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Proposal for a

**DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions**

(Text with EEA relevance)

{SWD(2012) 185}

{SWD(2012) 186}

## EXPLANATORY MEMORANDUM

### 1. CONTEXT OF THE PROPOSAL

#### 1.1. General

Since the UCITS Directive was adopted in 1985, the rules relating to depositaries in the Directive have remained unchanged: they consist of a number of generic principles setting out the duties of depositaries. The principal UCITS rule is that all assets of a UCITS fund must be entrusted to a depositary. This depositary shall, in accordance with national law, be liable for losses suffered as a result of a failure to perform its duties. The UCITS Directive, apart from employing a negligence-based standard, makes reference to national laws in respect of the precise contours of these duties. This reference leaves considerable scope for diverging interpretations regarding the scope of a depositary's duties and the liability for the negligent performance thereof. As a result, different approaches have developed across the European Union, leading to UCITS investors facing uneven levels of protection in different jurisdictions.

The potential consequences of national divergences in the liability standard came to the fore following the Lehman bankruptcy<sup>1</sup> and the Madoff fraud. In particular, the consequences of the Madoff fraud have been particularly acute in some EU Member States. In one instance, a particular fund that acted as a feeder fund for Madoff lost around €1.4 billion. The large scale of the Madoff fraud essentially went undetected for a long period because the depositary had delegated custody of the assets to an entity run by Bernard Madoff, the US broker "Bernard Madoff Investment Securities". At the same time, Bernard Madoff was also the manager and broker responsible for purchasing financial instruments on behalf of the fund. The Madoff case raised several important issues in relation to UCITS funds. First, it raises the question of the precise conditions under which a depositary acting on behalf of a UCITS fund can delegate safekeeping of assets to a sub-custodian? The current UCITS Directive is silent on the precise conditions under which custody may be delegated.

The Madoff case also raises the issue of conflicts of interest. More particularly, to what extent should the manager of an investment fund be allowed to belong to the same corporate group as the sub-custodian to whom custody has been delegated? Can it really be expected that a fund manager will always behave in a manner conducive to protecting the interests of a fund's investors where the manager is also the sub-custodian of the assets they invest in? In respect of conflicts of interests that may arise in relation to the independence of the depositary, the UCITS Directive is limited to stipulating the general principle that a company cannot manage a UCITS fund and also act as its depositary. The UCITS Directive contains no rule to cover the conflicts of interest that may arise in case the management function and the depositary functions are delegated to one and the same third party.

Finally, the Madoff case has also revealed general uncertainties within the UCITS framework, especially in relation to the principal custodian's liability in case of delegation of custody to a sub-custodian. The issue of liability in case of delegation, in the absence of hard and fast rules in the relevant UCITS Directive, is dealt with differently in individual Member States.

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<sup>1</sup> One of the consequences of the financial crisis was the bankruptcy of the Lehman Brothers International Europe, the Lehman UK entity which collapsed in 2008. This entity was entrusted as a sub-custodian with assets of some collective investment schemes (although non-UCITS funds, the regulatory model was similar to that of UCITS in terms of depositary rules).

The Madoff case brought to the fore an essential development in the UCITS sphere: while the UCITS provisions on depositaries have remained unchanged, the investment environment for UCITS has evolved. UCITS are now able to invest in a wider range of financial assets, which may be more complex and also may be issued and held in custody outside the EU (for instance, in emerging markets); fund portfolios are increasingly diverse and international.

As a consequence, holding assets through sub-custody arrangements, so as to match the fund's investment strategies, have become increasingly common. The Madoff fraud has shown that the risks associated with the use of delegated sub-custody networks are not always negligible. Assets can be lost at the level of the sub-custodian, which might include loss through fraud committed by the sub-custodian, negligence of the sub-custodian or the bankruptcy of the sub-custodian. Under the current UCITS framework, it is unclear what duties a depositary has in the selection and the oversight of the sub-custodian. As a result, there is a legal uncertainty to what extent a depositary is liable for losses at sub-custodian level.

It must be noted that on 12 July 2010 the Commission proposed the extension of investor compensation schemes to cover investors in UCITS. The amendments to Directive 97/9/EC aimed to cover situations where a depositary is liable for the loss of assets of UCITS but is not able to cover its liabilities. This should serve as an additional means to increase the protection for investors in UCITS. However, at this stage this proposal has not been accepted by the Council and is subject to further negotiations.

In addition, the financial crisis also revealed that the remuneration and incentive schemes commonly applied within financial institutions were themselves exacerbating the impact and scale of the crisis. Remuneration policies contributed to short-term decision making and created incentives for taking excessive risk.

Finally, the analysis of national sanctioning regimes carried out by the Commission, along with the Committees of Supervisors (now transformed into European Supervisory Authorities) has shown a number of divergences and weaknesses which may have a negative impact on the proper application of EU legislation, the effectiveness of financial supervision, and ultimately on competition, stability and integrity of financial markets and consumer protection. Therefore, in its Communication of 9 December 2010 "Reinforcing sanctioning regimes in the financial sector"<sup>2</sup> the Commission suggested setting EU minimum common standards on certain key issues, in order to promote convergence and reinforcement of national sanctioning regimes. The Commission has included such common rules, adapted to the specifics of the sectors concerned, in all its recent proposals for the review of the sectoral EU legislation concerned (CRD IV, MiFID, Market Abuse Directive, Transparency Directive). Extending this work to the UCITS framework is a natural additional step in this process.

This proposal forms part of a wider legislative package dedicated to rebuilding consumer trust in financial markets. The package has two other parts. The first is an extensive overhaul of the Insurance Mediation Directive 2002/92/EC to ensure that customers benefit from a high level of protection when buying insurance products. The final part of the package aims at improving transparency in the investment market for retail investors (a proposal for a Regulation on key information documents for investment products).

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<sup>2</sup> COM(2010)716 final.

## 1.2. Results of consultations with the interested parties and impact assessment

### 1.2.1. Consultation with interested parties

On 3 July 2009 the Commission launched a consultation on UCITS depositaries. This was followed by a feed-back statement in November of the same year.<sup>3</sup> The results of the consultation, supplemented by the technical input from ESMA, are duly reflected in the impact assessment report.

On 9 December 2010, the Commission services launched a second public consultation on the UCITS depositary function and on managers' remuneration, which closed on 31 January, 2011. In total, 58 contributions were received most of which signalled a broad support of the review initiative, particularly with respect to the clarification of depositary functions and to the simplification of the regulatory landscape as a result of the proposed alignment with the AIFM Directive.<sup>4</sup> Respondents however took a more critical stance *vis-à-vis* the issue of depositary liability.<sup>5</sup> The feed-back statements to both consultations are available in Annex 2 of that impact assessment.

As to the issue of administrative sanctions, this report reflects replies to an *ad hoc* questionnaire prepared by the Commission services and sent to the European Securities Committee (ESC), as well as to ESMA. A summary of the Member State replies to the questionnaire is presented as Annex 7 to the Impact Assessment.

### 1.2.2. Impact assessment

The impact assessment focused on five issues: eligibility to act as a depositary, criteria for delegating custody, liability for the loss of financial instruments held in custody, remunerations of UCITS managers and sanctions for breaches of the UCITS rules.

#### Eligibility to act as a depositary

The current UCITS framework provides little clarity on the institutions that are eligible to act as a depositary for a UCITS fund. According to Article 23(3) UCITS Member States enjoy significant discretion as to the institutions they deem eligible to act as UCITS depositaries, provided that the institutions comply with the requirements of Article 23 (2) (i.e. they are subject to prudential regulation and on-going supervision).

This has led to divergent approaches across Member States: out of the 17 Member States that require depositaries to be credit institutions, 12 impose specific capital requirements just for carrying out custody activities or other related UCITS depositary functions. In those Member States that allow entities other than credit institutions to act as a UCITS depositary, only 3 require depositaries to fulfil additional capital requirements.

