vary amongst Member States which has led to differences in the types of UCITS that have been authorised in Member States. However, this topic requires careful consideration and we recommend a separate consultation is appropriate, to include a review of the EU Recommendations on Derivatives (2004). The outcome should not form part of the level 2 measures for the reasons noted in (a) and (b), but appropriate matters could be included in Level 3 Guidance.

d) to establish principles for risk management processes to be employed in order to mitigate or otherwise manage and monitor the identified risks related to each portfolio position and their contribution to the overall risk profile of the portfolio. This could include requirements for management companies to ensure proper functioning of risk management processes, establishment of criteria for assessing the effectiveness of risk management processes, setting out principles for systems for operating risk limits, and / or the definition of reporting and monitoring obligations. This list is not intended to be exhaustive or a final indication of the necessary elements, and CESR should consider the best overall packaged of measures necessary for ensuring sound risk management

as (b) and (c) above.

⁶ Risk Management Principles for UCITS

2. What should be the content of the detailed rules regarding the accurate and independent assessment of the value of OTC derivatives as referred to in Article 51(1)?

We believe that the guidance in the Eligible Assets Directive is sufficient in determining the accurate and independent assessment of the value of OTC derivatives.

3. What detailed rules should govern the content and the procedure to be followed by the management company for communicating the information mentioned in Article 51(1) to the competent authorities of its home Member State?

We believe detailed rules governing the content and procedure should be produced as guidelines within level 3. There is a potential for differences of interpretation as to the content of the Risk Management Process document and level 3 guidance would be helpful. In the absence of level 3 guidance the RMP should be to the standards required by the fund's home state regulator.

1.2.5. On-the-spot verification and investigation (Article 101)

As an example, if a depositary/fund is based in the UK and the management company is in Luxembourg, the CSSF should arrange visits to the depositary via the FSA.

1.2.6. Exchange of information between competent authorities (Article 105)

We agree that MiFID would be a good place to start for both 1.2.5 and 1.2.6. However, the advice must ensure that robust mechanisms exist to enable effective remedial action to be taken against a Management Company (domiciled in another Member State), in circumstances where the competent authority, in which the UCITS is domiciled, has good reasons to suspect that the Management Company is responsible for acts that are contrary to the provisions of the UCITS Directive.

3.1. Merger of UCITS (Article 43(5))

1. With regard to the five kinds of information listed in Articles 43(3)(a) to (e) which the merging and the receiving UCITS have to provide to their investors, CESR is invited to advise the Commission:

a) which information should be considered useful and indispensable with regard to the background and the rationale of the proposed merger?

We believe that the UCITS Directive as written contains sufficient detail with regards to mergers. We do not believe that any further detail is required at level 2.

b) what could be other considerations than those already expressly mentioned in Article 43(3)(b) that would be useful and indispensable with regard to the possible impact of the proposed merger?

We do not believe that any further detail is required at level 2.

c) which 'density' of information (amount of detail) CESR would consider useful and indispensable with regard to the considerations that should be part of the information letter in order to describe the possible impact of the merger on unitholders?

The information should be based on the requirements outlined in Article 43(5) and should be sufficiently detailed so as to explain to unitholders the background, rationale, and how the merger will affect them. We believe that the level of detail required should not be considered at level 2.

d) what could be other specific rights than those already expressly mentioned in Article 43(3)(c)?

We believe that the unitholders in the discontinuing fund should have the right to vote. However, the continuing fund should only vote where the merger will have a material impact.

e) which relevant procedural aspects should be contained in the information letter?

This should not be covered at level 2.

2. With regard to Article 43(3)(e) which refers to the key investor information of the other UCITS involved in the proposed mergers, CESR is invited to clarify whether the KII of the other UCITS should be an integral part of the information letter or a standalone document attached to the information letter containing the information referred to in Article 43(3)(a) to (d).

Rather than duplicate any information in the information letter or increase the complexity of such, it is preferred for the information letter to include and therefore focus on only those matters relevant to the merger. The KID can be attached as a separate document.

3. Bearing in mind that the competent authorities cannot oblige the merging and the receiving UCITS to provide other information to their unitholders than those listed in Article 43(3), but that the merging and the receiving UCITS are free to add, on a voluntary basis, further information, CESR is invited to advise on the form in which the information letter and the additional information should be provided.

The information letter should be available in a medium which is acceptable to all unitholders. The information letter should be of free format with prescribed content rather than prescribed format.

4. CESR is encouraged to provide the Commission with a draft EU standard information letter.

- with regard to the format of the information letter:

CESR is encouraged to specify the format of the information letter.

- with regard to the way to provide the information letter:

We do not believe that a standard format should be written at level 2.

