Depositaries in European Investment Law: Towards Harmonization in Europe

Bewaarders ('*depositaries*') in het Europees Financieel Recht - De weg naar een geharmoniseerd regime in Europa
(met een samenvatting in het Nederlands)

Proefschrift

ter verkrijging van de graad van doctor aan de Universiteit Utrecht op gezag van de rector magnificus, prof.dr. G.J. van der Zwaan, ingevolge het besluit van het college voor promoties in het openbaar te verdedigen op dinsdag 9 januari 2018 des middags te 12.45 uur

door

Sebastiaan Niels Hooghiemstra

geboren op 9 januari 1987
te 's-Gravenhage

Promotor: Prof. dr. H. van Meerten

Preface

The idea for the topic of this Ph.d thesis was born during a coffee break at Zürich airport with my former colleagues Prof. Dr. Dirk Zetzsche and David Eckner LL.M. in January 2011. On that day, we were all heading to Liechtenstein to sign our agreements with the University of Liechtenstein to take upon an exciting challenge for being responsible for implementing UCITSD IV, the AIFMD and, later on, the CRD IV in Liechtenstein. As a result of the preparatory work we already did since the summer of 2010, we soon came to the conclusion that the developments in depositary regulation on the European level could be an interesting Ph.d topic. What we could not anticipate at that time is the degree to which depositary regulation would be overhauled on the European level.

When taking upon this Ph.d topic, the only European set of legislation targeting depositaries was UCITSD III, whereas 'custodians' were regulated by IORPD I, MiFID I and CRD III. The minimum set of regulation applicable at that time on the European level warranted a comprehensive in-depth study of the Member State implementations of these initiatives. In a couple of attempts to write my preliminary research brief, I faced numerous difficulties in understanding what a 'depositary' was. The understanding of the 'depositary' throughout Europe was, prior to the adoption of the AIFMD and UCITSD V, very different from Member State to Member State. Traditionally, the Dutch implementation under UCITSD I-IV, for example, allowed for the 'depositary' tasks to be entrusted to a 'trustee' (*bewaarderentiteit*) that exercises the controlling/monitoring/oversight duties towards UCITS ManCos, whereas the custody function was fully delegated to a custodian. In Austria, Germany, Liechtenstein and Switzerland the banking dominance, however, resulted in a 'depositary' that was mostly a bank that performed both functions simultaneously. Coming from a country (the Netherlands) with a non-banking asset management tradition, I had no experience with 'depositaries' nor did I understand it in a way that my colleagues coming from the abovementioned countries did. The introduction of new depositary regimes under the AIFMD, UCITSD V, IORPD II and the proposed PEPPR on the European level, the inconsistencies throughout these regimes, at the one, and with the MiFID II/CRD IV 'custodian' regimes, at the other hand, during the Ph.d. process strengthened the belief that the European regulation of depositaries in the various sectoral regulations should be clarified. This insight is what made this book happen.

Sebastiaan Niels Hooghiemstra

Etten-Leur/Utrecht, August 2017

Acknowledgments

Although a Ph.d. is, for the major part, conducted in solitude, it cannot be written without the help and the advice of others. For this reason, I would to thank several people that helped me to finalize my research.

First, I am extremely thankful for the ongoing, dutiful advise and support of my academic supervisor Prof. Dr. Hans van Meerten. After almost six years working as a research associate at the University of Liechtenstein, my academic supervisor Prof. Dr. Dirk Zetzsche made a transfer to the University of Luxembourg. My colleagues and I had to make a choice at what university we would want to finalize our Ph.d research. I chose the University of Utrecht. Hans warmly welcomed me and always gave me the freedom in pursuing my research interests. A combination of his strong background in international pensions and European law and my in-depth knowledge of European investment law proved to be very fruitful and resulted in a joint research Report on Pan-European Personal Products that was presented to and, to a large extent, adopted by the European Commission in its recent PEPPR proposal in June 2017.

I would like to also thank my former academic supervisor Prof. Dr. Dirk Zetzsche. His supervision and guidance for almost six years has inspired, motivated and guided me in the best way possible. My time as a research associate at the Propter Homines Chair at the University of Liechtenstein has been very crucial in my personal and professional development. Dirk's confidence in his team allowed us to take upon a lot of responsibility in implementing the UCITSD IV, AIFMD, CRD IV that were assigned to the Chair by the Liechtenstein Government in 2010-2014 and in developing the Proxy Advisors Best Practice Principles assigned by ESMA in 2013. The research conducted in this book has largely benefited from not only this but also his generosity in assigning research projects, lectures at the University of Liechtenstein, guest lectures at Tilburg University (2012-2014) and Heinrich-Heine University (2013) to me.

I would like to thank my colleagues and students at Utrecht University and University of Liechtenstein who directly or indirectly contributed to my dissertation.

I thank Emeritus Professor Christel Grundmann-van de Krol for the mentorship, confidence, support and discussions we had and Robert Smits (Council Clifford Chance) for the in-depth discussions and his insights related to the AIFMD/UCITSD V locational depositary restrictions and the 'custody plus' solution discussed in this thesis.

I thank the members of my PhD Committee, Professor Kleis Broekhuizen, Professor Nicolas Raschauer, Professor Sybe de Vries, Professor Jan-Willem Sap and Associate-Professor Ton van den Brink for their time, suggestions and commitment.

Most importantly, I would like to thank my family and close ones for their ongoing love, support and understanding. The love, care, and guidance of my parents, Hans and Laura Hooghiemstra, my sister Kim Hooghiemstra and my nephew Enzo Vugts are with me at every step in life. To them I owe this achievement. I dedicate this book to them.

Table of Contents

Preface i

Acknowledgments ii

List of Abbreviations xxiv

CHAPTER 1

Introduction 1

1. Background 1
2. The Case for the Introduction of a Cross-Sectoral European Passport for Depositaries 2
   - 2.1. Depositaries versus Custodians 3
   - 2.2. Overcoming the 'European Depositary Passport Paradox' 4
   - 2.3. The AIFMD/UCITSD V Depositary Passport 'Investor Protection Concerns' 5
     - 2.3.1. The concerns raised upon introduction of the 'Management Passport' under UCITSD IV 6
     - 2.3.2. The Investor Protection Concerns upon Introducing an AIF/UCITS Depositary Passport 8
4. Methodology 10
5. Limitations 12
6. Scientific & Societal Relevance 13
   - 6.1. Scientific Relevance 13
   - 6.2. Societal Relevance: The Growing Importance of Depositaries 14
     - 6.2.1. The rise of European AuM 14
     - 6.2.2. Possible Cost Reduction of a Depositary Passport 15
7. Study Outline 16

PART I: THE EUROPEAN DEPOSITARY PASSPORT PARADOX 18

CHAPTER 2

Locational Depositary Restrictions under the European Investment Laws 19

1. The European Depositary/Custodian Passport under European Investment Laws 19
   - 1.1. The European Passport for 'Custodians' under MiFID II/CRD IV 19
   - 1.2. The Location of the Depositary under the AIFMD & UCITSD V 20
     - 1.2.1. The Location of the Depositary for UCITS 21
     - 1.2.2. The Location of the Depositary for AIFs 24
       - 1.2.2.1. Location of the Depositary for EEA-AIFs 24
       - 1.2.2.2. Transitional Relief – AIFMs managing EEA-AIFs 26
       - 1.2.2.3. Location of the Depositary for TC-AIFs 26
       - 1.2.2.4. A Quasi-Depositary Passport Regime for TC-AIFs 27
     - 1.2.3. Conclusion 27

1.3. The Depositary Mutual Recognition Approach under IORPD II 28
1.3.1. 'Established in another Member State' 28
1.3.2. Mutual Recognition under IORPD II – applying to Depositaries and or Custodians? 29
1.3.3. Cooperation between Supervisory Authorities 30
1.3.4. Conclusion 31
1.4. The Proposed Inconsistent Locational Depositary Restriction Approach under the PEPPR 31
1.5. Conclusion 33

2. The European Depositary Passport Debate 34
2.1. UCITSD I-VI 34
2.1.1. UCITSD I 34
2.1.2. UCITSD II 36
2.1.3. UCITSD III/IV 38
2.1.3.1. Commission Communication 2004 38
2.1.3.2. Green Paper 2005 39
2.1.3.3. Expert Group on Investment Market Efficiency 40
2.1.3.4. Impact Assessment – White Paper on 'Enhancing the Single Market Framework for Investment Funds' 40
2.1.4. UCITSD V/VI 41
2.2. The AIFMD 42
2.3. ISD-MiFID I/II/Second Banking Directive- CRD IV 43
2.4. IORPD I/II 44
2.5. Conclusion 45

3. Conclusion 46

PART I - Conclusion 48

PART II: THE EEA'S APPROACH TOWARDS THE CROSS-BORDER PROVISION OF FINANCIAL SERVICES 49

CHAPTER 3

EEA Cross-Border Regulation for Financial Intermediaries 50

1. The Internal Dimension of the Cross-Border Provision of Financial Services 51
1.1. A Law and Economics Theory of the Internal Market for Financial Services 51
1.1.1. Market efficiency & Economies of Scale and Scope 51
1.1.1.1. Market efficiency 51
1.1.1.2. Economies of Scale and Scope 53
1.1.2. Risk Asymmetry & the Concept of 'production' and 'distribution' Member States 54
1.1.3. EEA Law as a Substitute for Risk Asymmetry 56
1.2. The Internal Dimension – the Four freedoms 57
1.2.1. The Freedom of Capital 57
1.2.2. The Freedom of Establishment 58
1.2.3. The Freedom to provide Services 59
1.2.4. Overlapping Fundamental Freedoms 59

2. The Evolution of the EEA Legal Framework for the Cross-Border Provision of Financial Services 60

2.1. The Era of National Treatment 60
2.1.1. Implementing Directives on the Free Movement of Establishment/Services .. 61
2.1.2. Reyners & Van Binsbergen 62
2.1.3. The First Generation of Banking (and Insurance) Directives 62
2.1.4. Review of the Principle of National Treatment and the Way to Mutual Recognition 63
2.2. The Era of Mutual Recognition and the Single License Concept 64
2.2.1. The White Paper on the Completion of the Internal Market (1985) 64
2.2.2. Mutual Recognition under the Second Banking Directive 66
2.2.3. Mutual Recognition under the Investment Services Directive 67
2.2.4. Hidden National Barriers to Entry: Grounds of 'General Good/Interest' 70
2.3. The Financial Services Action Plan (FSAP) 72
2.4. Overcoming Deficiencies of the Mutual Recognition Era 73
2.4.1. Maximum Harmonization as a Response to the Defragmented Market for Financial Services 73
2.4.2. Post-Crisis Reform: Redesigning the European Supervisory Architecture 75
2.5. Conclusion 77

3. The Joint Principles of the European Passport of EEA Financial Intermediaries 78
3.1. An Internal Market for Financial Intermediaries 78
3.2. The General Concept of the 'European Passport' 80
3.3. Positive Integration & EU Legal Instruments 80
3.3.1. The Choice of EU Policy Instruments 81
3.3.2. The Principles of Subsidiarity and Proportionality 83
3.3.3. The Lamfalussy Process 83
3.3.4. The Trend towards Maximum Harmonization 84
3.4. The Cornerstones of the European Passport for Financial Intermediaries: the 'Single Rulebook', 'Home Country Control' & the ESFS 85
3.4.1. The European Passport Substantive Legal Framework: 'The Single Rulebook' 85
3.4.1.1. Level 1 86
3.4.1.2. Level 2 88
3.4.1.3. Level 3 88
3.4.1.4. Level 4 88
3.4.2. The EEA Financial Supervisory Framework: Home Country Control & the ESFS 89
3.4.2.1. Home Country Control 89
3.4.2.2. The European System of Financial Supervision 89
3.5. Conclusion 90

4. The External Dimension of the Cross-Border Provision of Financial Services 91
4.1. The External Dimension – A Law and Economics Theory 92
4.1.1. TC Financial Services & the EEA's External Dimension 92
4.1.2. Risk Asymmetry, TC Financial Centres & the Concept of 'production' and 'distribution' States 93
4.1.3. Equivalency as a Substitute for Risk Asymmetry 93
4.1.3.1. The EEA's Third Country Rules Approaches 93
4.1.3.2. 'Equivalency' and Risk Asymmetry 94
4.2. The EU's Common Commercial Policy 95
4.3. The GATS 96

4.3.1. Scope of the GATS 97
4.3.1.1. Measures 97
4.3.1.2. Trade 97
4.3.1.3. Financial Services 98
4.3.2. General Obligations and Specific Commitments in the GATS 99
4.3.2.1. General Obligations 99
4.3.2.2. Specific Commitments 101
4.3.3. Exceptions to GATS Obligations and Commitments 102
4.3.3.1. General Exceptions 102
4.3.3.2. Prudential Exception ('prudential carve-out') 102
4.3.4. Economic Integration 103
4.3.5. Conclusion 104
4.4. Bilateral Trade Agreements 105
4.5. Membership of the European Economic Area (EEA) 105
4.6. EFTA Membership (Switzerland) 107

5. Third Countries & EEA Secondary Law 107
5.1. EEA Financial Intermediaries with an External Dimension 108
5.1.1. 'Qualifying Holding' and 'Close Links' Requirements for Non-EEA Shareholders 108
5.1.2. Delegation 109
5.1.2.1. General Principles of EEA Delegation Rules 110
5.1.2.2. 'Equivalency' as Common Principle for TC Delegation Rules? 111
5.1.3. Consolidated Supervision & Conglomerates 112
5.1.3.1. Consolidated Supervision: Sectoral Groups 113
5.1.3.2. Consolidated Supervision (FiCOD): Financial Conglomerates 116
5.1.3.3. Conclusion 121
5.2. Financial Intermediaries within the EEA 121
5.2.1. 'Stand-alone' Authorizations 121
5.2.1.1. Branch: Solvency II 122
5.2.1.2. National Private Placement Regimes under the AIFMD 123
5.2.1.3. CRD IV 124
5.2.1.4. The MiFID II Country-by-Country Branch Regime 124
5.2.2. European Passports for TC Financial Intermediaries 127
5.2.2.1. The TC-AIFM Passport Regime under the AIFMD 127
5.2.2.2. The MiFIR European Passport for TC Investment Firms 129
5.2.3. The (Mutual) Agreements Solution 130
5.2.3.1. Solvency II 130
5.2.3.2. Credit Institutions 132
5.3. EEA Financial Intermediary TC Market Access 133
5.3.1. The EU Commission Negotiation Mandate 133
5.3.2. The (Mutual) Agreements Solution under the Commission Negotiation Mandate 133

6. Joint Principles of EEA TC Financial Intermediary Regulation 134
6.1. Third Countries & EEA Secondary Law 134
6.1.1. The Internal Dimension – The Four Freedoms 135
6.1.2. The External Dimension: International Law Commitments & EEA Secondary Law 135
6.2. Equivalency in EEA Secondary Law 136
6.2.1. Equivalency of TC Regulatory and Supervision Regimes 136
6.2.2. Cooperation Agreements 139

6.2.3. Information Exchange ... 140
6.2.4. 'Legal Representation' in the EEA ... 140
6.2.4.1. EEA Subsidiary ... 140
6.2.4.2. EEA Branch ... 141
6.2.4.3. EEA 'Legal Representation' ... 141
6.3. The EEA's Centralized Rulemaking and Supervision ... 142
6.3.1. The Role of the European Commission in Centralized Rulemaking ... 142
6.3.2. The Role of ESAs in TC Regimes ... 143
6.4. Judicial Control ... 143
7. Conclusion ... 144
PART II- Conclusion ... 147

PART III: DEPOSITARIES VS. CUSTODIANS ... 148

A. GRAMMATICAL EXPLANATION ... 149

CHAPTER 4

The AIFMD and UCITSD V Depositary Regulation ... 150

1. Introduction ... 150
2. The Scope of the AIFMD and UCITSD V with Regard to Depositaries ... 151
2.1. The Obligation to Appoint a Depositary under the AIFMD ... 151
2.1.1. General Rule ... 151
2.1.2. The Retail AIF Depositary ... 151
2.1.3. Exemptions from the Depositary Obligation ... 153
2.1.3.1. 'Small' AIFMs ... 153
2.1.3.2. Private Placement Regime - AIFs managed by TC-AIFMs ... 155
2.1.4. Depositary-Lite Regime ... 156
2.2. The Obligation to Appoint a Depositary under the UCITSD V ... 158
3. Entities Eligible as a Depositary and Its Organizational Requirements ... 158
3.1. Entities Eligible as a Depositary under the AIFMD ... 158
3.1.1. Credit Institution ... 158
3.1.2. Investment Firm ... 159
3.1.3. Other Eligible Institutions ... 159
3.1.4. Prime Broker ... 160
3.1.4.1. The Prime Broker as Counterparty ... 161
3.1.4.2. The Prime Broker as Depositary ... 161
3.1.5. Eligible Non-EEA Entities ... 161
3.1.6. Option for Private Equity Funds, Venture Capital Funds and Real Estate AIFs 162
3.2. Entities Eligible as a Depositary under the UCITSD V ... 164
3.2.1. National Central Bank ... 165
3.2.2. Credit Institution ... 166
3.2.3. Another Legal Entity ... 167
3.2.3.1. Investment Firms as Per Sé Depositaries – A Missed Opportunity? ... 167
3.2.3.2. CSDs ... 169
3.2.3.3. Prime Brokers as UCITS Depositaries? ... 170
3.2.3.4. Other Legal Entities Eligible under UCITSD V Member State Laws ... 171

4. EEA AIF and UCITS Depositaries – General Requirements 173
4.1. Duty of Loyalty 173
4.2. Conflicts of Interest 173
4.3. The Third-Party Depositary Requirement 174
4.4. Independence Requirements under UCITSD V 175
4.4.1. Common Management/Supervision 176
4.4.2. Cross-Shareholdings/Group Inclusion 176

5. AIFMD Third-Country Depositaries 178
5.1. Additional Requirements for Third-Country Depositaries 178
5.2. The Third-Country Depositary and ‘Effective Prudential Regulation’ 179
5.2.1. Effectively Enforced Prudential Regulation 179
5.2.2. ‘Supervision Equivalent’ to That Applicable under EEA Law 180

6. The Depositary and Its Functions 180
6.1. The Particulars of the Written Contract 181
6.1.1. Eligible Assets 181
6.1.2. Flow of Information 182
6.1.3. Escalation Procedure 182
6.1.4. Third Parties 182
6.1.5. Termination of the Contract 183
6.2. Safekeeping 183
6.2.1. Financial Instruments That Should Be Held in Custody 183
6.2.2. Safekeeping Duties with Regard to Assets Held in Custody 184
6.2.2.1. Insolvency Protection UCITS Assets 186
6.2.3. ‘Other Assets’ 186
6.2.4. Safekeeping Duties regarding Ownership Verification and Record Keeping 187
6.3. Control 188
6.3.1. Oversight Duties – General Requirements 188
6.3.1.1. Ex Ante Verification 188
6.3.1.2. Ex Post Controls 189
6.3.2. Subscriptions/Redemptions 189
6.3.3. Valuation of Shares/Units 190
6.3.4. AIFM’s/UCITS ManCo Instructions 191
6.3.5. The Timely Settlement of Transactions 192
6.3.6. AIF’s Income Distribution 192
6.3.7. Monitoring of the AIF’s/UCITS’ Cash Flows 193
6.3.7.1. Cash Monitoring – General Requirements 194
6.3.7.2. Proper Monitoring of All AIF’s/UCITS’ Cash Flows 195
6.3.8. UCITS Mergers and Master-Feeder Structures 196
6.3.8.1. UCITS Mergers 196
6.3.8.2. Master-Feeder Structures 197

7. Delegation in the Depositary Chain 198
7.1. Avoiding Requirements 199
7.2. Objective Reason 200
7.3. Due Diligence 200
7.3.1. Due Diligence upon Appointment of the Sub-custodian 200
7.3.2. Ongoing Monitoring Diligence Sub-custodian 201
7.3.2.1. Adequate Structures and Expertise 201
7.3.2.2. Effective Prudential Regulation 201
7.3.2.3. Segregation of Assets 202
7.3.2.4. Asset Inventories for UCITS Assets 203

7.3.2.5. Re-hypothecation 203
7.3.2.6. General Obligations 204
7.3.2.7. Ongoing Monitoring and Periodic Review 204
7.3.3. Insolvency Protection of UCITS Assets 205
7.3.3.1. Sub-custodian 206
7.3.3.2. Depositary 207
7.4. Lex Specialis - The Prime Broker as a Sub-Custodian under the AIFMD 208

8. The liability regime under the AIFMD and UCITSD V 211
8.1. The Depositary's liability under the AIFMD and UCITSD V 213
8.1.1. Loss of Financial Instruments that can be held in Custody 213
8.1.2. The AIFMD and UCITSD V Liability Discharge 215
8.1.2.1. External Event 215
8.1.2.2. Beyond Reasonable Control 216
8.1.2.3. 'Reasonable Efforts' 216
8.1.3. The AIFMD Contractual Discharge of Liability 217
8.2. The impact of the AIFMD/UCITSD V Liability Regime for Depositaries 218
8.3. Rights of the AIFM/UCITS ManCo and Investors against the Depositary 222
8.3.1. AIFMD 222
8.3.2. UCITSD V 223
8.4. Conclusion 224

9. The Depositary under the 'AIFMD/UCITSD Product Regulations' 225
9.1. The ELTIFR Depositary Regime 225
9.2. The MMFR Depositary Regime 227
9.3. The EuVECAR/EuSEFR 'Depositary Regime' 227
9.4. The AIFMD Product Regulation Depositary Regimes versus the AIFMD/UCITSD V 229

10. The AIFM, Depositary and the Prime Broker in the Prime Brokerage relationship 230
10.1. The Role of the AIFM, Prime Broker and Depositary 230
10.1.1. AIFM 230
10.1.1.1. The Selection and Appointment of the Prime Broker 230
10.1.1.2. The AIFM Organizational Duties 231
10.1.2. The Prime Broker – Reporting Obligations towards the Depositary 232
10.1.3. The Depositary - frictional boundaries between the Prime Broker's Counterparty and Depositary Function 233
10.1.3.1. Safekeeping: Scope Financial Instrument held in Custody versus 'Other Assets' 233
10.1.3.2. Oversight Duties 234
10.1.3.3. Cash Management – Cooperation between the Prime Broker and the Depositary 235
10.2. Prime Broker Models: The Depositary/Prime Broker Relationship 235
10.2.1. The Prime Broker' as Depositary 235
10.2.2. The Prime Broker as Sub-Custodian 236
10.2.2.1. The Prime Broker using its own Sub-Custodian Network 236
10.2.2.2. The Prime Broker using the Depositary's Sub-Custodian Network 238
10.2.3. The Prime Broker as Counterparty 238
10.2.4. The AIFMD's Exemption: The Depositary Lite Model 240
10.3. Conclusion 240

11. Conclusion 240

CHAPTER 5

IORPD II Depositary Regime 242
1. Introduction 242
2. The Appointment of Depositaries under IORPD II 242
2.1. The Appointment for Full DC and other Types of IORPs 243
2.1.1. Full DC IORPs 243
2.1.2. Other Types of IORPs 245
2.2. Investment risks - Full DC, hybrid and/or Full DB IORPs? 245
2.3. The Definition of a ‘Depositary’ under IORPD II 247
2.4. The Appointment of a Single Depositary vs. Multiple Depositaries 249
2.4.1. The Inconsistency of the ‘Depositary’ Terminology under IORPD II 249
2.4.2. The Unclarity of the ‘Depositary’ definition under IORPD II 250
2.5. The discretionary choice of Member States for a ‘Depositary’ or ‘Custodian’ under the IORPD II 252
2.6. The Optional IORP Pooling Structure Exemption 253
3. The IORPD II Substantive Depositary Regime 254
3.1. The Scope of the IORPD II ‘Substantive’ Depositary Regime 255
3.2. Entities Eligible as a Depositary and Its Organizational Requirements 257
3.2.1. Entities Eligible 257
3.2.1.1. National versus European Depositaries 257
3.2.1.2. The Expanding list of Heterogeneous Eligible Entities under IORPD II... 257
3.2.1.3. The Impact of ‘Custodians’ and ‘Depositaries’ being IORPD II Depositaries 257
3.2.2. The AIFMD Depositaries eligible 258
3.2.2.1. The AIFMD Prime broker 258
3.2.2.2. The AIFMD ‘PE Depositary’ 259
3.2.2.3. UCITSD V Depositaries 259
3.2.2.4. Investment Firms under MiFID II 259
3.2.2.5. Conclusion 260
3.3. Depositary –General Requirements 260
3.3.1. Duty of Loyalty 261
3.3.2. Conflicts of Interest 261
3.4. The Depositary and its Functions 262
3.4.1. Particulars of the Written Depositary Contract 262
3.4.2. Safekeeping 263
3.4.3. Control 264
3.5. Delegation of the Depositary Chain 266
3.6. The Depositary Liability Regime 267
4. ‘Equivalent Protection’ for IORPs without a Depositary appointed 268
4.1. IORPs without a Depositary Appointed for Safekeeping 268
4.1.1. Financial instruments subject to due care and protection 269
4.1.1.1. Third-Party Custody 269
4.1.1.2. Self-Custody 270
4.1.1.3. Record keeping IORP Assets 271
4.1.1.4. Measures avoiding Conflicts of Interest 271
4.1.1.5. Notification Competent Authorities 271
4.1.2. ‘Equivalency Protection’ Criticism 271
4.2. IORPs without a Depositary Appointed for Oversight Duties 272
4.2.1. Oversight Duties duly performed within the IORP 272

4.2.1.1. Risk Management Organization within the IORP Governing Body 272
4.2.1.2. Trustees, Board of directors and Independent Oversight Committees 273
4.2.2. Equivalent Protection for Oversight Duties? 274
4.2.3. Tasks subject to Oversight by Depositaries 274

5. Conclusion 274

CHAPTER 6

The CRD IV, MiFID II and the CSDR 'Custodian Regime' 276

1. Introduction 276

2. The 'Custodian' under CRD IV and MiFID II 276
2.1. 'Safekeeping and Administration Services' as an 'Ancillary Service' 277
2.1.1. Credit Institutions under CRD IV 277
2.1.2. Investment Firm under MiFID II 277
2.2. The MiFID II versus CRD IV Definition of 'Safekeeping and Administration Services' 278
2.2.1. Safekeeping and administration of financial instruments for the account of clients 279
2.2.1.1. Safekeeping 279
2.2.1.2. Administration 282
2.2.1.3. For the Account of Clients 282
2.2.2. Custodianship and related services such as cash/collateral management 282
2.2.3. Exclusion: Securities Accounts at top Tier Level 283
2.3. Conclusion 283

3. The (Investor) CSD 284
3.1. The CSD under the CSDR 284
3.1.1. Core Services 285
3.1.1.1. Settlement Service 285
3.1.1.2. Notary Service 285
3.1.1.3. Central Maintenance Service 286
3.1.1.4. Ancillary Services 286
3.1.2. Non-banking-type Ancillary Services of CSDs 286
3.1.2.1. Operation of Settlement System 286
3.1.2.2. Central Safekeeping/Notary Function 287
3.1.2.3. 'Investor CSDs' 287
3.1.2.4. Any Other Service 287
3.1.3. Banking-type Ancillary Services 287
3.2. Conclusion 288

4. National Custodians under Member State Laws 288
4.1. National Custodians 289
4.1.1. Licensing Requirements 291
4.1.2. Prudential Requirements 293
4.1.3. Business Organizational Requirements 294
4.2. Self- Custody versus Third-Party Custody 296
4.3. Conclusion 298

5. The MiFID II Client Asset Requirements 298
5.1. General and Specific Organizational Requirements 299
5.2. Safeguarding of Client Financial Instruments and Funds 299
5.2.1. General Regime 300

5.2.2. Equivalent Measures achieving the same Level of Protection 301
5.2.3. Inappropriate Custody Liens over Clients Assets 301
5.2.4. Information and record-keeping 302
5.3. Depositing Client Financial Instruments 303
5.4. Depositing Client Funds 304
5.4.1. Eligible Entities for Depositing Client Funds 304
5.4.2. Depositing Client Funds – Due Diligence Requirements 305
5.4.3. Due Diligence – The Diversification of Client Funds 305
5.4.4. Intra-Group Deposits of Client Funds 306
5.5. Use of Client Financial Instruments 307
5.5.1. General Regime 307
5.5.2. Unintended use of Client Financial Instruments 308
5.5.3. Securities Financial Transactions and Collateralization 308
5.6. SFTs and TTCA 309
5.7. Inappropriate use of TTCA 309
5.7.1. TTCA 310
5.7.2. Appropriateness of TTCAs 310
5.8. Governance Arrangements concerning the Safeguarding of Client Assets 311
5.9. Reports by External Auditors 311
6. Conclusion 312
A. Grammatical Explanation - Conclusion 313

B. TELEOLOGICAL EXPLANATION 315

CHAPTER 7

Depositaries & Custodians – Investor & Market Protection 316

1. Depositary & Custodian Regulation as Financial Law: Investor & Market Protection 316
1.1. Investor Protection 316
1.2. The Stability of the Financial System 318
1.3. Market Integrity 319
1.4. The Three Objectives in light of the Internal Market 319
2. The Object and Purpose of Depositary/Custodian Regulation 320
2.1. Authorization 321
2.1.1. Credit Institutions, Investment Firms and 'Equivalent Other Legal Entities' 321
2.1.2. Authorization Requirements 324
2.2. Business Organizational Requirements 324
2.2.1. Internal Dimension: Depositaries versus Custodians – Key Risks 325
2.2.1.1. The Segregation of Assets and Third-Party Custody 325
2.2.1.2. Safekeeping 326
2.2.1.3. Oversight Duties 330
2.2.2. External Dimension: Depositaries versus Custodians as Risk-Mitigation Mechanism 330
2.2.2.1. Segregation of Assets and Third-Party Custody 331
2.2.2.2. Safekeeping, administration and 'other value-added services' 334
2.2.2.3. Oversight Duties 335
2.3. Prudential Requirements 336
2.3.1. The Depositary/Custodian as a Counterparty 336

2.3.1.1. Cash ... 336
2.3.1.2. Financial Instruments that can be held in Custody ... 338
2.3.1.3. ‘Other Assets’ ... 338
2.3.2. Prudential Requirements related to Credit Institutions, Investment Firms and ‘Equivalent Other Legal Entities’ ... 339
2.3.2.1. Credit institutions and Investment Firms ... 339
2.3.2.2. ‘Equivalent Other Legal Entities’ ... 340
2.4. Supervision ... 341
2.4.1. The European Supervisory Architecture ... 341
2.4.2. Equivalent Other Legal Entities ... 342
3. Conclusion ... 342
B. Teleological Explanation - Conclusion ... 344

C. SYSTEMATIC EXPLANATION ... 238

CHAPTER 8

AIFMD & UCITSD V: The Investment Triangle ... 346
1. Introduction: The Investment Triangle ... 346
2. Scope AIFMD versus UCITSD V ... 347
2.1. What is an AIF? ... 347
2.1.1. Collective Investment Undertakings ... 348
2.1.1.1. Investment ... 349
2.1.1.2. Pooled return/capital ... 349
2.1.1.3. Collective Investment ... 350
2.1.1.4. Third-Party Investment Management ... 350
2.1.2. Additional Requirements ... 351
2.1.2.1. Raising capital ... 351
2.1.2.2. A Number of Investors ... 352
2.1.2.3. Investing in accordance with a defined investment policy ... 353
2.1.2.4. For the Benefit of These Investors ... 354
2.1.2.5. No Authorization Pursuant to UCITSD V ... 354
2.1.3. Exemptions (Article 2(3) AIFMD)) ... 355
2.1.3.1. Holding Companies ... 355
2.1.3.2. Social Security and Pension Institutions ... 357
2.1.3.3. Undertakings Acting in the Public Interest ... 357
2.1.3.4. Other Undertakings for Collective Investment ... 357
2.1.4. Other Categories of Collective Investment Undertakings ... 358
2.1.5. De-minimis Exemption ... 358
2.1.6. Conclusion ... 359
2.2. The UCITS Definition ... 359
2.2.1. (Collective Investment) Undertakings ... 360
2.2.2. Liquid investments and Diversification ... 360
2.2.2.1. Liquid investments ... 361
2.2.2.2. Diversification ... 361
2.2.3. Legal Form Neutrality ... 362
2.2.4. UCITS Authorization vs. the AIFMD’s registration requirement? ... 362
2.2.5. Capital Raised From the Public ... 363
2.2.5.1. Raising Capital ... 363

2.2.5.2. ‘the Public’ ... 364
2.2.6. Open-End principle ... 365
2.2.7. Exemptions ... 365
2.2.7.1. Closed-end CIUs (‘AIFs’) ... 366
2.2.7.2. Private Placement (‘AIFs’) ... 367
2.2.7.3. TC-AIFs ... 367
2.2.7.4. AIFs ... 368
2.2.8. Conclusion ... 368
2.3. Conclusion ... 369
3. Intermediary Regulation ... 369
3.1. AIFMs ... 369
3.1.1. Services listed in Annex I No. 2 AIFMD ... 370
3.1.2. Core Activities ... 370
3.1.2.1. Portfolio management ... 370
3.1.2.2. Risk Management ... 370
3.1.3. Non-core Activities ... 372
3.1.3.1. Annex I No.2 AIFMD ... 372
3.1.3.2. Separate Authorization ... 372
3.1.3.3. UCITS management ... 372
3.1.4. Extension AIFM to provide additional services ... 373
3.2. AIFM Authorization and Operational Requirements ... 374
3.2.1. General Requirements ... 375
3.2.2. Organizational Requirements ... 378
3.3. Manager Regulation under the AIFMD/UCITSD ‘Product Regulations’ ... 380
3.3.1. Full AIFMs/UCITS ManCos ... 381
381
3.3.1.1. ELTIFR ... 381
3.3.1.2. MMFR ... 381
3.3.2. Small AIFMs ... 382
3.3.2.1. EuVECAR/EuSEFR ... 383
3.3.2.2. Small AIFMs: Registration vs. Authorization ... 383
3.3.3. Conclusion ... 386
3.4. UCITS ManCo ... 386
3.4.1. Manager Regulation based on Product Regulation ... 386
3.4.2. Extension UCITS ManCo license to provide additional services ... 387
3.5. UCITS ManCo Authorization and Operational Requirements ... 388
3.5.1. Authorization Requirements ... 388
3.5.2. Operational Conditions and Organizational Requirements ... 388
3.5.3. Conclusion ... 390
3.6. The AIFMD/UCITSD V Depositary ... 391
3.7. Conclusion ... 394
4. Product Regulation ... 395
4.1. General Product Regulation: Legal Forms ... 396
4.1.1. Legal forms under the AIFMD and UCITSD V ... 396
4.1.1.1. Common funds ... 396
4.1.1.2. Unit Trust ... 398
4.1.1.3. Investment company ... 398
4.1.1.4. (limited) (liability) partnerships ... 399
4.1.2. Member State Implementations under AIFMD and UCITSD V ... 399
4.1.3. Legal form neutrality under the AIFMD and UCITSD V ... 400

4.1.4. The Irrelevance of the Legal Title under the AIFMD and UCITSD V 401
4.1.5. Conclusion 402
4.2. Investor-specific Product Regulation 403
4.2.1. UCITSD V 404
4.2.2. Professional vs. Retail AIFs 405
4.2.3. 'AIFMD/UCITSD V Product Regulations' 408
4.2.3.1. MMF 408
4.2.3.2. ELTIF 409
4.2.3.3. European Venture Capital Funds/European Social Entrepreneurship Funds... 410
4.2.4. Conclusion 412
4.3. Conclusion 412
5. Disclosure/Sales Regulation 413
5.1. Investor Information & Reporting 414
5.1.1. UCITSD V 414
5.1.2. AIFMD 415
5.1.2.1. Transparency Requirements under the AIFMD 415
5.1.2.2. Ancillary European Disclosure/Reporting Requirements 420
5.1.2.3. Private Placement 423
5.1.3. The AIFMD/UCITSD V 'product regulations' 425
5.1.3.1. EuVECA/EuSEF 425
5.1.3.2. MMF 425
5.1.3.3. ELTIF 426
5.1.4. Conclusion 428
5.2. Conclusion 429
6. Investors as Residual Claimants 430
7. Conclusion 432

CHAPTER 9

The Optional Investment Triangle under IORPD II 434
1. The Optional Investment Triangle 434
2. Defining an IORP 435
2.1. Constitutive elements of the IORP-definition 436
2.1.1. Legal Form Neutrality 436
2.1.2. Pre-funding as sole Financing Method of an IORP 436
2.1.3. Separation from Sponsoring Undertakings 437
2.1.4. Providing Retirement Benefits 437
2.1.5. Occupational Activity 438
2.1.6. Agreement or Contract 438
2.1.7. Carrying out Activities Directly Arising Therefrom 438
2.2. Schemes Exempted under IORPD II 439
2.2.1. Institutions Managing Social-Security Schemes 439
2.2.2. Financial Institutions covered by EEA Regulation 439
2.2.3. Institutions which Operate on a Pay-as You-Go Basis 439
2.2.4. Institutions where Employees of the Sponsoring Undertakings have no Legal... Rights to Benefits 439
2.2.5. Book-Reserve Schemes 439
2.3. Application to Institutions operating Social-Security Schemes 440

2.4. Optional Application IORPD II 440
2.4.1. Optional Application Life Insurance Undertakings 441
2.4.2. Optional Application Small IORPs 441
2.4.3. Option: IORPs Guaranteed by a Public Authority 441
2.5. The IORP-definition Debate – Academic Criticism 442
2.6. The Role of IORPs in European Asset Management Law 443
2.6.1. IORPs versus Insurance Undertakings 443
2.6.2. Differences IORPs, UCITS, AIFs & Investment Firms 443
2.7. Conclusion 444

3. Intermediary Regulation 444
3.1. The IORPD II Governing Body & the System of Governance 444
3.1.1. The Governing Body 444
3.1.2. Member State Governance Requirements 444
3.1.2.1. The Appointment of the Governing Body 444
3.1.2.2. The Participation of Members in the Management of the IORP 446
3.1.2.3. The Responsibilities of the Governing Body 449
3.1.2.4. General Conduct of Business Principles 449
3.1.2.5. The Responsibilities of the Governing Body under national Member State Laws 450
3.1.3. IORPD II Governance Requirements 452
3.1.3.1. General Requirements: Fit & Proper Management and a Sound Remuneration 452
3.1.3.2. Key Functions 453
3.1.3.3. Documents concerning governance 455
3.1.3.4. Outsourcing 456
3.2. The Depositary/Custodian 457

4. Product Regulation 458
4.1. Legal Forms under IORPD II 458
4.1.1. Internal Governing Body 459
4.1.1.1. Corporate IORPs 459
4.1.1.2. Foundations 460
4.1.2. External Governing Body 460
4.1.2.1. Trust Form 460
4.1.2.2. Contractual Form 460
4.2. The IORPD II Prudent Person Rule & Quantitative Restrictions 461
4.2.1. The Prudent Person Rule 461
4.2.1.1. Freedom of Asset Allocation 462
4.2.1.2. Best Interests of Members/Beneficiaries 462
4.2.2. IORPD II Investment Restrictions 463
4.2.2.1. IORPD II 463
4.2.2.2. IORPD II Member State Implementations 463

5. Disclosure 464
5.1. Information given to Members and Beneficiaries 464
5.1.1. Prospective Members 464
5.1.2. Members 464
5.1.3. Beneficiaries 465
5.1.4. Additional Information to be given on request to Members and Beneficiaries 465
5.2. Information provided to Competent Authorities 465

6. Members, Beneficiaries and the Employer as Residual Claimants 466

6.1. The Nature of IORPs in Europe ... 466
6.2. IORP Members as Residual Claimants ... 467
6.2.1. Legal versus economic ownership ... 467
6.2.2. Asset Partitioning ... 468
6.2.2.1. Shielding ... 468
6.2.2.2. Limited Liability ... 468
6.2.3. Residual Claims: Investment risk vs. Investment Guarantee ... 469
6.3. Employers as Residual Claimants ... 469
6.4. Member Representation as Substitute for Exit Rights ... 470
7. The Compulsory Appointment of a Depositary for all IORPs as a Solution? 471
7.1. Legal framework: the VAT exemption of the Management of common investment funds ... 471
7.1.1. The VAT Exemption under the European VATD ... 471
7.1.2. The VAT position of IORPS ... 472
7.1.2.1. The European Definition 'Special Investment Fund' ... 472
7.1.2.2. UCITS and AIFs as 'special investment funds' ... 472
7.2. Competing Special Investment Funds ... 474
7.2.1. State Supervision ... 475
7.2.2. Funding ... 475
7.2.3. Risk-spreading ... 475
7.2.4. Investment Risk ... 476
7.2.4.1. Definition Investment Risk ... 476
7.2.4.2. Non-indexation as Investment Risk? ... 476
7.2.4.3. Indirect Investment Risk ... 477
7.2.4.4. To what extent do Members need to bear Investment Risk? ... 477
7.3. Lessons to be learned from the VAT European Case Law for the Compulsory IORP Depositary Appointment ... 479
8. Conclusion ... 479

CHAPTER 10

The (Virtual) Investment Triangle – MiFID II ... 481
1. The (Virtual) Investment Triangle ... 481
2. Investment Firm under MiFID II ... 482
2.1. Investment Advice ... 483
2.2. 'Execution-only' ... 484
2.3. Portfolio Management ... 485
2.3.1. Managing Portfolios ... 485
2.3.2. Client-by-Client Basis ... 485
2.3.3. One or More Financial Instruments ... 486
2.3.4. Mandate ... 486
2.3.5. Discretionary Management ... 486
3. Intermediary Regulation – Investment Firms ... 487
3.1. Authorization and Organizational Requirements ... 487
3.1.1. General Requirements ... 487
3.1.2. Specific Requirements ... 488
3.1.2.1. Compliance, Risk Management, Internal Audit ... 488
3.1.2.2. Complaints handling ... 489
3.1.2.3. Personal Transactions ... 489

3.1.2.4. Outsourcing ... 489
3.1.2.5. Safeguarding of Client Assets ... 490
3.2. Operating Conditions and the Protection of Clients ... 490
3.2.1. Conflicts of Interests ... 491
3.2.2. Inducements ... 491
3.2.3. Client Classification ... 492
3.2.4. Suitability and Appropriateness Tests ... 493
3.2.5. Best Execution ... 494
3.2.6. Order Handling ... 494
3.2.7. Record-Keeping ... 494
4. 'Product Regulation': Product Oversight Governance and Intervention Rules ... 495
4.1.1. Product Governance Rules ... 495
4.1.2. Product Intervention Rules ... 496
5. Disclosure and Reporting Requirements ... 497
5.1. Information provided to Clients ... 497
5.2. Reporting to Clients ... 498
6. Investors as Residual Claimants ... 499
7. Conclusion ... 500

CHAPTER 11

The Investment Triangle as Common Governance Framework in European Investment Law ... 503
1. A Law and Economics Theory of the Investment Triangle under European Investment Law ... 504
1.1. The Investment Triangle: A Transaction Cost Theory ... 504
1.1.1. Explaining the Investment Triangle as Common Governance Structure: The Four Stages of Capitalism ... 505
1.1.1.1. Four Stages of Capitalism ... 505
1.1.1.2. The Characterization of the European Investment Law Directives into the Four Stages of Capitalism ... 507
1.1.2. Agency Costs under European Investment Law ... 507
1.1.2.1. Fiduciary versus Agency Relationships ... 508
1.1.2.2. Collective versus Individual Investment ... 512
1.2. The Investment Triangle as (Fiduciary/agency) Governance Plus Asset Partitioning. ... 513
1.2.1. The Investment Triangle as Structural Separation of Investments and Management ... 514
1.2.1.1. Explaining the Separation of Investments and Management ... 515
1.2.1.2. Exit, voice, loyalty for Agency Services versus Exit as Substitute for Control for Fiduciary Services ... 516
1.2.1.3. Economies of Scope and Scale ... 522
1.2.2. (Fiduciary/Agency) Governance ... 523
1.2.3. Asset Partitioning ... 524
2. Intermediary, Product and Sales Regulation as Common Regulatory Pillars of European Investment Law ... 525
2.1. Regulatory Objective: Investor and Market Protection ... 525

2.2. Intermediary, Product Regulation and Marketing/Sales Regulation as 'Communicating Vessels' 526
2.3. Intermediary Regulation 527
2.4. Product Regulation 529
2.4.1. A Standardized Investment Policy: (Fiduciary) Governance 530
2.4.2. Legal Forms: Asset Partitioning for Collective Investment Relationships 531
2.5. Marketing & Sales Regulation 531
2.6. ESFS 532
2.7. The Investment Triangle, European Passport and the Development of European Financial Centres 532
3. The Role of the Depositary/custodian as Fundamental Pillar under European... Investment Law 533
4. Conclusion 535
C. Systematic Explanation - Conclusion 538

D. HISTORICAL EXPLANATION 433

CHAPTER 12

The Historical Development of the Custodian and the Depositary under the European Investment Laws 542

1. The Development of 'Custodian Regulation' 542
2. The 'Depositary' under UCITSD I-IV 542
2.1. The Depositary Regime under UCITSD I-IV 542
2.1.1. The Compulsory Appointment of a 'Depositary' 543
2.1.2. Eligible Entities and Organizational Requirements 544
2.1.3. The UCITSD I-IV Depositary Functions 546
2.1.3.1. The Safekeeping of Assets 546
2.1.3.2. The Controlling Function 547
2.1.4. The UCITSD I-IV Delegation Regime 550
2.1.4.1. Functions 551
2.1.4.2. Nature of the Sub-Custodian 551
2.1.4.3. Due Diligence 552
2.1.4.4. Locational Restrictions 553
2.1.5. The UCITSD I-IV Depositary Liability Regime 554
2.1.6. Conclusion 555
2.2. UCITSD I-IV 'Depositary' Governance Structures 556
2.2.1. Corporate Model 556
2.2.2. The Contractual/Unit Trust Model 558
2.2.2.1. The Contractual Model 558
2.2.2.2. The Trust Model 558
2.3. UCITSD V: Towards a Contractual Governance Model 559
2.4. Conclusion 559
3. Pre-AIFMD Depositary/Custodian Regimes 561
3.1. The Diverging Scope of Pre-AIFMD Fund Regimes 561
3.1.1. Austria 562
3.1.2. France 562
3.1.3. Germany 563

3.1.4. Ireland ... 564
3.1.5. Italy ... 565
3.1.6. Liechtenstein ... 566
3.1.7. Luxembourg ... 567
3.1.8. The Netherlands ... 568
3.1.9. Spain ... 569
3.1.10. UK ... 569
3.1.11. Conclusion ... 570
3.2. Pre-AIFMD Depositary/Custodian Regimes ... 570
3.2.1. No Depositary Requirement for AIFs ... 570
3.2.2. One-size Fits all Approach ... 571
3.2.3. Product-based Approach ... 572
3.2.3.1. Austria ... 572
3.2.3.2. Germany ... 573
3.2.3.3. Ireland ... 573
3.2.3.4. Luxembourg ... 574
3.2.3.5. UK ... 575
3.2.4. Depositaries/Custodians for AIFs Employing Substantial Leverage ... 576
3.2.4.1. The traditional Hedge Fund-model ... 577
3.2.4.2. The Depositary Model ... 579
3.2.4.3. The ‘Hybrid’ Model ... 580
3.3. The AIFMD Contractual Governance Structure ... 583
3.4. Conclusion ... 583
4. Depositaries and Custodians under IORPD I ... 583
4.1. The IORPD I National Depositary/Custodian Regimes ... 584
4.1.1. The Compulsory Appointment of a Depositary/Custodian ... 584
4.1.2. Entities Eligible as a Depositary and Its Organizational Requirements ... 585
4.1.2.1. Eligible Entities ... 585
4.1.2.2. Organizational Requirements ... 587
4.1.3. The IORPD I Depositary/Custodian Functions ... 589
4.1.3.1. The Safekeeping of Assets ... 590
4.1.3.2. The Controlling Function ... 592
4.1.4. Delegation under IORPD I ... 594
4.1.4.1. Functions ... 594
4.1.4.2. The Nature of the Sub-Custodian and Locational Restrictions ... 595
4.1.4.3. Due Diligence ... 596
4.1.5. The IORPD I Depositary/Custodian Liability Regime ... 596
4.1.5.1. ‘Improper Performance’ ... 597
4.1.5.2. Liability for lost Assets ... 597
4.1.5.3. Liability Depositary/Custodian in Cases of Delegation ... 598
4.1.5.4. Rights of the IORP, Members and Beneficiaries Against the IORP Depositary/Custodian ... 598
4.2. IORPD I/II Governance Structures ... 599
4.2.1. IORPs with Legal Personality ... 600
4.2.2. The Trust Model ... 601
4.2.3. The Contractual Model ... 602
4.3. IORPD III: Towards a Contractual Governance Model ... 602
4.4. Conclusion ... 603
5. Conclusion ... 604
D. Historical Explanation - Conclusion ... 605

PART III - Conclusion ... 606

PART IV TOWARDS A CROSS-SECTORAL DEPOSITARY PASSPORT ... 610

CHAPTER 13

Towards the Introduction of a Cross-Sectoral European Depositary Passport in European Investment Law ... 611

1. A Cross-Sectoral Passport for European Depositaries and Custodians – The 'Custody Plus' Solution ... 611
   1.1. The 'EEA Cross-Sectoral Investment Management Passport' as an Example ... 612
   1.2. The Basic Foundation of the Cross-Sectoral Depositary Passport: The MiFID II 'Stand-Alone' Custodian ... 613
      1.2.1. Considerations on a Cross-Sectoral European/TC Depositary Passport ... 613
      1.2.2. Credit institutions & Investment Firms as Full-Fledged MiFID II Custodians ... 614
      1.2.3. Credit institutions & Investment Firms as ('Cross-Sectoral') Eligible Depositary Entities ... 616
   1.3. The Depositary as 'Custody plus' under Sectoral Regulations ... 618

2. 'Custodianship' a Stand-alone Investment Service/Activity under MiFID II 619
   2.1. Defining 'Custodianship' as Stand-Alone Investment Service/Activity ... 620
   2.2. Authorization Requirements & Operational Conditions ... 621

3. The Depositary as 'Custody plus' under Sectoral Regulations ... 622
   3.1. The AIFMD & UCITSD V Depositary Regime– Towards Alignment? ... 622
   3.2. The IORPD II Depositary Regime – A Proposal ... 624
   3.3. The PEPPR Proposed Depositary Regime – An Alternative Proposal ... 625
      3.3.1. The Scope of the PEPP 'Sectoral' and 'Lex Specialis' Depositary Regime .. 626
         3.3.1.1. PEPP provider ... 626
         3.3.1.2. The Definition of the PEPP, PPPs & PEPP Schemes ... 626
      3.3.2. The PEPPR 'Lex Specialis Depositary Regime' ... 629
         3.3.2.1. The Mandatory Depositary Appointment ... 629
         3.3.2.2. Eligible Entities & Organizational Requirements ... 630
         3.3.2.3. The PEPPR Depositary Regime ... 631
      3.3.3. The PEPPR 'Sectoral Depositary Regime' ... 632
         3.3.3.1. AIFs/UCITS ... 633
         3.3.3.2. Solvency II & CRD IV ... 633
         3.3.3.3. National PPPs/PEPP Schemes under the PEPPR ... 633
         3.3.3.4. Conclusion ... 634
      3.3.4. The PEPPR Depositary Regime - Lex Ferenda ... 634
         3.3.4.1. Scope of the Proposed PEPPR Depositary Regime ... 635
         3.3.4.2. The Utility of a Depositary for National PEPP Schemes ... 636
         3.3.4.3. A Proposal for a Depositary Requirement for National PEPP Schemes.... 636
         3.3.4.4. The PEPPR 'UCITSD V Depositary Regime ... 638
      3.3.5. Conclusion ... 639

4. The Cross-Sectoral Depositary Passport & The Blockchain Revolution ... 640
   4.1. From 'Physical Certificates' and 'Intermediation' to 'Blockchain Settlement' ... 641
      4.1.1. Physical Certificates ... 641
      4.1.2. Intermediation ... 642
         4.1.2.1. Legal Consequences of 'Intermediation' ... 642

4.1.2.2. Rights 'in rem', Rights 'in personam' & The Role of Depositaries/Custodians 643
4.1.3. DTL – Blockchain 645
4.1.3.1. Distributed ledgers & the Disintermediation of the Intermediated Securities . Holding Chain 645
4.1.3.2. The 'Consensus mechanism' 647
4.1.3.3. Smart Contracts 648
4.1.3.4. Decentralized Autonomous Organizations 649
4.2. The Future of Depositaries & Custodians – From 'Intermediary' to 'Nodes' and 'Operators' in 'Fintech' & 'Oracle Data Providers' in 'TechFin' Platforms 650
4.2.1. The Road towards 'Crypto-Securities' 650
4.2.2. From the 'Intermediary' to the 'Fintech Era' 651
4.2.3. The Blockchain & the TechFin Era 652
4.2.4. Settlement Decentralized Autonomous Organizations- The Final Stage of Disintermediation? 652
5. Conclusion 653
PART IV - CONCLUSION 656

CHAPTER 14
Conclusion 657

Samenvatting 669

Bibliography 685

List of Legal Texts (EU/EEA) 751

Table of EU Case Law 759

Index 761

Curriculum Vitae 769

List of Abbreviations

ACD	Authorised Corporate Director
ACS	Authorised Contractual Scheme
AFM	Autoriteit Financiële Markten (The Netherlands)
AG	Aktiengesellschaft (Germany)
AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AIFMD	Alternative Investment Fund Managers Directive
AIFMD (Commission) Regulation	Commission Delegated Regulation (EU) No 231/2013
AIFMD (Commission) Regulation I	Commission Implementing Regulation (EU) No 447/2013
AIFMD (Commission) Regulation II	Commission Implementing Regulation (EU) No 448/2013
AIFMG	Gesetz über die Verwalter alternativer Investmentfonds in Liechtenstein – AIFM Act (Liechtenstein)
AIMA	Alternative Investment Management Association
ALFI	Association of the Luxembourg Fund Industry
AMF	Autorité des Marchés Financiers (France)
ARIA	Agréés à Règles d'Investissement Alleges (France)
AuM	Assets under Management
AuslInvestmG	Auslandinvestment-Gesetz – Foreign Investment Act (Germany)
AUT	Authorised Unit Trust Scheme
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht (Germany)
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BVAI	Bundesverband Alternative Investments e.V. (Germany)
BVI	Bundesverband Investment und Asset Management e.V. (Germany)
BVK	Bundesverband deutscher Kapitalbeteiligungsgesellschaften (Germany)
CASS	Client Asset Sourcebook (UK)
CBI	Central Bank of Ireland

CCP	Central Counterparty
CEBS	Committee of European Banking Supervisors
CEPS	Center for European Policy Studies
CESR	Committee of European Securities Regulators
CIU	Collective Investment Undertaking
CJEU	Court of Justice of the European Union
CLP	Société en Commandite Simple (France)
CONSOB	Commissione Nazionale per le Società e la Borsa (Italy)
COBS	Conduct of Business Sourcebook (UK)
COLL	Collective Investment Scheme Sourcebook (UK)
CP	Consultation Paper
CRD	Capital Requirements Directive
CRO	Chief Risk Officer
CRR	Capital Requirements Regulation
CSD	Central Securities Depository
CSSF	Commission de Surveillance du Secteur Financier (Luxembourg)
DB	Defined Benefit
DC	Defined Contribution
DLT	Distributed Ledger Technology
DNB	De Nederlandsche Bank (The Netherlands)
DP	Discussion Paper
Dutch FSA	Dutch Financial Supervision Act
EAD	Eligible Assets Directive
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
ECJ	European Court of Justice
ECOFIN	Council of European Finance Ministers
ECON	Committee on Economic and Monetary Affairs
ECR	European Court Report
EEA	European Economic Area

EEC	European Economic Community
EFAMA	European Fund and Asset Management Association
EFTA	European Free Trade Area
EIOPA	European Insurance and Occupational Pensions Authority
ELTIF	European Long-Term Investment Fund
ELTIFR	European Long-Term Investment Fund Regulation
EMIR	European Market Infrastructure Regulation
ESA	European Supervisory Authority
ESC	European Securities Committee
ESF	European Securitisation Forum
ESFS	European System of Financial Supervision
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
EuSEF	European Social Entrepreneurship Funds
EuSEFR	EuSEF Regulation
EuVECAR	EuVECA Regulation
EuVECA	European Venture Capital Fund
FAIFs	Funds of Alternative Investment Funds
FATCA	Foreign Accounts Tax Compliance (US)
FATF	Financial Action Task Force on Money Laundering
FCA	Financial Conduct Authority
FCD	Financial Collateral Directive
FCP	Fonds Communs de Placement (common fund)
FCPE	Fonds Communs de Placement d'Entreprise
FCPI	Fonds Communs de Placement dans l'Innovation
FCPR	Fonds Communs de Placement à Risques
FDF	Federal Department of Finance
FESE	Federation of European Securities Exchanges
HNWI	High-net Worth Individual
IIID	Initial Investor Information Document
Luxembourg AIF	Loi du 12 juillet relative aux gestionnaires de fonds d'investissement

Law	alternatifs et – portant transposition de la directive 2011/61/UE (…) in Luxemburg
SIF	Fonds d'investissement spécialisés, Spezialfonds
SIF Law 2007	la loi du 13 février 2007 relative aux fonds d'investissements spécialisés
FIU	Financial Intelligence Unit
FMA	Finanzmarktaufsicht (Financial Market Authority)
FMFC	French Monetary and Financial Code
FoF	Fund of Funds
FoHF	Fund of Hedge Funds
FR	Final Report
FSA	Financial Services Authority (UK)
FSAP	Financial Services Action Plan
FSB	Financial Stability Board
FSMA	Financial Services and Markets Act 2000 (UK)
FUND	Investment Funds Sourcebook
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GENPRU	General Prudential Sourcebook (UK)
GmbH	Gesellschaft mit beschränkter Haftung (Germany)
HNWI	High Net Worth Individual
IAA	Investment Adviser Act of 1940
IAIS	International Association of Insurance Supervisors
IAS	International Accounting Standards
ICA	Investment Company Act of 1940
ICGN	International Corporate Governance Network
ICI	The Investment Company Institute
ICSD	International Central Securities Depository
ICVC	Investment Company with Variable Capital
IFIA	Irish Funds Industry Association
IDD	Insurance Distribution Directive
IMA	Investment Management Association

InvG	Investmentgesetz - Investment Act (Germany)
IORP	Institutions for Occupational Retirement Provision
IORPD	Institutions for Occupational Retirement Provision Directive
IOSCO	International Organization of Securities Commissions
KAG	Kapitalanlagegesellschaft (Germany)
KAGB	Kapitalanlagegesetzbuch – Capital Investment Code (Germany)
KID	Key Information Document (PRIIPs)
KIID	Key Investor Information Document (UCITS)
KWG	Kreditwesengesetz - Banking Act (Germany)
LLP	Limited Liability Partnership
LP	Limited Partnership
LP	Limited Partnership
LR	Listing Rules
L. Rev.	Law Review
MAD	Market Abuse Directive
MAR	Market Abuse Regulation
MFN	Most favoured Nation
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
MMF	Money Market Fund
MMoU	Multilateral Memorandum of Understanding
NAV	Net Asset Value
NURS	Non-UCITS retail schemes
OECD	Organisation for Economic Cooperation and Development
OEIC	Open-ended Investment Company
OEIC Regulations	the Open-Ended Investment Companies Regulations (SI 2001/1228)
OPC	Organisme de Placement Collectif
OPC-Law 2010	Loi du 17 décembre 2010 concernant les organismes de placement collectif in Luxemburg
OPC-Law 2002	Loi du 20 décembre 2002 concernant les organismes de placement collectif et modifiant la loi modifiée du 12 février in Luxemburg

OPCVM	Organisme de Placement Collectif en Valeurs Mobilières
OTC	Over-The-Counter
PE	Private Equity
PEPP	Pan-European-Pension-Product
PERG	The Perimeter Guidance Manual (UK)
PFS Custodian	Professional Custodians of Assets other than Financial Instruments
PGR	Personen- und Gesellschaftsrecht – Persons and Companies Act (Liechtenstein)
PLC	Public Limited Company
PD	Prospectus Directive (Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC as amended)
PPP	Personal Pension products
PR	Prospectus Regulation Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC, OJ L 168/12, 30 June 2017, 12
PRA	Prudential Regulation Authority
PRIPs	Packaged Retail Investment Products
PRIIPs	Packaged Retail and Insurance-based Investment Products
PS	Policy Statement
QIF	Qualifying Investor Funds
QIS	Qualified Investor Scheme
RAO	Regulated Activities Order
RTS	Regulatory Technical Standards
SA	Société anonyme (limited company)
SARL	Société à responsabilité limitée (private limited company)
SCA	La société en commandite par actions (partnership limited by shares)
SCS	La société en commandite simple (limited partnership)
SCSp	La société en commandite spéciale (special limitied partnership)
SEC	Securities and Exchange Commission
SFT	Securities Financing Transactions

SI	Statutory Instrument
SICAF	Société d'Investissement à Capital Fixe (investment company with fixed capital)
SICAR	Investment Companies in Risk Capital Regimes (investment company in risk capital)
SICAV	Société d'Investissement à Capital Variable (investment company with variable capital)
SIF	Specialised Investment Funds
SLD	Securities Law Directive
SME	Small and Medium Enterprises
SRD	Shareholder Rights Directive
SRRI	Synthetic Risk and Reward Indicator
SPAC	Special Purpose Acquisition Company
SPV	Special Purpose Vehicle
SSRN	Social Science Research Network
TC	Third Country
TBD	Takeover Bid Directive
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TPD	Transparency Directive
TTCA	Title Transfer Collateral Arrangements
UCI	Undertaking for Collective Investments
UCIS	Unregulated Collective Investment Scheme
UCITS	Undertakings for Collective Investment in Transferable Securities
UCITSD	Undertakings for Collective Investment in Transferable Securities Directives
UCITSG	Gesetz über bestimmte Organismen für gemeinsame Anlagen in Wertpapieren in Liechtenstein – UCITS Act (Liechtenstein)
VAT	Value Added Tax
VC	Venture Capital
WTO	World Trade Organization

Chapter 1 Introduction

1. Background

A few decades after the four freedoms were introduced that allowed several types of financial intermediaries the freedom to provide services throughout all EEA Member States[1], it appears that this right is still undermined for depositaries providing services in European investment law.[2]

Interesting enough a *de facto* passport in this field already exists.[3] CRD IV, IORPD II and MiFID II all regulate the safekeeping of securities and the provision of custody services.[4] MiFID II lists the provisions of safekeeping services, including custodianship for financial instruments, as ancillary service and allows this service to be 'passported'[5], in addition to, the principle investment activities/services for which investment firms are authorized.[6] Similarly, CRD IV allows the safekeeping of securities and the provision of custody services to be passported, in addition to, the principle deposit-taking activity of credit institutions.[7] Under IORPD II the safekeeping of securities and the provision of custody services are subject to a mutual recognition approach.[8] IORPD II allows, in addition to UCITS/AIF depositaries, investment firms and credit institutions harmonized under the CRD IV and MiFID II to be appointed as a depositary regardless whether the depositary is established in the IORP home Member State.[9] The recently proposed PEPPR does not regulate this issue and, thus, also allows for a *de facto* depositary passport.[10]

Notwithstanding the fundamental principle of freedom to provide services[11], the AIFMD and UCITSD V only allow UCITS ManCos and AIFMs to appoint a depositary which is established or has a branch office in the EEA Member State in which the respective UCITS or AIF is established.[12] Strictly speaking, credit institutions or investment firms which are under CRD IV, MiFID II and IORPD II allowed to provide custody services cross borderly, may not exercise 'passporting rights' under the UCITS V and AIFMD, because these European

---

[1] Financial intermediaries, such as credit institutions, IORPs and insurance intermediaries currently enjoy the freedom of an European passport that is, indirectly based upon Art. 49 and 56 TFEU. See D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* 865 (D.A. Zetzsche ed, Kluwer 2015).

[2] See also C.P. Buttigieg, *The Case for A European Depositary Passport*, http://studylib.net/doc/13128849/the--case--for--a--european-...-passport (accessed 14 April 2017); S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2015).

[3] See for a discussion during the UCITSD II proposal on the 'the facto' European passport for custodians: European Parliament, *Report of the Committee on Legal Affairs and Citizen's Rights on the 1993 UCITS Proposal*, A5-0268/1993, 1 October 1993, http://goo.gl/rRSdJO (accessed 14 April 2017).

[4] See Art. 21(8) AIFMD; Art. 22(5) UCITSD V; Annex I Nr. 12 CRD IV; Annex I s. A MiFID I/II.

[5] See J-P Casey, J-P. & K. Lannoo, *The Mifid Revolution: A Policy View*, 7 Competition and Regulation in Network Industries 519 (2006); Cf. D.A. Zetzsche, D.A. & T.F. Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* 474 (D.A. Zetzsche ed, Kluwer 2015); D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 62-63 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[6] S.N. Hooghiemstra, *Depositary Regulation* 485 (D.A. Zetzsche ed, Kluwer 2015).

[7] *Ibid,* 484.

[8] Art. 33(3) IORPD II.

[9] See for 'IORP home Member State'; See on home and host Member States referred to as 'product' and 'distribution' states: D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 62-63 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[10] Art. 41 PEPPR.

[11] Art. 49 and 56 TFEU.

[12] Art. 21(5) AIFMD; Art. 23(1) UCITSD V.

directives preclude depositaries from doing so.[1] It would therefore be worthwhile to investigate whether depositaries under the AIFMD and UCITSD V should be allowed to enjoy passporting rights and whether and to what extent this fits in under the current 'de facto passports' available under European investment law.[2] If so, a cross-sectoral depositary passport could be considered and modelled after the cross-sectoral passport for investment management[3] services.[4]

2. The Case for the Introduction of a Cross-Sectoral European Passport for Depositaries

Depositaries under IORPD II and the proposed PEPPR[5] may safekeep assets and perform controlling duties on a cross-border basis under a 'de facto European depositary passport'.[6] In addition, 'Custodians' under MiFID II/CRD IV may safekeep assets on a cross-border basis under a MiFID II/CRD IV 'ancillary passport'.[7] This is currently not the case for AIF/UCITS depositaries.[8]

It is undisputed that the introduction of an AIF/UCITS or even a 'cross-sectoral' depositary passport would lead to economies of scale, increased competition, lower costs and more innovation.[9] The introduction of such a passport allows 'global custodians' to offer depositary services throughout the EEA at low costs. Currently, the depositary markets in Liechtenstein and other small Member States are underdeveloped. The reason for this is that the AIFMD/UCITSD V depositary locational restrictions makes it too expensive for 'global custodians' to offer their services in these markets as, at the minimum, an establishment of a branch is required in these Member States. Currently, Liechtenstein AIFs/UCITS are required to appoint a depositary in Liechtenstein. Liechtenstein is, however, a financial centre in which the fund industry is in the development stage and small compared to renowned fund jurisdictions such as Ireland and Luxembourg. No international depositary players are, till now, active in Liechtenstein and its depositary structure relies heavily upon local banks. These banks, however, invest limitedly in their depositary services as costs can only be offset in the local market. Depositary services in the local market are more expensive than in, for example, Luxembourg and provided with a lower degree of quality. Traditionally, delegation

---

[1] See European Parliament, *Report of the Committee on Legal Affairs and Citizen's Rights on the 1993 UCITS Proposal*, A5-0268/1993, 1 October 1993, http://goo.gl/rRSdJO (accessed 14 April 2017).
[2] Cf. Alternative Investment Management Association, *AIMA Position Paper UCITS V*, September 2012, http://giegold.korova.co/wp-content/uploads/2012/10/UCITS-V-AIMA-Position-Paper.pdf.pdf (accessed 14 April 2017).
[3] Portfolio management and risk management are both considered to be 'investment management'. See Point 1(a) and (b) Annex I and Art. 4(1)(w) AIFMD and Annex II, Article 6(2) UCITSD V. See also D.A. Zetzsche & D. Eckner, *Risk Management* 336 et seq. (D.A. Zetzsche ed, Kluwer 2015).
[4] The AIFMD, IORPD II UCITSD V allow AIFMs and UCITS ManCos that fulfill various additional criteria to manage IORPs and discretionary mandates as well. See Art. 6(3)(a) UCITSD V and Art. 6(4)(a) AIFMD;Cf. J-P Casey, *Shedding Light on the UCITS-MiFID Nexus and Potential Impact of MiFID on the Asset Management Sector*, ECMI Policy Brief nr. 12, April 2008; C.M. Grundmann-van de Krol, *Verlenen van MiFID-diensten door beheerders van beleggingsinstellingen en icbe's: enkele knelpunten*, 38 Ondernemingsrecht 198 (2014); Under Art. 32 IORPD II, IORPs may appoint for the management of investment portfolios, investment managers in accordance with UCITSD V, IORPD II, the AIFMD, CRD IV and MiFID II, as well as IORPs under IORPD II.
[5] See *infra* 4.3.
[6] See locational restrictions IORPD II: Chapter 2, section 1.3.; See for these restrictions under the PEPPR: Chapter 2, section 1.4.
[7] See on the 'ancillary nature' of safekeeping under CRD IV and MiFID: Chapter 6, section 2.1.
[8] See Chapter 2, section 1.2.
[9] See Chapter 3, section 1.1.1.2.

structures were used prior to the introduction of the UCITSD V/AIFMD as a countermeasure in which local banks delegated their tasks to global custodians in, for instance, Zürich. Contrary to what has been argued in the AIF/UCITS depositary passport discussion[10], these delegation structures led in many cases to higher depositary services provided in small Member States at lower costs. In addition, the introduction of a depositary passport would allow players from small Member States to enter big markets allowing them to invest more in depositary services and offering more choice for clients in the markets in big Member States. Finally, the introduction of an AIF/UCITS or even a cross-sectoral depositary passport would allow AIFMs/UCITS ManCos to appoint one depositary for all AIF/UCITS managed in the EEA.[11] The introduction of a (cross-sectoral) depositary passport would, thus, enable depositaries to offer their services on the European level and enables depositaries to consolidate services on a cross-sectoral and cross-border basis.

Notwithstanding the benefits of introducing an AIF/UCITS depositary passport, a European passport for UCITS and AIF depositaries has so far been multiple times considered, but not introduced due to investor protection concerns.[12] MEP Perreau de Pinninck in 1993 after the introduction of the 'ancillary European passport' under the ISD and Second Banking Directive considered that a European depositary passport for UCITS should not be introduced for two reasons.[13] First, it was considered that the depositary function was going beyond mere performing the 'custodian' function under the ISD and Second Banking Directive. Second, the depositaries in the UCITS domain had not been harmonized to effectively perform the controlling function.

Prior to introducing an AIF/UCITS or cross-sectoral depositary passport the question would, thus, need to be answered whether the differences between depositaries and custodians justify the locational restriction applicable to AIF/UCITS depositaries. Furthermore, it should be verified whether AIF, UCITS, IORP and PEPP are sufficiently harmonized or what should be done to make the introduction of a cross-sectoral passport acceptable.

2.1. Depositaries versus Custodians

Indeed, the depositary function goes beyond the function performed by 'custodians' under MiFID II/CRD IV and national regimes.[14] 'Custodians' merely perform a safekeeping function and 'depositaries' perform the safekeeping of assets and monitoring duties.[15] 'Custodians' and depositaries perform the same tasks under the safekeeping function.[16] Nevertheless, the additional monitoring task assigned to depositaries reflects that the role of a depositary goes beyond that of a mere custodian.[17] Depositaries under the 'investment triangle' as common governance framework[18] are mandatorily required under European investment law in EEA sectoral legislation regulating 'investment intermediaries' that perform discretionary investment and risk management for investors/members of 'collective

---

[10] See Chapter 2, section 1.2.
[11] See the reponse of Axa Investment Managers to the UCITSD VI Consultation: http://ec.europa.eu/finance/consultations/2012/ucits/docs/contributions/registered-organisations/axa-investment-managers_en.pdf (accessed 8 July 2017).
[12] See Chapter 2, section 1.2.
[13] European Parliament, *Report of the Committee on Legal Affairs and Citizen's Rights on the 1993 UCITS Proposal*, A5-0268/1993, 1 October 1993, http://goo.gl/rRSdJO (accessed 7 April 2017).
[14] See for the 'custodian' function: Chapter 6.
[15] See Chapter 11.
[16] See Chapter 7, section 2.2.
[17] See Chapter 11, section 1.2.2.
[18] See Chapter 11, section 1.1.2.1.

investment undertakings'[19] in which members investors 'fully bear investment risks'[20]. Due to the fiduciary and collective investment nature of these investment relationships, a depositary is required to monitor the 'investment intermediary'[21] on behalf of the joint investors/members. The controlling/monitoring duty is, however, limited to merely checking compliance of the discretionary investments made by 'investment intermediaries' with the common terms under the legal form employed, including the investment policy, that investors/members have contracted themselves into.[22] The marginal controlling/monitoring duty does not imply the full involvement of the depositary in the investment decisions that are made by 'investment intermediaries'. This would impair the discretionary nature of these collective investment relationships.[23] Instead, the monitoring/controlling duty has a 'technical nature'[24] If, for example, a fund agreement agreed upon sets out that the investment portfolio of an AIF may not have more than 10% of its assets invested in the timber industry, the depositary upon exceeding this limit will remind the AIFM to decrease its exposure to this industry. Depositaries, however, do not interfere with the investment decision how and to what extent the AIFM invests in the timber industry. The controlling duty is assigned to depositaries for these relationships as to overcoming collective action problems and as it is the cheapest solution under the 'cheapest cost avoider theory'.[25]

The monitoring/controlling duty and the different function of depositaries is also reflected in the separate set of legislation depositaries under the AIFMD, UCITSD V, IORPD II and proposed PEPPR are subjected to. Depositary provisions under these sectoral laws have 'lex specialis' provisions addressing the different role of depositaries in 'fiduciary governance'.[26] On the contrary, 'custodians' are under European investment law mainly appointed in the case of individual investment relationships, such as discretionary portfolio management and 'execution-only' services.[27] The main difference is that investors may give investment instructions and remain to have ultimate control over the (discretionary) investment decision made. For the purpose of the European passport discussion, indeed, depositaries are fundamentally different from 'custodians'.

2.2. Overcoming the 'European Depositary Passport Paradox'

A 'de facto European depositary passport' is granted to IORP and PEPP depositaries, whereas this is not available for AIF/UCITS depositaries. This is highly remarkable as depositaries perform the same functions with the same underlying investor protection objective. This inconsistency can be rightfully called an 'European depositary passport paradox' as the eligible entities and, in particular, the depositary function itself under the AIFMD and

---

[19] AIFs, UCITS, IORPs and PEPP schemes as part of a PEPP can be regarded as 'collective investment undertakings'. For that purpose, the AIFMD excludes IORPs from the scope of the AIF definition.

[20] See for considerations on 'fully bearing investment risks': Chapter 9, section 7.2.4.

[21] AIFMs, UCITS ManCos, investment firms authorized as portfolio manager or investment advisor, IORP governing boards and PEPP providers are considered as 'investment intermediaries'. See Chapter 11, section 1.1.2.

[22] See, in particular, for AIF/UCITS depositaries: Chapter 4, section 6.3.4.

[23] See for 'discretionary investments' under the AIFMD: Chapter 8, section 2.1.1.4.

[24] In Germany, they refer to this duty as 'technische verwaltung' ('technical management').

[25] K.D. Logue & J.B. Slemrod, *Of Coase, Calabresi, and Optimal Tax Liability,* Law & Economics Working Papers Law & Economics Working Papers Archive: 2003-2009, University of Michigan Law School Year 2009, 3, http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1097&context=law_econ_archive (accessed 17 August 2016 2016); G. Calabresi, *The Costs of Accidents: A Legal and Economic Analysis (*Yale University Press 1970).

[26] See *infra* section 4.

[27] See Chapter 11, section 1.2.2.

UCITSD V has been harmonized to a much larger extent than under the IORPD II and the proposed PEPPR.[28]

The AIFMD 'transitional relief' regime'[29] suggests that the duties, delegation and depositary's liability regime are sufficiently harmonized on the European level for the introduction of a European passport. Under this regime, credit institutions appointed as an AIF depositary are allowed to be appointed under a 'mutual recognition regime' provided that the AIF home Member State in which the AIF is established for which the depositary is appointed has implemented this option in its AIFMD implementation laws.[30] The 'trial phase' of this 'transitional relief regime' ended in early 2017. Nevertheless, the Member States that implemented this option have not ceded to allow AIFs domiciled in their Member States from appointing an EEA credit institution in another Member States as depositary. The AIFMD 'transitional relief regime', thus, seems to suggest that a European depositary passport could be introduced provided that eligible entities would be limited to 'credit institutions'. This suggestion seems to be confirmed by Recital 36 AIFMD that considers that:

> 'the Commission is invited to examine the possibilities of putting forward an appropriate horizontal legislative proposal that clarifies the responsibilities and liabilities of a depositary and governs the right of a depositary in one Member State to provide its services in another Member State'.

Giving the similarities under the UCITSD V depositary regime, similar considerations could be made regarding the introduction of a UCITSD V depositary passport.

In the light of this, the absence of a European passport for AIFs and UCITS remains, however, to be even more remarkable considering the fact that 'eligible depositary entities' under IORPD II and the proposed PEPPR are not limited to credit institutions nor any other EEA regulated entities, such as investment firms.[31] The 'de facto' IORP/PEPP depositary passports under IORPD II and the PEPPR, thus, do not comply with the modern approach towards European passports in which maximum harmonization of both the financial intermediary and its operations is required. This seems to suggest that the introduction of a 'cross-sectoral depositary passport' would require full harmonization of the depositary as a financial intermediary and also the harmonization of the PEPP/IORP depositary duties, delegation and liability standards would be necessary for a consistent approach.

2.3. The AIFMD/UCITSD V Depositary Passport 'Investor Protection Concerns'

Throughout the past few decades, the introduction of an AIF/UCITS depositary passport has been discussed numerous times. The concerns expressed are similar as for the 'management passport' that has been introduced under UCITSD V and was also adopted under the AIFMD. For this reason, first the concerns and solutions related to the introduction of this 'management passport' under UCITSD IV are being discussed before an assessment will be made whether and to what extent this discussion might offer a solution for investor protection concerns raised for the introduction of an AIF/UCITS depositary passport.

---

[28] See for the AIFMD/UCITSD V depositary regime: Chapter 4; See for the IORPD II depositary regime; See for the proposed PEPPR depositary regime: *infra* section 4.3.
[29] See Chapter 2, section 1.2.2.2.
[30] *Ibid.*
[31] Art. 33(3) IORPD II; Art. 2(23) PEPPR.

2.3.1. *The concerns raised upon introduction of the 'Management Passport' under UCITSD IV*

Upon the introduction of a 'management company passport' under UCITSD IV, a similar discussion has taken place as is currently the case for the introduction of an AIF/UCITS depositary passport.[32] The main issue in both discussion was the 'splitting of financial supervision between the Member State in which the UCITS and the depositary were established, at the one, and the Member State in which the UCITS ManCo is established, at the other hand.[33] The main argument for not introducing a UCITS 'management passport' until UCITSD IV was that fragmented regulation and supervision of the UCITS structure would have an impact on investor protection and the confidence of investors.[34]

The original UCITSD I text did not allow UCITS established as contractual funds and unit trusts to appoint a UCITS ManCo in another Member State.[35] The rationale behind this was that these legal forms did not enjoy legal personality and, therefore, the UCITS ManCo was required to be established in the same Member State. UCITSD I was based upon the most common method applied by Member States at that time of granting the legal title of the UCITS' assets to the (legal entity of the) UCITS ManCo.[36] UCITSD I required UCITS ManCos of these types of UCITS to represent units trusts and common funds in all legal affairs. The UCITSD I text did not require UCITS investment companies to be established in the same Member State as the UCITS ManCo appointed.[37] This was the case as UCITSD I was originally based upon the idea that UCITS investment companies would have legal capacity and, thus, would be self-managed.[38] The benefits of the structural separation between investments and management[39], however, were also noticed by UCITS investment companies and, therefore, they mainly appointed external specialized UCITS ManCos. The UCITSD I did not foresee this. During the implementation of UCITSD III that took many obstacles away and paved the way to today's success, CESR, contrary to the UCITSD III text, clarified that

> 'the legislator's intention does not seem to have been to impose to UCITS home Member State to recognize the possibility for a foreign management company to set up an investment company in their own constituency'.[40]

---

[32] European Commission, *Report of the Expert Group on Investment Fund Market Efficiency*, July 2006, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/efficiency_en.pdf (accessed 7 April 2017); European Commission, *White Paper of 15 November 2006 (COM (2006) 686 final) on enhancing the single market framework for investment funds*, http://ec.europa.eu/internal_market/securities/docs/ucits/whitepaper/whitepaper_en.pdf (accessed 7 April 2017); See also J.P.S. Worley, *UCITS III and the Freedom to Provide Fund Management Services*, http://www.avukati.org/common/fileprovider.ashx?id=633123978903617500 (accessed 8 July 2017).

[33] C.P. Buttigieg**,** *The Development of the EU Regulatory and Supervisory Framework applicable to UCITS: A Critical Examination of the Conditions and Limitations of Mutual Recognition***,** March 2014, 189, http://sro.sussex.ac.uk/48285/1/Buttigieg%2C_Christopher_P..pdf (accessed 7 April 2017).; J. Quinn, *The Management Company Passport: A New Era of Cross Border UCITS,* http://corkonlinelawreview.com/editions/2011/03/Jolene-Quinn.pdf (accessed 8 July 2017).

[34] C. Kremer & T. Seale, *Passport benefits may not be worth risk*, Financial Times (London 13 October 2008).

[35] See Chapter 2, section 1.2.1.

[36] D.A. Zetzsche, *Die Irrelevanz und Konvergenz des Organisationsstatus von Investmentfonds*, ZVglRWiss 111, 371 (2012); D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* § 19 (Mohr Siebeck 2015).

[37] J.P.S. Worley, *UCITS III and the Freedom to Provide Fund Management Services*, http://www.avukati.org/common/fileprovider.ashx?id=633123978903617500 (accessed 8 July 2017).

[38] *Ibid*.

[39] See Chapter 11, section 1.2.1.

[40] See question 6 'can an open-ended investment company designate a management company in another EU jurisdiction?, Committee of European Securities Regulators, *Consultation Paper - CESR's guidelines for*

UCITSD I-III, thus, required all UCITS, appointed UCITS ManCos and depositaries to be established in the same Member State to ease the UCITS home Member State supervision task.[41]

ISD/MiFID I investment firms authorized for portfolio management already enjoyed the benefits of an European passport since the mid 1990's. The increased harmonization of investment firms under MiFID I took away obstacles that impaired investment firms from exercising this passport, whereas UCITS ManCos could only exploit efficiency gains on the basis of delegation arrangements. Being aware of the potential efficiency gains resulting from a similar European passport for UCITS ManCos, the European Commission initiated discussions and consultations with stakeholders for the introduction of such a passport.[42]

A handful of Member States, including Ireland and Luxembourg, as for the depositary passport, strongly opposed this idea.[43] They held that the introduction of such a passport would lead to fragmentation of regulation and supervision of the UCITS structure.[44] CESR upon a request of the European Commission provided technical advice under what conditions the principle of mutual recognition could be introduced for UCITS ManCos.[45] CESR found three possible problems in which a 'management company passport' could endanger investor protection: difficulties of the depositary in fulfilling its duties, problems for investor in addressing his/her complaints and a possible 'letterbox entity' that would be left to the UCITS home Member State to supervise.[46] The first two arguments, were, however, immediately challenged by CESR. Physical presence of the depositary in the country of the UCITS ManCo was not considered necessary for the performance of its obligations. In addition, due to the UCITS distribution channels a direct relationship between UCITS ManCos and investors was already often absent. A 'management company passport' would, thus, not lead a worse situation for investor complaints. The third argument, however, needed careful consideration.

In this regard, CESR considered that

> 'effective supervision could be jeopardized if the fund is just a virtual/legal construction emptied of any substance and devoid of any activity, leaving supervisors in a situation where they have difficulty in discharging their responsibilities.'[47]

---

supervisors regarding the transitional provisions of the amending UCITS Directives (2001/107/EC and 2001/108/EC), CESR/04-434, October 2004.

[41] Chapter 2, section 1.2.1.

[42] European Commission, *Commission proposes improved EU framework for investment funds*, IP/08/1161,16 July 2008.

[43] Association of the Luxembourg Fund Industry, *ALFI contribution to the CESR consultation paper on UCITS management company passport,* http://www.alfi.lu/de/publications-statements/alfi-statements/alfi-response-cesr-consultation-paper-09-624 (accessed 8 July 2017); C. Niedner & A. Sawires, *Passport Flexibility*, 96 European Lawyer 45(2010); S. Johnson & S. Grene, *UCITS IV plan could be dropped*, Financial Times (14 April 2008); N. Tait & S. Johnson, *Brussels drops pan-Europe funds plan*, Financial Times (24 May 2008).

[44] C.P. Buttigieg**,** *The Development of the EU Regulatory and Supervisory Framework applicable to UCITS: A Critical Examination of the Conditions and Limitations of Mutual Recognition***,** March 2014, 189, http://sro.sussex.ac.uk/48285/1/Buttigieg%2C_Christopher_P..pdf (accessed 7 April 2017).

[45] Committee of European Securities Regulators, *Covering letter: Advice to the Commission on the UCITS Management Company Passport*, CESR08-067, 31 October 2008.

[46] European Commission, *Exposure Draft - Initial orientations for discussion on possible adjustments to the UCITS Directive: Management Company Passport*, 5, http://ec.europa.eu/internal_market/investment/docs/legal_texts/orientations/mcpexposure_en.pdf (accessed 8 July 2017).

[47] *Ibid.*

CESR provided the ultimate solution for this problem by setting out detailed requirements on the cooperation and exchange of information between relevant financial supervisors.[48] In addition, CESR countered the letterbox entity concerns of regulatory by requiring that the depositary from an investor protection point of view would remain to be located in the UCITS home Member State.[49] On this point CESR considered that depositaries should be held liable in accordance with the rules of the UCITS home Member State due to the non-harmonization in this area. For this reason, investors that subscribe to a UCITS in a given Member State should be protected by the supervision rules, depositary regime and investor compensation rules.[50] CESR, thus, made an attempt to protect investors on the presumption that investors would not invest in UCITS of Member States that have low quality depositary regulation.

These considerations together with the further harmonization of organizational and conduct of business requirements of UCITS ManCos provided the ultimate foundation of the introduction of UCITS 'management company passport' in UCITSD IV.[51]

2.3.2. *The Investor Protection Concerns upon Introducing an AIF/UCITS Depositary Passport*

Similarly as for the 'management company passport' discussion, custodians already upon the introduction of ISD enjoyed an ('ancillary') European passport. As a compromise of introducing the European 'management passport' under UCITSD IV and the AIFMD, the depositary remained to be required to be established in the UCITS/AIF home Member State. The remarks of CESR upon introducing the UCITS 'management passport' suggests that the 'invest protection concerns' related, in particular, to the minimum harmonization of UCITSD I-IV and pre-AIFM depositaries.[52] The 'transitional European AIF depositary passport' granted to credit institutions[53], however, seems to suggest that the efforts undertaken to sufficiently harmonize depositaries in the AIFMD and UCITSD V domain is sufficient provided that eligible entities are restricted to heavily regulated credit institutions (and, possibly, investment firms).[54]

Indeed, the introduction of an AIF/UCITS depositary passport would add an additional layer of fragmented supervision in the UCITSD V and AIFMD domain.[55] Limiting such

---

[48] Committee of European Securities Regulators,, *Advice to the Commission: UCITS Management Company Passport*, CESR08-867, October 2008; Committee of European Securities Regulators, *Guidelines for supervisors regarding the transitional provisions of the amending UCITS Directives (2001/107/EC and 2001/108/EC),* CESR/04-434b (2005).

[49] European Commission, *Exposure Draft - Initial orientations for discussion on possible adjustments to the UCITS Directive: Management Company Passport*, 23, http://ec.europa.eu/internal_market/investment/docs/legal_texts/orientations/mcpexposure_en.pdf (accessed 8 July 2017).

[50] *Ibid.*

[51] Committee of European Securities Regulators,, *Advice to the Commission: UCITS Management Company Passport*, CESR08-867, October 2008.

[52] See European Commission, *Exposure Draft - Initial orientations for discussion on possible adjustments to the UCITS Directive: Management Company Passport*, 23, http://ec.europa.eu/internal_market/investment/docs/legal_texts/orientations/mcpexposure_en.pdf (accessed 8 July 2017).

[53] Under the AIFMD proposal, the AIFMD intended to pave the way for an AIF depositary passport by limiting eligible entities to credit institutions. See Commission of the European Communities, *Directive of the European Parliament and the Council on Alternative Investment Fund Managers and amending Directives 2004/39/EC and 2009/.../EC*, Brussels, 30.4.2009, COM(2009) 207 final, 2009/0064 (COD), {SEC(2009)576}{SEC(2009)577}.

[54] See Chapter 2, section 1.2.2.2.

[55] C.P. Buttigieg**,** *The Development of the EU Regulatory and Supervisory Framework applicable to*

depositaries to credit institutions and investment firms under MiFID II would, however, ensure that any supervisory issues could be resolved with the involvement of the ‘colleges of supervisors’.[56] Furthermore, the argument could be brought up by Member States that the introduction of an AIF/UCITS depositary passport leads to the ‘UCITS’ being a ‘letterbox entity’.[57] UCITS, essentially, are liquid AIFs that are required to comply with ‘UCITSD V product regulation’. In this regard, ‘product regulation’ should be understood as consisting of regulated legal forms and limits related to the investment policy that complements ‘manager regulation’, i.e. the intermediary regulation applicable to AIFMs and UCITS ManCos.[58] The regulation of legal forms is, under both the AIFMD and UCITSD V, left over to individual Member States. This is the case as legal form under the AIFMD and UCITSD V in all Member State implementations merely establishes the structural separation between investments and management by catering for asset segregation and limited liability.[59] The fiduciary governance aspect of legal forms is, almost completely, provided for by the intermediary and sales regulation applicable to AIFMs/UCITS Mancos and depositaries under the AIFMD and UCITSD V.[60] The UCITS/AIF home Member State upon the introduction of an European AIF/UCITS depositary passport, thus, remains only to be responsible for the authorization of UCITS and AIFs, if required. The role primarily focusses on checking the AIF/UCITS’ investment policy prior to distribution. The introduction of an AIF/UCITS depositary passport, thus, does not lead to a ‘letterbox entity’ in the AIF/UCITS home Member States as AIFs/UCITS are primarily governed/represented by their AIFMs/UCITS ManCos and depositaries as intermediaries. The fund itself, unless internally managed, does not carry out any material activities.

The ‘de facto depositary passport’ under IORPD II and the proposed PEPPR seems to confirm this view. IORPs nor PEPPs are required to be established in the IORP/PEPP home Member State. In addition, IORP asset managers and PEPP providers/distributors are also not required to be established in the IORP/PEPP home Member State. AIFs, UCITS, IORPs and PEPPs are, thus, merely ‘bundles of contracts’ that are governed/represented by their investment intermediaries and depositaries

Not introducing an AIF/UCITS depositary passport in UCITSD V and the AIFMD seems, thus, to be largely driven by a national protectionist agenda of certain Member States that do not want foreign depositaries to compete with their national depositaries. Limiting AIF/UCITS depositaries to credit institutions and investment firms would take the final argument for these Member States away not to introduce such a passport.

3. Research Questions

Depositaries may provide cross-border custody services under IORPD II and MiFID II, whereas under the AIFM and UCITS V depositaries are precluded from doing so. This

---

UCITS: A Critical Examination of the Conditions and Limitations of Mutual Recognition, March 2014, 200, http://sro.sussex.ac.uk/48285/1/Buttigieg%2C_Christopher_P..pdf (accessed 7 April 2017).;

[56] C.P. Buttigieg, *The Development of the EU Regulatory and Supervisory Framework applicable to UCITS: A Critical Examination of the Conditions and Limitations of Mutual Recognition*, March 2014, 211, http://sro.sussex.ac.uk/48285/1/Buttigieg%2C_Christopher_P..pdf (accessed 7 April 2017).;

[57] European Commission, *Exposure Draft - Initial orientations for discussion on possible adjustments to the UCITS Directive: Management Company Passport*, 5, 23, http://ec.europa.eu/internal_market/investment/docs/legal_texts/orientations/mcpexposure_en.pdf (accessed 8 July 2017).

[58] See Chapter 8, section 4; See also Chapter 11, section 2.3.

[59] See Chapter 11, section 1.2.3.

[60] See Chapter 8.

contradiction creates a paradoxical tension for depositary obligations under European investment law.

In particular, it seeks to find out whether a 'cross-sectoral'[61] depositary passport should be introduced which allows depositaries to perform cross-border services for not only IORPs and clients under MiFID II, but also for AIFs and UCITS.

The author takes the view in this dissertation that not introducing an European passport for depositaries is a disregard of the fundamental freedom of services which characterizes the creation of an internal market for international financial services in the European Economic Area that cannot be justified in terms of investor protection. (thesis)

Consequently, this dissertation explores the question whether depositaries in European investment law should be allowed to enjoy the right of a cross-sectoral European passport.

In supporting this thesis, this dissertation seeks to answer this question by the following sub-questions:

- what inconsistencies in attributing an European depositary passport are to be found in European investment law?
- to what extent do financial intermediaries have to be harmonized on the EEA level to obtain a European passport?
- do the differences between depositaries and custodians justify the difference in treatment?what preconditions need to be fulfilled to introduce a European AIF/UCITS depositary passport and/or a cross-sectoral European depositary passport?

These questions need to be answered before a full European AIF and UCITS depositary passport and, eventually, a cross-sectoral depositary passport can be introduced.

4. Methodology

Having already established the basis of the theoretical outlook of this dissertation, which is also pertinent to the lens to which the evidence collected will be looked at, it is now necessary to reflect upon how evidence will be collected to support the arguments espoused in this dissertation. In studying the application of the European passport model on depositaries, the study applies the arguments pro/contra the introduction of an AIF/UCITS depositary passport of the European Commission[62], its mandates and interest groups[63], a law and economics analysis on the European passport and the application of the legal interpretation methods of *Von Savigny* on the study of positive norms of the depositary/custodian in European investment law, including the grammatical, teleological, systematic and historical explanation of what is a depositary.[64] The latter involves a study regarding positive law, academic literature and the application of the comparative method.

Positive law as the primary resource of this dissertation in studying depositaries/custodians aims to provide an an essentially descriptive analysis of a large number of technical and co-

---

[61] European law had the tendency to first harmonize various sectors, such as the insurance and banking sector. Currently, European law not only harmonizes legislation within a certain sector but also harmonizes the legislative standards throughout various sectors as to ensure consistency.

[62] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004; FEFSI, *Position Paper on Depositaries*, 4-5 (6 November 2002);

[63] Alternative Investment Management Association, *AIMA Position Paper UCITS V*, September 2012, http://giegold.korova.co/wp-content/uploads/2012/10/UCITS-V-AIMA-Position-Paper.pdf.pdf (accessed 14 April 2017); FEFSI, *Position Paper on Depositaries*, 4-5 (6 November 2002).

[64] F.C. Von Savigny, *System des heutigen Römischen Rechts § 33, A: Auslegung der Gesetze; 213.* (Berlin , 1840).

ordinated legal rules to be found in the European investment law directives. The aim of this method of research is to collate, organize and describe all legal rules concerning depositaries in European investment law.[65]

The European Commission, its mandates and various interest groups have issued consultations, reports, recommendations and proposal at the European level on the depositary/custodians laws on the European level.[66] These will be, in particular, be taken into account when analyzing the inconsistencies of the European depositary passport and why the European legislator has so far not adopted the European passport for AIF/UCITS depositaries (Part I), setting out the research parameters of what it requires to apply the European passport to (AIF/UCITS) depositaries/custodians (Part II), what differences there are between depositaries and custodians that justify this difference in treatment (Part III) and providing recommendations and proposals that on the European level could be applied to introduce a cross-sectoral European depositary passport (Part IV).

The comparative method is of great importance in this study.[67] It serves two purposes. First, it clarifies aspects of depositary regulation on the European level that have so far not been in detail clarified. Second, the approach of the European investment law directives towards the regulation of depositaries varies in the degree of harmonization. The AIFMD and UCITSD V regulate depositaries in detail[68], whereas IORPD II and MiFID II do not clarify into detail what entities are eligible are able to be appointed, what organizational structure and responsibilities depositaries should have.[69] As present studies, in particular, do not highlight the similarities and differences of depositaries/custodians in the IORPD II and MiFID II domain, the comparative method seeks to identify basic regulatory principles for IORP depositaries and MiFID II custodians.

The comparative study is being treated as essentially being the interpretation of the various Member States of the depositary regulation in European investment law. The recommendations and proposals provided in Part IV of this research aim to be applied by all Member States. Although France, Germany, Ireland, Luxembourg, the Netherlands and the UK dominate in terms of asset under management, no specific Member States are

---

[65] R. Zippelius, *Juristische Methodenlehre* (C.H.Beck 2012).

[66] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004; FEFSI, *Position Paper on Depositaries*, 4-5 (6 November 2002); European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 14 April 2017); European Commission, *Report of the Expert Group on Investment Fund Market Efficiency*, July 2006, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/efficiency_en.pdf (accessed 14 April 2017); European Commission, *White Paper of 15 November 2006 (COM (2006) 686 final) on enhancing the single market framework for investment funds*, http://ec.europa.eu/internal_market/securities/docs/ucits/whitepaper/whitepaper_en.pdf (accessed 14 April 2017).

[67] M. Van Hoecke, *Methodology of Comparative Legal Research*, http://rem.tijdschriften.budh.nl/tijdschrift/lawandmethod/2015/12/RENM-D-14-00001#content_RENM-D-14-00001.5738700789 (accessed 24 April 2017); G. Samuel, *An Introduction to Comparative Law Theory and Method* 81-82 (Hart Publishing 2014); M. Siems, *Comparative Law* (Cambridge University Press, 2014); M. Van Hoecke, *Do "Legal Systems" Exist? The Concept of Law and Comparative Law* 43-57. (S. Donlan & L. Heckendorn Urscheler eds., Ashgate 2014); K. Zweigert & H. Kötz, *Introduction to Comparative Law* 35 (Clarendon Press 1998).

[68] S.N. Hooghiemstra, *Depositary Regulation* 480 (D.A. Zetzsche ed, Kluwer 2015).

[69] European Insurance and Occupational Pensions Authority, *EIOPA's Advice to the European Commission on the review of the IORP Directive 2003/41/EC*, EIOPA-BOS-12/015, 15 February 2012; ; Annex I s. A MiFID I/II.

systematicly studied in this dissertation.[70] The latter approach is taken because a possible European legislative act needs to be decided upon on the European level. Basing a proposal upon merely a few Member State laws representing 31 EEA Member States would likely undermine this proposal. For this purpose, the comparative study mainly brings examples of the the dominating Member States regarding small interpretative issues on the European level. For issues in depositary/custodian regulation, which are completely regulated to a minimum extent on the European level, such as the 'PE-depositary'[71], the research is based upon mapping exercises of Member State laws. The outcomes of these mapping exercises, to the extent relevant, are categorized into different groups as to formulate general similarities and differences as how certain European investment law provisions are being implemented in the laws of Member States. The latter approach guarantees an efficient outcome which is realistically to be implemented on the European level.

With black letter analysis, the focus is on primary sources, in this research mainly statute and to a lesser extent, academic commentary.[72] As such, it focuses on the law in books rather than the law 'in action', thereby overlooking the sociological and political implications. To this extent, the limited available literature[73] in European investment law will be used, especially, in applying the teleological, systematic and historical explanation of depositaries in the European investment law domain as elaborated in Part III of this research.

This analysis made on the basis of this methodology offers the foundations for the commentary offered on the emergence and significance of the depositary in European investment law with the aim of identifying an underlying system that could provide the basis for the recommendations and proposals for a joint European passport of depositaries.

5. Limitations

The emphasis of this research project is on the eventual introduction of a cross-sectoral European depositary passport. The depositary will be solely studied from a regulatory law perspective. The study deals with regulatory law issues concerning the European passport and the depositary/custodian as an financial intermediary from a comparative perspective within the scope of MiFID I/II, the AIFMD, UCITSD V, the proposed PEPPR and IORPD II (the 'European investment laws'). This study includes the so-called AIFMD/UCITSD V 'product regulations, including the use of the depositary under EuVECAR/EuSEFR, MMFR and ELTIFR. Regulatory laws and legal fields touching upon depositaries, such as custody transfer law and (international) private law , will not be dealt with in this dissertation.

It is obvious that, in view of the amount of issues related to the subject of research a certain trade-off has to be made between comprehensive and thoroughness within the limits of this study. In this study, the author favours comprehensiveness. The chosen approach implicates that not every single and possible detail of depository regulation will be addressed in this study. In this respect, this study aims to take a pragmatic approach and will not extend beyond the limits set out in this proposal.

---

[70] See D.A. Zetzsche, *Prinzipien der kollektiven Vermögensanlage* A.I. (Mohr Siebeck 2015).

[71] D.A. Zetzsche, *Fondsregulierung im Umbruch – ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, ZBB 22 (2014).

[72] J.B. Murphy, *The philosophy of positive law: foundations of jurisprudence (Yale University Press 2005);* J. Raz, *The Concept of a Legal System* 141 (Clarendon Press 1980); J.B.M. Vranken, Methodology of legal doctrinal research, https://pure.uvt.nl/ws/files/1296852/Vranken_Methodology_of_legal_doctrinal_research_110118_publishers_embargo1y.pdf (accessed 23 April 2017).

[73] See infra 5.1. on 'scientific relevance'.

6. Scientific & Societal Relevance

6.1. Scientific Relevance

Currently there is no research with respect to the introduction of a cross-sectoral European passport for depositaries under European investment law.

After UCITSD II contained a proposal for the mutual recognition of EEA depositaries failed, various initiatives and studies on UCITS depositaries have been directly or indirectly initiated by the European Commission and were conducted from 2004-2012.[74] The European Commission in all these studies concluded that a lack of harmonization regarding the eligibility, organizational requirements, functions and responsibilities, delegation and liability regime would have to be overcome first before a European passport for UCITS depositaries could be seriously considered. Although some convergence over the years had taken place into the domain of eligible entities and the safekeeping function performed, the divergences regarding the types of oversight duties and the interpretation of the oversight duties imposed by UCITSD I-IV an obstacle which was not yet adequately addressed.[75] The various studies conducted influenced the adopted AIFMD and UCITSD V, as well as, the IORPD II depositary/custodian regime.[76] Despite of these revised legislative acts, the European Commission only reviewed a possible introduction of a depositary passport under UCITSD VI.[77] None of the initiatives and studies on the European level have so far considered the introduction of a cross-sectoral European depositary passport.

Apart from this, such a study is also not yet assumed by academic articles and books.

In general, the depositary in European investment law seems to be an unexplored area of law. Some authors have written on depositary law in relation to UCITS and AIFs.[78] These

---

[74] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004; FEFSI, *Position Paper on Depositaries*, 4-5 (6 November 2002); European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016); European Commission, *Report of the Expert Group on Investment Fund Market Efficiency*, July 2006, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/efficiency_en.pdf (accessed 7 April 2017); European Commission, *White Paper of 15 November 2006 (COM (2006) 686 final) on enhancing the single market framework for investment funds*, http://ec.europa.eu/internal_market/securities/docs/ucits/whitepaper/whitepaper_en.pdf (accessed 7 April 2017); See also European Commission, *Working Document of the Commission Services (DG Markt), Consultation Paper on the UCITS Depositary Function*, July 2009, http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/consultation_paper_en.pdf (accessed 7 April 2017); European Commission, *Consultation Paper on the UCITS Depositary Function and on the UCITS Managers' Remuneration*, 14 December 2010, MARKT/G4 D (2010) 950800, 16, 17, http://ec.europa.eu/finance/consultations/2010/ucits/docs/consultation_paper_en.pdf (accessed 7 April 2017).

[75] S.N. Hooghiemstra, *Depositary Regulation* 480 (D.A. Zetzsche ed, Kluwer 2015).

[76] European Insurance and Occupational Pensions Authority, *EIOPA's Advice to the European Commission on the review of the IORP Directive 2003/41/EC*, EIOPA-BOS-12/015, 15 February 2012.

[77] European Commission, *Consultation Document - Undertakings for Collective Investment in Transferable Securities (UCITS)Product Rules, Liquidity Management, Depositary, Money Market Funds, Long-term Investments*, July 2012, http://ec.europa.eu/finance/consultations/2012/ucits/docs/ucits_consultation_en.pdf (accessed 13 October 2016).

[78] S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013); S.N. Hooghiemstra, *Depositary Regulation* 480 (D.A. Zetzsche ed, Kluwer 2015); R.K. Th.J Smits, *De AIFMD-bewaarder; praktische gevolgen voor Nederlandse beleggingsinstellingen*, 11 V&O 200-204 (2012); C.P. Buttigieg, *The Case for A European Depositary Passport*, http://studylib.net/doc/13128849/the--case--for--a--european-...-passport (accessed 7 April 2017); C.P. Buttigieg, *The Alternative Investment Fund Managers*

studies, however, are highly descriptive in nature.[79]

This research is necessary since the current harmonization trends in European investment law indicate that there is an increasing need for the introduction of a depositary passport that not only serves the needs of AIFs and UCITS, but also for MiFID II clients and IORPs.

6.2. Societal Relevance: The Growing Importance of Depositaries

The rise of European AuM and possible cost reductions resulting from the introduction of a (cross-sectoral) European depositary passport show the growing importance of depositaries and their societal relevance.

6.2.1. *The rise of European AuM*

Total asset under management (AuM) in Europe increased 11% in 2012 and close to 9% in 2013, to reach an estimated EUR 16.8 trillion at the end of 2013.[80] Europe ranks second, after the US, in managing 33% of the EUR 47 trillion global asset management industry.[81] The social relevance is given since all these assets are safe-kept by European depositaries.[82]

In Europe, of the discretionary mandates (MiFID II) represented 52% of the total AuM at the end of 2012. Discretionary mandates are dominated by two markets: the UK and France, which together managed approximately 66% of all total European discretionary mandates at the end of 2012.[83]

The share of AIF and UCITS assets in total AuM stood at 48%. Of the latter 48% , over

---

Directive in Malta: Past, Present ... What Next?, 15, https://ssrn.com/abstract=2602750 (accessed 7 April 2017); See C.P. Buttigieg, *The 2009 UCITS IV Directive: A Critical Examination of the Framework for the Creation of a Broader and More Efficient Internal Market for UCITS,* https://ssrn.com/abstract=2137202 (accessed 7 April 2017); T. Dolan., *UCITS V brings convergence of the depositary role with AIFMD***,** 1 JIBFL 64B (2015).

[79] See, for example, I. Riassetto, *Le nouveau régime applicable aux dépositaires issu de la directive OPCVM V*, 3 Bulletin Joly Bourse 113 (2015) ; I. Riassetto, *Responsabilité de la société de gestion et du dépositaire d'un OPC envers les actionnaires d'une société cible, note sous Cass. com. fr. 27 mai 2015*, 4 RD Bancaire et Financier (2015) ;I. Riassetto, *Dépositaires - Quelles différences entre la directive OPCVM V et la directive AIFM?,* 4 RD Bancaire et Financier (2014); I.Riassetto, I., *La clarification des obligations et de la responsabilité des dépositaires par la directive OPCVM V,* 98 Revue Lamy Droit des Affaires 31 (2014) ; I.Riassetto, I., *Moyens et procédures adéquats pour la mise en œuvre de l'obligation de contrôle des dépositaires d'OPC*, 10 Bulletin Joly Bourse (2013) ; I. Riassetto, I. *L'obligation de restitution du dépositaire d'OPC en droit Luxembourgeois*, 30 Journal des Tribunaux Luxembourg 167 (2013) ; I.Riassetto, I. & A. Prüm, *La fonction de conservation du dépositaire, source de responsabilité civile, note sous Paris, 1ère Ch., Section H, 8 avril 2009, no. 2008/22218*, 3 Joly Bourse 191, §I-A-2 (2009);I.Riassetto, *Obligation de restitution du dépositaire d'OPCVM*, 4 RD Bancaire et Financier Comm. 161, point 1-B (July 2010).

[80] European Fund and Asset Management Association, *Asset Management in Europe,* Facts and Figures 7th ANNUAL REVIEW, June 2014, 10, http://www.efama.org/Publications/Statistics/Asset%20Management%20Report/Asset%20Management%20Report%202014.pdf (accessed 14 April 2017).

[81] The world's largest market is the US, which represents EUR 21.5 trillion in AuM and makes up approximately 46% oft he global asset management industry. See European Fund and Asset Management Association, *Asset Management in Europe,* Facts and Figures 7th ANNUAL REVIEW, June 2014, 12, http://www.efama.org/Publications/Statistics/Asset%20Management%20Report/Asset%20Management%20Report%202014.pdf (accessed 14 April 2017).

[82] See International Organization of Securities Commission, *Standards for the Custody of Collective Investment Schemes' Assets – Final Report*, FR 25/2015, November 2015, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD512.pdf (accessed 22 April 2017).

[83] The UK managed 47% and France 19%. European Fund and Asset Management Association, *Asset Management in Europe,* Facts and Figures 7th ANNUAL REVIEW, June 2014, 18, http://www.efama.org/Publications/Statistics/Asset%20Management%20Report/Asset%20Management%20Report%202014.pdf (accessed 14 April 2017).

75% were invested in UCITS, whereas approximately 25% were invested in AIFs.[84] In the UCITS domain, over 80% is invested by fund domiciled in four jurisdictions: Luxembourg (32.4%), France (20.6%), Ireland (14.4%), and the United Kingdom (11.5%).[85] The European AIF sector, apart from Germany, is also dominated by these four Member States.[86]
The potential total aggregated amount of IORPs amount to to 110.127 representing approximate assets held of 2.9 trillion for around 75 million beneficiaries in June 2014. Of these 110.127 IORPs only 75 are currently active cross-border IORPS.[87] Currently, 29 IORPs are domiciled in the UK, 25 in Ireland and 11 in Belgium. Together these Member States domicile 88% of the active cross-border IORPs.[88]

Overall, the European depositary industry is, thus, today entrusted with safekeeping of more than EUR 16.8 trillion of assets.

6.2.2. *Possible Cost Reduction of a Depositary Passport*

Not only the rise of AuM in the European investment management industry, but also a possible cost reduction of the introduction of a (cross-sectoral) European depositary passport shows the growing importance of depositaries and their societal relevance,.

AIF/UCITS depositaries must be located in the Member State in which the AIF/UCITS for which they are appointed, is established ,[89] Over 80% of all assets may, thus, only be safekept by depositaries in six EEA Member States, whereas in a fully competitive European market these assets could be held by depositaries established in all 31 EEA Member States.[90]

Despite of recent trends affecting the custody sector including increased global competition, the disappearance of local custodians and the emergence of a handful of global players the European depositary fees are still significantly higher compared to the US.[91] The cost of custody calculated as a percentage of the assets that held in custody varies in Europe for UCITS and AIFs between 0.25 and 1.25bp, whereas the costs of custody in the United

---

[84] European Fund and Asset Management Association, *Asset Management in Europe,* Facts and Figures 7th ANNUAL REVIEW, June 2014, 5, 6, http://www.efama.org/Publications/Statistics/Asset%20Management%20Report/Asset%20Management%20Report%202014.pdf (accessed 14 April 2017).

[85] See European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186),* 10

[86] European Fund and Asset Management Association, *Trends in the European Investment Fund Industry in the Third Quarter of 2014*, Quarterly Statistical Release November 2014, N° 59, 8, http://www.efama.org/Publications/Statistics/Quarterly/Quarterly%20Statistical%20Reports/141128_Quarterly%20Statistical%20Release%20Q3%202014.pdf (accessed 14 April 2017).

[87] European Insurance and Occupational Pensions Authority, Report on Cross Border IORP Market Developments, 2014, 4, https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-14-083-Market-Development-Report-2014-deff.pdf (accessed 23 April 2017).

[88] *Ibid.*

[89] Art. 21(5) AIFMD; Art. 23(1) UCITSD V.

[90] See European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186),* 10.

[91] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004; FEFSI, *Position Paper on Depositaries*, 4-5 (6 November 2002); European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186),* 12, 13.

States ranges from 0.2bp to a maximum of 0.5bp. [92] The costs of custody in Europa are, thus, between 200% and 500% higher than in the US. Given the fact that the cost of custody is normally calculated as a percentage of the assets that are held in custody on an annual basis, full competition by means of a depositary passport could, thus, save the European investors billions of Euros on an annual basis. Not even to speak about the increase in quality of services that the enhancement of the introduction of a cross-sectoral European depositary passport could, thus, affect millions of investors. Therefore it is clear that this research topic has societal relevance.

7. Study Outline

The purpose of this thesis is to assess whether a common European passport for depositaries servicing not only IORPs and clients of investment firms, but also UCITS and AIFs should be introduced. For that purpose, this research covers four parts each answering one sub-question.

Part I will give an overview of the 'depositary passport paradox' in European investment law, i.e. the problem of the inconsistency of the European depositary passport under the European investment law directives that is the key problem addressed in this dissertation. In order to point out the inconsistencies, first the locational restrictions of depositaries/custodians under the European investment laws are being discussed. In addition, the policy discussion related to the introduction of a European depositary will be addressed that sets out the historical context and indicates the reasons why such a passport so far has not been introduced. Part I concludes that for the introduction of a 'cross-sectoral European depositary/passport', two points need to be clarified. First, under what conditions do EEA and TC financial intermediaries obtain a European passport under EEA regulatory law and second, what is a depositary and to what extent does a depositary differentiate from a custodian. Before a proposal for a cross-sectoral European passport in Part IV is being made, Part II addresses the first question and Part III the second question

Part II addresses to what extent financial intermediaries have to be harmonized on the EEA level to obtain a European passport. It explores the political economy of a European passport for EEA financial intermediaries and the 'joint principles' under various legislative acts, including authorization, operational, notification and enforcement conditions that EEA financial intermediaries, generally, need to fulfill under harmonized in order to obtain a European passport. In addition, Part II studies the 'external dimension' of the European passport, i.e. the European passport granted to third-country financial intermediaries. To this end, it will be studied what additional conditions EEA financial intermediaries under various European legal acts need to fulfill in order to enter the internal market. The latter serves as to determine under what conditions a (cross-sectoral) European passport for third-country financial intermediaries could be introduced.

Part III aims to define what a depositary is and whether and to what extent depositaries and custodians differ. This serves two purposes. First, Part III clarifies out the whether a difference in treatment of depositaries, at the one, and custodians, at the other hand, throughout European investment law is justified from an investor protection perspective. Second, Part III seeks to find out whether common regulatory principles for depositaries and custodians, similar as for asset managers that conduct investment management under the European investment law directives, are to be found that would possibly justify a cross-

[92] European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186),* 12.

sectoral European depositary passport. To this end, the application of the legal interpretation methods of *Von Savigny* on the study of positive norms of the depositary in European investment law, including the grammatical, teleological, systematic and historical explanation will be applied in defining depositaries and custodians.

Part IV seeks to develop a cross-sectoral European depositary passport under European investment law. For this purpose, Part IV assesses whether and to what extent depositaries and custodians fulfill the pre-conditions of the introduction of an European passport for EEA and TC financial intermediaries as set out under Part II.

The eventual conclusion will be that depositaries and custodians are both safekeeping assets and, thus, 'custodians'. Depositaries, on top of being a 'custodian', however, also monitor asset managers by conducting controlling duties. The remaining problems related to the introduction of a cross-sectoral depositary passport, such as the non-harmonization of eligible depositary/custodian entities, can, thus, be regulated under a cross-sectoral regulatory framework in MiFID II, whereas the specific 'depositary' tasks may be regulated on the sectoral level. By undertaking this regulatory response, the European regulatory solves the issues related to the introduction of a cross-sectoral European depositary passport within the existing legal framework of European investment law.

PART I - The European Depositary Passport Paradox

There are inconsistencies in locational depositary restrictions in European investment law, i.e. the so-called European ‘depositary passport paradox’. To this end, Part I studies the locational depositary restrictions under European investment law.

Chapter 2 Locational Depositary Restrictions under the European Investment Laws

Notwithstanding the fundamental principle of freedom to provide services under constitutional EEA law[1], the AIFMD and UCITSD V restrict the choice of depositaries. The AIFMD and UCITSD V require depositaries to be 'established' in the funds' domicile.[2] Credit institutions, investment firms and UCITS depositaries which are under the terms of CRD IV, MiFID II and IORPD I/II allowed to provide custody services on a cross-border basis may not exercise 'passporting rights' under the UCITSD V and the AIFMD.

Strictly speaking, there is, thus, inconsistency in locational depositary restrictions, i.e. a European 'depositary passport paradox' in European investment management depositary law. The chapter proceeds by discussing the locational restrictions of depositaries/custodians under the European investment laws. In addition, the policy discussion related to the introduction of a European depositary will be discussed that sets out the historical context and indicates the reasons why such a passport so far has not been introduced.

1. The European Depositary/Custodian Passport under European Investment Laws

In practice, the same investment firms and credit institutions are acting as a custodian for discretionary mandates and 'execution only'[3] services under MiFID II/CRD IV, a depositary under the AIFMD/UCITSD V and a depositary/custodian under IORPD II. Nevertheless, the European investment laws, i.e. MiFID II, CRD IV, the AIFMD, UCITSD V and IORPD II are inconsistent in granting a depositary/custodian passport to these depositaries/custodians. They are both inconsistent throughout the directives and on a cross-sectoral basis. These inconsistencies are highlighted through this section and are referred to as the 'European depositary passport paradox'.

1.1. The European Passport for 'Custodians' under MiFID II/CRD IV

An 'ancillary' European passport for 'custodians' was being introduced under the Second Banking Directive and ISD. Under both the Second Banking Directive and ISD, the 'safekeeping and administration of securities' could be provided as a so-called 'ancillary service'. Credit institutions that were authorized for 'core services', such as deposit taking and lending[4], could be, additionally, authorized for acting as a custodian alongside these 'core services'. The ISD built upon this framework by allowing investment firms to be authorized for the ancillary service 'safekeeping and administration of financial instruments for the account of clients' in connection with investment services and activities, such as, amongst others, portfolio management and investment advice.[5] Throughout the updates of the Second Banking Directive to CRD IV and the ISD to MiFID II the safekeeping and administration of

---

[1] See Art. 49 and 56 TFEU.
[2] Art. 21(5) AIFMD and Art. 23(1) UCITSD V.
[3] See Annex I, s. A No. 1 and No. 2 MiFID I/II; Art. 25(4) MiFID II.
[4] Annex List of Activities subject to Mutual Recognition, Nr. 12 'safekeeping and administration of securities ' Second Banking Directive; Annex I s. C, Nr. 1 'safekeeping and administration in relation to one or more of the instruments listed in Section B' ISD.
[5]. Currently: Annex I s. A MiFID I/II.

securities remained to be an 'ancillary service' for which no separate authorization procedure nor a 'stand-alone' European passport is in place.[6]

1.2. The Location of the Depositary under the AIFMD & UCITSD V

The AIFMD/UCITSD V impose location restrictions for depositaries. Under Article 23(1) UCITSD V and Article 21(5) AIFMD a depositary shall either have its registered office or be established in the UCITS/EEA-AIF home Member State.

Originally, this restriction was introduced under the UCITSD I 'product regulation approach'[7]. UCITSD I harmonized and allowed European 'mutual funds', i.e. liquid retail collective investment undertakings, to be marketed throughout the EEA. The EEA wide marketing of these financial products was only allowed under the condition that these undertakings complied with an investment policy composed of financial instruments and other liquid financial assets.[8] UCITSD I was focussing on the product and was introducing a marketing passport. UCITS ManCos were, thus, only allowed to sell but not to manage UCITS on a cross-border basis.[9] The 'product regulation approach' required only the product and not the intermediaries, i.e. UCITS ManCos and depositaries, to be fully harmonized. Instead, UCITS ManCos and depositaries only needed to comply with 'principles-based' minimum requirements.[10] Consequently, the minimum harmonization of the organizational and conduct of business requirements applying to UCITS ManCos and depositaries implied that no European passport passport could be attributed to these intermediaries to provide services to UCITS on a cross-border basis.[11] As a result of the 'product regulation approach', UCITS ManCos and depositaries were under UCITSD I required to be established in the same Member State as the UCITS home Member State. The rationale behind this was that the UCITS home Member State would be equipped the best to verify compliance of the UCITS ManCo, depositary and UCITS with UCITSD I and enforce compliance, if necessary.[12] The introduction of UCITSD III and IV have led to the harmonization of UCITS ManCos to such an extent that a 'management passport', i.e. the right to manage UCITS on a cross-border basis throughout the EEA was introduced.

The AIFMD built upon the work done for UCITS and introduced both a marketing and management passport for AIFMs on the basis of an 'intermediary regulation approach'. Unlike for UCITS, the AIFMD focussed on the harmonization of AIFMs and not on the harmonization of AIFs. Upon the introduction of the AIFMD and subsequent adoption of UCITSD V, also the depositary regulatory framework has been substantially harmonized. A depositary passport, i.e. the right of a depositary to act on a cross-border basis by the cross-

---

[6] See Chapter 6, section 2.1.
[7] See Chapter 8, section 4.
[8] See Chapter 8, section 4.2.1.
[9] The UCITS ManCo passport was introduced under UCITSD IV. See C.P. Buttigieg, *The 2009 UCITS IV Directive: A Critical Examination of the Framework for the Creation of a Broader and More Efficient Internal Market for UCITS,* https://ssrn.com/abstract=2137202 (accessed 7 April 2017).
[10] C.P. Buttigieg**,** *The Development of the EU Regulatory and Supervisory Framework applicable to* UCITS: A Critical Examination of the Conditions and Limitations of Mutual Recognition**,** March 2014, 66, http://sro.sussex.ac.uk/48285/1/Buttigieg%2C_Christopher_P..pdf (accessed 7 April 2017).
[11] *Ibid*.
[12] See European Commission, *White Paper of 15 November 2006 (COM (2006) 686 final) on enhancing the single market framework for investment funds*, http://ec.europa.eu/internal_market/securities/docs/ucits/whitepaper/whitepaper_en.pdf (accessed 7 April 2017);

border free provision of services, however, has so far not been introduced.[13] Instead, depositaries are required to be 'established' in the home Member State of the UCITS/EEA-AIF. Established under the AIFMD means that either the registered office or a branch office is required to be located in the UCITS/AIF home Member State for which a depositary is appointed. The AIFMD, however, takes an inconsistent approach as it deviates from the locational restriction applying to EEA-AIFS for TC-AIFs. In the same vein, the AIFMD transitional relief allows Competent Authorities of the home Member State of an AIFM could until 22 July 2017 allow credit institutions that are established in another Member State to be appointed as a depositary.[14] The AIFMD is not only inconsistent in the locational restrictions that apply to depositaries. The absence of a European passport allows the Competent Authorities of the individual Member States to determine under what conditions a branch office of a depositary is being established within their domicile.

This section continues to discuss the 'depositary passport paradox' for AIF and UCITS depositaries. It will first address the location restrictions of UCITS depositaries in further detail. UCITSD V as the location restriction was introduced in UCITSD I, is still present under UCITSD V and was later copied in the AIFMD for EEA-AIFs. This section will then adress the inconsistent location restriction applying to depositaries that apply to EEA-AIFs and TC-AIFs, on the one, and between an EEA-AIFM and a TC-AIFM managing an AIF, on the other hand.

1.2.1. *The Location of the Depositary for UCITS*

Under Article 23(1) UCITSD V a depositary shall either have its registered office or be established in the UCITS home Member State.

Under the UCITSD V it is not defined what 'established' for depositaries means. 'Established' for depositaries under Art. 4(1)(j)(iii) AIFMD means 'having its registered office or branch in'. This definition is consistent with the section 'cross-border activities' as defined in various European legal initiatives that grant a European passport to financial intermediaries.[15]

The UCITS depositary location restrictions has to be read in conjunction with the eligible entity provision under UCITSD V.[16]

The initial UCITSD V draft had as its objective to limit UCITSD V eligible depositary entities to credit institutions and investment firms authorized under CRD IV and MiFID II.[17] Under this proposal the cross-border activities under CRD IV and MiFID II could have been used to determine whether a depositary is 'established', i.e. has its registered office or branch in the UCITS home Member State. Ever since the First Banking Directive and ISD have been adopted, CESR, predecessor of ESMA, has sought to clarify the conditions under which investment firms and credit institutions would be entitled to make use of their passporting rights.[18] The ongoing clarification under these directives of the 'cross-border activities' would have been useful.

---

[13] Under the AIFMD transitional relief, Competent Authorities of the home Member State of an AIFM could until 22 July 2017 allow credit institutions that are established in another Member State to be appointed as a depositary. See Art. 61(5) AIFMD.
[14] See Art. 61(5) AIFMD.
[15] D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* 865 (D.A. Zetzsche ed, Kluwer 2015).
[16] See for these eligible entity provisions: Article 23(2) UCITSD V.
[17] Art. 23a(2) UCITSD V Draft proposal.
[18] See CESR/07-337b.

The final version of UCITSD V, however, decided not to limit eligible depositary entities to credit institutions and investment firms.[19] Instead, Member States were left discretion to choice whether a credit institution[20], national central bank[21] or 'other eligible entities'[22] would be eligible to be appointed as a UCITS depositary within their domicile.[23]Member States have taken different approaches by not implementing at all this option[24], allowing all legal entities fulfilling these criteria to be appointed[25] or to specify the types of legal entities, such as investment firms[26], CSDs[27], prime brokers[28] or eligible legal entities authorized under national law[29] fulfilling the additional UCITSD V criteria to be appointed as a UCITS depositary.

The cross-border activity definitions of 'registered and branch office' under EEA legislation applying to EEA entities, including investment firms[30], CSDs[31], prime brokers[32] established as credit institution or investment firms qualifying as 'other legal entities' under national legislation could have been used. Nevertheless, the problem is that various Member States, such as Ireland and Malta, allow eligible legal entities authorized under national law that fulfil additional UCITSD V criteria to be appointed as a UCITS depositary. For these eligible legal entities, criteria under the respective national laws define what 'be established in the UCITS home Member State' means.[33]

Ireland allows Irish companies to be eligible as 'other eligible institution' provided that the

---

[19] Art. 23(2) UCITSD V.

[20] Art. 23(2)(b) UCITSD V.

[21] Art. 23(2)(a) UCITSD V.

[22] Article 23(2)(c) UCITSD V.

[23] Article 23(1) UCITSD V.

[24] The following Member States, for example, only allow credit institutions to be appointed as a UCITSD V depositary: Austria: § 41(1) Investmentfondsgesetz 2011 (InvFG 2011); Croatia: Art. 4(7) Act on Open-Ended Investment Funds with a Public Offering (Official Gazette 44/16); Denmark: Art. 2 (1) Nr. 11 Act no. 597 of 12 June 2013 on investment associations; Germany: § 68 (2) and (3) KAGB; Luxembourg; Art. 17(3) OPC law 2010.

[25] Cyprus: Art. 88(I)(2) Open-Ended Undertakings for Collective Investment (UCI) Law of 2012 Consolidated with Law 88(I)/2015; Liechtenstein: Art. 32(2)(c) UCITSG; the Netherlands: Art. 4:62n(a) Wft.

[26] Czech republic: § 69(1)(c) 240/2013 Sb.ZÁKON ze dne 3. července 2013 o investičních společnostech a investičních fondech; France: Art. L214-10-1 I.(a) Nr. 5 CMF; Liechtenstein: Art. 32(2)(a) and (b) UCITSG; the Netherlands: Art. 4:62n(c);Malta: Art. 13(2)(e) Investment Services Act (custodians of collective investment schemes) Regulations 2016; UK: COLL 6.6A.8R(3)(b)(i).

[27] Finland: Finnish Government Bill, draft legislation for Managers of Alternative
tive Investment Funds, 05.09.2013, 218; See also §16, Chapter 2 of the Act amending the Clearing Operations Act; See also Chapter 14, Section 3 Finnish Law on Alternative Investment Funds; Poland: Art. 71(3) ACT of 27 May 2004 on Investment Funds.

[28] See CSSF, Circular14/587, as amended by Circular CSSF 15/608, Sub-Chapter 7.3. Organisational arrangements at the level of the depositary and the UCITS in case of the appointment of a prime broker.

[29] Ireland: Art. 35(2)(c) (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (S.I. No. 352 of 2011); Malta: Art. 13(2)(e) Investment Services Act (custodians of collective investment schemes) Regulations 2016; UK: COLL 6.6A.8R(3)(b)(i).

[30] Czech republic: § 69(1)(c) 240/2013 Sb.ZÁKON ze dne 3. července 2013 o investičních společnostech a investičních fondech; France: Art. L214-10-1 I.(a) Nr. 5 CMF; Liechtenstein: Art. 32(2)(a) and (b) UCITSG; the Netherlands: Art. 4:62n(c);Malta: Art. 13(2)(e) Investment Services Act (custodians of collective investment schemes) Regulations 2016; UK: COLL 6.6A.8R(3)(b)(i).

[31] Finland: Finnish Government Bill, draft legislation for Managers of Alternative
tive Investment Funds, 05.09.2013, 218; See also §16, Chapter 2 of the Act amending the Clearing Operations Act; See also Chapter 14, Section 3 Finnish Law on Alternative Investment Funds; Poland: Art. 71(3) ACT of 27 May 2004 on Investment Funds.

[32] See CSSF, Circular14/587, as amended by Circular CSSF 15/608, Sub-Chapter 7.3. Organisational arrangements at the level of the depositary and the UCITS in case of the appointment of a prime broker.

[33] Cf. R.K. Th.J Smits, *De AIFMD-bewaarder; praktische gevolgen voor Nederlandse beleggingsinstellingen*, 11 V&O 200-204 (2012).

company is wholly owned by either a EEA/TC credit institution[34] or an equivalent EEA/TC institution[35] that guarantees the liabilities of the company and that have a paid-up share capital of at least EUR 5 million.[36] Similarly, Malta allows Maltese companies to be appointed as a depositary that are wholly owned by an EEA credit institution provided that the liabilities of the company are guaranteed by that credit institution.[37] Under the Irish UCITSD V implementation, Non-EEA credit institutions may, thus, through wholly owned subsidiaries with little substance (indirectly) offer depositary services to UCITS not only within Ireland, but also by means of a branch within other EEA Member States. The wholly owned subsidiary under Irish law is an 'EEA legal entity' and meets both the 'registered office' and, depending upon the assessment of Competent Authorities in question, the branch office requirement under the UCITSD V 'established in' definition. Non-EEA legal entities under the Irish UCITSD V implementation, thus, formally meet the requirement that they only may act as a UCITS depositary for Irish AIFs if they have their registered office in Ireland. In addition, they may act as a UCITS depositary in other EEA domiciles if they have a branch office within that EEA Member State. Non-EEA legal entities that do not have a subsidiary with an EEA registered office may not act as a depositary in any EEA Member State.[38] Even not if they have a branch office in the UCITS home Member State in which they want to act as UCITS depositary.[39]

The registered office may, however, be a 'letterbox'[40] as substance of 'other legal entities' authorized under national law have not been further defined and the UCITSD V only sets out some basic principles regarding the organizational requirements of these entities that need to be applied by national Competent Authorities.[41] The main problem is that this 'letterbox entity' may be established in another Member State as a 'branch'. UCITSD V, however, does not further define the criteria that a depositary 'branch office' needs to fulfil in order to be considered as being 'established in' a UCITS home Member States. The substance of a branch office, de facto, depends upon the national legislation and practical application of the 'branch office' requirement by the Competent Authorities of individual EEA Member States. Individual Member States, thus, have discretion in determining what operational activities UCITS depositaries are required to perform in the Member State in which the branch office of the depositary is established and what activities are allowed to be performed in the Member State in which the registered or other branch office established in another Member State of the depositary is established. The Netherlands, for example, has a 'representative office approach' towards branch offices of EEA depositaries.[42] Branch offices in the Netherlands are, de facto, representative offices representing the registered office of a depositary in another Member State that do not itself provide depositaries services.[43] Typically, a branch office carries out

---

[34] Art. 35(2)(c) (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (S.I. No. 352 of 2011).
[35] This is assessed by the Irish Central Bank. See Art. 35(2)(c)(iii) (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (S.I. No. 352 of 2011).
[36] Art. 35(2)(c) (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (S.I. No. 352 of 2011). See for similar depositaries under the AIFMD: Art. 22(3)(iii) AIFM Regulations.
[37] Art. 13(2)(d) Investment Services Act (CAP 370) (Custodians of Collective Investment Schemes) Regulations, 2016.
[38] Art. 23(2)(b) UCITSD V.
[39] *Ibid.*
[40] C.P. Buttigieg, *The Alternative Investment Fund Managers Directive in Malta: Past, Present … What Next?,* https://ssrn.com/abstract=2602750 (accessed 7 April 2017).
[41] Art. 23(2)(c) UCITSD V.
[42] R.K. Th.J Smits, *De AIFMD-bewaarder; praktische gevolgen voor Nederlandse beleggingsinstellingen*, 11 V&O 200-204 (2012).
[43] See on representative offices under MiFID I: CESR/07-337b, 13.

activities such as sales & marketing and relationship management.[44] The Netherlands allows these branch offices of EEA depositaries to conduct their operational depositaries in the Member State in which the registered office of the depositary is established or a so-called '*center of excellence/operational hub*' located elsewhere.[45]

The location restriction of UCITS depositaries is, thus, in practice not only arbitrary for 'other legal entities' authorized under the national laws of individual Member States but also for depositaries established as EEA legal entities. From an investor protection point of view, this can be justified for EEA legal entities that are authorized under EEA legislation and allowed to offer services under these legal initiatives on a cross-border basis. This is not the case for 'other legal entities' authorized under national legislation.

Irrespective of the eligible entity, it seems to depends upon the legislator and the national Competent Authorities of the individual Member States whether depositaries under the UCITSD V have a de facto 'European passport' or whether the locational restrictions of the UCITSD V are effectively enforced. Only the introduction of a European passport for UCITS depositaries based upon harmonized substantial and supervisory criteria would lead to clarification from an investor protection point of view.

1.2.2. *The Location of the Depositary for AIFs*

In determining whether and to what extent the AIFMD is applicable to a depositary, it is of utmost importance to know whether the depositary is located within or outside the European Union. The AIFMD makes, on the one hand, a distinction between EEA-AIFs and TC-AIFs, and, on the other hand, between an EEA-AIFM and a TC-AIFM managing an AIF:

Location of the Depositary – Depending on the Location of the AIF		
	EEA-AIF	**TC-AIF**
EEA AIFM	Home Member State AIF	Third country where the AIF is established Home Member State of the AIFM managing the AIF
TC-AIFM	Home Member State AIF	Third country where the AIF is established Member State of reference of the AIFM managing the AIF

1.2.2.1. Location of the Depositary for EEA-AIFs

Article 21(5) AIFMD requires a depositary for EEA-AIFs to be established in the home Member State of the EEA-AIF.[46] Following, Article 4(1)(j)(iii) AIFMD established means that depositaries of EEA-AIFs should have their registered office or branch in the same

---

[44] R.K. Th.J Smits, *De AIFMD-bewaarder; praktische gevolgen voor Nederlandse beleggingsinstellingen*, 11 V&O 200-204 (2012).

[45] *Ibid.*

[46.] Art. 21(5)(a) AIFMD; A transition relief from this mandatory rule is provided by Art. 61(5) AIFMD. On the basis of this relief, the Competent Authorities of the home Member State of an AIF or, in case where the AIF is not regulated, the Competent Authorities of the home Member State of an AIFM may until 22 July 2017 allow credit institutions that are established in another Member State to be appointed as a depositary; See also: C.P. Buttigieg, *The Alternative Investment Fund Managers Directive in Malta: Past, Present ... What Next?*, https://ssrn.com/abstract=2602750 (accessed 7 April 2017).

country as the EEA-AIF. The location of the depositary for EEA-AIFs has been adopted from UCITSD I-V. Similarly as for UCITS, the AIF depositary locational restriction is influenced by the eligible entities under the AIFMD. Under the AIFMD. The original idea of limiting UCITSD V entities to credit institutions and investment firms under the initial draft UCITSD V was inspired by the AIFMD that limits eligible entities for (liquid) EEA-AIFs to credit institutions, investment firms and prime brokers.[47] The UCITSD IV eligible entities under AIFMD were planned to be 'phased-out' under the ultimate limitation of entities proposed under the draft UCITSD V. Under the initial UCITSD V proposal, eligible entities under both the AIFMD and UCITSD V would have been limited to credit institutions, EEA investment firms and prime brokers that are credit institutions and EEA investment firms.[48] The UCITSD IV entities have to be dynamically interpreted under the AIFMD. For this reason, the so-called 'other legal entities' subject to minimum principle-based requirements under UCITSD V remain to be eligible under the AIFMD Member State implementations. The implications of allowing these 'other legal entities' under the AIFMD/UCITSD V Member State implementations to be eligible to be a depositary are under both directives the same.

Article 21(3)(a) and (b) AIFMD only allows credit institutions and investment firms that have their registered office in the EEA to act as a depositary for EEA-AIFs.[49]
Non-EEA investment firms that are under the MiFID II[50] third-country regime able to provide the ancillary service[51] of safekeeping and administration of financial instruments for the account of clients within the EEA are under the AIFMD, thus, precluded from acting as a depositary. This holds even true for non-EEA investment firms that have established a branch in the same Member State as an EEA-AIF.

The AIFMD is on this point inconsistent with the rationale behind the MiFID II third-country regime.

First, similar to the AIFMD, third-country service providers under MiFID II are subject to additional third-country requirements. Only third-country firms that are established in countries whose legal and supervisory framework are considered to be offering equivalent investor protection are allowed to operate on a cross-border basis. Non-EEA investment firms that are authorized by a Member State authority under the MiFID II third-country regime to operate though an EEA branch in a Member State are allowed to act as a custodian for professional and, under certain conditions, retail clients residing within the EEA, whereas they are precluded from acting as a depositary for EEA-AIFs.

Second, the AIFMD allows non-EEA entities to act as a depositary for non-EEA AIFs that are marketed to investors within the EEA on the basis of being of 'the same nature' as EEA credit institutions and investment firms. Non-EEA entities subjected to the more stringent harmonized MiFID II third-country regime are, to the contrary, precluded from acting as a depositary for EEA-AIFs that are marketed to the same investors within the EEA.

Third, the AIFMD allows other institutions eligible under UCITSD IV/V subject to minimum prudential standards to be appointed as a depositary for EEA-AIFs, whereas investment firms falling under the MiFID II third-country regime that are subject to the same organizational, prudential and capital requirements as investment firms are precluded from doing so.

Allowing Non-EEA investment firms that have established a branch within the EEA to act

[47] Art. 21(3) AIFMD.
[48] See S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2015).
[49] Art. 21(4)(a) AIFMD.
[50] Arts 39–43 MiFID II.
[51] These investment firms also have to provide the service of safekeeping and administering financial instruments as ancillary service, in addition to, one or more investment services/activities under Annex 1 MiFID II.

as an AIF depositary within that EEA Member State would, thus, be consistent with the MiFID II third-country regime.

1.2.2.2. Transitional Relief – AIFMs managing EEA-AIFs

The Competent Authorities of the home Member State of an AIF or, in case where the AIF is not regulated, the Competent Authorities of the home Member State of an AIFM could until 22 July 2017 allow credit institutions[52] that are established in another Member State to be appointed as a depositary.[53] The European Commission clarified that 'where the AIF is not regulated' should be interpreted as EEA-AIFs that either have not (yet) obtained an authorization or registration within an EEA Member State.[54]

EEA Member States have, thus, an option to (temporary) diverge from the AIFMD's mandatory requirement that depositaries of EEA-AIFs shall be established in the home Member State of the AIF.[55] This option is both available to EEA-AIFMs, as well as, TC-AIFMs that are managing EEA-AIFs.[56] Apart from this location restriction, depositaries appointed by AIFMs that are making use of this option are required to fully comply with all other provisions laid down by Article 21 AIFMD.

In practice, this option is, however, of limited importance given the temporary nature and the limited amount of Member States that have implemented this option in their legislation.[57]

1.2.2.3. Location of the Depositary for TC-AIFs

The depositary location requirements for TC-AIFs have a wider scope than for EEA-AIF. The location of a depositary for TC-AIFs depends upon whether the AIFM is located within or outside the EEA.

For TC-AIF with an EEA-AIFM, the depositary must be established:[58]

– in the third country where the AIF is established;[59] or
– in the home Member State of the AIFM[60] managing the AIF.[61]

---

[52] Art. 21(3)(a) AIFMD.
[53] Art. 61(5) AIFMD.
[54] See Dutch Act Financial Markets Amendment Act 2014 (Second Amendment, 3 September 2013), 21.
[55] Art. 21(5)(a) AIFMD.
[56] Art. 61(5) AIFMD refers to the location restriction as laid down in Art. 21(5)(a) AIFMD that applies to both EEA-AIFMs and TC-AIFMs that are managing EEA-AIFs.
[57] Czech Republic: art. 657(2) Czech Act on investment Fund and Investment Companies; Finland: Chapter 23, § 3, Part IX Transitional Provisions Finnish AIFM Act; Netherlands: Artikel VII (7) Wet van 12 juni 2013 tot wijziging van de Wet op het financieel toezicht, het Burgerlijk Wetboek, de Wet op de economische delicten en enige fiscale wetten ter implementatie van richtlijn nr. 2011/61/EU van het Europees Parlement en de Raad van de Europese Unie van 8 juni 2011 inzake beheerders van alternatieve beleggingsinstellingen en tot wijziging van de Richtlijnen 2003/41/EG en 2009/65/EG en van de Verordeningen (EG) Nr. 1060/2009 en (EU) Nr. 1095/2010 (PbEU 2011, L 174) (Stb. 2013, 228) amended by: Artikel XVIIa Wet van 25 november 2013 tot wijziging van de Wet op het financieel toezicht en enige andere wetten (Wijzigingswet financiële markten 2014) (Stb. 2013, 487); UK: Art. 77(1) The Alternative Investment Fund Managers Regulations, 2013, S.I (2013) No.1773.
[58.] Art. 21(5) AIFMD.
[59.] Art. 21(5)(a) AIFMD.
[60.] According to Art. 4(1)(q) AIFMD, 'home Member State of the AIFM' means the Member State in which the AIFM has its Registered Office. The registered office is the basic criterion to determine the location of an AIFM. However, the 'real seat' and 'registered seat' are unlikely to differ when it comes to an AIFM. The letter-box entity approach requires portfolio management and risk management to be exercised at the location where the AIFM is registered and may not be delegated. So in practice, there might be less legal uncertainty in determining the location for the AIFM and the location depositary as compared to the AIF. See for a possible conflict of laws in this regard D.A. Zetzsche & T. Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* (D.A. Zetzsche ed, Kluwer 2015).
[61.] Art. 21(5)(b) AIFMD.

Besides the option of appointing a depositary that is located in the third country where the TC-AIF is established, an EEA-AIFM may also decide to appoint a depositary within its home Member State.

For TC-AIFs, a TC-AIFM has either the choice of appointing a depositary:

– in the third country where the AIF is established;[62] or
– in the Member State of reference[63] of the AIFM managing the AIF.[64]

The latter becomes available to TC-AIFMs after 2015 at the earliest, when TC-AIFMs will be able to obtain a marketing passport under the AIFMD, allowing them to market both EEA-AIFs and TC-AIFs to (professional) investors across the EEA.[65]

1.2.2.4. A Quasi-Depositary Passport Regime for TC-AIFs

The free choice for AIFMs to appoint either an EEA or non-EEA depositary for TC-AIFs is remarkable considering the fact that depositaries for EEA-AIFs always need to be established in the same Member State as where the fund is located. The AIFMD seems to be inconsistent with the UCITS rationale of linking the depositary to the fund to ensure that the depositary comes under the same supervisory regime as the fund. AIFMs managing EEA-AIFs must appoint a depositary within the same Member State. They are not allowed to appoint a depositary in a different EEA Member State which underlie the harmonized AIFMD regime for EEA depositaries, whereas AIFMs managing TC-AIFs have the choice to appoint either an EEA or non-EEA depositary.

The AIFMD only allows third-country depositaries to be appointed that are subject to 'effectively enforced' prudential regulation (including minimum capital requirements) and supervision equivalent to EEA law.[66] However, this extraterritorial effect of the AIFMD on depositaries in third countries leads to minimum harmonization, whereas EEA depositaries that underlie the AIFMD, MiFID I/II and CRD IV are harmonized to a much larger extent. The AIFMD depositary location regime functions as a quasi-depositary passport regime for AIFMs managing TC-AIFs that can exploit economies of scale and may enter into regulatory arbitrage, whereas AIFMs managing EEA-AIFs are not able to do so.

1.2.3. *Conclusion*

A depositary passport, i.e. the right of a depositary to act on a cross-border basis by the cross-border free provision of services under the AIFMD/UCITSD V has so far not been introduced.[67] Instead, depositaries are required to be 'established' in the home Member State of the UCITS/EEA-AIF. Established under the AIFMD means that either the registered office or a branch office is required to be located in the UCITS/AIF home Member State for which a depositary is appointed. The locational restriction under the AIFMD/UCITSD V has to be read in conjunction with the eligible entities under the AIFMD/UCITSD V. Originally, both the AIFMD and UCITSD V were planned to 'phase out' all eligible entities for (liquid) EEA-AIFs/UCITS other than EEA credit institutions and investment firms. The final UCITSD V,

---

62. Art. 21(5)(a) AIFMD.
63. See D.A. Zetzsche & T. Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* (D.A. Zetzsche ed, Kluwer 2015).
64. Art. 21(5)(c) AIFMD.
65. Art. 37 AIFMD.
66. For details: Chapter 4, section 5.
67 Under the AIFMD transitional relief, Competent Authorities of the home Member State of an AIFM could until 22 July 2017 allow credit institutions that are established in another Member State to be appointed as a depositary. See Art. 61(5) AIFMD.

however, allows discretion to individual Member States to decide that 'other legal entities' under national law that fulfil minimum requirements to be appointed as a UCITS depositary. A dynamic interpretation of UCITSD IV eligible entities under the AIFMD allows Member States to allow AIFMs to appoint these 'other legal entities' as an AIF depositary as well.

'Established' for depositaries under Art. 4(1)(j)(iii) AIFMD means 'having its registered office or branch in'. A restriction of eligible entities under the AIFMD/UCITSD V to credit institutions and investment firms would have 'transposed' the 'establishment definitions' under CRD IV and MiFID II to UCITSD V and the AIFMD. Leaving the discretion to Member States to allow 'other legal entities' to be appointed under their implementation laws results in uncertainty related to what 'established in' means. In addition, the absence of a European passport for depositaries under the AIFMD/UCITSD V allows the Competent Authorities of the individual Member States to determine under what conditions a branch office of a depositary is being established within their domicile. This varies from Member State to Member States. Some Member States, such as the Netherlands, see a 'representative office' as a branch, whereas other Member States apply stricter criteria.

Furthermore, the AIFMD takes an inconsistent approach as it deviates from the locational restriction applying to EEA-AIFS for TC-AIFs. In the same vein, the AIFMD transitional relief allows Competent Authorities of the home Member State of an AIFM could until 22 July 2017 allow credit institutions that are established in another Member State to be appointed as a depositary.[68] The absence of a European passport, thus, not only leads to diverging interpretation of what constitutes 'established in', but, in particular, the AIFMD is also inconsistent in the locational restrictions that apply to depositaries appointed for EEA- and TC AIFs. The absence of a European passport, thus, not only allows the Competent Authorities of the individual Member States to determine under what conditions a branch office of a depositary is being established within their domicile. Only the introduction of a European passport for UCITS depositaries based upon harmonized substantial and supervisory criteria under the AIFMD and UCITSD V would lead to clarification from an investor protection point of view.

1.3. The Depositary Mutual Recognition Approach under IORPD II

Article 33(3) IORPD II requires Member States not to restrict IORPs from appointing, depositaries <u>established in another Member State</u> and duly authorized in accordance with CRD IV or MiFID II, or accepted as a depositary for the purpose of UCITSD IV/V or AIFMD.[69] The idea of granting a European passport to financial intermediaries that subject to 'harmonized European prudential standards' does not apply to IORP depositaries.[70] The locational freedom also applies to 'other legal entities' complying with the UCITSD V minimum standards that are authorized as UCITS depositaries under the national laws of individual Member States.

1.3.1. *'Established in another Member State'*

IORPD II does not clarify what 'established in another Member State' means. The AIFMD provides guidance on this point. Article 21(5) AIFMD requires a depositary for EEA AIFs to be established in the home Member State of the EEA-AIF. Following, Article 4(1)(j)(iii) AIFMD established means that depositaries of EEA-AIFs should have their registered office

[68] See art. 61(5) AIFMD.
[69] Art. 33(3) IORPD II.
[70] See Chapter 5, section 3.2.2.

or branch in the same country as the EEA-AIF. Depositaries are, thus, required to have their registered office or a branch in (another) Member State. This also includes Non-EEA investment firms that are duly authorized for acting as a custodian under MiFID II and have established a branch within a Member State.[71] Similar as for EEA-AIF and UCITS depositaries, 'established in' may be interpreted in various ways by the Competent Authorities of individual Member States as the depositary/custodian eligible entities are not completely harmonized under European law. UCITSD V 'exports' this uncertainty, thus, not only to the AIFMD, but also to IORPD II. Apart from this, the 'mutual recognition' approach seems to have a wider scope under IORPD II than under IORPD I.

1.3.2. *Mutual Recognition under IORPD II – applying to Depositaries and or Custodians?*

Under Article 19(2) IORPD I, Member States were required not to:

> 'restrict institutions from appointing, for the custody of their assets (emphasis added by author), custodians established in another Member State and duly authorised in accordance with Directive 93/22/EEC or Directive 2000/12/EC, or accepted as a depositary for the purposes of Directive 85/611/EEC'.

Taken a grammatical approach, Member States could under IORPD I not prevent Member States to allow an IORP to appoint a depositary or custodian established in another Member State '*for the custody of their assets*'. A grammatical interpretation implied that Member States were forced to accept custodians under CRD I and ISD, or depositaries accepted under the UCITSD I-IV, but only for the safekeeping of IORP assets. IORPs that either appointed or were compulsory required by Member State IORPD I implementation laws to appoint a depositary for safekeeping and oversight duties could be, on the basis of this, be prohibited by Member State laws.

Such a grammatical interpretation would be in line with the UCITSD IV/V and the AIFMD that both require a depositary to be established, i.e. to have a registered office or a branch, in the same Member State as an UCITS/EEA-AIF. In practice, however, this grammatical approach of Article 19(2) IORPD I was not applied by the majority of the Member States. Only some Member States, such as Hungary[72], Poland[73], Slovakia[74] and Spain[75] under their Article 19 IORPD I implementation restricted the appointment of a IORP depositary/custodian to domestic credit institutions. Most Member States allowed both depositaries for the safe-keeping of assets (custodians) and depositaries appointed for safe-keeping of assets and oversight duties to be appointed that were established in other Member States. Liechtenstein[76] and Malta[77] even explicitly allow non-EEA institutions to be appointed as an IORP depositary provided that additional conditions were fulfilled.

Under IORPD II, depositaries established in another Member State may be appointed and the sentence 'for the custody of their assets' has been removed. Depositaries are under Article 35(1) and (2) IORPD II either a depositary for safe-keeping of assets or a depositary

---

[71] See Chapter 4, section 3.1.2.
[72] § 50(1) CXVII 2007 Law on occupational pensions and institutions.
[73] Art. 158 ACT of 28 August 1997 Law on the Organisation and Operation of Pension Funds.
[74] § 56 (1) Act on Supplementary Pension Savings.
[75] Art. 82(1) Real Decreto 304/2004, de 20 de Febrero, Por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.
[76] Art. 12 Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung (Pensionsfondsgesetz; PFG).
[77] B.6 Custody of Retirement Fund's Assets, B.6.1 General Conditions, Directives for Occupational Retirement Schemes, Retirement Funds and Related Parties under the Special Funds (Regulation) Act, 2002.

appointed for safe-keeping of assets and oversight duties in accordance with the IORPD II. 'For the custody of their assets' was replaced by 'for both safekeeping and safekeeping and oversight duties' under IORPD II. The current practice that Member States under IORPD I do not differentiate between the appointment of 'depositaries' and 'custodians' established in another Member States has, thus, been formalized by IORPD II.

The latter, however, leads to a de facto depositary passport[78], i.e. the right for depositaries to provide services on a cross-border basis and the right to establish a branch in another Member State, for IORPD II depositaries that is not in place for EEA-AIFs and UCITS. This was received in the consultation phase by mixed responses in the industry. Some commentators emphasized the more efficient provision of depositary services which is ultimately beneficial to the pension scheme members and beneficiaries.[79] Others pointed out that if depositaries would be allowed to perform an oversight function, the depositaries should be necessarily established in the same country where the IORP is located as this function could not satisfactory be performed on a cross-border basis.[80] The 'de facto European IORP depositary passport' creates a paradoxical tension between the AIFMD and UCITSD V, at the one, and IORPD II at the other hand. UCITSD IV/V depositaries, investment firms and credit institutions under IORPD II may act as a depositary on a cross-border basis, whereas this is prohibited for EEA-AIF and UCITS depositaries.[81] This paradoxical tension is even exacerbated by the fact that under IORPD I implementation various Member States, such as Liechtenstein and Luxembourg, had depositary regimes in place that are similar to the depositary function as was implemented in their UCITSD I-IV implementation laws.[82] In fact, their IORPD I depositary regimes provided less regulation than their UCITSD I_IV depositary regulation, but none of the Member States required the depositary to be 'established' in their Member States. Under the expectation that the IORPD II implementation laws will not diverge much compared to IORPD I on this point, AIFMD/UCITSD V depositaries that are subjected to a larger degree of EU harmonization are not granted a European passport, whereas IORPD I/II depositaries subject to minimum harmonization do benefit from a 'de facto' IORPD II depositary passport. This problem is being referred to in this dissertation as the 'European depositary passport paradox'.

1.3.3. *Cooperation between Supervisory Authorities*

The 'de facto depositary passport' under IORPD II is supported by cooperation that is required amongst relevant supervisory authorities. Article 33(4) IORPD II requires that Member States shall take the necessary steps to enable competent authorities under their national to prohibit the free disposal of assets located within their territory at the request of the competent authorities in the IORP home Member State.

---

[78] EIOPA, *Summary of Comments on Consultation Paper: Response to the Call for Advice on the review of the IORP Directive 2003/41/EC: second consultation - EIOPA-CP-11/006*, EIOPA-BoS-12/016, 15 February 2012, Comment 95 (State Street).
[79] EIOPA, *Summary of Comments on Consultation Paper: Response to the Call for Advice on the review of the IORP Directive 2003/41/EC: second consultation - EIOPA-CP-11/006*, EIOPA-BoS-12/016, 15 February 2012, Comment 95 (State Street).
[80] *Ibid*, Comment 58 (ADEPO).
[81] Art. 19(2) sub-para. 2 IORPD I.
[82] Liechtenstein: Art. 12 Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung (Pensionsfondsgesetz; PFG); Luxembourg : Art. 18 (1) and Art. 42 (1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.

EIOPA stated that the effectiveness of the powers and procedures followed by the competent authorities suffer from a lack of experience among Member States.[83] EIOPA, however, concluded that there was not enough evidence to conclude that additional provisions regarding powers and procedures were needed to facilitate the de facto European IORPD depositary passport and concluded that more details in implementing measures would need to be adopted when further analysis of this issue would show the need to do so.[84]

1.3.4. *Conclusion*

Article 35(3) IORPD II requires Member States not to restrict IORPs from appointing, depositaries established in another Member State and duly authorized in accordance with CRD IV or MiFID II, or accepted as a depositary for the purpose of UCITSD IV/V or AIFMD.[85]The 'de facto European IORP depositary passport' creates a paradoxical tension between the AIFMD and UCITSD V, at the one, and IORPD II at the other hand. UCITSD IV/V depositaries, investment firms and credit institutions under IORPD II may act as a depositary on a cross-border basis, whereas this is prohibited for EEA-AIF and UCITS depositaries.[86] This paradoxical tension is even exacerbated by the fact that under IORPD I implementation various Member States, such as Liechtenstein and Luxembourg, had depositary regimes in place that are similar to the depositary function as was implemented in their UCITSD I-IV implementation laws.[87] This problem is being referred to in this dissertation as the 'European depositary passport paradox'.

1.4. The Proposed Inconsistent Locational Depositary Restriction Approach under the PEPPR

Under the proposed PEPPR, the European Commission seems to continue its inconsistent approach towards a (de facto) depositary passport in European investment law. The proposed regime depends upon the PEPP provider[88].[89] The appointment of a depositary for credit institutions[90], insurance undertakings[91], UCITS ManCos[92] and AIFMs[93] depends upon sectoral legislation, whereas a lex specialis depositary regime based upon IORPD II is proposed where the PEPP provider is an IORP or an investment firm authorized as portfolio manager or investment advice.[94] This 'dual regime' under the proposed PEPPR leads to an inconsistent locational depositary restrictions approach.

The locational restrictions applying to depositaries under the 'sectoral-based approach' depends upon the sectoral legislation applying to these providers, whereas for the 'lex specialis regime' locational restrictions related to depositaries are not regulated at all.

[83] EIOPA-BOS-12/015, 469.
[84] *Ibid*, 469.
[85] Art. 33(3) IORPD II.
[86] Art. 19(2) sub-para. 2 IORPD I.
[87] Liechtenstein: Art. 12 Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung (Pensionsfondsgesetz; PFG); Luxembourg : Art. 18 (1) and Art. 42 (1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.
[88] Art. 2(14) PEPPR.
[89] See Art. 41 PEPPR.
[90] Art. 5(1)(a) PEPPR.
[91] Solvency II.
[92] Art. 22(1) UCITSD V.
[93] Art. 21(1) AIFMD.
[94] Art. 41(1) PEPPR.

Under the 'sectoral approach', insurance undertakings are not required to appoint a depositary at all.[95] Similarly, credit institutions are under CRD IV and MiFID II not required to appoint a depositary.[96] They may, however, act as a custodian or appoint a third-party custodian for their clients and benefit from the CRD IV/MiFID II passporting regime.[97] Finally, AIFMs and UCITS ManCos are bounded by the locational restrictions for the appointment of AIF/UCITS depositaries under the AIFMD and UCITSD V.