National divergences as to the entities that can act as depositaries for a UCITS fund may be at the origin of significant legal uncertainty and could lead to differential levels of investor

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<sup>3</sup> Available at:

[http://ec.europa.eu/internal\\_market/consultations/docs/2009/ucits/feedback\\_statement\\_en.pdf](http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/feedback_statement_en.pdf)

<sup>4</sup> Categories of respondents: corporate entities and their industry associations (46), Member State public authorities (11), and consumer organisations (1).

<sup>5</sup> Two public consultations are respectively available at:

[http://ec.europa.eu/internal\\_market/consultations/docs/2009/ucits/consultation\\_paper\\_en.pdf](http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/consultation_paper_en.pdf) and  
[http://ec.europa.eu/internal\\_market/consultations/docs/2010/ucits/consultation\\_paper\\_en.pdf](http://ec.europa.eu/internal_market/consultations/docs/2010/ucits/consultation_paper_en.pdf)

protection. Furthermore, allowing entities that are not either credit institutions or investment firms to act as depositaries without applying minimum capital requirements entails considerable risk in relation to the resources available to these entities.

Three options emerged for harmonising the scope of institutions that are deemed to provide sufficient guarantees in terms of prudential regulation and capital requirements to fulfil the task of being a depositary. The impact assessment concludes that both credit institutions and regulated investment firms provide sufficient guarantees in terms of prudential regulation, capital requirements and effective supervision to act as UCITS depositaries. Other institutions (such as, e.g., law firms, notaries) are not deemed to provide these guarantees and would have, if they wished to act as UCITS depositaries, to transform themselves into regulated investment firms. As most UCITS depositaries are already credit institutions or regulated investment firms, the impact of the chosen option would thus only concern a small minority of unlicensed service providers. Notaries and law firms would, obviously, be allowed to continue to act in their traditional field as depositaries for non-UCITS funds, such as small venture capital and private equity funds that rarely invest in listed securities.

### Delegation of custody

Changes to the UCITS directive introduced in 2001 extended the scope of eligible assets for UCITS to new classes of assets.<sup>6</sup> As a result, UCITS managers now invest in a much greater number of countries and in more complex instruments than in 1985. As more investment opportunities arise in different third country jurisdictions, the necessity to appoint sub-custodians in these jurisdictions increases.

Despite the enlargement of eligible investment instruments, the UCITS Directive does not define the conditions applicable in case a depositary delegates custody to a sub-custodian. The lack of clarity pertains both to the conditions under which a delegation can take place (e.g., objective reason for delegation, level of skill in selecting sub-custodian, intensity of ongoing monitoring of sub-custodian) and to the conditions under which, exceptionally, custody might be delegated to third country custodians who do not meet prudential and supervisory standards.

The impact assessment concludes that the delegation of custody should be governed by rules on diligence in selecting an appointing a sub-custodian, and on the ongoing monitoring of the activities of the sub-custodian. For the rare case in which a UCITS' investment strategy would involve investing in financial instruments issued in countries that require mandatory local custody and where no custodian operates that could comply with the above delegation requirements and prudential standards, delegation should nevertheless be allowed so long as strict circumstances are fulfilled.

### Liability

According to Article 24 of UCITS Directive, liability for loss of a financial instrument that is held in custody only arises in case of 'unjustifiable failure to perform obligations' or 'improper performance' of these duties. These legal terms have given rise to different interpretations in

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<sup>6</sup> Including money market instruments, index-based funds including exchange traded funds (ETFs) fund of funds, derivatives (options, swaps, futures/forwards) or other over-the-counter derivatives. Please refer to Directive 2007/16/EC, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:079:0011:0019:EN:PDF>

Member States and thus differences in investor protection. Some Member States apply a so-called 'strict' liability regime, where the depositary has an immediate obligation to return the lost asset to the UCITS, while others take the view that the loss of assets does not always imply an unjustifiable failure to perform its duties on the part of the depositary that should lead to liability for that depositary. As a consequence, the liability standard is not the same in all Member States.

The issue of liability is most relevant where custody is delegated. According to Article 22(2), the depositary's liability *"shall not be affected by the fact that it has entrusted to a third party all or some of the assets in its safe-keeping"*. The UCITS Directive contains no further provisions governing liability for the loss of a financial instrument where custody has been delegated to a third party. This issue is left to the general principle expressed in Article 22(2), which gives a wide margin of interpretation to Member States. For instance, some Member States only impose an obligation to monitor the sub-custodian which means that the depositary will not be held liable in case of loss if it shows it has performed its monitoring duty correctly (a negligence-based standard). By contrast, other Member States impose an obligation to return the assets irrespective of whether a monitoring duty was breached. The Madoff case demonstrated the fundamental difference between strict liability and negligence standards.

The impact assessment concludes that a 'strict liability' standard obliging depositaries to return instruments lost in custody irrespective of fault or negligence is both conducive to ensuring a high level of investor protection and to achieving a uniform standard across the EU. In line with the needs of retail investors, liability in case of the loss of an instrument held in custody should be based on a uniform EU standard that entails a 'strict liability' for returning lost instruments at the cost of the principal custodian, without any option for the principal custodian to discharge liability in case of delegated custody.

### Remuneration

Given that the remuneration of UCITS managers is, at least partly, based on the performance of the fund, there is an incentive to increase the level of risk in a fund's portfolio in order to increase potential returns. However, the higher level of risk exposes the fund investors to higher potential losses than might be expected given the disclosed risk profile of the fund. Remuneration structures might be skewed so that managers participate in materialized returns but do not participate in materialized losses, creating further incentives to take on higher risk strategies. Furthermore, remuneration structures are seldom disclosed in the fund's offering documents, rendering managers largely unaccountable to investors as far as the determinants of executive pay in line with fund performance are concerned.

It is envisaged to introduce a requirement for the UCITS management company to implement remuneration policy that is consistent with sound risk management of the UCITS fund and complies with minimum remuneration principles. The UCITS management company would also be required to disclose the amount of remuneration for the financial year with appropriate detail in the annual report of the UCITS fund.

### Sanctions

The analysis of national rules on sanctions for breaches of the obligations of the UCITS Directive carried out by the Commission has revealed three salient features: (i) differences in the amounts of pecuniary sanctions (i.e. fines) applied to the same categories of breaches; (ii)

different criteria were applicable to determining the amount of administrative sanctions; and (iii) variations in the level of the use of sanctions.

The policy choice is to achieve minimum harmonization of the sanctioning regimes by requiring (i) a minimum catalogue of administrative sanctions and measures (including harmonization of the lower bound of the maximum amounts of administrative fines), (ii) a minimum list of sanctioning criteria, and (iii) competent authorities and management companies to establish whistle-blowing mechanisms. This sanctioning regime would apply to a catalogue of breaches of main investor protection safeguards in the UCITS Directive.

## **2. LEGAL ELEMENTS OF THE PROPOSAL**

### **2.1. Rules on depositaries' duties**

In relation to the depositary's core safekeeping and oversight duties, the draft proposes to amend Article 22 UCITS in the following manner:

Article 22(1) specifies that a single depositary shall be appointed for each UCITS fund. This rule intends to ensure that one fund cannot have several depositaries.

Article 22(2) proposes to specify that the appointment of a depositary shall be evidenced by written contract.

Article 22(3) makes uniform a list of oversight duties of depositaries of UCITS established in a contractual form and UCITS established in a corporate form. These duties involve verifying compliance with applicable rules when UCITS shares are sold, issued, re-purchased, redeemed and cancelled; verifying that any consideration is remitted to it within the usual time limits; verifying that the investment company's income is applied in accordance with the law and its instruments of incorporation, ensuring that the value of units in a UCITS is calculated in accordance with the applicable national law and the fund rules; and carrying out instructions of the management or investment company.

