

REGULATIONS

COMMISSION DELEGATED REGULATION (EU) 2016/438

of 17 December 2015

supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) ⁽¹⁾, and in particular Article 26b thereof,

Whereas:

- (1) It is important to ensure that the objectives of Directive 2009/65/EC are achieved uniformly throughout the Member States to enhance the integrity of the internal market and offer legal certainty for its participants, including retail and institutional investors, competent authorities and other stakeholders. The form of a Regulation ensures a coherent framework for all market operators and is the best possible guarantee for a level playing field, uniform conditions of competition and the common appropriate standard of investor protection. Furthermore, it ensures the direct applicability of detailed uniform rules concerning the operation of undertakings for collective investment in transferable securities (UCITS) and depositaries, which by their nature are directly applicable and therefore require no further transposition at national level. Adopting a Regulation also ensures that the relevant amendments to Directive 2009/65/EC, as introduced by Directive 2014/91/EU of the European Parliament and of the Council ⁽²⁾, may all be applied from the same date in all Member States.
- (2) Directive 2009/65/EC lays down an extensive set of requirements regarding depositaries' duties, delegation arrangements, and the liability regime for UCITS assets under custody in order to ensure a high standard of investor protection, that takes into account that UCITS is a retail investment scheme. Specific rights and obligations of the depositary, the management company and the investment company should therefore be set out clearly. The written contract should comprise all details necessary for the appropriate safe-keeping of all UCITS' assets by the depositary or a third party to whom safekeeping functions are delegated in accordance with Directive 2009/65/EC for the depositary to properly fulfil its oversight and control functions.
- (3) In order to allow the depositary to assess and monitor custody and insolvency risk, the written contract should provide sufficient detail on the categories of financial instruments in which the UCITS may invest and cover the geographical regions in which the UCITS plans to invest. The contract should also contain details of an escalation procedure in order to specify the circumstances, notification obligations and the steps to be taken by a depositary's staff member, at any level of its organisational structure, in relation to any detected discrepancies, including notification to the management company or the investment company or/and competent authorities, as required by this Regulation. Therefore, the depositary should alert the management company or the investment company of any material risk identified in a particular market's settlement system. The termination of the contract should reflect the fact that it represents the depositary's last resort when not satisfied that assets are sufficiently protected. It should also prevent moral hazard whereby the UCITS would make investment decisions irrespective of custody risks on the basis that the depositary would be liable. In order to maintain a high standard

⁽¹⁾ OJ L 302, 17.11.2009, p. 32.

⁽²⁾ Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 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 (OJ L 257, 28.8.2014, p. 186).

of investor protection, the requirement laying down the details for the monitoring of third parties should be applied in relation to the whole custody chain.

- (4) In order to ensure that the depositary is able to conduct its duties, it is necessary to clarify the tasks provided for in Article 22(3) of Directive 2009/65/EC, and in particular the second layer controls to be undertaken by the depositary. Such tasks should not prevent the depositary from conducting *ex-ante* verifications in agreement with the UCITS where it deems appropriate. In order to ensure that it is able to conduct its duties, the depositary should establish its own escalation procedure to address situations where discrepancies have been detected. That procedure should ensure the notification of the competent authorities of any material breaches. The oversight responsibilities of the depositary towards third parties should be without prejudice to the responsibilities incumbent on the UCITS under Directive 2009/65/EC.
- (5) The depositary should check that there is consistency between the number of units issued and the subscription proceeds received. Moreover, to ensure that payments made by investors upon subscription have been received, the depositary should further ensure that another reconciliation is conducted between the subscription orders and the subscription proceeds. The same reconciliation should be performed with regard to redemption orders. The depositary should also verify that the number of units in the UCITS' accounts matches the number of outstanding units in the UCITS' register. The depositary should adapt its procedures accordingly, taking into account the flow of subscriptions and redemptions.
- (6) The depositary should take all necessary steps to ensure that appropriate valuation policies and procedures for the assets of the UCITS are effectively implemented, through the performance of sample checks or by comparing the consistency of the change in the net asset value (NAV) calculation over time with that of a benchmark. When setting up its procedures, the depositary should have a clear understanding of the valuation methodologies used by the UCITS to value the UCITS' assets. The frequency of such checks should be consistent with the frequency of the UCITS' asset valuation.
- (7) By virtue of its obligation of oversight under Directive 2009/65/EC, the depositary should set up a procedure to verify on an *ex post* basis the UCITS' compliance with applicable law and regulations and its rules and instruments of incorporation. This should cover areas such as checking that the UCITS' investments are consistent with its investment strategies as described in the UCITS' rules and offering documents and ensuring that the UCITS does not breach its investment restrictions. The depositary should monitor the UCITS' transactions and investigate any unusual transaction. If the limits or restrictions set out in the applicable law or regulations or the UCITS rules and instruments of incorporation are breached, the depositary should act promptly to reverse the transaction that is in breach of those laws, regulations or rules.
- (8) The depositary should ensure that the income of the UCITS is calculated accurately in accordance with Directive 2009/65/EC. In order to achieve this, the depositary has to ensure that the income calculation and distribution is appropriate and, where it identifies an error, that the UCITS takes appropriate remedial action. Once the depositary has ensured this, it should verify the completeness and accuracy of the income distribution.
- (9) In order for the depositary to have a clear overview of all inflows and outflows of cash of the UCITS in all instances, the UCITS should ensure that the depositary receives without undue delay accurate information related to all cash flows, including from any third party with which an UCITS' cash account is opened.
- (10) In order for the UCITS' cash flows to be properly monitored, the depositary should ensure that there are procedures in place and that they are effectively implemented to appropriately monitor the UCITS' cash flows and that those procedures are periodically reviewed. In particular, the depositary should look into the reconciliation procedure to satisfy itself that the procedure is suitable for the UCITS and performed at appropriate intervals taking into account the nature, scale and complexity of the UCITS. Such a procedure should for example compare one by one each cash flow as reported in the bank account statements with the cash flows recorded in the UCITS' accounts. Where reconciliations are performed on a daily basis as for most UCITS, the depositary should perform its reconciliation also on a daily basis. The depositary should in particular monitor the discrepancies highlighted by the reconciliation procedures and the corrective measures taken in order to notify without undue delay the UCITS of any anomaly which has not been remedied and to conduct a full review of the reconciliation procedures. Such a review should be performed at least once a year. The depositary should also identify on a timely basis significant cash flows and in particular those which could be inconsistent with the UCITS' operations, such as changes in positions in UCITS' assets or subscriptions and redemptions, and it should

receive periodically cash account statements and check the consistency of its own records of cash positions with those of the UCITS. The depositary should keep its record up to date in accordance with Article 22(5)(b) of Directive 2009/65/EC.