On the contrary, the 'lex specialis regime' does not regulate any locational restrictions related to depositaries. This is a remarkable approach for various reasons. First, the PEPPR intends to introduce a lex specialis depositary regime for not only investment firms, but also IORP providers for which an IORP depositary regime is available under IORPD II. Although IORP providers under Article 41 PEPPR are mandatorily required to appoint a depositary for both safekeeping and oversight duties[98], it would have been logical that Article 41 PEPPR would have, at least, introduced the 'IORPD II mutual recognition' approach under which only certain eligible entities complying with EEA legislation would be allowed to be appointed. Article 2(23 PEPPR defines a depositary as

> 'an institution (emphasis added by the author) charged with the safekeeping of assets and oversight of compliance with the fund rules and applicable law'.

This definition shows some similarities to the depositary definition under UCITSD I-IV. Article 41, thus, allows any 'institution' to be appointed as a depositary. Although in practice, credit institutions and investment firms will mostly be appointed, Article 41 PEPPR does not restrict PEPP providers from appointing any 'institution' that are regulated on either the EEA level, national level or even TC institutions. Not regulating 'locational restrictions' related to 'eligible entities' is a problem as it is inconsistent with the depositary regimes laid down in the AIFMD/UCITSD V and contrary to the principles on which European and TC passports are based.[99] Credit institutions and investment firms are EEA regulated entities and enjoy as 'custodians' an European (ancillary) passport under MiFID II and CRD IV.[100] Granting a 'de facto' European passport to these 'institutions' under Article 41 PEPPR is inconsistent with the locational restrictions approach applying to AIF/UCITS depositaries under the AIFMD and UCITSD V that are, like the 'PEPP lex specialis depositaries', also required to exercise the safekeeping of assets and perform oversight duties.[101] Not defining the institutions eligible as a depositary and corresponding locational restrictions, allows PEPP providers under Article 41 PEPPR to appoint institutions regulated on the national level and TC institutions. In the Netherlands, for example, premium pension institutions qualify as an 'IORP' and, therefore, would be allowed to appoint a '*pensioenbewaarder*' (safekeeping entity) under Article 41 PEPPR as a 'depositary'.[102] These 'institutions' are not suitable to act as cross-border depositaries as they are not subject to the fully harmonized conduct of business rules and the

---

[95] European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 22.
[96] See CRD IV, MiFID II.
[97] See Chapter 6, section 1.2.
[98] Under Art. 33(1) and (2) IORPD II, Member States are granted the option to decide unilaterally whether a depositary is required to be appointed at all or whether a depositary is required to be appointed for merely performing the safekeeping task or for the safekeeping and oversight duties.
[99] See for these joint principles of EEA and TC passports: Chapter 3, section 3 and 6.
[100] Annex I s. A MiFID I/II.
[101] See Chapter 13, section 4.3.2.
[102] See , for Dutch premium pension institutions, for instance: A. Boutens, *Rol pensioenbewaarder en bescherming van deelnemers in een PPI*, 6 TPV 23 (2012); R.K. Tj. J. Smits, *Vermogensscheiding bij premiepensioeninstellingen*, 1 V&O 1 (2012).

prudential regime under MiFID II, CRD IV and CRR.[103] Allowing institutions regulated on the national level to be appointed as depositaries on a cross-border basis under the PEPPR is contrary to the concept of the European passport that only grants such a right to financial intermediaries for which the conduct of business rules and prudential regime is sufficiently harmonized[104] and for which a European system of financial supervision (the ESFS and 'home country control')[105] is in place.[106] Moreover, Article 41 PEPPR allows TC institutions to be appointed on a cross-border basis without requiring these institutions to be assessed on a (centralized) equivalency assessment, as is the case for TC depositaries appointed for AIFs[107], in which the conduct of business rules and prudential regime to which these TC institutions are subjected to are being verified. The substantial Article 41 PEPPR 'lex specialis' depositary regime does not provide sufficient investor protection as the IORPD II depositary regime is in itself only moderately harmonized. Compliance with Article 41 PEPPR alone, thus, does not provide sufficient safeguards for TC institutions to be appointed as it does not substitute for a centralized equivalency assessment on the European level as is in place for TC AIF depositaries.

Finally, all PEPPs under the PEPPR are required to be provided under an agreed 'PEPP scheme'.[108] A 'PEPP scheme' under the scope of the PEPPR is, essentially, a 'collective investment undertaking'[109] that supports the mandatory investment options a PEPP needs to contain.[110] These options are required as a result of a policy consideration on the European level that PEPP savers[111] should not be allowed to 'pick their stocks individually' as is the case under various national PPPs regimes.[112] The 'collective investment undertakings' eligible under the PEPPR are AIFs, UCITS, IORPs and national 'voluntary pension funds'[113] that qualify as a PEPP under the PEPPR. It would, thus, have been more logical under the PEPPR to base its depositary regime upon the nature of the 'PEPP scheme'. The 'sectoral-regime' could have been applied to PEPPs provided that have AIFs, UCITS and IORPs as agreed 'PEPP schemes', whereas a 'lex specialis' regime would have been designed, based upon the UCITSD V regime and locational restrictions therein, for depositaries appointed for 'voluntary pension funds' that often apply the old UCITSD I-IV depositary rules.[114] This would have allowed for more consistency between the PEPPR depositary regime and the locational restrictions applying to depositary regimes in other European investment laws.

1.5. Conclusion

In practice, the same investment firms and credit institutions are acting as a custodian for discretionary mandates and 'execution only'[115] services under MiFID II/CRD IV, a depositary under the AIFMD/UCITSD V and a depositary/custodian under IORPD II. The

---

[103] *Ibid.*
[104] See Chapter 3, section 3.4.1.
[105] See Chapter 3, section 3.4.2
[106] See Chapter 3, section 3.
[107] See Chapter 4, section 5.
[108] Art. 2(2) PEPPR; See Chapter 13, section 4.3.1.2.
[109] See for 'collective investment undertaking': Chapter 8, section 2.1.1. and 2.2.1.
[110] See for these options: Art. 34-39 PEPPR.
[111] See for a definition of 'PEPP savers': Art. 2(28) PEPPR.
[112] See for definition of PPPs: Art. 2(1) PEPPR.
[113] See European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products,* 16 May 2013, EIOPA/13/241, 10.
[114] See for these UCITSD I-IV depositary rules: European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004.
[115] See Annex I, s. A No. 1 and No. 2 MiFID I/II; Art. 25(4) MiFID II.

European investment laws, i.e. MiFID II, CRD IV, the AIFMD, UCITSD V and IORPD II are inconsistent in granting a depositary/custodian passport to these depositaries/custodians. They are both inconsistent throughout the directives and on a cross-sectoral basis. On a cross-sectoral basis, MiFID II and CRD IV have an 'ancillary' European passport for 'custodians' in place.[116] To the contrary, the AIFMD and UCITS require the depositary of UCITS and EEA-AIFs to be established in the UCITS/EEA-AIF home Member State,[117] whereas the same entities acting as a depositary/custodian under IORPD II do have a 'de facto' European passport.[118] Not only are the European investment laws inconsistent throughout the directives, also the directives itself are inconsistent. The AIFMD, for example, differentiates between a strict locational requirement for EEA-AIFs, whereas there is a 'quasi-depositary passport regime' in place for depositaries appointed for TC-AIFs.[119] The inconsistency in granting a European passport for depositaries under the European investment laws lead to a 'European depositary passport paradox'.

2. The European Depositary Passport Debate

For a better understanding of all legal issues related to the European depositary passport, it is of importance to examine the debate upon the European depositary passport in a historical context. For this purpose, the concerns raised upon introducing such a passport during the adoption of the various UCITS directives, the AIFMD, the ISD/MiFID I/II and IORPD I/II will be studied to get a better overview of the present situation.

2.1. UCITSD I-VI

Throughout UCITSD I-VI the UCITS depositary passport debate has developed itself.

2.1.1. *UCITSD I*

UCITSD I required the depositary to have its registered office in the same Member State as that of the management company or be established in that Member State if its registered office is in another Member State.[120] UCITSD I, thus, required to have the depositary's registered office within the EEA. Branches of Non-EEA banks could not be appointed as a depositary.[121] Subsidiaries of Non-EEA entities were allowed, as long as the entity was established in the same Member State as the UCITS for which it was being appointed and the UCITS ManCo Member State.[122] The latter was only possible if the respective entity fulfilled the national Member State criteria of being an eligible depositary under UCITSD I. At the time of the adoption, the restriction was justified based in the light of two legal considerations:[123] the (oversight) function that were performed by the depositary required a close relationship with the UCITS management company/investment company and the same Competent Authority at

---

[116] Annex I Nr. 12 CRD IV; Annex I s. A MiFID I/II.
[117] Art. 21(5) AIFMD and Art. 23(1) UCITSD V.
[118] Article 33(3) IORPD II.
[119] See also C.P. Buttigieg, *The Case for A European Depositary Passport*, http://studylib.net/doc/13128849/the--case--for--a--european-...-passport (accessed 7 April 2017); S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2015).
[120] See Art. 8 and 15 UCITSD I.
[121] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Vandamme Report'), 27, http://goo.gl/K0iUzv (accessed 13 October 2016).
[122] *Ibid.*
[123] European Commission, *Completing the Internal Market: White Paper from the European Commission to the European Council*, COM(85)310 Final, 14 June 1985, http://europa.eu/documents/comm/white_papers/pdf/com1985_0310_f_en.pdf (accessed 7 April 2017).

that time was responsible for the authorization for the authorization of the UCITS concerned, if applicable, its management company and the choice of the depositary.[124] In order to give legal effect to these arrangements, it was considered necessary for the depositary to be established in the same Member State as the UCITS and the UCITS Management Company, the registered office of the entities being taken as the decisive criterion.

The 'establishment criterion' was introduced under UCITSD I and has to be seen in the light of the First Banking Directive. Upon the adoption of UCITSD I, only UCITS as a product were harmonized. Both UCITS ManCos and depositaries were required to fulfil principle-based requirements.[125] It was, thus, logical that the UCITS Manco, depositary and UCITS were required to be established the same Member State.[126] The Second Banking Directive and ISD that introduced a European passport on the basis of the mutual recognition principle backed by harmonization of substantial and supervisory standards was not in place yet. In 1977 the First Banking Directive, the outcome of almost twelve years of negotiations, was being adopted.[127] The main objective was to liberate the banking market by allowing banks to set up branches without obstacles throughout the EEA. However, it was recognized that this would be a process that would be completed through time.[128] The First Banking Directive was the first initiative that allowed a banks to establish a branch in another Member State. De facto, however, this 'establishment' still posed important obstacles to this 'freedom of establishment'. European banks that had their registered office in another Member State and wanted to establish a branch in a 'host Member State' still were required to be authorized in their host Member State.[129] In addition, credit institutions remained to be subjected to the supervisor of the host Member State and were restricted in the range of permitted activities.[130] Finally, branches were required to be provided with so-called 'endownment capital' as if they were newly established domestic credit institutions.[131] Establishment under the First Banking Directive, thus, either constituted the establishment of a new legal entity as credit institution within a Member State (registered office) or a branch of another EEA Member State that was a de facto full authorization.

The entities allowed to be eligible as a depositary under UCITSD I were also not harmonized yet. This was due to the fact that only banks and insurance undertakings were to a limited extent harmonized under European law and all other developments still needed to take off. Depositaries were, however, for the largest part credit institutions.[132]

The 'establishment criterion' under the 1985 UCITSD I, thus, meant that financial intermediaries (mainly credit institutions) that were required to be located in the UCITS home Member State either had their registered office in that Member State or had a branch that was ,de facto, fully authorized in that Member State. The obstacles provided little incentives for

---

[124] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Vandamme Report'), 28, http://goo.gl/K0iUzv (accessed 13 October 2016).
[125] Art. 4(2) UCITSD I.
[126] *Ibid.*
[127] B. De Meester, *Liberalization of Trade in Banking Services – An International and European Perspective* 270 (Cambridge University Press 2014).
[128] B. De Meester, *Liberalization of Trade in Banking Services – An International and European Perspective* 270 (Cambridge University Press 2014).
[129] See Art. 3 First Banking Directive; Cf. A. Bande, *Banking Integration in the EU:a process marked by a battle between systems*, 9, https://www.utwente.nl/en/bms/pa/staff/donnelly/Thesis%20-%20A%20%20Bande%2020%2008%2012.pdf (accessed 7 April 2017).
[130] See Art. 3 First Banking Directive; Cf. E.B. Kapstein, *Governing the Global Economy –International Finance and the State* 136 (Havard University Press 1994).
[131] Art. 3 First Banking Directive.
[132] FEFSI, *Position Paper on Depositaries*, 4-5 (6 November 2002).

the establishment of branches of foreign Member States. The First Banking Directive, thus, was the cornerstone for the development of the European passport concept that was introduced under the Second Banking Directive and ISD. The 'establishment criterion' under UCITSD I based upon the First Banking Directive, however, was never amended after the introduction of the Second Banking Directive and the ISD. The 'established in' criterion, thus, throughout the years has gotten a different meaning compared to the time this restriction was being introduced under UCITSD I.

2.1.2. *UCITSD II*

Following the introduction of UCITS, the adaption of UCITS in Europe was slow. This was mostly due to the divergent legal implementations of the various Member States.[133] The original UCITSD I investment and marketing restrictions prevented the European fund industry to fully exploit the benefits of an single market.[134] Along the dissatisfaction with the UCITSD I, the European Commission presented a UCITSD II proposal in 1993[135] that was revised in 1994.[136]

The initial and amended UCITSD II draft considered that Member States should not restrict the freedom of UCITS to choose a depositary established in another Member State entailing both the freedom of services, as well as, the freedom of establishment. Depositaries must have an establishment in the same Member State as that of the UCITS, unless a credit institution or investment firm would be appointed that obtained an authorization to provide the safekeeping and administration services under the Second Banking Directive or ISD. It was generally felt that the introduction of the Second Banking Directive and ISD that introduced a European passport laid down the necessary condition to allow UCITS to appoint a credit institution or investment firm authorized for providing safekeeping and administration services as a depositary in another Member State.[137] The harmonized authorization, business organizational requirements together with the harmonization of financial supervision created an adequate level of protection that seemed to take away the rationale of not allowing depositaries to operate on the basis of a European passport.[138]

The amended UCITSD II draft (1994) imposed additional requirements on top of those

---

[133] N. Moloney, *EC Securities Regulation* 205 (3rd edn., Oxford University Press 2014).
[134] D. Pope & L. Garzaniti, *Single Market-Making: EC regulation of securities markets*, 14(3) Company Lawyer 44 (1993); D. Ciani, *European Investment Funds: The UCITS Directive of 1985 and the Objectives of the Proposal for a UCITS II Directive*, 4(2) Journal of Financial Regulation and Compliance 150-156 (1996).
[135] European Commission, *Proposal for a Directive amending Directive 85/611/EEC amending amending Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (ucits)*, com(93) final – syn 453, 9 February 1993, http://aei.pitt.edu/9161/1/9161.pdf (accessed 7 April 2017).
[136] European Commission, *Amended proposal for a Directive amending Directive 85/611/EEC on the Coordination of Laws, Regulations and Administrative Provisions Relating to UCITS*, Com(94)329, http://goo.gl/cMcOCa (accessed 7 April 2017).
[137] European Commission, *Proposal for a Directive amending Directive 85/611/EEC amending amending Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (ucits)*, com(93) final – syn 453, 9 February 1993, 11, http://aei.pitt.edu/9161/1/9161.pdf (accessed 7 April 2017); See also Recital 9 amended UCITSD II draft (1994).
[138] C.P. Buttigieg, The Alternative Investment Fund Managers Directive in Malta: Past, Present … What Next?, 7, https://ssrn.com/abstract=2602750 (accessed 7 April 2017).

required by the original UCITSD II draft (1993) to make this politically acceptable. To exercise this freedom, credit institutions or investment were proposed to:[139]

- comply with the UCITSD I depositary provisions, including:
  - the depositary's duty of loyalty and conflicts of interest rules;
  - the conditions for the replacement of the UCITS ManCo and the depositary as laid down in the fund rules; and
  - liability.
- declare that it has full knowledge of the legislation applicable to it when providing cross-border depositary services ;
- provide the competent authorities responsible for supervision of the unit trust with all information they may require ;
- conform to the supervisory rules provided for within cooperation agreements concluded between authorities of the relevant Member States.

Competent Authorities of the UCITS Home State were entrusted to request the Competent Authority responsible for supervising the depositary to cooperate to assess its organization.[140] The abovementioned cooperation agreements obliged the Competent Authority supervising the depositary to appropriate measures to resolve irregular situations that the UCITS home Member State CA was unable to resolve.

Apart from this, the initial and amended UCITSD II draft considered it desirable to make institutions and firms of third countries eligible as a UCITS depositary.[141] Member States were, under the UCITSD II draft proposals, permitted to allow branches of institutions or firms having their head office outside the EEA to be appointed as UCITS depositary provided that this resulted not in more favourable treatment for TC depositaries than EEA depositaries.[142]

Notwithstanding the benefits of introducing a depositary passport, UCITSD II was never adopted. The introduction of a European depositary passport was one of the main issues and lead to major disagreements in the European parliament.[143] In this regard, it is useful the major issues that Perreau De Pinninck raised in his report on the UCITSD II proposal in which he recommended that a depositary should continue to be established in the same Member State as the UCITS for which the depositary is appointed.[144] De Pinninck raised two main arguments.

First, De Pinninck was of the opinion that the safekeeping of assets and administrative services carried out by credit institutions and investment firms under the Second Banking Directive and ISD was not comparable to the role of the depositary under UCITSD I.[145] In particular, he remarked that the UCITS depositary does not restrict itself to the safekeeping of assets (collection of dividends or interest, presenting securities for redemption, acting in cases of capital increases or new issues, etc.) as investment firms and credit institutions under the Second banking Directive and ISD do.[146] Instead, depositaries also add high added value in

---

[139] European Commission, *Amended proposal for a Directive amending Directive 85/611/EEC on the Coordination of Laws, Regulations and Administrative Provisions Relating to UCITS*, Com(94)329, http://goo.gl/cMcOCa (accessed 7 April 2017).
[140] *Ibid.*
[141] Recital 10, Art. 8(5) and Art. 15(5) amended UCITSD II draft (1994).
[142] *Ibid.*
[143] Clifford Chance, *Single Market Update Services*, 9 Journal of Internal Banking and Financial Law 457 (1996).
[144] European Parliament, *Report of the Committee on Legal Affairs and Citizen's Rights on the 1993 UCITS Proposal*, A5-0268/1993, 1 October 1993, http://goo.gl/rRSdJO (accessed 7 April 2017).
[145] *Ibid.*
[146] *Ibid.*

supervising the UCITS ManCo, such as compliance with the UCITS investment policies and calculating the cash value of the fund. The controlling duties of UCITS depositaries in his opinion go beyond the mere safekeeping and administration of securities under the ISD and Second Banking Directive.

Second, De Pinnick felt that allowing a depositary passport would lead to less coordination/cooperation between the UCITS ManCo and depositary and create legal complexities. A lack of harmonization of requirements that eligible entities must satisfy, the requirements related to the safekeeping and controlling duties to be performed and the liability of depositaries towards UCITS and their investors was not in place. The differences in Member State implementations did not provide sufficient guarantees in terms of investor protection that would facilitate a depositary passport. The UCITSD II proposal was not based upon enough harmonisation of substantive depositary requirements to allow a European passport for depositaries to function properly.[147] The UCITSD II proposals proved to be controversial and were ultimately withdrawn.[148]

2.1.3. *UCITSD III/IV*

The depositary passport was one of the reasons of the UCITSD II failure and was not part of the UCITSD III and IV proposal. The European Economic and Social Committee, however, still stressed the point that the introduction of a depositary passport would be essential for the further rationalization of the internal market for UCITS.[149] Various reports and studies reflected that the absence of a depositary passport became an anomaly and that significant economies of scale could be obtained by introducing one.[150]

2.1.3.1. Commission Communication 2004

The Council along proposals for the 2001 UCITS Product Directive and the 2001 UCITS Management Directive requested the Commission to report on UCITS depositary regulation in Europe.[151] The Commission Communication along various research reports and consultations during the adoption of UCITSD III and IV indicated the risk for investor protection that an depositary passport could entail.[152] The national UCITSD I-III depositary

---

[147] C.P. Buttigieg, The Alternative Investment Fund Managers Directive in Malta: Past, Present … What Next?, 9, https://ssrn.com/abstract=2602750 (accessed 7 April 2017).

[148] N. Moloney, *EC Securities Regulation* 206 (3rd edn., Oxford University Press 2014).

[149] European Parliament, *Report of the Committee on Legal Affairs and Citizen's Rights on the 1993 UCITS Proposal*, A5-0268/1993, 1 October 1993, http://goo.gl/rRSdJO (accessed 7 April 2017).

[150] European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016); European Commission, *Report of the Expert Group on Investment Fund Market Efficiency*, July 2006, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/efficiency_en.pdf (accessed 7 April 2017).

[151] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004.

[152] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004; FEFSI, *Position Paper on Depositaries*, 4-5 (6 November 2002); European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016); European Commission, *Report of the Expert Group on Investment Fund Market Efficiency*, July 2006, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/efficiency_en.pdf (accessed 7 April 2017); European Commission, *White Paper of 15 November 2006 (COM (2006) 686 final) on enhancing the*

implementation laws showed large differences. The Commission Communication was based on an internet consultation in the autumn of 2002 concerning the different national rules impeding the development of the internal market in the case of UCITS depositaries.[153] The survey identified major disparities between national rules that explained the national depositary markets.[154] Four main areas of action were formulated: the prevention of conflicts of interest, clarification of the depositary's liability, convergence of national prudential rules and moves to enhance investor transparency and information.[155]

Apart from the Commission Communication in 2004 various other initiatives and studies, including the Green Paper in 2005, a report of the Expert Group on investment market efficiency and a subsequent White Paper addressing the single market framework for investment funds on the UCITS depositary, have been conducted during 2004 and 2008.

2.1.3.2. Green Paper 2005

The Green Paper issued by the European Commission in 2005 launched a discussion whether UCITS, UCITS ManCos and depositaries could benefit from further rationalization.[156] At that time, both the UCITS ManCo and depositary were required to be located in the UCITS home Member State. Upon the adoption of UCITSD I, integrated supervision was considered to be essential to ensure effective performance of UCITS ManCos and depositary services.[157] Stakeholders indicated the desire for greater freedom in the choice of the depositary. However, they agreed that the harmonization of the status mission and responsibilities of UCITS ManCos and depositaries would be a pre-requisite for granting a European passport to both UCITS ManCos and depositaries.[158] The European Commission, in addition, considered it to be of the essence that the investor protection implications of splitting the responsibility of financial supervision of UCITS, the depositary and UCITS ManCo amongst the Competent Authorities of different Member States would have to be studied in detail.[159]

---

single market framework for investment funds, http://ec.europa.eu/internal_market/securities/docs/ucits/whitepaper/whitepaper_en.pdf (accessed 7 April 2017); See also European Commission, *Working Document of the Commission Services (DG Markt), Consultation Paper on the UCITS Depositary Function*, July 2009, http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/consultation_paper_en.pdf (accessed 7 April 2017); European Commission, *Consultation Paper on the UCITS Depositary Function and on the UCITS Managers' Remuneration*, 14 December 2010, MARKT/G4 D (2010) 950800, 16, 17, http://ec.europa.eu/finance/consultations/2010/ucits/docs/consultation_paper_en.pdf (accessed 7 April 2017).

[153] Plan to harmonize national rules on UCITS depositaries; see http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=LEGISSUM:l24036d&from=EN (accessed 7 April 2017); European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004; FEFSI, *Position Paper on Depositaries*, 4-5 (6 November 2002).

[154] *Ibid.*

[155] *Ibid.*

[156] Cf. European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186),* 52; European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016).

[157] European Commission, *White Paper of 15 November 2006 (COM (2006) 686 final) on enhancing the single market framework for investment funds*, http://ec.europa.eu/internal_market/securities/docs/ucits/whitepaper/whitepaper_en.pdf (accessed 7 April 2017).

[158] European Commission, *Exposure Draft - Initial orientations for discussion on possible adjustments to the UCITS Directive: Management company passport*, 23.

[159] *Ibid.*

Upon introducing a UCITS ManCo passport, the European Commission later considered that the depositary must not be located in the same Member State as the registered office of the UCITS ManCo, but located in the UCITS home Member State. The European considered that this was necessary from an investor protection point of view as the investors subscribe to a UCITS located in a certain Member State ' should be subject to the investor protection rules of such Member State, which includes supervision rules, depositary regime and investor compensation rules'.[160]

2.1.3.3. Expert Group on Investment Market Efficiency

The Expert Group on investment market efficiency concluded in its report in July 2006 that the requirements of UCITS having a local depositary and UCITS ManCo artificially imposes a geographic organization of the UCITS value chain und leads to an unnecessary duplication of costs across fund domiciles.[161] The Expert Group, however, believed that pre-conditions must be met prior to establishing a depositary passport.[162]

The preconditions for granting more freedoms for the depositary would include a clarification on the depositary's role and responsibilities.[163] In particular, further work was needed to determine which elements of the depositary would need to be harmonized and under which conditions this could be best achieved.[164] To that extent the Group recommended a two-stage approach. In the short-term the Group recommended that branches of EEA establishes banks should be allowed to act as depositary for locally domiciled funds and that Member States should allow the depositary to delegate custodial functions to licensed custodians located elsewhere in the EEA. In the long-term, the Group Recommended that the European Commission should undertake a harmonization of the capital requirements for depositaries and investigate the legal barriers that should be removed.[165]

2.1.3.4. Impact Assessment – White Paper on 'Enhancing the Single Market Framework for Investment Funds'

---

[160] European Commission, *Appendices to the report on Investment Fund Market Efficiency*, July 2006, 50, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/annex_efficiency_en.pdf (accessed 7 April 2017); European Commission, *Commission Staff Working Document of 16 July 2008 (SEC(2008) 2263) accompanying the Proposal for a Directive of the European Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS): Impact Assessment of the Legislative Proposal amending the UCITS Directive*, (COM(2008) 458 final) {SEC(2008) 2264}, http://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2008/sec_2008_2263_en.pdf (accessed 7 April 2017); Cf the arguments of CESR related to a 'local point of contact' related to common contractual funds: Ref: CESR/08-867; The Committee of European Securities Regulators, CESR's advice to the European Commission on the UCITS Management Company Passport, October 2008, CESR/08-867, 9-11.
European Commission, *Exposure Draft - Initial orientations for discussion on possible adjustments to the UCITS Directive: Management company passport*, 23.

[161] European Commission, *Report of the Expert Group on Investment Fund Market Efficiency*, July 2006, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/efficiency_en.pdf (accessed 7 April 2017).

[162] Cf. European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186),* 52;

[163] European Commission, *Report of the Expert Group on Investment Fund Market Efficiency*, July 2006, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/efficiency_en.pdf (accessed 7 April 2017).

[164] *Ibid.*

[165] *Ibid.*

In a subsequent White Paper addressing the single market framework for investment funds, again the depositary passport was being addressed. For this purpose, three different options were being considered.[166] The first option related to a 'full depositary passport'. The second option on merely introducing a passport for the 'custodial function', whereas the controlling function would still be required to be performed in the UCITS home Member State and the third option considered a non-legislative harmonization through 'Level 3 guidelines' for depositaries to organize themselves on a pan-European basis.[167] The White Paper, however, concluded that the Green Paper failed to demonstrate the need for requiring action on the European level and that, therefore, no legislative measures were more efficient.[168]

The studies by interest groups and the European Commission itself that were made in preparation of UCITSD III/IV resulted in the European Commission having the objective to remove discrepancy in national rules governing depositaries in UCITSD V/VI and the AIFMD.[169]

2.1.4. *UCITSD V/VI*

After the Madoff case brought uncertainties related to the depositary function within the UCITSD framework, the European Commission has undertaken an effort to map the national divergences of the UCITSD depositary regime to develop a new UCITSD V depositary regime.[170] This mapping exercise revealed main differences in the eligible entities, the safekeeping and controlling task, delegation and liability regimes of depositaries throughout the EEA.[171] In the need to clarify and harmonize the depositary functions, respondents to the 2009 UCITSD V consultation highlighted the need to clarify the UCTIS depositary safekeeping and supervisory functions.[172] Three reasons for this were being identified:[173] first, the UCITS depositary regime had remained mostly unchanged since the introduction of UCITSD I. Second, differences and inconsistencies in the application of depositary rules highlighted in the Madoff fraud legal uncertainties in the industry. Finally, there was a need for a consistent approach between the UCITS depositary rules and other EU initiatives, such

---

[166] European Commission, *White Paper of 15 November 2006 (COM (2006) 686 final) on enhancing the single market framework for investment funds*, http://ec.europa.eu/internal_market/securities/docs/ucits/whitepaper/whitepaper_en.pdf (accessed 3 July 2015).
[167] *Ibid.*
[168] *Ibid.*
[169] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004.
[170] Committee of European Securities Regulators, *Mapping of duties and liabilities of UCITS depositaries (2010)*, CESR/09-175.
[171] *Ibid.*
[172] Cf. European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186),* 52;; European Commission, *Working Document of the Commission Services (DG Markt), Consultation Paper on the UCITS Depositary Function*, July 2009, http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/consultation_paper_en.pdf (accessed 7 April 2017).
[173] European Commission, *Feedback on public consultation on UCITS V*, http://ec.europa.eu/finance/consultations/2010/ucits/docs/summary_of_responses_en.pdf; European Commission, *Feedback Statement - Summary of Responses to UCITS Depositary's Consultation Paper*, 9, http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/feedback_statement_en.pdf (accessed 22 February 2017).

as MiFID I and CRD.[174]

Respondents in both the 2009 and 2010 consultation viewed that the full harmonization of the status, role and liability regime of UCITS depositaries should be a pre-requisite for a UCITS depositary passport.[175] In particular in the 2010 consultation, the European Commission envisaged that the depositary passport issues would need to be reviewed after a new UCITS depositary framework had come into force.[176]

It is envisaged that a provision is introduced into the UCITS Directive creating a commitment to assess and re-examine the need to address depositary passport issues, to be undertaken a few years after the new UCITS depositary framework has come into force.

After implementing UCITSD IV, the European Commission launched a consultation related to UCITSD VI.[177] Again, the European Commission sought to put the European depositary passport on the agenda. The main point of the European Commission was that the AIFMD and UCITSD V harmonized the the rules governing entities eligible to act as depositaries, the definition of safekeeping duties and oversight functions, the depositary's liability and the conditions for delegation of the custody function to such an extent that the introduction of a depositary passport could be considered.[178] Respondents, however, mainly highlighted during the consultation that the AIFMD and UCITSD V harmonized regimes would first need to be implemented in practice in order to resolve any issues that would need to be addressed prior to the introduction of such a passport.[179]

2.2. The AIFMD

During the AIFMD negotiation process on the Level 1 text, the introduction of a depositary passport was one of the main issues. Small Member States, such as Malta, were clearly in favour of the introduction of such a passport as it was generally felt that the restriction on the free movement of depositaries would negatively affect their fund domiciles.[180] As a result, Article 17(3) draft AIFMD intended to introduce a European passport for depositaries that are credit institutions authorized in the EEA. This would have allowed depositaries to both establish branches and provide depositary services on a cross-border basis. During discussions in the Council, a number of (big) Member States, however, requested that the text should be amended and require that depositaries would have to be established in the EEA-AIF home

---

[174] *Ibid.*

[175] European Commission, *Working Document of the Commission Services (DG Markt), Consultation Paper on the UCITS Depositary Function*, July 2009, http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/consultation_paper_en.pdf (accessed 7 April 2017); European Commission, *Consultation Paper on the UCITS Depositary Function and on the UCITS Managers' Remuneration*, 14 December 2010, MARKT/G4 D (2010) 950800, 16, 17, http://ec.europa.eu/finance/consultations/2010/ucits/docs/consultation_paper_en.pdf (accessed 7 April 2017).

[176] European Commission, *Consultation Paper on the UCITS Depositary Function and on the UCITS Managers' Remuneration*, 14 December 2010, MARKT/G4 D (2010) 950800, 16, 17, http://ec.europa.eu/finance/consultations/2010/ucits/docs/consultation_paper_en.pdf (accessed 7 April 2017).

[177] European Commission, *Consultation Document - Undertakings for Collective Investment in Transferable Securities (UCITS)Product Rules, Liquidity Management, Depositary, Money Market Funds, Long-term Investments*, July 2012, http://ec.europa.eu/finance/consultations/2012/ucits/docs/ucits_consultation_en.pdf (accessed 13 October 2016).

[178] *Ibid.*

[179] See Reponses to Consultation on UCITSD VI: http://ec.europa.eu/internal_market/consultations/2012 /ucits/registered-organisations/state-street-corporation_en.pdf (accessed 7 April 2017); C.P. Buttigieg, *The Case for A European Depositary Passport*, http://studylib.net/doc/13128849/the--case--for--a--european-...-passport (accessed 7 April 2017).

[180] C.P. Buttigieg, The Alternative Investment Fund Managers Directive in Malta: Past, Present … What Next?, 5, https://ssrn.com/abstract=2602750 (accessed 7 April 2017).

Member State.[181] It was generally felt that the prevention of the depositary passport was the preference of these Member States to retain control over their depositary business that service their domestic AIFs and distrust towards other Member States in terms of supervision over these depositaries.[182]

A compromised solution was agreed upon in the final AIFMD draft by introducing a transitional provision for EEA credit institutions appointed as a depositary during a period of four years whereby Member States were left the discretion to allow domestic AIFs to appoint a depositary in other Member States.[183] In addition, Recital 36 AIFMD invited the European Commission to introduce a horizontal legislative proposal that clarifies the responsibilities and liabilities of depositaries and the introduction of a depositary passport. The latter allowed small Member States to develop their domestic depositary industry, whereas the European Commission was given extra time to review legislative conditions for the introduction of a European depositary passport.

2.3. ISD-MiFID I/II/Second Banking Directive- CRD IV

The ancillary service nature of 'safekeeping and administration of securities' originally introduced under the Second Banking Directive has not evolved and is still the same under CRD IV.[184] To the contrary, the 'ancillary service nature' under ISD has been regulatory discussed over time. Prior to adopting MiFID I, it has been discussed whether 'custodianship' should be upgraded to a full-fledged investment service or not.[185] The European Commission considered that 'custodianship' should remain to be a 'non-core service'. The European Commission considered that the functions and related risks differ from the core provisions of investment firms.[186] Internalised settlement arrangements held within the organization, however, was considered to be included in the 'custodianship' definition.[187]

The European Commission further reasoned that an alternative could be to strictly limit custodianship to safekeeping assets/funds and account administration and to exclude settlement from the scope of an European 'custodian passport'.[188] The European Commission did not prefer this option as ICSDs and CSD provide settlement services for international clients.[189] The introduction of the ECD, allowing for cross-border settlement, however made this need obsolete.

In the light of the adoption of the CSDR regulating the latter, the original MiFID II draft proposed to upgrade the safekeeping and administration of financial instruments for the account of clients to a full-fledged investment service.[190] Following this proposal, any firm providing the service of safekeeping and administration of financial instruments for the account of clients would have be on a stand-alone basis subject to a separate authorization procedure.[191] This would have implied that under MiFID II, compared to MiFID I, not every

---

[181] *Ibid.*
[182] C.P. Buttigieg, The Alternative Investment Fund Managers Directive in Malta: Past, Present … What Next?, 15, https://ssrn.com/abstract=2602750 (accessed 7 April 2017).
[183] Art. 61(5) AIFMD.
[184] Annex I Nr. 12 CRD IV; Annex I s. A MiFID I/II.
[185] European Commission, *Preliminary orientations for revision of the Investment Services Directive (ISD), IP/01/1055*, July 2011, Annex 1: Definition and Scope of Investment Services Directive, 6.
[186] *Ibid.*
[187] *Ibid.*
[188] European Commission, *Preliminary orientations for revision of the Investment Services Directive (ISD)*, IP/01/1055, July 2011, Annex 1: Definition and Scope of Investment Services Directive, 7.
[189] *Ibid.*
[190]. See Annex 1 s. A MiFID II proposal.
[191]. *Ibid.*

investment firm,[192] but merely those entities with an authorization for safekeeping would have been eligible as a custodian. CSDs were to be excluded from the scope of MiFID II.

This proposal was, however, not adopted in the final version of MiFID II.[193] Under MiFID II the safekeeping and administration of financial instruments for the account of clients, thus, remains to be an ancillary service. CSDs also in the final MiFID II version were excluded from the scope of MiFID II. Member States remained, however, free to specify the types of entities that can be authorized for purely providing safekeeping/custodian services within their domiciles.[194] The non-harmonization in this area will, thus, also in the future remain to raise a number of questions as to whether the European legal framework for custodians needs to be further harmonized and strengthened to ensure a level playing field in terms of investor protection measures across all Member States.[195]

2.4. IORPD I/II

Upon adopting IORPD I, it was considered that 'restrictions regarding the free choice of approved (…) custodians limit competition in the internal market and should therefore be eliminated'.[196] Article 19(2) IORPD I required Member States not to restrict IORPs from appointing, for the custody of their assets, custodians established in another Member State and duly authorized in accordance with the ISD, CRD or accepted as a depositary for the purpose of UCITSD I.

Introducing a 'de facto European passport' on a mutual recognition basis for appointing custodians in another Member State for the 'custody of their assets' was, however, only partly consistent with the two points that Perreau De Pinninck raised during the European passport discussion of the UCITSD II proposal. Obviously, IORPD I only sought to liberalize the 'custodian' market for the 'custody of assets'. The 'custody of assets' could be interpreted as 'the safekeeping and administration of assets' provided by credit institutions and investment firms under the ISD and CRD I for which a European passport was already earlier introduced in the early 90s. Nevertheless, the IORPD I implementation of several Member States, including Liechtenstein and Luxembourg, did not introduce a custodian for the safekeeping of assets, but a depositary required to carry out safekeeping and controlling/monitoring tasks. Liechtenstein, Luxembourg and most other Member States requiring an IORP depositary, however, still allowed entities to be established in another Member State to carry out the IORP 'depositary function'.[197] This was contrary to the reasoning under UCITSD I that the UCITSD depositary function in carrying out safekeeping and controlling tasks was going beyond the mere safekeeping task of credit institutions and investment firms under the Second Banking Directive and ISD. Other Member States, such as

---

[192] Generally speaking, the MiFID custody rules apply to all 'MiFID investment firms', such as brokers, dealers, asset managers and advisers. See D. Frase, *Custody*, in *Law and Regulation of Investment Management* 276 (D. Frase ed., Sweet & Maxwell 2011).

[193] See for criticism on the proposed MiFID II upgrade for custodianship: H. Motani, *The proposed EU legislation on securities holding*, 69 (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013).

[194] Legal Certainty Group, *Second Advice of the Legal Certainty Group – Solutions to Legal Barriers related to Post-Trading within the EU*, August 2008, 25, 32.

[195] Question 3, Bank of New York Mellon response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.

[196] Recital 28 IORPD I.

[197] Liechtenstein: Art. 12 Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung (Pensionsfondsgesetz; PFG); Luxembourg : Art. 18 (1) and Art. 42 (1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.

Croatia[198], France[199] and Malta[200], indeed only allowed custodians in another Member State to be appointed for 'custody of their assets'. The IORPD I, however, allowed authorized UCITS depositaries to be appointed, whereas the European Commission in various policy documents and Perrea De Pinnick in his report and clearly indicated that first the eligible entities and, consequently, the authorization and business organizational requirements of UCITS depositaries would need to be authorized prior to introducing a UCITS depositary passport. The IORPD I approach towards custodians/depositaries was, thus, inconsistent with the UCITSD approach.

Despite various commentaries in the IORPD II consultation process[201], Article 33 (3) IORPD II still abided by the mutual recognition principle introduced under IORPD I. The wording, however, changed. Instead of referring to 'custodians', Article 33(3) refers to 'depositaries established in another Member State'. Depositaries within the meaning of IORPD II are being referred to as depositaries for 'safekeeping and safekeeping and oversight duties'. IORPD II, thus, recognized that Member States took different approaches in their IORPD I implementations by requiring a custodian, depositary or not custodian/depositary at all to be appointed under national legislation.[202] The eligible entities list allowed to be appointed in another Member State was expanded by entities accepted as a depositary under the AIFMD. Accepted depositaries allowed to be appointed under both UCITSD V and the AIFMD, depending upon the UCITSD V implementation of the individual Member States, still consists of 'other legal entities' authorized under national law. In addition, the IORPD II safekeeping and controlling tasks of IORPD II depositaries remain to have a minimum harmonization nature. Although the Level 1 safekeeping and controlling task have been (partly) copied out of UCITSD V and the AIFMD, the corresponding AIFMD/UCITSD V Level 2 provisions have not been adopted in a Level 2 IORPD II instrument.

The inconsistency with the UCITSD II proposal reasoning for not introducing a UCITS depositary passport because the eligible entities and tasks for UCITS depositaries have been harmonized to a limit extent, thus, also remains to exist under IORPD II.

2.5. Conclusion

For a better understanding of all legal issues related to the European depositary passport, it is of importance to examine the debate upon the European depositary passport in a historical context. For this purpose, the concerns raised upon introducing such a passport during the adoption of the various UCITS directives, the AIFMD, the ISD/MiFID I/II and IORPD I/II have been studied to get a better overview of the present situation.

Notwithstanding the benefits of introducing a depositary/custodian passport, a European passport for UCITS and AIFMD depositaries has so far been multiple times considered, but not introduced. MEP Perreau de Pinninck after the introduction of the 'ancillary European passport' under the ISD and Second Banking Directive considered that a European depositary

---

[198] Art. 79 (1) The Mandatory and Voluntary Pension Funds Law of 7 May 1999.
[199] L.143-4 du Code des Assurances.
[200] B.6 Custody of Retirement Fund's Assets, B.6.1 General Conditions, Directives for Occupational Retirement Schemes, Retirement Funds and Related Parties under the Special Funds (Regulation) Act, 2002.
[201] EIOPA, Summary of Comments on Consultation Paper: Response to the Call for Advice on the review of the IORP Directive 2003/41/EC: second consultation - EIOPA-CP-11/006, EIOPA-BoS-12/016, 15 February 2012, Comment 95 (State Street); EIOPA, Summary of Comments on Consultation Paper: Response to the Call for Advice on the review of the IORP Directive 2003/41/EC: second consultation - EIOPA-CP-11/006, EIOPA-BoS-12/016, 15 February 2012, Comment 58 (ADEPO).
[202] See Chapter 12, section 4.

passport for UCITS should not be introduced for two reasons.[203] First, it was considered that the depositary function was going beyond mere performing the 'custodian' function under the ISD and Second Banking Directive. Second, the depositaries in the UCITS domain had not been harmonized to effectively perform the controlling function.

This reasoning, however, does not explain why currently not a depositary passport has been introduced under the substantially harmonized depositary function under the AIFMD and UCITSD V. Neither does this explanation explain why depositaries and custodians under IORPD II under a minimum harmonized regime enjoy a 'de facto European passport' and why the AIFMD grants transition relief for credit institutions and a quasi-depositary passport for TC-AIFs.

3. Conclusion

In practice, the same investment firms and credit institutions are acting as a custodian for discretionary mandates and 'execution only'[204] services under MiFID II/CRD IV, a depositary under the AIFMD/UCITSD V and a depositary/custodian under IORPD II. The European investment laws, i.e. MiFID II, CRD IV, the AIFMD, UCITSD V and IORPD II are inconsistent in granting a depositary/custodian passport to these depositaries/custodians. They are both inconsistent throughout the directives and on a cross-sectoral basis. On a cross-sectoral basis, MiFID II and CRD IV have an 'ancillary' European passport for 'custodians' in place.[205] To the contrary, the AIFMD and UCITS require the depositary of UCITS and EEA-AIFs to be established in the UCITS/EEA-AIF home Member State,[206] whereas the same entities acting as a depositary/custodian under IORPD II do have a 'de facto' European passport.[207] Not only are the European investment laws inconsistent throughout the directives, also the directives itself are inconsistent. The AIFMD, for example, differentiates between a strict locational requirement for EEA-AIFs, whereas there is a 'quasi-depositary passport regime' in place for depositaries appointed for TC-AIFs.[208] The inconsistency in granting a European passport for depositaries under the European investment laws lead to a 'European depositary passport paradox'.

For a better understanding of all legal issues related to the European depositary passport, it is of importance to examine the debate upon the European depositary passport in a historical context. For this purpose, the concerns raised upon introducing such a passport during the adoption of the various UCITS directives, the AIFMD, the ISD/MiFID I/II and IORPD I/II have been studied. The 'ancillary European passport' for investment firms and credit institutions under MiFID II and CRD IV has never been updated to a full-fledged investment service as concerns have been raised related to the scope of 'safekeeping and administration' and, in practice, such a 'low margin service' is only being offered in connection with other investment services/activities. The non-harmonization in this area will, however, also in the future remain to raise a number of questions as to whether the European legal framework for custodians needs to be further harmonized and strengthened to ensure a level playing field in

---

[203] European Parliament, *Report of the Committee on Legal Affairs and Citizen's Rights on the 1993 UCITS Proposal*, A5-0268/1993, 1 October 1993, http://goo.gl/rRSdJO (accessed 7 April 2017).
[204] See Annex I, s. A No. 1 and No. 2 MiFID I/II; Art. 25(4) MiFID II.
[205] Annex I Nr. 12 CRD IV; Annex I s. A MiFID I/II.
[206] Art. 21(5) AIFMD and Art. 23(1) UCITSD V.
[207] Article 33(3) IORPD II.
[208] See also C.P. Buttigieg, *The Case for A European Depositary Passport*, http://studylib.net/doc/13128849/the--case--for--a--european-...-passport (accessed 7 April 2017); See also S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2015).

terms of investor protection measures across all Member States.[209] The adoption of the CSDR might help in clarifying the scope of such an initiative.

Notwithstanding the benefits of introducing a depositary/custodian passport, a European passport for UCITS and AIFMD depositaries has so far been multiple times considered, but not introduced. MEP Perreau de Pinninck after the introduction of the 'ancillary European passport' under the ISD and Second Banking Directive considered that a European depositary passport for UCITS should not be introduced for two reasons.[210] First, it was considered that the depositary function was going beyond mere performing the 'custodian' function under the ISD and Second Banking Directive. Second, the depositaries in the UCITS domain had not been harmonized to effectively perform the controlling function.

This reasoning, however, does not explain why currently not a depositary passport has been introduced under the substantially harmonized depositary function under the AIFMD and UCITSD V. Neither does this reasoning explain why depositaries and custodians under IORPD II enjoy a 'de facto European passport' under a minimum harmonized regime and why the AIFMD grants transition relief for credit institutions and a quasi-depositary passport for TC-AIFs. For this reason, Part II addresses under what conditions an European/TC passport could be granted to (AIF/UCITS) depositaries, whereas Part III sets out to what extent depositaries and custodians are different.

209. Question 3, Bank of New York Mellon response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.

210 European Parliament, *Report of the Committee on Legal Affairs and Citizen's Rights on the 1993 UCITS Proposal*, A5-0268/1993, 1 October 1993, http://goo.gl/rRSdJO (accessed 7 April 2017).

PART I - Conclusion

Strictly speaking, there is an inconsistency in locational depositary restrictions, i.e. a European 'depositary passport paradox' in European investment management depositary law. MiFID II/CRD IV grants a 'de facto' European passport to custodians and IORPD II to 'depositaries', whereas AIF and UCITS depositaries do not have a 'full' European passport. To this end, Part I studied the locational depositary restrictions under European investment laws. Part I concluded that in order to verify what the European regulator should do in order to introduce such a European passport for AIF/UCITS depositaries and, similar as to the 'cross sectoral management passport'[1] under the AIFMD/UCITSD V, to allow the same entities to enjoy a 'cross-sectoral European depositary/passport', two points need to be clarified. First, under what conditions do EEA and TC financial intermediaries obtain a European passport under EEA regulatory law and, second, what is a depositary and to what extent does a depositary differ from a custodian.This research continues with Part II addressing the first question, whereas Part III will answer the second question.

---

[1] See Chapter 8, section 3.1.4 and 3.4.2.

PART II- The EEA's Approach Towards the Cross-Border Provision of Financial Services

To determine under what conditions a (cross-sectoral) European/TC passport could be granted to 'depositaries' and 'custodians', Part II studies EEA's approach towards the cross-border provision of financial services.[1] In particular, the conditions under which European and TC European passports are granted to EEA and TC financial intermediaries are highlighted.

[1] K.W.H. Broekhuizen & W.A.K. Rank, *Grensoverschrijdende dienstverlening* 230-243 (A.J.C.C.M. Loonen et al., NIBE-SVV 2008).

Chapter 3 EEA Cross-Border Regulation for Financial Intermediaries

Ever since the adoption of the Maastricht Treaty, market liberalization in the EEA has taken a huge leap forward based on the free movement of persons, capital, establishment and goods. The same holds true for financial products and services and services provided by financial intermediaries. Since the early 90's, EEA legislation has developed an 'internal dimension' and an 'external dimension' related to the cross-border provision of financial services by financial intermediaries. The so-called 'internal dimension' is based upon the four freedoms and regulates the cross-border provisions of financial services by EEA financial intermediaries. The 'external dimension' regulates the cross-border provisions of financial services in the internal market by TC financial intermediaries and is based upon international law commitments and EEA secondary law.

The concept of the 'European passport' is at the heart of the 'internal dimension' of the EEA internal market for financial services.[1] It is a general concept which lays down the conditions for the 'mutual recognition' principle. The general idea is that financial products or services that are 'produced' (and marketed) in a 'home Member State' may, under conditions set out in European legislative acts, be marketed throughout the internal market without incurring further conditions imposed by 'host Member States'.[2] The concept is based upon centralized rulemaking and supervision that prevents *a race to the bottom* and ensures a 'level playing field' for all EEA financial intermediaries in the EEA internal market.

Since the early 90's the 'European passport' as a concept has rapidly spread through EEA financial legislation. Various types of European passports are currently applied in the EEA, including passports for market infrastructures (CCPs), disclosure/information requirements (PRIIPR), financial intermediaries (CRD IV, MiFID II) and financial products (IORPD II, UCITSD V).[3] Although the European passport of all these types are based upon the same principles, the focus of this chapter is on the cross-border provision of financial services and, in particular, European passports for financial intermediaries.

Along the development of the European passport as primary regulatory concept for EEA financial intermediaries, the EEA developed its 'external dimension', i.e. the conditions under which TC financial intermediaries may provide financial services in the internal market. TC financial intermediaries are not subject to the same centralized rulemaking and supervision as EEA financial intermediaries. Moreover, the harmonization of financial regulation on the international level various from sector to sector. Banking and insurance legislation are harmonized to a large degree, whereas other sectors, such as asset management, are hardly harmonized. For this reason, the EEA determines in EEA secondary legislation whether and to what extent TC financial intermediaries may provide certain services within the EEA. The degree in which markets are opened to those intermediaries variess on a sectoral basis. UCITSD V, for example, only allows TC financial intermediaries to be active in the internal market through the establishment or acquisition of an EEA subsidiary authorized as UCITS ManCo or as a delegate of an EEA based UCITS ManCo. MiFIR, however, grants a full TC

[1] See E. Ferran, *Building an EU Securities Market* (Cambridge University Press 2004).
[2] Host Member State do have some competences: See Recital 2, 7, Art. 86 MiFID II, Recital 4 CRD IV, Recital 85 Solvency II and Art. 21 UCITSD V ('reporting requirement for UCITS ManCos'). See on literature related to MiFID I/II: P. Casey & K. Lannoo, The MiFID Revolution, ECMI Policy Brief No. 3 (November 2006); J.P. Casey & K. Lannoo, *The MiFID revolution* (Cambridge University Press (2009); G. Ferrarini & E. Wymeersch, *Investor protection in Europe: corporate law making*, *the MiFID and beyond* (Oxford University Press 2006); International Organisation of Pension Supervisors, *Supervision of Pension Intermediation*, http://www.iopsweb.org/WpNo17Web.pdf (accessed 14 January 2017).
[3] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 101 et seq. (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

passport to TC firms providing investment services/activities to, for example, eligible counterparties. Generally, TC relationships are characterized by requiring equivalency of TC regulatory and supervision regimes. In addition, a form of 'legal representation' in the form of a branch, subsidiary or legal representative is required and cooperation agreements and information exchange between relevant Competent Authorities have to be in place.

This chapter studies the EEA's approach towards the cross-border provision of financial services in more detail. In particular, the conditions under which European and TC European passports are granted to EEA and TC financial intermediaries are studied as to determine under what conditions a (cross-sectoral) European/TC passport could be granted to 'depositaries' and 'custodians'.

1. The Internal Dimension of the Cross-Border Provision of Financial Services

The internal dimension of the cross-border provision of financial services has as its advantage that it leads to market efficiency and economies of scale and scope. The cross-border provision of financial services within the EEA, however, leads to 'risk asymmetry' that results from financial intermediaries that are located in a different EEA Member State than the Member State in which the financial services are being provided. For this reason, regulation is in place that intends to ward off any externalities resulting from 'risk asymmetry'. In the past, this has led to a large degree of legal fragmentation posing hurdles to the cross-border provision of financial intermediaries that could not be resolved by the 'four freedoms' due to the 'prudential carve-out' that justifies the infringements on the freedom of capital and establishment. This section explains that EEA secondary law, i.e. positive integration, is the only viable means in which an internal market for the cross-border provision of financial services can be established.

1.1. A Law and Economics Theory of the Internal Market for Financial Services

Since the Treaty of Rome, the establishment of a 'common market', 'single market' and 'internal market' have been policy objectives in, amongst others, achieving a free market for financial services without barriers in the EEA. This section explains the law and economics rationale behind the internal market for financial services. It discusses market efficiency and economies of scale and scope as primary advantages of the internal market for financial services. In addition, this section explains the externalities of an internal market for financial services by explaining the concept of 'risk asymmetry' resulting from the divergence between 'production' and 'distribution' Member States.[4] Finally, this section concludes by explaining how the harmonization of EEA substitutes for 'risk asymmetry' and, thus, achieves 'risk symmetry'.

1.1.1. *Market efficiency & Economies of Scale and Scope*

An internal market for financial services without barriers is the primary objective of EEA financial legislation as it increases market efficiency and economies of scale and scope.

1.1.1.1. Market efficiency

[4] 'Production Member States' could be seen as 'home Member States' under passporting arrangements, whereas 'distribution Member States' could be seen as 'host Member States'.

A successful integration of the European market for financial services in the EEA leads to operative, allocative and institutional (market) efficiency.[5]

The establishment of an internal market for financial services leads in the first place to operational efficiency.[6] This type of efficiency can be defined as the ratio between the input the operate a financial institution and the output gained from operating financial services.[7] In the financial services context, input factors to be considered would be transaction costs, including staff, application for authorizations to operate and other types of investments.[8] Output factors would be, amongst others, revenue, innovation, new clients and the time-to-market.

Considering the input factors, financial institutions offering their products and services are benefiting from lower transaction costs.[9] Authorization and notification requirements under European passport arrangements, for example, only need to be fulfilled in one Member State while having a large market to offer their financial products and services without worrying about multiple authorization application and the establishment of subsidiaries that would have led to a duplication of legal costs. Prices in an EEA internal market for financial services decline as fixed costs are shared amongst a larger client base.[10] Firms may organize themselves anywhere in the EEA, in small and big Member States and, as a result, have the potential to maximize their efficiency and become more competitive. In addition to reducing transaction costs, financial institutions from either smaller or bigger EEA Member States may market products and services to all of the European Union's 500 million citizens resulting in more revenue. Actors from smaller Member States are able to compete and more likely to invest and innovate as their client potential significantly increases. Finally, the time-to-market for firms aiming to market their products and services in multiple Member States is heavily reduced. Instead of applying for an authorization to conduct financial services activities to 31 regulators and comply with 31 different sets of legislations only a single authorization and notification process suffices under modern European passport arrangements.

An internal market for financial services also leads to allocative efficiency, firms only locate themselves only where the marginal benefit is equal to its marginal costs.[11] The bigger European economic market leads to more supply and demand for financial services increasing the liquidity for the market of services. The more supply and demand, the more innovation and a larger plurality of financial services being offered. The location of a supplier will be determined under competitive pressure there where its marginal benefits is slightly higher than its marginal costs in order to generate those profits giving firms the incentive to innovate and offer new products and services.[12]

Financial services providers will decide to locate themselves only there where the market sees them as most desirable and where there is high demand for their services. Most likely considering legal and non-legal factors, such as economic and social factors, firms primarily

---

[5] E. Davies, A. Dufour & B. Scott-Quin, *The MiFID: Competition in a new European equity market* 163-197 (G. Ferrarini & E. Wymeersch, Oxford 2006).
[6] See D. Gros, *The Economics of Brexit: It's not about the Internal Market*, https://www.ceps.eu/publications/economics-brexit-it%E2%80%99s-not-about-internal-market (accessed 14 January 2017).
[7] R.E. Bailey, *The Economics of Financial Markets* 22 (Cambridge University Press 2005).
[8] F. A. G. den Butter, *Managing Transaction Costs in the Era of Globalization* 58 (Edward Elgar Publishing 2012).
[9] D. Dietrich, *Transaction cost economics and beyond: towards a new economics of the firm* (Routledge 1994).
[10] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 56 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).
[11] J. Sloman, A. Wride, D. Garratt, *Economics* 293 (Pearson 2012).
[12] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 55 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

establish themselves in financial centers in Europe.[13] Firms are likely to establish themselves following their clients' needs and specialized financial services.[14] Basic services are provided on a local basis, whereas specialized financial services are centered in order to justify the costs for specialization.[15] They provide the expertise and infrastructure to offer these specialized services resulting in a service industry which coordinates their interests to further their business.

An efficient internal market for financial services enhances cross-border activity and leads to a transfer from capital and resources from multiple Member States to a few Member States in which a flourishing financial sector is established that offers the best conditions leading to a loss of tax revenues, political influence and employment.[16] Allocative efficiency should, thus, not be seen as Pareto efficiency[17], but as Kaldor-Hicks efficiency. By shifting resources the gain of the EEA financial sector would be greater than the loss in benefit of the other EEA Member States.[18]

An internal market for financial services could, however, at the downside lead to market failure when firms fail to allocate their resources efficiently. This might occur because of concentrated market power of an oligopoly of Member States that are only attractive enough to be established in. Pre-condition for allocative and operational efficiency is institutional efficiency. European laws have either unified or harmonized business practices/conditions across the 31 EEA Members to make a well-functioning internal market. The legal framework backing this up caters for integrity and stability of the European markets for financial services as a whole.[19] The latter enables the free market access of supply and demand leading to more liquidity and diversity at better service quality and lower prices.[20] The internal market for financial services, thus, leads to operative, allocative and institutional (market) efficiency.

1.1.1.2. Economies of Scale and Scope

Scale economies are the biggest advantage of an internal market for financial services. The European investment fund industry is the most successful example of this.

Following, the IOS scandal in the 1960s and 1970s[21], big fund distribution markets, such as Germany, for example, introduced legislation to protect their domestic markets.[22] Legal costs borne by fund managers residing in small Member States to obtain market access in big distribution markets increased significantly. For this reason, investments by fund managers in

---

[13] D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* 869-870 (D.A. Zetzsche ed, Kluwer 2015).
[14] D.A. Zetzsche, *Competitiveness of Financial Centers in Light of Financial and Tax Law Equivalence Requirements* (R.P. Buckley, E. Avgouleas & D.W. Arner eds., Cambridge University Press 2016).
[15] *Ibid.*
[16] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 55 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).
[17] R.E. Bailey, *The Economics of Financial Markets* 22 (Cambridge University Press 2005).
[18] *J. Hicks, The Foundations of Welfare Economics, 49 Economic Journal. The Economic Journal 696–712 (1939).*
[19] N. Vokuhl, *Kapitalmarktrechtlicher Anlegerschutz und Kapitalerhaltung in der Aktiengesellschaft* 180 (Nomos 2007).
[20] S. Kress, *Effizienzorientierte Kapitalmarktregulierung – eine Analyse aus institutionenökonomischer Perspektive* 59 (Wiesbaden 1996).
[21] D.A. Zetzsche, *Prinzipien der kollektiven Vermögensanlage*§ 14.C.III. (Mohr Siebeck 2015).
[22] G. Müller, *Die Rechtsstellung der Depotbank im Investmentgeschäft nach deutschem und schweizerischem Recht* (Benningen 1969).

the quality of their services were only done to a limited extent in these Member States.[23] Instead, fund managers preferred to establish themselves in the big distribution markets itself.

The introduction of a European (marketing) passport under UCITSD I was a double-edged sword in this regard. It enabled fund managers residing in small Member States, such as Ireland, Liechtenstein and Luxembourg, with a limited client base to market their UCITS in Member States with a bigger client basis. Liechtenstein, for example, became an EEA Member in 1995. Liechtenstein itself only has 36.000 inhabitants providing a small client basis for a successful fund industry. Its EEA Membership in conjunction with its implementation of the UCITSD I enabled a growth of its fund industry from 5 million CHF in 1995 to more than 40 billion CHF in 2017.[24]

Without the existence of an internal market for financial services[25], it would have not been worthwhile for any financial intermediaries to obtain an authorization to market financial services/products in small Member States, such as Liechtenstein, as the costs would exceed the benefits.[26] From the perspective of the large Member States, the competition of intermediaries of small Member States in marketing financial products/services in their domestic market leads to more competition, more innovation and financial services/products of a higher quality for lower prices.[27]

An internal market for financial services, thus, benefits small and big Member States.

1.1.2. *Risk Asymmetry & the Concept of 'production' and 'distribution' Member States*

The internal market for financial services enhances market efficiency and leads to economies of scale and scope. Conversely, the market access that an internal market facilitates may

---

[23] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 61 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014); D.A. Zetzsche & T.F. Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* 61 (D.A. Zetzsche ed, Kluwer 2015).

[24] See https://www.lafv.li/DE/Fonds/Statistik/FondsvermogennachStichtag (accessed 15 July 2017).

[25] H. van Meerten & S.N. Hooghiemstra, *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions*, https://ssrn.com/abstract=2993991 (accessed 4 July 2017).

[26] See, for instance, the broad discussion about the European passport of financial intermediaries in the UK after the Brexit: K. Lannoo, *EU Financial Market Access after Brexit*, CEPS Policy Brief, September 2016, https://www.ceps.eu/system/files/Brexit%20and%20the%20financial%20sector_0.pdf (accessed 14 January 2017); D. Schoenmaker, *The UK Financial Sector and EU Integration after Brexit: The Issue of Passporting*, https://ssrn.com/abstract=2844253 (accessed 14 January 2017); L. Noonan & J. Brunsden, *Banks fear chill wind of 'passport' freeze,* Financial Times, (21 September 2016); D. Gros, *The Economics of Brexit: It's not about the Internal Market*, https://www.ceps.eu/publications/economics-brexit-it%E2%80%99s-not-about-internal-market (accessed 14 January 2017); International Monetary Fund, *Macroeconomic implications of the United Kingdom leaving the European Union,* IMF Country Report No. 16/169 (2016), https://www.imf.org/external/pubs/ft/scr/2016/cr16169.pdf (accessed 14 January 2017); K. Lannoo, *Brexit and the City,* https://www.ceps.eu/publications/brexit-and-city (accessed 14 January 2017); K. Lannoo*, Britain's Finance Industry Needs the EU*, Wall Street Journal *(26 January 2016); M.* Emerson, *Which model for Brexit?*, CEPS Special Report, October 2016, https://www.ceps.eu/system/files/SR147%20ME%20Which%20model%20for%20Brexit.pdf (accessed 17 February 2017).

[27] D. Dietrich, *Transaction cost economics and beyond: towards a new economics of the firm* (Routledge 1994); K. Lannoo, *EU Retail Financial market Integration: Mirage Or Reality?,* ECRI Policy Brief No. 3 (June 2008).

create negative externalities[28], such as the insolvency of financial intermediaries or fraud that is particularly fueled by the 'risk asymmetry'.[29]

The 'risk asymmetry' component is in an internal market for financial services[30], home Member States might be inclined by political and economic motivations to stimulate their financial services/products that are 'produced' in their Member State (production state) by subjecting their financial intermediaries and products to a minimum set of regulation and/or lax enforcement of the regulatory framework in place.[31] If those products and services are primarily marketed outside of that home Member State, the positive effects of lax regulation and supervision are being enjoyed by the home Member State as 'production state', whereas the negative effects of that are to be borne by 'distribution states', i.e. the host Member States. This might lead to so-called 'risk asymmetry' that has been evidenced by the 'icesave scandal'[32] that took place in which Icelandic Supervisory Authorities with lax supervision allowed badly capitalized credit institutions to offer deposits to Dutch and British customers based upon the European passport to boost their domestic financial services industry.[33]

The degree of risk asymmetry in a specific field of financial services depends upon the degree in which home and host Member States of financial intermediaries have the same level of substantive laws and enforcement therefore to protect investors and prevent systematic risks.[34] The level of equivalency of the latter determines the risk of regulatory arbitrage, risk asymmetry and a possible *race to the bottom.*

To what extent risk asymmetry poses a threat to investor protection and systematic risks depends upon on the demand and supply of financial services within home and host Member States regarding a specific type of financial service.[35] Member States could either have a high supply and demand for a specific financial service, whereas financial intermediaries in other Member States primarily provide supply-side financial services ('production Member State')

---

[28] R. Gilson & R. Kraakman, *Market Efficiency after the Financial Crisis: It's Still a Matter of Information Costs*, 100 Va. L. Rev. 313 (2014).

[29] See D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 61 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014); D.A. Zetzsche, *Competitiveness of Financial Centers in Light of Financial and Tax Law Equivalence Requirements* 401-402 (R.P. Buckley, E. Avgouleas & D.W. Arner eds., Cambridge University Press 2016).

[30] This idea has been earlier published in: H. van Meerten & S.N. Hooghiemstra, *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions*, https://ssrn.com/abstract=2993991 (accessed 4 July 2017).

[31] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014), 62-63.

[32] I. Fridriksson, *The banking crisis in Iceland in 2008*, http://www.bis.org/review/r090226d.pdf (accessed 14 January 2017); Stefansson & T. Saethorsson, Cross-border issues in EU Deposit Guarantee Schemes: With a focus on the Icelandic case, 63-82, http://pure.au.dk/portal-asb-student/files/12991/Thesis_without_Appendix.pdf (accessed 14 January 2017).

[33] E.G. Gunnarsson, *The Icelandic Regulatory Responses to the Financial Crisis*, 1 European Business Organization Law Review 139 (2011); S. Benediktsdottir, J. Danielsson & G. Zoega, *Lessons from a collapse of a financial system*, https://www.tcd.ie/Economics/assets/pdf/version-20-ben-dan-zoega-revised.pdf (accessed 14 January 2017); Zhao Li, *Securities Regulation in the International Environment*, 110-115, http://theses.gla.ac.uk/691/1/2009zhaoliphd.pdf (accessed 14 January 2017); M. Guðmundsson, *The Fault Lines in Cross-Border Banking: Lessons From the Icelandic Case*, OECD Journal Financial Market Trends, Issue 2 (2011).

[34] D.A. Zetzsche, *Competitiveness of Financial Centers in Light of Financial and Tax Law Equivalence Requirements* 401 (R.P. Buckley, E. Avgouleas & D.W. Arner eds., Cambridge University Press 2016).

[35] D.A. Zetzsche & T.F. Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* 474-475 (D.A. Zetzsche ed, Kluwer 2015); D. Llewellyn, *The Economic Rationale for Financial Regulation* (FSA 1999).

or demand-side services ('distribution Member States').[36] In those Member States where demand and supply for a given financial service is even, legislators and Competent Authorities are expected to have introduced high quality financial regulation that is strictly enforced to cater for investor protection and prevent systematic risks. This would be in the best interests of both the intermediaries' and investors'/clients' interests.[37]

An imbalance of supply and demand within a particular Member State may either give legislators and Competent Authorities the incentive to overly protect financial institutions in 'production Member States' or investors in 'distribution Member States'.[38]

Financial intermediaries established in production Member States with a small domestic market are, by absence of a common European legislative framework, likely to be subjected to less strict laws and enforcement than financial institutions established in 'distribution Member States' with a large domestic consumer base. For this purpose, a difference should be made between laws and enforcement between prudential requirements preventing a financial institution from insolvency, at the one hand, and conduct of business rules preventing fraud, at the other hand. Production Member States have a strong interest in enforcing laws that prevent the insolvency of a financial institution, whereas the foreign client base would likely provide for less incentives to enforce conduct of business rules. EEA law substitutes for 'risk asymmetry'.

1.1.3. *EEA Law as a Substitute for Risk Asymmetry*

EEA law in the financial services domain substitutes for risk asymmetry. By harmonizing regulation on the EEA level to which financial service intermediaries are subjected to a level playing field is being created in which both intermediaries established in 'production' and 'distribution' Member States operate on the same minimum standards.[39] The harmonization of substantive EEA laws ensures a minimum degree of investor and market protection.[40] This is complemented by 'home state control'[41] and the 'ESFS'[42].

The rationale of 'regulatory competition'[43,] initially, led to a tendency of 'minimum harmonization by means of directives. The idea was that some degree of regulatory diversity would lead to more efficient financial law as Member States would tailor their laws according to the needs of financial intermediaries. Excessive 'goldplating'[44], i.e. additional national

---

[36] The terms 'production and 'distribution' Member State were introduced by: D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 60, 61 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).
[37] *Ibid*, 61.
[38] D.A. Zetzsche, *Competitiveness of Financial Centers in Light of Financial and Tax Law Equivalence Requirements* 410-411 (R.P. Buckley, E. Avgouleas & D.W. Arner eds., Cambridge University Press 2016).
[39] See for intermediary, product and sales regulation: Chapter 11, section 2.
[40] See *infra* 3.4.1.
[41] P.H Verdier, *Mutual Recognition in International Finance*, 52 Harvard International Law Journal 56 (2011).
[42] T. Möllers, *Auf dem Weg zu einer neuen europäischen Finanzmarktaufsichtsstruktur - Ein systematischer Vergleich der Rating-VO (EG) Nr. 1060/2009 mit der geplanten ESMA-VO*, 8 Neue Zeitschrift für Gesellschaftsrecht 285 (2010).
[43] W.W. Bratton & J.A. McCahery, *Regulatory Competition, Regulatory Capture, and Corporate Self-Regulation*, http://scholarship.law.upenn.edu/faculty_scholarship/1365 (accessed 15 July 2017).
[44] Directorate General for Internal Policies, '*Gold-plating*' *in the EAFRD – To what extent do national rules unnecessarily add to complexity and as a result, increase the risk of errors*?, IP/D/ALL/FWC/2009-056, 27 February 2014, http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/490684/IPOL-JOIN_ET%282014%29490684_EN.pdf(accessed 14 January 2017); W. Voermans, *Gold-plating and double banking: an overrated problem?* 79-88 (H. Snijders & S. Vogenauer eds.Sellier European Law Publishers 2009); J.H. Jans & L. Squintani, A. Aragão, R. Macrory & B.W. Wegener, *'Gold plating' of European Environmental Measures,* 6.4. Journal of European Environmental and Planning Law 417-435 (2009).

regulatory standards in (host) Member States, led, however, to a fragmented marketed. This problem was acerbated by the 'Big 5 Bias'. Five Member States, including France, Germany, Italy, Spain and the UK, have more than half of the EEA's population. Regardless of the efficiency of the laws in these Member States, financial intermediaries were complying with the 'goldplating' standards applicable in these Member States as they disproportionally represent a large consumer base. The inefficiencies of minimum harmonization led to a preference of financial intermediaries to establish themselves in large Member States to avoid regulatory costs and the choice not to offer financial services in small Member States.

This forced the EEA to move to a maximum harmonization strategy that enhanced the internal market for financial services. This is exemplified by the fund industry. Upon the adoption of UCITSD I, France was the biggest fund domicile. The gradual (maximum) harmonization of UCITS under UCITSD I-V, however, led to Luxembourg as the primary choice for UCITS.[45] EEA law in the financial services domain based upon maximum harmonization, thus, substitutes for risk asymmetry.

1.2. The Internal Dimension – the Four freedoms

The Treaty of Rome, concluded in 1957, obliged the Member States to 'establish a common market and progressively approximate the economic policies of the Member States'.[46] The primary aim of the treaty was the establishment of a customs union that ultimately would result in the elimination of tariffs imposed in intra-Community trade and the establishment of a common external tariff.[47] The Customs Union was established by a schedule of regulatory measures that lead to the harmonization of indirect taxes[48] and the creation of the European Monetary System[49]. The Treaty provided for the 'four freedoms', i.e. the free movement of goods, persons, services and capital that were designed to support the establishment of a customs union.

The 'four freedoms' introduced by the Treaty of Rome and also adopted in the EEA Treaty[50], still to date determine the internal dimension of the EEA. Relevant for EEA financial services are, in particular, the freedom of capital, establishment and services.

1.2.1. *The Freedom of Capital*

The free movement of capital laid down in Article 63(1) TFEU prohibits any restrictions on the movement of capital between Member States and between Member States and third countries.[51]

The free movement of capital is the only 'freedom' under the TFEU that has been significantly modified since its adoption in the original Rome Treaty.[52] The requirement that

[45] D.A. Zetzsche, *Prinzipien der kollektiven Vermögensanlage* Einleitung A.I. (Mohr Siebeck 2015).
[46] Treaty establishing the European Economic Community as amended by the Single European Act, Art. 1. Treaties establishing the European Communities, abridged. (Luxembourg : Office of Offical Publications of the European Communities, 1987); See E. Grabitz & M. Hilf, *Das Recht der Europäischen Union* (C.H. Beck 2009).
[47] S.J. Key, *Financial Integration in the European Community*, Board of Governors of the Federal Reserve System – International Finance Discussion Papers, No. 349 (April 1989), 5.
[48] Commission of the European Communities, *Completing the Internal Market: White Paper from the Commission to the European Council* 11-18 (Office of Official Publications of the European Communities 1985).
[49] P. Ludlow, *The Making of the European Monetary System: A Case Study of the Politics of the European Community* (Butterworth Scientific 1982).
[50] Arts 78-88 EEA Agreement.
[51] G. Baber, *The Free Movement of Capital and Financial Services: An Exposition? Hardcover – Unabridged* (Cambridge Scholars Publishing 2014).

this freedom was only applicable to residents of EU Member States under the Rome Treaty has been modified in the EC Treaty and the reference to third countries was added. This was maintained under the TFEU. Both EU and non-EU nationals may, thus, invoke the free movement of capital in the courts of EU Member States.[53]

Apart from the scope, also the substance of the provision on the free movement of capital has changed throughout the years. The current TFEU definition is the result of original provisions that were so unclear that individuals had problems in enforcing their rights before their national courts.[54] To date, the TFEU still does not contain a definition on the meaning of 'movement of capital'. In the absence of a definition, the CJEU has reiterated that the nomenclature annexed to the Council Directive 88/361/EEC should serve as an indicator.[55] Examples of 'movement of capital' mentioned in the nomenclature are, amongst others, direct investments, investments in real estate, operations in securities normally dealt in on the capital market, operations in units of collective investment undertakings, operations in securities and other instruments.[56] Restrictions on the free movement of capital are allowed if EEA Member States have a legitimate national or public security concern.[57] Article 65(1) TFEU allows Member States to act to prevent infringements of national law and regulations in the area of prudential financial regulation.

1.2.2. *The Freedom of Establishment*

Following Article 49(1) TFEU the freedom of establishment prohibits the restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member States. The prohibition also applies to primary[58] and secondary[59] establishments. Examples include the restriction on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established within the EEA.[60]

Article 49 TFEU, however, only applies to 'nationals of any Member State'. Natural and legal persons[61] from third countries may, thus, not rely upon the freedom of establishment, unless a third country has established a subsidiary 'in accordance with the law of a Member State and has their registered office, central administration or principle place of business

---

[52] J.A. Usher, *The Evolution of the Free Movement of Capital*, 31Fordham International Law Journal 1533 (2007).

[53] CJEU (Judgment of 14 December 1995), Joined cases C-163/94, C-165/94, C-250/94, *Sanz de Lera, ECLI:EU:*C:1995:451.

[54] J.A. Usher, *The Evolution of the Free Movement of Capital*, 31Fordham International Law Journal 1533 (2007).

[55] *Ibid.*

[56] Annex I Council Directive of 24 June 1988 for the implementation of Article 67 of the Treaty (88/361/EEC).

[57] See the grandfathering provisions: Art. 64(1) TFEU, see also: the public policy or public security: Art. 65 (1b) TFEU and Art. 52(1) TFEU.

[58] See on the primary establishment the following cases: CJEU (Judgment of 21 June 1974), C-2/74, *Reyners,* ECLI:EU:C:1974:68, paras. 15-16; CJEU (Judgment of 5 November 2002), C-208/00, *Überseering,* ECLI:EU:C:2002:632, paras. 78–82; CJEU (Judgment of 10 July 1986), C-79/85 *Segers*, ECLI:EU:C:1986:308, para. 14; CJEU (Judgment of 9 March 1999), C-212/97, *Centros,* ECLI:EU:C:1999:126, paras. 26–27; and CJEU (Judgment of 30 September 2003), C-167/01, *Inspire Art,* ECLI:EU:C:2003:512, paras. 96–98, 105.

[59] CJEU (Judgment of 13 July 1993), Case C-330/91, *Commerzbank,* ECLI:EU:C:1993:303, para. 13; CJEU (Judgment of 10 July 1986), C-79/85 *Segers*, ECLI:EU:C:1986:308, para. 13;CJEU (Judgment of 28 January 1986), C-270/*83, Commission v. France*, ECLI:EU:C:1986:37, para. 18; CJEU (Judgment of 16 July 1998), Case C-264/96, *Imperial Chemical Industries,* ECLI:EU:C:1998:370, para. 20; See on the right of secondary establishments of credit institutions: CJEU (Judgment of 5 October 2004), Case C-442/02, *Caixabank France*, ECLI:EU:C:2004:586, paras. 13–14.In the latter case, the EUCJ stated that CRD I does not entitle credit institutions that are authorized in one Member State to set up a subsidiary in another Member State. SeeCJEU (Judgment of 5 October 2004), Case C-442/02, *Caixabank France*, ECLI:EU:C:2004:586, para. 7.

[60] See Art. 49(1) TFEU.

[61] Art. 54 TFEU.

within the Union'.[62] The freedom of establishment is, thus, limited to secondary establishments of third country nationals. The freedom may, thus, not invoke by branches of third country nationals as it does not have legal personality. To benefit from this freedom, third country nationals, thus, need to establish a subsidiary within the EU (legal person). Claims on the free movement of establishment are, thus, for third country nationals restricted on the basis of its personal scope, whereas EU Members States may be derogated from restrictions on this freedom for EU nationals.

Following Article 52 TFEU, the freedom of establishment may be derogated by Member States by law, regulation or administration sanctions on grounds of public policy, public security or public health. Prudential financial regulation is, thus, derogated on the basis of public policy.

1.2.3. *The Freedom to provide Services*

Following Article 56(1) Member States are prohibited to restrict the freedom to provide services[63] in respect of nationals of Member States who are established in a Member State other than that of the person for whom the services are intended. The freedom of services applies to nationals that want to provide services in another Member State without establishing a branch or subsidiary in that Member State. Similar, to the free movement of establishment, the personal scope of this freedom is limited to EEA nationals, non-EU nationals cannot invoke this freedom.

On the basis of Article 61 TFEU, Member States may apply restrictions, as long as they have not been abolished, without distinction on grounds of nationality or residence to all persons provision services. Again, prudential regulation qualifies under this derogation.

1.2.4. *Overlapping Fundamental Freedoms*

The laws of Member States may infringe more than one fundament freedom. Convergence of the justifications and restrictions that are accepted for the fundamental freedoms renders the precise qualification of the fundamental freedom infringed irrelevant for intra-EEA cases. The qualification of the precise fundamental freedom infringed, is, however, relevant for TC financial intermediaries. The only fundamental freedom that applies to third countries is the free movement of capital. The TFEU does not contain any priority or exclusion rules. Laws may infringe both the freedom of capital and establishment, or services and establishment.[64] Some cases even touch upon the four freedoms simultaneously.[65] Throughout CJEU case law there are three approaches being used by the CJEU to ensure that the four freedoms are not being abused by TC financial intermediaries:

---

[62] The 'real and continuous' link principle was required by the 1961 General Programme on the abolition of restrictions on the freedom of establishment. See General Programme for the abolition of restrictions on the freedom of establishment within the European Economic Community, OJ 1962 2/36 English special edition: Series II Volume IX, p. 7 (Title I: Beneficiaries); Later the principle got adopted also in various European financial legislative acts: See, for instance, Art. 13(2)(a) CRD IV under which a credit institution must have their head and registered office in the same Member State.

[63] See Art. 57 TFEU.

[64] For a long time the literature, however, assumed that more freedoms could apply to a single case. See W. Schön, *Der kapitalverkehr mit Drittstaaten und das international Steuerrecht* 489-501 (R. Gocke, D. Gosch & M. Lang eds., C.H. Beck 2005).

[65] See the following case on Denmark's pension taxation rules : CJEU (Judgment of 30 January 2007), C-150/04, *Commission v. Denmark,* ECLI:EU:C:2007:69.

- the CJEU is reluctant to apply the free movement of capital if there is an overlap with another freedom;[66]
- the free movement of capital applies but the restricted is 'grandfathered';[67]
- restrictions affecting TC financial intermediaries are easier justified on the basis of a 'prudential carve-out'.[68]

The four freedoms, apart from the free movement of capital, , thus, do not apply to TC financial intermediaries. If TC financial intermediaries are affected by an infringement of this freedom, the CJEU usually uses one of these approaches to avoid that the free movement of capital is being 'abused' by TC financial intermediaries. Again, prudential regulation qualifies under any circumstance as a valid derogation from the free movement of capital.

Mere negative integration on the basis of invoking the 'four freedoms' to establish an internal market was for both EEA and TC financial intermediaries, thus, was not possible. Instead, positive integration in the EEA was necessary to unleash the potential of the internal market for financial services.

2. The Evolution of the EEA Legal Framework for the Cross-Border Provision of Financial Services

The 'prudential carve-out' under the 'four freedoms' impeded the establishment of an internal market for the cross-border provision of financial services in the internal market solely based upon negative integration. Instead, positive integration by means of secondary legislation was established. The evolution since the 1980s was characterised by a gradual increase in detailed EEA financial law harmonization, more centralized rulemaking and implementation of the EEA legal framework for the cross-border provision financial services. This section describes the road from 'national treatment' to a full-fledged European passport based upon maximum harmonization and the ESFS.

2.1. The Era of National Treatment

The starting point for the EEC was the principle of 'national treatment' (non-discrimination), i.e. the prohibition of discrimination between domestic and 'nationals'[69] of other Member States. Although the four fundamental freedoms were laid down in the Treaty of Rome[70], the primary focus of this Treaty was the establishment of a customs union that should ultimately

---

[66] See in particular: A-G Opinion (16 March 2006), C-452/04, *Fidium Finanz AG v. Bundesanstalt fur Finanzdienstleistungsaufsicht*, ECLI:EU:C:2006:182, para. 41 et seq.

[67] H. Rehm & J. Nagler, *Verbietet die Kapitalverkehrsfreiheit nach 1993 eingefuhrte Auslanderungleichbehandlung?,* 15 *Internationales Steuerrecht* 861(2006); CJEU (Judgment 13 March 2007), C-524/04, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, ECLI:EU:C:2007:161.

[67] CJEU (Judgment of 24 May 2007), C-157/05, *Winfried L. Holböck v. Finanzamt Salzburg-Land*, ECLI:EU:C:2007:297, paras. 40-41; D. Hohenwarter & P. Plansky, *Die Kapitalverkehrsfreiheit mit Drittstaaten im Lichte der Rechtssache Holböck*, SWI 346 (2007); CJEU (Judgment of 24 May 2007), C-157/05, *Winfried L. Holböck v. Finanzamt Salzburg-Land*, ECLI:EU:C:2007:297, paras. 40-41.

[68] CJEU (Judgment of 12 March 1996), C-441-93), *Panagis Pafitis and others v Trapeza Kentrikis Ellados*, ECLI:EU:C:1996:92, para. 49; CJEU (Judgment 12 October 2004), C-222/02, *Peter Paul and others* v *Germany*, ECLI:EU:C:2004:606, para. 44; A-G Opinion (16 March 2006), C-452/04, *Fidium Finanz AG v. Bundesanstalt fur Finanzdienstleistungsaufsicht*, ECLI:EU:C:2006:182, para. 42; A-G Opinion (26 January 1995), *Alpine Investments BV v Minister van Financiën,* ECLI:EU:C:1995:15, para. 44.

[69] Should be understood as nationals within the meaning of the free movement of establishment: legal and natural persons. See Art. 54 TFEU.

[70] Arts. 52, 59 Treaty of Rome.

lead to the elimination of all tariffs within the EU and establish a common external tariff.[71] Especially, the free movement on services, establishment and capital were the first pivotal step in establishing a single market for financial intermediaries. Further implementing directives would, however, be necessary to specify the application of the four freedoms set out in general terms under the Treaty during a transition period that ended on 1 January 1970.[72] Legislative action on the European level and decisions of the CJEU were necessary to implement these rights. For that reason, the freedom on establishment and services were supplemented by two general programs adopted on 18 December 1961 that indicated that a number of obstacles by means of directives needed to be eliminated to abolish restrictions related to these two freedoms.[73] Following the general programs, the Council of the European Communities adopted directives on numerous issues.[74]

2.1.1. Implementing Directives on the Free Movement of Establishment/Services

In 1973 a directive was adopted that introduced the principle of national (non-discriminatory) treatment for (self-employed activities of) banks and other financial institutions.[75] This principle implementing the freedom of establishment and services was declared applicable for various banking services linked with capital movements, such as the custody of securities.[76] Article 3(1) Council Directive 73/183/EEC implemented the principle of national treatment by requiring Member States to abolish restrictions that:

- prevent banks and other financial institutions of Member States from establishing themselves or from providing services in the host country under the same conditions and with the same rights as nationals of that country;[77]
- apply discriminating administrative practices to banks and other financial institutions of Member States that are discriminatory by comparison with that applied to nationals.[78]

---

[71] See J. Calmann, *The Common Market: the Treaty of Rome explained* (Blond 1967).
[72] See on the direct effect of the freedom of establishment: CJEU (Judgment of 21 June 1974), C-2/74, *Reyners,* ECLI:EU:C:1974:68, paras. 30-31; CJEU (Judgment of 3 December 1974), C-33-74, *Van Binsbergen,* ECLI:EU:C:1974:131.
[73] a General Programme on the abolition of restrictions to the freedom of establishment: General Programme for the abolition of restrictions on the freedom of establishment, OJ 1962 2/36 English special edition: Series II Volume IX, 7 ; See on the free movement of services: General Programme for the abolition of restrictions on the freedom to provide services, OJ 1962 2/32 English special edition: Series II Volume IX,, 3; V. Hatzopoulos, *Regulating Services in the European Union* 222 (Oxford University Press 2012).
74 R. Blanpain, *Freedom of Services in the European Union: Labour and Social Security Law* 181 (Kluwer 2006).
[75] A similar directive was introduced for insurance companies. See Council Directive 73/240/EEC of 24 July 1973 abolishing restrictions on freedom of establishment in the business of direct insurance other than life assurance [1973] O.J. L228/20.
[76] Directive 73/183/EEC of 28 June 1973 on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self-employed activities of banks and other financial institutions, OJ 1973 L194/1, List A, Direct investments, custody of securities and List B, Operations in securities dealt in on a stock exchange excluding units of unit trusts, custody of securities. See for an overview of this directive: J. Detienne, *La liberté d'établissement des banques et des autres établissements financiers*, Revue de la Banque, 290-295(1974).
[77] Art. 3(1)(a) Directive 73/183/EEC of 28 June 1973 on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self-employed activities of banks and other financial institutions, OJ 1973 L194/1.
[78] Art. 3(1)(b) Directive 73/183/EEC of 28 June 1973 on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self-employed activities of banks and other financial institutions, OJ 1973 L194/1.

Various examples of restrictions were included in Council Directive 73/183/EEC, including, for instance, a special authorization that was needed to be obtained by foreign banks in Denmark before accessing their market.[79]

2.1.2. Reyners & Van Binsbergen

The practical significance of this directive was lost after the CJEU held in the cases *Reyners* and *Van Binsbergen* that the failure to adopt the implementing directive before the transitional period had ended did not prevent the application of the fundamental freedoms under the Treaty.[80] The prohibition of discrimination on grounds of nationality could be invoked by the four freedoms itself that were to have direct effect. Implementing directives were not necessary as they do not constitute the basis of the four freedoms, but facilitate those rights by eliminating restrictions that could not be merely overcome by the principle of non-discrimination on grounds of nationality. The latter two judgments led to the repeal of a number of proposed directives aimed at implementing the four freedoms.

2.1.3. The First Generation of Banking (and Insurance) Directives

After a long time of negotiations[81], the First Banking Directive[82] adopted in 1977 was, together with the insurance directives[83], amongst the first to harmonize conditions for the taking up of business of financial intermediaries of European Member States. The directive confirmed the principle of national treatment and did not go far beyond the freedom of services and establishment.[84] It confirmed that in order to adhere to this principle[85], it was necessary to eliminate the most obstructive differences between the laws of Member States to make the take up and pursue of business by credit institutions easier.[86] This aim could, however, only be achieved if the discretionary powers of the Member States related to the authorization of credit establishments were being 'progressively reduced'.[87]

For this purpose, certain uniform authorization requirements for comparable types of credit institutions were introduced.[88] The conditions of general application harmonized were very limited and amounted to the possession of separate and adequate own funds and two persons that effectively directed the business of the credit institution that are sufficiently of good repute and experience.[89]

De facto, the only provision that prevented Member States from taking discriminating measures was being laid down in Article 3(3) First Banking Directive. This provision

---

[79] Art. 3(2)(b) Directive 73/183/EEC of 28 June 1973 on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self-employed activities of banks and other financial institutions, OJ 1973 L194/1.

[80] CJEU (Judgment of 21 June 1974), C-2/74, *Reyners,* ECLI:EU:C:1974:68, paras. 30-31; CJEU (Judgment of 3 December 1974), C-33-74, *Van Binsbergen,* ECLI:EU:C:1974:131.

[81] U. Leanza, *An Outline of the EEC Discipline on Credit Institutions*, 7 Journal of Regional Policy, 59 (1987).

[82] See on the First Banking Directive: P. Clarotti, *The harmonization of legislation relating to credit institutions*, 19 Common Market Law Review 245(1982).

[83] See on insurance directives: First Council Directive 73/239/EEC of 24 July 1973 on the coordintino of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance [1973] O.J. L228/3) ; First Council Directive 79/267/EEC of 5 March 1979 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life assurance [1979] O.J. L63/1). See D. Edward, *Establishment and Services : An Analysis of the Insurance Cases*, 12 European Law Review 231 (1987).

[84] See Art. 3 First Banking Directive.

[85] Recital 1 First Banking Directive.

[86] Recital 2, First Banking Directive.

[87] Recital 9 First Banking Directive.

[88] Recital 8 First Banking Directive.

[89] Art 3(2) First Banking Directive.

prohibited Member States from requiring the application for authorization to be examined in terms of 'economic needs of the market'. Protectionists measures could, thus, not been taken by Member States. Apart from this, Member States were required to impose the same authorization requirements to branches of credit institutions of other Member States as to credit institutions established domestically (if any).[90] Authorization could not be reused to a branch of a credit institutions

> 'on the sole ground that it is established in another Member State in a legal form which is not allowed in the case of a credit institution carrying out similar activities in the host country'.[91]

The First Banking Directive not only provided minimum requirements regarding European, but also for third country credit institutions. It stated that the rules governing branches of third country credit institutions should be analogous in all Member States.[92] For that purpose, it introduced the principle of 'no favourable treatment', i.e. Member States could not authorize branches of third country credit institutions on the basis of more favourable treatment than branches of credit institutions of Member States.[93] A mandatory requirement to notify the European Commission and Advisory Committee on all authorizations was introduced to accommodate the latter.[94] Finally, the European Commission could conclude agreements on the basis of the EEC Treaty with one or more third countries, on the basis of reciprocity, to grant branches of credit institutions from a certain third country identical treatment throughout the EEC.[95]

2.1.4. Review of the Principle of National Treatment and the Way to Mutual Recognition

The First Banking Directive was, thus, the first directive introducing the principle of national treatment of financial intermediaries.[96] This principle amounted to EEC Member States to offer the same opportunities for establishment of credit institutions from other Member States and the same rights to firms regarding business activities in host-Member States as their domestic credit institutions. The purpose of the policy of national treatment clearly was to create equal conditions of competition between domestic credit institutions and credit institutions in other Member States and to allow to compete them on the basis of a 'level playing field' within a particular Member State.[97]

In its recitals, it was being acknowledged that obstacles could not be removed by a single directive and that it was necessary to proceed by successive stages.[98] However, its ultimate

---

[90] Art. 4(1) First Banking Directive.
[91] Art. 4(2) First Banking Directive.
[92] Recital 13 First Banking Directive.
[93] Recital 13, Art. 9(1) First Banking Directive; See also Organisation for Economic Co-operation and Development, *National Treatment for Foreign-Controlled Enterprises* (Paris: OECD, 1985) for a discussion on the principle of national treatment and how it should be applied in OECD Member States.
[94] Art. 9(2) First Banking Directive.
[95] Art. 9(3) First Banking Directive.
[96] The OECD has defined 'national treatment' as treatment under host-country 'laws, regulations, and administrative practices…no less favourable than that accorded in like situations to domestic enterprises'. See *Organisation* for *Economic Co-operation* and *Development*, *Declaration on Internal Investment and Multinational Enterprises*, 15 I.L.M. 967 (1976).
[97] Recital 4, First Banking Directive. See also S.J. Key, *Financial Integration in the European Community*, Board of Governors of the Federal Reserve System – International Finance Discussion Papers, No. 349 (April 1989), 37.
[98] Recital 3 First Banking Directive.

purpose was to achieve a system (mutual recognition/European passport) whereby credit institutions having their 'head office'[99] in one Member State would be exempt from any national authorization requirement when setting up branches in other Member States.[100] The national principle treatment as an approach to integration within the EC (now: EU) led to a 'level playing field' in the 'host Member States'. The approach did, however, not remove the defragmented European (banking) markets. Although authorization standards had been minimized to a certain level, Member States were not required to recognize the authorization of credit institutions by other Member States. The directive also allowed Member States to impose domestic solvency and monitoring requirements on branches that were active in their domiciles.[101] The defragmented markets and the, de facto, restrictions to the establishment of branches, thus, hindered the cross-border banking business in growing. Economies of scale gained through the establishment of cross-border branches would be offset by the regulatory costs that were incurred by territorial expansion. This hampered the liberalization of cross-border banking services. National treatment, thus, introduced fair treatment for market entry within a particular Member State, but did not answer the question what would be necessary to achieve a system to regulate and supervise financial intermediaries whereby financial intermediaries authorized in one of the Member States would be exempt from any authorization requirement when making use of the free movement of establishment/services in another Member State.[102] The era of 'mutual recognition' would give an answer to this question.

2.2. The Era of Mutual Recognition and the Single License Concept

The second era of 'mutual recognition'[103] was being introduced by the White Paper on the Completion of the Internal Market by the European Commission in 1985.

2.2.1. The White Paper on the Completion of the Internal Market (1985)

The White Paper introduced a new approach towards the establishment of the internal market. Various measures that would necessary to complete the internal market were identified and classified in three groups: physical[104], technical[105] and fiscal barriers[106]. The harmonization of

---

[99] Modern European legislation use instead the term 'registered office'. Financial intermediaries are, however, required to have both the registered and head office within the Member State of their authorization as to prevent circumvention of regulation. See, for example, Recital 46, Art. 5(4)(b) MiFID II.

[100] Recital 10 First Banking Directive.

[101] B.C. Matthews, *the Second Banking Directive: Conflicts, Choices, and Long-Term Goals*, 2 Duke Journal of Comparative & International Law 89 (1992).

[102] See Recital 10 First Banking Directive. See for an analysis of this problem: S.J. Key, *Financial Integration in the European Community*, Board of Governors of the Federal Reserve System – International Finance Discussion Papers, No. 349 (April 1989), 38-39.

[103] The term 'mutual recognition' was developed with regard to professional qualifications in Art. 57 of the Treaty of Rome and later became jargon in European Financial Services: See, for example, Recital 4,8 Second Banking Directive.

[104] Commission of the European Communities, *Completing the Internal Market: White Paper from the Commission to the European Council* 11-18 (Office of Official Publications of the European Communities 1985).

[105] Commission of the European Communities, *Completing the Internal Market: White Paper from the Commission to the European Council* 19-41 (Office of Official Publications of the European Communities 1985); See also Commission of the European Communities, *Completing the Internal Market: An Area without Internal Frontiers—The progress Report Required by Article 8B of the Treaty*, COM (88) 650 final, 17 November 1988, 15-21.

essential standards for the provision of financial services was regarded as a removal of a technical barrier.

The White Paper primarily introduced a new strategy for the harmonization of laws. Although significant progress was made, the idea of the 'complete harmonization of laws' proved to be a slow legislative process.[107] Especially, the requirement of unanimity that was necessary to approve laws, regulations and administrative actions on the European level proved to be unsatisfactory.[108] The new policy objective was only to harmonize essential laws and regulations for both goods and services.[109] The harmonization would then serve as a basis for the 'mutual recognition', i.e. the equivalence and controls of laws, regulations and administrative procedures.[110]

The legal basis of the White Paper 'mutual recognition' approach was to be found in the decision of the CJEU in *Cassis de Dijon*.[111] The CJEU held that the import of a product (liquor) may only be prohibited when it necessary for the protection of public health, the fairness of commercial transactions, and the protection of consumers.[112] The White Paper stated that 'what is true for goods, is also true for services and people'.[113] Furthermore, it set out that the free circulation of 'financial products' should be possible at the EU level on the basis of a minimum coordination of rules as the basis for mutual recognition.[114] The European Commission indicated that the harmonization regarding the supervision of ongoing activities would be subjected to 'home country control'.[115] Under minimum harmonization and surveillance standards, the primary task of supervising a financial intermediary would be attributed to the Competent Authorities of the Member State in which the investment firm had its primary establishment.[116] The financial intermediary would have to communicate all information necessary for supervision to its home Member State Competent Authority.[117] The host Member State, i.e. Member State where a financial intermediary is active on the basis of the free movement of establishment/services, had a complementary role.

The mutual recognition approach, as introduced by the European Commission, was embedded in the Single European Act that in 1986 amended the Treaty of Rome.[118] The decision-making process became under the Single European Act more smooth as unanimous

---

[106] Commission of the European Communities, *Completing the Internal Market: White Paper from the Commission to the European Council* 43-56 (Office of Official Publications of the European Communities 1985); H.A. Benink, *Financial Integration in Europe* 8 (Springer 1993).

[107] Commission of the European Communities, *Completing the Internal Market: White Paper from the Commission to the European Council* 20-21 (Office of Official Publications of the European Communities 1985); M. Wiberg, *The EU Services Directive: Law or Simply Policy?* 25 (Springer 2014).

[108] *Ibid.*

[109] Commission of the European Communities, *Completing the Internal Market: White Paper from the Commission to the European Council* 21-24 (Office of Official Publications of the European Communities 1985); F. Weiss & C. Kaupa, European Union Internal Market Law 9 (Cambridge University Press 2014).

[110] Commission of the European Communities, *Completing the Internal Market: White Paper from the Commission to the European Council* 24 (Office of Official Publications of the European Communities 1985); G. Fitchew, *Political Choices* 4 (R.M. Buxbaum, G. Herzig, A. Hirsch & K.J. Hopt eds., De Gruyter 1991).

[111] CJEU (Judgment 20 February 1979), C-120-78, *Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein*, ECLI:EU:C:1979:42.

[112] *Ibid.*

[113] Commission of the European Communities, *Completing the Internal Market: White Paper from the Commission to the European Council* 19 (Office of Official Publications of the European Communities 1985);

[114] *Ibid,* 29.

[115] *Ibid.*

[116] M. Dougan, *Minimum Harmonization and the Internal Market*, 37 Common Market Law Review 853, 866 (2000).

[117] Commission of the European Communities, *Completing the Internal Market: White Paper from the Commission to the European Council* 29 (Office of Official Publications of the European Communities 1985).

[118] Arts. 13, 19 Single European Act.

voting was replaced by 'qualified majority voting'.[119] This was important as mutual recognition could only be introduced on the basis of harmonization of the regulatory and supervisory practices of Member States.

Major reforms to implement the principle of mutual recognition were taken in four areas: banking, investment services, securities markets[120] and insurance[121]. Due to the relevance for depositaries/custodians, the first two will now be addressed as examples of the introduction of 'mutual recognition' and the 'single license concept'.

2.2.2. Mutual Recognition under the Second Banking Directive

The Second Banking Directive was the first directive on financial intermediaries that implemented the 'mutual recognition approach'. The First Banking Directive was not repealed and, thus, both directives applied simultaneously.

The directive implemented the two principles that are the cornerstone of the current European passport concept : 'mutual recognition' and 'home country control'.[122] Member State are under 'mutual recognition' required to recognize the authorization granted to a credit institution in another Member State despite regulatory differences.[123] Based upon this principle, credit institutions were granted the right to establish a branch or provide cross-border services based upon a single authorization for a list with services annexed[124] to the directive that was valid in all Member States. Subsidiaries of credit institutions remained to be governed by the principle of national treatment. As a consequence, subsidiaries were required to obtain a separate authorization as credit institution. No European regulatory institution was established to issue and enforce the license. Instead, the principle of subsidiarity mandated that credit institutions that were active in the Community remained to be regulated by its home Member State.[125] The two core principles were supported by minimum harmonization of key economic and procedural aspects of the authorization process, including minimum capital requirements[126], information requirements[127], grounds for refusal of authorization[128] and provisions regarding the cooperation between home and host Member States.[129]

The Second Banking Directive also introduced a number of provisions in relation to third countries.[130] Competent Authorities of Member States were required to inform the European Commission of any authorization of a direct or indirect subsidiary of TC parent

---

[119] Art. 18 Single European Act.

[120] S.J. Key, S.J., *Financial Integration in the European Community*, Board of Governors of the Federal Reserve System – International Finance Discussion Papers, No. 349 (April 1989), 29-30.

[121] **Second Council Directive 88/357/EEC of 22 June 1988 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 73/239/EEC ; Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and amending Directives 73/239/EEC and 88/357/EEC (third non-life insurance Directive).**

[122] See E.M. Deerenberg, *Vergunningen, Europees paspoort en toezicht* 19-30 (F.M.A. 't Hart ed, NIBE-SVV 2007).

[123] Art. 18 Second Banking Directive.

[124] Along deposit-taking as primary service, there are other permitted activities, such as forms of borrowing, consumer credit, portfolio management. See Annex List of Activities subject to Mutual Recognition Second Banking Directive.

[125] Art. 1(7) Second Banking Directive.

[126] Art. 4 Second Banking Directive.

[127] Art. 5 Second Banking Directive.

[128] Arts 4-7 Second Banking Directive.

[129] Art. 14(3) Second Banking Directive.

[130] Art. 8 Second Banking Directive.

undertakings.[131] In addition, Competent Authorities of Member States were required to inform the Banking Advisory Committee (now: ECB) whenever TC parent undertakings acquired a holding in a Community credit institution.[132]

Apart from this, the Second Banking Directive included provisions on the treatment of EU credit institutions in third countries.[133] Member States were required to inform the European Commission on difficulties encountered by credit institutions related to establishing themselves or carrying on banking activities in a particular third country.[134] Furthermore, two provisions were foreseen to remedy those types of difficulties. First, the European Commission could submit to the European Council a proposal to obtain a mandate to negotiate better terms for EC credit institutions.[135] Second, the European Commission could initiate negotiations with third countries for effective market access of EC credit institutions.[136] The provisions on TC credit institutions only governed subsidiaries of third country credit institutions. Branches were not covered and, consequently, the First Banking Directive was still applicable to them.

Two directives were entering into force parallel to the Second Banking Directive: the Solvency Ratio Directive[137] and the Own Funds Directive.[138] Later, the Large Exposure Directive complemented these directives.[139]

2.2.3. Mutual Recognition under the Investment Services Directive

The ISD modelled after the Second Banking Directive, was the first European legal initiative that regulated investment firms on the European level. Until then, the absence of a common European regulatory framework for investment firms had led to enormous compliance costs for investment firms that had to deal with regulatory discrimination of foreign investment firms and multiple regulatory schemes.[140] Under the ISD, investment firms, like their counterparty credit institutions, would benefit from a mutual recognition regime that was also based on home country control and the harmonization of essential minimum prudential standards.[141] Under these two prerequisites, investment firms were granted the right to provide services across borders and establish branches throughout the Community without obtaining authorization from the host Member States in which they intended to be active.

The European Commission based the ISD on the Second Banking Directive to maintain fair competition between banks and investment firms that were allowed to provide investment services.[142] This level playing field objective was also reflected in the content of the ISD.

[131] Art. 8(a) Second Banking Directive.
[132] Art. 8(b) Second Banking Directive.
[133] Art. 9 Second Banking Directive.
[134] Art. 9(1) Second Banking Directive.
[135] Art. 9(3) Second Banking Directive.
[136] Art. 9(4) Second Banking Directive.
[137] Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions, OJ 1989 L 386/14.
[138] Council Directive 89/299/EEC of 17 April 1989 on the own funds of credit institutions, OJ 1989 L 124/16.
[139] Council Directive 92/121/EEC of 21 December 1992 on the monitoring and control of large exposures of credit institutions, OJ 1993 L 29/1.
[140] M.G. Warren, *The European Union's Investment Services Directive*, 15 Journal of International Law 186 (1994).
[141] E. Wymeersch, *The Implementation of the ISD and CAD in National Legal Systems* (G. Ferrarini ed. Kluwer 1998); M. Tison, *De interne markt voor bank- en beleggingsdiensten* (Intersentia rechtswetenschappen 1999).
[142] E.W. Warner, *"Mutual Recognition" and Cross-Border Financial Services in the European Community*, 55 *Law and Contemporary Problems* 7-28 (1992).

Many provisions were similar or identical to provisions in the Second Banking Directive.[143] Credit institutions authorized under that Directive, thus, did not need to obtain a separate authorization under the ISD to provide investment services in other Member States.[144] Authorization in the home Member State included five general conditions, including requirements related to: [145]

- sufficient financial resources;
- managers that are of 'sufficiently good repute and experience';
- the firm's shareholders that must be 'suitable persons';
- the circumvention of the home Member State regulatory regime is prevented; and
- a 'program of operations' that investment firms are required to send to their home Member States Competent Authorities with the type of activities envisaged.

Apart from this, the ISD established a set of 'prudential rules'[146] and principles with conduct of business that investment firms were required to comply with on an ongoing basis. Sound internal control mechanisms, the safeguard of investor funds and assets and conflicts of interests were examples of the minimum standards laid down in the ISD.[147] Member States could not agree upon 'conduct of business rules'. During the negotiations, some conduct of business rules were re-labelled as 'prudential rules'.[148] Other conduct of business rules were required to be harmonized by a separate European legislative act and, for that purpose, only embedded in the ISD in a few general principles, including, amongst others, acting in investors interests and general conflict of interest rules. The non-harmonization in this domain resulted in that the compliance with these rules were to be supervised by the host Member State, whereas the 'prudential rules' were to be supervised by the home Member State.[149]

The ISD applied to investment services that were set out in a list of services/activities annexed to the ISD.[150] Investment services to be offered, included, amongst others: portfolio management, individual investment advice and market making.[151] Services were only permitted to be provided with respect to financial instruments, such as, for example, transferable securities and money market investments.[152] In addition, the ISD Annex also included 'non-core services'. These services were allowed to be provided on a cross-border basis on the basis of a European passport if an investment firm had obtained authorization to provide one or more investment services.[153] These services were, thus, ancillary to the core investment services. Non-core services included, among others, the safekeeping and safe custody services, margin lending services, and corporate finance advisory services.[154]

---

[143] See European Commission, *Explanatory Memorandum - Proposal for a Directive on Investment Services in the Securities Field: Proposal for a Council Directive on investment services in the securities field*, (COM(88) 778 – syn 176).

[144] Art. 2 ISD; See C. Abrams, *The Investment Services Directive - who should be the principal regulator of cross-border services?*, 2 European Financial Services Law 317 (1995).

[145] See Art. 3 ISD.

[146] This term was controversial as it did not only involve capital standards and was in the first discussion draft of the ISD characterized as 'conduct of business rules'. See for a general overview: M.G. Warren, *The European Union's Investment Services Directive*, 15 Journal of International Law 186 (1994).

[147] Art. 10 ISD.

[148] See Art. 10 ISD for the prudential rules and Art. 11 ISD on the conduct of business rules.

[149] See Art. 11(1) and (2) ISD.

[150] See Annex Section A 'Services', Section B 'Instruments' and Section C 'Non-core services' ISD.

[151] See Annex Section A 'Services' ISD.

[152] Section B 'Instruments' ISD.

[153] Art. 3(1) ISD.

[154] See Section C 'Non-core services' ISD.

The ancillary services were agreed upon after long process of negotiations. The harmonization of rules related to investment services proved to be even more difficult than the harmonization rules applying to credit institutions. The reason behind this was that the process of global harmonization was not as advanced in the investment services domain as for credit institutions.[155] No equivalent of the Basel Accord on banking capital standards was agreed upon on the internal level for investment services nor an equivalent of the BIS Committee on Banking Regulations and Supervisory Practices was being established.[156] The harmonization of investment services, thus, proved to be difficult and the non-core services were seen as a step of gradual harmonization.[157] Consequently, investment firms were upon providing 'non-core services' not allowed to benefit from a European passport unless they provided the ancillary services along one of the 'core services'. Member States were, thus, allowed to regulate firms that were merely providing non-core services without core services under their national laws. In the custodian domain, this resulted in a large variety of regulatory regimes throughout the Member States. Some Member States in their initial ISD implementation, for example, subjected the stand-alone provision of the safekeeping of securities as if it was an investment service and subjected those custodians to the ISD implementation laws.[158] Austria, Germany and Liechtenstein, however, saw the (stand-alone) provisions of the safekeeping of securities as a banking activity for which a credit institution license was required, whereas other Member States did not regulate this in detail and allowed both credit institutions and investment firms under the Second Banking Directive and ISD to act as a custodian.[159]

Apart from this, the ISD extended the 'national treatment' third country approach previously adopted for credit institutions under the Second Banking Directive to investment firms.[160] The 'national treatment' approach under the ISD offered the same competitive opportunities to subsidiaries of TC 'investment firms' as for EC investment firms. Third country firms, thus, were required to incorporate an EC subsidiary in order to obtain a European passport under the ISD. Similar as under the Second Banking Directive, the Competent Authorities of Member States were required to:

- inform the European Commission of any authorization of a direct or indirect subsidiary of TC parent undertakings;[161]
- inform the Committee on Transferable Securities (until the establishment the Council) whenever TC parent undertakings acquired a holding in a Community investment firm.[162]

The ISD also adopted the 'effective market access' approach for EC investment firms that was introduced for EC credit institutions under the Second Banking Directive.[163]

The European Commission was required to report third-countries that do not provide national treatment or 'effective market access' to EC investment firms.[164] Member States

---

[155] S.J. Key, *Financial Integration in the European Community*, Board of Governors of the Federal Reserve System – International Finance Discussion Papers, No. 349 (April 1989), 27.
[156] *Ibid.*
[157] See for an overview of the developments regarding the pre-ISD stage: A. Ewing, The Single Market of 1992: Implications for Banking and Investment Services in the EC, 13 Hastings Int'L & Compl. L. Rev. 453 (1990). E.W. Warner, *"Mutual Recognition" and Cross-Border Financial Services in the European Community*, 55 *Law and Contemporary Problems* 7-28 (1992).
[158] See, for example, Ireland: S. 52 Investment Intermediaries Act 1995.
[159] See Chapter 6, section 4.
[160] G.S. Zavvos, *Towards a European Banking Act*, 25 Common Mkt. L. Rev p. 263 (1988).
[161] Art. 7(1)(a) ISD.
[162] Art. 7(1)(b) ISD.
[163] Art. 7(2) ISD.

were required to inform the European Commission on difficulties that EC investment firms encountered when establishing themselves or carrying on investment services in third countries.[165] Furthermore, two provisions were foreseen to remedy those types of difficulties. The same two remedies as under the Second Banking Directive were foreseen to remedy difficulties. First, the European Commission could submit to the European Council a proposal to obtain a mandate to negotiate better terms for EC investment firms. [166] Second, the European Commission could initiate negotiations with third countries for effective market access of EC credit institutions.[167] TC firm branches were not covered by the ISD and, therefore, did not benefit from any European passport under the ISD. Instead, Member States had the discretion to regulate TC firm branches.[168]The ISD was in 1993 complemented by the CAD that established capital requirements for both credit institutions and investment firms.[169]

2.2.4. *Hidden National Barriers to Entry: Grounds of 'General Good/Interest'*

The financial services legislation applying to intermediaries that was adopted under the mutual recognition approach dealt with credit institutions and investment firms. Although a passport was being granted to these intermediaries, it was based upon minimum harmonization.[170] Both, however, did not cover a number of areas, resulting in Member States still imposing stricter rules on both domestic and European intermediaries that were active within their domiciles (goldplating).[171] The main reason for this was that both the Second Banking Directive and ISD contained provisions which divided powers amongst home and host Member States.[172] Under the approach taken in both directives, the host Member States must adhere to the mutual recognition approach as long as activities by credit institutions and investment firms in the home Member State do not conflict with the laws and regulations protecting the 'general good'.[173] This exception gave Member States the freedom to continue to regulate credit institutions and investment firms from other Member States that were active within their domiciles justified on the basis of the 'general good'.[174] The problem was, however, that both directives did not define the term 'general good'. Host Member States, thus, retained the power to take appropriate measures to prevent or penalize irregularities committed within their domiciles which were contrary to legal or regulatory provisions that were adopted in the 'interest of the general good' and had to be properly justified and communicated.[175] What legal or regulatory provisions could be justified based on this definition remained to be unclear until the CJEU resolved the issue.

---

[164] Art. 7(3) ISD.
[165] Art. 7(2) ISD.
[166] Art. 7(5) ISD.
[167] *Ibid.*
[168] Recital 30 ISD.
[169] Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investments firms and credit institutions.
[170] E. Avgouleas, *The Harmonisation of Rules of Conduct in EC Financial Markets: Economic Analysis, Subsidiarity and Investor Protection*, 6 ECJ 72 (2002).
[171] See M. Dougan, *Minimum Harmonization and the Internal Market*, 37 Common Market Law Review 853, 866 (2000).
[172] Art. 8(3) ISD. Art. 13 Second Banking Directive.
[173] Recital 33 ISD.
[174] Art. 13 ISD.
[175] Art. 19(6) and (7) ISD.

Four insurances cases related to each other clarified under what conditions a host Member State could adopt restrictions on the basis of the general good.[176] In the related cases various Member States had adopted laws that required insurance companies that were already authorized in another Member State to apply for additional authorization and establish a branch in which they marketed their insurances.[177] In the light of the harmonized authorization procedure under the insurance directive of 1973[178], the European Commission took the point of view that Member States should not require insurance companies to be established within their domicile.[179]

Member States justified their legal requirements based upon grounds of the 'general good' (public interest). They argued that laws of other Member States were found to be not sufficient regarding, amongst others, the financial position and technical reserves of insurance companies. The CJEU held that authorization procedures were restrictions that infringed the freedom to provide services as the policyholders buying co-insurance were sophisticated.[180] In The CJEU also held that requiring additional authorization requirements could be justified in the case direct insurance involving small policyholders if there were 'imperative reasons relating to the public interest' that may justify restrictions on the freedom to provide services.[181] Restrictions could, however, not be justified if the public interest was already protected by the legislation of the home Member State or if the same result could have been obtained by less restrictive rules. Adopted legislation of host Member States were, however, in any case required to apply equally to domestic and (branches/subsidiaries of) other European insurance companies (national treatment).[182]

Although the cases were held on the basis of an insurance directive that was adopted in the national treatment area, the CJEU in these cases answered the question to what extent European host Member States could require authorization and other requirements on insurance companies based in other Member States that wished to offer cross-border services. The cases also indicated the degree of harmonization that would be necessary to introduce mutual recognition in the insurance sector. [183]

Member States could, based on the public interest test, continue to apply domestic legislation under a non-discriminatory basis (national treatment) provided that Community (now: EU) legislation did not yet harmonize that area of law.[184] Host Member State restrictions also remained to be subject to the 'public interest test'.[185]

---

[176] D. Edward, *Establishment and Services : An Analysis of the Insurance Cases*, 12 European Law Review 231 (1987).
[177] *Ibid.*
[178] First Council Directive 73/239/EEC of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance.
[179] CJEU (Judgment of 4 December 1986), C-220/83 *Commission v France,* ECLI:EU:C:1986:461, par. 120-121; CJEU (Judgment of 4 December 1986), C-205/84, *Commission v Germany*, ECLI:EU:C:1986:463, par. 82, 83; CJEU (Judgment 4 December 1986), C 206/84, *Commission v Ireland,* ECLI:EU:C:1986:464, par. 154.
[180] CJEU (Judgment of 4 December 1986), C-220/83 *Commission v France,* ECLI:EU:C:1986:461, par. 134.
[181] CJEU (Judgment of 4 December 1986), C-205/84, *Commission v Germany*, ECLI:EU:C:1986:463, par. 101-102.
[182] *Ibid*.
[183] S.J. Key, *Financial Integration in the European Community*, Board of Governors of the Federal Reserve System – International Finance Discussion Papers, No. 349 (April 1989), 52-53.
[184] *Ibid*, 55.
[185] See, for example, Recital 16 Second Banking Directive: 'Member State must ensure that there are no obstacles to carrying on activities receiving mutual recognition in the same manner as in the home Member State, as long as the latter do not conflict with legal provisions protecting the general good in the host Member State'. General good is not defined. See B.C. Matthews, *the Second Banking Directive: Conflicts, Choices, and Long-Term Goals*, 2 Duke Journal of Comparative & International Law 89 (1992).

The public interest test was embedded in the Second Banking Directive and the ISD. Following the implementation of, in particular, the ISD wide differences could be observed in, for example, national conduct of business rule, the application of marketing rules and the interpretation of the ISD by national legislators and Competent Authorities.[186]

Not surprising, the national regimes of Member States remained diverse and complex.

2.3. The Financial Services Action Plan (FSAP)

In 1998 the European Commission, on the basis of a request of the European Council[187], had published a Communication on building a framework for action on financial services .[188] The Communication concluded that the market integration had been slow and that measures would have to be considered that would make it possible to adopt and amend legislation faster.[189] Following a meeting of the European Council[190], the European Commission drafted an Action Plan on Implementing the Framework for Financial Services together with the Financial Services Policy Group.[191] The Financial Services Action Plan (FSAP), an annex to this communication, set out three strategic objectives: (1) a single EU wholesale market, (2) open and secure retail markets and (3) prudential rules and supervision adhering to international standards.[192] The FSAP also included proposals for the enactment of new legislation in areas that had not been harmonized yet and the mechanisms on how to achieve the three strategic objectives.[193] The FSAP set out forty-two actions that had to be adopted before 2005.[194] The amendments proposed, included, amongst others, the conduct of business rules of investment firms, collective investment schemes, the prohibition on market manipulation and insider dealing. The FSAP, thus, led to a far-reaching harmonization of the national financial regulation of the EU Member States.[195]

The FSAP did not only introduce a number of topics in which harmonization was sought, but also overhauled the legislative process. It was found that the lack of integration of banking and securities laws in Europe was due to the slow pace and efficiency in which financial

---

[186] E. Avgouleas, *A Critical Evaluation of the New EC Financial-Market Regulation: Peaks, Troughs, and the Road Ahead*, 18 Transnational Lawyer 179 (2005).
[187] Presidency Conclusions of the Cardiff European Council of 15 and 16 June 1998, para. 17.
[188] European Commission, *Commission Communication - Financial Services: Building a Framework of Action,* COM (98) 625 final, 28 October 1998; K. Lee, *Investor Protection in European Union: Post FSAP Directives and MiFID*, https://ssrn.com/abstract=1339305 (accessed 14 January 2017); See also: A.O., Kühne, *Ausgewählte Auswirkungen der Wertpapierdienstleistungsrichtlinie – MiFiD*, Zeitschrift für Bank- und Kapitalmarktrecht 275 (2005).
[189] *Ibid.*
[190] Presidency Conclusions of the Vienna European Council of 11 and 12 December 1998, para. 51.
[191] European Commission, *Commission Communication - Financial Services: Implementing the Framework for Financial Services Markets: Action Plan*, COM (1999) 232 final, 11 May 1999.
[192] M. Tison, *Financial market integration in the post FSAP era. In search of overall conceptual consistency in the regulatory framework* 443-464 (G. Ferrarini & E. Wymeersch, Oxford 2006).
[193] N. Moloney, *New Frontiers in EC Capital Markets Law: From Market Construction to Market Regulation,* 40 CMLR 809 (2003).
[194] Presidency Conclusions of the Lisbon European Council on 23 and 24 March 2000, para. 21.
[195] E. Avgouleas, *The New EC Financial Markets Legislation and the Emerging Regime for Capital Markets*, 23 Yearbook of European Law 321 (2004).

services regulation on the European level was enacted and implemented.[196] In 2000, the European Commission set up the 'Committee of Wise Men'.[197]

The Committee was mandated to recommend the most efficient procedure to enact financial services legislation. The Report provided an analysis of the problems encountered in the 'mutual recognition era' and concluded that the absence of unambiguous regulation impeded cross-border activities as the implementation of various directives by Member States (goldplating) prevented a level playing field and created barriers to entry.[198] The Report ultimately included a proposal to adopt more rapidly and efficiently European legislation in the field of financial services.[199] Consequently, the four level regulatory approach, known as the Lamfalussy process, as discussed in more detail *infra 3.3.3.*, was being introduced.[200]

2.4. Overcoming Deficiencies of the Mutual Recognition Era

Despite the adoption of the Lamfalussy procedure, the European Commission highlighted that the market integration had been a success story and that the economic benefit of the European financial integration were beyond doubt.[201] Notwithstanding the possibilities that the European passport brought in the 'mutual recognition era'[202], two core issues were identified under various policy reports regarding financial services policy between 2005-2010: [203] (1) the European financial markets remained to be fragmented despite the harmonization that sought to foster regulatory integration and (2) the principle of home state control showed its limits.[204] Minimum harmonization and home state control were the two fundamental pillars of the European passport granted to financial intermediaries under sectoral legislation in the mutual recognition era. The post-FSAP Era would lead to changes for both.

2.4.1. Maximum Harmonization as a Response to the Defragmented Market for Financial Services

EU lawmaking in the 'mutual recognition era' was characterized by the lawmaking process being an area in which Member States shared its lawmaking competence with the EU.[205] Member States, under the minimum harmonization approach, could take regulatory action as long as the legislator on the European level had not yet regulated a certain area and provided that Member States complied with European law (subsidiarity principle). The 'Grounds of the

---

[196] European Commission, *ECOFIN Council – Regulation of European Securities Markets – Terms of reference for the Committee of Wise Men*, 17 July 2000, 7.
[197] European Commission, *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, Brussels*, 15 February 2001, 13-15.
[198] *Ibid.*, 10-12; See also T. Tridimas, *EU Financial Regulation: Federalization, Crisis Management, and Law Reform* 784-785 (P. Craig & G. de Burca eds., Oxford University Press 2011).
[199] European Commission, *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, Brussels*, 15 February 2001, 13-15.
[200] D. Alford, *The Lamfalussy Process and EU Bank Regulation: Preliminary Assessment and Future Prospects'*, 21 Journal of International Banking Law and Regulation 59 (2006); Bradley, C., *Consumers of Financial Services and the Multi-Level Regulation in the European Union*, papers.ssrn.com/abstract=1132366 (accessed 9 February 2017).
[201] European Commission, *Green Paper on Financial Services Policy (2005 - 2010),* COM (2005) 177, 5.
[202] See Committee of European Securities Regulators, *The Passport under MiFID - Recommendations for the implementation of the Directive 2004/39/EC and Statement on practical arrangements regarding the late transposition of MiFID*, October 2007, CESR/07-337b.
[203] European Commission, *White Paper - Financial Services Policy 2005-2010*, http://ec.europa.eu/internal_market/finances/docs/white_paper/white_paper_en.pdf (accessed 26 June 2017).
[204] See European Commission, *Green Paper on Financial Services Policy (2005 - 2010),* COM (2005) 177, 5, 6.
[205] Art. 2(c) TFEU.

Public Good' jurisprudence confirmed that Member States could regulate such areas of law provided that they would, inter alia, respect the principle of non-discrimination.

The minimum harmonization imposed on Member States by European financial services legislation seemed, at first sight, to be justified on the fundamental principles of subsidiarity and proportionality as laid down in the TFEU.[206]Member States under, for instance, the Second Banking Directive and ISD, were able to maintain or adopt more stringent rules based on the public interest or issues that were not covered by EU harmonized legislation, such as administrative, criminal and consumer protection laws.[207]

Not surprisingly, Member States continued to apply their existing national framework and adopted laws that reflected their own local legal traditions. National legal regimes remained, despite the trend of minimum harmonization, to be diverse and complex. The market integration proved to be fragmented due to the patchwork of cumulative local legal patchworks of legislation that applied to financial intermediaries that made use of their European passport.[208]

Clearly, the minimum harmonization approach was detrimental for market participants. Many chose not to provide cross-border services in other Member States or through cross-border branches, but many financial intermediaries preferred to expand into other Member States by means of the establishment of a subsidiary for which a separate authorization was necessary.[209] The establishment of branches, for instance, still were only a limited part of cross-border business of, for instance, insurance companies.[210] Member States were permitted to impose stricter requirements and, thus financial intermediaries were discouraged from providing financial services in other Member States in general.[211] The latter increased transaction costs for markets participants that operated in multiple Member States and was also detrimental to legal certainty.

Both the functional equivalency of national regulatory regimes and the hidden national barriers to market entry through the residual application of host Member State laws were found to be an obstacle to cross-border activities of financial intermediaries.

The final report of the Inter-Institutional Monitoring Group on the Lamfalussy Process and the Larosière report concluded that goldplating of EU legislation would represent a threat for market integration of the financial markets in the EU.[212] The Inter-Institutional Monitoring Group recommended to indicate in the legislative measures taken clearly the level of

---

[206] See for the principle of subsidiarity and proportionality: Art. 5 TFEU.

[207] P. Dejmek, *The EU Internal Market for Financial Services—A Look at the First Regulatory Responses to the Financial Crisis and a View to the Future*, 15 Columbia Journal of European Law 455 (2009); See also S. Weatherill, *Harmonisation: How Much, How Little?*, 16 European Law Review 533, 539 (2005); W. Devroe, *Limits of Differentiation in European Economic Law: Ne Bis In Idem and Minimum versus Maximum Harmonisation*, 16 Maastricht Journal of European and Comparative Law 141 (2009).

[208] See on this : S. Weatherill, *Harmonisation: How Much, How Little?*, 16 European Law Review 533, 539 (2005).

[209] This was especially in the insurance sector the case. See P. Dejmek, *The EU Internal Market for Financial Services—A Look at the First Regulatory Responses to the Financial Crisis and a View to the Future*, 15 Columbia Journal of European Law 455 (2009).

[210] See European Commission, *Communication from the Commission to the European Parliament and the Council - Upgrading the investment services directive* , (93/22/EEC) /* COM/2000/0729 final */.

[211] European Commission, *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, Brussels*, 15 February 2001, 84, 88-89.

[212] Inter-institutional Monitoring Group, *Final Report Monitoring the Lamfalussy Process,* 11, http://ec.europa.eu/internal_market/finances/docs/committees/071015_final_report_en.pdf (accessed 26 June 2017); J. de Larosière, *The High-Level Group on Financial Supervision in the EU*, 25 February 2009, 27, http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf (accessed 26 June 2017).

harmonization that was ought to be achieved.[213] In addition, the Larosière report stated that the financial services industry was suffering from a lack of harmonization and that many options that were provided in the European directives caused divergences in the implementation and enforcement of European directives.[214] This could lead to competitive distortions, but also threaten financial stability. For this purpose, the Report advised to use regulations rather than directives and strive for maximum harmonization of core issues when directives are used as legislative instrument.[215]

The rationale was that if national Member State laws were increasingly substituted by EU legislation this would lead to larger market integration.[216] Member States were not able to goldplate legislation in case of maximum harmonization.[217] Based upon CJEU cases, Member States were not allowed to adopt stricter measures in areas that were covered by European legislation.[218] Member States only had limited possibilities to impose stricter requirements.[219] The post-FSAP approach to European financial services legislation, thus, combined the principle of the 'European passport' and home Member State control on the basis of detailed rules that were to the fullest extent harmonized.

2.4.2. Post-Crisis Reform: Redesigning the European Supervisory Architecture

The Lamfalussy report did not address problems related to the European supervisory architecture in the EU. It merely focused on smoothening rulemaking on the European level.[220] The Larosière report acknowledged the fragmentation of supervision in the EU. The principle of 'home country control' in the 'mutual recognition era' assumed that home Member State Competent Authorities were the only authority that possessed enough information and supervisory powers to monitor financial intermediaries that had been authorized within their domiciles. The supervision under this approach included all activities of an intermediary even if they for the largest part had been carried out through the cross-border provision of services or through local branches in other Member States. Competent Authorities in host Member States were only granted powers of 'last resort'.[221] They retained only competence as far as legal issues had not been addressed on the European level. Cross-border financial services and branches of financial intermediaries were, thus, not subject to prudential supervision carried out by competent authorities in host Member States. On the other hand, 'host Member States' were responsible for subsidiaries of large conglomerates

---

[213] Inter-institutional Monitoring Group, *Final Report Monitoring the Lamfalussy Process,* 12, http://ec.europa.eu/internal_market/finances/docs/committees/071015_final_report_en.pdf (accessed 26 June 2017).

[214] J. de Larosière, *The High-Level Group on Financial Supervision in the EU*, 27 February 2009, http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf (accessed 26 June 2017).

[215] J. de Larosière, *The High-Level Group on Financial Supervision in the EU*, 29 February 2009, http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf (accessed 26 June 2017)..

[216] European Commission, *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, Brussels*, 15 February 2001, 9.

[217] C. Gerner-Beuerle, *United in diversity: maximum versus minimum harmonization in EU securities regulation*, 3 Capital Markets Journal 317 (2012).

[218] See CJEU (Judgment of 15 September 2005), Joined Cases C-281/03 and C-282/03, *Cindu Chemicals BV and Others,* ECLI:EU:C:2005:549, para. 44 and CJEU (Judgment 8 September 2009), C-478/07, *Budeˇjovický Budvar v. Rudolf Ammersin GmbH,* ECLI:EU:C:2009:521, para. 106.

[219] See also: J. de Larosière, *The High-Level Group on Financial Supervision in the EU*, 27 February 2009, para. 106,http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf (accessed 26 June 2017).

[220] K. Lannoo & M. Levin, *Securities Market Regulation in the EU -Everything You Always Wanted to Know about the Lamfalussy Procedure*, CEPS Research Report in Finance and Banking, No. 33, (May 2004), 14.

[221] P. Dejmek, *The EU Internal Market for Financial Services—A Look at the First Regulatory Responses to the Financial Crisis and a View to the Future*, 15 Columbia Journal of European Law 455 (2009).

and groups and, thus, not supervised by the same Competent Authority as its parent company.[222]

The differential treatment of branches, at the one, and subsidiaries at the other hand that were established in the same Member State was an illogical consequence of the system of prudential supervision that was being established in the mutual recognition era. The different treatment was based upon the fact that subsidiaries are 'stand-alone' legal entities and branches are not. All legal persons are authorized and supervised in the Member State in which it has its registered office whether they belong to a financial conglomerate or not.

During the financial crisis the possible problems of home country control and the unclear approach to crisis management and resolution were highlighted by the Icesave case.[223]Until then, the expansion Iceland's banking system was politically supported by deregulation of the banking system that supported the rapid expansion of the Icelandic Banks Landsbanki, Kaupthing and Glitnir. By 2006, the lending portfolio of the three banks was so expanded that their ratio of deposit of deposit to lending were claimed to be too low by credit rating agencies.[224] The huge size of the banks compared to the country's size made it impossible for the three banks to raise enough deposits in Iceland itself. Icelandic banks first tried to raise wholesale deposits and later used the European passport to offer deposit accounts to retail clients in other European Member States. Landsbanki offered retail depositary accounts under the name Icesave. Landsbanki set up branches in the UK and the Netherlands and raised approximately EUR 5.6 billion in the UK and EUR 1.7 billion in the Netherlands. The Bank of France prevented the collection of deposits by endless delays in processing the application of branch offices in France. The problems of Landsbanki were widespreadly known by European Competent Authorities. The DNB (Central Bank of the Netherlands), however, said it could not legally prevent them from operating in the Netherlands.[225] Similar operations and problems occurred as a result of operations conducted by Kaupthing Bank and Glitnir.

Following the insolvency of Lehman Brothers, Flitnir collapsed and the Icelandic Government put both Kaupthing and Landsbanki into receivership.[226] The collapse of Landsbanki lead to high costs for the UK and the Netherlands that bailed out their retail depositors.[227] The case demonstrated that conflicts of interest and agency cost on the side of Member States exercising home country control proved to be an important shortcoming in European financial regulatory structure. This proved to be an inconsistency in how the EU addressed the dual objective of allowing market access based upon the European passport, at the one hand, and adequate supervision, at the other hand.

The home country control principle assumed that pan-European supervision was being exercised by the home Member State on the assumption that this Competent Authority has the best overview of the actions of any financial intermediary within its domicile. In addition, the principle was based upon the idea that Competent Authorities of the home Member State had

---

[222] *Ibid.*

[223] I. Fridriksson, *The banking crisis in Iceland in 2008*, http://www.bis.org/review/r090226d.pdf (accessed 14 January 2017); S. Van Rymenant, *De Europese maatregelen ter beheersing van de financiële crisis - Een selectie van maatregelen in de Europese banksector*, http://lib.ugent.be/fulltxt/RUG01/001/787/116/RUG01-001787116_2012_0001_AC.pdf (accessed 26 June 2017).

[224] A. Stefansson, A. & T. Saethorsson, *Cross-border issues in EU Deposit Guarantee Schemes: With a focus on the Icelandic case*, 63-82, http://pure.au.dk/portal-asb-student/files/12991/Thesis_without_Appendix.pdf (accessed 14 January 2017).

[225] A. de Moor, C.E. du Perron & P. Krop, *De bevoegdheden van de Nederlandsche Bank inzake Icesave*, https://www.dnb.nl/binaries/Rapport%20DNB-Icesave_tcm46-228434.pdf (accessed 26 June 2017).

[226] R. Spruk, *Iceland's financial and economic crisis: causes, consequences and implications*, https://ssrn.com/abstract=1574296 (accessed 26 June 2017).

[227] D. Raffson & G. van Vliet, *Het Icesave Drama / hoe een handvol IJslanders de financiele wereld uitkleedde. De hebberige bankiers, de falende polititci en de getergde slachtoffers* (Terra 2010).

the appropriate incentives to preserve stability in the domestic financial system.[228]

The Icelandic Competent Authority was, however, lax as the collapse of its banks would mainly have consequences for retail deposit holders in other Member States, giving Iceland little incentive to conduct proper supervision.[229] To the contrary, the Icelandic authorities faced a conflicts of interest and were encouraged by its government to promote Iceland as an international financial center. This did not only involve the privatization and deregulation of Icelandic banks, but also the enforcement of rules and regulations were being relaxed. The problem of lax enforcement was acerbated by what is referred to in the literature as 'the small country syndrome'.[230] The Icelandic government and competent authorities had a shortage in resources, were understaffed and were lacking experience. Moreover, the size of the banking sector amounted multiple time the national income of Iceland and the Central Bank of Ireland was unable to act as a lender of last resort.[231] Finally, host Member States could not rely upon the Icelandic Competent Authorities to act in their interests, but were under the European banking passport regime limited in taking actions.[232]

The case demonstrated the importance shortcomings in the European financial supervisory structure that needed to be addressed. This case ultimately resulted in the 'redesign' of the European Supervisory Architecture, discussed in detail *infra* 3.4.2.2., in which rulemaking and financial supervision have been centralized in the EEA to a larger extent. The redesign of the European Supervisory Architecture together with developments on the sectoral level, such as the Banking Union, mark the final stage of the evolution of the EEA legal framework for the cross-border provision of financial services.

2.5. Conclusion

The 'prudential carve-out' under the 'four freedoms' impeded the establishment of an internal market for the cross-border provision of financial services in the internal market solely based upon negative integration. Instead, positive integration by means of secondary legislation was established. A gradual evolution of the EEA legal framework for the cross-border provision of financial services took off with the 'era of national treatment'[233] that was characterized by the implementing directives on the free movement of establishment/services, the CJEU Reyners and Van Binsbergen judgements and the first generation of banking (and insurance) directives. This era was followed up by the 'era of mutual recognition' and the 'single license concept' that was based on the White Paper on the Completion of the Internal market. The Second Banking Directive and the ISD were among the first European initiatives in which the

---

[228] A. Bollars, *Being a responsible host: supervising foreign-owned banks* 3-15 (D.D. Evanoff & G.G. Kaufman eds., World Scienitific Publishing Co. 2005); A. Stefansson, A. & T. Saethorsson, *Cross-border issues in EU Deposit Guarantee Schemes: With a focus on the Icelandic case*, 63-82, http://pure.au.dk/portal-asb-student/files/12991/Thesis_without_Appendix.pdf (accessed 14 January 2017).

[229] S. Benediktsdottir, J. Danielsson & G. Zoega, *Lessons from a collapse of a financial system*, 44,https://www.tcd.ie/Economics/assets/pdf/version-20-ben-dan-zoega-revised.pdf (accessed 14 January 2017); Zhao Li, *Securities Regulation in the International Environment*, 110-115, http://theses.gla.ac.uk/691/1/2009zhaoliphd.pdf (accessed 14 January 2017); M. Guðmundsson, *The Fault Lines in Cross-Border Banking: Lessons From the Icelandic Case*, OECD Journal Financial Market Trends, Issue 2 (2011).

[230] S. Benediktsdottir, J. Danielsson & G. Zoega, *Lessons from a collapse of a financial system*, 23-36,https://www.tcd.ie/Economics/assets/pdf/version-20-ben-dan-zoega-revised.pdf (accessed 14 January 2017).

[231] See also House of Commons, *Treasury Committee, Banking Crisis: The impact of the failure of the Icelandic banks,* Fifth Report of Session 2008-09, 4 April 2009.

[232] Cf. E.G. Gunnarsson, *The Icelandic Regulatory Responses to the Financial Crisis*, 1 European Business Organization Law Review 139 (2011).

[233] See for a definition 'national treatment': International Organization of Securities Commissions, *IOSCO Task Force on Cross-Border Regulation – Final Report*, FR 23/2015, (2015), 7 et seq.

‘single license concept was introduced. This concept allowed for the cross-border provision of services and establishment of branches throughout the EEA based upon a single authorization in a home Member State without having to obtain authorization in host Member Stats. The single license concept was the development of a sophisticated form of multilateral recognition[234], i.e. mutual recognition that was based upon ‘home country control’ and a minimum degree of harmonization. Hidden national barriers to entry, i.e. grounds of ‘general good/interest’ still allowed ‘host Member States’ to require passported services to comply with extra requirements. The FSAP introduced the ‘Lamfalussy-procedure’, i.e. a rulemaking concept based upon four levels that allowed for faster and more efficient EEA rulemaking. This procedure also initiated the tendency to turn to maximum harmonization as a response to the defragmented market for financial service. The problems in the Icesave scandal highlighted the deficiencies of home country control. The redesign of the ‘European supervisory architecture’ complementing the principle of home country control marked the final development stage in the evolution of the EEA legal framework for the cross-border provision of financial services.

3. The Joint Principles of the European Passport of EEA Financial Intermediaries

The EEA internal market for financial intermediaries is based upon the principle of ‘mutual recognition’. The concept of the European passport is now widespread and commonly used to enhance the development of the EEA internal market for financial intermediaries that are active in a wide range of sectors. [235] The European passport and the overarching principle of ‘mutual recognition’ are based upon two cornerstones: the ‘single rulebook’, i.e. a thick set of harmonized rules[236] and a coordinated institutional framework for financial supervision comprising of ‘home state control’ and the ESFS that allows host Member States to defer supervision to home Member States and ESAs.[237] The European passport as regulatory tool is unique and not to be found in any other multilateral, regional or bilateral forms of cooperation on the international level.[238] The reason for this is the degree of centralized rulemaking and supervision on the EEA level on which the regulatory tool is based.[239] This section proceeds as follows. First, the internal market for financial intermediaries, the general concept of the European passport, positive integration, legal instruments and the role of the Lamfalussy procedure are being discussed. This section concludes by discussing in detail the ‘single rulebook’ and coordinated institutional framework for financial supervision in detail.

3.1. An Internal Market for Financial Intermediaries

The European passport as a common concept for EEA financial intermediaries has been introduced in many EEA secondary legislation initiatives. The concept is now widespread in

---

[234] See for a definition ‘recognition’: International Organization of Securities Commissions, *IOSCO Task Force on Cross-Border Regulation – Final Report*, FR 23/2015, (2015), 13 et seq.
[235] An earlier version of this section has been earlier published in: H. van Meerten & S.N. Hooghiemstra, *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions*, https://ssrn.com/abstract=2993991 (accessed 4 July 2017).
[236] C.M. Grundmann-van de Krol & J.B.S., Hijink, *Who is afraid of a single rulebook?* 3-16 (F.G.B. Graaf, R.H. Maatman & L.J. Silverentand eds, Kluwer 2012).
[237] N. Moloney, *Brexit, the EU and its Investment Banker: Rethinking ‘Equivalence’ for the EU Capital Market*, LSE Legal Studies Working Paper No. 5/2017, 5, https://ssrn.com/abstract=2929229 (accessed 18 June 2017).
[238] P.H Verdier, *Mutual Recognition in International Finance*, 52 Harvard International Law Journal 56 (2011).
[239] International Organization of Securities Commissions, *IOSCO Task Force on Cross-Border Regulation – Final Report*, FR 23/2015, (2015), 31 et seq.

European financial legislation as it is evidenced that it is effective in the development of an internal market for financial intermediaries.[240] The most commonly used TFEU legal basis for a legal instrument is the common 'internal market'.[241] Referring to the wording 'European passport' implies that the concept is used to establish an internal market for financial intermediaries in a particular sector on the basis of 'positive integration'[242].'Positive integration' is used to establish an underlying legal framework for harmonization in the EEA as to overcome widely differing national rules for financial intermediaries in sectors that are not yet harmonized and for which no European passport exists. A recent example of a sector that is considered to be harmonized is the internal market for PEPPs and its providers.[243]

The European Commission and EIOPA seek to establish an internal market for PEPPs and its providers on the basis of 'positive integration'[244]. This approach is logical as national rules for existing PPPs differ widely. EIOPA believes this is due to the fact that - in order to safeguard the interests of personal retirement savers - individual countries have introduced national rules of general good.[245] These rules relate to, amongst others, investment restrictions and requirements with regard to capping cost and charges.[246]Although the national rules of general good touch upon the free movement of persons[247], the free movement of establishment/services and the free movement of capital, negative integration by directly invoking the 'fundamental freedoms' by means of the CJEU is excluded as Member States in the financial services domain are able to justify obstacles related to establishing an 'internal market' for PPPs on the basis of consumer protection ('the general good').[248] Positive

---

[240] See, for example, the considerations on the introduction of a European (product) passport in the upcoming PEPP initiative: European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP),* 11 April 2016, EIOPA-16-341, 11.

[241] Cf. Arts 53, 62 and 114 TFEU.

[242] F.W. Scharpf, *Negative and Positive Integration in the Political Economy of European Welfare States* 15-39 (G. Marks ed, Sage Publisher 1996).

[243] See H. van Meerten & S.N. Hooghiemstra, *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions*, https://ssrn.com/abstract=2993991 (accessed 4 July 2017); See for considerations in the crowdfunding domain: S.N. Hooghiemstra & K. De Buysere, *The Perfect Regulation of Crowdfunding: What Should the European Regulator Do?*, (D. Brüntje & O. Gajda eds, Springer 2015); D.A. Zetzsche & C.D. Preiner, *Cross-Border Crowdfunding – Towards a Single Crowdfunding Market for Europe*, European Banking Institute Working Paper Series 2017 - No. 8, https://ssrn.com/abstract=2991610 (accessed 26 June 2017).

[244] F.W. Scharpf, *Negative and Positive Integration in the Political Economy of European Welfare States* 15-39 (G. Marks ed, Sage Publisher 1996); F.W. Scharpf, *Negative and Positive Integration in the Political Economy of European Welfare States* (G. Marks ed, Sage Publisher 1996).

[245] European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 13; European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP),* 04 July 2016, EIOPA-16/457, 58, 80.

[246]European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 14; European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP),* 04 July 2016, EIOPA-16/457, 60.

[247] See, for instance, for IORPD I/II:H. Van Meerten & P. Borsjé, *A European Pensions Union,* National Bank of Slovakia, Series 2014, May, 5, 22*,* https://ssrn.com/abstract=2425478 (accessed 14 January 2017).

[248] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 111-114 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014); European Parliament, Consumer Protection in the EU, http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/565904/EPRS_IDA%282015%29565904_EN.pdf (accessed 14 January 2017); International Organisation of Securities Commissions, *Objectives and Principles of Securities Regulation for market intermediaries,* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf (accessed 14 January 2017); *Organisation* for *Economic Co-operation* and *Development*, *G20 High Level*

integration is, thus, the only means in which an internal market for not only personal pensions and their providers/distributors but also other financial intermediaries that are not harmonized on the EEA level and for which no European passport exists, can be achieved.

Before the legal instruments that are used to establish a European passport on the basis of 'positive integration' are discussed, the European passport as a concept will be addressed.

3.2. The General Concept of the 'European Passport'

The so-called 'European passport' is at the heart of the EEA system for financial services. It is a general concept which lays down the conditions for the 'mutual recognition' principle. The general idea is that financial products or services that are 'produced' (and marketed) in a 'home Member State' may, under conditions set out in European legislative acts, be marketed throughout the internal market without incurring further conditions imposed by 'host Member States'.[249] The 'passporting' regulatory tool in European financial legislation is unique and not replicated in any other multilateral, regional or bilateral initiatives.[250]

There are various types of European passports that are currently applied in the EEA, including passports for market infrastructures (CCPs), disclosure/information requirements (PRIIPR), financial intermediaries (CRD IV, MiFID II[251]) and financial products (IORPD II, UCITSD V).[252] Although the European passport of all these types are based upon the same principles, the focus of this section is on European passports for financial intermediaries.

The underlying concepts of the European passport are 'risk asymmetry' and 'economies of scope and scale'.[253] To facilitate the 'mutual recognition' approach and overcome 'risk asymmetry', the European passport has to be based upon a harmonization of substantive law and financial supervision.[254] These legal frameworks are based upon positive integration and EU legal instruments.

3.3. Positive Integration & EU Legal Instruments

For the purpose of positive integration in the EEA to establish a European passport for financial intermediaries there are several legal instruments available to achieve an 'internal

---

Principles Financial Consumer Protection, http://www.oecd.org/dataoecd/58/26/48892010.pdf (accessed 14 January 2017).

[249] Host Member State do have some competences: See Recital 2, 7, Art. 86 MiFID II, Recital 4 CRD IV, Recital 85 Solvency II and Art. 21 UCITSD V ('reporting requirement for UCITS ManCos'). See on literature related to MiFID I/II: P. Casey & K. Lannoo, The MiFID Revolution, ECMI Policy Brief No. 3 (November 2006); J.P. Casey & K. Lannoo, *The MiFID revolution* (Cambridge University Press (2009); G. Ferrarini & E. Wymeersch, *Investor protection in Europe: corporate law making*, *the MiFID and beyond* (Oxford University Press 2006); International Organisation of Pension Supervisors, *Supervision of Pension Intermediation*, http://www.iopsweb.org/WpNo17Web.pdf (accessed 14 January 2017).

[250] N. Moloney, *Brexit, the EU and its Investment Banker: Rethinking 'Equivalence' for the EU Capital Market*, LSE Legal Studies Working Paper No. 5/2017, 5, https://ssrn.com/abstract=2929229 (accessed 18 June 2017); P.H Verdier, *Mutual Recognition in International Finance*, 52 Harvard International Law Journal 56 (2011).

[251] K.W.H. Broekhuizen & W.A.K. Rank, *Het Europees paspoort voor beleggingsondernemingen* 255-271 (D. Busch, D.R. Doorenbos, C.M. Grundmann-van de Krol, R.H. Maatman, M.P. Nieuwe Weme & W.A.K. Rank, Kluwer 2007).

[252] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 101 et seq. (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[253] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 102-108, 110-111 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014); M. Lehmann & D.A. Zetzsche, *Brexit and the Consequences for Commercial and Financial Relations between the EU and the UK*, https://ssrn.com/abstract=2841333 (accessed 14 January 2017); D.A. Zetzsche & T.F. Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* 474 (D.A. Zetzsche ed, Kluwer 2015). See *supra* 1.1.

[254] K. Lannoo & M. Levin, *Securities Market Regulation in the EU -Everything You Always Wanted to Know about the Lamfalussy Procedure*, CEPS Research Report in Finance and Banking, No. 33, (May 2004), 4.

market´ for financial intermediaries. Based upon Articles 53, 62 and 114(1) TFEU, 114(1)TFEU, the European Parliament and the Council may adopt measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market. Typically, financial regulation on the EEA level is being based upon the so-called 'Lamfalussy Procedure'. Before the Lamfalussy procedure will be addressed, first the choice of policy instruments and the principles of proportionality and subsidiarity on the EEA level will be discussed.

3.3.1. The Choice of EU Policy Instruments

The legal acts of the EU are listed in Article 288 TFEU. There are regulations, directives, decisions, recommendations and opinions. EU institutions may adopt any of these legal acts if they are empowered to do so by the Treaties[255]. The sources of law laid down in Article 288 TFEU are referred to as 'secondary legislation' as it is based upon the Treaties that are 'primary legislation'.

Articles 289, 290 and 291 TFEU establish a hierarchy of secondary legislation between legislative acts, delegated acts and implementing acts. Legislative acts are adopted through the ordinary or a special legislative procedures, whereas delegated acts are non-legislative acts of general application which supplement or amend certain non-essential elements of a legislative act.[256] Delegated acts may be delegated to the European Commission by the European Parliament and the Council.[257] The latter being referred to as the 'legislator' sets out the objectives content, scope and duration of the delegation in the legislative act and the conditions to which the delegation is subject.[258] Implementing acts are adopted by the European Commission if uniform conditions for implementing legally binding acts are needed. In specific cases which are duly justified and in areas of common foreign and security policy, the Council may only adopt implementing acts.[259]

There are under Article 288 TFEU various types of EU secondary legislation. The legal acts in the financial services domain include regulations, directives, decisions, recommendations and opinions.

Regulations function as a 'European law', i.e. no implementation on the Member State level is necessary and they are directly enforceable in all Member States (self-executing). Regulations have the object of maximum harmonization[260] and leave no discretion for 'goldplating'[261] by Member States.[262] They are designed to ensure uniform application of EU

---

[255] 'Treaties' on the EU level include the Treaty on European Union (TEU); Treaty on the Functioning of the European Union (TFEU); the protocols related to these treaties; the Character of Fundamental Rights of the European Union; the Treaty Establishing the European Atomic Energy Community (Euratom); international agreements; the principles of proportionality and subsidiarity of Union law and EU secondary legislation.

[256] European Commission, *Better Regulation "Toolbox",* Tool #15: The choice of policy instruments, 87, http://ec.europa.eu/smart-regulation/guidelines/docs/br_toolbox_en.pdf (accessed 14 January 2017).

[257] See for an overview how the mechanisms work out under IORPD II: A. van den Brink & H. van Meerten, *EU Executive Rule-Making and the Second Directive on Institutions for Occupational Retirement Provision,* 12 UU Law Review 1 (2016).

[258] European Commission, *Better Regulation "Toolbox",* Tool #15: The choice of policy instruments, 87, http://ec.europa.eu/smart-regulation/guidelines/docs/br_toolbox_en.pdf (accessed 14 January 2017).

[259] Article 291 TFEU.

[260] European Commission, *Better Regulation "Toolbox",* Tool #15: The choice of policy instruments, 87, http://ec.europa.eu/smart-regulation/guidelines/docs/br_toolbox_en.pdf (accessed 14 January 2017).

[261] Directorate General for Internal Policies, '*Gold-plating*' *in the EAFRD – To what extent do national rules unnecessarily add to complexity and as a result, increase the risk of errors*?, IP/D/ALL/FWC/2009-056, 27 February 2014, http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/490684/IPOL-JOIN_ET%282014%29490684_EN.pdf(accessed 14 January 2017); W. Voermans, *Gold-plating and double banking: an overrated problem?* 79-88 (H. Snijders & S. Vogenauer eds.Sellier European Law Publishers 2009);

law in all Member States and supersede national laws incompatible with their substantive provisions.[263]

Directives are a European legislative act that obliges Member States to achieve a result. This requires Member States to implement the act on the Member State level. How the Directive is implemented depends upon whether the Directive has maximum or minimum harmonization as its objective that is usually being taken from the recitals and other policy documents upon adopting the Directive.[264] Directives, however, leave to national authorities the choice of form and methods how to implement the act. Member States are given some discretion in implementing directives to take account of specific national circumstances. Member States are, however, obliged by Article 4(3) TFEU to guarantee the effectiveness of EU law in accordance with the principle of sincere cooperation. Directives that are not timely implemented or have led to a 'wrong' implementation may have 'direct effect', i.e. may be directly invoked as if it was a law in itself.[265]

Decisions are binding in its entirety to those to whom they are addressed. Individuals may invoke rights to Member States, natural or legal persons conferred by a decision.

Communications from the European Commission and advices/guidelines given by the ESA's[266] are not legally binding in itself and do not confer any rights or obligations on those to whom they are addressed by, in particular, provide guidance as how EU law has to be interpreted. In the financial services domain these comprise of communications from the European Commission and advices/guidelines given by the ESA's[267].[268] A Commission Communication is legally not binding and always leads to minimum harmonization that allows discretion to Member States how to implement the Communication in their national law.[269] ESA Guidelines are legally not binding in itself, unless any other legislative act explicitly delegates competences to ESA's related to a specific matter to be clarified by an ESA guidelines.[270] ESA Advice is to be asked by the European Commission prior to adopting Level 1 and Level 2 instruments. The advice concerned Level 2 is only mandatory in the cases that are expressly indicated in Level 1 instruments.. The European Commission, however, remains to be responsible and is not legally obliged to follow up the ESA advice.

J.H. Jans & L. Squintani**,** A. Aragão, R. Macrory & B.W. Wegener, *'Gold plating' of European Environmental Measures,* 6.4. Journal of European Environmental and Planning Law 417-435.

[262] Art. 288 TFEU.

[263] European Commission, *Better Regulation "Toolbox",* Tool #15: The choice of policy instruments, 87, http://ec.europa.eu/smart-regulation/guidelines/docs/br_toolbox_en.pdf (accessed 14 January 2017).

[264] C. Gerner-Beuerle, *United in diversity: maximum versus minimum harmonization in EU securities regulation*, 3 Capital Markets Journal 317 (2012).

[265] See Francovich case, joined cases C-6/90 and C-9/90); See also the Faccini Dori Case C-91/92, ECR, p. I-3325 et seq., point 25).

[266] See Art. 288 TFEU; European Commission, *Better Regulation "Toolbox",* Tool #15: The choice of policy instruments, 87, http://ec.europa.eu/smart-regulation/guidelines/docs/br_toolbox_en.pdf (accessed 14 January 2017).

[267] The ESA's are EIOPA, ESMA and EBA.

[268] See Art. 288 TFEU; European Commission, *Better Regulation "Toolbox",* Tool #15: The choice of policy instruments, 87, http://ec.europa.eu/smart-regulation/guidelines/docs/br_toolbox_en.pdf (accessed 14 January 2017).

[269] The Financial Services Action Plan ('FSAP ') was an European Union's attempt to create a single market for financial services by harmonizing financial services within the EU to a larger degree. The FSAP was initiated in 1999 and its implementing measures were completed by 2004.
See, for example, the simplified prospectus under UCITSD III: Commission staff working document, *Impact Assessment - Brussels, accompanying the Proposal for a Directive of the European Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities*, (UCITS){COM(2008) 458}{SEC(2008) 2264} SEC(2008) 2263, 57- 59.

[270] See Art. 290, 291 TFEU.

3.3.2. *The Principles of Subsidiarity and Proportionality*

All EU acts need to be in line with the fundamental principle of subsidiarity as laid down in EU law. Following Article 5 TFEU, the EU:

> 'shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.'

The principle has been introduced by the Treaty of Maastricht and is not only important from a legal, but also from a political and economic perspective.[271] The principle shields off undesirable EU acts, serves as a constitution principle and requires EU legislative acts to justify any proposals.[272]

Despite the principle has been introduced a long time ago, the CJEU has till date not rejected any EU legislation that had been challenged by Member States on the basis of this principle. The CJEU generally applies a 'form over substance approach', i.e. the CJEU sees the principle of subsidiarity as a political principle and checks primarily whether the legislative institutions in the legislative process have considered the principle sufficiently.[273]

This principle has, however, gained importance upon the adoption of the TFEU. by introducing two procedures. First, national parliaments may under the TFEU review legislative draft proposals on the basis of the principle of subsidiarity and a new Subsidiarity and Proportionality Protocol allows Member States to challenge EU legislation on the basis of this principle. Second, national Member States are allowed to make claims on substantial factors, including the scope of the cross-border effects, the (economic) benefits of EU legislation, the scale of the problem and the national benefits that are at stake.[274] By introducing these two procedures under the TFEU, EU acts specify in more detail the considerations from a subsidiarity and proportionality perspective.[275]

3.3.3. *The Lamfalussy Process*

In the Post-FSAP era[276], the so-called 'Lamfalussy procedure' is being used for EEA financial service initiative in fostering harmonization in pursuing the internal market and the recent 'capital markets union initiative'. Positive integration is sought be means of introducing an European passport for financial intermediaries on the basis of the 'internal market' that requires a qualified majority to adopt measures concerned with the EU.[277] The Lamfalussy

---

[271] G. Gelauf, *Subsidiarity and Economic Reform in Europe* (Springer 2008).

[272] H. van Meerten, A. van den Brink & S.A: de Vries, *Regulating Pensions: Why the European Union Matters (*Netspar Discussion Paper) 10, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1950765 (accessed 4 October 2016).

[273] A. Von Bogdandy, *Founding Principles* (A. Von Bogdandy & J. Bast, eds., Hart Publishing 2010).

[274] H. van Meerten & P. Borsjé, P., *A European Pensions Union,* National Bank of Slovakia, Series 2014, May, 5, 10, https://ssrn.com/abstract=2425478 (accessed 14 January 2017).