Article 22(4) contains detailed provisions on cash monitoring. This paragraph intends to equip the depositary with a view over all the assets of the UCITS, cash included. This paragraph also ensures that no cash account associated with the funds' transactions shall be opened without the depositary's knowledge. The aim is to avoid the possibility of fraudulent cash transfers. This paragraph also introduces 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 can at all times be identified as belonging to that UCITS; such a requirement aims to confer an additional layer of protection for investors should the depositary default.

Article 22(5) introduces a distinction between (1) custody duties relating to financial instruments that can be held in custody by the depositary and (2) verification of the ownership 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 to be held in a UCITS portfolio.

New Article 25(2) contains a series of customary provisions on conduct, the avoidance of and the management of conflicts of interest.

In this context, Article 26b introduces new implementing measures 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 securities 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.

## **2.2. Rules on delegation**

Article 22(7) defines the conditions in which the depositary's safekeeping duties can be delegated to a sub-custodian. Essentially, the conditions and requirements upon which a UCITS depositary may entrust its safekeeping duties to a third party are aligned with those applicable under the AIFM Directive.

Article 26b delegates to the Commission the power to adopt delegated acts that will further define the depositary's initial and on-going due diligence duties, including those that apply to the selection and appointment of a sub-custodian.

## **2.3. Rules on eligibility to act as a UCITS custodian**

In light of the different national eligibility criteria that currently apply to the activities of depositaries, the draft proposes to modify Article 23(2) setting out an exhaustive list of entities that are eligible to act as depositaries. The policy choice is to only allow credit institutions and investment firms to act as UCITS depositaries. Article 23 contains transitional provisions for UCITS that appointed entities that are no longer able to act as depositaries.

## **2.4. Rules on liability**

Article 24(1) aims to clarify the UCITS depositary's liability in case of the loss of a financial instrument that is held in custody. According to this paragraph, the UCITS depositary, in case a financial instrument held in custody is lost, shall be under the obligation to return a financial instrument 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 the depositary can prove that the loss is due to an 'external event beyond its reasonable control'. Moreover, it is made clear that, in case of assets that are lost, the UCITS depositary has the general obligation to return the financial instruments of the identical type or of the corresponding amount to the UCITS 'without undue delay'.

Article 26b provides for corresponding implementing measures to clarify certain technical aspects, for example to specify circumstances under which an instrument held in custody may be considered as lost.

Article 24(2) contains the rule according to which the depositary's liability is not affected by the fact that it has entrusted to a third party all or some of its custody tasks. As a result, the depositary is obliged to return instruments held in custody that are lost, even if the loss occurred with the sub-custodian. 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.

Article 24(2), in contrast to Article 21(12) AIFMD, therefore holds the depositary liable for the return of the instrument, also in case of delegation, without the possibility to discharge liability by contract. This strengthening of the liability in case of delegation of custody

appears justified in light of the very large investors base and the retail nature of UCITS holders. Introducing a regime with the same contractual possibility for the depositary to be discharged of its liability as it is allowed under AIFM Directive, is not considered to be entirely appropriate. To a similar extent, envisaging that the liability of the depositary could be discharged where assets are transferred to a sub-custodian that does not comply with delegation criteria would also not be appropriate.

## **2.5. Redress**

Article 24(5) concerns redress against the depositary. This paragraph aligns the rights of investors in both corporate and contractual UCITS so that they 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.

## **2.6. Remuneration**

The proposed Articles 14a and 14b reflect current policy on remuneration of senior management, risk takers and those who exercise control functions. These principles should also apply to those that manage a UCITS fund, be it managed in the form of an investment company or in the form of a management company.

## **2.7. Access to telephone and data records**

Existing telephone and data traffic records constitute important evidence to detect and prove a breach of the provisions of the UCITS Directive. Therefore, Article 98 is modified in order to ensure that competent authorities should be able to require existing telephone and existing data traffic records held by a telecommunication operator or by a UCITS, a management company, an investment company or a depositary, where a reasonable suspicion exists that such records related to the subject-matter of the inspection may be relevant to prove a breach of the provisions of the UCITS Directive. It should also be clear that these records shall however not concern the content of the communication to which they relate.

## **2.8. Sanctions and measures**

Articles 99a to 99e reflect current horizontal policies in the financial service sector concerning sanctions and measures. They define a common approach to the main breaches of the UCITS Directive. Article 99a sets out a list of the main breaches. It also lays down the administrative sanctions and measures that the competent authorities should be empowered to apply in case of the main breaches.

## **3. BUDGETARY IMPLICATION**

There are no implications for the EU budget in that no additional funding and no additional posts will be required to perform these tasks. The tasks envisaged for the European Securities and Markets Authority fall within the scope of existing responsibilities for this Authority, therefore the allocation of resources and staff foreseen in the approved Legislative Financial Statements for this Authority will be sufficient to facilitate the execution of these tasks.

Proposal for a

**DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions**

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 53(1) thereof,

Having regard to the proposal from the European Commission<sup>7</sup>,

After transmission of the draft legislative act to the national Parliaments,

Having regard to the opinion of the European Central Bank<sup>8</sup>,

After consulting the European Data Protection Supervisor,

Acting in accordance with the ordinary legislative procedure,

Whereas:

- (1) Directive 2009/65/EC of the European Parliament and of the Council<sup>9</sup> should be amended in order to take into account market developments and the experiences of market participants and supervisors gathered so far, in particular to address discrepancies between national provisions in respect of depositaries' duties and liability, remuneration policy and sanctions.
- (2) In order to address the potentially detrimental effect of poorly designed remuneration structures on the sound management of risks and control of risk-taking behaviour by individuals, there should be an express obligation for undertakings of collective investment in transferable securities (UCITS) management companies to establish and maintain, for those categories of staff whose professional activities have a material impact on the risk profiles of the UCITS they manage, remuneration policies and practices that are consistent with sound and effective risk management. Those

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<sup>7</sup> OJ C.,p.

<sup>8</sup> OJ C.,p.

<sup>9</sup> OJ L 302,17.11.2009, p.32.

categories of staff should at least include senior management, risk takers, control functions, and any employees receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers. Those rules should also apply to UCITS investment companies that do not designate a management company.

- (3) The principles governing remuneration policies should recognise that UCITS management companies are able to apply those policies in different ways according to their size and the size of the UCITS they manage, their internal organisation and the nature, scope and complexity of their activities.
- (4) The principles regarding sound remuneration policies established in this Directive should be consistent with and be complemented by the principles set out in the Commission Recommendation 2009/384/EC of 30 April 2009 on remuneration policies in the financial services sector<sup>10</sup>.
- (5) In order to promote supervisory convergence in the assessment of remuneration policies and practices, the European Securities and Markets Authority (ESMA), established by Regulation (EU) No 1095/2010 of the European Parliament and of the Council<sup>11</sup> should ensure the existence of guidelines on sound remuneration policies in the asset management sector. The European Banking Authority (EBA) established by Regulation (EU) No 1093/2010 of the European Parliament and of the Council<sup>12</sup> should assist ESMA in the elaboration of such guidelines.
- (6) The provisions on remuneration should be without prejudice to the full exercise of fundamental rights guaranteed by the Treaties, general principles of national contract and labour law, applicable legislation regarding shareholders' rights and involvement and the general responsibilities of the administrative and supervisory bodies of the institution concerned, as well as the right, where applicable, of social partners to conclude and enforce collective agreements, in accordance with national laws and custom.
- (7) In order to ensure the necessary level of harmonisation of the relevant regulatory requirements in different Member States additional rules should be adopted defining the tasks and duties of depositaries, designating the legal entities that may be appointed as depositaries and clarifying the liability of depositaries in cases UCITS assets are lost in custody or in the case of depositaries' improper performance of their oversight duties. Such improper performance may result in the loss of assets but also in the loss of the value of assets, if, for example, a depositary tolerated investments that were not compliant with fund rules, while exposing the investor to unexpected or anticipated risks. Additional rules should also clarify the conditions under which depositary functions may be delegated.
- (8) It is necessary to clarify that a UCITS should appoint a single depositary having general oversight over the UCITS's assets. Requiring that there be a single depositary should ensure that the depositary has a view over all the assets of the UCITS and both fund managers and investors have a single point of reference in the event that

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<sup>10</sup> OJ L 120,15.5.2009,p.22.