- (11) The depositary has to ensure that all payments made by or on behalf of investors upon the subscription of shares or units of an UCITS have been received and booked in one or more cash accounts in accordance with Directive 2009/65/EC. The UCITS should therefore ensure that the depositary is provided with the relevant information it needs to properly monitor the receipt of investors' payments. The UCITS has to ensure that the depositary obtains this information without undue delay when the third party receives an order to redeem or issue units of an UCITS. The information should therefore be transmitted at the close of the business day from the entity which is responsible for the subscription and redemption of units of an UCITS to the depositary in order to avoid any misuse of investors' payments.
- (12) The depositary should hold in custody all financial instruments of the UCITS that could be registered or held in an account directly or indirectly in the name of the depositary or a third party to whom safekeeping functions are delegated, notably at the level of the central securities depositary. In addition the depositary should hold in custody those financial instruments that are only directly registered with the issuer itself or its agent in the name of the depositary or a third party to whom safekeeping functions are delegated. Those financial instruments that in accordance with applicable national law are only registered in the name of the UCITS with the issuer or its agent should not be held in custody. All financial instruments which could be physically delivered to the depositary should be held in custody. Provided that the conditions on which financial instruments are to be held in custody are fulfilled, financial instruments which are provided as collateral to a third party or are provided by a third party for the benefit of the UCITS have to be held in custody too by the depositary itself or by a third party to whom safekeeping functions are delegated as long as they are owned by the UCITS.
- (13) Financial instruments which are held in custody should be subject to due care and protection at all times. To ensure that the custody risk is properly assessed, in exercising due care, clear obligations should be established for the depositary, which should in particular know what third parties constitute the custody chain ensure that the due-diligence and segregation obligations have been maintained throughout the whole custody chain, ensure that it has an appropriate right of access to the books and records of third parties to whom safekeeping functions are delegated, ensure compliance with the requirements of due-diligence and segregation, with the documents and make those documents available to the management company or the investment company.
- (14) The depositary should at all times have a comprehensive overview of all assets that are not financial instruments to be held in custody. Those assets would be subject to the obligation to verify the ownership and maintain a record under Directive 2009/65/EC. Examples of such assets are physical assets which do not qualify as financial instruments under Directive 2009/65/EC or could not be physically delivered to the depositary, financial contracts such as certain derivatives and cash deposits.
- (15) To ensure a sufficient degree of certainty that the UCITS is indeed the owner of the assets, the depositary should make sure it receives all information it deems necessary to be satisfied that the UCITS holds the ownership right over the asset. That information could be a copy of an official document evidencing that the UCITS is the owner of the asset or any formal and reliable evidence that the depositary considers appropriate. If necessary, the depositary should request additional evidence from the UCITS or as the case may be from a third party.
- (16) The depositary should also keep a record of all assets for which it is satisfied that the UCITS holds ownership. It may set up a procedure to receive information from third parties, whereby procedures which ensure that the assets could not be transferred without the depositary or the third party to whom safekeeping functions are delegated having been informed of such transactions.
- (17) When delegating safekeeping functions to a third party in accordance with Article 22a of Directive 2009/65/EC, the depositary is required to implement and apply an appropriate and documented procedure to ensure that the delegate complies with the requirements of Article 22a(3) of that Directive at all times. In order to ensure a sufficient level of protection of assets, it is necessary to set out certain principles that should be applied in relation to the delegation of safekeeping functions.
- (18) Those principles should not be taken to be exhaustive, either in terms of setting out all details of the depositary's exercise of due skill, care and diligence, or in terms of setting out all the steps that a depositary should take in

relation to those principles themselves. The obligation to monitor on an ongoing basis the third party, to whom safekeeping functions have been delegated should consist of verifying that the third party correctly performs all the delegated functions and complies with the delegation contract and other legal requirements such as independence requirements and prohibition of reuse. The depositary should also review elements assessed during the selection and appointment process and compare them with the development of the market. The depositary should at all times be in a position to appropriately assess the risks related to the decision to entrust assets to the third party. The frequency of the review should be adapted so as to always remain consistent with market conditions and associated risks. For the depositary to effectively respond to a possible insolvency of the third party, it should undertake contingency planning, including the possible selection of alternative providers as may be relevant. While such measures may reduce the custody risk faced by a depositary, they do not alter reduce the obligation to return the financial instruments or pay the corresponding amount should they be lost, which depends on whether or not the requirements of Article 24 of Directive 2009/65/EC are fulfilled.

- (19) In order to be satisfied that UCITS assets and UCITS rights are protected against a third party insolvency, the depositary has to understand the insolvency law of the third country where a third party is located and ensure the enforceability of their contractual relation. Before delegating the safekeeping functions to a third party located outside of the Union, the depositary has to receive an independent legal opinion on the enforceability of the contractual arrangement with the third party under the applicable insolvency law and case law of the country the third party is located in, in order to ensure that the contractual arrangement is enforceable also in case of insolvency of the third party. A depositary's duty to assess the regulatory and legal framework of the third country also includes the reception of the independent legal opinion assessing insolvency law and case law of the third country where that third party is located. Those opinions may be combined, as the case may be, or issued for each jurisdiction by relevant industry federations or law firms for the benefit of several depositaries.
- (20) The contractual arrangement with the selected third party to whom the safekeeping functions are delegated should contain an early termination clause, as it is necessary for the depositary to be in position to terminate that contractual relationship in cases where the law or case law of a third country changes in such a way that the protection of the UCITS' assets is no longer ensured. In those cases the depositary has to notify the management company or the investment company thereof. The management company or the investment company has to notify its competent authorities and take all necessary measures which are in the best interest of the UCITS and its investors. The notification of the competent authorities about the increased custody and insolvency risk to UCITS' assets in a third country should not discharge the depositary or the management company or the investment company from their duties and obligations laid down in Directive 2009/65/EC.
- (21) When delegating safekeeping functions, the depositary should ensure that the requirements of Article 22a(3)(c) of Directive 2009/65/EC are fulfilled and that the assets of the UCITS clients of the depositary are properly segregated. This obligation should particularly ensure that assets of the UCITS are not lost due to insolvency of the third party to whom safekeeping functions are delegated and that assets of UCITS are not reused by the third party on its own account. Furthermore, the depositary should be allowed to prohibit temporary deficits in client assets, use buffers or put in place arrangements prohibiting the use of a debit balance for one client to offset a credit balance for another. While such measures may reduce the custody risk faced by a depositary when delegating safekeeping functions, they do not alter the obligation to return the financial instruments or pay the corresponding amount where these are lost, which depends on whether or not the requirements of Directive 2009/65/EC are fulfilled.
- (22) Before and during the delegation of safekeeping functions, the depositary should ensure, by means of its pre-contractual and contractual arrangements, that the third party takes measures and puts in place arrangements to ensure that the UCITS assets are protected from distribution among or realisation for the benefit of creditors of the third party itself. Directive 2009/65/EC requires all Member States to bring their relevant insolvency laws in line with this requirement. It is therefore necessary that the depositary obtain independent information about the applicable insolvency laws and case law of a third country where the UCITS' assets are required to be held.
- (23) The depositary's liability under the second subparagraph of Article 24(1) of Directive 2009/65/EC is triggered in the event of the loss of a financial instrument held in custody by the depositary itself or by a third party to whom the safekeeping has been delegated, provided that the depositary does not demonstrate that the loss results from an external event beyond reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary. That loss should be distinguished from an investment loss for investors resulting from a decrease in the value of assets as a consequence of an investment decision.