[275] *Ibid.*

[276] See K. Lee, *Investor Protection in European Union: Post FSAP Directives and MiFID*, https://ssrn.com/abstract=1339305 (accessed 14 January 2017); European Commission, *Commission Staff Working Document of 11 April 2013: Consumer protection in third-pillar retirement products,*7, http://ec.europa.eu/dgs/health_food-safety/dgs_consultations/ca/docs/swd_consumer_protection_thirds_pillar_pensions_en.pdf (Accessed 14 January 2017). Directorate General for Internal Policies, *Consumer Protection Aspects of Financial Services*, IP/A/IMCO/ST/2013, 07 February 2014, http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/507463/IPOL-IMCO_ET%282014%29507463_EN.pdf (accessed 22 December 2016).

[277] See Arts 53, 62 and 114 TFEU.

framework is the legislative framework on which a European passport is being based. The Lamfalussy procedure was being developed to accelerate the speed of accomplishing an internal market for financial services.[278]

The framework is being structured in four levels. The so-called Level 1 legislative acts are being agreed upon between the Council of ministers and the involvement of the European Parliament. By means of a Regulation or a Directive the general framework including the general principles to be regulated are being set out. Directives and regulations as 'binding-acts' under the Lamfalussy process, require democratic control and ensure that legislative competences are delegated to European institutions subject to this control[279]. At Level 2, the European Commission with the assistance of the ESA's elaborate the certain aspect as indicated in the Level 1 initiative in directives or regulations. At Level 3, a committee comprising of the ESA's advice on the regulation and implementing the supervision. ESA's may publish guidelines deliberately or are asked by Level 1 or Level 2 instruments to do so. At Level 4, the European legislation is implemented by the Member States and the European Commission ensures that this is done correctly, if necessary by commencing an infringement procedure pursuant to Article 258 TFEU.

3.3.4. The Trend towards Maximum Harmonization

The primary legal instruments being used for harmonization of both at Level 1 are directives and regulations. Recently, the 'maximum harmonization approach' has led to an increasing use of the regulation as legal instrument. This has, however, not always been the case.

The first generation of 'product passports', including IORPs and UCITS under the IORPD I and UCITSD I, have been adopted as a directive rather than a regulation. Although both legal instruments take precedence over Member State laws, the nature of the instrument is entirely different. Regulations as 'European laws' have direct effect, whereas directives offer Member States the possibility to choose the means by which the objectives set out by the directive would be achieved. The directive as a legal instrument was chosen over regulations under the first generation of 'product passports' as directives by nature accommodate the principles of subsidiarity and proportionality between EU law and institutions and national law and institutions on the Member State level better. As a consequence of regulating by directives, Member States were responsible for transposing EU law into national law. The objective of (product) regulation in the IORPD I and UCITSD I were minimum harmonization. As a result of this characteristic, Member States had the possibility to set higher standards, provided that they do not discriminate, i.e. restrict access from financial products in Member States that are satisfied with the minimum standard set out by the directive.

Many Member States made use of their discretion under the IORPD I and UCITSD I to set higher standards or abiding to different interpretations of similar terms resulting in the hindrance of an internal market of IORPs and UCITS. A decade after the implementation of IORPD I, this is exemplified by IORPs of which currently not even 100 are operating on a cross-border basis, whereas it took for UCITS until UCITSD III till it became a success.[280] Although the EU and the US are similar in terms of GDP, the average UCITS was, until the introduction of UCITSD IV, five times smaller than its US counterparts (mutual fund).[281]

---

[278] K. Lannoo & M. Levin, *Securities Market Regulation in the EU -Everything You Always Wanted to Know about the Lamfalussy Procedure*, CEPS Research Report in Finance and Banking, No. 33, (May 2004).
[279] *Ibid.*
[280] U. Klebeck, *Interplay between AIFMD and the UCITSD* 96-97 (D.A. Zetzsche ed, Kluwer 2015).
[281] European Commission, *Green Paper on the Enhancement of the EU Framework for Investment Funds of 12 July 2005 (SEC(2005) 947)*, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 14 January 2017).

Post-FSAP, directives and regulations adopted at Level 1 have the nature of 'maximum harmonization'. Unsurprising, the tendency on the European level is to establish Level 1 instruments by means of a regulation that prevent 'goldplating' by national Member States.[282] Recent examples of product regulation established as a regulation include the ELTIFR, EuSEFR, EuVECAR and the MMFR.[283].

3.4. The Cornerstones of the European Passport for Financial Intermediaries: the 'Single Rulebook', 'Home Country Control' & the ESFS

'Mutual recognition', the underlying concept of the European passport, relies upon a 'single rulebook', i.e. detailed harmonized rules based upon the Lamfalussy procedure that governs the EU financial internal market and that allows host Member States to defer supervision to home Member States.[284] The European passport for financial intermediaries is complemented by coordinated supervision through the concept of 'home state control' and the EU's ESFS.[285] The so-called 'single rulebook' and ESFS together support sectoral European passports that allows for market access, removes host state control and prevents risks related to (cross-border) threats related to investor protection, financial stability and market integrity.[286]

3.4.1. The European Passport Substantive Legal Framework: 'The Single Rulebook'

The 'single rulebook concept' is applied to various types of European passports that are currently applied in the EEA, including passports for market infrastructures (CCPs), disclosure/information requirements (PR, PRIIPR), financial intermediaries (CRD IV, MiFID II) and financial products (IORPD II, UCITSD V).[287] Although the European passport of all these types are based upon the same principles, the focus of this section is on European passports for financial intermediaries.

Financial intermediaries, including credit institutions, UCITS ManCos, AIFMs and investment firms, all have a substantive legal framework, i.e. a thick dense 'single rulebook' with harmonized rules, on the basis of which they are allowed to 'passport' their services/products throughout the EEA. The general terminology for this 'single rulebook' that financial intermediaries have to comply with to obtain a European passport is 'intermediary regulation', i.e. the regulation of sectoral specific intermediaries that focusses on investor

---

[282] See also the different implementations of the AIFMD: See D.A. Zetzsche*, Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014); Cf. W. Voermans, *Gold-plating and double banking: an overrated problem?* 79-88 (H. Snijders & S. Vogenauer eds.Sellier European Law Publishers 2009); J.H. Jans & L. Squintani**,** A. Aragão, R. Macrory & B.W. Wegener, *'Gold plating' of European Environmental Measures,* 6.4. Journal of European Environmental and Planning Law 417-435.

[283] S.N. Hooghiemstra, *Wat is een beleggingsinstelling onder de AIFM-richtlijn?*, 3 Ondernemingsrecht 24 (2014).

[284] N. Moloney, *Brexit, the EU and its Investment Banker: Rethinking 'Equivalence' for the EU Capital Market*, LSE Legal Studies Working Paper No. 5/2017, 10, https://ssrn.com/abstract=2929229 (accessed 18 June 2017).

[285] M. Lehmann & C. Manger-Nestler, *Die Vorschläge zur neuen Architektur der europäischen Finanzaufsicht*, 3 Europäische Zeitschrift für Wirtschaftsrecht 87 (2010); M. Lamandini, *When more is needed: the European financial supervisory reform and its legal basis,* 6 European Company Law 197-202 (2009).

[286] *Ibid.*

[287] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 101 et seq. (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

protection and market protection.[288] Generally, 'intermediary regulation' is structured according to the four 'Lamfalussy levels'.

3.4.1.1. Level 1

At Level 1, the framework directive/regulation adopted usually includes provisions governing the:

- object, definitions &scope;
- authorization;
- operational conditions;
- cross-border activity (European Passport);
- enforcement (ESFS vs. national Competent Authorities);
- sanctions.

The object, definitions and scope of any Level 1 initiative sets out the purpose, clarifies the definition of general terms, such as 'home and host Member States' and more specific terms related to the sector that the initiative intends to regulate, such as the definition of an 'AIF' and 'AIFM' under the AIFMD.[289]

The authorization of financial intermediaries depends upon the authorization conditions and the compliance of the intermediary with the operational conditions laid down in sectoral EEA legislation. Credit institutions, AIFMs, UCITS ManCos and depositaries/custodians, for instance, have to comply with general (authorization and) organizational requirements that are common to financial intermediaries in European financial law and specific requirements aimed at the provision of financial services/activities and products.[290]

General organizational requirements require the establishment of an organizational structure that clearly assigns responsibilities, employ personnel with the rights skills, knowledge and experience, establish adequate systems to safeguarding information and ensure business continuity.[291] General organizational requirements include:[292]

- fit & proper senior management;
- minimum capital requirements that vary upon the type of financial service/product provided;
- a business plan;
- adequate risk organization;
- sound third country relationships; and
- reliable significant shareholders.

Specific organizational requirements complement general requirements. These include, for example, compliance, risk management internal audit, complaints handling, personal transaction and delegation/outsourcing.[293]

---

[288] See for a detailed review of not only 'intermediary', but also 'product' and 'sales regulation': Chapter 11, section 2.
[289] See for the definition of an 'AIF' and 'AIFM' under AIFMD: Arts 4(1)(a) &(b) AIFMD.
[290] *Ibid.*
[291] European Commission, *Background Note accompanying Draft Commission Directive implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive*, February 2006, 6 et seq.
[292] D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* 865 (D.A. Zetzsche ed, Kluwer 2015).
[293] C.M. Grundmann-van de Krol, *The Markets in Financial Instruments Directive and Asset Management* (D. Busch & D.A. DeMott eds, Oxford 2012).

By requiring certain common organizational and operational requirements upon authorization, the EEA legislature ensures that only fit & proper financial intermediaries are active on the European markets that are required by sectoral legislation to be highly specialized in the financial services/products they are, with certain exceptions in the asset management domain[294], offering.[295]

Level 1 initiatives regulating financial intermediaries include a section ‘cross-border activity’.[296] Once a financial intermediary has been authorized in a Member State, it may, on the basis of a so-called ‘notification procedure’, provide its products and services throughout the whole EEA by either ‘acting on a cross-border basis’ (providing services on a cross-border basis) or on the basis of the establishment of a branch without having to apply for any additional authorization.[297]

An European passport, thus, requires:[298]

- an application of a financial intermediary under the authorization requirements to the Competent Authority of the home state;
- a review of the European provisions by this Competent Authority;
- a notification from the Competent Authority of the home state to the authorities of the host state;
- and a minimum waiting period before the intermediary may provide services in the host state.

In addition, financial intermediaries that wish to establish a branch in another Member state would be required to:

- show that it meets the organisational requirements to conduct business according to the rules in the host state; and
- subject itself to supervision within a limited scope in the host state.

All Level 1 initiatives, thus, include a include a notification procedure of the home Member State in which the financial intermediary is authorized and the notification to host Member States in which the financial intermediary intends to provide its services.

The notification is the procedure which accommodates the ‘cross-border activity’ (the European passport) for financial intermediaries. Upon, for example, the authorization of a UCITS, the UCITS ManCo sends a notification file that comprises all information necessary to be duly authorized to the Competent Authorities of the UCITS home Member State.[299]

---

[294] UCITS ManCos and AIFMs are allowed to discretionary manage IORPs and individual portfolio’s under the AIFMD and UCITSD V. Nevertheless, MiFID II, AIFMD and UCITSD V all regulate the core business of ‘investment management’. Another exception are credit institutions that are ‘automatically’ recognized as investment firms under MiFID II. See Art. 1(3) MiFID II and Annex 1 CRD IV.

[295] A legal entity that obtained an authorization as UCITS ManCo is, for example, for that reason prohibited from obtaining a license as an insurance undertaking. See Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment inTransferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20December 1985* (‘Vandamme Report’), 3, http://goo.gl/K0iUzv (accessed 14 January 2017).

[296] See Recital 19, Title V Provisions concerning the freedom of establishment and the freedom to provide services CRD IV; Art. 6(3) MiFID II; Recital 18, Arts 145, 146 Solvency II; Arts 16-21 UCITSD V (UCITS ManCo ‘management passport’); Arts 91-96 UCITSD V (UCITS ManCo ‘marketing passport’. See on the ‘rights of EU AIFMs to market and manage EU AIFs in the Union’: Chapter VI AIFMD.

[297] *Ibid.*

[298] D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* 865 (D.A. Zetzsche ed, Kluwer 2015); See also: S.N. Hooghiemstra & K. De Buysere, *The Perfect Regulation of Crowdfunding: What Should the European Regulator Do?*, (D. Brüntje & O. Gajda eds, Springer 2015).

[299] See, for example, Art. 32 AIFMD for the ‘marketing passport’ and Art. 33 AIFMD for the ‘management passport’.

Upon being duly authorized, a UCITS ManCo may make use of its right to market UCITS to investors in other EEA Member States.[300] For that purpose, the UCITS ManCo must send a notification file, including all necessary information, to the Competent Authority of the UCITS home Member State.[301] This Competent Authority checks the completeness of the notification.[302] If the notification file is complete, the Competent authority adds an attestion (the so-called European passport) or informs the UCITS ManCo what is failing.[303] Along sending its notification file, the UCITS ManCo may indicate in what EEA Member States it wishes to market its UCITS. Within 10 days after receiving the notification letter of the UCITS ManCo, the Competent Authority of the home Member State is obliged to notify all Competent Authorities of the Member States in which the UCITS ManCo intends to market its UCITS.[304] After the Competent Authority of the home Member State informs the UCITS ManCo of the transmission date for the notification file, the marketing process may start immediately.[305] The host Member State may check ex-post, but has to rely upon a cooperation mechanism between the home and host Member State in which, in non-accurate instances, the host Member State has to rely upon measures being taken by the Competent Authority of the home Member State.[306] The prudential and financial supervision of the business activities/financial products provided by a financial intermediary, thus, remains with the Competent Authority in the Member State that granted the initial authorization.

The Level 1 regimes, in addition, contains provisions related to enforcement that primarily requires the national Competent Authorities of the home Member State to take measures if financial intermediaries do not comply with the relevant sectoral EEA law.[307] Enforcement also addresses the cooperation between home and host Member States and the cooperation between national Competent Authorities and the ESA's.[308]

Sanctions include fines based upon administrative law and, in the worst case, a revoke of the European passport of a particular financial intermediary complement the Level 1 initiatives.[309]

3.4.1.2. Level 2

Level 1 could also include provisions delegating responsibilities to the European Commission to adopt directive/regulations clarifying the general framework set out in Level 1. UCITSD V, for example, sets out the details of the notification procedure, the KIID and master-feeder structures in Level 2 measures.[310]

3.4.1.3. Level 3

Guidelines issued by ESAs, complement the Level 1 and 2 measures. These so-called 'Level 3 measures', for example under UCITSD V, determine risk management methods and the format in which a KIID is required to be presented.[311]

3.4.1.4. Level 4

[300] Art. 91 UCITSD V.
[301] Art. 93(1) and (2) UCITSD V.
[302] Art. 93(3) sub-para. 1 UCITSD V.
[303] Art. 93(3) sub-para. 2 UCITSD V.
[304] *Ibid.*
[305] Art. 93(3) sub-para. 3 UCITSD V.
[306] Art. 91(2) UCITSD V.
[307] Art. 101(3) UCITSD V.
[308] See Chapter XII and XIII UCITSD V.
[309] See, for instance, Art. 70 MiFID II.
[310] See, for instance, Art. 108 UCITSD V.
[311] See the KIIDR.

At Level 4, the European legislation is implemented by the Member States and the European Commission ensures that the required secondary EEA law implementation is done correctly (Level 4). If necessary, the European Commission commences an infringement procedure pursuant to Article 258 TFEU.

3.4.2. The EEA Financial Supervisory Framework: Home Country Control & the ESFS

Financial supervision under a European passport is throughout sectoral EEA secondary legislation based upon (1) home country control and (2) the European System of Financial Supervision.

3.4.2.1. Home Country Control

Traditionally underpinning European (product) passport is the principle of home country control, i.e. the Member State where the financial product is being registered/authorized or the financial intermediary has its statutory/real seat is responsible for carrying out the supervision of the product or intermediary. The European passport requires that the Competent Authorities of the host Member State trust the supervision being carried out by the home Member State. Competent Authorities in host Member States, i.e. the Competent Authorities in Member States where the service provider may offer its products and services, have frequently expressed doubts regarding this equivalence.[312] The financial crisis and events like the Icesave scandal[313] led to a larger degree of cooperation to supervise the activities of entities from other Member States by the establishment of the European System of Financial Supervision.

3.4.2.2. The European System of Financial Supervision

The European System of Financial Supervision[314] complements 'home country control' and consists of the ESRB carrying out macro-prudential supervision[315] and three ESAs (EBA, EIOPA and ESMA[316]) that carry out micro-prudential supervision on a sectoral basis.[317] In 2011, the ESAs received more binding legal powers related to rulemaking, the implementation of EU law, emergency powers, conflict resolution and restricting certain financial products.[318]

---

[312] K. Lannoo & M. Levin, *Securities Market Regulation in the EU -Everything You Always Wanted to Know about the Lamfalussy Procedure*, CEPS Research Report in Finance and Banking, No. 33, (May 2004), 14; See also: Boswijk, P., Jansen, O.J.D.M.L. & Widdershoven, R.J.G.M., *Transnationale samenwerking tussen toezichthouders in Europa*, https://www.wodc.nl/binaries/1532b-volledige-tekst_tcm28-69614.pdf (accessed 9 February 2017).

[313] E. Wymeersch, *Europe's New Financial Regulatory Bodies*, 5, http://ssrn.com/abstract=1813811 (accessed 14 January 2017); E. Wymeersch, *The institutional reforms of the European Financial Supervisory System, an interim Report,* https://ssrn.com/abstract=1541968 (accessed 16 February 2017).

[314] N. Moloney, *The European Securities and Markets Authority and institutional design for the EU financial market. A tale of two competences: part (1) rule making*, 12 European Business Organization Law Review 41-86 (2011). See also: N. Moloney, *The European Securities and Markets Authority and institutional design for the EU financial market. A tale of two competences: part (2) rules in action*, 12 European Business Organization Law Review 177-225 (2011).

[315] N. Kost - de Sevres & L. Sasso, *The new European financial markets legal framework: a real improvement? An analysis of financial law and governance in European capital markets from a micro- and macro-economic Perspective,* 7 Capital Markets Law Journal 30 (2011).

[316] D. Fischer-Appelt, *The European Securities and Market Authority: the beginnings of a powerful European securities authority?,* 1 Law and Financial Markets Review 21-32 (2011).

[317] See the ESRBR, EBAR, EIOPAR, ESMAR, ECBR and the ESRBR.

[318] H. van Meerten & A.T. Ottow, *The proposals for the European Supervisory Authorities (ESAs): the right (legal) way forward?,* 1/2 TvFR 5 (2010); G. Baur & M. Boegl, *Die neue europäische Finanzmarktaufsicht – Der Grundstein ist gelegt*, Zeitschrift für Bank und Kapitalmarktrecht 177 (2011); G. Baur, M. Boegl & J.A.

ESA's have an advisory function in the rulemaking process for developing Level 1 directives or regulations. In addition, ESAs are involved in a preparatory and advisory capacity related to the Level 2 implementing acts that are adopted by the European Commission on the basis of Article 290 TFEU. The ultimate decision lies, however, in principle with the European Commission.

This second important competence relates to verifying compliance of the implementation of the directives and regulations in the national jurisdictions, including the Regulatory technical standards by ESAs.[319] Non-compliance is, based upon Article 258 TFEU, to be identified by the European Commission and to be brought before the CJEU. According to the ESA Regulations, the identification is being attributed to ESAs that 'shall act' upon non-compliance and dialogues between ESAs and national Competent Authorities shall take away most issues. After the dialogue, national Competent Authorities that continue to be non-compliant may receive a formal opinion of the European Commission that might be based upon the recommendation of the ESA and is subject to review by the CJEU.[320]

Emergency situations, such as developments that jeopardize the orderly functioning and integrity of the financial markets, that are declared by the Council of ministers may be addressed 'decision' to the ESAs concerned. A recommendation or a request may be made by the ESRB or the ESA and ESAs may require national Competent Authorities to take action to ensure that the Level 1 measures are being complied with. In the absence of a Council decision, the ESA may also adopt emergency measures in exceptional circumstances when a serious danger arises to the orderly functioning of the markets or to financial stability. If the national authority does not respond to this request, ESAs may take direct actions that target the financial institutions in that Member State.[321]

Earlier experiences under European passport arrangements have shown that Competent Authorities sometimes experience difficulties in reaching agreements. The ESA Regulations have provided a mechanism for dispute resolution between Competent Authorities to be settled by a decision of an ESA. This may, however, only be used for matters that are precisely expressed in a Level 1 document to be open for mediation and dispute resolution.[322] The procedure consists of a 'reconciliation phase' and a 'decision phase'. The decision made by ESAs are addressed to national Competent Authorities. In the case of non-compliance, however, ESAs may directly target financial institutions in individual Member State to ensure compliance with EU law.

ESAs on the basis of Article 9 of the ESA Regulations are attributed with the power to prohibit or restrict certain 'financial activities', including financial products. This power is related to activities that threaten the 'orderly functioning and integrity of financial markets or the stability of whole or part of the financial system in the Union'. Decision taken by ESAs directly affect the financial intermediaries conducting those financial activities without the involvement without any intervention of the national Competent authority.

3.5. Conclusion

Kämmerer, *Das neue Europäische Finanzaufsichtssystem (ESFS) – Modell für eine europäisierte Verwaltungsarchitektur?*, Neue Zeitschrift für Verwaltungsrecht 1281 (2011); E. Wymeersch, *Europe's Financial Regulatory Bodies* (H. S. Birkmose, M. Nevillie & K. E. SØrensen eds., Kluwer 2012).

[319] J. Doelder & I.M. Jansen, *Een nieuw Europees toezichtraamwerk,* 1/2 TvFR 17 (2010).

[320] E. Ferran, *Understanding the New Institutional Architecture of EU Financial Market Supervision,* Paper No. 29/2011 (2011).

[321] H. van Meerten & A.T. Ottow, *The proposals for the European Supervisory Authorities (ESAs): the right (legal) way forward?,* 1/2 TvFR 5 (2010).

[322] E. Ferran & K. Alexander, *Can Soft Law Bodies be Effective? Soft Systemic Risk Oversight Bodies and the Special Case of the European Systemic Risk Board,* Paper No. 36/2011(2011).

The so-called 'European passport' is at the heart of the EEA system for financial services. It is a general concept which lays down the conditions for the 'mutual recognition' principle. The general idea is that financial products or services that are 'produced' (and marketed) in a 'home Member State' may, under conditions set out in European legislative acts, be marketed throughout the internal market without incurring further conditions imposed by 'host Member States'.[323] The concept is now widespread in European financial legislation as it is evidenced that it is effective in the development of an internal market for financial intermediaries.[324] The underlying concepts of the European passport are 'risk asymmetry' and 'economies of scope and scale'.[325] To facilitate the 'mutual recognition' approach and overcome 'risk asymmetry', the European passport has to be based upon a harmonization of substantive law and financial supervision based upon positive integration and EU legal instruments.[326]

The European passport and the overarching principle of 'mutual recognition' are based upon two cornerstones: the 'single rulebook', i.e. a thick set of harmonized rules and a coordinated institutional framework for financial supervision comprising of 'home state control' and the ESFS that allows host Member States to defer supervision to home Member States and ESAs.[327] The so-called 'single rulebook' and ESFS together support sectoral European passports that allows for market access, removes host state control and prevents risks related to (cross-border) threats related to investor protection, financial stability and market integrity.[328] The European passport as regulatory tool is unique and not to be found in any other multilateral, regional or bilateral forms of cooperation on the international level.[329]

4. The External Dimension of the Cross-Border Provision of Financial Services

The regulation of TC financial intermediaries that want to offer cross-border financial services in the internal market is based upon the same 'law and economics' considerations as the regulation of EEA financial intermediaries. The 'external dimension', at the one hand, offers benefits in terms of market efficiency and economies of scale and scope. At the other hand, however, the possible 'risk asymmetry' externalities resulting from granting market

---

[323] Host Member State do have some competences: See Recital 2, 7, Art. 86 MiFID II, Recital 4 CRD IV, Recital 85 Solvency II and Art. 21 UCITSD V ('reporting requirement for UCITS ManCos'). See on literature related to MiFID I/II: P. Casey & K. Lannoo, The MiFID Revolution, ECMI Policy Brief No. 3 (November 2006); J.P. Casey & K. Lannoo, *The MiFID revolution* (Cambridge University Press (2009); G. Ferrarini & E. Wymeersch, *Investor protection in Europe: corporate law making*, *the MiFID and beyond* (Oxford University Press 2006); International Organisation of Pension Supervisors, *Supervision of Pension Intermediation*, http://www.iopsweb.org/WpNo17Web.pdf (accessed 14 January 2017).

[324] See, for example, the considerations on the introduction of a European (product) passport in the upcoming PEPP initiative: European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP),* 11 April 2016, EIOPA-16-341, 11.

[325] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 102-108, 110-111 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014); M. Lehmann & D.A. Zetzsche, *Brexit and the Consequences for Commercial and Financial Relations between the EU and the UK*, https://ssrn.com/abstract=2841333 (accessed 14 January 2017); D.A. Zetzsche & T.F. Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* 474 (D.A. Zetzsche ed, Kluwer 2015); Tegelaar, J. & Haentjes, M., *Brexit: financieelrechtelijke gevolgen*, 74 Bedrijfsjuridische Berichten 257 (2016).

[326] K. Lannoo & M. Levin, *Securities Market Regulation in the EU -Everything You Always Wanted to Know about the Lamfalussy Procedure*, CEPS Research Report in Finance and Banking, No. 33, (May 2004), 4.

[327] N. Moloney, *Brexit, the EU and its Investment Banker: Rethinking 'Equivalence' for the EU Capital Market*, LSE Legal Studies Working Paper No. 5/2017, 5, https://ssrn.com/abstract=2929229 (accessed 18 June 2017).

[328] *Ibid.*

[329] P.H Verdier, *Mutual Recognition in International Finance*, 52 Harvard International Law Journal 56 (2011).

access are even bigger than for EEA financial intermediaries.[330] TC financial intermediaries are not subject to the same centralized rulemaking and supervision as EEA financial intermediaries. In imposing regulation to these TC financial intermediaries in warding off externalities, international law obligations ensure that TC financial intermediaries are not treated on a discriminatory basis. The European Commission is representing the entire EU in a so-called common commercial policy to ensure a consistent approach. The obligations on the international law level that have to be taken into account when regulating TC financial intermediaries are laid down in the GATS, obligations arising from the EEA and EFTA treaty and bilateral trade agreements concluded between the European Commission and third countries.

4.1. The External Dimension – A Law and Economics Theory

4.1.1. TC Financial Services & the EEA's External Dimension

The political economy of the internal market for financial services has a different approach towards the provision of cross-border financial services from and to third countries, i.e. the 'external dimension'.[331] Theoretically, the benefits of market efficiency and scales of scope and economies for financial intermediaries also apply to an internal market with an 'external dimension'.[332] Allowing third country financial intermediaries to offer their financial services within the EEA leads to an internal market for financial services with an 'external dimension' leading to more larger supply, competition and innovation.[333] The problem, however, is that TC firms are not subject to the EU's unique supranational rulemaking and enforcement system.[334] The deepening of the internal market in financial services has been characterized detailed harmonization, centralized rulemaking and implementation at the European level under the Lamfalussy process.[335] In addition, the European Commission has the ability to monitor implementation and force Member States to comply with EEA regulatory standards through enforcement proceedings before the CJEU.[336] This is supplemented by a strong supranational ESFS system.[337] The enforcement of TC relationships, however, depends upon bilateral treaties. The problems related to the Icesave case have highlighted the potential problems that such relationships could face.[338] This suggests that EEA market access for TC

---

[330] See European Commission, *Europe a World partner: the External Dimension of the Single Market*, 21(10) Bulletin of the European Communities (1988), http://aei.pitt.edu/1770/1/World_partner_1988.pdf (accessed 21 April 2017).

[331] Commission of the European Communities, *Commission Staff Working Document – The external Dimension of the Single Market Review accompanying document to the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions*, *A single market for the 21st century Europe,* {COM(2007) 724 final} {SEC(2007) 1517} {SEC(2007) 1518}{SEC(2007) 1520} {SEC(2007) 1521},http://ec.europa.eu/citizens_agenda/docs/sec_2007_1519_en.pdf (accessed 21 April 2017).

[332] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 60 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[333] *Ibid.* 60, 61.

[334] P.H Verdier, *Mutual Recognition in International Finance*, 52 Harvard International Law Journal 56 (2011).

[335] K. Lannoo & M. Levin, *Securities Market Regulation in the EU -Everything You Always Wanted to Know about the Lamfalussy Procedure*, CEPS Research Report in Finance and Banking, No. 33, (May 2004).

[336] See Article 258 TFEU.

[337] H. Siekmann, H., *Das neue Europäische Finanzaufsichtssystem - Working Paper Series 40* (Institute for Monetary and Financial Stability 2010); H. Siekmann, *Die Europäisierung der Finanzmarktaufsicht - Working Paper Series 47* (Institute for Monetary and Financial Stability 2011).

[338] E.G. Gunnarsson, *The Icelandic Regulatory Responses to the Financial Crisis*, 1 European Business Organization Law Review 139 (2011); S. Benediktsdottir, J. Danielsson & G. Zoega, *Lessons from a collapse of a financial system*, https://www.tcd.ie/Economics/assets/pdf/version-20-ben-dan-zoega-revised.pdf (accessed 14 January 2017); Zhao Li, *Securities Regulation in the International Environment*, 110-115,

financial intermediaries is only a viable option for intermediaries established in third countries with comparable levels of economic development and financial regulation.[339] Again, the concept of 'risk asymmetry' determines the EEA's approach towards the provision of cross-border financial services from and to third countries.

4.1.2. Risk Asymmetry, TC Financial Centres & the Concept of 'production' and 'distribution' States

The degree of 'risk asymmetry' is important for determining the EEA's regulatory approach towards the provision of cross-border financial services from and to a specific third country. 'Risk asymmetry' does not depend upon the size of States. Instead, it depends upon the supply and demand of certain types of financial products/services within a given State.[340] For example, Singapore is a financial centre with a large fund industry. Nevertheless, the degree of 'risk asymmetry' is small as Singapore has many domestic professional investors with a large demand for investment funds. Singapore is, thus, a 'product' and a 'distribution' State for fund services. The degree in which the supply exceeds domestic demand determines the degree of 'risk (a)symmetry'. A TC State in which the supply exceeds domestic demand can be characterized as a 'production State'.[341] Such a TC State, de facto, has a higher 'export' than 'import' of specific financial services/products. TC States in which the demand exceeds supply can be labelled as 'distribution State'. Due to the 'risk symmetry' in Singapore for fund services, Singapore has an incentive to protect its investors and subjects investment funds to a high degree of financial regulation and supervision. The degree of 'risk symmetry' of specific financial products/services in a third country determines the requirements EEA law requires to be fulfilled upon granting access to the internal market. The concept of 'equivalency' functions as a substitute for 'risk asymmetry'.

4.1.3. Equivalency as a Substitute for Risk Asymmetry

The EEA internal market for financial services is built upon the principle of 'mutual recognition' that is facilitated by a harmonized substantive legal framework and a high degree of coordination in financial supervision. The TFEU as a multilateral treaty provides a strong basis for the highly centralized rulemaking and coordinated supervision at the EEA level in the financial services domain.[342] By the absence of such a multilateral framework in relation to third countries, the EEA relies upon various approaches in overcoming 'risk asymmetry' in relation to third countries. These approaches include 'national treatment', unilateral and multilateral (mutual) recognition and 'passporting'.[343] The latter two approaches are based upon the concept of 'equivalency'.

4.1.3.1. The EEA's Third Country Rules Approaches

---

http://theses.gla.ac.uk/691/1/2009zhaoliphd.pdf (accessed 14 January 2017); M. Guðmundsson, *The Fault Lines in Cross-Border Banking: Lessons From the Icelandic Case*, OECD Journal Financial Market Trends, Issue 2 (2011).

[339] E.F. Greene, *Beyond Borders: Time To Tear Down the Barriers to Global Investing, 48*HARV. INT'L L.J. 92 (2007).

[340] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 67 et seq. (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[341] See for 'production States' and 'distribution States: D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 60, 61 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[342] Cf. Schammo, P., *Equivalence-Based Regulation and EU/EEA Prospectus Law – The Shadow Regime* 493 (D. Prentice & A. Reisberg eds., Oxford University Press 2011).

[343] International Organization of Securities Commissions, *IOSCO Task Force on Cross-Border Regulation – Final Report*, FR 23/2015, (2015), 31 et seq.

EEA law has three approaches in regulating the 'external dimension' of the international market: national treatment, unilateral/multilateral (mutual) recognition and 'passporting'.

All EEA sectoral financial laws, such as CRD IV, the AIFMD, UCITSD V and Solvency II, allow TC firms to enter the internal market based upon the concept of 'national treatment'. This approach essentially implies that TC firms are treated in the same manner as EEA entities in terms of market access and ongoing regulatory requirements.[344] The national treatment approach under the mentioned directives, essentially, allows subsidiaries of TC firms to be established and authorized under the same conditions as EEA entities. These subsidiaries are EEA legal entities and, thus, fall within the EEA centralized rulemaking and supervision framework.

Second, some types of TC firms are allowed EEA market access on the basis of unilateral/multilateral (mutual) recognition.[345] 'Recognition' is a regulatory tool on the basis of which a regulatory and supervisory regime of a specific third country is being assessed by the European Commission and/or another EU institution as being 'equivalent' and, thereupon, EEA market access is granted to the TC firm.[346] Depending upon the condition of 'reciprocity', i.e. the condition of 'mutual market access', the approach is to be labelled as unilateral or mutual recognition.[347] An example of unilateral recognition on the EEA level is the TC regime for AIF depositaries.[348]

The mutual recognition approach was clearly observed in the First Banking Directive and the ISD.[349] 'Reciprocity' as a requirement of market access is, however, less applied nowadays.[350]

Finally, 'passporting' is a regulatory tool on which TC financial intermediaries may offer financial services/products throughout the EEA upon the authorization in a single Member State upon complying with a set of rules laid down in EEA law.[351] Examples of 'passporting', include the passport for TC-AIFMs under the AIFMD and TC investment firms under MiFID II.[352]

Under the approaches 'recognition' and 'passporting' TC firms may provide financial services within the EEA without the need of establishing a legal entities (subsidiary) in the EEA. The cross-border provision of services and the establishment of branches is based upon the concept of 'equivalency'.

4.1.3.2. 'Equivalency' and Risk Asymmetry

The concept of 'equivalency' is used in EEA as a substitute for 'risk asymmetry' to ward off any potential externalities of the 'external dimension' of the internal market.

'Equivalency' can be seen as a concept in which effectively conditions related to granting market access in the internal market depend upon the existence of an equivalent regulatory and supervisory system in the home state.[353] Based upon this concept laid down in a variety of

---

[344] See A. Mattoo, *National Treatment in the GATS. Corner-Stone or Pandora's Box?,* 31 Journal of World Trade 107 (1997).

[345] International Organization of Securities Commissions, *IOSCO Task Force on Cross-Border Regulation – Final Report*, FR 23/2015, (2015), 13 et seq.

[346] *Ibid,* 13.

[347] L. Bruni, M. Gilli & V. Pelligra, *Reciprocity: theory and facts,* 55 International Review of Economics 1-11 (2008).

[348] See Chapter 4. section 5.

[349] See *supra* 2.2.

[350] See *supra* 2.1.

[351] International Organization of Securities Commissions, *IOSCO Task Force on Cross-Border Regulation – Final Report*, FR 23/2015, (2015), 31 et seq.

[352] See *infra 5.2.2.*

[353] P.H Verdier, *Mutual Recognition in International Finance*, 52 Harvard International Law Journal 56 (2011).

ways in sectoral financial EEA law, the EEA recognizes the adequacy of the regulation or supervision of an activity or financial intermediary as a substitute for its own.[354] The concept of equivalency, thus, reduces the risk resulting from risk asymmetries, i.e. the risk that regulatory failures originating in the home state will affect the internal market. Equivalency has, at least, three benefits.[355] First, it bypasses time-consuming harmonization efforts on the international level. Albeit the an equivalency assessment procedure consumes time, it is easier than agreeing and implementing standards on the international level. Second, it fosters regulatory competition, innovation and allows for flexibility. Finally, market access granted upon a set of minimum standards under an equivalency assessment ensures that TC financial intermediaries in their home states will lobby for laxer financial regulation as this would lead to a withdrawal of market access in the EEA.

The EEA's third country rules approaches and the equivalency concept in overcoming 'risk asymmetry' have to abide by the rules related to the external dimension of the four freedoms and the obligations arising out of GATS in regulating:

- EEA financial intermediaries with an external dimension;
- TC financial intermediaries within the EEA; and
- EEA financial intermediaries within third countries.

The equivalency approach in EEA law, however, appears in a variety of ways. These will now be subsequently discussed.

4.2. The EU's Common Commercial Policy

Under the TFEU, European institutions and other bodies have an exclusive competence with regard to the EU's 'common commercial policy'.[356]

The European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, are responsible for defining the framework for implementing the common commercial policy.[357] Agreements with one or more third countries or international organizations are concluded by the Council.[358] The European Commission may make recommendations to the Council to open necessary negotiations that may in its turn authorize the European Commission to enter these negotiations.[359] Both the Council and the Commission are responsible for ensuring that the agreements negotiated are compatible with the international policies and rules of the EU.[360] EU secondary law specifying the freedom to provide services and the freedom of establishment qualifies as 'internal rules of the EU'.

Any negotiations undertaken by the European Commission shall be undertaken in consultation with a special committee appointed by the Council that supports the European Commission and 'within the framework of such directives as the Council may issue to it'.[361] The European Commission has to report regulatory to this committee and the European

[354] International Organization of Securities Commissions, *IOSCO Task Force on Cross-Border Regulation – Final Report*, FR 23/2015, (2015), 13 et seq.
[355] P.H Verdier, *Mutual Recognition in International Finance*, 52 Harvard International Law Journal 56 (2011).
[356] A. Dimopoulos, *Re-thinking the European Constitution in an Enlarged European Union,* https://www.pravo.unizg.hr/_download/repository/Rethinking_Subsidiarity_and_the_Balance_of_Powers_in_the_EU_in_Light_of_the_Lisbon_Treaty_and_Beyond_-_Simona_Constantin%5B1%5D.pdf (accessed 21 June 2017); P. Eeckhout, *EU External Relations Law* (Oxford University Press 2011).
[357] Art. 207(2) TFEU.
[358] Art. 207(3), (4), Art. 218(2) TFEU.
[359] Art. 207(3) TFEU.
[360] *Ibid.*
[361] Art. 207(3) sub-para. 3 TFEU.

Parliament on the progress of the negotiations.[362] Unanimity is required for the negotiation and conclusion of agreements in the fields of trade in services.[363] This type of agreements has to be concluded for the purpose of centralized equivalency assessments that are the basis of deeming third country regulations and supervision as 'equivalent'.

The exercise of these competences by the Council and the European Commission shall, however, not affect the delimitation of competences between the EU and the Member States.[364] In particular, the exercise of these competences shall

> 'not lead to harmonization of legislative or regulatory provisions of the Member States in so far as the Treaties exclude such harmonization'.[365]

4.3. The GATS

The GATS was concluded on 15 April 1994 and established the WTO as part of the 'Uruguay package' that ultimately entered into force on 1 January 1995.[366] The GATT did not include the liberalization of financial services, but only dealt with the trade in goods. The pivotal role, however, that financial services play and prudential concerns led to a situation in which services were being hindered by the diverging patches of legislations that were hindering them from being provided on a cross-border basis.[367] The GATS was the first international initiative to liberalize the trade in services.[368] In 1997, the Members reached a deal that specifically targeted the liberalization of financial services.[369]

The EU, as a WTO member, is obliged to comply with the GATS when regulating and supervising their market for financial services with regard to activities of TC firms. The latter stems from Article 206 TFEU that states that the EU aims at 'the progressive abolition of restriction on international trade and foreign investments'. In the Poulsen case, the CJEU affirmed Article 206 TFEU by stating that the EU must respect international law when exercising its powers.[370] In addition, the individual EU Member States as WTO Members have also the obligation to comply with both EU law and the GATS.[371]

---

[362] *Ibid.*
[363] Art. 207(4) TFEU.
[364] Art. 207(6) TFEU.
[365] *Ibid.*
[366] General Agreement on Trade in Services, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization (WTO Agreement), Annex 1B, Legal Instruments – Results of the Uruguay Round vol 28 (1994), 33 I.L.M. 44 (1994) (GATS), http://www.wto.org/english/docs_e/legal_e/legal_e.htm (accessed 6 June 2017). See also: https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm (accessed 5 June 2017).
[367] R. Bismuth, *Financial Sector Regulation and Financial Services Liberalization at the Crossroads: The Relevance of International Financial Standards in WTO Law*, 44 Journal of World Trade 489 (2010).
[368] See for an overview of the differences between the trade in goods and services: P. Morrison, *The Liberalisation of Trade in Financial Services and the General Agreement on Trade in Services*, 5 Singapore Journal of Internal & Comparative Law 594-596 (2001).
[369] K. Alexander, *The World Trade Organization and Financial Stability: The Balance between Liberalisation and Regulation in the GATS*, 9, https://www.repository.cam.ac.uk/handle/1810/225211 (accessed 6 June 2017); E. Leroux, *Trade in Financial Services under the World Trade Organization*, 36 Journal of World Trade 413 (2002); See for the importance of financial services in the services sector: J.S. Jarreau, *Interpreting the General Agreement on Trade in Services and the WTO Instruments Relevant to the International Trade of Financial Services: The Lawyer's Perspective* 25 N.C.J. INT'L L. & COM. REG. 1, 8 (1999).
[370] CJEU, (Judgment of 24 November 1992), Case C-286/90, *Poulsen and Diva Navigation*, ECLI:EU:C:1992:453, para. 9.
[371] K. Byttebier and S. Fares, *The EU Liberalisation of Financial Services: The EC Obligations in Comparison to the GATS Commitments* 85–119 (K. Byttebier & K. Vander Borght eds., Cameron May 2007);

This sections describes the relevant scope, obligations and commitments resulting from the GATS that the EU and its Member States is required to comply with, as well as, the exceptions.

4.3.1. Scope of the GATS

The obligations and commitments in GATS apply to 'measures by Members affecting trade in services'.[372] The scope of the GATS based upon this wording is very broad. The scope of GATS, thus, depends on what should be understood under 'measures', 'trade' and (financial) services.

4.3.1.1. Measures

The scope of the GATS only includes 'measures by Members'. Article XXVIII(a) GATS defines 'measure' broadly as 'any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form'. Following Article I:3(a) GATS, 'measures by Members' have to be interpreted as measures taken by governments at any level, including states, provinces and municipalities and those to whom delegated powers are attributed to be under the scope of the GATS.

Measures in the field of financial services may involve either regulation or any supervisory assessment made whether a financial services provider complies with requirements that led to obtain an authorization and during the provision of the service.[373]

Measures taken must 'affect' trade in services to be within the scope of GATS. [374] What affects trade in services has not been defined by the GATS itself, but by case law. WTO case law clarified that measures that directly govern the supply of a service, or may regulate other matters but nevertheless affect trade in services fall within the scope of GATS.[375] The GATS, thus, has a very broad scope concerning its application.[376]

4.3.1.2. Trade

Trade of services is under GATS defined as the supply of a service.[377] The GATS, by the so-called 'four modes of trade in services', have recognized that the supply- and demand-side of a service may be in a different jurisdiction.

The first mode is the cross-border supply of services.[378] The service under this mode is supplied from a service provider located in a different jurisdiction than the service customer. Both the service supplier and customer do not cross any border in order to execute the trade of services.[379]

The second mode is the consumption of services abroad also referred to in the literature as 'supply abroad' mode.[380] Trade of services is, under this mode, defined as the supply of

---

[372] Art. I:1 GATS.
[373] See for banks: B. De Meester, *Liberalization of Trade in Banking Services - An International and European Perspective* 90 (Cambridge University Press 2014).
[374] Art. I:1 GATS.
[375] Panel Reports, *European Communities – Regime for the Importation, Sale and Distribution of Bananas (EC – Bananas III).*
[376] *Ibid.*
[377] Art. I:2 GATS.
[378] *Article XXVIII* (b) GATS: 'supply of a service' includes the production, distribution, marketing, sale and delivery of a service.
[379] B. De Meester, *Liberalization of Trade in Banking Services - An International and European Perspective* 96 (Cambridge University Press 2014).
[380] See for the consumption of services abroad: P. Morrison, *The Liberalisation of Trade in Financial Services and the General Agreement on Trade in Services*, 5 Singapore Journal of Internal & Comparative Law 599 (2001).

service in the territory of one Member to the service consumer of another Member.[381] Under the second mode, a service consumer moves abroad to another Member to receive services. Under the third mode, the trade of services is defined as the supply of a service of one Member, through the commercial presence in the territory of any other Member.[382]
The third mode covers both the commercial presence of legal and non-legal persons.

Under Article XXVIII (d) 'commercial presence' means any type of business or professional establishment within the territory of a Member for the purpose of supplying a service either by means of constituting, acquiring or maintaining a juridical person[383] or establishing a branch or a representative office.[384]

Mode four applies to the trade of services involving a service supplier of one Member, through the presence of natural persons of a Member in the territory of any other Member.[385] This mode involves both self-employed service providers, as well as, employees of service providers that travel to supply services abroad.

Defining the type of 'trade in services' involved is important to determine whether Members have made any commitments with regard to a specific mode of supply.[386] Overlaps may occur between de different modes.[387]

4.3.1.3. Financial Services

The definition of 'service' under GATS includes 'any service in any sector except services supplied in the exercise of government authority.'[388] Paragraph 1(d) Annex on Financial Services includes, however, a more detailed definition on financial services.[389] Financial services are 'any service of a financial nature offered by a financial service supplier of a Member'.[390] They include all insurance and insurance-related services, and all banking and other financial services (excluding insurance).[391] The Annex includes a non-exhaustive list of examples related to insurance and insurance-related services, at the one hand, and banking and other financial services (excluding insurance), at the other hand. Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depositary and trust services are mentioned as examples of banking and other financial services that fall under the scope of the definition of financial services.[392]However, the service definition excludes 'services supplied in the exercise of government authority. Following Article I :3(b) and (c) GATS, these are defines as services that are supplied neither on a commercial nor in competition with one or more service suppliers. Within the context of financial services, 'services supplied in the exercise of

---

[381] Art. I:2(b) GATS.
[382] Art. I:2(c) GATS.
[383] Art. XXVIII(d)(i) GATS.
[384] Art. XXVIII(d)(ii) GATS.
[385] Art. I:2(d) GATS.
[386] See M.J. Hahn, *W.T.O. Rules on Trade in Financial Services: A Victory of Greed over Reason?* 176–205 (R. Grote & T. Marauhn eds., Cambridge University Press, 2006); J.S. Jarreau, *Interpreting the General Agreement on Trade in Services and the WTO Instruments Relevant to the International Trade of Financial Services: The Lawyer's Perspective* 25 N.C.J. INT'L L. & COM. REG. 1-74 (1999).
[387] See B. De Meester, *Liberalization of Trade in Banking Services - An International and European Perspective* 98 (Cambridge University Press 2014).
[388] Art. I:3(b) GATS.
[389] A. Von Bogdandy & J.Windsor, *Annex on Financial Services* 618–639 (R.Wolfrum, P. Stoll and C. Feinäugle eds., Martinus Nijhoff 2008).
[390] Art. 5(a) Annex on Financial Services.
[391] *Ibid.*
[392] See point (XIII) Banking and other financial services (excluding insurance) Annex on Financial Services.

governmental authority'[393] include, amongst others, activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies.[394] Again, services that are supplied 'in competition with a public entity or a financial service supplier' are not excluded from the scope of GATS.[395]

Apart from this, the definition of 'financial service supplier'[396] excludes public entities.[397] Public entities either refer to:[398]

- 'a government, a central bank or a monetary authority, of a Member, or an entity owned or controlled by a Member, that is principally engaged in carrying out governmental functions or activities for governmental purposes, not including an entity principally engaged in supplying financial services on commercial terms;[399] or
- a private entity, performing functions normally performed by a central bank or monetary authority, when exercising those functions.'[400]

Financial services that are taking place in a commercial context fall, thus, under the scope of the GATS.[401]

4.3.2. General Obligations and Specific Commitments in the GATS

The obligations and commitments in GATS applying to 'measures by Members affecting trade in services' can be twofold either they are general obligations or specific commitments.[402] The difference between the two is that general obligations apply directly to all WTO members, whereas specific commitments only apply as far as WTO members have made a specific commitment to the relevant obligation involved.[403]

4.3.2.1. General Obligations

The most important general obligation for financial services under GATS is the obligation of most-favoured-nation treatment.[404] The obligation requires that any favour that is being

---

[393] E. Leroux, *What is a "Service supplied in the exercise of governmental authority" under art. I:3(b) and of the General Agreement on Trade in Services?*, 40 Journal of World Trade 345(2006).
[394] Art. I(b) Annex on Financial Services.
[395] Art. I(c) Annex on Financial Services.
[396] A financial service suppliers means 'any natural or juridical person of a Member wishing to supply or supplying financial services'. See Art. 5(b) Annex on Financial Services.
[397] Art. 5(b) Annex on Financial Services.
[398] Art. 5(c) Annex on Financial Services.
[399] Art. 5(c)(i) Annex on Financial Services.
[400] Art. 5(c)(ii) Annex on Financial Services.
[401] P. Morrison, *The Liberalisation of Trade in Financial Services and the General Agreement on Trade in Services*, 5 Singapore Journal of Internal & Comparative Law 598 (2001).
[402] See for general obligations: Part II GATS and for specific commitments: Part III GATS.
[403] The commitments of the European Union and its Member States are combined in a single schedule. See European Communities and their Member States, Schedule of Specific Commitments, GATS/SC/31 (15 April 1994), including four supplements. The financial service commitments that are applicable are contained in (Revised) Supplement 4 (GATS/SC/31/Supp.4/Rev. (18 November1999). See for a draft Schedule of Commitments that aims to consolidate all schedules of Member States after the enlargements of the EU took place: Communication of the European Communities and its Member States, Draft Consolidated GATS Schedule, 14 and 29 September 2006, S/C/W/273 (9 October 2006).
[404] Art. II GATS; See A. Mattoo, *MFN and the GATS* 51–99(T. Cottier, P. Mavroidis & P. Blatter eds.,University of Michigan Press, 2000); See also G. De Búrca, *Unpacking the Concept of Discrimination in EC and International Trade Law* 181–195 (C. Bernard & J. Scott eds., Hart 2002).

granted to services and service suppliers of any Member shall also be accorded on no less favourable terms to services and service suppliers to any other Member.[405]

An infringement of the MFN obligation and national treatment obligation involves a two step-assessment. First, it must be considered to what extent the services or services suppliers are alike.[406] Second, it must be determined to what extent certain services (or suppliers) are treated less favourably than others.

Favoured conditions that are agreed upon between Members on a bilateral or multilateral basis are, thus, automatically granted to other Members. The obligations prevents Members that have more market power to obtain more advantageous trading conditions.[407]
The obligation of most-favoured-national treatment applies to full extent, except when an explicit exemption is made by a WTO Member in their lists of Article II exemptions. The EU, for instance, has not made any specific most-favoured-national exemptions for banking services. Discriminatory provisions by EU legislation therefore cannot be used to prevent foreign financial services suppliers from 'trading' (read: providing) their financial services in the EU.[408]

Recognition is argued in the literature to be a 'conditional MFN'[409] and, thus, another important obligation.[410] It is regulated in Article VII GATS, as well as, Paragraph 3 Annex on Financial Services. The obligation of recognition implies that a Member that is a host country may, whole or in part, accept the authorization and licensing conditions imposed to a service provider by a home Member without having to comply with regulation in the host countries in this regard.[411] The obligation has as its purpose that mutual or unilateral recognition is being granted to reduce trade-aversion.[412] The recognition may, both under Article VII GATS and Paragraph 3 Annex on Financial Services, be made conditional upon harmonization, recognition agreements or arrangements or accorded autonomously.[413]

Three conditions are imposed by both Article VII GATS and Paragraph 3 Annex on Financial Services to ensure that recognition does not hinder trade liberalization. First, recognition arrangements must be notified to the Council of Trade in Services.[414] Second, it must be 'open' recognition. In other words, other interested Members shall be offered adequate opportunities to negotiate the accession to such agreements or arrangements.[415]

---

[405] Art. II(1) GATS; Y. Wang, *Most-Favoured-Nation Treatment under the General Agreement on Trade in Services – and Its Application in Financial Services*, 30 Journal of World Trade 91(1996); P. Van den Bossche, *The Law and Policy of the World Trade Organization, Text, Cases and Materials* chapter 4 (Cambridge 2005); See also D. Mc Rae, *MFN in the GATT and the WTO*, 7 *Asian Journal of WTO & International Health Law and Policy* 1-24 (2012).
[406] M. Cossy, *Determining "Likeness" under the GATS: Squaring the Circle?,* www.wto.org/english/res_e/reser_e/ersd200608_e.pdf. (accessed 5 June 2017).
[407] P. Morrison, *The Liberalisation of Trade in Financial Services and the General Agreement on Trade in Services*, 5 Singapore Journal of Internal & Comparative Law 601 (2001).
[408] European Communities and their Member States, Final List of Artice II (MFN) Exemptions, GATS/EL/31, 15 April 1994, 7.
[409] J. Mathis, *Mutual Recognition Agreements: Transatlantic Parties and the Limits to Non-tariff Barrier Regionalism in the WTO*, 32 Journal of World Trade 25 (1998).
[410] See W. Davey & J. Pauwelyn, *MFN Unconditionality: A Legal Analysis of the Concept in View of Its Evolution in the GATT/WTO Jurisprudence with Particular Reference to the Issue of "Like Product* 13–50 (T. Cottier, P. Mavroidis and P. Blatter eds., University of Michigan Press, 2000); J. Nielson, *Trade Agreements and Recognition* 155–203 (OECD Publishing 2004).
[411] Art. VII(1) GATS.
[412] B. De Meester, *Liberalization of Trade in Banking Services - An International and European Perspective* 161 (Cambridge University Press 2014); A. Zampetti, *Market Access through Mutual Recogntiion: The Promise and Limits of GATS Article VII* 283-306, 305 (P. Sauvé and R. Stern eds., Brookings Institution Press 2000).
[413] Art. VII(1) and (7) GATS; Paragraph 3(a) Annex on Financial Services.
[414] Art. VII : 4(a) GATS ; Para. 3(c) GATS Annex on Financial Services.
[415] Art. VII(2) GATS; Paragraph 3(b) Annex on Financial Services.

Finally, recognition cannot constitute a means of discrimination between countries in its application of standards or criteria for authorization, licensing or the certification of services suppliers, or constitute a disguise restriction on trade in services.[416]

4.3.2.2. Specific Commitments

Commitments involve 'progressive liberalization'. Commitments that are made by each individual Members, with regard to market access and national treatment should be reviewed to determine the extent to which they have agreed upon liberalizing their market for services.[417] In contrary to the obligations discussed above, commitments only are binding upon Members to that extent that Members have committed to them in the schedules that are specific to financial services commitments.[418]

The commitment of market access has as its objective to establish access for foreign service providers to foreign markets for all modes of supply.[419] For that purpose, Article XVI(1) GATS requires that each Member shall allow services and service providers of other Members treatment that is no less favourable than the terms, limitations and conditions that the Member agreed upon and specified in its schedule. Market access may, thus, not be hindered by a WTO Member if the Member concerned has made a commitment not do so. Members may, however, include limitations in their schedules of commitments.

Market access is different from GATS obligations and commitments that are based upon discrimination, such as the GATS provisions on most-favoured-nation treatment and national treatment. The commitment of market access are related to measures taken by Members that impede financial and other suppliers of accessing the market, while the two abovementioned discriminatory provisions are aiming at post-entry measures.[420]

Article XVI GATS has a very limited scope as otherwise all general regulations applying to service suppliers in general would constitute a restriction to the market access within a certain state.[421]

The scope of the commitment is narrowly defined by an exhaustive list of six types listed in Article XVI(2) of measures that are considered to be restrictions to market access.[422] The measures listed are of a quantitative nature, such as, for instance, measures that limit the number of service providers or measures that are restrictive with regard to the type of legal entity through which a foreign financial service provider would supply the service.[423]
Restrictions listed are prohibited per sé without any further assessments. Restrictive measures are only allowed if no commitment or a limitation thereto is being made by a WTO Member in its schedule of commitments. WTO Members that have committed themselves to market accesss, however, may rely justifications on general exceptions in Article XIV GATS or the prudential exception in the Annex of Financial Services.

---

[416] Art. VII(3) GATS ; Paragraph 3(b) Annex on Financial Services.
[417] A. Von Bogdandy & J.Windsor, *Annex on Financial Services* 647–666 (R.Wolfrum, P. Stoll and C. Feinäugle eds., Martinus Nijhoff 2008).
[418] See for a thorough overview of commitments: B. De Meester, *Liberalization of Trade in Banking Services - An International and European Perspective* 62-63 (Cambridge University Press 2014).
[419] J. Marchetti & P. Mavroidis, *Walking the Tightrope between Domestic Policy and Globalization: Market Access, Discrimination and Regulatory Intervention under the GATS* (Mimeo 2006).
[420] P. Morrison, *The Liberalisation of Trade in Financial Services and the General Agreement on Trade in Services*, 5 Singapore Journal of Internal & Comparative Law 603 (2001).
[421] See also: A. Zampetti, *Market Access through Mutual Recognition: The Promise and Limits of GATS Article VII* 283–306 (P. Sauve´ & R. Stern eds., Brookings Institution Press, 2000).
[422] See on the exhaustive nature of this list: Panel Report, *US- Gambling*, paras 6.298, 6.318.
[423] See Art. XVI:2(a) and (e) GATS.

Article XVII :1 GATS reads that a member 'shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers'.[424] Essentially, the commitment of national treatment prohibits discrimination between domestic services or service suppliers and comparable services or service suppliers of other WTO members.[425]

Unlike the most-favoured-nation obligation, national treatment only applies to the extent that specific commitments have been taken in the schedules of specific commitments of the Members.[426] Both situations of *de jure* and *de facto* distrimination are being cought by Article XVII :2 GATS.[427] Again, the same two-step assessment as under the most-favoured-nation obligation has to be carried out whether like services or services suppliers and whether 'less favourable treatment' is involved.[428]

4.3.3. Exceptions to GATS Obligations and Commitments

Members are bound to the obligations and the specific commitments of the GATS they have made in their schedules. Despite this, restrictive measures of Members may invoke certain general and prudential exceptions.

4.3.3.1. General Exceptions

Article XIV GATS justifies restrictive measures of WTO members that infringe any obligations or commitments under the GATS. Article XIV lists examples of non-discriminative measures pursuing non-commercial policy objectives that may be adopted or enforced. Examples include the protection of public morals and maintaining the public order.[429]

Article XIV(c) GATS allows Members with regard to financial services to adopt and enforce measures that are necessary to ensure compliance with laws or regulations including those relating to:

- the prevention of deceptive and fraudulent practices and with the effects of a default on services contracts;[430]
- the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts.[431]

On the basis of this provision, Members may, thus, adopt and enforce measures preventing prudential risks and data protection.[432]

4.3.3.2. Prudential Exception ('prudential carve-out')

---

[424] See A. Mattoo, *National Treatment in the GATS. Corner-Stone or Pandora's Box?,* 31 Journal of World Trade 107 (1997).

[425] B. De Meester, *Liberalization of Trade in Banking Services - An International and European Perspective* 167 (Cambridge University Press 2014).

[426] J.S. Jarreau, *Interpreting the General Agreement on Trade in Services and the WTO Instruments Relevant to the International Trade of Financial Services: The Lawyer's Perspective* 25 N.C.J. INT'L L. & COM. REG. 40, 48 (1999).

[427] See L. Ehring, *De Facto Discrimination in World Trade Law. National and Most- Favoured-Nation Treatment – or Equal Treatment?,* 36 Journal of World Trade 921 (2002).

[428] Art. XVI:2 and XVI :3 GATS.

[429] Art. XIV(a) GATS.

[430] Art. XIV(a)(i) GATS.

[431] Art. XIV(a)(ii) GATS.

[432] P. Morrison, *The Liberalisation of Trade in Financial Services and the General Agreement on Trade in Services*, 5 Singapore Journal of Internal & Comparative Law 608 (2001).

GATS obligations and commitments severely restrict WTO Members to regulate and supervise financial service providers. Violations, however, may be justified based upon the prudential exception as laid down in Article 2(a) Annex on Financial Services.[433]

Measures of prudential reasons are, thus, subject to the GATS and the Annex on Financial Services, but if they violate them, may be justified upon the exception for 'prudential reasons'.[434] For reasons of financial stability[435], WTO members wanted to be able to adopt measures for prudential reasons.[436]

For that purpose, Article 2(a) Annex on Financial Services provides a (non-exhaustive) list of examples of what type of measures could be taken for 'prudential reasons'.[437] This list includes measures 'for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system.' The definition is kept vague as only under a broad 'prudential carve-out' WTO were willing to commit themselves to the liberalization of trade in services.[438]

Allowing WTO members, however, to overly rely upon prudential regulation for protectionist reasons would be contrary to the objective of progressive liberalization of trade in services under GATS.[439]

Despite the wide scope of 'prudential measures' paragraph 2(a) GATS Annex on Financial Services, requires that measures that do not conform with the provisions of GATS shall not be used 'as a means of avoiding' obligations and commitments under GATS.

The prudential exception is, due to its wide scope, primarily enforced based upon WTO dispute settlement.

4.3.4. Economic Integration

Article V:1 GATS states that the GATS 'shall not prevent any of the WTO members from being a party to or entering into an agreement liberalizing trade in services between or among the parties to such agreement'.[440] The provision on economic integration, thus, enables

---

[433] M. McAllister-Shepro, *Preserving National Regulatory Autonomy in Financial Services: The GATS' Prudential Carve-Out* http://ssrn.com/abstract=2418764 (accessed 5 June 2017); F. Mishkin, *Prudential Supervision: Why is it Important and What Are the Issues?* 1-29 (F. Mishkin ed., University of Chicago Press 2001).

[434] M. Yokoi-Arai, *GATS' Prudential Carve Out in Financial Services and Its Relation with Prudential Regulation* 57 International and Comparative Law Quarterly 638-640 (2008).

[435] See for the vague concept of financial stability: C. Borio & M. Drehmann, *Towards an Operational Framework for Financial Stability: "Fuzzy" Measurement and Its Consequences* http://www.bis.org/publ/work284.htm (accessed 5 June 2017).

[436] The scope of prudential exceptions was, therefore, kept wide: See A. Gkoutzinis, *International Trade in Banking Services and the Role of the WTO: Discussing the Legal Framework and Policy Objectives of the General Agreement on Trade in Services and the Current State of Play in the Doha Round of Trade Negotiations*, 39 International Lawyer 877 (2005); See for an overview of the GATS prudential carve-out negotiations history: J. Marchetti, *The GATS Prudential Carve-Out* 280-286 (P. Delimatsis & N. Herger eds., Kluwer 2011).

[437] L. Panourgias, *Banking Regulation and World Trade Law* 83-90 (Hart 2006).

[438] See for a discussion on jurisprudence on 'prudential reasons': B. Jung, *Standard of Review for Jurisprudence on Prudential Measures*, 1 ILSP L.J. 49, 50 (2009).

[439] S.J. Key, *Trade Liberalization and Prudential Regulation: The International Framework for Financial Services*, 75 Int. Affairs 61, 63 (1999).

[440] See J. Marchetti & P. Mavroidis, *I Now Recognize You (and Only You) as Equal. An Anatomy of (Mutual) Recognition Agreements in the GATS* 415–443 (I. Lianos and O. Odudu eds., Cambridge University Press 2012); See also: S. Stephenson, *GATS and Regional Integration* 509–527 (P. Sauve & R. Stern eds., Brookings Institution Press 2000).

members to enter into preferential trade agreements.[441] Such an agreement is only valid provided that the agreement has 'substantial sectoral coverage'[442] and provides for national treatment.[443] In addition, the agreement must be 'designed to facilitate trade between the parties to the agreement and shall not in respect of any Member outside the agreement raise the overall level of barriers to trade in services within the respective sectors or subsectors compared to the level applicable prior to such an agreement'.[444] WTO members who are a party to the European Union may, thus, grant more favourable treatment to financial services supplier of other European Member States.[445]

Although Article V:6 GATS provides a mitigation of the negative effects that a preferential arrangement might have. It requires that a juridical person constituted under the laws of a party to the preferential agreement that engages in substantive business operations in the territory of the parties to such agreement shall also be entitled to the benefits of the preferential agreement.[446]Any TC financial service providers that establishes a legal person under EU law and operates substantive business operations within the EU may, thus, benefit from EU law.[447]

4.3.5. Conclusion

The EU, as a WTO member, is obliged to comply with the GATS when regulating and supervising their market for financial services with regard to activities of TC firms. Especially, the obligation of most-favoured-nation treatment and the commitment of national treatment are the two cornerstones upon the which EU regulation on TC service providers must be built. In this regard, the obligation of most-favoured-nation treatment has more relevance as the European Union has bound itself to this obligation without limitations. The role of GATS seems, however, in this regard to be limited. The exception on the basis of prudential reasons and the allowance of preferential arrangements on the basis of economic integration makes it inevitable that a larger harmonization on the internal level of financial services is needed to come to more binding arrangements.[448]

---

[441] For a good comparative overview of the EU and NAFTA as examples of economic integration under the WTO: J.P. Trachtman, *Trade in Financial Services under GATS, NAFTA and the EC: A Regulatory Jurisdiction Analysis* 323–402 (J.P. Trachtman ed., Cameron May 2006); T. Cottier & M. Molinuevo, *Article V GATS* 146 (R. Wolfrum, P. Stoll & C. Feinäugle eds., Martinus Nijhoff, 2008).
[442] Art. V:1(a) GATS.
[443] Art. V:1(b) GATS; See also J. Mathis, *Mutual Recognition Agreements: Transatlantic Parties and the Limits to Non-tariff Barrier Regionalism in the WTO*, 32 Journal of World Trade 5(1998); P. Mavroidis, *Highway XVI Revisited: The Road from Non-discrimination to Market Access in GATS*, 6 World Trade Review 1(2007); See on 'national treatment', i.e. non-discrimination in this regard: K. Nicolaïdis, *Non-discriminatory Mutual Recognition: An Oxymoron in the New WTO Lexicon?* 267–301 (P. Mavroidis and P. Blatter eds., University of Michigan Press, 2000).
[444] Art. V:4 GATS.
[445] See on the relationship between EU and GATS: K. Byttebier and S. Fares, *The EU Liberalisation of Financial Services: The EC Obligations in Comparison to the GATS Commitments* 85–119 (K. Byttebier & K. Vander Borght eds., Cameron May 2007); F. Ortino, *Basic Legal Instruments for the Liberalization of Trade: A Comparative Analysis of EC and WTO Law* (Hart 2004).
[446] Fink refers to this as the 'liberal rule of origin'. See C. Fink, *PTAs in Services: Friends or Foes of the Multilateral Trading System?*126 (J. Marchetti and M. Roy eds., Cambridge University Press, 2008); See also T. Beck, A. Demirgüç-Kunt & R. Levine, *Law and Finance: Why Does Legal Origin Matter?,* 31 Journal of Comparative Economics 653 (2003).
[447] See for the example of the primary and secondary establishment of banks: B. De Meester, *Liberalization of Trade in Banking Services - An International and European Perspective* 293, 294 (Cambridge University Press 2014).
[448] J.P. Trachtman, *Addressing Regulatory Divergence through International Standards: Financial Services* 27–41 (A. Mattoo & P. Sauvé eds., Oxford University Press, 2003).

4.4. Bilateral Trade Agreements

In the past decade, the EU has increasingly concluded bilateral trade agreements with a large amount of countries that contain obligations and commitments that go even beyond GATS.[449] Financial services were a key priority in a number of agreements, including the EU-Chile Association Agreement, the EU-Singapore free trade agreement and the Comprehensive Economic and Trade Agreement (CETA)[450] with Canada.[451]

Bilateral trade agreements in the banking, capital markets and insurance markets domain contain commitments on financial services including market access and national treatment to all 'modes of supply'.[452] The main purpose of these agreements is to freeze the existing levels (and barriers) of market access in the road towards gradual liberalization. Bilateral agreements, typically, include limitations related to the right of establishment and the removal of related discriminatory measures such as demanding that financial intermediaries have their registered office in the host country.[453] Commitments on cross-border supply are, usually, only made in sub-sectors of financial services, such as insurance and reinsurance.[454]

Finally, a common element of bilateral agreements are 'prudential carve-outs', i.e. various forms of carve-outs related to prudential regulation and supervision of financial intermediaries entering host countries on the terms of the agreement.[455] Market access for TC financial intermediaries on the basis of bilateral agreements is, thus, limited.

4.5. Membership of the European Economic Area (EEA)

The Agreement on the EEA entered into force in 1994 and includes three EFTA members: Iceland, Liechtenstein and Norway. Under the EEA Agreement all relevant EU legislation is ought be implemented by EEA Members. The Agreement includes, amongst others, the 'four freedoms' that apply on a reciprocal basis between EEA and EU Member States.[456] There are not restrictions related to the right of establishment or the provision of services. EEA

---

[449] C.V. Gortsos, *Potential concepts for the future EU-UK relationship in financial services*, January 2017, 21, 25, http://www.europarl.europa.eu/RegData/etudes/STUD/2016/595335/IPOL_STU%282016%29595335_EN.pdf (accessed 15 June 2017).

[450] See http://ec.europa.eu/trade/policy/in-focus/ceta. http://ec.europa.eu/trade/policy/in-focus/ceta (accessed 19 June 2017).

[451] See for these agreements: http://ec.europa.eu/trade/policy/countries-and-regions (accessed 19 June 2017); See also A. Lang & C. Conyers, *Financial Services in EU Trade Agreements*, PE 536.300, European Parliament, Brussels, 2014,http://www.europarl.europa.eu/RegData/etudes/STUD/2014/536300/IPOL_STU(2014)536300_EN.pdf (accessed 19 June 2017).

[452] C.V. Gortsos, *Potential concepts for the future EU-UK relationship in financial services*, January 2017, 21, 25, http://www.europarl.europa.eu/RegData/etudes/STUD/2016/595335/IPOL_STU%282016%29595335_EN.pdf (accessed 15 June 2017).

[453] *Ibid.*

[454] A. Lang & C. Conyers, *Financial Services in EU Trade Agreements*, PE 536.300, European Parliament, Brussels, 2014, 16, 17,http://www.europarl.europa.eu/RegData/etudes/STUD/2014/536300/IPOL_STU(2014)536300_EN.pdf (accessed 19 June 2017).

[455] A. Lang & C. Conyers, *Financial Services in EU Trade Agreements*, PE 536.300, European Parliament, Brussels, 2014, 17-19, http://www.europarl.europa.eu/RegData/etudes/STUD/2014/536300/IPOL_STU(2014)5 36300_EN.pdf (accessed 19 June 2017).

[456] Arts 78-88 EEA Agreement.

nationals may, amongst others, set up branches or subsidiaries in the EU and vice versa.[457] The same holds true for the freedom to provide services.[458] This chapter, thus, refers to 'EEA internal market' as, de facto, not only EU Member States, but also EEA Member States benefit from the internal market and passporting rights under sectoral EEA financial laws.[459]

EEA membership is possibly considered as a Brexit option.[460] The UK would remain part of the internal market, whereas they would not be found by EU policies covering common agriculture and fisheries policies; customs union; common trade policy; common foreign and security policy; justice and home affairs; direct and indirect taxation; or economic and monetary union.[461] EEA membership for the UK in the 'internal market' is, however, not such a seamless transition as some suggest.[462] Sectoral financial laws have to be adopted under the EEA agreement and this may lead to, as was the case for the AIFMD, significant delays in adoption and the effective functioning of European passports available.[463]

This option would, however, require the application of the UK to become an EFTA member and the approval of both EU and EEA Member States to become an EEA member.[464] Given the interest of various EU Member States in a relocation of (a part of) the UK's financial industry, the approval of EU Member States is not politically feasible. It is also uncertain whether the current small EEA Member States, in particular Norway as largest EEA member, are willing cooperate with such a dominant state.

---

457 See for the general provisions on the right of establishment: Annexes VIII-XI EEA Agreement; Annex IX EEA Agreement applies to financial services.

458 Annexes IX-XI EEA Agreement; The term 'services' is defined as meaning, *inter alia*, activities of a commercial character such as 'financial services' (Art. 37 sub-para. 2 EEA Agreement).

459 Usually, directives and regulations set out in the preamble the phrase 'with EEA relevance' that indicates that such initiatives may be extended to the EEA on the basis of the EEA agreement. See, for example, the pre-amble of the AIFMD.

460 M. Lehmann& D.A. Zetzsche, *Brexit and the Consequences for Commercial and Financial Relations between the EU and the UK*, https://ssrn.com/abstract=2841333 (accessed 14 January 2017); A. Dodds, *Brexit: A New Deal for Financial Services*, January 2017,https://d3n8a8pro7vhmx.cloudfront.net/labourclp259/pages/511/attachments/original/1485858504/Anneliese_Dodds_-_A_New_Deal_for_Financial_Services.pdf?1485858504 (accessed 16 June 2017); K. Lannoo, *EU Financial Market Access after Brexit*, CEPS Policy Brief, September 2016, https://www.ceps.eu/system/files/Brexit%20and%20the%20financial%20sector_0.pdf (accessed 14 January 2017); K. Lannoo, *Brexit and the City*, https://www.ceps.eu/publications/brexit-and-city (accessed 14 January 2017); M. Arnold, *Banks Study Loopholes to Enable UK Branches to sell to EU Clients*, Financial Times, 2 February 2017; K. Lannoo, *Britain's Finance Industry Needs the EU, Wall Street Journal* (26 January 2016); K. Lannoo, *EU Retail Financial market Integration: Mirage Or Reality?*, ECRI Policy Brief No. 3 (June 2008).

461 M. Duvillet-Margerit, M. B. Mesnard, & A. Xirou, *Third Country Equivalence in EU Banking Legislation*, 1, 9 December 2016, http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/587369/IPOL_BRI%282016%29587369_EN.pdf (accessed 15 June 2017).

462 C.V. Gortsos, *Potential concepts for the future EU-UK relationship in financial services*, January 2017, 21, 25, http://www.europarl.europa.eu/RegData/etudes/STUD/2016/595335/IPOL_STU%282016%29595335_EN.pdf (accessed 15 June 2017).

463 D.A. Zetzsche & C.D. Preiner, *Das liechtensteinische AIFM-Gesetz: Die erste Umsetzung der europäischen AIFM-Richtlinie*, RiW, 265 (2013); D.A: Zetzsche, *Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).

464 C.V. Gortsos, *Potential concepts for the future EU-UK relationship in financial services*, January 2017, 21, 25,http://www.europarl.europa.eu/RegData/etudes/STUD/2016/595335/IPOL_STU%282016%29595335_EN.pdf (accessed 15 June 2017).

Not only EU Member States, but also EEA Member States benefit from the internal market and passporting rights under sectoral EEA financial laws.[465]

4.6. EFTA Membership (Switzerland)

The EEA members and Switzerland are EFTA members.[466] The EEA Member States have access to the internal market on the basis of the EEA Agreement. Switzerland, however, is not part of the 'EEA internal market' as EFTA membership does not grant members access to the internal market nor does it grant members passporting rights.[467] The more than 100 bilateral agreements concluded between Switzerland and the EU deal with cooperation related to a large number of sectors.[468] With the exception of the agreement on life assurance activities[469], none of the bilateral treaties covers any financial services.[470] Switzerland, however, unilaterally implements EEA law in the financial services domain.[471] They are forced to do so as, for example, provisions related to delegation/outsourcing require delegates to be subject to effective regulation and supervision.[472] EFTA membership, thus, does not grant provide any direct access to the internal market and members have to rely upon their EEA membership or, in the case of Switzerland, bilateral agreements in the financial services domain.[473]

5. Third Countries & EEA Secondary Law

The 'prudential carve-out' under both the 'four freedoms' and GATS prevents the establishment of an 'internal market with external dimension' for financial services.[474] Already upon the introduction of the First Banking Directive, it was recognized that only market access conditions in EEA secondary law could lead to the establishment of an 'internal market with external dimension'.

The tendency of adopting a TC approach in secondary law has several advantages. First, a coordinated approach strengthens the position of the EU in international financial

---

[465] Usually, directives and regulations set out in the preamble the phrase 'with EEA relevance' that indicates that such initiatives may be extended to the EEA on the basis of the EEA agreement. See, for example, the pre-amble of the AIFMD.

[466] http://www.efta.int/about-efta/european-free-trade-association (accessed 19 June 2017).

[467] C.V. Gortsos, *Potential concepts for the future EU-UK relationship in financial services*, January 2017, 22,http://www.europarl.europa.eu/RegData/etudes/STUD/2016/595335/IPOL_STU%282016%29595335_EN.pdf (accessed 15 June 2017).

[468] M. Lehmann & D.A. Zetzsche, *Brexit and the Consequences for Commercial and Financial Relations between the EU and the UK*, https://ssrn.com/abstract=2841333 (accessed 14 January 2017).

[469] Agreement between the European Economic Community and the Swiss Confederation on direct insurance other than life assurance, OJ L 205/3, 27 July 1991.

[470] M. Lehmann & D.A. Zetzsche, *Brexit and the Consequences for Commercial and Financial Relations between the EU and the UK*, https://ssrn.com/abstract=2841333 (accessed 14 January 2017).

[471] D. Fischer, *Einfluss des europäischen Rechts auf die Rechtsstellung von externen Vermögensverwaltern in der Schweiz* 505 et seq. (R. Fahrländer & R.A. Heizmann eds., Zürich/St. Gallen 2013); T. Jutzi, *Der Einfluss des EU-Rechts auf das schweizerische Recht der Kollektiven Kapitalanlagen*, 1 AJP/PJA 1 (2015); V.E.M. Köpfer, *Anwendung und Auswirkung des europäischen Kapitalmarktrechts auf Akteure aus Drittstaaten*, Diss. St. Gallen 2015, http://verdi.unisg.ch/www/edis.nsf/SysLkpByIdentifier/4410/$FILE/dis4410.pdf (accessed 10 June 2017).

[472] For example, delegation of investment and risk management under the AIFMD to asset managers in Switzerland; See J. Frick, *Umsetzung der AIFM-Drittstaatenregelung in der Schweiz* (D. Gericke ed., Schulthess 2013).

[473] I. Kawka, *The Movement of Services between the European Union and Switzerland*, *10 CYELP* 325-339 *(2014).*

[474] J. Marchetti, *The GATS Prudential Carve-Out* 280-286 (P. Delimatsis & N. Herger eds., Kluwer 2011).

governance.[475] The centralized and coordinated approach at the EU level ensures an influential position in negotiating financial regulation on the international level. Second, the centralized foreign commercial policy towards third country market access leads to a level playing field for small and big Member States.[476] Big Member States have a stronger position not only in international financial governance, but also could negotiate market access in third countries on better terms. Finally, a coordinated approach of the internal market as huge 'distribution target' for offshore financial centers reduces the regulatory gap between 'production' and 'distribution states'. EEA financial regulation, whether third countries are bound to it or not on a bilateral basis, has an extraterritorial effect on third countries as being regarded as 'non-equivalent' on the EEA level forecloses market access.

The EEA's equivalency concept in overcoming 'risk asymmetry' has, however, to abide by the rules related to the external dimension of the four freedoms and the obligations arising out of GATS in regulating:

- EEA financial intermediaries with an external dimension;
- TC financial intermediaries within the EEA; and
- EEA financial intermediaries within third countries.

The equivalency approach in EEA law, however, appears in a variety of ways. These will now be subsequently discussed.

5.1. EEA Financial Intermediaries with an External Dimension

TC financial intermediaries, usually, enter the internal market by either establishing an EEA subsidiary or acquiring 'qualifying holdings'[477] and 'close links'[478] in EEA financial intermediaries.[479] EEA subsidiaries may then be authorized under the respective EEA sectoral legislative acts[480], whereas EEA financial intermediaries in which a 'qualifying holding' or 'close link' is acquired may have already done so. EEA law preserves the internal market by demanding compliance with EEA 'qualifying holding' and delegation requirements. EEA law also requires groups and conglomerates to comply with the EEA requirements related to consolidated supervision and conglomerates.

5.1.1. 'Qualifying Holding' and 'Close Links' Requirements for Non-EEA Shareholders

---

[475] N. Moloney, *The EU in International Financial Governance*, 1 Russell Sage Journal of the Social Sciences 138-152(2017).
[476] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 80 et seq. (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).
[477] 'Qualifying holding' under various sectoral EEA legislative acts means a direct or indirect holding in an investment firm which represents 10 % or more of the capital or of the voting rights or a holding which makes it possible to exercise a significant influence over the management of the EEA financial intermediary in which that holding subsists; See for precise definitions: Art. 4(2) Nr. 12 MiFID II; Art. 4(1)(ah) AIFMD; See for a less detailed definition: Art. 2(1)(i) UCITSD V; Art. 13 Nr. 21 Solvency II; Art. 4 Nr. 36 CRR.
[478] 'Close links' under various sectoral EEA legislative acts means a situation in which two or more natural or legal persons are linked by participation in the form of ownership, direct or by way of control, of 20 % or more of the voting rights or capital of an undertaking; See Art. 2(1)(i), (4) UCITSD V; Art. 4(1)(e) AIFMD; Art. 4 Nr. 38 CRR; Art. 4(2) Nr. 26 MiFID II.
[479] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 81 et seq. (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).
[480] For example: the AIFMD, UCITSD V, MiFID II, CRD II or Solvency II.

Upon the authorization of EEA financial intermediaries, a common requirement in sectoral EEA financial legislation is the duty to inform the relevant Competent Authority of the identities of the shareholders or members that have 'qualifying holdings' and the amounts of those holdings.[481] Competent Authorities are required refuse authorization of an EEA financial intermediary if, taking into account the need to ensure the sound and prudent management of an investment firm, they are not satisfied as to the suitability of the shareholders or members that have qualifying holdings.[482]

This duty also applies where 'close links'[483] exist between an EEA financial intermediary applying for authorization and other natural or legal persons.[484] 'Close links' include those natural or legal persons that are not direct shareholders of the EEA financial intermediary. Authorization to an EEA financial intermediary shall only be granted if those 'close links' do not prevent the effective exercise of the supervisory functions of the Competent Authority.[485]

Competent Authorities shall also be notified of changes related to 'qualifying holdings'.[486]

5.1.2. Delegation

TC firms often establish a subsidiary within one of the EEA Member States in order to have EEA market access. TC firms, however, have their main resources in the third country in which they are established and authorized in. For this reason, TC firms often establish a subsidiary within the EEA to use an EEA European passport within a particular sector, whereas business activities are being delegated[487] under sectoral delegation arrangements by the EEA subsidiary to the TC firm. Upon delegation of all critical or important operational functions[488] by the EEA subsidiary to the TC firm, the relevant Competent Authority may under all EEA sectoral financial laws revoke the authorization of the EEA subsidiary.[489] The effect of this is, however, small as it 'punishes' the EEA subsidiary, whereas the TC firm received the majority of the fee income.

In Liechtenstein, for example, several EEA UCITS ManCos as subsidiaries of Suisse asset managers are being established to enable EEA market access.[490] Liechtenstein UCITS ManCos are, typically, responsible for fund administration and, in some cases, distribution, whereas investment and risk management is being delegated to the Suisse asset manager.

---

[481] See Art. 4(2) Nr. 12 MiFID II; Art. 4(1)(ah) AIFMD; See for a less detailed definition: Art. 2(1)(i) UCITSD V; Art. 13 Nr. 21 Solvency II; Art. 4 Nr. 36 CRR.

[482] Art. 10(1) MiFID II; Art. 8(1) (d) AIFMD; Art. 14(1) CRD IV; Art. 24(1) Solvency II; Art. 8(1) UCITSD V.

[483] Art. 7(2) UCITSD V (UCITS ManCos), Art. 29(1)(c) a.E. UCITSD V (UCITS Investment Companies); Art. 10(1) sub-para.3 MiFID II; Art. 8(3)(a) AIFMD; Art. 14(3) sub-para. 1 CRD IV; Art. 19(1) Solvency II.

[484] See Art. 2(1)(i), (4) UCITSD V; Art. 4(1)(e) AIFMD; Art. 4 Nr. 38 CRR; Art. 4(2) Nr. 26 MiFID II.

[485] Art. 10(1) sub-para 3 MiFID II; Art. 7(2) UCITSD V (UCITS ManCos), Art. 29(1)(c) UCITSD V (Investment Companies); Art. 8(3) (a) AIFMD; Art. 14 (3) sub-para. 1 CRD IV; Art. 19(1) Solvency II.

[486] Art. 14(3) CRD IV; Art. 7(2) UCITSD V (UCITS ManCo), Arts 8, 10 AIFMD; Art. 19(3) Solvency II, Art. 11(1), (3) MiFID II.

[487] MiFID II refers to 'outsourcing'. See Art. 2(3) Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive: 'outsourcing means an arrangement of any form between an investment firm and a service provider by which that service provider performs a process, a service or an activity which would otherwise be undertaken by the investment firm itself'.

[488] See Art. 31 Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive

[489] Art. 70 MiFID II.

[490] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 97 et seq. (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

Although the subsidiary is legally delegating these tasks to the Suisse asset manager, the asset manager is in practice a 'customer' that chooses its UCITS ManCo. The UCITS ManCo does not necessarily have to be a subsidiary, but may also by a 'third-party' UCITS ManCo that is specialized in 'white-label funds'.[491] Again, revoking the authorization of the UCITS ManCo only 'punishes' the UCITS ManCo and not the Suisse asset manager as the 'client' that benefits.

For this reason, EEA sectoral financial laws require EEA financial intermediaries to comply with delegation/outsourcing requirements on an ex-ante and ongoing basis to ward off externalities.

5.1.2.1. General Principles of EEA Delegation Rules

EEA sectoral financial laws do not prohibit[492] delegation as delegation also fosters efficiency.[493] EEA sectoral financial laws, however, increasingly regulate delegation arrangements.[494]

The main joint principle underlying EEA delegation rules is the 'letterbox company' prohibition.[495] Authorized financial intermediaries may not delegate their important operational function to such an extent that they are a, de facto, 'letterbox company'.[496]

In this regard, European investment law requires that important functions may not be delegated in such a way that its impairs materially the quality of the internal control of the EEA financial intermediary concerned and the ability of the responsible Competent Authority to monitor the intermediary's compliance with all obligations.[497]

Other common principles to which delegation is subjected to be found in European investment laws are:[498]

- notification (in some cases authorization) of the delegation arrangement to the relevant Competent Authority;[499] Information on arrangements made for (sub-)delegation to third parties of functions is, when capable of constituting a material change of the conditions for the

[491] See R. Steyer, *White-label funds on rise for DC plans*, Pensions & Investments, October 27, 2014, http://www.pionline.com/article/20141027/PRINT/310279972/white-label-funds-on-rise-for-dc-plans (accessed 8 June 2017).

[492] See Recital 43 Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive: 'a general prohibition on the outsourcing of one or more critical or important functions. Investment firms should be allowed to outsource such functions if the outsourcing arrangements established by the firm comply with certain conditions'.

[493] P. Laaper, *Uitbesteding in de financiële sector - in het bijzonder van vermogensbeheer door pensioenfondsen* 57-60, 211 (Kluwer 2015).

[494] See, for example, the delegation requirements applicable to AIFMs: T. Partsch, T., *Delegation* (D.A. Zetzsche ed, Kluwer 2015).

[495] See for a recent statement on 'letterbox companies' in relation to financial services and Brexit: European Securities and Markets Authority, *Opinion - General principles to support supervisory convergence in the context of the United Kingdom withdrawing from the European Union*, ESMA42-110-433, 31 May 2017.

[496] A. Lewis, R. Pretorius & E. Radmore, *Outsourcing in the financial services sector*, 106 C.O.B. 1 (2013).

[497] See, for example, Art. 16(5) MiFID II.

[498] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 98-99 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[499] Art. 20(1) sub-para. 1 AIFMD, Art. 81(2) AIFMD (Commission) Regulation; Art. 13(1)(a) UCITSD V; Art. 31(2) Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

authorization of an EEA financial intermediary, shared with other relevant Competent Authorities.[500]
- an objective reason for delegation;[501]
- the delegate must dispose of sufficient resources and an appropriate organizational structure to perform the respective tasks. The EEA financial intermediary must be in a position to monitor effectively the delegated activity, to give at any time further instructions to the delegate and to withdraw the delegation with immediate effect when this is in the interest of their clients;[502]
- delegates for authorized activities, generally, may only be undertakings which are authorized for carrying out that activity and subject to supervision regardless whether established within or outside the EEA;[503]
- the delegate cooperates with the Competent Authorities of the EEA financial intermediary in connection with the delegated functions;[504]
- the responsibility and liability of EEA financial intermediaries is not affected upon delegatin critical or important operational functions;[505]
- the delegation must not prevent the effectiveness of supervision of the relevant authorized/registered EEA financial intermediary.[506]

Sub-delegation arrangements under EEA sectoral financial laws are subject to the same delegation requirements a 'regulator delegation arrangements' irrespective whether the delegate is established in or outside the EEA.[507] In addition, financial intermediaries are required to inform the relevant Competent Authority about sub-delegations.[508]
Similar regulation apply to delegation are to be found for, amongst others, insurance undertakings under Solvency II and IORPs under IORPD II.[509]

5.1.2.2. 'Equivalency' as Common Principle for TC Delegation Rules?

---

500 Recital 44 Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive;Arts 7(2)(e), 10(1) AIFMD; Art. 5(6) UCITSD V.

501 Art. 20(1) sub-para. 2(a) AIFMD, Art. 76 AIFMD (Commission) Regulation.

502 Art. 20(1) sub-para. 2(b) and (f) AIFMD, Art. 77 AIFMD(Commission) Regulation; Art. 13(1)(f)-(h) UCITSD V; Art. 16 MiFID II, Art. 31(1) Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

503 Art. 20(1) sub-para. 2(c) AIFMD, Art. 78 AIFMD (Commission) Regulation; Art. 13(1)(c) UCITSD V; Art. 31(2) Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

504 Art. 79(b) AIFMD (Commission) Regulation; Art. 31(2)(h) Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

505 Arts 31(1) Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive; Art. 13(2) UCITSD V; Art. 20(3) AIFMD, Art. 75 AIFMD (Commission) Regulation.

506 Art. 20(1) sub-para. 2(e) AIFMD, Art. 79 AIFMD (Commission) Regulation;Art. 13(1)(b) UCITSD V; Art. 16 MiFID II, Arts 31(2),(5), 32(1)(a) Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

507 See for example for UCITS depositaries: Art. 22a UCITSD V; Art. 17(4) UCITSD V (Commission) Regulation.

508 *Ibid.*

509 Art. 13 NR 28, Art. 41(3) and Art. 49 Solvency II; Art. 31, 32 IORPD II.

Upon delegation to TC firms, European investment laws require a number of extra requirements to be complied with. For the delegation of portfolio- and risk management under the AIFMD and portfolio management under MiFID II to TC firms, for example, an appropriate cooperation agreement between the Competent Authority of the AIFM/investment firm and the Supervisory Authority of the delegate is required.[510] Although formally no equivalency is being required for TC firms, the requirement that TC firm delegates under European investment law for authorized activity may only be undertakings that are authorized and subject to supervision[511] for carrying out that activity leads to a 'de facto' equivalency requirement.[512] TC firms are under delegation arrangements required to be subject to equivalent authorization and supervision requirements as EEA financial intermediaries.

5.1.3. Consolidated Supervision & Conglomerates

Since the introduction of the European passport, consolidated supervision, on a sectoral and cross-sectoral basis, has gradually emerged. This tendency responds to the accelerating consolidation in the financial industry and the development of (cross-) sectoral links between financial intermediaries in and outside of the EEA.[513] Credit institutions, investment firms and insurance companies increasingly carry on (parts of) their business through subsidiaries and affiliated entities on a sectoral or cross-sectoral basis.[514] The ongoing consolidation in the financial industry resulting from increasing mergers and acquisitions leads to economies of scale and scope. At the same time, however, consolidation also leads to an increase of systematic risks.[515] For this reason, European banking and securities laws require credit institutions, investment firms and insurance companies to be both supervised on an individual and consolidated basis.[516]

CRD IV/CRR and Solvency II regulate financial intermediaries on a sectoral basis. They cover solo and consolidated supervision applying on a sectoral basis to groups of credit institutions, investment firms, insurance companies and financial institutions.[517] On top of this, FiCOD regulates groups of regulated entities that operate in more than one financial sector (conglomerates). FiCOD does not replace existing sectoral supervision. Instead, FiCOD applies as supplementary supervision of regulated entities. FiCOD primarily aims at coordinating the supervision of various supervisory authorities of different sectors of the

---

[510] Art. 113 AIFMD (Commission) Regulation; Art. 32(1)(b) Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

[511] Art. 20(1) sub-para. 2(c) AIFMD, Art. 78 AIFMD (Commission) Regulation; Art. 13(1)(c) UCITSD V; Art. 31(2) Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

[512] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 99-100 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[513] See Recital 2, 3 FiCOD.

[514] D. Amel, C. Barnes, F. Panetta & C. Salleo, *Consolidation and efficiency in the financial sector: a review of the international evidence*, 28 Journal of Banking and Finance 2493-2519 (2004).

[515] T.H. Troeger, *Organizational Choices of Banks and the Effective Supervision of Transnational Financial Institutions*, 48 Texas International Law Journal 177 (2012).

[516] V. Peleckiene, K. Peleckis & G. Duzeviciute, *New Challenges of Supervising Financial Conglomerates*, 5 Intellectual Economics 298-311 (2011).

[517] See M. Gruson, *Consolidated and Supplementary Supervision of Financial Groups in the European Union*, Der konzern , Teil 1, 65-93, Teil II, 249-265 (2004)

financial industry so that a conglomerate can be prudentially supervised on a group-wide basis.[518]

This section, in particular, reflects the EEA approach towards sectoral group structures and conglomerates in which both EEA and TC financial intermediaries are involved.

5.1.3.1. Consolidated Supervision: Sectoral Groups

CRD IV/CRR and Solvency II regulate the consolidated supervision of EEA and TC financial intermediaries on a sectoral basis.

Credit institutions and Investment Firms

Consolidated supervision under the CRD IV/CRR applies on a sectoral basis to groups of credit institutions, investment firms and financial institutions.[519]

CRD IV/CRR requires consolidated supervision of various requirements, including own funds, valuation and reporting of capital requirements, the monitoring of large exposures, liquidity coverage and the calculation of the leverage ratio at the group level.[520]

The CRD IV group regimes applies supervision on a consolidated basis[521] to (1) parent credit institutions[522], (2) parent financial holding companies[523] and (3) parent mixed financial holding companies[524].[525]

Parent institutions are institutions (credit institutions or investment firms)[526] that have an institution or a financial institution[527] as a subsidiary[528] or hold a participation[529] in either of those institutions.[530] Parent institutions may not be a subsidiary of another institution authorized in the same Member State, or of a (mixed) financial holding company set up in the same Member State.[531]

Parent (mixed) financial holding companies are companies which are not itself a subsidiary of an institution, a financial holding company or mixed financial holding company set up in the same Member State.[532]

---

[518] See Tripartite Group of Bank & Securities and Insurance Regulators, *The Supervision of Financial Conglomerates*, Bank for International Settlements, July 1995, 16; See also: A.E. Wilmarth, *The dark side of universal banking: Financial conglomerates and the origins of the subprime crisis*, 41 Connecticut Law Review 963-1050 (2009).

[519] Art. 111 CRD, Art 11 et seq CRR. See M. Gruson, *Consolidated and Supplementary Supervision of Financial Groups in the European Union*, Institute for Law and Finance Johann Wolfgang Goethe- Universität Frankfurt, Working Paper Series No. 19 (2004), 66.

[520] Arts 11(1)-(3) CRR determine that Parts Two-Four, Six and Seven should be consolidated.

[521] Art. 4(48) CRR: 'Consolidated situation means the situation that results from applying the requirements of this Regulation in accordance with Part One, Title II, Chapter 2 CRR to an institution as if that institution formed, together with one or more other entities, a single institution'. See Ar. 4(47) CRR.

[522] Art. 111(1) CRD IV.

[523] Art.111(2) CRD IV.

[524] *Ibid.*

[525] Art. 111 CRD IV and Art. 11 CRR; M. Gruson, *Supervision of Financial Holding Companies in Europe: The EEA Directive on Supplementary Supervision of Financial Conglomerates*, 36 The International Lawyer 1229-1260 (2002).

[526] Art. 3(1)(24) CRD IV; Art. 4(1) Nr. 28 CRR.

[527] A ‘financial institution’: an undertaking other than an institution, the principal activity of which is to acquire holdings or to pursue one or more activities listed in points 2 to 12 and point 15 of Annex I to CRD IV, including a financial holding company or a mixed financial holding company. See also Article 4(26) CRR).

[528] Art. 2(10) FiCOD.

[529] Art. 2(11) FiCOD.

[530] Article 4(28) CRR.

[531] *Ibid.*

[532] See for parent financial holding company: Article 4(30) CRR; See for parent mixed financial holding company: Article 4(32) CRR.

Financial holding companies are financial institutions that are not mixed financial holding companies that have subsidiaries that are exclusively or mainly institutions or financial institutions of which at least one of the subsidiaries qualify as an institution.[533] A financial holding company may be a holding company that has only one credit institution or investment firm as a subsidiary.

To the contrary, mixed financial holding companies are parent undertakings, other than regulated entities, that together with their subsidiaries of which at least one is an EEA regulated entity and other entities constitute a financial conglomerate.[534]

Only credit institutions, investment firms and (mixed) financial holdings companies, can, thus, be the parent of a group that is subject to consolidated supervision.[535] Financial institutions are also part of a group subject to consolidated supervision if they are a subsidiary of either one of those institutions. Consolidated supervision is not required for those institutions if they are merely subsidiaries of companies that are not credit institutions, investment firms or (mixed) financial holdings companies.

CRD IV and the CRR require Competent Authorities of EEA credit institutions and investment firms that are subsidiaries of TC parent undertakings[536] to verify whether the consolidated supervision carried out by the TC home state of that undertaking is equivalent to the standards and requirements set out in CRD IV and the CRR.[537] In the absence of equivalency, Member States may apply CRD IV and the CRR by analogy to the European credit institutions and investment firms involved.[538] Alternatively, the Competent Authorities responsible may apply other appropriate supervisory techniques to achieve the objectives of supervision on a consolidated basis of institutions.[539] The Competent Authority responsible for consolidated supervision must, however, after consulting other Competent Authorities involved, agree upon the method used.[540] Competent Authorities may, in particular, require the establishment of a (mixed) financial holding company in the EEA and apply the provisions on consolidated supervision to that (mixed) financial holding company.[541]

Article 48 CRD IV also grants the option to the European Commission, after having sent a proposal to the Council, to negotiate reciprocal bilateral agreements with one or more third countries related to consolidated supervision over credit institutions and investment firms that have a TC parent undertaking and TC investment firms and credit institutions that have an EEA parent undertaking.[542] Such agreements, in particular, have to ensure that the relevant EEA and TC Competent Authorities are able to obtain information necessary for the supervision of the CRD IV/CRR group on a consolidated basis.[543]

Insurance Undertakings

The Solvency II group supervision regime is applied at the level of the group of insurance reinsurance undertakings which are part of a group.[544]

---

[533] Art. 4(32) CRR.
[534] Art. 4(21) CRR.
[535] See Art. 2(15) FiCOD.
[536] Third country parent undertaking is required to be ‘an institution, a financial holding company or mixed financial holding company’. See Art. 127(1) CRD IV; See also: M. Gruson, *Foreign Banks and the Financial Holding Company* (M. Gruson & R. Reisner eds., Lexis Nexis Matthew Bender 4th ed. 2003).
[537] Ar. 127 CRD IV refers to Part One, Title II, Chapter 2 CRR.
[538] Art. 127(3) CRD IV.
[539] *Ibid.*
[540] Art. 127(3) sub-para. 2 CRD IV.
[541] Art. 127(3) sub-para. 3 CRD IV.
[542] Art. 48(1) CRD IV.
[543] Art. 48(2) CRD IV.
[544] Art. 213(1) Solvency II.

A group is under Solvency II defined as (non-)EEA (re-)insurance or (mixed-activity) holding company[545] with one or more participating interests in subsidiaries that are primarily insurance or reinsurance firms.[546] Entities linked by a horizontal structure also qualify as a group.[547] The supervision of insurance and reinsurance undertakings relates to: the group solvency capital requirements[548], risk concentration and intra-group transactions[549], the group system of governance[550], the group own risk and solvency assessment (ORSA)[551] and disclosure and reporting requirements at the group level[552].[553] The Solvency II group supervision provisions supplements the supervision of the individual insurance firms in the group. The provisions of Solvency II is being applied to the group as a whole. In some cases, smaller parts of an insurance group may be supervised at the national or European level ('subgroup supervision').[554]

Group supervision applies to parent insurance companies or insurance holding companies.[555]

Insurance holding companies are parent undertakings, other than mixed financial holding companies[556], that mainly acquire and hold participations in subsidiary undertakings which are exclusively or mainly (non-) EEA insurance or reinsurance undertakings.[557]

A group headed by a non-insurance undertaking that carries out insurance activities as an 'ancillary' activity are referred to as 'mixed insurance holding companies'. Mixed-activity insurance holding companies are parent undertakings other than (non-)EEA insurance undertakings that have at least one insurance or reinsurance undertaking as a subsidiary although the core activity of the group is not insurance business.[558]

The approach towards the group supervision of insurance groups that are headed by TC parent undertakings depends upon an equivalency test.[559] Equivalency assessments are undertaken by the European Commission and binding on all EEA Member States.[560] Group

---

[545] See for a definition of 'insurance holding company': Art. 212(1)(f) Solvency II; See for the definition of 'mixed-activity insurance holding company': Art. 212(1)(g) Solvency II.
[546] Referred to in the definition of 'group'under Art. 212 (c)(i) Solvency II as 'participating undertaking'. See a definition of 'participating undertaking' under Art. 212(1)(a) Solvency II.
[547] Art. 212(c) (ii) Solvency II.
[548] Art. 218-243 Solvency II.
[549] Art. 244-245 Solvency II.
[550] Art. 246 Solvency II.
[551] Art. 45 Solvency II; See also: European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. 14/017 on Guidelines on own risk and solvency assessment*, 28 January 2015,EIOPA-BoS-14/259.
[552] Art. 256 Solvency II.
[553] S.A. Lumpkin, *Risks in Financial Group Structures*, 2 OECD Journal: Financial Market Trends 105-136 (2010).
[554] See for the provisions on the ultimate parent at EEA level: Art. 215 Solvency II. See for the ultimate parent undertaking at the national level: Art. 216 Solvency II.
[555] Art. 213(1) and(2) Solvency II.
[556] See Art. 2(15) FiCOD: 'mixed financial holding company shall mean a parent undertaking, other than a regulated entity, which together with its subsidiaries, at least one of which is a regulated entity which has its head office in in the Union, and other entities, constitutes a financial conglomerate'.
[557] See Art. 212(1)(f) Solvency II.
[558] See Art. 212(1)(g) Solvency II.
[559] See Art. 260 Solvency II; See Title III Third Country Equivalence and Final Provisions, Commission Delegated Regulation (EEA) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) Text with EEA relevance (hereafter : Solvency II Commission Delegated Regulation.
[560] See for specific country assessments the EC Delegated Decisions of 5 June 2015 on Australia, Bermuda, Brazil, Canada, Mexico, Switzerland and the USA: https://eiopa.EEAropa.EEA/external-relations/equivalence/overview-of-equivalence-decisions (accessed 27 June 2017); See also: J. Vinuales, *The*

supervision may be (fully) left to the Competent Authority of the TC parent undertaking provided that an equivalent level of policyholder protection is in place and that there are strong mutual co-operation arrangements concluded between EEA insurance and TC Competent Authorities.[561]

By absence of equivalency, the Solvency II provisions may be applied to EEA (sub) groups or other methods may be applied that would ensure appropriate supervision of the group.[562]

5.1.3.2. Consolidated Supervision (FiCOD): Financial Conglomerates

FiCOD applies to EEA regulated entities, in addition to their sectoral supervision for solo firms or groups, provided that these EEA entities belong to a financial conglomerate.[563] Under Article 1 FiCOD EEA regulated entities are defined as credit institutions, investment firms and insurance companies that have obtained an authorization under CRD IV, Solvency II or MiFID II.[564]

Subject to FiCOD is every regulated entity:[565]

- being at the head of a financial conglomerate ;
- whose parent undertaking is a EEA mixed financial holding company[566,] and
- linked with another financial sector entity by a horizontal group relationship.[567]

EEA regulated entities that do fall outside this scope may be subject to the FiCOD third country regime if its parent undertaking is either a TC regulated entity or TC mixed financial holding company for which no equivalency decision has been taken in accordance with Article 18 FiCOD.[568]

Financial Conglomerate

For the scope of application of FiCOD it is required that EEA regulated entities belong to a ' financial conglomerate'. The term financial conglomerate is pivotal in determining the personal scope of application of FiCOD. The term is being defined by FiCOD on the basis of the following criteria that apply on a cumulative basis:[569]

- the financial conglomerate must qualify as a group or subgroup ;[570]
- the (sub)group must include a EEA regulated entity;[571]
- if the (sub)group is headed by a EEA regulated entity, that entity must at least being linked
    - with one entity in the financial sector;[572] or

International Regulation of Financial Conglomerates: A Case-Study of Equivalence as an Approach to Financial Integration, 37 California Western International Law Journal 1-61 (2006); H. Holopainen, *Integration of financial supervision*, Bank of Finland Research Discussion Papers12 (2007).

[561] Arts 261, 264 Solvency II.

[562] Art. 262 and 263 Solvency II.

[563] Cf. Joint Forum, *Principles for the Supervision of Financial Conglomerates*, Bank for International Settlements, September 2012.

[564] Art. 1 FiCOD.

[565] Art. 5(2) FiCOD.

[566] Art. 5(2)(b) FiCOD.

[567] Art. 5(2)(c) FiCOD; See also Article 12(1) Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts.

[568] Art. 5(3) FiCOD.

[569] Art. 2(14) FiCOD.

[570] Art. 2(14)(a) FiCOD.

[571] Art. 2(14) FiCOD.

- o have that entity as a subsidiary or as a participation.
  - o non-EEA regulated entities at the head of the group must be operating mostly in the financial sector.[573]
- at least one of the entities in the group must be within the insurance sector and at least one within the banking or investment services sector;[574]
- the group must have significant cross-sectoral activities in both the banking, investment services and insurance sector.[575]

FiCOD distinguishes between groups that are headed by an EEA regulated entity and groups that are headed by TC regulated or a non-regulated entities.[576] Financial conglomerates that are headed by a non-regulated entity are mixed financial holding companies. Financial conglomerates may, thus, be headed by EEA regulated entities, non-EEA regulated entities and mixed financial holding companies. To all three entities that may be head of a financial conglomerate the general criteria of the involvement of at least one EEA regulated entity and significant cross-sectoral activities must be fulfilled. Depending upon whether an EEA regulated or TC entity is a head of the group specific criteria apply to those groups in order to meet the definition of a financial conglomerate. Before those criteria will be discussed in detail, first an inquiry will be made under what conditions an EEA regulated entity is part of a group.

A group is defined as a group of undertakings that consists of a parent-subsidiary relationship[577], a relationship based upon participation[578] or a horizontal structure.[579]
The parent-subsidiary relationship covered is being defined by the definition 'parent undertaking'. The definition in FiCOD includes both the definition of the term, according to Article 1 Directive 83/349/EEC, and every undertaking which, in the Competent Authorities' opinion, exercises a dominant influence on another undertaking.[580] Subsidiaries are an undertaking[581] and any undertaking, subject, in the Competent authorities' opinion, to the parent undertaking's dominant influence.[582] Participations include 'participations'[583] or the direct or indirect ownership of more of the voting rights or capital of an undertaking.[584]Non-equity relationships may also be covered if they are managed on a unified basis pursuant to a contract or charter provision or if the administration management or supervisory bodies of both undertakings consist for the major part of the same persons.[585]

To qualify as a financial conglomerate, FiCOD requires groups to include at least one EEA regulated entity irrespective of the parent-subsidiary relationship within the group. For that

---

[572] Art. 12(1) Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts.
[573] Art. 2 (14)(b)(i) FiCOD.
[574] Art. 2(14)(a)(ii) and (b)(ii) FiCOD.
[575] Art. 2(14)(a)(iii) and (b)(iii) FiCOD.
[576] See V. De Vuyst, *Internal governance bij financiele conglomeraten* (Intersentia 2010).
[577] Art. 2(9) FiCOD.
[578] *Ibid.*
[579] See Art. 2(12) FiCOD. M. Gruson, *Supervision of Financial Conglomerates in the European Union,* 198 Journal of International Banking Law and Regulation 363-381, 364 (2004).
[580] Art. 2(11) FiCOD.
[581] Art. 1 Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts.
[582] Art. 2(9) FiCOD.
[583] Article 17 Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies.
[584] Art. 2(11) FiCOD.
[585] Art. 12(1) Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts.

purpose, EEA regulated entities are defined as credit institutions, insurance undertakings and investment firms.[586] AIFMs[587] and asset management companies[588] are considered as 'regulated entities' provided that a group already qualified as a financial conglomerate[589] and that AIFMs or asset management companies are part of that group.[590]

All other categories of financial intermediaries than credit institutions, insurance undertakings and investment firms do not qualify as 'EEA regulated entity' even though they might be authorized on the European or the national level. The activities of those entities are only taken into account at the level of the parent undertaking if a group qualifies as a financial conglomerate. A group solely consisting of these types of entities, thus, does not qualify as a financial conglomerate.

The group must, to qualify as a financial conglomerate, have significant cross-sectoral activities in both the banking, investment services and insurance sector.[591] Irrespective of how a group is structured at least one of its entities must be within the insurance sector and at least one within the banking or investment services sector.[592] FiCOD does not require more than one of those entities to be authorized under MiFID II, Solvency II or CRD IV. In practice, however, almost all activities in these domains are fully harmonized under European law.[593] Article 2(14) FiCOD requires at least one regulated entity to have its legal seat within the EEA. All other (regulated) entities are, however, not required to be EEA entities.[594] Financial groups solely consisting of insurance undertakings do not satisfy the criterion 'cross-sectoral activities'.[595] They are subject to the sectoral group regulation under Solvency II. Groups that solely consist of investment firms and credit institutions do not qualify as 'financial conglomerate' and, for that reason, solely within the scope of CRD IV.

The consolidated and aggregated activities of the entities in the (sub)group within the insurance sector and of the entity within the banking and investment services sector must be also 'significant'.[596] The assessment required is based upon quantitative criteria.
The activities of entities in both sectors[597] of financial conglomerates headed by an EEA, non-EEA regulated entity or mixed financial holding companies should represent at least 10% of the average ratio balance sheets and solvency ratio requirements of the group[598] or the smallest sector in the group must exceed 6 billion Euro.[599] Groups not headed by EEA regulated entities, on top of that, only qualify as a financial conglomerate if the group activities mainly occur in the financial sector.[600]

---

[586] Art. 2(14)(a)(ii) FiCOD.
[587] See for a definition of an 'alternative investment fund manager': Art. 2(5a) FiCOD.
[588] See for a definition of an 'asset management company': Art. 2(5) FiCOD.
[589] Art. 4 FiCOD.
[590] See Art. 30 and 30a FiCOD.
[591] Art. 2(14)(a)(iii) and (b)(iii) FiCOD.
[592] Art. 2(14)(a)(ii) and (b)(ii) FiCOD.
[593] See Art. 2(14) FiCOD. Art. 2(14)(a)(ii) and (b)(ii) FiCOD refer to 'entities' and not 'regulated entities'. Gortsos comes to the conclusion that on the basis of this the second entity may be unregulated. See Ch.V.Gortsos, *The Supervision of Financial Conglomerates under European Financial Law (Directive 2002/87/EC)*, 25 Banking & Financial Law Review 295-313 (2010).
[594] Art. 2(14)(a)(ii) and (b)(ii) FiCOD do not refer to Art. 1 FiCOD.
[595] M. Gruson, *Consolidated and Supplementary Supervision of Financial Groups in the European Union*, Institute for Law and Finance Johann Wolfgang Goethe- Universität Frankfurt, Working Paper Series No. 19 (2004).
[596] Art. 2(14)(a)(iii) and (b) (iii) FiCOD.
[597] The insurance sector, at the one hand, and the activities of the entities in the banking and investment services sector, at the other hand.
[598] Art. 3(2) FiCOD.
[599] Art. 3(3) and (3a) FiCOD.
[600] Art. 2(8) FiCOD.

Specific criteria apply to groups headed by EEA regulated or non-EEA regulated entities.

Groups or sub-groups headed by a EEA regulated entity must at least being linked with one entity in the financial sector[601] or have that entity as a subsidiary[602] or as a participation[603]. Irrespective of what categoy applies, the EEA regulated entity must be linked to another entity 'of the financial sector'[604].The term 'financial sector' is defined by Article 2(8) FiCOD and includes regulated and non-regulated entities in the banking, insurance and investment services sector, including:

- credit institutions, financial institutions, or ancillary services undertaking;[605]
- insurance undertakings, reinsurance undertakings and insurance holding companies;[606] and
- investment firms.[607]

For that purpose, it is not important whether that entity in the financial sector is regulated, non-regulated[608] or whether it is established within the EEA.[609]

Non-EEA regulated entities at the head of the group must be operating mostly in the financial sector. [610] The balance sheet total of the (non-)regulated financial sector entities in the group should exceed 40% of the balance sheet total of the group.[611]

Supplementary Supervision

Supplementary supervision is exercised on a 'solo plus' basis. FiCOD supplements the sectoral solo supervision of individual entities by a quantitative assessment of the group and a quantitative assessment of the capital adequacy of the conglomerate.[612] FiCOD covers capital adequacy[613], risk concentration[614], intra-group transactions[615] and internal control mechanisms and risk management processes.[616]

Article 6 and Annex I FiCOD covers the capital adequacy of of a financial conglomerate. The objective is to control risks arising from eliminating 'double gearing', i.e. intra-group creation of own funds and excessive leverage.[617] For that purpose, Annex I FiCOD sets forth different methods of the calculation of the solvency position for conglomerates and adequate capital policies at the level of the conglomerate.

---

[601] Art. 2(8) FiCOD.
[602] Art. 2(10) FiCOD.
[603] Art. 2(11) FiCOD.
[604] Defined in Art. 2(8)(a) FiCOD.
[605] Art. 2(8)(a) FiCOD.
[606] Art. 2(8)(b) FiCOD; See also Arts 13(1),(2),(4),(5) and 212(1)(f) Solvency II.
[607] Art. 2(8)(c) FiCOD.
[608] See, for instance, Art. 2(8)(a) FiCOD that refers to 'a financial institution or an ancillary services undertaking within the meaning of Directive 2006/48/EC (now replaced by CRD IV)'.
[609] Ch.V. Gortsos, *The Supervision of Financial Conglomerates under European Financial Law (Directive 2002/87/EC)*, 25 Banking & Financial Law Review 295-313 (2010).
[610] Art. 2 (14)(b)(i) FiCOD.
[611] Art. 3(1) FiCOD.
[612] M. Gruson, *Supervision of Financial Conglomerates in the European Union,* 198 Journal of International Banking Law and Regulation 363-381, 364 (2004).
[613] Art. 6 and Annex 1 FiCOD.
[614] Art. 7 and Annex II FiCOD.
[615] Art. 8 and Annex II FiCOD.
[616] Art. 9 FiCOD.
[617] European Commission, *Proposal for a Directive of the European Parliament and of the Council amending Directives 98/78/EC, 2002/87/EC and 2006/48/EC as regards the supplementary supervision of financial entities in a financial conglomerate*, 16 August 2010, COM(2010) 433 final**,** 2010/0232 (COD), 2.

Intra-group transactions may, in addition, lead to arbitrage where capital or other legal requirements are being evaded or risk concentrations where losses born by one entity within a conglomerate may cause the insolvency of other regulated entities or the conglomerate as a whole.[618]

To prevent these risks that might arise from intra-group transactions and risk concentration, FiCOD requires adequate risk management and internal control mechanisms – encompassing reporting and accounting procedures – at the level fo the financial conglomerate.[619] On top of that, regulated entities or mixed financial holding companies are required on, at least, an annual basis to report significant risk concentration and intra-group transactions of regulated entities at the level of the conglomerate.[620]

These shall be reviewed by the coordinator Competent Authority that may act after having consulted other relevant competent authorities.[621] FiCOD requires the exchange of information of the entities within a financial conglomerate and the exchange of information and cooperation between all Competent Authorities supervising the regulated entities within a financial conglomerate.622 For that purpose, FiCOD requires a coordinator. This coordinator is a Competent Authority that has been appointed among the authorities involved to coordinate the supervision conducted over the regulated entities within the conglomerate.623 The coordinator has as its tasks, amongst others, to coordinate the gathering and disseminate relevant information concerning the conglomerate624, to assess the financial situation625, the compliance with the rules on capital adequacy626 and of risk concentration and intra-group transactions627 and to plan and coordinate supervisory activities conducted628.

The coordinator ensures the close cooperation between the authorities supervising the regulated entities within a financial conglomerate.629

Equivalent Supplemented Supervision for TC Parent Undertakings

FiCOD does not directly target groups headed by parent undertakings of conglomerates outside the EEA.[630] The FiCOD applies, however, to TC parent undertakings that are not subject to equivalent standards and requirements as set out in FiCOD.[631] The equivalency assessment is carried out by the 'coordinator'.[632] Successful equivalency assessments result in conglomerates entirely being supervised by the home Competent Authority of the TC parent undertaking.[633]

In the absence of equivalency, Member States may apply, like under CRD IV and the CRR, by analogy FiCOD to the EEA regulated entities involved.[634] Alternatively, the

---

[618] Art. 2(19) FICOD.
[619] Art. 9(1)-(3), (5) FiCOD.
[620] Art. 7(2) sub-para. 2, Art. 8(2), Annex II FiCOD.
[621] Art. 7(2), Art. 8(2) sub-para. 2 FiCOD.
[622] Recital 13, Art. 12 FiCOD.
[623] Art. 10(1) FiCOD.
[624] Art. 11(1)(a) FiCOD.
[625] Art. 11(1)(b) FiCOD.
[626] Art. 11(1)(c) FiCOD.
[627] Art. 11(1)(c) FiCOD.
[628] Art. 11(1)(e) FiCOD.
[629] Art. 12 FiCOD.
[630] Art. 18 FiCOD.
[631] Art. 18(2) FiCOD.
[632] No coordinator needs to be appointed if the FiCOD is not applicable. The Competent Authority that would be the coordinator if the FiCOD would be applicable to the conglomerate will carry out the equivalency assessment. This is being referred to in the literature as the 'hypothetical coordinator'.
[633] Art. 18(3) FiCOD.
[634] Art. 56a sub-para. 4 FiCOD. See also Art. 127(3) CRD IV.

Competent Authorities responsible may apply other appropriate supervisory techniques to achieve the objectives of the supervision on a consolidated basis.[635]

The European Commission may submit proposals to the EEA Council for the negotiation of reciprocal bilateral agreements concerning the application of FiCOD of financial conglomerates that have regulated entities within the EEA of which their parent undertaking is outside the EEA.[636]

5.1.3.3. Conclusion

Since the introduction of the European passport, consolidated supervision, on a sectoral and cross-sectoral basis, has gradually emerged. This tendency responds to the accelerating consolidation in the financial industry and the development of (cross-) sectoral links between financial intermediaries in and outside of the EEA.[637] CRD IV/CRR and Solvency II regulate financial intermediaries on a sectoral basis. They cover solo and consolidated supervision applying on a sectoral basis to groups of credit institutions, investment firms, insurance companies and financial institutions.[638] On top of this, FiCOD regulates groups of regulated entities that operate in more than one financial sector (conglomerates).

Provided that requirements related to equivalence and exchange of information are complied with, the EEA regime on consolidation and conglomerates may allow the home state of an TC financial intermediary heading a group/conglomerate to perform ‘consolidated supervision’.[639] The EEA consolidation and conglomerate regime (partly) substitutes the relevance of EEA sectoral delegation regimes.[640]

5.2. Financial Intermediaries within the EEA

Solely allowing EEA firms to be active within the internal market would be contrary to the GATS.[641] For this reason, EEA law intends to offer a legal framework for TC firms that want to provide services within the EEA to avoid externalities that would put investor protection, the market integrity or the financial system in the EEA as a whole at risk. To this end, the EEA principle of ‘mutual recognition’ in the form of the equivalency of TC regulatory and supervisory frameworks is required by sectoral EEA secondary legislation to be in place in such a way that TC firms have access to the EEA. The TC regimes regulating this vary from sector to sector as some sectors, such as banking and insurance, are harmonized to a larger extent at the international level than other sectors (for example, asset management). For this reason, some EEA secondary laws require TC firms to comply with ‘stand-alone authorizations’, whereas others grant access to the EEA on the basis of ‘central negotiation’ or even a European passport to TC financial intermediaries. These are now discussed in detail in this section.

5.2.1. ‘Stand-alone’ Authorizations

---

[635] Art. 56a sub-para. 5 FiCOD.
[636] Art. 10a FiCOD.
[637] See Recital 2, 3 FiCOD.
[638] See M. Gruson, *Consolidated and Supplementary Supervision of Financial Groups in the European Union*, Der konzern , Teil 1, 65-93, Teil II, 249-265 (2004)
[639] See *supra* 5.1.3.
[640] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 152 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).
[641] See *supra* 4.4.

Throughout the most recent European banking and securities laws Solvency II, the AIFMD CRD IV and MiFID II have TC regulations in which Member States may, under the minimum conditions set out in these directives, authorize TC firms to be active within their domiciles on the basis of a 'stand-alone' authorization regime.

5.2.1.1. Branch: Solvency II

Under Solvency II, TC insurance undertakings willing to carry out the direct life and non-life insurance business within the EEA are subject to an authorization.[642] For that purpose, Solvency II imposes requirements to the TC insurance company[643] and a branch of the TC company is required to be established within a Member State of the EEA in which authorization is sought.[644]

TC insurance companies are required to:

- be entitled to pursue insurance business under its national law;[645]
- set up branch accounts specific to the business which it pursues there, and keep all records there related to the business transacted;[646]
- designate a general representative approved by the relevant supervisory authorities;[647]
- fulfill various minimum capital and solvency requirements;[648]
- appoint a claims representative in each Member State other than the Member State in which the authorization is sought.[649]

In addition, branches of TC insurance companies must:

- comply with certain Solvency II governance requirements;[650]
- be established in the Member State in the territory of the Member State in which authorisation is sought;[651]
- submit a scheme of operations;[652]
- separate non-life and life insurance business.[653]

Solvency II, thus, requires an authorization of a branch of a TC insurance company within the EEA.[654] Solvency II does not require TC insurance companies to comply with an equivalency test as Solvency II is partly applicable to the branch of the TC insurance company.[655]

Several advantages are granted to TC insurance companies that have authorized branches in more than one Member State.[656] The Solvency II capital requirements, for example may be

---

[642] Art. 162(1) Solvency II; Articles 162 to 171 refer only to direct life and non-life insurance business according to the first subparagraph of Article 2(1) Solvency II. Reinsurers, therefore, do not fall under this provision but can access the EEA on the basis of Art. 172 et seq. Solvency II.
[643] Art. 162(2) Solvency II.
[644] Arts 162(2)(b), 169 Solvency II.
[645] Art. 162 (2)(a) Solvency II.
[646] Art. 162(2)(c) Solvency II.
[647] Art. 162(2)(d) Solvency II.
[648] Art. 162(2)(e), (f) Solvency II.
[649] Art. 162(2)(g) Solvency II.
[650] Art. 162(2)(i) Solvency II. The governance requirements as laid down in chapter IV, Section 2 Solvency II.
[651] Art. 162(2)(b) Solvency II.
[652] Art. 162(2)(h) Solvency II. Comply with the requirements as set out in Art. 163 Solvency II.
[653] Art. 169 Solvency II.
[654] Art. 162(1) Solvency II.
[655] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 100 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).
[656] Art. 167, 169, 170 Solvency II.

calculated in relation to the entire business. In addition, deposits are only required to be lodged in one of the Member States in which the TC insurance company has an authorized branch and assets representing the required minimum capital only has to be localized in any one of the Member States in which the TC insurance company pursues its activities.[657]

The application to benefit from the abovementioned advantages has to be made by the TC insurance companies to the Competent Authorities of all the Member States in which it has an authorized branch.[658] Upon the reception of a positive reply or replies, only one of the Competent Authorities will be responsible to supervise the solvency of the entire business of all the branches established within the EEA.[659] The advantages are, however, subjected to the veto right of all Competent Authorities of the Member States concerned.[660] If one of the Member States disagrees or requests a withdrawal, the advantages provided shall be withdrawn in all Member States concerned.[661]

The advantages of the authorization procedure for TC insurance companies branches under Article 162 et seq. Solvency II are, however, limited. The administrative hurdles and costs associated by requiring the establishment of a separate branch for each EEA Member State in which a TC insurance company wants to be active de facto only enables the big Member States to benefit from the increased supply of (re)insurance services within the EEA of third country undertakings.[662] The latter poses hurdles to the objective of increasing market efficiency.[663]

For this reason, Solvency II gives European institutions the power to conclude mutual agreements with third countries on a reciprocal basis.[664] TC insurance undertakings may, if they are established in a third country with which an agreement is concluded, access the EEA without the establishment and authorization of branches within the Member States in which they are willing to be active.

The EU may, however, by means of agreements concluded with one or more third countries agree to apply the Solvency II third country requirements differently. Recently, the EU institutions have increasingly made use of this option.[665]

5.2.1.2. National Private Placement Regimes under the AIFMD

The AIFMD provides for a national placement regime under which TC-AIFs marketed by EEA-AIFMs and AIFs marketed by TC-AIFMs are, for a transitional period, permitted to be authorized on a country-by-country basis.[666]

EEA-AIFMs may market TC-AIFs on a country-by country basis as long as they comply with all AIFMD requirements except the provisions related to the appointment, delegation and liability of depositaries under Article 21 AIFMD.[667]

TC-AIFMs may market (TC-)AIFMs on the basis of a national placement regime if they comply with a number of provision of the AIFMD regarding investor information and reporting obligations to Competent Authorities.[668] The TC-AIFM is subjected to the AIFM

---

[657] Art. 169(1)(a)-(c) Solvency II.
[658] Art. 169(2) Solvency II.
[659] Art. 169(2) Solvency II.
[660] Art. 169(3) Solvency II.
[661] Art. 169(4) Solvency II.
[662] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 108 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).
[663] See *supra* 4.1.1.
[664] See Art. 171, 175(2) Solvency II.
[665] Art. 171 Solvency II.
[666] Recital 85 AIFMD.
[667] Art. 36(1)(a) AIFMD.
[668] Art. 42 AIFMD.

regulation of the third country concerned. No equivalency requirement is imposed to the AIFM.

Member States may, however, impose stricter rules on the AIFM in respect of the marketed of units or shares of TC-AIFs within their territory. Not all Member States, for example, grant the 'depositary-lite' option.[669] In addition, to the general requirement of compliance with the AIFMD, AIFMs using the national placement regime must comply with two specific requirements under Articles 36 and 42 AIFMD.

The first of the two requirements is that a cooperation agreement on information exchange for the purpose of systematic risk oversight must be signed between EEA and TC Competent Authorities.[670] Under Article 36 AIFMD, the cooperation arrangements must be in place between the Competent Authorities of the home Member State of the AIFM and the supervisory authorities of the third country where the TC-AIF is established.[671] Article 42 AIFMD requires the cooperation arrangement to be concluded between the Competent Authorities of the Member States where the AIFs are marketed, in so far as applicable, the Competent Authorities of the EEA AIFs concerned and the Supervisory Authorities of the third country where the TC AIFM is established, at the one hand, and, in so far as applicable, the Supervisory Authorities of the third country where the non-EU AIF is established., at the other hand.[672]

The second requirement is that the third country where the TC-AIF or TC-AIFM is established may not be listed as a non-cooperative country and territory by the Financial Action Task Force on anti-money laundering and terrorist financing (FATF).[673]

AIFMs making use of the national placement regime are, thus, at the one hand, required to fully or partially comply with the AIFMD and, at the other hand, with the two additional requirements regarding the cooperation agreements on information exchange and FATF compliance.

5.2.1.3. CRD IV

CRD IV does not contain any harmonized rules for the cross-border provision of services. Member States may on a country-by-country basis authorize branches of TC credit institutions.[674] Member States may, however, not treat the branches of TC credit institutions more favourable than branches of EEA credit institutions.[675] An authorization of a TC credit institution branch is, however, limited to the Member State in which a branch has been authorized.

5.2.1.4. The MiFID II Country-by-Country Branch Regime

Under MiFID I, the provision of investment services by TC firms was not harmonized.[676] TC firms seeking to do business in the EEA were subject to national regimes and requirements.[677] Each Member State could, thus, regulate the access in their domicile in its own way, subject

---

[669] See D.A. Zetzsche, *Fondsregulierung im Umbruch – ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, ZBB 22 (2014).

[669] See Chapter 5, section 3.1.6.

[670] Art. 36(1)(b), Art. 42(1)(b) AIFMD.

[671] Art. 36(1)(b) AIFMD.

[672] Art. 42(1)(b) AIFMD.

[673] See D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* 455, 463 (D.A. Zetzsche ed, Kluwer 2015).

[674] Recital 23 CRD IV.

[675] Recital 23 , Art. 47 CRD IV.

[676] See R. Maggi, *MiFID II: Marktzugang, Umsetzung, Handlungsoptionen* (Zürich/Basel/Genf 2014)

[677] Recital 41 MiFIR.

to the principles laid down in GATS and under the condition that TC firms could not be given a more favourable treatment than EEA firms.[678]

This resulted in a highly fragmented regime for TC firms willing to do business in the EEA.[679] Moreover, TC firms authorized in accordance with the domestic TC regime of a single Member State could not make use of an European passport, i.e. they could not provide services and the right of establishment in Member States other than the one where they were authorized.[680] TC firms willing to do business in more than one EEA Member State were under MiFID required to obtain an authorization in every each Member State that they would be willing to provide services in. In practice, TC firms could only obtain a European passport by establishing a newly created EEA legal entity (subsidiary) that was authorized under MiFID.[681]

Under MiFID II/MiFIR, a harmonized legal regime for TC firms willing to provide investment services in the EEA has been introduced that ensures uniform treatment and a comparable level of protection of clients that are receiving services by TC firms.[682] For that purpose, a regime was designed that depends upon the MiFID II client categorization. The MiFID II TC approach differentiates between retail clients and elective professional investors[683], at the one hand, and eligible counterparties and per sé professional clients, at the other hand. The former relies on a country-by-country authorization basis, whereas a European TC passport under MiFID II is available for TC investment firms providing services to eligible counterparties and and per sé professional clients. The 'country-by-country MiFID II authorization' is discussed here, whilst the MiFIR European TC passport is discussed *infra* 5.2.2.1.

The provision of services by TC firms in the EEA to retail clients and elective professional clients in their domiciles under MiFID II still relies to a large degree on national regimes and requirements.[684]

Under MiFID II there is no European passport available for TC firms wishing to provide services to retail and certain professional clients.[685] The only way to obtain a European passport for these type of TC firms is by establishing a legal entity (subsidiary) that obtains an authorization as an EEA investment firm under MiFID II in one of the EEA Member States.[686]

Article 39 MiFID II grants Member States the option to require TC firms intending to provide investment services or perform investment activities with or without any ancillary services to retail clients or to eligible professional clients in its territory to establish a branch in that Member State.

---

[678] See U. Klebeck & J. Eichhorn, *Drittstaatenregulierung der MiFID II und MiFIR*, 3 RdF 1 (2014).
679 Recital 41 MiFIR.
[680] Recital 31 MiFIR.
[681] See T. Jutzi & C. Feuz, *MiFID II, AIFMD und UCITSD: Auswirkungen des EU-Vermögensverwaltungsrechts aufdas grenzüberschreitende Geschäft Schweizer Finanzintermediäre*, Jusletter Next, 25. April 2016, http://www.iwr.unibe.ch/unibe/portal/fak_rechtwis/e_dep_dwr/inst_iwr/content/e36453/e162340/e172868/e172869/files426879/2016_04_25_Jusletter_ger.pdf (accessed 10 June 2017); A. Kern & A. Schmidt, *The Market in Financial Instruments Directive and Switzerland*, 1 GesKR45 (2012); R. Sethe, *Das Drittstaatenregime von MiFIR und MiFID II*, 6 SZW/ RSDA 615 (2014).
[682] Recital 41 MiFIR.
[683] See R. Sethe, *Das Drittstaatenregime von MiFIR und MIFID II*, 6 SZW 2014, 615 (2014).
[684] Recital 109 MiFID II.
[685] European Principal Traders Association, *Special Report Series: Third Country Firms Under MiFID II*, 25. Juni 2014, http://www.futuresindustry.org/downloads/Special%20report%20seven%2025% 20June%20-%20Third%20country%20firms%20under%20MiFID%20II.pdf (accessed 18 June 2017).
[686] See for authorization requirements EEA investment firms under MiFID II: D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D.A. Zetzsche ed, Kluwer 2015).

Upon the establishment of a branch within a Member State under Article 39 MiFID II, TC firms do not enjoy passporting rights, i.e. they do not have the freedom to provide services and right of establishment in Member States other than the one in which they have established a branch.[687]

The requirements applicable to branches being established are subject to common harmonized EEA standards under MiFID II in light of the principle that TC firms should not be treated more favourable by Member States than EEA investment firms.[688]

According to Chapter IV MiFID II, various conditions would need to be met for the establishment of a branch. Member States in which a TC firms intends to establish a branch only may grant an authorization to those firms that fullfill (1) conditions for the establishment of a branch and (2) complying with certain MiFID II provisions.[689]

Pursuant to Article 39(2) MiFID II, an authorization for the establishment of branch shall only be granted by Competent Authorities of a Member State if the following conditions are fulfilled:

- the provision of services for which the TC firm requests authorization is subject to authorization and supervision in the TC where it is established, whereby the relevant Competent Authority pays due regard to:
    - FATCA recommendations; and
    - countering financing of terrorism.
- cooperation arrangements, including exchange of information for the purpose of enforcing regulatory compliance, are in place between the Competent Authorities of the Member State in which the branch is established and the Supervisory Authorities of the third country where the TC firm is established;
- sufficient initial capital is at free disposal of the branch;
- one or more persons are appointed and responsible for the management of the branch and compliance with MiFID II;[690]
- the third country where the TC firm is established has signed an agreement with the Member State where the branch is established with the standards laid down in Article 26 OECD Model Tax Convention;
- the TC firm belongs to an investor-compensation scheme authorized or recognized in accordance with Directive 97/9/EC.

Prior to obtaining authorization for the provision of any investment services, TC firms have, in accordance with Article 40 MiFID II, the obligation to provide information to the Competent Authority of the Member State in which they request authorization. They are required, amongst others, the Competent Authority of that Member State with the name of the third country Supervisory Authority by which they are supervised, relevant details of the firm, name of persons responsible for management of branch and information about the initial capital of the firm.[691] In addition to the conditions related to the authorization of the branch, the TC firm needs to comply with certain MiFID II provisions.[692]

---

[687] Recital 109 MiFID II.

[688] See for these EEA standards:J-P. Casey & K. Lannoo, *The MiFID Revolution*, ECMI Policy Brief No. 3 (November 2006); J-P. Casey & K.Lannoo, The MiFID revolution (Cambridge University Press (2009); J-P. Casey & K.Lannoo, *The Mifid Revolution: A Policy View*, 7 Competition and Regulation in Network Industries 519 (2006).

[689] Art. 41 MiFID II.

[690] See Art. 9(1) MiFID II.

[691] Art. 41(2) MiFID II.

[692] D. Busch & M. Louisse, *MiFID II/MiFIR's Regime for Third-Country Firms* (D. Busch & G. Ferrarini eds, Oxford 2017).

In case Member States do not implement the branch requirement, the provision of services to retail clients and elective professional clients will remain to be subject to its national laws. It is unclear as to whether TC firms may provide services to retail clients in which a Member State does not require the establishment of a branch. MiFID II is silent on this point. At any times, however, TC firms may not be treated more favourable by individual Member States than EEA investment firms[693] under MiFID II. The requirements set out for EEA branches should, thus, be seen as minimum requirements applying to individual legal TC regimes of Member States for those Member States that allow TC firms to provide cross-border services within their domicile.[694]

5.2.2. European Passports for TC Financial Intermediaries

A recent legal innovation introduced in European investment law is the European passport for TC firms. TC-AIFMs and TC investment firms are the first TC intermediaries that are able to fully benefit from the cross-border provision of financial services throughout the EEA.

5.2.2.1. The TC-AIFM Passport Regime under the AIFMD

The third country passport for TC-AIFMs is modelled after the EEA-AIFM management and marketing passport.[695]

EEA-AIFMs may make use of the AIFMD management and marketing passport by means of of cross-border activity. EEA-AIFMs may either rely on the freedom to provide services or the freedom of establishment (establishing a branch office in the host Member State).[696] The management passport entitles an AIFM to manage AIFs in a host Member State, whereas under the AIFMD marketing passport, an EEA-AIFM is allowed to market AIF units to professional investors.[697] The AIFMD management and marketing passport both require a notification procedure. A notification will be sent be the AIFM's Competent Authorities to the host Competent Authorities if the EEA-AIFM fully complies with the AIFMD and the relevant information is provided along the notification.[698]

TC-AIFMs may under Articles 32, 33 and 37 AIFMD obtain a management and marketing passport. For this purpose, the AIFMD imposes additional requirements to the third country, in which the TC-AIFM has its registered and head office, and to the TC-AIFM itself.[699]

The third country in which the TC-AIFM is established:

- must have a cooperation agreement on information exchange in place between the Competent Authority of the 'Member State of reference'[700], the Competent authorities of the home

---

[693] Recital 41 MiFIR.
[694] Recital 109 MiFID II.
[695] See European Securities and Markets Authority, *Consultation paper - ESMA's draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive in relation to supervision and third countries* (Consultation paper), 23 August 2011, ESMA/2011/270.
[696] Arts. 32, 33 AIFMD; Similarly: Art. 16-21 UCITSD V; See also: M.J. Aramendía, *Third Country Rules for Alternative Investments: Passport flexibility comes at a price*, ECMI Commentary nr. 27, 16 december 2010.
[697] See T. Jutzi & C. Feuz, *MiFID II, AIFMD und UCITSD: Auswirkungen des EU-Vermögensverwaltungsrechts aufdas grenzüberschreitende Geschäft Schweizer Finanzintermediäre*, Jusletter Next, 25. April 2016, http://www.iwr.unibe.ch/unibe/portal/fak_rechtwis/e_dep_dwr/inst_iwr/content/e36453/e162340/e172868/e172869/files426879/2016_04_25_Jusletter_ger.pdf (accessed 10 June 2017).
[698] See Annex IV AIFMD for the AIFMD marketing passport and Art. 33(2) and (3) for the AIFMD management passport.
[699] D.A. Zetzsche, & T.F. Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* 474 (D.A. Zetzsche ed, Kluwer 2015).
[700] *Ibid.*, 465.

Member State of the EEA-AIFs concerned and the Supervisory Authorities of the third country where the TC-AIFM is established.[701]

- may not be listed as a non-cooperating state by FATF and the third country where the TC-AIFM is established;[702] and
- has signed an agreement with the Member State of reference, which fully complies with the standards laid down in Article 26 of the OECD Model Tax Convention on Income and on Capital and ensures an effective exchange of information in tax matters, including any multilateral tax agreements.[703]

Apart from these requirements, the effective exercise by the Competent Authorities of their supervisory functions under this AIFMD may not be prevented by prevented by the laws, regulations or administrative provisions of a third country governing the TC-AIFM, nor by limitations in the supervisory and investigatory powers of that third country's Supervisory Authorities.[704]

A TC-AIFM that manages/markets AIFs using the EEA passport must fully comply with the AIFMD, including the EEA passporting requirements related to the EEA management and marketing passport with the exception of Chapter VI that regulates AIFMs that manage specific types of AIFs.[705]

Under Article 37(2) AIFMD, a TC-AIFM is exempt from this requirement if it can demonstrate that compliance with one or more provisions of the AIFMD is 'incompatible with compliance with the law to which the TC-AIFM and/or the TC-AIF marketed in the EEA is subject'.[706] The TC-AIFM is, however, in that case required to demonstrate that the third country rules the TC-AIFM is subjected to are equivalent and have 'the same regulatory purpose and offer the same level of protection to investors as the AIFMD'.[707]

Following Article 37 AIFMD, TC-AIFMs have to be authorized in an 'Member State of reference ' for the marketing or management of AIFs for which the TC-AIFM wants to use an EEA passport. The Member State in which the TC-AIFM is authorized is also the Member State that will supervise the TC-AIFM on an ongoing basis and ensures the TC-AIFM's compliance with the AIFMD.[708] The determination of the 'Member State of reference' depends upon the type of marketing or management that the TC-AIFM intends to undertake and can be extremely complex.[709] Factors considered in Article 37 AIFMD are, amongst

---

[701] Art. 40(2)(c) AIFMD.

[702] Art. 40(2)(b) AIFMD.

[703] See for a definition of the Member State of reference: Art. 37(4) AIFMD.

[704] Art. 37(7)(g) AIFMD.

[705] Art. 37(2) AIFMD; R.E. Labeur, *Uniform derdelandenbeleid AIFMD: Nog een lange weg te gaan*, 10 TvFR 391-395 (2015); M. Bergervoet, *De impact van de AIFM Richtlijn voor derde landen en in het bijzonder voor Curaçao*, 4 TvFR 120 (2014).

[706] Art. 37(2)(a) AIFMD; M.J. de Manuel Aramendèa, *Third Country Rules for Alternative Investments: Passport flexibility comes at a price*, ECMI Commentary nr. 27 (2010); U. Klebeck & C. Meyer, *Drittstaatenregulierung der AIFM-Richtlinie*, Recht der Finanzinstrumente 95 (2012).

[707] Art. 37(2)(b) AIFMD;European Securities and Markets Authority, *Advice to the European Parliament, the Council and the Commission on the application of the AIFMD passport to non-EU AIFMs and AIFs* ESMA/2016/1140, 12 September 2016; European Securities and Markets Authority, *Advice to the European Parliament, the Council and the Commission on the application of the AIFMD passport to non-EU AIFMs and AIFs*, ESMA/2015/1236, 30 July 2015; European Securities and Markets Authority, *Consultation paper - ESMA's draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive in relation to supervision and third countries (Consultation paper)*, 23 August 2011, ESMA/2011/270.

[708] Art. 37(10) AIFMD.

[709] See R.P. Raas, *De AIFM Richtlijn en derde landen* 59-69 (N.B. Spoor, M. Tausk, J.B. Huizink & R.P. Raas, Kluwer 2012).

others, the Member of the EEA-AIF, the total AuM managed and the development of effective marketing.[710]

The TC-AIFM is, thus, not obliged to establish a subsidiary or branch in the Member State of reference. Instead, the TC-AIFM must appoint a legal representative that acts as a contact person of the TC-AIFM for the investors of the relevant AIFs, ESMA and the Competent Authorities involved.[711]

Apart from this, the legal representative also needs to ensure compliance with the AIFMD for the management/marketing activities performed within the EEA under the AIFMD.[712]

5.2.2.2. The MiFIR European Passport for TC Investment Firms

MiFIR has also introduced a harmonized regime for TC firms that want to provide services to eligible counterparties and per sé professional clients in the EEA.[713] This regime allows this type of TC firms to operate on a cross-border basis from outside the EEA or from an EEA-based branch. This harmonized regime allowing for passporting services throughout the EEA is, however, solely limited to eligible counterparties and per sé professional clients.[714] TC firms willing to provide services under MiFID II to retail clients and eligible professional clients have to comply with the Member State implementations of Article 39 MiFID II.

Following Article 46 MiFIR, TC firms may provide investment services on a cross-border basis to eligible counterparties and per sé professional clients without the establishment of a branch. Several conditions, however, need to be fulfilled. First, the European Commission has to adopt an equivalency decision, i.e. it must adopt a decision recognizing that the regulatory (prudential and business conduct requirements) and supervisory regime in which the TC firm is established and supervised achieves the same objectives as the EEA regime and with equivalent access to its markets.[715] Following Article 47 MiFIR, an equivalent regime is in place if, amongst others, the firm is subject to authorization and to effective supervision and enforcement on an ongoing basis[716], subject to sufficient capital requirements and appropriate requirements applicable to shareholders and members of their management body[717], the firm has adequate organization requirements in the area of internal control funds and subject to appropriate conduct of business rules[718]. Second, the firm must be subject to effective supervision and enforcement ensuring full compliance with regulatory requirements applicable in the third country.[719] Third, ESMA must have established cooperation

---

[710] See Art. 37(4)(g) AIFMD.
[711] Art. 37(7)(c) AIFMD.
[712] See Art. 38(3) AIFMD.
713 See Art. 46 et seq. MiFIR; European Principal Traders Association, Special Report Series: Third Country Firms Under MiFID II, 25. Juni 2014, http://www.futuresindustry.org/downloads/Special%20report%20seven%2025% 20June%20-%20Third%20country%20firms%20under%20MiFID%20II.pdf (accessed 18 June 2017); R. Sethe, *Das Drittstaatenregime von MiFIR und MIFID II*, 6 SZW 2014, 615 (2014;R. Maggi, *MiFID II: Marktzugang, Umsetzung, Handlungsoptionen* (Zürich/Basel/Genf 2014).
[714] These professional clients are listed in Annex II, Section I MiFID II.
[715] Art. 46 MiFIR; U. Klebeck & J. Eichhorn, *Drittstaatenregulierung der MiFID II und MiFIR*, 3 RdF 1 (2014); D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D.A. Zetzsche ed, Kluwer 2015).
[716] Art. 47(1)(a) MiFIR.
[717] Art. 47(1)(b) MiFIR; D. Busch & M. Louisse, *MiFID II/MiFIR's Regime for Third-Country Firms* (D. Busch & G. Ferrarini eds, Oxford 2017); A. Kern & A. Schmidt, *The Market in Financial Instruments Directive and Switzerland*, 1 GesKR45 (2012); R. Sethe, *Das Drittstaatenregime von MiFIR und MiFID II*, 6 SZW/ RSDA 615 (2014).
[718] Art. 47(1)(c) and (d) MiFIR.
[719] Art. 46 (1)(b) MiFIR.

arrangements with the Competent Authority of that third country.[720] Finally, ESMA has included the TC firm in a register that is publicly accessible.[721]

TC firms providing services must inform their EEA clients, prior to providing services to them, that they are not allowed to provide services to retail and elective retail clients.[722] Following, Article 46(7) MiFIR, ESMA has developed RTS to specify information that TC firms must provide to ESMA regarding their application of registration and in what format the information should be delivered.[723]

Three years following the adoption of the equivalence decision, non-EEA firms have the choice either to register with ESMA or continue to conduct investment services in compliance with Member States' national regimes.[724] The latter, however, implies that no European passport is available for the TC firm concerned.[725] Similarly, the national regimes are applicable to TC firms if the European Commission withdraws its equivalency decision or no equivalency decision has been adopted.[726]

Alternatively, TC firms may provide services to eligible counterparties or professional clients by means of a 'European passport' in all Member States through an EEA branch that has been authorized by a Competent Authority of a Member State pursuant to Article 39 MiFID.[727] TC firms must, however, for this purpose be established in a third country for which the European Commission has adopted an equivalence decision.[728] Finally, TC firms must also comply with the information requirements as laid down in Article 34 MiFID II**.**

5.2.3. The (Mutual) Agreements Solution

Access to the internal market is also granted to TC firms on the basis of (mutual) agreements concluded by the European institutions and their counterparts all over the world. Solvency II and CRD IV provide examples of this solution in the insurance and banking domain.

5.2.3.1. Solvency II

Third country insurance undertakings may on the basis of Article 162 et seq. Solvency II obtain access to the EEA by establishing a branch that is subject to an authorization.[729] In addition, Solvency II gives European institutions the power to conclude mutual agreements on a reciprocal basis.[730] Third country insurance undertakings may, if they are established in a third country with which an agreement is concluded, access the EEA without the establishment and authorization of branches within the Member States in which they are willing to be active. Solvency II also contains a similar procedure for reinsurance undertakings. This type of undertakings are left outside the scope of the Solvency II third country 'branch regime'. Requirements, however, differ for (non-)life insurance undertakings, at the one hand, and reinsurance undertakings, at the other hand.[731] The differentiation

---

[720] Art. 46(2)(c) and Art. 47(2) MiFIR.
[721] Art. 46(4), 48 MiFIR.
[722] Art. 46(5) MiFIR.
[723] European Securities Market Authority, *Final Report -MiFID II/MiFIR draft Technical Standards on authorisation, passporting, registration of third country firms and cooperation between competent authorities*,29 June 2015, ESMA/2015/1006.
[724] Art. 54 MiFIR.
[725] *Ibid.*
[726] See Art. 49 MiFIR.
[727] Art. 47 MiFIR.
[728] Art. 47(3) MiFIR.
[729] Art. 162 Solvency II.
[730] See Art. 171, 175(2) Solvency II.
[731] This differentiation has evolved since the adoption of the first Non-life (Art. 29), the Life insurance Directive (Art. 32) and the Reinsurance Directive (Art. 50).

between the third country regimes discussed stems from the fact that reinsurance undertakings may only access the EEA on a basis of an agreements concluded with third countries, whereas (non-)life insurance undertakings may either access the EEA by means of the establishment of an authorized branch in the EEA Member State in which they wish to be active or on the basis of any agreement concluded.

On behalf of (non-)life insurance undertakings, European institutions may, by means of agreements concluded on the basis of Article 218 TFEU, agree to grant access to third country insurance undertakings on the basis of requirements different to those provided under the third country branches regime.[732] Agreements on the basis of Article 171 Solvency II, however, need to fulfill the condition of reciprocity and adequate protection for policy holders and insured persons in the EEA Member States.[733]

Under a predecessor of this provision[734], European institutions have currently, for example, concluded an agreement with Switzerland regarding non-life insurance companies.[735] The policy of reciprocity under this agreement implies that non-life insurance companies from Switzerland may establish direct branches in any EEA Member States on the same terms as non-life insurance companies from EEA Member States and vice versa.[736] The second requirement of adequate protection for policy holders and insured persons in the Member States is elaborated by the commitment of Switzerland to conform its insurance legislation, on the basis of the agreement, to the standards as set forth in Solvency II.[737] The harmonization of insurance legislation under Solvency II has, thus, being extended to Switzerland. The ambit of the agreement is, however, limited as Swiss non-life insurance undertakings do not benefit from the provisions of Solvency II with regard to cross-border services.[738]

The latter treaty does not prevent individual EEA Member States to conclude insurance agreements with third countries. Liechtenstein, for instance, has concluded a direct insurance agreement, including life and non-life insurances, that has been in force since 1997.[739] The agreement allows Swiss and Liechtenstein insurance companies freedom of establishment and services on a reciprocal basis. The agreement is based upon the pre-FSAP principles governing the single license, home country control and the supervision on solvency of the insurance companies. The ambit of this agreement does not include reinsurers and social insurance schemes.[740]

The European Council under Article 175(1) Solvency II may negotiate with one or more third countries agreements regarding the means of exercising supervision over reinsurance

---

[732] Art. 171 Solvency II.
[733] *Ibid.*
[734] See Art. 29 Non-life Insurance Directive.
[735] See the agreement between the European Economic Community and the Swiss Confederation on direct insurance other than life insurance, in Official Journal of the European Communities L. 205. July 27, 1991
[736]; See Proposal for a Council Decision on the conclusion of the Agreement between the Swiss Confederation and the European Economic Community concerning direct insurance other than life assurance; See also the Proposal for a Council Directive on the implementation of the Agreement between the Swiss Confederation and the European Economic Community concerning direct insurance other than life assurance. COM (83) 106 final, 28 February 1983.
[737] See Agreement between the European Economic Community and the Swiss Confederation on direct insurance other than life assurance, OJ L 205/3, 27 July 1991.
[738] Agreement between the European Economic Community and the Swiss Confederation on direct insurance other than life assurance, OJ L 205/3, 27 July 1991.
[739] Agreement between the Principality of Liechtenstein and the Swiss Confederation concerning Direct Insurance, Liechtenstein Law Gazette, 1998/129, 20 August 1998.
[740] J. Gasser & M. Schwingshackl, *Asset Protection through Liechtenstein Annuities and Life Insurance*, (M. Gantenbein & M.A. Mata eds., John Wiley & Sons 2008).

undertakings.[741] Agreements concluded grant, under the condition of market equivalence of prudential regulation and reciprocity, effective market access for reinsurance undertakings though establishment or the cross-border provision of services.[742] The criteria for the equivalence assessments under Article 172(1) and (3) Solvency II are relevant for what third countries might be eligible to conclude an agreement.[743] The assessment criteria provide for a basis to assess the equivalence of prudential equivalence of third countries on a European-wide basis as to improve the liberalization of reinsurance services in third countries.[744] Under any agreement concluded, the contracting parties would be legally bound to recognize the prudential supervision being carried out by the home country, whereas the host country regulator would abandon its right to prudential supervision on the condition of information exchange.[745]

Under Article 175(1) Solvency II, the solvency regime of third countries, applying to reinsurance activities, may also be determined to be equivalent to the Solvency II Directive.[746] Following a positive equivalency decision, Member States are required to treat reinsurance contracts concluded with reinsurance undertakings in the relevant third country in the same manner as reinsurance contracts concluded with EEA undertakings that are authorized under Solvency II.[747] EEA Member States are prohibited to claim the pledging of assets to cover unearned premiums and outstanding claims provisions[748] and the localization of assets within the EEA to cover risks in the EEA, nor assets that represent reinsurance recoverables.[749]

In the absence of treaties concluded under Article 175 Solvency II and an equivalence decision under Article 271 Solvency II, the treatment of reinsurance contracts remains to be subject to the laws of the individual EEA Member States. The national treatment of the individual EEA Member States, in such cases, are subject to the principle of non-discrimination. Article 174 Solvency II prohibits EEA Member States to treat third country undertakings more favourable than EEA undertakings.[750]

5.2.3.2. Credit Institutions

Similar to Solvency II, CRD IV only grants a European passport to third country credit institutions on the basis of the conclusion of international treaties. CRD IV contains the legal basis on which the European Union may conclude agreements (Article 218 TFEU) with one or more third countries for branches of credit institutions to provide services on a cross-border basis throughout the EEA.[751] Till now, no agreements have been concluded.

Apart from this, the European Commission is on the basis of Article 48 CRD IV also entitled to submit proposals to the European Council for the negotiation of agreements with one or more third countries regarding the exercise of supervision of third country parent undertakings or the parent undertakings of EEA conglomerates/groups on a consolidated

---

[741] H. Geiger, *Transnational Supervisory Recognition: a Macro-Jurisdictional Overview* 317, 318 (J. Burling, S.C. Chambers & K. Lazarus eds., Edward Elgar Publishing 2012).
[742] Recital 89, Art. 172(2) Solvency II.
[743] H. Geiger, *Transnational Supervisory Recognition: a Macro-Jurisdictional Overview* 318 (J. Burling, S.C. Chambers & K. Lazarus eds., Edward Elgar Publishing 2012).
[744] Recital 89 Solvency II.
[745] Art. 172(2)(a) and (b) Solvency II.
[746] Art. 172(1) Solvency II.
[747] Art. 172(3) Solvency II.
[748] Art. 172(3) Solvency II.
[749] Art. 134 Solvency II.
[750] Art. 174 Solvency II Directive.
[751] Art. 47(3) CRD IV.

basis.[752] The latter type of agreements shall, in particular, ensure that the competent authorities of Member States and EBA are able to obtain information necessary for conducting financial supervision.[753]

5.3. EEA Financial Intermediary TC Market Access

Originally, market access of EEA financial intermediaries in third countries was based upon bilateral and international treaties concluded by individual Member States or, to the extent there was an EEA legislative initiative with an 'external dimension', the European institutions.[754] A disadvantage of this was the fragmented landscape of market access for EEA financial intermediaries in third countries. Since an amendment of the Treaty of Nice, the EU common commercial policy became an exclusive competence of the EU.[755] To this end, various EEA secondary laws grant the European Commission a 'negotiation mandate' to ensure that EEA financial intermediaries are granted market access in third countries, on a reciprocal basis.

5.3.1. The EU Commission Negotiation Mandate

The common commercial policy includes autonomous measures on the basis of which the European Parliament and Council may adopt measures to define the framework for implementing the common commercial policy.[756] In addition, they also have the competence to negotiate and conclude agreements with one or more third countries or internal organizations.[757]

The establishment of subsidiaries, branches and the provision of cross-border services by EEA financial intermediaries in third countries is, thus, exclusive competence of the EU and Member States may not act unilaterally, unless European legislation allows them to do so.[758]

5.3.2. The (Mutual) Agreements Solution under the Commission Negotiation Mandate

Upon the adoption of the First Banking Directive and the ISD, sectoral EEA financial laws began to grant the European Commission a 'negotiation mandate' to ensure effective market access, on a reciprocal basis, for TC firms willing to provide investment and banking services within the EEA. Under the First Banking Directive, for example, the European Commission could conclude agreements on the basis of the EEC Treaty with one or more third countries, on the basis of reciprocity, to grant branches of credit institutions from a certain third country identical treatment throughout the EEC.[759] By granting a 'negotiation mandate' to the European Commission, 'negotiation power' was being bundled to prevent EEA financial intermediaries from being discriminated in third countries.

Similar 'negotiation mandates' have been granted to the European Commission under, amongst others[760], UCITSD V, AIFMD, Solvency II and the IDD.

Article 9 UCITSD V regulates the 'relations with third countries'. Article 9(1) UCITSD V states that 'relations with third countries shall be regulated in accordance with Article 15

---

[752] Art. 48(1) CRD IV.
[753] Art. 48(2) CRD IV.
[754] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 67 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).
[755] Art. 3(1)(e) TFEU.
[756] Art. 207(2) TFEU.
[757] Art. 207(3) TFEU.
[758] Art. 2(1) TFEU.
[759] Art. 9(3) First Banking Directive.
[760] See also Art. 15 MiFID I.

