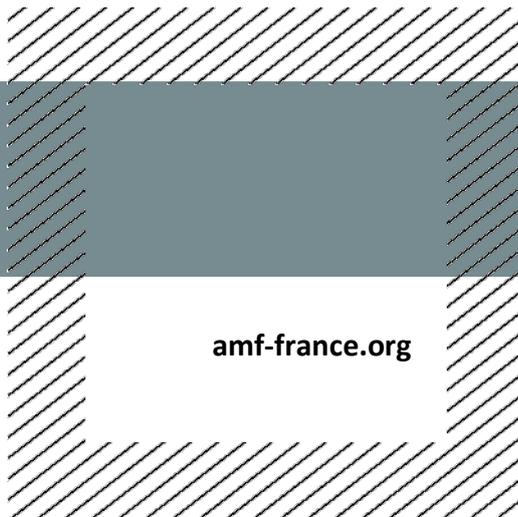


NOVEMBER 2018

**GUIDE FOR IMPLEMENTING
UCITS V REQUIREMENTS FOR
DEPOSITARIES**



amf-france.org

AUTORITÉ
DES MARCHÉS FINANCIERS



INTRODUCTION

Following the works that resulted in the authorisation of the performance specifications and programmes of activity of all of the UCITS depositaries, the Autorité des marchés financiers (French Financial Markets Authority or AMF) wished to provide an overview of the campaign, review the main points of discussion with the participants and present the follow-up actions for building on the instruction works carried out.

1. CHANGE IN THE REGULATORY FRAMEWORK

1.1. THE NEW REGULATORY FRAMEWORK

The objective of the UCITS V Directive¹ was to amend Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 (“UCITS IV”).

The text, which was not intended as a complete revision of the UCITS IV Directive, specifically concerns the functions of UCITS depositaries, as regards their duties and liability, as well as the remuneration policies of fund managers and the sanctions that apply to them. The objective was to harmonise the rules for depositaries with those introduced by Directive 2011/61/EU of 8 June 2011 (the “AIFM Directive”), which came into force on 22 July 2013.

The UCITS V Directive (“Level 1 measures”) was transposed into French law by an order issued on 18 March 2016 modifying the legislative section of the French Financial and Monetary Code and a decree published on 6 April 2016 modifying the General Regulation of the AMF (“GRAMF”).

The tasks and duties of UCITS depositaries were then specified in a delegated regulation² published on 24 March 2016 and applying from 13 October 2016, with which the GRAMF was brought into line by decree on 20 October 2016.

AMF instruction DOC-2016-01, which came into force on 19 April 2016, clarified the procedures to follow for the authorisation of investment firm UCITS depositaries and review of the performance specifications of other UCITS and AIF depositaries.

1.2. FOLLOWING THE TRANSITIONAL ARRANGEMENTS

Under Article 23(4) of the UCITS V Directive, depositaries must meet the requirements of the European text before 18 March 2018.

This transitional measure, referring specifically to the requirements set out in paragraph 2 of Article 23 of the Directive, thus only concerns the conditions for eligibility to act as a depositary, i.e. having received authorisation or having had its performance specifications approved.

Thus, UCITS depositaries must have received approval of their performance specifications or an authorisation before 18 March 2018.

¹ Directive 2014/91/EU of 23 July 2014

² Delegated Regulation (EU) 2016/438 of 17 December 2015

2. FRENCH UCITS DEPOSITARIES

Following the presentation of the first performance specifications to the AMF Board on 4 July 2017, the works continued with all of the participants. Numerous exchanges took place with all institutions in order to smooth out the granularity of the description of the organisation and means, specify the expectations of the regulator, clarify the meaning of certain points of the regulation and ensure that all files were finalised before the end of the transitional period.

To this end, the analysis grid drawn up by the AMF departments and sent to the institutions in February 2017 provided them with information about the level of requirements of the new regulation and a description of compliance procedures.