- (24) For a loss to give rise to a depositary's liability, it has to be definitive, without prospect of recovering the financial asset. Thus, situations where a financial instrument is only temporarily unavailable or frozen should not count as losses within the meaning of Article 24 of Directive 2009/65/EC. In contrast, three types of situations can be identified where the loss should be deemed to be definitive: where the financial instrument no longer exists or never existed; where the financial instrument exists but the UCITS has definitively lost its right of ownership over it; and where the UCITS has the ownership right but can no longer transfer title of or create limited property rights in the financial instrument on a permanent basis.
- (25) A financial instrument is deemed no longer to exist for instance when it has disappeared following an accounting error that cannot be corrected, or if it never existed, when the UCITS' ownership was registered on the basis of falsified documents. Situations where the loss of financial instruments is caused by fraudulent conduct should be deemed a loss.
- (26) No loss can be ascertained when the financial instrument has been substituted by or converted into another financial instrument, in situations where shares are cancelled and replaced by the issue of new shares in a company reorganisation. The UCITS should not be considered as permanently deprived of its right of ownership over the financial instrument if it has legitimately transferred ownership to a third party. Consequently, where there is a distinction between the legal ownership and the beneficial ownership of assets, the definition of loss should refer to loss of the beneficial ownership right.
- (27) Only in the case of an external event beyond the control of the depositary, the consequences of which are unavoidable despite all reasonable efforts to the contrary, may the depositary avoid to be held liable under Article 24 of Directive 2009/65/EC. The cumulative fulfilment of those conditions should be proven by the depositary in order for it to be discharged of liability, and a procedure should be laid down to be followed for that purpose.
- (28) It should first be determined whether the event which led to the loss was external. The depositary's liability should not be affected by the delegation of safekeeping functions and therefore an event should be deemed external if it does not occur as a result of any act or omission of the depositary or the third party to whom the safekeeping of financial instruments held in custody has been delegated. Then, it should be assessed whether the event is beyond the depositary's control, by verifying that there was nothing a prudent depositary could reasonably have done to prevent the occurrence of the event. Under these steps both natural events and acts of a public authority may be considered as external events beyond reasonable control. In contrast, a loss caused by failure to apply the segregation requirements laid down in Article 21(11)(d)(iii) of Directive 2009/65/EC or the loss of assets because of disruption in the third party's activity in relation to its insolvency cannot be seen as being external events beyond reasonable control.
- (29) Finally, the depositary should prove that the loss could not have been avoided despite all reasonable efforts to the contrary. In this context, the depositary should inform the management company or the investment company and take appropriate action depending on the circumstances. For instance, in a situation where the depositary believes the only appropriate action is to dispose of the financial instruments, the depositary should duly inform the management company or the investment company, which must in turn instruct the depositary in writing whether to continue holding the financial instruments or to dispose of them. Any instruction to the depositary to continue holding the assets should be reported to the UCITS' investors without undue delay. The management company or the investment company should give due consideration to the depositary's recommendations. Depending on the circumstances, if the depositary remains concerned that the standard of protection of the financial instrument is not sufficient, despite repeated warnings, it should consider further possible action, such as termination of the contract provided the UCITS is given a period of time to find another depositary in accordance with national law.
- (30) Investor protection safeguards within the depositary regime need to take into account possible interconnections between the depositary and the management or the investment company such as those arising from common or affiliated management or cross-shareholdings. Those interconnections, where and to the extent permitted under national law, could give rise to the conflict of interests represented by risk of fraud (unreported irregularities to the competent authorities to avoid bad reputation), legal recourse risk (reluctance or avoidance to take legal steps against the depositary), selection bias (the choice of the depositary not based on quality and price), insolvency risk (lower standards in asset segregation or attention to the depositary's solvency) or single group exposure risk (intragroup investments).
- (31) The operational independence of the management company or of the investment company and the depositary, including situations where safekeeping functions have been delegated, provides additional safeguards that ensure

investor protection without undue costs by raising behavioural standards of the entities that belong to the same group or that are otherwise linked. The requirements for operational independence should address material elements such as identity or personal links of managers, employees or persons discharging supervisory functions towards other entities or companies in the group, including situations where such persons are affiliated.

- (32) To ensure proportionate treatment, where the management company or the investment company and depositary belong to the same group, at least one third of the members or two persons on the bodies in charge of the supervisory functions or on the management bodies which are also in charge of the supervisory functions, whichever is lower, should be independent.
- (33) As regards corporate governance, the specific features of both one-tier system, where a company is governed by one corporate body that undertakes both the management and supervisory functions, and two-tier system, where the board of directors and the supervisory board exist side by side, should be reflected.
- (34) In order to allow competent authorities, UCITS and depositaries to adapt to the new provisions contained in this Regulation so that those provisions can be applied in an efficient and effective manner, it is appropriate to defer the date of application of this Regulation by 6 months from its date of entry into force.
- (35) The measures provided for in this Regulation are in accordance with the opinion of the expert group of the European Securities Committee,

HAS ADOPTED THIS REGULATION:

CHAPTER 1

DEFINITIONS AND DETAILS OF THE WRITTEN CONTRACT

(Article 22(2) of Directive 2009/65/EC)

Article 1

Definitions

For the purpose of this Regulation, the following definitions shall apply:

- (a) 'link' means a situation in which two and more natural or legal persons are either linked by a direct or indirect holding in an undertaking which represents 10 % or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the undertaking in which that holding subsists;
- (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/EU of the European Parliament and of the Council ⁽¹⁾ or international accounting standards adopted in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council ⁽²⁾.

Article 2

Contract for the appointment of a depositary

1. The contract evidencing the appointment of the depositary in accordance with Article 22(2) of Directive 2009/65/EC shall be drawn up between, on the one hand, the depositary and, on the other hand, the investment company or the management company for each of the common funds that the management company manages.