MiFID I'. Article 15 MiFID I requires Member States to inform the European Commission of any general difficulties which investment firms in establishing themselves or carrying out activities in any third country.[761] Under Article 15 MiFID I, the Council may grant a mandate to the European Commission to initiate negotiation to remedy the situation.[762] In the circumstance that EEA investment firms are not granted 'effective market access', the European Commission may even order national Competent Authorities to limit, suspend requests related to pending or future requests for authorization and the acquisition of holdings by direct or indirect parent undertakings governed by the law of the third country in question.[763]In addition, Article 9(2) UCITSD V requires Member States to inform any general difficulties which UCITS encounter in marketing their units in any third country.

Modern sectoral EEA financial laws, such as Article 67(2)(c) AIFMD, Article 177 Solvency II and Article 1(6) sub-paragraph 4 IDD, only require the latter approach. Under Article 67(2)(c) AIFMD, for example, ESMA shall base its opinion and advice on the application of the passport to the marketing of TC-AIFs by EEA-AIFMs in the Member States and the management and/or marketing of AIFs by TC-AIFMs in the Member States, inter alia, on

> 'the potential market disruptions and distortions in competition (level playing field) or any general or specific difficulties which EEA-AIFMs encounter in establishing themselves or marketing AIFs they manage in any third country.'

The (mutual) agreements solution under the 'Commission negotiation mandate', thus, serves as to grant EEA financial intermediaries market access in third countries on a reciprocal basis.[764]

6. Joint Principles of EEA TC Financial Intermediary Regulation

The regulation of TC financial intermediaries that want to offer cross-border financial services in the internal market is based upon the 'internal dimension', i.e. the 'four freedoms', and the external dimension that includes international law commitments and EEA secondary law. The equivalency of TC regulatory and supervision regimes to which TC financial intermediaries are subjected to serve the basis of 'equivalency' that is required to be in place upon market access in the internal market. In addition, equivalency in EEA secondary law requires 'legal representation' in the EEA by means of subsidiaries, branches or 'legal representatives' to ensure compliance with EEA law. Both are complemented by cooperation and information exchange agreements that are required to be in place between the relevant Competent Authorities. Moreover, the European Commission and ESA's have a role in centralized rulemaking and supervision and, finally, TC financial intermediaries are subject to 'judicial control'.

6.1. Third Countries & EEA Secondary Law

Investor and market protection are the two primary goals of not only EEA, but also TC financial intermediary regulation.[765] EEA secondary law addressing third country

---

[761] I.M. Hamstra, *Gedragsregels voor Nederlandse beleggingsondernemingen handelend met cliënten buiten de Europese Economische Ruimte*, 6 V&O 122-125 (2010).
[762] Art. 15(2) MiFID I.
[763] Art. 15(3) MiFID I.
[764] See L. Bruni, M. Gilli & V. Pelligra, *Reciprocity: theory and facts,* 55 International Review of Economics 1-11 (2008).

relationships are required to fulfill both legal requirements related to the EEA's internal and external dimension.

6.1.1. The Internal Dimension – The Four Freedoms

The internal market grants to EEA firms free access to the national market for goods, capital and cross-border-services.[766] The prerequisites for granting the principle of mutual recognition are (minimum) harmonization[767] and home state control.[768] The economic benefits of a European market resulting in more market efficiency and scale of economies benefitting both firms and their clients may only flourish when externalities resulting from risk asymmetry[769] can be avoided. EEA secondary laws prohibit that Member States treat TC firms more favourable than EEA firms.[770] TC firms that want to access the EEA are, therefore, required to comply with EEA secondary legislation.[771] Depending upon the specific sector, TC firms may access the EEA upon establishing a subsidiary, a branch or representative office that is required to wholly or partially comply with EEA secondary legislation. The 'four freedoms' and EEA secondary legislation, thus, are the minimum conditions for market entry for TC firms.[772]

6.1.2. The External Dimension: International Law Commitments & EEA Secondary Law

The EEA's 'external dimension' sets out the upper limit for what TC firms may be required to comply with upon EEA market access. The upper limit depends upon the international treaties to which the EU is bounded. In this regard, the most important commitment under the EU's common policy is the GATS. The EU, as a WTO member, is obliged to comply with the GATS when regulating and supervising their market for financial services with regard to activities of TC firms. Especially, the obligation of most-favoured-nation treatment and the commitment of national treatment are the two cornerstones that EEA secondary legislation needs to comply with.

Throughout EEA secondary law there are two types of regulations that comply with the EEA's internal and external dimension.[773] First, detailed market access requirements that apply to TC and EEA financial intermediaries equally (national treatment). Preferential arrangements, such as an eventual treaty regarding market access for financial intermediaries negotiated between the UK and the EU upon a Brexit[774], may be granted under the GATS 'economic integration' exception.[775] Under such an arrangement, the GATS allows the EU and UK to determine that the supervision over financial intermediaries entering both markets

---

[765] D.A. Zetzsche, *Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?*, in *The European Financial Market in Transition* (H. S. Birkmose, M. Nevillie & K. E. SØrensen eds., Kluwer 2012).

[766] See the Single European Act.

[767] In this regard, 'minimum harmonization' means a minimum level of harmonization. Not a limit degree of harmonization.

[768] See Zhao Li, *Securities Regulation in the International Environment*, 110-115, http://theses.gla.ac.uk/691/1/2009zhaoliphd.pdf (accessed 14 January 2017).

[769] See *supra* 4.1.2.

[770] See, for instance, Art. 41(2) MiFID II.

[771] See for example: Art. 36, 42 AIFMD.

[772] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 141 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[773] *Ibid*, 142.

[774] N. Moloney, *LSE Law Brexit Special #6: Negotiating a Financial Services Deal*, LSE Law - Policy Briefing Paper No. 25-2017, https://ssrn.com/abstract=2941373 (accessed 18 June 2017).

[775] J.P. Trachtman, *Addressing Regulatory Divergence through International Standards: Financial Services* 27–41 (A. Mattoo & P. Sauvé eds., Oxford University Press, 2003).

is, for example, carried out partly or fully by the home state. Clearly contrary to GATS would be any EEA market access requirements imposed to TC firms that go far beyond what is required for EEA firms. A disadvantage of this approach, however, is that this approach does not offer a solution for difficulties that EEA firms encounter upon accessing particular third countries. For this reason, the equivalency assessment based (unilateral) 'recognition' approach is increasingly used.[776]

6.2. Equivalency in EEA Secondary Law

Equivalency of TC regulation and supervision regimes is more and more used as a pre-condition for EEA market access for TC firms.[777] The concept of equivalency in EEA secondary law is based upon three pillars: cooperation in exercising financial supervision, information exchange and 'representation in the EEA'.[778]

6.2.1. Equivalency of TC Regulatory and Supervision Regimes

The equivalency of substantive laws and enforcement is increasingly used as an underlying regulatory tool for unilateral/multilateral (mutual) recognition under EEA secondary law. Equivalency serves as to creates 'risk symmetry' prior to granting market access to TC firms. Equivalency may be granted in full or partially, for an indefinite period or with a time limit, to an entire supervisory framework of a TC state or to some of its supervisory authorities.[779]

The degree of 'recognition' granted by the EEA determines the scope of any equivalency assessment undertaken. 'Full recognition' of the EEA substantive laws and enforcement requires a larger equivalency assessment than 'partial recognition'.[780] Full recognition requires comparable levels of economic development and financial regulation.[781] The latter determines the level of risk asymmetry in a specific field of financial services and, therefore, the need to protect investors and prevent systematic risks.[782] The level of equivalency of the latter determines the risk of regulatory arbitrage, risk asymmetry and a possible *race to the bottom.*

Any equivalency assessment undertaken depends upon the international standards adopted in a specific field of financial services. In the past decades, the BCBS and IAIS, for example, have played a major role in developing international regulatory and supervision standards in the banking and insurance domain.[783] These standards require compliance with rules related to anti-money laundering, tax information exchange[784] and measures countering the financing of

---

[776] See Art. XXIX GATS.

[777] T.B. Wei, *The Equivalence Approach to Securities Regulation*, 225 Northwestern Journal of International Law & Business 1 (2007).

[778] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 145 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[779] See European Commission, *Recognition of non-EU financial frameworks (equivalence decisions)*, https://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/recognition-non-eu-financial-frameworks-equivalence-decisions_en (accessed 15 June 2017).

[780] Cf. European Securities and Markets Authority, *Call for evidence on AIFMD passport and third country AIFMs (Consultation paper),* 7 November 2014, ESMA/2014/1340.

[781] P.H Verdier, *Mutual Recognition in International Finance*, 52 Harvard International Law Journal 56 (2011);

[782] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 61 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[783] Basel Committee on Banking Supervision, *Basel III: A global regulatory framework for more resilient banks and banking systems*, December 2010;International Association of Insurance Supervisors, *Insurance Core Principles*, **November 2015.**

[784] *Organisation* for *Economic Co-operation* and *Development*, *Commentary to the Model Double Taxation Convention on Income and on Capital* Art. 26 (OECD 2010); *Organisation for Economic Co-operation* and

terrorism. The adoption of international standards has led to an increasing convergence of banking and insurance law on the international level that is also reflected in the EEA's insurance and banking TC regimes. Under both CRD IV and Solvency II, the internal market grants market access to TC firms on the basis of (mutual) agreements concluded by the European institutions and their counterparts all over the world.

On the contrary, no such degree of harmonization on the international level exists for investment law.[785] Until the AIFMD and the Dodd-Frank Act many types of AIFs in the EEA and US were not regulated.[786] To date, this still holds true for, amongst others, private foundations and family offices.[787] This is also reflected in the TC regimes of, for example, the AIFMD and MiFID II. Under the AIFMD and the MiFID II TC 'retail regime', various requirements are imposed to TC intermediaries and third countries before market access is granted.[788] The AIFMD and MiFID II require TC-AIFMs and TC firms to fully or partially comply with the organizational and conduct of business requirements applying to EEA-AIFMs and investment firms.[789]

The extent to which a TC firm under MiFID II is being subjected to EEA legislation depends upon:

- the type of activity/service the intermediary seeks to access the EEA; and
- the investor typology (professional or non-professional investors).

In addition, TC-AIFMs and TC firms (providing 'retail services') under the AIFMD and MiFID II are required to be 'legally represented'[790] in the EEA by for supervisory purposes by means of a legal representative within a reference state[791], a branch[792] or a subsidiary.
Apart from this, third countries are required:

- not to be listed at FATF black list;[793]

Development, *Tackling Offshore Tax Evasion: The G20/OECD Continues to Make Progress 2* (June 2012), http://www.oecd.org/dataoecd/19/9/50630916.pdf (accessed 18 June 2017).

[785] Many areas of financial services do not have TC (equivalence) regimes. See O. Cherednychenko, *The UK's potential withdrawal from the EU and Single Market Access under EU financial services legislation*, January 2017,
http://www.europarl.europa.eu/RegData/etudes/IDAN/2016/595334/IPOL_IDA%282016%29595334_EN.pdf (accessed 15 June 2017).

[786] See for a comparison in terms of investors protection between the investment funds regimes in the EEA and the US: H. Wegman, *Investor Protection. Towards Additional EU Regulation of Investment Funds?* (Kluwer 2015).

[787] See for family office within the scope of the AIFMD:A.O. Kühne & M. Eberhardt, *Erlaubnispflicht eines 'Family Office' unter Berücksichtigung des neuen Finanzdienstleistungstatbestandes der Anlageberatung*, 8 Zeitschrift für Bank- und Kapitalmarktrecht 133 (2008); P. Schaubach, *Family Office: Ein Beitrag zur Begriffsfindung*, 51 Bank-Archiv: Zeitschrift für das gesamte Bank- und Börsenwesen 897 (2003); E. Waclawik, *Aufsichtsrechtliche Aspekte der Tätigkeit privater Family Offices*, Zeitschrift für Bankrecht und Bankwirtschaft 401 (2005); E. Waclawik, *Erlaubnispflicht privater Family Offices nach Umsetzung der MiFID?*, Zeitschrift für Wirtschaftsrecht 1341 (2007).

[788] Art. 37 AIFMD; Art. 39 MiFID II.

[789] Art. 37 AIFMD; Art. 41 MiFID II.

[790] Cf. Art. 4(1)(u) AIFMD: 'legal representative means a natural person domiciled in the Union or a legal person with its registered office in the Union, and which, expressly designated by a non-EU
AIFM, acts on behalf of such non-EU AIFM vis-à-vis the authorities, clients, bodies and counterparties to the non- EU AIFM in the Union with regard to the non-EU AIFM's
obligations under this Directive'.

[791] See Art. 37 AIFMD.

[792] Art. 39 MiFID II.

[793] Art. 40(2)(b) AIFMD; Art. 39(2)(a) MiFID II.

- to have cooperation agreements in place between the relevant TC Supervisory Authorities and the EEA Member State Competent Authorities involved;[794] and
- to have tax information exchange agreements modelled after Article 26 OECD Model between the relevant third countries and EEA Member States in place.[795]

The AIFMD and MiFID II 'retail' third country regimes ensure 'equivalency' not by an equivalency assessment carried out by a European institution, but by laying down detailed requirements related to the TC-AIFM, TC firm and the third country in which these intermediaries are established in.

The equivalency concept as regulatory tool based upon an centralized assessment and EEA secondary law are, thus, communicating vessels.[796] The more requirements TC firms and third countries are required to fulfil under EEA secondary law upon EEA market access, the less relevant is the equivalency of substantive laws and enforcement to which a TC intermediary is subjected to in its home state and vice versa.[797]

Depending upon the equivalency approach taken, reciprocity may also play a role. The third country approaches under the AIFMD and MiFID II 'retail regime' are based upon unilateral recognition in which 'equivalence' for TC-AIFMs and TC firms is given upon compliance with the EEA secondary law regime. In the past, 'reciprocity' was a pre-condition for EEA market access of TC intermediaries in EEA secondary law regimes.[798] Although Article 41(3) MiFID II Proposal also contained such a requirement, it was removed in the final version.[799] Reciprocity, thus, seems to have lost its importance in equivalency regimes based upon EEA secondary law.

Reciprocity may, however, play a bigger role for the equivalency approach based upon a centralized assessment, such as TC-AIF depositaries and the MiFID II TC regime for 'professional investors'.[800] It may be a requirement for an equivalency assessment in the first place or European institutions may prioritize their equivalency assessment based upon reciprocity.[801] Recital 41 MiFIR, for example, states that:

> 'when initiating those equivalence assessments, the Commission should be able to prioritise among third-country jurisdictions taking into account the materiality of the equivalence

---

[794] Art. 40(2)(a) AIFMD; Art. 39(2)(b) MiFID II.

[795] *Organisation for Economic Co-operation* and *Development*, *Commentary to the Model Double Taxation Convention on Income and on Capital* Art. 26 (OECD 2010); *Organisation for Economic Co-operation* and *Development*, *Tackling Offshore Tax Evasion: The G20/OECD Continues to Make Progress 2* (June 2012), http://www.oecd.org/dataoecd/19/9/50630916.pdf (accessed 18 June 2017).

[796] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 149 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[797] *Ibid.*

[798] See *supra* section 2.1.

[799] Art. 41(3) Proposal for a Directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council (Recast), COM(2011) 656 final, 2011/0298 (COD) ('third country provides for equivalent reciprocal recognitionof the prudential framework applicable to investment firms authorised in accordance with this directive'); See also N. Moloney, *EC Securities Regulation* 403-405 (3rd edn., Oxford University Press 2014).

[800] See for TC-AIF depositaries: Art. 21(6) AIFMD; Art. 84 AIFMD (Commission) Regulation.; See for MiFID II: Art. 46, 47 MiFIR; U. Klebeck & J. Eichhorn, *Drittstaatenregulierung der MiFID II und MiFIR*, 3 RdF 1 (2014); D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D.A. Zetzsche ed, Kluwer 2015).

[801] O. Cherednychenko, *The UK's potential withdrawal from the EU and Single Market Access under EU financial services legislation*, January 2017, http://www.europarl.europa.eu/RegData/etudes/IDAN/2016/595334/IPOL_IDA%282016%29595334_EN.pdf (accessed 15 June 2017).

> finding to Union firms and clients, the existence of supervisory and cooperation agreements between the third country and the Member States, the existence of an effective equivalent system for the recognition of investment firms authorised under foreign regimes as well as the interest and willingness of the third country to engage in the equivalence assessment process.'

Equivalency is based upon the presumption that TC authorities are effectively supervising TC intermediaries. For this purpose, cooperation agreements are required to be in place.

6.2.2. Cooperation Agreements

A core element of the mutual recognition principle in the internal market for EEA financial intermediaries is the principle of home country control that is complemented by the ESFS.[802] The absence of an equivalent centralized supervision framework between third countries and EEA Member States requires bilateral cooperation agreements for effective supervision to be in place.[803]

Broadly speaking, there are two approaches related to the conclusion of cooperation agreements to be recognized on the EEA level.[804]

The first approach is that cooperation agreements are established as part of the equivalency decision between the relevant TC Competent Authority and one of the relevant ESAs. The equivalency decision has, de facto, no legal effect without a cooperation agreement being in place. This approach is, in particular, used for TC regimes where a centralized equivalency decision is required. Article 47(2) MiFIR, for example, requires ESMA to conclude cooperation arrangements with the relevant Competent Authorities of the TC whose legal and supervisory frameworks have been recognized as 'equivalent'. The cooperation agreement concluded is a mechanism for the exchange of information between the two authorities[805], requires the TC Competent Authority to promptly notify ESMA when the TC firm infringes the conditions of its authorization[806] and sets outs procedures related to the coordination of supervisory activities including, where appropriate, on-site inspections[807].

The second approach is that cooperation agreements as a 'stand-alone' requirement besides a TC (equivalency) regime.[808] An example is the AIFMD TC regime. Under the AIFMD, the TC-AIFM passport regime is built upon 'equivalence' that is embedded in the abovementioned mentioned minimum requirements a TC-AIFM needs to comply with. As a consequence, cooperation agreements are concluded between TC Competent Authorities and individual Member States.[809] Compared to the first approach, this approach leads to a 'Big 5 Bias'. Small Member States, such as Liechtenstein, play such a minor role in international financial governance that they have little negotiation power. Cooperation agreements are, however, a constitutive requirement for the TC-AIFM passport regime. The first approach,

---

[802] E. Wymeersch, *Europe's New Financial Regulatory Bodies*, 5, http://ssrn.com/abstract=1813811 (accessed 14 January 2017); E. Wymeersch, *The institutional reforms of the European Financial Supervisory System, an interim Report,* WP 2010-01 (2010).
[803] See, for example, Art. 40(2)(c) AIFMD.
[804] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 144 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014); O. Cherednychenko, *The UK's potential withdrawal from the EU and Single Market Access under EU financial services legislation*, January 2017, http://www.europarl.europa.eu/RegData/etudes/IDAN/2016/595334/IPOL_IDA%282016%29595334_EN.pdf (accessed 15 June 2017).
[805] Art. 47(2)(a) MiFIR.
[806] Art. 47(2)(b) MiFIR.
[807] Art. 47(2)(c) MiFIR.
[808] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 144 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).
[809] See, for example, Art. 40(2)(a) AIFMD.

thus, leads to a better outcome for the 'internal market with an external dimension' as it grants small Member States the same opportunities as bigger Member States.[810]

6.2.3. Information Exchange

Cooperation agreements are mainly concluded as a mechanism for the exchange of information.In this regard, the conclusion of cooperation agreements between Supervisory Authorities of third countries and Competent Authorities of EEA Member States traditionally, had a 'voluntary' nature. Under Article 66 Solvency II, for instance, Member States 'may' conclude cooperation agreements under the premise that information disclosed is subject to guarantees of professional secrecy and information disclosed that originates in another Member State is not disclosed without the express agreement of the Competent Authority of that Member State.[811] Individual Member States had discretion whether and to what extent they cooperated with third countries. Recently, Member States increasingly have a 'mandatory' duty to conclude cooperation arrangements. Under Article 115 CRD IV 'the consolidating supervisor and the other competent authorities shall have written coordination and cooperation arrangements in place'. This tendency is also observed in Article 19 FiCOD II and Article 68 Solvency II regulating consolidated supervision.

6.2.4. 'Legal Representation' in the EEA

TC regimes under secondary EEA legislation may require a 'legal presence' within the EEA for the purpose of 'effective supervision'. The 'legal presence' may be a natural or legal person within the EEA and acts on behalf of the TC financial intermediaries vis-à-vis the authorities, clients, bodies and counterparties to the TC financial intermediary in the EEA with regard to the obligations to complied with under EEA law.[812] Depending upon the TC regime at hand, TC financial intermediaries may be 'represented' by means of a subsidiary, branch or legal representative. The 'legal representation' required depends upon the degree of TC market access granted under sectoral EEA legislation and the design of the specific TC regime.

6.2.4.1. EEA Subsidiary

Under EEA secondary law that does not offer any TC regime, TC financial intermediaries may only establish or acquire an EEA subsidiary that obtains an authorization for the desired sector. UCITSD V is an example of an EEA legislative initiative that does not have any TC regime. Subsidiaries have to comply with EEA sectoral legislation as EEA legal entities. They might, however, have TC relations due to TC shareholders, TC delegates or they might be part of a group structure/conglomerate that includes TC intermediaries. EEA legislation on 'qualifying holdings'[813] and 'close links'[814], delegation[815] and consolidation/conglomerates preserve the 'substance' of the subsidiary within the EEA.

Provided that requirements related to equivalence and exchange of information are complied with, the EEA regime on consolidation and conglomerates may allow the home state of an TC financial intermediary heading a group/conglomerate to perform 'consolidated supervision'.[816] Such 'consolidation' is allowed as such groups and conglomerates are

[810] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 144 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).
[811] Art. 66 Solvency II.
[812] Cf. Art. 4(1)(u) AIFMD.
[813] See, for example, Art. 8(1)(d) AIFMD.
[814] See, for example, Art. 8(3)AIFMD.
[815] See for AIFMs: Article 20 AIFMD; See for depositaries: Art. 20(11) AIFMD.
[816] See *supra* 5.1.3.

considered to be a ‘single entity’ for financial law purposes.[817] This generally means that the head entity of the group/conglomerate is responsible for all or most of the obligations. The EEA consolidation and conglomerate regime (partly) substitutes the relevance of EEA sectoral delegation regimes.[818]

6.2.4.2. EEA Branch

The second type of ‘legal presence’ required under, for instance, Solvency II, CRD IV and the MiFID II ‘retail regime’ is the establishment of a branch.[819] The establishment of a branch may grant EEA market access on the basis of country-by-country authorization or a European passport.[820] A branch is not a legal entity, but ensures a certain degree of ‘substance’ of the TC intermediary by, for example under Solvency II, representatives within the EEA that carry out legal matters on behalf of the TC intermediary and the fulfillment of minimum capital and solvency requirements.[821]

The requirement under EEA secondary legislation to establish an EEA branch that needs to fulfill certain requirements complements the relevant equivalency regime. The branch requirement, usually, compensates for a less stringent equivalency requirement related to the TC regulatory and supervision regimes.[822]

6.2.4.3. EEA ‘Legal Representation’

The TC regimes of reinsurance undertakings under Solvency II, TC-AIFMs under the AIFMD and the MiFID II ‘professional regime’ do not require the presence of a subsidiary nor a branch within the EEA. Instead, they grant a European passport for TC intermediaries on the basis of a centralized equivalency assessment complemented by cooperation agreements. The European passport granted is based upon a high degree of equivalency required under the assessment.[823] The cooperation agreements concluded have to ensure a flow of information between TC and Member State Competent Authorities preserving effective compliance of EEA law in the TC home state.[824] In addition, some EEA legal initiatives require the presence of a ‘legal representative’ of the TC intermediary within the EEA that is the contact point for any official correspondence between the Competent Authorities of the Member States and consumers.[825] Moreover, the legal representative is required to perform the compliance function related to EEA law.[826]

Apart from this, EEA law may require additional requirements to be fulfilled by the TC intermediary and the relevant TC state. Depending upon the comprehensiveness of the sectoral equivalency assessment, TC intermediaries may be (partly) subjected to the relevant sectoral EEA law. Finally, the third country in which the TC financial intermediary is established upon granting market access will need to comply with requirements related to

---

[817] *Ibid.*

[818] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 152 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[819] Art. 162(2) Solvency II; Recital 23 , Art. 47 CRD IV, Art. 39 MiFID II.

[820] Solvency II, CRD IV, the MiFID II ‘retail regime’ and the AIFMD private placement regime grant EEA market access, whereas the establishment of a branch under MiFIR under the ‘professional regime’ grants a European passport.

[821] See, for example, Art. 162(2)(e), (f) Solvency II.

[822] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 152 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[823] See for a definition ‘passporting’: International Organization of Securities Commissions, *IOSCO Task Force on Cross-Border Regulation – Final Report*, FR 23/2015, (2015), 31 et seq.

[824] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 153 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[825] See, for example, Art. 37(3) AIFMD.

[826] *Ibid.*

anti-money laundering, the FATF blacklist[827] and the conclusion of a tax information agreement.[828]

6.3. The EEA's Centralized Rulemaking and Supervision

The European Commission and ESAs increasingly take a role in centralized rulemaking and supervision.

6.3.1. The Role of the European Commission in Centralized Rulemaking

In the TC domain, the European Commission has an ever increasing role in 'centralized rulemaking'. Centralized equivalency assessments, for example, are typically initiative by the European Commission and the power to adopt such a decision is discretionary.[829] Equivalency decisions are most adopted after technical advice has been given by a relevant ESA. Decisions are made in the form of an implementing or delegated act depending upon the delegation provision in secondary law.[830]

Recently, the equivalency process has been criticized for not being transparent.[831] The European Commission in a Report has been reviewing the equivalency process and made an attempt in improving the transparency related to the assessment procedure.[832]

The European Commission represents the collective interest not only in equivalency assessment procedures but also in concluding (mutual) agreements in 'reciprocity matters'.[833] This solution is favourable in cases of reciprocity negotiations as TCs cannot grant more favourable conditions under bilateral treaties to big 'distribution Member States', whereas market access is disrupted for small 'production' Member States. Mutual agreements concluded on the basis of Article 218 TFEU prevent the fragmentation of market access EEA financial intermediaries at the expense of small Member States and adequately addresses investor and market protection concerns.[834]

In concluding (mutual) agreements, the bargaining power of the European Commission depends, however, upon the size of the EEA internal market compared to the size of the negotiation partner (for example, the US, China). Despite a possible Brexit, the role of the

---

[827] Financial Action Task Force on Money Laundering (FATF), *International Standards on combating money laundering and the financing of terrorism*, The FATF Recommendations, February 2012, http://www.fatfgafi. org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf (accessed 18 June 2017); Financial Action Task Force on Money Laundering (FATF), *Methodology for assessing technical compliance with the FATF Recommendations and the Effectiveness of AML/CFT systems*, February 2013, http://www.fatfgafi.org/media/fatf/documents/methodology/FATF%20Methodology%2022%20Feb%202013.pdf (accessed 18 June 2017); Financial Action Task Force on Money Laundering (FATF), *Procedures for the FATF Fourth Round of AML/CFT mutual evaluations*, October 2013, http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF-4th-Round-Procedures.pdf (accessed 18 June 2017).

[828] See D.A. Zetzsche & T.F. Marte, *The AIFMD's Cross-Border Dimension, TC Rules and the Equivalence Concept* 460 (D.A. Zetzsche ed., Kluwer 2015).

[829] N. Moloney, *Brexit, the EU and its Investment Banker: Rethinking 'Equivalence' for the EU Capital Market*, LSE Legal Studies Working Paper No. 5/2017, https://ssrn.com/abstract=2929229 (accessed 18 June 2017).

[830] O. Cherednychenko, *The UK's potential withdrawal from the EU and Single Market Access under EU financial services legislation*, January 2017, http://www.europarl.europa.eu/RegData/etudes/IDAN/2016/595334/IPOL_IDA%282016%29595334_EN.pdf (accessed 15 June 2017).

[831] N. Moloney, *Brexit, the EU and its Investment Banker: Rethinking 'Equivalence' for the EU Capital Market*, LSE Legal Studies Working Paper No. 5/2017, https://ssrn.com/abstract=2929229 (accessed 18 June 2017).

[832] European Commission, *EU Equivalence Decisions in Financial Services Policy: An Assessment* (SWD (2017) 102) final, 27 February 2017.

[833] See Art. 9(1) UCITSD V.

[834] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 141 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

European Commission and other European institutions is likely to increase in international financial governance due to ever increasing centralized rulemaking and supervision in financial law.[835]

6.3.2. The Role of ESAs in TC Regimes

The ESAs also play various important roles related to third countries.

First, ESAs play a role in international relations. ESAs may develop contacts and enter into administrative arrangements with supervisory authorities, international organizations and the administrations of third countries.[836] They may, however, not create legal obligations on behalf of the EU and its Member States nor shall their role in international relations prevent Member States and their Competent Authorities from concluding (bilarateral/multilateral) arrangements with those third countries.[837]

Second, ESAs shall assist in preparing equivalency decisions pertaining to supervisory regimes in third countries.[838]

Third, ESAs are, in particular, under the 'centralized equivalency approach' responsible for concluding cooperation agreements with TC Competent Authorities of the TC whose legal and supervisory frameworks have been recognized as 'equivalent'.[839] The cooperation agreement is a mechanism for the exchange of information between the relevant ESA and TC Competent Authority.[840] The ESAs are allowed to request the Competent Authorities of the Member States to deliver relevant information to them that is necessary in relation to their duties.[841] The information provided to ESAs has subject to professional secrecy obligations and the GDPR.[842]

Finally, TC Competent Authorities cooperating with ESAs of TCs are allowed to participate in the work of ESAs.[843] The rationale behind this is that ESAs are ought to foster dialogue and cooperation with TC Competent Authorities in the light of the globalization of financial services and the increased importance of international standards.[844] The participation is open to EEA Member States[845] and third countries that have been recognized as equivalent in the areas of competence of the respective ESA[846].Third countries are allowed to participate in the work of the ESAs in accordance with the agreements concluded.[847] The nature, scope and procedural aspects of the involvement of the countries, including provisions relating to financial contributions and staff, are specified in those agreements.[848]

6.4. Judicial Control

[835] P.H Verdier, *Mutual Recognition in International Finance*, 52 Harvard International Law Journal 56 (2011); N. Moloney, *The EU in International Financial Governance*, 1 Russell Sage Journal of the Social Sciences 138-152(2017).
[836] Art. 33 EBAR, Art. 33 ESMAR, Art. 33 EIOPAR.
[837] *Ibid.*
[838] Art. 33 sub-para. 2 EBAR, Art. 33 sub-para. 2 ESMAR, Art. 33 sub-para. 2 EIOPAR.
[839] See Art. 47(2) MiFIR.
[840] See, for example, Art. 47(2)(a) MiFIR.
[841] Art. 35(1) EBAR, Art. 35(1) ESMAR, Art. 35 EIOPAR.
[842] Cf. European Commission, *Commission decisions on the adequacy of the protection of personal data in third countries*, http://ec.europa.eu/justice/policies/privacy/thridcountries/index_en.htm (accessed 18 June 2016).
[843] Recital 44 EBAR, Recital 44 ESMAR, Recital 44 EIOPAR.
[844] *Ibid.*
[845] Art. 75(1) EBAR, Art. 75(1) ESMAR, Art. 75(1) EIOPAR.
[846] Art. 75(2) EBAR, Art. 75(2) ESMAR, Art. 75(2) EIOPAR.
[847] Recital 65 EBAR, Recital 65 ESMAR, Recital 65 EIOPAR.
[848] Art. 75(3) EBAR, Art. 75(3) ESMAR, Art. 75(3) EIOPAR.

The CJEU has jurisdiction over all EU acts. The judicial control includes assessment of the validity of primary and secondary EU law. The CJEU is, thus, competent to adjudge actions for annulment or give preliminary rulings pertaining to EU market access in the light of EU directives or regulations establishing sectoral TC regimes.[849] In addition, any centralized equivalency decisions made by the European Commission on the basis of Article 263 TFEU is subject to the CJEU's jurisdiction. Member States, EU institutions, or, where the act is of direct and individual concern to them, EEA/TC natural/legal persons may challenge the legality of equivalence decisions made by the European Commission.[850] This could be, for instance, the revoke of a decision already made.[851] The validity of any inaction in taking equivalency decisions, however, is not challengeable. The EFTA court has jurisdiction over passporting rights that are extended to EEA countries.[852]

7. Conclusion

This chapter studied the EEA's approach towards the cross-border provision of financial services in more detail. In particular, the conditions under which European and TC European passports are granted to EEA and TC financial intermediaries have been studied as to determine under what conditions a (cross-sectoral) European/TC passport could be granted to 'depositaries' and 'custodians'.

EEA law in regulating financial intermediaries has an 'internal' and 'external dimension'.The so-called 'internal dimension' is regulated by EEA secondary law that is based upon the four freedoms and regulates the cross-border provisions of financial services in the internal market by EEA financial intermediaries. The 'external dimension' regulates the cross-border provisions of financial services in the internal market by TC financial intermediaries and is based upon international law commitments and EEA secondary law.

EEA law in regulating both the 'internal' and 'external dimension' has as its purpose to establish an internal market for financial services that enhances market efficiency and leads to economies of scale and scope. Authorization and notification requirements under European passport arrangements, for example, only need to be fulfilled in one Member State while having a large market to offer their financial products and services without worrying about multiple authorization application and the establishment of subsidiaries that would have led to a duplication of legal costs. Prices in an EEA internal market for financial services decline as fixed costs are shared amongst a larger client base.[853] Firms may organize themselves anywhere in the EEA, in small and big Member States and, as a result, have the potential to maximize their efficiency and become more competitive. In addition to reducing transaction costs, financial institutions from either smaller or bigger EEA Member States may market products and services to all of the European Union's 500 million citizens resulting in more revenue.

---

[849] In particular, related to Arts 263, 265, 267 TFEU.

[850] A. Duvillet-Margerit, M. Magnus, B. Mesnard, & A. Xirou, *Third Country Equivalence in EU Banking Legislation*, 9 December 2016, http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/587369/IPOL_BRI%282016%29587369_EN.pdf (accessed 15 June 2017).

[851] P.P. Craig & G. De Búrca, *EU Law: Text, Cases, and Materials* 369 (Oxford University Press 2015, 6th Edition).

[852] See V. Skouris, *the ECJ and the EFTA Court under the EEA Agreement: A Paradigmfor International Cooperation between Judicial Institutions* 123–129 (C. Baudenbacher, P. Tressel & T. Örlygsson eds., Hart Publishing 2005).

[853] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 56 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

The market access that an internal market facilitates may create negative externalities, such as the insolvency of financial intermediaries or fraud that is particularly fuelled by 'risk asymmetry'.[854] In the past, this has led to a large degree of legal fragmentation posing hurdles to the cross-border provision of financial intermediaries that could not be resolved by the 'four freedoms' due to the 'prudential carve-out' that justifies the infringements on the freedom movement of capital and establishment.

The 'European passport' is at the heart of the EEA system for financial services. It is a general concept which lays down the conditions for the 'mutual recognition' principle. The general idea is that financial products or services that are 'produced' (and marketed) in a 'home Member State' may, under conditions set out in European legislative acts, be marketed throughout the internal market without incurring further conditions imposed by 'host Member States'.[855] The concept of the European passport is now widespread and commonly used to enhance the development of the EEA internal market for financial intermediaries that are active in a wide range of sectors. [856] The European passport and the overarching principle of 'mutual recognition' are based upon two cornerstones: the 'single rulebook', i.e. a thick set of harmonized rules and a coordinated institutional framework for financial supervision comprising of 'home state control' and the ESFS that allows host Member States to defer supervision to home Member States and ESAs.[857] The European passport as regulatory tool is unique and not to be found in any other multilateral, regional or bilateral forms of cooperation on the international level.[858] The reason for this is the degree of centralized rulemaking and supervision on the EEA level on which the regulatory tool is based.[859]

Along the development of the European passport as primary regulatory concept for EEA financial intermediaries, the EEA developed its 'external dimension', i.e. the conditions under which TC financial intermediaries may provide financial services in the internal market. TC financial intermediaries are not subject to the same centralized rulemaking and supervision as EEA financial intermediaries. Moreover, the harmonization of financial regulation on the international level various from sector to sector. Banking and insurance legislation are harmonized to a large degree, whereas other sectors, such as asset management, are hardly harmonized. For this reason, the EEA determines in EEA secondary legislation whether and to what extent TC financial intermediaries may provide certain services within the EEA.

The regulation of TC financial intermediaries that want to offer cross-border financial services in the internal market is based upon the 'internal dimension', i.e. the 'four freedoms', and the external dimension that includes international law commitments and EEA secondary

---

[854] See D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 61 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014); D.A. Zetzsche, *Competitiveness of Financial Centers in Light of Financial and Tax Law Equivalence Requirements* 401-402 (R.P. Buckley, E. Avgouleas & D.W. Arner eds., Cambridge University Press 2016).

[855] Host Member State do have some competences: See Recital 2, 7, Art. 86 MiFID II, Recital 4 CRD IV, Recital 85 Solvency II and Art. 21 UCITSD V ('reporting requirement for UCITS ManCos'). See on literature related to MiFID I/II: P. Casey & K. Lannoo, The MiFID Revolution, ECMI Policy Brief No. 3 (November 2006); J.P. Casey & K. Lannoo, *The MiFID revolution* (Cambridge University Press (2009); G. Ferrarini & E. Wymeersch, *Investor protection in Europe: corporate law making*, *the MiFID and beyond* (Oxford University Press 2006); International Organisation of Pension Supervisors, *Supervision of Pension Intermediation*, http://www.iopsweb.org/WpNo17Web.pdf (accessed 14 January 2017).

[856] An earlier version of this section has been earlier published in: H. van Meerten & S.N. Hooghiemstra, *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions*, https://ssrn.com/abstract=2993991 (accessed 4 July 2017).

[857] N. Moloney, *Brexit, the EU and its Investment Banker: Rethinking 'Equivalence' for the EU Capital Market*, LSE Legal Studies Working Paper No. 5/2017, 5, https://ssrn.com/abstract=2929229 (accessed 18 June 2017).

[858] P.H Verdier, *Mutual Recognition in International Finance*, 52 Harvard International Law Journal 56 (2011).

[859] International Organization of Securities Commissions, *IOSCO Task Force on Cross-Border Regulation – Final Report*, FR 23/2015, (2015), 31 et seq.

law. The equivalency of TC regulatory and supervision regimes to which TC financial intermediaries are subjected to serve the basis of ‘equivalency’ that is required to be in place upon market access in the internal market. In addition, equivalency in EEA secondary law requires ‘legal representation’ in the EEA by means of subsidiaries, branches or ‘legal representatives’ to ensure compliance with EEA law. Both are complemented by cooperation and information exchange agreements that are required to be in place between the relevant Competent Authorities. Moreover, the European Commission and ESA’s have a role in centralized rulemaking and supervision and, finally, TC financial intermediaries are subject to ‘judicial control’.

PART II- Conclusion

Part II studied under what conditions a (cross-sectoral) European/TC passport could be granted to ‘depositaries’ and ‘custodians’. In particular, the EEA’s approach towards the cross-border provision of financial services and the ‘joint principles’ under which European and TC European passports are granted, were highlighted. Part II held that the cornerstones of the European passport for financial intermediaries, such as custodians and depositaries, are the ‘single rulebook’, ‘home country control’ and the ESFS. Similarly, TC passports are based upon the ‘internal dimension’ and ‘external dimension’. The ‘internal dimension’ is based upon the four freedoms and the ‘external dimension’ upon international law commitments and EEA secondary law. EEA secondary law requires TC financial intermediaries to be subject to ‘equivalent’ regulation and supervision. ‘Equivalent regulation’ is achieved by requiring TC intermediaries to comply with EEA secondary legislation and/or a ‘centralized equivalency assessment’. This is complemented by ‘legal representation in the EEA’, cooperation agreements and information exchange that have to be in place between relevant Competent Authorities.

Depositaries are ‘custodians’, i.e. financial intermediaries performing the safekeeping and administration of financial instruments, that perform additional ‘controlling/monitoring’ duties. This additional task could justify the difference in treatment for the purpose of introduction of an European/TC passport between AIF/UCITS depositaries, at the one, and MiFID II/CRD IV ‘custodians’, at the other hand. This will be studied in detail in Part III.

PART III - Depositaries vs. Custodians

Part III aims to define what a depositary is and whether and to what extent depositaries and custodians differ. This serves two purposes. First, Part II clarifies whether a difference in treatment of depositaries, at the one, and custodians, at the other hand, throughout European investment law is justified from an investor protection perspective. Second, Part III seeks to find out whether common regulatory principles for depositaries and custodians, similar as for asset managers that conduct investment management under the European investment law directives, are to be found that would possibly justify a cross-sectoral European depositary passport. To this end, the application of the legal interpretation methods of *Von Savigny* on the study of positive norms of the depositary in European investment law, including the grammatical, teleological, systematic and historical explanation will be applied in defining depositaries and custodians.

PART III - Depositaries vs. Custodians

A. Grammatical Explanation

European investment law nor the Member State implementations of the AIFMD, UCITSD V, IORPD II and MiFID I/CRD IV contain consistent definitions of what ‘depositaries’ and ‘custodians’ are. This leads to confusion as to the similarities and differences between ‘depositaries’ and ‘custodians’ on the European and national level.

The AIFMD does not contain any depositary definition. Its meaning should be derived from the tasks as set out in Article 21 AIFMD. UCITSD V defines in Article 2(1) UCITSD V a 'depositary' as

> an institution entrusted with the duties as set out in Articles 22 and 32 and subject to the other provisions laid down in Chapter IV and Section 3 of Chapter V UCITSD V.

IORPD II refers in Article 33(1) and (2) IORPD II to ‘depositaries’ appointed for carrying out ‘safekeeping tasks’ and ‘depositaries’ appointed for carrying out ‘safekeeping’ and ‘oversight duties’. The AIFMD, UCITSD V and IORPD II, thus, do not contain a consistent ‘depositary’ definition. Instead, these directives refer to the provisions laid down in the directives that apply to depositaries.[1]

The unclarity related to ‘depositaries’ can also be seen in the Member State implementation laws of these directives. Ireland, for example, refers in its UCITSD V implementation to ‘trustees’ instead of ‘depositaries.[2] The Netherlands defines a ‘depositary’ a ‘the entity that is entrusted with the safekeeping of the assets of an AIF’.[3]

Similar as for ‘depositaries’, CRD IV, MiFID II and the CSDR do not define what ‘custodians’ are. Instead, CRD IV and MiFID II regulate the ‘safekeeping and administration of financial instruments/securities’.[4]

A study of the positive norms laid down related to ‘depositaries’ and ‘custodians’ is, thus, warranted to point out whether and to point out whether and to what extent ‘depositaries’ and ‘custodians’ differ.

---

[1] Art. 2(23) IORPD II of the proposed PEPPR defines a ‘depositary’ as ‘an institution charged with the safekeeping of assets and oversight of compliance with the fund rules and applicable law’.

[2] Ireland: Art. 35 (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (S.I. No. 352 of 2011).

[3] See the definition of a ‘*bewaarder’* under Art. 1:1Wft.

[4] Annex I Nr. 12 CRD IV; Annex I s. A and B MiFID I/II.

CHAPTER 4 The AIFMD and UCITSD V Depositary Regulation

1. Introduction

Since the mandatory appointment of depositaries was adopted in the UCITSD I in 1985, the appointment of a depositary for AIFs remained a subject left to Member States. This lack of harmonization left room for diverging interpretations of AIF's/UCITS' depositary duties and liabilities.[1] As a result, different depositary regimes have been developed providing investors with different levels of investor protection in various European jurisdictions. The potential consequence was highlighted in the course of the financial crisis. Huge amounts of assets of collective investment schemes that were entrusted to Lehman Brothers Internal Europe vanished into thin air after its collapse in 2008. In addition, the asset management business of Bernard Madoff was uncovered as a giant Ponzi scheme.[2] These two events raised a number of questions as to whether the European legal framework for depositaries needed to be further harmonized and strengthened to ensure a level playing field in terms of investor protection measures across all Member States.[3]

Following the Madoff fraud and Lehman Brothers bankruptcy, the European Commission developed a strong desire to clarify, homogenize, and strengthen the depositary function. In 2009 and 2010, the European Commission launched two public consultations on the role of UCITS depositaries.[4] These consultations have been taken into consideration when adopting the depositary provisions in the AIFMD.[5] By means of the AIFMD and UCITSD V, legal clarity and certainty concerning the responsibilities of depositaries within the AIF and UCITS domain have been created amongst Member States.[6]

This chapter focuses on the AIFMD and UCITSD V depositary framework. Section 2 discusses the obligation to appoint a depositary, section 3 which entities are eligible, section 4

---

[1] Earlier versions of the AIFMD depositary regime have been published in: S.N. Hooghiemstra, S.N., *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2015) and S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2012).

[2] See L. Fortado, *Lehman segregated accounts appeal may delay payouts,* http://www.canadianhedgewatch.com/content/news/general/?id=5643 (accessed 29 August 2016); G.N. Gregoriou, & F.S. Lhabitant, Madoff, *A riot of red flags*, EDHEC (2009); S. Gene, *Luxembourg Called On to "Brush Up" Governance*, Financial Times, Fund Management Supplement, (26 January 2009); P. Skypala, *UCITS Victory Soured by Madoff Scandal*, Financial Times, Fund Management Supplement, (19 January 2009), 6; P. Hollinger, B. Hall & N. Tait, *Grand Duchy Hits Back at Madoff*, Financial Times (14 January 2009), 23; P. Hollinger & J. Chung, *Madoff Affair Sparks Demand for Revamp of Investment Fund Rules*, Financial Times, (13 January 2009), 15.

[3] N. Amenc, S. Focardi, F. Goltz, D. Schröder, & L. Tang, *EDHEC-Risk European private wealth management survey*, EDHEC (2010).

[4] European Commission, Consultation Paper on the UCITS Depositary Function …, Markt/G4 D (2010) 950800. European Commission, Working Document of the Commission Services (DG Markt), Consultation Paper on the UCITS Depositary Function, July 2009; Summary of Responses to UCITS Depositary's Consultation Paper – Feedback Statement; Working Document of the Commission Services (DG Markt), Consultation Paper on the UCITS Depositary Function and on the UCITS Managers' Remuneration (December 2010), MARKT/G4 D (2010) 950800; Feedback on public consultation on UCITS V (February 2011).

[5] Most of the AIFMD depositary framework provisions that are discussed in this chapter applies to UCITS depositaries as well. See Arts 22–26b UCITSD V.

[6] I.Riassetto, *Dépositaires - Quelles différences entre la directive OPCVM V et la directive AIFM ?,* 4 RD Bancaire et Financier (2014) ; K. Lachgar, *From the UCITS Directive to the transposition of AIFMD: exegesis of evolutions's depositary activity in Europe*, Joly Bourse (2014); I. Riassetto, *La clarification des obligations et de la responsabilité des dépositaires par la directive OPCVM V,* 98 Revue Lamy Droit des Affaires 31 (2014); I. Riassetto, *Le nouveau régime applicable aux dépositaires issu de la directive OPCVM V*, 3 Bulletin Joly Bourse 113 (2015).

what general requirements apply to depositaries and section 5 what additional requirements apply to third-country depositaries. Section 6 focuses on the functions and the role of depositaries in relation to investors and AIFMs/UCITS ManCos. In particular, this part seeks to define the safekeeping and oversight duties of depositaries under the AIFMD and UCITSD V. Section 7 analyses the AIFMD's (sub-)delegation requirements for depositary functions, section 8 the AIFMD/UCITSD V depositary liability regime and section 9 the 'lex specialis' depositary provisions laid down in the AIFMD/UCITSD V 'product regulations'. Section 10 sets out the AIFM, depositary and prime broker in the 'prime brokerage relationship' and section 11 concludes.

2. The Scope of the AIFMD and UCITSD V with Regard to Depositaries

The AIFMD and UCITSD V harmonize the law applicable to depositaries by requiring, with a few exemptions under the AIFMD, a depositary to be appointed for all AIFs and UCITS.

2.1. The Obligation to Appoint a Depositary under the AIFMD

The appointment of a depositary under the AIFMD			
		EEA-AIF	**TC-AIF**
EEA AIFM	Private Placement	AIFMD Depositary	Depositary-lite
	AIFMD Marketing Passport	AIFMD Depositary	Depositary-lite
TC-AIFM	Private Placement	None- MS Law	None- MS Law
	AIFMD Marketing Passport	AIFMD Depositary	AIFMD Depositary

2.1.1. *General Rule*

Prior to the AIFMD, managers of European AIFs were in several Member States not required to appoint a depositary.[7] The AIFMD ended up this inconsistency amongst Member States by requiring AIFMs to appoint a single depositary for each AIF it manages.[8]

2.1.2. *The Retail AIF Depositary*

The obligation to appoint a depositary applies to AIFMs regardless of whether units or shares of AIFs are marketed to professional or retail investors. Member States are only left the discretionary choice whether they allow AIFMs to market AIFs to retail investors in their

[7] In the Netherlands, for instance, many AIFs were not subjected to regulatory law and, thus, did not have to appoint a depositary at all. See S.N. Hooghiemstra, *The AIFM's Transposition in the Netherlands* (D.A. Zetzsche ed, Kluwer 2015); M. Tausk, *De verplichting om een bewaarder te benoemen: alles gaat veranderen* 22-43 (N.B. Spoor, M. Tausk, J.B. Huizink & R.P. Raas, Kluwer 2012).
[8] Art. 21(1) AIFMD; K. Lachgar, *Le rôle du dépositaire dans l'ère AIFM: 'business as usual' ou opportunité de différenciation?*, 749 Revue Banque (2012).

territory which are managed in accordance with the AIFMD or not.[9] For that purpose, Member States may determine:[10]

– the types of AIFs which AIFMs are allowed to market to retail investors in their territory;[11]
– any additional requirements that the Member State imposes for the marketing of AIFs to retail investors.[12]

Stricter (depositary) requirements may be imposed on the AIFM or the AIF by Member States than the requirements applicable to professional AIFs provided that these are not stricter than those imposed on AIFs marketed domestically.[13]

Germany[14] and Luxembourg[15] have made use of this opportunity as they are of the opinion that a higher degree of protection should be offered to retail AIF investors compared to professional AIFs.[16] Both Member States limit the eligible entities of retail AIFs to credit institutions.[17] On top of that, both Germany and Luxembourg extend the stricter retail investor protection depositary provisions offered under the UCITSD V and the UCITSD V (Commission) Regulation to retail AIF depositaries that relate to the:[18]

– requirement to provide an inventory of assets;[19]
– independence of the management/investment company and the UCITS depositary;[20]
– prohibition on right of use / re-hypothecation of assets;[21]
– client asset protection on insolvency of the depositary or a sub-custodian;[22]
– strict liability for a loss of custody assets;[23] and
– redress of investors against the depositary.[24]

Similarly, Austria[25] applies its UCITSD V implementation to two types of retail-AIFs, including Special Funds[26] and Other Funds[27]. Unlike Germany and Luxembourg, Austria has, however, not specified whether the UCITSD V (Commission) Regulation applies to these retail-AIFs. Given the extension of the UCITSD V depositary regime to these types of retail-

---

[9] This applies to all managed AIFs, irrespective of whether such AIFs are marketed on a domestic or cross-border basis or whether they are EEA or non-EEA AIFs. See Art. 43(1) AIFMD.
[10] Art. 43(2) AIFMD.
[11] Art. 43(2)(a) AIFMD.
[12] Art. 43(2)(b) AIFMD.
[13] Art. 43(1) AIFMD.
[14] § 87 KAGB.
[15] Art. 15 law of 17 December 2010 relating to undertakings for collective investment.
[16] Germany: Gesetzentwurf der Bundesregierung Entwurf eines Gesetzes zur Umsetzung der Richtlinie 2014/91/EU des Europäischen Parlaments und des Rates vom 23. Juli 2014 zur Änderung der Richtlinie 2009/65/EG zur Koordinierung der Rechts- und Verwaltungsvorschriften betreffend bestimmte Organismen für gemeinsame Anlagen in Wertpapieren (OGAW) im Hinblick auf die Aufgaben der Verwahrstelle, die Vergütungspolitik und Sanktionen, Drucksache 18/6744, 18.11.2015, 35-36; Luxembourg: See the commentary on Art. 3 and 15 Projet de loi du portant transposition- de la directive 2014/86/UE du Conseil du 8 juillet 2014 modifiant la directive 2011/96/UE, Session ordinaire 2014-2015, 05.08.2015.
[17] Germany: § 87 KAGB; Luxembourg: Art. 15 law of 17 December 2010 relating to undertakings for collective investment.
[18] T. Dolan, *UCITS V brings convergence of the depositary role with AIFMD*, 1 JIBFL 64B (2015).
[19] Art. 22(6) UCITSD V.
[20] See Art. 26b UCITSD V; Art. 21 UCITSD V (Commission) Regulation.
[21] Art. 22(7) UCITSD V.
[22] Art. 22(8) UCITSD V.
[23] Art. 24 UCITSD V.
[24] Art. 24 UCITSD V.
[25] § 164(2), § 167(1) InvFG 2011.
[26] § 164(2) InvFG 2011.
[27] § 167(1) InvFG 2011.

AIFs, the UCITSD V (Commission) Regulation should be applied analogously.

Ireland[28] and the UK[29] impose a few additional tasks upon retail AIF compared to professional AIF depositaries.[30] They do, however, not extend the UCITSD V depositary requirements to retail AIFs.

France[31], Liechtenstein[32], Malta[33] and the Netherlands[34], have implemented the UCITSD V but do not require stricter requirements for depositaries of retail-AIFs compared to professional AIFs.

Member States are, thus, not allowed to derogate the mandatory depositary appointment for AIFs that are (solely) marketed to retail investors. Instead, Art. 43 AIFMD allows them impose stricter depositary rules to retail AIFs.

2.1.3. *Exemptions from the Depositary Obligation*

The AIFMD provides several exemptions from the general depositary obligation. EEA-AIFMs managing TC-AIFs that are marketed outside of the EEA are not required to appoint a depositary as they fall outside the scope of the AIFMD.[35] The same holds true for:

- AIFs which are managed by 'small' AIFMs.
- (non-) EEA AIFs that are managed by third-country AIFMs (TC-AIFMs)[36] and marketed in the EEA on a private placement basis.[37]

2.1.3.1. 'Small' AIFMs

The AIFMD contains a *de minimis* exemption for 'small' AIFMs.[38] Although the AIFMD exempts these AIFMs from the scope of the AIFMD, Member States are allowed to adopt stricter rules with respect to 'small' AIFMs.[39] As a result, whether a depositary needs to be appointed or not for an AIF that is either marketed to professional and/or retail investors by a 'small' AIFM depends upon the AIFMD implementation laws of the individual Member States. For this purpose, various Member States differentiate between 'small' AIFMs that market AIFs to retail and professional investors, whereas others apply a depositary regime to AIFs managed by 'small' AIFMs regardless whether the AIF is being marketed to professional or retail AIFs.

'small' AIFMs that are managing professional AIFs in Austria[40], Germany[41], Luxembourg[42] and the Netherlands[43] are solely subject to the minimum registration

---

[28] Ireland: See for example: Central Bank of Ireland, Chapter 1 - Retail Investor AIF Requirement, Part I. General Rules, 2. Supervisory requirements, v. Replacement of depositary,56.

[29] UK has retained pre-AIFMD existing standards for retail authorized funds ('NURS'); See COLL 6.6.

[30] Ireland: See for example: Central Bank of Ireland, Chapter 1 - Retail Investor AIF Requirement, Part I. General Rules, 2. Supervisory requirements, v. Replacement of depositary,56; UK: COLL 6.6.

[31] Arts L214-10 et seq. CMF.

[32] Art. 32 et seq. UCITSG.

[33] Investment Services Act (custodians of collective investment schemes) Regulations 2016.

[34] Art. 4:621 - 4:62w Wft.

[35] See Art. 42(1)(a) AIFMD. The same applies to AIFs that are marketed to retail investors. See Art. 43 AIFMD.

[36] TC-AIFMs refers to AIFMs that are established outside of the EEA.

[37] Art. 42 AIFMD.

[38] This exemption refers to AIFMs managing (i) AIFs whose AuM do not exceed a threshold of EUR 100 million, irrespective of whether such AuM are wholly or partly acquired through the use of leverage, or (ii) AIFs whose AuM in total do not exceed a threshold of EUR 500 million, provided that such AuM are unleveraged and investors are not granted redemption rights for a period of five years.[38] AIFMs wishing to rely on these exemption are subject to a duty to register themselves with the Competent Authorities of the AIF's home Member State. See Art. 3 AIFMD.

[39] D.A. Zetzsche & C.D. Preiner, *Scope of the AIFMD* (D.A. Zetzsche ed, Kluwer 2015).

[40] § 1(5) Austrian AIFM Law.

requirement laid down in the AIFMD. Consequently, Austria[44], Germany[45] and the Netherlands do not require a depositary for professional AIFs to be appointed. Luxembourg exempts professional AIFs from the AIFMD depositary requirement as well. Nevertheless, Luxembourg requires a depositary to be appointed in its national product regulation for SICARs and SIFs that are managed by 'small' AIFMs.[46] For these SIFs/SICARs an amended depositary regime is applicable which is based upon both the AIFMD and the pre-AIFMD depositary regime.[47]

Austria[48] and the Netherlands[49] require 'small' AIFMs that market AIFs to retail investors to obtain a full authorization under the AIFMD.[50] For these AIFs, a depositary needs to be appointed. In Germany, it depends upon the type of AIF whether a depositary needs to be appointed or not.[51] Closed-end AIFs that do not exceed the EUR 100 million AIFMD threshold (including leverage) and are not exclusively marketed to professional investors are only subject to a registration requirement.[52] All closed-end retail AIFs that are not managed by a 'small' internally managed AIFM[53] that does not manage more than EUR 5 million (including leverage) and does not have more than 5 natural persons as investors must, amongst others[54], appoint a depositary.[55] The same applies to internally managed closed-end retail AIFs that are being established as a cooperative[56] and do not manage more than EUR 100 million euro (incl. leverage).[57] Similar as for SIFs and SICARs, Luxembourg exempts retail AIFs (UCIs) managed by 'small' AIFMs from the AIFMD depositary requirement. Luxembourg requires, however, a depositary to be appointed in its national product regulation for UCIs that are managed by 'small' AIFMs.[58] Similar as for SIFs and SICARs, the pre-AIFMD depositary regime is, to a large extent, maintained in Luxembourg for UCIs marketed

---

[41] § 2(4) KAGB; § 2(5), § 44(1) (3)-(7), § 45-48 KAGB.
[42] Art. 3(3) Luxembourg AIFM Law.
[43] Art. 2:66a Wft.
[44] § 1(5) Austrian AIFM Law.
[45] § 2(4) KAGB; § 2(5), § 80-90 KAGB.
[46] See Art. 16-19 SIF Law; Art. 8-10 SICAR Law; For SIFs, and SICARs Luxembourg delineates between Part I and Part II of the SIF/SICAR Law. Part I of the SIF/SICAR law applies to (1) SIFs/SICARs that do not qualify as AIFs, and (2) SIFs/SICARs benefitting from the 'small' AIFM regime.
[47] Part I SICAR/SIF depositaries do not have to exercise any controlling duties under the Luxembourg depositary regime. The AIFMD delegation and liability regimes are for these depositaries also not applicable. Part II SIFs and Part II SICARs fall entirely within the AIFMD and, thus, have to apply the AIFMD depositary rules; See Arts 16-19 SIF Law; Arts 8-10 SICAR Law.
[48] § 2(5) Austrian AIFM Law.
[49] Extra requirements apply to the organization of the AIFMs that is marketing AIFs to retail investors. See § 10.3.1.1. Besluit Gedragstoezicht financiële ondernemingen Wft.
[50] Member States, however, differ in their interpretation of what constitutes a 'retail investor' under the AIFMD; See D.A. Zetzsche, *Fondsregulierung im Umbruch – ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, ZBB 22 (2014); See also Chapter 8, section 3.3.2.
[51] § 80-90 KAGB.
[52] § 2 (5), 80-90 KAGB.
[53] § 2(4a) KAGB.
[54] § 1-17, 26-28 (Conduct of business and organizational requirements), 42 and 44 KAGB.
[55] § 2(4a) KAGB, § 80-90 KAGB.
[56] § 53-64c Genossenschaftgesetz.
[57] § 2 (4b) KAGB.
[58] Art. 90 (2) UCI Law; Some adjustment to the pre-AIFMD depositary regime were made. Both credit institutions and investment firms are in the post-AIFMD era allowed to be appointed as a depositary. Under the UCI Law, depositaries remained to be partly exempted of their obligations. For contractual funds this concerns the valuation controlling duty and the AIFMD depositary liability. Furthermore, SICAVs[58] and UCIs which have not been constituted as common funds or are not subject to the valuation and AIFM instruction controlling duty.
[58] See Art. 95 (1b), 99 (6bis) UCI Law.

to retail investors managed by 'small' AIFMs.[59]

Ireland and France do not differentiate between professional and retail investors and require all types of 'small' AIFMs to obtain a full-fledged AIFM authorization.[60] Both Ireland and France, however, dispense from certain AIFMD requirements.[61] France, for example, does not require the 'small' AIFMs managing professional AIFs to appoint a depositary.[62] Ireland, however, does require a depositary.[63] In Liechtenstein 'small' AIFMs are subjected to a 'light authorization'. The appointment of a depositary is mandatory irrespective of whether the AIF is marketed to professional or retail investors. [64]

The UK does not differentiate between professional and retail AIFs managed by 'small' AIFMs for the purpose depositary regulation either. Unlike France and Ireland, however, a full-fledged AIFM authorization is not required.[65] 'small' AIFMs, including 'small authorized AIFMs'[66] and 'small registered AIFMs'[67], both do not have to abide by the AIFMD depositary rules irrespective whether they manage professional or retail AIFs. The application of the COLL depositary requirements in the UK is applicable to AIFs depending upon whether the 'small' AIFM managing them is a small authorized AIFM or a small registered AIFM. The COLL depositary regulation does not apply to (unauthorized) AIFs managed by small registered AIFMs.[68] The application of the COLL depositary rules to a small authorized AIFM depends on whether it manages an authorized AIF or an unauthorized AIF.[69] A small authorized AIFM which manages an authorized AIF will be subject to the requirements in COLL, but a small authorized UK AIFM of an unauthorized AIF is not subjected to COLL.[70] The specific depositary requirements under COLL depend on whether the authorized AIF qualifies as a NURS or a QIS.[71] The mandatory duty to appoint a depositary for 'small' AIFMs that manage professional and retail investors, thus, varies from Member State to Member State.

2.1.3.2. Private Placement Regime - AIFs managed by TC-AIFMs

---

[59] Art. 90(2), Art. 95 (1b), 99 (6bis) UCI Law.

[60] France :L 214-24 III CMF and Art. 532-9 CMF, that refer to L214-24 II CMF; See also AMF, Guide des mesures de modernisation apportées aux placements collectifs français (Julliet 2013), 3 et seq.., 21 et seq; Ireland:Central Bank of Ireland, AIF Rulebook, July 2013, Chapter 2 – Qualifying Investor AIF Requirements, Part. III. Additional Provisions Applicable to Qualifying Investor AIFs which have a registered AIFM.

[61] See also AMF, Guide des mesures de modernisation apportées aux placements collectifs français (Julliet 2013), 3 et seq., 21 et seq;

[62] Central Bank of Ireland, AIF Rulebook, July 2013, Chapter 2 – Qualifying Investor AIF Requirements, Part. III. Additional Provisions Applicable to Qualifying Investor AIFs which have a registered AIFM.

[63] France: Art. L 214-24 III. Code monétaire et financier. See also L. 532-9 Code monétaire et financier; Ireland : Central Bank of Ireland, AIF Rulebook, July 2013, Chapter 2 – Qualifying Investor AIF Requirements, Part. III. Additional Provisions Applicable to Qualifying Investor AIFs which have a registered AIFM.

[64] Also other provisions of the AIFMD partly apply to these AIFMs. Apart from the mandatory appointment of an authorized administrator, Liechtenstein requires, amongst others, the appointment of an auditor/account, the AIFMD's rules of conduct and valuation to be applied. See Art. 3(1), (4)-(6) Liechtenstein AIFM Law. Several provisions, such as the minimum capital requirement, the securitization provisions and the AIFMD remuneration requirements do not apply.

[65] See Siena, J.R., Eckner, D., *The AIFM's Transposition in the United Kingdom* (D.A. Zetzsche ed, Kluwer 2015), 805.

[66] FUND 1.3.6 G.

[67] FUND 1.3.7G. The small registered AIFM is limited to three types of AIFMs for which registeration is possible: the small internal AIFM, the small property AIFM and managers of EuSEF and EuVECAF; See Siena, J.R., Eckner, D., *The AIFM's Transposition in the United Kingdom*(D.A. Zetzsche ed, Kluwer 2015), 805-806.

[68] COLL 6.1 and COLL 6.6.

[69] COLL 6.6.

[70] COLL 6.1 and COLL 6.6.

[71] See for non-UCITS retail schemes: COLL 6.6 .See for Qualified Investor Schemes: COLL 8.5.4.

Member States may for AIFs managed by TC-AIFMs and marketed within their domicile decide to extend the AIFMD depositary laws to AIFs that do not use the AIFMD marketing passport in their respective private placement regimes. The approaches taken by Member States that decided to implement Article 42 AIFMD differ significantly. Austria[72] requires an AIFMD depositary to be appointed, whereas Ireland,[73] Luxembourg,[74] the Netherlands[75] and the UK[76] do not impose a depositary requirement to TC-AIFMs that wish to market (Non-)EEA AIFs to professional investors within their domiciles.

Denmark,[77] France,[78] Germany,[79] and Liechtenstein[80] take a position in the middle. They do not require TC-AIFMs that are permitted to market (Non-)EEA AIFs to professional investors on a private placement basis in their domiciles to appoint a depositary that complies with Article 21 AIFMD nor do they exempt them from appointing a depositary fully. Instead, they make use of the option to require stricter rules regarding the marketing of non-EEA funds managed by TC-AIFMs by extending the Article 36 AIFMD 'depositary-lite' requirement to their Article 42 AIFMD implementation.[81] It is, however, possible that the private placement regime will be phased out in 2018 and that this 'exemption' from the depositary requirements under the private placement regime may not be available after that date. Compliance with the depositary requirements is, however, in any case required by the AIFMD when an AIF is marketed to professional investors on the basis of the pan-European passport for both EEA and TC-AIFMs.

2.1.4. *Depositary-Lite Regime*

Article 36 AIFMD provides an option for Member States to relax the AIFMD depositary regime with respect to TC-AIFs that are managed by EEA-AIFMs and marketed to professional investors in their domiciles on the basis of a private placement regime (referred to in practice as 'depositary-lite'). This option may only be granted by Member States to EEA-AIFMs provided that:[82]

---

72. Section 47(1) Austrian AIFM Act.

73. The Irish implementation grants by means of Art. 43(4) AIFM Regulations the Central Bank of Ireland the power to impose additional conditions or requirements, such as the appointment of a depositary, where it considers it necessary for the proper and orderly regulation and supervision of AIFMs. No such conditions or restrictions have been made to date.

74. Art. 45 Luxembourg AIFM Law.

75. Art. 1:13b(1), (2) FSMA. See C.M. Grundmann- van de Krol, *Regulering beleggingsinstellingen en icbe*'*s in de Wft* (Boom Juridische Uitgevers 2013), 166–170; See on the general implementation of the implementation of Art. 42 AIFMD in the Netherlands: S.N. Hooghiemstra, *The AIFM's Transposition in the Netherlands* (D.A. Zetzsche ed, Kluwer 2015).

76. Art. 57 Alternative Invesment Fund Managers Regulations, 2013, S.I. (2013) No. 1773 as implemented in: FUND 10.5.9–10.5.11A; PERG 8.37 AIFMD Marketing.

77 In Denmark, the depositary-lite provision is only required for TC-AIFMs marketing TC-AIFs. No depositary-lite requirement exists for EEA-AIFs being marketed on the basis of national private placement rules by TC-AIFMs in their domicile. See s. 130(5) Alternative Investment Fund Managers Etc. Act (Act No. 598 of the 12 June 2013); s. 4. Executive Order on authorization for alternative investment fund managers to market the alternative investment fund established in third country in Denmark (EO No. 798 of the 26 June 2014).

78 D214-32 CMF.

79 Paragraph 330(1) sub-para. 1, (2) KAGB.

80. Non-EEA AIFMs willing to market (Non-)EEA AIFs in Liechtenstein without making use of the AIFM marketing passport need to be authorized according to Art. 128, 150 Liechtenstein AIFM Law. See Art. 133(1)(a) Liechtenstein AIFM Law.

81. See *Infra* 2.1.4.

82. Recital 63, Art. 36(1) AIFMD.

- appropriate cooperation arrangements providing for information exchange between the Competent Authorities of both the home Member State of the AIFM and the supervisory authorities of the Non-EEA AIF should be in place;[83]
- the country where the TC-AIF is established is not listed as a Non-Cooperative Country and Territory by FATF;[84] and
- the (EEA) AIFM complies with all the AIFMD requirements with the exception of the mandatory appointment of a depositary under Article 21 AIFMD.[85]

Member States that exempt EEA-AIFMs from appointing an Article 21 AIFMD depositary should, however, instead require EEA-AIFMs to ensure that one or more entities are appointed to carry out depositary duties mentioned under Article 21(7)–(9) AIFMD.[86] The depositary duties to be performed by these entities include: the monitoring of cash,[87] the safekeeping of assets[88] and the performance of oversight duties.[89] Unless Member States have chosen to impose stricter rules on such entities,[90] the AIFMD depositary eligibility criteria, the AIFMD delegation and liability regime are not applicable. The AIFM managing and marketing the TC-AIF may not at the same time perform those depositary functions for this AIF.[91] The AIFM shall provide its supervisory authorities with the information about the identity of the entities responsible for carrying out the depositary functions.[92]

Several Member States have adopted the depositary-lite model under their Article 36 AIFMD implementation.[93] The safekeeping of financial instruments may in all Member States only be performed by investment firms, credit institutions or other domestic entities that have obtained an authorization to provide custody services.[94] The regulatory approach taken regarding the entities performing the monitoring of cash and the performance of oversight duties differs from Member State to Member State. Ireland, for instance does only require entities providing the safekeeping function, including both the custody as the record keeping tasks, to be authorized under the Investment Intermediaries Act 1995.[95] Entities that are only providing the cash monitoring, regulatory oversight or both functions will not need to obtain

83. Art. 36(1)(b) AIFMD.
84. Art. 36(1)(c) AIFMD.
85. Art. 36(1)(a) AIFMD.
86. Art. 36(1)(a) AIFMD.
87. The monitoring of the TC-AIFs cash flows includes the reconciliation of the cash accounts with the records of third parties. See *infra* at 6.3.7.
88. The safekeeping function comprises of either holding financial instruments assets in custody, where such assets can be held in custody, or verifying the fund's ownership of assets that cannot be held in custody. See *infra* 6.2.
89. The performance of oversight function includes, amongst others, the calculation of distributions made to investors and checking the compliance with investment restrictions.
90. Art. 36(2) AIFMD.
91. Art. 36(1)(a) AIFMD.
92. Art. 36(1)(a) AIFMD.
93. Austria: Art. 38(1) sub-para. 1, (2) Austrian AIFM Ac; Germany: para. 329(1)(2) KAGB; Ireland: Art. 37(2)(a) SI 257 of 2013- European Union (Alternative Investment Fund Managers) Regulations 2013 (AIFM Regulation); Liechtenstein: Art. 128(1)(a) Liechtenstein AIFM Law; Luxembourg: Art. 37 Luxembourg AIFM Act; Malta: Art. 7(1)(a) Investment Services Act (Alternative Investment Fund Manager)(Third Country) Regulations; UK: FUND 3.11.33.
94. Central Bank of Ireland, *Consultation on carrying out depositary duties in accordance with Article 36 of the AIFMD*, 2014; Central Bank of Ireland, *Feedback Statement on CP78: Consultation on carrying out depositary duties in accordance with Article 36 of the AIFMD, Consultation Paper CP 78*, 2014.
95. *Ibid.*

authorization. To the contrary, both Malta[96] and the UK[97] require entities appointed to carry out one of the latter two functions to obtain an authorization as a depositary/custodian.

2.2. The Obligation to Appoint a Depositary under the UCITSD V

A UCITS ManCo has to ensure that for each UCITS a single depositary is appointed in accordance with UCITSD V.[98] UCITSD V requires a depositary to be appointed irrespective of the legal form of the UCITS and whether or not the UCITS is listed.[99] Unlike under the AIFMD, no exemptions from this requirements are available. This can be explained by the fact that UCITS are undertakings for collective investment that are mandatorily open-ended and are required by the UCITS product regulation to invest mainly in liquid financial assets.

3. Entities Eligible as a Depositary and Its Organizational Requirements

Since the creation of the EEA legal framework for UCITSD I, the depositary became, alongside the fund and the UCITS ManCo, the third pillar of the investment fund.[100] Depositaries were, however, subject to a very limited number of principles and duties at EEA level, leaving Member States free to regulate many aspects of depositaries. The AIFMD and UCITSD V harmonize the law applicable to entities that are eligible as depositaries and its organizational requirements. In this regard, the AIFMD diverges from the UCITSD V due to the larger variety of undertakings of collective investment that fall under the scope of the AIFMD compared to the UCITSD V.[101]

3.1. Entities Eligible as a Depositary under the AIFMD

The depositary of an AIF must be: (1) a credit institution; (2) an investment firm; (3) an eligible entity under the UCITSD V; (4) a prime broker or (5) an equivalent non-EEA entity.[102] In addition, the AIFMD allows discretion for Member States to appoint a person or entity as depositary for certain closed-ended funds.

3.1.1. *Credit Institution*

Under Article 21(3)(a) AIFMD, credit institutions eligible to be appointed must have their registered office in the EEA and be authorized in accordance with CRD IV. Unlike investment firms, the AIFMD does not require credit institutions to be have obtained an authorization to provide the 'ancillary service' of safekeeping and administration of

---

96. SLC 1.03, Part BIV: Part BIV: *Standard Licence Conditions applicable to Investment Services Licence Holders* which *qualify* as *Custodians*, *Investment Services Rules* for *Investment Services Licence Holders* ; See MFSA, Feedback statement further to industry responses to MFSA Consultation Document dated 18 September 2013 on the introduction of the depositary lite provisions, 2.1.1. [I]. Feedback Statement.

97. See FCA, *Frequently Asked Questions: Q9: Does an Article 36 custodian require a Part 4A permission for acting as depositary of an AIF?*, http://www.fca.org.uk/firms/markets/international-markets/aifmd/depositaries, (accessed 15 Jun. 2015); FCA, *Implementation of the Alternative Investment Fund Managers Directive*, PS 13/5, 39 (2013).

98 Art. 22(1) UCITSD V.

99 Recital 32 UCITSD V; J.E. Klerk & R. Slange, *UCITS V and beyond*, 1/2 TvFR 34-39 (2015).

100. See D.A. Zetzsche, '*Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?*' 337–355 (Birkmose, Neville & K. Sørensen (eds), Kluwer Law International 2012).

101 D.A. Zetzsche & C.D. Preiner, *Scope of the AIFMD* (D.A.Zetzsche ed, Kluwer 2015).

102. A prime broker can also be appointed as a depositary, but is, in particular subject to the requirements of Art. 21(4) AIFMD. See D.A. Zetzsche, *(Prime) Brokerage* (D.A. Zetzsche ed, Kluwer 2015).

securities[103] to be eligible as a depositary.[104] The mere authorization of credit institutions for deposit-taking activities suffices.[105]

3.1.2. *Investment Firm*

Under Article 21(3)(b) AIFMD, investment firms eligible to be appointed must have their registered office in the EEA. Compared to credit institutions, eligible investment firms have to be subject to capital adequacy requirements in accordance with Article 95(1) CRR, including capital requirements for operational risks and authorized in accordance with MiFID II. Only those investment firms are eligible that provide the ancillary service of safekeeping and administration of financial instruments for the account of clients in accordance with Section B Annex I MiFID I/II.[106] This implies that the safekeeping and administration of financial instruments for the account of clients is not an investment service or activity and can only be provided by investment firms in connection with investment services and activities, such as, amongst others, portfolio management and investment advice.[107] Unlike credit institutions under CRD IV, obtaining an authorization for one of the investment services and activities under MiFID I/II does not suffice to be eligible as a depositary under the AIFMD. Investment firms that provide this ancillary service shall not have less initial capital than EUR 730 000 referred to in Article 28 CRD IV.

3.1.3. *Other Eligible Institutions*

Besides investment firms and credit institutions, the AIFMD allows other institutions that were on 21 July 2011 eligible under the UCITSD IV to be appointed as a depositary.[108]

The recently adopted UCITSD V creates in Member States uncertainty regarding the question whether these institutions other than credit institutions and investment firms that were eligible under UCITSD IV may from March 2016 onwards be appointed as a depositary for AIFs.

Under the original UCITSD V proposal, the appointment of 'other eligible institutions' as depositaries for AIFs would effectively only be allowed during a transitional period. The UCITSD V proposal provided an exhaustive list of eligible entities, including credit institutions and investment firms that would be allowed to be appointed as depositaries. After entry into force, the UCITSD V would have set aside this 'grandfathering clause'[109] under the AIFMD.[110] Except for TC-entities and the carve-out for private equity, commodity and real estate funds,[111] no other entities than credit institutions and investment firms would be eligible under the AIFMD.[112]

---

103. Annex I Nr. 12 CRD IV.
104 See for a more detailed explanation of credit institutions providing the ancillary service of safekeeping and administration of securities: Chapter 6, section 2.1.
105. Art. 3(1) point 1 CRD IV/Art. 4(1) point 1 CRR.
106 See P.J. van Zaal, *Aanhouden van gelden door beleggingsondernemingen en betaaldienstverleners*, 9 TvFR 226-237 (2010).
107. Annex I s. A MiFID I/II.
108. Art. 21(3)(c) AIFMD.
109. European Commission, *Working Document of the Commission Services (DG Internal Market and Services) – Consultation Paper on the UCITSD Depositary Function and on the UCITS Managers' Remuneration*, MARKT/G4 D (2010) 950800, 14 December 2010, 16.
110. Art. 23a(2) UCITSD V Draft proposal.
111. See *infra* at 2.2.4 and 2.2.5.
112. Notaries and law firms would still be allowed to continue to act on their traditional field as depositaries for AIFs.

The final UCITSD V text, however, finally settled on an extension of eligible institutions compared to the originally proposed UCITSD V.[113] Depositaries under the UCITSD V may be a credit institution, a national central bank or another legal entity that is authorized by Member States to carry on depositary activities[114] that are subject to ongoing supervision as well as minimum capital, prudential and organizational requirements.[115]

UCITSD V did nor its preparatory documents have provided any clarity on whether and to what extent these other eligible institutions will be allowed to be appointed under the AIFMD as an AIF depositary.[116] The UCITSD V 'other legal entities' eligible as depositaries are subjected to minimum harmonization on the European level regarding capital, prudential and organizational requirements.[117] Additional minimum requirements regarding these other legal entities apply in relation to infrastructure,[118] experience,[119] administrative and accounting procedures,[120] internal control mechanisms,[121] risk management procedures[122] and arrangements to prevent conflicts of interest.[123] These entities are, thus, offering more investor protection than some of the institutions that Member States determined to be eligible as a depositary under UCITSD IV.[124] By interpreting the AIFMD 'grandfathering provision' dynamically, entities complying with these requirements can both be determined by Member States to be appointed as a depositary for UCITS and AIFs.[125] Apart from this, it prevents that in some Member States entities are excluded from the AIFMD depositary market that fulfil similar minimum capital, prudential and organizational requirements as credit institutions and investment firms.[126] Taken into account that for TC-AIFs it is under the AIFMD possible for a depositary not only to be a credit institution or investment firms, but also any other entity of the same nature as these entities this dynamic interpretation should be acceptable.[127]

3.1.4. *Prime Broker*

The AIFMD recognizes the fact that many AIFs, such as hedge funds, make use of a prime broker.[128] Under the AIFMD, the prime broker may, in addition to its role as counterparty to an AIF, be appointed as a depositary (and as a sub-custodian).[129]

---

113. See Art. 23(2) UCITSD V.
114. Art. 23(2) UCITSD V.
115. Art. 23(2)(c) sub-para. 1 UCITSD V.
116. See the Explanatory Memorandum of the UCITSD V Draft proposal, 4,5.
117. Art. 23(2)(c) sub-para. 1 UCITSD V.
118. Art. 23(2)(c) sub-para. 1(a) UCITSD V.
119. Art. 23(2)(c) sub-para. 1(g), (h) UCITSD V.
120. Art. 23(2)(c) sub-para. 1(c) UCITSD V.
121. Art. 23(2)(c) sub-para. 1(b), (c) UCITSD V.
122. Art. 23(2)(c) sub-para. 1(c) UCITSD V.
123. Art. 23(2)(c) sub-para. 1(d) UCITSD V.
124. Dutch UCITS IV depositaries, for instance, were only subject to an own funds requirement of EUR 112,500, which is sufficiently lower than the EUR 730,000 required by Art. 23(2)(c) UCITSD IV. See Art. 48(1)(n) Prudential Rules Decree of 12 October 2006 (Besluit prudentiële regels, Bpr).
125. European Commission, Undertakings for collective investment in transferable securities – amended Directive (UCITS V): Frequently asked questions, MEMO/14/198, 15 April 2014, Question 7. What is the link between the provisions on depositaries in the Alternative Investment Fund Managers Directive and the amended UCITS Directive?
126. European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186)*, 32,33.
127. Recital 34 AIFMD; This dynamic interpretation is applied in practice by the Dutch AIFMD and UCITSD V implementation. The eligible entities for both (Dutch) AIF and UCITS depositaries has been completely harmonized under Art. 4:62n Wft.
128 Recital 43 AIFMD.

3.1.4.1. The Prime Broker as Counterparty

Under Article 4(1)(af) AIFMD the prime broker is being defined as

> 'a credit institution, a regulated investment firm or another entity subject prudential regulation and ongoing supervision, offering one or more services to professional investors primarily to finance or execute transactions in financial instruments as counterparty and which may also provide other services such as clearing and settlement of trades, custodial services, securities lending, customized technology and operational support facilities.'

Following this definition, prime brokers under the AIFMD are primarily counterparties to AIFs. Prime brokers are 'offering one or more services to professional investors primarily to finance or execute transactions in financial instruments as counterparty'.[130]. In its capacity as counterparty, prime brokers, when offering 'core' services, may also provide 'ancillary' services, including the clearing and settlement of trades, custodial services, securities lending, customized technology and operational support facilities Prime brokers may, however, only provide 'custodial services' as 'ancillary' service to AIFs[131] by being appointed as a depositary (or a sub-custodian) under the AIFMD provided that certain conditions preventing conflicts of interest are in place.[132]

3.1.4.2. The Prime Broker as Depositary

Under Article 21(4)(b) AIFMD, prime brokers acting as counterparty to an AIF may only be appointed as a depositary for that AIF provided that:

- it has functionally and hierarchically separated the performance of its depositary functions from its tasks as prime broker; and
- the potential conflicts of interest that may arise from the fact that the depositary is also acting as prime broker are identified, managed, monitored and disclosed to the investors of the AIF.

The rationale behind this mandatory segregation of depositary from prime broker functions is that there is an inherent conflict of interest between prime brokers acting as counterparties to AIFs and, therefore, the prime broker in its capacity as counterparty cannot at the same time act in the best interest of the AIF as is required of a depositary.[133]

Prime brokers acting as an counterparty for an AIF may, thus,, only be appointed as a depositary for that AIF provided that Chinese walls.[134]

3.1.5. *Eligible Non-EEA Entities*

For TC-AIFs, either a credit institution or any other entity of the same nature as an EEA investment firm may be appointed. The depositary, however, shall be subject to effective prudential regulation, including minimum capital requirements and supervision, which has the

---

[129] See D.A. Zetzsche, *(Prime) Brokerage* 580-590 (D.A. Zetzsche ed, Kluwer 2015); See for the prime broker as a sub-custodian: *infra* 10.2.2.

[130] Art. 4(1)(af) AIFMD. See on the counterparty function and its risks: M.R. King & P. Maier, *Hedge funds and financial stability: Regulating prime brokers will mitigate systemic risks* , 5 Journal of Financial Stability 283–297 (2009); K. Benjamin & B. Rzepkowski, *Hedge Funds and Prime Brokers: The Role of Funding Risk* (EFA 2009 Bergen Meetings Paper), http://ssrn.com/abstract=1343673 (accessed 3 September 2016); N. Tuchschmid, E. Wallerstein & A. Zanolin, *Hedge Funds and Prime Brokers: The Role of Funding Risk*, http://ssrn.com/abstract=1343673 (accessed 3 September 2016); N. Bryce, *Hedge Funds, Liquidity and Prime Brokers,* 3 Fordham Journal of Corporate &Financial Law 4 (2008).

[131] Recital 43 AIFMD.

[132] Art. 21(4)(b) AIFMD

[133] See Recital 43 AIFMD.

[134] Art. 21(4)(b) AIFMD

same effect as EU law and is effectively enforced.[135] In addition, third-country depositaries underlie the requirements discussed below in section 5.

3.1.6. *Option for Private Equity Funds, Venture Capital Funds and Real Estate AIFs*

Member States may authorize both TC-AIFs and EEA-AIFs to appoint a person or entity as depositary (e.g., a lawyer, trustee, notary or registrar) not belonging to the eligible entities as discussed above.[136]

Such persons or entities are required to:

- carry out the depositary functions as part of their professional or business activities;
- be subject to mandatory professional registration recognized by law or to statutory or regulatory provisions or rules of professional conduct; and
- furnish sufficient financial and professional guarantees to be able to effectively perform the relevant depositary functions and meet the commitments inherent to those functions.

Member States may allow this for AIFs:

- that have no redemption rights exercisable during a period of five years from the date of their initial investments and which, according to their core investment policy, generally do not invest in financial instruments that must be held in custody; or
- generally invest in issuers or non-listed companies in order to potentially acquire control over such companies.[137]

This option is designed for closed-ended AIFs, such as private equity, venture capital and real estate funds, that generally do not invest in financial instruments. Credit institutions and investment firms have little expertise in safekeeping such assets as real estate, partnership shares, ships and physical assets (e.g., pure gold).[138] Moreover, these assets cannot be held in bank accounts. As this option requires significant private law and corporate law expertise, the AIFMD allows specialists to carry out the safekeeping of these types of assets.

The implementation of this option diverges from Member State to Member State. France has chosen not to implement this option. Only the ‘regular depositaries’, including credit institutions, investment firms and UCITSD IV/V depositaries may be appointed under the AIFMD implementation in France.[139]

To the contrary, Ireland and the Netherlands subject their ‘PE-depositary’ to the minimum requirements under Article 21(3)(c) sub-para. 3 AIFMD.[140] Both Ireland and the Netherlands do not specify what professionals or entities may perform this function. All persons and entities as indicated under the AIFMD may be appointed as a ‘PE-depositary’. Ireland, however, requires professionals and entities to have a minimum capital of at least EUR 125.000.[141] For entities and professionals that undertake business activities riskier activities

---

[135] Art. 21(3)(c) sub-para. 2 AIFMD.

[136] Art. 21(3)(c) sub-para. 3 AIFMD; O. Schröder & A. Rahn, *Das KAGB und Private-Equity-Transaktionen – Pflichten für Manager von Private-Equity-Fonds und deren Verwahrstellen*, GWR 49 (2014).

[137] Art. 21(3)(c) sub-para. 3 AIFMD.

[138] D.A. Zetzsche, *Fondsregulierung im Umbruch – ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, ZBB 22 (2014).

[139] See Art. L214-24-5 CMF

[140] Ireland: Nr. 22(3)(a)(iii) AIFM Regulations; CBI, AIF Rulebook, July 2013, Chapter 6 – AIF Depositary Requirements, Annex I Minimum Capital Requirement Report – Notes on Compilation (Depositary); The Netherlands: Art. 115g BfGO.

[141] Nr. 22(3)(a)(iii) AIFM Regulations; Central Bank of Ireland, AIF Rulebook, July 2013, Chapter 6 – AIF Depositary Requirements, Annex I Minimum Capital Requirement Report – Notes on Compilation (Depositary).

than, for example, the safekeeping of assets other than financial instruments that can be held in custody more minimum capital is required.[142]

In Austria and Liechtenstein only professional trustees are eligible as a 'PE-depositaries' to carry out depositary functions as part of their professional activities.[143] Liechtenstein trustees are subject to the professional conduct rules as laid down in the Liechtenstein Trustee Act. [144] In addition, the trustee is required to have a mandatory liability insurance.[145] Trustees appointed as a 'PE-depositaries' depositary' in Austria are also required to conclude a liability insurance contract.[146] Moreover, trustees in Austria have to notify the financial market authority of the duration of the insurance contract and the conditions under which the contract may be terminated in case an insurance company is covering the financial guarantees of the trustee.[147] Similarly, Germany also allows trustees to be appointed as a depositary for illiquid assets.[148] A different regime applies depending upon whether the trustee is appointed for professional or retail AIFs.[149] Trustees acting for retail AIFs need to obtain an authorization, whereas trustees action for professional AIFs are exempted from this obligation.[150] The authorization procedure for retail AIF trustees requires Germany trustees to be 'fit and proper' and to furnish sufficient financial and professional guarantees. Trustees are not allowed to safekeep any financial instruments that should be held in custody or any funds belonging to an AIF. In addition, a liability insurance contract and enough financial resources are required.[151] Finally, a depositary contract needs to be concluded between the trustee and the AIFM.[152]

Luxembourg and the UK have taken another approach by introducing a specific type of 'national investment firm' that needs to obtain an authorization as a 'PE-depositary'. In Luxembourg a new category of investment firm had been introduced that is authorized to act as a 'professional depositary of assets other than financial instruments'.[153] This depositary is authorized to safekeep assets other than financial instruments for SIFs, SICARs and Part II UCIs. Only legal entities having a minimum subscribed and paid-up share capital of EUR 500.000 may be authorized to act as professional depositary of assets other than financial instruments.'PE depositaries' in Luxembourg may, additionally, be authorized for other investment services/activities, such as fund administration.[154] Similarly, 'PE depositaries' in the UK have to be authorized as a specific type of 'national investment firm'.[155] Unlike

---

[142] Central Bank of Ireland, AIF Rulebook, July 2013, Chapter 6 – AIF Depositary Requirements, Annex I Minimum Capital Requirement Report – Notes on Compilation (Depositary).

[143] Referred to as 'treuhänder'. See in Austria: § 19 (18) Austrian AIFM Law.; See in Liechtenstein: Art. 57 Liechtenstein AIFM Law.

[144] Art. 57 Liechtenstein AIFM Law.

[145] Art. 5-11 Treuhändergesetz.

[146] § 19(18) Austrian AIFM Law.

[147] § 19(18) Austrian AIFM Law.

[148] § 80(3) KAGB; See also: BaFin, a Guidance Notice on the requirements for trustees acting as depositary (Merkblatt zu den Anforderungen an Treuhänder als Verwahrstelle nach para. 80 Absatz 3 KAGB, Geschäftszeichen WA 41-Wp 2137-2013/0080); J. Kobbach & D. Anders, *Umsetzung der AIFM-Richtlinie aus Sicht der Verwahrstellen*, NZG 1170 (2012).

[149] BaFin, a Guidance Notice on the requirements for trustees acting as depositary ('Merkblatt zu den Anforderungen an Treuhänder als Verwahrstelle nach § 80 Absatz 3 KAGB, Geschäftszeichen WA 41-Wp 2137-2013/0080').

[150] § 69(1), (2) and (4), § 87 KAGB.

[151] § 80(3) sub-para. 2 KAGB. BaFin, *Merkblatt zu den Anforderungen an Treuhänder als Verwahrstelle nach § 80 Absatz 3 KAGB*, WA 41-Wp 2137-2013/0080, 18 July 2013.

[152] § 80(1), (2) and (3); See also Art. 83 AIFMD (Commission) Regulation.

[153] Art. 26-1 Law of 5 April 1993 on the financial sector, as amended on 12 june 2013.

[154] D.A. Zetzsche, *Fondsregulierung im Umbruch – ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, ZBB 22 (2014).

[155] FUND 3.11.12 R; FUND 3.11.12 R; FUND 3.11.14 R: See also the Glossary Definition FCA: 'Part 4a Permission' and 'acting as trustee or depositary of an AIF' and 'own funds'. (FUND 3.11.12-14).

Luxembourg, the 'PE-depositary' is not restricted to only safekeep other assets than financial instruments that can be held in custody. Instead, the UK requires substantially more own capital for 'PE-depositaries' that undertake activities with a higher risk, such as the safekeeping of financial instruments that can be held in custody.[156]

Most Member States in the EEA, thus, have implemented the option of the 'PE-depositary' in their national laws. There are, however, considerable differences in how Member States have implemented this option. The main differences in the national implementations relate to (1) the entities which are allowed to serve as a 'PE-depositary', (2) the conduct of business rules and (3) prudential regulation. Given the AIFMD depositary liability regime, the different implementation of the 'PE-depositary' in the national laws of Member States are unsurprising. Under Article 21 AIFMD, the professionals/entities under the national Member State laws safekeep financial instruments that can be held in custody are subjected to the 'guarantor liability' under the AIFMD depositary liability regime. This liability also applies to 'PE-depositaries' that do not have the organizational structure to safekeep financial instruments that can be held in custody and, in practice, fully delegate this safekeeping task to sub-custodians. It would have been more logical that the AIFMD would have required a 'prime custodian' either being a credit institution or investment firm to be appointed that would be responsible for safekeeping financial instruments that can be held in custody. Credit institutions and investment firms have the organizational structure to keep, can grant access to settlement systems and have a better overview of the custody holding chain than 'PE-depositaries' and would be better suited to bear the AIFMD 'guarantor liability' under the AIFMD depositary liability regime.

In short, it can be concluded that the special depositary option for closed-end AIFs funds has been warmly welcomed in Europe. Considerable differences exist in the implementation laws of the national Member States and it can, therefore, be questioned whether the purpose of increasing competition amongst professionals to minimize depositary costs can be obtained.

3.2. Entities Eligible as a Depositary under the UCITSD V

UCITSD IV provided little clarity on the entities eligible as a UCITS depositaries.[157] Under Article 23(3) UCITSD IV, Member States had the sole discretion to determine the entities eligible provided that they were subject to prudential regulation and ongoing supervision.[158] This discretion led to differences regarding the entities eligible as UCITS depositaries throughout the EEA.[159] The UCITSD V proposal sought to introduce a closed list of eligible entities comprising credit institutions and investment firms addressing the issue of non-harmonized minimum capital requirements, effective regulation and supervision that were present under UCITSD IV.[160] Although harmonization in this area was warmly welcomed in

---

[156] FUND 3.11.15, 3.11.16 and 3.11.17 R.

[157] European Commission, Consultation Paper on the UCITS Depositary Function and on the UCITS Managers' Remuneration (December 2010), MARKT/G4 D (2010) 950800; European Commission, Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments, COM(2004) 207 final, 30 March 2004; FEFSI, *Position Paper on Depositaries*, 4-5 (6 November 2002).

[158] See Art. 23(2) UCITSD IV.

[159] UCITSD V proposal, 4, 5; European Commission, Consultation Paper on the UCITS Depositary Function and on the UCITS Managers' Remuneration (December 2010), MARKT/G4 D (2010) 950800.

[160] European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions*

the UCITSD V consultation responses[161] and industry position papers[162], the proposal also received criticism that in common law countries such a limited list would disregard an entire sector or depositary services providers that were under UCITSD IV active in at least ten different Member States.[163] Eliminating other entities than credit institutions and investment firms from being eligible as a UCITS depositary was found to go beyond what is reasonable in order to ensure a proper level playing field without undermining the protection of UCITS investors.[164] The European Fund and Asset Management Association and the European Banking federation proposed that other entities authorized in Member States to act as depositaries under UCITSD IV should remain eligible to act as depositaries as long as they are subject to prudential regulation and ongoing supervision and provide sufficient guarantees in terms of capital requirements, investor protection, conflicts of interests and risk management.[165]

Article 23(2) UCITSD V adopted this criticism by determining that national central banks, credit institutions and other legal entities complying with additional prudential, organizational and capital requirements to provide sufficient guarantees are allowed to be eligible as UCITS depositaries. The UCITSD V leaves Member States discretion to determine in their national Member State laws which of the three categories of institutions shall be eligible to be UCITS depositaries.[166]

3.2.1. *National Central Bank*

Under Article 23(2)(a) UCITSD V, national central banks are eligible as UCITS depositaries. Adopting national central banks as eligible entity remains to be somewhat surprising as very few Member States allowed them to be UCITS depositaries under UCITSD IV. [167] The UCITSD V nor its preparatory documents[168] explain why this, to the contrary of the UCITSD

---

relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186), 32.

[161] See Art. 23(2) UCITSD V proposal; European Banking Federation, *EBF Position on UCITS V*, 5, http://www.ebf-fbe.eu/uploads/D1425F-2012-Final%20EBF%20position%20on%20UCITS%20V.pdf (accessed 29 August 2016); European Fund and Asset Management Association, *EFAMA Position Paper on the legislative proposal of the Commission amending Directive 2009/65/EC ("UCITS V"),* 4, www.efama.org/Publications/Public/UCITS/12-4040_EFAMA position paper on UCITS V.pdf (accessed 29 August 2016).

[162] European Banking Federation, *EBF Position on UCITS V*, 5, http://www.ebf-fbe.eu/uploads/D1425F-2012-Final%20EBF%20position%20on%20UCITS%20V.pdf (accessed 29 August 2016); European Fund and Asset Management Association, *EFAMA Position Paper on the legislative proposal of the Commission amending Directive 2009/65/EC ("UCITS V"), 3,* 4, www.efama.org/Publications/Public/UCITS/12-4040_EFAMA position paper on UCITS V.pdf (accessed 29 August 2016).

[163] European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186),* 33.

[164] European Banking Federation, *EBF Position on UCITS V*, 5, http://www.ebf-fbe.eu/uploads/D1425F-2012-Final%20EBF%20position%20on%20UCITS%20V.pdf (accessed 29 August 2016); European Fund and Asset Management Association, *EFAMA Position Paper on the legislative proposal of the Commission amending Directive 2009/65/EC ("UCITS V"), 3,* 4, www.efama.org/Publications/Public/UCITS/12-4040_EFAMA position paper on UCITS V.pdf (accessed 29 August 2016).

[165]Art. 23(2)(c) UCITSD V.

[166] Art. 23(3) UCITSD V.

[167] See, for example, Belgium: Art. 50 § 2 2° Wet betreffende de instellingen voor collectieve belegging die voldoen aan de voorwaarden van Richtlijn 2009/65/EG en de instelling voor belegging in schuldvorderingen, Belgisch Staatsblad, 19 oktober 2012, Opschrift vervangen bij artikel 414 van de wet van 19 april 2014 - BS 17 juni 2014.

[168] European Commission, Consultation Paper on the UCITS Depositary Function …, Markt/G4 D (2010) 950800. European Commission, Working Document of the Commission Services (DG Markt), Consultation

V proposal, has been adopted in the final version UCITSD V version. Taken the suggestion of EFAMA in its position paper, the merit of extending the categories of eligible institutions to national central banks is that they might play a useful role of "last resort in exceptional circumstances'.[169] The UCITSD V does not explicitly require central banks to fulfill any a specific organizational, prudential or additional capital requirements.[170] The UCITSD V, thus, deems that national central banks provide in any case sufficient guarantees to be eligible as a UCITS depositary. Nevertheless, few Member States have implemented this option under their UCITSD V implementation laws.[171]

3.2.2. *Credit Institution*

Article 23(2)(b) UCITSD V allows credit institutions to be appointed as a UCITS depositary. The European Commission in its UCITSD V Impact Assessment considered credit institutions (and investment firms) to be the most suitable entities to perform the UCITS depositary task. According to the European Commission, Credit institutions (and investment firms) are subjected to sound conduct of business rules, have expertise in investment services and safekeeping and are subject to strong EEA mechanisms that protect clients' interests in case of default.[172]

All Member States have adopted credit institutions in their UCITSD V implementation laws.[173] This is unsurprising given that all major UCITS jurisdictions under UCITSD IV already required a depositary to be a credit institution (or an investment firm).[174]

By adopting credit institutions it has been acknowledged that they fulfil in any case

---

Paper on the UCITS Depositary Function, July 2009; Summary of Responses to UCITS Depositary's Consultation Paper – Feedback Statement; Working Document of the Commission Services (DG Markt), Consultation Paper on the UCITS Depositary Function and on the UCITS Managers' Remuneration (December 2010), MARKT/G4 D (2010) 950800; Feedback on public consultation on UCITS V (February 2011).

[169] European Fund and Asset Management Association, *EFAMA Position Paper on the legislative proposal of the Commission amending Directive 2009/65/EC ("UCITS V"),* 4, www.efama.org/Publications/Public/UCITS/12-4040_EFAMA position paper on UCITS V.pdf (accessed 29 August 2016).

[170] Art. 23(2)(a) UCITSD V.

[171] See France: Art. L214-10-1 I.(a) Nr. 1 CMF. France also allows la Caisse des dépôts et consignations to be appointed under Art. L214-10-1 I.(a) Nr. 1 CMF; Malta: Art. 13(2)(a) Investment Services Act (CAP 370) (Custodians of Collective Investment Schemes) Regulations, 2016; See in the UK: COLL 6.6A.8R.

[172] European Commission, *Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries {C(2015) 9160 final},* 82.

[173] Austria: § 41(1) Investmentfondsgesetz 2011 (InvFG 2011); Croatia: Art. 4(7) Act on Open-Ended Investment Funds with a Public Offering (Official Gazette 44/16); Cyprus:Art. 88(I)(2) Open-Ended Undertakings for Collective Investment (UCI) Law of 2012 Consolidated with Law 88(I)/2015; Czech republic: § 69 (1)(a) and (b) 240/2013 Sb.ZÁKON ze dne 3. července 2013 o investičních společnostech a investičních fondech; Denmark: Art. 2 (1) Nr. 11 Act no. 597 of 12 June 2013 on investment associations;Germany: § 68 (2) and (3) KAGB; France: Art.L214-10-1 I.(a) Nr. 3 CMF; Ireland: Art. 35 (2) (*a*) and (*b*) (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (S.I. No. 352 of 2011); Liechtenstein: Art. 32(2)(a) and (b) UCITSG; Luxembourg; Art. 17(3) OPC law 2010; Malta: Art. 13(2)(b) Investment Services Act (custodians of collective investment schemes) Regulations 2016; the Netherlands: Art. 4:62n(b) Wft; UK: COLL 6.6A.8R (2).

[174] See CESR/09-175; European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186*), 32,33; European Commission, *Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries {C(2015) 9160 final}*, 81.

sufficient guarantees in terms of minimum capital requirements, effective regulation and supervision.

3.2.3. *Another Legal Entity*

Apart from national central banks and credit institutions, Member States may under Article 23(2)(c) UCITSD V determine which kind of other legal entities are eligible to carry out the UCITS depositary function provided that a certain amount of requirements are met.[175] Similar as investment firms under the AIFMD[176], 'another legal entity' should be subject to capital adequacy requirements as laid down in Art. 315 or 317 CRD IV and have own funds of not less than 730.000 Euro. Unlike under the AIFMD, 'another legal entity' under UCITSD V is not required to be authorized for the ancillary service of safekeeping and administration of financial instruments as this would effectively restrict the eligible entities to investment firms and credit institutions. Instead, only those entities are allowed to be eligible by Member States that satisfy the minimum requirements regarding infrastructure[177], experience[178], administrative and accounting procedures[179], internal control mechanisms[180], risk management procedures[181] and arrangements to prevent conflicts of interest[182].

Member States have, thus, have discretion whether or not 'other entities' are eligible in their domicile as UCITSD V depositaries. Member States have taken different approaches by not implementing at all this option[183], allowing all legal entities fulfilling these criteria to be appointed[184] or to specify the types of legal entities, such as investment firms[185], CSDs[186], prime brokers[187] or eligible legal entities authorized under national law[188] fulfilling the additional UCITSD V criteria to be appointed as a UCITS depositary.

3.2.3.1. Investment Firms as Per Sé Depositaries – A Missed Opportunity?

The UCITSD V proposal was based on the approach of establishing a closed list of entities that could be appointed as depositaries. Apart from credit institutions, investment firms

[175] Art. 23(2)(c) UCITSD V.
[176] Art. 21(3)(b) AIFMD.
[177] Art. 23(2)(c) sub-para. 2(a) UCITSD V.
[178] Art. 23(2)(c) sub-para. 2(g) and (h) UCITSD V.
[179] Art. 23(2)(c) sub-para. 2(c) UCITSD V.
[180] Art. 23(2)(c) sub-para. 2(b) and (c) UCITSD V.
[181] Art. 23(2)(c) sub-para. 2(c) UCITSD V.
[182] Art. 23(2)(c) sub-para. 2(d) UCITSD V.
[183] The following Member States, for example, only allow credit institutions to be appointed as a UCITSD V depositary: Austria: § 41(1) Investmentfondsgesetz 2011 (InvFG 2011); Croatia: Art. 4(7) Act on Open-Ended Investment Funds with a Public Offering (Official Gazette 44/16); Denmark: Art. 2 (1) Nr. 11 Act no. 597 of 12 June 2013 on investment associations; Germany: § 68 (2) and (3) KAGB; Luxembourg; Art. 17(3) OPC law 2010.
[184] Cyprus: Art. 88(I)(2) Open-Ended Undertakings for Collective Investment (UCI) Law of 2012 Consolidated with Law 88(I)/2015; Liechtenstein: Art. 32(2)(c) UCITSG; the Netherlands: Art. 4:62n(a) Wft.
[185] Czech republic: § 69(1)(c) 240/2013 Sb.ZÁKON ze dne 3. července 2013 o investičních společnostech a investičních fondech; France: Art. L214-10-1 I.(a) Nr. 5 CMF; Liechtenstein: Art. 32(2)(a) and (b) UCITSG; the Netherlands: Art. 4:62n(c);Malta: Art. 13(2)(e) Investment Services Act (custodians of collective investment schemes) Regulations 2016; UK: COLL 6.6A.8R(3)(b)(i).
[186] Finland: Finnish Government Bill, draft legislation for Managers of Alternative
tive Investment Funds, 05.09.2013, 218; See also §16, Chapter 2 of the Act amending the Clearing Operations Act; See also Chapter 14, Section 3 Finnish Law on Alternative Investment Funds; Poland: Art. 71(3) ACT of 27 May 2004 on Investment Funds.
[187] See CSSF, Circular14/587, as amended by Circular CSSF 15/608, Sub-Chapter 7.3. Organisational arrangements at the level of the depositary and the UCITS in case of the appointment of a prime broker.
[188] Ireland: Art. 35(2)(c) (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (S.I. No. 352 of 2011); Malta: Art. 13(2)(e) Investment Services Act (custodians of collective investment schemes) Regulations 2016; UK: COLL 6.6A.8R(3)(b)(i).

authorized under MiFID II to provide safekeeping and administration of financial instruments for the account of clients and subject under the capital adequacy and own funds requirements under CRD IV were proposed to be eligible under the UCITSD V proposal.[189] The eligibility of this closed list of entities was based upon the European Commission UCITSD V Impact Assessment that considered credit institutions and investment firms on the basis of its conduct of business rules, expertise in investment services and safekeeping the protection of clients' interests in case of default to be the most suitable entities to perform the UCITS depositary task.[190]

Article 23(2) UCITSD V has not listed investment firms, amongst national central banks and credit institutions, as ‘per sé depositaries’, i.e. depositaries that are in any case considered by the UCITSD V to fulfil the additional criteria required for the eligibility of ‘other legal entities’ under Article 23(2)(c) UCITSD V as a depositary. Instead, investment firms qualify as ‘another legal entities’. This is highly surprising as under the AIFMD investment firms qualify as ‘per sé depositaries’[191] and the UCITSD V Impact Assessment also considered investment firms to be addressing the issue of minimum capital requirements, effective regulation and supervision that were under UCITSD IV not harmonized for UCITS depositaries.[192] In Member States that limit UCITSD V eligible entities to, for example, credit institutions this leads to discrepancies with the AIFMD as investment firms qualify as ‘per sé depositaries' under the AIFMD.[193]

Investment firms authorized under MiFID II to provide safekeeping and administration of financial instruments for the account of clients qualify as ‘another legal entity’ and are, formally, required to comply with the prudential regulation and ongoing supervision minimum requirements under Article 23(2)(c) UCITSD V. In various Member States, including the Czech Republic, Liechtenstein and the Netherlands, investment firms are considered to be ‘per sé UCITSD V depositaries’.[194] In France, Malta and the UK, investment firms are eligible provided that they (formally) fulfil the Article 23(2)(c) UCITSD V minimum requirements related to prudential regulation and ongoing supervision.[195] Given the view of the European Commission in its UCITSD V Impact Assessment, investment firms in Member States, such as Cyprus[196], that allow any legal entity fulfilling the Article 23(2)(c)

---

[189] Art. 23(2) UCITSD V proposal.

[190] European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186)*, 32; European Commission, *Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries {C(2015) 9160 final},* 82; See also European Commission, *Commission Staff Working Document of 30 April 2009 (SEC(2009) 576) accompanying the Proposal for the AIFM-Directive: Impact Assessment*, 5, 37, http://ec.europa.eu/internal_market/investment/docs/alternative_investments/fund_managers_impact_assessment.pdf (accessed 29 August 2016).

[191] Art. 21(3)(b) AIFMD.

[192] European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186)*, 32.

[193] Member States may under Art. 43 AIFMD require stricter requirements for retail-AIF depositaries by limiting the entities eligible to, for instance, credit institutions.

[194] Czech republic: § 69(1)(c) 240/2013 Sb.ZÁKON ze dne 3. července 2013 o investičních společnostech a investičních fondech; Liechtenstein: Art. 32(2)(a) and (b) UCITSG; the Netherlands: Art. 4:62n(c);

[195] France: Art. L214-10-1 I.(a) Nr. 5 CMF; Malta: Art. 13(2)(e) Investment Services Act (custodians of collective investment schemes) Regulations 2016; UK: COLL 6.6A.8R(3)(b)(i).

[196] Cyprus: Art. 88(I)(2) Open-Ended Undertakings for Collective Investment (UCI) Law of 2012 Consolidated with Law 88(I)/2015.

UCITSD V minimum requirements should in any case be deemed to be eligible as a UCITSD V depositary.[197]

3.2.3.2. CSDs

Considering that various Member States under the AIFMD[198] allow CSDs to be eligible as a (UCITSD IV) depositary, the question is relevant whether CSDs may qualify as 'another legal entity' within the meaning of Article 23(2)(c) UCITSD V. The UCITSD V nor the CSDR provides a straightforward answer to this question.

Recital 21 UCITSD V mentions that CSDs[199] that are initially recording the securities of a UCITS in a book-entry system through initial crediting and maintaining those securities in an account at the top tier level[200] are not considered to be sub-custodians of that UCITS.[201] Entrusting the custody of securities of a UCITS by a UCITS depositary to any CSD, or to any third-country CSD is, however, considered to be a delegation of custody functions.[202]

Under Section B Annex CSD Regulation, CSDs may on top of the core services of CSDs under Section A

> 'establish CSD links[203], provide, maintain or operate securities accounts in relation to the settlement service, collateral management, other ancillary services'.[204]

This includes the opening of 'lower tier' securities accounts, either in direct holding systems or when the CSD acts as 'investor CSD' by maintaining for its customers securities issued in 'issuer CSDs'.[205]

The European Commission in its CSDR Impact Assessment confirms that CSDs may combine

> 'the core function 'central safekeeping' with 'non-central safekeeping' (from ancillary services) on the basis that the related prudential and conduct of business rules (e.g. on protection of customer assets) should in principle be the same'.[206]

---

[197] European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186)*, 32,33.

[198] Finland: Finnish Government Bill, draft legislation for Managers of Alternative
tive Investment Funds, 05.09.2013, 218; See also §16, Chapter 2 of the Act amending the Clearing Operations Act; See also Chapter 14, Section 3 Finnish Law on Alternative Investment Funds; Poland: Art. 71(3) ACT of 27 May 2004 on Investment Funds.

[199] See Art. 2(1) CSDR.

[200] See Section A Annex CSDR.

[201] Recital 21 UCITSD V.

[202] *Ibid.*

[203] Art. 2(1) Nr. (29) CSDR: 'CSD link' means an arrangement between CSDs whereby one CSD becomes a participant in the securities settlement system of another CSD in order to facilitate the transfer of securities from the participants of the latter CSD to the participants of the former CSD or an arrangement whereby a CSD accesses another CSD indirectly via an intermediary. CSD links include standard links, customised links, indirect links, and interoperable links'.

[204] See on investor CSDs: Chapter 6, section 3.

[205] European Commission, *Commission Staff Working Document of 07 March 2012 (SWD(2012) 22) accompanying the Proposal for the CSDR: Impact Assessment* (COM(2012) 73) (SWD(2012) 23), 7, http://ec.europa.eu/internal_market/investment/docs/alternative_investments/fund_managers_impact_assessment.pdf (accessed 29 August 2016).

[206] See also European Commission, *Commission Staff Working Document of 07 March 2012 (SWD(2012) 22) accompanying the Proposal for the CSDR: Impact Assessment* (COM(2012) 73) (SWD(2012) 23), 7, 90,

CSDs under the CSDR and under the view of the European Commission may, thus, provide 'custody' under the UCITS depositary's safekeeping function.

Unclear is whether and to what extent CSDs are suitable to perform UCITS depositary oversight[207] and cash management[208] services. The author takes the view that these can be considered to be 'other ancillary services' under Section B Annex CSDR. The oversight and cash management function are of a similar 'administrative' nature as the other non-banking-type ancillary services are listed under Section B CSDR and do not entail credit or liquidity risks. CSDs are, thus, able to be determined by individual Member States as 'another legal entity' carrying out the UCITS depositary function. CSDs eligible as a UCITS depositary may perform banking-types of ancillary services[209] under the CSDR, such as, amongst others, the provision of cash accounts and accepting deposits provided that the CSD either:[210]

- has obtained an authorization as a credit institution itself; or
- establishes a separate legal entity, authorized as a credit institution under CRD IV which is located either within or outside the group of which the CSD is a part.

In practice, CSDs not entitled to provide commercial bank money services are likely to play a minor role in exercising the depositary function as they would be restricted in the re-use of assets. The credit institution authorization under CRD IV necessary for providing these services would, however, directly or indirectly entitle such CSDs already to be eligible as a depositary. Investor CSDs are, thus, subject to sufficient capital, organizational and prudential requirements that may, along acting as a sub-custodian, by individual Member States be determined to be a UCITS depositary within the meaning of Article 23(2)(c) UCITSD V. CSDs, in practice, however, might already be directly or indirectly entitled to be eligible as a depositary based upon an authorization as a credit institution obtained under CRD IV.

3.2.3.3. Prime Brokers as UCITS Depositaries?

Unlike the AIFMD, UCITSD V does not regulate prime brokers and the prime brokerage relationship between UCITS ManCos, depositaries and prime brokers. This leaves the question whether prime brokers under UCITSD V are allowed as a depositary and/or sub-custodian.

In its FAQ, the European Commission answered the question 'what is a UCITS depositary?' by indicating that the UCITS depositary must be an 'entity that is independent from the UCITS fund and the UCITS fund's investment manager'.[211] In addition, the European Commission clarified that 'neither the fund manager nor any prime brokers that act as so-called 'counterparties' to a fund may also act as a UCITS depositary'.[212] Finally, the European Commission pointed out that the independence of a depositary is necessary because the depositary by exercising its controlling duties the 'legal conscience' of a UCITS and

---

http://ec.europa.eu/internal_market/investment/docs/alternative_investments/fund_managers_impact_assessment.pdf (accessed 29 August 2016).

[207] Art. 21(9) AIFMD.

[208] Art. 21(7) AIFMD.

[209] See Section C Annex CSDR.

[210] Art. 54 CSDR.

[211] European Commission, Undertakings for collective investment in transferable securities – amended Directive (UCITS V): Frequently asked questions, MEMO/14/198, 15 April 2014, Question 2. What is a UCITS depositary?

[212] European Commission, Undertakings for collective investment in transferable securities – amended Directive (UCITS V): Frequently asked questions, MEMO/14/198, 15 April 2014, Question 2. What is a UCITS depositary?

oversees the UCITS' assets.[213] By referring to 'prime brokers that act as counterparties' instead of prime brokers in general, the European Commission confirms the view that prime brokers can have the same roles, i.e. act as a counterparty, a depositary or a sub-custodian, under the UCITSD V as under the AIFMD.[214] The FAQ, however, does not answer the question whether prime brokers may be appointed as a UCITS depositary if they, as under Article 21(4)(b) AIFMD, functionally and hierarchically separate its counterparty and depositary function and conflicts of interests are remedied.[215]

Luxembourg has clarified that prime brokers are eligible as depositaries (and sub-custodians) provided that prime brokers functionally and hierarchically separate its counterparty and depositary function and that conflicts of interests are remedied.[216] Depositaries in Luxembourg may, however, only be credit institutions.[217] Only prime brokers that are authorized as a credit institution are, thus, allowed to be appointed as a depositary.[218] In addition, Luxembourg has extended the AIFMD prime broker definition[219], provisions related to the selection and appointment of the prime broker[220] and the functions of the AIFM[221], depositary[222] and prime broker[223] in the prime brokerage relationship to UCITS. The Luxembourg view makes sense as it is the only way how 'Newcits'[224] could operate. Prohibiting prime brokers as UCITS depositaries or sub-custodians would imply that UCITS would be severally restricted in employing leverage at all.[225] Prime brokers may in Luxembourg, thus, be appointed as a depositary provided that they are established as a credit institution and abide to the AIFMD conflicts of interest rules.

3.2.3.4. Other Legal Entities Eligible under UCITSD V Member State Laws

---

[213] *Ibid*.
[214] See also *infra* 10.2.
[215] The UCITSD V leaves open the question whether the restriction on the 'reuse' of assets by the depositary or a sub-custodian for own account prohibits prime brokers from being appointed as a depositary or a sub-custodian under the UCITSD V; See T. Moroni & L. Wibbeke, *OGAW V: Die Sprunglatte für OGAW-Verwahrstellen liegt höher*, 3 Recht der Finanzinstrumente 187.
[216] Essentially, Luxembourg extends Article 21(4)(b) AIFMD to its UCITS depositaries. See CSSF, Circular14/587, as amended by Circular CSSF 15/608, Sub-Chapter 7.3. Organisational arrangements at the level of the depositary and the UCITS in case of the appointment of a prime broker.
[217] Luxembourg; Art. 17(3) OPC law 2010.
[218] Under Art. 4(1)(af) AIFMD a 'prime broker' may be a credit institution, a regulated investment firm or another entity subject to prudential regulation and ongoing supervision. Prime brokers under the UCITSD V may be established as these entities as well. Luxembourg, however, restricts its UCITSD V eligible entities to credit institutions. This effectively limits prime brokers willing to act as UCITS depositaries to those authorized as a credit institution.
[219] CSSF, Circular14/587, as amended by Circular CSSF 15/608, 11 July 2014, 7, 8; See for the prime broker definition under the AIFMD: Art. 4(1)(af) AIFMD.
[220] CSSF, Circular14/587, as amended by Circular CSSF 15/608, 11 July 2014, Sub-Chapter 7.3. Organisational arrangements at the level of the depositary and the UCITS in case of the appointment of a prime broker
[221] Extended the AIFM functions, including (1) risk management duties, (2) compliance duties and (3) reporting and disclosure duties to UCITS ManCos; Art. 15(4), 24, 27 AIFMD; See ESMA2011/379, 49-51.
[222] CSSF, Circular14/587, as amended by Circular CSSF 15/608, 11 July 2014, Chapter 7. Specific organisational arrangements at the level of the depositary in view of the investment policy of the UCITS or the techniques that the UCITS employs.
[223] See for the reporting obligations towards the Depositary: CSSF, Circular14/587, as amended by Circular CSSF 15/608, 11 July 2014, Annex 3. List of information to be received by a depositary of a UCITS which has appointed a prime broker; See also Art. AIFMD; See also T. Moroni & L. Wibbeke, *OGAW V: Die Sprunglatte für OGAW-Verwahrstellen liegt höher*, 3 Recht der Finanzinstrumente 187.
[224] EDHEC Risk Institute, *Are Hedge Fund UCITS the Cure-All?* (EDHEC-Position Paper 2010).
[225] T. Moroni & L. Wibbeke, *OGAW V: Die Sprunglatte für OGAW-Verwahrstellen liegt höher*, 3 Recht der Finanzinstrumente 187.

Cyprus, Ireland, Malta, the Netherlands and the UK, along the eligible UCITSD V depositaries mentioned above, allow under their UCITSD V implementation laws other legal entities than investment firms, CSDs and prime brokers to be eligible as a depositary.

Cyprus[226], Liechtenstein[227] and the Netherlands[228] do not specify the types of legal entities and allow under their national implementation laws all legal entities that comply with Article 23(2)(c) UCITSD V to be appointed as a UCITS depositary. In the Netherlands, this option has, in particular, been implemented to continue to allow the traditional Dutch 'safekeeping entity' (*bewaarderentiteit*) that was traditionally appointed as a UCITSD IV depositary to be eligible under UCITSD V.[229] In the Netherlands, this safekeeping entity is traditionally a legal person that has the legal title of the UCITS' assets.[230] All legal persons can be appointed as a safekeeping entity provided that the sole object of its articles of association is the holding of assets and administering the goods in the UCITS invests.[231] This safekeeping entity is not a depositary as under the UCITSD IV commonly understood in the EEA. Dutch non-corporate legal forms, including limited partnerships and funds for joint account, were only established on the basis of private law and do not provide for limited liability and asset segregation.[232] For this purpose, the mandatory appointment of a legal entity (the safekeeping entity) that holds the legal title of the UCITS' assets covers for the absence of these two corporate elements under Dutch private law.[233] Under the Dutch UCITSD IV implementation, the safekeeping entity could act as a 'depositary' as it was assigned for performing oversight duties. The safekeeping of financial instruments that can be held in custody was, however, delegated to credit institutions as sub-custodians.[234] This was necessary as safekeeping companies traditionally do not have the resources to act as a 'custodian' and are unlikely to fulfil the prudential regulation and ongoing supervision requirements under UCITSD V. Under UCITSD V they remain, however, required to be mandatorily appointed for non-corporate

---

[226] Art. 88(I)(2) Open-Ended Undertakings for Collective Investment (UCI) Law of 2012 Consolidated with Law 88(I)/2015.

[227] Art. 32(2)(c) UCITSG.

[228] Art. 4:62n(a) Wft.; C.J. Groffen, *UCITS V implementatie in Nederland*, 3 TvFR 114 (2016); Grundmann-van de Krol, C.M., *Consultatiewetsvoorstel implementatie UCITS V in de Wft*, 49 Ondernemingsrecht 262 (2015).

[229] See explanatory notes (Memorie van Toelichting), UCITSD Amendment Act (Implementatiewet wijziging richtlijn icbe's), 2,3; See for the role safekeeping company pre-AIFMD: S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2012); See for the role of the safekeeping company post-AIFMD: S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2015); R.K.Th.J., Smits, *De AIFMD-bewaarder; praktische gevolgen voor Nederlandse beleggingsinstellingen*, 11 V&O 200-204 (2012); C.J. Groffen, N.B. Spoor & J.W.P.M. van der Velden, J. W., *Hoofdstuk 13 Beleggingsinstellingen*, in *Onderneming en Financieel Toezicht* (D. Busch ed., Kluwer 2010).

[230] This tradition applies to both AIFs and UCITS. See J. W. P. M. van der Velden, *Hoofdstuk 25 Beleggingsinstelling en aansprakelijkheid in het zicht van de nieuwe regelgeving*, in *Aansprakelijkheid in de Financiële Sector* 976-977 (D. Busch, C.J.M. Klaassen & T.M.C. Arons, Kluwer Law 2013); S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013); C.M. Grundmann- van de Krol, *Regulering beleggingsinstellingen en icbe's in de Wft* 223-228 (Den Haag: Boom Juridische Uitgevers, 2013); J.W.P.M. Van der Velden, *Beleggingsfondsen naar Burgerlijk recht* 129-185 (Kluwer 2008).

[231] Art. 4:44(1) Wft.

[232] This ranking of claims preserves the segregation of the UCITS' assets from the estate of the participants, the UCITS ManCo and the depositary (SPV) itself. See Art. 4:44 Wft. The requirement that the safekeeping company must be a legal entity ensures limited liability for investors.

[233] See for possible liability arising for investors when the depositary is not the legal owner of the assets: D. Busch & J.W.P.M. van der Velden, *Aansprakelijkheid en verhaal bij Fondsen voor Gemene Rekening*, 9 TvFR 161-162 (2009).

[234] In the Netherlands this is being referred to as a 'babylonian confusion of tongues'. See J.W.P.M. van der Velden, *Babylonische bewaarders*, 17 Ondernemingsrecht 173(2009).

UCITS.[235]

Unlike the abovementioned Member States, Ireland, Malta and the UK allow, along credit institutions (and investment firms)[236], legal entities authorized under national law under their Article 23(2)(c) UCITSD V implementation laws to be appointed as a UCITS depositary.[237] Ireland allows Irish companies to be eligible as 'other eligible institution' provided that the company is wholly owned by either a EEA/TC credit institution[238] or an equivalent EEA/TC institution[239] that guarantees the liabilities of the company and that have a paid-up share capital of at least EUR 5 million.[240] Similarly, Malta allows Maltese companies to be appointed as a depositary that are wholly owned by an EEA credit institution provided that the liabilities of the company are guaranteed by that credit institution.[241] In the UK, 'another legal entity' may be an investment management firm to which IPRU(INV) 5 applies and that satisfies the UCITSD V prudential regulation and ongoing supervision requirements.[242] These are firms whose permitted activities include designated investment business other than, amongst others, credit institutions and investment firms. The designated investment business is to act as a trustee or depositary of a UCITS.[243] Various Member States, thus, allow under their UCITSD V implementation other legal entities than investment firms, CSDs and prime brokers to be eligible as a depositary.

4. EEA AIF and UCITS Depositaries – General Requirements

The AIFMD and UCITSD V impose a general duty of loyalty and a duty to prevent conflicts of interest on all (non-)EEA AIF and UCITS depositaries.

4.1. Duty of Loyalty

The AIFMD and UCITSD V set out an overarching rule of conduct.[244] In the context of the respective roles of the AIFM, UCITS ManCo and the depositary, the depositary shall act honestly, fairly, professionally, independently and in the interest of the AIF/UCITS and the investors of the AIF/UCITS. This duty applies to all depositary functions under the AIFMD and UCITSD V. The depositary may, for instance, not offer or accept payments or any other inducements, if such payments or inducements would be detrimental to the interests of its clients.

4.2. Conflicts of Interest

---

235 Art. 4:44(1) Wft.

236 Malta and the UK also allow investment firms. Ireland does not allow this. See Malta: Art. 13(2)(e) Investment Services Act (custodians of collective investment schemes) Regulations 2016 and the UK: COLL 6.6A.8R(3)(b)(i).

237 Ireland: Art. 35 (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (S.I. No. 352 of 2011); Malta: Art. 13 Investment Services Act (CAP 370) (Custodians of Collective Investment Schemes) Regulations, 2016; UK: COLL 6.6.A8R.

238 Art. 35(2)(c) (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (S.I. No. 352 of 2011).

239 This is assessed by the Irish Central Bank. See Art. 35(2)(c)(iii) (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (S.I. No. 352 of 2011).

240 Art. 35(2)(c) (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (S.I. No. 352 of 2011). See for similar depositaries under the AIFMD: Art. 22(3)(iii) AIFM Regulations.

241 Art. 13(2)(d) Investment Services Act (CAP 370) (Custodians of Collective Investment Schemes) Regulations, 2016.

242 COLL 6.6.A8R(3)(b)(c)(ii).

243 See Art.40 and 42a Financial Services and Markets Act 2000; See also Art. 51ZB Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

244 Article 21(10) AIFMD; Art. 25(2) sub.para 1 UCITSD V.

The AIFMD and UCITSD V try to prevent conflicts of interest by requiring depositaries not to carry out activities with regard to the AIF/UCITS (or the AIFM/UCITS ManCo on behalf of the AIF/UCITS) that may create conflicts of interest between the AIF/UCITS, its investors, the relevant AIFM/UCITS ManCo and itself, unless the depositary has functionally and hierarchically separated its depositary tasks from its other potentially conflicting tasks.[245] The AIFMD and UCITD V impose a general duty on depositaries to identify, manage and ultimately disclose conflicts of interest to the investors of the AIF/UCITS.[246] This duty applies to depositaries in addition to the general requirement to act in the AIFs/UCITS and its investors' best interests. The duties referred to are in addition to the general duty of loyalty under the depositary contract, as well as the general duty of loyalty.[247]

4.3. The Third-Party Depositary Requirement

The AIFMD and UCITSD V, on top of the general duty of care and prevention of conflict of interests, require the depositary to be a 'third-party'. In order to avoid conflicts of interest between the depositary, the AIFM, AIF and its investors[248,] Article 21(4)(a) AIFMD requires that 'an AIFM shall not act as depositary'. Similarly, Article 25 UCITSD V sets out that 'no company shall act as both management company and depositary' and 'no company shall act as both investment company and depositary'. The reference to 'company' under the UCITSD V and the definition of 'AIFMs' under the AIFMD that requires an AIFM to be a legal person whose regular business is managing one or more AIFs'[249] seems to indicate that the AIFMD and UCITSD V require the depositary to be a separate legal entity from the AIFM/UCITS ManCo.[250] This can be explained by (1) the controlling tasks to the AIF and UCITS depositary and (2) the entities eligible as a depositary under the AIFMD and UCITSD V.

First, the AIFMD assigns controlling tasks to the AIF and UCITS depositary. For this reason, MiFID II does not require investors nor investment firms to appoint a third-party custodian. The difference can be explained by the collective investment nature of AIFs and UCITS as opposed to the individual investment nature under MiFID II. Investment firms that perform portfolio management or investment advice perform investment services/activities and ancillary services relate to individual portfolios.[251] The law demands individual investors to supervise the investment firm themselves by, for example, giving investment instructions or terminating their service agreement based upon the MiFID II information that is being provided to them. The collective investment nature of AIFs and UCITS implies that AIFMs and UCITS ManCos invest upon the behalf of multiple investors that are sharing 'pooled risks' as they are bound by the terms of a single legal form. The plurality of investors leads to investor passivity as a result of collective action problems.[252] Instead, the AIFMD and UCITSD V require the depositary to performing controlling tasks on behalf of the plurality of investors based upon the economic principle of 'cheapest cost avoider' efficiency.[253] Given

---

[245] Article 21(10) sub-para. 2 AIFMD; Art. 25(2) sub-para 2 UCITSD V.
[246] Article 21(10) sub-para. 2; Art. 25(2) sub-para 2 UCITSD V.
[247] Article 21(10) sub-para. 1 AIFMD; Art. 25(2) sub-para 1 UCITSD V.
[248] Art. 21(4) AIFMD.
[249] Art. 4(1)(b) AIFMD.
[250] D.A. Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 21 (Mohr Siebeck 2015).
[251] See for portfolio management: Art. 4(1) Nr. 8 MiFID II.
[252] M. Olsen, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Harvard University Press 1971) (describing that the free rider problem results in a disincentive to act because any shareholder may decide to save itself the cost of acting in the belief that other shareholders will do so); R. Hardin, *Collective action* (Routledge 1982).
[253] K.D. Logue & J.B. Slemrod, *Of Coase, Calabresi, and Optimal Tax Liability,* Law & Economics Working Papers Law & Economics Working Papers Archive: 2003-2009, University of Michigan Law School Year 2009,

the existence of transaction costs[254], the optimal legal solution is to assign the depositary to perform controlling tasks as the depositary is the party that is able to minimize negative externalities (or third-party harms), the sum of the cost of (preventing) accidents for the plurality of investors, most efficiently.[255] The depositary for the performing of the controlling tasks, thus, needs to be a separate legal entity from the AIFM and UCITS ManCo.[256]

Second, third-party depositary requirement can be explained by the entities eligible as a depositary under the AIFMD and UCITSD V. Investment firms are allowed to perform the safekeeping and administration of financial instruments for investors along their core investment services/activities.[257] Investment firms are merely subjected to client assets protection requirements and under MiFID II not required to establish a separate legal entity for performing the safekeeping and administration of financial instruments.[258] In contrary to AIFMs and UCITS ManCos under the AIFMD and UCITSD V, only credit institutions and investment firms may be authorized under MiFID II.[259] AIFMs nor UCITS ManCos are necessarily credit institutions or investment firms. A third-party depositary is, thus, required as credit institutions and investment firms as (1) they can safekeep all of the AIF and UCITS assets, (2) they are less prone to insolvency as they are both subjected to the CRR and have 'stronger balance sheets' than AIFMs and UCITS ManCos and (3) investment firms and credit institutions are generally accepted as CSDs participants allowing for effective segregation and protection of assets upon an insolvency of the AIFM/UCITS ManCo.[260]

To prevent conflicts of interests, the depositary needs to be a separate legal entity from the AIFM and UCITS ManCo.[261] Depositaries may, however, be independent or part of a financial conglomerate that might comprise AIFMs/UCITS ManCos, brokers and custodians. For this reason, the third-party depositary requirement is under the UCITSD V (Commission) Regulation complemented by additional 'independence requirements'. Various Member States require similar 'independence requirements' for their AIFs.[262]

4.4. Independence Requirements under UCITSD V

Despite the third-party depositary requirement, the independence of the management/investment company and the UCITS depositary can still be jeopardized by the existence of links related to the common management/supervision and cross-shareholdings/group inclusion between these parties.[263] For that purpose, Article 25(2)

3, http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1097&context=law_econ_archive (accessed 17 August 2016 2016); G. Calabresi, *The Costs of Accidents: A Legal and Economic Analysis (*Yale University Press 1970).

[254] R.H. Coase, *The Problem of Social Cost*, 3 Journal of Law and Economics 1 (1960).

[255] K.D. Logue & J.B. Slemrod, *Of Coase, Calabresi, and Optimal Tax Liability,* Law & Economics Working Papers Law & Economics Working Papers Archive: 2003-2009, University of Michigan Law School Year 2009, 3, http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1097&context=law_econ_archive (accessed 17 August 2016 2016).

[256] Art. 21(4)(a) AIFMD; Art. 25 UCITSD V.

[257] Annex I s. A MiFID I/II.

[258] Individual Member States may, however, require a separate legal entity to be established. See for the safekeeping company established by credit institutions in the Netherlands: Art. 4:87 Wet op het financieel toezicht; § 6.5 Regels met betrekking tot de bescherming van de rechten, financiële instrumenten of gelden van de cliënt (Arts 7:14-7:20) P. Rank, *Vermogensscheiding* (D. Busch & C.M. Grundmann-van de Krol, Kluwer 2009); See also P. Rank, *Vermogensscheiding* (D. Busch & C.M. Grundmann-van de Krol, Kluwer 2009).

[259] See for AIFMs: Arts 6 et seq. AIFMD; See for UCITS ManCos: Arts 6 et seq. UCITSD V.

[260] D. A. Zetzsche. Prinzipien der kollektiven Vermögensanlage § 21 (Mohr Siebeck 2015), 575.

[261] Art. 21(4)(a) AIFMD; Art. 25 UCITSD V.

[262] See for research conducted by ESMA in this regard: ESMA/2014/1417, ESMA/2014/1183.

[263] See Art. 26b UCITSD V; See also ESMA/2014/1183, 18; ESMA/2014/1417,

UCITSD V and Chapter 4 UCITSD V (Commission) Regulation[264] require, on top of the duty of loyalty and conflict of interest provisions, UCITS ManCos and the depositary to be independent in carrying out their respective functions.[265]

4.4.1. *Common Management/Supervision*

Upon introducing UCITSD V, the European Commission and ESMA considered that the independence of the depositary could be eroded if the management/investment company and the depositary, by means of executive power or supervision, could control the actions of each other.[266] For this reason, the management bodies of these entities should be kept separate.[267] UCITSD V has introduced limitations to the possibility for members of the body in charge of the supervisory functions of one of the entities to be also members of the management body, the body in charge of the supervisory functions or employees of the other entity. In particular:

– no person may at the same time be both a members of the management body of the management company (investment company) and a member of the management body of the depositary;[268]
– no person may at the same time be both a members of the management body of the management company (investment company) and an employee of the depositary;[269] and
– 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.[270]

Where the management body of the management company or depositary is not in charge of the supervisory functions, up to one-third of the members of the body in charge of the supervisory functions of the other entity may also be members of the management body, the body in charge of the supervisory functions or employees of that other entity.[271] For management company and depositaries that have a two-tier board structure[272] less stringent rules for the members of the body in charge of the supervisory functions applies.[273] The reason for introducing this less stringent regime for two-tier board structures is that for entities that have a two tier-board structure strong safeguards should already be in place at the level of the body carrying out the managerial function.[274]

4.4.2. *Cross-Shareholdings/Group Inclusion*

The European Commission and ESMA upon introducing UCITSD V considered that the independence of the management/investment company and the depositary could also be prejudiced if either of them could control the other by means of means of voting or if both are part of the same group.[275] To this end, the independence requirements under Chapter 4 UCITSD V (Commission) Regulation require measures and arrangements to be taken by the management company (investment company) and the depositary if these entities are having a (1) link or a (2) group link. The management company and the depositary are deemed to be

[264] These are not intended to replicate: Chapter III-Obligations regarding management companies and Chapter V-Obligations regarding investment companies, See ESMA/2014/1183, 17.
[265] See also ESMA/2014/1183, 17.
[266] ESMA/2014/1183, 18.
[267] See for the meaning of 'management body': Art. 2(1) UCITSD V.
[268] Art. 21(a) UCITSD V (Commission) Regulation; ESMA/2014/1183, 22.
[269] Art. 21(b) UCITSD V (Commission) Regulation; ESMA/2014/1183, 22.;
[270] Art. 12(c) UCITSD V (Commission) Regulation.
[271] Art. 21(d) and (e) UCITSD V (Commission) Regulation; ESMA/2014/1183, 22.
[272] See ESMA/2014/1183, 19.
[273] ESMA/2014/1183, 19.
[274] ESMA/2014/1183, 20.
[275] ESMA/2014/1183, 20.

'linked' if they are in a situation if either entity has by a direct or indirect holding of 10% or more capital or voting rights or which makes it possible to exercise a significant over the management of the undertaking in which that holding subsists.[276]Both are considered to be having a 'group link' if they are included in the same group under the Consolidated Accounts Directive, as defined in Directive 2013/34/EU, or in accordance with recognized international accounting rules.[277] Chapter 4 UCITSD V (Commission) Regulation imposes measures and arrangements to management companies and depositaries having a link or a group link (cross-shareholdings).[278] In addition, specific governance and organizational arrangements have to be put in place to UCITS ManCos and depositaries that are part of the same group to preserve the independence of both (group inclusion).[279]

The UCITS ManCo and the depositary that have a link or a group link are obliged to justify the choice of the depositary/sub-custodian and put in place conflict of interest policies to avoid conflict arising from the qualifying shareholding or group structure.[280] The UCITS ManCo shall put in place a decision-making process for appointing a depositary which is based upon objective pre-defined criteria and at the same time meets the exclusive interests of the UCITS and its investors.[281] ManCos appointing a depositary to which it has a link[282] or a group link[283] have to keep documentary evidence of:[284]

– an assessment comparing the merits of the appointment of a depositary with and without a cross-shareholding with the UCITS ManCo, taking into account the costs, expertise, financial standing and the quality of services provided by the depositaries assessed;[285]
– a report based upon the assessment describing the way in which the appointed depositary meets the objective pre-defined criteria and that the appointed is made in the sole interest of the UCITS and the investors of the UCITS.[286]

The UCITS ManCo has to demonstrate the competent authority of the UCITS home Member State that it is satisfied with the choice of the depositary and that the appointment is in the sole interest of the UCITS and its investors.[287] For this purpose, the UCITS ManCo shall make the documentary evidence available to the competent authority.[288] The UCITS ManCo also has to justify to investors the choice of the depositary upon request.[289] Finally, the depositary has to have a decision-making process in place for choosing sub-custodians to whom it may delegate safekeeping functions[290] that is also based upon objective pre-defined criteria that meet the sole interest of the UCITS and its investors.

UCITS ManCos and depositaries that are either having a link or group link are require to ensure[291] that they identify all conflicts of interest arising from that link[292] and that they take

[276] Art. 1(a) UCITSD V (Commission) Regulation; The definition of link is based upon the definition of 'qualifying holding' in Art. 2(1)(j) UCITSD V; See ESMA/2014/1183, 20.
[277] Art. 1(b) UCITSD V (Commission) Regulation; ESMA/2014/1183, 20-21.
[278] See Art. 22 and 23 UCITSD V (Commission) Regulation.
[279] See Art. 24 UCITSD V (Commission) Regulation.
[280] ESMA/2014/1183, 23.
[281] Article 22(1) UCITSD V (Commission) Regulation; ESMA/2014/1183, 23.
[282] Art. 1(a) UCITSD V (Commission) Regulation.
[283] Art. 1(b) UCITSD V (Commission) Regulation.
[284] Art.22(2) UCITSD V (Commission) Regulation.
[285] Art.22(2)(a) UCITSD V (Commission) Regulation.
[286] Art.22(2)(b) UCITSD V (Commission) Regulation.
[287] Art.22(3) UCITSD V (Commission) Regulation.
[288] Art.22(3) UCITSD V (Commission) Regulation.
[289] Art.22(4) UCITSD V (Commission) Regulation.
[290] Safekeeping functions are being referred to the functions as set out in Article 22a UCITSD V.
[291]Article 23 sub-para. 1 UCITSD V (Commission) Regulation.

all reasonable steps to avoid those conflicts of interest[293].Where conflicts of interest, however, cannot be avoided, the UCITS ManCo and depositary are required to manage, monitor and disclose that conflict of interest in order to prevent adverse effects on the interests of the UCTIS and of the investors of the UCITS.[294]

For group structures consisting of both the management and the depositary additional arrangements should be put in place. The management bodies of UCITS ManCos and depositaries of one-tier structures are required to have at least one-third of the members management body or two persons, whichever is lower, to be independent that are in charge of the supervisory functions of the above companies on the management body.[295] The management bodies of UCITS ManCos and depositaries of two-tier structures shall the same amount of independent members on the body in charge of the supervisory functions with the management company and depositary.[296] Independence within the group structure, for this purpose, is understood as requiring that independent directors may not be member of the management body, the supervisory body nor employees of any of the undertakings within the group.[297] Nor may they have any of those functions in the undertakings between which a group link exists and should the members be free of any business, family or other relationship with the UCITS ManCo and depositary or any other undertaking within the group that gives rise to a conflict of interest.[298] The independence requirement for management boards and supervisory functions is put in place as to prevent an impaired judgment of its members.[299]

UCITSD V, thus, complements the third-party depositary requirement that targets the independence of the management/investment company and the UCITS depositary, whereas equivalent measures are being left up to the Member States under the AIFMD.[300]

5. AIFMD Third-Country Depositaries

5.1. Additional Requirements for Third-Country Depositaries

The AIFMD extends the European 'mutual recognition' approach to TC-AIFs and TC-AIFMs that are willing to benefit from a European passport within the EEA. The appointment of a depositary established in a third country is subject to the following requirements:

– cooperation and exchange of information agreements must be concluded between: (1) the supervisory authority of the depositary, and (2) the supervisory authorities of the AIFM, and (3) all the supervisory authorities of the Member State in which the AIFM intends to market its AIFs;[301]
– the third country where the depositary is established must not be listed as a non-cooperative country and territory by the Financial Action Task Force (FATF);[302]
– tax information exchange arrangements complying with Article 26 of the OECD Model Tax Convention must be in place between: (1) the country in which the depositary is established;

[292] Article 23 sub-para. 1(a) UCITSD V (Commission) Regulation.
[293] Article 23 sub-para. 1(b) UCITSD V (Commission) Regulation.
[294] See also for the general conflict of interest duty: Article 25(2) UCITSD V.
[295] Article 24(1)(a) UCITSD V (Commission) Regulation.
[296] Article 24(1)(b) UCITSD V (Commission) Regulation.
[297] ESMA/2014/1183, 24.
[298] Art. 24(2) UCITSD V (Commission) Regulation.
[299] Art. 24(2) UCITSD V (Commission) Regulation.
[300] See Art. 26b UCITSD V; See also ESMA/2014/1183, 18.
[301]. Art. 21(6)(a) AIFMD.
[302]. Art. 21(6)(c) AIFMD.

(2) the AIFM home Member State and (3) all Member States in which the AIF is intended to be marketed;[303]

– the depositary is subject to 'effectively enforced' prudential regulation (including minimum capital requirements) and supervision which have the same effect as EU law;[304]
– the depositary must contractually subject itself to the AIFMD depositary liability regime and commit itself to comply with the AIFMD rules on delegation duties and appointment of sub-custodians.[305]

5.2. The Third-Country Depositary and 'Effective Prudential Regulation'

Pursuant to Article 21(6)(b) AIFMD, the depositary must be subject to 'effectively enforced' prudential regulation (including minimum capital requirements) and 'supervision equivalent' to that applicable under EEA law.

5.2.1. *Effectively Enforced Prudential Regulation*

The AIFMD (Commission) Regulation sets out that prudential regulation, supervision and its effective enforcement shall be assessed against the following criteria:[306]

– the depositary has to be subject to authorization and ongoing supervision by a public Competent Authority with adequate resources to fulfil its tasks.[307]
– the law of the third country shall set out criteria for authorization as a depositary that have the same effect as those set out for the access to the business of credit institutions or investment firms within the European Union.[308]
– the capital requirements imposed on the depositary in the third country shall have the same effect as those applicable in the European Union, depending on whether the depositary is of the same nature as an EU credit institution or investment firm.[309]
– the operating conditions applicable to a depositary in the third country have the same effect as those set out for credit institutions or investment firms within the European Union, depending on the nature of the depositary.[310]
– the requirements regarding the performance of the specific duties as AIF depositary established in the law of the third country shall have the same effect as those provided for in Article 21(7)–(15) AIFMD and its implementing measures and the relevant national laws.[311]
– the law of the third country shall provide for the application of sufficiently dissuasive enforcement actions in case of breach by the depositary of the requirements of the AIFMD and its implementing measures.[312]

The assessment of whether there is 'supervision which has the same effect as Union law' should be made by comparing: (1) the authorization criteria, and (2) the ongoing operating conditions (including capital requirements) applicable to the third-country depositary against the corresponding requirements that the AIFMD imposes on credit institutions or investment firms within the EEA for authorization.[313]

---

303. Art. 21(6)(d) AIFMD.
304. Art. 21(6)(b) AIFMD.
305. Art. 21(6)(e) AIFMD.
306. Art. 84 AIFMD (Commission) Regulation.
307. Art. 84(a) AIFMD (Commission) Regulation.
308. Art. 84(b) AIFMD (Commission) Regulation.
309. Art. 84(c) AIFMD (Commission) Regulation.
310. Art. 84(d) AIFMD (Commission) Regulation.
311. Art. 84(e) AIFMD (Commission) Regulation.
312. Art. 84(f) AIFMD (Commission) Regulation.
313. Recital 96 AIFMD (Commission) Regulation.

Under third-country legislation, other entities comparable to EEA credit institutions or investment firms are eligible. In that case, such entities must also be subject to prudential oversight and be licensed under a local category, whereas those local criteria should have the same effect as those for credit institutions or investment firms under the AIFMD.[314]

5.2.2. *'Supervision Equivalent' to That Applicable under EEA Law*

This equivalence with the AIFMD can only be achieved if the depositary established in a third country is subject to prudential supervision performed by a 'Competent Authority'. The exact nature of a Competent Authority is not clarified by the AIFMD (Commission) Regulation. According to ESMA's Final Report, this can be understood as oversight by a public authority that can 'effectively enforce' a depositary established in a third country to comply with the third country's prudential regulation.[315] A third-country authority is considered to be competent if it is compliant with Part II ('The Regulator') of the IOSCO Objectives and Principles for Securities Regulation[316] and relevant methodology,[317] and the Basel Committee Core Principles[318] and its relevant methodology.[319] However, according to ESMA, this does not imply that the authority itself needs to be a member of this organization.[320] The oversight of the third country should merely mean being able to 'effectively enforce' its prudential regulation, meaning that the third-country authority should, at least, have the power to request information, intervene and sanction the depositary as regards to the relevant requirements under its domestic legislation.[321]

6. The Depositary and Its Functions

Since the creation of the UCITS framework,[322] depositaries are one of the three fundamental pillars of European collective investment law, alongside the fund (the joint investors) and its manager.[323] Upon the introduction of the AIFMD, both AIFMs and UCITS ManCos are required to ensure that a single depositary is appointed for each AIF/UCITS they manage. The AIFMD, thus, extended the tripartite structure which may be called the 'investment triangle'[324] to AIFs.[325] The question of how a depositary relationship is established under the

---

314. Recital 95, 96 AIFMD (Commission) Regulation. See also ESMA/2011/379, 145–146.
315. ESMA/2011/379, 145.
316. IOSCO, *Objectives and Principles of Securities Regulation*, Part II 'The Regulator' (2003).
317. IOSCO, *Methodology – For Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation*, FR 08/11, (2011).
318. Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision* (2006). In December 2011 a revised version was issued for consultation.
319. Basel Committee on Banking Supervision, *Core Principles Methodology* (2006).
320. ESMA/2011/379, 145.
321. *Ibid*, 144–145.
322. Directive 85/611/EEC.
323. Arts 22 et seq. UCITSD V; Art. 21 AIFMD; Art. 13(7) and (8) MiFID and Arts 16–19 MiFID I (Commission) Regulation/ Art. 16(8)-(10) MiFID II and Arts 2-8 MiFID II (Commission) Regulation; Arts 8 and 19(2) IORPD/Art. 35 IORPD II (it is within the discretion of the Member States to decide whether the appointment of a depositary/custodian is being made compulsory). See D.A., Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* (D.A. Zetzsche ed, Kluwer 2015).
324. K. Ohl, *Die Rechtsbeziehungen innerhalb des Investment-Dreiecks* (1989); D.A. Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 21 (Mohr Siebeck 2015); D.A. Zetzsche. *Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?*, in *Financial Markets in Transition* 337 (Birkmose et al. eds, Kluwer Law 2012); N. Seegebarth. *Stellung und Haftung der Depotbank im Investment-Dreieck* (2004).
325. See D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* (D.A. Zetzsche ed, Kluwer 2015).

AIFMD and UCITSD V will now be addressed, and the particulars of the depositary's safekeeping and control function will then be discussed.

6.1. The Particulars of the Written Contract

The AIFM and UCITS ManCo must ensure that a depositary is appointed for each AIF/UCITS it manages.[326] The AIFMD and UCITSD V require that each AIF/UCITS must have one single depositary, meaning that the functions of a depositary (safekeeping and control) must be carried out by one and the same entity.[327]

The evidenced written contract appointing the depositary shall be drawn up between the depositary on the one, and the AIFM/UCITS ManCo and/or the AIF/UCITS or other entity acting on behalf of the AIF/UCITS, on the other hand.[328] In particular, the written contract regulates the flow of information, which is necessary for a depositary and its sub-custodians to appropriately perform its safekeeping, as well as for the proper compliance of the depositary's oversight functions[329] with relevant laws, regulations or administrative provisions.[330] It is possible for the AIFM/UCITS ManCo and the depositary to enter into a framework agreement that applies to several AIFs/UCITS managed by that AIFM/UCITS ManCo, unless otherwise provided by relevant national laws.[331]

The specific rights and obligations that are required to be set out in the written contract can be found in the AIFMD and UCITSD V (Commission) Regulation.[332]

6.1.1. *Eligible Assets*

The depositary contract has to contain a description of the depositary services and the particular procedures to be adopted for each type of asset in which the AIF/UCITS is allowed to invest.[333] In order to allow the depositary to assess and monitor custody risk, the contract shall provide a description of the assets in which the AIF/UCITS can invest so that the depositary knows upon its appointment what procedures it shall set up to allow the appropriate safekeeping of the assets of the AIF/UCITS as well as procedures for the oversight functions that the depositary will exercise over them.[334] With respect to custody duties, the description of the categories of assets shall not necessarily contain all assets and sub-categories of financial instruments to be subject to safekeeping.[335] It must, however, include country lists, as well as procedures for adding and withdrawing countries from the list so that the depositary can assess and monitor custody risks.[336] This shall be consistent with the information provided in the AIF/UCITS rules, instruments of incorporation and offering documents regarding the assets in which the AIF/UCITS may invest.[337]

---

326. Art. 21(1) AIFMD; Art. 22(1) UCITSD V.
327 Article 21(1) AIFMD; Art. 22(1) UCITSD V.
328. Art. 21(2) AIFMD; Art. 22(2) UCITSD V.
329. Recital 94 AIFMD (Commission) Regulation; Recital 20 UCITSD V (Commission) Regulation.
330. Art. 83(6) AIFMD (Commission) Regulation and Art. 2(5) UCITSD V (Commission) Regulation require the national laws applicable to the contract appointing the depositary and any subsequent agreements to be specified. Although this contract might contain confidentiality obligations applicable to the parties that signed the depositary contract, this shall not impair the ability of the relevant Competent Authorities to have access to all relevant documents and information related to the depositary contract.
331. Art. 83(5) AIFMD (Commission) Regulation; Art. 2(4) UCITSD V (Commission) Regulation.
332 Article 83 AIFMD (Commission) Regulation; Art. 2 UCITSD V (Commission) Regulation.
333. ESMA/2011/379, 142.
334. *Ibid.*
335. *Ibid.*
336. Art. 83(1)(b) AIFMD (Commission) Regulation; Art. 2(2)(b) UCITSD V (Commission) Regulation.
337. *Ibid.*

6.1.2. *Flow of Information*

The core aim of the depositary contract is, amongst other things, to regulate the flow of information.[338] In particular, the AIFM/UCITS ManCo is required[339] to ensure that the depositary receives all information it needs to perform its safekeeping[340] and oversight duties,[341] including information to be provided directly by third parties, such as prime brokers and third parties where bank accounts have been opened in the name of the AIF/UCITS or the AIFM/UCITS ManCo acting on behalf of the AIF/UCITS.[342] The depositary can check the quality of the information provided by enquiring into the conduct of the AIFM/UCITS ManCo and/or the AIF/UCITS, by accessing the books of the AIF/UCITS and/or AIFM/UCITS ManCo, or by way of on-site visits.[343] On the other hand, procedures have to be established that ensure that the AIFM/UCITS ManCo and/or the AIF/UCITS can review the performance of the depositary with regard to its duties.[344]

6.1.3. *Escalation Procedure*

Details of escalation procedures shall be included in the depositary contract.[345] For example, the depositary has the obligation to alert the AIFM/UCITS ManCo if it has identified any material risk in a particular market's settlement system.[346] This includes the identification of the persons to be contacted within the AIF/UCITS and/or the AIFM/UCITS ManCo by the depositary when it launches such a procedure.[347]

6.1.4. *Third Parties*

The contract must take into account the details of, and steps taken to monitor, sub-custodians.

---

338. The contract does, for instance, also contain elements on information on the obligations related to the prevention of money laundering and the financing of terrorism (Art. 83(1)(m) AIFMD(Commission) Regulation; Art. 2(2)(k) UCITSD V (Commission) Regulation)) and the procedures to be followed when a modification to the AIF rules, instruments of incorporation or offering documents is considered (Art. 83(1)(i) AIFMD(Commission) Regulation; Art. 2(2)(g) UCITSD V (Commission) Regulation)).

339. Art. 83(1)(g) AIFMD (Commission) Regulation and Art. 2(2)(f) UCITSD V (Commission) Regulation set out that the contract shall include the means and procedures by which the AIFM/UCITS ManCo or the AIF/UCITS will transmit all relevant information or will ensure that the depositary has access to all the information it needs to fulfil its duties, including ensuring that the depositary will receive information from any relevant third parties appointed by the AIF/UCITS or the AIFM/UCITS ManCo.

340. See Art. 83(1)(b) AIFMD (Commission) Regulation and Art. 2(2)(b) UCITSD V (Commission) Regulation. See Art. 83(1)(h) AIFMD (Commission) Regulation and for the obligation to whether the depositary and its sub-custodians to which it has delegated safekeeping function is allowed or not to reuse the AIF's assets and, where relevant, the conditions related to the potential reuse. See also the obligation of the depositary under Art. 83(1)(p) AIFMD (Commission) Regulation and Art. 2(2)(n) UCITSD V (Commission) Regulation to notify the AIFM/UCITS ManCo when the segregation of assets is not or no longer sufficient to protect assets from insolvency of a sub-custodian to whom assets have been delegated.

341. See on necessary information to be exchanged between the AIF/UCITS, AIF/UCITS and a third party acting on behalf of the AIFM/UCITS ManCo, AIF/UCITS or the depositary upon subscriptions/redemptions Art. 83(1)(j) AIFMD (Commission) Regulation and Art. 2(2)(h) UCITSD V (Commission) Regulation, upon the AIFM's/UCITS ManCo's instructions Art. 83(1)(k) AIFMD (Commission) Regulation and Art. 2(2)(i) UCITSD V (Commission) Regulation, and upon exercising any rights attached to assets Art. 83(1)(f) AIFMD (Commission) Regulation and Art. 2(2)(e) UCITSD V (Commission) Regulation.

342. See Art. 83(1)(f) and Art. 83(1)(n) AIFMD (Commission) Regulation; Art. 2(2)(e) and Art. 2(2)(l) UCITSD V (Commission) Regulation,

343. Art. 83(1)(q) AIFMD (Commission) Regulation; Art. 2(2)(o) UCITSD V (Commission) Regulation.

344. Art. 83(1)(r) AIFMD (Commission) Regulation; Art. 2(2)(p) UCITSD V (Commission) Regulation.

345. Art. 83(1)(o) AIFMD (Commission) Regulation; Art. 2(2)(m) UCITSD V (Commission) Regulation.

346. Recital 94 AIFMD (Commission) Regulation; Recital 2 UCITSD V (Commission) Regulation.

347. Art. 83(1)(o) AIFMD (Commission) Regulation; Art. 2(2)(m) UCITSD V (Commission) Regulation.

Depositary contracts concluded by both AIFMs and UCITS ManCo contains provisions that the depositary, AIF/UCITS and relevant AIFM/UCITS ManCo exchange information on a regular basis and, upon request, information on the criteria used to select third parties and the steps undertaken to monitor the activities carried out by the selected third party. In addition, the depositary contract concluded by AIFMs includes a statement that the depositary's liability is not affected by any delegation of its custody functions, unless it has discharged itself contractually of its liability in accordance with Article 21(13) and (14) AIFMD. In particular, the contract has to set out in detail the conditions under which the depositary can transfer its liability to a sub-custodian.