<sup>11</sup> OJ L 331,15.12.2010,p.84.

<sup>12</sup> OJ L 331,15.12.2010,p.12.

problems occur in relation to the safekeeping of the assets or the performance of oversight functions. The safekeeping of assets includes holding assets in custody or, where assets are of such a nature that they cannot be held in custody, verification of the ownership of those assets as well as record-keeping for those assets.

- (9) In performing its tasks, a depositary should act honestly, fairly, professionally, independently and in the interest of the UCITS or of the investors of the UCITS.
- (10) In order to ensure a harmonised approach to the performance of depositaries duties in all Member States irrespective of the legal form taken by the UCITS, it is necessary to introduce a uniform list of oversight duties that are incumbent on both a UCITS with a corporate form (an investment company) and a UCITS in a contractual form.
- (11) The depositary should be responsible for the proper monitoring of the UCITS' cash flows, and, in particular, for ensuring that investor money and cash belonging to the UCITS is booked correctly on accounts opened in the name of the UCITS, or in the name of the management company acting on behalf of the UCITS, or in the name of the depositary acting on behalf of the UCITS. Therefore detailed provisions should be adopted on cash monitoring so as to ensure effective and consistent levels of investor protection. When ensuring investor money is booked in cash accounts, the depositary should take into account the principles set out in Article 16 of Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive<sup>13</sup>.
- (12) In order to prevent fraudulent cash transfers, it should be required that no cash account associated with the funds' transactions be opened without the depositary's knowledge.
- (13) Any financial instrument held in custody for a UCITS should be distinguished from the depositary's own assets, and at all times be identified as belonging to that UCITS; such a requirement should confer an additional layer of protection for investors should the depositary default.
- (14) In addition to the existing duty to safe keep assets belonging to a UCITS, assets should be differentiated between those that are capable of being held in custody and those that are not, where a record-keeping and ownership verification requirement applies instead. The group of assets that can be held in custody should be clearly differentiated, since the duty to return lost assets should only apply to that specific category of financial assets.
- (15) It is necessary to define the conditions for the delegation of the depositary's safe-keeping duties to a third party. Delegation and sub-delegation should be objectively justified and subject to strict requirements in relation to the suitability of the third party entrusted with the delegated function, and in relation to the due skill, care and diligence that the depositary should employ to select, appoint and review that third party. For the purpose of achieving uniform market conditions and an equally high level of investor protection, such conditions should be aligned with those applicable under Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC

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<sup>13</sup> OJ L 241, 2.9.2006, p. 26.

and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010<sup>14</sup>. Provisions should be adopted to ensure that third parties dispose of the necessary means to perform their duties and that they segregate UCITS' assets.

- (16) Entrusting the custody of assets to the operator of a securities settlement system as provided for in Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems<sup>15</sup> or entrusting the provision of similar services to third-country securities settlement systems should not be considered a delegation of custody functions.
- (17) A third party to whom the safe-keeping of assets is delegated should be able to maintain an omnibus account, as a common segregated account for multiple UCITS.
- (18) Where custody is delegated to a third party, it is also necessary to ensure that the third party is subject to specific requirements on effective prudential regulation and supervision. In addition, in order to ensure that the financial instruments are in the possession of the third party to whom custody was delegated, periodic external audits should be performed.
- (19) In order to ensure consistently high levels of investor protection, provisions on conduct and on the management of conflicts of interest should be adopted and they should apply in all situations, including in case of delegation of safe-keeping duties. Those rules should in particular ensure a clear separation of tasks and functions between the depositary, the UCITS and the management company.
- (20) In order to ensure a high level of investor protection and to guarantee an appropriate level of prudential regulation and on-going control, it is necessary to establish an exhaustive list of entities that are eligible to act as depositaries, such that only credit institutions and investment firms are permitted to act as UCITS depositaries. In order to allow other entities that may have previously been eligible to act as depositaries for UCITS funds to convert themselves into eligible entities, transitional provisions should be provided for those entities.
- (21) It is necessary to specify and clarify the UCITS depositary's liability in case of the loss of a financial instrument that is held in custody. The depositary should be liable, where a financial instrument held in custody has been lost, to return a financial instrument of the identical type or of the corresponding amount to the UCITS. No further discharge of liability in case of loss of assets should be envisaged, except where the depositary is able to prove that the loss is due to an 'external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary'. In this context, a depositary should not be able to rely on internal situations such as a fraudulent act by an employee to discharge itself of liability.
- (22) Where the depositary delegates custody tasks and the financial instruments held in custody by a third party are lost, the depositary should be liable. It should also be established that in case of loss of an instrument held in custody, a depositary is bound to return a financial instrument of identical type or the corresponding amount, even if the loss occurred with a sub-custodian. The depositary shall only discharge that

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<sup>14</sup> OJ L 174, 1.7.2011, p. 1.

<sup>15</sup> OJ L 166, 11.6.1998, p. 45.

liability where it can prove that the loss resulted from an external event beyond its reasonable control and with consequences that were unavoidable despite all reasonable efforts to the contrary. In this context, a depositary should not be able to rely on internal situations such as a fraudulent act by an employee to discharge itself of liability. No discharge of liability either regulatory or contractual should be possible in case of loss of assets by a depositary or its sub-custodian.

- (23) Every investor in a UCITS fund should be able to invoke claims relating to the liability of its depositary, either directly or indirectly, through the management company. Redress against the depositary should not depend on the legal form that a UCITS fund takes (corporate or contractual form) or the legal nature of the relationship between the depositary, the management company and the unit-holders.
- (24) On 12 July 2010 the Commission proposed amendments to Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor compensation schemes.<sup>16</sup> It is essential that that the proposal of 12 July 2010 be complemented by clarifying the obligations and the scope of the liability of the depositary and the sub-custodians of UCITS with a view to provide a high level of protection for UCITS investors where a depositary cannot meet its obligations set out in this Directive.
- (25) It is necessary to ensure that the same requirements apply to depositaries irrespective of the legal form a UCITS takes. Consistency of requirements should enhance legal certainty, increase investor protection and contribute to a creating uniform market conditions. The Commission has not received any notification that the derogation from the general obligation to entrust assets to a depositary has been used by an investment company. Therefore, the requirements of Directive 2009/65/EC regarding the depositary of an investment company should be considered redundant.
- (26) In line with the Commission Communication of 8 December 2010 on reinforcing sanctioning regimes in the financial services sector,<sup>17</sup> competent authorities should be empowered to impose pecuniary sanctions which are sufficiently high so as to be dissuasive and proportionate, so as to offset expected benefits from behaviours which breach requirements.
- (27) In order to ensure a consistent application across Member States, when determining the type of administrative sanctions or measures and the level of administrative pecuniary sanctions, Member States should be required to ensure that competent authorities take into account all relevant circumstances.
- (28) In order to strengthen the dissuasive effect on the public at large and to inform them about breaches of rules which may be detrimental to investors' protection, sanctions should be published, save in certain well-defined circumstances. In order to ensure compliance with the principle of proportionality, sanctions should be published on an anonymous basis where publication would cause a disproportionate damage to the parties involved.

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<sup>16</sup> OJ L 84, 26.03.1997,p.22

<sup>17</sup> COM(2010)716 final..