⁽¹⁾ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (OJ L 182, 29.6.2013, p. 19).

⁽²⁾ Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ L 243, 11.9.2002, p. 1).

2. The contract shall include at least the following elements:
 - (a) a description of the services to be provided by the depositary and the procedures to be adopted by the depositary for each type of assets in which the UCITS may invest and which are entrusted to the depositary;
 - (b) a description of the way in which the safekeeping and oversight functions are to be performed depending on the types of assets and the geographical regions in which the UCITS plans to invest, including in respect to the safekeeping duties, country lists and procedures for adding or withdrawing countries from the lists. This shall be consistent with the information provided in the UCITS rules, instruments of incorporation and offering documents regarding the assets in which the UCITS may invest;
 - (c) the period of validity and the conditions for amendment and termination of the contract, including the situations which could lead to the termination of the contract and details regarding the termination procedure and the procedures by which the depositary send all relevant information to its successor;
 - (d) the confidentiality obligations applicable to the parties in accordance with relevant laws and regulations. Those obligations shall not impair the ability of competent authorities to have access to the relevant documents and information;
 - (e) the means and procedures by which the depositary transmits to the management company or the investment company all relevant information that it needs in order to perform its duties, including the exercise of any rights attached to assets, and to allow the management company or the investment company to have a timely and accurate overview of the accounts of the UCITS;
 - (f) the means and procedures by which the management company or the investment company transmits all relevant information or ensures the depositary has access to all the information it needs to fulfil its duties, including the procedures ensuring that the depositary will receive information from other parties appointed by the management company or the investment company;
 - (g) the procedures to be followed when an amendment to the UCITS rules, instruments of incorporation or offering documents is being considered, detailing the situations in which the depositary is to be informed, or where the prior agreement of the depositary is needed to proceed with the amendment;
 - (h) all necessary information that needs to be exchanged between the investment company or the management company, or a third party acting on behalf of the UCITS on the one hand, and the depositary, on the other hand, related to the sale, subscription, redemption, issue, cancellation and re-purchase of units of the UCITS;
 - (i) all necessary information that needs to be exchanged between the investment company or the management company, or a third party acting on behalf of the UCITS and the depositary related to the performance of the depositary's duties;
 - (j) where parties to the contract envisage appointing third parties to carry out parts of their respective duties, a commitment to provide, on a regular basis, details of any third party appointed and, upon request, information on the criteria used to select the third party and the steps envisaged to monitor the activities carried out by the selected third party;
 - (k) information on the tasks and responsibilities of the parties to the contract in respect of obligations relating to the prevention of money laundering and the financing of terrorism;
 - (l) information on all cash accounts opened in the name of the investment company or of the management company acting on behalf of the UCITS and the procedures ensuring that the depositary will be informed when any new account is opened;
 - (m) details regarding the depositary's escalation procedures, including the identification of the persons to be contacted within the management company or the investment company by the depositary when it launches such a procedure;
 - (n) a commitment by the depositary to notify that the segregation of assets is no longer sufficient to ensure protection from insolvency of a third party, to whom safekeeping has been delegated in accordance with Article 22a of Directive 2009/65/EC in a specific jurisdiction;

- (o) the procedures ensuring that the depositary, in respect of its duties, has the ability to enquire into the conduct of the management company or the investment company and to assess the quality of information received, including by way of having access to the books of the management company or the investment company and by way of on-site visits;
- (p) the procedures ensuring that the management company or the investment company are enabled to review the performance of the depositary in respect of the depositary's duties.

The details of the means and procedures set out in points (a) to (p) shall be described in the contract appointing the depositary and any subsequent amendment to the contract.

3. The parties may agree to transmit all or part of the information that flows between them electronically provided that proper recording of such information is ensured.

4. Unless otherwise provided by national law, there shall be no obligation to enter into a specific written contract for each common fund.

The management company and the depositary may enter into a single contract agreement listing the common funds managed by that management company to which the contract applies.

5. The contract evidencing the appointment of the depositary and any subsequent agreement shall indicate the law applicable to the contract.

CHAPTER 2

DEPOSITARY FUNCTIONS, DUE DILIGENCE DUTIES, SEGREGATION OBLIGATION AND INSOLVENCY PROTECTION

(Article 22(3), (4) and (5) and Article 22a(2)(c) and (d) of Directive 2009/65/EC)

Article 3

Oversight duties — general requirements

1. At the time of its appointment, a depositary shall assess the risks associated with the nature, scale and complexity of the investment policy and strategy of the UCITS' and with the organisation of the management company or the investment company. On the basis of that assessment, the depositary shall devise oversight procedures which are appropriate to the UCITS and the assets in which it invests and which are then implemented and applied. Those procedures shall be regularly updated.

2. In performing its oversight duties under Article 22(3) of Directive 2009/65/EC, a depositary shall perform *ex post* controls and verifications of processes and procedures that are under the responsibility of the management company or the investment company or an appointed third party. The depositary shall in all circumstances ensure that an appropriate verification and reconciliation procedure exists which is implemented and applied and frequently reviewed. The management company or the investment company shall ensure that all instructions related to the UCITS' assets and operations are sent to the depositary, so that the depositary is able to perform its own verification or reconciliation procedure.

3. A depositary shall establish a clear and comprehensive escalation procedure to deal with situations where potential discrepancies are detected in the course of its oversight duties, the details of which shall be made available to the competent authorities of the management company or the investment company upon request.

4. The management company or the investment company shall provide the depositary, upon commencement of its duties and on an ongoing basis thereafter, with all the relevant information it needs in order to comply with its obligations pursuant to Article 22(3) of Directive 2009/65/EC including information to be provided to the depositary by third parties.

The management company or the investment company shall particularly ensure that the depositary is able to have access to the books and perform on-site visits on premises of the management company or the investment company and of any service provider appointed by the management company or the investment company, or to review reports and statements of recognised external certifications by qualified independent auditors or other experts in order to ensure the adequacy and relevance of the procedures in place.

Article 4

Duties regarding subscription and redemptions

1. A depositary shall be deemed to comply with the requirements set out in point (a) of Article 22(3) of Directive 2009/65/EC where it ensures that the management company or the investment company has established, implements and applies an appropriate and consistent procedure to:

- (a) reconcile the subscription orders with the subscription proceeds, and the number of units issued with the subscription proceeds received by the UCITS;
- (b) reconcile the redemption orders with the redemptions paid, and the number of units cancelled with the redemptions paid by the UCITS;
- (c) verify on a regular basis that the reconciliation procedure is appropriate.

For the purpose of points (a), (b) and (c), the depositary shall in particular regularly check that there is consistency between the total number of units in the UCITS' accounts and the total number of outstanding units that appear in the UCITS' register.

