

Deloitte regulatory news alert

UCITS V Level 2 – the key takeaways for depositaries and management companies

13 April 2016

On 24 March, the long awaited UCITS V Level 2 on depositary regime has been published on the European Official Journal. [Commission delegated Regulation \(EU\) 2016/438](#) (hereafter “the delegated Regulation”) supplements Directive UCITS 2009/65/EC amended by Directive 2014/91/EU (UCITS V) by clarifying further the technical aspects of the implementation of the UCITS V depositary regime.

The delegated Regulation will apply from 13 October 2016. By that date, the relevant provisions of CSSF Circular 14/587 will be amended so as to be aligned with the delegated Regulation.

Most of the contents of the delegated Regulation are aligned with the depositary related provisions of the AIFM Commission Delegated Regulation n° 231/ 2013, except for two additional set of provisions for which the EU Commission received special empowerments in order to 1/ provide enhanced insolvency protection of the UCITS assets and 2/ ensure that the depositary and the management company act independently.

This Alert focuses only on these specific provisions of the delegated Regulation that deviate from the AIFM framework. It also provides an update on the key milestones and next steps which depositaries and management companies must now consider in order to comply with the new framework by the agreed dead-line.

Global overview on the topics covered by the delegated Regulation

Mandatory contractual provisions	Reconciliation and verification on capital transactions	Liability discharge
Collateral arrangements	Safekeeping duties	Cash monitoring
Selection and monitoring of sub-custodians / third-parties	Segregation and insolvency protection	Conflicts of interests and independency

The Key takeaways of the delegated Regulation

Requirement to obtain independent legal advice confirming bankruptcy remoteness of agreements and account segregation

As part of the due diligence that a depositary must perform on its sub-custody network, the depositary must seek independent legal advice confirming the effectiveness of the segregation and the enforceability of the agreement in the case of bankruptcy of a correspondent. The Depositary shall also further ensure that each correspondent does the same.

Legal opinions may be combined or issued by relevant industry federations or law firms for the benefit of several depositaries.

Actual protection must be ensured on a permanent basis, therefore the frequency of the review should be adapted so as to always remain consistent with market conditions and associated risks.

Early termination of sub-custody contract as last resort measure to protect the assets

As part of the multiple safeguards which a depositary must have in place in order to protect investors' interests, the delegated Regulation provides that the depositary must be able to terminate the contract with the sub-custodian without delay, in the case where the law of a sub-custodian country changes in such a way that the protection of the UCITS assets is no longer ensured.

Operational independence between management company and depositary

The Regulation provides for strict operational independence between the management company on the one hand and the depositary / its delegates on the other hand.

In the context of *Tier 1* governance structures (such as a Société Anonyme operated by a Board of Directors), no member of the Board of Directors of the management company must be a member of the Board of Directors of the depositary / delegate of the depositary or an employee thereof, and vice-versa. Alternative incompatibility rules are foreseen for the particular context of a Company (SA) operated by a Management Board AND a Supervisory board instead (*Tier 2* governance structures subject to articles 60bis 1 and following of the law of 10 August 1915 on Commercial Companies).

In addition, in the case where a group link¹ exists between the management company and the depositary, at least one third of the members or two persons, whichever is lower, of the respective bodies of each entity must be independent².

Also, where a *link* or a *group link* exists between the depositary and the management company, the following safeguards must be put in place: the management company must demonstrate and document that the appointment of the *linked* depositary is in the best interest of the investors (as compared to another possible depositary, regarding costs, expertise, financial standing, quality of services, etc.); and the management company and the depositary shall put in place procedures to prevent and/or address possible conflicts of interests between them.

¹ Commission delegated Regulation (EU) 2016/438, Chapter 1, Article 1(b): 'group link' means 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/EU¹¹ or international accounting standards adopted in accordance with Regulation (EC) No 1606/2002.¹²

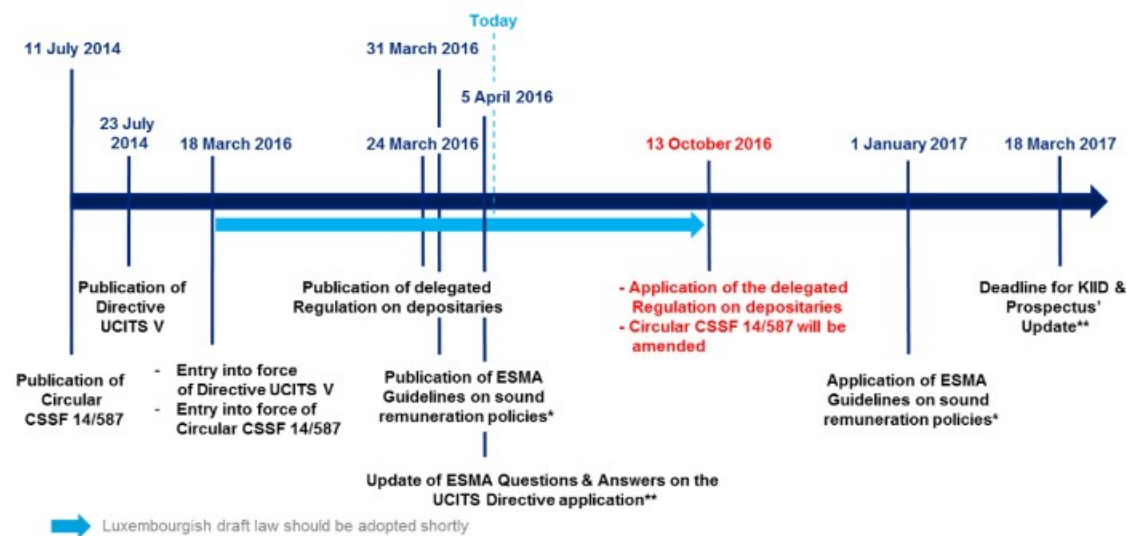
² Commission delegated Regulation (EU) 2016/438, Chapter 4, Article 24(2): For the purposes of the first paragraph, members of the management body of the management company, members of the management body of the depositary or members of the body in charge of the supervisory functions of the above companies 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 judgment.

The chart below illustrates the key references, milestones and the next applicable compliance deadlines.

Although a few grey areas may subsist for the next few months ahead as regards the application of certain provisions of CSSF circular 14/587 as amended, depositaries must now engage the necessary upgrades to their contractual arrangements in line with the UCITS V rules, so as to be able to formally comply with the new framework at the latest by 13 October 2016.

Implementation timeline

UCITS V - What's next?



* Final report - Guidelines on sound remuneration policies under the UCITS Directive and AIFMD, 31 March 2016 | ESMA/2016/411

** Questions and Answers Application of the UCITS Directive, 05 April 2016 | ESMA/2016/569

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