- (29) In order to detect potential breaches, competent authorities should be entrusted with the necessary investigatory powers, and should establish effective mechanisms to encourage reporting of potential or actual breaches.
- (30) This Directive should be without prejudice to any provisions in the law of Member States relating to criminal offences and sanctions.
- (31) This Directive respects the fundamental rights and observes the principles recognised in the Charter of Fundamental Rights of the European Union as enshrined in the Treaty on the Functioning of the European Union.
- (32) In order to ensure that the objectives of this Directive are attained, the Commission should be empowered to adopt delegated acts in accordance with Article 290 of the Treaty on the Functioning of the European Union. In particular, the Commission should be empowered to adopt delegated acts to specify the particulars that need to be included in the standard agreement between the depositary and the management company or the investment company, the conditions for performing depositary functions, including the type of financial instruments that should be included in the scope of the depositary's custody duties, the conditions subject to which the depositary may exercise its custody duties over financial instruments registered with a central depositary and the conditions subject to which the depositary should safe keep the financial instruments issued in a nominative form and registered with an issuer or a registrar, the due diligence duties of depositaries, the segregation obligation, the conditions subject to and circumstances in which financial instruments held in custody should be considered as lost, what is to be understood by external events beyond reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary. The Commission, when preparing and drawing-up delegated acts, should ensure simultaneous, timely and appropriate transmission of relevant documents to the European Parliament and to the Council.
- (33) In accordance with the Joint Political Declaration of 28 September 2011 of Member States and the Commission on explanatory documents<sup>18</sup>, Member States have undertaken to accompany, in justified cases, the notification of their transposition measures with one or more documents explaining the relationship between the components of a directive and the corresponding parts of national transposition instruments. With regard to this Directive, the legislator considers the transmission of such documents to be justified.
- (34) The objectives of the actions to be taken to improve investors' confidence in UCITS, by enhancing requirements concerning the duties and the liability of depositaries, the remuneration policies of management companies and investment companies, and by introducing common standards for the sanctions applying to the main breaches of the provisions of this Directive, cannot be sufficiently achieved by Member States acting independently of one another. Since only action at the European level can address the identified weaknesses, and therefore such action can be better achieved at Union level, the Union should adopt the necessary measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on the European Union. In accordance

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<sup>18</sup> OJ C 369, 17.12.2011, p. 14.

with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve that objective.

(35) Directive 2009/65/EC should therefore be amended accordingly,

HAVE ADOPTED THIS DIRECTIVE:

#### *Article 1*

Directive 2009/65/EC is amended as follows:

(1) The following Articles 14a and 14b are inserted:

"Article 14a

1. Member States shall require management companies to establish and apply remuneration policies and practices that are consistent with and promote sound and effective risk management and do not encourage risk-taking which is inconsistent with the risk profiles, rules or instruments of incorporation of the UCITS they manage.

2. The remuneration policies and practices shall cover salaries and discretionary pension benefits.

3. The remuneration policies and practices shall apply to those categories of staff, including senior management, risk takers, control functions and any employee receiving total remuneration that falls within the remuneration bracket of senior management and risk takers and whose professional activities have a material impact on the risk profiles of the management companies or of UCITS they manage.

4. In accordance with Article 16 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council(\*), ESMA shall issue guidelines addressed to competent authorities which comply with Article 14b. Those guidelines shall take into account the principles on sound remuneration policies set out in Commission Recommendation 2009/384/EC(\*\*), the size of the management company and the size of UCITS they manage, their internal organisation and the nature, the scope and the complexity of their activities. In the process of development of the guidelines ESMA shall cooperate closely with the European Banking Authority (EBA) in order to ensure consistency with requirements developed for other sectors of financial services, in particular credit institutions and investment firms.

Article 14b

1. When establishing and applying the remuneration policies referred to in Article 14a, management companies shall comply with the following principles in a way and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities:

(a) the remuneration policy is consistent with and promotes sound and effective risk management and does not encourage risk-taking which is

inconsistent with the risk profiles, rules or instruments of incorporation of the UCITS they manage;

- (b) the remuneration policy is in line with the business strategy, objectives, values and interests of the management company and the UCITS it manages or the investors of such UCITS, and includes measures to avoid conflicts of interest;
- (c) the management body of the management company, in its supervisory function, adopts and periodically reviews the general principles of the remuneration policy and is responsible for its implementation;
- (d) the implementation of the remuneration policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for remuneration adopted by the management body in its supervisory function;
- (e) staff engaged in control functions are compensated in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control;
- (f) the remuneration of the senior officers in the risk management and compliance functions is directly overseen by the remuneration committee;
- (g) where remuneration is performance related, the total amount of remuneration is based on a combination of the assessment of the performance of the individual and of the business unit or UCITS concerned and of the overall results of the management company, and when assessing individual performance, financial as well as non-financial criteria are taken into account;
- (h) the assessment of performance is set in a multi-year framework appropriate to the life-cycle of the UCITS managed by the management company in order to ensure that the assessment process is based on longer term performance and that the actual payment of performance-based components of remuneration is spread over a period which takes account of the redemption policy of the UCITS it manages and their investment risks;
- (i) guaranteed variable remuneration is exceptional, occurs only in the context of hiring new staff and is limited to the first year;
- (j) fixed and variable components of total remuneration are appropriately balanced and the fixed component represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy on variable remuneration components, including the possibility to pay no variable remuneration component;
- (k) payments related to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward failure;

- (l) the measurement of performance used to calculate variable remuneration components or pools of variable remuneration components includes a comprehensive adjustment mechanism to integrate all relevant types of current and future risks;
- (m) subject to the legal structure of the UCITS and its fund rules or instruments of incorporation, a substantial portion, and in any event at least 50% of any variable remuneration consists of units of the UCITS concerned, or equivalent ownership interests, or share-linked instruments or equivalent non-cash instruments, unless the management of UCITS accounts for less than 50% of the total portfolio managed by the management company, in which case the minimum of 50% does not apply.

The instruments referred to in this point shall be subject to an appropriate retention policy designed to align incentives with the interests of the management company and the UCITS it manages and the investors of such UCITS. Member States or their competent authorities may place restrictions on the types and designs of those instruments or ban certain instruments as appropriate. This point shall be applied to both the portion of the variable remuneration component deferred in line with point (n) and the portion of the variable remuneration component not deferred;

- (n) a substantial portion, and in any event at least 40%, of the variable remuneration component, is deferred over a period which is appropriate in view of the life cycle and redemption policy of the UCITS concerned and is correctly aligned with the nature of the risks of the UCITS in question.

The period referred to in this point shall be at least three to five years unless the life cycle of the UCITS concerned is shorter; remuneration payable under deferral arrangements vests no faster than on a pro-rata basis; in the case of a variable remuneration component of a particularly high amount, at least 60% of the amount shall be deferred;

- (o) the variable remuneration, including the deferred portion, is paid or vests only if it is sustainable according to the financial situation of the management company as a whole, and justified according to the performance of the business unit, the UCITS and the individual concerned.

The total variable remuneration shall generally be considerably contracted where subdued or negative financial performance of the management company or of the UCITS concerned occurs, taking into account both current compensation and reductions in payouts of amounts previously earned, including through malus or clawback arrangements;

- (p) the pension policy is in line with the business strategy, objectives, values and long-term interests of the management company and the UCITS it manages.

If the employee leaves the management company before retirement, discretionary pension benefits shall be held by the management company for a period of five years in the form of instruments referred to in point (m). In the case of an employee reaching retirement, discretionary pension benefits shall be paid to the employee in the form of instruments referred to in point (m), subject to a five year retention period;

- (q) staff are required to undertake not to use personal hedging strategies or remuneration- and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements;
- (r) variable remuneration is not paid through vehicles or methods that facilitate the avoidance of the requirements of this Directive.