The review of the files presented led the Board to approve the performance specifications/programmes of activity of the following depositaries:

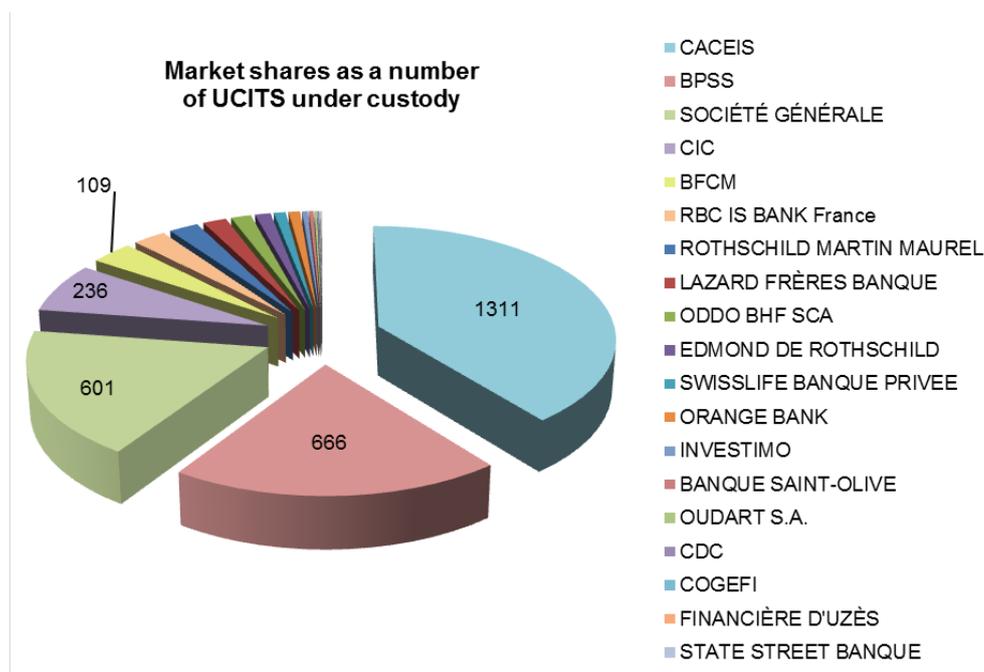
- Credit institutions having their registered office in France:
 - Banque Fédérative du Crédit Mutuel
 - Banque Saint-Olive
 - BNP Paribas Securities Services
 - CACEIS Bank
 - Crédit Industriel et Commercial – CIC
 - Edmond de Rothschild
 - Lazard Frères Banque
 - Odde et Cie
 - Orange Banque (ex-Groupama Banque)
 - Oudart S.A.
 - RBC Investor Services Bank France SA
 - Rothschild Martin Maurel
 - Société Auxiliaire d'Études et d'Investissements Mobiliers (Investimo – Groupe SMABTP)
 - Société Générale (Securities Services)
 - State Street Banque S.A.
 - Swisslife Banque Privée

To date, none of the depositaries are a branch of a European credit institution.

- Investment firms:
 - Conseil de Gestion Financière – COGEFI
 - Financière d'Uzès

- La Caisse des dépôts et consignations. Despite its authorisation by nature, Caisse des dépôts et consignations drew up performance specifications that were analysed by the departments and the conclusions were presented to the AMF Board.

The chart below shows, at 31 December 2017, the breakdown³ of market shares by number of UCITS under custody:



3. ANSWERS TO THE MOST FREQUENTLY ASKED QUESTIONS

3.1. INDEPENDENCE REQUIREMENTS

Article 21 of the UCITS V Delegated Regulation treats the issues of governance, and aims, through various prohibitions, to safeguard the independence of the asset management company and the depositary.

These provisions apply to all management companies and all depositaries working together for the needs of one or more UCITS.

The provisions of Article 24 of the same regulation stipulate additional independence rules when there is a group link⁴ between the management company and the depositary.

3.1.1. Review of the relevant provisions of the UCITS V Regulation

Article 21

Common management

The management company or the investment company and the depositary shall at all times comply with all of the following requirements:

(a) no person may at the same time be both a member of the management body of the management company and a member of the management body of the depositary;

³ The detailed figures taken from the GECO website are provided in Appendix 1.