2. A depositary shall ensure and regularly check that the procedures regarding the sale, issue, repurchase, redemption and cancellation of units of the UCITS comply with the applicable national law and with the UCITS rules or instruments of incorporation and verify that those procedures are effectively implemented.

3. The frequency of the depositary's checks shall be consistent with the flow of subscriptions and redemptions.

Article 5

Duties regarding the valuation of units

1. A depositary shall be deemed to comply with the requirements set out in point (b) of Article 22(3) of Directive 2009/65/EC where it puts in place procedures to:

- (a) verify on an ongoing basis that appropriate and consistent procedures are established and applied for the valuation of the assets of the UCITS in compliance with the applicable national law as laid down in Article 85 of Directive 2009/65/EC and with the UCITS rules or instruments of incorporation;
- (b) ensure that the valuation policies and procedures are effectively implemented and periodically reviewed.

2. The depositary, shall conduct the verifications referred to in paragraph 1 at a frequency consistent with the frequency of the UCITS' valuation policy as defined in the national law adopted in accordance with Article 85 of Directive 2009/65/EC, and with the UCITS rules or instruments of incorporation.

3. Where a depositary considers that the calculation of the value of the units of the UCITS has not been performed in compliance with applicable law or the UCITS rules or with instruments of incorporation, it shall notify the management company or the investment company and ensure that timely remedial action is taken in the best interest of the investors in the UCITS.

*Article 6***Duties regarding the carrying out of the UCITS' instructions**

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

- (a) appropriate procedures to verify that instructions of the management company or the investment company comply with applicable laws and regulations and with the UCITS' rules and instruments of incorporation;
- (b) an escalation procedure where the UCITS has breached one of the limits or restrictions referred to in second subparagraph.

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

*Article 7***Duties regarding the timely settlement of transactions**

1. A depositary shall be deemed to comply with the requirements set out in point (d) of Article 22(3) of Directive 2009/65/EC where it establishes a procedure to detect any situation where consideration in transactions involving the assets of the UCITS is not remitted to the UCITS within the usual time limits, to notify the management company or the investment company accordingly and, where the situation has not been remedied, to request the restitution of the assets from the counterparty where possible.

2. Where transactions do not take place on a regulated market, the depositary shall carry out its duties pursuant to paragraph 1 taking into account the conditions attached to these transactions.

*Article 8***Duties related to the UCITS' income calculation and distribution**

1. A depositary shall be deemed to comply with the requirements set out in point (e) of Article 22(3) of Directive 2009/65/EC where it:

- (a) ensures that the net income calculation is applied in accordance with the UCITS rules, instruments of incorporation and applicable national law every time income is to be distributed;
- (b) ensures that appropriate measures are taken where the UCITS' auditors have expressed reserves on the annual financial statements. The management company or the investment company shall provide the depositary with all information on reserves expressed on the financial statements;
- (c) checks the completeness and accuracy of dividend payments, every time income is to be distributed.

2. Where a depositary considers that the income calculation has not been applied in compliance with applicable law or with the UCITS rules or instruments of incorporation, it shall notify the management company or the investment company and ensure that timely remedial action has been taken in the best interest of the UCITS' investors.

*Article 9***Cash monitoring — general requirements**

1. Where a cash account is maintained or opened at an entity referred to in point (b) of Article 22(4) of Directive 2009/65/EC in the name of the investment company or of the management company acting on behalf of the UCITS, the management company or the investment company shall ensure that the depositary is provided, upon commencement of its duties and on an ongoing basis, with all relevant information necessary for having a clear overview of all UCITS' cash flows so that the depositary is able to comply with its obligations.
2. Upon the depositary's appointment the investment company or the management company shall inform the depositary of all existing cash accounts opened in the name of the investment company, or the management company acting on behalf of the UCITS.
3. The investment company or the management company shall ensure that the depositary is provided with all information related to the opening of any new cash account by the investment company, or the management company acting on behalf of the UCITS.

*Article 10***Monitoring of the UCITS' cash flows**

1. A depositary shall be deemed to comply with the requirements set out in Article 22(4) of Directive 2009/65/EC where it ensures effective and proper monitoring of the UCITS' cash flows and, in particular, it at least:
 - (a) ensures that all cash of the UCITS is booked in accounts opened with either a central bank or a credit institution authorised in accordance with Directive 2013/36/EU of the European Parliament and of the Council⁽¹⁾ or a credit institution authorised in a third country, where cash accounts are required for the purposes of the UCITS' operations, provided that the prudential supervisory and regulatory requirements applied to credit institutions in that third country are considered by the competent authority of the UCITS home Member State as at least equivalent to those applied in the Union;
 - (b) implements effective and proper procedures to reconcile all cash flow movements and performs such reconciliations on a daily basis, or, in case of infrequent cash movements, when such cash flow movements occur;
 - (c) implements appropriate procedures to identify at the close of each business day significant cash flows and cash flows which could be inconsistent with UCITS' operations;
 - (d) reviews periodically the adequacy of those procedures, including through a full review of the reconciliation process at least once a year, and ensures that the cash accounts opened in the name of the investment company 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 are included in the reconciliation process;
 - (e) monitors on an ongoing basis the outcomes of the reconciliations and the actions taken as a result of any discrepancies identified by the reconciliation procedures, and notifies the management company or the investment company if a discrepancy has not been corrected without undue delay and also the competent authorities if the situation cannot be corrected;
 - (f) checks that there is consistency between its own records of cash positions and those of the UCITS.

For the purposes of assessing the equivalence of prudential supervisory and regulatory requirements applied to credit institutions of a third country referred to in point (a), competent authorities shall take into account the implementing acts adopted by the Commission pursuant to Article 107(4) of Regulation (EU) No 575/2013 of the European Parliament and of the Council⁽²⁾.

⁽¹⁾ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

⁽²⁾ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

2. The management company or the investment company shall ensure that all instructions and information related to a cash account opened with a third party are sent to the depositary, to enable the depositary to perform its own reconciliation procedure.

Article 11

Duties regarding payments upon the subscriptions

A management company or an investment company shall ensure that the depositary is provided with information about payments made by or on behalf of investors upon the subscription of units of an UCITS at the close of each business day on which the investment company or the management company acting on behalf of the UCITS, or a party acting on behalf of UCITS, such as a transfer agent, receives such payments or an order from the investor. The management company or the investment company shall ensure that the depositary receives all other relevant information it needs to make sure that the payments are booked in cash accounts opened in the name of the investment company or in the name of the management company acting on behalf of the UCITS or in the name of the depositary in accordance with Article 22(4) of Directive 2009/65/EC.