2. The principles set out in paragraph 1 shall apply to remuneration of any type paid by the management companies and to any transfer of units or shares of the UCITS, made to the benefits of those categories of staff, including senior management, risk takers, control functions and any employee receiving total remuneration that falls into the remuneration bracket of senior management and risk takers, whose professional activities have a material impact on their risk profile or the risk profiles of the UCITS that they manage.

3. Management companies that are significant in terms of their size or the size of the UCITS they manage, their internal organisation and the nature, the scope and the complexity of their activities shall establish a remuneration committee. The remuneration committee shall be constituted in a way that enables it to exercise competent and independent judgment on remuneration policies and practices and the incentives created for managing risk.

The remuneration committee shall be responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk and risk management of the management company or the UCITS concerned and which are to be taken by the management body in its supervisory function. The remuneration committee shall be chaired by a member of the management body who does not perform any executive functions in the management company concerned. The members of the remuneration committee shall be members of the management body who do not perform any executive functions in the management company concerned.

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(\*) OJ L 331, 15.12.2010, p. 12.

(\*\*) OJ L 120, 15.5.2009, p. 22.”

- (2) In Article 20(1), point (a) is replaced by the following:

"(a) the written contract with the depositary referred to in Article 22(2); "

- (3) Article 22 is replaced by the following:

"Article 22

1. An investment company and, for each of the common funds it manages, a management company shall ensure that a single depositary is appointed in accordance with the provisions of this Chapter.

2. The appointment of the depositary shall take the form of a written contract.

That contract shall comprise rules establishing the flow of information deemed necessary to allow the depositary to perform its functions in respect of the UCITS for which it has been appointed as depositary, as set out in this Directive and in other laws, regulations and administrative provisions which are relevant for depositaries in the UCITS home Member State.

3. The depositary shall:

- (a) ensure that the sale, issue, re-purchase, redemption and cancellation of units of the UCITS are carried out in accordance with the applicable national laws and the fund rules or instruments of incorporation;
- (b) ensure that the value of the units of the UCITS is calculated in accordance with the applicable national laws and the fund rules or the instruments of incorporation;
- (c) carry out the instructions of the management company or an investment company, unless they conflict with the applicable national laws or the fund rules or the instruments of incorporation;
- (d) ensure that in transactions involving the assets of the UCITS any consideration is remitted to the UCITS within the usual time limits;
- (e) ensure that the income of the UCITS is applied in accordance with the applicable national laws and the fund rules or the instruments of incorporation.

4. The depositary shall ensure that the cash flows of the UCITS are properly monitored, and shall in particular ensure that all payments made by or on behalf of investors upon the subscription of units of the UCITS have been received, and that all cash of the UCITS has been booked in cash accounts that meet the following conditions:

- (a) they are opened in the name of the UCITS or in the name of the management company acting on behalf of the UCITS, or in the name of the depositary acting on behalf of the UCITS;
- (b) they are opened at an entity referred to in points (a), (b) and (c) of Article 18(1) of Commission Directive 2006/73/EC(\*) and
- (c) they are maintained in accordance with the principles set out in Article 16 of Directive 2006/73/EC.

Where the cash accounts are opened in the name of the depositary acting on behalf of the UCITS, no cash of the entity referred to in point (b) of the first subparagraph and none of the own cash of the depositary shall be booked on such accounts.

5. The assets of the UCITS shall be entrusted to the depositary for safe-keeping as follows:

- (a) for financial instruments that may be held in custody, the depositary shall:
  - (i) hold in custody all financial instruments that may be registered in a financial instruments account opened in the depositary's books and all financial instruments that can be physically delivered to the depositary;
  - (ii) ensure that all those financial instruments that can be registered in a financial instruments account opened in the depositary's books are registered in the depositary's books within segregated accounts in accordance with the principles set out in Article 16 of Directive 2006/73/EC, opened in the name of the UCITS or the management company acting on behalf of the UCITS, so that they can be clearly identified as belonging to the UCITS in accordance with the applicable law at all times;
- (b) for other assets the depositary shall:
  - (i) verify the ownership of the UCITS or the management company acting on behalf of the UCITS of such assets by assessing whether the UCITS or the management company acting on behalf of the UCITS holds the ownership based on information or documents provided by the UCITS or the management company and, where available, on external evidence;
  - (ii) maintain a record of those assets for which it is satisfied that the UCITS or the management company acting on behalf of the UCITS holds the ownership and keep that record up-to-date.

6. Member States shall ensure that in the event of insolvency of the depositary, assets of a UCITS held by the depositary in custody are unavailable for distribution among or realisation for the benefit of creditors of the depositary.

7. The depositary shall not delegate to third parties its functions as referred to in paragraphs 3 and 4.

The depositary may delegate to third parties the functions referred to in paragraph 5 only where:

- (a) the tasks are not delegated with the intention of avoiding the requirements of this Directive;
- (b) the depositary can demonstrate that there is an objective reason for the delegation;
- (c) the depositary has exercised all due skill, care and diligence in the selection and the appointment of any third party to whom it wants to delegate parts of its tasks, and keeps exercising all due skill, care and diligence in the periodic review and ongoing monitoring of any third party to whom it has delegated parts of its tasks and of the arrangements of the third party in respect of the matters delegated to it.

The functions referred to in paragraph 5 may be delegated by the depositary only to a third party which at all time during the performance of the tasks delegated to it:

- (a) has structures and expertise that are adequate and proportionate to the nature and complexity of the assets of the UCITS or the management company acting on behalf of the UCITS which have been entrusted to it;
- (b) for custody tasks referred to in point (a) of paragraph 5, is subject to effective prudential regulation, including minimum capital requirements, and supervision in the jurisdiction concerned;
- (c) for custody tasks referred to in point (a) of paragraph 5, is subject to an external periodic audit to ensure that the financial instruments are in its possession;
- (d) segregates the assets of the clients of the depositary from its own assets and from the assets of the depositary in such a way that they can at any time be clearly identified as belonging to clients of a particular depositary;
- (e) in the event of insolvency of the third party, assets of a UCITS held by the third party in custody are unavailable for distribution among or realisation for the benefit of creditors of the third party;
- (f) complies with the general obligations and prohibitions set out in paragraph 5 and Article 25.

Notwithstanding point (b) of the third subparagraph where the law of a third country requires that certain financial instruments be held in custody by a local entity and no local entities satisfy the delegation requirements laid down in that point, the depositary may delegate its functions to such a local entity only to the extent required by the law of the third country and only for as long as there are no local entities that satisfy the delegation requirements, and only where:

- (a) the investors of the relevant UCITS are duly informed that such delegation is required due to legal constraints in the law of the third country and of the circumstances justifying the delegation, prior to their investment;
- (b) the UCITS, or the management company on behalf of the UCITS, have instructed the depositary to delegate the custody of such financial instruments to such a local entity.

The third party may, in turn, sub-delegate those functions, subject to the same requirements. In such a case, Article 24(2) shall apply *mutatis mutandis* to the relevant parties.

For the purposes of the first to the fifth subparagraphs, the provision of services as specified by Directive 98/26/EC of the European Parliament and of the Council(\*\*) by securities settlement systems as designated for the purposes of Directive 98/26/EC or the provision of similar services by third-country securities settlement systems shall not be considered a delegation of its custody functions.

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(\*) OJ L 241, 2.9.2006, p. 26.

(\*\*) OJ L 166, 11.6.1998, p. 45.”