⁴ Under Article 1(b) of the UCITS V Delegated Regulation, a group link is defined as a situation in which two or more undertakings or entities belong to the same group within the meaning of Article 2(11) of Directive 2013/34/EU of the European Parliament and of the Council or international accounting standards adopted in accordance with Regulation (EC) No. 1606/2002 of the European Parliament and of the Council. In national law, to assess the existence of a group link, refer to the notion of control specified in the provisions of Articles L. 233-16 II of the French Commercial Code.

- (b) no person may at the same time be both a member of the management body of the management company and an employee of the depositary;
- (c) no person may at the same time be both a member of the management body of the depositary and an employee of the management company or the investment company;
- (d) where the management body of the management company is not in charge of the supervisory functions within the company, no more than one third of the members of its body in charge of the supervisory functions shall consist of members who are at the same time members of the management body, the body in charge of the supervisory functions or employees of the depositary;
- (e) where the management body of the depositary is not in charge of the supervisory functions within the depositary, no more than one third of the members of its body in charge of the supervisory functions shall consist of members who are at the same time members of the management body of the management company, or the body in charge of the supervisory functions of the management company or of the investment company or employees of the management company or of the investment company.

Article 24

Independence of management boards and supervisory functions

1. Where a group link exists between them, the management company or the investment company and the depositary shall ensure that:

(a) where the management body of the management company and the management body of the depositary are also in charge of the supervisory functions within the respective companies, at least one third of the members or two persons, whichever is lower, on the management body of the management company and on the management body of the depositary shall be independent;

(b) where the management body of the management company and the management body of the depositary are not in charge of the supervisory functions within the respective companies, at least one third of the members or two persons, whichever is lower, on the body in charge of the supervisory functions within the management company and within the depositary shall be independent.

2. For the purposes of the first paragraph, members of the management body of the management company, members of the management body of the depositary or members of the body in charge of the supervisory functions of the above companies shall be deemed independent as long as they are neither members of the management body or the body in charge of the supervisory functions nor employees of any of the other undertakings between which a group link exists and are free of any business, family or other relationship with the management company or the investment company, the depositary and any other undertaking within the group that gives rise to a conflict of interest such as to impair their judgement.

3.1.2. Regarding the notions of management body and supervisory body

As a reminder, **for a public limited company (*société anonyme*) with a management board and a supervisory board, i.e. a “two-tier” board structure:**

- the management board is invested with the broadest powers to act on behalf of the company⁵;
- the supervisory board solely exercises control functions, performing the required audits and controls, receives the documents needed for its duties⁶ and in principle⁷ has no power to dismiss the members of the management board.

⁵ Article L. 225-61 subparagraph 1 of the French Commercial Code.

⁶ Article L. 225-68 of the French Commercial Code.

⁷ The law grants this power to the general meeting of shareholders. By way of exception, Article L. 225-61 of the Commercial Code permits the articles of incorporation to attribute this power of dismissal to the supervisory board.

In this case, it is easy to identify the management body (the management board) and the supervisory body (the supervisory board).

In a public limited company with a board of directors, i.e. a one-tier board structure, the corporate bodies are:

- the board of directors, which “determines the company’s business strategy and oversees its implementation”⁸, may handle “all matters involving the proper functioning of the company and settles all matters concerning it”⁹, has the power to dismiss at any moment the members of general management (chairman of the board of directors, managing director and deputy managing directors, where relevant¹⁰); its acts bind the company in relation to third parties; lastly, it exercises a right of control and audit¹¹;
- the managing director, who has the power to represent the company in relation with third parties¹²; he or she is in charge of the daily management of the company.

Here, the management body also carries out the supervisory functions (board of directors).

For limited partnerships (*sociétés en commandite simple*), Article L. 221-3 of the French Commercial Code stipulates that they shall be administered by one or several managers (whether partners or not), having the power to bind the company in relation to third parties, by acts falling within the company’s objects¹³. While the partners have the power to dismiss the managers¹⁴, non-managing partners do not have the power to bind the company nor to determine its business strategy or deal with matters relating to the proper functioning of the company. Thus, for limited partnerships, and for the purposes of the UCITS V Delegated Regulation, the management body consists of **all members of the management committee** and the company must provide for a body that will take on the supervisory functions.