6.1.5. *Termination of the Contract*

The contract should include situations which could lead to the termination of the contract as well as details regarding the termination procedure.[348] Following the depositary's liability regime with regard to the custody of assets, this would be the ultimate recourse for the depositary if it is not satisfied with how assets are protected.[349] This possibility should prevent moral hazards whereby AIFMs/UCITS ManCos make investment decisions irrespective of custody risks on the basis that the depositary would be liable in these cases.[350]

By using the principles-based approach and not providing a model agreement, there seems to be a balance between, on the one hand, ensuring the flow of information that a depositary needs to fulfil its safekeeping and oversight functions and, on the other hand, sufficient freedom for the industry to adapt their contracts to a wide range of AIFs/UCITS, investment strategies and different national legal frameworks.

6.2. Safekeeping

Safekeeping the assets of an AIF/UCITS is the *raison d'être* of a depositary. The AIFMD and UCITSD V seek to clarify the understanding of this safekeeping duty by making reference to the type of assets held by the AIF/UCITS. In doing so, it makes a distinction between 'financial instruments that can be held in custody', on the one hand, and 'other assets', including financial instruments that cannot be held in custody, on the other.

6.2.1. *Financial Instruments That Should Be Held in Custody*

Depending on the type of assets, the depositary's safekeeping functions can take the form of custody, for financial instruments that can be held in custody, or record keeping for other assets.[351] According to the AIFMD and UCITSD V, the depositary shall hold in custody all *financial instruments* that:[352]

- can be registered in a financial instruments account opened in the depositary's book; and
- can be physically delivered to the depositary.

Financial instruments, which cannot be physically delivered to the depositary, fall within the scope of the depositary's custody obligation when they are either: (1) transferable securities, or (2) capable of being registered or held in an account directly or indirectly in the name of the depositary. The definition of transferable securities includes certain types of

348. Art. 83(1)(d) AIFMD (Commission) Regulation; Art. 2(2)(c) UCITSD V (Commission) Regulation.
349. Recital 94 AIFMD (Commission) Regulation; Recital 2 UCITSD V (Commission) Regulation.
350. *Ibid.*
351. Art. 21(8)(b) AIFMD; Art. 22(5)(b) UCITSD V.
352 Article 21(8)(a); Art. 22(5)(a) UCITSD V.

derivatives,[353] money market instruments and units of collective investment undertakings.[354] The definition is broad and captures certain instruments, such as derivatives, in Annex I, Section C of MiFID that were in some jurisdictions traditionally not being considered as assets to be held in custody.[355] Beyond the AIFMD and UCITSD V (Commission) Regulation, the EMIR[356] provides a list of derivatives that have to be cleared via central counterparties.[357] This list has brought more legal certainty as to what types of financial instruments are considered to be transferable securities and, thus, fall within the scope of the depositary's custody obligation.[358] The custody obligation includes financial instruments that are provided to a third party, or by a third party to the AIF/UCITS as collateral, as long as they are owned by the AIF/AIFM or UCITS/UCITS ManCo on behalf of the AIF/UCITS.[359] This is also valid for financial instruments for which the AIFM/UCITS ManCo has given its consent to the depositary to reuse as long as the right of reuse has not been exercised.[360]

The definition of financial instruments is designed to capture all financial instruments the depositary is in a position to control and retrieve. Following the AIFMD and UCITSD V (Commission) Regulation[361], this excludes all securities that are directly registered with the issuer itself or its agent (i.e., a registrar or a transfer agent) in the name of the AIF/UCITS, except in the situation where financial instruments can be physically delivered to the depositary[362] or are registered/held in an account directly or indirectly in the name of the depositary (through a subsidiary or sub-custodian).[363]

Financial instruments that can be held in custody fall within the scope of the depositary liability regime that is defined by the AIFMD and UCITSD V which obliges depositaries to return the financial instrument or an identical type or the corresponding amount in case of a loss of a financial instrument held in custody by the depositary.[364] This liability is clearly linked to assets for which only the depositary can instruct a transfer, including where it is the registered owner in the issuer's register.[365] Instruments that do not comply with the requirements above for satisfying the definition of 'financial instruments' should be considered to be 'other assets' within the meaning of the AIFMD/UCITSD V and are subject to record keeping duties.[366]

6.2.2. *Safekeeping Duties with Regard to Assets Held in Custody*

---

353. These derivatives have to be in accordance with Art. 51(3) UCITS IV and Art. 10 EAD. See Art. 88(1)(a) AIFMD (Commission) Regulation and Art. 12(1)(a) UCITSD V (Commission) Regulation.
354. Art. 88(1)(a) AIFMD (Commission) Regulation and Art. 12(1)(a) UCITSD V (Commission) Regulation.; See on the status of derivate contracts and holdings in collective investment undertakings: ESMA/2015/850, 22.
355. ESMA/2011/379, 157.
356. See, in particular: Art. 6 EMIR.
357. Art. 88(1) AIFMD (Commission) Regulation; Art. 12(1) UCITSD V (Commission) Regulation.
358. *Ibid*.
359. Recital 100 AIFMD (Commission) Regulation; Recital 12 UCITSD V (Commission) Regulation.
360. In contrast to ESMA/2011/379, 158, the final text of Art. 88 AIFMD (Commission) Regulation and Art. 12 UCITSD V (Commission) Regulation brings more uncertainty with respect to the issue of collateral provided by the AIF or AIFM on behalf of the AIF.
361 Recital 100 AIFMD (Commission) Regulation; Recital 12 UCITSD V (Commission) Regulation.
362. Art. 88(3) AIFMD (Commission) Regulation; Art. 12(3)UCITSD V (Commission) Regulation
363. Art. 88(1)(b) AIFMD (Commission) Regulation; Art. 12(1)(b) UCITSD V (Commission) Regulation
364. See C. Clerc, *The AIF Depositary's Liability for Lost Assets* (D.A. Zetzsche ed, Kluwer 2015).
364. Art. 21(12) AIFMD; Art. 24 UCITSD V.
365. See explanation ESMA/2011/379, 157.
366 Art. 21(8)(b) AIFMD; Art. 22(5)(b) UCITSD V.

Financial instruments that can be held in custody include transferable securities, money market instruments and units in collective investment undertakings.[367] Financial instruments held in custody should be subject to due care and protection at all times.[368] The meaning of 'due care' is clarified in the AIFMD and UCITSD V (Commission) Regulation.[369] This obligation requires the depositary to ensure that custody risk is properly assessed. In doing so, 'due care' obliges the depositary to know which custodians are a part of the custodian chain. In order to comply with this obligation, the AIFMD and UCITSD (Commission) Regulation require the depositary to ensure that:[370]

– financial instruments shall be properly registered in a segregated financial instruments account;[371]
– its sub-custodians maintain records and segregated accounts for cash and financial instruments held for AIFs/UCITS;[372]
– it regularly reconciles the internal accounts and records of the depositary and the sub-custodian;[373]
– due care is exercised and all relevant custody risks throughout the custody chain are monitored;[374]
– custody risks throughout the custody chain are assessed and monitored and material risks reported to the AIFM/UCITS ManCo;[375]
– adequate organizational arrangements are introduced to minimize the risk of the loss, diminution of financial instruments, or the rights in connection with those financial instruments;[376]
– the AIF's/UCITS' ownership right over the assets or of the AIFM/UCITS ManCo acting on behalf of the AIF/UCITS are verified.[377]

The depositary has to ensure that financial instruments are subject to due care and protection at all times.[378] To that extent, the depositary has to properly assess the custody risk throughout the custody chain.[379] In exercising due care, the depositary identifies all sub-custodians, ensures that due diligence and segregation obligations are maintained throughout the custody chain and that it has access to the books and records of third parties to whom custody functions have been delegated.[380]

In order to avoid circumvention of these strict requirements, the AIFMD (Commission) Regulation requires a 'look-through approach' regarding the depositary's safekeeping duties.[381] This implies that whenever the AIF has set up a legal structure between itself and

367. See Annex I, s. C Financial Instruments MiFID. Please note that not all financial instruments within Annex I, s. C are financial instruments that can be held in custody under Art. 21(8) AIFMD and Art. 22(5) UCITSD V. By contrast, assets that cannot be held in custody are: real estate, physical assets (gold, coal), non-tradeable partnership shares and ships.
368. Art. 89 AIFMD (Commission) Regulation; Art. 13 UCITSD V (Commission) Regulation.
369 Recital 101 AIFMD (Commission) Regulation; Recital 13 UCITSD V (Commission) Regulation.
370 Article 89 AIFMD (Commission) Regulation; Art. 13 UCITSD V (Commission) Regulation.
371. Art. 89(1)(a) AIFMD (Commission) Regulation; Art. 13(1)(a) UCITSD V (Commission) Regulation.
372. Art. 89(1)(b) AIFMD (Commission) Regulation; Art. 13(1)(b) UCITSD V (Commission) Regulation.
373. Art. 89(1)(c) AIFMD (Commission) Regulation; Art. 13(1)(c) UCITSD V (Commission) Regulation.
374. Art. 89(1)(d) AIFMD (Commission) Regulation; Art. 13(1)(d) UCITSD V (Commission) Regulation.
375. Art. 89(1)(e) AIFMD (Commission) Regulation; Art. 13(1)(e) UCITSD V (Commission) Regulation.
376. Art. 89(1)(f) AIFMD (Commission) Regulation; Art. 13(1)(f) UCITSD V (Commission) Regulation.
377. Art. 89(1)(g) AIFMD (Commission) Regulation; Art. 13(1)(g) UCITSD V (Commission) Regulation.
378. Recital 101, Art. 89(2) AIFMD (Commission) Regulation; Recital 13, Art. 13(2) UCITSD V (Commission) Regulation.
379. *Ibid.*
380. Art. 89(2) AIFMD (Commission) Regulation; Art. 13(2) UCITSD V (Commission) Regulation
381 Article 89(3) AIFMD (Commission) Regulation.

the assets in which it wishes to invest, the depositary must apply the abovementioned safekeeping rules to the underlying assets of financial and/or legal structures that are controlled directly or indirectly by the AIF or the AIFM acting on behalf of the AIF.[382] The UCITSD V (Commission) Regulation does not require a similar 'look-through approach' regarding the UCITS depositary's safekeeping duties.[383]

6.2.2.1. Insolvency Protection UCITS Assets

Article 22(8) UCITSD V requires Member States to ensure that in the event of an insolvency of the depositary and or sub-custodian located in the EEA to which custody of UCITS assets has been delegated, the assets of a UCITS held in custody shall be unavailable for distribution among, or the realization for the benefit of, creditors of such a depositary/sub-custodian.[384]

6.2.3. *'Other Assets'*

All assets that do not fall under the definition of financial instruments constitute 'other assets'.[385] These include:

- physical assets (non-financial assets) that do not qualify as financial instruments or cannot be physically delivered to the depositary (e.g., real estate, commodities, ships);
- financial instruments which can neither be held in book entry form nor be physically delivered to the depositary (e.g., financial contracts), such as (OTC) derivatives other than those embedded in the transferable securities definition within Article 21(8)(a) AIFMD and Article 22(5)(a) UCITSD V, in particular, derivatives are other assets which are important for prime broker settings;[386]
- cash deposits;[387]
- financial instruments issued in nominative form and registered with an issuer or a registrar.[388]

The last category refers to assets which are not intermediated and where the ownership derives from direct registration in the register held by the issuer itself (or a registrar agent acting on its behalf). Examples include investments in privately held companies, or participation interest in funds with a capital call structure, such as real estate or private equity funds. Also assets of the AIF/UCITS provided as collateral in general will be subject to safekeeping duties related to 'other assets'.[389]

The depositary should have a comprehensive overview of all assets that are not financial instruments to be held in custody.[390] These assets are subject to the obligation of the depositary to verify that the relevant 'other assets' effectively belong to the AIF/UCITS itself or to the AIFM/UCITS ManCo acting on behalf of the AIF/UCITS ManCo.[391] The ownership verification must be based on information or documents provided by the AIF/UCITS or the AIFM/UCITS ManCo and, where available, external evidence.[392] External evidence could be a copy of an official document showing that the AIF/UCITS is the owner of the asset(s) or

---

382. See Recital 102 AIFMD (Commission) Regulation and ESMA/2011/379, 160.
383 See Article 13 UCITSD (Commission) Regulation.
384 Art. 22(8) UCITSD V. See also *infra* 7.3.3. for extra requirements preserving insolvency protection on the sub-custodian level for UCITS assets.
385. Art. 21(8)(b) AIFMD; Art. 22(5)(b) UCITSD V.
386. See D.A. Zetzsche, *(Prime) Brokerage* (D.A. Zetzsche ed, Kluwer 2015).
387. Recital 103 AIFMD (Commission) Regulation and Recital 14 UCITSD V (Commission) Regulation. See also ESMA/2011/379, 161.
388. See Art. 88(2) AIFMD (Commission) Regulation and Art. 12(2) UCITSD V (Commission) Regulation.
389. ESMA/2011/379, 162.
390. Financial instruments within the meaning of Art. 21(8)(a) AIFMD and Art. 22(5)(a) UCITSD V.
391. Art. 21(8)(b) AIFMD; Art. 22(5)(b) UCITSD V.
392. Art. 21(8)(b)(ii) and (iii) AIFMD; Art. 22(5)(b)(i) and (ii) UCITSD V.

any formal and reliable evidence that the depositary considers appropriate.[393] If necessary, the depositary should request additional evidence from the AIF/UCITS or AIFM/UCITS ManCo or, as the case may be, from a third party.[394] A broad range of evidence could potentially prove ownership.[395] The parameters of the verification obligation are, however, uncertain. The official document clarifies whether this obligation covers both the legal and equitable or beneficial title. The verification obligation of the depositary is also unclear insofar as, for instance, the enforceability of derivatives or share borrowing contractual arrangements are concerned. A record of those assets shall be maintained and regularly updated.[396]

6.2.4. *Safekeeping Duties regarding Ownership Verification and Record Keeping*

For 'other assets', the AIFM/UCITS ManCo is obliged to provide the depositary on an ongoing basis with all relevant information that the depositary needs to comply with its obligations.[397] In doing so, it ensures that the depositary is also provided with all relevant information by any third parties.[398] In order for a depositary to comply with ownership verification and record keeping duties it shall meet the following requirements:[399]

– it shall access without undue delay the relevant information it needs to perform its ownership verification and record keeping duties, including information to be provided by third parties;[400]
– it shall make sure it possesses sufficient and reliable information to satisfy the AIF/AIFM's and UCITS/UCITS Manco's ownership rights over the AIF's/UCITS' assets;[401]
– it shall maintain a record of the assets of which the AIF holds the ownership and it shall: (1) register in its record the name of the AIF's/UCITS' assets[402], (2) be able to provide at any time a comprehensive and up-to-date inventory of a AIF's/UCITS' assets.[403]

To that end, the depositary has to ensure that:[404]

– the procedures are in place so that assets registered cannot be assigned, transferred, exchanged or delivered without the depositary or its delegate being informed of such transactions; or
– it has access without undue delay to documentary evidence of each transaction and positions of relevant third parties.

Regarding the last requirement, AIFMs/UCITS ManCos are obliged to ascertain that relevant third parties provide depositaries with certificates or other documentary evidence without undue delay every time there is a sale, acquisition of assets or a corporate action resulting in the issue of financial instruments. This must happen at least once a year.

---

393. Recital 104 AIFMD (Commission) Regulation. See also ESMA/2011/379, 162.
394. *Ibid.*
395. *Ibid.*
396. Art. 21 (8)(b)(i) AIFMD; Art. 22(5)(b)(i) UCITSD V; Recital 105 AIFMD (Commission) Regulation and Recital 16 UCITSD V (Commission) Regulation.
397. Art. 90(1) AIFMD (Commission) Regulation and Art. 14(1) UCITSD V (Commission) Regulation.
398. *Ibid.*
399. Art. 90(2) AIFMD (Commission) Regulation and Art. 14(2) UCITSD V (Commission) Regulation.
400. Art. 90(2)(a) AIFMD (Commission) Regulation and Art. 14(2)(a) UCITSD V (Commission) Regulation.
401. Art. 90(2)(b) AIFMD (Commission) Regulation and Art. 14(2)(b) UCITSD V (Commission) Regulation.
402. Art. 90(2)(c)(i) AIFMD (Commission) Regulation and Art. 14(2)(c)(i) UCITSD V (Commission) Regulation.
403. Art. 90(2)(c)(ii) AIFMD (Commission) Regulation and Art. 14(2)(c)(ii) UCITSD V (Commission) Regulation.
404. Art. 90(2)(c) sub-para. 2 AIFMD (Commission) Regulation and Art. 14(2)(c) sub-para. 2 UCITSD V (Commission) Regulation.

Depositaries have to ensure that AIFMs/UCITS ManCos implement the appropriate procedures to verify that the assets being acquired by the AIF/UCITS are appropriately registered in the name of the AIF/UCITS or AIFM/UCITS ManCo acting on behalf of the AIF/UCITS. The depositary's duty is to check consistency between the positions in the AIFM's records and assets for which the depositary has satisfied that the AIF/UCITS or the AIFM/UCITS ManCo has ownership. In addition, the AIFM/UCITS ManCo has to send all instructions and relevant information related to the AIF's/UCITS' assets to the depositary so that the depositary can carry out its own verification or reconciliation procedure.[405]

If an anomaly is detected, depositaries shall set up and implement an escalation procedure. This procedure shall include a notification of the AIFM/UCITS ManCo, and, if the situation cannot be clarified, to the Competent Authority.[406]

Equivalent to the safekeeping requirements for assets to be held in custody, the AIFMD (Commission) Regulation applies a 'look-through' approach to the record keeping obligations of a depositary that apply vis-à-vis assets which are, for example, held by the AIF via intermediary companies. The duties of a depositary do not stop at the level of a top holding company.[407] Again, the UCITSD V (Commission) Regulation does not apply a'look-through approach' to the UCITS depositary's record keeping obligations.[408]

6.3. Control

Besides the safekeeping of assets, the AIFMD and UCITSD V impose on depositaries the additional duty to control the AIF's/UCITS' compliance with the applicable national laws and its rules or instruments of incorporation. The oversight duties require depositaries to ensure compliance with applicable law and AIF/UCITS rules in relation to:

- subscriptions/redemptions;
- valuations of share/unit pricing;
- duties relating to the carrying out of the AIFM's instructions;
- timely settlement of transactions;
- distribution of income;
- cash management.

These will now be subsequently discussed.

6.3.1. *Oversight Duties – General Requirements*

General requirements relating to the depositary's oversight duties are given in the AIFMD and UCITSD V (Commission) Regulation to ensure that the depositary is able to carry out its duties.[409] These general requirements relate to *ex ante* verification and *ex post* controls to be undertaken by the depositary.[410]

6.3.1.1. *Ex Ante* Verification

The depositary should set up procedures and processes to define *ex ante* oversight procedures which are proportionate to the estimated risks of an AIF/UCITS and the assets in which it invests.[411] Upon its appointment, the depositary is, therefore, required to assess the risk associated with the nature, scale and complexity of the AIF's/UCITS' strategy and the

405. Art. 90(3) AIFMD (Commission) Regulation and Art. 14(3) UCITSD V (Commission) Regulation.
406. Art. 90(4) AIFMD (Commission) Regulation and Art. 14(4) UCITSD V (Commission) Regulation.
407. Art. 90(5) AIFMD (Commission) Regulation.
408 See Article 14 UCITSD (Commission) Regulation.
409. Art. 92 AIFMD (Commission) Regulation; Art. 3 UCITSD V (Commission) Regulation.
410. Recital 106 AIFMD (Commission) Regulation/Recital 4 UCITSD V (Commission) Regulation.
411. Art. 92(1) AIFMD (Commission) Regulation; Art. 3(1) UCITSD V (Commission) Regulation.

AIFM's/UCITS ManCo' organization. In doing so, the depositary has to take into account various factors, such as the size of the AIF/UCITS and of the AIFM/UCITS ManCo, the type of assets, the procedures in place at the AIF/UCITS, the AIFM/UCITS ManCo, a third party and the AIF's/UCITS' trading frequency.[412] This is in line with the rationale behind the *ex ante* risk assessment that it should make sure that appropriate processes are in place rather than double-checking every single event.[413]

6.3.1.2. *Ex Post* Controls

The depositary shall conduct *ex post* verification and procedures that are the responsibility of the AIFM/UCITS ManCo, the AIF/UCITS or an appointed third party.[414] The third parties involved can, for example, be an administrator or accountant working with the appropriate procedures controlled by the depositary[415] that are frequently reviewed. In addition, the AIFM/UCITS ManCo must send all instructions related to the AIF's/UCITS' assets and operations to the depositary so that it is able to perform its own verification or reconciliation procedure.

The depositary should have its own clear and comprehensible escalation procedure to address and detect irregularities in order to ensure that it is able to carry out its duties.[416] Such a procedure shall include a notification of Competent Authorities in case of any material breaches.[417] Moreover, the depositary must make available the details of the escalation to Competent Authorities upon request.[418]

The AIFM/UCITS ManCo also ensure that the depositary is able to have access to the books and perform on-site visits on its own premises and of those of any service provider appointed by the AIF/UCITS or the AIFM/UCITS ManCo, such as an administrators or external valuers and/or to review reports and statements of recognized external certifications by qualified independent auditors or other experts to ensure the adequacy and relevance of the procedures in place.[419]

6.3.2. *Subscriptions/Redemptions*

Depositaries have the duty to check that the sale, issue, re-purchase, redemption and cancellation of units or shares of the AIF are carried out in accordance with the applicable national laws and the AIF/UCITS rules or instruments of incorporation.[420]

In doing so, the depositary shall ensure that the AIF/UCITS, the AIFM/UCITS ManCo or the designated entity establishes, implements and applies an appropriate procedure to:[421]

(1) reconcile:
- the subscription/redemption orders with the subscription proceeds/redemptions paid;[422] and
- the number of units or shares issued/cancelled with the subscription proceeds received/redemptions paid by the AIF;[423]

---

412. ESMA/2011/379, 165.
413. *Ibid*, 164.
414. Art. 92(2) AIFMD (Commission) Regulation; Art. 3(2) UCITSD V (Commission) Regulation.
415. ESMA/2011/379, 165.
416. Art. 92(3) AIFMD (Commission) Regulation; Art. 3(3) UCITSD V (Commission) Regulation.
417. ESMA/2011/379, 165.
418. Art. 92(3) AIFMD (Commission) Regulation; Art. 3(3) UCITSD V (Commission) Regulation.
419. Art. 92(4) AIFMD (Commission) Regulation; Art. 3(4) UCITSD V (Commission) Regulation.
420. Art. 21(9)(a) AIFMD; Art. 22(3)(a) UCITSD V.
421. Art. 93(1) AIFMD (Commission) Regulation; Art. 4(1) UCITSD V (Commission) Regulation.
422. Art. 93(1)(i) AIFMD (Commission) Regulation; Art. 4(1) sub-para. 1(a) UCITSD V (Commission) Regulation.

(2) verify on a regular basis that the reconciliation procedure is appropriate.[424]

To that end, the depositary has the obligation to verify that the number of units or shares in the AIF's/UCITS' account matches the number of outstanding units or shares in the AIF's/UCITS' register.[425]

The depositary has to ascertain and regularly check the subscription/redemption of the AIF/UCITS with the applicable national laws, the AIF/UCITS rules and/or instruments of incorporation and verify that these procedures are effectively implemented.[426]

The frequency of the depositary's checks shall be consistent with the frequency of subscriptions and redemptions.[427] This implies that the depositary is expected to adapt its procedures taking into account the frequency of subscriptions and redemptions.[428] The frequency of these controls could be defined at the time of the depositary's appointment.[429]

In this regard, it should be noted that the duties regarding subscription and redemptions are relevant for open-ended AIFs and UCITS. The AIFMD itself makes no distinction between open-ended and closed-ended AIFs relating to the oversight duties with respect to subscriptions and redemptions.[430] The AIFMD and UCITSD V (Commission) Regulation, however, requires that the frequency of the depositary's checks is proportionate to the frequency of subscriptions and redemptions.[431] This clause provides for flexibility for the depositary to adapt its oversight duties to, for instance, closed-ended AIFs.[432]

6.3.3. *Valuation of Shares/Units*

The depositary must ensure that the value of the units or shares of the AIF/UCITS is calculated in accordance with the applicable national laws, the AIF/UCITS rules or instruments of incorporations and the procedures with regard to valuation.[433]

To comply with this requirement the depositary shall:[434]

– verify on an ongoing basis that appropriate and consistent valuation policies and procedures for the assets of the AIF are effectively implemented, and periodically reviewed;
– ensure that the valuation policies and procedures are effectively implemented and periodically reviewed.

---

423. Art. 93(1)(ii) AIFMD (Commission) Regulation; Art. 4(1) sub-para.1(b) UCITSD V (Commission) Regulation.
424. Art. 93(1)(iii) AIFMD (Commission) Regulation; Art. 4(1) sub-para.1(c) UCITSD V (Commission) Regulation.
425. Art. 93(1)(iii) sub-para. 2 AIFMD (Commission) Regulation; Art. 4(1) sub-para.1(c) UCITSD V (Commission) Regulation.
426. In ESMA/2011/379, 158 and 167, ESMA clarifies that this requirement should be seen as limited to the sales of units of shares by the AIF or the AIFM. ESMA argues that it would be materially impossible for a depositary to check the compliance with applicable law and AIF rules regarding the sales on a secondary market. Such a situation would entail that if an AIF sets out in its rules that units of an AIF shall not be distributed to investors of a certain country for tax purposes, the depositary would have the obligation to ensure no units/shares would be sold by any unit-/shareholder to such an investor.
427. Art. 93(3) AIFMD (Commission) Regulation; Art. 4(3) UCITSD V (Commission) Regulation.
428. ESMA/2011/379, 166. See also Recital 107 AIFMD (Commission) Regulation; Recital 5 UCITSD V (Commission) Regulation.
429. ESMA/2011/379, 166.
430. *Ibid.*
431 Article 93(3) AIFMD (Commission) Regulation; The same applies to UCITS. See Article 4(3) UCITSD V (Commission) Regulation.
432. *Ibid.*
433. For the AIF depositary this shall be compliant with the AIFMD valuation rules as laid down in Article 19 AIFMD. See Art. 21(9)(b) AIFMD; Art. 22(3)(b) UCITSD V.
434. Art. 94(1) AIFMD (Commission) Regulation; Art. 5(1) UCITSD V (Commission) Regulation.

This implies that the AIFM/UCITS ManCo is responsible for the valuation process and that the depositary is not expected to systematicly recalculate the NAV.[435]

The depositary's procedures shall be conducted at a frequency consistent with the frequency of the AIF's[436]/UCITS' valuation policy and its implementing measures.[437] In order to comply, the depositary will have to ascertain that the valuation process procedures are appropriate, taking into account the nature, scale and complexity of the AIF/UCITS, and that the valuation of shares/units provided to investors is appropriate.[438] Compliance with these requirements could be achieved by performing sample checks, where appropriate, or by comparing the consistency of the evolution of the NAV calculation over time with that of a benchmark.[439]

When the depositary establishes valuation procedures, it shall have a clear understanding of the valuation methodologies that are used by the AIFM or the external valuer to value the AIF's/UCITS' assets. If NAV valuation takes place on a daily basis, the depositary is not required to check the valuation every day. It shall, however, define a frequency of enquiries consistent with the frequency to asset valuation of the AIF/UCITS.[440]

The depositary is obliged to notify the AIFM /UCITS ManCo and monitor the changes to the valuation process if the depositary considers the valuation procedure not to be appropriate or effectively implemented.[441] This duty shall ensure that corrective measures are being taken in time for the safekeeping of the interests of the investors.[442] In addition, the depositary shall check, where an external valuer has been appointed, that the appointment is in accordance with the legislation and its implementing measures.[443]

6.3.4. *AIFM's/UCITS ManCo Instructions*

The depositary has to carry out the instructions of the AIFM/UCITS ManCo, unless they conflict with the applicable national laws, the AIF/UCITS rules or instruments of incorporation.[444]

The AIFMD and UCITSD V (Commission) Regulation clarifies that this general duty of the depositary to carry out ongoing oversight entails at least:[445]

- the set up and implementation of appropriate procedures to verify the compliance of the AIF/UCITS and AIFM/UCITS ManCo with applicable laws and regulations as well as with the AIF's/UCITS' rules and instruments of incorporation;[446] and
- the set up and implementation of an escalation procedure if the AIF/UCITS has breached one of the limits or restrictions referred to above.[447]

---

435. ESMA/2011/379, 168.
436 See Article 19 AIFMD on valuation.
437. Art. 94(2) AIFMD (Commission) Regulation; Art. 5(2) UCITSD V (Commission) Regulation
438. ESMA/2011/379, 168.
439. Recital 108 AIFMD (Commission) Regulation; ESMA/2011/379, 168; Recital 6 UCITSD V (Commission) Regulation.
440. Recital 108 AIFMD (Commission) Regulation; Recital 6 UCITSD V (Commission) Regulation.
441. Art. 94(3) AIFMD (Commission) Regulation; Art. 5(3) UCITSD V (Commission) Regulation.
442. ESMA/2011/379, 168.
443. Again this shall be for AIFs compliant with the valuation rules set out in Article 19 AIFMD. See Art. 94(4) AIFMD (Commission) Regulation.
444. Art. 21(9)(c) AIFMD; Art. 22(3)(c) UCITSD V.
445 Article 95 AIFMD (Commission) Regulation; Art. 6 sub-para.1 UCITSD V (Commission) Regulation.
446. Art. 95(a) AIFMD (Commission) Regulation; Art. 6 sub-para.1(a) UCITSD V (Commission) Regulation.
447. Art. 95(b) AIFMD (Commission) Regulation; Art. 6 sub-para. 1(b) UCITSD V (Commission) Regulation.

The depositary has to verify on an *ex post* basis, by virtue of its oversight obligation, the compliance of the AIF with applicable laws, regulations and the AIF/UCITS rules and instruments of incorporation.[448] In particular, the depositary has to monitor the AIF's/UCITS' transactions and investigate any that are 'unusual',[449] and check the AIF's/UCITS' compliance with the investment restrictions and leverage limits defined in the AIF's/UCITS' offering documents.[450] This involves a general check on whether the AIFM/UCITS ManCo applies the investment policy described in the constituting documents.

The depositary shall set up and implement an escalation procedure.[451] Should any breach be identified, the depositary shall obtain from the AIFM/UCITS ManCo the instruction to reverse the transaction that is in breach at its own cost.[452] Although these duties have to be carried out by a depositary on an *ex post* basis, this does not prevent the depositary from adopting an *ex ante* approach where it seems appropriate.

6.3.5. *The Timely Settlement of Transactions*

The depositary must ensure that, in transactions involving the AIF's/UCITS' assets, any consideration is remitted to the AIF/UCITS within the usual time limits.[453]

Compliance with this duty entails that at least the following requirements are met:

- The depositary shall set up a procedure to detect any situation where consideration involving the AIF's/UCITS' assets is not remitted to the AIF/UCITS within the usual time limits.[454] In such a case, the depositary shall notify the AIFM/UCITS ManCo and, if the situation has not been remedied, request the restitution of the financial instruments from the counterparty.[455]
- Where the transactions do not take place on a regulated market, the usual time limits shall be assessed with regard to the conditions, attached to the transaction (OTC derivative contracts, investments in real estate assets or in privately held companies).[456]

The duty relating to the timely settlement of transactions is relatively clear in situations concerning open-ended AIF's and UCITS that trade in liquid markets.[457] However, where the transactions do not take place on a regulated market the 'usual time limit' shall be assessed with regard to the conditions attached to the transactions. In these cases the 'usual time limit' could be determined by referring to the relevant contract by which the AIF/UCITS has secured its investment.[458]

6.3.6. *AIF's Income Distribution*

Once an income distribution is declared by an AIFM/UCITS ManCo, the depositary must:

- ascertain that the AIF's/UCITS' income is being applied in accordance with the applicable national laws and the AIF/UCITS rules or instruments of incorporation;[459]

---

448. Recital 109 AIFMD (Commission) Regulation; Recital 7 UCITSD V (Commission) Regulation.
449. *Ibid*.
450. Art. 95(a) AIFMD (Commission) Regulation; Art. 6 sub-para1(a) UCITSD V (Commission) Regulation.
451. Art. 95(b) AIFMD (Commission) Regulation; Art. 6 sub-para1(b) UCITSD V (Commission) Regulation.
452. Recital 109 AIFMD (Commission) Regulation; Recital 7 UCITSD V (Commission) Regulation.
453. Art. 21(9)(d) AIFMD; Art. 22(3)(d) UCITSD V.
454. Art. 96(1) AIFMD (Commission) Regulation; Art. 7(1) UCITSD V (Commission) Regulation.
455. *Ibid*.
456. Art. 96(2) AIFMD (Commission) Regulation; Art. 7(2) UCITSD V (Commission) Regulation.
457. ESMA/2011/379, 170.
458. ESMA/2011/379, 170.
459. Art. 21(1)(9)(e) AIFMD; See also Art. 97(1)(a) AIFMD (Commission) Regulation; Art. 22(3(e) UCITSD; See also Art. 7(2) UCITSD V (Commission) Regulation.

– take the appropriate steps and monitor where auditors have expressed reserves on the AIF's annual accounts to ensure that such reserves will not be reiterated.[460] The AIF/UCITS or the AIFM/UCITS ManCo provides the depositary with all information on reserves expressed on the financial statements;[461]
– check the completeness and accuracy of dividend payments, once declared by the AIFM/UCITS ManCo, and, where relevant, of the carried interest.[462]

The depositary's role is to ensure that the income distribution is appropriate, and, where an error has been identified, ensure that the AIFM/UCITS ManCo takes the appropriate remedial action.[463] The net income calculation can be performed by the AIFM/UCITS ManCo itself or another entity appointed to provide that calculation.[464] The depositary verifies the completeness and accuracy of the income distribution once it has ensured that the net income calculation (primarily of dividend payments) is correct.[465]

6.3.7. *Monitoring of the AIF's/UCITS' Cash Flows*

The depositary must ensure that the AIF's/UCITS' cash flows are properly monitored. In particular, it must ensure that all payments made by or on behalf of investors upon the subscription of units or shares of an AIF/UCITS have been received and that all the AIF's/UCITS' cash has been booked into cash accounts.[466]

The AIF's/UCITS' cash must be booked in one or more cash accounts opened in the name of either:[467]

– the AIF/UCITS itself; or
– the AIFM/UCITS ManCo acting on behalf of the AIF/UCITS; or
– the depositary acting on behalf of the AIF/UCITS.

The depositary ensures that all the AIF's/UCITS' cash is booked in accounts opened at:[468]
– a central bank;[469]
– an EEA credit institution;[470] or
– a non-EEA bank.[471]

460. ESMA/2011/379, 171.
461. Art. 971)(b) AIFMD (Commission) Regulation; Art. 8(1)(b) UCITSD V (Commission) Regulation.
462. Art. 97(1)(c) AIFMD (Commission) Regulation; Art. 8(1)(c) UCITSD V (Commission) Regulation.
463. Art. 97(2) AIFMD (Commission) Regulation; Art. 8(2) UCITSD V (Commission) Regulation.
464. ESMA/2011/379, 171.
465. See ESMA/2011/379, 171.
466. Although Art. 21(7) AIFMD, Art. 86 AIFMD (Commission) Regulation; Art. 22(4) UCITSD V, Art. 10 UCITSD V (Commission) Regulation. only refer to the cash flow monitoring regarding the subscription moneys received. This obligation should be interpreted as covering all relevant AIF cash flows, such as cash flows resulting from transactions, corporate actions and, where relevant, redemptions.
467. Art. 21(7) AIFMD; Art. 22(4)(a) UCITSD V.
468. Art. 21(7) AIFMD and Art. 22(4)(b) UCITSD V. refer for the depositing of clients funds to Art. 18(1)(a)–(c) MiFID I (Commission) Directive/Art. 4(1)(a)–(c) MiFID II (Commission) Directive. Compared to the MiFID I and II (Commission) Directive, qualifying money market funds are not eligible.
469. Art. 18(1)(a) MiFID I (Commission) Directive/Art. 4(1)(a) MiFID II (Commission) Directive.
470. Art. 18(1)(b) MiFID I (Commission) Directive/Art. 4(1)(b) MiFID II (Commission) Directive.
471. Art. 18(1)(c) MiFID I (Commission) Directive/Art. 4(1)(c) MiFID II (Commission) Directive. The AIFMD allows cash accounts to be opened at 'another regulated entity of the same nature' in the relevant (non-EEA) market where cash accounts are provided. Such an entity has to be subjected to 'effectively enforced' prudential regulation (including segregation rules) and supervision which have the same effect as Union law and are effectively enforced in accordance with Art. 16 Directive MiFID I (Commission) Directive/Art. 2 MiFID II (Commission) Directive. What is meant be 'effective prudential regulation and supervision' is already discussed in *infra* 5.2.

Where the cash accounts are opened in the name of the depositary acting on behalf of the AIF, no cash from the entity and none of the depositary's own cash shall be booked on such accounts, as will be the usual case when depositary banks are involved.[472]

When depositing third country clients' funds, the depositary must also ensure that the third-country entity makes adequate arrangements to safeguard the AIF's/UCITS' funds, especially in the case of insolvency. When doing so, the depositary should take into account the third country's legal regime, which could affect the AIF's/UCITS' rights. The requirements for safeguarding the AIF's/UCITS' funds encompass the obligation for a depositary to ensure that client funds deposited in such third-country entities are held in an account or accounts identified separately from any accounts used to hold funds belonging to third-party entities.[473]

6.3.7.1. Cash Monitoring – General Requirements

The depositary should ensure that the AIF's/UCITS' cash flows are properly monitored. As a pre-requisite, the AIFM/UCITS ManCo is required to ensure that the depositary has access to all information it needs to perform its cash management function. This obligation on the part of the AIFM encompasses the duty to provide this information upon commencement of the depositary's duties as well on an ongoing basis.[474] The AIFM and UCITSD V (Commission) Regulation leave open who must provide this information. According to ESMA's Advice, such information can be either provided directly by the AIF/UCITS, the AIFM/UCITS ManCo acting on the AIF's/UCITS' behalf or by any other entity appointed by the AIF/UCITS or AIFM/UCITS ManCo, such as prime brokers, third-party banks or administrators.[475]

The AIFMD and UCITSD V (Commission) Regulation takes into account various situations that can occur under the AIFMD and UCITSD V relating to cash accounts and their impact on the depositary's ability to monitor.[476] The AIFMD and UCITSD V distinguish between the situations in which:[477]

– the account is opened by the depositary itself;
– the account is opened by a third party in the name of the depositary;
– the account is opened by a third party in the name of the AIF/UCITS or in the name of the AIFM/UCITS ManCo on behalf of the AIF/UCITS.

In the first two situations, the depositary has complete knowledge of all inflows and outflows and there cannot be a transfer without its knowledge. However, in the last situation, the depositary has clearly to rely upon information provided by third parties.

To that extent, the AIFMD and UCITSD V (Commission) Regulation require the depositary to be informed upon its appointment of all existing cash accounts opened in the name of the AIF/UCITS or the AIFM/UCITS ManCo acting on behalf of the AIF/UCITS.[478] Moreover, the depositary must be informed when any new cash account is opened by either the AIF/UCITS or the AIFM/UCITS ManCo acting on its behalf,[479] and, for cash accounts

---

472. Art. 21(7) sub-para. 2 AIFMD.
473. Art. 16(1)(e) MiFID I (Commission) Directive; Art. 2(1)(e) MiFID (Commission Directive.
474. Art. 85(1) AIFMD (Commission) Regulation; Art. 9(1)UCITSD V (Commission) Regulation.
475. ESMA/2011/379, 151.
476. *Ibid*.
477 Art. 85(1) AIFMD (Commission) Regulation; Art. 9(1) UCITSD V (Commission) Regulation.
478. Art. 85(2)(a) AIFMD (Commission) Regulation; Art. 9(2) UCITSD V (Commission) Regulation.
479. Art. 85(2)(b) AIFMD (Commission) Regulation; Art. 9(2) UCITSD V (Commission) Regulation.

opened by a third party, those third parties shall provide the depositary directly with all such information.[480]

6.3.7.2. Proper Monitoring of All AIF's/UCITS' Cash Flows

The depositary must ascertain that the AIF's/UCITS' cash flows are properly monitored. To that end, the depositary's obligation is to verify that there are procedures effectively implemented to appropriately monitor the AIF's/UCITS' cash flows and that these procedures are reviewed periodically.[481]

The depositary shall ensure effective and proper monitoring of the AIF's/UCITS' cash flows by ascertaining that all the AIF's/UCITS' cash is booked into accounts opened with entities as referred to above.[482] Where the cash accounts are opened by the depositary, this could be done by the depositary itself. In other cases, this could be performed by the AIFM/UCITS ManCo, its accountant/administrator or another service provider.[483]

When monitoring, the depositary should in particular establish reconciliation procedures for all cash flow movements and ensure that these procedures are verified at an appropriate interval taking into account the nature, scale and complexity of the AIF/UCITS.[484] Such a reconciliation procedure should compare each cash flow individually, as reported in the bank accounts statements with the cash flows recorded in the AIF's/UCITS' accounts.[485] Accordingly, the depositary must define its own verification process.[486] For example, if reconciliation is performed daily, as it is for most open-ended AIF's/UCITS' , the depositary would be expected to perform its verifications also on a daily basis.[487]

The depositary's verification procedures with respect to cash management should consist of:

– conducting a full review of the reconciliation procedures at least once a year, i.e., checking that cash accounts opened by third parties in the name of the AIF/UCITS, AIFM/UCITS ManCo or depositary are included in an appropriate and effectively implemented reconciliation process;[488]
– monitoring on an ongoing basis the discrepancies detected by the reconciliation procedures and the corrective measures taken in order to notify the AIFM/UCITS ManCo of any anomaly which has not have been remedied without undue delay.[489]

In addition, the depositary must ensure that significant cash flows, which could be inconsistent with the AIF's/UCITS' investment policy, are identified on a timely basis.[490] This monitoring consists of checking the changes of: (1) positions in the AIF's/UCITS' assets, or (2) subscriptions/redemptions with the periodic cash account statements and the consistency of its own records of cash positions with those of the AIFM/UCITS ManCo.[491] The AIFM/UCITS ManCo, on its behalf, shall ensure that all instructions and information related to the cash accounts opened by third parties are sent to the depositary. Without the

---

480. Art. 85(2)(c) AIFMD (Commission) Regulation; See also ESMA/2015/850, 20; ; Art. 9(2) UCITSD V (Commission) Regulation.
481. Recital 98 AIFMD (Commission) Regulation.
482. Art. 86(a) AIFMD (Commission) Regulation.
483. ESMA/2011/379, 152.
484. Art. 86(b) AIFMD (Commission) Regulation.
485. Recital 98 AIFMD (Commission) Regulation.
486. *Ibid*.
487. *Ibid*.
488. Art. 86(d) AIFMD (Commission) Regulation.
489. Art. 86(e) AIFMD (Commission) Regulation.
490. Art. 86(c) AIFMD (Commission) Regulation.
491. Art. 86(f) AIFMD (Commission) Regulation.

appropriate information, the depositary is not able to carry out its own verification or reconciliation procedures.

6.3.8. *UCITS Mergers and Master-Feeder Structures*

The depositary in the UCITSD V has got assigned as a 'third-party monitor' for UCITS mergers[492] and has got extended obligations to fulfil its controlling duties of feeder UCITS in master-feeder structures.

6.3.8.1. UCITS Mergers

UCITSD IV introduced (cross-border) mergers to allow UCITS to exploit economies of scale.[493] Mergers are under the UCITSD V subject to prior authorization by the Competent Authorities of the the merging UCITS (home Member State).[494] For this purpose, common draft terms of the proposed merger are prepared and agreed by the UCITS ManCos of the merging UCITS and the receiving UCITS. The common draft terms of merger must set out the particulars under the UCITSD V.[495] Once prepared, the common draft terms of merger must be reviewed and be satisfied by the depositories of the merging and receiving UCITS as a 'third party monitor'.[496] The depositary of the merging and receiving UCITS shall review and be satisfied that the common draft terms of merger are in conformity with the law and with the merging UCITS fund rules or instruments of incorporation.[497] The role of the depositary is, thus, not to verify whether the proposed merger is in the interest of the investors but rather to verify whether the common draft terms comply with all legal requirements.[498] The compliance check involves, in particular, the criteria adopted in the common draft terms related to valuing the assets and liabilities of each UCITS[499], the exchange ratio in relation to shares in each UCITS[500], and the cash payment per unit/share[501]. The compliance has to be completed by the depositary (or the competent authority) of either the merging or the receiving UCITS in advance of the merger.[502] Each of the depositaries would have to inform the merging UCITS and the receiving UCITS in writing of its approval to the proposed common draft terms of merger so as to enable the UCITS to include such information in its application file for

---

[492] Recital 29 and 31, Art. 39 UCITSD V.
[493] Cross-border mergers between all types of UCITS (contractual, corporate and unit trusts) are permitted . See Recital 27 UCITSD V; See also Appendices to the report on Investment Fund Market Efficiency, *Facilitating UCITS Mergers* , 9, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/annex_efficiency_en.pdf (accessed 22 August 2016); European Commission, *Green Paper on the Enhancement of the EU Framework for Investment Funds of 12 July 2005 (SEC(2005) 947)*, 31-34 ,http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 3 July 2015); European Commission, *White Paper of 15 November 2006 (COM (2006) 686 final) on enhancing the single market framework for investment funds*, 10-16, http://ec.europa.eu/internal_market/securities/docs/ucits/whitepaper/whitepaper_en.pdf (accessed 3 July 2015).
[494] See Recitals: 27-33, Arts: 37-49 UCITSD V.
[495] Arts 39(2)(a), 40 UCITSD V.
[496] Recital 31 UCITSD V.
[497] Art. 41 UCITSD V.
[498] European Commission, *Exposure Draft - Initial orientations for discussion on possible adjustments to the UCITS Directive: Merger*, 14, http://ec.europa.eu/finance/investment/docs/ucits-directive/poolingexposurel_en.pdf (accessed 22 August 2016).
[499] Recital 31, Art. 42(1)(a) UCITSD V.
[500] Recital 31, Art. 42(1)(b) UCITSD V.
[501] Recital 31, Art. 42(1)(c) UCITSD V.
[502] Art. 41 UCITSD V.

regulatory approval.[503] Reports of the depositary statements shall be provided on request to investors in the merging and receiving UCITS and their respective Competent Authorities.[504]

The Competent Authorities of the merging UCITS, additionally, require an up-to-date version of the prospectus and the KIID of the merging UCITS and information on the proposed merger that the merging funds intend to provide to their respective investors.[505] Investors of both the merging UCITS and the receiving UCITS have the right to request the repurchase or redemption of their units[506] or to convert their units into units in other UCITS with similar investment policies managed by the same UCITS ManCo.[507] Once the Competent Authorities have received the complete file, they will consider the potential impact of the proposed merger on unit-holders of the merging and the receiving UCITS respectively, to assess whether authorization should be granted or not.[508]

6.3.8.2. Master-Feeder Structures

The master-feeder structure introduced under UCITSD IV[509] offers another solution for UCITS ManCos seeking to achieve economies of scale across their existing fund structures.[510] Feeder UCITS are under the UCITSD V allowed to invest at least 85% of its assets in a single master UCITS.[511] Feeder UCITS may invest up to 15% of its assets in ancillary liquid assets and financial derivate instruments that are used for hedging purposes.[512] Master UCITS are under the UCITSD V prohibited from simultaneously acting as a feeder fund.[513]

This so-called ‘entity pooling’ makes it more difficult for the depositary to monitor the UCITS ManCo of a feeder UCITS since its investment policy depends on that of the master UCITS.[514] The problem may be accentuated when the master and feeder UCITS are established in different Member States.[515] Feeder and master UCITS that are established in different Member States are, however, obliged to appoint a depositary in the Member State in

---

[503] Art. 39(2)(c) UCITSD V.
[504] Art. 42(3) UCITSD V.
[505] Arts 39(2)(b), 43 UCITSD V.
[506] Recital 30, Art. 45(1) UCITSD V.
[507] Recital 30, Art. 45(1) UCITSD V.
[508] Art. 39(3) and (4) UCITSD V.
[509] Recitals 51-57, Arts 58-68 UCITSD V.
[510] Establishing multiple ‘local’ feeders in specific EEA Member States that (almost) exclusively invest in a master UCITS based in a European asset management domicile may be used for tax or marketing reasons. Entity pooling may, thus, lead to achieve economies of scale and cost efficiencies; See Investment Management Association, *Pooling: how can fund managers respond efficiently to different investor needs?,*http://www.theinvestmentassociation.org/assets/files/research/20050701pooling.pdf (accessed 22 August 2016); European Commission, *Green Paper on the Enhancement of the EU Framework for Investment Funds of 12 July 2005 (SEC(2005) 947)*, 33, 54 ,http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 3 July 2015); European Commission, *White Paper of 15 November 2006 (COM (2006) 686 final) on enhancing the single market framework for investment funds*, 16-20, http://ec.europa.eu/internal_market/securities/docs/ucits/whitepaper/whitepaper_en.pdf (accessed 3 July 2015).
[511] Art. 58(1) UCITSD V.
[512] Art. 58(2) UCITSD V.
[513] Art. 58(3)(b) UCITSD V.
[514] European Commission, *Exposure Draft - Initial orientations for discussion on possible adjustments to the UCITS Directive: Pooling*, 3, http://ec.europa.eu/finance/investment/docs/ucits-directive/poolingexposurel_en.pdf (accessed 22 August 2016); See also Appendices to the report on Investment Fund Market Efficiency, *Pooling for Investment-Funds*, 24, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/annex_efficiency_en.pdf (accessed 22 August 2016).
[515] European Commission, *Exposure Draft - Initial orientations for discussion on possible adjustments to the UCITS Directive: Pooling*, 3, http://ec.europa.eu/finance/investment/docs/ucits-directive/poolingexposurel_en.pdf (accessed 22 August 2016).

which they are established.[516] The requirements that feeder UCITS must at least invest 85 % of its assets in a master UCITS creates a 'strong link' between the feeder UCITS and the master UCITS.[517] In the case where the master and feeder UCITS appoint two different depositaries, the depositary of the feeder UCITS can only comply with its controlling tasks if it 'looks through' into the master UCITS.[518]

For this purpose the UCITSD V imposes two additional requirements to ensure that the depositary of the feeder UCITS can comply with its controlling duties. First, the UCITSD V requires that where the depositaries of the master and feeder UCITS are different entities, they must enter into a depositary information sharing agreement in order to ensure the fulfilment of their respective duties.[519] The information sharing agreement is the legal basis for information request of the feeder UCITS' depositary that allows the depositary to have timely access to all relevant information and documents to meet its obligations.[520] Second, the master UCITS depositary is required to immediately inform the Competent Authorities of the master UCITS home Member State, the feeder UCITS or, where applicable, the UCITS ManCo and the depositary of the feeder UCITS about any irregularities it detects with regard to the master UCITS which are deemed to have a negative impact on the feeder UCITS.[521] Given the 'strong link' between feeder UCITS and master UCITS, this enables both Competent Authorities and the feeder UCITS depositary to check whether a master UCITS complies its legal obligations and to take the appropriate decisions to protect the interests of their investors.[522]

7. Delegation in the Depositary Chain

Delegation in the depositary chain concerns the appointment of a sub-custodian to which a depositary may delegate its safekeeping function.[523] The AIFMD and the UCITSD V allow a depositary to delegate neither its cash management[524] function nor its oversight duties[525] to third parties. By allowing depositaries to delegate its safekeeping duties, the AIFMD and UCITSD V recognize that the vast majority of securities are held in indirect holding systems involving a large and complex chain of intermediaries that record the rights of securities as book entries at the various levels of the intermediaries in the chain of holdings.

The appointment of a sub-custodian is subject to numerous requirements. For the purpose of the AIFMD and UCITSD V, all 'sub-custodians' are considered to be delegates of the AIF's/UCITS' depositary.

The term 'sub-custodian' is not being defined under the AIFMD and UCITSD V. The Recitals in the AIFMD and UCITSD V, however, provide some guidance in answering the question what 'delegates' should be regarded as 'sub-custodians'.

---

[516] See Art. 23 UCITSD V.

[517] European Commission, *Exposure Draft - Initial orientations for discussion on possible adjustments to the UCITS Directive: Pooling*, 17, http://ec.europa.eu/finance/investment/docs/ucits-directive/poolingexposurel_en.pdf (accessed 22 August 2016).

[518] *Ibid*.

[519] Art. 61(1) UCITSD V.

[520] European Commission, *Exposure Draft - Initial orientations for discussion on possible adjustments to the UCITS Directive: Pooling*, 17, http://ec.europa.eu/finance/investment/docs/ucits-directive/poolingexposurel_en.pdf (accessed 22 August 2016).

[521] Article 61(2) UCITSD V.

[522] European Commission, *Exposure Draft - Initial orientations for discussion on possible adjustments to the UCITS Directive: Pooling*, 17, http://ec.europa.eu/finance/investment/docs/ucits-directive/poolingexposurel_en.pdf (accessed 22 August 2016).

[523.] Art. 21(11) AIFMD; Art. 22a UCITSD V.

[524.] Art. 21(7) AIFMD; Art. 22(4) UCITSD V.

[525.] Art. 21(9) AIFMD; Art. 22(3) UCITSD V.

Recital 41 AIFMD provides that

> 'entrusting the custody of assets to the operator of a securities settlement system as designated for the purposes of Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems or entrusting the provision of similar services to third-country securities settlement systems should not be considered to be a delegation of custody functions'.

Recital 21 UCITSD V states the following:

> 'when a Central Securities Depositary (CSD), as defined in point (1) of Article 2(1) CSDR, or a third-country CSD provides the services of operating a securities settlement system as well as at least either the initial recording of securities in a book-entry system through initial crediting or providing and maintaining securities accounts at the top tier level, as specified in Section A of the Annex to that Regulation, the provision of those services by that CSD with respect to the securities of the UCITS that are initially recorded in a book-entry system through initial crediting by that CSD should not be considered to be a delegation of custody functions. However, entrusting the custody of securities of the UCITS to any CSD, or to any third-country CSD should be considered to be a delegation of custody functions'.

Entrusting the custody of assets to 'operators of a securities settlement systems' is, thus, not considered to be a delegation of custody functions under the AIFMD, whereas under UCITSD V entrusting the custody of assets to 'Issuer CSDs'[526] is not considered to be a 'delegation of custody functions'. In light of UCITSD V, confusion arose under the AIFMD whether both 'Issuer' and 'Investor CSDs' or only 'Issuer CSDs' qualify as 'operators of a securities settlement system'. Against this background, ESMA has recently published an opinion that argues in favour of convergence between UCITSD V and the AIFMD. For this purpose, ESMA suggests that the AIFMD also should refer to 'Issuer CSDs' instead of 'securities settlement systems'.[527] Taken this into account, 'sub-custodians' under the AIFMD and UCITSD V are entities to which the custody of assets are being entrusted, with the exception of 'Issuer CSDs'. 'Investors CSDs' are, thus, also seen as 'sub-custodians' under the AIFMD and UCITSD V.

Sub-custodians may further delegate the safekeeping duties assigned to them subject to similar conditions as applicable to the appointment of sub-custodians themselves.[528]

7.1. Avoiding Requirements

The depositary may not delegate (or sub-delegate) safekeeping functions to a sub-custodian with the intention of avoiding the requirements of the AIFMD and UCITSD V.[529] The AIFMD/UCITSD V and AIFMD/UCITSD V (Commission) Regulation do not specify this requirement. In line with the 'letter-box entity' approach of delegating AIFM functions under Article 20 AIFMD, one can understand this requirement as follows. Depositaries must obtain an authorization before they may take up any of the functions under the AIFMD and UCITSD V. When successfully applying for authorization, the depositary has to ensure it complies with a number of organizational requirements, such as fit-and-proper tests, conflict of interest rules

---

[526] See Chapter 6, section 2.2.3.

[527] European Securities and Markets Authority, *Opinion - Asset segregation and application of depositary delegation rules to CSDs*, 20 July 2017, ESMA34-45-277, 28 et seq.

[528]. Security settlement systems operators are not considered as delegates within the meaning of the AIFMD. See Art. 21(11) sub-par. 2 (b) AIFMD; Art. 22a(2)(b) UCITSD V.

[529]. Art. 21(11) sub-par. 2 (a) AIFMD; Art. 22a(2)(a) UCITSD V.

and numerous operating conditions (conduct of business rules). For that purpose, the AIFMD and UCITSD V impose a general duty on the depositary not to delegate its safekeeping function to the extent that, in essence, it undermines the conditions for which the depositary is authorized to carry out its duties in accordance with the AIFMD and UCITSD V.[530]

7.2. Objective Reason

The depositary has to demonstrate that there is an objective reason for the delegation.[531] Unlike the delegation of AIFM/UCITS ManCo functions, neither the AIFMD/UCITSD V nor the AIFMD and UCITSD V (Commission) Regulation specify this obligation in the context of delegation. The depositary may assess the criteria of the objective reasons for the contractual discharge of liability for guidance.[532] Objective reasons could be that a certain depositary has expertise related to certain assets or a specific region.

The depositary has the obligation to provide further explanations and/or provide documents to the Competent Authorities, if requested, to prove that the delegation structure is based on objective reasons.[533] The objective reasons may also be included in the delegation contract concluded with the sub-custodian.

7.3. Due Diligence

The depositary may only delegate to a third party its safekeeping function if it has exercised all due skill, care and diligence in the selection and appointment of the third party to whom it wants to delegate parts of its tasks, and continues to exercise such diligences on an ongoing basis.[534]

The AIFMD and UCITSD V distinguish between, on the one hand, a due diligence obligation by the depositary when appointing a sub-custodian and, on the other hand, the diligence to perform on an ongoing basis as part of monitoring the sub-custodian.[535] This difference is reflected in the AIFMD and UCITSD V (Commission) Regulation.[536]

7.3.1. *Due Diligence upon Appointment of the Sub-custodian*

Compliance with the due diligence duties requires a depositary to be responsible for the implementation and an appropriately documented (due diligence) procedure for the selection and ongoing monitoring of the sub-custodian.[537]

When selecting and appointing a sub-custodian, the depositary shall exercise all due skill, care and diligence to ensure that entrusting financial instruments to a sub-custodian provides an adequate level of protection.[538] Such a process of selecting and appointing a sub-custodian to whom financial instruments that can be held in custody can be delegated, requires the depositary to assess whether the risk of delegating the tasks to a sub-custodian is acceptable by ensuring that the following requirements are met:[539]

– in the process of appointing a sub-custodian, the depositary must assess the regulatory and

530. See Recital 111 AIFMD (Commission) Regulation; Recital 18 UCITSD V (Commission) Regulation.
531. Art. 21(11) sub-par. 2 (b) AIFMD; Art. 22a(2)(b) UCITSD V.
532. See *infra* 8.1.3.
533. Art. 21(11) sub-par. 2 (b) AIFMD; Art. 22a(2)(b) UCITSD V.
534. Art. 21(11) sub-par. 2(c) AIFMD; Art. 22a(2)(c) UCITSD V.
535. Art. 21(11) sub-par. 2(c) AIFMD. See ESMA/2011/379, 173; Art. 22a(2)(c) UCITSD V.
536 Art. 98(1) and (2) AIFMD (Commission) Regulation; Art. 15(1) and (2) UCITSD V (Commission) Regulation.
537. Art. 98(1) AIFMD (Commission) Regulation; Art. 15(1) UCITSD V (Commission) Regulation.
538. Art. 98(2) AIFMD (Commission) Regulation; Art. 15(2) UCITSD V (Commission) Regulation.
539. *Ibid.*

legal framework, including country risk, custody risk and the enforceability of the third party's contracts.[540] This analysis is done to evaluate the potential implications of insolvency of the sub-custodian.[541] In particular, it shall take into account the assets and rights of the AIF/UCITS and notify the AIFM/UCITS ManCo immediately if it becomes aware that the segregation of assets is not protected sufficiently from insolvency;[542]

– the depositary shall conduct an assessment as to whether the sub-custodian's practice, procedures and internal controls ensure that the financial instruments belonging to the AIF/UCITS are subject to a high standard of care and protection;[543]
– the sub-custodian's financial strength and reputation shall be assessed.[544] This assessment shall be based on information provided by the sub-custodian, as well as other data and information where available;[545]
– the depositary shall make sure that the sub-custodian has the operational and technological capabilities to perform the delegated custody tasks with a satisfactory degree of protection and security.[546]

7.3.2. *Ongoing Monitoring Diligence Sub-custodian*

Ongoing monitoring mainly consists of verifying that the sub-custodian performs all of its tasks correctly and complies with the elements specified in the contract. The depositary ensures that the sub-custodian meets certain conditions at all times during the performance of the tasks delegated to it.[547]

7.3.2.1. Adequate Structures and Expertise

The depositary must ensure that the sub-custodian has the structures and expertise that are adequate and proportionate to the nature and complexity of the AIF/UCITS or the AIFM/UCITS ManCo acting on behalf of the AIF/UCITS which has been entrusted to it.[548] Pursuant to the AIFMD and the UCITSD V, the depositary has to perform this due diligence duty irrespective of the type of assets (including record keeping tasks).[549] The delegation of record keeping tasks is likely to concern administrative functions in most cases.[550]

Where the depositary decides to delegate safekeeping functions related to 'other' assets, it is only required to implement an appropriate and documented procedure to ensure that the sub-custodian complies with the ongoing monitoring requirements.[551]

7.3.2.2. Effective Prudential Regulation

For financial instruments to be held in custody, the sub-custodian should be subject to effective prudential regulation, including minimum capital requirements and supervision in the jurisdiction concerned. Moreover, the sub-custodian has to be subject to an external periodic audit to ensure that the financial instruments are in its possession.[552] It might, however, be the case that the law of a third country requires certain financial instruments to be held in custody by a local entity and that none of such entities satisfies these additional

---

540. Art. 98(2)(a) AIFMD (Commission) Regulation; Art. 15(2)(a) UCITSD V (Commission) Regulation.
541. *Ibid.*
542. *Ibid.*
543. Art. 98(2)(b) AIFMD (Commission) Regulation; Art. 15(2)(b) UCITSD V (Commission) Regulation.
544. Art. 98(2)(c) AIFMD (Commission) Regulation; Art. 15(2)(c) UCITSD V (Commission) Regulation.
545. *Ibid.*
546. Art. 98(2)(d) AIFMD (Commission) Regulation; Art. 15(2)(d) UCITSD V (Commission) Regulation. Where the sub-custodian decides to further delegate any of the function delegated to it, the same conditions apply.
547. Art. 21(11) sub-par.2 (d) AIFMD; Art. 22a(3)(a) UCITSD V.
548. Art. 21(11) sub-par.2 (d)(i) AIFMD; Art. 22a(3)(a)(i) UCITSD V.
549. Article 21(11) AIFMD; Art. 22a UCITSD V.ESMA/2011/379, 173 and seq.
550. Recital 111 AIFMD (Commission) Regulation; Recital 18 UCITSD V (Commission) Regulation.
551. ESMA/2011/379, 173 and seq.
552. Art. 21(11) sub-par. 2 (d)(ii) AIFMD; Art. 22a(3)(b) UCITSD V

requirements related to the delegation to third-country entities. In that case, the AIFMD and UCITSD V allows the depositary to delegate its functions to such an entity only to the extent required by the law of the third country and only as long as there is no local entity available that satisfies the delegation requirements under the AIFMD and UCITSD V. This exemption is subject to two requirements:

– the investors of the relevant AIF/UCITS have to be duly informed that such delegation is required due to legal constraints in the law of the third country and of the circumstances prior to their investment; and
– the AIF/UCITS, or the AIFM/UCITS ManCo acting on behalf of the AIF/UCITS, have instructed the depositary to delegate the custody of such financial instrument to such local entity.

7.3.2.3. Segregation of Assets

The depositary must ensure that the sub-custodian segregates the assets of the depositary's clients, its own assets and the assets from the depositary in such a way that they can be clearly identified as belonging to clients of a particular depositary.

When safekeeping functions are delegated partly or wholly to a sub-custodian, the depositary has to make sure that the requirements of Article 21(11)(d)(iii) AIFMD and Article 22a(3) UCITSD V are fulfilled and that the assets of the AIF/UCITS clients of the depositary are properly segregated.[553] These segregation obligations apply to both financial instruments held in custody and to assets subject to record keeping.[554] The objective of the segregation requirements in the depositary chain is to prevent the loss of assets as a result of the insolvency of a sub-custodian when safekeeping tasks are delegated.[555] This requirement should be seen in conjunction with the due diligence requirements regarding the appointment of sub-custodians and its ongoing monitoring.

By verifying whether sub-custodians have appropriate segregation of assets in place, the depositary assesses certain requirements. The sub-custodian has to keep such records and accounts so that it can without delay distinguish the assets of the depositary's clients from:[556]

– its own assets;
– assets of its own clients;
– assets held by the depositary for its own account; and
– assets held for clients of the depositary which are not AIFs/UCITS.[557]

Records and accounts are maintained by the sub-custodian in a way that ensures their accuracy, and in particular their correspondence to the assets under safekeeping for the depositary's clients.[558] The sub-custodian conducts, on a regular basis, reconciliations between its internal accounts and records and any other parties to whom it may have delegated safekeeping functions.[559] Adequate organizational arrangements are introduced by the sub-custodian to minimize the risk of loss or diminution of financial instruments or of

---

553. Recital 112 AIFMD (Commission) Regulation; Recital 21 UCITSD V (Commission) Regulation.
554. ESMA/2011/379, 176.
555. *Ibid.*
556. Currently, ESMA considers to publish guidelines on how this asset segregation shall be exactly applied in practice. Questions during the consultation phase have arisen as to whether assets can be held in an account of only those (non-)AIFs from the same delegating depositary or whether an omnibus account can hold assets for (non-)AIF clients coming from different delegating depositaries. See ESMA/2014/1326.
557. Art. 99(1)(a) AIFMD (Commission) Regulation; Art. 16(1)(a) UCITSD V (Commission) Regulation.
558. Art. 99(1)(b) AIFMD (Commission) Regulation; Art. 16(1)(b) UCITSD V (Commission) Regulation.
559. Art. 99(1)(c) AIFMD (Commission) Regulation; Art. 16(1)(c) UCITSD V (Commission) Regulation.

rights in connection with those financial instruments as a result of misuse of the financial instruments, fraud, poor administration, inadequate record keeping or negligence.[560]

The depositary shall take the necessary steps to ensure that the AIF's/UCITS' cash is held in an account[561], as discussed above, if the delegate is a:[562]

- central bank;
- credit institution; or
- bank authorized in a third country, which is subject to effective prudential regulation and supervision that has the same effect as EU law and is effectively enforced.

The segregation requirements should particularly ensure that the assets of the AIF/UCITS are not lost due to insolvency of the sub-custodian, to whom safekeeping functions are delegated.[563] However, if for reasons of applicable law, including the law relating to property or insolvency, the effect of segregation is not recognized, the depositary shall take additional steps.[564] These steps include:[565]

- making a disclosure to AIF/UCITS and AIFM/UCITS ManCo so that this aspect of custody risk is properly taken into account in the investment decision;
- taking such measures as possible in the local jurisdictions to make the assets as 'insolvency-proof' as possible based on local legal advice;
- using buffers;
- prohibiting temporary deficits in client assets;
- putting in place arrangements prohibiting the use of a debit balance for one client to offset a credit balance for another.

However, while taking into account these additional measures when delegating safekeeping functions, they do not alter the obligation to return the financial instruments or pay the corresponding amount where these are lost if the depositary can be held liable based on the fulfilled criteria of the depositary liability regime.[566]

If sub-custodians further delegate a part or all of the safekeeping functions, the above segregation requirements shall apply to that delegate.[567]

7.3.2.4. Asset Inventories for UCITS Assets

UCITSD V, to the contrary of the AIFMD, contains the (additional) requirement for depositaries to provide the UCITS ManCo, on a regular basis, with a comprehensive inventory of all of the assets of the UCITS.[568] This inventory relates both to assets that can and cannot be held in custody.[569]

7.3.2.5. Re-hypothecation

---

560. Art. 99(1)(d) AIFMD (Commission) Regulation; Art. 16(1)(d) UCITSD V (Commission) Regulation.
561 An account in accordance with the requirements of Art. 21(7) AIFMD and Art. 22(4) UCITSD V.
562. Art. 99(1)(e) AIFMD (Commission) Regulation; Art. 16(1)(e) UCITSD V (Commission) Regulation.
563. Recital 112 AIFMD (Commission) Regulation; Recital 21 UCITSD V (Commission) Regulation.
564. Art. 99(2) AIFMD (Commission) Regulation; Art. 16(2) UCITSD V (Commission) Regulation.
565. Recital 112 AIFMD (Commission) Regulation; Recital 21 UCITSD V (Commission) Regulation.
566 See Art. 21(12) AIFMD and Art. 24 UCITSD V.
567. Art. 99(3) AIFMD (Commission) Regulation; Art. 16(2)UCITSD V (Commission) Regulation.
568 Art. 22(6) UCITSD V.
569 *Ibid.*

Re-hypothecation rights allow a firm to treat a client's assets as its own and may involve outright title transfer or a security interest accompanied by a right of use.[570] Both the AIFMD and UCITSD V imposes restrictions on depositaries and its sub-custodians that want to reuse the assets safekept by the depositary.

Under the AIFMD, the AIF's assets may only be used (re-hypothecated) if the depositary has received the prior consent of the AIF (or of the AIFM acting on its behalf).[571] To the contrary of the AIFMD, the UCITSD V prohibits the depositary or its sub-custodian to reuse UCITS for their own account.[572] Reuse is defined as any transaction of assets that can be held in custody including, but not limited to, transferring, pledging, selling and lending.[573] Reuse of assets held in custody by the depositary is allowed if it is for the account of the UCITS[574] and subject to certain conditions, including:[575]

- the depositary is carrying out the instructions of the UCITS ManCo;[576]
- the reuse is for the benefit of the UCITS and in the interest of the unit holders;[577] and
- the transaction is covered by high-quality and liquid collateral received by the UCITS under a title transfer arrangement.[578]

The market value of the collateral required to amount, at all times, to at least the market value of the reused assets plus a premium.[579]

The reuse of assets under UCITSD V is, thus, severally restricted compared to the AIFMD.

7.3.2.6. General Obligations

The sub-custodian needs to take into account all the general obligations related to the safekeeping of assets[580], as well as a general duty of loyalty to act in the best interests of the AIF/UCITS, its investors and the duty not to carry out activities with regard to the AIF/UCITS or AIFM/UCITS ManCo acting on its behalf that might create conflicts of interest without establishing Chinese walls.[581]

7.3.2.7. Ongoing Monitoring and Periodic Review

When monitoring, the depositary shall exercise all due skill, care and diligence in the periodic review and monitoring to ensure that the sub-custodian continues to comply with the implemented and documented procedures as prescribed by the depositary and the ongoing diligence conditions as discussed above.[582] To this end, the depositary shall at least:

- monitor the sub-custodian and its compliance with the depositary's standards;[583]

---

[570] Singh, M. & Aitken, J., *The (sizeable) Role of Rehypothecation in the Shadow Banking System* (IMF Working Paper 2010).
[571] Art. 21(11)(d)(iv) AIFMD.
[572] Art. 22(7) UCITSD V.
[573] *Ibid.*
[574] Art. 22(7)(a) UCITSD V.
[575] Art. 22(7) UCITSD V.
[576] Art. 22(7)(b) UCITSD V.
[577] Art. 22(7)(c) UCITSD V.
[578] Art. 22(7)(d) UCITSD V.
[579] Art. 22(7) sub-paragraph 2 UCITSD V.
[580] These are set out in Art. 21(8) AIFMD and Art. 22(5) UCITSD V.
[581] Chinese walls might be established based upon Art. 21(10) AIFMD and Art. 25(2) UCITSD V.
[582.] Art. 98(3) AIFMD (Commission) Regulation; Art. 15(3) UCITSD V (Commission) Regulation.
[583.] Art. 98(3)(a) AIFMD (Commission) Regulation; Art. 15(3)(a) UCITSD V (Commission) Regulation.

– ensure that the sub-custodian exercises a high standard of care, prudence and diligence in the performance of its custody tasks and, in particular, effectively segregates financial instruments;[584]
– review the risks associated with delegating the safekeeping of assets to a third party. If, based on the information it has from sub-custodians as well as other data, there is any potential risk it shall promptly notify the relevant AIF/UCITS or AIFM/UCITS ManCo.[585]

Ongoing monitoring mainly consists of verifying that the sub-custodian correctly performs all of the duties mentioned above and that it complies with the delegation contract.[586] In this regard, ESMA clarified this obligation in its advice by giving the example that regular reviews can take the form of mutual visits and/or conference calls between the depositary and the sub-custodian.[587]

The frequency of the review should be adapted by the depositary so as to remain consistent with market conditions and associated risks.[588] For instance, during market turmoil or when risks have been identified, the frequency and scope of the review should be increased.[589] If the segregation of assets is no longer sufficient to ensure that the AIF's/UCITS' assets are protected from insolvency due to the legislation of the country where the sub-custodian is located, the depositary shall immediately inform the relevant AIFM/UCITS ManCo.[590] In any case, a depositary should effectively be prepared to respond to the possible insolvency of a sub-custodian by having designated contingency plans for each market in which it appoints a sub-custodian.[591] Such contingency planning shall include the designation of alternative strategies and the possible selection of alternative providers if relevant.[592] It should be noted, however, that such a plan does not alter the obligation to return the financial instruments or pay the corresponding amount should any financial instruments be lost and the criteria under the depositary liability are be fulfilled.[593]

Given the introduction of the liability regime under the AIFMD and UCITSD V, the depositary is liable for a loss of financial instruments held in custody by itself or any of its sub-custodians. The depositary has, thus, a vested interest in monitoring the sub-custodian.[594]

In any case, the depositary shall ensure that any conflicts of interest are avoided by ensuring that sub-custodians neither sub-delegate safekeeping functions to the relevant AIFM/UCITS ManCo nor sub-delegate any of these functions to a prime broker that is acting as an counterparty to an AIF, unless it has functionally and hierarchically separated the performance of its depositary functions from its tasks as a prime broker.[595] However, if the relevant conditions under Article 21(11) AIFMD and Article 22a UCITSD V are met and all potential conflicts of interest are properly identified, managed, monitored and disclosed to investors of the AIF/UCITS, delegation to such a prime broker is allowed.

7.3.3. *Insolvency Protection of UCITS Assets*

584. Art. 98(3)(b) AIFMD (Commission) Regulation; Art. 15(3)(b) UCITSD V (Commission) Regulation.
585. Art. 98(3)(c) AIFMD (Commission) Regulation; Art. 15(3)(c) UCITSD V (Commission) Regulation.
586. Recital 111 AIFMD (Commission) Regulation; Recital 17, 18 UCITSD V (Commission) Regulation.
587. ESMA/2011/379, 174.
588. Art. 98(3)(c) AIFMD (Commission) Regulation; Art. 15(3)(c) UCITSD V (Commission) Regulation.
589. *Ibid.*
590. *Ibid.*
591. Art. 98(6) AIFMD (Commission) Regulation; Art. 15(5) UCITSD V (Commission) Regulation.
592. Recital 111 AIFMD (Commission) Regulation Recital 17, 18 UCITSD V (Commission) Regulation.
593. *Ibid.*
594. See also in this regard: ESMA/2011/379, 174.
595. Art. 98(5) AIFMD (Commission) Regulation; Art. 15(3)(e) UCITSD V (Commission) Regulation.

UCITSD V requires the insolvency protection of UCITS assets when safekeeping is delegated by depositaries to sub-custodians.[596] Article 17 UCITSD V (Commission) Regulation imposes obligations on both the sub-custodian and the depositary. Article 17 UCITSD V (Commission) Regulation applies to the sub-custodian to which custody is delegated a non-exhaustive list of measures, arrangements and tasks to be put in place and performed on an ongoing basis.[597] This non-exhaustive list takes into the account whether the sub-custodian is operating inside or outside the EEA, its insolvency laws and relevant jurisprudence.[598] Depositaries, in the case of the delegation of safe-keeping duties, are required to take measures to ensure that the sub-custodian fulfills its obligations.[599]

7.3.3.1. Sub-custodian

To ensure insolvency protection of UCITS assets, a depositary has to ensure that the sub-custodian, to whom custody has been delegated[600], takes 'all necessary steps' to 'protect UCITS assets' upon its insolvency.[601] Protecting UCITS assets requires steps by the sub-custodian that ensure, in the event of an insolvency of the sub-custodian, that the assets of the UCITS held by the sub-custodian in custody are unavailable for distribution among, or realization for the benefit of creditors of that sub-custodian.[602] The 'necessary steps' to be taken by the sub-custodian depends upon whether the sub-custodian is located in a third country or within the EEA.[603] This differentiation is based upon the premise that the applicable insolvency laws and jurisprudence within the EEA are expected to have implemented Article 22(8) UCITSD V that require that assets of UCITS cannot be distributed to the creditors of a sub-custodian in case of its insolvency.[604]

Sub-custodians located in a third country are required to receive independent legal advice, to verify that the applicable insolvency laws and jurisprudence:[605]

- recognize the segregation of the UCITS' assets from the own assets of the sub-custodian and from the assets of the depositary; and
- the UCITS' segregated assets do not form part of the sub-custodian's estate in case of insolvency and are unavailable for distribution among or realization for the benefit of creditors of the third party.

The sub-custodian has to ensure that the abovementioned steps are taken at the moment of the conclusion of the delegation arrangement with the depositary and on an ongoing basis for the entire duration of the contract.[606] During the life of the delegation agreement with the sub-custodian, the conditions may no longer be met or amended due to modifications of insolvency laws and/or jurisprudence. In such an occasion, the sub-custodian is required to inform the depositary when any of the abovementioned conditions is no longer met.[607] To ensure that the depositary receives appropriate information on the insolvency laws applicable

---

[596] Art. 22(3)(e) UCITSD V.
[597] ESMA/2014/1183, 8.
[598] *Ibid*, 8, 10.
[599] *Ibid*, 8.
[600] Article 22a UCITSD V.
[601] Art. 17(1) UCITSD V (Commission) Regulation; In its consultation, ESMA spoke of 'reasonable' efforts. See ESMA/2014/1183, 14.
[602] Art. 22(3)(e) UCITSD V; Art. 17(1) UCITSD V (Commission) Regulation.
[603] See Art. 17(1) and (3) UCITSD V (Commission) Regulation.
[604] See ESMA/2014/1183, 10.
[605] Art. 17(2)(a) UCITSD V (Commission) Regulation.
[606] Art. 17(2)(b) UCITSD V (Commission) Regulation.
[607] Art. 17(2)(c) UCITSD V (Commission) Regulation; See ESMA/2014/1183, 10.

to the UCITS assets, sub-custodians are required to adequately inform the depositary about the rules and conditions applicable.[608] For that purpose, Article 17(2)(d)-(f) UCITSD V (Commission) Regulation requires the sub-custodian to:

- maintain accurate and up-to-date records and accounts of the UCITS' assets on the basis of which the depositary is able to make an inventory of UCITS assets held with the sub-custodian;[609]
- provide, on a regular basis, and in any case whenever a change occurs, a statement to the depositary detailing the assets of the depositary's UCITS clients;[610]
- inform the depositary about changes of applicable insolvency law and of its effective application.[611]

EEA sub-custodians are deemed to be subject to insolvency laws that do not allow UCITS assets to be distributed to personal creditors in case of insolvency.[612] The duty of EEA sub-custodians are reduced to merely providing on a regulator basis a statement to each depositary that gives an overview of the UCITS' assets held for or on behalf of such a depositary.[613] The requirement applying to EEA and Non-EEA sub-custodians are required to be applying mutatis mutandis to third parties to whom all or parts of its safekeeping functions have been sub-delegated.[614]

7.3.3.2. Depositary

Before and during the delegation of safekeeping functions, the depositary has to ensure that the sub-custodian takes measures and puts in lace arrangements to ensure the insolvency protection of UCITS assets.[615] The depositary has to ensure, by means of (pre-) contractual arrangements, that the UCITS assets are protected from distribution among or realization for the benefit of creditors of the sub-custodian.[616] For this purpose, the UCITSD V deems the insolvency laws of EEA Member States all already in line with this requirement.[617] Depositaries, however, in case of delegation of safe-keeping duties to Non-EEA sub-custodians, are required to take extra due diligence measures to ensure that the sub-custodian fulfills its obligations.[618] These extra measures serve as extra protection against an insolvency of a sub-custodian and in general, require the depositary to understand the insolvency law of the third country in which the sub-custodian is established and ensures that the sub-custodian contract concluded is enforceable. Before the selection and appointment of any Non-EEA sub-custodians, the depositary[619] has to obtain independent information about the applicable insolvency laws and case law of a third country where the UCITS' assets are required to be held to assess:[620]

---

[608] See ESMA/2014/1183, 10.
[609] Art. 17(2)(d) UCITSD V (Commission) Regulation.See alsoArt. 22(6) UCITSD V.
[610] Art. 17(2)(e) UCITSD V (Commission) Regulation.
[611] Art. 17(2)(f) UCITSD V (Commission) Regulation.
[612] See ESMA/2014/1183, 10.
[613] Art. 17(3) UCITSD V (Commission) Regulation.
[614] Art. 17(4) UCITSD V (Commission) Regulation; See also Art. 22a UCITSD V.
[615] Recital 22 and Article 17(1) UCITSD V (Commission) Regulation.
[616] *Ibid.*
[617] Recital 22 UCITSD V (Commission) Regulation.
[618] *Ibid.*
[619] ESMA/2014/1183, 15.
[620] Recital 22 UCITSD V (Commission) Regulation; The opinions on the applicable insolvency laws and case law of third countries 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; See Recital 19 UCITSD V (Commission) Regulation; ESMA/2014/1183, 16.

– the material effects of the provisions of the delegation arrangement governing the relationship with the sub-custodian on the UCITS' rights in respect of its assets;
– how the provisions of the delegation arrangement would operate in the jurisdictions where the assets are held, including the event of insolvency of the sub-custodian.

The contractual arrangement between the depositary and sub-custodian should allow the depositary to terminate of the contractual relationship without undue delay in case:621
– the applicable insolvency laws and jurisprudence do not longer guarantees the segregation of UCITS' assets in the event of an insolvency of the sub-custodian; or
– the conditions under the laws and jurisprudence are no longer fulfilled.[622]

In those cases, the depositary is obliged to inform the UCITS ManCo.[623] The UCITS ManCo has to notify the Competent Authorities about the increased custody and insolvency risk to UCITS' assets in a third country. The depositary nor the UCITS ManCo are upon such a notification discharged from their duties and obligations under the UCITSD V.[624]

UCITSD V requires the insolvency protection of UCITS assets when safekeeping is delegated by depositaries to sub-custodians.[625] Article 17 UCITSD V (Commission) Regulation imposes obligations on both the sub-custodian and the depositary. There is a natural link between this provision and the segregation of assets requirements under Article 22a(3)(d) UCITSD V. The segregation of assets requirement ensures that assets held by sub-custodian, upon an insolvency of the sub-custodian, do not form part of the estate of the sub-custodian under insolvency proceedings[626] since those assets would be solely identified as being assets of a UCITS.[627] For the purpose of insolvency protection of UCITS assets, the depositary has to ensure that in the event of insolvency of the sub-custodian, UCITS assets held in custody by that sub-custodian are unavailable for distribution among or realization for the benefit of the creditors of the sub-custodian.[628]

7.4. Lex Specialis - The Prime Broker as a Sub-Custodian under the AIFMD

Under Recital 43 AIFMD, depositaries may delegate custody tasks to one or more prime brokers or other third parties. In addition to being appointed as a sub-custodian, prime brokers are allowed to provide prime brokerage services as a counterparty to AIFs.[629] This is logical as entities under the AIFMD that qualify as a prime broker primarily perform prime brokerage services as a counterparty to AIFs. Apart from their function as counterparty providing prime brokerage services, prime brokers may under certain conditions be appointed as a

[621] Recital 20 UCITSD V (Commission) Regulation; ESMA/2014/1183, 16.
[622] *Ibid.*
[623] Recital 20 UCITSD V (Commission) Regulation.
[624] Recital 20 UCITSD V (Commission) Regulation.
[625] Art. 22(3)(e) UCITSD V.
[626] Art. 22a(3)(e) and 26b(e) UCITS V.
[627] ESMA/2014/1183, 9.
[628] Art. 22(3)(e) UCITSD V.
[629] Recital 43 AIFMD; Art. 21 (4)(b) AIFMD restricts the safekeeping of prime brokers also to 'counterparties'. This term is not defined by the AIFDM. Following Art. 20(2) AIFMD (Commission) Regulation 'counterparties' should be understood as'counterparties of an AIFM or an AIF in an OTC derivatives transaction, in a securities lending or in a repurchase agreement'.

depositary[630] and/or a sub-custodian[631]. Prime brokers, thus, provide services to AIFs as counterparties, depositaries and sub-custodians.[632]

Under Article 21(4)(b) AIFMD depositaries are, in accordance with Article 21(11) AIFMD, allowed to delegate *custody tasks* to one or more prime brokers[633] provided that relevant conditions are met.[634] Article 21(4)(b) AIFMD applies as a *lex specialis* for prime brokers that are appointed as a sub-custodian. Article 21(4)(b) AIFMD amends the general conditions for delegation by AIFMD depositaries to prime brokers laid down under Article 21(11) AIFMD in various ways.

Article 21(4)(b) AIFMD limits the delegation of functions by depositaries to prime brokers as sub-custodians to *custody tasks*[635]. Like under Article 21(11) AIFMD, Article 21(4)(b) AIFMD allows depositaries to delegate neither its cash management[636] function nor its oversight duties[637] to prime brokers.[638] Under Article 21(11) AIFMD, however, the delegation of functions to all other types of sub-custodians than prime brokers concerns the appointment of a sub-custodian to which a depositary may delegate its *safekeeping function*.[639] The safekeeping function is under Article 21(8) defined as the safekeeping of assets concerning 'financial instruments that can be held in custody'[640] and the safekeeping of 'other assets' that include financial instruments that cannot be held in custody[641]. Article 21(4)(b) AIFMD as *lex specialis*, however, effectively limits the delegation of the *safekeeping function* under Article 21(11) AIFMD by the depositary to a prime broker as a sub-custodian to *custody tasks*.[642]

Following, various provisions of the AIFMD, 'custody tasks' refer to the safekeeping of 'financial instruments that can be held in custody' under Article 21(8)(a) AIFMD.[643] Depositaries are, thus, not allowed to delegate the safekeeping of 'other assets' under Article 21(4)(b) AIFMD to a prime broker as sub-custodian.[644] To the contrary of 'financial instruments that can be held in custody', depositaries may, thus, deliver 'other assets', such as cash and derivatives on behalf of an AIF to prime brokers acting as counterparties without being obliged to appoint the prime broker as a sub-custodian under the AIFMD. At the same time, the depositary remains to be subject to ownership verification and record-keeping rules to 'other assets' that are being delivered to the prime broker as a counterparty. Depositaries, thus, have to ensure that these assets cannot be assigned, transferred, exchanged or delivered by the prime broker without the depositary or a sub-custodian that has been informed of such transactions and the depositary shall also have access to documentary evidence of each transaction from the relevant prime broker.[645]

---

[630] See *supra* 3.1.4.
[631] See Art. 21(10) and (11) AIFMD.
[632] D.A. Zetzsche, *(Prime) Brokerage* 580-590 (D.A. Zetzsche ed, Kluwer 2015).
[633] Recital 43 AIFMD.
[634] Art. 21(4)(b) AIFMD.
[635] Art. 21 (4)(b) AIFMD restricts the safekeeping of prime brokers also to 'counterparties'. This term is not defined by the AIFDM. Following Art. 20(2) AIFMD (Commission) Regulation 'counterparties' should be understood as'counterparties of an AIFM or an AIF in an OTC derivatives transaction, in a securities lending or in a repurchase agreement'.
[636] Art. 21(7) AIFMD.
[637] Art. 21(9) AIFMD.
[638] Prime brokers should be, in this regard, understood as prime brokers solely acting as counterparty to an AIF.
[639] Art. 21(11) AIFMD.
[640] Art. 21(8)(a) AIFMD. See *supra* 6.2.1.
[641] Art. 21(8)(b) AIFMD. See *supra* 6.2.2.
[642] See Recital 43 AIFMD.
[643] See Recital 34, 37, 44, 45, 47 and Art. 21 (11)(d)(ii), (13), (14) and (17)(c)(i) AIFMD.
[644] See *supra* 6.2.1.
[645] Art. 90(2)(c) para. 2 AIFMD (Commission) Regulation.

Depending upon the legal status of financial instruments (that can be held in custody) they qualify as‘other assets’ and may be held by prime brokers without the regulatory duty of the depositary under Article 21(4)(b) AIFMD to appoint the prime broker holding these financial instruments as a sub-custodian.

Financial instruments may be unencumbered, encumbered, i.e. subject to a security interest or right of rehypothecation in favour of the depositary/prime broker[646] or on title transfer.[647] The holding of financial instruments that can be held in custody on an unencumbered basis are clearly within the scope of the definition of financial instruments that can be held in custody. Prime brokers may under Article 21(4)(b) AIFMD not hold these assets without being appointed as a sub-custodian.The same holds true for financial instruments owned by the AIF (or the AIFM on its behalf) for which the AIF (or the AIFM on its behalf) has given its concent to a right of re-use of assets for the depositary. These financial instruments remain to be held ‘in custody’ as long as the right of re-use[648] has not been exercised.[649] Financial instruments which are provided as collateral to a prime broker or are provided by a third party to a prime broker for the benefit of the AIF have to be held in custody too by the depositary itself or the prime broker as sub-custodian as long as they are owned by the AIF or the AIFM acting on behalf of the AIF.[650] Financial instruments, thus, do not fall outside of the scope of ‘financial instruments that can be held in custody’ simply because they are subject to particular business transactions such as financial collateral arrangements.[651] The prime brokerage relationship between depositaries and prime brokers related to unencumbered and encumbered financial instruments that can be held in custody can under the AIFMD be arranged in several ways:[652]

- the prime broker as collateral taker is appointed as the depositary of the AIF or is appointed by the AIF’s depositary as sub-custodian over the AIF’s collateralized assets;
- the AIF’s depositary appoints a sub-custodian that acts for the prime broker as collateral taker; or
- the collateralized assets remain with the AIF’s depositary and are ‘earmarked’ in favour of the prime broker as collateral taker.

Financial instruments that are provided to a prime broker by way of title transfer do not qualify under the AIFMD as ‘financial instruments that can be held in custody’. Upon a title transfer, the AIF loses its proprietary claim to the financial instruments in return for a contractual claim on the prime broker as collateral taker, for re-delivery.[653] Assets for which a TTCA is concluded are, thus, considered ‘other assets’ that may be delivered to the prime broker without the obligation for depositaries to appoint them as a sub-custodian within the meaning of Article 21(4)(b) AIFMD.

---

[646] D.A. Zetzsche, (Prime) Brokerage 586 (D.A. Zetzsche ed, Kluwer 2015).
[647] Allen & Overy, *Alternative Investment Fund Managers Directive: Allen & Overy Briefing Paper No. 7 Impact on Prime Brokers*, http://www.allenovery.com/archive/Documents/Legacy/62666.pdf (accessed 15 August 2016).
[648] T.R.M.P. Keijser, *A Custodian*'*s Right of Use under Dutch Law?* 40-42 (T. Keijser ed, Report on A ‘Right of use’ for collateral takes and custodians, Presented to the UNIDROIT Secretariat (2003).
[649] Recital 100 AIFMD (Commission) Regulation; Recital 12 UCITSD V (Commission) Regulation.
[650] Recital 100 AIFMD (Commission) Regulation; Recital 12 UCITSD V (Commission) Regulation.
[651] *Ibid*.
[652] Recital 98 AIFMD (Commission) Regulation; Recital 10 UCITSD V (Commission) Regulation.
[653] Allen & Overy, *Alternative Investment Fund Managers Directive: Allen & Overy Briefing Paper No. 7 Impact on Prime Brokers*, http://www.allenovery.com/archive/Documents/Legacy/62666.pdf (accessed 15 August 2016).

Under Article 21(4)(b) AIFMD depositaries are, in accordance with Article 21(11) AIFMD, allowed to delegate custody tasks to one or more prime brokers.[654] Upon appointing a prime broker as a sub-custodian, the depositary needs to make sure that upon appointment and on an ongoing basis the prime-broker fulfills the depositary delegation requirements as set out in Article 21(11) AIFMD. In particular, the depositary needs to make sure that the prime broker as sub-custodian complies with the obligations and prohibitions concerning its safekeeping (custody) task. These concern Article 21(8)(a) AIFMD and the related provisions laid down in the AIFMD (Commission) Regulation.[655]

Under Article 21(4)(b) AIFMD depositaries fulfilling the requirements under Article 21(11) AIFMD may only delegate custody tasks to prime brokers provided that relevant conditions are met.[656] These relevant conditions are laid down in Article 21(10) and (11) AIFMD. Article 21(10) and (11) AIFMD do not only require the depositary but also its sub-custodian to act honestly, fairly, professionally and in the interests of the AIF or the investors in the AIF. Article 21(10) AIFMD also imposes a requirement to prime brokers acting as a counterparty to an AIF that are appointed as a sub-custodian for that AIF not to carry out activities with regard to the AIF or the AIFM that may create conflicts of interest between the AIF, its investors, the AIFM and the depositary unless there is due separation of function and management of conflicts. Such prime brokers, thus, are required to functionally and hierarchically separate its sub-custodian tasks from its tasks as a counterparty to that AIF.[657] In addition, prime brokers are under Article 21(10) AIFMD required to properly identify, manage, monitor and disclose potential conflicts of interest to the investors of an AIF.[658] Finally, any assets kept by the prime broker as a sub-custodian may not be reused by the prime broker without the prior consent of the AIF or the AIFM acting on behalf of the AIF.[659]

The latter three conflicts of interests requirements are derived from the fact that, in addition to being a delegate of custody tasks, prime brokers are allowed to provide prime brokerage services to the AIF. Prime brokerage (counterparty) services do not form part of the delegation arrangement.[660] The AIFM, thus, remains to be responsible for appointing the prime broker and prime brokerage management (counterparty, i.e. prime brokerage services), whereas the depositary is responsible for the due diligence upon the appointment and the ongoing due diligence of the prime broker as sub-custodian. The depositary remains to be responsible for carrying out its controlling functions, cash monitoring and its safekeeping task comprising record-keeping.

The delegation of custody tasks by the depositary to prime brokers is, in accordance with Article 21(11) AIFMD is, thus, allowed if relevant conditions related to mitigating conflicts of interest are met.[661]

8. The liability regime under the AIFMD and UCITSD V

One of the most debated issues in the field of depositary regulation that has had a large impact on the industry is the depositary liability regime under the AIFMD and UCITSD V.[662]

---

[654] Recital 43 AIFMD.
[655] See *supra* 6.2.1.
[656] Art. 21(4)(b) AIFMD.
[657] Recital 43 and Article 21(10) AIFMD; This requirement is similar as for prime brokers appointed as depositaries. See Article 21(4)(b) AIFMD.
[658] Art. 21 (10) and (11)(d)(v) AIFMD.
[659] *Ibid.*
[660] Recital 43 AIFMD.
[661] Recital 43 AIFMD.
[662] An earlier version of of this paragraph that targetted the AIFMD depositary liability regime has been published in: S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178

After the Madoff-fraud[663] it became clear that a lack of harmonization has led to different depositary liability regimes in Europe.[664] In France, for example, depositaries were acting as a guarantor of financial instruments being safe-kept.[665] Lost financial instruments that were subject to a custody duty would trigger a strict liability for the depositary, unless an Act of God was proven.[666] At the other hand, most European countries only held depositaries for lost assets to be held in custody liable to the extent that the loss could be attributed to culpable conduct of the depositary itself or its sub-custodian.[667] The AIFMD introducted, following the French example[668], an 'insurer liability' for lost assets to be held by depositaries that has led to many questions on the political and industry level.[669] UCITSD V introduced a depositary liability regime that is to a large extent the same for UCITS depositaries.[670]

This paragraph discusses the AIFMD and UCITSD V depositary liability regime, its consequences for AIF and UCITS depositaries and the rights of the AIFM/UCITS ManCo and investors against the AIF/UCITS depositary.

(2013); See C. Clerc, *The AIF Depositary's Liability for Lost Assets* (D.A. Zetzsche ed, Kluwer 2015), 521-530.

[663] G.N. Gregoriou & F.S. Lhabitant, *Madoff: A Riot of Red Flags* (EDHEC-Position Paper 2009); S. Gene, *Luxembourg Called On to "Brush Up" Governance*, Financial Times, Fund Management Supplement, (26 January 2009); P. Skypala, *UCITS Victory Soured by Madoff Scandal*, Financial Times, Fund Management Supplement, (19 January 2009), 6; P. Hollinger, B. Hall & N. Tait, *Grand Duchy Hits Back at Madoff*, Financial Times (14 January 2009), 23; P. Hollinger & J. Chung, *Madoff Affair Sparks Demand for Revamp of Investment Fund Rules*, Financial Times, (13 January 2009), 15; D. Schwartz, *European banks tally losses linked to Madoff*, New York Times (17 December 2008), http://www.nytimes.com/2008/12/17/business/worldbusiness/17iht-17exposure.18747038.html?pagewanted=1&_r=1 (accessed 3 July 2015).

[664] CESR/09-175.

[665] See S. Dussart, F. Rodriguez et M. Thouch, *La restitution des actifs par le dépositaire,* Joly Bourse 542 (2008); I. Riassetto & A. Prüm, *La fonction de conservation du dépositaire, source de responsabilité civile, note sous Paris, 1ère Ch., Section H, 8 avril 2009, no. 2008/22218*, 3 Joly Bourse 191, §I-A-2 (2009); M. Storck, *Particularisme de l'obligation de restitution incombant au dépositaire*, RTD com. 573, § I-B (2010); I. Riassetto, *Obligation de restitution du dépositaire d'OPCVM*, 4 RD Bancaire et Financier Comm. 161, point 1-B (July 2010); S. Gaouaoui, *Conservation d'actifs, la Cour d'appel entérine la responsabilité des dépositaires*, 1025 Option finance 10 (2009); Ph. Goutay, *Obligation de restitution des dépositaires : les arrêts du 8 avril 2009 de la Cour d'appel de Paris*, 2 RD Bancaire et Financier 166 (2009); P. Guilhaumaud, *La responsabilité civile du dépositaire d'OPCVM*, 25 Banque et Droit 551 (1992); M. Karlin, *Responsabilité des teneurs de compte conservateurs*, 2 RD Bancaire et Financier étude 8 (2009).

[666] Also referred to as an obligation of results, i.e. a strict obligation to return all assets entrusted to a depositary. See J.R. Siena, *Depositary Liability: A Fine Mess and How to Get Out of It* (D.A. Zetzsche ed, Kluwer 2015), 568-569; M. Pierrat, *De la distinction entre obligations de moyens et obligations de resultat: pile ou face?* 15 Journal des Tribunaux 61 et seq (2011); C. Clerc, *The AIF Depositary's Liability for Lost Assets* (D.A. Zetzsche ed, Kluwer 2015), 528.

[667] This standard of liability is being referred to in practice as an obligation of means, i.e. a standard of care to act without negligence or wilful failure to execute one's responsibilities. See J.R. Siena, *Depositary Liability: A Fine Mess and How to Get Out of It* (D.A. Zetzsche ed, Kluwer 2015), 568-569; M. Pierrat, *De la distinction entre obligations de moyens et obligations de resultat: pile ou face?* 15 Journal des Tribunaux 61 et seq (2011). See also CESR/09-175; See also: H. Hövekamp & G. Hugger, *Die Reichweite der Haftung der Depotbanken vor dem Hintergrund des Madoff-Skandals* 2015-2028 (S. Grundmann, B. Haar & H. Merkt eds., De Gruyter 2010).

[668] Letter from French Finance Minister Christine Lagarde to Charlie McCreevy, EC, Jan. 2009;

[669] A. Maffei, *Controverse autour des obligations du dépositaire*, 1 RD Bancaire et Financier étude 8 (2011); J.R. Siena, *Depositary Liability: A Fine Mess and How to Get Out of It* (D.A. Zetzsche ed, Kluwer 2015), 541-544; R. Weber & S. Grünewald, *UCITS and the Madoff scandal: liability depositary banks?,* http://www.zora.uzh.ch/20149/ (accessed 15 May 2017).

[670] I.Riassetto, *Dépositaires - Quelles différences entre la directive OPCVM V et la directive AIFM?,* 4 RD Bancaire et Financier (2014) ; K. Lachgar, *From the UCITS Directive to the transposition of AIFMD : exegesis of evolutions's depositary activity in Europe*, Joly Bourse (2014); I. Riassetto, *La clarification des obligations et de la responsabilité des dépositaires par la directive OPCVM V,* 98 Revue Lamy Droit des Affaires 31 (2014); I. Riassetto, *Le nouveau régime applicable aux dépositaires issu de la directive OPCVM V*, 3 Bulletin Joly Bourse 113 (2015).

8.1. The Depositary's liability under the AIFMD and UCITSD V

The AIFMD and UCITSD V deviate between liability of the depositary for the loss of financial instruments that can be held in custody and other losses. The depositary is under the AIFMD and UCITSD V liable to the AIF/UCITS or to the investors for losses of financial instruments held in custody either by the depositary itself or sub-custodians to whom custody has been delegated.[671] Upon a loss, the depositary shall return a financial instrument of identical type or the corresponding amount to the AIF/UCITS, or the AIFM/UCITS ManCo, without undue delay.[672] The depositary shall not be liable if it can prove in a private law case that the loss has arisen as a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.[673] This strict liability regime is not applicable to real estate and any other assets than financial instruments that can be held in custody. With regard to losses for these assets, the depositary is liable to the AIF/UCITS, or the investors of the AIF/UCITS, if the loss is the result of the depositary's negligent or intentional failure to properly fulfil its obligations under the AIFMD/UCITSD V.[674] Determining liability will, regarding these assets, solely be based upon the private law standards of the individual Member States. In civil law jurisdictions claims are likely to be based upon a breach of contract or a general tort law provision.[675] The AIFMD and UCITSD V does not assign for these losses the burden of proof to the depositary, but to the AIF/UCITS, AIFM/UCITS ManCo or investors involved. To the contrary, the AIFMD and UCITSD V (Commission) Regulation regulate in detail (1) when a financial instruments that can be held in custody is considered to be lost, (2) what exactly consistutes an external event beyond the reasonable effort, the consequences of which would have been unavoidable despite reasonable efforts so that the depositary can be discharged from liability and under the AIFMD (Commission) Regulation (3) whether and to what extent the depositary may contractually discharge itself from liability. This will now be discussed in detail.

8.1.1. *Loss of Financial Instruments that can be held in Custody*

The depositary's liability is triggered in the event of a 'loss of financial instruments held in custody' by the depositary itself or by a sub-custodian to whom safekeeping has been delegated.[676] The definition of loss is important as it determines the scope of the liability of a depositary. A loss of a financial instruments held in custody only gives rise to a depositary's liability if the loss is definitive, and there is no prospect of recovering the financial asset.[677] Situations where a financial instrument is only temporarily unavailable or frozen do not count as a loss.

A 'loss of financial instruments held in custody' should be distinguished from an investment loss that investors face as a result from a decrease in value of assets as a consequency of an investment decision.[678]

---

[671] Art. 21(12) AIFMD; Art. 24(1) UCITSD V.
[672] I. Riassetto, *L'obligation de restitution du dépositaire d'OPC en droit Luxembourgeois*, 30 Journal des Tribunaux Luxembourg 167 (2013).
[673] Art. 21(12) AIFMD; Art. 24(1) UCITSD V.
[674] Art. 21(12) AIFMD; Art. 24(1) UCITSD V; I. Riassetto, Responsabilité de la société de gestion et du dépositaire d'un OPC envers les actionnaires d'une société cible, note sous Cass. com. fr. 27 mai 2015, 4 RD Bancaire et Financier (2015); I. Riassetto, *Moyens et procédures adéquats pour la mise en œuvre de l'obligation de contrôle des dépositaires d'OPC*, 10 Bulletin Joly Bourse (2013).
[675] For example in the Netherlands: Art. 6:162 and Art. 6:74 BW.
[676] Art. 21(12) AIFMD; Art. 24(1) UCITSD V.
[677] Recital 114 AIFMD (Commission) Regulation; Recital 24 UCITSD V (Commission) Regulation.
[678] Recital 113 AIFMD (Commission) Regulation; Recital 24 UCITSD V (Commission) Regulation.

Following the AIFMD and UCITSD V (Commission) regulation, a 'loss' of a financial instrument held in custody shall be be deemed to have taken place when:[679]

- a stated right of ownership of the AIF/UCITS is demonstrated not to be valid because it either ceased to exist or never existed;[680]
- the AIF/UCITS has been definitively deprived of its right of ownership over the financial instrument; [681]
- the AIF/UCITS is definitively unable to directly or indirectly dispose of the financial instrument.[682]

The situation in which financial instruments no longer exist or never existed is the most obvious type of situation in which the loss of the financial instrument should be deemed to be 'definitive'.[683] A financial instrument, for example, is deemed no longer to exist when it has disappeared following an accounting error that cannot be corrected, or if it never existed, when the AIF's/UCITS' ownership was registered on the basis of falsified documents.[684] All situations where the loss of financial instruments is caused by fraudulent conduct should be deemed a loss.[685]

In the other two situations set out in the the AIFMD and UCITSD V (Commission) regulation, it will need to be ascertained that the the financial instruments are lost, without any prospect of recovering the financial assets in question.[686] There is only a loss in those situations if the AIF/UCITS has been permanently deprived of its ownership right over the financial instruments or is permanently unable to dispose of them.[687] Financial instruments are only deemed to be lost when the financial instrument exist but the AIF/UCITS has definitively lost its right of ownership over it and where the AIF/UCITS has the ownership right but can no longer transfer title of or create property rights over the financial instrument on a permanent basis.[688]

No loss can be ascertained when a financial instrument has been substituted by or converted into another financial instruments, for instance, in situations where shares are cancelled and replaced by the issue of new shares in a company reorganisation.[689] Situations where financial instruments are only temporarily unavailable or frozen do not count as a loss. If, for instance, a depositary can temporarily not dispose of financial instruments as a result of an insolvency procedure[690] of a sub-custodian or as a consequence of an error in an settlement system, the financial instruments shall not deemed to be lost.[691]

According to ESMA, financial instruments upon an insolvency of a sub-custodian should be considered to be permanently lost:[692]

- where the sub-custodian failed to apply the AIFMD's/UCITSD V segregation rules;

---

[679] Art. 100(1) AIFMD (Commission) Regulation; Art. 18(1) UCITSD V (Commission) Regulation.
[680] Art. 100(1)(a) AIFMD (Commission) Regulation; Art. 18(1)(a) UCITSD V (Commission) Regulation.
[681] Art. 100(1)(b) AIFMD (Commission) Regulation; Art. 18(1)(b) UCITSD V (Commission) Regulation.
[682] Art. 100(1)(c) AIFMD (Commission) Regulation; Art. 18(1)(c) UCITSD V (Commission) Regulation.
[683] Recital 114 AIFMD (Commission) Regulation; Recital 24 UCITSD V (Commission) Regulation.
[684] Recital 115 AIFMD (Commission) Regulation; Recital 25 UCITSD V (Commission) Regulation.
[685] Recital 115 AIFMD (Commission) Regulation; Recital 25 UCITSD V (Commission) Regulation; See also ESMA/2011/379, 181.
[686] Recital 114 AIFMD (Commission) Regulation; Recital 24 UCITSD V (Commission) Regulation.
[687] ESMA/2011/379, 178.
[688] Recital 114 AIFMD (Commission) Regulation; Recital 24 UCITSD V (Commission) Regulation.
[689] Recital 116 AIFMD (Commission) Regulation; Recital 26 UCITSD V (Commission) Regulation.
[690] ESMA/2011/379, 181; See also Art. 101(4) and (5) AIFMD (Commission) Regulation.
[691] Art. 100(4) AIFMD (Commission) Regulation; Art. 18(4) UCITSD V (Commission) Regulation.
[692] Recital 27 UCITSD V (Commission) Regulation; See also ESMA/2011/379, 180-181.

- where the law of the country where the financial instruments are being held does not recognize the AIFMD's/UCITSD V segregation rules; and
- in the event a small percentage of the assets are lost in the insolvency procedure due to the disruption in the entity's activity in relation to its default.

Following the AIFMD and UCITSD V (Commission) Regulation, the second situation might, however, be considered to be an external event beyond thee control of the depositary. For the other two situations, the depositary is only not held liable if it can prove that the loss resulted from an external event beyond its reaonsable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.[693]

8.1.2. *The AIFMD and UCITSD V Liability Discharge*

Depositaries can only avoid to be held liable under the AIFMD and UCITSD V in the case of an external event beyond the reasonable control of the depositary, the consequences of which are unavoidable despite all reasonable efforts to the contrary.[694] The depositary should prove that it cumulatively fulfils the conditions of the liability discharge.[695] The AIFMD and UCITSD V (Commission) Regulation lays down a procedure that needs to be followed by the depositary for that purpose.[696] To be discharged of liability, the depositary would first need to prove that the event which led to the loss of the financial instruments held in custody was 'external'.[697] Then, the depositary should prove that the event was 'beyond its reasonable control', which is understood by the AIFMD and UCITSD V (Commission) Regulation as an event that the depositary could not have prevented by reasonable efforts.[698] Finally, the depositary should prove that the loss could not have been prevented by the depositary with reasonable efforts.[699] These requirements shall now be discussed in detail.

8.1.2.1. External Event

The depositary would first need to prove that the event which led to the loss of the financial instruments held in custody was 'external'.[700] The rationale behind this is that the depositary's liability under the AIFMD and UCITSD V may not be effected by delegation.[701] An event is deemed to be external if it does not occur as a result of any act or omission of the depositary or sub-custodian to which custody of financial instruments has been delegated.[702] Depositaries may, for example, not be able to rely on internal situations such as a fraudulent acts by employees or an accounting error to discharge itself from liability.[703] Depositaries may also

[693] Recital 27 UCITSD V (Commission) Regulation; See also ESMA/2011/379, 181.
[694] Art. 21(12) AIFMD; See Recital 117 AIFMD (Commission) Regulation; Art. 24(1) UCITSD V; Recital 27 UCITSD V (Commission) Regulation.
[695] Art. 21(12) AIFMD; See Recital 117 AIFMD (Commission) Regulation; Art. 24(1) UCITSD V; Recital 27 UCITSD V (Commission) Regulation.
[696] Art. 21(12) AIFMD; See Recital 117 AIFMD (Commission) Regulation; Art. 24(1) UCITSD V; Recital 27 UCITSD V (Commission) Regulation; See also ESMA/2011/379, 179.
[697] Recital 118, Art. 101(1)(a) AIFMD (Commission) Regulation; Recital 28, Art. 19(1)(a) UCITSD V (Commission) Regulation.
[698] Recital 118, Art. 101(1)(b) AIFMD (Commission) Regulation; Recital 28, Art. 19(1)(b) UCITSD V (Commission) Regulation.
[699] Recital 119, Art. 101(1)(c) AIFMD (Commission) Regulation; Recital 28, Art. 19(1)(c) UCITSD V (Commission) Regulation; ESMA/2011/379, 179.
[700] Recital 118, Art. 101(1)(a) AIFMD (Commission) Regulation; Recital 28, Art. 19(1)(a) UCITSD V (Commission) Regulation.
[701] Recital 118 AIFMD (Commission) Regulation; Recital 28 UCITSD V (Commission) Regulation.
[702] Art. 101(1)(a) AIFMD (Commission) Regulation; Art. 19(1)(a) UCITSD V (Commission) Regulation; See also ESMA/2011/379, 184.
[703] Recital 44 AIFMD; Art. 101(3) AIFMD (Commission) Regulation; Art. 19(3) UCITSD V (Commission) Regulation.

not rely upon these 'internal situations' that occur at the level of one of the depositary's sub-custodians to discharge itself from liability. A technical failure at the level of the CSD or another settlement system are examples that would be considered to be 'external'.

8.1.2.2. Beyond Reasonable Control

Any external events that are proven by a depositary only lead to a discharge of liability if the event is considered to be beyond the reasonable control of the depositary.[704] For this purpose, the depositary would have to prove that it could have done nothing to be a more 'prudent depositary' in preventing the occurrence of the event.[705] Depositaries that have adopted all precautions incumbent on a diligent depositary as reflected in common industry practice that has conducted rigorous and comprehensive due diligence to prevent a loss are considered to be a prudent depositary.[706]

The AIFMD and UCITSD V (Commission) Regulation sets out a non-exhausitive list of circumstances that can be seen as 'external events beyond the reasonable control of the depositary'.[707] Deemed as external events beyond reasonable control would be the following circumstances:

- natural events beyond human control or influence[708]
- war, riots or other major upheavals;[709] and
- the adoption of any laws, decrees, regulation, decision or any orders issues by governmental body, including any court or tribunal which impacts the financial instruments held in custody;[710]

8.1.2.3. 'Reasonable Efforts'

Finally, the depositary should prove that the loss could not have been avoided despite all reasonable efforts to the contrary. For this purpose, the depositary has (1) to ensure that they have the appropriate means to identify and monitor events that are deemed beyond its control and could lead to a loss, (2) the depositary should regularly update its assessment of such events and (3) take appropriate action when needed.[711]

This would be deemed to be fullfilled under AIFMD and UCITSD V (Commission) Regulation when the depositary could not have prevented the loss despite rigorous and comprehensive due diligence as documented by:[712]

- 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 AIF/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;[713]
- assessing on an ongoing basis whether any of the events identified under the first indent presents a significant risk of loss of a financial instrument held in custody;[714]

---

[704] ESMA/2011/379, 185.
[705] Recital 118, Art. 101(1)(b) and (c) AIFMD (Commission) Regulation; Recital 28, Art. 19(1)(b) and (c) UCITSD V (Commission) Regulation.
[706] Recital 118, Art. 101(1)(b) and (c) AIFMD (Commission) Regulation; Recital 28, Art. 19(1)(b) and (c) UCITSD V (Commission) Regulation.
[707] Recital 118, Art. 101(2) AIFMD (Commission); Recital 28, Art. 19(2) UCITSD V (Commission) Regulation.
[708] Art. 101(2)(a) AIFMD (Commission) Regulation; Art. 19(2)(a) UCITSD V (Commission) Regulation.
[709] Art. 101(2)(b) AIFMD (Commission) Regulation; Art. 19(2)(b) UCITSD V (Commission) Regulation.
[710] Art. 101(2)(c) AIFMD (Commission) Regulation; Art. 19(2)(c) UCITSD V (Commission) Regulation.
[711] ESMA/2011/379, 185.
[712] Art. 101(1)(c) AIFMD (Commission) Regulation; Art. 19(1)(c) UCITSD V (Commission) Regulation.
[713] Art. 101(1)(c)(i) AIFMD (Commission) Regulation; Art. 19(1)(c)(i) UCITSD V (Commission) Regulation.
[714] Art. 101(1)(c)(ii) AIFMD (Commission) Regulation; Art. 19(1)(c)(ii) UCITSD V (Commission) Regulation.

- informing the AIFM/UCITS ManCo 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.[715]

The depositary should inform the AIFM/UCITS ManCo and take appropriate action depending on the circumstances.[716] This can, for example, be the case in a situation where the depositary believes that the only appropriate action is the disposal of the financial instruments held in custody.[717] The AIFM/UCITS ManCo must in turn instruct the depositary in writing whether the financial instruments should be continued to be held or to dispose of them.[718] Any such instruction to continue to hold the financial instruments should be reported to the AIF's/UCITS'investors.[719] Informing the AIFM/UCITS ManCo by the depositary, however, does not discharge the depositary of its liability.[720] When the standard of protection of the financial instruments held in custody remains to be insufficient despite repeated warnings, the depositary might consider to take other actions, such as transferring the liability contractually to a sub-custodian or the termination of the depositary contract concluded with the AIFM/UCITS ManCo.[721]

8.1.3. *The AIFMD Contractual Discharge of Liability*

The depositary's liability is not affected by any delegation of the safekeeping task to a sub-custodian.[722] The AIFMD, to the contrary of the UCITSD V[723], provides the possibility for depositaries to contractually discharge itself of liability if the depositary complies with a number of strict requirements.[724] First, the depositary must be able to prove that all requirements for the delegation of its custody tasks set out in the AIFMD are met.[725] Second, the sub-custodian must accept the transfer of liability of the depositary to that sub-custodian by means of a written contract concluded between the depositary and the sub-custodian. The written contract should include that it is possible for the AIF or the AIFM to make a claim against the sub-custodian in respect of the loss of financial instruments or for the depositary to make such a claim on their behalf. [726] Finally, the written contract between the depositary and the AIF (or AIFM) should expressly allow a discharge of the depositary's liability and establish an 'objective reason'[727] to contract such a discharge.[728] The objective reason for contracting such discharge should be accepted by both the depositary and the AIF (or AIFM).[729] For each discharge of liability[730] an objective reason should be established that takes into account the concrete circumstances in which custody has been delegated.[731] The objective reason established should also be consistent with the depositary's policies and

---

[715] Art. 101(1)(c)(iii) AIFMD (Commission) Regulation; Art. 19(1)(c)(iii) UCITSD V (Commission) Regulation.
[716] Recital 119 AIFMD (Commission) Regulation; Recital 29 UCITSD V (Commission) Regulation.
[717] Recital 119 AIFMD (Commission) Regulation; Recital 29 UCITSD V (Commission) Regulation.
[718] Recital 119 AIFMD (Commission) Regulation; Recital 29 UCITSD V (Commission) Regulation.
[719] Recital 119 AIFMD (Commission) Regulation; Recital 29 UCITSD V (Commission) Regulation.
[720] ESMA/2011/379, 185.
[721] Recital 119 AIFMD (Commission) Regulation; Recital 29 UCITSD V (Commission) Regulation.
[722] Art. 21(13) AIFMD; Art. 24(2) UCITSD V.
[723] Art. 24(3) UCITSD V.
[724] Art. 21(13) AIFMD.
[725] See Recital 45, Art. 21(13) sub-para. 2 AIFMD; Art. 24(2) UCITSD V.
[726] Recital 45 AIFMD.
[727] Recital 122, Art. 102 lid 1 AIFMD (Commission).
[728] Art. 21(13)(c) AIFMD.
[729] Recital 121 AIFMD (Commission) Regulation.
[730] Recital 121, Art. 102(2) AIFMD (Commission) Regulation.
[731] Art. 102(1)(a) AIFMD (Commission) Regulation.

decisions.[732] When considering an objective reason, careful considerations should be made to ensure that the contractual discharge can be effectively relied upon by the depositary if needed and that sufficient safeguards are put in place to avoid any misuse.[733] Under no circumstances the contractual discharge of liability may be used to circumvent the depositary's liability requirements under the AIFMD.[734] Contracting a discharge shall always be in in the best interest of the AIF (or AIFM acting on its behalf) and its investors.[735]

The depositary should be able to demonstrate that it was forced by the specific circumstances to delegate custody to a sub-custodian[736] In particular, the AIFMD (Commission) Regulation considers this to be the case where:[737]

- the law of a third country requires that certain financial instruments shall be held in custody by a local entity and local entities exist that satisfy the delegation criteria laid down in Article 21(11) AIFMD; or
- the AIFM insists on maintaining an investment in a particular jurisdiction despite warnings by the depositary as to the increased risk this presents.

Where the law of a third country requires certain financial instruments to be held by a local entity and no local entities satisfy the criteria as laid down in the AIFMD[738], the depositary may only discharge itself of liability provided that:[739]

- the rules or instruments of incorporation of the AIF concerned expressly allow for such a discharge; [740]
- the investors of the relevant AIF have been duly informed of that discharge and of the circumstances justifying the discharge prior to their investment; [741]
- the AIF (or AIFM) instructed the depositary to delegate the custody of such financial instruments to a local entity;[742]
- the written contract between the depositary and the AIF (or the AIFM) expressly allows such a discharge;[743] and
- the written contract between the depositary and the third party expressly transfers the liability of the depositary to that local entity and makes it possible for the AIF(or AIFM) to make a claim against that local entity in respect of the loss of financial instruments or for the depositary to make such a claim on their behalf.[744]

8.2. The impact of the AIFMD/UCITSD V Liability Regime for Depositaries

The AIFMD and UCITSD V depositary liability regime upon its implementation has had a major impact in Europe. An 'insurer' or 'guarantor' liability[745] was introduced for

[732] Art. 102(1)(b) AIFMD (Commission) Regulation.
[733] Recital 122 AIFMD (Commission) Regulation.
[734] Recital 122 AIFMD (Commission) Regulation.
[735] Recital 122 AIFMD (Commission) Regulation.
[736] Recital 122 AIFMD (Commission) Regulation.
[737] Art. 102(3) AIFMD (Commission) Regulation.
[738] See Art. 21(11)(d)(ii) AIFMD, Art. 22a(3)(b) UCITSD V.
[739] Art. 21(14) AIFMD.
[740] Art. 21(14)(a) AIFMD.
[741] Art. 21(14)(b) AIFMD.
[742] Art. 21(14)(c) AIFMD.
[743] Art. 21(14)(d) AIFMD.
[744] Art. 21(14(e) AIFMD.
[745] J.R. Siena, Depositary Liability: A Fine Mess and How to Get Out of It (D.A. Zetzsche ed, Kluwer 2015), 450-551.

safekeeping financial instruments that can be held in custody that triggers a liability for depositaries to restitute the lost assets, unless a Act of God discharges them.[746]

First, the broad definition of 'financial instruments to be held in custody' under the AIFMD and UCITSD V results in a broad scope of financial instruments for which depositaries have become guarantors.[747] The definition includes all financial instruments that can be registered in a financial instruments account opened in the depositary's books and all financial instruments that can be physically delivered to the depositary. The definition, however, also includes financial instruments that are capable of being registered or held in an account directly or indirectly in the name of the depositary.[748] This includes financial instruments, such as non-listed units of collective investment undertakings, that are not traded on a regulated or an equivalent market and are not lodged or registered in an issuer CSD. Therefore, these financial instruments fall outside the scope of the certainty of settlement that 'delivery versus payment' systems of CSDs provide. For financial instruments that are capable of being registered or held in an account directly or indirectly in the name of the depositary, the depositary and not the (investors of the) AIF/UCITS are owner of the financial instruments, whereas either the investors or the AIF/UCITS have a contractual claim to the (balance sheet of the) depositary. This is not in line with the international accepted standards in which financial instruments can only be hold in custody[749]if in rem property rights exist for financial instruments in the holding chain that are being kept by the depositary in custody with taking into account the rules of asset segregation[750] on behalf of (the investors of) an AIF/UCITS.[751] The AIFMD and UCITSD V depositary liability regime, thus, also holds the depositary liable for financial instruments for which no rights in rem exist in the holding chain and the depositary lacks the means to control.

Second, the vast scope of the depositary guarantor liability is not only the result of the broad definition of financial instruments, but also due to a very broad interpretation of the financial instruments subject to financial collateral arrangements that are considered to be held 'in custody'. The key question during the consultation of the AIFMD was whether the holding of assets which are encumbered, but have not been transferred[752] to a collateral taker by way of title transfer, fall within the depositary's custody function or not.[753] In this regard, the AIFMD/UCITSD V determines that financial instruments subject to a security financial collateral arrangement[754] should be considered as being held in custody as long as they are owned by the AIF/UCITS (or AIFM/UCITS ManCo on its behalf) whether that arrangement

---

[746] J.R. Siena, *Depositary Liability: A Fine Mess and How to Get Out of It* (D.A. Zetzsche ed, Kluwer 2015), 450-551.

[747] *Ibid*, 450-551.

[748] Art. 88(2) AIFMD (Commission) Regulation; Art. 12(2) UCITSD V (Commission) Regulation.

[749] See D. Frase, *Custody*, in *Law and Regulation of Investment Management* (D. Frase ed., Sweet & Maxwell 2011), 274; J.R. Siena, *Depositary Liability: A Fine Mess and How to Get Out of It* (D.A. Zetzsche ed, Kluwer 2015), 450-551.

[750] In practice, depositaries use, for instance, earmarking to administratively segregate assets held on behalf of (the investors of an) AIF/UCITS from the assets of the depositary itself and other clients of the depositary.

[751] The AIFMD and UCITSD V are based upon the concept in which (the investors of an) AIF/UCITS are legal or beneficial owner of the assets safekept by the depositary. The transfer of custody laws in some Member States attribute legal ownership to (the investors of an) AIF/UCITS by granting a deemed 'continued ownership of assets', whereas other Member States deem (the investors of an) AIF/UCITS to be beneficial owners that have a 'preferential creditor status'. See IOSCO 1996, 12, 13; See also M. Haentjens, *Harmonisation of Securities Law: Custody and Transfer of Securities in European Private Law* (Private Law in European Context Series), 131-172.

[752] T.R.M.P. Keijser, Financiële zekerheidsovereenkomsten, 11 Ars Aequi 835-840 (2006).

[753] ESMA/2011/379, 148, 158.

[754] T.R.M.P. Keijser, Financiële zekerheidsovereenkomsten, 11 Ars Aequi 835-840 (2006).

includes a transfer of the financial instruments to a third-party for that purpose or not.[755] The final position taken in the AIFMD/UCITSD V was surprising as ESMA in its advice considered to exclude all encumbered financial instruments from the scope of the depositary's custody duty as encumbered financial instruments are often not any more in the 'possession or control' of the AIF/UCITS, but of the collateral taker.[756] The AIFMD/UCITSD V has as a consequence that collateral takers of AIFs/UCITS, such as (prime) brokers, may not hold encumbered financial instruments without being a depositary or sub-custodian.This does not prevent a prime broker from vesting security interests over assets held in custody with the depositary or a sub-custodian, but the absence of control of the assets could gives rise to operational and legal barriers to enforcement.[757] Given the additional risks faced by prime brokers, the holding of encumbered assets in the division performing prime broker functions have been prohibited.[758] Instead, prime brokers have required an increasing amount of title-transferred assets for providing credit to compensate for the additional credit risk borne.[759] The position of the AIFMD/UCITSD V towards encumbered financial instruments has, thus, led to a change in the way assets in prime brokerage relationships are being kept in the hedge fund domain.[760]

Third, pursuant to the AIFMD and UCITSD V, a 'loss' of a financial instrument held in custody by a depositary or any of its sub-custodians triggers directly an obligation for the depositary to return a financial instrument of an identical type or the corresponding amount to be triggered.[761] The depositary can only be discharged from liability if it can demonstrate that the loss resulted from an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.[762] The depositary's liability regime has been an important issue upon the introduction of the AIFMD and UCITSD V and very controversial.[763] It has established a practice that has led to important changes of the depositary's liability regime in many Member states. Prior to the AIFMD and UCITSD V, depositaries were in most Member States only liable for a lost financial instrument in the event of failure or negligence that could be attributed to the depositary itself or any of its sub-custodians.[764] After the introduction of the AIFMD and UCITSD V, only acts of State, acts of God[765] are considered as being an 'external event beyond reasonable control'. In addition, a depositary can only in limited circumstances contractually transfer liability to any of its sub-custodians. Depositaries have been made responsible for all internal events of sub-custodians, including events in which there is not any event of failure or negligence at the depositary level, that are not under the absolute control of the depositary.

During the consultation phase of the AIFMD and UCITSD V, the industry has brought forward the argument that depositaries do not delegate the custody of assets to circumvent

---

[755] Recital 100 AIFMD (Commission) Regulation; Recital 12 UCITSD V (Commission) Regulation.
[756] ESMA/2011/379, 148, 158; J.R. Siena, *Depositary Liability: A Fine Mess and How to Get Out of It* (D.A. Zetzsche ed, Kluwer 2015), 544.
[757] Allen & Overy, *Alternative Investment Fund Managers Directive: Allen & Overy Briefing Paper No. 7 Impact on Prime Brokers*, http://www.allenovery.com/archive/Documents/Legacy/62666.pdf (accessed 15 August 2016).
[758] *Ibid.*
[759] *Ibid.*
[760] Art. 21(4)(b) AIFMD; See D.A. Zetzsche, (Prime) Brokerage 600-605 (D.A. Zetzsche ed, Kluwer 2015).
[761] Art. 21(12) AIFMD; Art. 24(1) UCITSD V.
[762] Art. 21(12) AIFMD; Art. 24(1) UCITSD V.
[763] ESMA/2011/379, 178.
[764] CESR/09-175.
[765] J.R. Siena, *Depositary Liability: A Fine Mess and How to Get Out of It* (D.A. Zetzsche ed, Kluwer 2015), 450-551.

liability, but that the appointment of a sub-custodian is necessary to have access to a large variety of markets to serve their clients.[766] This might, for example, be the case if certain financial instruments in certain markets are registered at local CSDs (not Euroclear or Clearstream) whereas foreign global custodians are not allowed to open any financial instruments account. In addition, the contractual discharge of liability leads to legal complexities. The AIFMD and UCITSD V require that, in order to succesfully transfer contractually liability, the AIF/UCITS or its AIFM/UCITS ManCo have to be able to hold the sub-custodian liable. This implicates that in practice the written agreement between the depositary and sub-custodian needs to contain a 'third-party clause'. Unclear is how this could be established in the case of omnibus-accounts[767]. Practically it is almost impossible for a depositary to include such a clause in all written agreements that are being concluded for each individual AIF/UCITS.

Finally, the 'insurer' or 'guarantor' liability[768] introduced under the AIFMD and UCITSD V has been argued to lead to increased systemic risk.[769] The AIFMD and UCITSD V limit not only the type of entities that are able to be appointed as a depositary, but also impose a liability on depositaries for which the depositary can hardly (contractually) discharge itself.[770] Triggering such a liability on depositaries might lead, in the case of huge amounts of assets being safekept by the depositary, to a insolvency of the depositary. This insolvency can be systematic, i.e. the failure of a depositary can trigger a chain reaction of bankruptcies of investors that have contracted with the depositary.[771] This effects both secured creditors of the depositary, as well as, investors of AIFs/UCITS. On top of that, depositaries and investors increasingly share beneficial rights in assets safekept by depositaries leaving AIFs/UCITS investors not with an in rem, but an in personam right against the depositary. In the depositary contract, the depositary often negotiates a right of use. This creates uncertainy whether the creditors of the depositary, in the event of bankruptcy, may claim against all assets or merely the assets in which the depositary has an interest that increases the costs for investors to transact with the depositary and may discourage transactions all together.[772]

The AIFMD/UCITSD V leads, thus, to the consequence that depositary under the AIFMD and UCITSD V serve as a liability guarantor for all financial instruments that can be held in custody.[773] For other losses the depositary is only liable towards the AIF or its investors in the event of failure or negligence.

---

[766] *Ibid*, 541-544.

[767] An omnibus account is an account opened in the name of a depositary as account provider in which securities are credited that belong to several clients of the depositary. The depositary maintains the interests of the clients in respect of the financial instruments that are credited to the account in the name of the depositary on his own books and records. Omnibus accounts may contain the depositary's own and clients' assets. See http://ec.europa.eu/internal_market/financial-markets/docs/certainty/background/31_8_5_turing_en.pdf; The CSDR refers to 'omnibus client segregation'. See Recital 42, Art. 38(3) CSDR: 'A CSD shall keep records and accounts that enable any participant to hold in one securities account the securities that belong to different clients of that participant'.

[768] J.R. Siena, Depositary Liability: A Fine Mess and How to Get Out of It (D.A. Zetzsche ed, Kluwer 2015), 450-551.

[769] ESMA/2011/379, 178.

[770] N. Moloney, *EC Securities Regulation* 298 (3rd edn., Oxford University Press 2014); See also J. Woolfe, Big Issue to Resolve to Wrap Up the Directive, Financial Times, Fund Management Supplement, 18 January 2010, 8.

[771] S.L. Schwarcz, *Systemic Risk*, 1 Georgetown Law Journal (2008); Financial Services Authority, *Implementation of the Alternative Investment Fund Managers Directive*, DP 12/1 (January 2012), 70, http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/discussion/dp12-01.pdf (accessed 11 August 2016).

[772] S.L. Schwarcz, *Systemic Risk*, 1 Georgetown Law Journal (2008).

[773] A. Maffei, *Controverse autour des obligations du dépositaire*, 1 RD Bancaire et Financier étude 8 (2011).

8.3. Rights of the AIFM/UCITS ManCo and Investors against the Depositary

The depositary is under the AIFMD/UCITSD V liable to the AIF/UCITS or to the investors[774] for the loss of financial instruments. With regard to other losses, the depositary is liable to the AIF/UCITS or the investors if the loss is the result of the depositary's negligent or intentional failure to properly fulfil its obligations under the AIFMD/UCITSD V.[775] In case the depositary does not lawfully perform its tasks damages based on either a breach of contract or tort law. An important issue concerns the 'direct' or 'indirect' rights of investors to raise claims against the depositary. The AIFMD and the UCITSD V provide different regimes to invoke liability for investors.

8.3.1. *AIFMD*

Under Article 21(15) AIFMD

> 'liability to the investors of the AIF may be invoked directly or indirectly through the AIFM, depending on the legal nature of the relationship between the depositary, the AIFM and the investors.'

Article 21(15) AIFMD provides an option for Member States to grant AIFMs and/or its investors to opt for legal standing against the depositary based upon regulatory and/or private laws.[776]

Article 21(15) AIFMD is based upon Article 24 sub-para. 2 UCITSD IV that stated that

> 'liability to unit-holders may be invoked directly or indirectly through the management company, depending on the legal nature of the relationship between the depositary, the management company and the unit-holders.'

Under UCITSD IV, Member States established different regimes for UCITS investors depending on the legal form of the UCITS. The reference in Article 24 sub-para. 2 UCITSD IV to 'unit-holders' under Article 24 UCITSD IV indirectly referred to UCITS established as unit-trust and common contractual funds that do not have legal personality. UCITSD IV did not regulate the legal standing of 'shareholders', i.e. investors investing in investment companies, towards depositaries. UCITSD IV, thus, allowed Member States to grant only legal standing to UCITS ManCos to the depositary or to both UCITS ManCos and investors. UCITSD IV, however, did not require Member States to hold depositaries to be liable to both UCITS ManCos and investors at the same time. In addition, Member States could implement this option by regulating liability solely based upon regulatory law or a combination of regulatory and private law. The latter option was provided by Article 24 sub-para. 2 UCITSD IV that referred to

> 'the legal nature of the relationship between the depositary, the management company and the unit-holders.'

---

[774] M. Reiss, *Pflichten der Kapitalanlagegesellschaft und Depotbank gegenüber dem Anleger und die Rechte des Anlegers bei Pflichtverletzungen* (Duncker & Humblot 2006), 279 et seq.

[775] Art. 21(12) AIFMD; Art. 24(1) UCITSD V; I. Riassetto, Responsabilité de la société de gestion et du dépositaire d'un OPC envers les actionnaires d'une société cible, note sous Cass. com. fr. 27 mai 2015, 4 RD Bancaire et Financier (2015); I. Riassetto, *Moyens et procédures adéquats pour la mise en œuvre de l'obligation de contrôle des dépositaires d'OPC*, 10 Bulletin Joly Bourse (2013).

[776] D.A. Zetzsche, *Aktivlegitimation gemäß § 78, 89 KAGB im Investment-Drei-und –Viereck* 691 (M. Casper, L. Klöhn, W.H. Roth & C. Schmies eds, RWS Verlag 2016).

Member States could, thus, not only determine in their regulatory law whether solely UCITS ManCos have legal standing towards depositaries but could also differentiate in this regard for UCITS established in different legal forms.[777] A court in Luxembourg, for example, held that shareholders in a UCITS established as a SICAV (a public limited liability company) had no right to directly invoke liability against the depositary as they were shareholders of the SICAV and had no direct contractual relationship with the depositary and UCITS ManCo.[778] Luxembourg, however, granted direct legal standing to investors of common contractual funds as not the public limited liability company but the investors itself suffer damages and could, therefore, directly invoke liability.[779]

By amending the reference to 'unit-holders' to 'investors' under Article 21(15) AIFMD, investors have the right to claim in relation to the liabilities of depositaries either directly or indirectly through the AIFM, irrespective of the legal form of the AIF. Article 21(15) AIFMD continues, however, to refer to the 'legal nature of the relationship between the depositary, the AIFM and the investors'. Article 21(15) AIFMD refers to 'liability to the investors of the AIF may be invoked directly or indirectly through the AIFM, depending on the legal nature of the relationship between the depositary, the AIFM and the investors'. The latter suggests that all investors, i.e. unit-holders and shareholders, have to be granted legal standing towards the depositary. Article 21(15) AIFMD, however, does not preclude Member States from restricting shareholders to invoke liability indirectly through the AIFM.[780] The AIFMD, thus, seems not to offer more protection to investors in invoking depositary liability compared to UCITSD IV.

8.3.2. *UCITSD V*

The UCITSD V grants the right to every investor in a UCITS to invoke claims relating to the liability of its depositary directly or indirectly through the management company or the investment company.[781] To the contrary of the AIFMD, UCITSD V provides legal standing against the depositary that does not depend on the legal form of the UCITS (corporate or contractual) or the legal nature of the relationship between the depositary, the management company and the unit-holders.[782] The right of unit-holders is, however, limited as it may not

---

[777] See for examples of private law standing for investor investing in UCITS established as common contractual fund, unit trust and investment company: D.A. Zetzsche, *Aktivlegitimation gemäß § 78, 89 KAGB im Investment-Drei-und –Viereck* 685 (M. Casper, L. Klöhn, W.H. Roth & C. Schmies eds, RWS Verlag 2016).

[778] V. Naveaux & R. Graas, *Direct action by investors against a UCITS depositary – a short-lived landmark ruling?,* 7 Capital Markets Law Journal 455 (2012).

[779] *Ibid.*

[780] In Germany, the AIFM/UCITS ManCo is obliged to invoke liability of the depositary by means of claiming damages for the account of the investors. Invoking liability by the AIFM/UCITS ManCo on behalf of the investors does not preclude investors to claim damages on their own behalf. See § 78(2) and § 89(2) KAGB. See also M. Reiss, *Pflichten der Kapitalanlagegesellschaft und Depotbank gegenüber dem Anleger und die Rechte des Anlegers bei Pflichtverletzungen* (Duncker & Humblot 2006), 279 et seq.; In Luxembourg, AIF and UCITS investors of common contractual funds may only invoke the liability of the depositary if the AIFM/UCITS ManCo has during a period of three months refrained from doing so. See Art. 19 sub-para. 3 OPC Law 2010; Art. 19(15) sub-para. 2 Luxembourg AIFM Law. AIF and UCITS shareholders of investment companies may, however, not directly invoke liability of a depositary. See V. Naveaux & R. Graas, *Direct action by investors against a UCITS depositary – a short-lived landmark ruling?,* 7 Capital Markets Law Journal 455 (2012); In the Netherlands, all written depositary contracts concluded by eithers AIFMs or UCITS ManCo and the depositary need to mandatorily contain a clause that stipulates that the contract is being concluded on behalf of not only the AIF/UCITS, but also its investors ('third-party clause'). In case the depositary does not lawfully perform its tasks, the AIFM/UCITS ManCo, AIF/UCITS and its investors may claim damages based on either a breach of contract or tort law. See Art. 4:62m(2)Wft, Art. 6:74 BW and Art. 6:162 BW.

[781] Recital 28, Art. 28(5) UCITSD V.

[782] Recital 28 UCITSD V.

lead to a duplication of redress or to unequal treatment of the unit-holders.[783]

The right of unit-holders to invoke depositary liability under the UCITSD V differs in three respects from the right under the AIFMD. First, the UCITSD V refers to 'unit-holders' instead of investors'. The term 'unit-holder' is likely 'copy-pasted' from Article 24 sub-para. 2 UCITSD IV without realizing the legal implications it had under UCITSD IV. This view is supported by Recital 28 UCITSD V that confirms the view of the UCITSD V consultation in 2010 that

> 'UCITS units-holders and UCITS share-holders should have the same rights regardless the legal structure of the UCITS they invest in.'[784]

Second, investors under UCITSD V have the right to claim liability of the depositary regardless of the legal form. The term 'unit-holders', thus, needs to be interpreted as 'investors' that have the right to claim in relation to the liabilities of depositaries either directly or indirectly through the UCITS ManCo, irrespective of the legal form of the fund.[785] Third, the UCITSD V approach diverges from the AIFMD approach by having mandatory legal standing for investors. Member States, thus, do not have the option to grant UCITS ManCos and/or its investors legal standing against the depositary based upon regulatory and/or private laws.[786] Instead, investors have directly <u>or</u> indirectly always the right to invoke liability based upon regulatory law.

Finally, the 'direct <u>or</u> indirect' investor right to invoke liability under UCITSD V is limited, as opposed to the AIFMD, as it may not lead to a duplication of redress or to unequal treatment of the unit-holders.[787] This provision has to be explained in such a way that investors may not directly and indirectly invoke liability to receive 'double damages' (ni perte, ni profit).[788] In claiming damages, investors are, from a procedural law perspective, not limited in their right to claim both damages directly and indirectly through the UCITS ManCo.[789] The duplication of redress and unequal treatment of unit-holders only refers to the damages ultimately received by the investor.

To the contrary of the AIFMD, the UCITSD V, thus, does not give any Member States discretion to grant UCITS ManCos and/or its investors a legal standing against the depositary based upon regulatory and/or private laws.[790] Under the UCITSD V, investors always have the right to directly and indirectly claim damages through the UCITS ManCo provided that this does not lead to a duplication of redress or to unequal treatment of the unit-holders.[791]

8.4. Conclusion

The Madoff fraud made painfully clear that a lack of harmonization has led to many different depositary liability regime in Europe. Prior to the AIFMD and UCITSD V, France treated the depositary as a liability guarantor for lost financial instruments that can be held in custody,

---

[783] Recital 28, Art. 28(5) UCITSD V.
[784] European Commission, Consultation Paper on the UCITS Depositary Function and on the UCITS Managers' Remuneration (December 2010), MARKT/G4 D (2010) 950800, 15.
[785] European Commission, Consultation Paper on the UCITS Depositary Function and on the UCITS Managers' Remuneration (December 2010), MARKT/G4 D (2010) 950800, 15.
[786] D.A. Zetzsche, *Aktivlegitimation gemäß § 78, 89 KAGB im Investment-Drei-und –Viereck* 691 (M. Casper, L. Klöhn, W.H. Roth & C. Schmies eds, RWS Verlag 2016).
[787] Recital 28, Art. 28(5) UCITSD V.
[788] D.A. Zetzsche, *Aktivlegitimation gemäß § 78, 89 KAGB im Investment-Drei-und –Viereck* 694 (M. Casper, L. Klöhn, W.H. Roth & C. Schmies eds, RWS Verlag 2016).
[789] *Ibid*, 694.
[790] *Ibid*, 691.
[791] Recital 28, Art. 28(5) UCITSD V.

whereas in most other European countries depositaries were only liable towards the AIF/UCITS or its investors in the event of failure or negligence of either the depositary and/or its sub-custodian. The AIFMD and UCITSD V (partly) harmonizes the lack of harmonization of the depositary's liability in Europa by, in accordance with the French example, determining that a 'loss' of a financial instrument held in custody by a depositary or any of its sub-custodians triggers directly an obligation for the depositary to return a financial instrument of an identical type or the corresponding amount to be triggered. This is the case unless it can prove that the loss has arisen as a result of an 'external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary'.

Following the AIFMD and UCITSD V (Commission) Regulation, it has become clear that the exoneration is only accepted in exceptional cases and that the depositary may only under strict conditions contractually transfer its liability to a sub-custodian. This strict depositary liability, however, is not applicable to all 'other losses'. The depositary is for these losses only liable towards the AIF/UCITS and its investors in the event of failure or negligence.

An important issue in this regard concerns the 'direct' or 'indirect' rights of investors to raise liability claims against the depositary. The AIFMD and the UCITSD V provide different regimes to invoke liability for investors. The AIFMD provides an option for Member States to grant AIFMs and/or its investors to opt for legal standing against the depositary based upon regulatory and/or private laws.[792] Under the UCITSD V, investors always have the right to directly and indirectly claim damages through the UCITS ManCo provided that this does not lead to a duplication of redress or to unequal treatment of the unit-holders.[793]

Having analyzed the AIFMD and UCITSD V it becomes clear that the AIFMD and UCITSD V have introduced a strict liability for lost financial instruments that can be held in custody that de facto is a guarantor liability that has a big impact on depositaries serving AIFs/UCITS in practice.

9. The Depositary under the 'AIFMD/UCITSD Product Regulations'

The 'AIFMD Product Regulations' have wholly or partly introduced depositary legislation that applies on top of the AIFMD and UCITSD V depositary regimes or (partly) replaces these regimes.

9.1. The ELTIFR Depositary Regime

EEA-AIFMs authorized under the AIFMD (full-AIFMs) may apply for an authorization for an ELTIF.[794] ELTIFRs are, thus, in the first place AIFs that are subject to the Article 21 AIFMD depositary regime. In addition to the AIFMD, Article 29 ELTIFR applies certain UCITSD V depositary provisions concerning the eligible entities that are allowed to act as a depositary[795], the 'no contractual discharge of liability' rule[796], and the reuse of assets[797] to

---

[792] D.A. Zetzsche, *Aktivlegitimation gemäß § 78, 89 KAGB im Investment-Drei-und –Viereck* 691 (M. Casper, L. Klöhn, W.H. Roth & C. Schmies eds, RWS Verlag 2016).

[793] Recital 28, Art. 28(5) UCITSD V.

[794] Recital 8, Article 5(2) ELTIFR; D.A. Zetzsche, *Verordnung über europäische langfristige Investmentfonds (ELTIF-VO) – Langfristigkeit im Sinne der Kleinanleger?,* 6 ZBB 362 (2015); T. Bühler, *ELTIF – eine neue Säule der Finanzierung der Europäischen Realwirtschaft*, 3 Recht der Finanzinstrumente 196 (2015).

[795] Art. 23(2) UCITSD V.

[796] Art. 24(3) UCITSD V.

ELTIFs. The ELTIFR is, however, unclear whether the additional (UCITSD V) depositary regulation applies to ELTIFs marketed to retail investors, professional investors or both.[798]

Recital 45 ELTIFR suggests that only ELTIFs that are marketed to retail investors should comply with the UCITSD V requirements, whereas ELTIFs that are solely marketed to professional investors merely have to comply with Article 21 AIFMD. This view seems to be confirmed by the heading of Article 29 ELTIFR that reads: 'specific provisions concerning the depositary of an ELTIF marketed to retail investors'. Article 29 ELTIFR, however, seems to suggest another view. Article 29(1)-(4) ELTIFR all specifically refer to being applicable to retail ELTIFS by referring to 'ELTIFs being marketed to retail investors'[799], whereas Article 29(5) ELTIFR refers to the reuse of 'assets held in custody by the depositary of an ELTIF'. A grammatical interpretation of this provision would imply that Article 29(5) ELTIFR is applicable to all ELTIFs regardless whether the ELTIF is marketed to only professional or to both professional and retail investors. The conditional reuse of assets is copied from the UCITSD V offering retail investor protection.[800] The fact that AIFs that are not authorized as ELTIF and solely marketed to professional investors are subjected to a more lenient re-hypothecation provision under the AIFMD seems to confirm the view that all provisions under Article 29 ELTIFR only apply to 'ELTIFs marketed to retail investors'.[801] ELTIFs that are marketed to retail investors should comply with the UCITSD V requirements concerning the entities eligible to act as a depositary, the 'no discharge of liability' rule, and the reuse of assets.[802] The depositary of retail ELTIFs are required to be an entity of the type permitted under UCITSD V.[803] De facto, Article 29(1) ELTIFR prohibits retail ELTIFs, regardless of its investment policy and closed-end nature, to appoint a 'PE-depositary'. ELTIFs that are, however, marketed to professional investors remain to be entitled to appoint a 'PE-depositary' under national Member States laws if they fulfil the AIFMD criteria related to the redemption rights exercisable (closed-end nature) and having a core investment policy of investing in illiquid assets.[804] Professional ELTIFs not fulfilling these 'PE-depositary' criteria or residing in a Member State that has not implement this option are under the AIFMD required to appoint a credit institution, investment firm or a UCITSD V[805] depositary.[806] The depositary of retail ELTIFs is in any case required to be an entity of the type permitted under UCITSD V.[807]

Apart from this, depositaries of retail ELTIFs may under Art. 29 ELTIFR not apply the AIFMD 'contractual discharge of liability'.[808] Like under UCITSD V, the retail ELTIF depositary's liability cannot be excluded or limited by agreement nor is a depositary allowed to discharge itself of liability in the event of a loss of financial instruments held in custody by

---

[797] Art. 22(7) UCITSD V.

[798] See D.A. Zetzsche & C.D. Preiner, *ELTIFR versus AIFMD* 149- 150 (D.A. Zetzsche ed, Kluwer 2015).; D.A. Zetzsche, *Verordnung über europäische langfristige Investmentfonds (ELTIF-VO) – Langfristigkeit im Sinne der Kleinanleger?,* 6 ZBB 362 (2015).

[799] Article 29(1)-(4) ELTIFR.

[800] See Art. 22(7) UCITSD V.

[801] See for a different view: D.A. Zetzsche & C.D. Preiner, *ELTIFR versus AIFMD* 149- 150 (D.A. Zetzsche ed, Kluwer 2015).

[802] Recital 45 ELTIFR.

[803] Art. 29(1) ELTIFR.

[804] See Art. 26 AIFMD.

[805] This is an dynamic interpretation UCITSD IV depositaries eligible under Article 21(3) AIFMD of the author. See *supra* 3.1.3.

[806] Art. 21(3) AIFMD.

[807] Art. 29(1) ELTIFR.

[808] Art. 29(2) ELTIFR.

a third party.[809] Any agreement that contravenes this provision are void.[810]

Finally, ELTIF assets held in custody are prohibited to be reused[811] for the own account by the depositary or any sub-custodian.[812] Like under UCITSD V, assets held in custody may only be reused by the ELTIF's depositary provided that[813] the depositary is carrying out the instruction of the AIFM[814], the reuse is for the account[815], the benefit[816] and the interests[817] of the ELTIF and covered by high quality and liquid collateral received under a title transfer arrangement.[818] The market value of the collateral is required to be at all times amount to at least the market value of the reused assets plus a premium.[819] The ELTIFR depositary regime, thus, seems to be consistent with the professional investor nature under the AIFMD and the retail investor nature under UCITSD V.

9.2. The MMFR Depositary Regime

Consistent with the AIFMD and UCITSD V, the MMFR requires the UCITSD V depositary regime to be applied for UCITS-MMFs and the AIFMD depositary regime for AIF-MMFs marketed to professional investors.[820] Like under the AIFMD, the depositary regime for MMFs established as retail-AIFs depends upon the private placement regimes of the individual Member States implementing Article 43 AIFMD.[821] Similar as for UCITS[822], however, MMFs authorized as AIF-MMF both marketed to retail and professional investors must upon authorization obtain approval for the choice of the depositary.[823]

9.3. The EuVECAR/EuSEFR 'Depositary Regime'

'small' AIFMs managing and marketing EuVECAs/EuSEFs are under the EuVECAR/EuSEFR not required to appoint a depositary. Instead, an auditor of the EuVECA/EuSEF must be appointed to conduct, at least annually, an audit of the EuVECA/EuSEF confirming that (1) money and assets are held in name of the qualifying EuVECA/EuSEF and (2) records are adequately kept by the EuVECA/EuSEF manager.For two reasons this 'depositary' regime is logical and fits in the AIFMD depositary regime.

First, EuVECAs and EuSEFs may only be managed and marketed by 'small' AIFMs. Only full-AIFMs managing and marketing EuVECAS/EuSEFS are subjected to the compulsory depositary requirement under the AIFMD.[824] AIFs managed and marketed by 'small' AIFMs under the AIFMD are exempted from depositary appointment and individual Member States

[809] Art. 29(3) ELTIFR.
[810] Art. 29(4) ELTIFR.
[811] Reuse comprises any transaction of assets held in custody including, but not limited to, transferring, pledging, selling and lending; Article 29(5) sub-para. 1 ELTIFR; See also Art. 22(7) UCITSD V.
[812] Art. 29(5) sub-para. 1 ELTIFR.
[813] Art. 29(5) sub-para. 2 ELTIFR.
[814] Art. 29(5) sub-para. 2(b) ELTIFR.
[815] Art. 29(5) sub-par. 2(a) ELTIFR.
[816] Art. 29(5) sub-para. 2(c) ELTIFR.
[817] Art. 29(5) sub-para. 2(c) ELTIFR.
[818] Art. 29(5) sub-para. 2 ELTIFR.
[819] Art. 29(5) sub-para. 3 ELTIFR.
[820] Art. 4(2), 4 MMFR.
[821] See *supra* 2.1.2.
[822] Art. 5(1) MMFR.
[823] *Ibid.*
[824] See *supra* 2.1.

may decide whether they extend the compulsory depositary requirement to AIFs managed by these AIFMs.[825]

Second, closed-end AIFs managed by full-AIFMs that are similar to EuVECAs/EuSEFs are under the Member State implementations of the AIFMD allowed to appoint a 'PE depositary' if they if they fulfil the AIFMD criteria related to the redemption rights exercisable. EuVECAs/EUSEFs have a core investment policy of investing in illiquid assets that in any case complies with the 'PE depositary' requirements under the AIFMD.[826] The mandatory investment policy under the EuVECAR/EuSEFR for these types of AIFs requires at least 70% of their investment portfolio to be invested in non-liquid assets. The qualifying portfolio companies in which they are required to invest must be directly held by the EuVECA/EuSEF and may, therefore, not be listed on a regulated market. The (quasi-) equity instruments invested in may be financial instruments, but in many occasions do not qualify as financial instruments that can be held in custody. In practice, the 70% qualifying investments are, thus, not invested in transferable securities, MMFs and CIUs that can be directly registered or held in an account on behalf of a depositary. The assets would under the AIFMD qualify as 'other assets' which would require a record-keeping requirement on behalf of the depositary that requires the verification of ownership and the keeping of records. The 30% assets that are other than qualifying investments might be financial instruments that can be held in custody. The EuVECA/EuSEF may, but is not required to, appoint (Non-)EEA custodians which might be authorized under CRD IV, MiFID I/II or equivalent Non-EEA regulations.

Considering these two reasons, it is logical that an audit is merely required to confirm whether money and assets are held in name of the qualifying EuVECA/EuSEF and records are adequately kept by the EuVECA/EuSEF manager. The 'small' AIFM managing EuVECAs/EuSEFs and illiquid nature of the investments invested in, however, do not explain why an auditor is allowed under the EuVECAR/EuSEFR to perform the safekeeping function related to 'other assets' of an AIF depositary. Under the AIFMD, the PE-depositary, being a lawyer, notary or specialized financial intermediary, appointed is required to be subjected to mandatory professional registration recognized by law or to legal or regulatory provisions or rules of professional conduct. From this perspective, the choice for an auditor as a 'depositary' under the EuVECAR/EuSEFR seems to be remarkable as auditors are under most Member State laws not allowed to perform the function of 'PE depositary'.[827] The choice for the auditor may, however, be explained on the basis of the AIFMD depositary liability regime. AIFs managed by 'small' AIFMs fall outside the scope of the AIFMD depositary regime and its strict liability rules on the loss of financial instruments that can be held in custody. The EuVECAR/EuSEFR does not contain such a strict depositary liability rule. Under the AIFMD, the PE-depositary is subjected to the strict depositary liability regime related to financial instruments that can be held in custody. Even if financial instruments that can be held in custody are not safe-kept by the PE-depositary but by a sub-custodian appointed by them, the liability regime applies to them as they are deemed to be a depositary und the AIFMD. This is remarkable as, in particular professionals, such as lawyers and notaries do not have the resources to conduct due diligence over financial instruments that can be held in custody as they have in the first place not the technical infrastructure to perform the safekeeping of these assets by themselves. Many Member States are aware of the potential consequences of the AIFMD depositary liability regime applying to these types of depositaries. As a result, most Member States require PE-depositaries to be subjected to

---

[825] See *supra* 2.1.3.1.
[826] See Art. 26 AIFMD.
[827] See *supra* 3.1.6.

either strict organizational, conduct of business requirements and for professionals own capital and indemnity insurances.[828] The absence of the strict liability rules on the loss of financial instruments that can be held in custody is, thus, the explanation for the EuVECAR/EuSEFR to require an auditor to be appointed to substitute the appointment of a depositary.

9.4. The AIFMD Product Regulation Depositary Regimes versus the AIFMD/UCITSD V

The ‘AIFMD Product Regulations’ differ from the AIFMD and UCITSD V for three reasons.

First, AIFMs may be ‘small’ AIFMs or full-AIFMs. Full-AIFMs are subjected to the compulsory depositary requirement, whereas small AIFMs under the AIFMD are exempted from depositary appointment and it is left over to the individual Member States whether they extend the compulsory depositary requirement to AIFs managed by these AIFMs.[829] This criterion is reflected in the ELTIFR and MMFR that applies to full-AIFMs and the EuVECAR and EuSEFAR that solely applies to ‘small’ AIFMs. Under the MMFR only authorized UCITS and full-AIFMs managing AIFs may apply for MMF authorizations.[830] The UCITSD V or AIFMD depositaries applies depending upon whether an MMF is a UCITS or an AIF. Similarly, only full-AIFMs may apply for retail-ELTIF authorization that requires ‘patch-up’ depositary provisions under the ELTIFR to be complied with on top of the provisions set out under the AIFMD.[831]

Second, the regulations are different in terms of depositary regulation due to the different type of investors to which they may be marketed.[832] EuSEFs and EuVECAs may only be marketed to professional investors and HNWIs.[833] The MMFR requires the UCITSD V depositary regime to be applied for MMFs that are established as UCITS. UCITS are allowed to be marketed to both retail and professional investors.[834] The AIFMD depositary regime applies to MMFs registered as professional AIFs.[835] The depositary regime for MMFs established as retail-AIFs depends upon the private placement regimes of individual Member States implementing Article 43 AIFMD. Similarly, the ELTIFR requires the AIFMD depositary regime to be applied to ELTIFs being marketed to professional investors, whereas retail ELTIFRs are, on top of the AIFMD, required to be applying the additional UCITSD V depositary provisions.[836]

Finally, the difference in terms of the investment policy pursued by UCITS and different types of AIFs in terms of investment policy is also reflected under the ‘AIFMD Product Regulations’. EuSEFs/EuVECAs are required to invest at least 70% of their assets in illiquid assets and would, if managed and marketed by an full-AIFM, all be allowed to appoint a ‘PE-depositary’ under the AIFMD. The MMFR requires the depositary regimes applying to ‘liquid

---

[828] *Ibid.*
[829] See *supra* 2.1.3.1.
[830] Article 4(2) and 5(1) MMFR.
[831] Recital 45, Article 29 ELTIFR.
[832] This is exemplified by Recital 47 AIFMD that states that the AIFMD depositary regime is without prejudice to any future legislative measures with respect to the depositary in the UCITSD (UCITSD V was later adopted), because UCITS and AIFs are different in terms of the investment policy that they may pursue and the type of investors to which they may be marketed. Recital 2 UCITSD V (Commission) Regulation also states that the UCITSD V takes into account the retail investor nature of a UCITS.
[833] Art. 6 EuVECAR/EuSEFR.
[834] Art. 4(2) MMFR.
[835] Art. 5(1) MMFR.
[836] Art. 4(2), 5(1) MMFR.