(4) Article 23 is amended as follows:

(a) Paragraph 2 is replaced by the following:

"2. The depositary shall be:

- (a) a credit institution authorised in accordance with Directive 2006/48/EC;
- (b) an investment firm, subject to capital adequacy requirements in accordance with Article 20(1) of Directive 2006/49/EC including capital requirements for operational risks and authorised in accordance with Directive 2004/39/EC and which also provides the ancillary service of safe-keeping and administration of financial instruments for the account of clients in accordance with point (1) of Section B of Annex I to Directive 2004/39/EC; such investment firms shall in any case have own funds not less than the amount of initial capital referred to in Article 9 of Directive 2006/49/EC;

Investment companies or management companies acting on behalf of the UCITS they manage, that, before [date: transposition deadline set out in Article 2(1) first subparagraph], appointed as a depositary an institution that does not meet the requirements set out in this paragraph, shall appoint a depositary that meets those requirements before [date: 1 year after a deadline set out in Article 2(1) first subparagraph]"

(b) Paragraphs 3, 4, 5 and 6 are deleted.

(5) Article 24 is replaced by the following:

"Article 24

1. Member States shall ensure that the depositary shall be liable to the UCITS and to the unit holders of the UCITS for the loss by the depositary or a third party to whom the custody of financial instruments held in custody in accordance with point (a) of Article 22(5) has been delegated.

In case of a loss of a financial instrument held in custody, Member States shall ensure that the depositary shall return a financial instrument of identical type or the corresponding amount to the UCITS or the management company acting on behalf of the UCITS without undue delay. The depositary shall not be liable if it can prove 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.

Member States shall ensure that the depositary shall also be liable to the UCITS, and to the investors of the UCITS, for all other losses suffered as a result of the

depository's negligent or intentional failure to properly fulfil its obligations pursuant to this Directive.

2. The liability of the depository shall not be affected by any delegation referred to in Article 22(7).

3. The liability of the depository referred to in paragraph 1 shall not be excluded or limited by agreement.

4. Any agreement that contravenes the provision of paragraph 3 shall be void.

5. Unit holders in the UCITS may invoke the liability of the depository directly or indirectly through the management company."

(6) In Article 25, paragraph 2 is replaced by the following:

"2. In carrying out their respective functions, the management company and the depository shall act honestly, fairly, professionally, independently and in the interest of the UCITS and the investors of the UCITS.

A depository shall not carry out activities with regard to the UCITS or the management company on behalf of the UCITS that may create conflicts of interest between the UCITS, the investors in the UCITS, the management company and itself, unless the depository has functionally and hierarchically separated the performance of its depository tasks from its other potentially conflicting tasks, and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the UCITS."

(7) Article 26 is replaced by the following:

"Article 26

1. The law or the fund rules of the common fund shall lay down the conditions for the replacement of the management company and the depository and rules to ensure the protection of unit-holders in the event of such replacement.

2. The law or the instruments of incorporation of the investment company shall lay down the conditions for the replacement of the management company and the depository and rules to ensure the protection of unit-holders in the event of such replacement.

(8) The following Articles 26a and 26b are inserted:

"Article 26a

The depository shall make available to its competent authorities, competent authorities of the management company's home Member State and the competent authorities of the UCITS home Member State, on request, all information which it has obtained while performing its duties and that may be necessary for the competent authorities to carry out their duties under this Directive.

Article 26b

1. The Commission shall be empowered to adopt, by means of delegated acts in accordance with Article 112 and subject to the conditions of Articles 112a and 112b, measures specifying:
  - (a) the particulars that need to be included in the written contract referred to in Article 22(2);
  - (b) the conditions for performing the depository functions pursuant to Articles 22(3), (4) and (5), including:
    - (i) the type of financial instruments to be included in the scope of the custody duties of the depository in accordance with point (a) of Article 22(5);
    - (ii) the conditions subject to which the depository is able to exercise its custody duties over financial instruments registered with a central depository;
    - (iii) the conditions subject to which the depository is to safekeep the financial instruments issued in a nominative form and registered with an issuer or a registrar, in accordance with point (b) of Article 22(5);
  - (c) the due diligence duties of depositories pursuant to point (c) of second subparagraph of Article 22(7);
  - (d) the segregation obligation pursuant to point (d) of third subparagraph of Article 22(7);
  - (e) the conditions subject to which and circumstances in which financial instruments held in custody are to be considered as lost for the purpose of Article 24;
  - (f) what is to be understood by external events beyond reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary pursuant to Article 24(1)."
- (9) In Article 30, the first paragraph is replaced by the following:

"Articles 13, 14, 14a and 14b shall apply *mutatis mutandis* to investment companies that have not designated a management company authorised pursuant to this Directive."
- (10) Section 3 of Chapter V is deleted.
- (11) In Article 69(3) the following second subparagraph is added:

"The annual report shall also contain:

  - (a) the total amount of remuneration for the financial year, split into fixed and variable remuneration paid by the management company and by the

investment company to its staff, and the number of beneficiaries, and where relevant, the carried interest paid by the UCITS;

- (b) the aggregate amount of remuneration broken down by senior management and members of staff of the management company and, where relevant, of the investment company, whose actions have a material impact on the risk profile of the UCITS."

(12) Article 98 is amended as follows:

- (a) In paragraph 2 point (d) is replaced by the following:

"(d) require existing telephone records and traffic data, as defined in Article 2 (b) of Directive 2002/58/EC of the European Parliament and of the Council(\*), that are held by UCITS, management companies, investment companies or depositories where a serious suspicion exists that such records related to the subject-matter of the inspection may be relevant to prove a breach by the UCITS, management companies, investment companies or depositories of their obligations under this Directive; these records shall however not concern the content of the communication to which they relate.

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(\* ) OJ L 201, 31.7.2002, p. 37."

- (b) The following paragraph 3 is added:

"3. If a request for records of telephone or data traffic referred to in point (d) of paragraph 2 requires authorisation from a judicial authority according to national rules such authorisation shall be applied for. Such authorisation may also be applied for as a precautionary measure."

(13) Article 99 is replaced by the following:

"Article 99

1. Member States shall provide that their respective competent authorities may take appropriate administrative sanctions and measures where the national provisions adopted in the implementation of this Directive have not been complied with, and shall ensure that those measures are applied. The sanctions and measures shall be effective, proportionate and dissuasive.

2. Member States shall ensure that where obligations apply to UCITS, management companies, investment companies or depositories, in case of a breach, sanctions or measures may be applied to the members of the management body, and to any other individuals who under national law are responsible for the breach.

3. Competent authorities shall be given all investigatory powers that are necessary for the exercise of their functions. In the exercise of their powers, competent authorities shall cooperate closely to ensure that sanctions or measures produce the desired results and coordinate their action when dealing with cross border cases."

(14) The following Articles 99a, 99b, 99c, 99d and 99e are inserted:

"Article 99a

1. This Article shall apply when:

- (a) the activities of UCITS are pursued without obtaining authorisation in breach of Article 5;
- (b) the business of a management company is carried on without obtaining prior authorisation in breach of Article 6;
- (c) the business of an investment company is carried on without obtaining prior authorisation in breach of Article 27;
- (d) a qualifying holding in a management company is acquired, directly or indirectly, or such a qualifying holding in a management company is further increased so that the proportion of the voting rights or of the capital held would reach or exceed 20%, 30% or 50% or so that the management company would become its subsidiary (hereinafter referred to as the proposed acquisition), without notifying in writing the competent authorities of the management company in which the acquirer is seeking to acquire or increase a qualifying holding in breach of Article 11(1);
- (e) a qualifying holding in a management company is disposed of, directly or indirectly, or reduced so that the proportion of the voting rights or of the capital held would fall below 20%, 30% or 50% or so that the management company would cease to be a subsidiary, without notifying in writing the competent authorities, in breach of Article 11(1);
- (f) a management company has obtained an authorisation through false statements or any other irregular means in breach of Article 7(5)(b);
- (g) an investment company has obtained an authorisation through false statements or any other irregular means in breach of Article 29(4)(b);
- (h) a management company, on becoming aware of any acquisition or disposal of holdings in their capital that cause holdings to exceed or fall below one of the thresholds referred to in Article 11(10) of Directive 2004/39/EC, fails to inform the competent authorities of those acquisitions or disposals in breach of Article 11(1);
- (i) a management company fails to, at least once a year, inform the competent authority of the names of shareholders and members possessing qualifying holdings and the sizes of such holdings in breach of Article 11(1);
- (j) a management company fails to comply with procedures and arrangements imposed in accordance with the national provisions implementing Article 12(1)(a);