Lastly, **in simplified joint stock companies (*sociétés par actions simplifiées*)**, under Article L. 227-5 of the French Commercial Code, the conditions according to which the company is managed are defined in the articles of incorporation. This great statutory freedom thus does not enable to determine in abstracto the company body that has the management powers. Conversely, under the provisions of Article L. 227-6 of the French Commercial Code, French simplified joint stock companies have a president who “is invested with the broadest powers to act on behalf of the company in all circumstances within the limit of the corporate purpose”. The president is thus considered a management body. Moreover, and for the purposes of the UCITS V Delegated Regulation, it is recommended that the creation of a supervisory body and the powers granted to it be written into the articles of incorporation.

The table below summarises the different situations observed:

Legal form of the company	Management body	Supervisory body
“Two-tier” public limited company	Management board	Supervisory board
“One-tier” public limited company	Board of directors	Board of directors
Limited partnership	Members of the management committee	Statutory body
Simplified joint stock company	President or statutory body	Statutory body

⁸ Article L. 225-35 of the French Commercial Code.

⁹ Article L. 225-35 subparagraph 1 of the French Commercial Code.

¹⁰ For the principle of dismissal at any time of the chairman of the board of directors (Article L. 225-47 of the French Commercial Code). For the dismissal of the managing director or deputy managing directors at any time by the board of directors (Article L. 225-55 of the French Commercial Code).

¹¹ Subparagraphs 3 and 4 of Article L. 225-35 of the French Commercial Code.

¹² Article L. 225-56 of the French Commercial Code.

¹³ Article L. 221-5 of the French Commercial Code.

¹⁴ Article L. 221-12 of the French Commercial Code: unanimous dismissal of the statutory managers by the partners or according to the rules provided for in the company statutes for non-statutory managers.

3.1.3. Regarding parallel modes of governance between the management company and the depositary

When there is a **group link** between the management company and the depositary, the provisions of Article 24 of the UCITS V Delegated Regulation apply, even when they have different modes of governance. Thus, these two entities must have at least one third of the members or two persons, whichever is lower, on the body in charge of the supervisory functions who are independent.

3.1.4. Regarding the required number of independent members

In application of Article 24 of the UCITS V Delegated Regulation, to meet the independence requirement of “one third of the members or two persons, whichever is lower”, the rule is the following¹⁵:

Number of members	Number of independent members
1	1
2	1
3	1
4	1
5	1
6 or more	2

3.1.5. Regarding the quality of independent member in the case of a corporate mandate in a financial holding company

As indicated above, Article 24.2 of the UCITS V Regulation defines a double presumption for considering the independent nature of a member of the management or supervisory boards:

- An objective presumption of independence: the relevant member of the first entity (management company or depositary) may not be a member of the management body or the body in charge of the supervisory functions nor an employee of any of the other undertakings between which a group link exists.
- An additional subjective presumption of independence: the relevant member of the first entity (management company or depositary) must not be linked by any:
 - o business,
 - o family
 - o or other relationship

with the second entity, or any other undertaking within the group that would give rise to a conflict of interest such as to impair their judgement.