AIFs' and UCITS under the AIFMD and UCITSD V to apply. The ELTIFR seems in this regard to be a bit inconsistent. Professional ELTIFs may under the applicable AIFMD depositary regulation appoint a 'PE-depositary', whereas retail-ELTIFs are at all times required to appoint an eligible entity under UCITSD V that excludes this option. In sum, the 'AIFMD Product Regulations' seem to be consistent with the depositary regimes under the UCITSD V and AIFMD.

10. The AIFM, Depositary and the Prime Broker in the Prime Brokerage relationship

Depending upon whether a prime broker is solely acting as a counterparty or counterparty and depositary/sub-custodian, the prime broker may either enter into an prime brokerage agreement with the AIFM for acting as counterparty and an agreement with the depositary for acting as a sub-custodian. Often this results in a tri-partite agreement between the AIFM, prime broker and the depositary.[837] The checks and balances under the AIFMD investment triangle, require the AIFM, prime broker and depositary to fulfil certain duties in the prime brokerage relationship. The duties of AIFMs regarding its organization and disclose/reporting need to be proportionally applies and continue to apply at any time, whereas the depositary's (or custody division of the prime broker) duties depend on whether and to what extent the prime broker holds financial instruments that can be held in custody. In discussing the AIFM, depositary and prime broker duties, especially the frictional boundaries between the prime broker's counterparty and depositary functions will be highlighted. Finally, 'prime broker models' that are used to resolve this frictions are being discussed.

10.1. The Role of the AIFM, Prime Broker and Depositary

10.1.1. *AIFM*

AIFMs are in the prime brokerage relationship responsible for 'prime broker management'.[838] AIFMs carry out due diligence and appoint prime brokers as AIF counterparty. In addition, AIFMs need to fulfil various organizational requirements under the AIFMD related to risk management, compliance and reporting/disclosure upon enter into a prime brokerage agreement.

10.1.1.1. The Selection and Appointment of the Prime Broker

AIFMs shall exercise due skill, care and diligence in the selection and appointment of prime brokers with whom a contract is to be concluded.[839] The AIFM is responsible for prime broker management.[840] The AIFM on behalf of the AIF shall set out the terms in a written contract that govern the use of services of the prime broker. The contract shall set out in particularly that the depositary must be informed of the contract and the terms regulating re-hypothecation. All terms are freely to be negotiated provided that they comply with the AIF rules or instruments of incorporation.[841] The depositary may be but is not required to be a party to it.

Before entering into an agreement and on an ongoing basis thereafter the AIFM must exercise due skill, care and diligence in selecting and appointing each prime broker (or

[837] D.A. Zetzsche, *(Prime) Brokerage* 581 (D.A. Zetzsche ed, Kluwer 2015).
[838] Article 4(1)(af) AIFMD.
[839] Art. 14 (3) AIFMD.
[840] Article 4(1)(af) AIFMD.
[841] Art. 14(3) AIFMD.

counterparty).[842] In selecting and appointing, AIFMs should ensure that prime brokers are subject to ongoing supervision[843], are financially sound[844] and have the necessary organizational structure[845] appropriate to the services to be provided to the AIFM or the AIF.[846] Prime brokers should only be considered financially sound when they are subject to relevant prudential regulation, including adequate capital requirements and effective supervision.[847] The AIFM must make available to AIF investors for each AIF it manages, a description of any material arrangements with, or changes to the identity of, its prime brokers, and the way in which conflicts of interest are managed.[848]

10.1.1.2. The AIFM Organizational Duties

The AIFM's duties upon and during the appointment of a prime broker can be categorized in risk management, compliance duties and reporting/disclosure duties[849].

Upon the appointment of a prime broker, the AIFM is required to employ the proportionally the risk management requirements in Article 15(4) AIFMD.[850] In particular, the AIFM must determine:[851]

- the amount of leverage which may be employed on behalf of each AIF; and
- the extent of the right to reuse collateral or guarantee that could be granted under the leveraging arrangement.

In applying Article 15(4) AIFMD, the AIFM must take into account, amongst others, the type of the AIF, the investment strategy and the sources of leverage of the AIF.[852]

The use of prime brokers also requires AIFMs to conduct intensified compliance. Along issues related to, amongst others, inducements and best execution[853], the AIFMD's conflicts of interest provisions need to be complied with. [854] This may, in particular, be the case when the prime broker and the AIFM belong to the same corporate family. Conflicts of interests that cannot be mitigated will have to be disclosed to investors.[855]

Upon the appointment of a prime broker, various disclosure and reporting obligations of the AIFM are applicable. The AIFM arranges the information flow towards all parties in the prime brokerage relationship.[856] The AIFM has reporting and disclosure obligation towards the depositary, investors and Competent Authorities.

The AIFM has a reporting duty towards the depositary for the data provided by the prime broker to the depositary.[857] This, in particular, enables depositaries that are not party to the prime brokerage agreement to obtain the information flow necessary to exercise its safekeeping and cash monitoring and oversight functions.

---

[842] Art. 14(3) and 20 AIFMD.
[843] Art. 20(2)(a) AIFMD.
[844] Art. 20(2)(b) AIFMD.
[845] Art. 20(2)(c) AIFMD.
[846] Recital 41, Art. 20 (3) AIFMD.
[847] Recital 41 AIFMD; See also Art. 20(4) AIFMD.
[848] Art. 23 AIFMD.
[849] See Dornseifer, F., *Hedge Funds and Systematic Risk Reporting* (D.A. Zetzsche ed, Kluwer 2015).
[850] D.A. Zetzsche, & D. Eckner, *Risk Management* (D.A. Zetzsche ed, Kluwer 2015).
[851] Art. 15(4) AIFMD.
[852] Art. 15(4) AIFMD.
[853] Art. 24, 27 AIFMD; See also ESMA2011/379, 49-51.
[854] Art. 30-37 AIFMD (Commission Regulation).
[855] Art. 21(10) AIFMD.
[856] Art. 57 et seq. AIFMD.
[857] Art. 90(2)(c) sub-para. 2 AIFMD (Commission) Regulation.

The AIFM also needs to fulfil various disclosure requirements related to prime brokers towards investors. In its IIID the AIFM must describe, amongst others, the type of assets in which the AIF is allowed to invest, investment techniques that are allowed to be employed and investment restrictions.[858] Furthermore, any safekeeping function being delegated by the depositary, the identity of the prime broker and the material arrangements of the AIF in which way conflicts of interests are being managed.[859]AIFMs will also need to disclosure investor periodic information containing information about the prime broker, including, amongst others: information on the current risk profile of the AAIF and the risk management systems employed, the maximum amount of leverage to be employed by the AIF and the right of the reuse of collateral or any guarantee granted to the prime broker.[860]Third, the AIFM might need to disclose to investors any arrangement that the depositary has made with the prime broker to contractually discharge itself from liability.[861] Finally, the AIFM is required to disclose to its investors all risks that is not being able to mitigate.[862]

Besides information to be disclosed to investors, the AIFM is obliged to report to its Competent Authorities information regarding substantial leverage being employed, including:

– the risk profile and risk management systems;[863]
– stress tests being performed;[864]
– leverage reporting, in particular, from borrowing cash securities and the leverage embedded in financial derivatives.[865]

10.1.2. *The Prime Broker – Reporting Obligations towards the Depositary*

After the AIFM has informed the depositary of the prime brokerage agreement, Article 14(3) AIFMD requires the prime broker to directly report to the depositary. The reporting obligations clearly distinguish upon the functions exercised by the prime broker.

Article 91(1) AIFMD Commission Regulation requires from the date of the appointment prime brokers to make available to the depositary the following information relating to its counterparty functions:

– the value of non-custody (other) assets held as collateral by the prime broker in respect of secured transactions entered into under a prime brokerage agreement;
– the value of the assets where the prime broker has exercised a right of use in respect of the AIF's assets; and
– a list of all the institutions at which the prime broker holds or may hold cash of the AIF in an account opened in the name of the AIF or in the name of the AIFM acting on behalf of the AIF in accordance with Article 21(7) of Directive 2011/61/EU.[866]

The prime broker acting as a sub-custodian to an AIF has to report to the depositary no later than the close of the next business day the following items:

[858] Art. 23(1) AIFMD.
[859] Art. 23(1) AIFMD.
[860] Arts 23(4), 23(5)(a) and (b) AIFMD.
[861] Art. 23(2) AIFMD.
[862] Art. 14 AIFMD.
[863] Art. 23(2)(c) AIFMD.
[864] Art. 15(3), 16(1) AIFMD.
[865] Art. 23(4) AIFMD.
[866] See for the cash monitoring function of the depositary: *supra* 6.3.7.

– the total value of assets held by the prime broker for the AIF, including values related to, amongst others, cash loans made to the AIF and accrued interest, securities to be redelivered by the AIF under open short positions entered into on behalf of the AIF and current settlement amounts to be paid by the AIF under any futures contracts;
– details of any other matters having an material impacts on the value of assets that are being safe-kept by the prime broker as a sub-custodian.

The information regarding the assets must not be made available to the depositary of the AIF later than the close of the next business day.[867]

10.1.3. *The Depositary - frictional boundaries between the Prime Broker's Counterparty and Depositary Function*

The AIFMD has imposed the mandatory appointment of a depositary for AIFs. The depositary's functions include the safekeeping of assets, conducting oversight duties and the monitoring of cash flows. Especially, in the case of an hedge fund, the depositary's function under the AIFMD overlaps concerning the role of custody in part with the custody role traditionally performed by the prime broker. This causes frictional boundaries between depositary functions, whether carried out by a separate depositary or as a segregated division of a prime broker) and those of the prime broker acting controlling and retrieving the AIFs assets as a counterparty. The frictional boundaries between the prime broker's counterparty and the depositary function related to the safekeeping of assets, the performance of oversight duties and the monitoring of cash flows will be discussed.

10.1.3.1. Safekeeping: Scope Financial Instrument held in Custody versus 'Other Assets'

Traditionally, prime brokers are required to safekeep hedge fund's assets to settle transactions, vest security interests over the AIF's assets or to mitigate credit risks borne by the prime broker.[868] The AIFMD safekeeping provisions have made this traditional role more complex.[869] The legal relationship between the depositary and prime broker depends upon the type and status of assets held by the prime broker. Under the AIFMD, the relationship related to financial instruments that can be held in custody that are held by prime brokers is more complex than for 'other assets'.

Prime brokers may not hold financial instruments that can be held in custody without being appointed as a depositary under or as a sub-custodian under Article 21(4)(b) AIFMD.[870] Prime brokers appointed as depositaries and sub-custodians would need to comply with the

[867] Art. 91(2) AIFMD (Commission) Regulation.
[868] See on prime brokers: D. Enderli, *Kreditgeschäft von Hedge Funds* 30 to 49 (Master Thesis, Universität St. Gallen 19 Mai 2008); K. Jud, *Das Prime Brokerage-Geschäft mit Hedge Funds* (Haupt 1996); P. Hildebrand, *Hedge funds and prime broker dealers: step towards a 'best practice proposal'*, Banque de France, Financial Stability Review – Special issue on hedge funds, No. 10; N. Tuchschmid, E. Wallerstein & A. Zanolin, *Hedge Funds and Prime Brokers: The Role of Funding Risk*, http://ssrn.com/abstract=1343673 (accessed 3 September 2016); D. P. Delmont, *Managing Hedge Fund Risk and Financing – Adapting to a New Era* 7 (Wiley 2011); L. Silverentand & P. Zijp, *The Draft Directive on Alternative Investment Fund Managers*, in *Hedge Funds and Prime Brokers* (M. Berman ed., 2nd edn, RiskBooks 2010). R. R. Lindsey, *What are Prime Brokers?, in Hedge Funds and Prime Brokers* (M. Berman ed., 2nd edn, Risk Books 2010).
[869] See for an comparative overview of the pre-AIFMD prime broker regulations in various Member states: Report of the Alternative Investment Expert Group, *Managing, Servicing and Marketing Hedge Funds in Europe of July 2006*, http://ec.europa.eu/finance/investment/docs/other_docs/reports/hedgefunds_en.pdf (accessed 3 September 2016).
[870] *Infra* 10.2.

'AIF's best interest' and 'conflicts management' rule.[871] Not only the qualification of assets as financial instruments that can be held in custody but also the status of these financial instruments are important to determine whether a prime broker is obliged to be appointed as a depositary itself or as a sub-custodian. Financial instruments that can be held in custody may be unencumbered, encumbered (subject to a security interest or right of re-hypothecation in favour of the prime broker) or on title transfer.[872]The holding of financial instruments that can be held in custody on an unencumbered basis is clearly is under the AIFMD reserved for depositaries and its sub-custodians. Financial instruments that can be held in custody that are encumbered, i.e. subject to a security interest or right of re-hypothecation in favour of the prime broker, fall within the depositary's custody function under Article 21 (8)(a) AIFMD as long as the AIF (or the AIFM on its behalf) has retained the title over these financial instruments. Assets that, for instance, are merely pledged to the prime broker to secure the AIF's debt may not be held by a prime broker without the prime broker being appointed as a depositary or a sub-custodian. Financial instruments that are re-hypothecated, i.e. they are not merely subject to a right of reuse but the right or reuse is being exercised, fall outside the scope of the depositary's custody duty. The AIF (or the AIFM on its behalf) has lost title over these financial instruments. Similarly, financial instruments that have been provided to the prime broker on title transfer also do not fall within the scope of the depositary's custody duty under Article 21(8)(a) AIFMD. The AIF (or AIFM on its behalf) loses its proprietary claim to the assets in return for a contractual claim on the prime broker for re-delivery.[873] Prime brokers can, thus, hold financial instruments on title transfer without being a depositary or depositary's sub-custodian.

Other assets than financial instruments held in custody, such as derivatives, are merely subject to a record keeping duty. The depositary (or the prime broker's depositary division) will need to verify ownership of these assets. This may not be exercised by the counterparty division of the prime broker. Prime brokers only need to be appointed as a depositary or a sub-custodian for financial instruments held in custody.[874] Prime brokers may, thus, control and retrieve other assets, such as derivatives or financial instruments that can be held in custody on title transfer or that are re-hypothecated[875] without becoming a sub-custodian of the depositary (depositary's division of the prime broker).[876] The depositary remains to be responsible for performing the safekeeping duty of verification for these assets.[877]

10.1.3.2. Oversight Duties

The type of assets, encumbered by security interests or a right of reuse or not, does not have an impact on the oversight duties to be performed by the depositary. The depositary or the

---

[871] See for the 'AIF's best interest' and 'conflicts management' rule for the prime broker as depositary: *supra* 3.1.4.2; see for AIF's best interest' and 'conflicts management' rule the prime broker as sub-custodian: *infra* 10.2.2.

[872] Allen & Overy, *Alternative Investment Fund Managers Directive: Allen & Overy Briefing Paper No. 7 Impact on Prime Brokers*, http://www.allenovery.com/archive/Documents/Legacy/62666.pdf (accessed 15 August 2016).. See also the 'three buckets of assets': D.A. Zetzsche, *(Prime) Brokerage* 585-586 (D.A. Zetzsche ed, Kluwer 2015).

[873] Allen & Overy, *Alternative Investment Fund Managers Directive: Allen & Overy Briefing Paper No. 7 Impact on Prime Brokers*, http://www.allenovery.com/archive/Documents/Legacy/62666.pdf (accessed 15 August 2016).

[874] Art. 21(4)(b) AIFMD.

[875] Recital 100 AIFMD (Commission) Regulation; See D. Frase, *Custody*, in *Law and Regulation of Investment Management* 274 (D. Frase ed., Sweet & Maxwell 2011).

[876] Recital 100 AIFMD (Commission) Regulation.

[877] Art. 21(8)(b) AIFMD.

depositary division of a prime broker are obliged to carry out the oversight functions and may not delegate this task to third parties.[878]

10.1.3.3. Cash Management – Cooperation between the Prime Broker and the Depositary

The nature of cash determines the duties of a depositary(or the segregated division of a prime broker carrying out depositary functions) towards it. They can either be under the safekeeping duty of the verification of ownership and record keeping[879] and/or subject to the cash monitoring function of the depositary[880].

Cash being deposited at banks does not qualify as a financial instrument being held in custody. For this purpose, cash may either be held with third party institutions, such as prime brokers or other counterparties, that are monitored by the depositary, or be with the depositary itself.[881] The AIFMD's mandatory delegation regime is restricted to prime brokers holding financial instruments that can be held in custody. Prime brokers acting as a counterparty to an AIF do not need to be appointed by the depositary as sub-custodian in order to 'control or retrieve' AIF's cash. Cash deposited at a prime broker (at the counterparty division) qualifies as 'other assets' leaving the depositary with a duty to verify ownership and keep records.

The cash flow monitoring of the cash of an AIF being held by prime brokers needs to be conducted by the depositary or the segregated division of a prime broker carrying out depositary functions. Cash flow monitoring includes several duties that are undertaken by the depositary to oversee the AIFM. For both functions, the depositary (or the depositary division of the prime broker) will need all relevant information from the AIFM and third parties (prime brokers) to comply with its obligations.[882]

10.2. Prime Broker Models: The Depositary/Prime Broker Relationship

Following the introduction of the AIFMD, several prime broker models have emerged.[883] The prime broker models chosen by the depositary and prime broker depend on how much risk both parties are willing to take. The more financial instruments are being held in custody by the prime broker as a sub-custodian, the more risk the depositary has under the AIFMD 'guarantor liability' regime. At the other hand, the more financial instruments are being held by the depositary's custody network, the less willing the prime broker is to provide leverage to the AIF as the prime broker has less grip on the AIF's assets and the execution and settlement of transactions will be more complex. Depending upon the risk appetite of both parties, prime broker models range from where financial instruments that can be held are only held by the depositary's custody network to where the assets are solely held in custody by the prime broker. Some broad categories of prime brokerage models possible under the AIFMD will be (non-exhaustively) discussed.

10.2.1. *The Prime Broker' as Depositary*

[878] Art. 21(11) AIFMD.
[879] Art. 21(8)(b) AIFMD.
[880] Art. 21(7) AIFMD.
[881] Art. 21(7) AIFMD.
[882] See for the flow of information: *supra* 6.1.2.
[883] KPMG, *The prime brokerage industry: An exploration of evolving standards – operational accountability, internal controls, and transparency*, https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/the-prime-brokerage-business.pdf (accessed 3 September 2016).

The prime broker may carry out both depositary and counterparty functions as long as the functional and hierarchical separation of both functions is being preserved.[884] This is possible provided that the prime broker will manage conflicts of interests when carrying out the two functions properly.[885] A 'prime broker' providing both functions may either apply the prime depositary or the depositary prime model.[886]

Under the 'prime depositary' model, the prime broker merely has to separate its custodian division performing the AIFMD depositary function from its counterparty function.

Under the 'depositary prime' model, a depositary may step in as a 'prime broker'. The AIF or AIFM on its behalf may grant security interests and the right of reusing the AIF's assets to the depositary as 'prime broker' that in return offers the AIF services to finance or execute transactions in financial instruments as counterparty.[887] Depending upon whether the depositary qualifies as a prime broker under the AIFMD or not, the depositary needs to comply with the 'conflicts management rule' under Article 21(4)(b) AIFMD for prime brokers or under Article 21(10) sub-para. 2 AIFMD for depositaries.[888] De facto, thee qualification of the 'depositary' as a 'prime broker' or vice versa is irrelevant as either parties need to functionally and hierarchically separate the counterparty from the depositary function.

This model has, till now, not proven to be welcomed in practice as taking upon the counterparty function by depositaries requires them to invest in risk management technology to retain more own capital.[889]

10.2.2. *The Prime Broker as Sub-Custodian*

Instead of being appointed as a depositary, prime brokers may also be appointed by depositaries as a sub-custodian. The depositary liability standard and the difficulties of discharging liability under the AIFMD have led to some variations that are applied in practice of prime broker models in which prime brokers are appointed as sub-custodians.

There are two broad categories of prime broker models that have emerged in which prime brokers are either appointed as a sub-custodian that uses its own sub-custodian network[890] or the sub-custodian network of the depositary.[891] Within both categories, depositaries and prime broker have been seeking to balance the risks of 'guarantor liability' and operational complexity by developing a few sub-models that are subsequently discussed.

10.2.2.1. The Prime Broker using its own Sub-Custodian Network

Under the first category, the depositary of an AIF appoints the prime broker as its sub-custodian, whereas the prime broker uses its own sub-custodian network.

---

[884] Art. 21(4)(b) AIFMD.
[885] *Ibid.*
[886] Terminology adapted from: See D.A. Zetzsche, *(Prime) Brokerage* 601-602 (D.A. Zetzsche ed, Kluwer 2015).
[887] Art. 4(1)(af) AIFMD.
[888] See Art. 4(1)(af) AIFMD.
[889] Pre-AIFMD this model was used in Liechtenstein and Switzerland. See D.A. Zetzsche, *(Prime) Brokerage* 601-602 (D.A. Zetzsche ed, Kluwer 2015).
[890] BEAMA AIFMD FAQ Deel 1, Q25: Welke 'Prime Broker'-modellen zijn er nog nog mogelijk onder de AIFMD?, www.beama.be/nl/faq/aimfd-faq-deel-i (accessed 3 September 2016).
[891] Deloitte, *AIFMD Implementation – Depositary webinar*, 11, http://www2.deloitte.com/content/dam/Deloitte/ie/Documents/FinancialServices/investmentmanagement/aifmd_depositary_webinar.pdf (accessed 3 September 2016); Matheson, *AIFMD Factsheet: Prime Brokers,* http://www.matheson.com/images/uploads/publications/AIFMD_Factsheet_Prime_Brokers.pdf (accessed 3 September 2016); Grant Thornton, *Alternative Investment Fund Managers Directive (AIFMD) - The Depositary and Prime Broker (PB) Operating Model Dilemma*, http://www.grant-thornton.co.uk/Global/Publication_pdf/AIFMD.pdf (accessed 3 September 2016).

The first sub-model used in this category is the appointment of a prime broker as sub-custodian without contracting liability discharge or an indemnity clause for lost financial instruments that can be held in custody.[892] Without any liability discharge or indemnification from the side of the prime broker, the depositary bears the risk of the loss of all financial instruments that can be held in custody.[893] The problem in this regard is that under the AIFMD not the depositary but the AIFM is the primary party responsible for appointing the prime-broker (as a counterparty) that carries out due diligence upon the appointment and on an ongoing basis.[894] This problem is accelerated by the fact that the due diligence duty that the AIFM is carrying out on the prime broker concerns only its function as a counterparty and not as a sub-custodian. The depositary is responsible for the appointment of the prime broker acting as counterparty as a sub-custodian and may not refuse the appointment of prime brokers that fulfil the requirements laid down in Article 21(4)(b) and (11) AIFMD. The depositary under this model retains liability and is dependent upon the information being provided by the prime broker.[895] In addition, it will likely conduct extensive ongoing due diligence related to the prime broker's role as sub-custodian. Especially, when the prime broker is using various sub-custodians in 'dangerous' markets. To address this liability issue, two other variations have developed in practice.

The second sub-model is the 'liability discharge' model in which upon the appointment of the prime broker as a sub-custodian, the depositary and the prime broker agree upon a contractual discharge of liability.[896] A contractual discharge of liability transfers the liability risk for lost financial instruments that can be held in custody from the depositary to the prime broker as sub-custodian. The prime broker as sub-custodian may further transfer this risk 'down the chain' by agreeing upon a contractual discharge of liability with any of its sub-custodians in its network. There are two options that might qualify as 'objective reason'. The selection of a particular prime broker by an AIFM that is also appointed as a sub-custodian by a depositary is considered to be sufficient as an objective reason for both the delegation of custody tasks and a valid contractual discharge of liability being assumed by both the depositary and the prime broker.[897] Another objective reason to contract such a discharge by prime-brokers would be that any of its sub-custodians are established in third countries that do not satisfy the AIFMD's criteria and for which no alternative in the respective market is available.[898] This sub-model, however, depends upon the willingness of prime brokers to accept liability for the use of their own sub-custodian network.[899]

The third sub-model is the 'indemnification model'.[900] This model emerged in practice as the AIFMD heavily restricts the liability discharge model. To address this issue, depositaries

[892] Deloitte, *AIFMD Implementation – Depositary webinar*, 11, http://www2.deloitte.com/content/dam/Deloitte/ie/Documents/FinancialServices/investmentmanagement/aifmd_depositary_webinar.pdf (accessed 3 September 2016).
[893] See Article 21(12) AIFMD.
[894] Art. 14(3) and 20 AIFMD.
[895] Art. 14(3) AIFMD, Art. 91(1) AIFMD (Commission) Regulation.
[896] BEAMA AIFMD FAQ Deel 1, Q25: Welke 'Prime Broker'-modellen zijn er nog nog mogelijk onder de AIFMD?, www.beama.be/nl/faq/aimfd-faq-deel-i (accessed 3 September 2016); Grant Thornton, *Alternative Investment Fund Managers Directive (AIFMD) - The Depositary and Prime Broker (PB) Operating Model Dilemma*, http://www.grant-thornton.co.uk/Global/Publication_pdf/AIFMD.pdf (accessed 3 September 2016); Matheson, *AIFMD Factsheet: Prime Brokers,* http://www.matheson.com/images/uploads/publications/AIFMD_Factsheet_Prime_Brokers.pdf (accessed 3 September 2016).
[897] ESMA/2011/209, 390; ESMA/2011/379, 44-45.
[898] See *supra* 7.2.
[899] S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013).
[900] BEAMA AIFMD FAQ Deel 1, Q25: Welke 'Prime Broker'-modellen zijn er nog nog mogelijk onder de AIFMD?, www.beama.be/nl/faq/aimfd-faq-deel-i (accessed 3 September 2016); Deloitte, *AIFMD*

and prime brokers as sub-custodians may agree upon an indemnity clause which stipulates that depositaries upon any 'guarantor liability' triggered for lost financial instruments that can be held in custody in the prime broker's sub-custodian network have to be compensated by the prime broker. There are, however severe disadvantages for the depositary under this model. Depositaries accepting indemnity clauses have to accept counterparty risk to the prime broker for the contractual indemnity offered.[901] The indemnity clause does not offer protection to depositaries for financial instruments that can be held in custody that are lost as the result of the bankruptcy of the prime broker. Finally, prime brokers may be unwilling to provide contractual indemnity as this may have severe implications on the capital structure of the prime broker. Depending upon the particular relationship, depositaries and prime brokers might consider to use other prime broker models that are available.

10.2.2.2. The Prime Broker using the Depositary's Sub-Custodian Network

Under the second category, the depositary appoints the prime broker as a sub-custodian, whereas the depositary retains its liability. In turn, the prime broker is under this model only allowed to appoint sub-custodians of the depositary's sub-custodian network. All the assets of the AIF concerned are, thus, safekept by the sub-custodian network of the depositary. Given the oversight that the depositary has of this network, the depositary is able to mitigate liability issues better than in the case assets are kept in the prime broker's sub-custodian network.
All settlement and clearing transactions under this model remain, however, to be directed by the prime broker. The downside of this model is that the prime broker will need to invest in new sub-custodian networks, in addition to, its current network for TC-AIFs. In addition, the sub-custodian network of the depositary might not suit the investment policies of the AIF as well as in comparison with the sub-custodian network of the prime broker.

The latter issue might be solved by the prime broker appointing a third-party (a global custodian) that is affiliated with the depositary. Global custodians might have more suitable sub-custodian networks for providing access to a larger amount of markets.[902]

10.2.3. *The Prime Broker as Counterparty*

Prime broker may also solely act as a counterparty to an AIF without being appointed as a depositary or a sub-custodian for performing the custody functions.[903] Under this model, the

---

Implementation – Depositary webinar, 11, http://www2.deloitte.com/content/dam/Deloitte/ie/Documents/FinancialServices/investmentmanagement/aifmd_depositary_webinar.pdf (accessed 3 September 2016); Matheson, *AIFMD Factsheet: Prime Brokers,* http://www.matheson.com/images/uploads/publications/AIFMD_Factsheet_Prime_Brokers.pdf (accessed 3 September 2016); Grant Thornton, *Alternative Investment Fund Managers Directive (AIFMD) - The Depositary and Prime Broker (PB) Operating Model Dilemma*, http://www.grant-thornton.co.uk/Global/Publication_pdf/AIFMD.pdf (accessed 3 September 2016).

[901] See on the risks associated with prime brokers D. Duffie, *The Failure Mechanics of Dealer Banks*, Journal of Economic Perspectives 51 to 72 (2010); See on the implications of bankrupt prime brokers: J. S. Aikman, *When Prime Brokers Fail: The Unheeded Risk to Hedge Funds, Banks, and the Financial Industry* (Bloomberg 2010); J. Mackintosh, *Lehman collapse puts prime broker model in question*, Financial Times (24 September 2008); G. O. Aragon & P. E. Strahan, *Hedge Funds as Liquidity Providers: Evidence from the Lehman Bankruptcy* (August 2009), http://www.nber.org/papers/w15336 (accessed 30 September 2012); See also *Bear Stearns, S. Chaplinsky, Bear Stearns and the Seeds of its Demise*, Darden Case No. UVA-F-1574.

[902] Deloitte, *AIFMD Implementation – Depositary webinar*, 11, http://www2.deloitte.com/content/dam/Deloitte/ie/Documents/FinancialServices/investmentmanagement/aifmd_depositary_webinar.pdf (accessed 3 September 2016); Grant Thornton, *Alternative Investment Fund Managers Directive (AIFMD) - The Depositary and Prime Broker (PB) Operating Model Dilemma*, http://www.grant-thornton.co.uk/Global/Publication_pdf/AIFMD.pdf (accessed 3 September 2016).

[903] BEAMA AIFMD FAQ Deel 1, Q25: Welke 'Prime Broker'-modellen zijn er nog nog mogelijk onder de AIFMD?, www.beama.be/nl/faq/aimfd-faq-deel-i (accessed 3 September 2016);

depositary and other sub-custodians will be responsible for the safekeeping of assets. The prime broker may under this arrangement not hold any assets that should be held in custody provided that the prime broker is not appointed as a depositary or sub-custodian. This allows the depositary to remain in control over all of the AIF's assets and it can, therefore, retain liability. This requires, however, the prime broker to transfer the AIF's financial instruments that can be held in custody to the depositary's network on a daily basis. The prime broker still requires that an AIF provide its assets as collateral to the prime broker as collateral taker. The AIFMD, however, requires these assets to be kept in custody as long as the AIF owns the financial instruments. Collateral arrangements can be dealt with in several ways.[904]

One option is that the AIF's depositary or one of its sub-custodians acts as agent for the prime broker as collateral taker (the 'prime custody' model). Under this model, security interests are vested on the financial instruments that can be held in custody by means of an control agreement or earmarking in favour of the prime broker as collateral taker. This model avoids the prime broker and the depositary taking principal risk at the same time.[905]

Another possibility is that prime brokers require financial instruments that can be held in custody to be title transferred to them to serve as collateral ('the title transfer' model).[906] As the AIF no longer owns financial instruments on title transfer, financial instruments are under the AIFMD not anymore being considered as assets that can be held in custody. Prime brokers may, thus, hold these assets without being appointed as a depositary or sub-custodian. Under this model, AIFs need to accept considerable counterparty risk. AIFMs would need to to carry out intensified ongoing due diligence on the prime broker to make the counterparty risk acceptable.

The third possible option is that the prime broker only holds and retains security interests on 'other assets' than financial instruments that can be held in custody (the 'prime only' model).[907] The AIF is, however, under this model exposed to the insolvency risk of the prime broker.

The downside of the prime broker only acting as an counterparty in all three sub-models is that the depositary is facing an intra-day 'guarantor liability' exposure to the prime broker as the prime broker only transfers the assets to the depositary's network on a daily basis. For this

---

Matheson, *AIFMD Factsheet: Prime Brokers,* http://www.matheson.com/images/uploads/publications/AIFMD_Factsheet_Prime_Brokers.pdf (accessed 3 September 2016); Grant Thornton, *Alternative Investment Fund Managers Directive (AIFMD) - The Depositary and Prime Broker (PB) Operating Model Dilemma*, http://www.grant-thornton.co.uk/Global/Publication_pdf/AIFMD.pdf (accessed 3 September 2016).

[904] European Commission, Commission Delegated regulation (EU) No …/.. of 19.12.2012 supplementing Directive 2011/61/ EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision, Brussel, 19.12.2012, C (2012) 8370 final, 9.

[905] I. Kaminska, *Prime custody, and the business of collateral*, Financial Times (13 July 2012); City, *Prime Custody: Asset Protection & Operational Simplicity,* http://citi.com/icg/global_markets/prime_finance/docs/Citi_PFinance_Custody_White_Paper_Feb_2010.pdf(accessed 3 September 2016); J.P. Morgan – *J.P. Morgan's Integrated Prime Brokerage and Custody Service – Prime-Custody Solutions*, https://www.jpmorgan.com/cm/BlobServer/PrimeCustody_Solutions.pdf?blobkey=id&blobnocache=true&blobwhere=1320555967068&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs (accessed 3 September 2016); COOConnect, *What Prime Custody is doing to Prime Brokerage*, http://cooconnect.com/online-magazine/what-prime-custody-doing-prime-brokerage (accessed 3 September 2016).

[906] Grant Thornton, *Alternative Investment Fund Managers Directive (AIFMD) - The Depositary and Prime Broker (PB) Operating Model Dilemma*, http://www.grant-thornton.co.uk/Global/Publication_pdf/AIFMD.pdf (accessed 3 September 2016).

[907] ESMA/2011/209, 390.

reason, this model is operationally inefficient for certain type of AIFs, such as long/short AIFs, that involve multiple instructions/settlements for carrying out a single transaction.

10.2.4. *The AIFMD's Exemption: The Depositary Lite Model*

Under the various Member State implementations of the private placement regime under Article 36 AIFMD[908], AIFMs may either appoint a single depositary that performs all duties and might delegate the safekeeping of financial instruments to a prime broker (the integrated model) or take a multiple-provider approach in which the depositary duties are carried out by more than one entity (the open-architecture model).[909]

Under the open-architecture model, in practice, amongst others, the following two sub-models are mostly applied:[910]

- prime brokers/custodians perform the safekeeping of financial instruments (custody), administrators the cash flow monitoring and the verification of other assets (record keeping) functions and a depositary is appointed to perform oversight duties; and
- prime brokers/custodians perform the safekeeping of financial instruments (custody) but a depositary is appointed to perform the cash flow monitoring, verification of other assets (recordkeeping) and oversight duties.

Whether and to what extent these models can be applied within individual Member States, thus, depends upon the terms of the authorization of the specific service providers, the legislation they are subjected to, as well as, the adoption and interpretation of Article 36 AIFMD in the domestic laws of the respective Member States involved.

10.3. Conclusion

The prime brokerage relationship involves the AIFM, depositary and the PB. The AIFM is responsible for the relationship with the prime broker acting as a counterparty to the AIF, whereas the depositary appoints prime brokers as sub-custodian. The AIFM responsible for the prime brokerage agreement is required to comply with various organizational requirements related to risk management, compliance and disclosure/reporting. Prime brokers acting as counterparty are responsible for reporting assets to depositary, whereas there are various frictional boundaries between the role of the depositary and prime broker. The prime brokers is to be mandatorily appointed as a depositary or as a sub-custodian depending upon the type of assets (financial instruments that can be held in custody) and the status of these assets (unencumbered, encumbered or on title transfer). Various 'prime broker models' have been developed in practice to solve the frictional boundaries between the depositary and the prime broker that are primarily based on the risk appetite of both.

11. Conclusion

Prior to adopting the AIFMD and UCITSD V, Member States enjoyed significant discretion as to whether the appointment of a depositary was required and as to which entities were allowed to act as a depositary. This led to divergent approaches in Member States regarding the duties and responsibilities depositaries had and under which conditions these responsibilities could be delegated to a sub-custodian, which caused legal uncertainty and

---

[908] See *supra* 2.1.4.
[909] Global Fund Media, *AIFMD Depositary Models 2014 – Special Report,* http://www.hedgeweek.com/sites/default/files/GFM_AIFMD_14.pdf (accessed 3 September 2016).
[910] B. Prew, *Six Months To Go For AIFMD - A review of developments in the depositary-lite market,* http://www.thehedgefundjournal.com/node/9183 ((accessed 29 August 2016).

different levels of investor protection in the EEA. The introduction of the AIFMD and UCITSD V depositary framework has provided clarification on these points by requiring a single depositary to be appointed for each AIF/UCITS that an AIFM/UCITS ManCo manages. The depositary of an AIF must be: (1) a credit institution; (2) an investment firm; (3) an eligible entity under UCITSD V, (4) prime brokers or (5) an equivalent non-EEA entity.[911] In addition, the AIFMD allows discretion for Member States to appoint professionals as depositaries for certain closed-ended funds. National central banks, credit institutions and other legal entities complying with additional prudential, organizational and capital requirements to provide sufficient guarantees may all be provided for by the implementing laws of the individual Member States as eligible depositaries under UCITSD V.[912] Besides clarifying the eligible entities, both the AIFMD and UCITSD V clarify the safekeeping and controlling functions of a depositary, set out the conditions under which delegation of safekeeping may take place and clarifies the liability of depositaries for both financial instruments that can be held in custody and 'other assets'.

Depositary regulation under both the AIFMD and UCITSD V is, thus, largely the same. This is unsurprising given the fact that UCITS are 'liquid AIFs'.[913] The larger scope of the AIFMD that includes not only liquid, but also illiquid and highly leveraged AIFs and the retail investor nature of UCITSD V, however, have led to some differences related to, in particular, the eligible entities, the practical application of functions, the UCITSD V depositary delegation and liability regime.[914]

Following the new (cross-sectoral) consistent regime for depositaries under both the AIFMD and the UCITSD V, one can clearly conclude that by clarifying the appointment, eligible entities, the depositary's functions, delegation and liability, a level playing field in depositary regulation for AIFs and UCITS in the EEA is achieved.

---

[911] A prime broker can also be appointed as a depositary, but is in particular subject to the requirements of Art. 21(4) AIFMD. For details see D.A. Zetzsche, *(Prime) Brokerage* (D.A. Zetzsche ed, Kluwer 2015).
[912] Art. 23(3) UCITSD V.
[913] See for a detailed explanation on this: See Chapter 8, section 2.2.
[914] See Chapter 8, section 2.

CHAPTER 5 IORPD II Depositary Regime

1. Introduction

IORPD I was originally enacted to harmonize the regulation across the EU of institutions for occupational retirement provision whilst promoting the cross-border provision of occupational pensions to a larger extent by allowing the plan sponsor, the IORP and its asset manager and depositary to be located in different countries of the EEA. By introducing an European passport for IORPS, it European Commission to increase economies of scale by allowing the pooling of schemes of companies operating in several EEA Member States. The rules set out by IORPD I and the harmonization it accomplished were minimal.[1] Given the diversity in national securities laws requirements and social and labour laws[2], the IORPD has now had very limited success. In 2015, there were only 88 cross-border IORPs out of approximately 120,000 schemes.[3] After carrying out a review of the IORPD I, and after having sought the advice of the EIOPA, IORPD II contains a large amount of amendments in comparison to IORPD I. The amendments in IORPD II aim at:[4]

- removing remaining prudential barriers to cross-border IORPs;
- ensuring good governance and risk management in relation to IORPs;
- providing clear and relevant information to members and beneficiaries; and
- ensuring supervisors have the necessary tools to effectively supervise IORPs.

IORPD II harmonizes the legal framework applicable to IORPs and their depositaries to a much larger extent.IORPD II leaves the decision of making the appointment of a depositary compulsory to each individual Member States to avoid unjustified changes to their pension system.[5] Nevertheless, an IORPD II depositary has been established to promote convergence for the depositaries that are required to be appointed by individual Member States.[6] The depositary legal regime is based on the preparatory work that has been done under the AIFMD and UCITSD V[7] and harmonizes the entities eligible, the depositary's duties and liabilities.

2. The Appointment of Depositaries under IORPD II

---

[1] CEIOPS-OP-03-08 final, concludes, based on the questionnaire on custodian/depositary, that there are differences across Member States in relation to the appointment of a custodian, the type of body which is appointed to fulfil this role and the function that it performs. Diversity also exists around the role of competentauthorities, some of whom play a role in the process of the custodian's appointment.

[2] H. Van Meerten, *Pension reform in the European Union*, 14 Pensions Int J 259-272 (2009); H. Van Meerten & B. Staring, *Cross-border obstacles and solutions for pan-European pensions*, 1 EC Tax Rev 30-41 (2011).

[3] EIOPA-BoS-15/144 09, 11.

[4] European Insurance and Occupational Pensions Authority, *Call for Advice from European Insurance and Occupational Pensions Authority (EIOPA) for the Review of Directive 2003/41/EC (IORP II),* https://eiopa.europa.eu/Publications/Requests%20for%20advice/20110409-CfA-IORPII-final.pdf (accessed 27 July 2016).

[5] EIOPA-BOS-12/015, 463.

[6] European Insurance and Occupational Pensions Authority, *Call for Advice from European Insurance and Occupational Pensions Authority (EIOPA) for the Review of Directive 2003/41/EC (IORP II),* https://eiopa.europa.eu/Publications/Requests%20for%20advice/20110409-CfA-IORPII-final.pdf (accessed 27 July 2016).

[7] See EIOPA-BOS-12/015, 451-459, 467-469.

In EIOPA's final advice the most prominent question to be answered was whether Member States should be required to make the appointment of a depositary compulsory.[8] EIOPA considered that a more consistent approach among Member States in relation to the appointment of a depositary was necessary.[9] Given the heterogeneity of IORPs throughout the EEA, EIOPA considered that convergence in relation to the appoint of depositaries was difficult to achieve.[10] IORPs in one Member State may show resemblance to investment funds, whereas in other Member States IORPs have more features in common with pension funds and insurance companies.[11] Apart from this, it was an important consideration that many IORPs do not have a depositary and that in those Member States a similar level of protection to members and beneficiaries would be in place that require a similar level of protection.[12] In particular, requiring the compulsory requirement for the appointment of a depositary would not fit in the existing legal regimes of all Member States and could to lead to an increase in costs.[13]

Taking into account these considerations of EIOPA and its stakeholders, IORPD II leaves the decision of making the appointment of a depositary compulsory to each individual Member States to avoid unjustified changes to their pension system.[14] IORPD II differentiates between full DC and other types of IORPs in the degree in which IORP home Member States are left the discretion for making the appointment of depositaries compulsory. The difference in degree of discretion for these different types of IORPs will now be discussed.

2.1. The Appointment for Full DC and other Types of IORPs

For the purpose of the appointment of a depositary, IORPD II differentiates between IORPs in which members and beneficiaries fully bear and do not fully bear investment risks.

2.1.1. *Full DC IORPs*

Member States may require IORPs operating schemes where members and beneficiaries fully bear the investment risks to appoint one or more depositaries for the safekeeping of assets and oversight duties in accordance with the IORPD II depositary regime.[15]

The discretional choice of IORP home Member States[16] no to require a full DC IORP to appoint one or more depositaries is, however, limited by the national laws of host Member States.[17] Host Member States[18] may require full DC IORPs that carry out cross-border

[8] EIOPA-BOS-12/015, 460.
[9] *Ibid*, 460.
[10] *Ibid*, 463.
[11] N. Kortleve et al., European Supervision of Pension Funds: Purpose, Scope and Design, Netspar Design Papers No. 4 (Oct. 2011), 15-18; H. Van Meerten, The Scope of the EU 'Pensions'-Directive: Some Background and Solutions for Policymakers, in *Social Services of General Interest in the EU* 413-431 (U. Neergaard, E. Szyszczak, J.W. van de Gronden & M. Krajewski eds, Springer 2013).
[12] EIOPA-BOS-12/015, 463.
[13] *Ibid*, 460.
[14] *Ibid*, 463.
[15] Art. 33(1) IORPD II.
[16] Art. 6(10) IORPD II: 'home Member State' means the Member State in which the IORP has been registered or authorised and in which its main administration is located in accordance with Article 9.' Following Art. 9 sub-para. 1 IORPD II the location of the main administration is the place where the main strategic decisions of an IORP are made.
[17] Art. 33(1) IORPD II.
[18] Art. 6(11) IORPD II: 'host Member State means the Member State whose social and labour law relevant to the field of occupational pension schemes is applicable to the relationship between the sponsoring undertaking and members or beneficiaries.'

activity[19] to appoint one or more depositaries for the safekeeping of assets and oversight duties[20] under the condition that such an appointment is required under its national law.

DC IORPs that carry out cross-border activity in one or more host Member States that requires a depositary in accordance with the IORPD II depositary regime to be appointed have to appoint such a depositary regardless of the discretionary choice made under the national law of the IORP home Member State. The limitation in the discretion of the depositary appointment under the national law of the home IORP Member State only applies to IORPs that carry out a cross-border activity under Article 11 IORPD II. Under Article 11 IORPD II, home Member States have to allow an IORP that is registered or authorized[21] to carry out cross-border activity. Under Article 6(19) IORPD II a cross-border activity is defined as the operating of a pension scheme[22] by an IORP that is governed by the social labour law of another Member State than the home Member State. The pension scheme might be a contract, agreement, trust deed or rules (other legal form) that stipulate which retirement benefits are granted and under which conditions[23] these are being granted in the relationship between the sponsoring undertaking[24] and the members[25] and beneficiaries[26].

Following Recital 5 IORPD II, the cross-border activity is determined by the applicability of the social labour law of the IORP host Member State without prejudice to the national social and labour law that applies to the IORP pension scheme to the relationship between the sponsoring undertaking and members and beneficiaries. of the host Member State. The mere fact that the members and beneficiaries of an IORP pension scheme reside in another Member State than the Member State where the sponsoring undertaking and the IORP are located does not constitute a cross-border activity. It is, thus, decisive that the social and labour law of another Member State than the home Member state[27] applies to the relationship between the sponsoring undertaking and members or beneficiaries to constitute a cross-border activity.

Full DC IORPs carrying out a cross-border activity that are both not required to appoint a depositary have to ensure under Article 34 and 35 IORPD II that equivalent protections are in place for the performance of the safekeeping and oversight duties.[28] Full DC IORPs that do not have equivalent protections in place for either of these functions are, thus, de facto,

---

[19] Art. 6(19) IORPD II: 'cross-border activity' means operating a pension scheme where the relationship between the sponsoring undertaking, and the members and beneficiaries concerned, is governed by the social and labour law relevant to the field of occupational pension schemes of a Member State other than the home Member State.'

[20] A depositary that performs the duties in accordance with Art. 34 and 35 IORPD II; See Art. 33(1) IORPD II.

[21] See Art. 9 IORPD II.

[22] Art. 6(2) IORPD II: 'pension scheme' means a contract, an agreement, a trust deed or rules stipulating which retirement benefits are granted and under which conditions.'

23 Art. 6(4) IORPD II: 'retirement benefits means benefits paid by reference to reaching, or the expectation of reaching, retirement or, where they are supplementary to those benefits and provided on an ancillary basis, in the form of payments on death, disability, or cessation of employment or in the form of support payments or services in case of sickness, indigence or death. In order to facilitate financial security in retirement, these benefits may take the form of payments for life, payments made for a temporary period, a lump sum, or any combination thereof.'

[24] See Art. 6(3) IORPD II: 'any undertaking or other body that acts as an employer or in a self-employed capacity or any combination thereof and which offers a pension scheme or pays contributions to an IORP. Sponsor undertakings may include or consist of one or more legal or natural persons.'

[25] See Art. 6(5) IORPD II: 'members' means 'a person, other than a beneficiary or prospective members, whose past or current occupational activities entitle or will entitle him/her to retirement benefits in accordance with the provisions of a pension scheme.'

[26] See Art. 6(6) IORPD II: 'a person that receives retirement benefits.'

[27] See Art. 6(11) IORPD II.

[28] See *infra* 4.

compulsory required to appoint a depositary for the safekeeping or the safekeeping and oversight function.[29]

2.1.2. *Other Types of IORPs*

For IORPs in which the members and beneficiaries do not fully bear the investment risk, the IORP home Member State may require an IORP to appoint a depositary for safe-keeping of assets or for safe-keeping of assets and oversight duties in accordance with the IORPD II depositary regime.[30] There are two differences between the appointment of a depositary for full DC IORPs and other types of IORPs.

First, the IORP home Member States has the full discretion to decide whether a depositary is required to be appointed for this type of IORP.[31] DB and hybrid IORPs carrying out cross-border activity that are not required by their IORP home Member State to appoint a depositary may not be 'forced' by any of their host Member States to appoint a depositary.

Second, Article 33(2) IORPD II allows home Member States the choice for DB and hybrid IORPs to require a depositary for safe-keeping of assets or for safe-keeping of assets and oversight duties or not to require anything in this regard at all and leave it completely up to market practice. In practice, there will, however, in this regard not be any difference with full DC IORPs. Home Member States have the discretion not to require a depositary for the safekeeping of assets and oversight duties. The discretion being left to the home Member State to require a depositary for both functions at all in itself leaves the possibility open to IORP home Member States to require merely a depositary to be appointed for the safekeeping of assets function. Article 34(5) IORPD II leaves this open as 'equivalent protections' only need to be provided for the situation 'where no depositary is appointed for the safe-keeping of assets'. Article 34(5) IORPD II does not prevent home Member States from doing so. Full DC IORPs that carry out cross-border activities are, however, still obliged to appoint a depositary for both functions if a host Member State requires under their national law regardless of the implementation of the IORPD II depositary regime under the national law of the IORP home Member State.

Host Member States are, thus, the only Member State that determine whether and what type of depositary should be appointed for DB and hybrid IORPs that are authorized or registered in their territory. The appointment of the depositary for full DC IORPs depends upon the national implementation of the IORPD II depositary provision under the home Member State laws and, if carrying out a cross-border activity, also upon implementation of the host Member States in which particular IORPs operate.

The crucial question for IORPs whether and to what extent to apply the IORPD II appointment of a depositary regime is, thus, whether members and beneficiaries of an IORP fully bear investment risk. For this purpose, it should be clarified what 'fully bearing investment risks' means.

2.2. Investment risks - Full DC, hybrid and/or Full DB IORPs?

For the purpose of the appointment of a depositary, IORPD II differentiates between IORPs in which members and beneficiaries fully and do not fully bear the investment risk.[32]

IORPD II leaves the decision of making the appointment of a depositary compulsory to

---

[29] Recital 45 Draft IORPD II February 2016: 'institutions operating schemes where members and beneficiaries bear all the risks and where equivalent protections are not already in place, should be required to appoint a depositary'.

[30] Art. 33(2) IORPD II.

[31] Art. 33(2) IORPD II.

[32] See Art. 33(1) and (2) IORPD II.

each individual Member States to avoid unjustified changes to their pension system.[33] For this purpose, however, IORPD II differentiates between full DC and other types of IORPs in the degree in which IORP home Member States are left the discretion for making the appointment of depositaries compulsory. The compulsory appointment of the depositary for full DC IORPs depends upon the national implementation of the IORPD II depositary provision under the home Member State laws and, for IORPs carrying out a cross-border activity, also upon the national laws of the host Member States in which particular IORPs operate.

The rationale behind the differentiation lies in EIOPA's IORPD II preparatory work. EIOPA, in considering the need for having a (compulsory) depositary appointed, reviewed the depositary practices under the UCITSD, the AIFMD and Solvency II.[34] While in the first two Directives a depositary is to be appointed, the latter Directive does not contain such a requirement. This is mainly because IORPs showing resemblance to insurance companies (full DB and hybrid IORPs) manage assets and, generally, the employer and/or IORP bears the costs of any operational failures associated with the safeguard of assets and investment operations.35 Therefore, the need for safekeeping and oversight functions to be performed by a depositary to protect members/beneficiaries was not being seen as imperative.36 The situation, however, is different for IORPs showing resemblance to AIFs and UCITS in which members/beneficiaries bear investment risk (full DC IORPs). The external appointment of a depositary that safe-keeps assets and oversees the activities of the IORP was considered to ensure due care of assets and mitigate the risk of fraud.[37] This consideration ultimately led to the difference in the appointment of a depositary requirements between IORPs in which members and beneficiaries fully and do not fully bear the investment risk.

IORPD II does not contain a definition of IORPs in which members and beneficiaries fully and do not fully bear investment risk. The actual function under Article 28 IORPD II provides some guidance on this point. Under this provision an actuary is required for IORPs that 'provides cover against biometric risks[38] or guarantees either an investment performance or a given level of benefits'. Under Article 33(1) IORPD II, thus, seems to suggest that members fully bear the investment risk if an IORP does not guarantee either an investment performance or a given level of benefits.

Whether the appointment of a depositary depends upon the national laws of merely the home Member State or also upon the national laws of host Member States for IORPs carrying out a cross-border activity, thus, depends on whether a scheme's plan is a full defined contribution (DC), a defined benefit (DB) or a hybrid plan. For IORPS that employ full DC IORPs, plan sponsors and/or insurance company/asset manager do not bear any of the financial (or biometric risks) that are related to the IORPS' pension plan.[39] Instead, the benefits paid eventually paid out to its members are purely determined on the basis of the investment result yielded. The eventual cost of operational failures that are stemming from the management of the plan's assets by an asset manager, such as administrations risks including contributions and investment returns allocated to an incorrect account[40] are fully borne by members/beneficiaries of full DC IORPs.[41] In DB and hybrid plans, to the contrary, either the

---

[33] EIOPA-BOS-12/015, 463.
[34] EIOPA-BOS-12/015, 460,
[35] EIOPA-BOS-12/015, 460.
[36] EIOPA-BOS-12/015, 460.
[37] EIOPA-BOS-12/015, 460.
[38] Art. 6(h) IORPD II: 'biometric risks' mean risks linked to death, disability and longevity.'
[39] F. Stewart & J. Yermo, *Pension Fund Governance: Challenges and Potential Solutions*, OECD Working Papers on Insurance and Private Pensions No. 18 (June 2008), 3.
[40] EIOPA-BOS-12/015, 462.
[41] *Ibid*.

plan sponsor, the insurance company or the asset manager insures the plans' members against some extent of financial or biometric risk.[42] Any of these actors may guarantee to the plan's members a guaranteed minimum rate of return on investments or annuitization rate, or a formula is specified through which the guarantee will be calculated based upon the employee's past earnings.[43] DB and hybrid schemes, thus, bear (to some extent) the cost of potential failures that are related to managing and safeguarding assets.[44]

EIOPA in its final advice considered a similar appointment of a depositary as for full DC IORPs not appropriate for hybrid schemes as there are many different types of hybrids schemes within the EEA. EIOPA stated that further clarification of the function of depositaries for these schemes would be necessary before imposing a similar requirement.[45]

The appointment of a depositary that both exercises both safe-keeping and oversight is depends, thus, upon the national laws of the home Member State and host Member States for IORPs carrying out a cross-border activity for IORPs in which no investment guarantee at all is given by the pension plan sponsor and/or the IORP. The IORPD II leaves it up to the home Member States to decide whether or not a depositary is required for other types of IORPs (hybrid and DB IORPs).

2.3. The Definition of a 'Depositary' under IORPD II

The IORPD II eligible entities requirement applies to depositaries. Article 33(1) and (2) IORPD II defines a depositary as both being a depositary for safekeeping of assets or for safekeeping of assets <u>and</u> oversight duties in accordance with the IORPD II. The wording is different compared to IORPD I. Under Article 19(2) IORPD I, were required not to

> 'restrict institutions from appointing, for the custody of their assets, custodians established in another Member State and duly authorized in accordance with Directive 93/22/EEC or Directive 2000/12/EC, or accepted as a depositary for the purposes of Directive 85/611/EEC.'

Member States could require either the appointment of a depositary or a custodian to be compulsory.[46] Article 19(2) IORPD I referred to 'custodians' established in another Member State and duly authorized in accordance with the ISD (predecessor MiFID I/II) or CRD I (predecessor CRD IV) or accepted as a 'depositary' for the purposes of UCITSD V.

Article 33(3) IORPD II requires Member States not to restrict IORPs from appointing, depositaries <u>established in another Member State</u> and duly authorized in accordance with CRD IV or MiFID (II), or accepted as a depositaries for the purposes of UCITSD IV/V or the AIFMD.[47] In conjunction with Article 33(1) and (2) IORPD II, the 'IORPD I custodian' has, thus, been replaced by a 'depositary for safe-keeping of assets' and the 'IORPD I depositary' by a depositary appointed for safe-keeping of assets and oversight duties in accordance with the IORPD II.

EIOPA stated in its IORPD II final advice that the terms custodian/depositary might correspond to different types of function that would depend upon the jurisdiction and the type of IORP.[48] EIOPA found it, for that purpose, relevant to establish a common and harmonized understanding of 'custodians' and 'depositaries' and their functions.The term 'depositary'

---

[42] F. Stewart & J. Yermo, *Pension Fund Governance: Challenges and Potential Solutions*, OECD Working Papers on Insurance and Private Pensions No. 18 (June 2008), 3;
[43] *Ibid.*
[44] EIOPA-BOS-12/015, 461.
[45] *Ibid.*, 462.
[46] Art. 19(2) sub-para. 2 IORPD I; See also CEIOPS-OP-03-08 final, 12-13, 56-58.
[47] Art. 33(3) IORPD II.
[48] EIOPA-BOS-12/015, 451.

under the AIFMD was being taken as 'benchmark' as it was the most 'advanced piece of legislation' and taken as a template for the role of the depositary under UCITSD V. According to the AIFMD and UCITSD V, being referred to by EIOPA, the depositary has two core functions: the safekeeping assets and the compliance with fund rules and applicable law.[49] Further, EIOPA, without making reference to CRD IV, MiFID II or the CSDR, stated that 'the custodian function relates only to the safekeeping of assets'.[50]

Despite the fact that EIOPA recognized that both terms imply different functions, EIOPA advised to always refer to the word 'depositary', as is the case under the AIFMD and UCITSD V.[51] This advice was followed up in the final legal text of IORPD II and creates major confusion about (compulsory or optional) appointment of depositaries and the mandatory duties to be performed.[52]

Article 33(1) IORPD II regulates for full DC IORPs the appointment of one or more depositaries for the safe-keeping of assets and oversight duties. In contrary, Article 33(2) IORPD II refers, for all other types of IORPs, to the appointment of a depositary for safe-keeping of assets or for safe-keeping of assets and oversight duties.

Under Article 33(1) IORPD II, the requirement of the appointment of a depositary for full DC IORPs seem to have a similar meaning as depositaries within the meaning of the AIFMD and UCITSD V. Member States for other types of IORPs may under their national laws, thus, require the appointment of 'custodians' or 'depositaries'.

The difference of the meaning of a depositary under Article 33(1) and (2) IORPD II does, however, de facto not exist. Home Member States may require an IORP under Article 33(1) IORPD II to appoint one or more depositaries for the safekeeping of assets and oversight duties in accordance with the IORPD II depositary regime. The phrase 'may require' under Article 33(1) IORPD II suggests that home Member States may also choose to not require a 'depositary for the safekeeping of assets and oversight duties'. Taken a grammatical approach, the discretion given by 'may require' leaves open the choice to home Member States to require, instead, a depositary to be appointed for safekeeping of assets or for safekeeping of assets and oversight duties in accordance with the IORPD II depositary regime. This discretion, again, is limited for full DC IORPs that carry out cross-border activity and are required by one or more host Member States to appoint a depositary for the safekeeping of assets and oversight duties in accordance with the IORPD II depositary regime. The preference of EIOPA to always use the word 'depositary' for both 'custodians' and 'UCITSD V/AIFMD depositaries' required to be appointed might be explained by the fact that Member States in their national laws have the discretion to require both a 'custodian' or a 'depositary' for both full DC IORPs and other types of IORPs.[53] The meaning of a depositary under both Article 33(1) and (2) IORPD II for both full DC and other types of IORPs should, thus, be read as either a 'custodian' or an 'UCITSD V/AIFMD depositary'. The limitation provided under Article 33(1) IORPD II by a possible requirement to appoint a depositary for host Member States for full DC IORPs carrying out cross-border activity is an exception to the main rule and solely refers to 'UCITSD V/AIFMD depositaries'.

In light of the AIFMD and UCITSD V that refer to the concept of 'depositary' comprising both the safe-keeping and oversight function, whereas the custodian function under CRD IV

---

[49] *Ibid.*, 451.
[50] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments, COM(2004) 207 final*, 30 March 2004, 7, 14, 26.
[51] EIOPA-BOS-12/015, 471.
[52] *Ibid.*, 471.
[53] EIOPA-BOS-12/015, 471.

and MiFID II only relates to the safe-keeping of assets, the IORPD II has, thus, made the political choice of referring to both IORPD I custodians and depositaries for being 'depositaries' under the IORPD II.[54]

2.4. The Appointment of a Single Depositary vs. Multiple Depositaries

The double meaning of the word 'depositary' used in Article 33 IORPD II leads to inconsistency with the single depositary requirement under the AIFMD/UCITSD V and unclarity in the application of various IORPD II depositary provisions.

2.4.1. *The Inconsistency of the 'Depositary' Terminology under IORPD II*

Throughout the IORPD II consultation process upon the appointment of depositaries, it has been debated whether the IORPs should be required to appoint a single depositary or not. The Initial Draft IORPD II required the compulsory appointment of a single depositary for full DC IORPs.[55] Article 35(2) Initial Draft IORPD II proposed to allow Member States in their national laws to require an IORP to appoint either a single depositary or multiple depositaries for other types of IORPs.[56] Unlike the Initial Draft IORPD II, the final IORPD II text does not differentiate for this purpose for between appointing 'one or more' of a 'custodian' or a 'depositary'. The main rule is that the terminology 'depositaries' under Article 33(1) and (2) IORPD II leaves discretion to (host) Member States to either require a 'custodian' or an 'UCITSD V/AIFMD depositary' to be appointed for full DC and other types of IORPs. Leaving the option open to either require one or more 'depositaries' seems, thus, to have as the rationale as this can refer to both 'custodians' as 'UCITSD V/AIFMD depositaries'.

Leaving the decision to the Member States to allow an IORP to appoint multiple depositaries for depositaries that perform both safe-keeping of assets and oversight duties is, however, at odds with the compulsory appointment of a single depositary for these duties under the AIFMD and the UCITSD V.[57] Similarly, allowing Member States to appoint a single depositary for other IORPs for merely the safe-keeping of assets is at odds with CRD IV/MiFID II that both do not require the appointment of a single depositary for safe-keeping of assets (custodian).[58]

In the Final Advice of EIOPA it was clearly stated to leave the decision of making of requiring the appointment of one or more depositaries to each Member State in order to avoid unjustified changes to their pension systems.[59] This advice was followed up in the final text of IORPD II.

The idea behind the compulsory requirement of a single depositary was also discussed prior to the introduction of the 'single depositary rule'[60] under the UCITSD V and AIFMD. For the UCITSD V consultation is was pointed out that the UCITSD I-IV did not expressly mention that a UCITS may only have a single depositary and clarification on this point was desirable.[61]

---

[54] EIOPA-BOS-12/015, 471.
[55] Art. 35(1) Initial Draft IORPD II.
[56] Art. 35(2) Initial Draft IORPD II.
[57] Art. 21(1) AIFMD and Art. 22(1) UCITSD V.
[58] See Annex I Section A MiFID I/II.
[59] EIOPA-BOS-12/015, 463.
[60] European Commission, *Consultation Paper on the UCITS Depositary Function and on the UCITS Managers' Remuneration (December 2010)*, MARKT/G4 D (2010) 950800, 19, 20.
[61] European Commission, *Summary of Responses to UCITS Depositary's Consultation Paper - Feedback Statement*, 9.

The outcome of the UCITSD V consultation was that the compulsory appointment of a single depositary was the only way to guarantee that the depositary has an exhaustive and complete overview of the fund's assets (e.g. a single depositary for an umbrella structure or a single fund).[62] This principle was considered to be essential to ensure that the depositary keeps an overview of all the assets and cash transaction of the UCITS/AIF portfolio and, therefore, be in a proper position to perform its oversight duties (such as to control that, for instance, a UCITS complies with the applicable regulatory ratios).[63]

Requiring a single depositary both ensures a complete overview of all of the assets and allows both asset managers and investors have a single point of reference in the event that problems occur in relation to the safekeeping of assets or the performance of oversight functions.[64]

In light of these considerations, Member States should require a single depositary for both full DC and other IORPs that is appointed for safe-keeping of assets and oversight duties. Depositaries appointed for merely the safe-keeping of assets should in line with the CRD IV and MiFID II not be required to appoint a single depositary, but one or more depositaries. For that purpose, Article 34 (1) IORPD II should clarify that a single depositary shall be entrusted for the safekeeping for those depositaries that are entrusted with both the safekeeping and oversight task. This is in line with the rationale of a single depositary assigned for both tasks: resolving collective action issues and to be institutionalized based upon the cheapest cost avoider theory.[65] Nonetheless, such type of depositaries shall not be prevented from delegating its safe-keeping to sub-custodians.[66] Such a requirement should not be put in place for depositaries merely performing the safekeeping task as these depositaries do not perform oversight duties and do not need to have an overview of all the assets of an IORP. These depositaries are only required to have a comprehensive and up-to-date inventory of all assets under their safekeeping and not from all assets assigned to all depositaries for the purpose of safekeeping.[67]

2.4.2. *The Unclarity of the 'Depositary' definition under IORPD II*

The double meaning of the word 'depositary' used in Article 33 IORPD II also leads to unclarity in the application of various IORPD II depositary provisions.

First, a grammatical interpretation of Article 33(3) IORPD II seems to suggest that the entities eligible as a depositary are limited for Member States that either choose the appointment of a single depositary or multiple depositaries or both to be appointed. Article 33(3) IORPD II refers to the appointment of depositaries established in another Member State and duly authorised in accordance with the CRD IV or MiFID II, or accepted as a depositary for the purpose of UCITSD IV/V or the AIFMD. From the wording 'accepted as a depositary' the single depositary requirement as applied in UCITSD IV/V and the AIFMD can be deducted. In the context of the IORPD II, however, it could lead to the confusion that

---

[62] European Commission, *Consultation Paper on the UCITS Depositary Function and on the UCITS Managers' Remuneration (December 2010)*, MARKT/G4 D (2010) 950800, 19, 20.
[63] European Commission, *Working Document of the Commission Services (DG Markt), Consultation Paper on the UCITS Depositary Function*, July 2009, 9;; European Commission, *Commission Staff Working Document of 3 July 2012* (SWD(2012) 185 final): accompanying the Proposal for the UCITSD V: Impact Assessment, Question 9., http://eur-lex.europa.eu/legal content/EN/TXT/PDF/?uri=CELEX:52012SC0185&from=EN (accessed 27 July 2016).
[64] See Recital 12 UCITSD V.
[65] See D.A. Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 21 (Mohr Siebeck 2015).
[66] See for considerations regarding the 'single depositary rule' under UCITSD V: European Commission, Summary of Responses to UCITS Depositary's Consultation Paper - Feedback Statement, 9.
[67] See EIOPA-BOS-12/015, 465.

only depositaries under UCITSD IV/V and the AIFMD are eligible to be appointed in those Member States that choose a single 'UCITSD V/AIFMD depositary' or 'custodian' to be appointed. In contrary, a grammatical interpretation of 'the appointment of depositaries' under Article 33(3) IORPD II could suggest that only entities under CRD IV or MiFID II would be eligible for those Member States that would allow one or more depositaries to be appointed. This confusion has either way no practical relevance as credit institutions and investment firms are also eligible under the AIFMD if a grammatical interpretation of this provision would be applied.

A similar confusion is to be observed in applying Article 34 and 35 IORPD II related to the safekeeping of assets and the exercise of the oversight duties of IORPD II depositaries.

Article 34 IORPD II for the purpose of applying the safekeeping of assets provisions refers to assets being 'entrusted to a depositary (emphasis added by the author) for safekeeping'. Article 34 IORPD II is unclear whether a single or multiple depositaries may be appointed for the safekeeping function. This is relevant as Article 33 IORPD II allows multiple 'custodians' and 'UCITSD V/AIFMD depositaries' to be appointed, but does not clarify whether the safekeeping function may be carried out by a single or by multiple depositaries.

A grammatical interpretation of Article 34 IORPD II would restrict Member States to only allow a single depositary to be appointed for the safekeeping function. Such an interpretation of both provision, however, leads to confusion as Member States under their national laws may require 'one or more' 'custodians' or 'UCITSD V/AIFMD depositaries' to be appointed. Again, not differentiating between 'UCITSD V/AIFMD depositaries' and 'custodians' leads to an unsatisfactory result. Full DC IORPs that show larger resemblance to AIFs and UCITS, for which a single depositary for safekeeping of assets and oversight duties is required, may appoint either a single or multiple depositaries for performing the safekeeping task.[68] In contrary, Member States may compulsory require a single 'custodian' to be appointed for the safe-keeping of, whereas the appointment of a single custodian is not required under the CRD IV/MiFID II.

Article 35 spreads similar confusion about whether or not multiple depositaries may be appointed for performing oversight duties.

Article 35(1) IORPD II requires 'the depositary appointed for oversight duties' to carry out the oversight duties. An earlier draft version of this Article required 'at least one of the depositaries' appointed under the IORPD II to carry out oversight duties. IORPD II, thus, allows IORPs to appoint multiple 'UCITSD V/AIFMD depositaries' to be appointed for IORPs. This is inconsistent with the single depositary requirement under the AIFMD and UCITSD V. Safekeeping and oversight duties may, thus, both be carried out by multiple depositaries whether a Member State requires an 'UCITSD V/AIFMD depositary' or a 'custodian' to be appointed.

Allowing multiple depositaries for these tasks prevents a (single) depositary from keeping a complete overview of all the assets that is necessary to perform its oversight duties.. Multiple depositaries being appointed by an IORP for performing the oversight duties could lead to coordination problems. The appointment of multiple depositaries for both the safekeeping and oversight duties would make the performance of both functions even harder. Member States are, thus, well suggested to implement IORPD II by requiring a single depositary to be appointed for 'UCITSD V/AIFMD depositaries' performing both tasks, whereas they could leave it open for 'custodians' being appointed.

The confusing wording used in Article 33(3), Article 34 and Article 35 IORPD II should, thus, be seen as to accommodate the intention to leave a large room for discretion to

[68] Art. 33(1) and (2) IORPD II.

individual Member States to either require the appointment of a 'custodian' or a 'UCITSD V/AIFMD depositary'.

2.5. The discretionary choice of Member States for a 'Depositary' or 'Custodian' under the IORPD II

Member States are left the choice whether or not to compulsory require a depositary for safe-keeping of assets or for safe-keeping of assets and oversight duties for full DC, hybrid or DB IORPs in accordance with the IORPD II depositary regime.[69] IORPs not required to appoint a depositary at all are required to adhere to 'equivalent protections' for performing the safekeeping and oversight duties under Article 34 and 35 IORPD II.

The draft IORPD II contained a mandatory requirement for full DC IORPs to appoint a depositary for both safekeeping and oversight duties.[70] The external appointment of a depositary that safe-keeps assets and oversees the activities of full DC IORP was considered by EIOPA to ensure due care of assets and mitigate the risk of fraud as members/beneficiaries bear that bear full investment risk.[71] This consideration ultimately led to the difference in the appointment of a depositary requirements between IORPs in which members and beneficiaries fully and do not fully bear the investment risk under IORPD II.

It is, however, unclear whether this differentiation between full DC IORPs and other types of IORPs will be followed up by the IORPD II Member States. None of the Member States upon implementing the IORPD I in their national laws delineated for the purpose of the compulsory appointment of a depositary/custodian between full DC and other types of IORPs.[72] Liechtenstein and Luxembourg, for example, required for IORPs that may operate DC, hybrid and DC IORPs a depositary for both tasks to be appointed.[73] Belgium, France and Malta required for all types of IORPs custodian to be appointed[74], whereas other Member States, including Denmark, Finland and the Netherlands, did not require a mandatory depositary or custodian for any type of IORP.[75]

Under the IORPD I Member State implementation laws the compulsory appointment of depositaries for IORPs varied from Member State to Member State for different reasons.

First, the nature of the IORPs available within a domicile varies from Member State to Member State. Essentially, the choice whether and to what extent investment guarantees are provided determines the attribution of risks. The larger the insurance element is, the less risk will be borne by the members/beneficiaries and vice versa.

Second, the interpretation of Member States whether members/beneficiaries bear investment risks may differ from Member State to Member State. The members and

---

[69] Art. 33(1), 34 and 35 IORPD II.

[70] Art. 35(1) Initial Draft IORPD II.

[71] EIOPA-BOS-12/015, 460.

[72] See Chapter 12, section 4.1.1.

[73] Liechtenstein: Art. 12 Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung (Pensionsfondsgesetz; PFG); Luxembourg: Arts 18 (1) and 42 (1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.

[74] Belgium: Art. 92 Law of 27 October 2006 on the supervision of institutions for occupational retirement provision; France: Art. L.143-4 du Code des Assurances; Malta: B.6 Custody of Retirement Fund's Assets, B.6.1 General Conditions, Directives for Occupational Retirement Schemes, Retirement Funds and related Parties under the Special Funds (Regulation) Act, 2002.

[75] Denmark: Consolidated Supervision of Company Pension Funds Act (Consolidated Act no. 1017 of 24 October 2005); Pensions Act (Consolidated Act no. 939 of 15 September 2004) ; Finland: Act on Employment Pension Insurance Companies, 25.4.1997/354, Netherlands: Wet van 7 december 2006 houdende regels betreffende pensioenen (Pensioenwet).

beneficiaries of (full) DB and hybrid IORPs may only have a residual interest in a slight sense as investment guarantees may be partially or fully given. Almost all IORPs of the latter type, however, only provide a conditional investment guarantee, i.e. the investment guarantee is only been granted if the regulatory funding ratio of an IORP allows such a guarantee to be given. Regardless of whether IORPs are full DC, hybrid or full DB IORPs, members/beneficiaries of all types of IORPs bear, thus, at least an 'indirect investment risk'[76]. Depending upon the funding ratio of an hybrid or DB IORP, investment losses may lead to non-indexation of pension benefits or another form of benefit cut. Member States may, thus, decide that members/beneficiaries in their domicile bear (indirectly) the cost of any operational failures associates with investment operations and, therefore, require a compulsory depositary to perform safekeeping and oversight duties for all types of IORPs in order to protect policyholders' interest.[77]

Finally, Member States may, regardless of their interpretation of investment risk, be of the opinion that equivalent measures for oversight duties are already in place to ensure that the oversight duties are being properly performed. Based upon this consideration, Member States may decide not to require any compulsory depositary for at all for any type of IORPs. Instead, the IORP governing body has been given the full discretion to decide to appoint a depositary exercising safekeeping and oversight duties or a depositary for exercising the safekeeping function or, if allowed by the national regulation applicable, to perform self-custody.[78] Member States, thus, vary in their compulsory depositary requirement for all types of IORPs under their IORPD I implementation laws and for the three reasons mentioned above this is unlikely to change under the IORPD II Member State implementation laws.

2.6. The Optional IORP Pooling Structure Exemption

The IORPD II leaves it up to the home Member States to decide whether or not a depositary is required for all types of IORPs. The February 2016 draft of IORPD II contained an 'IORP pooling structure exemption' for both full DC and other types of IORPs. Article 35(1) IORPD II of this draft version required Member States to appoint a single depositary or depositaries for full DC IORPs under the condition that a depositary had not already been appointed in relation to pension scheme assets in financial products in accordance with the AIFMD or UCITSD V. For other types of IORPs, Member States were under Article 35(2) IORPD II of this draft were not allowed to require IORPs fulfilling the IORP pooling structure exemption to appoint a depositary for safe-keeping of assets or for safe-keeping of assets and oversight duties. Member States were required to exempt IORPs from appointing a depositary to the extent that they invested all of their assets in one or more AIFs/UCITS for which a depositary had been appointed.

The IORP pooling structure exemption had been added to the February 2016 IORPD II version after industry comments indicated that IORPs for efficiency purposes establish pooling structures in which IORPs invest in one or more AIF/UCITS that already appoint a depositary for each of the fund involved.[79] IORP asset pooling structures are, generally, set up for full DC IORPs in which members have investment freedom, i.e. members are allowed to

[76] See Chapter 9, section 7.2.4.3.
[77] Art. 33(1) and (2) IORPD II.
[78] Organization for Economic Co-Operation and Development, OECD Recommendation on Core Principles of Occupational Pension Regulation (OECD 2009), Principle 6.8; EIOPA-BOS-12/015, 448.
[79] See R. Maatman, *Dutch Pension Funds - Fiduciary Duties and Investing*, Kluwer (Kluwer 2005), 187; Pensions Europe, *Position Paper on the proposal for an IORP II Directive*, 6 October 2014, 19, http://www.pensionseurope.eu/system/files/PensionsEurope%20position%20paper%20IORP%20II.pdf (Accessed 28 July 2016).

make a limited range of default investment plans with different risk profiles. For this purpose, IORPs are, generally, unit-linked and investing in one or more AIF/UCITS.[80] Requiring a compulsory depositary to be appointed for these types of IORPs was considered to be leading to a duplication of costs and meaningless as AIFs and UCITS already have a depositary obligation.

The IORPD II in the final version, however, leaves it up to the home Member States to decide whether or not a depositary is required for all types of IORPs whether these are 'IORP pooling structures' or not. Member States, thus, have the discretion whether or not an IORP pooling structure exemption to be included in their national legislation is useful or not. It is likely that some Member States chose this earlier option to be included in their national laws. A similar exemption is currently included for the appointment of a depositary for voluntary pension funds in, for example, Ireland[81] and Sweden[82].The rationale of this exemption seems to suggest that pure unit-linked full DC IORPs should be exempt of any depositary requirement as they resemble, for example, unit-linked insurances for which no depositary is required to be appointed either.[83] Member States could, therefore, decide that IORPs exempted from a 'UCITSD V/AIFMD depositary' or 'custodian' under the custodian that invest all their pension scheme assets in a AIF or UCITS for which a depositary has been appointed.[84] The latter exemption would exclude AIFs managed by small AIFMs for which the appointment of a depositary under the AIFMD is not mandatory and national Member States of the small AIFM has not decided either to appoint a depositary.[85] Implementing such an exemption is, however, debatable as, for example, master-feeder and fund-of-fund structures, which are comparable to unit-linked IORPs, under UCITSD V are not exempt from the depositary obligation.[86] At the other hand, IORP pooling structures resemble unit-linked life insurances for which no depositary has to be appointed either. The IORPD II Member State implementations are likely to take different positions on this point.

3. The IORPD II Substantive Depositary Regime

IORPD II leaves the decision of making a depositary compulsory, to a large extent, to each Member State.[87] Nevertheless, IORPD II seems to have established a more consistent approach with regard to, amongst others, eligible institutions, its organizational requirements, the safekeeping and oversight duties rules of IORP depositaries regardless of whether Member States require depositaries to be compulsory appointed by IORPs. Moreover, the substantive IORPD II depositary standards also raise the standards of alternative mechanisms applied to the safekeeping of IORP assets and the exercise of oversight duties in case a depositary is not appointed.[88] These will be subsequently discussed.

---

[80] See R. Maatman, *Dutch Pension Funds - Fiduciary Duties and Investing*, Kluwer (Kluwer 2005), 187; Pensions Europe, *Position Paper on the proposal for an IORP II Directive*, 6 October 2014, 19, http://www.pensionseurope.eu/system/files/PensionsEurope%20position%20paper%20IORP%20II.pdf (Accessed 28 July 2016).

[81] See for 'Custodian' and 'Custodian Account' under Section 91 (1) PENSIONS (AMENDMENT) ACT, 2002.

[82] § 5 Individual Pension Savings Act (1993:931): 'assets of a pension savings institute that are not invested as deposits under Chapter 2. § 2 shall be kept separate from institution's assets. Investment fund assets are to be held by a depositary.'

[83] See EIOPA-BOS-12/015, 460-461.

[84] See Art. 35(1) 4th Amendment Draft IORPD II.

[85] See Chapter 4, section 2.1.3.1.

[86] For master-feeder structures: Chapter VIII UCITSD V; See for fund of funds: Art. 55 UCITSD V.

[87] EIOPA-BOS-12/015, 463.

[88] EIOPA-BOS-12/015, 464.

3.1. The Scope of the IORPD II 'Substantive' Depositary Regime

The discretion left to Member States to require a compulsory depositary under Art. 33(1) and (2) IORPD II has created confusion for Member States whether they should implement Articles 33-35 IORPD II or not. In particular, Member States, such as the Netherlands, indicated during the IORPD II implementation phase that the implementation of Article 33-35 was not necessary as they opted in for not requiring a compulsory depositary for IORPs. The Netherlands considered that alternative mechanism that offer a similar level of protection to members and beneficiaries are already in place[89] and that for this reason Articles 33(1)-(7), 34(1)-(4) and Art. 35(1), (2) IORPD II did not need to be implemented.[90]

IORPD II is unclear on this point. Taking a grammatical and teleological interpretation of Arts 33-35 IORPD it seems, however, that the 'substantive depositary regime' is applicable to depositaries appointed by IORPs regardless of whether Member States require in their implementation laws a compulsory depositary for the purpose of performing the safekeeping task or the safekeeping task and oversight duties. The decisive criterion seems to be that Articles 33 and 34 IORPD II are applicable to depositaries appointed by IORPs for safe-keeping purposes and Articles 33, 34 and 35 IORPD II to depositaries appointed for safe-keeping and oversight duties. The obligation to comply with these provisions seems to be based upon the decision by IORPs to appoint a depositary and not upon the decision of individual Member States to introduce a compulsory obligation for IORPs to appoint a depositary.

Article 34(1) IORPD II, for example, refers to 'where the assets of an IORP[…] are entrusted to a depositary for safekeeping' and Article 35(1) IORPD II refers to 'in addition to the tasks referred to in Article 34(1) and (2), the depositary appointed for oversight duties shall'. Other examples are to be found in Articles 34(5) and Article 35(3) IORPD II. Article 34(5) IORPD II refers to 'where no depositary is appointed for the safe-keeping of assets, the IORP shall'. Similarly, Article 35(3) IORPD II refers to 'where no depositary is appointed for oversight duties'. None of these provisions relates to the optional compulsory obligation to require the appointment a depositary by Member States under Article 33(1) and (2) IORPD II. Instead, all four provisions target the appointment of a depositary by an IORP.

The question remains whether and to what extent Article 33(1) and (2) IORPD II have a function in determining the application of the 'substantive IORP regime'. Article 33(1) and (2) IORPD II both read that

> '[…] the home-Member State may require the IORP to appoint one or more depositaries for the safe-keeping of assets and oversight duties in accordance with Articles 34 and 35'.

Article 33(1) and (2) IORPD II refers, however, to Article 34 and 35 to define what a depositary is for the purpose of the compulsory depositary appointment under Art. 33(1) and (2) IORPD II. Most likely this provision is based upon an equivalent provision in UCITSD V.[91] The sole purpose of the discretion seems to be to let Member States determine whether IORPs should appoint an 'UCITSD V/AIFMD depositary' or a 'CRD IV/MiFID II

---

[89] See EIOPA-BOS-12/015, 463.

[90] See Arts. 33-35 IORPD II Transponeringstabel implementatie Richtlijn 2016/2341/EU van het Europees Parlement en de Raad van 14 december 2016 betreffende de werkzaamheden van en het toezicht op instellingen voor bedrijfspensioenvoorziening (IBPV's) (PbEU 2016, L 354/37) in de Pensioenwet, Wet verplichte beroepspensioenregeling en daarop gebaseerde regelgeving; See also Kamerbrief resultaat onderhandelingen herziening IORP-richtlijn, 24 june 2016, https://www.rijksoverheid.nl/documenten/kamerstukken/2016/06/24/kamerbrief-resultaat-onderhandelingen-herziening-iorp-richtlijn (accessed 10 Mai 2016).

[91] Art. 2(1)(a) UCITSD V.

custodian'. A grammatical interpretation of Article 34(1), (4) and Article 35(1), (3) suggests that the substantive safe-keeping and oversight tasks are directed to depositaries that are appointed to perform these duties. The substantive requirements of Article 33, 34 and 35 IORPD II, thus, apply to depositaries appointed by IORPs regardless whether Member States require such an appointment in their implementation laws or IORPs appoint an IORP depositary deliberately. This is logical for three reasons.

First, not applying Article 33, 34 and 35 IORPD II to depositaries that are deliberately appointed by IORPs in Member States in which no compulsory obligation exists would jeopardize a level playing field for IORP depositaries in Europe. Under such an interpretation, depositaries appointed by IORPs that are required to appoint a compulsory depositary would have to comply with the requirements laid down in Article 33, 34 and 35, whereas the same depositaries that are deliberately appointed by IORPs, 'custodians' in particular, would be exempted from doing so. This would be very problematic as, in practice, all IORPs need to appoint custodians to be able to access (settlement) services provided by CSDs regardless whether the legislator required them to appoint them compulsory or not.

Second, requiring all depositaries appointed by IORPs regardless whether compulsory required by IORPD II Member State implementation laws or not would ensure consistency with the depositary regimes under the AIFMD and UCITSD V on the basis of which the regime is inspired.[92] Many IORP depositaries and Member States requiring compulsory depositaries are likely following the practice laid down in the AIFMD and UCITSD V (Commission) Regulation related to the safe-keeping and oversight duties tasks to be performed by depositaries.[93]

Finally, such an interpretation is contrary to the purpose and meaning of the IORPD II depositary regime. Following EIOPA's Final Advice to the Commission regarding IORPD II in 2012, the aim of IORPD II was to create a 'more consistent approach' for depositaries on the EEA level.[94] In this regard, EIOPA stated in its advice that

> 'Taking into account the previous considerations, EIOPA advices to leave the decision of making the appointment compulsory to each Member State, in order to avoid unjustified changes to their pension systems and increase of costs that will ultimately be pass on to members and beneficiaries. <u>This does not however prevent the creation of a more consistent approach from a supervisory perspective in relation to the eligible institutions, the liability regime, the duties of a depositary in case it is appointed to perform oversight functions, the rules regarding conflicts of interest or incompatibility,etc</u>.'[95]

EIOPA seems, thus, to point out a substance over form approach in which a consistent approach for, amongst others, eligible institutions, the liability regime and the duties of a depositaries is being applied regardless of whether a Member State requires a compulsory appointment of depositaries in the form of 'UCITSD V/AIFMD depositaries' or 'custodians'. The substantive provisions of Article 33, 34 and 35 IORPD II, thus, apply to depositaries appointed by IORPs regardless whether they have a compulsory obligation under national Member States to do so.

Not implementing Articles 33-35 IORPD II in national legislation by Member States that do not require a compulsory depositary is, thus, contrary to the grammatical and teleological interpretation of these provisions under IORPD II.

---

[92] EIOPA studied the AIFMD and UCITSD V depositary regimes extensively in its Final Advice to the European Commission. See EIOPA-BOS-12/015, 460-461.
[93] See Chapter 4, section 6.2 and 6.3.
[94] EIOPA-BOS-12/015, 463.
[95] EIOPA-BOS-12/015, 463.

3.2. Entities Eligible as a Depositary and Its Organizational Requirements

3.2.1. *Entities Eligible*

Under Article 33(3) IORPD II, Member States may not restrict IORPs from appointing depositaries established in another Member State and duly authorized in accordance with CRD IV or MiFID II, or accepted as a depositary for the purposes of UCITSD V or the AIFMD.

3.2.1.1. National versus European Depositaries

The wording of Article 33(3) IORPD II suggests that Member States in their national laws under all circumstances have to allow depositaries authorized under CRD IV, MiFID II, UCITSD V and the AIFMD to be appointed by IORPs that appoint depositaries in another Member State. Article 33(3) IORPD II, however, does not explicitly prohibit individual Member States from allowing entities other than the ones listed in either of these European Directives and authorized under national regulatory law to be appointed by IORPs within their domicile.

Allowing IORPs to appoint any of the abovementioned depositaries in another Member State leads to a de facto harmonization of eligible entities under the IORPD II. IORP depositaries under the national laws of the individual Member States are, likely, not able to compete with the depositaries regulated under European law that are able to exploit both vertical and horizontal economies of scale. Vertical economies of scale as they may be appointed as a depositary on a cross-border basis for all EEA IORPs and national IORP depositaries are only eligible to the extent that an individual Member State allows it. Horizontal economies of scale as the listed 'European depositaries' are not only eligible as an IORP depositary, but also as a depositary under the AIFMD and UCITS or as a custodian under the CRD IV and MiFID II. This explains why Member States have almost exclusively decided under their IORPD I implementation laws to allow for 'European depositaries' to be appointed not only on a cross-border basis but also within their national domiciles itself and are likely to maintain this status quo under their IORPD II implementation laws.[96]

3.2.1.2. The Expanding list of Heterogeneous Eligible Entities under IORPD II

The heterogeneous list of entities eligible to be appointed as an IORP depositary seems under IORPD II to be expanded in comparison to IORPD I.[97] EIOPA considered in its final advice that there was no need to include a more detailed list of institutions eligible under IORPD II as an depositary.[98] A regulatory update of the references that refer to the predecessors of the MiFID II, CRD IV and UCITSD IV/V were considered to be sufficient. The final categories of eligible entities under the IORPD II have, however, been expanded by referring for both IORPD I custodians and depositaries to the term depositaries under IORPD II and including AIFMD depositaries in the eligible entities list. On top of that, the amendments of both UCITSD V and MiFID II have led to an ever bigger expansion of eligible entities to be appointed under IORPD II.

3.2.1.3. The Impact of 'Custodians' and 'Depositaries' being IORPD II Depositaries

[96] See Chapter 12, section 4.1.2.
[97] EIOPA-BOS-12/015, 450-451.
[98] See EIOPA-BOS-12/015, 464.

Under IORPD I, Member States could require either the appointment of a depositary or a custodian to be compulsory.[99] Article 19(2) IORPD I referred to 'custodians' established in another Member State and duly authorized in accordance with the ISD (predecessor MiFID I/II) or CRD I (predecessor CRD IV) or accepted as a 'depositary' for the purposes of the UCITSD. Taken a grammatical interpretation, Member States could, thus, restrict the eligible entities under IORPD I for custodians to investment firms under the ISD and CRD I, whereas only those entities eligible under UCITSD IV were could be restricted to be eligible as depositaries under IORPD I. Article 33(3) IORPD II, however, requires Member States not to restrict IORPs from appointing, depositaries established in another Member State and duly authorized in accordance with CRD IV or MiFID (II), or accepted as a depositaries for the purposes of UCITSD IV/V or AIFMD.[100] IORPD II, formally, does for the eligible entities to be appointed not differentiate anymore whether a 'custodian' or an 'UCITSD V/AIFMD depositary' is appointed. Credit institutions and investment firms were however, under the IORPD I Member State implementation laws in many Member States already eligible as both UCITSD IV depositaries and ISD custodians. De facto, the change of referring to 'depositaries' under IORPD II instead of differentiating between 'custodians' and 'depositaries' under IORPD I, thus, in practice does not affect the eligible entities under IORPD II much.

3.2.2. *The AIFMD Depositaries eligible*

The inclusion of AIFMD depositaries as eligible entities for IORP depositaries seems not to be well considered.[101] The AIFMD not only allows credit institutions and investment firms, but also UCITS depositaries (UCITSD IV/V), eligible non-EEA entities, prime brokers (subject to a functional and hierarchical separation of functions) and 'PE depositaries' to be appointed. De facto, the inclusion of the AIFMD depositaries, thus, only added the latter three types of eligible entities to the list as credit institutions, investment firms and UCITS depositaries were already under the other listed European Directives eligible as an IORP depositary. Although formally eligible, non-EEA entities are not eligible as IORP depositaries as the entities eligible are restricted to only 'depositaries established in another Member State'.[102] Although this has not been clarified under the IORPD II, the AIFMD provides guidance on this point. Article 21(5) AIFMD requires a depositary for EEA AIFs to be established in the home Member State of the EEA-AIF. Following, Article 4(1)(j)(iii) AIFMD established means that depositaries of EEA-AIFs should have their registered office or branch in the same country as the EEA-AIF. Non-EEA entities are, thus, excluded from being appointed as an IORP depositary. Prime brokers and 'PE depositaries' established in another Member State, however, fulfill this criterion. The utility of including both types of eligible entities in the IORPD II seems to be questionable.

3.2.2.1. The AIFMD Prime broker

Prime brokers are under the AIFMD credit institutions, regulated investment firms or other entities subject to prudential regulation and ongoing supervision offering 'prime brokerage services'.[103] Prime brokers are the main counterparty for substantially leveraged AIFs that

---

[99] Art. 19(2) sub-para. 2 IORPD I.
[100] Art. 35(3) IORPD II.
[101] EIOPA nor the European Commission prior to the Initial Draft IORPD II considered to include IORP depositaries in the list of eligible entities; See Art. 35(3) Initial Draft IORPD II; See also EIOPA-BOS-12/015, 464.
[102] Art. 33(3) IORPD II.
[103] Art. 4(1)(af) AIFMD defining a prime broker defines these 'prime brokerage services' as 'services to professional investors primarily to finance or execute transactions in financial instruments as counterparty and

have a clear overview of all AIF assets that serve as collateral for underlying obligations.[104] Allowing prime brokers to be appointed as a depositary, thus, leads to cost reductions.

IORPs are, however, by means of the prudent person rule and product regulationprohibited from acting as a 'substantially leveraged AIF'. [105] Allowing a prime broker to be a depositary for IORPs seems to be of no use.

3.2.2.2. The AIFMD 'PE Depositary'

'PE depositaries', persons or entities carrying out the AIFMD depositary functions as part of their professional or business activities are allowed to be appointed for AIFs that have no redemption rights exercisable during a period of five years from the date of their initial investments and which, according to their core investment policy, generally, do not invest in financial instruments that must be held in custody.[106] IORPs, due to their nature, do not have any redemption rights. Their core investment policy, however, is required to be very diversified and includes liquid, illiquid, as well as, (substantially) leveraged assets to fulfil their short and long-term duty of balancing IORP funding requirements and paying out the benefits due to its beneficiaries.[107] IORPs do not fulfill the investment policy requirement under the AIFMD and may, thus, not be appointed as an IORP depositary.

3.2.2.3. UCITSD V Depositaries

Depositaries under the UCITSD V may, apart from being a credit institution, also be a national central bank or another legal entity that is authorized by Member States to carry on depositary activities[108] that are subject to ongoing supervision as well as minimum capital, prudential and organizational requirements.[109] Other legal entities are subjected to requirements that go beyond UCITSD IV. UCITS IV only required depositaries to be an institution which is subject to prudential and ongoing supervision and furnishes sufficient financial and professional guarantees to be able to pursue its business as a depositary.[110] Member States had under UCITSD IV a lot of discretion to determine the types of eligible entities fulfilling this requirement.[111]

The UCITSD IV prudentially regulated intermediaries still qualify under the UCITSD V as 'other legal entities' eligible as depositaries if they are subjected to minimum harmonization on the European level regarding capital, prudential and organizational requirements.[112] IORP investment policies contain liquid, illiquid and (substantially) leveraged assets. The depositaries eligible under UCITSD V are suitable to perform their depositary functions related to these assets and are, therefore, suitable as IORP depositary.

3.2.2.4. Investment Firms under MiFID II

The list of heterogeneous eligible entities has been significantly expanded by MiFID II. Under MiFID II a third-country regime has been introduced that allows TC-investment firms to

---

which may also provide other services such as clearing and settlement of trades, custodial services, securities lending, customised technology and operational support facilities.'

[104] See D.A. Zetzsche, D.A., *(Prime) Brokerage* (D.A Zetzsche ed, Kluwer 2015), 574-578; D.P. Delmont, *Managing Hedge Fund Risk and Financing – Adapting to a New Era* 7 (Wiley 2011).

[105] See Chapter 9, section 4.2.

[106] Art. 21(3)(c) sub-para. 3 AIFMD.

[107] Art. 19 IORPD II.

[108] Art. 23(2) UCITSD V.

[109] Art. 23(2) sub-para. 1 UCITSD V.

[110] Art. 23(2) UCITSD IV.

[111] Art. 23(2) and (3) UCITSD V.

[112] Art. 23(2) sub-para. 1 UCITSD V.

provide safekeeping and the administration of financial instruments, including custodianship in the EEA by means of the establishment of a branch or on a cross-border basis.

Article 33(3) IORPD II requires Member States not to restrict IORPs from appointing, depositaries 'established in another Member State' and duly authorized in accordance with MiFID II. Unlike the AIFMD, the IORPD II does not clarify what 'established in another Member State' means. Following, Article 4(1)(j)(iii) AIFMD established means that depositaries of EEA-AIFs should have their registered office or branch in the same country as the EEA-AIF. Article 21(3)(b) AIFMD, however, merely allows investment firms that have their registered office in the EEA to act as a depositary for EEA-AIFs.[113] Only EEA investment firms that have a branch in the same country as the EEA-AIF may, thus, act as a depositary for EEA-AIFs. The IORPD II, in contrary, does not explicitly restrict IORPs from appointing Non-EEA investment firms from being appointed as a depositary provided that they are duly authorized in accordance with MiFID II and established in another Member State.[114]

In contrary to the AIFMD, Non-EEA investment firms are not subject to additional third country depositary requirements as discussed under the AIFMD. Pursuant to Article 21(6)(b) AIFMD, third country depositaries must be subject to 'effectively enforced' prudential regulation (including minimum capital requirements and 'supervision equivalent' to that applicable under EEA law. This seems to be justified as MiFID II Non-EEA investment firms are mandatorily subject to authorization and supervision in the EEA.[115] There are, thus, no additional requirements for third country investment firms necessary to determine whether these investment firms are subjected to regulation that has the same effect as those for investment firms in that third country.[116] This is already done upon authorizing a branch of a Non-EEA investment firm within the EEA. Both EEA investment firms and Non-EEA investment firms that have a branch in another Member State and are duly authorized for providing safekeeping and the administration of financial instruments are under the IORPD II suitable to be appointed as a depositary.

3.2.2.5. Conclusion

The heterogeneous list of entities eligible to be appointed as an IORP depositary has been under IORPD II expanded in comparison to IORPD I.[117] Allowing AIFMD depositaries to be appointed have allowed prime brokers and 'PE-depositaries' to become eligible IORP depositaries. The upgrade from UCITSD IV to UCITSD V allows depositaries, apart from being a credit institution, also to be a national central bank or another legal entity that is authorized by Member States to carry on depositary activities[118] that are subject to minimum capital, prudential and organizational requirements.[119] Finally, the introduction of MiFID II allows both EEA investment firms and Non-EEA investment firms that have a branch in another Member State and are duly authorized for providing safekeeping and the administration of financial instruments to be appointed as a depositary under the IORPD II.

3.3. Depositary –General Requirements

---

[113] Art. 21(4)(a) AIFMD.
[114] See Art. 33(3) IORPD II.
[115] Art. 39-43 MiFID II; Recital 41-43, Arts 46-49MiFIR.
[116] See for the conditions under which third country investment firms are allowed to perform depositary services under MiFIR: Art. 47 MiFIR.
[117] See EIOPA-BOS-12/015, 451.
[118.] Art. 23(2) UCITSD V.
[119.] Art. 23(2) sub-para. 1 UCITSD V.

IORPD II introduces IORP depositaries a general duty of loyalty and a duty to prevent conflicts of interests for IORP depositaries.[120] Both are modelled after Article 21(10) AIFMD as EIOPA was of the view that “potential conflicts of interest or incompatibility could be an obstacle for appropriate functioning of the safe-keeping and oversight duties and therefore should be avoided.’

3.3.1. Duty of Loyalty

Article 33(6) IORPD II sets out an overarching rule of conduct. It requires the IORP and the depositary to act honestly, fairly, professionally, independently and in the interest of the scheme’s members and beneficiaries.[121] Following EIOPA, this is crucial for depositaries which do not only safe-keep, but also exercise oversight duties over the investment process.[122]

3.3.2. Conflicts of Interest

IORPD I was both silent on the rules regarding conflicts of interests or incompatibility.[123] EIOPA in its final advice was of the opinion that potential conflicts of interest or incompatibility could be an obstacle for depositaries in performing the safekeeping and oversight duties and that this should be avoided.[124] Especially, a general conflicts of interest rule was considered to be very crucial for depositaries both carrying out these functions.[125]

For this reason, IORPD II has introduced a general rule intends to prevent conflicts of interest by requiring depositaries not to carry out activities with regard to the IORP which may create conflicts of interest between the IORP, the scheme’s members and beneficiaries and itself.[126] Carrying out activities leading to a conflicts of interest are, however, allowed when the depositary has functionally and hierarchically separated the performance of its depositary tasks from its other potentially conflicting tasks[127] and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the IORP and the scheme members/beneficiaries and to the governing body of the IORP.[128]

EIOPA advised not to prevent Member States from laying down more detailed rules on conflicts of interest or incompatibility.[129] The IORPD II does not indicate whether this is allowed or not. Given that a large discretion is being given to Member State, introducing more detailed conflicts of interest rules, such as extending the UCITSD V independence requirements[130] to IORP depositaries, should be seen as acceptable.[131]

Where no depositary is appointed, IORPs shall make arrangements to prevent and resolve any conflict of interest in the course of tasks otherwise performed by a depositary and an asset manager.[132] The latter refers to the situation that a Member State does not require a

---

[120] See art. 33(6) and (7) IORPD II.
[121] Art. 33(6) IORPD II.
[122] EIOPA-BOS-12/015, 466.
[123] EIOPA-BOS-12/015, 466.
[124] EIOPA-BOS-12/015, 466.
[125] EIOPA-BOS-12/015, 467.
[126] Art. 33(7) IORPD II.
[127] Art. 33(7) IORPD II is based upon Art. 21(10) AIFMD and Art. 25(2) sub. para. 2 UCITSD V; See EIOPA-BOS-12/015, 466; Art. 25(2) sub-para. 2 AIFMD/UCITSD V.
[128] Art. 33(7) IORPD II.
[129] See also EIOPA-BOS-12/015, 467.
[130] The independence requirements under UCITSD V, include Art. 25(2) and 26(b)8h) UCITSD V that are further elaborated in provisions on common management/supervision (Art. 20, 21 and 24 UCITSD V (Commission) Regulation)) and on cross-shareholdings/group inclusion (Art. 22 and 23 UCITSD V (Commission) Regulation)).
[131] See Chapter 4, section 4.4.
[132] Art. 33(8) IORPD II.

compulsory depositary for either tasks, but, de facto, allows an IORP governing body to either act both itself as an asset manager and a depositary or to appoint an investment firm that both acts as an asset manager and a depositary for a specific IORP. The MiFID II safeguarding client assets regime[133] aimed at preventing conflicts of interests between both conflicting tasks does, in general, not apply to IORPs as they are left out of the scope of the MiFID II.[134] Article 33(8) IORPD II, thus, de facto requires that IORPs within their risk management organization[135] or any investment firms both tasks would need to implement similar procedures as would be otherwise performed under the safeguarding client assets regime by an investment firm both acting as a depositary and an asset manager under MiFID II.

The overarching conflicts of interest rule under Article 33(8) IORPD II where no depositary is appointed applies, in addition to, the conflicts of interest rules that applies to IORPs where no depositary is appointed for the safekeeping of assets.[136] Article 34(5)(c) IORPD II, however, specifies that it only applies in relation to the safekeeping of assets. Article 33(8) IORPD II, thus, seeks to introduce an overarching conflicts of interest rule for IORPs where no depositary is appointed for both safekeeping and oversight duties.

3.4. The Depositary and its Functions

IORPD II harmonizes the depositary function for DC or other types of IORPs that are by individual Member States required to be appointed for performing the safe-keeping or the safe-keeping and controlling function. The particulars of the written contract governing the relationship between the IORP and depositary, the safekeeping and control function under IORPD II will now be discussed.

3.4.1. *Particulars of the Written Depositary Contract*

The appointment of the depositary by an IORP must by evidenced by a written contract.[137] Although not specified by IORPD II, the written contract has to be concluded by the depositary and the IORP. EIOPA considered the written contract to be relevant as strengthening the relationship between the depositary and the IORP would improve the protection pension scheme members and beneficiaries.[138]

The written contract shall stipulate the transmission of the information necessary for the depositary to perform its duties as set out in the IORPD II.[139]

Unlike the AIFMD and UCITSD V, the IORPD II does not specify the elements of the written contract nor includes a delegation provision for the European Commission to specify any elements.[140] EIOPA, however, considered in its Final Report that Article 21(2) AIFMD for the purpose of the IORPD II should be adopted.[141] EIOPA related to the fact that the written contract has a wider scope under the AIFMD and is, therefore, more appropriate for strengthening the relationship between the depositary and the IORP than the written contract under the UCITSD IV.[142]

Considering this, it is likely that the elements of the written contract in the AIFMD

---

[133] See Chapter 6, section 5.
[134] See Art. 16(8)-(10) MiFID II.
[135] See *infra* 4.2.1.1.
[136] Art. 34(5) IORPD II.
[137] Art. 33(5) IORPD II.
[138] EIOPA-BOS-12/015, 464.
[139] Art. 33(5) IORPD II.
[140] See for the delegation provisions under the AIFMD and UCITSD: Art. 21 (17) AIFMD and Art. 26b UCITSD. V.
[141] EIOPA-BOS-12/015, 468.
[142] See also EIOPA-BOS-12/015, 468.

(Commission) Regulation text will be adopted by Member State IORPD II implementation laws and in practice. This argument finds support in the elements of the written contract under the UCITSD V that are almost the same. Furthermore, the safekeeping and oversight tasks of depositaries under IORPD II are also inspired by these two directives.

Based upon this, it is reasonably to be expected that the required written contract regulates, amongst others:[143]

- a description of the depositary services and the particular procedures to be adopted for each type of asset in which an IORP invests;
- the flow of information ensuring that the depositary receives all information necessary to perform its safekeeping or its safekeeping and oversight function;
- details and steps taken to monitor sub-custodians;
- escalation procedures; and
- conditions relating to the termination of the depositary contract.

Unlike the AIFMD and UCITSD V, however, depositaries under the IORPD are both appointed for the safekeeping of assets or for the safekeeping of assets and oversight duties.[144] The question that remains is to what extent the elements of the written contract should be adopted in depositary contracts for depositaries that are only appointed for the safekeeping of assets. MiFID II, for example, does not require custodians to enter into a written contract with either the investor of the asset manager at all.

A solution could be to require the abovementioned element to be proportionally be applied on the basis of whether a depositary is solely appointed for the safekeeping of assets or for the safekeeping of assets and oversight duties. The leading principle of the written contract is to transmit the information necessary for the depositary to perform its duties as set out in the IORPD II. Of all written contract elements only the flow of information ensuring that the depositary receives all information necessary to perform its safekeeping or its safekeeping and oversight function seems relevant to be proportionally applied depending upon the type of depositary appointed.

3.4.2. *Safekeeping*

IORPD II introduced the AIFMD/UCITSD V safekeeping of assets provision in the IORPD II depositary regime.[145] The European Commission took the same approach to overcome the differences that became apparent under the IORPD I Member State implementation laws and to ensure cross-sectoral consistency on the European level related to the safekeeping function.

Depending on the type of assets, the IORPD II distinguishes between safekeeping duties with regard to financial instruments that can be held in custody and record-keeping duties for all other assets. Financial instruments which can be held in custody are defined as all financial instruments that can be registered in a financial instruments account opened in the depositary's books or can be physically delivered to the depositary.[146]

For this type of assets, the depositary has the duty to ensure that these are properly registered in the depositary's books within segregated accounts at credit institutions in order to be identified at all times.[147] The depositary has a record-keeping duty applying to all other assets of an IORP pension scheme than financial instruments that can be held in custody.[148]

---

[143] *Ibid*, 464, 468.
[144] See Art. 35(1) and (2) IORPD II.
[145] Art. 21(8) AIFMD and Art. 22(5) UCITSD V.
[146] Art. 34(1) sub-para. 1 IORPD II; See also 21(8)(a)(i) AIFMD and Art. 22(5)(a)(i) UCITSD V.
[147] Art. 34(1) sub-para. 2 IORPD II; See also 21(8)(a)(ii) AIFMD and Art. 22(5)(a)(ii) UCITSD V.
[148] Art. 34(2) IORPD II; See also 21(8)(b) AIFMD and Art. 22(5)(b) UCITSD V.

The record-keeping duty requires IORP depositaries to verify that the IORP is the owner of such assets and to maintain a record of those assets.[149] The verification has to be carried out by the depositary on the basis of information or documents provided by the IORP and, where available, on the basis of external evidence.[150] The depositary has to ensure that its records shall be up-to-date.[151]

The extensive set of depositary safekeeping duties are under the AIFMD and UCITSD V complemented by an AIFMD and UCITSD V (Commission) Regulation that clarifies the definition of 'financial instruments to be held in custody'[152] and specifies the safekeeping duties with regard to assets held in custody[153] and safekeeping duties regarding ownership verification and record keeping[154].

The IORPD II does not contain any similar delegation provision the European Commission to adopt similar measures.[155] The safekeeping task is, thus, not harmonized to the same degree under the IORPD II as under the AIFMD and UCITSD V. Considering that the safekeeping task has been copied from the AIFMD and UCITSD V, it is, however, likely that national Member States, competent authorities and legal practice will interpret the definition of financial instruments held in custody and the safekeeping duties in the same way as under the AIFMD and UCITSD V (Commission) Regulation.

3.4.3. *Control*

IORPD II introduced oversight duties for depositaries under its depositary regime to overcome the differences that became apparent under the IORPD I Member State implementation laws and to ensure cross-sectoral consistency on the European level.[156] Full DC and other IORPs are only required to appoint a depositary for the safekeeping of assets and oversight duties if the national law of the home Member States requires such a depositary to be appointed.[157] Host Member States may require full DC IORPs that carries out cross-border activity to appoint a depositary for both tasks if the home Member State does not require the appointment of such a depositary under its national law.[158] Article 35(1) IORPD II requires depositaries appointed for oversight duties to carry out these duties, in addition to, the safekeeping of assets under Article 34(1) and (2) IORPD II.[159] Member States under its national laws are, thus, prohibited from solely requiring a depositary to be appointed for oversight duties.

To the contrary of the safekeeping task, IORPD II has only partly based the required oversight duties on the AIFMD and UCITSD V. IORPD II distinguishes between mandatory

[149] Art. 34(2) IORPD II; See also 21(8)(b)(i) AIFMD and Art. 22(5)(b)(i) UCITSD V.
[150] Art. 34(2) IORPD II; See also 21(8)(b)(ii) AIFMD and Art. 22(5)(b)(ii) UCITSD V.
[151] Art. 34(2) IORPD II; See also 21(8)(b)(iii) AIFMD and Art. 22(5)(b)(ii) UCITSD V.
[152] Art. 21(8)(a) AIFMD and Art. 22(5)(a) UCITSD V; Art. 88 AIFMD (Commission) Regulation and Art. 12 UCITSD V (Commission) Regulation.
[153] Art. 21(8)(a) AIFMD and Art. 22(5)(a) UCITSD V; Art. 89 AIFMD (Commission) Regulation and Art. 13 UCITSD V (Commission) Regulation.
[154] Art. 21(8)(b) AIFMD and Art. 22(5)(b) UCITSD V; Art. 90 AIFMD (Commission) Regulation and Art. 14 UCITSD V (Commission) Regulation.
[155] See Art. 21 (17) AIFMD and Art. 26b UCITSD. V.
[156] See for IORPD I controlling tasks: Chapter 12, section 4.1.3.2.
[157] Art. 35(1) and (2) IORPD II.
[158] Art. 35(1) and (2) IORPD II.
[159] Art. 35(1) IORPD II reads: 'In addition to the tasks referred to in Article 34(1) and (2), the depositary appointed for oversight duties shall'.

and optional oversight duties.

The IORPD II mandatorily requires depositaries appointed for oversight duties to:[160]

- carry out instructions of the IORP, unless they conflict with the applicable national law or the IORP rules;[161]
- ensure that in transactions involving an IORP or pension scheme's assets any consideration is remitted to it within the usual time limits;[162]
- ensure that income produced by assets is applied in accordance with the applicable national law and the IORP rules.[163]

These oversight duties are based upon the AIFMD and UCITSD V. The oversight duties related to subscriptions/redemptions and the valuation of units under the AIFMD and UCITSD V are not mandatorily required for IORPs.[164] These two duties were considered to be inappropriate as IORPs have an occupational nature and only supports schemes that are limited to certain employees. Under the IORPD II, no subscriptions and redemptions take place.[165] Instead, new employees may upon signing their employment contract be automatically enrolled in their scheme and receive benefits upon retirement. It could, however, be argued that some types of IORPs, such as full DC IORPs, resemble open-end AIFs/UCITS. Unsurprisingly, some Member States required (full DC) IORPs to perform oversight duties regarding subscriptions/redemptions and the duties regarding the valuation of units under their IORPD I implementation laws to be performed.[166]

Notwithstanding the mandatory oversight tasks under the IORPD, Member States of IORPS may establish other oversight duties to be performed by the depositary.[167] The optional oversight duties are provided under the IORPD II to accommodate the ambiguous nature of the IORP.[168] EIOPA mentioned in its Final advice that Member States should have the opportunity to introduce 'whistle-blowing duties' for depositaries.[169] According to EIOPA, depositaries having a 'whistle-blowing duty' would be required to inform competent authorities in case a breach of national law or IORP rules is identified.[170] Examples of other oversight duties to be adopted are to be found under the AIFMD and UCITSD V. The oversight duties regarding subscriptions/redemptions and the valuation of units for full DC IORPs could, for example, be considered by Member States for full DC IORPs.[171] Finally, a cash flow monitoring duty would be an option as this duty has been mandatory for depositaries under several IORPD I Member State implementation laws and Member States could choose to maintain their current regimes.[172]

Member States have, thus, the option under their IORPD II implementation laws to adopt the mandatory oversight duties and maintain any other oversight duties to be performed by the depositary as an option.[173]

The extensive set of depositary oversight duties are under the AIFMD and UCITSD V

---

[160] Art. 35(1) IORPD II.
[161] Art. 35(1)(a) IORPD II.
[162] Art. 35(1)(b) IORPD II.
[163] Art. 35(1)(c) IORPD II.
[164] EIOPA-BOS-12/015, 468.
[165] EIOPA-BOS-12/015, 468.
[166] See Chapter 12, section 4.1.3.2.
[167] Art. 35 (2) IORPD II.
[168] See Chapter 9, section 2.
[169] EIOPA-BOS-12/015, 466.
[170] EIOPA-BOS-12/015, 466.
[171] See, as an example, Art. 21(9)(a),(b)AIFMD and Art. 23(a),(b) UCITSD V.
[172] See Chapter 12, section 4.1.3.2.
[173] Art. 35(2) IORPD II.

complemented by an AIFMD and UCITSD V (Commission) Regulation that specifies the general requirements related to oversight duties[174], duties regarding the carrying out of the AIFM's/UCITS' instructions[175], duties regarding the timely settlement of transactions[176] and duties related to the AIF's/UCITS' income calculation and distribution[177]. The absence of a delegation provision under IORPD II for the European Commission to adopt the same measures and the discretion for Member States to include optional oversight tasks leads to less harmonization of the oversight duties as compared to the AIFMD and UCITSD V. This is enhanced by the likelihood of less Member States requiring oversight tasks for depositaries under Article 35 IORPD II as compared to merely the safekeeping task under Article 34 IORPD II.

Similar as for the safekeeping task, the mandatory oversight duties have been copied from the AIFMD and UCITSD V and, therefore, it is likely that national Member States, competent authorities and legal practice interpret these duties in the same way. The same might hold true for optional oversight duties regarding subscriptions/redemptions and the duties regarding the valuation of units that might be imposed upon depositaries by Member States. For other optional oversight duties no interpretation is available on the European level. The interpretation of comparable optional duties are for these duties likely to vary from Member State to Member State.

3.5. Delegation of the Depositary Chain

Article 34(4) IORPD II requires Member States to ensure that a depositary's liability shall not be affected by the fact that it has entrusted to a third party all or some of the assets in its safekeeping. The depositary liability regime introduced under IORPD II has been taken from the general and very broad UCITSD I-IV depositary delegation provisions. The UCITSD I-IV depositary delegation/liability regime received after the Madoff case a lot of criticism and was, consequently, being replaced by a very detailed depositary delegation regime under the AIFMD and UCITSD V.[178]

Like under UCITSD I-IV, IORPD I did not provide any rules in relation to the delegation of functions by IORP depositaries either. Quite some Member States did not impose any conditions on the delegation of the depositary.[179] The regulatory landscape of the Member States that unilaterally adopted an IORP depositary delegation regime was fragmented. Some of the Member States that imposed conditions restricted the use of delegation to certain depositaries, whereas others imposed various conditions that needed to be fulfilled before depositaries were allowed to delegate tasks.[180]

IORPD II is, however, unlikely to significantly change the approach of Member States taken under IORPD I. The prior experience with UCITSD I-IV has shown that the

[174] Art. 21(9) AIFMD and Art. 22(3) UCITSD V; Art. 92 AIFMD (Commission) Regulation and Art. 3 UCITSD V (Commission) Regulation.
[175] Art. 21(9)(c) AIFMD and Art. 22(3)(c) UCITSD V; Art. 95 AIFMD (Commission) Regulation and Art. 6 UCITSD V (Commission) Regulation.
[176] Art. 21(9)(d) AIFMD and Art. 22(3)(d) UCITSD V; Art. 96 AIFMD (Commission) Regulation and Art. 7 UCITSD V (Commission) Regulation.
[177] Art. 21(9)(e) AIFMD and Art. 22(3)(e) UCITSD V; Art. 97 AIFMD (Commission) Regulation and Art. 8 UCITSD V (Commission) Regulation; M. van der Westen, Survey: More than 83% of Dutch pension assets under fiduciary management, IPE 3 Januari 2014, http://www.ipe.com/survey-more-than-83-of-dutch-pension-assets-under-fiduciary-management/10000711.fullarticle (Accessed 28 July 2016).
[178] Art. 21(11) AIFMD and Art. 22(a) UCITSD V; Art. 98, 99 AIFMD (Commission) Regulation and Art. 15, 16 UCITSD (Commission) Regulation on due diligence and the segregation obligation.
[179] See Chapter 12, section 4.1.4.
[180] *Ibid.*

introduction of the UCITSD IV regime under IORPD II may lead to a similar variety of depositary delegation regimes under Member State laws.[181] IORPD II only requires those Member States that did not provide for any depositary delegation regime to introduce in their national legislation that

> 'a depositary's liability shall not be affected by the fact that it has entrusted to a third party all or some of the assets in its safekeeping'.

IORPD II, thus, requires depositaries not to be able to absolve themselves of their responsibilities by delegating to sub-custodians all or some of the assets in its safekeeping.[182] Article 34(4) IORPD II, however, does not clarify the duties that are allowed to be delegated and the conditions under which depositaries may delegate their duties. Article 34(4) IORPD II only refers to the delegation of safekeeping duties. Under UCITSD I-IV, Member States had implemented this provisions in various ways. Some Member States allowed other duties than safekeeping, such as oversight duties, to be delegated, whereas other Member States prohibited the delegation of all duties other than safekeeping.[183] In between these extreme examples the approaches differed from Member State to Member State.[184]

To the contrary, the AIFMD and UCITSD V introduced detailed conditions in their depositary delegation regimes on the basis of which safekeeping duties can be entrusted to a delegate. Safekeeping and all other depositary duties, except oversight duties (including cash management)[185], are allowed to be delegated. A depositary may, however, only delegate the safekeeping tasks to sub-custodians that are subject to equivalent levels of regulation and supervision.[186] In the aftermath of the Madoff affair, this regime would have been more suitable for IORPD II depositaries.

Adopting the UCITSD I-IV depositary regime in IORPD II is unlikely to significantly change the approach of Member States taken under IORPD I. Member States will, as was the case under UCITSD IV, continue to impose depositaries to a large variety of delegation provisions in their IORPD II implementation laws.

3.6. The Depositary Liability Regime

Article 34(3) IORPD II requires Member States to ensure that a depositary is liable to the IORP or the members and beneficiaries for any loss suffered by them as a result of its unjustifiable failure to perform its obligations or its improper performance of them. Similar as for the delegation of depositary tasks, Article 34(3) IORPD II introduces the UCITSD I-IV liability regime for IORPD II depositaries. IORPD I did not contain any depositary liability regime and the different approaches taken by Member States in their national IORPD I implementations were similar as for UCITS under UCITSD I-IV.The UCITSD I-IV depositary liability regime received after the Madoff case even more criticism than the UCITSD I-IV delegation regime. Similarly, The UCITSD IV regime was being replaced by a very detailed depositary liability regime under the AIFMD and UCITSD V.[187]

---

[181] See Chapter 12, section 2.1.4.
[182] See also EIOPA-BOS-12/015, 464.
[183] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004, 8.
[184] S.N. Hooghiemstra, De AIFM-richtlijn en de aansprakelijkheid van de bewaarder, 6 TvFR 178 (2013).
[185] IORPD II does not contain a mandatory duty related to cash management. See Art. 35 IORPD II.
[186] CESR/09-781, 7; See Hooghiemstra, S.N., *Depositary Regulation* 511-518 (D.A. Zetzsche ed, Kluwer 2015).
[187] Art. 21(12) AIFMD and Art. 24 UCITSD V; Art. 100 AIFMD (Commission) Regulation and Art. 18 UCITSD V (Commission) Regulation related to a loss of a financial instrument held in custody; Art. 101 and 102

Nevertheless, the UCITSD I-IV liability regime was introduced in IORPD II after EIOPA in its advice set out that the liability regime under the AIFMD was too burdensome.[188] The introduction of this depositary liability regime is, however, likely to be implemented in Member States in the same way as was the case UCITSD I-IV. The preparatory works leading to the AIFMD and UCITSD V have proven that the UCITSD I-IV liability regime had resulted in different approaches taken by Member States regarding:[189]

- the interpretation of what is considered to be 'improper performance';
- who should be liable for any loss of assets?;
- the scope of depositary liability (when assets are lost by a sub-custodian);
- the burden of proof; and
- the rights of the IORP, members and beneficiaries against the IORP depositary.

The introduction of the UCITSD I-IV liability regime in IORPD II may lead to some Member States applying a 'strict' liability regime, while others would consider a loss of assets not necessarily to be 'unjustifiable'.[190] IORPD II is, thus, unlikely to significantly change the approach of Member States taken under IORPD I.

4. 'Equivalent Protection' for IORPs without a Depositary appointed

IORPD II introduces minimum requirements for the internal organization for IORPS that either do not appoint a depositary at all or only for the safe-keeping of assets.

In its final advice, EIOPA considered that many IORPs do not have a depositary and that in those Member States a similar level of protection to members and beneficiaries are in place that require a similar level of protection.[191] In particular, requiring the compulsory requirement for the appointment of a depositary would not fit in all Member States and could lead to an increase in costs.[192] For this purpose, the IORPD II has introduced 'equivalent protection' rules for IORPs that are not required to appoint a depositary for full DC IORPs and other types of IORPs in relation to duty of Member States to require a compulsory depositary for an IORP to be appointed.

The national law of the IORP Member State has to provide for equivalent protection for safe-keeping assets and oversight duties equivalent to the IORPD II depositary regime.[193] This duty applies to Member States regardless whether they do not require a depositary to be appointed at all or a depositary is only required for performing the safekeeping of assets.[194] Essential for Member States is to clarify whether and to what extent their implementation laws provide for equivalent protection for the safe-keeping of assets and oversight duties under Article 34(5) and Article 35(3) IORPD II.

4.1. IORPs without a Depositary Appointed for Safekeeping

Member State laws under their national laws have to provide for equivalent protection under Article 34(5) IORPD II for the safekeeping assets 'where no depositary is appointed for the

AIFMD.(Commission) Regulation related to a liability discharge and objective reasons for the depositary to contract a discharge of liability.

[188] EIOPA-BOS-12/015, 468.

[189] Derived from: CESR/09-781, 12-15.

[190] See on the UCITSD V: CESR/09-781, 14; See also EIOPA-BOS-12/015, 453-454.

[191] See also EIOPA-BOS-12/015, 463.

[192] See also EIOPA-BOS-12/015, 460.

[193] See Arts 34(5) and 35(3) IORPD II.

[194] See Art. 33(1), 34 and 35 IORPD II.

safekeeping of assets'.[195]

Member States that under Article 33(1) and (2) IORPD II require one or more depositaries to be appointed for the safekeeping function (and oversight function) that comply with the IORPD II depositary safekeeping requirements under Article 34(1)-(4) IORPD II are exempted from applying these requirements.

Article 34(5) IORPD II indicates what is considered to be equivalent protection provided by the implementation laws of Member States for exercising the IORPD II depositary regime safekeeping duty. The provision has as its objective to ensure that appropriate procedures/controls are in place for cases where there is no appointment of a depositary in relation to the risk of a loss of assets or rights related to those assets as a result of fraud, inadequate record-keeping and other operational risks within the IORP.[196] Article 34(5) that when no depositary is appointed for the safe-keeping of assets IORPs are, at least, required to:[197]

- ensure that financial instruments are subject to due care and protection;[198]
- keep records to identify all IORP assets at all times and without delay;[199]
- take the necessary measures to avoid conflicts of interest in relation to the safe-keeping of assets;[200]
- inform the competent authorities, upon request, about the manner in which assets are kept.[201]

4.1.1. *Financial instruments subject to due care and protection*

The OECD Guidelines for pension fund governance allows the custody of the IORP assets to be carried out by the pension entity (self-custody IORP), the financial institution that manages the pension fund or by an independent custodian (both third-party custody).[202] This requirement implements this rule.

4.1.1.1. Third-Party Custody

The OECD Guidelines for pension fund governance allows third-party custody either to be carried out by the financial institution that manages the pension fund or by an independent custodian.[203]

IORPD II allows a 'financial institution managing the pension fund' to act as a third-party custodian. A financial institution managing the pension fund may in IORP context either be an external IORP governing board for contractual IORPs or an external asset manager to which the governing board has fully or partly delegated asset management. Considering the conflicts of interest requirement discussed below, such a financial institution would need to be an investment firm, credit institution subjected to the safeguarding of client assets regime under MiFID II or an equivalent financial institution regulated on the national level that is subject to this or an equivalent safeguarding of client assets regime.[204]

---

[195] Art. 34(5) IORPD II.
[196] See also EIOPA-BOS-12/015, 465.
[197] Art. 34(5) IORPD II.
[198] Art. 34(5)(a) IORPD II.
[199] Art. 34(5)(b) IORPD II.
[200] Art. 34(5)(c) IORPD II.
[201] Art. 34(5)(d) IORPD II.
[202] Organization for Economic Co-Operation and Development, OECD Recommendation on Core Principles of Occupational Pension Regulation (OECD 2009), Principle 6.8.
[203] Organization for Economic Co-Operation and Development, OECD Recommendation on Core Principles of Occupational Pension Regulation (OECD 2009), Principle 6.8.
[204] See, for instance, the UK: The UK Financial Services and Markets Act 2000 (FSMA 2000) classifies the 'safeguarding and administering assets belonging to another which consist of or include investments' as a

A compulsory requirement for the appointment of an independent custodian, different from the IORP or 'the financial company managing the IORP' is an effective way to safeguard the physical and legal integrity of the IORP assets.[205] In addition, independent custodians may provide additional services, such as securities lending, cash management, investment accounting, reporting and performance measurement. The latter is a huge advantage of an independent custodian in comparison to IORP self-custody.[206]

Member States in various ways already require financial instruments that are allowed to be held by an third-parties to be subject to due care and protection by means of requiring an authorization for operating as an independent custodian[207]. On the European level, credit institutions and investment firms authorized for the ancillary service to operate as a custodian under MiFID II may be required to be appointed by Member States to fulfill this requirement. Similarly, the appointment of custodians regulated under national law that are required to fulfill similar conduct of business, prudential requirements as credit institutions and investment firms performing the ancillary service of custodianship[208] and have access to a CSD may be deemed to 'ensure that financial instruments are subject to due care and protection' as well. Examples of this type of national custodians are to be found in Austria[209], Germany[210] and Liechtenstein[211] where all custodians are required to be credit institutions, In addition, national custodians in Ireland[212], Luxembourg[213] and the UK[214] that are required to fulfill similar criteria as credit institutions and investment firms under MiFID II should be deemed to be eligible as well.

4.1.1.2. Self-Custody

---

regulated activity. See Section 19, Schedule 2 Part I Clause (5)(1) FSMA 2000.The Financial Conduct Authority (FCA) has adopted rules on client assets (CASS).The FCA adopts these rules relying on Financial Services and Markets Act 2000, s138. The CASS rules partly implement MiFID II and the MiFID II (Commission) Regulation; See for Ireland: Central Bank of Ireland, Guidance on Client Asset Regulations For Investment Firms, March 2015.

[205] See Organization for Economic Co-Operation and Development, OECD Recommendation on Core Principles of Occupational Pension Regulation (OECD 2009), Principle 6.8.

[206] Organization for Economic Co-Operation and Development, OECD Recommendation on Core Principles of Occupational Pension Regulation (OECD 2009), Principle 6.8.

[207] According to the European Commission, a custodian is 'an entity entrusted with the safekeeping and administration of securities and other financial assets on behalf of others, and may moreover provide additional services, including clearing and settlement, cash management, foreign exchange and securities lending. ' See European Commission, Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments, COM(2004) 207 final, 30 March 2004, 14.

[208] See Annex I Section A MiFID I/II.

[209] § 1(1) Nr. 5 BWG.

[210] § 1(1) sub-para. 2 Nr. 5. KWG; BaFin, Merkblatt Depotgeschäft - Hinweise zum Tatbestand des Depotgeschäfts, 6 Januar 2009 (Stand: Februar 2014).

[211] Art. 3(1) and (2)(c) BankG.

[212] See Section 2(1) '*investment business firm*' and Section (2) '*investment business services*' (*h*) custodial operations involving the safekeeping and administration of investment instruments; Part IV and Part VII Investment Intermediaries Act 1995; See also Central Bank of Ireland, *Guidance Note on Completing and Submitting an Application for Authorisation Under Section 10 of the Investment Intermediaries Act,1995 (as amended) excluding Restricted Activity Investment Product Intermediaries*, January 2012.

[213] Art. 26 Law of 5 April 1993 on the financial sector on 'Professional depositaries of financial instruments' .

[214] The UK Financial Services and Markets Act 2000 (FSMA 2000) classifies the 'safeguarding and administering assets belonging to another which consist of or include investments' as a regulated activity. See Section 19, Schedule 2 Part I Clause (5)(1) FSMA 2000.The Financial Conduct Authority (FCA) has adopted rules on client assets (CASS).The FCA adopts these rules relying on Financial Services and Markets Act 2000, s138.

Some Member States, such as in Germany, allow certain assets to be kept in a safe inside the resident building of the IORP (this is e.g. common practice for registered bonds, so called 'Namenspapiere' in Germany, or German mortgage loans).[215] To fulfil the criterion that financial instruments are subject to due care and protection, Member States might require that these safes are complying with certain security criteria.[216] This ensures that the practice of keeping certain kinds of assets in self-custody that would otherwise lead to unnecessary additional costs for IORPs can be continued.[217]

4.1.1.3. Record keeping IORP Assets

By absence of a depositary, the IORP explicitly is required to at any time to provide a comprehensive and up-to-date inventory of all assets safe-kept.[218]

4.1.1.4. Measures avoiding Conflicts of Interest

Depositaries and third-party custodians appointed are all subjected to conflicts of interest rules as part of their authorization.[219] The same measures to avoid conflicts of interest in relation to self-custody are not in place. For that purpose, the Member State IORP implementation laws have to ensure that, for instance, people administering the IORP do not have sole and uncontrolled access to the safes where assets are held in self-custody.[220]

4.1.1.5. Notification Competent Authorities

Competent authorities are to be informed, upon request, about whether and to what extent assets are being safe-kept by means of self-custody or a third-party custodian. This requirement enables competent authorities to check whether IORPs comply with the rules catering for the security of the self-custody of assets.

4.1.2. *'Equivalency Protection' Criticism*

The 'equivalency provision' under Article 34(5) IORPD II indicates what is considered to be equivalent protection provided by the implementation laws of Member States for exercising the IORPD II depositary regime safekeeping duty is remarkable. EIOPA and the OECD have clearly indicated the advantages of having an independent depositary for the safekeeping of assets to be appointed.

EIOPA sees, the following advantages of requiring at least a (single) depositary to be appointed for the purpose of the safekeeping of assets:[221]

- depositaries can provide at any time a comprehensive and up-to-date overview of all assets held under its safekeeping;

[215] Pensions Europe, *Position Paper on the proposal for an IORP II Directive*, 6 October 2014, 19, 20, http://www.pensionseurope.eu/system/files/PensionsEurope%20position%20paper%20IORP%20II.pdf (Accessed 28 July 2016).
[216] Pensions Europe, *Position Paper on the proposal for an IORP II Directive*, 6 October 2014, 20, http://www.pensionseurope.eu/system/files/PensionsEurope%20position%20paper%20IORP%20II.pdf (Accessed 28 July 2016).
[217] Pensions Europe, *Position Paper on the proposal for an IORP II Directive*, 6 October 2014, 19, http://www.pensionseurope.eu/system/files/PensionsEurope%20position%20paper%20IORP%20II.pdf (Accessed 28 July 2016).
[218] See also EIOPA-BOS-12/015, 465.
[219] See for custodians under MiFID II: Chapter 6, section 5; See for AIF/UCITS depositaries: Chapter 4, section 4.2.
[220] Pensions Europe, *Position Paper on the proposal for an IORP II Directive*, 6 October 2014, p. 20; EIOPA-BOS-12/015, 467.
[221] See also EIOPA-BOS-12/015, 465.

- information of safe-kept assets is centralized;
- risk of fraud and other operational risks of an IORP are reduced;
- depositaries can play a whistleblowing role in alerting an IORP to a material risk identified in a specific market settlement system;
- depositaries may make it easier for the supervisory authorities to limit or prohibit the free disposal of assets.

In addition, the OECD sees the appointment of an independent depositary for the safekeeping of assets an effective way to safeguard the physical and legal integrity of the assets of an IORP.[222] Custodians do not only hold the IORP assets and ensure their safekeeping, but also provide additional services, such as securities lending, cash management, investment accounting, reporting and performance measurement.[223] It is, thus, questionable whether allowing the custody of IORP assets to be carried out by the IORP to be considered to be an equivalent way of safeguarding the physical and legal integrity of the assets of an IORP.

4.2. IORPs without a Depositary Appointed for Oversight Duties

Member States may under Article 33(1) and (2) IORPD II require IORPs to appoint one or more depositaries for the safekeeping and oversight function that comply with the IORPD II depositary oversight duties[224]. IORPs for which no depositary is appointed for oversight duties are under Article 35(3) IORPD II required to implement procedures which ensures that the tasks, otherwise subject to oversight by depositaries, are being duly performed within the institution.

4.2.1. *Oversight Duties duly performed within the IORP*

Article 35(3) IORPD II does not clarify what 'implementing procedures to duly perform oversight tasks duly within the IORP' means. This could be interpreted twofold. First, could mean that the internal risk management organization of the governing body of the IORP[225] would have to implement procedures to ensure the tasks otherwise subject to oversight by depositaries are being duly performed within the institution. Second, Article 35(3) IORPD II could imply that the board of directors, trustees or the independent oversight committees of the legal form in which the IORP is established would suitable to perform these oversight tasks. These options will both have to be reviewed in order to assess how Member States could comply with Article 35(3) IORPD II.

4.2.1.1. Risk Management Organization within the IORP Governing Body

Taken a grammatical interpretation, 'procedures for oversight duties duly performed within the IORP' would indicated that the risk management organization of the IORP governing board would need to implement procedures for oversight functions otherwise performed by depositaries. This interpretation seems to be unlikely intended by IORPD II as operational/internal control are already mandatory performed by the compliance, internal audit and risk management function required under the IORPD II for all governing bodies of

[222] Organization for Economic Co-Operation and Development, OECD Recommendation on Core Principles of Occupational Pension Regulation (OECD 2009), Principle 6.8.
[223] Organization for Economic Co-Operation and Development, OECD Recommendation on Core Principles of Occupational Pension Regulation (OECD 2009), Principle 6.8.
[224] Arts 35(1) and (2) IORPD II.
[225] Governing body is being referred to as 'management or supervisory body of the IORP that has the ultimate responsibility under national law for compliance.' See Art. 21(1) IORPD II.

IORPs regardless of the legal form employed.[226]

This view seems to be confirmed by EIOPA in its Final Report. EIOPA is of the view that depositaries can play an important oversight role.[227] EIOPA, however, stresses in its report that the appointment of a depositary with oversight duties is not aimed to duplicate any task. In particular, no task is aimed to be duplicated related to operational/internal control already performed by the IORP itself.[228] Instead, the depositary would act as an additional external and independent control mechanism.[229] Taken this into consideration, Article 35(3) IORPD II likely required the trustees, board of directors or independent oversight committee of the legal form in which the IORP is established to implement procedures to ensure the tasks otherwise subject to oversight by depositaries are being duly performed within the institution.

4.2.1.2. Trustees, Board of directors and Independent Oversight Committees

The question remains whether and to what extent trustees, board of directors and independent oversight committees could be considered by Member States to implement Article 35(3) IORPD II.[230]

EIOPA considered that the compulsory appointment of a depositary is already seen as a widespread risk mitigation mechanism among Member States for pure DC IORPs.[231] For that purpose, EIOPA proposed to make the depositary compulsory for these full DC IORPs regardless of the legal form employed by the IORP. EIOPA, however, stated that it should be taken into account that in some Member States additional requirements may be in place to ensure that the activities of the IORP are being properly monitored.[232] In this regard, EIOPA mentioned the example of a trust based system, employed in Ireland and the UK, in which trustees are required to perform an oversight function and that, therefore, appointing a depositary with oversight duties would lead to a duplication of role/cost without extra benefits in terms of member/beneficiary protection.[233]

EIOPA in its IORPD II consultation considered whether IORPD II should comprise of different depositary regimes depending upon the legal form of the IORP.[234] More specifically, EIOPA asked respondents in its consultation to consider the compulsory appointment of a depositary for trust based and contractual IORPs and leave the appointment to the discretion of the individual Member States for IORPs with legal personality. EIOPA ultimately came to the conclusion that a legal form dependent depositary regime should not be considered as this would lead to minimum harmonization as the majority of Member States have IORPs with legal personality.[235] This is the reason why the appointment of a depositary was being left to the discretion of the individual Member States for all types of IORPs regardless of the legal form in which they are established.

Article 35(3) IORPD II is, thus, clearly inspired by the legal form based approach that EIOPA pursued in its consultations. The fact that EIOPA explicitly mentioned trust based systems as an example[236] and referred to alternative mechanisms being in place for the performance of oversight duties implies that trustees, board of directors and independent

[226] Art. 24-26 IORPD II.
[227] EIOPA-BOS-12/015, 465, 469.
[228] EIOPA-BOS-12/015, 465.
[229] *Ibid.*
[230] Art. 35(3) IORPD II.
[231] EIOPA-BOS-12/015, 462.
[232] *Ibid.*
[233] EIOPA-BOS-12/015, 462.
[234] *Ibid.*
[235] EIOPA-BOS-12/015, 463.
[236] EIOPA-BOS-12/015, 462.

oversight committees within the legal form of the respective IORPs are considered by EIOPA to be providing 'equivalent protection'.

The question remains to answered to what extent trustees, board of directors and independent oversight committees could be considered by Member States to fulfill the criterion of duly performing within the IORP 'oversight duties that are otherwise subject to oversight by depositaries'.[237]

4.2.2. *Equivalent Protection for Oversight Duties?*

Member States seem not necessarily to have a consistent practice in requiring a compulsory depositary to be employed for IORPs with a specific legal form. Unclear, however, remains whether Member States have the discretion to require the appointment of trustees, separate oversight committees, as well as, a board of directors under the legal form of an IORP in their national laws as to fulfill the criteria 'tasks, otherwise subject to oversight by depositaries' that are 'duly performed within the IORP'. The wording 'duly performed within the IORP' is not clarified in the IORPD II and spreads confusion in this regard. A grammatical interpretation would exclude a trustee for trust-based and a separate oversight committee for contractual IORPs from performing 'tasks, otherwise subject to oversight by depositaries'. Both can be considered to be an external and independent control mechanism but are not 'duly performed within the IORP'. If both would be seen as providing 'equivalent protection' as a board of directors for IORPs with legal personality it would have been better to replace 'duly performed within the IORP' by 'equivalent protection for the performance of oversight duties'.[238]

The large room for discretion under Article 33(1) and (2) IORPD II leaves it up to to individual Member States to decide whether or not the roles played by trustees, separate oversight committees, as well as, a board of directors under the legal form of an IORP in their national laws is being regarded as providing for 'tasks, otherwise subject to oversight by depositaries' that are 'duly performed within the IORP'.

4.2.3. *Tasks subject to Oversight by Depositaries*

Where no depositary is appointed for oversight duties, the board of directors, trustee or separate oversight committee have to implement procedures to ensure that the tasks are being duly performed within the IORP. Article 35(3) IORPD II refers for these tasks to tasks that are 'otherwise subject to oversight by depositaries'. These oversight duties involve the mandatory oversight duties as laid down in Article 35(1) IORPD II and the other oversight duties otherwise to be performed by the depositary that individual Member States may optionally establish.[239]

5. Conclusion

Prior to IORPD II, Member States enjoyed discretion as to whether to require the appointment of a 'depositary' or 'custodian'. Similar as under UCITSD I-IV, this led to considerable differences across Member States in relation to whether or not an depositary or custodian was being appointed, the type of entities to fulfil this rule and the duties the depositary/custodian

---

[237] Spain: Art. 13 Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulacila de los Planes y Fondos de Pensiones; Portugal: Art. 53 Decreto-Lei n.o 12/2006 de 20 de Janeiro.

[238] 'Equivalent protection' was being referred to under Art. 35(1) Draft IORPD II February 2016.

[239] Art. 35(1) and (2) IORPD II.

was required to perform.[240] The divergent practices caused legal uncertainty and different levels of investor protection.[241]

Despite considerable joint efforts of EIOPA and the European Commission, the IORPD II depositary framework is not likely to lead to the same degree of harmonization as for UCITS and AIF depositaries. IORPD II leaves the decision of making the appointment of a 'depositary' or 'custodian' compulsory for both full DC and other IORPs to each individual Member States to avoid unjustified changes to their pension system.[242]. IORPD II only requires the compulsory appointment for full DC IORPs if an IORP carries out cross-border activity and the appointment of one or more depositaries for safekeeping and oversight duties is being compulsory under the national laws of a host Member State and not compulsory under the law of the home Member State.

The IORPD II 'substantive depositary regime', nevertheless, seems to have established a more consistent approach with regard to, amongst others, eligible institutions, its organizational requirements, the safekeeping and oversight duties rules of IORP depositaries. Although there are unclarities in the implementation process, the IORPD II 'substantive depositary regime' seems to be applicable to all 'depositaries' and 'custodians' that are appointed by IORPS regardless of whether Member States require a compulsory appointment of 'depositaries' and 'custodians'. Compared to UCITS and AIF depositaries, the IORPD II depositary regime is not as much harmonized. IORPs that do not appoint 'depositaries' or 'custodians' may, for instance, use 'alternative mechanisms' for the safekeeping of IORP assets and the exercise of oversight duties under IORPD II. This provisions seek to ensure 'equivalent' investor protection. It is questionable, however, whether the conditions set out in IORPD II will achieve this objective.[243] In addition, the 're-introduction' of the former non-harmonized UCITSD I-IV delegation and liability regime for IORPs under IORPD II will not bring any harmonization compared to the depositary regimes of Member States under IORPD I.

Finally, the level 2 measures applicable to depositaries under the AIFMD and UCITSD V are not being extended to IORP depositaries. Whether or not the same interpretation will be followed under IORPD II for the provisions copied from the AIFMD and UCITSD V, such as the safekeeping and oversight duties, will be completely left over to the individual Member States. The non-harmonization of the appointment of 'depositaries' and 'custodians', the 'alternative mechanisms' ensuring 'equivalent protection' for IORPs without a 'depositary' appointed and the UCITSD I-IV delegation and liability regime for IORPs under IORPD II leaves, thus, the considerable differences in investor protection amongst Member States under IORPD I to be unresolved. Only a fully harmonized approach under future amendments of IORPD II that addresses these issues would likely change this.

---

[240] EIOPA-BOS-12/015, 451.
[241] *Ibid*, 460.
[242] *Ibid*, 463.
[243] EIOPA-BOS-12/015, 464.

CHAPTER 6 The CRD IV, MiFID II and the CSDR 'Custodian Regime'

1. Introduction

No definition is found in European law of what is a 'custodian'[1]. The European Commission in a Commission Communication reviewing possible developments on the regulation of UCITS depositaries defined custodians as

> 'an entity entrusted with the safekeeping and administration of securities and other financial assets on behalf of others, and may moreover provide additional services, including clearing and settlement, cash management, foreign exchange and securities lending'.

Although not directly targeted, the CRD IV and MiFID II regulate credit institutions and investment firms that provide the service of 'safekeeping and administration of securities/financial instruments' as an ancillary service.[2] The 'ancillary service' nature under CRD IV and MiFID implies that credit institutions and investment firms are only regulated for providing 'custodianship' if they are authorized for 'core services' that are for credit institutions deposit taking[3] and investment firms investment services/activities[4]. Similar as for depositaries under the UCITSD V, AIFMD and IORPD II, this leaves a 'regulatory gap'[5] for Member States to regulate their own national custodians. Furthermore, 'investor CSDs' under the CSDR are allowed to maintain securities accounts in relation to the settlement service, collateral management and other ancillary services.[6] Investor CSDs are, thus, performing similar services as investment firms and credit institutions acting as custodians. Nevertheless, MiFID II explicitly excludes CSDs from its scope.[7]

The question to be answered in this chapter is what custodians are and whether and to what extent custodians are regulated in the EEA. By reviewing credit institutions, investment firms, national custodians, 'investor CSDs' and the MiFID II client asset requirements, this chapter seeks to answer this and to highlight to what extent custodians differ from depositaries under the UCITSD V, AIFMD and IORPD II.

2. The 'Custodian' under CRD IV and MiFID II

Credit institutions and investment firms acting as 'custodians' are under the CRD IV and MiFID II are indirectly regulated. This paragraph seeks to answer what 'custodianship' under both legislative acts is, to what extent the definition of the ancillary services allowed to be performed under both acts differ and to what extent national Member States may diverge from the European standards.

---

[1] European Commission, Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments, COM(2004) 207 final, 30 March 2004, 7, 14, 26.

[2] Annex I Nr. 12 CRD IV.

[3] Arts 8, 9 CRD IV.

[4] Annex I s. A MiFID I/II.

[5] LCG 2008, 36.

[6] Annex - List of Services, S. B, Nr. 4 CSDR.

[7] Annex I s. B MiFID I/II.

2.1. 'Safekeeping and Administration Services' as an 'Ancillary Service'

2.1.1. Credit Institutions under CRD IV

The CRD IV[8] contains an authorization obligation and requirements for credit institutions. Pursuant to the CRD IV, a 'credit institution' is an undertaking, the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account.[9]

Credit institutions must obtain an authorization before conducting business. Credit institutions may, in addition to deposit taking and lending, engage in any of the activities of Annex I to CRD IV within the EEA on a cross-border basis (European passport).[10] The most relevant activity regarding the exercise of depositary functions is listed under Number 12 (safekeeping and administration of securities).[11] In addition to this list, credit institutions may provide the investment services/activities and ancillary services under Annex I MiFID I/II,[12] in particular the

> 'safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management and excluding maintaining securities accounts at the top tier level'.[13]

Unlike investment firms, credit institutions are authorized under the CRD IV and do not need to obtain authorization under MiFID I/II in order to provide safekeeping and administration of securities. Credit institutions that, in addition, provide any of the MiFID investment services/activities and ancillary services are, however, required to comply with certain MiFID I/II provisions, such as the general organizational requirements, operational conditions (conduct of business rules) safeguarding of client financial instruments and funds.[14] Like investment firms, credit institutions are required under MiFID I/II to be members of authorized investor compensation schemes.[15]

2.1.2. Investment Firm under MiFID II

Under MiFID I/II, the provision of investment services or activities, with or without ancillary services, requires authorization. Authorization must be granted by the Competent Authority. Before authorization may be granted, an investment firm must fulfil a number of conditions.

---

8. Arts 8, 9 CRD IV.
9. Art. 3(1) Nr. 1 CRD IV/Art. 4(1) Nr. 1 CRR.
10. Arts 8, 9 CRD IV grants each Member State the option to decide for itself whether one or more of the activities listed in Annex I are regulated businesses requiring authorization, with the exception of Number 1 of Annex I (acceptance of deposits and other repayable funds), which may only be conducted by authorized credit institutions. In this regard, it should, however, be noted that such credit institutions being authorized on a 'private placement' basis do not benefit from the European passport as discussed below. See also Art. 33, 34 CRD IV.
11. Annex I Nr. 12 CRD IV.
12. See for the investment services/activities and the ancillary services which credit institutions are able to provide: Annex I s. A and B MiFID I/II.
13. This ancillary service includes custodianship and related services, such as cash/collateral management and excludes maintaining securities accounts at the top tier level. See Annex I s. B MiFID I/II.
14. See Recital 18, Art. 1(2)MiFID I/Recital 38, Art. 1(3) MiFID II.
15. Article 11 MiFID I/Art. 14 MiFID II; ICSD. The ICSD protects investors when a firm is unable to return financial instruments or money held on a client's behalf related to investment services. See also Proposal for a Directive of the European Parliament and of the Council amending Directive 97/9/EC of the European Parliament and of the Council on investor-compensation schemes (COM/2010/371 final - 2010/0199 (COD).

Inter alia, the investment firm has to be a member of an authorized investor compensation scheme.[16]

The safekeeping and administration of financial instruments for the account of clients is an ancillary service under Section B Annex I MiFID I/II. This implies that the safekeeping and administration of financial instruments for the account of clients is not an investment service or activity and can only be provided by credit institutions and investment firms in connection with investment services and activities, such as, amongst others, portfolio management and investment advice.[17]

Under the original MiFID II proposal, the safekeeping and administration of financial instruments for the account of clients was proposed to be upgraded to a full-fledged investment service.[18] Following this proposal, any firm providing the service of safekeeping and administration of financial instruments for the account of clients would have be on a stand-alone basis subject to a separate authorization procedure.[19] This would have implied that under MiFID II, compared to MiFID I, not every investment firm,[20] but merely those entities with an authorization for safekeeping would have been eligible as a custodian. This proposal was, however, not adopted in the final version of MiFID II. Under MiFID II the safekeeping and administration of financial instruments for the account of clients, thus, remains to be an ancillary service. Member States are, however, free to specify the types of entities that can be authorized for purely providing safekeeping/custodian services within their domiciles.[21] The non-harmonization in this area will, thus, also in the future remain to raise a number of questions as to whether the European legal framework for custodians needed to be further harmonized and strengthened to ensure a level playing field in terms of investor protection measures across all Member States.[22]

2.2. The MiFID II versus CRD IV Definition of 'Safekeeping and Administration Services'

The MiFID II and CRD IV definition of 'safekeeping and administration services' differs in various respects. The MiFID II relates to 'financial instruments' being defined under Section C Annex I MiFID I/II, whereas the CRD IV refers to 'securities' that has not been further elaborated. In addition, the MiFID II definition includes the wording 'for the account of clients' and 'custodianship and related services such as cash/collateral management'.[23] Finally, the MiFID II version, in comparison to MiFID I, has clarified that this ancillary service excludes 'maintaining securities accounts at the top tier level'.[24]

The meaning of both definitions have not been further elaborated on the European level. Given the fact that CRD IV has been adopted in 2013 and MiFID II in 2014, the narrow definition of 'safekeeping and administration of securities' under CRD IV has to be interpreted dynamically in the light of MiFID II. A dynamic interpretation holds water as the

---

16. *Ibid.*
17. Annex I s. A MiFID I/II.
18. See Annex 1 s. A MiFID II proposal.
19. *Ibid.*
20. Generally speaking, the MiFID custody rules apply to all 'MiFID investment firms', such as brokers, dealers, asset managers and advisers. See D. Frase, *Custody*, in *Law and Regulation of Investment Management* 276 (D. Frase ed., Sweet & Maxwell 2011).
21. Legal Certainty Group, *Second Advice of the Legal Certainty Group – Solutions to Legal Barriers related to Post-Trading within the EU*, August 2008, 25, 32.
22. Question 3, Bank of New York Mellon response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.
23 *Id.*
24 See Annex 1 s. B MiFID II proposal.

original purpose of the introduction of the ISD, predecessor of MiFID I/II, was to provide a level playing field of investor protection for banking and investment services provided to clients.[25]

2.2.1. *Safekeeping and administration of financial instruments for the account of clients*

2.2.1.1. Safekeeping

Under MiFID I/II and CRD IV, investment firms (custodians) may be, additionally, authorized for safekeeping on behalf of investors. Firms that obtained authorization are allowed to hold financial instruments and cash.[26] Financial instruments can either be held in book-entry form or physically. Following the dematerialization and immobilization trend[27], financial instruments are mainly held in book-entry form, i.e. a dematerialized form in which financial instruments are held electronically with no physical certificate issued.[28]
Issuers may issue electronic financial instruments through a CSD that are the central service providers that provide the definitive record of ownership and facilitate the central settlement of securities.[29]

CSDs maintains accounts for participating intermediaries (custodians) and provided the service of clearing and settlement of securities to them.[30] Upon a transfer of securities, the CSDs credited/debited the amount of securities to the accounts of the intermediaries held at the CSD (book entry settlement).[31] These intermediaries (custodians) maintains accounts for their investors/intermediaries. The latter, may again hold accounts for their investors/intermediaries, etc. The CSD, thus, centralizes the custody of security certificates.

CSDs and national laws typically differ in what type of securities[32] and intermediaries are admitted to a CSD and whether investors may hold an account with a CSD.[33] As a result, the length of a holding chain depends upon the laws applicable to the accounts held by the

---

[25] See S.J. Key, *Financial Integration in the European Community*, Board of Governors of the Federal Reserve System – International Finance Discussion Papers, No. 349 (April 1989), 105-106.
[26] See on depositing client financial instruments: Art. 3(1) sub-para. 1 MiFID II (Commission) Directive; Art. 17(1) sub-para. 1 MiFID I (Commission) Directive; See on depositing client funds: Art. 16(10) MiFID II; Art. 18(1) MiFID I (Commission) Directive.
[27] M. Haentjens, *Harmonisation of Securities Law: Custody and Transfer of Securities in European Private Law* (Private Law in European Context Series), 29 et seq.
[28] LCG 2008, 36; D. Einsele, *Wertpapier als Schuldrecht: Funktionsverlust von Effektenurkunden, international Rechtsverkehr* (Tübingen: Mohr Siebeck 1995).
[29] See K.M. Löber, *The Developing EU Legal Framework for Clearing and Settlement of Financial Instruments*, European Central Bank – Legal Working Paper Series, No. 1 (February 2006), 8.
[30] Under the SLD proposal, it is suggested that account providers in the first place be responsible for effectively safeguarding clients' book-entry securities; See H. Motani, *The proposed EU legislation on securities holding*, 68-73.
[31] M. Haentjes, *Clearing and Settlement –Ways Forward*, 5 Journal of International Banking Law and Regulation (2011); L. Thévenoz, *Transfer of intermediated securities*, 135-159. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013).
[32] E. Micheler, *The Legal Nature of Securities: Inspirations from Comparative Law,* 131-149. (L. Gullifer & J. Payne eds, Hart Publishing 2010); C.W. Mooney, *Law and Systems for Intermediated Securities and the Relationship of Private Property Law to Securities Clearance and Settlement: United States, Japan, and the Unidroit Draft Convention, Bank of Japan*, Institute for Monetary Economic Studies Discussion Paper Series, No. 2008-E.7, http://www.imes.boj.or.jp/research/papers/english/08-E-07.pdf (Accessed 8 August 2016).
[33] M. Haentjens, *Harmonisation of Securities Law: Custody and Transfer of Securities in European Private Law* (Private Law in European Context Series), 131-172; L. Thévenoz, *Intermediated Securities, Legal Risk, and the International Harmonization of Commercial Law*, 13 Stanford Journal of Law, Business & Finance (2008), 384-452; L. Thévenoz, *Who holds (Intermediated) Securities? Shareholders, Account Holders, and Nominees?,* 3-4 Uniform Law Review (2010), 845-859.

custodians and CSDs involved.[34] For this purpose, securities that are held across national borders typically involve a holding chain of intermediaries in which custodians hold the securities of their investors and need to main an account through, for example, a second account, which holds an account with a CSD in a foreign market that is centrally keeping the securities of an issuer centrally.[35] Custodians have to segregate their client securities from securities that are held for their own account, i.e. their own securities and the securities held for clients are booked into distinct accounts with the account provider[36] of the custodian.

Figure Custody holding chain[37]

Generally, there are two account types that are used omnibus and segregated accounts. Omnibus accounts are accounts in which the custodian holds the financial instruments that it holds on behalf of all its clients in the single ('omnibus') at a CSD. Segregated securities

---

[34] P. Paech, *Cross-Border Issues of Securities Law- European Efforts to Support the Securities Market with a Coherent Legal Framework, Study prepared for the European Parliament*, http://www.europarl.europa.eu/document/activities/cont/201106/20110606ATT20781/20110606ATT20781EN.pdf (Accessed 8 August 2016); P. Paech, *Market needs as paradigm – breaking up the thinking on EU securities law*, 22-64. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013); E. Micheler, *Custody chains and asset values: why crypto securities are worth contemplating*, 3 Cambridge Law Journal 1-6 (2015); E. Micheler, *Intermediated Securities and Legal Certainty,* LSE Law, Society and Economy Working Papers No. 3 (2014), 3-7; E. Micheler, P.E., *Custody Chains and Asset Values,* http://ssrn.com/abstract=2539074 (accessed 9 July 2017); P. Dupont, *Rights of the account holder relating to securities credited to its securities account*, 90-104. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013); H.P. Conac, *Rights of the investor*, 105-134. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013).

[35] H. De Vaplane & J.P.. Yon, *The concept of integrity in securities holding systems*, 193-214. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013).

[36] Principle 22(c) European Commission, *EU Consultation Document 'Legislation on Legal Certainty of Securities Holding and Dispositions'. DG Markt G2 MET/OT/acg D(1010) 768690,* http://ec.europa.eu/finance/consultations/2010/securities/docs/consultation_paper_en.pdf (accessed 8 August 2016): 'account provider' means a person who maintains securities accounts36 for account holders36 and is authorized in accordance with MiFID II)or is a Central Securities Depositary as defined in the CSDR and, in either case, is acting in that capacity.