- (k) a management company fails to comply with structural and organisational requirements imposed in accordance with the national provisions implementing Article 12(1)(b);
- (l) an investment company fails to comply with procedures and arrangements imposed in accordance with the national provisions implementing Article 31;
- (m) a management company or an investment company fails to comply with requirements related to delegation of its functions to third parties imposed in accordance with the national provisions implementing Articles 13 and 30;
- (n) a management company or an investment company fails to comply with rules of conduct imposed in accordance with the national provisions implementing Articles 14 and 30;
- (o) a depositary fails to perform its tasks in accordance with national provisions implementing paragraphs (3) to (7) of Article 22;
- (p) an investment company and, for each of the common fund it manages, a management company repeatedly fails to comply with obligations concerning the investment policies of UCITS set out by national provisions implementing Chapter VII;
- (q) a management company or an investment company fails to employ a risk management process and a process for accurate and independent assessment of the value of OTC derivatives as set out in national provisions implementing Article 51(1);
- (r) an investment company and, for each of the common fund it manages, a management company repeatedly fails to comply with obligations concerning information to be provided to investors imposed in accordance with the national provisions implementing Articles 68 to 82;
- (s) a management company or an investment company marketing units of UCITS it manages in a Member State other than the UCITS home Member State fails to comply with the notification requirement set out in Article 93(1).

2. Member States shall ensure that in all cases referred to in paragraph 1, the administrative sanctions and measures that may be applied include at least the following:

- (a) a public statement which indicates the natural or legal person and the nature of the breach;
- (b) issuing an order requiring the natural or legal person to cease the conduct and to desist from a repetition of that conduct;
- (c) in case of a management company or a UCITS, withdrawal of the authorisation of the management company or the UCITS;

- (d) imposing a temporary ban against any member of the management company's or the investment company's management body or any other natural person, who is held responsible, to exercise functions in those companies;
- (e) in case of a legal person, imposing administrative pecuniary sanctions of up to 10% of the total annual turnover of that legal person in the preceding business year; where the legal person is a subsidiary of a parent undertaking, the relevant total annual turnover shall be the total annual turnover resulting from the consolidated account of the ultimate parent undertaking in the preceding business year;
- (f) in case of a natural person, imposing administrative pecuniary sanctions of up to EUR 5 000 000, or in the Member States where the euro is not the official currency, the corresponding value in the national currency on the date of entry into force of this Directive;
- (g) imposing administrative pecuniary sanctions of up to twice the amount of the profits gained or losses avoided because of the breach where those can be determined.

#### Article 99b

Member States shall ensure that the competent authorities publish any sanction or measure imposed for breach of the national provisions adopted in the implementation of this Directive without undue delay, including information on the type and nature of the breach and the identity of persons responsible for it, unless such publication would seriously jeopardise the stability of financial markets. Where publication would cause a disproportionate damage to the parties involved, competent authorities shall publish the sanction or measure imposed on an anonymous basis.

#### Article 99c

1. Member States shall ensure that when determining the type of administrative sanctions or measures and the level of administrative pecuniary sanctions, the competent authorities shall take into account all relevant circumstances, including:

- (a) the gravity and the duration of the breach;
- (b) the degree of responsibility of the responsible natural or legal person;
- (c) the financial strength of the responsible natural or legal person, as indicated by the total turnover of the responsible legal person or the annual income of the responsible natural person;
- (d) the importance of profits gained or losses avoided by the responsible natural or legal person, insofar as they can be determined;
- (e) the level of cooperation of the responsible natural or legal person with the competent authority;
- (f) previous breaches by the responsible natural or legal person.

2. ESMA shall issue guidelines addressed to competent authorities in accordance with Article 16 of Regulation (EU) No 1093/2010 on types of administrative measures and sanctions and level of administrative pecuniary sanctions.

#### Article 99d

1. Member States shall ensure that competent authorities establish effective mechanisms to encourage reporting of breaches of the national provisions implementing this Directive to competent authorities.

2. The mechanisms referred to in paragraph 1 shall include at least:

- (a) specific procedures for the receipt of reports on breaches and their follow-up;
- (b) appropriate protection for employees of investment companies and management companies who report breaches committed within the company;
- (c) protection of personal data concerning both the person who reports the breaches and the natural person who is allegedly responsible for a breach, in compliance with the principles laid down in Directive 95/46/EC of the European Parliament and of the Council(\*).

3. Member States shall require institutions to have in place appropriate procedures for their employees to report breaches internally through a specific channel.

#### Article 99e

1. Member States shall provide ESMA annually with aggregated information regarding all measures or sanctions imposed in accordance with Article 99. ESMA shall publish this information in an annual report.

2. Where the competent authority has published a measure or sanction, it shall also report the measures or sanctions to ESMA. Where a published measure or sanction relates to a management company, ESMA shall add a reference to the published measure or sanction in the list of management companies published under Article 6(1).

3. ESMA shall develop draft implementing technical standards concerning the procedures and forms for submitting information as referred to in this Article.

Power is conferred on the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with Article 15 of Regulation (EU) No 1095/2010.

ESMA shall submit those draft implementing technical standards to the Commission by [insert date]."

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(\*) OJ L 281, 23.11.1995, p. 31."

- (15) The following Article 104a is inserted:

"Article 104a

1. Member State shall apply Directive 95/46/EC to the processing of personal data carried out in the Member State pursuant to this Directive.

2. Regulation EC No 45/2001 of the European Parliament and of the Council(\*) shall apply to the processing of personal data carried out by ESMA pursuant to this Directive.

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(\*) OJ L 8, 12.1.2001, p. 1."

- (16) In Article 112, paragraph 2 is replaced by the following:

"2. The power to adopt the delegated acts referred to in Articles 12, 14, 43, 51, 60, 61, 62, 64, 75, 78, 81, 95 and 111 shall be conferred on the Commission for a period of four years from 4 January 2011. The power to adopt the delegated acts referred to in Article 50a shall be conferred on the Commission for a period of four years from 21 July 2011. The power to adopt the delegated acts referred to in Article 26b shall be conferred on the Commission for a period of four years from [...]. The Commission shall draw up a report in respect of delegated powers not later than six months before the end of the four-year period. The delegation of power shall be automatically extended for periods of an identical duration, unless the European Parliament or the Council revokes them in accordance with Article 112a."

- (17) In Article 112a, paragraph 1 is replaced by the following:

"1. The delegation of power referred to in Articles 12, 14, 26b, 43, 50a, 51, 60, 61, 62, 64, 75, 78, 81, 95 and 111 may be revoked at any time by the European Parliament or by the Council."

- (18) Annex I is amended as set out in the Annex to this Directive

#### *Article 2*

1. Member States shall adopt and publish, by [...] at the latest, the laws, regulations and administrative provisions necessary to comply with this Directive. They shall forthwith communicate to the Commission the text of those provisions.

They shall apply the laws, regulations and administrative provisions referred to in paragraph 1 from [...].

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

*Article 3*

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

*Article 4*

This Directive is addressed to the Member States.

Done at Brussels,

*For the European Parliament*  
*The President*

*For the Council*  
*The President*

## ANNEX

In Annex I, point 2 of the Schedule A is replaced by the following;

"2. Information concerning the depositary:

2.1. The identity of the depositary of the UCITS and a description of its duties;

2.2. A description of any safe-keeping functions delegated by the depositary, the identification of the delegate and any conflicts of interest that may arise from such delegation"