Article 12

Financial instruments to be held in custody

1. Financial instruments belonging to the UCITS which are not able to be physically delivered to the depositary shall be included in the scope of the custody duties of the depositary where all of the following requirements are met:

- (a) they are financial instruments referred to in points (a) to (e) and (h) of Article 50(1) of Directive 2009/65/EC or transferable securities which embed derivatives as referred to in the fourth subparagraph of Article 51(3) of Directive 2009/65/EC;
- (b) they are capable of being registered or held in a securities account directly or indirectly in the name of the depositary.

2. Financial instruments which, in accordance with applicable national law, are only directly registered in the name of the UCITS with the issuer itself or its agent, such as a registrar or a transfer agent, shall not be held in custody.

3. Financial instruments belonging to the UCITS which are able to be physically delivered to the depositary shall in all cases be included in the scope of the custody duties of the depositary.

Article 13

Safekeeping duties with regard to assets held in custody

1. A depositary shall be deemed to comply with the requirements set out in point (a) of Article 22(5) of Directive 2009/65/EC with respect to financial instruments to be held in custody where it ensures that:

- (a) the financial instruments are properly registered in accordance with Article 22(5)(a)(ii) of Directive 2009/65/EC;
- (b) records and segregated accounts are maintained in a way that ensures their accuracy, and in particular record the correspondence with the financial instruments and cash held for UCITS;
- (c) reconciliations are conducted on a regular basis between the depositary's internal accounts and records and those of any third party to whom safekeeping has been delegated in accordance with Article 22a of Directive 2009/65/EC;
- (d) due care is exercised in relation to the financial instruments held in custody in order to ensure a high standard of investor protection;

- (e) all relevant custody risks throughout the custody chain are assessed and monitored and the management company or the investment company is informed of any material risk identified;
- (f) adequate organisational arrangements are introduced to minimise the risk of loss or diminution of the financial instruments, or of rights in connection with those financial instruments as a result of fraud, poor administration, inadequate registering or negligence;
- (g) the UCITS's ownership right or the ownership right of the management company acting on behalf of the UCITS over the assets is verified.

2. Where a depositary has delegated its safekeeping functions, with regard to assets held in custody, to a third party in accordance with Article 22a of Directive 2009/65/EC, it shall remain subject to the requirements of points (b) to (e) of paragraph 1 of this Article. The depositary shall also ensure that the third party complies with the requirements of points (b) to (g) of paragraph 1 of this Article.

Article 14

Safekeeping duties regarding ownership verification and record keeping

1. The management company or the investment company shall provide the depositary, upon commencement of its duties and on an ongoing basis thereafter, with all relevant information it needs to comply with its obligations pursuant to point (b) of Article 22(5) of Directive 2009/65/EC, and ensure that the depositary is provided with all relevant information by third parties.

2. A depositary shall be deemed to comply with the requirements set out in point (b) of Article 22(5) of Directive 2009/65/EC where it at least:

- (a) has access without undue delay to all relevant information it needs in order to perform its ownership verification and record-keeping duties, including relevant information to be provided to the depositary by third parties;
- (b) possesses sufficient and reliable information for it to be satisfied of the UCITS' ownership right over the assets;
- (c) maintains a record of those assets for which it is satisfied that the UCITS holds the ownership by:
 - (i) registers in its records, in the name of the UCITS, assets, including their respective notional amounts, for which it is satisfied that the UCITS holds the ownership;
 - (ii) is able to provide at any time a comprehensive and up-to-date inventory of the UCITS' assets, including their respective notional amounts.

For the purposes of point (c)(ii) of this paragraph, the depositary shall ensure it has procedures in place so that registered assets cannot be assigned, transferred, exchanged or delivered without the depositary or the third party to whom the safekeeping has been delegated in accordance with Article 22a of Directive 2009/65/EC having been informed of such transactions. The depositary shall have access without undue delay to documentary evidence of each transaction and position from the relevant third party. The management company or the investment company shall ensure that the relevant third party provides the depositary without undue delay with certificates or other documentary evidence every time there is a sale or acquisition of assets or a corporate action resulting in the issue of financial instruments and at least once a year.

3. A depositary shall ensure that the management company or the investment company has and implements appropriate procedures to verify that the assets acquired by the UCITS are appropriately registered in the name of the UCITS, and shall check the consistency between the positions in the UCITS records and the assets for which the depositary is satisfied that the UCITS holds ownership. The management company or the investment company shall ensure that all instructions and relevant information related to the UCITS' assets are sent to the depositary to enable the depositary to perform its own verification or reconciliation procedure.

4. A depositary shall set up and implement an escalation procedure for situations where a discrepancy is detected including notification of the management company or the investment company and of the competent authorities if the situation cannot be corrected.

Article 15

Due diligence

1. A depositary shall be deemed to comply with the requirements set out in point (c) of Article 22a(2) of Directive 2009/65/EC where it implements and applies an appropriate documented due diligence procedure for the selection and ongoing monitoring of the third party, to whom safekeeping functions are to be or have been delegated in accordance with Article 22a of that Directive. That procedure shall be reviewed regularly and, at least, once a year.

2. When selecting and appointing a third party to whom safekeeping functions are to be delegated in accordance with Article 22a of Directive 2009/65/EC, a depositary shall exercise all due skill, care and diligence to ensure that entrusting financial instruments to that third party provides an adequate standard of protection. The depositary shall at least:

- (a) assess the regulatory and legal framework, including country risk, custody risk and the enforceability of the contract entered into with that third party. That assessment shall in particular enable the depositary to determine the implications of a potential insolvency of the third party for the assets and rights of the UCITS;
- (b) ensure that the assessment of the enforceability of the contractual provisions referred to in point (a), where the third party is located in a third country, is based on the legal advice of a natural or legal person independent from the depositary or that third party;
- (c) assess whether the third party's practice, procedures and internal controls are adequate to ensure that the assets of the UCITS are subject to a high standard of care and protection;
- (d) assess whether the third party's financial strength and reputation are consistent with the tasks delegated. That assessment shall be based on information provided by the potential third party as well as other data and information;
- (e) ensure that the third party has the operational and technological capabilities to perform the delegated safekeeping tasks with a high degree of protection and security.

3. A depositary shall exercise all due skill, care and diligence in the periodic review and ongoing monitoring to ensure that the third party continues to comply with the criteria provided for in paragraph 2 and the conditions set out in points (a) to (e) of paragraph 3 of Article 22a of Directive 2009/65/EC, and shall at least:

- (a) monitor the third party's performance and its compliance with the depositary's standards;
- (b) ensure that the third party exercises a high standard of care, prudence and diligence in the performance of its safekeeping tasks and in particular that it effectively segregates the financial instruments in line with the requirements of Article 16 of this Regulation;
- (c) review the custody risks associated with the decision to entrust the assets to the third party and without undue delay notify the management company, or the investment company of any change in those risks. That assessment shall be based on information provided by the third party and other data and information. During market turmoil or when a risk has been identified, the frequency and the scope of the review shall be increased;
- (d) monitor compliance with the prohibition laid down in paragraph 7 of Article 22 of Directive 2009/65/EC;
- (e) monitor compliance with the prohibition laid down in Article 25 of the Directive 2009/65/EC and the requirements laid down in Articles 21 to 24 of this Regulation.