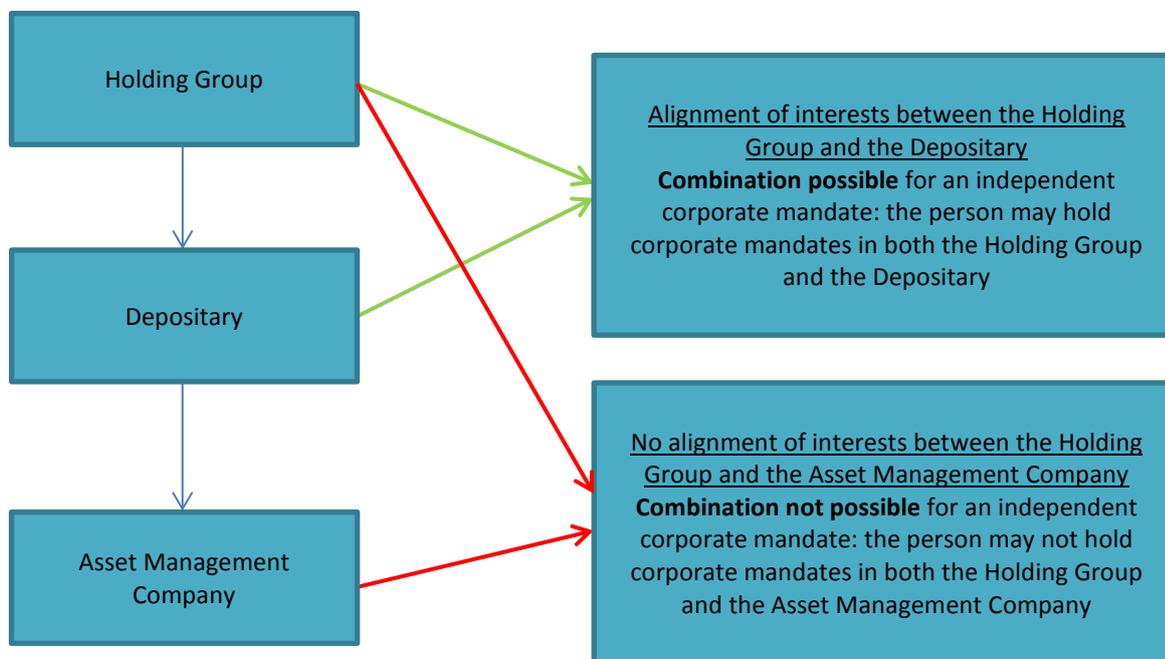
Thus, combining a director’s mandate/membership on the supervisory board in a financial holding company with a director’s mandate/membership on the supervisory board in the depositary would not be an obstacle to qualifying as an independent member within the meaning of the UCITS V Regulation when the financial holding company does not have direct and exclusive control of the depositary such as the interests of the two entities would be aligned.

However, it would not be possible for a person to be considered “independent” in the case that they combine functions within a same group, if these functions include, on the one hand, a director’s mandate/membership on the supervisory board and, on the other, a director’s mandate/membership on the supervisory board within the

¹⁵ Impact study supplementing the UCITS V Delegated Regulation of the European Commission of 17 December 2015. See notably page 39: “Due to downward rounding, this implies that boards of three and four members in total would only need to appoint one independent member”.

holding company that owns the depositary. In this scenario, this person would have corporate mandates in two entities between which a conflict of interest could arise such as to impair their judgement.

For example:



3.1.6. Regarding the quality of independent member on the supervisory boards of sister management companies

To the extent that Article 24 of the UCITS V Delegated Regulation aims to consider only the conflicts of interest between the depositary and the management company when they are related via a group link, a person who combines a director's mandate/membership on the supervisory board in another management company of the group may be deemed an independent member.

It is thus possible for a same person to be an independent member of the supervisory boards of two management companies related via a group link as long as that person does not also hold corporate mandates in the depositary or any other entity whose interests are aligned with the depositary.

3.2. INDEPENDENT LEGAL OPINIONS

The independent legal opinions referred to in Articles 15 and 17 of the UCITS V Delegated Regulation to ensure insolvency protection of UCITS assets when delegating custody functions to third parties in third countries covers:

- the assessment of the regulatory and legal framework (including country risk and custody risk) and the enforceability of the contract (Article 15),
- the concept of the segregation of the assets of the UCITS in case of insolvency of the third party to whom safekeeping functions have been delegated in its local laws (Article 17).

The legal opinion required by Article 15(2) of the UCITS V Delegated Regulation must be financed by the depositary in order to ensure that it is based on the legal advice of a natural or legal person independent from the third party in question.

The assessment of the legal and regulatory framework of the third country applicable in case of insolvency can where necessary be done jointly¹⁶, on the condition that this assessment is sufficiently general and aims to carry out an overall analysis of the current regulations of the third country.

Conversely, the assessment of the enforceability of the contract entered into with the third party to whom safekeeping functions have been delegated with regard to the applicable insolvency law and case law of the country the third party is located in remains specific to each bilateral relationship and must be carried out for each contract.

In the assumption that a French depositary safekeeps the assets via a branch located in a third country, it has the same obligations, i.e. to obtain a legal opinion as stipulated in Article 15(2) of the UCITS V Delegated Regulation on the links it will establish with local sub-custodians, as well as their specific regulatory and legal framework.

This legal opinion must be received by the depositary before entering into a new contract.

