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EU Commission Public Consultation on the UCITS Depository Function

Ladies and Gentlemen

The International Securities Services Association (ISSA) is a non-profit organisation under Swiss law. ISSA provides leadership in the formulation and promotion of best practice to improve efficiency and risk management in the global asset servicing industry. Currently, the association has 88 member institutions in 48 countries. Most member institutions are engaged in securities and predominantly in custody services and they are particularly concerned by the development in the European regulatory environment as it relates to potential liabilities to be assumed by UCITS Depository institutions.

The ISSA Board has mandated a working group to establish an educational background document relating to the entire intermediary chains typically involved in the servicing of UCITS assets, touching on the processes and responsibilities of the parties involved as well as describing the risks and liabilities inherent in those services. ISSA has decided not to formally reply to the Commission's Public Consultation on the UCITS Depository Function but to provide the Commission in due course with the background document.

Nevertheless, ISSA would like to draw the Commission's attention to the following points that are reason for considerable concern among our constituency:

Recent developments including court decisions resulting in an immediate duty of restitution of assets from Fund Depositories to Fund Investors have the potential to fundamentally alter the landscape of the UCITS Depository Function in Europe. Bearing in mind that a Depository is often only one of the parties involved in complex transactions and as such the onerous liabilities the Commission is considering imposing on the Depository providers could be incompatible with the remuneration and risk profile of the Fund Depository Industry in Europe.

In fact, taking the EUR 4.5 trillion UCITS assets cited in the Commission's consultation document as a reference point, it would simply be impossible that the Fund Depository Industry could at any time guarantee a fraction of the total value in the event of a significant default. Furthermore, the enforcement of such guarantees could cause a domino effect with negative systemic consequences. It should also be considered that "Guarantee or insurance cost" for such amount would have to be transferred to the UCITS and ultimately to the investors who would nevertheless still be exposed to the risk of a Depository's default.

At a market level, it is conceivable that if such rigorous liability provisions are assigned to Depositories they will in turn be more circumspect and thus reduce the number of markets in which they are willing to offer services. This is likely to restrict the investment universe into which UCITS funds may invest on behalf of shareholders thus reducing choice and investment into some of the world's economies. This in turn may entail the unintended consequence of reducing the number of organisations willing to act as Fund Depositories, which will reduce competition and increase concentration risk. When considered at a regional or country level the concentration risk may be further compounded where typically larger institutions with a proprietary sub-custody network are the only organisations willing to assume liabilities in the higher risk markets and thus potentially lead to few providers of Fund Depository services in certain markets. The costs of providing such services are likely to increase considerably under such circumstances.

Understanding the gravity of the situations, we would like to draw the Commission's attention to the fact that national insolvency laws and the concept of "Force majeure" are two crucial aspects that should be taken into account when assessing liability issues. In general, bankruptcy proceedings may lead to a temporary loss of availability of assets until such moment that free disposal has been re-established. Under such circumstances it would be inequitable to impose immediate restitution responsibilities on Fund Depositories where they have acted properly in performing their duties. Contrast this with the common treatment of "Force majeure" in commercial agreements between organisations where it is generally accepted that responsibilities are waived where adverse impacts of "Force majeure" prevail. Forcing restitution of assets being lost or impaired due to "Force majeure" would create a gross imbalance in the sharing of risk and reward.

Finally, it should be considered that when assets are not held by the Depository through a chain of intermediaries, we believe that the same concept of custody does not apply. Imposing a blanket approach to the "Asset restitution" concept could be inappropriate considering the different technical processes and market structures and may be challengeable in court.

As far as the latter point is concerned, we urge the Commission also to consider that with reference to the Madoff and Lehman affairs, court proceedings are still open and we would encourage the Commission to wait for the court rulings before completing its assessment of the UCITS framework.

Investor protection is in the interest of the ISSA constituency as asset managers seek the support of specialised firms for improved risk mitigation and cost efficiency. However, a full guarantee and restitution liability put on the Fund Depository is not necessarily the best way to meet this goal. We do welcome the Commission's intention to clarify the liability regime applicable to the UCITS Depositories and to strive for a harmonisation in the EU-wide interpretation and adoption of the relevant segments of the UCITS Directive.

Very truly yours,

International Securities
Services Association



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Chairman



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