4. Paragraphs 1, 2 and 3 shall apply *mutatis mutandis* when the third party to whom safekeeping functions are delegated in accordance with Article 22a of Directive 2009/65/EC has decided to sub-delegate all or part its safekeeping functions to another third party pursuant to the third subparagraph of Article 22a(3) of Directive 2009/65/EC.

5. A depositary shall devise contingency plans for each market in which it appoints a third party to whom safekeeping functions are delegated in accordance with Article 22a of Directive 2009/65/EC. A contingency plan shall include the identification of an alternative provider, if any.

6. A depositary shall take measures, including termination of the contract, which are in the best interest of the UCITS and its investors where the third party to whom safekeeping has been delegated in accordance with Article 22a of Directive 2009/65/EC no longer complies with the requirements of this Regulation.

7. Where the depositary has delegated its safekeeping functions in accordance with Article 22a of Directive 2009/65/EC to a third party located in a third country, it shall ensure that the agreement with the third party allows for an early termination, taking into account the need to act in the best interest of UCITS and its investors, in case the applicable insolvency laws and case law no longer recognises the segregation of the UCITS's assets in the event of insolvency or the third party or the conditions laid down in law and case law are no longer fulfilled.

8. Where the applicable insolvency law and case law no longer recognise the segregation of the UCITS' assets in the event of insolvency of the third party to whom safekeeping functions have been delegated in accordance with Article 22a of Directive 2009/65/EC or no longer ensure that the assets of the depositary's UCITS clients do not form part of the third party's estate in case of insolvency and are unavailable for distribution among, or realisation for the benefit of, creditors of the third party to whom safekeeping functions are delegated pursuant to Article 22a of Directive 2009/65/EC, the depositary shall immediately inform the management company or the investment company.

9. On receipt of the information referred to under paragraph 8, the management company or the investment company shall immediately notify its competent authority of such information and consider all the appropriate measures in relation to the relevant assets of the UCITS, including their disposal taking into account the need to act in the best interest of the UCITS and its investors.

Article 16

Segregation obligation

1. Where safekeeping functions have been delegated wholly or partly to a third party, a depositary shall ensure that the third party to whom safekeeping functions are delegated pursuant to Article 22a of Directive 2009/65/EC acts in accordance with the segregation obligation laid down in point (c) of Article 22a(3) of Directive 2009/65/EC by verifying that the third party:

- (a) keeps all necessary records and accounts to enable the depositary at any time and without delay to distinguish assets of the depositary's UCITS clients from its own assets, assets of its other clients, assets held by the depositary for its own account and assets held for clients of the depositary which are not UCITS;
- (b) maintains records and accounts in a way that ensures their accuracy, and in particular their correspondence to the assets safe-kept for the depositary's clients;
- (c) conducts, on a regular basis, reconciliations between the depositary's internal accounts and records and those of the third party to whom it has sub-delegated safekeeping functions in accordance with the third subparagraph of Article 22a(3) of Directive 2009/65/EC;
- (d) introduces adequate organisational arrangements to minimise the risk of loss or diminution of financial instruments or of rights in connection with those financial instruments as a result of misuse of the financial instruments, fraud, poor administration, inadequate record-keeping or negligence;
- (e) holds the UCITS' cash in an account or accounts with a central bank of a third country or a credit institution authorised in a third country, provided that the prudential supervisory and regulatory requirements applied to credit institutions in that third country are considered by the competent authorities of the UCITS home Member States as at least equivalent to those applied in the Union, in accordance with point (c) of Article 22(4) of Directive 2009/65/EC.

2. Paragraph 1 shall apply *mutatis mutandis* when the third party, to whom safekeeping functions are delegated in accordance with Article 22a of Directive 2009/65/EC, has decided to sub-delegate all or part of its safekeeping functions to another third party pursuant to the third subparagraph of Article 22a(3) of Directive 2009/65/EC.

Article 17

Insolvency protection of UCITS assets when delegating custody functions

1. A depositary shall ensure that a third party located in a third country, to whom custody functions are to be or have been delegated in accordance with Article 22a of Directive 2009/65/EC takes all necessary steps in order to ensure that in the event of an 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 that third party.

2. A depository shall ensure that the third party takes the following steps:
- (a) receives legal advice from an independent natural or legal person confirming that the applicable insolvency law recognises the segregation of the assets of the depository's UCITS clients from its own assets and from the assets of its other clients, from the assets held for the depository's own account and from the assets held for clients of the depository which are not UCITS as referred to in Article 16 of this Regulation and that the assets of the depository's UCITS clients do not form part of the third party's estate in case of insolvency and are unavailable for distribution among, or realisation for the benefit of, creditors of the third party to whom safekeeping functions have been delegated in accordance with Article 22a of Directive 2009/65/EC;
 - (b) ensures that the conditions laid down in the applicable insolvency laws and case law of that third country recognise that the assets of the depository's UCITS clients are segregated and unavailable for distribution among, or realisation for the benefit of creditors, as referred to in point (a), are met when concluding the delegation agreement with the depository as well as on an ongoing basis for the entire duration of the delegation;
 - (c) immediately informs the depository where any of the conditions referred to in point (b) is no longer met;
 - (d) maintains accurate and up-to-date records and accounts of the UCITS' assets on the basis of which the depository can at any time establish the precise nature, location and ownership status of those assets;
 - (e) provides a statement to the depository, on a regular basis, and in any case whenever a change occurs, detailing the assets of the depository's UCITS clients;
 - (f) informs the depository about the changes of applicable insolvency law and of its effective application.
3. Where the depository has delegated its safekeeping functions in accordance with Article 22a of Directive 2009/65/EC to a third party located in the Union, that third party shall provide a statement to the depository, on a regular basis, and in any case whenever a change occurs, detailing the assets of the depository's UCITS clients.
4. The depository shall ensure that duties laid down in paragraphs 1 and 2 shall apply *mutatis mutandis* when the third party, to whom safekeeping functions are delegated pursuant to Article 22a of Directive 2009/65/EC, has decided to sub-delegate all or part of its safekeeping functions to another third party pursuant to the third subparagraph of Article 22a(3) of Directive 2009/65/EC.