It should be noted that the depositary must in all cases (i) ensure that the contractual arrangement with the third party sub-custodian allows for an early termination in cases where the legal and regulatory framework changes in such a way that the obligations stemming from the transposition into French law of the UCITS V Delegated Regulation are no longer fulfilled and (ii) inform the management company of the UCITS concerned of the situation¹⁷.

The legal opinion referred to in Article 17 can be instructed by the third-party sub-custodian itself, with the depositary having here the responsibility of ensuring that its delegate located in a third country has obtained an independent opinion on the segregation of the assets.

Lastly, where the depositary uses a “global custodian” established in a third country, it must obtain a legal opinion as part of its relationship with the global custodian, which must provide a legal opinion on the relationship with its sub-custodian. If this legal opinion is not provided by the global custodian, the French depositary must obtain it.

3.3. CONTROL OF SUB-CUSTODIANS

Paragraph 1 of Article L. 214-9 of the French Monetary and Financial Code specifies that the depositary must act honestly, fairly, professionally, and independently, and in the sole interest of the UCITS and its unit or shareholders.

Thus, regardless of the valuation of the assets under custody and the nature of the relationship between the depositary and its sub-custodian, the depositary must have a procedure for the selection of its delegates to safeguard investors’ interests as well as procedures for the control and monitoring of the services provided.

To this end, note that certifications issued at the demand of the delegate relative to its control procedures does not exempt the depositary from performing its own controls based on due diligence and on-site visits.

3.4. SEPARATION OF THE COMPLIANCE FUNCTION AND THE DEPOSITARY CONTROL

Article L. 214-10-5 of the French Monetary and Financial Code identifies the operating functions of the depositary, notably:

¹⁶ As provided for in recital 19 of the Delegated Regulation: “those opinions may be combined, as the case may be, or issued for each jurisdiction by relevant industry federations or law firms for the benefit of several depositaries”.

¹⁷ UCITS V Regulated Delegation, Articles 15(6) and 15(8).

- The safekeeping of assets,
- Control of decisions relating to the UCITS, called “depository control”,
- Monitoring of the cash flows.

The “depository control” function, which for the depository consists of ensuring that the management company complies with laws and regulations and the regulatory documents of the UCITS, thus constitutes an “operational” activity on which second-level controls must be carried out.

Note that:

- In application of Article 22 of Delegated Regulation 2017/565 and Article 312-1 of the AMF General Regulation, the investment services compliance officer must control the entire scope of the depository's activity, and thus cannot also be in charge of the depository function (which is an “operational” role). The compliance officer thus may not be responsible for the depository control either, as it is part of the “operational” functions of the activity of the depository.
- The person(s) in charge of the depository control (who perform(s) first-level controls) must be placed under the responsibility of the depository function as this task is one of the functions of the depository. This organisation enables the compliance function, which must be independent, to perform its second-level controls.
- However, based on the principle of proportionality, when justified by the nature, scale and complexity of the business, it is possible that a single employee be in charge of both the depository and compliance controls, on the condition that the second-level controls are carried out by another entity, under the responsibility of the depository (consulting firm, for example), independently from the operational functions. This organisation is reviewed by the AMF at the time of the authorisation of the performance specifications or programme of activity of the depository.

3.5. CONTROL OF REGULATORY AND STATUTORY RATIOS

In accordance with 3° III of Article L. 214-10-5 of the French Monetary and Financial Code, the depository of a UCITS “Executes the instructions of the SICAV or management company of the UCITS unless they are contrary to applicable laws or regulations, the rules or instruments of incorporation of the UCITS or its prospectus”. Article L. 214-10-6 of said Code stipulates that this function can also be delegated to third parties.

Article 323-19 of the AMF General Regulation states that:

“The depository shall establish and implement a control plan. This plan shall define the purpose, nature and regularity of the controls concerned.

Controls shall be carried out ex post and exclude any discretionary review. They shall include verifications of the following:

1° Compliance with the investment and asset composition rules;

2° Minimum asset size;

3° The regularity of UCITS valuations;

4° The rules and procedures for establishing the net asset value;

5° Justification of the content of UCITS suspense accounts;

6° Elements specific to certain types of UCITS;

7° The inventory reconciliation report communicated by the asset management company.