[37] Association for Financial Markets in Europe, *Post Trade explained - The role of post-trade services in the financial sector*, February 2015, 12.

account structures, i.e. accounts held for a specific (sub-category) of end-investors may also be held. The latter is the preference in the market as it is less complex and more cost-effective to operate.[38] Date, for example, only needs to be stored, maintained and updated in one place so that updates do not need to be processed through multiple accounts leading to less operational risk that it will not be processed in the same manner or at the same time.[39]
Omnibus accounts are, however, associated with asset protection, asset servicing and operational issues.[40] Asset protection issues might arise as some legal systems recognize the intermediary (i.e. a nominee), and not the end investor as the legal owner of a specific financial instrument.[41] Asset servicing may be caused for end investors, for example, to effectuate their voting rights.[42] Operational issue might be generated by the different requirements regarding the CSD account structure.[43]

For that purpose, the proposed SLD sets out a core role for account providers being, amongst others, custodians.[44] It is proposed that account providers in the first place be responsible for effectively safeguarding clients' book-entry securities.[45] Custodians as account providers would be responsible for correctly crediting and debiting account-held securities related to the acquisitions and dispositions of account-held securities and limited securities.[46] They would make sure that they would hold enough securities to cover the corresponding number of securities credited to clients' accounts.[47] Errors should be avoided by appropriate remedies.[48] Account providers must follow the instructions of the account holder or any other person entitled to give instructions[49] and process corporate actions[50]

---

[38] Association for Financial Markets in Europe, *Post Trade explained - The role of post-trade services in the financial sector***,** February 2015, 13.
[39] *Ibid*, 9.
[40] *Ibid*, 5.
[41] D.A. Zetzsche, *Shareholder Passivity, Cross-Border Voting and the Shareholder Rights Directive*, 8 Journal of Corporate Law Studies 289 (2008).
[42] C. Strenger & D.A. Zetzsche, *Corporate Governance, Cross-Border Voting and the (draft) Principles of the European Securities Law Legislation – Enhancing Investor Engagement Through Standardisation*, JELS 503 (2013), C. Strenger & D.A. Zetzsche,, *Institutionelle Anleger, Verbesserung der Corporate Governance und Erleichterung der grenzüberschreitenden Stimmrechtsausübung*, AG 397 (2013).
[43] Association for Financial Markets in Europe, *Post Trade explained - The role of post-trade services in the financial sector***,** February 2015, 12.
[44] Principle 22(c) European Commission, *EU Consultation Document 'Legislation on Legal Certainty of Securities Holding and Dispositions'. DG Markt G2 MET/OT/acg D(1010) 768690,* http://ec.europa.eu/finance/consultations/2010/securities/docs/consultation_paper_en.pdf (accessed 8 August 2016); T. Voss, *Die Securities Law Directive und das deutsche Depotrecht*, 6 Europäisches Wirtschafts- und Steuerrecht (2010), 209-211.
[45] LCG 2008, 36.
[46] See Principle 4 Methods for acquisition and disposition*'* European Commission, *EU Consultation Document 'Legislation on Legal Certainty of Securities Holding and Dispositions'. DG Markt G2 MET/OT/acg D(1010) 768690,* http://ec.europa.eu/finance/consultations/2010/securities/docs/consultation_paper_en.pdf (accessed 8 August 2016): Principle 4.2 sets out the methods for acquisition and dispositions. Six methods are recognized and categorized based upon book-entry and non-book-entry methods.
[47] Principle 7 Principle 22(c) European Commission, *EU Consultation Document 'Legislation on Legal Certainty of Securities Holding and Dispositions'. DG Markt G2 MET/OT/acg D(1010) 768690,* http://ec.europa.eu/finance/consultations/2010/securities/docs/consultation_paper_en.pdf (accessed 8 August 2016):
[48] Principle 4 European Commission, *EU Consultation Document 'Legislation on Legal Certainty of Securities Holding and Dispositions'. DG Markt G2 MET/OT/acg D(1010) 768690,* http://ec.europa.eu/finance/consultations/2010/securities/docs/consultation_paper_en.pdf (accessed 8 August 2016):
[49] Principle 11 European Commission, *EU Consultation Document 'Legislation on Legal Certainty of Securities Holding and Dispositions'. DG Markt G2 MET/OT/acg D(1010) 768690,*

exclusively in accordance with the account agreement. Account providers would be required to report on securities movements and holdings in a manner , with a scope and regularity as prescribed by the applicable law.[51] Finally, other duties of account providers would be subject to contract.

Custodians, thus, hold their clients' financial instruments through the custody holding chain, i.e. accounts that they hold at CSDs established in each market or through (sub-)custodians that are clients of such a CSD.

2.2.1.2. Administration

The provision of administration by custodian has its roots in the physical safekeeping by banks.[52] The safekeeping of financial instruments and the holding of cash led to the development of additional services that were related to settlement and asset servicing. This development can be explained by the fact that custodians developed economies of scale in providing these services as they were the exclusive provider of physical safekeeping and other assets that were deposited in their vaults.[53] Custodians in the dematerialized and immobilized custody environment still cater for delivering and receiving financial instruments on behalf of clients against the negotiated amount of cash as referred to as 'settlement'[54].

Furthermore, custodians generally provide services related to the benefits, rights and obligations of an investor portfolio held by the custodian on behalf of their clients. Examples of asset related services include, amongst others, the collection of income receivable (for example, dividends and interest),corporate actions, reclaiming of tax refunds.[55]

2.2.1.3. For the Account of Clients

Custodians are safekeeping and administrating assets on behalf of eligible counterparties, professional and retail clients. The provision of the safekeeping and administration of financial instruments does not include the safekeeping of the financial instruments that belong to the legal property of the investment firm itself.[56]

2.2.2. Custodianship and related services such as cash/collateral management

Safekeeping and the administration of financial instruments is under MiFID II generally referred to as 'custodianship'.[57] The definition of the ancillary service, in addition, refers to

---

http://ec.europa.eu/finance/consultations/2010/securities/docs/consultation_paper_en.pdf (accessed 8 August 2016).

[50] Principle 15 European Commission, *EU Consultation Document 'Legislation on Legal Certainty of Securities Holding and Dispositions'. DG Markt G2 MET/OT/acg D(1010) 768690,* http://ec.europa.eu/finance/consultations/2010/securities/docs/consultation_paper_en.pdf (accessed 8 August 2016).

[51] *Ibid*, Principle 16.

[52] See K.M. Löber, *The Developing EU Legal Framework for Clearing and Settlement of Financial Instruments*, European Central Bank – Legal Working Paper Series, No. 1 (February 2006), 6.

[53] *Ibid.*

[54] Art. 2(1) Nr. 7 CSDR: 'settlement' means the completion of a securities transaction where it is concluded with the aim of discharging the obligations of the parties to that transaction through the transfer of cash or securities, or both.

[55] European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) *Annex to the* Green Paper on the enhancement of the EU Framework for Investment Funds, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016), 22, 23.

[56] In general investment activities/services and ancillary services need to be provided for the account of clients in order to fall within the scope of MiFID I/II. See See Art. 4(1) Nr. 1 MiFID II.

[57] See Annex I s. B MiFID I/II. Annex I CRD IV, however, does not include the term 'custodianship'.

the provision of 'related services such as cash/collateral management'. The latter indicates that custodians under MiFID I/II are allowed to provide other value-added services in addition to the core service of the safekeeping and administration of securities. Adding 'such as' refers to other value-added services that may be provided apart from cash/collateral management. Examples of value-added services include: investment reporting, fund accounting, performance measurement, transfer agency, foreign exchange transactions and fiduciary and trust services.[58]

2.2.3. Exclusion: Securities Accounts at top Tier Level

The ancillary service under MiFID II excludes providing and maintaining securities accounts at the top tier level ('central maintenance service').[59] The CSDR refers to the central maintenance service as 'providing and maintaining securities accounts at the top tier level'.[60] A 'top tier securities account' has not been defined by the CSDR. The European Commission in its impact assessment considering the proposal for the CSDR considered that 'top tier securities accounts' are securities accounts that are placed at the top of the holding chain and are the accounts into which securities are being recorded in book-entry form for the first time.[61] The safekeeping and administration service under CRD IV and MiFID II, thus, aims at those credit institutions and investment firms that act as 'account keepers' by maintaining securities accounts that are not held at the top tier level, i.e. hold accounts with an CSD. CSDs, however, may, besides acting as an 'issuer CSD', also act as an 'investor CSD'. CSDs, however, fall outside of the scope of the ancillary safekeeping and administration service under CRD IV and MiFID II. The question that remains is whether 'investors CSDs' that maintain securities accounts with other CSDs on behalf of investors are to be seen as a 'custodian'.

2.3. Conclusion

Credit institutions and investment firms may act as 'custodians' under the CRD IV and MiFID II. Both may perform safekeeping and administration services as an ancillary service, in addition to, the 'core services' for which they have obtained an authorization. The ancillary service status leaves a regulatory gap as for the activity itself credit institutions nor investment firms have to obtain an authorization under the CRD IV and MiFID II. National Member States are, thus, free to regulate their own national custodians. Moreover, the ancillary service nature of 'safekeeping and administration services' has led to a diverging and unclear definitions of the precise definition of the activity under CRD IV and MiFID II. The CRD IV definition defines the activity as the 'safekeeping and administration of securities', whereas the MiFID II definition is more extended. The CRD IV ancillary service definition, however,

---

[58] See for 'other valued-added services' Annex - List of Services, s. C CSDR.
Association for Financial Markets in Europe, *Post Trade explained - The role of post-trade services in the financial sector*, February 2015, 14; Oxera, *The Role of Custody in European Asset Management*, 13, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx.
[59] The definition of safekeeping and administration services under Annex 1 s. B MiFID II was replaced by Art. 71(3) CSDR.
60 Annex - List of Services, S. A, Nr. 2 CSDR.
[61] See for 'top tier securities account': Annex 14 – Glossary of terms, European Commission, *Commission Staff Working Document of 7 March 2012 (SWD(2012) 22 final) accompanying the Proposal for a Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on Central Securities Depositories (CSDs) and amending Directive 98/26/EC{COM(2012) 73 final}: Impact Assessment,* http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012SC0022&from=EN (accessed (8 August 2016).

has to be interpreted in the light of the MiFID II definition. The nature of MiFID II is to prevent regulatory arbitrage between MiFID II and CRD IV.[62] In addition, credit institutions performing investment services are investment firms that fall under the scope of MiFID II and the MiFID II has been adopted at a later stage. The definition of the CRD IV ancillary service has, thus, to be interpreted dynamically in the light of MiFID II. The MiFID II definition, however, excludes CSDs, including CSDs that act as 'investor CSDs'. The question remains what CSDs are, to what extent they are different from CRD IV and MiFID II 'custodians' and what the difference is between 'investor CSDs' and 'issuer CSDs'.

3. The (Investor) CSD

During the MiFID I and II discussions regarding the possible update from custodianship to a fully-fledged investment service one of the arguments not introducing a 'custodian passport' was that it was unclear whether and to what extent CSDs would fall within the scope of MiFID I/II.[63]

The 'investor CSD' is similar as a custodian.[64] For cross-border transactions investors can access securities in an issuer CSD by using either a custodian bank or an investor CSD that has an account with the issuer CSD (investor CSD).[65] Furthermore, (investor) CSDs may perform the same ancillary services as custodians. Some CSDs, especially those licensed as credit institution under CRD IV, compete with custodians regarding certain administration services and value-added services provided to custodians. Delineating custodians from CSDs has been for a long time uncertain as regarding the duties and tasks employed. The CSDR has clarified this issue as it has introduced a definition of what is a CSD and, in particular, an 'investor CSD' under the CSDR.

3.1. The CSD under the CSDR

Under the CSDR a CSD means a legal person that operates a settlement service and the notary and/or central maintenance service ('core services'[66]).[67] In addition, CSDs are permitted to perform certain 'ancillary' services, which are mostly related to the core services[68]. These

---

[62] See S.J. Key, *Financial Integration in the European Community*, Board of Governors of the Federal Reserve System – International Finance Discussion Papers, No. 349 (April 1989), 105-106.

[63] European Commission, Preliminary orientations for revision of the Investment Services Directive (ISD), IP/01/1055, July 2011, Annex 1: Definition and Scope of Investment Services Directive, 6-7; See for 'non-central safekeeping of financial instruments for the account of clients': European Commission, *Public Consultation on Central Securities Depositaries (CSDs) and on the Harmonisation of certain aspects of securities settlement in the European Union, DG Markt G2 D(201)8641*, 9, http://ec.europa.eu/finance/consultations/2011/csd/docs/consultation_csd_en.pdf (accessed 8 August 2016); See for the proposed update of the safekeeping and administration services definition in which safekeeping was proposed to be an investment service: draft MiFID II.

[64] See B.J.A. Zebregs, *De CSD-verordening in het licht van de Capital Markets Union* (*Ondernemingsrecht* 2017/18).

[65] European Commission, *Commission Staff Working Document of 7 March 2012 (SWD(2012) 22 final) accompanying the Proposal for a Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on Central Securities Depositories (CSDs) and amending Directive 98/26/EC{COM(2012) 73 final}: Impact Assessment,*9, http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012SC0022&from=EN (accessed (8 August 2016).

66Annex - List of Services, S. A CSDR.

67 Recital 26 CSDR; Annex - List of Services, S. A CSDR.

68 Annex - List of Services, S. A CSDR.

'ancillary' services can be ‘non-banking-type ancillary services of CSDs[69]’ and ‘banking-type ancillary services’. [70]

3.1.1. Core Services

The CSDR sees the operation of the settlement service, and the notary and/or central maintenance service as ‘core services’ for which a CSD needs to be authorized. An authorized CSD may provide services across the EU, including through setting up a branch, provided that those services are covered by its authorization.[71] These core services determine whether a CSD needs to be authorized or not as in practice the vast majority of CSDs in the pre-CSDR era performed these three services.

3.1.1.1. Settlement Service

The operation of a securities settlement system has been defined under Article 2(a) Settlement Finality Directive as ‘being a formal arrangements allowing transfers of securities between three or more participants, governed by the law of a Member State chosen by the participants, and designated as a system and notified as such to the EU Commission’.[72] De facto this means the operation of the settlement service means through which securities are initially delivered to investors or are exchanged between buyers and sellers.[73] CSDs, in this regard, operate IT platforms that provide the settlement of securities transactions.[74] Transactions, typically being settled in a process called ‘delivery versus payment’, will be ‘settled’ by the CSD by crediting the purchased securities and debiting the corresponding cash amount of the accounts of the buyer, whereas the seller’ securities account will be debited and its corresponding cash account credited.[75]

3.1.1.2. Notary Service

The ‘notary’ function refers to the function of CSDs in relation to the securities issuance process. CSDs are the ‘first entry point’ for the recording of securities into a book-entry system. Securities issued by issuers are in practice deposited into a CSD, referred to as ‘issuer CSD’.[76] The notary service of CSD is characterized by a ‘central register’ that is being kept for a particular issue of securities in order to enable the settlement of the corresponding securities.[77] The CSD makes sure that the number of securities issued equals the securities the

---

69 Annex - List of Services, S. B CSDR.
70 Annex - List of Services, S. C CSDR.
71 Recital 21, Art. 23 CSDR.
[72] Proposal for a Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC /* COM/2012/073 final - 2012/0029 (COD) */. 7.
[73] See for the settlement function: http://ecsda.eu/facts/faq (accessed 8 August 2016).
[74] European Commission, *Public Consultation on Central Securities Depositaries (CSDs) and on the Harmonisation of certain aspects of securities settlement in the European Union, DG Markt G2 D(201)8641*, http://ec.europa.eu/finance/consultations/2011/csd/docs/consultation_csd_en.pdf (accessed 8 August 2016), 7, 8; Proposal for a Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC /* COM/2012/073 final - 2012/0029 (COD) */. 7, 8.
[75]European Central Bank, *T2S Framework Agreement*, https://www.ecb.europa.eu/paym/t2s/pdf/csd_FA/T2S_Framework_Agreement_Schedules.pdf (accessed 9 August 2016).
[76] See for the notary function: http://ecsda.eu/facts/faq (accessed 8 August 2016).
[77] European Commission, *Public Consultation on Central Securities Depositaries (CSDs) and on the Harmonisation of certain aspects of securities settlement in the European Union, DG Markt G2 D(201)8641,* http://ec.europa.eu/finance/consultations/2011/csd/docs/consultation_csd_en.pdf (accessed 8 August 2016), 6.

securities booked in the accounts of investors. CSDs, thus, ensure the integrity of the issue by ascertains the existence of the securities when the reimbursement upon maturity takes place.[78] The CSD notary function should be distinguished from the keeping of the central register for the issuer. The latter is being performed registrars and services a different purpose namely the provision of information to shareholders.

3.1.1.3. Central Maintenance Service

The 'central safekeeping' function means the maintenance of 'top tier' accounts in a book entry system.[79] CSDs performing this function are the central account provider for the entire market of the relevant financial instrument. The participants of the CSD may, thus, deposit their securities in securities accounts provided to them by the CSD on which transfers resulting from transactions are debited/credited.[80]All rights and obligations linked t the securities are managed under the central maintenance service. The central maintenance of securities include, for example, the processing of corporate actions such as dividend and interest payments, or voting rights in the case of shares.[81] The central maintenance is carried out related to securities at the 'top tier level', i.e. all holdings in a given financial instruments that is ultimately being kept in a securities account at a CSD.[82]

3.1.1.4. Ancillary Services

CSDs authorized to carry out the core services may additionally provide non-banking and banking-type of ancillary services. The CSDR differentiates between the two as for non-banking ancillary services the CSDR does not take principal risk (credit or liquidity risks). Banking ancillary services are those ancillary services provided by CSDs that have, simultaneously, obtained a license as credit institution. CSDs must obtain such a license as they do take principal risks, including credit and/or liquidity risks.

3.1.2. Non-banking-type Ancillary Services of CSDs

Non-banking-type ancillary services of CSDs are services that may be performed, in addition to, the core services for which a CSD is authorized. On top of that, there is are two extra categories, including the function of 'investor CSD' and 'any other service'.[83]

3.1.2.1. Operation of Settlement System

---

[78] European Commission, *Public Consultation on Central Securities Depositaries (CSDs) and on the Harmonisation of certain aspects of securities settlement in the European Union, DG Markt G2 D(201)8641,* http://ec.europa.eu/finance/consultations/2011/csd/docs/consultation_csd_en.pdf (accessed 8 August 2016), 6; Proposal for a Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC /* COM/2012/073 final - 2012/0029 (COD) */, 7.

[79] European Commission, *Public Consultation on Central Securities Depositaries (CSDs) and on the Harmonisation of certain aspects of securities settlement in the European Union, DG Markt G2 D(201)8641,* http://ec.europa.eu/finance/consultations/2011/csd/docs/consultation_csd_en.pdf (accessed 8 August 2016), 7; Proposal for a Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC /* COM/2012/073 final - 2012/0029 (COD) */, 7.

[80] European Commission, *Public Consultation on Central Securities Depositaries (CSDs) and on the Harmonisation of certain aspects of securities settlement in the European Union, DG Markt G2 D(201)8641,* http://ec.europa.eu/finance/consultations/2011/csd/docs/consultation_csd_en.pdf (accessed 8 August 2016), 7; Proposal for a Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC /* COM/2012/073 final - 2012/0029 (COD) */, 7.

[81] See for the central maintenance function: http://ecsda.eu/facts/faq (Accessed 8 August 2016).

82 See http://ecsda.eu/facts/faq (Accessed 8 August 2016).

83 Annex - List of Services, S. B, Nr. 3(a) CSDR.

Ancillary services allowed to be provided along the notary function are: Organizing a securities lending mechanism[84], the providing of collateral management services and settlement matching[85], order routing and trade confirmation/verification[86].

3.1.2.2. Central Safekeeping/Notary Function

Ancillary services that may be provided linked to the central administration central safekeeping of securities and the notary function are: services related to shareholders' registers[87], the processing of 'corporate actions'[88] and the new issue services, such as the allocation and management of ISIN codes[89].

3.1.2.3. 'Investor CSDs'

Regardless of the core services provided, CSD may maintain securities accounts in relation to the settlement service, collateral management and other ancillary services.[90] CSDs are under this ancillary service allowed to open 'lower tier' securities accounts, either in direct holding systems or by acting as an 'investor CSD' by maintaining securities accounts for itscustomers for securities issued in 'issuer CSDs'.[91] The investor CSD is similar as a custodian. For cross-border transactions investors can access securities in an issuer CSD by using either a custodian bank or an investor CSD that has an account with the issuer CSD.[92] CSDs may also perform the same ancillary services as custodians.

3.1.2.4. Any Other Service

On top of this, CSDs may general ancillary services referred to 'any other service' supporting the core services, including, the provision of general collateral management services as agent[93], regulatory reporting[94] and providing data and statistics to market/census bureaus[95].

The list of non-banking-ancillary services is indicative. CSDs are not restricted in performing other ancillary services than the services explicitly mentioned in Section B, Annex List of Services CSDR.

3.1.3. Banking-type Ancillary Services

CSDs under (Article 54) Title IV CSDR may be authorized to provide banking-type ancillary services. CSDs may, however, only be 'limited purpose credit institutions'. They are restricted to a legal framework that governs the provision of commercial bank money settlement by CSDS to their participants. An example of an ancillary service allowed to be provided is the provision of cash accounts and the accepting deposits from its participants.[96]

---

84 Annex - List of Services, S. B, Nr. 1(a) CSDR.
85 Annex - List of Services, S. B, Nr. 1(b) CSDR.
86 Annex - List of Services, S. B, Nr. 1(c) CSDR.
87 Annex - List of Services, S. B, Nr. 2(a) CSDR.
88 Annex - List of Services, S. B, Nr. 2(b) CSDR.
89 Annex - List of Services, S. B, Nr. 2(c) CSDR.
90 Annex - List of Services, S. B, Nr. 4 CSDR.
91 Proposal for a Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC /* COM/2012/073 final - 2012/0029 (COD) */, 7.
92 Proposal for a Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC /* COM/2012/073 final - 2012/0029 (COD) */, 8.
93 Annex - List of Services, S. B, Nr. 4(a) CSDR.
94 Annex - List of Services, S. B, Nr. 4(b) CSDR.
95 Annex - List of Services, S. B, Nr. 4(c) CSDR.
96 Annex - List of Services, S. C(a) CSDR.

CSDs may either obtain such a license by themselves[97] or a separate legal entity may obtain the license belong to the group of which both entities are ultimately controlled by the same parent entity.[98]

3.2. Conclusion

Under the CSDR a CSD is a legal person that operates a settlement service and the notary and/or central maintenance service ('core services'[99]).[100] In addition, CSDs are permitted to perform certain 'ancillary' services, which are mostly related to the core services.[101] These 'ancillary' services can be 'non-banking-type ancillary services of CSDs[102]' and 'banking-type ancillary services'. [103]

Under MiFID I/II and the CRD IV, CSDs are excluded that are authorized for providing and maintaining securities accounts at the top tier level ('central maintenance service').[104] Regardless of the core services provided, CSD may, as a non-banking ancillary service, maintain securities accounts in relation to the settlement service, collateral management and other ancillary services.[105] CSDs are under this ancillary service allowed to open 'lower tier' securities accounts, either in direct holding systems or by acting as an 'investor CSD' by maintaining securities accounts for its customers for securities issued in 'issuer CSDs'.[106] Investor CSDs, thus, partly provide similar services as 'custodians' under CRD IV and MiFID II. The core services provided under the CSDR, however, delineate 'investor CSDs' from 'custodians'.

4. National Custodians under Member State Laws

The entities that may provide custody services in the EEA are limitedly harmonized. Throughout the EEA both investment firms and credit institutions may provide the service of safekeeping financial instruments as an ancillary service. The European passport that comes along with obtaining an authorization as a credit institution (CRD IV) or investment firm (MiFID II) enables these entities to provide safekeeping and administration services throughout the EEA.

Entities that provide safekeeping and administration services but no 'investment services and activities' under MiFID II[107] or 'deposit taking and lending' under CRD IV are not subject to MiFID II and CRD IV. The regulation applicable to such an 'custodian' therefore depends on the regulatory regime in the jurisdiction where it provides such services.[108] There are, thus, not only European custodians regulated under CRD IV and MiFID II but also

---

97 Art. 54(3) CSDR.
98 Art. 54(4) CSDR.
99Annex - List of Services, S. A CSDR.
100 Recital 26 CSDR; Annex - List of Services, S. A CSDR.
101 Annex - List of Services, S. A CSDR.
102 Annex - List of Services, S. B CSDR.
103 Annex - List of Services, S. C CSDR.
104 The definition of safekeeping and administration services under Annex 1 s. B MiFID II was replaced by Art. 71(3) CSDR.
105 Annex - List of Services, S. B, Nr. 4 CSDR.
106 Proposal for a Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC /* COM/2012/073 final - 2012/0029 (COD) */, 7.
107 Annex I s. A MiFID I/II.
108 H. Motani, *The proposed EU legislation on securities holding*, 69. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013).

‘national custodians’.[109]

These entities have to be authorized according to national legislation that might be (partly) based upon CRD IV/MiFID II. National custodians not authorized under CRD IV or MiFID II do not benefit from the advantage of having an European passport and might, thus, be restricted in providing safekeeping and administrative services on a cross-border basis.

4.1. National Custodians

There are three approaches taken by Member States in regulating custodians.

The first group of Member States, such as Italy[110], the Netherlands[111] and Spain[112] do not have specific national regulation for custodians and, thus, merely rely upon CRD IV, MiFID II and the CSDR. For decades, the Netherlands prohibited non-bank investment from offering safekeeping and administration services.[113] Recently, the Netherlands allowed both credit institutions and (non-bank) investment firms to provide safekeeping and administration services.[114] Dutch law contains ‘lex specialis’ asset segregation requirements. Investment firms are required to be subject to the Dutch transfer of custody law (‘Wet giraal effectenverkeer’) or establish a separate securities custody company that is set up for this purpose.[115] The latter is not a ‘custodian‘ in itself, but a fully owned subsidiary of the investment firm that is established for the purpose of asset segregation.

The second group contains Member States, such as Austria[116], Germany[117] and

---

[109] LCG 2008, 25.

[110] See for credit institutions: Art. 1(2)(f) Nr. 12 custodia e amministrazione di valori mobiliari Decreto Legislativo, 1 settembre 1993, n. 385, Testo unico delle leggi in materia bancaria e creditizia; See for investment firms: Art. 1(6)(a) ‘la custodia e amministrazione di strumenti finanziari e relativi servizi connessi’, Sezione B - Servizi accessori (1) Affitto di cassette di sicurezza e amministrazione di strumenti finanziari per conto dei clienti, inclusi la custodia e i servizi connessi come la gestione di contante/garanzie collaterali, Decreto legislativo 24 febbraio 1998, n. 58: Testo unico delle disposizioni in materia di intermediazione finanziaria, ai sensi degli articoli 8 e 21 della legge 6 febbraio 1996, n. 520F.

[111] See Art. 4:87 Wet op het financieel toezicht; § 6.5 Regels met betrekking tot de bescherming van de rechten, financiële instrumenten of gelden van de cliënt (Arts 7:14-7:20) Nadere regeling gedragstoezicht financiële ondernemingen Wft;

[112] See for credit institutions: Anexo – Lista de actividades objecto de reconocimiento mutuo, Nr. 12. Custodia y administración de valores negociables, , Ley 10/2014, de 26 de junio, de ordenación, supervisión y solvencia de entidades de crédito. (BOE de 27 de junio) (Corrección de errores BOE de 28 de junio); Spain, however, limits safekeeping and administration services to by brokers and broker-dealers authorized as an investment firm. See for investment firms: Art. 64 Ley 24/1988, de 28 de julio, del Mercado de Valores.

[113] D. Busch & L. Silverentand, *The Netherlands* 206-207 (D. Busch & D.A. DeMott eds, Oxford 2012),; B.F.L.M. Schim, *Giraal effectenverkeer en goederenrecht* (Serie Onderneming en Recht Deel 36); M. Haentjens, *Harmonisation of Securities Law: Custody and Transfer of Securities in European Private Law* (Private Law in European Context Series), 131-172; P. Rank, *Vermogensscheiding* (D. Busch & C.M. Grundmann-van de Krol, Kluwer 2009); M.G.C.M. Peeters & W.A.K. Rank, *Bescherming van rechten van derivatencliënten bij insolventie van een intermediair* 137-176 (Kluwer 2011).

[114] AFM, Consultatieversie - Besluit van (…datum), houdende wijziging van de Nadere regeling gedragstoezicht financiële ondernemingen Wft van 15 november 2006 in verband met regels met betrekking tot de bescherming van de rechten, financiële instrumenten of gelden van de cliënt, Februari 2016. https://www.afm.nl/nl-nl/nieuws/2016/feb/consultatie-nrgfo-vermogensscheiding (accessed 4 August 2016); AFM, Consultatieversie, Besluit van (…datum), houdende wijziging van de Nadere regeling gedragstoezicht financiële ondernemingen Wft van 15 november 2006 in verband met regels met betrekking tot de bescherming van de rechten, financiële instrumenten of gelden van de cliënt, juli 2016. https://www.afm.nl/nl-nl/nieuws/2016/jul/consultatie-nrgfo-vermogensscheiding (accessed 4 August 2016);

[115] See R. Labeur, *Consultatieperikelen beleggersgiro*, 3 TvFR (2016); P. Rank, *Requiem voor het effectenbewaarbedrijf?*, 3 TvFR 70 (2016).

[116] § 1(1) Nr. 5 BWG.

[117] § 1(1) sub-para. 2 Nr. 5. KWG; BaFin, Merkblatt Depotgeschäft - Hinweise zum Tatbestand des Depotgeschäfts, 6 Januar 2009 (Stand: Februar 2014).

Liechtenstein[118] that classify the safekeeping and administration service as a 'stand-alone' banking activity. This implies that the safekeeping and administration of securities requires a banking license. These 'banks' are, thus, not authorized as credit institutions that are primarily authorized to conduct deposit-taking under CRD IV but might offer safekeeping and administration as an ancillary service.

The third group of Member States, including France[119], Ireland[120], Luxembourg[121] and the UK[122] regulates, besides credit institutions (and investment firms), a specific 'national investment firm' that is authorized to provide safekeeping and administration services. In this regard Member States can be organized in two sub-groups.

First, Ireland[123], Luxembourg[124] and the UK[125] regulate 'national investment firms' as an 'investment service/activity' under national law that is (partly) subject to the authorization, prudential and business organizational requirements under MiFID II. These 'national investment firms', however, fall outside of the scope of the European passport regime under MiFID II. In Ireland firms, outside the scope of MiFID or CRD IV, may be authorized[126] to hold client assets as a stand-alone regulatory activity.[127] The Investment Intermediaries Act 1995 was enacted upon implementing the ISD. The safekeeping and administration of financial instruments, amongst other ancillary services, were made a stand-alone investment service/activity under this act and continued to apply after MiFID I/II were adopted. Ireland applies the MiFID Client Asset Requirements to this type of intermediaries.[128]

---

[118] Art. 3(1) and (2)(c) BankG.

[119] Custody services are regulated by L. 211-3-211.12 of the French Monetary and Financial Code; See also Chapter II Title II of Book III and Title V of Book V of the AMF General Regulation. The latter establishes the conditions for authorizing and engaging in the business of custody account-keeping and central securities depositaries.

[120] Section 2(1) '*investment business firm*' and Section (2) '*investment business services*' (*h*) custodial operations involving the safekeeping and administration of investment instruments; Part IV and Part VII Investment Intermediaries Act 1995; See also Central Bank of Ireland, *Guidance Note on Completing and Submitting an Application for Authorisation Under Section 10 of the Investment Intermediaries Act,1995 (as amended) excluding Restricted Activity Investment Product Intermediaries*, January 2012.

[121] Art. 26 Law of 5 April 1993 on the financial sector on 'Professional depositaries of financial instruments'.

[122] The UK Financial Services and Markets Act 2000 (FSMA 2000) classifies the 'safeguarding and administering assets belonging to another which consist of or include investments' as a regulated activity. See Section 19, Schedule 2 Part I Clause (5)(1) FSMA 2000.The Financial Conduct Authority (FCA) has adopted rules on client assets (CASS).The FCA adopts these rules relying on Financial Services and Markets Act 2000, s138.

[123] Section 2(1) '*investment business firm*' and Section (2) '*investment business services*' (*h*) custodial operations involving the safekeeping and administration of investment instruments; Part IV and Part VII Investment Intermediaries Act 1995; See also Central Bank of Ireland, *Guidance Note on Completing and Submitting an Application for Authorisation Under Section 10 of the Investment Intermediaries Act,1995 (as amended) excluding Restricted Activity Investment Product Intermediaries*, January 2012.

[124] Art. 26 Law of 5 April 1993 on the financial sector on 'Professional depositaries of financial instruments'.

[125] The UK Financial Services and Markets Act 2000 (FSMA 2000) classifies the 'safeguarding and administering assets belonging to another which consist of or include investments' as a regulated activity. See Section 19, Schedule 2 Part I Clause (5)(1) FSMA 2000.The Financial Conduct Authority (FCA) has adopted rules on client assets (CASS).The FCA adopts these rules relying on Financial Services and Markets Act 2000, s138.

[126] See under Section 2 : '*investment business services*' including : (h) 'custodial operations involving the safekeeping and administration of investment instruments'; See for the authorisation process: Section 10 Investment Intermediaries Act, 1995.

[127] Section 52 of the Investment Intermediaries Act, 1995.

[128] Central Bank of Ireland, Guidance on Client Asset Regulation for Investment Firms, March 2015 https://www.centralbank.ie/press-area/press-releases/Documents/150330%20Guidance%20on%20Client%20Asset%20Regulations%20for%20Investment%20Firms.pdf.

Luxembourg also regulates professional custodians of financial instruments as a specialized professional of the financial sector (PFS)[129]. These custodians are professionals who engage in the receipt into custody of financial instruments exclusively from the professionals of the financial sector, such as asset managers and other financial institutions. They are entrusted with the safekeeping and administration thereof, including custodianship and related services, and with the task of facilitating their circulation.[130]

In the UK treat the safekeeping of assets as a 'stand-alone' service.[131] The mere safekeeping of assets requires authorization with prudential requirements, conduct of business rules and functions and responsibilities, which are based upon MiFID I/II.[132] Eligible custodians include approved banks, depositaries, members of recognized investment exchange, firms whose permitted activities include safeguarding and administering investments, regulated clearing firms, and any person outside the UK whose business includes the provision of custodial services, is able to provide such services which are appropriate to the client and in the client's best interest to use, that person.

Second, in France, for example, providing custody is an stand-alone regulatory activity to which a specific authorization procedure, including tailor-made conduct-of-business rules and prudential requirements apply. In France not only credit institutions and investment firms be authorized to provide custody services[133], but also state controlled financial institutions, such as the French Treasury and the Bank of France, issuers of publicly traded financial instruments, credit institutions, investment firms and custodians established in and outside France.[134] Credit institutions and investment firms may, however, be authorized as part of the authorization that it grants to these institutions and firms to provide one or more investment services.[135]

4.1.1. Licensing Requirements

The licensing requirements for all approaches taken by Member States in regulating their custodians show similarities as they are all (partly) based upon CRD IV and MiFID II.

The first group of Member States, including Italy[136] and Spain[137], merely comply with

---

[129] Professionals of the financial sector (PFS) are regulated companies that perform non-banking financial services. These are either offered as a single activity as well as in the form of connected and/or complementary services. Luxembourg has three main groups of PFS : investment firms, specialized PFS and support PFS. Only the first category is entitled to the European passport under MiFID.

[130] Art. 26 Law of 5 April 1993 on the financial sector.

[131] CASS 1.2.7. referring to regulated activity. The safeguarding and administration of assets is a regulated activity under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544).

[132] The Conduct of Business Sourcebook (COBS), for instance, applies to custodians. The COBS according to COBS 1.1.1. R. applies to 'designated investment business'. Following the FCA Glossary under f) safeguarding and administering investments is considered to be an designated investment business. Following, the same FCA Glossary 'designated investment business' captures mainly MiFID II regulatory activities/services.

[133] Custody services are regulated by Arts L. 211-3-211.12 of the French Monetary and Financial Code ; See also Chapter II Title II of Book III and Title V of Book V of the AMF General Regulation. The latter establishes the conditions for authorizing and engaging in the business of custody account-keeping and central securities depositaries.

[134] Art. L. 542-1 French Monetary and Financial Code allows, amongst others, the French Treasure, the Bank of France and credit institutions, investment firms and legal entities having their primary or solve purpose the custody or administration of financial instruments which are not established in France to be appointed as a custodian.

[135] L. 211-3-211.12 of the French Monetary and Financial Code ; See also Chapter II Title II of Book III and Title V of Book V of the AMF General Regulation. See also: AMF, *Securities custody account-keeping* http://www.amf-france.org/en_US/Acteurs-et-produits/Prestataires-financiers/Teneurs-de-comptes-conservateurs.html (accessed 5 August 2016).

[136] See for credit institutions: Art. 1(2)(f) Nr. 12 custodia e amministrazione di valori mobiliari Decreto Legislativo, 1 settembre 1993, n. 385, Testo unico delle leggi in materia bancaria e creditizia; See for investment

European legislation regulating custodians follow the 'standard European model'. Investment firms that are either credit institutions or investment firms are subject to the licensing requirements under MiFID II.[138] Credit institutions that are not authorized to conduct any investment services/activities under MiFID II are solely subject to the licensing requirements of CRD IV. Credit institutions are in most Member States be deposit-taking institutions authorized to provide custody as an ancillary service.

The second group of Member States classify the safekeeping and administration service as a banking entity under their national legislation. In Austria[139], Germany[140] and Liechtenstein[141] providing safekeeping and administration services is a regulatory activity in itself that falls, in case it is not provided as an (ancillary) service in connection with the deposit-taking business, outside of the scope of CRD IV (European passport), but is subjected to the same licensing requirements.

The third group of Member States, including France[142], Ireland[143], Luxembourg[144] and the UK[145] regulate, besides credit institutions (and investment firms), a specific 'national investment firm' that is authorized to provide safekeeping and administration services. Authorization requirements depend upon whether Member States regulate 'national investment firms' that are (partly) based upon MiFID II or the safekeeping and administration is a 'stand-alone' regulatory activity to which a specific authorization procedure applies. In Luxembourg PFS that are solely authorized to provide custody are authorized in analogy to the MiFID I/II licensing requirements. Similar, in the UK for safeguarding and Safeguarding and administering investments (Article 40 RO), a firm must apply to the FCA under Part IV of FSMA 2000 for permission to carry on one or more regulated activities. These licensing requirements are (partly) based upon MiFID II. In Ireland, however, a 'national investment firm' that is authorized for safekeeping and administration services are regulated based upon the former licensing requirements of the ISD.[146]

---

firms: Art. 1(6)(a) 'la custodia e amministrazione di strumenti finanziari e relativi servizi connessi', Sezione B - Servizi accessori (1) Affitto di cassette di sicurezza e amministrazione di strumenti finanziari per conto dei clienti, inclusi la custodia e i servizi connessi come la gestione di contante/garanzie collaterali, Decreto legislativo 24 febbraio 1998, n. 58: Testo unico delle disposizioni in materia di intermediazione finanziaria, ai sensi degli articoli 8 e 21 della legge 6 febbraio 1996, n. 520F.

[137] See for credit institutions: Anexo – Lista de actividades objecto de reconocimiento mutuo, Nr. 12. Custodia y administración de valores negociables, , Ley 10/2014, de 26 de junio, de ordenación, supervisión y solvencia de entidades de crédito. (BOE de 27 de junio) (Corrección de errores BOE de 28 de junio); Spain, however, limits safekeeping and administration services to by brokers and broker-dealers authorized as an investment firm. See for investment firms: Art. 64 Ley 24/1988, de 28 de julio, del Mercado de Valores.

[138] Chapter I Conditions and procedures for authorization MiFID II.

[139] § 1(1) Nr. 5 BWG.

[140] § 1(1) sub-para. 2 Nr. 5. KWG; BaFin, Merkblatt Depotgeschäft - Hinweise zum Tatbestand des Depotgeschäfts, 6 Januar 2009 (Stand: Februar 2014).

[141] Art. 3(1) and (2)(c) BankG.

[142] L. 211-3-211.12 of the French Monetary and Financial Code; See also Chapter II Title II of Book III and Title V of Book V of the AMF General Regulation. The latter establishes the conditions for authorizing and engaging in the business of custody account-keeping and central securities depositaries.

[143] Part IV and Part VII Investment Intermediaries Act 1995

[144] See for 'national custodians': Art. 26 Law of 5 April 1993 on the financial sector on 'Professional depositaries of financial instruments';See for investment firms: Annex II S. C Nr. 1 Law of 5 April 1993 on the financial sector.

[145] Section 19, Schedule 2 Part I Clause (5)(1) FSMA 2000.The Financial Conduct Authority (FCA) has adopted rules on client assets (CASS).The FCA adopts these rules relying on Financial Services and Markets Act 2000, s138.

[146] See Section 10(5) Investment Intermediaries Act. See also Guidance Note on Completing and Submitting an Application for Authorisation Under Section 10 of the Investment Intermediaries Act, 1995 (as amended) excluding Restricted Activity Investment Product Intermediaries, p. 4. Central Bank of Ireland, Application for

In France, custodians are subjected to an stand-alone regulatory activity to which a specific authorization procedure, including tailor-made conduct-of-business rules and prudential requirements apply. Other entities than credit institutions, investment firms or 'national investment firms' might be authorized as a custodian. Following L. 542-1 of the Financial and Monetary Code CSD's are subject to the specific rules and sanctions on CSD's. All other entities are subject, with regard to their financial instrument custody or administration activities, to the laws and regulations, the rules of supervision and the sanctions laid down for investment service providers by the Financial and monetary code. Foreign credit institutions, investment firms and legal entities must be subject in their State of origin to rules governing the custody or administration of financial instruments and supervision equivalent to those applied in France.[147]

Apart from France, the credit institutions, investment firms and 'national investment firms' regulated as a custodian under the laws of the Member States in the three groups are subjected to broadly the same licensing requirements as under the CRD IV and MiFID II.Credit institutions that obtained an authorization according CRD IV are subject to broadly the same licensing requirements as MiFID II. Some of the requirements to be found in both MiFID II and CRD IV to which custodians are subjected include:[148]

- fit & properness requirements for senior management;[149]
- minimum capital requirements;[150]
- a business plan;[151]
- an adequate risk organization;[152]
- an adequate and appropriate business organization;[153]
- reliable significant shareholders.[154]

Licensing requirements throughout the three groups of Member States regulating custodians are, thus, broadly the same.

4.1.2. Prudential Requirements

In most Member States there are no specific prudential requirements for credit institutions and investment firms that provide safekeeping and administration services. Instead, they are subjected to the capital requirements that apply generally to credit institutions and investment firms under CRD IV and MiFID II. The prudential requirements for credit institutions and investment firms, however, diverge from Member State to Member State.

Austria[155], Germany[156], Ireland[157] apply to credit institutions upon authorization an initial capital of EUR 5 million. The capital requirements for being authorized as an credit institution

---

Authorisation under Section 10 of the Investment Intermediaries Act, 1995, as amended' (the 'application form'), January 2012.

[147] L. 211-3-211.12 of the French Monetary and Financial Code; See also Chapter II Title II of Book III and Title V of Book V of the AMF General Regulation. The latter establishes the conditions for authorizing and engaging in the business of custody account-keeping and central securities depositaries.

[148] See D.A. Zetzsche., *The AIFMD and the Joint Principles of European Asset Management Law* (D.A. Zetzsche ed, Kluwer 2015), 749.

[149] Art. 9 MiFID II; Art. 91 CRD IV.

[150] Art. 15 MiFID II; Art. 12 CRD IV.

[151] Art. 7 MiFID II; Art. 8 CRD IV.

[152] Art. 16(2) MiFID II; Art. 74 CRD IV.

[153] Art. 16(3) MiFID II; Art. 74 CRD IV.

[154] Art. 10 MiFID II; Art. 14 CRD IV.

[155] § 5(1) Nr. 5 BWG.

[156] § 33 (1) Nr. 1 (d) BWG.

[157] Art. 9E S.I. No. 158 of 2014 - European Union (Capital Requirements) Regulations 2014.

varies in other Member States, such as EUR 6,3 million Euro in Italy[158], EUR 8,7 million in Luxembourg[159],CHF 10 million in Liechtenstein[160] and EUR 18 million in Spain[161].

In Member States where (national) investment firms are allowed to provide safekeeping and administration services the minimum own funds required by Ireland[162], Luxembourg[163] (EUR 125,000), Spain[164] and the UK[165] amount to EUR 125,000, whereas in Italy investment firms holding client assets must satisfy higher initial and on-going capital requirements (minimum EUR 1 million) compared to those applicable to investment firms that do not clients assets (minimum EUR 385,000).[166] In Luxembourg professional depositaries of financial instrument are subjected to a minimum capital of EUR 730,000 euros[167], whereas in France there is a specific capital requirement that applies to all custodians that amounts to EUR 3,8 million.[168] In most Member States there are, thus, no specific prudential requirements for credit institutions and (national) investment firms that provide safekeeping and administration services.

4.1.3. Business Organizational Requirements

Similar as for the licensing requirements, the business organizational requirements for all three approaches taken by Member States in regulating their custodians show common principles as they are all (partly) based upon CRD IV and MiFID II.

The first group of Member States, including Italy[169] and Spain[170], merely comply with European legislation regulating custodians follow the 'standard European model'. Depending upon whether credit institutions provide along the ancillary safekeeping and administration service investment services/activities, credit institutions either have to abide to the business organizational requirements of CRD IV or MiFID II. Non-bank investment firms have to

---

[158] Credit institutions must have an minimum capital of 6.3 million or for cooperative credit institutions EUR 2 million. Banca d'Italia, Circolare n. 229 del 21 aprile 1999, Istruzioni di Vigilanza per le banche, Titolo 1, Capitolo 1, Sezione 1.

[159] Art. 8(1) Law of 5 April 1993 on the financial sector.

[160] 20 Million CHF. On an ongoing basis the minimum capital may not be lower than 10 million CHF or the equivalent avlue in Euro or US-dollar. See Art. 24(1) BankG.

[161] Art. 2(1)(b) Real Decreto 256/2013, de 12 de abril, por el que se incorporan a la normativa de las entidades de crédito los criterios de la Autoridad Bancaria Europea de 22 de noviembre de 2012, sobre la evaluación de la adecuación de los miembros del órgano de administración y de los titulares de funciones clave.

[162] Art. 27 S.I. No. 158 of 2014 - European Union (Capital Requirements) Regulations 2014.

[163] Art. 20 Law of 5 April 1993 on the financial sector.

[164] Art. 15 Real Decreto 217/2008, de 15 de febrero, sobre el régimen jurídico de las empresas de servicios de inversión y de las demás entidades que prestan servicios de inversión y por el que se modifica parcialmente el Reglamento de la Ley 35/2003, de 4 de noviembre, de Instituciones de Inversión Colectiva, aprobado por el Real Decreto 1309/2005, de 4 de noviembre.

[165] IFPRU 1.1.9 R.

[166] Art. 7-bis Decreto legislativo 24 febbraio 1998, n. 58: Testo unico delle disposizioni in materia di intermediazione finanziaria, ai sensi degli articoli 8 e 21 della legge 6 febbraio 1996, n. 520F

[167] Art. 26 Law of 5 April 1993 on the financial sector.

[168] Regulation CRBF n° 96-15.

[169] See for credit institutions: Art. 1(2)(f) Nr. 12 custodia e amministrazione di valori mobiliari Decreto Legislativo, 1 settembre 1993, n. 385, Testo unico delle leggi in materia bancaria e creditizia; See for investment firms: Art. 1(6)(a) 'la custodia e amministrazione di strumenti finanziari e relativi servizi connessi', Sezione B - Servizi accessori (1) Affitto di cassette di sicurezza e amministrazione di strumenti finanziari per conto dei clienti, inclusi la custodia e i servizi connessi come la gestione di contante/garanzie collaterali, Decreto legislativo 24 febbraio 1998, n. 58: Testo unico delle disposizioni in materia di intermediazione finanziaria, ai sensi degli articoli 8 e 21 della legge 6 febbraio 1996, n. 520F.

[170] See Anexo – Lista de actividades objecto de reconocimiento mutuo, Nr. 12. Custodia y administración de valores negociables, , Ley 10/2014, de 26 de junio, de ordenación, supervisión y solvencia de entidades de crédito. (BOE de 27 de junio) (Corrección de errores BOE de 28 de junio).

comply in any case with the business organizational rules of MiFID II. Credit institutions that are not authorized to conduct any investment services/activities under MiFID II are solely subject to the licensing requirements of CRD IV. Member States, such as Austria[171] and Liechtenstein[172], that provide custody as a regulatory banking activity in itself apply these CRD IV business organizational rules as well.

CRD IV and MiFID II contain similar rules on the business organizational rules that include, *inter alia:*[173]

- the commitment to fairness, honesty and acting in the investor's best interest;[174]
- conflict of interests rules;[175]
- rules on the intermediary's remuneration;[176]
- the prohibition of letter-box entities.[177]

The third group of Member States, including Ireland[178], Luxembourg[179] and the UK[180] regulate, besides credit institutions (and investment firms), a specific 'national investment firm' that is authorized to provide safekeeping and administration services and complies with the MiFID II business organizational rules. Ireland applies to its 'national custodians' the business organizational rules that were introduced upon the ISD. The UK applies the COBS to its custodians. The MiFID II business organizational rules are proportionally applicable to custodians. De facto, the general rules apply with the exclusion of requirements related to, inter alia, appropriateness and suitability.[181] Ireland and the UK apply also the MiFID II (Commission) Directive to their 'national custodians'.[182] On top of that, Ireland and the UK apply additional rules applying to client assets, including, amongst others, rules concerning collateral[183], custody[184] and client money.[185] These additional rules partly apply to both

[171] § 1(1) Nr. 5 BWG.
[172] Art. 3(1) and (2)(c) BankG.
[173] D.A. Zetzsche., *The AIFMD and the Joint Principles of European Asset Management Law* (D.A. Zetzsche ed, Kluwer 2015), 749.
[174] Recital 86, Art. 24(1) MiFID II; Art. 91(8) CRD IV.
[175] Art. 16(3) MiFID II; Art. 88 CRD IV.
[176] Art. 9(3)(c) MiFID II; Art. 92 CRD IV.
[177] Art. 16(5) MiFID II;
[178] Part IV and Part VII Investment Intermediaries Act 1995.
[179] See for 'national custodians': Art. 26 Law of 5 April 1993 on the financial sector on 'Professional depositaries of financial instruments';See for investment firms: Annex II S. C Nr. 1 Law of 5 April 1993 on the financial sector.
[180] Section 19, Schedule 2 Part I Clause (5)(1) FSMA 2000.The Financial Conduct Authority (FCA) has adopted rules on client assets (CASS).The FCA adopts these rules relying on Financial Services and Markets Act 2000, s138.
[181] See Art. 25 MiFID II.
[182] Ireland: Central Bank, application for authorisation under Section 10 of the Investment Intermediaries Act, 1995 (as amended) Excluding Restricted Activity Investment Product Intermediaries, Section 7 – Organisational structure, January 2012; Central Bank of Ireland, Guidance on Client Asset Regulation for Investment Firms, March 2015 https://www.centralbank.ie/press-area/pressreleases/Documents/150330%20Guidance%20on%20Client%20Asset%20Regulations%20for%20Investment%20Firms.pdf; UK: See CASS 6.1.1.
[183] Ireland: Central Bank of Ireland, Guidance on Client Asset Regulation for Investment Firms, March 2015 https://www.centralbank.ie/press-area/pressreleases/Documents/150330%20Guidance%20on%20Client%20Asset%20Regulations%20for%20Investment%20Firms.pdf; UK: CASS 3.
[184] Ireland: Central Bank of Ireland, Guidance on Client Asset Regulation for Investment Firms, March 2015 https://www.centralbank.ie/press-area/pressreleases/Documents/150330%20Guidance%20on%20Client%20Asset%20Regulations%20for%20Investment%20Firms.pdf; UK: CASS 6.

'MiFID II and 'non-MiFID II business', whereas for certain requirements such as client money they differ.[186]

Luxembourg does not impose the MiFID II (Commission) Directive to 'national investment business firms', all other business organizational rules under MiFID II are, however, required for these custodians.[187]

France other entities than merely credit institutions and investment firms may be authorized to provide custody services. Most of these other entities are, except for CSD's and foreign entities, subject to the rules and sanctions as laid down for investment service providers (MiFID II). However, in addition to that all custody account-keepers are subject to additional business organizational rules with regard to human resources, information systems, accounting procedures, customer service and investor protection and internal control.[188]

Similar as for licensing requirements, the business organizational requirements applying to national custodians are (partly) based upon the CRD IV and MiFID II.

4.2. Self- Custody versus Third-Party Custody

MiFID II and CRD IV do not explicitly require that client' assets are to be held with a third-party custodian. MiFID II only requires investment firms to safeguard client instruments and funds, whereas CRD IV does not regulate anything similar in this regard.[189]

Under MiFID II and CRD IV, financial instruments can, thus, either be held (1) by the investment firm itself holding financial instruments for a client for which it provides investment services/activities (self-custody), or (2) by a custodian ('third-party custodian'), which is appointed by the investment firm or client.[190] Under self-custody, an investment firm under MiFID provides the safekeeping of financial instruments 'in house' for his clients. Investment firm providing self-custody are required to apply asset segregation for the purpose of safeguarding client instruments and funds.[191] The assets held on behalf of clients are, however, not legally separated from the legal entity in which the investment firm that carries out investment services/activities is organized. MiFID II, thus, only provides for a 'virtual investment triangle').[192] This contrasts the situation in which a third-party custodian is being appointed ('full investment triangle').

CRD IV and MiFID II allow credit institutions and investment firms to provide self-custody.[193] Member States do not prohibit credit institutions from providing the safekeeping

---

[185] Ireland: Central Bank of Ireland, Guidance on Client Asset Regulation for Investment Firms, March 2015 https://www.centralbank.ie/press-area/pressreleases/Documents/150330%20Guidance%20on%20Client%20Asset%20Regulations%20for%20Investment%20Firms.pdf; UK: CASS 7.

[186] Ireland: Central Bank of Ireland, Guidance on Client Asset Regulation for Investment Firms, March 2015 https://www.centralbank.ie/press-area/pressreleases/Documents/150330%20Guidance%20on%20Client%20Asset%20Regulations%20for%20Investment%20Firms.pdf; UK: CASS 7.

[187] Art. 36, 36-1 Law of 5 April 1993 on the financial sector.

[188] AMF Regulation, Chapter II – custody account – keepers, paragraph 3 – resources and procedures

[189] See *infra* 5.

[190] S. Fuchs, *der Portfolio-Manager in der Global-Custody-Beziehung – Partner oder Störenfried*, (Haupt Verlag 2004).

[191] Art. 13(2) MiFID II; See Y.O.M. van Vugt & A.A. van Angeren, *Vermogensscheiding: aandachtspunten bij de bescherming van rechten van cliënten*, 6 TvCo 172-176 (2007).

[192] *Ibid.*

[193] Austria: § 1(1) Nr. 5 BWG; Liechtenstein: Art. 3(1) and (2)(c) BankG; France: France: L. 211-3-211.12 of the French Monetary and Financial Code; See also Chapter II Title II of Book III and Title V of Book V of the AMF General Regulation. The latter establishes the conditions for authorizing and engaging in the business of custody account-keeping and central securities depositaries; Germany: § 1(1) sub-para. 2 Nr. 5. KWG; BaFin, Merkblatt Depotgeschäft - Hinweise zum Tatbestand des Depotgeschäfts, 6 Januar 2009 (Stand: Februar 2014);

and administration of securities amongst providing other services and activities under CRD IV and MiFID II. Various Member States, however limit non-bank investment firms to provide self-custody. Austria[194], Germany[195], and Liechtenstein[196], Netherlands[197] require a full investment triangle for non-bank investment firms. In these Member States, providing the safekeeping and administration of financial instruments for the account of clients amongst other investment services/activities is prohibited, unless the investment firm obtains an authorization as an credit institution.

Spain limits its requirement for a full investment triangle to certain non-bank investment firms. Providing the safekeeping and administration of financial instruments for the account of clients amongst other investment services/activities is exclusively reserved to broker-dealers, brokers and authorized credit institutions. Investment firms acting as portfolio manager are prohibited to conduct self-custody.[198]

Ireland, France, Italy, Luxembourg and the UK allow both investment firms and credit

---

Ireland: See for investment firms: S.I. No. 60 of 2007, European Communities (Markets in Financial Instruments) Regulations 2007, Schedule 1, Part 2, Nr. 1; See for credit institutions: S.I. No. 158 of 2014, European Union (Capital Requirements) Regulations 2014, Schedule - List of activities subject to mutual recognition, Nr. 12; See for national custodians: Central Bank of Ireland, Guidance on Client Asset Regulation for Investment Firms, March 2015 https://www.centralbank.ie/press area/pressreleases/Documents/150330%20Guidance%20on%20Client%20Asset%20Regulations%20for%20Investment%20Firms.pdf; Section 2(1) '*investment business firm*' and Section (2) '*investment business services*' (*h*) custodial operations involving the safekeeping and administration of investment instruments; Part IV and Part VII Investment Intermediaries Act 1995; See also Central Bank of Ireland, *Guidance Note on Completing and Submitting an Application for Authorisation Under Section 10 of the Investment Intermediaries Act,1995 (as amended) excluding Restricted Activity Investment Product Intermediaries*, January 2012; Italy: See for credit institutions: Art. 1(2)(f) Nr. 12 custodia e amministrazione di valori mobiliari Decreto Legislativo, 1 settembre 1993, n. 385, Testo unico delle leggi in materia bancaria e creditizia; See for investment firms: Art. 1(6)(a) 'la custodia e amministrazione di strumenti finanziari e relativi servizi connessi', Sezione B - Servizi accessori (1) Affitto di cassette di sicurezza e amministrazione di strumenti finanziari per conto dei clienti, inclusi la custodia e i servizi connessi come la gestione di contante/garanzie collaterali, Decreto legislativo 24 febbraio 1998, n. 58: Testo unico delle disposizioni in materia di intermediazione finanziaria, ai sensi degli articoli 8 e 21 della legge 6 febbraio 1996, n. 520F; Luxembourg: See for 'national custodians': Art. 26 Law of 5 April 1993 on the financial sector on 'Professional depositaries of financial instruments'; See for credit institutions Annex I Nr. 12 Law of 5 April 1993 on the financial sector; See for investment firms: Annex II S. C Nr. 1 Law of 5 April 1993 on the financial sector; Netherlands: See Art. 4:87 Wet op het financieel toezicht; § 6.5 Regels met betrekking tot de bescherming van de rechten, financiële instrumenten of gelden van de cliënt (Arts 7:14-7:20) Nadere regeling gedragstoezicht financiële ondernemingen Wft; Spain: for credit institutions : Anexo – Lista de actividades objecto de reconocimiento mutuo, Nr. 12. Custodia y administración de valores negociables, , Ley 10/2014, de 26 de junio, de ordenación, supervisión y solvencia de entidades de crédito. (BOE de 27 de junio) (Corrección de errores BOE de 28 de junio); See for investment firms: See Art. 64 Ley 24/1988, de 28 de julio, del Mercado de Valores; UK: The UK Financial Services and Markets Act 2000 (FSMA 2000) classifies the 'safeguarding and administering assets belonging to another which consist of or include investments' as a regulated activity. See Section 19, Schedule 2 Part I Clause (5)(1) FSMA 2000.The Financial Conduct Authority (FCA) has adopted rules on client assets (CASS).The FCA adopts these rules relying on Financial Services and Markets Act 2000, s138.

[194] § 1(1) Nr. 5 BWG.

[195] § 1(1) sub-para. 2 Nr. 5. KWG; BaFin, Merkblatt Depotgeschäft - Hinweise zum Tatbestand des Depotgeschäfts, 6 Januar 2009 (Stand: Februar 2014).

[196] Art. 3(1) and (2)(c) BankG.

[197] See Art. 4:87 Wet op het financieel toezicht; § 6.5 Regels met betrekking tot de bescherming van de rechten, financiële instrumenten of gelden van de cliënt (Arts 7:14-7:20) Nadere regeling gedragstoezicht financiële ondernemingen Wft.

[198] In Spain four types of regulated investment firms (1) Sociedades de valores (Broker-dealers), (2) Agencias de valores (Brokers), (3) Sociedades gestoras de carteras (portfolio management companies) and (iv) Empresas de asesoramiento financiaro (Financial advisors firms). See Art. 64 Ley 24/1988, de 28 de julio, del Mercado de Valores.

institutions to perform self-custody.[199]

Whether self-custody is allowed or not, thus, depends on the CRD IV and MiFID II implementation laws of the individual Member States. Member States that restrict the provision of safekeeping and administration services to credit institutions and certain types of investment firms have, however, to allow investment firms from other Member States and TC to use the MiFID II passport to provide them within their domicile as an ancillary service along 'core' investment services/activities.[200]

4.3. Conclusion

Entities that provide safekeeping and administration services but no 'investment services and activities' under MiFID II[201] or 'deposit taking and lending' under CRD IV are not subject to MiFID II and CRD IV. The regulation applicable to such an 'custodian' therefore depends on the regulatory regime in the jurisdiction where it provides such services.[202] These 'national custodians'[203] in most Member States have to be authorized according to national legislation that is largely based upon CRD IV/MiFID II. National custodians that are not authorized under CRD IV or MiFID II do not benefit from the advantage of having an European passport and might, thus, be restricted in providing safekeeping and administrative services on a cross-border basis.

5. The MiFID II Client Asset Requirements

MiFID II requires general and specific organizational requirements to ensure the safeguarding of client assets. These specific organizational requirements related to the safeguarding of client assets applies to (non-bank) investment firms. For credit institutions these requirements are only applicable to the extent that they provide investment services/activities and, therefore, fall within the scope of MiFID II.

Considering the regulation to which CSDs are subjected to for providing their core services under the CSDR, CSDs are not required to comply with MiFID II for the provision of the non-banking ancillary service to maintain 'lower tier' securities accounts.[204]

These requirements do also not apply to custodians regulated under national law. As the regulation of these 'national custodians' is largely based upon the CRD IV/MiFID II, various

[199] Ireland: Part IV and Part VII Investment Intermediaries Act 1995; France: L. 211-3-211.12 of the French Monetary and Financial Code; See also Chapter II Title II of Book III and Title V of Book V of the AMF General Regulation. The latter establishes the conditions for authorizing and engaging in the business of custody account-keeping and central securities depositaries; Italy: See for investment firms: Art. 1(6)(a) 'la custodia e amministrazione di strumenti finanziari e relativi servizi connessi', Sezione B - Servizi accessori (1) Affitto di cassette di sicurezza e amministrazione di strumenti finanziari per conto dei clienti, inclusi la custodia e i servizi connessi come la gestione di contante/garanzie collaterali, Decreto legislativo 24 febbraio 1998, n. 58: Testo unico delle disposizioni in materia di intermediazione finanziaria, ai sensi degli articoli 8 e 21 della legge 6 febbraio 1996, n. 520F; Luxembourg: See for 'national custodians': Art. 26 Law of 5 April 1993 on the financial sector on 'Professional depositaries of financial instruments';See for investment firms: Annex II S. C Nr. 1 Law of 5 April 1993 on the financial sector; UK: Section 19, Schedule 2 Part I Clause (5)(1) FSMA 2000.The Financial Conduct Authority (FCA) has adopted rules on client assets (CASS).The FCA adopts these rules relying on Financial Services and Markets Act 2000, s138.

[200] Chapter III Rights of investment firms MiFID II.

[201] Annex I s. A MiFID I/II.

[202] H. Motani, *The proposed EU legislation on securities holding*, 69. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013).

[203] LCG 2008, 25.

[204] **Proposal for a Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC** /* COM/2012/073 final - 2012/0029 (COD) */, 7.

Member States, such as Ireland[205], have decided to apply these requirements an unilateral basis to their 'national custodians'.

5.1. General and Specific Organizational Requirements

Before authorization an investment firm must comply with many organizational requirements that MiFID II imposes on investment firms. Specific general and specific organizational requirements apply.

The basis provision covering general organizational requirements is Article 13(2) MiFID II. This provision requires firm to establish adequate policies and procedures sufficient to ensure compliance of the firm, including its managers, employees and tied agents and appropriate rules governing personal transactions by such persons. In addition, specific organizational features are required regarding risk management and internal audit, outsourcing, conflicts of interests and the safeguarding of client assets. These procedures aim to avoid operational risks, conflict of interest and adequate protection of clients assets.[206]

5.2. Safeguarding of Client Financial Instruments and Funds

MiFID II lays down specific organizational requirements to investment firms that concern the safeguarding of client' assets that are elaborated in detail in the MiFID II (Commission) Directive with regard to the safeguarding of financial instruments and funds belonging to clients. Organizational requirements imposed by MiFID II relate to the safeguarding of client financial instruments[207] and funds[208], the use of client financial instruments[209], the inappropriate use of TTCA[210] and reports by external auditors[211].

Article 16(2) MiFID II requires investment firms to establish adequate policies and procedures to ensure compliance of the investment firm with the governance arrangements concerning the safeguarding of client assets.[212]

The protection of investor's ownership and other similar rights in respect of securities and the investor's rights in respect of funds entrusted to an investment firm are an important part of the MiFID II investor protection regime.[213] For this purpose, an investment firm shall, when holding financial instruments and funds belonging to clients have in place adequate arrangements to safeguard investor's ownership and rights with respect to the securities and funds entrusted to an investment firm.[214] In particular, those rights should be kept distinct from those of the investment firm.[215] Investments firms, when holding financial instruments belonging to clients, are required to make adequate arrangements to safeguard the ownership rights[216] of clients in the event of the investment firm's insolvency and to prevent the use of a

[205] Central Bank of Ireland, Guidance on Client Asset Regulation for Investment Firms, March 2015 https://www.centralbank.ie/press area/pressreleases/Documents/150330%20Guidance%20on%20Client%20Asset%20Regulations%20for%20Investment%20Firms.pdf
[206] See Art. 16(2)-(10) MiFID II.
[207] Art. 16(8) MiFID II; Art. 2 and 3 MiFID II (Commission) Directive.
[208] Art. 16(9) MiFID II; Art. 2 and 4 MiFID II (Commission) Directive.
[209] Art. 16(8) and (9) MiFID II; Art. 5 MiFID II (Commission) Directive.
[210] Art. 16(10) MiFID II; Art. 6 MiFID II (Commission) Directive.
[211] Art. 16(8), (9) and (10) MiFID II; Art. 5 MiFID II (Commission) Directive.
[212] Art. 16(2) MiFID II; Art. 7 and 8 MiFID II (Commission) Directive.
[213] Recital 51 MiFID II; Recital 1 and 2 MiFID II (Commission) Directive.
[214] Recital 2 MiFID II (Commission) Directive.
[215] Recital 51 MiFID II.
[216] Art. 1(2), (3) and (4) MiFID II determines that this provision is applicable to both investment firms and credit institutions.

client's instruments on own account except with the client's express consent (re-hypothecation).[217] Similarly, investment firms, when holding funds belonging to clients are required to make adequate arrangements to safeguard clients' rights.[218] Investment firms, except in the case of credit institutions, are additionally required to prevent the use of client funds for its own account.[219] The safeguarding of client financial instruments and funds, however, do not prevent investment firms from doing business in its name but on behalf of the investor, where that is required by the nature of the transaction and the investor is in agreement, for example securities lending.[220]

5.2.1. General Regime

Article 2 MiFID II (Commission) Directive requires investment firm for the purpose of safeguarding client financial instruments and funds to:

- keep records and accounts as are necessary to enable them at any time and without delay to distinguish assets held for one client from assets held for any other client, and from their own assets (asset segregation);[221]
- maintain records and accounts in a way that ensures their accuracy and, in particular, their correspondence to the financial instruments and funds held for clients and that may be used as an audit trail;[222]
- introduce adequate organizational arrangements to minimize the risk of the loss or diminution of client assets, or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.[223]

Investment firms that deposit client financial instruments and funds must:

- conduct reconciliations, on a regular basis, between their internal accounts, records and those of any third parties by whom those assets are held;[224]
- take the necessary steps to ensure that client instruments deposited with a third party are identifiable separately from the financial instruments belonging to the investment firm and from financial instruments belonging to that third party, by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection;[225]
- take the necessary steps to ensure that client funds (client money) are deposited in a central

---

[217] Art. 16(8) MiFID II/Art. 13 (7) MiFID I; In the case of Art. 13 MiFID I, CESR (now ESMA) had been designed as the relevant specialist group and, accordingly, advised that Art. 13 MiFID I should require a custodian to separate its own assets from those of its clients. See K.M. Löber, *The Developing EU Legal Framework for Clearing and Settlement of Financial Instruments*, European Central Bank – Legal Working Paper Series, No. 1 (February 2006), 27.
[218] Art. 16(10) MiFID II.
[219] Art. 16(10) MiFID II.
[220] Recital 51 MiFID II.
[221] Art. 2(1)(a) MiFID II (Commission) Directive/Art. 16(1)(a) MiFID I (Commission) Directive.
[222] Art. 2(1)(b) MiFID II (Commission) Directive/Art. 16(1)(b) MiFID I (Commission) Directive; See also Principle 1, IOSCO 1996.
[223] Art. 2(1)(f) MiFID II (Commission) Directive/Art.16(1)(f) MiFID I (Commission) Directive.
[224] Art. 2(1)(c) MiFID II (Commission) Directive/Art.16(1)(c) MiFID I (Commission) Directive.
[225] Art. 2(1)(d) MiFID II (Commission) Directive/Art.16(1)(d) MiFID I (Commission) Directive; Art. 3 MiFID II (Commission) Directive, discussed below, lay down the specific steps to be taken for depositing client financial instruments.[225]

bank, a credit institution or a bank authorized in a third country or a qualifying money market fund[226] that are held in an account or accounts identified separately from any account used to hold funds belonging to the investment firm.[227]

5.2.2. Equivalent Measures achieving the same Level of Protection

Member States are required to put in place arrangements to ensure that client' assets are safeguarded to meet the objectives of the safeguarding of client financial instruments and funds. MiFID II recognizes that there can be situations where applicable national law[228], in particular the law relating to property or insolvency, may prevent investment firms from complying with the requirements related to the depositing of client financial instruments and funds.[229] In such cases, Member States shall require investment firms to put in place arrangements to ensure that the objectives of safeguarding client assets of Article 2(1) MiFID II (Commission) Directive are being met.[230] If national law prevents investment firms from complying with the requirements related to the depositing of client financial instruments and funds, Member States shall require equivalent requirement in terms of safeguarding clients' rights.[231]

When relying on such equivalent requirements, Member States have to ensure that investment firms inform clients that they do not benefit from provisions related to the depositing of client financial instruments and funds under MiFID II.[232]

If the applicable law[233] prevent investment firms from complying[234] with the requirements related to the depositing of client financial instruments and funds, Member States shall prescribe requirements that have an equivalent effect on the safeguarding of clients' rights.[235] Investment firms have to inform clients in the circumstance that they rely on equivalent requirements and not on the MiFID II regime related to the depositing of client financial instruments and funds.[236]

5.2.3. Inappropriate Custody Liens over Clients Assets

MiFID II explicitly prohibits investment firms to grant security interests, liens or rights of set-off over financial instruments or funds that allows third parties to dispose these in order to recover debts that do not relate to the clients or the provision of services to the client.[237]

MiFID II has introduced this general prohibition as liens of a general and wide-ranging

[226] See for a definition of 'qualifying money market fund': Art. 1(4) MiFID II (Commission) Directive/Art. 18(2) MiFID I (Commission) Directive.
[227] Art. 2(1)(e) MiFID II (Commission) Directive/Art.16(1) MiFID I (Commission) Directive; Art. 4 MiFID II (Commission) Directive, discussed below, lay down the specific steps to be taken for depositing client funds.
[228] The applicable law, for instance, related to property or insolvency, may prevent investment firms established in a particular Member State to comply with any of the requirements discussed in this paragraph. See Art. 2(2) MiFID II (Commission) Directive.
[229] Art. 2(2) MiFID II (Commission) Directive/Art. 16(2) MiFID I (Commission) Directive; ESMA/2014/549, 61.
[230] Art. 2(2) MiFID II (Commission) Directive.
[231] Art. 2(3) sub-para. 1 MiFID II (Commission) Directive.
[232] Art. 2(3) sub-para. 2 MiFID II (Commission) Directive.
[233] The applicable law, for instance, related to property or insolvency, may prevent investment firms established in a particular Member State to comply with any of the requirements discussed in this paragraph. See Article 2(2) MiFID II (Commission) Directive.
[234] Article 2(2) MiFID II (Commission) Directive/Art. 16(2) MiFID I (Commission) Directive; ESMA/2014/549, 61.
[235] Art. 2(3) sub-para. 1 MiFID II (Commission) Directive.
[236] Art. 2(3) sub-para. 2 MiFID II (Commission) Directive.
[237] Art. 2(4) sub-para. 1 MiFID II (Commission) Directive; ESMA/2014/1570, 60, 66.

nature were allowed under MiFID I[238.] Examples of liens were identified after the 2008 Lehman insolvency in which investment firms granted third parties the right to dispose of the (client') financial instruments in the event of a default insolvency of the investment firm itself or any of its affiliated group entities to satisfy the investment firm's obligations towards that party.239 A general prohibition of these type of transactions is embedded in MiFID II as clients are not party to these type of agreements and the risks they face are, thus, not obvious for them until an insolvency of an investment firm occurs.[240]

The holding of client assets in some third country jurisdictions, however, may require general and wide-ranging liens to be granted.[241] For this purpose, MiFID II exempts investment firms of this general prohibition when 'cliens' of this nature are required by the applicable law in a third country jurisdiction in which the client funds or financial instruments are held.[242] Investment firms in such an occasion are exempted from the provision provided that the investment firm has disclosed this information to his clients indicating to them the risks associated with those arrangements.[243]

Liens, security interests or other encumbrances over client funds/financial instruments that are in accordance with these requirements are valid.[244] Such security interests, where granted by an investment firm or where the firm has been informed that they are granted, should be kept in the firm's own record so that the ownership status of client assets are clear upon an insolvency of the firm.[245]

5.2.4. Information and record-keeping

Investment firms are required under MiFID II to hold basic information and information under record-keeping requirements related to the safeguarding of client assets that can be easily accessed by insolvency practitioners, competent authorities and those responsible for the resolution of failed institutions.[246] This requirement resulted from relevant parties having difficulties in timely accessing information to return these to clients to take appropriate action, for example, to request freezing orders or the immediate return of funds.[247]

Making information easily available to insolvency practitioners and relevant authorities by holding information under record-keeping requirements related to the safeguarding of client assets reduce this risk and help to increase the speed of return of client' asset after insolvency.[248] Investment firms are required to make the following information readily available:

- related internal accounts and records that readily identify the balances of funds and instruments held for each client (reconciliations, client ledgers, cash books etc.);[249]
- details of the third-party accounts where client financial instruments/funds are held and the

---

[238] An investment firm was permitted to conclude such liens under Art. 13(7) and (8) MiFID I and Art. 19, 32(6), (7) MiFID I(Commission) Directive.
[239] ESMA/2014/1570, 60.
[240] ESMA/2014/1570, 60.
[241] ESMA/2014/1570, 60.
[242] Recital 14, Article 2(4) sub-para. 1 MiFID II (Commission) Directive.
[243] Art. 2(4) sub-para. 2 MiFID II (Commission) Directive ; ESMA/2014/1570, 48, 60; See also Principle 3, IOSCO 1996.
[244] Recital 14 MiFID II (Commission) Directive; ESMA/2014/1570, 60, 61.
[245] Art. 2(4) sub-para. 3 MiFID II (Commission) Directive; ESMA/2014/1570, 60, 61, 66, 67.
[246] ESMA/2014/549, 62; ESMA /2014/1569, 74; C.A. Rooke, *MiFID en custodians: let op extra informatieverplichtingen!,* 1/2 TvFR 43-46 (2008).
[247] ESMA/2014/549, 62.
[248] ESMA/2014/549, 60.
[249] Art. 2(5)(a) MiFID II (Commission) Directive.

relevant agreements with those entities;[250]

- details of third parties carrying out any related outsourced tasks and the details of those tasks;[251]
- the key employees of the investment firm that are responsible for related processes, including those responsible for compliance with the requirements related to the safeguarding of client assets;[252] and
- agreements relevant to establish client ownership over assets.[253]

5.3. Depositing Client Financial Instruments

MiFID II allows investment firms to deposit financial instruments held by them on behalf of their clients into an account or accounts opened with a sub-custodian. Depositing client financial instruments is only allowed if such an investment firm performs ex ante and ongoing due diligence upon appointing a sub-custodian. This obligation recognizes the fact that depositing client financial instruments to a sub-custodian reduces the protection of clients' financial instruments.[254] To ensure that financial instruments are subject to due care and protection at all times, an investment firm has to exercise all due skill, care and diligence in the selection, appointment and periodic review of any sub-custodian they deposit clients' financial instruments with, as well as in the choice of the arrangements for the holding and safekeeping of those instruments.[255]

Investment firms also have to take into account the expertise and market reputation of the third party custodian, as well as, legal requirements or market practices related to the holding of those financial instruments that could adversely affect clients' rights.[256] This is intended to protect the client by requiring the firm to use a as a custodian a firm which is subject to specific regulation and supervision of safekeeping of financial instruments for the account of other persons.[257]

Investment firms that deposit client' financial instruments with a sub-custodian in a third country that does not regulate and supervise the holding and safekeeping of financial instruments for the account of another person is only allowed if:[258]

- the nature of the financial instruments or of the investment services connected with these instruments requires them to be deposited with a safe-keep in that particular country;[259] or
- a professional client requests in writing to deposit financial instruments with a sub-custodian in such a third country.[260]

The ex-ante and ongoing due diligence requirements set out by Article 3 MiFID II (Commission) Directive also apply if a sub-custodian has sub-delegated any of its functions concerning the holding and safekeeping of financial instruments.

Article 3 MiFID II (Commission) Directive only applies to investment firms that provide

---

[250] Art. 2(5)(b) and (c) MiFID II (Commission) Directive.
[251] Art. 2(5)(d) MiFID II (Commission) Directive.
[252] Art. 2(5)(e) MiFID II (Commission) Directive.
[253] Art. 2(5)(f) and (c) MiFID II (Commission) Directive.
[254] IOSCO 1996, 20.
[255] Recital 11, Art. 3(1) sub-para. 1 MiFID II (Commission) Directive; Art. 17(1) sub-para. 1 MiFID I (Commission) Directive.
[256] Recital 11, Art. 3(1) sub-para. 2 MiFID II (Commission) Directive; Art. 17(1) sub-para. 2 MiFID I (Commission) Directive.
[257] Art. 3(2) MiFID II (Commission) Directive; Art. 17(2) MiFID I(Commission) Directive.
[258] Art. 3(3) MiFID II (Commission) Directive; Art. 17(3) MiFID I(Commission) Directive
[259] Art. 3(3)(a) MiFID II (Commission) Directive; Art. 17(3)(a) MiFID I(Commission) Directive
[260] Art. 3(3)(b) MiFID II (Commission) Directive; Art. 17(3)(b) MiFID I(Commission) Directive.

the ancillary service of safekeeping and administration of financial instruments for the account of clients. This is clear from Article 3(1) sub-paragraph 1 MiFID II (Commission) Directive that applies to investment firms that deposit 'financial instruments held by them'. Investment firms that only perform investment services and activities for a particular client, such as portfolio management[261], but do not provide the specific ancillary service of safekeeping and administration of financial instruments for the account of that particular client are not subjected to the due diligence requirements set out in Article 3 MiFID II (Commission) Directive. No due diligence obligation, thus, applies to such investment firms for financial instruments held by third-party custodians[262] or, if allowed by the specific laws of the individual Member States, in self-custody.

5.4. Depositing Client Funds

Investment firms, when holding funds belonging to clients are required to make adequate arrangements to safeguard clients' rights.[263]

5.4.1. Eligible Entities for Depositing Client Funds

Investment firms are required, on receiving any client funds[264], to promptly place those funds into one or more accounts opened with:[265]

- a central bank;
- a credit institution within the meaning of CRD IV;
- a bank authorized in a third country; and
- a qualifying money market fund.[266]

Credit institutions are exempted from this requirement in relation to deposits within the meaning of CRD IV. The rationale behind this is that deposits received by credit institutions are protected by the regulatory requirements laid down in the CRD IV, the DGSD and other European (banking) regulations that are directly and indirectly protecting deposits. Credit institutions receiving client funds in the course of providing investment services are exempt from mandatory placing funds into one or more accounts opened with any of the abovementioned entities when providing investment services to the extent that client funds

[261] See Annex I, s.A, Nr. 4 MiFID II.
[262] Third-party custodians may, however, be subjected to this requirement if they are investment firms within the scope of MiFID II or the requirements applying to the depositing of client financial instruments set out in Art. 3 MiFID II (Commission) Directive are being extended by their national legislation to custodians that are merely authorized as a custodian under national law.
[263] Art. 16(10) MiFID II.
[264] In Ireland and the UK 'client funds' are often being referred to as 'client money'. See for Ireland: Central Bank of Ireland, Guidance on Client Asset Regulation for Investment Firms, March 2015 https://www.centralbank.ie/pressarea/pressreleases/Documents/150330%20Guidance%20on%20Client%20Asset%20Regulations%20for%20Investment%20Firms.pdf ; See for the UK: CASS 7; Central Bank of Ireland, Guidance on Client Asset Regulation for Investment Firms, March 2015, 58. https://www.centralbank.ie/press-area/pressreleases/Documents/150330%20Guidance%20on%20Client%20Asset%20Regulations%20for%20Investment%20Firms.pdf. 'client money' are funds being deposited in a bank account that are legally owned by the investment firm and beneficially owned by the investment firm's clients.
[265] Art. 16 (1)(e) MiFID; Art. 18(1) MiFID I (Commission) Directive.
[266] A qualifying money market fund means in this regard a UCITS or a collective investment undertaking which is subject to supervision and authorized by an (competent) authority that is satisfying additional conditions and, therefore, qualifies as a 'high quality' money market fund. See for the definition of a qualifying money market fund and any of the additional conditions for collective investment undertakings other than UCITS: Art. 1 MiFID II (Commission) Directive; Art. 18(2) MiFID I (Commission) Directive.

can be considered to be deposits within the meaning of CRD IV.[267]

Deposits are defined by Annex I Nr. 1, Recital 14 and Article 9(1) CRD IV. Annex I Nr. 1 refers to 'taking deposits and other repayable funds'. Recital 14 CRD IV refers to deposit-taking business as 'to receive repayable funds from the public, whether in the form of deposits or in other forms'. Article 9(1) CRD IV prohibits 'persons or undertakings that are not credit institutions from carrying out the business of taking deposits or other repayable funds from the public'. Deposits can under the respective provisions under the CRD IV be defined as a form of repayable funds received from the public.

Credit institutions receiving funds that qualify as deposits are not considered to be client funds' and, therefore, credit institutions are not mandatorily required to deposit these funds with an eligible entity and to comply with any other requirements applying to the depositing of client funds.

5.4.2. Depositing Client Funds – Due Diligence Requirements

General due diligence requirements apply to investment firms when depositing client funds to eligible entities other than central banks.[268] Investment firms are required upon depositing client funds to such entities to exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution, bank or money market fund where the funds are placed and the arrangements for the holding of those funds.[269]

In appointing eligible entities other than central banks, investment firms have to take into account the expertise and market reputation of such institutions, as well as, legal requirements or market practices related to the holding of those financial instruments that could adversely affect clients' rights.[270] Clients have the right to oppose the placement of their funds in a qualifying money market fund.[271] To ensure their right to be effective, investment firms are required to inform clients that funds placed with qualifying money market funds are not in accordance with the requirements for safeguarding client funds as set out in MiFID II.[272]

5.4.3. Due Diligence – The Diversification of Client Funds

MiFID II has introduced to consider the diversification of investment firm's holding of client funds as part of the depositing client fund due diligence requirements. [273] This to prevent that an investment firm places all client funds at a single institution and a significant risk of misuse and loss of the funds upon an insolvency of such an institution.[274] Investment firms may not circumvent their duty to consider diversification by requiring clients to waive protection.[275] The diversification requirement does, however, not apply to credit institutions in relation to deposits[276] and to investment firm that do not hold the money. [277] Examples of situations in which investment firms do not hold money are, for example, where clients have

---

[267] Art. 18 (1) sub-para. 2 MiFID I (Commission) Directive; IOSCO 1996, 25.
[268] Art. 4(2) sub-para. 1 MiFID II (Commission) Directive.
[269] Art. 4(2) sub-para. 1 MiFID II (Commission) Directive; Art. 18(3) MiFID I (Commission) Directive
[270] Art. 4(2) sub-para. 1 MiFID II (Commission) Directive; Art. 18(3) sub-para. 2 MiFID I (Commission) Directive.
[271] Recital 4, Art. 4(2) sub-para. 3 MiFID II (Commission) Directive; Art. 18(3) sub-para. 3 MiFID I (Commission) Directive.
[272] Art. 4(2) sub-para. 3 MiFID II (Commission) Directive.
[273] Art. 4(2) sub-para. 1 MiFID II (Commission) Directive; ESMA/2014/1570, 57, 58.
[274] Recital 12 MiFID II (Commission) Directive; ESMA/2014/1570, 66, 67.
[275] Recital 12 MiFID II (Commission) Directive.
[276] Art. 4(1) sub-para. 2 MiFID II (Commission) Directive;
[277] Art. 4(2) sub-para. 1 MiFID II (Commission) Directive; ESMA/2014/1570, 57.

their own bank account and the investment firm has received an mandate from its client to instruct the bank.[278]

Investment firms are expected to conduct a due diligence as if they were considering to place their own funds.[279] No specific criteria for consideration are laid down by MiFID II as factors could vary significantly between different investment firms. Investment firms are, therefore, allowed to determine their own factors of consideration.[280] The judgment should be proportionate and may include factors, such as the size of the firm and the diversity of its clients base.[281]

The diversification requirement is not intended to interfere with operational necessities of undertaking transactions for clients. Funds that have been transferred to a transaction account to make a specific transaction are, therefore, not subject to the requirement to diversify.[282] Funds transferred to a clearing house (CCP) or exchange to pay margin calls are examples of funds that are not intended to be subjected to a requirement to diversify.[283]

5.4.4. Intra-Group Deposits of Client Funds

The portion of client funds deposited outside/inside the group are subject to the general due diligence requirements demanding the diversification of funds.[284] The placing of funds within the same group as the investment firm may, similar to the placement of client funds with one single institution, lead to concentration and contagion risk.[285] Concentration risks are created when placing all client funds in a single institution and contagion risk in the sense that when one firm in a group fails, the other firms will also fail.[286]

When considering the need for diversification, investment firms have to take into account for avoiding concentration risks various factors, such as the total balance of client funds held, the operational risks of using more than one institution and the credit worthiness of the institution where client funds are deposited.[287] When considering contagion risk, investment firms have to consider the extent to which funds are deposited at an intra-group entity or outside of the group.[288]

Extra requirements apply, in addition to, the general diversification requirements of client funds for intra-group deposits of client funds.[289] Investment depositing client funds with a credit institution, bank or money market fund of the same group as the investment firm are required to comply with a deposit limit of 20% if client funds are placed with an intra-group entity.[290] Group entities or a combination of group entities are considered intra-group entities.[291]

---

[278] Art. 4(2) sub-para. 1 MiFID II (Commission) Directive; ESMA/2014/1570, 57.
[279] ESMA/2014/1570, 57.
[280] ESMA/2014/1570, 57, 58.
[281] ESMA/2014/1570, 57, 58.
[282] ESMA/2014/1570, 58.
[283] Recital 12 MiFID II (Commission) Directive; ESMA/2014/1570, 58.
[284] ESMA/2014/1570, 59.
[285] European Commission, *Request to ESMA for Technical Advice on possible Delegated Acts and Implementing Acts concerning the Regulation on Markets in Financial Instruments and amending Regulation [EMIR] on OTC Derivatives, Central Counterparties and Trade Repositories [MiFIR((EC) No XX/2014] and the Directive on Markets in Financial Instruments in repealing Directive 2004/39/EC (MiFID (EC) No XX/2014),* 23 April 2014, 19.
[286] ESMA/2014/1570, 59.
[287] Recital 13 MiFID II (Commission) Directive; ESMA/2014/1570, 59.
[288] Recital 13 MiFID II (Commission) Directive; ESMA/2014/1570, 59.
[289] Art. 4(3) MiFID II (Commission) Directive.
[290] Art. 4(3) sub-para. 1 MiFID II (Commission) Directive; ESMA/2014/1570, 65.
[291] Art. 4(3) sub-para. 1 MiFID II (Commission) Directive.

An investment firm may choose not to comply with this limit if it is able to demonstrate that the limit is not proportionate.[292] The limit may not proportionate in the view of the nature, scale and complexity of the business, the small balance of client funds the investment firm holds or the safety offered by third party institutions considered.[293] Investment firms are required to periodically review the their proportionality assessment made and notify their initial and reviewed assessments to their national competent authorities.[294]

The deposit limit does in any case not apply where investment firms are not receiving client funds, for instance, where it only has a mandate over the client bank account.295 The deposit limit does also not apply to credit institutions receiving deposits that are exempt of Article 4(1) MiFID II (Commission) Directive and are considered to be subject to appropriate prudential regime and oversight addressing banking risks.[296]

5.5. Use of Client Financial Instruments

5.5.1. General Regime

Article 16(8) MiFID II contains a general prohibition on using client financial instruments without client consent. Article 5 MiFID II (Commission) Directive sets out the conditions related to client consent for using client financial instruments. Investment may not enter into arrangements concerning SFT in respect of financial instruments held by them on behalf of a client, or otherwise use such financial instruments for their own account or the account of another person or client of the firm, unless:[297]

- the client has given his prior express consent evidenced in writing to the use of the instruments on specified terms;[298] and
- the use of that client's financial instruments is restricted to the specified terms to which the client consents.[299]

Recital 10 MiFID II (Commission) Directive requires that prior express consent should be given and recorded by investment firms so that the investment firm is able to demonstrate to what the client agreed to and the status of client assets can be clarified.[300] MiFID II does not set out legal requirements in respect of the form in which the consent may be given nor, as long as it is clear that the client has consented to the use of his securities.[301]

Investment firms may, in addition, not enter into arrangements for SFTs in respect of financial instruments which are held on behalf of a client in an omnibus account maintained by a third party, or otherwise use financial instruments held in such an account for their own account or of another client unless, in addition to the criteria set out above:[302]

---

[292] Art. 4(3) sub-para. 2 MiFID II (Commission) Directive; ESMA/2014/1570, 65.
[293] Recital 13, Art. 4(3) sub-para. 2 MiFID II (Commission) Directive.
[294] Recital 13, Art. 4(3) sub-para. 2 MiFID II (Commission) Directive.
[295] These situations fall outside the scope of Art. 18(1) MiFID I(Commission) Directive and, thus, the limit is not applicable.
[296] ESMA/2014/1570, 59.
[297] Art. 5(1) MiFID II (Commission) Directive; MiFID II, in comparison with MiFID I, has extended the written evidence requirement of the express consent to both professional and retail clients.Under MiFID I this was only required for retail clients. See Art. 19 MiFID I (Commission) Directive.
[298] Art. 5(1)(a) MiFID II (Commission) Directive; Art. 19(1)(a) MiFID I (Commission) Directive.
[299] Art. 5(1)(b) MiFID II (Commission) Directive; Art. 19(1)(b) MiFID I (Commission) Directive.
[300] Recital 10 MiFID II (Commission) Directive.
[301] Recital 10 MiFID II (Commission) Directive.
[302] Art. 5(2) MiFID II (Commission) Directive; Art. 19(2) MiFID I (Commission) Directive.

- each client has expressed his prior consent;[303]
- the investment firms has in place systems and controls which ensure that only financial instruments belonging to clients who have given prior express consent are used.[304]

The investment firm shall held in the records details of the client on whose instructions the use of the financial instruments has been effected, as well as, the number of financial instruments that are used belonging to each client who has given his consent.[305] The latter is to enable to correct allocations of any loss.[306]

5.5.2. Unintended use of Client Financial Instruments

MiFID II introduced additional measures that aim to strengthen the organizational requirements of investment firms to prevent the unintended use of client financial instruments and supplement the measures discussed above.[307]

ESMA gave a clear example of one situation that may lead to the unintended use of client financial instruments.[308] This example relates to the automated settlement systems and omnibus accounts that are opened at a CSD where fungible securities in a company are held for several of the investment firm's clients in omnibus accounts.[309] ESMA referred to the risk that a sales transaction is executed whereas instruments are not available on the account of the client.[310] Delivery and settlement of the securities on the clients' account in such a case could occur at some point of time in the future on an automated basis, and therefore the instruments of an unrelated client are used to settle the transaction.[311]

Investment firms are required by MiFID II to prevent these situations by taking measures that may include:[312]

- the conclusion of arrangements with clients on the measures to be taken by the firm in case the client does not have the required instruments on its account on the settlement date (e.g. borrowing of securities or unwinding the position);[313]
- the close monitoring of the projected ability to deliver the instruments on the settlement date and implementing remedial measures if this cannot be done;[314] and
- the monitoring and prompt requesting of undelivered securities that are outstanding on the settlement date and beyond.[315]

5.5.3. Securities Financial Transactions and Collateralization

Investment firms have to make sure that specific arrangements are adopted for all clients to ensure that the borrower of client financial instruments provide appropriate collateral irrespective whether it concerns arrangements for retail or non-retail clients.[316] Firms are

---

[303] Art. 5(2)(a) MiFID II (Commission) Directive; Art. 19(2)(a) MiFID I (Commission) Directive.
[304] Art. 5(2)(b) MiFID II (Commission) Directive; Art. 19(2)(b) MiFID I (Commission) Directive.
[305] Art. 5(2) sub-para. 2 MiFID II (Commission) Directive; Art. 19(2) sub-para. 2 MiFID I (Commission) Directive.
[306] Art. 5(2) sub-para. 2 MiFID II (Commission) Directive; Art. 19(2) sub-par. 2 MiFID I (Commission) Directive.
[307] ESMA/2014/1570, 61.
[308] ESMA/2014/1570, 61.
[309] ESMA/2014/1570, 61.
[310] ESMA/2014/1570, 61.
[311] ESMA/2014/1570, 61.
[312] Art. 5(3) MiFID II (Commission) Directive.
[313] Art. 5(3)(a) MiFID II (Commission) Directive.
[314] Art. 5(3)(b) MiFID II (Commission) Directive.
[315] Art. 5(3)(c) MiFID II (Commission) Directive.
[316] Art. 5(4) MiFID II (Commission) Directive; ESMA/2014/1570, 64.

expected to monitor on an ongoing basis the appropriateness of such collateral and to take the necessary steps to maintain the balance with the value of client assets.[317] The duty of investment firms to monitor collateral applies when they are party to an SFT agreement. The monitoring duty also applies to investment firms that act as an agent for the conclusion of a SFT or in the case of a tripartite agreement between the external borrower, the client and the investment firm.[318]

5.6. SFTs and TTCA

Article 5(5) MiFID II (Commission) Directive ensures that investment firms do not enter into arrangements which are prohibited under Article 16(10) MiFID II.[319] Article 16(10) MiFID II precludes the use of TTCAs by any party for retail clients. Article 5(1) (Commission) Directive, however, allows investment firms to enter into arrangements for SFTs if retail client consent has been given for the use of their assets by any party. Article 16(10) MiFID II does not explicitly affect the use of retail client instruments under Article 5(1) (Commission) Directive.[320] Some types of transactions that fall under the definition of 'securities financing transaction'[321], such as securities lending, require the transfer of title in some jurisdictions.[322] This use of retail client financial instruments would be allowed when all the requirements under Article 5(1) (Commission) Directive would be met.[323] Under Article 16(10) MiFID II such a transaction requiring the transfer of title would qualify as a collateral arrangement concluded with a retail client for the purpose of securing or otherwise covering present or future, actual or contingent or prospective obligations that are prohibited under Article 16(10) MiFID II.[324] Article 5(5) MiFID II (Commission) Directive, thus, ensures that investment firms do not enter into transfer financial collateral arrangements on the basis of Article 5(1) (Commission) Directive that are prohibited under Article 16(10) MiFID II.

5.7. Inappropriate use of TTCA

MiFID II required investment firms to safeguard client assets. Under TTCAs investment firms can take full ownership of client financial instruments and funds for the purpose of securing or covering present or future, actual or contingent or prospective obligations of any client.[325] Clients lose their legal title to the instruments and funds subjected to the TTCA and, instead, receive a contractual claim that entails a promise of the investment firm's to repay funds or (equivalent) financial instruments.[326] The loss of legal entitlement to the client instruments and funds implies that those client assets do not benefit from MiFID II protections that would otherwise apply if a TTCA would not have been concluded. Under TTCAs concluded, the nature of the risks involved for the client alter from having full ownership to a contractual claim resulting in a counterparty risk that could materialize upon an insolvency of the

---

[317] Art. 5(4) MiFID II (Commission) Directive.
[318] Recital 9 MiFID II (Commission) Directive.
[319] See also Recital 8 MiFID II (Commission) Directive.
[320] ESMA/2014/1570, 56.
[321] 'Securities financing transactions' are defined in: Art. 3(11) of Regulation 2015/2365 on the transparency of securities financing transactions and of reuse; See Art. 1(3) MiFID II (Commission) Directive; See also S.L. Schwarcz, *Systemic Risk*, 1 Georgetown Law Journal (2008); S.L. Schwarcz, *Intermediary Risk in a Global Economy, 6* Duke Law Journal (2001).
[322] ESMA/2014/1570, 56.
[323] ESMA/2014/1570, 56.
[324] ESMA/2014/1570, 56.
[325] See Recital 27 MiFID I/Recital 52 MiFID II. See also European Commission, *Review of the Markets in Financial Instruments Directive (MiFID)* (Public Consultation), 8 December 2010, 70.
[326] ESMA/2014/1570, 55.

investment firm.[327] TTCAs may be used for transactions, such as repos or re-hypothecation in prime brokerage.[328] Considering the risks with TTCA, Article 16(10) MiFID II prohibits investment firms to conclude TTCA with retail clients for the purpose of securing or covering present or future, actual or contingent or prospective obligations for clients.[329] MiFID II, however, does not prohibit investment firms from concluding TTCA with non-retail (read: professional and eligible counterparties) clients. MiFID II. Non-retail clients (i.e. professional clients and eligible counterparties) could also be exposed to risks resulting from TTCA that undermine the effectiveness of the segregation of client assets requirements.330 This could lead to the indiscriminate use of TTCA with regard to non-retail clients. In light of the effects of TTCAs on investment firms' duties towards clients and in ensuring that the MiFID II safeguarding and segregation rules are not undermined, MiFID II regulates the indiscriminate use of TTCAs.[331]

5.7.1. TTCA

Recital 52 MiFID II refers to the Financial Collateral Directive for a definition of 'title transfer financial collateral arrangement'. Under Article 2(1)(b) FCD a 'title transfer financial collateral arrangement' means:

> 'an arrangement, including repurchase agreements, under which a collateral provider transfers full ownership of financial collateral to a collateral taker for the purpose of securing or otherwise covering the performance of relevant financial obligations.'[332]

5.7.2. Appropriateness of TTCAs

Investment firms are allowed to use TTCA if they demonstrate the appropriateness of TTCA in relation to the client obligations and disclose the risks involved, as well as, the effect of the TTCA on the client assets.[333] When considering and documenting the appropriateness of the use of TTCA, investment shall take into account whether:[334]

- there is only a very weak connection between the client's liability or consideration to the firm and the use of TTCA, including where the likelihood of a liability arising is slow or negligible;[335]
- the amount of client funds or financial instruments that are subject to TTCA far exceeds the client's liability, or is even unlimited if the client has any liability at all to the firm;336 or
- the firm insist that all clients' assets must be subject to TTCA, without considering what obligation each client has to the firm.[337]

Investment firms in demonstrating a connection under a TTCA and client's liability are not precluded in taking appropriate security against client obligations.[338] Investment firms under

---

[327] Recital 6 MiFID II (Commission) Directive; ESMA/2014/1570, 55.
[328]ESMA/2014/1570, 55.
[329] See Recital 6 MiFID II (Commission) Directive.
[330] European Commission, *Review of the Markets in Financial Instruments Directive (MiFID)* (Public Consultation), 8 December 2010, 18.
[331] Recital 6, Art. 6 MiFID II (Commission) Directive.
[332] See also Recital 27b MiFID I.
[333] Recital 6, Art. 6(1) MiFID II (Commission) Directive; ESMA/2014/1570, 63.
[334] Art. 6(2) MiFID II (Commission) Directive.
[335] Art. 6(2)(a) MiFID II (Commission) Directive.
[336] Art. 6(2)(b) MiFID II (Commission) Directive.
[337] Art. 6(2)(c) MiFID II (Commission) Directive.
[338] Recital 7 MiFID II (Commission) Directive.

MiFID II may require sufficient collateral and, where appropriate, by a TTCA.[339] The obligation to demonstrate a 'robust link' does not prevent the compliance of an investment firm with the obligations under EMIR and does not prohibit the use of appropriate TTCAs for concluding contingent liability transactions or repos for non-retail clients.[340]

Investment firms are required to have a documented process of their use of TTCAs.[341] The ability of investment firms to enter into TTCAs does not exempt firm from the need to obtain clients' prior express consent to use client assets.[342] Provided that the abovementioned conditions are met, investment firms still may make use of TTCA, if besides the appropriateness of the TTCA, they ensure that their non-retail clients are properly informed of the risks involved and the effect of the TTCA on the assets of the client when concluding a TTCA.[343]

5.8. Governance Arrangements concerning the Safeguarding of Client Assets

Article 16(2) MiFID II requires investment firms to establish adequate policies and procedures to ensure compliance of the investment firm with the governance arrangements concerning the safeguarding of client assets.[344] Notwithstanding the existing requirements relating to the compliance function, investment firms are required by MiFID II to appoint a single officer of sufficient skill and authority with specific responsibility for matter relating to the compliance by firms with their obligations regarding the safeguarding of client financial instruments and funds.[345] The appointment of such an officer reduces fragmented responsibility across diverse departments and prevents that there is insufficient seniority and oversight within the organization of an investment firm to solve issues related to client assets.[346] The single officer is not only required to possess sufficient skills and authority, they have also the duty to report to the investment firm's senior management in respect of compliance with the safeguarding of client assets requirements.[347] MiFID II allows the single officer to carry out additional roles where this does not prevent the officer from fulfilling his duties related to the safeguarding client financial instruments and funds effectively.[348] Article 7 MiFID II (Commission) Directive, thus, allows investment firms to decide whether full compliance with this regime is done by a single appointed officer solely dedicated to this task or whether the officer has additional responsibilities.[349]

5.9. Reports by External Auditors

Investment firms are required to ensure that external auditors report, at least, annually to the competent authority of the home Member State of the investment firm on the adequacy of the safeguarding of client financial instruments and funds.[350]

---

[339] Recital 7 MiFID II (Commission) Directive.
[340] Recital 7 MiFID II (Commission) Directive.
[341] Recital 6, Art. 6(1) MiFID II (Commission) Directive.
[342] Recital 6 MiFID II (Commission) Directive.
[343] Art. 6(3) MiFID II (Commission) Directive; ESMA/2014/1570, 56, 64.
[344] Art. 16(2) MiFID II; Arts 7 and 8 MiFID II (Commission) Directive.
[345] Art. 7 sub-para. 1 MiFID II (Commission) Directive.
[346] Recital 5 MiFID II (Commission) Directive.
[347] Recital 5 MiFID II (Commission) Directive.
[348] Recital 5, Art. 7 sub-para. 2 MiFID II (Commission) Directive; ESMA/2014/1570, 55.
[349] Art. 7 sub-para. 2 MiFID II (Commission) Directive.
[350] Art. 8 MiFID II (Commission) Directive.

6. Conclusion

No definition is found in European law of what a 'custodian' is[351]. The European Commission in a Commission Communication reviewing possible developments on the regulation of UCITS depositaries defined custodians as

> 'an entity entrusted with the safekeeping and administration of securities and other financial assets on behalf of others, and may moreover provide additional services, including clearing and settlement, cash management, foreign exchange and securities lending'.

Although not directly targeted, the CRD IV and MiFID II regulate credit institutions and investment firms that provide the service of 'safekeeping and administration of securities/financial instruments' as an ancillary service.[352]

The CRD IV definition defines the activity as the 'safekeeping and administration of securities', whereas the MiFID II definition is more extended. The CRD IV ancillary service definition, however, has to be interpreted in the light of the MiFID II definition. The nature of MiFID II is to prevent regulatory arbitrage between MiFID II and CRD IV.[353] In addition, credit institutions performing investment services are investment firms that fall under the scope of MiFID II and the MiFID II has been adopted at a later stage.

Under MiFID I/II and the CRD IV, CSDs are excluded that are authorized for providing and maintaining securities accounts at the top tier level ('central maintenance service').[354] Regardless of the core services provided, CSDs may, as a non-banking ancillary service, maintain securities accounts in relation to the settlement service, collateral management and other ancillary services.[355] CSDs are under this ancillary service allowed to open 'lower tier' securities accounts, either in direct holding systems or by acting as an 'investor CSD' by maintaining securities accounts for its customers for securities issued in 'issuer CSDs'.[356] Investor CSDs, thus, partly provide similar services as 'custodians' under CRD IV and MiFID II. The core services provided under the CSDR, however, delineate 'investor CSDs' from 'custodians'.

The ancillary service status leaves a regulatory gap as for the activity itself credit institutions nor investment firms have to obtain an authorization under the CRD IV and MiFID II. National Member States are, thus, free to regulate their own national custodians. Nevertheless, 'national custodians'[357] in most Member States have to be authorized according to national legislation that is largely based upon CRD IV/MiFID II.

The question to be answered in this chapter was what custodians are and whether and to what extent custodians are regulated in the EEA. Custodians within the meaning of the Commission Communication of the European Commission are entrusted with the safekeeping and administration of securities and other financial assets on behalf others, including various

---

[351] European Commission, Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments, COM(2004) 207 final, 30 March 2004, 7, 14, 26.

[352.] Annex I Nr. 12 CRD IV.

[353] See S.J. Key, *Financial Integration in the European Community*, Board of Governors of the Federal Reserve System – International Finance Discussion Papers, No. 349 (April 1989), 105-106.

[354] The definition of safekeeping and administration services under Annex 1 s. B MiFID II was replaced by Art. 71(3) CSDR.

[355] Annex – List of Services, S. B Nr. 4 CSDR.

[356] Proposal for a Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC /* COM/2012/073 final - 2012/0029 (COD) */, 7.

[357] LCG 2008, 25.

ancillary services. [358] By reviewing credit institutions, investment firms, national custodians, 'investor CSDs' and the MiFID II client asset requirements, this chapter highlighted that the credit institutions, investment and national custodians are to be seen as 'custodians'.

A. Grammatical Explanation - Conclusion

No common definition is found in European law of what 'depositaries' and 'custodians'[359] are. The European Commission in a Commission Communication reviewing possible developments on the regulation of UCITS depositaries defined custodians as

> 'an entity entrusted with the safekeeping and administration of securities and other financial assets on behalf of others, and may moreover provide additional services, including clearing and settlement, cash management, foreign exchange and securities lending'.

Although not directly targeted, the CRD IV and MiFID II regulate credit institutions and investment firms that provide the service of 'safekeeping and administration of securities/financial instruments' as an ancillary service.[360] 'Investor CSDs' partly provide similar services as 'custodians' under CRD IV and MiFID II. The core services provided under the CSDR, however, delineate 'investor CSDs' from 'custodians'. By reviewing credit institutions, investment firms, national custodians, 'investor CSDs' and the MiFID II client asset requirements, the review of MiFID II, CRD IV, the CSDR and corresponding Member State implementations highlighted that the credit institutions, investment and national custodians are to be seen as 'custodians'.

The AIFMD, UCITSD V and IORPD II contain 'lex specialis' provisions targeting 'depositaries'. Depositaries under the AIFMD and UCITSD V are 'institutions that are entrusted with the safekeeping of assets and oversight of compliance with the fund rules and applicable law'.[361] Under IORPD II, 'depositaries' may be appointed for the safe-keeping of assets or for safe-keeping of assets and oversight duties in accordance with the IORPD II depositary regime.[362] The meaning of a 'depositary' under both Article 33(1) and (2) IORPD II for both full DC and other types of IORPs should, however, be read as either a 'custodian' or an 'UCITSD V/AIFMD depositary'.[363]

The additional monitoring/controlling duty of depositaries has led to 'lex specialis' depositary regulation that facilitates the different role that depositaries play in 'fiduciary governance'. These 'lex specialis provisions' to be found in the AIFMD, UCITSD V, IORPD II and the proposed PEPPR relate to:

- the mandatory appointment of a single depositary;[364]
- the legal independence of the depositary and the IORP (governing board) and related requirements;[365]
- the eligible entities required to be appointed and the organizational requirements applicable to them (depending upon the UCITSD V Member State implementation: credit institutions, investment firms, and 'other legal entities');[366]

---

[358] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004, 7, 14, 26.
[359] *Ibid.*
[360]. Annex I Nr. 12 CRD IV.
[361] Cf. Art. 2(23) PEPPR.
[362] Art. 33(2) IORPD II.
[363] EIOPA-BOS-12/015, 471.
[364] Art. 22(1) UCITSD V; Art. 21(1) AIFMD; Art. 33(1) and (2) IORPD II; Art. 41(1) PEPPR.
[365] See Arts 25, 26b UCITSD V; Art. 21 UCITSD V (Commission) Regulation; Art. 33(7) IORPD II.

- the re-use of assets;[367]
- the safekeeping duties;[368]
- the oversight duties;[369]
- the delegation regime;[370] and
- the depositary's liability regime.[371]

[366] Art. 23(2) UCITSD V; Art. 21(3) AIFMD; Art. 33(3) IORPD II.
[367] Art. 21(11)(d)(iv) AIFMD; Art. 22(7) UCITSD V.
[368] Art. 22(5) UCITSD V; Art. 21(8) AIFMD; Art. 34 IORPD II; Art. 41(3) PEPPR.
[369] Art. 22(3) UCITSD V; Art. 21(9) AIFMD; Art. 35 IORPD II; Art. 41(4) PEPPR.
[370] Art. 22a UCITSD V; Art. 21(11) AIFMD; Art. 34(4) IORPD II; Art. 41(3) PEPPR.
[371] Art. 24(1) UCITSD V; Art. 21(12) AIFMD; Art. 34(4) IORPD II; Art. 41(3) PEPPR.

PART III - Depositaries vs. Custodians

B. Teleological Explanation

Despite of the differences between how the depositary is being regulated throughout European investment law and in the implementation of the Member States, common principles, however, argue in favour of the introduction of an AIF/UCITS or even a cross-sectoral depositary passport.

Depositaries under the AIFMD/UCITSD V perform a safekeeping and oversight role and custodians under CRD IV, MiFID II and on the national level merely a safekeeping role. Despite of this, the same entities that within individual Member States that act as a depositary perform mainly safekeeping under MIFID II and safekeeping (and oversight duties) under IORPD II. At the same time, they are subjected to the same custody transfer laws that determine the legal scope of the safekeeping function. The author holds that this is the case because depositary law is an specialized area of custody law. The depositary is, thus, a 'specialized custodian'.

A *teleological explanation* of the depositary throughout the European investment law directives explains this. By imposing an depositary/custodian, the law seeks to protect investors, preserve the stability of the financial system and ensure market integrity.

CHAPTER 7 Depositaries & Custodians – Investor & Market Protection

European investment law seeks to regulate depositaries and custodians for investor and market protection reasons. For this purpose, the European investment law directives require depositaries and custodians to be prudentially regulated entities. Authorization under these directives ensures that the object and purpose of investor and market protection is being met. The business organizational requirements to which depositaries and custodians are subjected to primarily seek to address the investor protection objective. This chapter explains that business organizational requirements to which depositaries and custodians are subjected to have an 'internal' and an 'external dimension'. The 'internal dimension' seeks to protect investors from fraud and insolvency of the depositary/custodian itself, whereas the 'external dimension' protects investors from the fraud and insolvency of third-parties, such as asset managers and other 'investment intermediaries'. The prudential requirements targeting depositaries/custodians as a 'counterparty' seeks to address the objective of market protection. The business organizational and prudential requirements imposed to depositaries/custodians are being enforced by financial supervision. This chapter will now discuss the objectives of investor protection and market protection in more detail. In particular, it highlights that the difference between 'depositaries' and 'custodians' under the teleological explanation lies in the business organizational requirements under sectoral European depositary laws that require depositaries to perform a controlling/monitoring task towards 'investment intermediaries'. In ensuring investor protection, in particular, the 'external dimension' of the business organizational requirements is different in the sectoral depositary laws as compared to the laws regulating 'custodians'.

1. Depositary & Custodian Regulation as Financial Law: Investor & Market Protection

Traditionally, financial law[1] serves investor protection, the stability of the financial system and market integrity. [2]

1.1. Investor Protection

Investor protection is seen as a pivotal pre-condition for a sound financial system. The primary objective for investor protection is that investors need to be protected from the possible consequences of information asymmetries that exist between investors and financial services providers.[3] This derives from the fact that financial services providers have expert

---

[1] D.A. Zetzsche, *Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?*, in *The European Financial Market in Transition* (H. S. Birkmose, M. Nevillie & K. E. SØrensen eds., Kluwer 2012); G. Miller, *Essential Papers on the Economics of Financial Law*, NYU Law and Economics Research Paper No. 16-01 (2016).

[2] Art. 2(1) Regulation (EU) 1093/2010 & Art. 2(1) Regulation (EU) 1094/2010, Reg. (EU) 1095/2010 refers to the preservation of sufficient protection of customers (investors), financial stability and ensuring confidence in the financial system as a whole; See also: P. Mülbert, *Anlegerschutz und Finanzmarktregulierung – Grundlagen*, 177 ZHR 160 (2013); International Organisation of Securities Commissions, *Objectives and Principles of Securities Regulation for market intermediaries,* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf (accessed 14 January 2017).

[3] C. Goodhart, *The Central Bank and the financial system* 434(Palgrave Macmillan UK 1995); P. Clouth, *Anlegerschutz. Grundlagen aus Sicht der Praxis*, 177 ZHR 112 (2013); N. Moloney, *Investor Protection and the Treaty*: an Uneasy Relationship17-61 (G. Ferrarini, K.J. Hopt & E. Wymeersch eds., Kluwer 2002); Organisation for Economic Co-operation and Development*, G20 High Level Principles Financial Consumer Protection,* http://www.oecd.org/dataoecd/58/26/48892010.pdf (accessed 14 January 2017); N. Moloney, *The*

knowledge, whereas investor have difficulties in accessing and evaluating financial information related to financial intermediaries.[4]

Investors are prone to problems arising from information asymmetries related to the provision of financial services such as conflicts of interest and fraudulent practices.[5] Conflicts of interest are a core issue as the rising complexity and growing specialization and division of labor necessitates an increasing reliance on specialized financial services providers.[6] In almost all financial transactions financial service providers acting as intermediaries are involved.[7] In acting as financial intermediaries for financial transactions, financial services providers often have to make a trade-off between competing interests of their investors and their own.[8] This problem is acerbated by the fact that many providers provide many different kinds to financial services to different investors at the same time.[9] In their role as agents, financial intermediaries have the duty to act in the best interest of their investors as principles. Given agency problems related to moral hazard and adverse selection problems there is a high likelihood of opportunistic conduct of financial services providers.[10] Moral hazard occurs where the actions of financial services providers are to the detriment of investors bearing the cost of those actions after a transaction has taken place.[11] Adverse selection problems occur as investors due to information asymmetries are not always able to protect themselves by screening financial services providers or identifying signals of quality.[12] Investors are not always able to evaluate the financial soundness of financial service provider in deciding whether or not to entrust their assets with that provider.[13] The financial safety and soundness of financial service providers has both systematic, as well as, consequences for individual investors. Investors may, for instance, have the risk that their assets are not properly safeguarded.[14] The reduction of systematic risk is therefore not the only reason why financial regulation demands prudential regulation to reduce the risk of failure of financial

---

Investor Model Underlying the EU's Investor Protection Regime: Consumers or Investors?, 13 E.B.O.R. 169 (2012).

[4] M. Kruithof, *Conflicts of Interest in Institutional Asset Management: Is the EU Regulatory Approach Adequate?,* 31, http://ssrn.com/abstract=871178 (accessed 30 September 2016).

[5] IOSCO 2003, 5; J.R. Boatright, *Ethics in Finance* 5 (Wiley-Blackwell 2014); C. Goodhart et al., *Financial Regulation: Why, how and where now?* 5 (Routledge 1998); D. E. Y. Sarna, *History of Greed: Financial Fraud from Tulip Mania to Bernie Madoff* (Wiley 2010).

[6] C. Kumpan & P. Leyens, *Conflicts of interest of Financial Intermediaries – Towards a Global Common Core in Conflicts of Interest Regulation,* 1 European Company and Financial Law 72 (2008); A. Crockett, T. Harris, F.S. Mishkin & E.N. White, *Conflicts of Interest in the Financial Services Industry: What Should We Do About Them?*, 5 Geneva Reports on the World Economy (2003).

[7] International Organisation of Securities Commissions, *Guidelines for Regulation of Conflicts of Interest Facing Market, Intermediaries"*http://www.iosco.org/library/pubdocs/pdf/IOSCOPD342.pdf (accessed 14 January 2017).

[8] J.R. Boatright, *Ethics in Finance* 50 (Wiley-Blackwell 2014).

[9] *Ibid,* 51.

[10] K.M. Eisenhardt, *Agency Theory: An Assessment and Review*, 14 Academy of Management Review 57-74 (1989); K.J. ARROW, *The Economics of Agency* 37-51 (J.W. Pratt & R.J. Zeckhauser eds., (Harvard Business School Press 1985); E. Posner, *Agency Models in Law and Economics* 225-243. (E. Posner ed., Foundation Press 2000).

[11] J.C. Sharipo, *Investment, Moral Hazard, and Licensing*, 53 Review of Economic Studies 843 (1986).

[12] G. A. Akerlof: *The Market for Lemons: Quality Uncertainty and the Market Mechanism*. In: Quarterly Journal of Economics. Band 84, Nr. 3, 1970, S. 488–500.

[13] C.P. Buttigieg, *The Development of the EU Regulatory and Supervisory Framework applicable to UCITS: A Critical Examination of the Conditions and Limitations of Mutual Recognition*, 40, http://sro.sussex.ac.uk/48285/1/Buttigieg%2C_Christopher_P..pdf (accessed 5 October 2016); C Goodhart and others, '*Financial Regulation: Why, how and where now?*' (Routledge 1998) 5.

[14] C Goodhart and others, '*Financial Regulation: Why, how and where now?*' (Routledge 1998) 5.

institutions.[15] To overcome these information asymmetries, financial regulation only allows duly authorized financial service providers to provide investment services to the public.[16]

For this purpose, financial service providers need to fulfil conduct of business rules and prudential regulation.[17] Conduct of business rules set out minimum standards for financial service providers to ensure that investors are treated in a just and equitable matter.[18] Conduct of business rules address not only the behavior of the financial services providers but also of its employees towards investors and other constituencies.[19] Prudential regulation requires financial service providers to fulfil initial and ongoing capital requirements imposed upon duly authorized financial services providers to ensure that providers meet the demands of its counterparties and prevent losses to its investors.[20]

In ensuring investor protection[21], financial regulation is complemented by supervision of financial service providers. Financial law does not exclude investors seeking redress and compensation for a breach of laws on the basis of private law mechanisms. Their vulnerability to misconduct by financial services providers and their limited capacity to take action[22] requires private law mechanisms to be complemented by effective supervision and enforcement by regulators.

1.2. The Stability of the Financial System

The stability of the financial system depends upon the financial soundness and governance of individual financial service providers.[23] Although no financial failure of service providers can be avoided, financial regulation aims to reduce the risk of failure.[24] Where financial services providers nonetheless fail, financial regulation seeks to reduce the impact and isolate the risk to that provider.[25] In particular, regulation should aim to prevent 'systematic risk'[26], i.e.

---

[15] See R. Lastra, *Systemic Risk, SIFIs and Financial Stability*, 6 Capital Markets Law Journal 197 (2011); P. Yeoh, *The challenges and implications of systemic risks for financial regulation*, (2010)
31 Company Lawyer 389 (2010); H. Scott, *Reducing Systemic Risk through the reform of capital regulatio*n, 13 Journal of International Economic Law 763 (2010); S.L. Schwarcz, *Systematic Risk*, *1* Georgetown Law Journal 97 (2008); J. Caruana, *Systemic risk: how to deal with it?* (BIS 2010); G. Kaufmann & K. Scott, *What Is Systemic Risk, and Do Bank Regulators Retard or Contribute to It?*, 7:3 The Independent Review 371 (2003).

[16] IOSCO 2003, 5.

[17] H.E. Leland, Quacks, Lemons, and Licensing: A Theory of Minimum Quality Standards , 87 Journal of Polical Economy 1328 (1978).

[18] IOSCO 2003, 5.

[19] C.P. Buttigieg, *The Development of the EU Regulatory and Supervisory Framework applicable to UCITS: A Critical Examination of the Conditions and Limitations of Mutual Recognition*, 42, http://sro.sussex.ac.uk/48285/1/Buttigieg%2C_Christopher_P..pdf (accessed 5 October 2016).

[20] *Ibid*, 40.

[21] M. Tison, *De bescherming van de beleggers in het kapitaalmarktrecht: de hobbelige weg naar een Europees ius commune*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1142777 (accessed 9 February 2017); G. Ferrarini & E. Wymeersch, *Investor protection in Europe: corporate law making, the MiFID and beyond* (Oxford University Press 2006).

[22] IOSCO 2003, 6.

[23] European Commission, *Green Paper: Corporate governance in financial institutions and remuneration polices*, COM(2010)284 Final, 2 June 2010.

[24] IOSCO 2003, 6.

[25] *Ibid.*

[26] R. Lastra, *Systemic Risk, SIFIs and Financial Stability*, 6 Capital Markets Law Journal 197 (2011); P. Yeoh, *The challenges and implications of systemic risks for financial regulation*, (2010)
31 Company Lawyer 389 (2010); H. Scott, *Reducing Systemic Risk through the reform of capital regulatio*n, 13 Journal of International Economic Law 763 (2010); S.L. Schwarcz, *Systematic Risk*, *1* Georgetown Law Journal 97 (2008).

systematic instability of the financial system triggered by the failure of a systematicly important financial services provider.[27]

Financial services providers are, therefore, subject to initial and ongoing capital and other prudential requirements.[28] This is complemented by 'default handling' that applies, on top of, the insolvency law of a certain jurisdiction.29 Financial instability may cause a chain reaction amongst several jurisdictions. On the EEA and international level, there are, therefore, initiatives that address financial stability on the internal level through cooperation and information sharing.[30]

1.3. Market Integrity

Financial law seeks to ensure fair markets. Market integrity partly overlaps the objective of investor protection and has as its aim that market structures, such as exchange and trading system operators, do not unduly favor one investor over the other.[31] In particular, financial law seeks to grant fair access to market facilities and price information to curb market manipulation[32] and unfair trading practices.[33] Pre- and post-trade transparency also has a cardinal function in ensuring fairness and efficiency of financial markets.[34] Financial law, thus, safeguards and maintains fair markets to preserve investor confidence in financial markets from a macro-economic perspective.[35]

1.4. The Three Objectives in light of the Internal Market

From a European perspective, these three objectives should be seen in the light of the creation of an internal market of financial services. The European passport for EEA and TC financial intermediaries fosters economic growth by removing barriers to cross-border financial services. The European passport concept without adequate regulation and supervision allows market failures in the one Member State to generate negative effects in other Member States.[36] For this reason, the European passport for EEA and TC financial intermediaries is based upon the three principles of mutual recognition, a European regulatory framework (minimum/maximum harmonization) and the European Financial Supervisory Architecture.[37] Within this context, the European legislative framework regulating EEA and TC financial intermediaries on the European level seeks to generate investor confidence, systematic stability and market integrity in the creation of an internal market of financial services.

Although no full-fledged European passport is in place for AIF and UCITS depositaries and (MiFID II/CRD IV) custodians, reflecting how regulation achieves investor protection,

---

[27] R. Lastra, *Systemic Risk, SIFIs and Financial Stability*, 6 Capital Markets Law Journal 197 (2011).
[28] IOSCO 2003, 7.
[29] *Ibid.*
[30] See, for example, the Banking Union, Single Supervisory Mechanism and Single Resolution Mechanism (SRM) that are two pillars that complement the Single rulebook. See Chapter 3, section 3.4.1.
[31] IOSCO 2003, 6
[32] See MAD II and MAR; N. Moloney, *EC Securities Regulation* 699 et seq. (3rd edn., Oxford University Press 2014).
[33] IOSCO 2003, 6; N. Moloney, *EC Securities Regulation* 699 et seq. (3rd edn., Oxford University Press 2014).
[34] TPD II; N. Moloney, *EC Securities Regulation* 127 et seq. (3rd edn., Oxford University Press 2014).
[35] C.P. Buttigieg, *The Development of the EU Regulatory and Supervisory Framework applicable to UCITS: A Critical Examination of the Conditions and Limitations of Mutual Recognition*, 52, http://sro.sussex.ac.uk/48285/1/Buttigieg%2C_Christopher_P..pdf (accessed 5 October 2016).
[36] See on risk symmetry: D.A. Zetzsche & T.F. Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* 474 (D.A. Zetzsche ed, Kluwer 2015).
[37] See Chapter 3, section 3.4.2.

financial stability and market integrity.[38] in regulating depositaries and custodians on the European level might be helpful in understanding why depositaries are custodians that exercise, on top of safekeeping tasks, oversight tasks.

2. The Object and Purpose of Depositary/Custodian Regulation

The principle activity under the AIFMD , UCITSD V and IORPD II for which a depositary is required to be appointed is the safekeeping of fund assets.[39] The safekeeping function includes the custody function for financial instruments that can be held in custody and keeping of ownership of 'other assets' that cannot be held in custody.[40] Under CRD IV/MiFID II, a 'custodian'[41] is a credit institution or an investment firm entrusted with the safekeeping and administration of securities on behalf of others.[42] Both depositaries and custodians also provide additional (ancillary) services such as securities lending, brokerage and execution of foreign exchange trades.[43] The principle activity for both depositaries and custodians under the respective directives is, thus, the safekeeping and administration of assets on behalf of others. Depositaries are, thus, custodians. Under the AIFMD and UCITSD V, the notion of 'depositary' is wider than the notion of pure 'custodian'[44], in that the both UCITSD V and the AIFMD Directive require the depositary UCITS depositaries also to (monitor cash flows and) exercise additional oversight functions.[45] The viewpoint that depositaries are custodians that perform, on top of safekeeping functions, oversight duties is confirmed by IORPD II that refers to both entities that are pure 'custodians' and depositaries as under the AIFMD/UCITSD V performing both safekeeping and oversight functions. Depending upon the IORPD II Member State implementation, 'depositaries'[46] may be required to perform merely the safekeeping or both the safekeeping and oversight duties.[47] Unsurprisingly, the same large international credit institutions and, to lesser extent, investment firms and other equivalent legal entities provide in practice in their capacity as 'depositary' safekeeping services to UCITS, AIFs, IORPs but at the same time also act as a 'custodian' under MiFID II, CRD IV or national law to other investors, e.g. pension funds,

---

[38] IOSCO 2003, 6; See also V. Acharya, et al. *Prologue: A Bird's Eye View. The Financial Crisis of 2007-2009: Causes and Remedies* (V. Acharya & M. Richardson eds., Wiley 2009).
[39] Art. 21(8) AIFMD; Art. 22(5) UCITSD V; Art. 34 IORPD II.
[40] *Ibid.*
[41] Both CRD IV and MiFID II do not make reference to this term. See Chapter 6.
[42] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004; See Annex I s. B MiFID I/II. Annex I CRD IV.
[43] See for a custodian definition: European Commission, Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments, COM(2004) 207 final, 30 March 2004; See Annex I s. B MiFID I/II. Annex I CRD IV; European Commission, Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries {C(2015) 9160 final}, 5, Annex 4. Annex 4 Impact Assessment refers to activities/services that are not considered as depositary functions under UCITS, including, amongst others, fund accounting/administration, transfer agency, foreign exchange management, prime brokerage, treasury and securities lending, collateral management, banking services and the performance of investment (ancillary) services under MiFID II.
[44] European Commission, Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries {C(2015) 9160 final}, 5, Annex 4.
[45] Art. 21(9) AIFMD; Art. 22(3) UCITSD V; Art. 35 IORPD II.
[46] Note that the IORPD II refers to both 'depositaries' and 'custodians': Chapter 5, section 2.4.1.
[47] See Art. 33, 35 IORPD II.

insurance companies and individual investors.[48] The regulation and oversight for depositaries and custodians relate to the performance of the safekeeping function, thus, both direct to risks related to, for instance, the misappropriation of assets and the prevention of a loss of assets as a result of the insolvency of the depositary/custodian. The AIFMD, UCITSD V and IORPD II, however, apply additional conduct of business rules to depositaries to target risks that relate to the depositary's oversight functions.[49]

2.1. Authorization

2.1.1. Credit Institutions, Investment Firms and 'Equivalent Other Legal Entities'

In essence, both depositaries and pure 'custodians', are at least performing the safekeeping function as a custodian. This is also reflected in the authorization and supervision of intermediaries that are allowed to be eligible as a custodian under MiFID II and CRD IV and as a depositary under the AIFMD, UCITSD V and IORPD II.[50] The AIFMD, UCITSD V and IORPD II do not contain a separate authorization regime for depositaries as is the case for AIFMs, UCITS ManCo and IORPs. Instead, these three directives reflect the 'custody plus' nature[51] of the depositary, i.e. the depositary as a custodian performing additional oversight duties, by (partly) referring to credit institutions, investment firms or equivalent legal other legal entities eligible as depositaries/custodians that are regulated in other European legislative acts.

Under the AIFMD, eligible 'per sé depositaries' are credit institutions authorized under CRD IV and investment firms authorized for the performance of the ancillary service of safe-keeping and administration of financial instruments for the account of clients in accordance with MiFID II.[52] Article 21(3) AIFMD further refers to Non-EEA Entities[53], prime brokers[54] and UCITSD IV/V depositaries[55] and as eligible AIFMD depositaries. De facto, the latter three type of eligible entities are legal entities subject to equivalent prudential regulation and ongoing supervision as credit institutions and investment firms under CRD IV and MiFID II. Depending upon the locational restrictions under the AIFMD, AIFMs either a credit institution or any other entity of the same nature as an EEA investment firm may be appointed may be appointed as a 'Non-EEA depositary'. The 'Non-EEA depositary' shall, however, be subject to effective prudential regulation, including minimum capital requirements and supervision, which has the same effect as EU law and is effectively enforced.[56] Prime brokers allowed to be appointed may under Article 4(1)(af) AIFMD be credit institutions, investment firms or 'another entity subject to prudential regulation and ongoing supervision'.[57] Article

---

[48] European Commission, Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries {C(2015) 9160 final}, 5.
[49] The High Level Group on Financial Supervision in the EU, *Report* (25 Feb. 2009), http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf (accessed 7 October 2016).
[50] Art. 21(3) AIFMD; Art. 23(2) UCITSD V; Art. 33(3) IORPD II.
[51] I am indebted to Robert Smits working for Clifford Chance Amsterdam for pointing out that the services of depositaries in practice are being referred to as 'custody plus'.
[52] Art. 21(3)(a) and (b) AIFMD.
[53] Art. 21(3)(c) sub-para. 2 AIFMD.
[54] Art. 21(4)(b) AIFMD.
[55] See Chapter 4, section 3.1.3.
[56.] Art. 21(3)(c) sub-para. 2 AIFMD.
[57] The latter reference is similar to the appointment of Non-EEA entities as depositaries under the AIFMD. Article 21(3)(c) sub-para. 2 AIFMD allows for TC-AIFs, either a credit institution or 'any other entity of the same nature as an EEA investment firm' may be appointed.

4(1)(af) AIFMD, however, refers to the appointment of a credit institution as a counterparty. Prime brokers that are eligible as a depositary, in addition to 'the conflicts of management rule'[58], need to fulfil the eligible entities and location restriction provisions under the AIFMD. Apart from credit institutions[59] and investment firms[60], only prime brokers that would qualify as eligible 'Non-EEA depositaries' for TC-AIFs or UCITSD V depositaries would be eligible as a depositary.

'PE depositaries' are an exception to the 'custody plus' model of depositaries under the AIFMD. Depending upon the Member State implementation of the 'PE depositary option'[61], 'PE depositaries' that are eligible under the AIFMD for closed-end AIFs cannot be seen as 'custodians' that are performing safekeeping and oversight duties. 'PE depositaries' are professionals or investment firms regulated under national law that may be appointed for AIFs that mainly do not invest in financial instruments that can be held in custody.[62] The AIFMD formally treats 'PE depositaries' as custodians by assigning both the custody task for financial instruments that can be held in custody and the record-keeping task for 'other assets' to these type of depositaries. In addition, 'PE depositaries' also fall within the scope of the 'guarantor liability regime' of Article 21(12) AIFMD. In practice, however, various Member States in their national implementations limit the safekeeping task of 'PE depositaries' to merely the record-keeping task for 'other assets' under Article 21(8)(b) AIFMD. It, thus, depends upon the Member State implementation of national Member States whether or not the professionals and 'national investment firms'[63] eligible as 'PE depositary' can be seen as a custodian performing additional oversight duties.

Under UCITSD V, an exhaustive list of entities are eligible act as depositaries.[64] Those entities are limited to national central banks[65], credit institutions[66] and other legal entities authorized under the laws of individual Member States to carry out depositary activities.[67] These 'other entities' must be subject to 'equivalent' prudential and ongoing supervision regulation as investment firms under MiFID II.[68] Examples under Member State implementations include investment firms[69], (investor) CSDs[70], prime brokers[71] and various other legal entities eligible under national UCITSD V Member State implementation laws.[72] Member States, however, remain to have discretion what entities of the exhaustive list of entities are eligible to act as depositaries.[73]

Under Article 33 IORPD II, Member State implementation laws decide whether a 'depositary' or 'custodian' is compulsory to be appointed for IORPs. Similar as to the UCITSD V and AIFMD, Article 33(3) IORPD II requires Member States not to restrict IORPs from appointing, 'custodians' established in another Member State and duly authorized in accordance with CRD IV or MiFIDII, or accepted as a depositaries for the

---

[58] Art. 21(4)(b) AIFMD.
[59] Art. 21(3)(a) AIFMD; Art. 23(2)(b) UCITSD V.
[60] Art. 21(3)(b) AIFMD; Art. 23(2)(c) UCITSD V.
[61] See Chapter 4, section 3.1.6.
[62] *Ibid*.
[63] Art. 21(3)(c) sub-para. 3 UCITSD V.
[64] Recital 25, Art. 23UCITSD V.
[65] Art. 23(2)(a) UCITSD V.
[66] Art. 23(2)(b) UCITSD V.
[67] Art. 23(2)(c) UCITSD V.
[68] See Chapter 4, section 3.2.3.
[69] See Chapter 4, section 3.2.3.1.
[70] See Chapter 4, section 3.2.3.2.
[71] See Chapter 4, section 3.2.3.3.
[72] See Chapter 4, section 3.2.3.4.
[73] Art. 23(3) UCITSD V.

purposes of UCITSD V or the AIFMD.[74] Similar as to the AIFMD[75], IORPD II and UCITSD V, thus, treat their depositaries as 'custodians' performing additional oversight duties and allow credit institutions, investment firms and other eligible entities providing equivalent investor protection as credit institutions and investment firms to be appointed as depositaries and custodians. The exact range of entities eligible under the AIFMD, UCITSD V and IORPD II within individual Member States essentially depends upon the UCITSD V implementation of that Member State.

The CRD IV and MiFID II regulate the safekeeping and administration of securities on behalf of others as 'ancillary service'.[76] As a consequence, Member States may in their national laws also allow other entities to be authorized as custodian.[77] There are, thus, not only European custodians regulated under CRD IV and MiFID II but also 'national custodians'.[78] Member States, generally, require similar authorization, prudential and business organizational requirements to national custodians that are fully or partly based upon CRD IV and MiFID II.[79]

Depositaries and custodians under the various European directives may be credit institutions, investment firms or 'equivalent other legal entities'. Most depositaries and custodians operating in Europe are authorized as credit institution under CRD IV.[80] Investment firms account for a small portion of the market. In comparison to credit institutions, investment firms have, however, significantly fewer assets in custody.[81] Equivalent other legal entities are effectively 'single market' depositaries/custodians that have in practice, as a result of the absence of a European passport, lost the race in competing with credit institutions and investment firms on both service and cost.[82] Nevertheless, the authorization, conduct of business rules, prudential regulation, supervision and enforcement of credit institutions, investment firms and 'equivalent other entities' are considered under the various European directives to be appropriately addressing the risks related to the safekeeping function of custodians and depositaries. The notion of 'depositary' under IORPD II, UCITSD V and the AIFMD is wider than the notion of pure 'custodian'[83]. For this reason, IORPD II, UCITSD V and the AIFMD require additional conducts of business rules to be fulfilled for depositaries that in their capacity of acting as a custodian perform oversight duties. Depositary law is, thus, a separate area of law applying on top of the 'general law' applying to

---

[74] Art. 33(3) IORPD II; By referring to 'not restricting IORPs from appointing', Art. 33(3) IORPD II leaves it up to Member States to allow other eligible entities to be appointed as an IORP custodian or depositary. Member States in practice, however, do not make use of this option. See Chapter 5, section 3.2.

[75] See for the limited usefulness of including AIFMD depositaries, in particular, the prime broker and the 'PE depositary'.

[76] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004; See Annex I s. B MiFID I/II. Annex I CRD IV.

[77] See Chapter 6, section 4.1.

[78] Legal Certainty Group, *Second Advice of the Legal Certainty Group – Solutions to Legal Barriers related to Post-Trading within the EU*, August 2008, 25.

[79] See Chapter 6, section 4.1.

[80] European Commission, *Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries* {C(2015) 9160 final}, 81, 82.

[81] *Ibid.*

[82] European Central Bank – Legal Working Paper Series, No. 1 (February 2006), 21; European Commission, *Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries* {C(2015) 9160 final}, 115-116.

[83] European Commission, Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries {C(2015) 9160 final}, Annex 4.

credit institutions, investment firms or 'other equivalent legal entities' authorized to act as a custodian.

2.1.2. Authorization Requirements

Eligible depositaries and custodians that are regulated under CRD IV, MiFID II and equivalent (national) regulation are required to comply with the same general authorization requirements in reducing risks related to the safekeeping function to investors of loss caused by negligent, fraudulent practices and the protection of insolvency to be fulfilled.
Some of the authorization requirements to be found in MiFID II, CRD IV and 'equivalent legal entities' to which depositaries/custodians are subjected include:[84]

- fit & properness requirements for senior management;[85]
- (minimum) capital requirements;[86]
- a business plan;[87]
- an adequate risk organization;[88]
- an adequate and appropriate business organization;[89]
- reliable significant shareholders.[90]

Authorization requirements set out the conditions for entering the depositary/custodian market. The fit & properness, business plan and adequate and appropriate business organization requirements and reliable significant shareholders requirements ensure that depositaries/custodians participating in the market have enough knowledge, resources, skills and the right 'ethical attitude'.[91] Initial and ongoing capital requirements ensure that only solvent depositaries/custodians offer their services, whereas requiring an adequate and appropriate business organization prevent both fraudulent and financially instable depositaries/custodians from being active.

By requiring these conditions to be fulfilled, regulation for both depositaries and custodians set out similar conditions of entry complemented by conduct of business rules and prudential regulation.

2.2. Business Organizational Requirements

Conduct of business rules have as its purpose to protect investors and to preserve market integrity.[92] The need for this has been highlighted by the Madoff affair.[93] Similar as for authorization requirements, the business organizational requirements for eligible depositaries under the European investment law directives and custodians show common principles as

---

[84] See D.A. Zetzsche., *The AIFMD and the Joint Principles of European Asset Management Law* (D.A. Zetzsche ed, Kluwer 2015), 749.
[85] Art. 9 MiFID II; Art. 91 CRD IV.
[86] Art. 15 MiFID II; Art. 12 CRD IV.
[87] Art. 7 MiFID II; Art. 8 CRD IV.
[88] Art. 16(2) MiFID II; Art. 74 CRD IV.
[89] Art. 16(3) MiFID II; Art. 74 CRD IV.
[90] Art. 10 MiFID II; Art. 14 CRD IV.
[91] IOSCO 2003, 33.
[92] See also IOSCO 2003, 35.
[93] G.N. Gregoriou & F.S. Lhabitant, *Madoff: A Riot of Red Flags* (EDHEC-Position Paper 2009); S. Gene, *Luxembourg Called On to* "*Brush Up*" *Governance*, Financial Times, Fund Management Supplement, (26 January 2009); P. Skypala, *UCITS Victory Soured by Madoff Scandal*, Financial Times, Fund Management Supplement, (19 January 2009), 6; P. Hollinger, B. Hall & N. Tait, *Grand Duchy Hits Back at Madoff*, Financial Times (14 January 2009), 23; P. Hollinger & J. Chung, *Madoff Affair Sparks Demand for Revamp of Investment Fund Rules*, Financial Times, (13 January 2009), 15.

they are all regulated under CRD IV MiFID II and equivalent (national) regulation.[94] CRD IV, MiFID II and equivalent (national) regulation lay down general organizational requirements that custodians and depositaries as financial intermediaries need to comply with. The general conduct of business requirements under CRD IV, MiFID II and equivalent (national legislation) contain similar rules that include, *inter alia:*[95]

- the commitment to fairness, honesty and acting in the investor's best interest;[96]
- conflict of interests rules;[97]
- rules on the intermediary's remuneration;[98]
- the prohibition of letter-box entities.[99]

These general requirements are imposed on depositaries and custodians are equivalent to those for other financial intermediaries[100] regulated on the European level. Specific requirements are laid down in MiFID II for investment firms entrusted with the ancillary service[101] of providing safekeeping and administration of securities on behalf of others.[102] Custodians regulated under CRD IV are not subject to any specific requirements other than the general authorization and general conduct of business requirements. In addition, the AIFMD, IORPD II and UCITSD V, on top of that, require specific conduct of business rules to be fulfilled that relate to the depositary's safekeeping and oversight functions.[103]

In discussing the conduct of business rules applying to both depositaries and custodians there is an 'internal' and an 'external dimension'. The internal dimension relates to rules that prevent risks related to the depositary/custodian and its sub-custodians and the external dimension to rules imposed on depositaries/custodians that function as a risk-mitigation mechanism for operation risks that do not relate to the depositary/custodian itself.

2.2.1. Internal Dimension: Depositaries versus Custodians – Key Risks

Conduct of business rules not only protects investors and preserves and market integrity in serving as 'external risk mitigating mechanism' but also prevent the risks related to the use of (third-party) depositaries/custodians and their sub-custodian network.[104]

2.2.1.1. The Segregation of Assets and Third-Party Custody

Depositaries/custodians are required to segregate assets.[105] There is, however, a risk that these 'client assets' in the depositary's/custodian's care may become co-mingled with:

---

[94] D.A. Zetzsche., *The AIFMD and the Joint Principles of European Asset Management Law* (D.A. Zetzsche ed, Kluwer 2015).
[95] D.A. Zetzsche., *The AIFMD and the Joint Principles of European Asset Management Law* (D.A. Zetzsche ed, Kluwer 2015), 749.
[96] Recital 86, Art. 24(1) MiFID II; Art. 91(8) CRD IV.
[97] Art. 16(3) MiFID II; Art. 88 CRD IV.
[98] Art. 9(3)(c) MiFID II; Art. 92 CRD IV.
[99] Art. 16(5) MiFID II;
[100] See, for instance, insurance companies under Solvency II.
[101] See Annex I s. B MiFID I/II. Annex I CRD IV.
[102] European Commission, Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments, COM(2004) 207 final, 30 March 2004.
[103] The High Level Group on Financial Supervision in the EU, *Report* (25 Feb. 2009), http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf (accessed 7 October 2016).
[104] Oxera, *The Role of Custody in European Asset Management*, 20, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx (accessed 7 October 2016).

- the assets of the investment firm, asset manager, AIFM, UCITS ManCo or IORP (governing body);[106]
- the assets of the depositary/sub-custodian throughout the custody chain; or
- the assets of other investors of the depositary of the depositary/custodian, unless held in a permissible omnibus account.[107]

The co-mingling of assets could result the ownership of the assets belonging to investors, AIFs, UCITS or IORPs to be called in question upon the insolvency of the depositary/custodian.[108] As a result, the difficulties in differentiating ownership of the assets could result in client assets being used to fulfil the claims of personal creditors of the depositary/custodians.

The AIFMD and UCITSD V require a third-party depositary to be appointed.[109] In addition, MiFID II allows 'self-custody' for investment firms under the condition that the safeguarding of client assets regime is being applied.[110] In this way, the AIFMD, UCITSD V and MiFID II try to curb conflicts of interests. CRD IV does not contain specific, but general conflicts of interest rules that require conflicts between their custodian department and other functions to be remedied. Regardless of the third-party depositary/custodian requirement, almost all depositaries/custodians appointed are credit institutions, investment firms or equivalent entities.[111] Credit institutions and investment firms may not be authorized for 'custody services' on a stand-alone basis. Instead, their provision of these services is under CRD IV and MiFID II always an 'ancillary service'.[112] There are, thus, always conflicts of interest present that will need to be remedied. The safety and integrity of assets may, thus, be at risk if the depositary/custodian or any of its sub-custodians fail to address conflicts of interest in a way that minimizes conflicts between its custody department and other functions.[113]

2.2.1.2. Safekeeping

Most risks conduct of business rules aim to resolve relate to the 'custody task' of depositaries and custodians. The risks related to record-keeping of 'other assets' and oversight duties are less prominent.

The custody task of depositaries/custodians is characterized by multiple tiers of holding. Financial instruments that can be held in custody are for the largest part dematerialized and immobilized in a CSD that constitute the first tier of holding. Since investors are not usually members of the CSD, they will have accounts at depositaries/custodians that is a member of the CSD creating at least two tiers in the custody holding chain.[114] There may be many more tiers, with each depositary/custodian concluding agreements with sub-custodians. Risks depositary and custodian regulation intend to mitigate with conduct of business rules, thus, relate to risks (1) at the level of the depositary/custodian and (2) at the level of the sub-

---

[105] See Art. 21(11)(d)(iii) AIFMD; Art. 22a(3) UCITSD V; Art. 2(1)(a) MiFID II (Commission) Directive/Art. 16(1)(a) MiFID I (Commission) Directive; IORPD II and CRD IV do not explicitly refer to asset segregation related to the safekeeping function. Although no statutory asset segregation duty applies, this principle is also applied by custodians and depositaries under IORPD II and CRD IV.
[106] See Art. 21(11)(d)(iii) AIFMD; Art. 22a(3) UCITSD V.
[107] See for example: Art. 5(2) MiFID II (Commission) Directive.
[108] IOSCO 2015, 6.
[109] Art. 21(1) AIFMD; Art. 22(1) UCITSD V.
[110] See Art. 13(2) MiFID II.
[111] Art. 21(9) AIFMD; Art. 22(3) UCITSD V; Art. 35 IORPD II; Annex I s. B MiFID I/II. Annex I CRD IV.
[112] Annex I s. B MiFID I/II; Annex I CRD IV.
[113] IOSCO 2015, 7.
[114] Oxera, *The Role of Custody in European Asset Management*, 14, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx (accessed 7 October 2016).; See also on the intermediary holding chain: Chapter 13, section 5.1.2.

custodian. Although there are also risks in the custody holding chain at the CSD level, these risks are being regulated by the CSDR.[115]

Main risks being targeted by conduct of business rules at the level of the depositary/custodian involve the risk of fraud or theft and information technology risk.
The inevitable risk related to the custody function is that the assets could be lost or misappropriated by (an employee of) the depositary/custodian. This could by falsified records or the stealing from accounts belonging to clients.[116] In addition, financial instruments that can be held in custody are held in book-entry form in the accounts opened with the depositary/custodian. There could be fraud, a loss of data, human error or system failure that could result in, for example, incorrectly calculated NAV.[117]

Delegation of custody tasks to sub-custodians may adversely affect the protection of financial instruments that can be held in custody. Clients and depositaries/custodians conclude independent (depositary/custody) contracts.[118] Depositaries/custodians on their turn conclude independent contracts between themselves and a sub-custodian. Clients, such as AIFMs, UCITS ManCos, individual investors or IORP governing bodies do not have any rights under the sub-custodian contract except under the depositary/custodian contract concluded with the depositary/custodian.[119] Delegation, thus, dilutes investor protection as their protection depends upon the sub-custodian contract concluded further down the chain and also the legal insolvency and regulatory laws of the jurisdictions in which those sub-custodians are established.[120] There is no limitation on delegation in the intermediary holding chain resulting in chains of Custody chains make it difficult for AIFMs, UCITS ManCos, individual investors or IORP governing bodies to enforce their claims towards the assets further down the custody holding chain.[121] This risk is further enhanced by incompatible national securities laws and conflict of law regimes that apply to the different levels of the security chain.[122]

The AIFMD and UCITSD V have introduced a guarantor liability for depositaries that holds depositaries/custodians fully responsible for lost financial instruments that can be held in custody throughout the entire custody holding chain. Equivalent liability protection by investors does not exist under CRD IV, MiFID II and IORPD II.[123]

Depositaries/custodians often agree in their agreement with clients on the ‘right of reuse’.[124] Reuse is defined as any transaction of assets that can be held in custody including, but not limited to, transferring, pledging, selling and lending.[125] AIFs, UCITS, IORPs and individual investors may hold large amounts of (liquid) financial instruments and may re-use these assets through securities lending or as collateral to finance their investment

[115] See Chapter 6, section 3.
[116] IOSCO 1996, 6.
[117] *Ibid*, 6; The AIFMD/UCITSD V liability regime addresses this. See Art. 21(12) AIFMD; Art. 24(1) UCITSD V.
[118] See for the written agreement: Art. 21(1) AIFMD; Art. 22(1) UCITSD V; Art. 33(5) IORPD II.
[119] E. Micheler, P.E., *Custody Chains and Asset Values,* http://ssrn.com/abstract=2539074.
[120] E. Micheler, *Custody chains and asset values: why crypto securities are worth contemplating*, 3 Cambridge Law Journal (2015), 1-6.
[121] E. Micheler, P.E., *Custody Chains and Asset Values,* http://ssrn.com/abstract=2539074.
[122] of Law, Business & Finance (2008), 384-452; L. Thévenoz, *Who holds (Intermediated) Securities? Shareholders, Account Holders, and Nominees?,* 3-4 Uniform Law Review (2010), 845-859; E. Micheler, *Intermediated Securities and Legal Certainty,* LSE Law, Society and Economy Working Papers No. 3 (2014), 3-7; P. Dupont, *Rights of the account holder relating to securities credited to its securities account*, 90-104. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013); H.P. Conac, *Rights of the investor*, 105-134. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013).
[123] See Chapter 5, section 3.5 and Chapter 6.
[124] See for a definition under the right of reuse: Art. 22(7) UCITSD V.
[125] *See, for example,* Art. 22(7) UCITSD V.

strategies.[126] On the other side, depositaries and custodians may re-use the assets of their clients and/ or collateral received to fund their balance sheets or to generate additional revenues through collateral management services.

Re-hypothecation rights allow a depositary/custodian to treat a client's assets as its own and may involve outright title transfer or a security interest accompanied by a right of use.[127] Rights of re-use are inherent in TTCAs (because ownership of the property actually changes) whereas under, for example, a pledge, the collateral taker will only enjoy rights of re-hypothecation if the parties have expressly agreed to this in their written pledge agreement.[128] Re-hypothecation is standard market practice allowing depositaries and custodians to offer reduced fees for its services through a reduction in operating costs as a result of access to client' collateral.

TTCAs and rights of re-use that have been exercised, depositaries/custodians take full ownership of client' instruments or funds so that they no longer are owned by the client that will not benefit from the safekeeping protections under the AIFMD, CRD IV, UCITSD V, IORPD II and MiFID II that would otherwise apply.[129] Instead, clients upon agreeing to a right of re-use accept the depositary's/custodian's promise to repay the funds or (equivalent) financial instruments.[130] The nature of the risks involved for the client is therefore significantly altered as clients do not have a 'proprietary right'[131] (right in rem)[132] towards the assets but instead receive a claim on the depositary/custodian facing counterparty risks (right in personam)[133]. The 2007-2008 crisis, such as the Lehman Brothers bankruptcy[134], has shown the impact of rights of re-use by both the counterparty risks being borne by investors and the systematic implications on the financial system as a whole.[135] In addition, the erosion of client asset protection under the depositary's/custodian's safekeeping obligation was enhanced by the:

- indiscriminate use of TTCAs;[136]
- inappropriate custody liens on client financial instruments and funds of a too general and wide-ranging nature;[137] and
- the unintended use of client financial instruments.[138]

---

[126] Art. 21(11)(d)(iv) AIFMD; Art. 22(7) UCITSD V; Art. 16(8) MiFID II and Art. 5 MiFID II (Commission) Directive.
[127] M. Singh & J. Aitken, *The (sizeable) Role of Rehypothecation in the Shadow Banking System* (IMF Working Paper 2010).
[128] Art. 16(8) MiFID II and Art. 5 MiFID II (Commission) Directive.
[129] ESMA/2014/549, 55.
[130] ESMA/2014/549, 55.
[131] See IOSCO 1996, 12, 13; See also M. Haentjens, *Harmonisation of Securities Law: Custody and Transfer of Securities in European Private Law* (Private Law in European Context Series), 131-172.
[132] See D. Frase, *Custody*, in *Law and Regulation of Investment Management* (D. Frase ed., Sweet & Maxwell 2011), 274;
[133] J.R. Siena, *Depositary Liability: A Fine Mess and How to Get Out of It* (D.A. Zetzsche ed, Kluwer 2015), 450-551
[134] ESMA/2014/549, 60.
[135] J. Mackintosh, *Lehman collapse puts prime broker model in question*, Financial Times (24 September 2008); G. O. Aragon & P. E. Strahan, *Hedge Funds as Liquidity Providers: Evidence from the Lehman Bankruptcy* (August 2009), http://www.nber.org/papers/w15336 (accessed 30 September 2012); See also *Bear Stearns, S. Chaplinsky, Bear Stearns and the Seeds of its Demise*, Darden Case No. UVA-F-1574.
[136] ESMA/2014/549, 55.
[137] ESMA/2014/549, 60.
[138] ESMA/2014/549, 60.

To prevent the indiscriminate use of rights of re-use eroding investor protection, the AIFMD, UCITSD V and MiFID II have adopted extra measures. Both the AIFMD and UCITSD V imposes restrictions on depositaries and its sub-custodians that want to reuse the assets safe-kept by the depositary.Under the AIFMD, the AIF's assets may only be used (re-hypothecated) if the depositary has received the prior consent of the AIF (or of the AIFM acting on its behalf).[139] To the contrary of the AIFMD, the UCITSD V prohibits the depositary or its sub-custodian to reuse UCITS for their own account and subject to certain conditions.[140]

Article 16(8) MiFID II contains a general prohibition on using client financial instruments without client consent. Investment firms may not enter into arrangements concerning SFTs in respect of financial instruments held by them on behalf of a client, or otherwise use such financial instruments for their own account or the account of another person or client of the firm, unless:[141]

- the client has given his prior express consent evidenced in writing to the use of the instruments on specified terms;[142] and
- the use of that client's financial instruments is restricted to the specified terms to which the client consents.[143]

Under MiFID II, this general is complemented by specific rules on:

- the indiscriminate use of Title Transfer Collateral Arrangements (TTCA);[144]
- SFT, TTCA and collateralisation;[145]
- inappropriate custody liens on client financial instruments and funds;[146] and
- prevents the unintended use of client financial instruments.[147]

The same risks applying to depositaries/custodians apply at the level of the sub-custodian.[148] For that reason, the AIFMD and UCITSD V require:

- safekeeping not to be delegating with the intention to avoid the requirements under the AIFMD/UCITSD V;[149]
- an objective reason;[150]
- due diligence upon the appointment and on an ongoing basis of the sub-custodian, including:[151]
    - adequate structures and expertise;[152]
    - effective prudential regulation;[153]

---

[139] Art. 21(11)(d)(iv) AIFMD.
[140] Art. 22(7) UCITSD V.
[141] Art. 5(1) MiFID II (Commission) Directive; MiFID II, in comparison with MiFID I, has extended the written evidence requirement of the express consent to both professional and retail clients.Under MiFID I this was only required for retail clients. See Art. 19 MiFID I (Commission) Directive.
[142] Art. 5(1)(a) MiFID II (Commission) Directive; Art. 19(1)(a) MiFID I (Commission) Directive.
[143] Art. 5(1)(b) MiFID II (Commission) Directive; Art. 19(1)(b) MiFID I (Commission) Directive.
[144] Recital 6, Art. 6 MiFID II (Commission) Directive; ESMA/2014/549, 55.
[145] Art. 5(5) MiFID II (Commission) Directive; ESMA/2014/549, 56.
[146] Art. 16(10) MiFID II; Art. 6 MiFID II (Commission) Directive.; ESMA/2014/549, 60.
[147] Art. 5(3) MiFID II (Commission) Directive.; ESMA/2014/549, 61.
[148] Oxera, *The Role of Custody in European Asset Management*, 20, 21, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx (accessed 7 October 2016).
[149] Art. 21(11) AIFMD; Art. 22a UCITSD V.
[150] Art. 21(11) sub-par. 2 (b) AIFMD; Art. 22a(2)(b) UCITSD V.
[151] Art. 21(11) sub-par. 2(c) AIFMD; Art. 22a(2)(c) UCITSD V.
[152] Art. 21(11) sub-par.2 (d)(i) AIFMD; Art. 22a(3)(a)(i) UCITSD V.
[153] Art. 21(11) sub-par. 2 (d)(ii) AIFMD; Art. 22a(3)(b) UCITSD V.