CHAPTER 3

LOSS OF FINANCIAL INSTRUMENTS AND LIABILITY DISCHARGE

(Article 24(1) of Directive 2009/65/EC)

Article 18

Loss of a financial instrument held in custody

1. The loss of a financial instrument held in custody within the meaning of the second subparagraph of Article 24(1) of Directive 2009/65/EC shall be deemed to have taken place where, in relation to a financial instrument held in custody by the depository or by a third party to whom the safekeeping of financial instruments has been delegated in accordance with Article 22a of Directive 2009/65/EC, any of the following conditions is met:
- (a) a stated right of ownership of the UCITS is demonstrated not to be valid because it either ceased to exist or never existed;
 - (b) the UCITS has been definitively deprived of its right of ownership over the financial instrument;
 - (c) the UCITS is definitively unable to directly or indirectly dispose of the financial instrument.
2. The ascertainment by the management or the investment company of the loss of a financial instrument shall follow a documented process readily available to the competent authorities. Once a loss is ascertained, it shall be notified immediately to investors in a durable medium.

3. A financial instrument held in custody shall not be deemed to be lost within the meaning of the second subparagraph of Article 24(1) of Directive 2009/65/EC where an UCITS is definitively deprived of its right of ownership in respect of a particular instrument, as long as that instrument is substituted by or converted into another financial instrument or instruments.

4. In the event of insolvency of the third party to whom the safekeeping of financial instruments has been delegated in accordance with Article 22a of Directive 2009/65/EC, the loss of a financial instrument held in custody shall be ascertained by the management company or the investment company as soon as one of the conditions listed in paragraph 1 is met with certainty.

There shall be certainty as to whether any of the conditions set out in paragraph 1 is fulfilled at the latest at the end of the insolvency proceedings. The management company or the investment company and the depositary shall monitor closely the insolvency proceedings to determine whether all or some of the financial instruments entrusted to the third party to whom the safekeeping of financial instruments has been delegated in accordance with Article 22a of Directive 2009/65/EC are effectively lost.

5. A loss of a financial instrument held in custody shall be ascertained irrespective of whether the conditions set out in paragraph 1 are the result of fraud, negligence or other intentional or non-intentional behaviour.

Article 19

Liability discharge

1. A depositary's liability under the second subparagraph of Article 24(1) of Directive 2009/65/EC shall not be triggered provided the depositary can prove that all the following conditions are met:

- (a) the event which led to the loss is not the result of any act or omission of the depositary or of a third party to whom the safekeeping of financial instruments held in custody in accordance with point (a) of Article 22(5) of Directive 2009/65/EC has been delegated;
- (b) the depositary could not have reasonably prevented the occurrence of the event which led to the loss despite adopting all precautions incumbent on a diligent depositary as reflected in common industry practice;
- (c) the depositary could not have prevented the loss despite rigorous and comprehensive due diligence as documented by:
 - (i) establishing, implementing, applying and maintaining structures and procedures and insuring expertise that are adequate and proportionate to the nature and complexity of the assets of the UCITS in order to identify in a timely manner and monitor on an ongoing basis external events which may result in loss of a financial instrument held in custody;
 - (ii) assessing on an ongoing basis whether any of the events identified under point (i) presents a significant risk of loss of a financial instrument held in custody;
 - (iii) informing the management company or the investment company of the significant risks identified and taking appropriate actions, if any, to prevent or mitigate the loss of financial instruments held in custody, where actual or potential external events have been identified which are believed to present a significant risk of loss of a financial instrument held in custody.

2. The requirements referred to in points (a) and (b) of paragraph 1 may be deemed to be fulfilled in the following circumstances:

- (a) natural events beyond human control or influence;
- (b) the adoption of any law, decree, regulation, decision or order by any government or governmental body, including any court or tribunal, which impacts the financial instruments held in custody;
- (c) war, riots or other major upheavals.

3. The requirements referred to in points (a) and (b) of paragraph 1 shall not be deemed to be fulfilled in cases such as an accounting error, operational failure, fraud, failure to apply the segregation requirements at the level of the depositary or a third party to whom the safekeeping of financial instruments held in custody in accordance with point (a) of Article 22(5) of Directive 2009/65/EC has been delegated.

CHAPTER 4

INDEPENDENCE REQUIREMENTS AND FINAL PROVISIONS

(Article 25 of Directive 2009/65/EC)

Article 20

Management body

For the purposes of this Chapter 'management body of the management company' shall include the management body of the management company or the management body of the investment company.

Article 21

Common management

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

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

Article 22

Appointment of depositary and delegation of safekeeping

1. The management company or the investment company shall have in place a decision-making process for choosing and appointing the depositary, which shall be based on objective pre-defined criteria and meet the sole interest of the UCITS and the investors of the UCITS.

2. Where the management company or the investment company appoints a depositary to which it has a link or a group link, it shall keep documentary evidence of the following:

- (a) an assessment comparing the merits of appointing a depositary with a link or a group link with the merits of appointing a depositary which has no link or no group link with the management company or the investment company, taking into account at least the costs, the expertise, financial standing and the quality of services provided by all depositaries assessed;

(b) a report, based on the assessment referred to in point (a), describing the way in which the appointment meets the objective pre-defined criteria referred to in paragraph 1 and is made in the sole interest of the UCITS and the investors of the UCITS.

3. The management company or the investment company shall demonstrate to the competent authority of the UCITS home Member State that it is satisfied with the appointment of the depositary and that the appointment is in the sole interest of the UCITS and the investors of the UCITS. The management company or the investment company shall make the documentary evidence referred to in paragraph 1 available to the competent authority of the UCITS home Member State.

4. The management company or the investment company shall justify to investors of the UCITS, upon request, the choice of the depositary.

5. The depositary shall have in place a decision-making process for choosing third parties to whom it may delegate the safekeeping functions in accordance with Article 22a of Directive 2009/65/EC, which shall be based on objective pre-defined criteria and meet the sole interest of the UCITS and the investors of the UCITS.

Article 23

Conflicts of interest

Where a link or a group link exists between them, the management company or the investment company and the depositary, shall put in place policies and procedures ensuring that they:

- (a) identify all conflicts of interest arising from that link;
- (b) take all reasonable steps to avoid those conflicts of interest.

Where a conflict of interest referred to in the first subparagraph cannot be avoided, the management company or the investment company and the depositary shall manage, monitor and disclose that conflict of interest in order to prevent adverse effects on the interests of the UCITS and of the investors of the UCITS.

Article 24

Independence of management boards and supervisory functions

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

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

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

*Article 25***Entry into force and application**

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

It shall apply from 13 October 2016.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 17 December 2015.

For the Commission

The President

Jean-Claude JUNCKER