The control plan, reports of controls carried out and notes on any anomalies shall be retained for five years” .

The UCITS V Delegated Regulation then stipulates in its recital (7) that:

“By virtue of its obligation of oversight under Directive 2009/65/EC, the depository should set up a procedure to verify on an ex post basis the UCITS' compliance with applicable law and regulations and its rules and instruments of incorporation. This should cover areas such as checking that the UCITS' investments are consistent with its investment strategies as described in the UCITS' rules and offering documents and ensuring that the UCITS does not breach its investment restrictions. The depository should monitor the UCITS' transactions and investigate any unusual transaction. If the limits or restrictions set out in the applicable law or regulations or the UCITS rules and

*instruments of incorporation are breached, the depositary should act **promptly** to reverse the transaction that is in breach of those laws, regulations or rules”.*

Likewise, Article 6 of the Delegated Regulation specifies that:

“A depositary shall be deemed to comply with the requirements set out in point (c) of Article 22(3) of Directive 2009/65/EC where it establishes and implements at least:

(a) appropriate procedures to verify that instructions of the management company or the investment company comply with applicable laws and regulations and with the UCITS' rules and instruments of incorporation;

(b) an escalation procedure where the UCITS has breached one of the limits or restrictions referred to in second subparagraph.

For the purposes of point (a), the depositary shall in particular monitor the UCITS' compliance with investment restrictions and leverage limits to which the UCITS is subject. The procedures referred to in point (a) shall be proportionate to the nature, scale and complexity of the UCITS”.

Thus, as control of the lawfulness of the decisions of the UCITS may not be delegated, the calculation of the regulatory and statutory ratios must be done by the depositary itself and using its own means, which implies that the depositary has its own calculation tools.

It may use a tool provided to it by a technical provider in the framework of a services contract for the provision of technical means. This contract must define the parameters and specify the possibility to control the calculation of the ratios by the depositary.

As the depositary may not, without delegating the calculation of the ratios, use the results of the calculations of the asset management company or its administration and accounting delegate, any technical provider it may use may not be the administration and accounting services provider of the asset management company, as this would lead to a conflict of interests.

Lastly, to fulfil its oversight obligation relating to the instructions of the UCITS or its management company and to react quickly in the event of an unusual transaction, the depositary must ensure compliance with the ratios for each transaction and, at least, at the publication of each net asset value.

4. CONCLUSION: THE 2018 ACTION PLAN

The AMF will draw up an annual questionnaire to be filled out by the depositories in order to collect information on their activities, service providers, delegates, and identify the main changes they underwent in the past year.

The AMF will also establish a procedure to update the performance specifications, define its frequency, specify the changes that would require the updated version to be transmitted to the AMF for information, and draw up a list of significant modifications that would have to be presented to the AMF Board for approval of the new version of the performance specifications or programme of activity. These elements would modify instruction DOC-2016-01.

At the European level, equivalent projects conducted in different countries led to questions about the various themes, such as the notion of delegation, the scope of the depositary control, the segregation of the assets of the UCITS, etc. The AMF participates in these exchanges and will remain attentive to their conclusions as well as to upcoming texts. For example, the European Commission has adopted two draft delegated regulations modifying Delegated Regulations 2016/438 (UCITS) and 231/2013 (AIFM) with regard to the safe-keeping obligations of depositories, and in particular the segregation of assets. The AMF will ensure that these changes will be taken into account.

Appendix 1

Breakdown of the market shares of UCITS under custody

Depository	Number of UCITS
CACEIS	1,311
BPSS	666
SOCIÉTÉ GÉNÉRALE	601
CIC	236
BFCM	109
RBC IS BANK France	84
ROTHSCHILD MARTIN MAUREL	75
LAZARD FRÈRES BANQUE	60
ODDO BHF SCA	51
EDMOND DE ROTHSCHILD	39
SWISSLIFE BANQUE PRIVEE	30
ORANGE BANK	29
INVESTIMO	14
BANQUE SAINT-OLIVE	11
OUDART S.A.	7
CDC	4
COGEFI	3
FINANCIÈRE D'UZÈS	2
STATE STREET BANQUE	2