3.2. Master-feeder structures

3.2.1. Article 60(6) regarding the content of the agreement/internal conduct of business rules between feeder and master UCITS

As a minimum, there needs to be agreement regarding access to records, the RMP, auditor and depositary reports.

Where master and feeder funds are in different Member States, the agreement should also state which applicable law shall prevail. Where there are differences in interpretations of the Directive between the jurisdictions, the agreement should state which interpretation should apply to the master in situations where both interpretations could be applied in the jurisdiction of the master. The agreement should be in English.

The applicability of law would also need to consider the relevant numbers of feeders investing in a master. For example, if there were several feeders investing in one master and they were from several different Member States, which would be the most appropriate legal basis?

However, we believe that this level of detail should be given consideration at level 3.

3.2.2. Article 60(6) regarding the appropriate measures to avoid market timing

We do not believe that level 2 should provide detailed guidance on how to prevent or deter market timers as each case is unique. IMA has detailed guidelines⁷ which UK fund managers can consider when dealing with market timing and we believe that level 3, or even industry guidelines can adequately deal with these potential issues. Nevertheless, this aspect should be covered in the agreement mentioned in 3.2.1 above.

3.2.3. Article 60(6) regarding the procedures for approvals in case of liquidation, merger or division of the master UCITS

We do not believe that any further detail should be written at level 2. It would also be helpful to clarify when the process for a UCITS to be “liquidated” / “merged” starts in practice, and how that impacts the commencement of the time period for Home Member State approval.

⁷ Market Timing - Guidelines for Managers of Investment Funds, July 2008

There will also be a need to ensure that information regarding the master UCITS' intentions is given to all feeders at the same time to ensure that investors are treated fairly.

3.2.4. Article 61(3) regarding the agreement between depositaries

1. CESR is invited to advise the Commission:

a) on the useful and indispensable elements to be covered by the agreement between the depositaries of the feeder and the master UCITS and, if appropriate, the way they should be stipulated in order to satisfy the requirements under Article 61(1).

We believe that the depositary of the master UCITS should agree to provide the depositary of the feeder UCITS such information and in a time frame as the depositary of the feeder UCITS requires to enable the depositary of the feeder UCITS to discharge its regulatory obligations under the relevant rules specified by the competent authority of the feeder UCITS. We believe that the detail should be covered in the related information sharing agreement as this could be changed more easily if rules were to change but it would be more appropriate for such "useful or indispensable" elements to be covered at Level 3.

In terms of minimum indispensable elements, the feeder's depositary should have access to: information regarding breaches; a master fund's depositary's concerns; and a master fund's depositary's monitoring. This may require visits to the master's depositary.

b) on a need to take account of specific circumstances (e.g. whether the depositaries of the feeder and the master UCITS are established in the same or in different Member States).

The responsibilities of the depositary are articulated in Article 22. However, these are not implemented consistently across the Member States. The agreement between the depositaries will need to take account of these differences but will vary on a case-by-case basis depending on their respective domiciles. In particular, the agreement may have to take account of the fact that a feeder UCITS and its depositary must comply with the applicable laws of the Member State in which they are situated and the agreement must allow such obligations to be satisfied. However, as noted in 1(a) above we believe that, if necessary, particulars of what should be covered by an agreement can be articulated at Level 3.

2. CESR is encouraged to provide the Commission with a draft model agreement.

Given that depositary responsibilities differ amongst Member States, we do not believe that a model agreement at Level 2 is appropriate. This is a matter that could be considered at Level 3, in terms of content only.

3. Article 61(1) does not lay down whether and how the depositaries of the master and the feeder UCITS may choose the applicable law for the agreement. Given that the competent authorities of the feeder UCITS have to check the agreement, CESR is invited to reflect on any restrictions regarding the choice of the applicable law.

We believe that the applicable law should be that which governs the feeder UCITS and its depositary. This is because a feeder UCITS or the manager must comply with the law and fund rules in the Member State in which it is domiciled. The obligations imposed by Article 22 of the UCITS Directive, which are designed to ensure that the feeder UCITS complies with the law and fund rules, must be interpreted and applied as required by that Member State.

3.2.5. Article 61(3) regarding the irregularities the depositary of the master UCITS has to report

1. When carrying out its tasks, the depositary of the master UCITS may not only detect irregularities in the master UCITS' business that are directly related to the afore-mentioned tasks of the depositary (e.g. detect that the valuation is not in line with the law or fund rules), but by chance the depositary may become aware of other irregularities in the course of carrying out its tasks.

CESR is invited to advise the Commission on whether also those irregularities that the depositary detected in the course of carrying out its tasks should be relevant in this context.

A Master's Depositary should report other appropriate irregularities to its local regulator.

2. CESR is invited to provide the Commission with a list of irregularities the depositary of a UCITS may detect and to categorize these irregularities.

