

## Regulatory News Alert

### The European Securities and Markets Authority (ESMA) published four new Questions and Answers on the Application of the UCITS Directive

17 August 2018

#### **Three new questions were answered in the Section I – General:**

##### **Question regarding Issuer concentration**

**Question 5b:** Can netting and hedging arrangements be taken into account for the purposes of calculating issuer concentration limits pursuant to Article 52 of the UCITS Directive?

**Answer 5b: Only netting arrangements** in accordance with the definition and conditions set out in the guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS (Ref. CESR/10-788) **may be taken into account when calculating issuer concentration limits.**

##### **Question regarding UCITS investing in other UCITS with different investment policies**

**Question 6a:** Is a UCITS permitted to invest in other UCITS or collective investment undertakings with different investment strategies or investment restrictions? By way of example, could a UCITS that in accordance with its fund rules or instruments of incorporation and prospectus is not permitted to invest in certain assets or use derivatives for purposes other than hedging invest in other UCITS or collective investment undertakings that are not subject to the same investment restrictions?

**Answer 6a:** The prospectus of a UCITS should clearly disclose whether in the case of fund of fund investments, the target fund(s) might have different investment strategies or restrictions. Where the fund rules or instruments of incorporation and prospectus of a UCITS expressly rule out certain types of assets or derivative use without any reservations, UCITS management companies/self-managed investment companies should carry out proportionate due diligence to ensure that fund of fund investments do not result in a circumvention of the investment strategies or restrictions set out in the fund rules or instruments of incorporation and prospectus of the investing UCITS. In short, ESMA put forward the idea that the investment rules of the UCITS and the underlying investments should be consistent with one another. Namely, if a UCITS has a full restriction on

the use of derivatives, it shall ensure that the funds in which it invests follow a similar approach

## **Question regarding Supervision of branches**

**Question 7a:** What are the supervisory responsibilities of competent authorities in host Member States when a UCITS management company provides investment services through a branch established in the host Member State?

**Answer 7a:** Under both the UCITS and the AIFM Directives, **supervisory** powers of competent authorities in relation to branches of UCITS management companies or alternative investment fund managers (AIFMs) established in a Member State that is not the home Member State **are shared**. The competent authority of the Member State in which **the branch is located** (host Member State) is responsible for the supervision of the branch's **compliance with conduct rules** referred to in Article 17(5) of the UCITS Directive and Article 45(2) of the AIFMD and the competent authority of the Member State in which the UCITS management company or the alternative investment fund manager is established (**home Member State**) is **responsible for the supervision** of the other requirements provided under the **relevant applicable framework**.

Neither the UCITS Directive nor the AIFMD provides for an explicit framework for the allocation of supervisory responsibilities and powers for those cases where UCITS management companies or AIFMs are authorized to carry out investment services set out in Article 6(3) of the UCITS Directive and Article 6(4) of the AIFMD and have branches providing those services in other Member States. ESMA is of the view that responsibilities of home and host Member States should be identified similarly to, and consistently with, the general framework established for the provision of activities pursued by UCITS management companies and AIFMs through branches as well as with the MiFID II framework regulating the supervision on the provision of investment services across the EU. This approach is in line with the division of responsibilities provided under the MiFID II framework. In accordance with Article 35(8) of MiFID II, the competent authority of the host Member State has the responsibility for ensuring that the services provided by the branch of an investment firm or a credit institution in its territory comply with the MiFID II requirements under Articles 24 ("General principles and information to clients") and 25 ("Assessment of suitability and appropriateness and reporting to clients") of MiFID II, which also apply to UCITS management companies and AIFMs providing investment services.

## **One new question was answered in the Section X – Depository:**

### **Question regarding Depositaries as counterparties in a transaction of assets that they hold in custody**

**Question 1:** According to Article 22(7) of the UCITS Directive the depository (or any third party to which the custody function has been delegated) shall not reuse the assets they hold in custody for their own account. Does this provision imply that a depository (or a delegated third party) should never act as counterparties in a transaction of assets that they hold in custody (including, but not limited to, transfer, pledge, sale and lending of those assets)?



**Answer to Question 1: No.** A depositary (or a delegated third party) should be able to act as counterparties in a transaction of assets that they hold in custody, provided that (i) the four conditions under Article 22(7)(a) to (d) of the UCITS Directive are complied with, and (ii) conflicts of interest are properly managed and (iii) the transaction is conducted on an arm-length basis.

### **How Deloitte can help ?**

Deloitte can help you set and design appropriate strategies for your fund operations at management or depositary level.

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