As above, a Master's Depositary should report other appropriate irregularities to its local regulator.

Any communication from the depositary of the master regarding the master UCITS business should be made available equally and at the same time to all depositaries of investors in the master. Therefore a requirement, for example, to notify the feeder of any material pricing breaches in accordance with the law in which the feeder is domiciled, means that all other depositaries of investors in that master would need to be informed. It should be noted that DATA supports a level playing field, but a depositary of a master's duty to inform here should be primarily to the regulator/management company of the master.

Reporting of irregularities to the regulator should be limited to breaches of the master UCITS' rules, but there needs to be differentiation between breaches that need to be reported at an appropriate regular interval (periodic reporting) and those that need to be reported immediately because of their materiality.

3.2.6. Article 62(4) regarding the agreement between auditors

Whilst it is not appropriate for us to comment in detail, as auditor responsibilities differ across Member States, we recommend that any work undertaken should be at Level 3.

3.2.7. Article 64(4) regarding the format and the way to provide information on a conversion into a feeder UCITS or on a change of the master UCITS

No comment

3.2.8 Article 64(4) regarding a contribution in kind

CESR is invited to advise the Commission on the elements of the procedure for valuing and auditing a contribution in kind while reflecting, in particular, on the following elements:

a) Similarities between a merger and a contribution in kind which may justify modelling the procedures for a contribution in kind on Article 42.

In the UK, we are familiar with an in-specie issue or cancellation. This would need to follow requirements under the Collective Investment Schemes Sourcebook (COLL 6.2.15) and how the process is explained in the UCITS' Prospectus. The rules allow for the depositary to take into or pay out of the scheme property assets other than cash as payment for the issue or cancellation of units but only if:

- (1) it has taken reasonable care to ensure that the property concerned would not be likely to result in any material prejudice to the interests of unitholders; and
- (2) The instrument constituting the scheme so provides.

The current UK process for mergers (which appears similar to that proposed for the revised UCITS IV Directive), is more onerous than that currently undertaken for UK 'in-species'.

Before a merger is undertaken, an FSA approved Scheme of Arrangement will provide all investors of the discontinuing fund (unless the merger materially prejudices the ongoing fund) with the opportunity to vote on the proposal. For a UK in-specie it may be the case that the terms of the Prospectus will provide a unitholder with no option in the matter.

Also when carrying out a UK in-specie, the depositary will oversee the process as described above. There is no requirement for an auditor to independently review this information, or indeed, for either the auditor or the depositary to provide a copy of any report as required by Article 42 (3).

When we take this into consideration there could be a strong argument to say that there should be a similar treatment, where applicable, of a contribution in kind in this type of scenario, to that proposed for mergers.

Since there is no UK requirement to have an in-specie independently audited, consideration should be given to what additional costs this alignment might impose and who would be responsible for paying these. In the case of the proposals for mergers, the costs would be the responsibility of the manager, not the UCITS.

Another consideration should be the viability of appointing an independent auditor to undertake such a requirement, in the time between the decision being made to convert/change for either a feeder or master UCITS, and implementation itself (the point at which the auditor would need to be involved). However, the cost implications of this should be carefully considered.

(b) Role of the depositaries of the feeder and the master UCITS in a contribution in kind.

In the case of a receiving fund, a depositary will usually look at the following:

- For an issue, a review of assets to be included as part of the in-specie to ensure that they meet the investment objective/policy of the receiving fund and the assets satisfy the current investment strategy of the fund such that the Fund manager is willing to retain them in the fund.
- For an issue, that the assets involved in the in-specie are valued on the same basis i.e. mid/mid as the receiving fund is priced.
- For a cancellation, that there has been no cherry picking of assets, that is to say that a fund manager is pro-rating (as far as possible) all assets involved in the in-specie.
- For both issues and cancellations, that an independent valuation (at the point of the issue or cancellation) of the assets to be delivered, has been undertaken and provided to the depositary.

If the Commission (on the advice of CESR) were to advise that mergers and contributions in kind should be treated in the same way this would mean additional responsibilities for the UK depositary and for Managers with a resultant increase in costs.

(c) The date for valuing the assets and liabilities of the feeder and the master UCITS and for calculating the exchange ratio.

The assets to be transferred as part of a contribution in kind should be valued at the same time as the valuation point of the receiving UCITS. Depending on the scenario, i.e. feeder and master in the same Member State or feeder and master in different Member States, there would need to be the ability to align the two valuation points by having the flexibility to undertake a 'special valuation' for this explicit purpose.

(d) The effective date for the contribution in kind.

The effective date for the contribution in kind should be determined in line with requirements under Article 47(1).

3.3. Notification procedure

We support IMA's response on this matter.