- the segregation of assets;[154] and
- restrictions related to the right of reuse.[155]

MiFID II requires investment firms to firm perform ex ante and ongoing due diligence upon related to the depositing of client financial instruments/funds upon appointing a custodian.[156] IORPD II allows depositaries/custodians to delegate their safekeeping task while remaining responsible to investors.[157]

Investors holding assets with 'investor CSDs' face additional risks that are regulated by the CSDR.[158] These risks include: asset-commitment risk, the risk that insufficient securities/funds are available to meet commitments (liquidity risk), counterparty risk and the risk of CSDs acting as an 'investor-CSD' ('CSD-on-CSD risk').[159]

The risks involved related to 'other assets', such as physical gold and wine, are less complex given the fact that these assets fall outside the intermediary holding chain. Typically, there are only two-tiers of 'safekeeping' (recordkeeping) involved. 'PE depositaries' that are almost exclusively safekeeping 'other assets' are, therefore, subject to less stringent conduct of business rules and prudential regulation.[160] Risks related to these 'other assets' involve 'inadequate record keeping' and additional operational risks.[161] The segregation of 'other assets' depends on depositaries/custodians maintaining appropriate records of ownership.[162] Inadequate record keeping involves the risk that the title of client' assets is lost or incorrect due to inadequate record keeping.[163] In addition, the holding of 'other assets' might face additional risks depending upon the nature of these 'other assets'. The safekeeping of physical gold requires, for example, a depositary/(sub-)custodian with appropriate vault facilities. Depositaries/custodians would need to care, for instance, for the physical security of physical gold or other proper storage.[164] If the depositary/custodian cannot offer appropriate services to safekeeping these 'other assets' they are obliged to delegate the safekeeping of these assets to specialist custodians. The conduct of business rules related to the depositary's/custodian's safekeeping and delegation duties regulate this safekeeping task.

2.2.1.3. Oversight Duties

AIFs, UCITS and IORP investors/members face legal and compliance risks where a depositary fails to comply with its oversight duties. Negligence or breaches of depositaries with regard to its oversight duties may lead to investor losses. The AIFMD, UCITSD V and IORPD II, therefore, require depositaries to comply with conduct of business rules related to these oversight duties.[165]

2.2.2. External Dimension: Depositaries versus Custodians as Risk-Mitigation Mechanism

---

[154] Article 21(11)(d)(iii) AIFMD and Article 22a(3) UCITSD V.
[155] Art. 21(11)(d)(iv) AIFMD; Art. 22(7) UCITSD V.
[156] Recital 11 MiFID II; Art. 16(10) MiFID II; Art. 3 and 4 MiFID II (Commission) Directive.
[157] Art. 34(4) IORPD II.
[158] Annex - List of Services, S. B, Nr. 4 CSDR.
[159] Oxera, *The Role of Custody in European Asset Management*, 21, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx (accessed 7 October 2016).
[160] See on the 'PE depositary': Art. 21(3)(c) sub-para. 3 AIFMD.
[161] IOSCO 2003, 7.
[162] Art. 21(8)(b) AIFMD; Art. 22(5)(b) UCITSD V.
[163] IOSCO 2003, 7.
[164] *Ibid,* 7.
[165] Art. 21(9) AIFMD; Art. 22(3) UCITSD V; Art. 35 IORPD II.

The conduct of business rules applicable have to be understood in light of the 'external dimension' of role and responsibilities that depositaries and custodians have.

2.2.2.1. Segregation of Assets and Third-Party Custody

The segregation of assets is a general principle related to the safekeeping task to be applied by depositaries and MiFID II custodians.[166] Both depositaries and custodians are required to segregate assets belonging to, for instance, investors, AIFs, UCITS or IORPs from:

- the assets of the investment firm, asset manager, AIFM, UCITS ManCo or IORP governing body;[167]
- the assets of the depositary/sub-custodian throughout the custody chain; and
- the assets of other investors of the depositary of the depositary/custodian, unless held in a permissible omnibus account.[168]

Asset segregation is applied by depositaries and custodians to 'safeguard client assets' in the course of ordinary business of investment firms, asset managers, AIFMs, UCITS ManCos and IORP governing bodies. The use of depositaries and custodians prevents misappropriation of client funds[169] by these firms to meet their own expenses. It also prevents that client assets are not used to settle claims of the personal creditors of investment firms, asset managers, AIFMs, UCITS ManCos and IORP governing bodies.[170] In addition, asset segregation prevents a loss of assets if those firms default. Instead, investors are exposed to the risk of misappropriation failure of the depositary/custodian itself.

Asset segregation is complemented by the insolvency and regulatory law that preserve client' assets in insolvency.[171] Client assets of insolvent depositaries/custodians are receiving differential treatment to prevent the use of these assets to settle claims of the personal creditors of the depositary/custodian. For this purpose, two mechanisms are generally used in the insolvency and regulatory law of Member States. First, insolvency regimes may grant a 'preferential creditor status', i.e. the creditors of the client held by the depositary/custodian are treated as preferred creditors that rank ahead of other creditors related to the assets segregated on behalf of the client rank ahead of the creditors of the depositary/custodian upon an insolvency of the latter.[172] Second, regimes provide the 'continuing client ownership of client assets'.[173] This mechanism provide that although assets are held or controlled by depositaries/custodians, they are not property of the depositary/custodian and available for distribution to the depositary's/custodian's creditor in the event of their insolvency.[174] Under this mechanism, the depositary/custodian may hold the assets or depositary them with a sub-custodian, but the client remains title to the assets and can assert title against the depositary/custodian and its creditors.[175] Member States are, for instance, obliged under the

---

[166] See Art. 21(11)(d)(iii) AIFMD; Art. 22a(3) UCITSD V; Art. 2(1)(a) MiFID II (Commission) Directive/Art. 16(1)(a) MiFID I (Commission) Directive.
[167] See Art. 21(11)(d)(iii) AIFMD; Art. 22a(3) UCITSD V.
[168] See for example: Art. 5(2) MiFID II (Commission) Directive.
[169] Art. 2(1)(f) MiFID II (Commission) Directive/Art.16(1)(f) MiFID I (Commission) Directive.
[170] Oxera, *The Role of Custody in European Asset Management*, 17, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx (accessed 7 October 2016).
[171] IOSCO 1996, 12.
[172] *Ibid*., 13.
[173] Art. 22(3)(e) and 22(8) UCITSD V; Ar. 17 UCITSD V (Commission) Regulation; See ESMA/2014/1183, 14; Art. 33(4) IORPD II.
[174] IOSCO 1996, 13.
[175] *Ibid.*

IORPD II and UCITSD V to implement this mechanism for assets safekept by IORPD II and UCITSD V depositaries/custodians and their sub-custodians.[176]

Both mechanisms may be achieved under the private laws of Member States in various ways. In common law jurisdictions, assets under both mechanisms are generally held in trust that requires assets to be able to be 'traced'.[177] In Member States having the continental legal tradition, the same effect can be achieved by regulatory law that providers that assets are (1) subject to a mandatory ranking of claims[178] or (2) client assets held by depositaries/custodians are not available to meet the depositary's/custodian's creditor claims.[179] Both mechanisms are only effective if they are supported by asset segregation to distinguish client assets from the assets the assets of the investment firm, asset manager, AIFM, UCITS ManCo or IORP governing body,[180] the assets of the depositary/sub-custodian and the assets of other investors of the depositary of the depositary/custodian, unless held in a permissible omnibus account.[181] These two mechanisms, however, only protect 'counterparty risk' of depositaries/custodians for financial instruments that can be held in custody. The record keeping obligation for 'other assets' also leads to asset segregation. Clients, however, do not always have a proprietary interest in 'other assets'. Cash is an example 'other assets' that are merely a claim. Upon the insolvency of a depositary/custodian, clients become an ordinary creditor of the depositary in receivership or liquidation.[182] To the contrary, a loss of financial instruments that can be held in custody do enjoy this protection and the risk of clients related to these assets upon a default of an depositary/custodian are limited to disruption and inconvenience from the freezing of assets during insolvency proceedings that only lead to loss in terms of liquidity and opportunity costs.

The appointment of a third-party depositary/custodian may reduce the risk of misappropriation of client assets by investment firms, asset managers, AIFMs, UCITS ManCos and IORP governing bodies.[183] In particular, client assets held in a discretionary portfolio may still be moved at the manager's discretion.[184] The asset segregation requirement does not preclude that these parties have control over client accounts.[185] Any of these intermediaries providing (discretionary) management services along the safekeeping function may be tempted to use cash to meet their own expenses or sell assets to settle claims of personal creditors. The risk of misappropriation and other operational risks may be mitigated if assets are held by a third-party depositary/custodian.

The AIFMD and UCITSD V require that assets are strictly segregated from the AIFM and UCITS ManCo by requiring a mandatory third-party depositary. In addition, UCITSD V recognizes that the third-party depositary requirement can still be jeopardized by the existence

---

[176] Art. 22(3)(e) and 22(8) UCITSD V; Ar. 17 UCITSD V (Commission) Regulation; See ESMA/2014/1183, 14; Art. 33(4) IORPD II.

[177] R.H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 Cornell Law Review 621 (2004).

[178] See Dutch UCITS: 4:37j Wft; See for Dutch IORPs: 4:71a Wft.

[179] Art. 22(3)(e) and 22(8) UCITSD V; Ar. 17 UCITSD V (Commission) Regulation; See ESMA/2014/1183, 14; Art. 33(4) IORPD II.

[180] *Ibid.*

[181] See Art. 5(2) MiFID II (Commission) Directive.

[182] Oxera, *The Role of Custody in European Asset Management*, 17, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx (accessed 7 October 2016).

[183] Art. 2(1)(f) MiFID II (Commission) Directive/

[184] Oxera, *The Role of Custody in European Asset Management*, 17, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx (accessed 7 October 2016).

[185] Oxera, *The Role of Custody in European Asset Management*, 17, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx (accessed 7 October 2016).

of links related to the common management/supervision and cross-shareholdings/group inclusion between these parties.[186] For this reason, independence of the management/investment company and the UCITS depositary is required.[187]

No similar third-party depositary/custodian is available under IORPD II. Member States may require IORPs to appoint a third-party depositary, custodian and even self-custody.[188]Article 36(5) IORPD requires that when no depositary/custodian is appointed for the safe-keeping of assets IORPs are, at least, required to:[189]

- ensure that financial instruments are subject to due care and protection;[190]
- keep records to identify all IORP assets at all times and without delay;[191]
- take the necessary measures to avoid conflicts of interest in relation to the safe- keeping of assets;[192]
- inform the competent authorities, upon request, about the manner in which assets are kept.[193]

CRD IV does not contain similar third-party custodian requirements. Credit institutions that do not provide any investment services/activities under MiFID II are apparently considered to be subject to conduct of business, prudential regulation and supervision of such a nature that a third-party custodian requirement is not deemed to be necessary.

Under MiFID II self-custody by credit institutions and investment firms that provide safekeeping and administration of financial instruments for others as an ancillary service are allowed.[194] Under MiFID II, self-custody is possibly allowed as investment firms and credit institutions are, due to its principle risk taking activities, subject to more stringent conduct of business rules, capital requirements and supervision compared to, for example, AIFMs and UCITS ManCos that do not take principle risks by providing their discretionary management services. Self-custody is, however, only allowed under the condition that they employ adequate arrangements to safeguard client assets.[195] The safeguarding of client assets regime is to ensure that investor protection and public confidence is maintained for clients that are dependent on investment firms that provide various investment services/activities to them.[196] In particular, investment firms may hold and control client assets, transfer client assets and use assets, such as cash, to acquire securities in the course of providing their services to client.[197] The MiFID II safeguarding of client assets regime ensures client asset protection.[198] Adequate arrangements need to in place to safeguard ownership right of clients, especially in the event of the investment firm's insolvency.[199] The investment firm shall not use the client's financial instruments on own account, except with the consent of the client.[200] In addition,

---

[186] See Art. 26b UCITSD V; See also ESMA/2014/1183, 18; ESMA/2014/1417,
[187] See Art. 26b UCITSD V; Art. 21 UCITSD V (Commission) Regulation.
[188] Chapter 5, section 3.2.
[189] Art. 34(5) IORPD II.
[190] Art. 34(5)(a) IORPD II.
[191] Art. 34(5)(b) IORPD II.
[192] Art. 34(5)(c) IORPD II.
[193] Art. 34(5)(d) IORPD II.
[194] Chapter 6, section 4.2.
[195] Chapter 6, section 5.
[196] IOSCO 1996, 7.
[197] *Ibid.*
[198] See Art. 16(2)-(10) MiFID II.; See S.J. Key, *Financial Integration in the European Community*, Board of Governors of the Federal Reserve System – International Finance Discussion Papers, No. 349 (April 1989), 105-106.
[199] Art. 16(8) MiFID II.
[200] *Ibid.*

investment firms, when holding client funds, have to make adequate arrangements to safeguard the rights of clients and, except in the case of credit institutions, prevent the use of client funds for its own account.[201] Finally, investment shall not conclude any TTCA with retail clients for the purpose of securing or covering present or future, actual or contingent or prospective obligations of clients.[202] Despite MiFID II allowing self-custody by credit institutions and investment firms providing safekeeping of securities and administration for others, various Member States, however, limit self-custody to credit institutions or specific types of investment firms.[203]

2.2.2.2. Safekeeping, administration and 'other value-added services'

Both depositaries and custodians have as key objective to protect physical and legal integrity of assets by means of safekeeping.[204] The safekeeping of assets reduces the risk of theft and accidental destruction of investments.

The safekeeping tasks for depositaries and custodians applies under the AIFMD, UCITSD V and IORPD II to both financial instruments which can be held in custody[205] and 'other assets'[206]. Although, CRD IV and MiFID II refers to the safekeeping and administration of securities for others, the safekeeping duty of credit institutions and investment need to be considered equivalent.[207]

Under these directives, the 'custody tasks' of are a key risk-mitigation mechanism of the depositary's and custodian's safekeeping task. Mostly financial instruments that can be held in custody are recorded in book entry systems that are held through accounts with CSDs, thus, avoiding the risk of loss or destruction of the assets upon effecting transfer of ownership.[208] Custodians act as settlement agents on behalf of others and reduce settlement errors due to their expertise in dealing with CSDs, cash-payment systems and central counterparties. In addition, they have invested in information technology which identifies problems related to trades, simplifies the collection of client entitlements and the response to corporate actions and identify large or risk trades and verifies trade information.[209] This, in addition to regular and independent reconciliation of assets, may bring to light both errors and fraudulent activities.

To the contrary, all other assets which by their nature cannot be held in custody (e.g. derivate instruments or physical gold) are subject to the record-keeping obligation of the depositary/custodian, i.e. the depositary/custodian needs to maintain and keep up-to-date a record of all 'other assets'.[210] The risk mitigation role of depositaries and custodians is less pronounced for these 'other assets'. Financial instruments that can be held in custody are recorded in book entry systems that are held through accounts with CSDs, thus, creating a minimum of two tiers of custody. This intermediary holding chain is necessary as investors

---

[201] Art. 16(9) MiFID II.
[202] Art. 16(10) MIFID II.
[203] Chapter 6, section 4.2.
[204] See IOSCO 2015, 3.
[205] Art. 21(8)(a) AIFMD; Art. 22(5)(a) UCITSD V.
[206] Art. 21(8)(b) AIFMD; Art. 22(5)(b) UCITSD V.
[207] Chapter 6, section 2.1.
[208] Oxera, *The Role of Custody in European Asset Management*, 17, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx (accessed 7 October 2016).
[209] *Ibid*, 18.
[210] Art. 21(8)(b) AIFMD; Art. 22(5)(b) UCITSD V.

are not usually allowed to be members of CSDs.[211] 'Other assets', to the contrary, do not fall within the scope of the 'intermediary holding chain' and, therefore, no tiers of custody are involved.[212]

Addition investor protection offered depends upon 'administration' and 'other value-added services' that are concluded in the custody agreement, in addition, to the regulatory safekeeping task.

2.2.2.3. Oversight Duties

Although the safekeeping task of depositaries and custodians prevent operational failures, the safekeeping task of the depositary/custodians alone does not mitigate the agency cost resulting from the actions of, in particular, (collective) asset manager's related to those assets. Under the AIFMD and UCITSD V, depositaries are, therefore, to ensure compliance of AIFM's and UCITS ManCo's actions related to with applicable law and AIF/UCITS rules in relation to:[213]

– subscriptions/redemptions;
– valuations of share/unit pricing;
– duties relating to the carrying out of the AIFM's instructions;
– timely settlement of transactions;
– distribution of income;
– cash management.

Similarly, IORPD II requires depositaries appointed for both safekeeping and oversight duties to:[214]

- carry out instructions of the IORP, unless they conflict with the applicable national law or the IORP rules;[215]
- ensure that in transactions involving an IORP or pension scheme's assets any consideration is remitted to it within the usual time limits;[216]
- ensure that income produced by assets is applied in accordance with the applicable national law and the IORP rules.[217]

The AIFMD, UCITSD V and IORPD II in requiring the explicit obligation to monitor the assets, in particular, prevent:[218]

- the breach of investment policy guidelines, i.e. the (collective) asset manager purchases assets that are not permitted under the investment policy guidelines, law and regulations;
- unintentional errors by (collective) asset managers in issuing orders to brokers (misdealing);
- the incorrect valuation of fund assets (mispricing);

---

[211] Oxera, *The Role of Custody in European Asset Management*, 14, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx (accessed 7 October 2016).
[212] *Ibid*.
[213] Chapter 4, section 6.3.
[214] Art. 35(1) IORPD II.
[215] Art. 35(1)(a) IORPD II.
[216] Art. 35(1)(b) IORPD II.
[217] Art. 35(1)(c) IORPD II.
[218] Oxera, *The Role of Custody in European Asset Management*, 18, 19, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx (accessed 7 October 2016).

- the misappropriation of fund' assets by the (collective) asset manager, including its employees and its delegates;
- failure in best execution.

In short, the oversight duties of depositaries under the AIFMD, UCITSD V and IORPD II prevents against the (collective) asset manager's misuse of fund' assets and fraud. In particular, depositaries are entrusted with the task whether the holding and disposition of fund' assets is in compliance with investment policy guidelines and to monitor the regulatory of dealings.[219]

CRD IV, MiFID II and national equivalent regulations do not contain such an explicit obligation for custodians.[220] This can be explained by the agency costs borne by AIF/UCITS investors and IORP Members in relation to (collective) asset managers compared to individual investors related to investment firms. The AIFMD, UCITSD and IORPD II regulate collective investment in which the (collective) asset manager – investor/member relationship is of a fiduciary nature, i.e. investors/members may not give investment instructions or individually agree upon the investment policy. In contrast, investment firms may offer execution only, investment-based advice or discretionary portfolio management services that have a more agency nature, i.e. investors may give investment directions and have the final decision related to the purchase of their investments. The subsequent chapter pays in particular attention to examining the monitoring and oversight functions performed by depositaries in preventing agency costs compared to the mere the safekeeping tasks of custodians in the governance relationship between investors/members, depositaries/custodians and (collective) asset managers/investment firms.

2.3. Prudential Requirements

The protection of investors and stability of the financial system are increased by an adequate supervision of prudential requirements.[221] Typically, clients, including AIFs/UCITS/IORPs and individual investors, are exposed to the credit risk of the depositary/custodian and the risk that is defaults if it becomes insolvent to the extent that depositaries/custodians are acting as a counterparty.

2.3.1. The Depositary/Custodian as a Counterparty

Assets safe-kept by depositaries/custodians include cash, 'financial instruments held in custody' and 'other assets'.

2.3.1.1. Cash

Depositaries/custodians that are authorized as a credit institution are allowed to receive deposits from the public.[222] This includes cash belonging to investment firm's clients, AIFs, UCITS and IORPs.[223] Cash deposits may be considerations from transactions and any cash held on an ancillary basis or as collateral, for example, in the context of SFTs. The counterparty risk is that in upon the insolvency of a credit institution is that the credit institution may be unable to return deposited cash amount to the extent that these exceed the DGSD guarantee threshold of EUR 100.000.[224]

---

[219] *Ibid.*
[220] See Chapter 10, section 4.
[221] IOSCO 2003, 34.
[222] Art. 3(1) Nr. 1 CRD IV/Art. 4(1) Nr. 1 CRR.
[223] Art. 21(7) AIFMD; Art. 22(4)(a) UCITSD V; Art. 2, 4(1) MiFID II (Commission) Directive; Art. 54 CSDR.
[224] Art. 6 DGSD.

Depositaries/custodians established as credit institutions may but are not required to hold cash itself. Investment firms and other legal entities are prohibited from holding cash itself.[225] Under the AIFMD/UCITSD V, the depositary is entrusted with the cash-flow monitoring task.[226] This includes the monitoring of AIF's/UCITS' cash that is booked with third-party eligible entities.[227] Depositaries may open accounts in its own name on behalf of the AIF/UCITS. No cash belonging to the depositary or the third-party entity may, however, be booked on such an account.[228] Depositary's counterparty risk may be mitigated by opening cash account with eligible third-parties in the name of the depositary by being clearly identifiable as cash belonging to the AIF/UCITS.[229] Thus, the protection of cash belonging to AIFs/UCITS against the insolvency of a depositary may be achieved by opening cash accounts with eligible third-party in the name of the AIF/UCITS or the AIFM/UCITS ManCo on behalf of the AIF/UCITS. Cash segregation is required to avoid the risk of commingling and preserve segregation of cash booked on such an account as clearly belonging to AIFs/UCITS in case of insolvency of the depositary.

Similarly, non-bank investment firms are required, on receiving any client funds[230], to promptly place those funds into one or more accounts opened with:[231]

- a central bank;
- a credit institution within the meaning of CRD IV;
- a bank authorized in a third country; and
- a qualifying money market fund.[232]

Investment firms have a general due diligence duty upon depositing client' funds.[233] Specific due diligence duties apply to the diversification[234] and intra-group deposits of client funds[235].

IORPD II does not contain any provisions related to cash. Unclear is whether the AIFMD/UCITSD V or the MiFID II provisions related to cash would need to be applied in analogy. The safekeeping task has, however, been copy/pasted from the AIFMD/UCITSD

---

[225] Art. 2, 4(1) MiFID II (Commission) Directive.

[226] Art. 21(7) AIFMD, Art. 86 AIFMD (Commission) Regulation; Art. 22(4) UCITSD V, Art. 10 UCITSD V (Commission) Regulation.

[227] Art. 21(7) AIFMD and Art. 22(4)(b) UCITSD V. refer for the depositing of clients funds to Art. 18(1)(a)–(c) MiFID I (Commission) Directive/Art. 4(1)(a)–(c) MiFID II (Commission) Directive.

[228] Art. 21(7) AIFMD, Art. 86 AIFMD (Commission) Regulation; Art. 22(4) UCITSD V, Art. 10 UCITSD V (Commission) Regulation.

[229] Art. 21(7) sub-para. 2 AIFMD; Art. 22(4) UCITSD V.

[230] In Ireland and the UK 'client funds' are often being referred to as 'client money'. See for Ireland: Central Bank of Ireland, Guidance on Client Asset Regulation for Investment Firms, March 2015 https://www.centralbank.ie/pressarea/pressreleases/Documents/150330%20Guidance%20on%20Client%20Asset%20Regulations%20for%20Investment%20Firms.pdf ; See for the UK: CASS 7; Central Bank of Ireland, Guidance on Client Asset Regulation for Investment Firms, March 2015, 58. https://www.centralbank.ie/press-area/pressreleases/Documents/150330%20Guidance%20on%20Client%20Asset%20Regulations%20for%20Investment%20Firms.pdf. 'client money' are funds being deposited in a bank account that are legally owned by the investment firm and beneficially owned by the investment firm's clients.

[231] Art. 16 (1)(e) MiFID; Art. 18(1) MiFID I (Commission) Directive.

[232] A qualifying money market fund means in this regard a UCITS or a collective investment undertaking which is subject to supervision and authorized by an (competent) authority that is satisfying additional conditions and, therefore, qualifies as a 'high quality' money market fund. See for the definition of a qualifying money market fund and any of the additional conditions for collective investment undertakings other than UCITS: Art. 1 MiFID II (Commission) Directive; Art. 18(2) MiFID I (Commission) Directive.

[233] Art. 4(2) MiFID II (Commission) Directive.

[234] Art. 4(2) sub-para. 1 MiFID II (Commission) Directive; ESMA/2014/1570, 57, 58.

[235] Art. 4(3) MiFID II (Commission) Directive.

V.[236] Similar depositary counterparty protection, thus, should, as a minimum, should be deemed to be available for IORPs appointing depositaries for both the safekeeping and oversight task under IORPD II.

2.3.1.2. Financial Instruments that can be held in Custody

Financial instruments that can be held in custody are mostly in book entry form and registered on the depositary's/custodian's book in segregated accounts, so that they can be clearly identified as belonging to client's and the client' rights are safeguarded upon the depositary's/custodian's insolvency.[237] In the case of delegation under the AIFMD and UCITSD V, sub-custodians are required to segregate such financial instrument from its own assets and the assets of the depositary so that these financial instruments can be identified as belonging to the AIF/UCITS and not to the AIFM/UCITS ManCo, depositary, the sub-custodian or other clients.[238] AIFs/UCITS, however, may bear counterparty risk for unencumbered financial instruments that can be held in custody of a depositary that faces 'guarantor liability' for the loss of financial instruments on the sub-custodian level.[239]

In depositing client' financial instruments, investment firms under MiFID II have to take into account the expertise and market reputation of institutions other than central banks, as well as, legal requirements or market practices related to the holding of those financial instruments that could adversely affect clients' rights.[240] Sub-custodians are under CRD IV, MiFID II and IORPD II are not required to hold client' financial instruments in segregated accounts. Omnibus accounts are, thus, also allowed. Client's generally, thus, do not face counterparty risks of depositaries/custodians for unencumbered financial instruments that can be held in custody. Counterparty risk may, however, arise upon a loss of financial instruments at the depositary/custodian or the sub-custodian level.

For encumbered financial instruments and those on title transfer, financial instruments are under the AIFMD and UCITSD V not considered to be in custody anymore if the legal title has been lost by the AIF/UCITS.[241] The loss of title is also under the national implementation laws of MiFID II considered to be resulting in counterparty risk, whereas for encumbered assets it depends upon the individual Member State under what conditions encumbered assets fall within the MiFID II safeguarding of client assets regime.[242] The same holds true for custodians regulated under CRD IV and depositaries under IORPD II.[243]

2.3.1.3. 'Other Assets'

Assets other than financial instruments held in custody and cash that qualify as 'other assets' do not result in counterparty risk. Such assets are not lost due to the depositary's/custodian's insolvency, since they are subject to ownership verification and record-keeping and do not fall

[236] Art. 34 IORPD II.
[237] Art. 85(1) AIFMD (Commission) Regulation; Art. 9(1) UCITSD V (Commission) Regulation; Art. 4(1)(a)–(c) MiFID II (Commission) Directive.
[238] Article 21(11)(d)(iii) AIFMD and Article 22a(3) UCITSD V; Art. 4(1)(a)–(c) MiFID II (Commission) Directive.
[239] Art. 21(12) AIFMD; Art. 24(1) UCITSD V;
[240] Art. 4(2) sub-para. 1 MiFID II (Commission) Directive; Art. 18(3) sub-para. 2 MiFID I (Commission) Directive.
[241] Recital 114 AIFMD (Commission) Regulation; Recital 24 UCITSD V (Commission) Regulation.
[242] See also S.L. Schwarcz, *Intermediary Risk in a Global Economy*, 6 Duke Law Journal 1541 (2001); S.L. Schwarcz, *Indirectly Held Securities and Intermediary Risk,* 2 Uniform Law Review 283 (2001).
[243] See D. Frase, *Custody*, in *Law and Regulation of Investment Management* (D. Frase ed., Sweet & Maxwell 2011), 274.

under the custody task.[244] If there is a segregation of clients 'other assets', the depositary/custodian is a 'pure investment service provider'.[245]

2.3.2. *Prudential Requirements related to Credit Institutions, Investment Firms and 'Equivalent Other Legal Entities'*

Depositaries and custodians are mostly credit institutions, investment firms or 'equivalent other legal entities'.

2.3.2.1. Credit institutions and Investment Firms

Credit institutions and investment firms are regulated under the so-called 'banking union'[246] that sets out a common financial regulatory framework ('single rulebook') and is complemented by a Single Supervisory Mechanism and a Single Resolution Mechanism.[247]

'Single Rule Book'

The 'Single Rulebook' is the name of a single set of harmonized prudential rules which credit institutions and investment firms must comply with. The term 'Single Rulebook' refers to the aim of a unified regulatory framework for the EEA financial sector that would complete the single market in financial services.[248] The 'Single Rulebook' consists of three main legislative acts, including CRD IV/CRR, the DGSD and the BRRD.[249]

CRD IV/CRR implements Basel III under which credit institutions (and investment firms) are required to hold better and more own capital, conservation buffers and countercyclical buffers. CRD IV and the CRR aim to avoid the impact of possible financial meltdown and mitigate factors addressing systematic risk.[250] CRD IV/CRR also apply to investment firms. Depending upon the business model of investment firms taking more or less 'principal risk', investment firms are required to hold more own capital and abide to capital adequacy rules.[251]

The banking union has sought to improve the existing European legislation on the protection of depositors in cases of the failure of credit institutions. The DGSD regulates deposit insurance in case of a credit institution's inability to pay its debts.[252] For that purpose,

---

[244] Art. 21(8) AIFMD; Art. 22(5) UCITSD V; Art. 34 IORPD II.

[245] Oxera, *The Role of Custody in European Asset Management*, 22, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx (accessed 7 October 2016).

[246] K. Lannoo, *The Great Financial Plumbing: From Northern Rock to Banking Union* 40 (Rowman and Littlefield International 2015).

[247] D. Busch & G. Ferrarini, *A Banking Union for a Divided Europe: An Introduction* (D. Busch & G. Ferrarini, Oxford 2015); K. Alexander, *Reforming the Structure of the EU Banking Sector* (D. Busch & G. Ferrarini, Oxford 2015); E. Ferran, *European Banking Union: Imperfect, But it Can Work* (D. Busch & G. Ferrarini, Oxford 2015); N. Moloney, *Banking Union and the Implications for Financial Market Governance in the EU: Convergence or Divergence* (D. Busch & G. Ferrarini, Oxford 2015); E. Wymeersch, *The European Banking Union, a First Analysis,* Financial Law Institute Working Paper Series WP 2012-07 (2012).

[248] G. Ferrarini & F. Recine, *The Single Rulebook and the SSM: Should the ECB Have More Say in Prudential Rule-making*? (D. Busch & G. Ferrarini, Oxford 2015).

[249] E. Ferran, *European Banking Union: Imperfect, But It Can Work,* University of Cambridge Faculty of Law Research Paper No. 30/2014 (2014).

[250] P. Muelbert & A. Wilhelm, *CRD IV Framework for Banks' Corporate Governance* (D. Busch & G. Ferrarini, Oxford 2015); International Organisation of Securities Commissions, *Mitigating Systemic Risk - A Role for Securities Regulators: Discussion Paper* (IOSCO 2011).

[251] C.P. Buttigieg, *The Development of the EU Regulatory and Supervisory Framework applicable to UCITS: A Critical Examination of the Conditions and Limitations of Mutual Recognition*, 40, http://sro.sussex.ac.uk/48285/1/Buttigieg%2C_Christopher_P..pdf (accessed 5 October 2016);

[252] F. Arnaboldi, *Deposit Guarantee Schemes – A European Perspective* (Springer 2014).

the DGSD reimburses a limited amount of deposits (EUR 100.000) to depositors.[253] From a financial stability perspective, this promise prevents depositors from making panic withdrawals from their credit institutions, thereby preventing severe economic consequences.[254] This is necessary for the overall financial stability in the single market.[255]

The BRRD is part of the second pillar of the Banking Union. It is considered to be a cornerstone in the EEA setting out of measures dealing with the failures of banking and certain investment firms ('financial institutions').[256] The BRRD providers various resolution tolls to prevent insolvency of financial institutions or, when insolvency occurs, to minimize damage and loss to investors and the financial system as a whole by preserving the systemically important functions of financial institutions.[257]

The Single Resolution Mechanism (SRM) is a pillar of the Banking Union that implements the BRRD in participating Member States and establishes a Single Resolution Fund (SRF) to finance their restructuring.[258] The SRF, essentially, requires credit institutions to pay for resolution so that taxpayers will be protected from having to bail out credit institutions if they go bust.[259]

The SRM is complemented by the Single Supervisory Mechanism' (SSM) that grants the ECB a supervisory role to monitor the financial stability of credit institutions based in participating states.[260] Eurozone Member States are obliged to participate, whereas Member states of the EU outside the eurozone may voluntarily participate.[261] The SSM functions in conjunction to the SRM as the two pillars underlying the 'Single Rulebook'.[262]

2.3.2.2. 'Equivalent Other Legal Entities'

---

[253] Art. 6 DGSD.

[254] P. Muelbert & A. Wilhelm, *CRD IV Framework for Banks' Corporate Governance* (D. Busch & G. Ferrarini, Oxford 2015); Commission staff working document, Impact Assessment - Accompanying document to the Proposal for a Directive …/…/EU of the European Parliament and of the Council on Deposit Guarantee Schemes [recast] and to the Report from the Commission to the European Parliament AND to the Council Review of Directive 94/19/EC on Deposit Guarantee Schemes COM(2010) 368 COM(2010) 369 SEC(2010) 835, /* SEC/2010/0834 final */.

[255] Proposal for a Directive …/…/EU of the European Parliament and of the Council on Deposit Guarantee Schemes [recast]/* COM/2010/0368 final - COD 2010/0207 */.

[256] V. Seriere, *Recovery and Resolution Plans of Banks in the Context of the BRRD and the SRM: Some Fundamental Issues* (D. Busch & G. Ferrarini, Oxford 2015).

[257] E. Wymeersch, *Banking Union: Aspects of the Single Supervisory Mechanism and the Single Resolution Mechanism Compared,* ECGI - Law Working Paper No. 290/2015 (2015).

[258] E. Ferran & V.S.G. Babis, *The European Single Supervisory Mechanism*, University of Cambridge Faculty of Law Research Paper No. 10/2013 (2013); D. Busch, *Governance of the Single Resolution Mechanism* (D. Busch & G. Ferrarini, Oxford 2015); V. Seriere, *Recovery and Resolution Plans of Banks in the Context of the BRRD and the SRM: Some Fundamental Issues* (D. Busch & G. Ferrarini, Oxford 2015); A. Gardella, *Bail-in and the Financing of the SRM* (D. Busch & G. Ferrarini, Oxford 2015).

[259] Council Implementing Regulation (EU) 2015/81 of 19 December 2014 specifying uniform conditions of application of Regulation (EU) No 806/2014 of the European Parliament and of the Council with regard to ex ante contributions to the Single Resolution Fund; European Commission, *Press release- Single Resolution Mechanism to come into effect for the Banking Union*, 31 December 2015; R.Z. Wiggins, M. Wedow & A. Metrick, *European Banking Union B: The Single Resolution Mechanism,* Yale Program on Financial Stability Case Study 2014-5B-V1 (2014).

[260] E. Wymeersch, *The Single Supervisory Mechanism: Institutional Aspects* (D. Busch & G. Ferrarini, Oxford 2015); G. Ferrarini & F. Recine, *The Single Rulebook and the SSM: Should the ECB Have More Say in Prudential Rule-making*? (D. Busch & G. Ferrarini, Oxford 2015).

[261] T.H. Troeger, *The Single Supervisory Mechanism – Panacea or Quack Banking Regulation?,* SAFE Working Paper No. 27 (2013).

[262] E. Wymeersch, *The Single Supervisory Mechanism or 'SSM', Part One of the Banking Union,* European Corporate Governance Institute (ECGI) - Law Working Paper No. 240/2014 (2014).

'Equivalent other legal entities' are required under the AIFMD, UCITSD V and IORPD II to fulfil minimum prudential regulation standards under CRD IV/CRR.[263] Prudential regulation for 'national custodians' is normally based upon the MiFID II and CRD IV/CRR.[264] Usually, these concern only various provisions from the CRD IV/CRR and other prudential regulation under the 'Single Rulebook', 'Single Resolution Mechanism' and 'Single Supervisory Mechanism'.[265] This is acceptable as 'national custodians' are under Member State regulation only allowed to provide safekeeping and administration of securities for others. 'National custodians' are pure investment service providers as they are not authorized to provide 'other value-added services'[266] and, thus, do not bear principle risk. Safekeeping and administration of securities for others is a low margin business.[267] Most fees are earned through 'other value-added services' that lead to 'principle risk' for which only credit institutions and investment firms are authorized. Domestic custodians do not have any systematic impact and, therefore, a minimum set of prudential regulation is considered to be acceptable.

2.4. Supervision

The regulatory framework is complemented by initial and ongoing supervision of depositaries/custodians on the national and European level. Credit institutions and investment firms are being supervised on a macro- and micro-prudential level by the so-called 'European Supervisory Architecture'. Equivalent other legal entities are only supervised on the national level.

2.4.1. The European Supervisory Architecture

The European supervisory architecture (ESFS) involves both macro-, as well as, micro-prudential supervision. [268] Four bodies together form the European System of Financial Supervision that complement 'Home Member State Control', i.e. prudential supervision on the Member State in which the depositary/custodian is established'.[269]

The ESRB carries out macro-prudential supervision. Its primary task is the prevention/mitigation of systematic risks.[270] For that purpose, the ESRB determines, collects and analyzes information[271]. On the basis of that the ESRB issues warnings and recommendations.[272] The ESRB has no legal personality and has no binding powers.[273] All its

---

[263] Art. 23(2)(c) UCITSD V.
[264] See Chapter 6, section 4.
[265] G. Ferrarini & L. Chiarella, *Common Banking Supervision in the Eurozone: Strengths and Weaknesses,* ECGI - Law Working Paper No. 223/2013 (2013).
[266] See Chapter 6, section 4.
[267] European Commission, Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries {C(2015) 9160 final}, 5, Annex 4.
[268] See the ESRBR, EBAR EIOPAR, ESMAR, ECBR and the ESRBR.
[269] E. Wymeersch, Eddy, *Europe's New Financial Regulatory Bodies*, 5, http://ssrn.com/abstract=1813811 (accessed 8 October 2016); E. Wymeersch, *The institutional reforms of the European Financial Supervisory System, an interim Report,* WP 2010-01 (2010).
[270] Art. 3(1) EBAR.
[271] Art. 3(1)(a) EBAR.
[272] Art. 3(1)(c)-(d), 16-18 EBAR.
[273] .J. Doelder & I.M. Jansen, *Een nieuw Europees toezichtraamwerk,* 1/2 TvFR 17 (2010); E. Ferran, *Understanding the New Institutional Architecture of EU Financial Market Supervision,* PAPER NO. 29/2011 (2011).

recommendations have to be implemented by Member States on a 'comply-or-explain basis.[274]

Micro-prudential supervision is being carried out by three 'ESAs'. The three ESA's are EBA, EIOPA and ESMA. Depending upon whether depositaries/custodians act under the AIFMD, UCITSD V, CRD IV, IORPD II or MiFID II, one or more ESA's are involved in supervising depositaries/custodians.

First, ESAs have 'rule making powers'. They advise the European Commission on new legislation to be adopted on both Level 1 initiatives and more detailed advice for Level 2 measures. The advisory function is mandatory for cases expressly stated in Level 1 instruments. ESAs may be involved in preparing and advising on delegating and implementing acts. However, the ultimate decision has to be made by the European Commission.

Apart from the rule making powers, the ESAs play also a role in the consistent application of adopted European law. ESAs are empowered to prevent inconsistent application by Member States of European law by enter into a dialogue with the competent authority of the Member State concerned. By absence of adequate measures, ESA issues a recommendation of non-compliance to the European Commission. The European Commission is entitled to start an infringement procedure before the CJEU against Member States.[275]

ESAs have also emergency powers in situations that have to be formally declared as an 'emergency situation' by the Council of ministers. ESAs may also adopt emergency measures in absence of a Council decision when otherwise danger would arise to the orderly functioning of the financial markets or financial stability.[276] Further, ESAs are entitled to settle cross-border disagreements between national Competent Authorities. They may assist in conflict resolution in the college of supervisors.[277] This may be exercised in cases expressively declared open for mediation by a Level 1 instrument. Finally, ESAs are entitled to prohibit or restrict 'financial activities' in case of emergency.[278]

2.4.2. Equivalent Other Legal Entities

Equivalent other legal entities are only supervised on the national level. Equivalent other legal entities are only under the AIFMD, UCITSD V and IORPD II subject to minimum European standards.[279] Remarkably, 'Equivalent other legal entities' may be appointed as 'UCITSD V depositary' on a cross-border basis (a de facto European passport) under the IORPD II although the European Supervisory Architecture does not (fully) apply to these entities.

3. Conclusion

European investment law in regulating depositaries and custodians seeks to protect investors, preserve the stability of the financial system and market integrity. [280]

---

[274] H. van Meerten & A.T. Ottow, *The proposals for the European Supervisory Authorities (ESAs): the right (legal) way forward?,* 1/2 TvFR 5 (2010).

[275] E. Ferran & K. Alexander, *Can Soft Law Bodies be Effective? Soft Systemic Risk Oversight Bodies and the Special Case of the European Systemic Risk Board,* Paper No. 36/2011(2011).

[276] N. Kost - de Sevres & L. Sasso, *The new European financial markets legal framework: a real improvement? An analysis of financial law and governance in European capital markets from a micro- and macro-economic Perspective, 7* Capital Markets Law Journal 30 (2011).

[277] E.J. van Praag, *Het grensoverschrijdend financieel toezicht loopt tegen grenzen aan*, 9 TvFR 259 (2011).

[278] Art. 11 EBAR, EIOPA Regulation and ESMA Regulation.

[279] Art. 23(2)(c) UCITSD V.

[280] Art. 2(1) Regulation (EU) 1093/2010 & Art. 2(1) Regulation (EU) 1094/2010, Reg. (EU) 1095/2010 refers to the preservation of sufficient protection of customers (investors), financial stability and ensuring confidence in the financial system as a whole; See also: P. Mülbert, *Anlegerschutz und Finanzmarktregulierung – Grundlagen*,

In essence, both depositaries and pure 'custodians', are at least performing the safekeeping function as a custodian. This is also reflected in the authorization and supervision of intermediaries that are allowed to be eligible as a custodian under MiFID II and CRD IV and as a depositary under the AIFMD, UCITSD V and IORPD II.[281] The AIFMD, UCITSD V and IORPD II do not contain a separate authorization regime for depositaries as is the case for AIFMs, UCITS ManCo and IORPs. Instead, these three directives reflect the 'custody plus' nature of the depositary, i.e. the depositary as a custodian performing additional oversight duties, by (partly) referring to credit institutions, investment firms or equivalent legal other legal entities eligible as depositaries/custodians that are regulated in other European legislative acts. For this purpose, eligible depositaries and custodians that are regulated under CRD IV, MiFID II and equivalent (national) regulation are required to comply with the same general authorization requirements in reducing risks related to the safekeeping function to investors of loss caused by negligent, fraudulent practices and the protection of insolvency to be fulfilled.

Although the safekeeping task of depositaries and custodians prevent operational failures, the safekeeping task of the depositary/custodians alone does not mitigate the agency cost resulting from the actions of, in particular, (collective) asset manager's related to those assets. For this purpose, depositaries under sectoral 'depositary laws' are required to perform oversight duties towards these (collective) asset managers. CRD IV, MiFID II and national equivalent regulations do not contain such an explicit obligation for custodians.[282] This can be explained by the agency costs borne by AIF/UCITS investors and IORP Members in relation to (collective) asset managers compared to individual investors related to investment firms. The subsequent chapters explain the monitoring and oversight functions performed by depositaries in preventing agency costs compared to the mere the safekeeping tasks of custodians in the governance relationship between investors/members, depositaries/custodians and (collective) asset managers/investment firms.

---

177 ZHR 160 (2013); International Organisation of Securities Commissions, *Objectives and Principles of Securities Regulation for market intermediaries,* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf (accessed 14 January 2017).

[281] Art. 21(3) AIFMD; Art. 23(2) UCITSD V; Art. 33(3) IORPD II.

[282] See Chapter 10, section 4.

B. Teleological Explanation - Conclusion

The authorization, conduct of business rules, prudential regulation, supervision and enforcement of credit institutions, investment firms and 'equivalent other entities' are considered under the various European directives to be appropriately addressing the investor and market protection risks related to the safekeeping function of custodians and depositaries. The notion of 'depositary' under IORPD II, UCITSD V and the AIFMD is wider than the notion of pure 'custodian'[1]. For this reason, IORPD II, UCITSD V and the AIFMD require additional conducts of business rules to be fulfilled for depositaries that in their capacity of acting as a custodian perform oversight duties. Depositary law is, thus, a separate area of law applying on top of the 'general law' applying to credit institutions, investment firms or 'other equivalent legal entities' authorized to act as a custodian.

The subsequent chapters pay, in particular, attention to examining the monitoring and oversight functions performed by depositaries in preventing agency costs compared to the mere the safekeeping tasks of custodians in the governance relationship between investors/members, depositaries/custodians and (collective) asset managers/investment firms as 'investment intermediaries'.

[1] European Commission, *Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries {C(2015) 9160 final}*, Annex 4.

PART III - Depositaries vs. Custodians

C. Systematic Explanation

The difference between 'depositaries' and 'custodians' is that depositaries, apart from safekeeping, also perform oversight duties.[1] In this regard, it should be noted that the AIFMD and UCITSD V require mandatorily a depositary to be appointed, MiFID I/II a custodian to be appointed[2], whereas IORPD II leaves it up to the Member States whether a depositary/custodian is appointed at all and if so, whether either a depositary or custodian must be appointed.[3] There are, thus, not only differences between 'depositaries' and 'custodians', but also between various types of 'depositaries' throughout sectoral EEA legislation.

This is the result of how the different European investment law directives deal with the 'structural separation of investments and management'. The 'investment assets' legally/beneficially owned by investors/members and the 'operational assets' legally/beneficially owned by 'investment intermediaries' and 'depositaries'/'custodians' form two separate 'asset patrimonies'. European investment law establishes this structural separation by means of warranting an (optional/virtual) 'investment triangle' to be in place that involves an 'investment intermediary', depositary/custodian and investors/members. This 'triangle' regulates (fiduciary/agency) governance and asset partitioning.

The structural separation leads to agency costs. The (virtual/optional) investment triangle under European investment law regulates this by requiring 'investment intermediaries' and 'depositaries/custodians' to be regulated under intermediary regulation, financial products such as AIFs, UCITS and PEPPs, are subject to product regulation, whereas disclosure/sales/marketing regulation ensures that investors/members are adequately informed. Depositaries/custodians are, thus, merely one investor protection mechanism in the investment triangle that regulates the agency costs resulting from the structural separation of investments and management under the European investment law directives. The *systematic explanation* clarifies that depositaries are required to be appointed under European investment law directives that have an 'fiduciary' and 'collective investment' nature and in which investors/members bear 'full investment risks', whereas custodians are used under those directives that have an 'agency' and 'individual investment' nature.

[1] International Organization of Securities Commission, *Standards for the Custody of Collective Investment Schemes' Assets – Final Report*, FR 25/2015, November 2015, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD512.pdf (accessed 14 April 2017).
[2] Recital 32, Art. 22(1) UCITSD V; Art. 21(1) AIFMD.
[3] Art. 33(1) and (2) IORPD II.

CHAPTER 8 AIFMD & UCITSD V: The Investment Triangle

1. Introduction: The Investment Triangle

Since the creation of the EU legal framework with the UCITS Directive,1 depositaries are one of the three fundamental pillars of European collective investment law, alongside the fund (the joint investors) and its manager.[2] By requiring AIFM's to ensure that a single depositary is appointed for each AIF it manages, the AIFM Directive extends this legal framework covering the 'investment triangle' from UCITS to AIFs.[3]

Within the investment triangle, an AIFM/UCITS ManCo holds the discretionary authority to make investment decisions unilaterally on behalf of the fund (the joint investors). By investing money, AIFM/UCITS ManCo are acting as a fiduciary on behalf of investors that do not have direct control over the investment decisions being made. While investing, there could be a risk of attachment when the personal creditors of an AIFM/UCITS ManCo would have recourse against the assets of investors should the manager default. Moreover, the assets of an investment portfolio could be comingled with the assets of the financial intermediary that is managing the portfolio or with the assets of investment portfolios belonging to other individual investors or collective investment schemes. In addition, there is an risk of wrongdoing or fraud by the manager. Especially, in collective investment situations, in which many small investors participate in a fund with a small stake and delegate the investment decision making to a professional on behalf of the fund, individual investors do not have the incentive to monitor the managers.

The AIFMD and UCITSD V deal with these problems between investors and AIFM/UCITS ManCo by requiring an intervening depositary that plays a key role in the protection of the investor's assets, as a result of the assigned responsibilities to keep the assets safe and exercise oversight duties over them.[4] By safekeeping investors assets, the depositary is holding assets in custody and assets that cannot be held directly are being registered by the depositary. In addition to safekeeping assets, the depositary also holds the funds. The depositary receives the monies from the investors on behalf of the fund upon its issuance of the units to the investors. Upon redemption, the depositary transfers the funds to the investors back. The depositary is, thus, the point of contact for money flowing to and from the investors and ensures that the manager's access to the funds monies and assets is reduced. Both the AIFM/UCITS ManCo and the depositary oversee each other's activities ensuring that either of the intermediaries cannot cheat investors on the transactions made or even run away with the assets and monies belonging to the fund. Depositaries are, thus, the legal nexus between the investors, at the one, and AIFM/UCITS ManCo, at the other hand safeguarding the

---

[1] Directive 85/611/EEC

[2] Art.22 et seq. UCITSD; Art.21 AIFMD; Art.13(7) and (8) MiFID and Art.16 through 19 MiFID Implementing Directive 2006/73/EG; Art 31(1) and (2) IORPD II (it is within the discretion of the Member States to decide whether the appointment of a depositary/custodian is being made compulsory).

[3] D.A. Zetzsche, *Introduction* (D.A. Zetzsche ed, Kluwer 2015); In fact, the first investment fund in the world 'unity creates strength' already applied the 'investment triangle'. See W.H. Berghuis, *Ontstaan en ontwikkeling van de Nederlandse beleggingfondsen tot 1914* (Van Gorcum 1967); T.M.J Möllers, *Umfang und Grenzen des Anlegerschutzes im Investmentgesetz - Der Trennungsgrundsatz und die Grenzen der Aufrechnung im InvG*, 9 BKR 353 (2011); O Sachtleber, *Zivilrechtliche Strukturen von open-end-Investmentfonds in Deutschland und England*. (Bank- und Kapitalmarktrecht, 2011).

[4] D.A. Zetzsche, *Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?* (H. S. Birkmose, M. Nevillie & K. E. SØrensen eds., Kluwer 2012).

interests of AIFs investors by safekeeping the entrusted assets and monies of the AIF and performing a series of controls on behalf of the joint investors.

Under European investment law, the fiduciary relationships between the collective asset managers (AIFMs/UCITS ManCos), the investors and depositaries, i.e. the 'investment triangle', is being regulated by 'intermediary', 'product' and 'disclosure/reporting' regulation. The AIFMD/UCITSD V intermediary regulation targets the authorization and organizational rules that apply to AIFMs/UCITS ManCos and depositaries. Product regulation relates to the legal forms in which AIFs/UCITS are allowed to be established and the investment portfolios in which (specific types of) AIFs/UCITS under the respective legislative acts are allowed to invest in, whereas disclosure (marketing)/reporting regulation stipulates the investor information and reporting requirements that AIFMs and UCITS ManCos are required to provide to investors and competent authorities. The intermediary, product and disclosure/reporting regulation under the AIFMD/UCITSD V will now be addressed in detail in order to determine the specific oversight role that depositaries have under the AIFMD/UCITSD V governance.

2. Scope AIFMD versus UCITSD V

The duty to obtain an authorization[5] as an AIFM depends upon the question whether a legal entity is managing/marketing one or more AIFs in the EEA.[6] Similarly, UCITSD V requires for both the management (authorization UCITS ManCo) as the marketing[7] of UCITS units/shares to the public (authorization of the UCITS) an authorization to be obtained. The definitions of an AIF and UCITS need to be clarified in order to clarify the scope of both directives and justify any possible differences in depositary law. The paragraph clarifies that both UCITS and AIFs are qualifying as collective investment undertakings that raise capital, from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors.[8] UCITS, however, diverge from AIFs. AIFs may be illiquid, substantially leveraged or liquid collective investment undertakings, whereas UCITS are open-ended, mandatorily required to be authorized and AIFs are solely marketed based upon the AIFMD marketing passport to professional investors. UCITS are, thus, 'AIFs' that are authorized under UCITSD V. This section continues to explain first the AIF definition and then the UCITS definition to highlight the similarities and differences in detail.

2.1. What is an AIF?

The duty to obtain an authorization[9] as an AIFM depends upon the question whether a legal entity is managing/marketing one or more AIFs in the EEA.[10] In order to answer this question, the definition of an AIF needs to be clarified.[11]

---

[5] Small AIFMs have, instead of an authorization duty, the duty to register themselves. See Art. 3(3) AIFMD.
[6] Art. 2(1) AIFMD; This paragraph has been partly published in Dutch in: S.N. Hooghiemstra, *Wat is een beleggingsinstelling onder de AIFM-richtlijn?*, 3 Ondernemingsrecht 24 (2014); See also P. Athanassiou, *The AIFM Directive: an overview of the final rules*, 26 Journal of International Banking Law and Regulation 237 (2011); D. Awrey, *The limits of EU hedge fund regulation*, 5 Law and Financial Markets Review 119 (2011).
[7] Referred to in Art.5 UCITSD V as 'pursuing activities'.
[8] Art. 4(1) AIFMD.
[9] Small AIFMs have, instead of an authorization duty, the duty to register themselves. See Art. 3(3) AIFMD.
[10] Art. 2(1) AIFMD; This paragraph has been partly published in Dutch in: S.N. Hooghiemstra, *Wat is een beleggingsinstelling onder de AIFM-richtlijn?*, 3 Ondernemingsrecht 24 (2014); See also P. Athanassiou, *The AIFM Directive: an overview of the final rules*, 26 Journal of International Banking Law and Regulation 237 (2011); D. Awrey, *The limits of EU hedge fund regulation*, 5 Law and Financial Markets Review 119 (2011).

The obligation to obtain an authorization under the AIFMD is directed to AIFMs whose business either is managing or marketing one or more (Non-) EEA-AIFs.[12] An AIFM is a legal person[13] whose regular business is managing one or more AIFs.[14] The obligation to obtain an authorization applies to all AIFMs regardless of the legal form of the AIF[15], whether the AIF is of an open-ended or a closed-ended type[16] or whether or not the AIF is listed.[17] The AIFMD is applicable to all collective asset managers of collective investment undertakings that do not require authorization pursuant to UCITSD V. The core question whether an collective asset manager needs to obtain an AIFM authorization is the question whether a collective investment undertaking qualifies as an AIF or not.[18] The AIF-definition under the AIF comprises three elements[19], including (1) an undertaking for collective investments, (2) four additional criteria that such an undertaking needs to fulfill in order to qualify as an AIF and (3) a limited list with entities to which the AIFMD is not applicable.[20]

2.1.1. Collective Investment Undertakings

Collective investment undertakings are an undefined definition in the AIFMD that is also used in other European banking and securities laws.[21] Based upon the scarce literature[22] and the

---

[11] During the implementation of the AIFMD in several Member States, this question proved to be not easily answered. During the AIFMD parliamentary debate in the Netherlands, for example, it was discussed whether entities pooling pension fund assets would fall within the scope of the AIFMD. See Kamerstukken II, 2012/13, 33 235, No. 11. See also Kamerstukken II, 2012/13, 33 235, No. 13; Several other European legislators and competent authorities questioned the content of the AIF-definition. See BaFin, Auslegungsschreiben zum Anwendungsbereich des KAGB und zum Begriff des Investmentvermögens (2013); FSA, Implementation of the Alternative Investment Fund Managers Directive (2012); FCA, Implementation of the Alternative Investment Fund Managers Directive, (2013), Annex P, Amendments to the Perimeter Guidance manual (PERG).

[12] C.M. Grundmann-van de Krol, *Regulering beleggingsinstellingenen icbe's in de Wft* (Boom Juridische uitgevers 2013); See J. Kammel, *Alternative Investmentfonds Manager-Gesetz (AIFMG)&Co – Eine erste Bestandsaufnahme*, 7 Österreichisches Bankarchiv 483 (2013); E. Wallach, *Alternative Investment Funds Managers Directive – ein neues Kapitel des europäischen Investmentrechts*, 2 Recht der Finanzinstrumente 80 (2011).

[13] D.A. Zetzsche & C.D. Preiner, *Scope of the AIFMD* 66, 67 (D.A. Zetzsche ed, Kluwer 2015); D. Busch & L. Van Setten, *The European AIFMD* (D. Busch ed, Oxford 2014); J. Ph. Broekhuizen & J. den Hamer, *Toezicht op alternative investment fund managers*, 3 Vastgoedrecht 73 (2010); J. Ph. Broekhuizen & J. den Hamer, *Voorgang implementatie toezicht op alternative investment fund managers*, Tijdschrift Vastgoedrecht 9 (2012).

[14] Art. 4(1)(b) AIFMD; L.J. Silverentand, *De AIFM-richtlijn – een stap verder?*, Tijdschrift voor financieel recht 65 (2010); L.J. Silverentand & F.W.J. van der Eerden & B. Bierman, *De concept-richtlijn inzake beheerders van alternatieve beleggingsinstellingen; work in progress*, 9 TvFR 332-342 (2009).

[15] See D.A. Zetzsche, *Die Irrelevanz und Konvergenz des Organisationsstatuts von Investmentfonds*, 111 ZvglRWiss 371 (2012).

[16] Recital 34 AIFMD; Cf. M. Oppitz, *Wohin mit den geschlossenen Fonds? – Ein Veranlagungsinstrument zwischen BWG, WAG, KMG, AIFMG und Gewerbeordnung,* 1 Österreichisches Bankarchiv 49 (2014).

[17] Recital 6 AIFMD; G. Spindler & S. Tancredi, *Die Richtlinie über Alternative Investmentfonds (AIFM-Richtlinie) – Teil I*, 30 Wertpapier-Mitteilungen Zeitschrift für Wirtschafts- und Bankrecht 1393 (2011); G. Spindler & S. Tancredi, *Die Richtlinie über Alternative Investmentfonds (AIFM-Richtlinie) – Teil II*, 31 Wertpapier-Mitteilungen Zeitschrift für Wirtschafts- und Bankrecht 1441 (2011).

[18] S.C.M. de Visser-Wiggers & J. Kerkvliet, *Bent u al AIFMD-proof?,* 5 TOP 29-33 (2014); M. Scheele, *Toezicht op alle beheerders van beleggingsinstellingen vanaf juli 2013*, 15 Ondernemingsrecht 150-160 (2013).

[19] D.A. Zetzsche & C.D. Preiner, *Scope of the AIFMD* 66, 67 (D.A. Zetzsche ed, Kluwer 2015).

[20] *Ibid.*

[21] See for an overview of these Directives: D.A. Zetzsche & C.D. Preiner, *Scope of the AIFMD* 51, 52 (D.A. Zetzsche ed, Kluwer 2015); Art. 2(1)(i) MiFID II: collective investment undertakings and pension funds whether coordinated at Union level or not and the depositaries and managers of such undertakings; Art. 1(2)(a) PR: exempts from the scope of the PR: 'units issued by collective investment undertakings other than the closed-end type'.

[22] See S.W Kind & S.A. Haag, *Der Begriff des Alternativen Investment Fonds nach der AIFM-Richtlinie – geschlossene und private Vermögensanlagegesellschaft im Anwendungsbereich?*, 30 Deutsches Steuerrecht 1526

ESMA Guidelines on the key concepts of the AIFMD, 'collective investment undertaking collective investments' have four key characteristics.[23] These key characteristics include (1) an investment; (2) a pooled return; (3) collective investment (a number of investors); and third-party investment management. These key characteristics will be subsequently discussed.

2.1.1.1. Investment

The criterion investment serves already for many years for regulatory law purposes to delineate collective investment undertakings from entrepreneurial/commercial enterprises.[24] To ensure a consistent application of this definition, ESMA clarified in its guidelines that an undertaking is not considered to be an undertaking for collective investment if its pursuing a general commercial or industrial purpose.[25] To this end, ESMA defines as a general or commercial or industrial purpose the purpose of pursuing a business strategy which include characteristics such as running predominantly:[26]

- a commercial activity, involving the purchase, sale, and/or exchange of goods or commodities and/or the supply of non-financial services, or
- an industrial activity, involving the production of goods or construction of properties, or
- a combination thereof.

Despite ESMA's attempt to define what is to be regard as an 'investment', the guidelines do not clarify in all circumstances what is an investment or an entrepreneurial/commercial activity. The latter will be discussed in more detail in the subsequent section 'exemptions'in which holding companies are discussed in greater detail.

2.1.1.2. Pooled return/capital

An undertaking needs in order to qualify as an undertaking for collective investments raise capital that is legally being pooled for investment purposes. This 'pooled capital' for regulatory purposes needs to be delineated from discretionary asset management. An asset manager managing discretionary mandates needs to obtain an authorization based upon MiFID II and not the AIFMD.[27]

Following ESMA's guidelines, an undertaking only fullfills the criterium of 'pooled capital' when it pools together capital raised from ist investors for the purpose of investment with a view to generate a 'pooled return'[28] for those investors.[29] The decisive criterion is, thus, whether a 'pooled return' is generated. A pooled return is a return that is generated by the pooled risk from acquiring, holding or selling investment assets.[30] This includes activities that

---

(2010); See also: BaFin, *Auslegungsschreiben zum Anwendungsbereich des KAGB und zum Begriff des Investmentvermögens*, Q 31-Wp 2137-2013/0006, 9 März 2015.
D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* Erster Teil (Mohr Siebeck 2015).

[23] See also D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* Erster Teil (Mohr Siebeck 2015); ESMA uses similar criteria to define a 'collective investment undertaking'. See
See ESMA/2013/611, 6 et seq., for 'investment': Nr. 12 a), a 'pooled return': Nr 12 b), 'collective': Nr. 12 b) and 'third-party management': Nr. 12 c).

[24] See in the Netherlands: C.J Groffen, N.B. Spoor & J.W.P.M. van der Velden, *Beleggingsinstellingen* 465-474 (D. Busch et al, Kluwer 2010); J. den Hamer & L. Ait Youss, *Ondernemen of beleggen?,* 5 VGR 2010 132; C.M. Grundmann-van de Krol, *Koersen door de Wet op het financieel toezicht* 95-104 (Kluwer 2012).

[25] ESMA/2013/611, 6; D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* , § 1 B. III (Mohr Siebeck 2015).

[26] ESMA/2013/611, 3.

[27] Annex I, Section A No. 4 MiFID II.

[28] See D.A. Zetzsche & C.D. Preiner, *Scope of the AIFMD* 52, 53 (D.A. Zetzsche ed, Kluwer 2015); ESMA/2013/611, 3, 4, 6.

[29] ESMA/2013/611, 5

[30] ESMA/2013/611, 3.

are aimed at optimizing or increasing the value of these assets, irrespective of whether different returns are generated for investors.[31] An example of the latter is a tailored dividend policy.[32]

In summary, there is has to be a 'pooled risk'. In the ESMA guidelines this criterion has not been elaborated further. ESMA seems to point out the process of legally blending the assets of the individual investors that are inextricably combined.[33] What 'pooled risk' means can be exemplified by the risk that individual investors are exposed to in the event of an insolvency of an collective investment undertaking.[34] All individual investors of an collective investment undertaking or not able to reclaim their capital or proportional share in the assets of the fund upon the insolvency of the undertaking.[35] All investors in a single collective investment undertaking are, thus, equally effected upon an insolvency of the fund. The risks that the individual investors face are, thus a 'pooled risk'. This criterion is easily explained by taking managed accounts as an example.[36] Discretionary asset managers, often manage two or more managed accounts on behalf of several individual clients by managing them parallel, i.e. an discretionary asset manager applies exactly the same investment strategy to two or more managed accounts (for example, pension funds).[37] The latter is being done to avoid client insolvency risk involved in pooling client funds and obtaining economies of scale.[38]
Prior to the AIFMD, it was often unclear whether managing parallel accounts could be seen as collective investment. Although parallel accounts achieve a similar effect to the participation of collective investment undertakings the *pooled risk* resulting from the legal pooling of client funds/assets is avoided. The accounts, due to different custodians and trade execution administration, do not necessarily perform identically nor do the parallel accounts a joint estate in which all individual investors are unable to reclaim their capital.[39] This would have been differently if an collective asset manager would have economically and legally pooled capital/assets on behalf of the joint individual investors by establishing a legal form.
For investment purposes capital, thus, needs to be raise and legally pool assets to establish a pooled return/risk that constitutes the obligation for a collective asset manager to obtain authorization is an AIFM.

An undertaking needs in order to qualify as an undertaking for collective investments raise capital that is legally being pooled for investment purposes.

2.1.1.3. Collective Investment

Collective investment undertakings only qualify as an AIF if the unitholders or shareholders of the undertaking, as a collective group, have no *day-to-day discretion or control*.[40] The references to 'unitholders or shareholders' and 'as a collective group' implies that more than one investor will need to invest in an undertaking to qualify as an AIF within the scope of the AIFMD.[41]

2.1.1.4. Third-Party Investment Management

[31] *Ibid.*
[32] *Ibid.*
[33] D.A. Zetzsche & C.D. Preiner, *Was ist ein AIF?*, 45 Zeitschrift für Wirtschafts- und Bankrecht 2101 (2013).
[34] See D.A. Zetzsche & C.D. Preiner, *Scope of the AIFMD* 52, 53 (D.A. Zetzsche ed, Kluwer 2015);
[35] *Ibid.*
[36] D.A. Zetzsche & C.D. Preiner, *Was ist ein AIF?*, 45 Zeitschrift für Wirtschafts- und Bankrecht 2101 (2013).
[37] D. Frase, *Overview* 4 (D. Frase ed., Sweet & Maxwell 2011).
[38] *Ibid.*
[39] D. Frase, *Overview* 4,5 (D. Frase ed., Sweet & Maxwell 2011).
[40] ESMA/2013/611, 5.
[41] S. Bäuml, *Investmentvermögen im neuen Kapitalanlagegesetzbuch* (Teil I) (2013).

The criterion third-party management excludes investment clubs[42] and MiFID discretarionary portfolio magement from qualifying as an collective investment undertaking.[43] The criterion also excludes *special purpose vehicles* that are establishes for securitizations[44] and investment advisers[45] from the scope of the AIFMD.

Following ESMA, the criterion 'third-party investment management' is fulfilled if the unitholders or shareholders of the undertaking , as a collective group, have no *day-to-day discretion or control* over the defined investment policy to be pursued.[46] If one or more unitholders or shareholders are granted *day-to-day discretion or control,* this does not necessarily imply that the undertaking is not a collective investment undertaking.[47]

ESMA guidelines define *day-to-day discretion or control* as a form and on-going power of decision over operational matters relating to the daily management of the undertakings' assets.[48] The mere form of direct and on-going power of decision suffices this criterion. Not required is that the power of decision is in practice exercised or not. The direct and on-going power of decision must, however, extend substantially further than the ordinary exercise of decision or control through voting at shareholder meetings regarding matters such as, amongst others, mergers or liquidation or the election of shareholder representatives.[49]

2.1.2. Additional Requirements

Following the AIFMD, a collective investment undertaking is an AIF if that undertaking (1) raises capital, (2) from a number of investors, (3) with a view to invest it in accordance with a defined investment policy, (4) for the benefit of those investors. An undertaking qualifies only as an AIF under the AIFMD if an collective investment undertaking fulfills these additional requirements. Consequently, the obligation of authorisation as an AIFM under the AIFMD only applies if these requirements are applicable.

2.1.2.1. Raising capital

Another criterion that needs to be fulfilled, is the raising of capital.[50] Following ESMA's guidelines, the 'raising of capital' is seen as an commercial activity by an undertaking or a person or entity acting on its behalf (typically, the AIFM).[51] This commercial activity must involve direct or direct steps undertaken by an undertaking to procure the transfer or commitment of capital by one or more investors to the undertaking. It is immaterial whether the activity may take place only once, on several occasions or on an ongoing basis and the transfer or commitment of capital make take the form of subscriptions in cash or in kind.[52] The transfer or commitment of capital must subsequently be invested on behalf of the

---

[42] See BaFin, *Hinweise zur Erlaubnispflicht von Investmentclubs und ihrer Geschäftsführer nach § 32 KWG*, Q 31-QF 2100-2008/0003, 9 Juni 2011.

[43] ESMA also uses the criterion 'third-party management to define a 'collective investment undertaking'. See ESMA/2012/117, 11.

[44] See D.A. Zetzsche & D. Eckner, *Securitizations* 607 (D.A. Zetzsche ed, Kluwer 2015); See also: I. Barbour & K. Hostalier, *The Concept of Securitisation* (F. J. Fabozzi & M. Choudhry eds, Wiley 2004).

[45] Annex I, Section A No. 5 MiFID II.

[46] D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* § 1 D (Mohr Siebeck 2015); See D.A. Zetzsche & C.D. Preiner, *Scope of the AIFMD* 52, 53 (D.A. Zetzsche ed, Kluwer 2015); See also ESMA/2013/611, 4, 6.

[47] ESMA/2013/611, 6, 15.

[48] See ESMA/2013/611, 4.

[49] See ESMA/2013/611, 4.

[50] D. Loff & U. Klebeck, *Fundraising nach der AIFM-Richtlinie und Umsetzung in Deutschland durch das KAGB*, BKR 353 (2012).

[51] ESMA/2013/611, 6; See also BaFin, Auslegungsschreiben zum Anwendungsbereich des KAGB und zum Begriff des Investmentvermögens (2013), Nr. I.5.

[52] ESMA/2013/611, 6.

investors in accordance with a defined investment policy.[53] ESMA, thus, differentiates in its guidelines between capital that has been raised with and without commercial activity.

This criterion 'raising of capital' intends to exclude from the scope of the AIFMD undertakings that invest private wealth on behalf of investors.[54] Following ESMA, this is the case when capital is exclusively invested in an undertaking that has been exclusively established for the investment of private wealth of a group of family members[55], where the existence of the group pre-dates the establishment of the undertaking (*pre-existing group*).[56] Required is that the family members are the sole ultimate beneficiaries of such a legal structure.[57] This does not prevent family members to join the group after the undertaking has been established. Family members include, amongst others, the spouse of an individual and relatives in direct line.[58]

In the event that one or more investors not being members of a *pre-existing group* invest alongside the members of a pre-existing group in such an undertaking has the consequence that the criterion 'raising capital' is fulfilled.[59]

It is unclear how investment clubs should be seen in this regard that appoint a third- party as an asset manager.[60] In accordance with the guidelines that are published by ESMA and BaFIN and the view of the author, this should qualify as investors providing internal capital.[61] Investment clubs do not fulfill the commercial activity criterion. They do not procure transfers or commitments of capital by one or more investors to a undertaking to invest in accordance with a pre-defined investment policy.[62]

2.1.2.2. A Number of Investors

The criterion 'a number of investors' is decisive in determining whether an asset manager needs to obtain an authorisation for managing an AIF or managing discretarionary portfolio's within the scope of MiFID I/II.

Following, the ESMA guidelines, undertakings do not necessarily need to raise capital of more than one investor (a number of investors) to fulfill this criterion. Undertakings that only have one investor could also qualify as an AIF. To fulfill this criterion, it suffices that an undertaking is not prevented by its national law, the rules or instruments of incorporation, or any other provision or arrangement of binding legal effect, from raising capital from more

[53] *Ibid*.
[54] Recital 7 AIFMD.
[55] See M. Krause & U. Klebeck, *Family Office und AIFM-Richtlinie – Zugleich eine Suche nach dem Regelungsadressat der AIFM-Richtlinie*, 34 Betriebs-Berater 2063 et seq. (2012); P. Schaubach, 'Family Office: Ein Beitrag zur Begriffsfindung', 51 Bank-Archiv : Zeitschrift für das gesamte Bank- und Börsenwesen 897 (2003).
[56] ESMA/2013/611, 4.
[57] See for the pre-existing group definition: ESMA/2013/611, 4.
[58] ESMA/2013/611, 4.
[59] E. Waclawik, *Aufsichtsrechtliche Aspekte der Tätigkeit privater Family Offices*, Zeitschrift für Bankrecht und Bankwirtschaft 401 (2005); E. Waclawik, *Erlaubnispflicht privater Family Offices nach Umsetzung der MiFID?*, Zeitschrift für Wirtschaftsrecht 1341 (2007).
[60] Prior to the adoption of the official guidelines ESMA clarified this point: ESMA/2012/845, 52.
[61] BaFin, Hinweise zur Erlaubnispflicht von Investmentclubs und ihrer Geschäftsführer nach § 32 KWG, Q 31-QF 2100-2008/0003, 9 juni 2011, Nr. I.3; M. Krause & U. Klebeck, *Fonds(anteils)begriff nach der AIFM-Richtlinie und dem Entwurf des KAGB,* 1 RdF 4 (2013).
[62] ESMA/2013/611, 6; BaFin, Auslegungsschreiben zum Anwendungsbereich des KAGB und zum Begriff des Investmentvermögens (2013), Nr. I. 3. B; See FCA, Implementation of the Alternative Investment Fund Managers Directive, (2013), Annex P, Amendments to the Perimeter Guidance manual (PERG), Question 2.48, 2.50.

than one investor. A minimum transfer or commitment of capital upon subscription is not required.[63]

Undertakings which are legally[64] preventing from raising capital from more than one investor can also fullfil the criterion ‘a number of investors’, if the sole investor:[65]

- invests capital which it has raised from more than one legal or natural person with a view to investing it for the benefit of those persons; and
- consists of an arrangement or structure which in total has more than one investor for the purposes of the AIFMD.

Examples mentionted by ESMA include arrangements or structures, including master-feederstructures where a single feeder fund invests in a master undertaking and fund of funds that are the sole investor.[66]

2.1.2.3. Investing in accordance with a defined investment policy

The AIFMD is applicable to undertakings that have a policy of how the pooled capital is to be managed to generate a pooled return for the investors. This criterion highlights the difference between investments and commercial activities.[67] The discretionary management is required to be aimed at generating a pooled return for the investors from whom the (pooled) capital has been raised.

The AIFMD is not limited to AIFs applying certain defined investment policies.[68] AIFs may invest in a broad range of assets, including, amongst others, wine, patents and financial instruments.[69] It is also irrelevant whether the principle of diversification is applied to an AIF’s investment strategy. An AIFs defined investment policy may, thus, consist of either a concentrated or diversified portfolio not limited to a certain number of assets.[70]

Following ESMA, there are factors that, singly or cumulatively, indicate the existence of such as defined investment policy. A defined investment policy is:[71]

- fixed, at the latest by the time that investors’ commitments to the undertaking (AIF) become binding on them;
- determined a document that is part of or referenced in the rules or instruments of incorporation ;
- legally binding for the undertaking/legal person managing the undertaking (AIFM) towards investors to investors to follow the investment policy, including all changes to it;
- specifying investment guidelines, with reference to criteria including any or all of the following:

---

[63] ESMA/2013/611, 6, 7; See also ESMA/2012/117, 10; C. Tollmann, Art.2 *Geltungsbereich*, in *AIFM-Richtlinie* 111-112 (F. Dornseifer et al., eds, 1st edn, C.H. Beck 2013).

[64] Again this means its national law, the rules or instruments of incorporation, or any other provision or arrangement of binding legal effect. See also the ESMA criterion on the ‘number of investors’: ESMA/2013/611, 6.

[65] ESMA/2013/611, 7; See also ESMA/2012/117, 10.

[66] ESMA/2013/611, 6

[67] ESMA/2013/611, 7; BaFin, Auslegungsschreiben zum Anwendungsbereich des KAGB und zum Begriff des Investmentvermögens (2013), Nr. I.5; FCA, Implementation of the Alternative Investment Fund Managers Directive, (2013), Annex P, Amendments to the Perimeter Guidance manual (PERG), Question 2.13.

[68] Art.4(1)(a) AIFMD; Recital 34 AIFMD refers to private equity, venture capital and real estate AIFs.

[69] This is in contrary to the opinion of Kind and Haag. They argue that undertakings that merely invest in a single asset should be excluded from the scope of the AIFMD. See S.W Kind & S.A. Haag, *Der Begriff des Alternativen Investment Fonds nach der AIFM-Richtlinie – geschlossene und private Vermögensanlagegesellschaft im Anwendungsbereich?*, 30 Deutsches Steuerrecht 1526 (2010); ESMA mentions six different investment strategies. See ESMA 2012/117, 10.

[70] See D.A. Zetzsche & C.D. Preiner, *Scope of the AIFMD* 61, 62 (D.A. Zetzsche ed, Kluwer 2015).

[71] ESMA/2013/611, 7; ESMA/2012/117, 10 et seq.

- the investment in certain categories of assets (asset allocation);
- certain investment strategies;
- investments in particular geographical regions;
- restrictions on leverage ;
- minimum holding periods ; or
- risk diversification/concentration.

Investment guidelines, regarding the latter point, shall mean all guidelines given for the management of an undertaking that determine investment criteria other than those set out in the business strategy followed by an undertaking having a general commercial or industrial purpose.[72]

Collective investment undertakings might also appoint a collective asset manager without determining investment guidelines. In these events, the full discretion to make investment decisions is attributed to the collective asset manager. Following the ESMA guidelines, leaving full discretion to such a collective asset manager should not be used as a mean to circumvent the provisions of the AIFMD.[73]

2.1.2.4. For the Benefit of These Investors

Investing must be for the benefit of the investors. This implies that the activities of a collective investment undertaking must aim to increase the value of the invested assets.[74] Under circumstances, it may be in the interest of the investors to optimize the assets as to protect it from, certain risks, including inflation or currency risks.[75] Apart from this (main) objective collective investment undertakings may also pursue other investment objectives, such as social objectives. Collective investment undertakings investing in social objectives fulfill the criterion 'for the benefit of these investors' even if doing so results in a lower return.[76] Undertakings pursuing a general commercial or industrial purpose are, however, not investing 'for the benefit of investors'. These undertakings, thus, fall outside of the scope of the AIFMD.[77]

2.1.2.5. No Authorization Pursuant to UCITSD V

The scope of the AIFMD is very broad. Its scope entails all collective investment undertakings that do not require authorisation pursuant to the UCITSD.[78] This criterion is unclear. Following the AIFMD, it was considered disproportionate to regulate the structure or composition of the portfolios of AIFs (fund types) managed by AIFMs at EEA level.[79] The AIFMD, therefore, allows Member States from applying national requirements in respect of the AIF that are established in their Member State. Member States may, thus, regulate an AIF fund type, for instance a fund type that only invests in liquid financial instruments, that could

---

[72] ESMA/2013/611, 7.
[73] ESMA/2013/611, 7.
[74] See.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* § 4 D. I-III § 1 B. III (Mohr Siebeck 2015) and C. Tollmann, Art.2 *Geltungsbereich*, in *AIFM-Richtlinie* 113-114 (F. Dornseifer et al., eds, 1st edn, C.H. Beck 2013).
[75] See for 'activities to optimize or increase the value of these assets': ESMA/2013/611, 4.
[76] See Recital 1,4, 12 EuSEFR.
[77] See on 'collective investment undertaking': ESMA/2013/611, 6; See for 'general commercial or industrial purpose´: ESMA/2013/611, 3.
[78] UCITS are undertakings (1) with the sole object of collective investment in transferable securities or in other liquid financial assets of capital raised from the public which operate on the principle of risk-spreading; and with units which are, at the request of holders, repurchased or redeemed, directly or indirectly, out of those undertakings' assets; : See Art.1(2) UCITSD V. See also R. Slange & G.A.M. Verwilst, *De aangepaste ICBE-richtlijn. Op naar een verbeterde interne markt voor beleggingsinstellingen*, 10/11 TvFR 332-342 (2008).
[79] Recital 10 AIFMD.

also be construed in accordance with the UCITSD V.[80] The 'not requiring authorization pursuant to the UCITSD V requirement should, thus, be read as collective investment undertakings that are not 'being authorized as a UCITS'.[81]

2.1.3. Exemptions (Article 2(3) AIFMD))

The definition of a collective investment undertaking and the four additional criteria do not clarify what is an AIF under all circumstances. For this purpose, the AIFMD provides in Article 2(3) AIFMD a catalogue in which contains undertakings that are explicitly excluded from the scope of the AIFMD. The catalogue contains undertakings that do not satisfy one ore more of the abovementioned four additional criteria. The catalogue is, thus, embedded in the AIFMD to provide legal certainty what collective investment undertakings fall under the scope of the AIFMD. These undertakings will now be discussed in more detail.

2.1.3.1. Holding Companies

The AIFMD does not delineate in detail the differences between commercial/operational business activity and investments. To that end, the exemption catalogue excludes several activities which are connected to commercial/operational business. Treasury departments of commercial enterprises, joint ventures[82] and employee participation schemes or employee savings schemes[83] are, thus, explicitly exempted. In practice, it remains to be difficult to delineate AIFs from holding companies.[84]

For that purpose, the AIFMD has made an attempt to clarify what is a holding company by defining what is a holding company.[85] Following this definition, a holding company is a company, with shareholding in one more other companies in order to:[86]

- contribute to their long-term value by carrying out a business strategy or strategies through its subsidiaries, associated companies or participants; and
- which is either a company:
  - operating on its own account and whose shares are admitted to trading on a regulated market in the EEA; or
  - not established for the main purpose of generating returns for its investors by means of divestment of its subsidiaries or associated companies, as evidenced in its annual report or other official documents.

Despite the attempt by the AIFMD to define the holding company, it seems that none of the criteria clarifies under all circumstances what a holding company is.[87] ESMA has also not provided legal certainty regarding the criteria used in this definition. The example of the special purpose acquisition company (SPAC) proves that the definition of a holding company

---

[80] D.A. Zetzsche & C.D. Preiner, *Scope of the AIFMD* 64, 65 (D.A. Zetzsche ed, Kluwer 2015).
[81] D.A. Zetzsche & C.D. Preiner, *Scope of the AIFMD* 64, 65 (D.A. Zetzsche ed, Kluwer 2015).
[82] See Q&A European Commission, ID 1160.
[83] Art. 2(3)(f) AIFMD. See Q&A European Commission, ID 1155: ' Employee savings funds may be considered as AIFs according to the definition of Art. 4(1)(a). As there is no clear definition […], but there is a large variety of such schemes in the Member States, we suggest that each form of such a scheme be assessed on its own merits in order to conclude whether it fulfils or not the elements of the definition of an AIF as laid down in Art. 4(1)(a) of the AIFMD'.
[84] C.J Groffen, N.B. Spoor & J.W.P.M. van der Velden, *Beleggingsinstellingen* 465-506 (D. Busch et al, Kluwer 2010); See B. Bloch & H.C. von der Crone, *Operative Gesellschaft oder kollektive Kapitalanlage? – Entscheid des Schweizerischen Bundesgerichts 2C_571/2009 vom 5. November 2010 i.S. Eidgenössische Finanzmarktaufsicht gegen Dr. A. & Co VIII Sachwert-Beteiligung Kommanditgesellschaft*, 2 SZW 214 (2011).
[85] Art. 4(1)(o) AIFMD.
[86] Art. 4(1)(o) AIFMD.
[87] The Q&A of the European Commission does not clarify this point: 'The exclusion of a holding company in Art. 2(3)(a) was meant to exclude from the AIFMD large corporates such as Siemens or Shell´. See Q&A European Commission, ID 1146.

under the AIFMD is problematic. SPACs are listed shell companies that have no operations but go public with the objective of investing in private equity type transactions, such as leveraged buyouts, with the proceeds of the SPAC's IPO.[88] Prior to the AIFMD, these undertakings were subject to several disclosure duties[89], but in several Member States regarded as commercial/operational business activity and, thus, exempted from the regulatory regime applying to collective investment undertakings.

After the introduction of the AIFMD, national Member States need to assess whether SPACs are holding companies or qualifying as AIF within the scope of the AIFMD. Not qualifying as an AIF would imply that these undertakings are exempted from detailed business organizational requirements applying to the managers of the SPACs. These include provisions regarding risk-, liquidity management and the special *'private equity'*-provisions.[90] For that purpose, the AIFMD has made an attempt to clarify what is a holding company by defining what is a holding company.[91] Following this definition, a holding company is a company, with shareholding in one more other companies pursuing a commercial purpose of which is to:[92]

- carry out a business strategy or strategies through its subsidiaries, associated companies or participations in order to contribute to contribute to their long-term value; and
- which is either a company:
  - operating on its own account and whose shares are admitted to trading on a regulated market in the EEA; or
  - not established for the main purpose of generating returns for its investors by means of divestment of its subsidiaries or associated companies, as evidenced in its annual report or other official documents.

Undisputable is that SPAC's are having direct or indirect shareholdings in one or more other companies. Unclear is whether a SPAC is a shareholder with the commercial purpose of carrying out a business strategy.[93] The German BaFIN sees commercial activities as activities, involving the purchase, sale, and/or exchange of goods or commodities and/or the supply of non-financial services and/or industrial activities involving the production of goods or construction of properties.[94] The British FCA in assessing whether an undertaking has a commercial purpose or not primarily assesses whether the legal form and the remuneration are structured as is usual practice for AIFs.[95] Following the different assessment criteria that are used by the German BaFin and the British FCA, it seems to be that competent authorities have a different understanding of what is a 'commercial purpose' under the AIFMD.

In addition, the definition of a holding company under the AIFMD requires that undertaking by pursue a commercial purpose as to contribute to the long-term value of the subsidiaries, associated companies or participants in which they are invested. The criterion is rather vague. Some AIFs are having long investment horizons, whereas some holding

---

[88] See C. Rottwilm, Private Equity 2.0, Manager Magazine (11.06.2008), http://www.manager-magazin.de/finanzen/geldanlage/a-558527.html (accessed 26 January 2017).
[89] SPACs had to comply with obligations arising out of the PR and TPD.
[90] Art. 26 et seq. AIFMD. See C. Clerc, *The AIFM's Duties upon the Acquisition of Non-listed Firms* (D.A. Zetzsche ed, Kluwer 2015).
[91] Art. 4(1)(o) AIFMD.
[92] *Ibid*.
[93] ESMA/2013/611, 3.
[94] See also the definition of *general commercial or industrial purpose* under ESMA/2013/611, 3.
[95] See FCA, Implementation of the Alternative Investment Fund Managers Directive, (2013), Annex P, Amendments to the Perimeter Guidance manual (PERG), Question 2.18 et seq.

companies are selling their shareholdings as part of their investment strategy after a relatively short holding period.[96]

Similarly, the two characteristics of holding companies mentioned in point two of the abovementioned definition of a holding company also do not in all cases delineate holding companies from collective investment undertakings. Firstly, the characteristic of a holding company being an company that is listed on a regulated market in the EEA is extremely vague.[97] Following Recital 8 AIFMD, the mere fact that (private equity) managers are managing AIFs whose shares are admitted to trading on a regulated market does not exclude AIFs from the scope of the AIFMD. The listing itself on a regulated market, thus, seems not to be a decisive feature of holding companies. Furthermore, an exclusion this feature could, under a strict interpretation, be seen as an exempted of all internally managed AIF.[98]

The second debatable characteristic of point two is that a holding company may not be established for the main purpose of generating returns for its investors by means of divestment of its subsidiaries or associated companies, as evidenced in its annual report or other official documents.

This characteristic seems to assume that a holding company is a shareholder in other companies without the purpose of selling its stake[99], whereas private equity fund focus on generating returns by divesting of its subsidiaries and associated companies. AIFs, however, buy, hold and sell their assets, regardless whether the manager increases the value of the assets. [100] The annual report or other official document, thus, also do not clearly delineate by means of this characteristic a holding company from an AIF.

2.1.3.2. Social Security and Pension Institutions

The second group that is carved out of the scope of the AIFMD are institutions that manage funds supporting social security and pension systems.[101] These institutions may be either of private or public nature. Private institutions are IORPs and its (asset) asset managers. The latter is exempted from the scope AIFMD to the extent that the asset manager does not simultaneously manage AIFs. Examples of public institutions include national, regional and local governments managing funds supporting social security and pension systems.[102]

2.1.3.3. Undertakings Acting in the Public Interest

The third group includes undertakings acting in the public interest. This group includes supranational institutions, such as, amongst others, the European Central Bank, and national, regional and local governments.[103] These undertakings are only exempted to the extent they are acting in the public interest. From the viewpoint of the AIFMD, the AIFMD has not only as its purpose to protect investors, but also to avail systematic risks.[104]

2.1.3.4. Other Undertakings for Collective Investment

---

[96] D.A. Zetzsche & C.D. Preiner, *Was ist ein AIF?*, 45 Zeitschrift für Wirtschafts- und Bankrecht 2101 (2013).
[97] See for a commentary of the European Commission related to listed real estate AIFs: Q&A European Commission ID 1164.
[98] See FCA, Implementation of the Alternative Investment Fund Managers Directive, (2013), Annex P, Amendments to the Perimeter Guidance manual (PERG), Question 6.3.
[99] See Q&A European Commission, ID 1146.
[100] See D.A. Zetzsche & C.D. Preiner, *Was ist ein AIF?*, 45 Zeitschrift für Wirtschafts- und Bankrecht 2101 (2013); See also ESMA/2013/611, 3.
[101] Art. 2(3)(e) AIFMD.
[102] Art. 2(3)(e) AIFMD.
[103] Art. 2(3)(c)-(e) AIFMD.
[104] R. Wilhelmi & M. Bassler, *AIFMD, Systematic Risk and the Financial Crisis* (D.A. Zetzsche ed, Kluwer 2015); D.A. Zetzsche, *Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?* 341-345 (H. S. Birkmose, M. Nevillie & K. E. SØrensen eds., Kluwer 2012).

The AIFMD has also exempted various other undertakings for collective investment.[105] At the one hand, this includes SPVs that are indirectly regulated by the AIFMD.[106] At the other hand, these are undertakings that are already regulated by other European acts. For instance, pension funds and insurance undertakings.[107]

2.1.4. Other Categories of Collective Investment Undertakings

On the contrary of the abovementioned exempted entities, the EuSEF, EuVECA and ELTIF[108] can be seen as (European) sub-categories of AIFs.[109] Similar to UCITS, the Regulations harmonize the investment policy of these types of collective investment undertakings.[110] The AIFMD leaves it up to the Member States to regulate and supervise AIFs at the national level.[111] The EuVECAR, EuSEFR and ELTIFR can be opted-in by AIFMs and do not preclude national Member States from regulating the structure or composition of the portfolios of other types of AIFs. Opting into the European Regulations, however, allows for the cross-border marketing of AIFs based upon an European marketing passport.The EuVECAR/EuSEFR facilitates the cross-border marketing of AIFs managed by 'small' AIFMs to professional investors and HNWIs, whereas the ELTIF Regulation facilitates the cross-border marketing of AIFs to both professional and retail investors.

2.1.5. De-minimis Exemption

Managers managing and/or marketing AIFs do not have to obtain an authorization as AIFM if they fall within the scope of the AIFMD de-minimis exemption. The AIFMD allows Member States to merely subject small AIFMs to registration with the competent authorities of their home Member States.[112] These AIFMs are not subjected to the full AIFMD as the activities of these type of AIFMs are considered not to individually give rise to systematic risks.[113] Small AIFMs upon registration are required to report relevant information to competent authorities, including the main instruments they are trading and the principal exposures of the AIF in question.[114] The AIFMD only allows Member States to exempt AIFMs whose assets under management directly or indirectly do not exceed:[115] EUR 100 million; or EUR 500 million .[116]

---

[105] M. Courvoisier & R. Schmitz, *Grenzfälle kollektiver Kapitalanlagen*, Schweizerische Zeitschrift für Wirtschafts- und Finanzmarktrecht 407 (2006).
[106] Art.17 AIFMD.
[107] Recital 8 AIFMD. See for criteria to difference investments from insurances: D.A Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 5 (Mohr Siebeck 2015; D.A. Zetzsche & C.D. Preiner, *Scope of the AIFMD* 72, 73 (D.A. Zetzsche ed, Kluwer 2015).
[108] Art. 1(1) ELTIFR refers to the AIF definition laid down in Art. 4(1)(a) AIFMD.
[109] The qualification of EuVECAs and EuSEFs as AIFs follows from the copy-pasted AIF definition as laid down in Art.3(1)(1)(b) EuVECAR and Art.3(1)(b) EuSEFR. It must be noted, however, that the term 'collective investment undertaking' and AIF are unjustifiably used as synonyms in these Regulations.
[110] See for the EuSEFR and EuVECAR: M. Scheele, *Toezicht op alle beheerders van beleggingsinstellingen vanaf juli 2013*, 28 Ondernemingsrecht 150 (2013); C.M. Grundmann-van de Krol, *Voorstel Verordening geldmarktfondsen* ("MMFs"), 18 Ondernemingsrecht 103 (2014); See for the ELTIFR: C.M. Grundmann-van de Krol, *Voorstel Verordening Europese langetermijninvesteringsfondsen*, 16 Ondernemingsrecht 591 (2013).
[111] Recital 10 AIFMD.
[112] Art. 3(1)-(4) AIFMD.
[113] Recital 17 AIFMD.
[114] Art. 3(3) AIFMD.
[115] The term 'indirectly' refers to through a company with which the AIFM is linked by common management or control, or by a substantive direct or indirect holding, manage portfolios of AIFs. See Art.3(3)(a) and (b) AIFMD.
[116] The 'de minimis exemption' has been implemented differently throughout Member States. Member States in general apply stricter requirements to retail AIFs than professional AIFs. Germany and the Netherlands are examples of Member States that decided to refrain from imposing stricter requirements that go beyond the *de minimis* exemption for AIFMs that are exclusively marketing AIFs to professional investors. See for Germany: I.

The latter threshold is only applied, provided that the portfolio(s) under management of the AIFM concerned are not leveraged and that investors in their respective AIFs have no redemption rights exercisable for a period of five years.

The AIFMD provides an opt-in procedure for small AIFMs falling within the *de minimis* exemption, that wish to be authorized in order to benefit from the European management and marketing_passports.[117] The managers wishing to opt-in, however, need to comply with the full AIFMD.[118]

2.1.6. Conclusion

The introduction of the AIFMD has tremendously increased the importance of the definition of an AIF. Prior to the AIFMD, AIFMs were in several Member States exempted from regulatory law. The AIFMD has made it mandatory for all these AIFMs to obtain an authorization. The AIF definition determining the scope of the AIFMD has been, however, only partly been clarified by ESMA's guidelines. These systematization of the AIFMD in conjunction with these guidelines make clear that collective investment undertakings in the EEA have to be defined as UCITS and AIFs.[119] AIFs are collective investment undertakings that fulfil four additional criteria. Only those collective investment undertakings may qualify as an an AIF that (1) raise capital, (2) from a number of investors, with a view to (3) investing in accordance with a defined investment policy (4) for the benefit of those investors. The list of exempted entities only serve the purpose of legal certainty and confirm that the individual entities do either not fulfil one or more of the abovementioned four additional criteria. Finally, an analysis of the AIF definition has made clear that both the AIFMD and ESMA guidelines do not provide clarification of whether an undertaking qualifies as AIF under all circumstances.

2.2. The UCITS Definition

The UCITSD V requires for both the management (authorization UCITS ManCo) as the marketing[120] of UCITS units/shares to the public (authorization of the UCITS) an authorization to be obtained. Both authorizations are only applicable to UCITS that are established within the EEA.[121] The UCITSD V applies whether or not UCITS are marketed in their home Member States or in other Member States.[122] Defining what is a UCITS is, thus, important to determine whether a UCITS or a ManCo needs to obtain a mandatory authorization.UCITS within the meaning of the UCITS V means an undertaking:[123]

Kamptner, *Auswirkungen der AIFM-Richtlinie auf Spezialfonds*, ÖBA 127 (2013); See for the Netherlands: K. Groffen & B. Spoor, *Netherlands* (D. Busch ed, Oxford 2014).
Austria, France and Ireland are examples of Member States that require small AIFMs managing retail AIFs to obtain a full authorization under the AIFMD. See D.A. Zetzsche, *Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).

[117] See D.A. Zetzsche & T.F. Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* (D.A. Zetzsche ed, Kluwer 2015).

[118] Recital 17 AIFMD.

[119] See D.A. Zetzsche, *Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).

[120] Referred to in Art.5 UCITSD V as 'pursuing activities'.

[121] Art. 1(1) UCITSD V.

[122] Art. 1(1) UCITSD V.

[123] Art. 1(2) UCITSD V.

- with the sole object of which is the collective investment in transferable securities or in other liquid financial assets[124], capital raised from the public and which operate on the principle of risk-spreading;[125] and
- with the units of which are repurchased or redeemed out of these undertakings' assets.[126]

2.2.1. (Collective Investment) Undertakings

The definition of a UCITS does not include the term 'collective investment undertaking'. Despite of this fact, the definition refers to 'undertakings with the sole object of which is the collective investment'. Its full name, 'undertakings for collective investment in transferable securities' refers to UCITS as being collective investment undertakings. Apart from this, the exemptions laid down in Article 3 UCITSD V refer to 'collective investment undertakings' suggesting that UCITS are collective investment undertakings.[127]
The AIFMD[128] even explicitly exempts authorized UCITS from the scope of the AIFMD.[129] Without having done so, collective investment undertakings abiding to the diversification and liquidity requirements of the UCITSD V would have qualified as an AIF. Its collective asset managers would in that case have to mandatorily apply for an authorization as an AIF under the AIFMD.[130] Collective asset managers that are managing undertakings that could fall under the UCITSD V, but are not authorized to manage and/or market UCITS nor have obtained an authorization for the 'UCITS' that they manage/market, thus, have to obtain an authorization as an AIFM under the AIFMD.

Dynamically interpreting the UCITS definition based upon the AIFMD and the ESMA guidelines would lead to the conclusion that UCITS are collective investment undertakings. UCITS characterized by the four features of collective investment undertakings, as discussed for the AIF definition[131], including investments, a number of investors, third-party management and a pooled risk/return ('fund').[132] Authorized UCITS have, however, not been placed in the exempted entities section under the AIFMD.[133] Based upon a systematic interpretation of the AIFMD, UCITS are not only qualifying as collective investment undertakings, but also as collective investment undertakings that raise capital, from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors.[134] A grammatical and systematic interpretation of UCITS under the UCITSD would lead to the conclusion that UCITS are 'AIFs' (read: collective investment undertakings) authorized under UCITSD V.

2.2.2. Liquid investments and Diversification

Unlike AIFs, UCITS are collective investment undertakings ('AIFs') that invest in transferable securities and/or in another 'liquid financial assets' and operate on the principle of risk-spreading.

---

[124] See Art.50(1) UCITSD V.
[125] Art. 1(2)(a) UCITSD V.
[126] Art. 1(2)(b) UCITSD V.
[127] Art. 3(a)-(d) UCITSD V.
[128] See the AIF definition in Art. 4(1) AIFMD.
[129] See *supra* 2.1.2.5.
[130] Art.2 AIFMD; D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* (D.A. Zetzsche ed, Kluwer 2015).
[131] See *supra* 2.1.
[132] A 'fund' is plain language referring to as an collective investment undertaking raising. capital that is legally being pooled for investment purposes. See *supra* 2.1.1.2.
[133] See for the exempted entities: See *supra* 2.1.3.
[134] See Art. 4(1) AIFMD.

2.2.2.1. Liquid investments

Originally, UCITS were constrained to a strict investment policy regime under UCITSD I that merely included transferable securities and other liquid financial assets.[135] Demand by industry actors to make use of the marketing passport on a broader scale, lead to UCITSD III allowing for more investment options.[136] UCITSD III (EAD) not only allowed investments in listed shares and bonds, but widened investment options[137], including, amongst others: money market instruments, OTC instruments (fulfilling the UCITS liquidity requirements), bank deposits derivatives for investment purposes and investments in AIFs (up to 30%).[138] Investment strategies, such as index- and fund-of-funds structures were also allowed.[139] UCITSD V currently, thus, not only applies to 'transferable securities' and 'other liquid financial assets', but also includes structured debt products, credit derivatives, closed-end funds, financial indices and money-market instruments that embeds derivatives.[140]

In the UCITSD VI consultation the question popped-up whether more eligible assets and a more lenient approach to the use of derivatives should be allowed.[141] Consulted items related to the investment policy, included the use of efficient portfolio management techniques, OTC derivatives and the (extraordinary) liquidity management rules.[142] Since then, the ELTIFR was adopted that took away some concerns.[143] Other retail AIFs may under Article 43 AIFMD only be marketed based upon a private placement regime of the individual Member States.[144] Until this issue is being resolved, this likely will foster future UCITS/retail AIF investment policy discussions.

2.2.2.2. Diversification

UCITSD V not only limits the investment policy of UCITS, but also mandates diversification. UCITS are mandatory required to invest in a wide array of assets to reduce the amount of risk that (retail) investors face.[145] Diversification prevents events that affect one assets from

---

[135] Art. 50(1)(a) UCITSD V; N. Moloney, *EC Securities Regulation* 225 (3rd edn., Oxford University Press 2014).

[136] Art. 50(1)(b)-(f) UCITSD V; N. Moloney, *EC Securities Regulation* 205, 206 (3rd edn., Oxford University Press 2014).

[137] This was to enhance the cross-border sale of UCITS: See also D. Schubauer, *The Inadequacy of the UCITS Directive in a Global Marketplace*, 21:2 New York Law School Journal of International and Comparative Law 323, 324 (2002); See also CESR, *CESR's Advice on Clarification of Definitions concerning Eligible Assets for Investments of UCITS: Consultation Paper*, 05-064b (2005) and *CESR's Draft Advice on Clarification of Definitions concerning Eligible Assets for Investments of UCITS: 2nd Consultation Paper*, 05-490b (2005); See CESR, *CESR's advice to the European Commission on clarification of definitions concerning eligible assets for investments of UCITS*, 06-005 (2006).

[138] See for previous restrictions related to OTC derivatives: ESMA's Guidelines for competent authorities and UCITS management companies – Guidelines on ETFs and other UCITS issues (18 Dec. 2012), ESMA/2012/832EN; N. Moloney, *EC Securities Regulation* 206 (3rd edn., Oxford University Press 2014).

[139] N. Moloney, *EC Securities Regulation* 231-233(3rd edn., Oxford University Press 2014).

[140] See Art. 50(1)(c)-(g) UCITSD V.

[141] European Commission, *Consultation Document - Undertakings for Collective Investment in Transferable Securities (UCITS)Product Rules, Liquidity Management, Depositary, Money Market Funds, Long-term Investments*, July 2012, http://ec.europa.eu/finance/consultations/2012/ucits/docs/ucits_consultation_en.pdf (accessed 13 October 2016).

[142] See B. Haar, *Organizing Regional Systems: The EU Example* 160 (N. Moloney, E. Ferran & J. Payne eds., Oxford 2015).

[143] D.A. Zetzsche, & C.D. Preiner, *ELTIFR versus AIFMD* (D.A. Zetzsche ed, Kluwer 2015); C.M. Grundmann-van de Krol, *Voorstel Verordening Europese langetermijninvesteringsfondsen*, 16 Ondernemingsrecht 591 (2013).

[144] Art. 43 AIFMD.

[145] N. Moloney, *How to Protect Investors: Lessons from the EC and the UK* 139, 152, 162-165 (Cambridge University Press 2010).

affecting an entire investment portfolio therefore making large losses less likely.[146] UCITS, for example may not investment more than 5% of its assets in the transferable securities or money market instruments of a single issuer.[147] UCITS imposes similar limits to financial derivatives and deposits.[148] UCITSD V, additionally, imposes restrictions, including derivative exposure limits, lending and borrowing restrictions essentially controlling the leverage employed by UCITS. An example of an undertaking which is not operating on the principle of risk-spreading are holding companies whose object is to provide funding for businesses that have no access to the financial market or to exercise control over businesses in which they are shareholders.[149]

2.2.3. Legal Form Neutrality

Undertakings qualify as UCITS regardless of the legal form they are established in. Undertakings might be constituted under the law of contract (so-called 'common funds') managed by UCITS management companies, trust law (unit trusts), or statute (investment companies).[150]

Similarly, it is irrelevant whether the legal ownership of the fund' assets is attributed to the management company, the unit-holders collectively or the depositary.[151] Generally, UCITS established under contract law are in most Member States the legal property of the unit-holder collectively, who are the joint owners of the assets.[152] Unit trusts assign the legal ownership to a trustee, either being the UCITS ManCo or depositary[153], and the beneficial ownership to the unit-holders, whereas investment companies are the legal owner of the assets.[154] Unit-holders are in investment companies shareholders that are the owners of the company.[155]

2.2.4. UCITS Authorization vs. the AIFMD's registration requirement?

UCITS focusses on investor protection for units/shares marketed to the public. For this purpose, UCITSD V, requires UCITS to be authorized in the Member State in which it is situated.[156] Authorization is valid throughout the EEA and allows the authorized UCITS to be marketed in both its home member state and other EEA Member States.[157] Authorization of common funds/unit trusts involves the approval of the UCITS ManCo, the fund rules and the

---

[146] See also D.A Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 3 D (Mohr Siebeck 2015).
[147] Art. 52 UCITSD V.
[148] Art. 52(1) UCITSD V.
[149] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20December 1985* ('Vandamme Report'), 2,3, http://goo.gl/K0iUzv (accessed 13 October 2016).
[150] Art. 1(3) UCITSD V. See also Recital 12 UCITSD V; Liechtenstein even allows UCITS to be established as a limited partnership. See D.A. Zetzsche, *Das UCITSG und seine Folgen* 24-26 (H. Heiss, A. Kellerhals, A.K. Schnyder & F. Schurr eds., Schriften des Zentrums für liechtensteinisches Recht (ZLR) an der Universität Zürich 2013); See also S.N. Hooghiemstra & D. Litwin, *The Liechtenstein 2011 UCITS Law Opens New Opportunities for Collective Investment Vehicles*, https://www.uni.li/de/neuigkeiten/the-liechtenstein-2011-ucits-law-opens-new-opportunities-for-collective-investment-vehicles (accessed 13 October 2016).
[151] D.A Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 19 A I (Mohr Siebeck 2015).
[152] This is, for instance, the case in Luxembourg. See Art.13 OPC Law. In the Netherlands a separate SPV is, under specific circumstances, required to be the legal owner of the assets of a contractual fund. See S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013).
[153] The depositary is, generally, the trustee in Ireland and the UK. In Liechtenstein, the management company is usually the trustee. See D.A Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 19 A I 3 (Mohr Siebeck 2015).
[154] D.A Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 19 A II (Mohr Siebeck 2015).
[155] *Ibid.*
[156] Art. 4 UCITSD V.
[157] Art. 5, 16-21 UCITSD V.

choice of the depositary.[158] In the event an investment company is being approved, the instruments of incorporation and the choice of depositary have to be approved.[159] Apart from this, all provisions related to the UCITS product regulation will have also have to be approved.[160] The term 'approval' has not been further defined in UCITSD V. Article 2(r) PR defines 'approval' as the positive act at the outcome of the scrutiny of the completeness of the prospectus by the home Member State's competent authority including the consistency of the information given and its comprehensibility'. Applying this to UCITS, approval, i.e. authorization, entails not only the check of the completeness of the information filed to the home Member State, but also a compliance check of the information provided in the UCITS authorization procedure.[161]

Under the AIFMD, professional AIFs are, instead of being authorized, required to be registered.[162] This differentiation between UCITSD V and the AIFMD departs from both the retail investor nature[163] and the regulatory technique of combining 'manager regulation' with 'product regulation' under UCITSD V.[164] The AIFMD takes a modern approach by focusing on 'manager regulation' that requires well-staffed and well-organized financial intermediaries with fit and proper employees to manage and market AIFs.[165] This approach takes the view that regulators are too slow to adapt to the innovation of regulating individual financial products and addresses the source (AIFM) instead of the symptoms (the AIF).[166] For this purpose, AIFMs have to register all the AIFs they manage so that Competent Authorities have all necessary information to check the compliance of AIFMs with the requirements of the AIFMD.[167] UCITSD V takes a combined approach of both regulating UCITS ManCos ('manager regulation') and regulating each individual UCITS ('product regulation'). Member States have under Article 43 AIFMD have the discretion to require retail AIFs under national legislation to be either registered or authorized.[168]

2.2.5. Capital Raised From the Public

2.2.5.1. Raising Capital

A prerequisite for the authorization of an undertaking is that the capital must be 'raised from the public'.[169] Similar as under the AIFMD, the raising of capital must be from external, unaffiliated/third parties.[170] Constitutive for this element is that there needs to be a business

---

[158] Art. 5(2) UCITSD V. Fund rules are all contractual rules that govern the legal relations between the UCTIS management company, the depositary and the unit-holders.
[159] Art. 5(2) UCITSD V.
[160] See Arts 49-57 UCITSD V.
[161] See Recitals 19-21 UCITSD V; See also Recital 8 UCITSD V on the authorization of UCITS ManCos: 'The competent authority should register the manager if all necessary information has been provided and if suitable arrangements to comply with the requirements of this Regulation are in place'.
[162] Art.3(3) AIFMD.
[163] ELTIFs under Art. 5 ELTIFR and MMFs established as both UCITS or AIFs are also required to be 'authorized'. See Art .3(2) and (3) MMFR.
[164] See on the difference between UCITS manager and product regulation: U. Klebeck, *Interplay between AIFMD and the UCITSD* 120 (D.A. Zetzsche ed, Kluwer 2015).
[165] A.J.P.Tillema, *Enkele opmerkingen over deskundigheid, betrouwbaarheid en integriteit* 239-248 (P. Zijp, A. Tillema, H. Van Everdingen & P. Rank, Kluwer 2011).
[166] D.A. Zetzsche, D.A. & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* 120 (D.A. Zetzsche ed, Kluwer 2015); See for retail AIFs: D.A. Zetzsche, *Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).
[167] Recital 8 AIFMD; See, for example, also Recital 36 EuSEFR/Recital 32 EuVECAR.
[168] See D.A. Zetzsche, *Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).
[169] See Art. 1(2) UCITSD V.
[170] See Art. 4(1)(a) AIFMD.

communication by or on behalf of the undertaking (UCITS) seeking capital which results in the transfer of cash or assets.[171] This raising of capital should be expressly linked to a defined investment policy that is in conformity with the investment policy and diversification requirements under UCITSD V.[172] This criterion, thus, amongst others, excludes investment clubs, since they are not open to the public but restrict their membership to a limited number of investors.[173] UCITSD V does not cover collective investment undertakings which do not raise their capital from the public at large.[174]

2.2.5.2. 'the Public'

Pre-AIFMD, promoting to the 'public' was seen as all promotions other than 'private placements'.[175] Private placement is a distribution method through which investors can buy and sell financial instruments to each other without having to comply with the regulatory regime that applies to public or to retail investors.[176] It is a well-established method for professional investors in distribution collective investment undertakings in the world.[177]
Based upon the post-AIFMD developments regarding collective investment undertakings, it is clear that the word 'public' needs to be dynamically interpreted. Promotion to the 'public' based upon the AIFMD, EuSEFR/EuVECAR and the ELTIFR means professional and retail investors.[178] This seems to the confirmed by the MMFR that refers in its memorandum to 'a Union wide level playing field for those who offer MMFs to either professional or retail investors'. The MMFR applies to both AIFs and UCITS, its investors are, thus, to be qualified as either professional or retail investors. This leaves the question whether the criterion promoting the sale of their units/shares to the 'public' is fulfilled when a UCITS ManCo intends to only market units/shares of an UCITS to professional investors. MMFs may either be marketed to retail investors and/or professional investors. Apart from this, the term 'public' must be teleological interpreted. The UCITSD V offers retail protection. UCITS could, thus, on the basis of a teleological argument be marketed to retail and/or professional investors. The

---

[171] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20December 1985* ('Vandamme Report'), 3, http://goo.gl/K0iUzv (accessed 13 October 2016).
[172] See *supra* 4.2.1.
[173] See D.A Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 1 C II (Mohr Siebeck 2015).
. See also Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20December 1985* ('Vandamme Report'), 3, http://goo.gl/K0iUzv (accessed 13 October 2016).
[174] See Recital 5, 48 Art.1(2) and UCITSD V.
[175] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20December 1985* ('Vandamme Report'), 11, http://goo.gl/K0iUzv (accessed 13 October 2016); See on this point the Dutch explanatory notes (Kamerstukken II 2005-2006, 29 708, nr. 19, 383).
[175] See retail investor nature with wide retail investor protection: N. Moloney, *EC Securities Regulation* 250(1st edn., Oxford University Press 2002).
[176] European Commission, *Commission Staff Working Document – Impact Assessment Report on Private Placement*, 17 July 2008, SEC(2008) 2340,{SEC(2008) 2341}, 27, 28; European Commission*, Private Placement Regimes in the EU- Summary Report of Workshops organized by DG Internal Market and Services January 15th and February 7th 2008*, http://ec.europa.eu/finance/investment/index.htm (accessed 14 October 2016); European Commission*, Call For Evidence regarding Private Placement Regimes in the EU*, April 2007, 6; European Commission, *Commission Staff Working Document – Executive Summary to the Impact Assessment Report*, 17.7.2008, SEC(2008) 2341, {SEC(2008) 2340}.
[177] European Commission, *Commission Staff Working Document – Impact Assessment Report on Private Placement*, 17 July 2008, SEC(2008) 2340,{SEC(2008) 2341}, 27, 28; Pre-AIFMD, the Netherlands required UCITS to be promoted to at least 100 investors. See C.M. Grundmann-van de Krol, *Koersen door de Wet op het financieel toezicht* 84 (Den Haag: Boom Juridische Uitgevers, 2008).
[178] Art. 4(1)(ag) and (aj) AIFMD; Art. 6 EuVECA/EuSEF Regulation; Art. 5 ELTIFR.

focus of this criterion is, thus, whether capital is raised or not from professional/retail investors to fulfill this criterion.[179]

2.2.6. Open-End principle

Only undertakings, fulfilling the abovementioned criteria, are UCITS that issue units which are, directly or indirectly, purchasable or redeemable out of the undertakings' assets, on the request of the unit-holders.[180]

The elements 'purchasable or redeemable' and 'directly or indirectly' were included in this definition as to cover the large variety of open-end collective investment undertakings that were present in the EEA upon adopting UCITSD I.[181] In some Member States, units were redeemed and cancelled, whereas in other Member States units could be repurchased directly by the UCITS itself or indirectly by an intermediary/affiliated company and be 're-issued' to new investors.[182]

UCITSD V further states that 'action by a UCITS needs to be taken to ensure that the stock exchange value of its units does not significantly vary from their net asset value shall be regarded as equivalent to such repurchase or redemption'. This part of the UCITS definition intends to include units/shares of listed units that were indirectly repurchased/redeemed at regulated markets.[183]

Undertakings that subject the repurchase/redemption to a time-limit, restrict it to certain periods, a maximum amount or certain periods also qualify as a UCITS as long as there is a provision for repurchase or redemption.[184] Those undertakings are considered to be falling within the scope of the UCITSD V.

2.2.7. Exemptions

Four exemptions that do not fulfill the UCITS definition under the UCITSD, but provide extra legal certainty are laid down in Article 3 UCITSD V. The following undertakings are not subject to the UCITSD V:[185]

- collective investment undertakings of the closed-ended type;[186]
- collective investment undertakings which raise capital without promoting the sale of their units to the public within the EEA or any part of it;[187]
- collective investment undertakings of which units are sold only to the public in third countries;[188]

---

[179] It should be noted, however, that the voluntary character of the UCITSD and the marketing/management passport proved to be beneficial that the the definition has in practice not been contested.
[180] Art. 1(2)(b) UCITSD V.
[181] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20December 1985* ('Vandamme Report'), 4,5, http://goo.gl/K0iUzv (accessed 13 October 2016); N. Moloney, *EC Securities Regulation* 216, 217 (3rd edn., Oxford University Press 2014).
[182] *Ibid.*
[183] An example in the Netherlands was Robeco who repurchased/redeemed its listed units indirectly by an intermediary company. See Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Vandamme Report'), 5, http://goo.gl/K0iUzv (accessed 13 October 2016).
[184] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Vandamme Report'), 6, http://goo.gl/K0iUzv (accessed 13 October 2016);
[185] Art. 3 UCITSD V.
[186] Art. 3(a) UCITSD V.
[187] Art. 3(b) UCITSD V.

- collective investment undertakings that do not comply with the UCITSD V investment and borrowing policies.[189]

2.2.7.1. Closed-end CIUs ('AIFs')

Only undertakings are UCITS that issue units which are, directly or indirectly, purchasable or redeemable out of the undertakings' assets, on the request of the unit-holders.[190] The UCITS definition only refers to the provision of redemption/repurchase and does not make reference to 'closed-end' and 'open-end' collective investment undertakings. The latter, however, does not clarify how to delineate open-end funds from closed-end funds in all cases.

The PR does not provide any further guidance as Article 1(2) PR also refers to 'collective investment undertakings other than closed-end type' as 'units of which are, at the holder's request, repurchased or redeemed, directly or indirectly, out of the assets of these undertakings'.[191]

The meaning of what is a collective investment undertaking of the closed-end type might, however, be dynamically interpreted based upon the recently adopted AIFMD Delegation Regulation.[192] This Regulations lays down the distinguishing factors in determining whether an AIFM manages AIFs of the open-ended or closed-ended type. For the purpose of correctly applying the rules on liquidity management and the valuation procedures under the AIFMD.[193]

Open-ended AIFs repurchase or redeems its shares or units with its investors, at the request of any of its shareholders or unitholders, prior to the commencement of its liquidation phase or wind-down.[194] Redemptions/repurchases that are made by an undertaking after the commencement of its liquidation phase or wind-down is, thus, a closed-ended fund.[195] Furthermore, the redemption policy, including its procedure and frequency, must be set out in the rules or instruments of incorporation, prospectus or offering documents.[196] Closed-end funds often have a predefined 'lifetime' and the assets are usually held to maturity.[197] The length of the lock-up period should be irrelevant for the purpose of determining whether an AIF is to be qualified as open- or closed-ended.[198]

Decreases of capital of AIFs in connection with distributions, based upon the abovementioned constitutive and disclosure documents, are not being taken into account whether an AIF is of the open-ended type.[199] Only repurchases and redemptions that are the ones made out of the assets of the AIF qualify are relevant for determining whether an AIF is open-ended.[200] The shares or units of AIFs that can be negotiated on the secondary market or are not repurchased/redeemed by AIFs are not qualifying as an open-ended AIF.[201] The use of

---

[188] Art. 3(c) UCITSD V.
[189] Art 3(d) UCITSD V; See also Chapter VII and Art. 83 UCITSD V.
[190] Art. 3(a) UCITSD V; Art. 1(2)(b) UCITSD V.
[191] Art. 3(b) UCITSD V; Art. 2(p) PR; See H.W. Hofmeester & S. Swaak, *De prospectusplicht voor beheerders van beleggingsinstellingen*, 10 TvFR 328-333 (2013).
[192] AIFMD (Commission) Regulation III.
[193] Recital 2, 3, Art.1(2) AIFMD (Commission) Regulation III; See also: H. Hologan & D. Masson, *Les principes d'évaluation applicables aux gestionnaires de fonds alternatifs*, 758 Revue Banque (2013).
[194] Recital 3, Art.1(2) AIFMD (Commission) Regulation III.
[195] See, for instance, the Redemption policy and life of ELTIFs under the ELTIFR: Art.18 ELTIFR.
[196] Recital 3, Art.1(2) AIFMD (Commission) Regulation III.
[197] See ESMA/2013/413, 6.
[198] See *Ibid*, 9.
[199] Recital 3, Art.1(2) sub-para. 1 AIFMD (Commission) Regulation III.
[200] Recital 4 AIFMD (Commission) Regulation III..
[201] Recital 4, Art.1(2) sub-para. 3 AIFMD (Commission) Regulation III.

so-called repurchase entities or companies remains to be a possibility to redeem units or shares on the secondary market without qualifying as a closed-ended AIF.[202]

2.2.7.2. Private Placement ('AIFs')

Collective investment undertakings which raise capital without promoting the sale of their units to the public within the EEA or any part of it fall outside the scope of UCITSD V.[203] This exemption reaffirms that 'capital must be raised' from the 'public', i.e. retail and/or professional investors[204], as a prerequisite for an undertaking to obtain an authorization as a UCITS under UCITSD V. Similar as under the AIFMD, the raising of capital must be from external, unaffiliated/third parties.[205]

2.2.7.3. TC-AIFs

Collective investment undertakings that may be sold only to the public in third countries are exempt from the UCITSD V.[206] UCITS are frequently marketed outside the EEA. Several third countries even have a simplified authorization procedure that allow UCITS to be marketed in their territories.[207] The UCITSD V, however, only requires that UCITS may not only be sold to the public in third countries. In fact, 40% of all new UCITS sales currently take place outside of the European Union.[208] In South America UCITS are largely represented in Chile and Peru, whereas Singapore, Hong Kong and Taiwan are the main markets for UCITS distribution in Asia.[209] Promotion of UCITS within the EEA is facilitated by the EEA marketing passport. This UCITSD V passporting regime is, however, not available in third countries. UCITS may either be marketed on the basis of a public offering or private placement regime.[210] Undertakings only do not fall within the scope of the UCITSD V when the rules or instruments of incorporation explicitly reserve their units/shares to be exclusively reserved to be promoted to the public in third countries.[211] Undertakings under this interpretation, thus, still qualify as UCITS when they are exclusively promoted outside the EEA, but the rules or instruments of incorporation of UCITS do not explicitly rule out the possibility of UCITS being marketed to the public within the EEA.[212] Undertakings that do so, however, qualify as (TC-)AIFs.[213]

---

[202] See ESMA/2013/413, 10.
[203] Art. 3(b) UCITSD V.
[204] Art. 4(1)(ag) and (aj) AIFMD; Art. 6 EuVECA/EuSEF Regulation; Art. 5 ELTIFR.
[205] See *supra* 2.1.2.1.
[206] Art. 3(c) UCITSD V.
[207] See, for instance, Taiwan and Switzerland: C.P Shao, *Taiwan* (E. Wymeersch ed. Kluwer 2012); M. Senn, *Switzerland* (E. Wymeersch ed. Kluwer 2012).
[208] G. Turner, *UCITS Growth Takes Old Problems to New Places*, Financial news, 7 February, 2011; See K. Johannsen, *Jumping the gun: hedge funds in search of capital under UCITS IV*, 5 Brooklyn Journal of Corporate, Financial & Commercial Law 473 (2011);See also P. Dejmek, *The EU Internal Market for Financial Services – A Look at the First Regulatory Responses to the Financial Crisis and a View to the Future*, 15 Columbia Journal of European Law 455, 472 (2009); R. Pozen & T. Hamacher, *Cross-Border Distribution – The Global Fund-Leadership Playoffs: Europe vs. the US*, 18 Luxembourg Fund Review 27 et seq. (2011).
[209] C. D. Christian, *UCITS outside Europe* 450 (D. Frase ed., Sweet & Maxwell 2011).
[210] See for an overview of the public offering and private placement regimes of Chile, Peru, Singapore, Hong Kong and Taiwan: C. D. Christian, *UCITS outside Europe* 450 (D. Frase ed., Sweet & Maxwell 2011).
[211] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Vandamme Report'), 12, http://goo.gl/K0iUzv (accessed 13 October 2016).
[212] *Ibid*.
[213] Art. 2(1)(c) AIFMD.

2.2.7.4. AIFs

Collective investment undertakings that do not comply with the UCITS investment policy fall outside the scope of the UCITSD V.[214] All these types of collective investment undertakings are captured by the AIFMD that regulate collective investment undertakings, such as real estate, infrastructure, private equity[215] and hedge funds[216], as well as all other funds other than those regulated in the UCITSD V.[217]

2.2.8. Conclusion

The UCITSD V requires for both the management (authorization UCITS ManCo) as the marketing[218] of UCITS units/shares to the public (authorization of the UCITS) an authorization to be obtained. Defining what is a UCITS is, thus, important to determine whether a UCITS or a ManCo needs to obtain a mandatory authorization. UCITS within the meaning of the UCITS V means an undertaking:[219]

- with the sole object of which is the collective investment in transferable securities or in other liquid financial assets[220], capital raised from the public and which operate on the principle of risk-spreading;[221] and
- with the units of which are repurchased or redeemed out of these undertakings' assets.[222]

The definition of a UCITS does not include the term 'collective investment undertaking'. A grammatical and systematic interpretation of UCITS under the UCITSD leads to the conclusion that UCITS are collective investment undertakings , as discussed for the AIF definition[223] and also applied in the PR[224], that raise capital, from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors.[225] UCITS are, thus, 'AIFs' (read: collective investment undertakings) authorized under UCITSD V.Unlike AIFs, UCITS are collective investment undertakings ('AIFs') that are under UCITSD V required to invest in transferable securities and/or in another 'liquid financial assets', operate on the principle of risk-spreading (apply diversification) and always are open-end funds regardless of the legal form they are established in. UCITS focusses on investor protection for units/shares marketed to the public. For this purpose, UCITSD V, requires UCITS to be authorized in the Member State in which it is situated.[226] A prerequisite for the authorization of an undertaking is that the capital must be 'raised from the public'.[227] UCITS can, thus, be marketed to retail and/or professional investors. The exemptions listed in UCITSD V provide extra legal certainty that certain undertakings do not qualify as a UCITS

---

[214] Art. 3(d) UCITSD V.
[215] C.D. Spetter, *Private equity – wat is het en hoe is het gereguleerd in Nederland?*, 2 *Onderneming en Financiering* 52-67 (2013); J. Kerkvliet, *De gevolgen van de AIFM Richtlijn voor de Nederlandse private equity-industrie*, 3 *V&O* 55 (2011); C.C. Sip, *Richtlijn inzake beheerders van alternatieve beleggingsfondsen; gevolgen voor de private-equity industrie*, 3 TOP 78-84 (2011).
[216] F.S. Lhabitant, *Handbook of Hedge Funds* (Wiley 2006).
[217] U. Klebeck, *Interplay between AIFMD and the UCITSD* 84-85 (D.A. Zetzsche ed, Kluwer 2015).
[218] Referred to in Art.5 UCITSD V as 'pursing activities'.
[219] Art. 1(2) UCITSD V.
[220] See Art.50(1) UCITSD V.
[221] Art. 1(2)(a) UCITSD V.
[222] Art. 1(2)(b) UCITSD V.
[223] See *supra* 2.1.
[224] Under Art. 2(p)(i) PR 'collective investment undertakings' 'raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors'.
[225] See Art. 4(1) AIFMD.
[226] Art. 4 UCITSD V.
[227] See Art. 1(2) UCITSD V.

under UCITSD V. Undertakings not subject to UCITSD V include collective investment undertakings of the closed-end type, undertakings that are solely raising capital and are promoted outside of the EEA (TC-AIFs) and undertakings that do not comply with the UCITSD V investment policy.

2.3. Conclusion

Based upon a systematic interpretation of the AIFMD and UCITSD V, both UCITS and AIFs are qualifying as collective investment undertakings that raise capital, from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors.[228]

UCITS diverges from AIFs in three dimensions. First, their structure and investment policy is different compared to AIFs. UCITS are open-ended, which is supported by mandatory investment in liquid assets and a diversification requirement.[229] Second, UCITS are mandatorily subject to an authorization procedure. Professional AIFs under the AIFMD are only required to obtain registration, whereas for retail AIFs this is being left over to the individual Member States.[230] Third, AIFs are marketed based upon the AIFMD marketing passport to professional investors, whereas UCITS may use of the marketing passport when marketing to the public, including both professional and retail investors.[231] UCITS are, thus, 'AIFs' that are authorized under UCITSD V.

3. Intermediary Regulation

Under the AIFMD/UCITSD V, financial intermediaries, including AIFMs/UCITS ManCos and depositaries, play a pivotal role in fund governance.[232] To verify the role of the depositary, the regulation of these intermediaries involved will be discussed.

3.1. AIFMs

Under the AIFMD, AIFMs are required to authorize that manage or market (Non-)EEA AIFs in the EEA to (professional) investors. This authorization not only applies to EEA-, but also to TC-AIFMs.[233]

Under the AIFMD, AIFMs are 'legal persons whose regular business is managing one or more AIFs'.[234] Each AIF managed under the AIFMD must either have an external AIFM or, where the legal form of the AIF permits it, the AIF may be internally managed.[235] The scope of the authorized activities for AIFMs is, similar to UCITS, limited. The AIFMD intends to

---

[228] Art. 4(1) AIFMD.

[229] N. Moloney, *How to Protect Investors: Lessons from the EC and the UK* 139, 152, 162-165 (Cambridge University Press 2010).

[230] Art. 43 AIFMD; This is due to retail investor protection concerns. See J. Fisch & T. Wilkinson-Ryan, *Why Do Retail Investors Make Costly Mistakes? An Experiment on Mutual Fund Choice*, 162 U. Pa. L. Rev. 605 (2013–2014).

[231] Art. 4(1)(ag) and (aj) AIFMD; Art.6 EuVECA/EuSEF Regulation; Art.5 ELTIFR.

[232] A.B.R Lancellotta, P.A. Pike & P.S.Stevens, *Fund Governance: A Successful, Evolving Model,* 10(3) Virginia Law & Business Review 455-489 (2016).

[233] Cf. D.A. Zetzsche, D.A. & T.F. Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* (D.A. Zetzsche ed, Kluwer 2015); J-P. Gauzès, *Focus on AIFMD: The AIFM Directive*, Luxembourg Fund Review 18 (2011).

[234] Art. 4(1)(b) AIFMD.

[235] Arts 5(1), 6(1) AIFMD.

guarantee a certain degree of specialization and avoid conflicts of interests[236] that do not arise from asset management activities.[237] Article 6 AIFMD limits the activities of AIFMs to three types of activities: (1) the services listed in Annex I AIFMD, (2) the additional management of UCITS and (3) the management of portfolios under MiFID II.

3.1.1. Services listed in Annex I No. 2 AIFMD

External AIFMs and internally managed AIFs may not engage in activities other than listed in Annex I.[238] Annex I categorizes the activities in (1) investment functions which an AIFM shall at least perform when managing an AIF[239] and (2) other functions that an AIFMs may additionally perform in the course of the collective management of an AIF.[240] The investment functions are the 'core-activities' and the other functions the 'non-core activities'.

AIFMs are legal persons whose regulator business is managing one or more AIFs. [241] Following Article 4(1)(w) AIFMD, 'managing an AIF' comprises of at least investment management functions referred to in point 1(a) or (b) of Annex I for one or more AIFs. These investment management functions are portfolio[242] and risk management. Following Article 6(5)(d) and Recital 21 AIFMD, an AIFM may never be authorized to provide management without also providing risk management or vice versa. The two investment management functions can, thus, be seen as the 'core activities' that carry the authorization of the AIFM.[243]

3.1.2. Core Activities

3.1.2.1. Portfolio management

Portfolio management, other than in MiFID II, has not been defined in the AIFMD. Like under the UCITSD, portfolio management has to be understood as 'collective investment', i.e. the decision to buy, hold or sell assets, including pre- and post-trade analysis of the investment decision on behalf of one or more investors.[244]

3.1.2.2. Risk Management

The AIFMD introduces risk management as an authorized activity instead of an operating condition.[245] Risk management as authorized activity should not be seen as purely the operating condition under Article 15 AIFMD. Instead, risk management as core-activity is characterized by three elements, including, control, the optimization of business activity and

---

[236] Technical Committee of International Organization of Securities Commissions, *Private Equity Conflicts of Interest: Final Report*, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD341.pdf (accessed 3 July 2015).
[237] See D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 209 (D.A. Zetzsche ed, Kluwer 2015); R. Sklar,, *Hedges or Thickets: Protecting Investors from Hedge Fund Managers' Conflicts of Interest*, 77:6 Fordham Law Review 3251 (2008-2009); See on conflicts of interest resolution under the theory of investments and management: J. Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 Yale L.J. 1228 (2014).
[238] Art. 6(2)(3) AIFMD.
[239] Annex 1(1) AIFMD.
[240] Annex 1(2) AIFMD.
[241] Art. 4(1)(b) AIFMD.
[242] U. Klebeck, & S. Kolbe, *Anlageverwaltung und Finanzmarktaufsicht*, 31:5 Zeitschrift für Wirtschaftsrecht 215 (2010).
[243] Art. 6(5)(d) AIFMD.
[244] Zetzsche points out that the definition should be interpreted for two reasons different. First, the investment policy is laid down in the constitutive documents for AIFs. Second, MiFID II portfolios are limited to financial instruments. See D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 195 (D.A. Zetzsche ed, Kluwer 2015).
[245] See 'risk management' as the AIFM's core activity: D.A. Zetzsche & D. Eckner, *Risk Management* 336 et seq. (D.A. Zetzsche ed, Kluwer 2015); S. Timmerbeil & D. Spachmüller, *Anforderungen an das Risikomanagement nach der AIFM–Richtlinie*, DB 1425 (2012).

the firm-internal governance function of risk management.[246] The control dimension point at the organizational, operational and procedural measures to prevent and minimalize risks.[247] Such as the requirement to appoint a risk manager under Article 39 AIFMD (Commission Regulation). The element of optimizing business activity points at the maximization of the risk-return ratio upon exercising the portfolio management function.[248] Finally the firm-internal governance function of risk management relies upon the governance of the AIFM to goes beyond eliminating risks itself.[249] Legal requirements surrounding risk management may be categorized among institution risk management provisions that requires the AIFM to implement effective structures as a prerequisite for risk management procedures and measurement (institutional risk management).[250] The operational procedures that the organization must adopt providing a basis for risk measurement (operational risk management) and the technical quantificatication of risks (technical risk management).[251]

The two investment management functions can, thus, be seen as the 'core-activities' that carry the authorization of the AIFM.[252] This in contrast to the UCITS ManCo authorization under which the non-core service under the AIFMD are part of the core-services.[253] UCITS ManCos, thus, are based upon the administration model in which investment management, administration and marketing may either be carried out by the UCITS ManCo or fully be delegated. For instance, the UCITS ManCo may focus itself completely on the administration functions, whereas investment management and marketing are being carried out by delegates. At the other hand, the AIFMD is based upon the asset manager model in which the AIFM must always be authorized to perform the investment management functions. The approach of Member States divers with regards to what extent portfolio management and risk management may be delegated.[254] The investment policy, in contrary to UCITS, is very broad and gives

---

[246] D.A. Zetzsche & D. Eckner, *Risk Management* 325 et seq. (D.A. Zetzsche ed, Kluwer 2015).
[247] *Ibid.*
[248] M. Crouhy, D. Galai & R. Mark , *Risk Management* (McGraw-Hill 2001); P. Jorion, *Risk management for hedge funds with position information*, 34 Journal of Portfolio Management 130 (2007); S. Lleo, *Risk Management: A Review* (W. V. Haslett ed., Wiley 2010).
[249] D.A. Zetzsche & D. Eckner, *Risk Management* 327 et seq. (D.A. Zetzsche ed, Kluwer 2015).
[250] C.f. M. McCarthy, *How Risk Management Can Benefit Portfolio Managers* (W. V. Haslett ed., Wiley 2010); D. Chance, M., Grant, K. & J. Morsland, *Risk Management in Managing Investment Portfolios: A Dynamic Process* (Maginn ed., 3rd edn., Wiley 2007).
[251] L. Rahl, *Risk Management for Alternative Investment Strategies* (Wiley 2010).
[252] Art. 6(5)(d) AIFMD.
[253] See D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 195 (D.A. Zetzsche ed, Kluwer 2015).
[254] Under the Dutch AIFMD implementation, for example, a legal person does not qualify as an AIFM under the AIFMD if it is not both performing portfolio and risk management. See Kamerstukken II 2011-2012, 33 235, nr. 3, 41; Austria: FMA, Frequently Asked Questions zur Anwendung des Alternative Investmentfonds Manager – Gesetzes (AIFMG), 24.10.2013, https://www.fma.gv.at/typo3conf/ext/dam_download/secure.php?u=0&file=10522&t=1390046444&hash=d5551f99506d886130f02ce328f74bbc (accessed 26 January 2017); Ireland: Central Bank of Ireland, AIFMD Questions and Answers, 5th Edition, 8 November 2013, ID 1037 (*Q. Will the Central Bank permit AIFM to delegate portfolio or risk management functions)*; Liechtenstein: FMA Liechtenstein, FAQ Umsetzung AIFMG (Stand 27.08.2013), 7, http://www.fma-li.li/no_cache/finanzintermediaere/bereich-wertpapiere/verwalter-alternativer-investmentfonds/faq.html?cid=3093&did=2447&sechash=2e2eae02; UK: FCA, Implementation of the Alternative Investment Fund Managers Directive, PS 13/5, June 2013, 363-368. ('Question 3.2: If a person performs only one of the activities listed in the answer to Question 3.1 does it manage an AIF?').See also C.M. Grundmann-van de Krol, *Regulering beleggingsinstellingenen icbe's in de Wft* 76 (Boom Juridische uitgevers 2013); See also Recital 21 AIFMD. See for the approach of other Member States: D.A. Zetzsche, *Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014); B. Weiser & M. Hüwel, *Verwaltung alternativer Investmentfonds und Auslagerung nach dem KAGB-E*, 19 Betriebs-Berater 1091, 1097 (2013).

rise to systematic risk considerations that might explain the different regulatory approaches in manager regulation.[255]

3.1.3. Non-core Activities

AIFMs may, on top of the core-activities also perform the non-core activities as set out in the Annex I No. 2. AIFMD. External AIFMs may, on top of that, also perform the additional management of UCITS and portfolio management under MiFID II.

3.1.3.1. Annex I No.2 AIFMD

Internally managed AIFs or external AIFMs may perform other functions in the course of the collective management of an AIF.[256] These 'non-core' activities comprise of administration, marketing and asset related services.[257]

Annex I No 2. AIFMD lists several services which are considered to be 'administration', including (1) legal and fund management accounting services; (2) customer inquiries; (3) valuation and pricing, including tax returns; (4) regulatory compliance monitoring; (5) maintenance of unit-/shareholder register; (6) distribution of income; (7) unit/shares issues and redemptions; (8) contract settlements, including certificate dispatch and (ix) record keeping. [258]The valuation of assets and the calculation of the unit price are regulated in more detail elsewhere in the AIFMD.[259]

Marketing under Annex I No. 2(b) AIFMD is further defined under Article 4(1)(x) AIFMD.Under this provision 'marketing' means the

> 'direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the Union'.

Finally, asset-related services may be provided by AIFMs. Annex I No. 2(c) AIFMD defines these services as the services necessary to meet the fiduciary duties of the AIFM. Examples mentioned are, amongst others, facilities management, real estate administration activities, advice to undertakings on capital structure and industrial strategy and related matters.[260]

3.1.3.2. Separate Authorization

Administration, marketing and asset-related services are 'non-core' services that may be performed, in addition to, the core-services portfolio and risk management. In line with the proportionality approach under Article 8(4) AIFMD, Member States may require additional resources for performing these resources.[261] For example, AIFMs may in many cases delegate marketing to investment firms or credit institutions. If AIFMs decide to carry out marketing themselves, they will need to have a minimum 'sales organization' that prevents conflicts of interests and implement this in their risk management procedures.

3.1.3.3. UCITS management

---

[255] D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 161 (D.A. Zetzsche ed, Kluwer 2015).
[256] Annex 1(2) AIFMD.
[257] These activities may only be provided by AIFMs, on top of portfolio and risk management. See Art.6(2) and (5) AIFMD.
[258] Administration should, however, not be confused with the 'administration' in relation to shares or units of collective investment undertakings under Art.6(4)(b)(ii) AIFMD.
[259] See Art. 19 AIFMD.
[260] Annex I No. 2(c) AIFMD
[261] Art. 6(5), 8(4) AIFMD; See for the principle of proportionality: Art. 13(2), Art. 8 AIFMD and Art. 22 (2), Art. 31(1), Art. 40(1) AIFMD (Commission) Regulation.

Under Art. 6(2) and Recital 21 AIFMD external AIFMs should be allowed to manage UCITS under the condition that they, in addition to the AIFM authorization, obtain an authorization under the UCITSD as UCITS ManCo. Under the AIFMD, the UCITS 'co-authorization' imposes a number of binding provisions to such AIFMs.[262] AIFMs, however, will not need to change their organization significantly as the AIFMD demands more detailed organizational requirements in terms of leverage, valuation (illiquid assets) and liquidity management.[263] At the other hand, many AIFMs may specialize themselves on investment management and would under their AIFM authorization delegate administration and marketing. A co-authorization for these AIFMs means that they will need to comply with additional organizational requirements with regard to carrying out the latter two non-core services.

3.1.4. Extension AIFM to provide additional services

The AIFMD allows Member States to authorize an (external)[264] AIFM, in addition to the management of AIFs, to provide a limited range of investment services without requiring them to obtain a separate authorization as investment firm under MiFID II.[265]

AIFMs are under the AIFMD permitted to pursue the activity of management of portfolios of investments on client-by-client basis (individual portfolio management) to achieve significant economies of scale.[266] The management of portfolios of investments, includes those of pension funds and IORPs.[267] Along portfolio management, AIFMs, similar to UCITS ManCos,may perform 'non-core services' comprising investment advice[268] and/or the safekeeping and administration in relation to shares or units of collective investment undertakings[269].[270] AIFMs may, additionally, provide the non-core service of reception and transmission of orders in relation to financial instruments.[271] The term 'non-core service' indicates that these investment services may only be performed if the AIFM is authorized to perform the portfolio management function.[272] The AIFMD prohibits that AIFMs merely manages individual portfolios.[273]

Upon the additional authorization for investment services, AIFMs are required to comply with several operating conditions laid down in MiFID II to ensure a homogenous regulatory framework. AIFMs are prohibited to invest 'all or part of the client's portfolio in units or

---

[262] See Arts 6(2), 7(4), 8(2), 9(10), 14(19(d) AIFMD; D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 204-205 (D.A. Zetzsche ed, Kluwer 2015).
[263] D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 205 (D.A. Zetzsche ed, Kluwer 2015).
[264] The MiFID services may only be provided by externally managed AIFMs. Internally managed AIFs may, however, delegate their portfolio management to an investment firm. See Art. 78(2) AIFMD (Commission) Regulation.
[265] J.C.A.Tonino, , *Op zoek naar de grenzen van het AIFMD-activiteitenverbod: beleggingsdienstverlening door een beheerder van een beleggingsinstelling*, 7/8 TvFR 299-305 (2015).
[266] See Recital 21 AIFMD refers to the exercise of portfolio management, in addition to, the management of AIFs, but does not make reference to the economies of scope and scale; See for the exercise of MiFID II portfolio management: Art. 6(4)(a) AIFMD.
[267] Art. 6(4)(a) AIFMD.
[268] Art. 5(4)(b)(i) AIFMD
[269] The scope of this safekeeping function can be seen as more limited compared to the ancillary service of safekeeping and administrating financial instruments. CIU units are financial instruments, however, the AIFMD clearly points out that only CIU units may be safe-kept and, thus, not any other financial instruments.
[270] Recital 12, Art. 5(4)(b) AIFMD.
[271] Art. 5(4)(b)(iii) AIFMD
[272] Art. 6(3) UCITSD and Art. 6(5)(b) AIFMD; C.M. Grundmann-van de Krol, *Verlenen van MiFID-diensten door beheerders van beleggingsinstellingen en icbe's: enkele knelpunten*, 38 Ondernemingsrecht 198 (2014).
[273] Art. 6(5)(a) AIFMD; See also European Commission, AIFMD ID 1142; The latter is not explicitly mentioned in UCITSD V, but taking a systematic explanation would also have to apply for UCITS. D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 205-206 (D.A. Zetzsche ed, Kluwer 2015).

shares of the AIFs they manage, unless they received prior approval from the client'.[274] In addition, all MiFID investment services need to be subjected to an investor compensation scheme.[275] On top of these requirements Article 6(6) AIFMD requires was additional requirements are applicable to the investment services additionally performed.[276] The most important requirements involve additional own capital, organizational and conduct of business rules.[277]

All Article 6(4) AIFMD investment services may be passported by AIFMs along their management of AIFs. Investment services other than expressively indicated under the AIFMD, may not be provided by AIFMs. In addition, AIFMs may not obtain a separate authorization as an investment firm under MiFID II.[278] Under the initial AIFMD implementation, there were differing views about whether Article 33 AIFMD restricted AIFMs to passport the Article 6(4) AIFMD investment services along its right to provide on a cross-border basis AIF management services to other EU/EEA states. [279] The initial position supported by the European Commission in its Q&A was that AIFMs were restricted from doing so.[280] Nevertheless, various Member States accepted Article 6(4) AIFMD investment services passport notifications.[281] Ultimately, Article 92 MiFID II amended Article 33 AIFMD and expressly allowed for the passporting by an AIFM of Article 6(4) AIFMD investment services into other EU/EEA states.

3.2. AIFM Authorization and Operational Requirements

AIFMs are required under Article 6 AIFMD to be authorized to manage[282] or market AIFs[283].[284] Authorization must be granted by the Competent Authorities of the home Member State.[285]

The authorization may be restricted to one or more types of investment strategies.[286] Upon authorization, an AIFM is allowed to manage and markets AIFs under the AIFMD passporting arrangements.[287]

---

[274] Art. 14(2)(d) AIFMD.
[275] Art. 12(2) AIFMD.
[276] See Art. 2(2), Arts 15, 16 and 24 MiFID II; C.M. Grundmann-van de Krol, *Verlenen van MiFID-diensten door beheerders van beleggingsinstellingen en icbe's: enkele knelpunten*, 38 Ondernemingsrecht 198 *(* 2014).
[277] See Art. 2(2), Arts 15, 16 and 24 MiFID II;
[278] See European Commission, Q&A ID 1142, 22 March 2013. The European Commission explicitly prohibited AIFMs to obtain an authorization as credit institution or investment firm. This consideration can, according to the author, also be applied to UCITS ManCos. See C.M. Grundmann-van de Krol, *Verlenen van MiFID-diensten door beheerders van beleggingsinstellingen en icbe's: enkele knelpunten*, 38 Ondernemingsrecht 198 (2014).
[279] See D.A. Zetzsche, *Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).
[280] C.M. Grundmann-van de Krol, *Verlenen van MiFID-diensten door beheerders van beleggingsinstellingen en icbe's: enkele knelpunten*, 38 Ondernemingsrecht 198 *(* 2014).
[281] D.A. Zetzsche, *Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).
[282] Art. 4(1)(w) AIFMD.
[283] Art. 4(1)(x) AIFMD.
[284] N.B. Spoor & J.M.W.M., Franken, *De impact van de AIFM Richtlijn op de beleggingsfondsensector*, 6 Bedrijfsjuridische Berichten 20-23 (2011); N.B. Spoor, *De effecten van de AIFM Richtlijn vanuit een investment management optiek* 144-158 (M.L. Lennarts & J. Roest, Kluwer 2012); N.B. Spoor, *De AIFM Richtlijn: een tour d'horizon* 9-21 (N.B. Spoor, M. Tausk, J.B. Huizink & R.P. Raas, Kluwer 2012).
[285] Art. 6 AIFMD; T. Wirth, C. Bögli & M. Valenti, *Interne Organisation von Vermögensverwaltern kollektiver Kapitalanlagen*, ST 560 (2012); R. Kramer & R. Recknagel, *Die AIFM-Richtlinie – Neuer Rechtsrahmen für die Verwaltung alternativer Investmentfonds*, 37 Der Betrieb 2077 (2011); U. Klebeck, *Neue Richtlinie für Verwalter von alternativen Investmentfonds?*, 42 Deutsches Steuerrecht 2154 (2009).
[286] D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 215-216 (D.A. Zetzsche ed, Kluwer 2015); Recital 10, Art. 8(4), Art. 12(1) AIFMD.

Under Article 8 and 9 AIFMD, the AIFM must comply with general authorization conditions that are also to be found in other European legislative acts.[288] Authorization requirements to be fulfilled by AIFMs include:[289]

- compliance with the AIFMD;[290]
- sufficient initial capital and own funds;[291]
- fit and proper key personnel;[292]
- suitable significant shareholders/members with qualifying holdings;[293]
- the head office and the registered office of the AIFM are located in the same home Member State;[294]
- avoiding obstacles that prevent the effective exercise of the supervisory functions of Competent Authorities.[295]

Apart from the general authorization conditions, the AIFMD requires AIFMs that have obtained an authorization as an AIFM to comply with general requirements, organizational requirements and provisions governing the delegation of AIFM functions on an ongoing basis.

3.2.1. General Requirements

Article 12 AIFMD sets out some general conduct of business principles that can be organized along the two 'corporate law principles' of the duty of loyalty aimed at the prevention of 'stealing' by fiduciaries and the duty of care that prevents the 'shirking' of fiduciaries.[296] Both are embodied in Article 12(1)(a) AIFMD that requires AIFMs to 'act honestly, with due skill, care and diligence and fairly in conducting their activities'. The duty of loyalty is embodied in a number of sub-principles that include the requirement to 'act in the best interests of the AIFs or the investors of the AIFs they manage and the integrity of the market'[297], to maintain a conflicts of interest organization[298] and 'to treat all AIF investors fairly'[299].

---

[287] The right to manage cross-border AIFs is being referred to as 'management passport' and the right to market AIFs on a cross-border basis is being referred to as 'marketing passport'. See D.A. Zetzsche, D.A. & T.F. Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* (D.A. Zetzsche ed, Kluwer 2015).
[288] See Arts 6 et seq. UCITSD V; Art. 9 IORPD II; Arts 5 et seq. MiFID II; Arts 8 et seq. CRD IV; Arts 14 et seq. Solvency II; See also Arts 4 et seq. EuSEFR, Arts 4 et seq. EuVECAR and Arts 3 et seq. ELTIFR.
[289] Art. 8, 9 AIFMD; D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 216 (D.A. Zetzsche ed, Kluwer 2015); L. Schäfer, *Corporate Governance bei Kapitalanlagegesellschaften – Fund Governance* (Duncker & Humblot 2009).
[290] Art. 8(1)(a) AIFMD.
[291] Art. 8(1)(b) AIFMD.
[292] Art. 8(1)(c) AIFMD.
[293] Art. 8(1)(d) AIFMD.
[294] Art. 8(1)(e) AIFMD.
[295] Art. 8(3) AIFMD.
[296] D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 226 (D.A. Zetzsche ed, Kluwer 2015); See also: W.A. Gregory, *The Fiduciary Duty of Care: A Perversion of Words*, 38 Akron Law Review 181 (2005); J. Velasco, *How Many Fiduciary Duties are There in Corporate Law*, 83 Southern California Law Review 1231 (2010); See also: S. Kalss, *Anlegerinteressen – Der Anleger im Handlungsdreieck von Vertrag, Verband und Markt* (Springer 2001).
[297] Art. 12(1)(e) AIFMD; Art. 17 AIFMD (Commission) Regulation.
[298] Art. 12(1)(d) AIFMD requires AIFMs to 'take all reasonable steps to avoid conflicts of interest and, when they cannot be avoided, to identify, manage and monitor and, where applicable, disclose, those conflicts of interest in order to prevent them from adversely affecting the interests of the AIFs and their investors and to ensure that the AIFs they manage are fairly treated'; The requirement related to the conflicts of interest organization is elaborated in Art. 14 AIFMD and Arts 30 et seq. AIFMD (Commission) Regulation.
[299] Art. 12(1)(f) AIFMD.

The duty of care requires AIFMs to act 'with due skill, care and diligence'[300] and requires AIFMs to employ an adequate organization[301], comply with the AIFMD[302] and treat investors equally[303].

These general principles are umbrella-requirements that are specified in a number of provisions related to remuneration[304], conflicts of interests[305], risk management[306], liquidity management[307] and the investment in securitization provisions[308].

Article 13(1) sub-para. 1 AIFMD requires AIFMs to establish a remuneration policy that reduces excessive risk taking by categories of staff of an AIFM which includes senior management, risk takers, control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers.[309] The AIFM internal governance structure is responsible for the design, implementation and supervision of the AIFM remuneration policy.[310]

Article 13(1) sub-para. 1 AIFMD requires an AIFM's remuneration policy to be 'consistent with and promote sound and effective risk management" and should not "encourage risk-taking which is inconsistent with the risk profiles, fund rules or instruments of incorporation of the AIF it manages'.

Article 13(1) sub-para. 2 and Annex II AIFMD lays down general and specific risk-alignment requirements that a remuneration policy needs to fulfil. General risk-alignment requirements, *inter alia*, require an appropriate retention policy[311], do not allow personal hedging strategies[312], limits guaranteed variable remuneration[313] and do not allow remuneration policies that reward failure.[314] Specific requirements, for example, require an appropriate balance between fixed and variable components of an compensation package.[315] The remuneration policy shall be applied with the principle of proportionality taken into account.[316]

Article 14(1) AIFMD requires AIFMs to take all reasonable steps to identify conflicts of interest between the AIFM, the AIF investors and amongst investors.[317]AIFMs are also

---

[300] Art. 12(1) AIFMD.
[301] Art. 12(1)(c) AIFMD; Art. 57 AIFMD (Commission) Regulation.
[302] Art. 12(1)(e) AIFMD: 'comply with all regulatory requirements applicable to the conduct of their business activities so as to promote the best interests of the AIFs or the investors of the AIFs they manage and the integrity of the market'.
[303] Art. 12(1)(f) AIFMD: 'No investor in an AIF shall obtain preferential treatment, unless such preferential treatment is disclosed in the relevant AIF's rules or instruments of incorporation'; See
H.M. Vletter-van Dort, *Gelijke behandeling van beleggers bij informatieverstrekking* (Kluwer 2001).
[304] Art. 13 AIFMD.
[305] Art. 14 AIFMD; Arts 30-37 AIFMD (Commission) Regulation.
[306] Art. 15 AIFMD; Arts 38-45 AIFMD (Commission) Regulation.
[307] Art. 16 AIFMD; Arts 46-49 AIFMD (Commission) Regulation.
[308] Art. 17 AIFMD; Arts 50-56 AIFMD (Commission) Regulation.
[309] See on the difference between the 'sales orientation' of MiFID II and the 'risk orientation' of the AIFMD: D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* 129 (D.A. Zetzsche ed, Kluwer 2015); N.B. Spoor, N.B. & G.A.M. Verwilst, *Beloning van fondsbestuurders*, 1/2 TvFR 45-49 (2014).
[310] See P. Camara, *The AIFM's Governance and Remuneration Committees: The Impact of the AIFMD* (D.A. Zetzsche ed, Kluwer 2015); See also: European Securities and Markets Authority, *Consultation paper – Guidelines on sound remuneration policies under the AIFMD*, 28 June 2012, ESMA/2012/406.
[311] Annex II(1)(m) sub-para. 2 AIFMD.
[312] Annex II(1)(q) AIFMD.
[313] Annex II(1)(i) AIFMD.
[314] Annex II(1)(k) AIFMD.
[315] Annex II(1)(j) AIFMD.
[316]Annex II(1) AIFMD.
[317] Art. 14(1) sub-para. 1 (a)-(e) AIFMD.

required to maintain and operate effective organizational and administrative arrangements with a view to taking all reasonable steps designed to identify, prevent, manage[318] and monitor[319] conflicts of interest and prevent them from adversely affecting the interests of the AIF and its investors.[320] AIFMs, within their own operating environment, have to segregate incompatible tasks and responsibilities that potentially generate conflicts of interest.[321] Where such organizational requirements made by the AIFM are not sufficient, AIFMs are required to disclose[322] conflicts of interest to investors before undertaking business on their behalf and develop appropriate policies and procedures.[323]

Article 15(1) AIFMD requires AIFMs to 'functionally and hierarchically' separate the risk management function from the operating units, including from the portfolio management function subject to review by the Competent Authority of the AIFM home Member State.[324] AIFMs are required to implement risk management systems in order to identify, measure, manage and monitor all risks relevant to all AIF investment strategies that shall be, at least, once a year reviewed.[325] AIFMs, shall at least, implement and document a due diligence process when investing on behalf of the AIF and ensure that the risks associated with each investment position of the AIF and their overall effect on the AIF's portfolio can be accurately identified, measured and monitored at any time through stress testing procedures.[326] In doing so, AIFMs are required to ensure that the AIF's risk profile corresponds to the size, portfolio structure and investment strategies and objectives of the AIF.[327] Taken the characteristics of the AIF[328], AIFMs shall set a maximum level of leverage for each AIF they manage, as well as, the extent of the right to reuse collateral or guarantee that could be granted under the leveraging arrangement.[329]

AIFMs are required to employ an appropriate liquidity management system for each AIF they manage that are not unleveraged closed-ended AIFs and adopt procedures that ensures that the liquidity profile of the investments in the AIF complies with its underlying obligations.[330] For that purpose, AIFMs shall regularly conduct stress tests to assess and monitor liquidity risks of the AIFs.[331] AIFMs should also ensure that for each AIF it manages the investment strategy, the liquidity profile and the redemption policy are consistent.[332]

AIFMs that invest in securitization positions on behalf of AIFs have to comply with certain requirements.[333] The requirements include, in particular, a risk retention requirement[334], qualitative requirements concerning sponsors and originators[335] and qualitative requirements

---

[318] Art. 34 AIFMD (Commission) Regulation.
[319] Art. 35 AIFMD (Commission) Regulation.
[320] Art. 14(1) sub-para. 2 AIFMD.
[321] Art. 14(1) sub-para. 3 AIFMD.
[322] Art. 36 AIFMD (Commission) Regulation.
[323] Art. 14(2) AIFMD.
[324] Art. 42 AIFMD (Commission) Regulation.
[325] Art. 15(2) AIFMD; Art. 41 AIFMD (Commission) Regulation.
[326] Art. 15(3)(a) and (b) AIFMD; Art. 45(1) AIFMD (Commission) Regulation.
[327] Art. 15(3)(c) AIFMD; Recital 63, Art. 45(2) AIFMD (Commission) Regulation.
[328] Art. 15(4)(a)-(h) AIFMD.
[329] Art. 15(4) AIFMD; Art. 112 AIFMD (Commission) Regulation.
[330] Art. 16(1) sub-para. 1 AIFMD; Art. 47(1)(b) AIFMD (Commission) Regulation.
[331] Art. 16(1) sub-para. 2 AIFMD; Art. 48 AIFMD (Commission) Regulation.
[332] Art. 16(2) AIFMD; Art. 48(1) AIFMD (Commission) Regulation.
[333] Art. 17 AIFMD.
[334] Art. 51 AIFMD (Commission) Regulation; Committee of European Banking Supervisors, *Call for technical advice on the effectiveness of a minimum retention requirement for securitizations*, https://www.eba.europa.eu/documents/10180/16106/Advice.pdf (accessed 3 July 2015).
[335] Art. 52 AIFMD (Commission) Regulation.

concerning AIFMs exposed to securitization positions[336]. AIFMs may only invest in securitization positions under the prerequisite that the originator, the sponsor or the original lender retain a net economic interest of not less than 5% in the securitization.[337] The risk retention requirement is the most important instrument to avoid misalignment of interests between the investor, originators and sponsors.[338] In addition, AIFMs have to verify that sponsors and originators meet qualitative requirements before assuming the exposure to the credit risks of a securitization on behalf of the AIF.[339] Sponsors and originators, for example, have to grant credit based on sound and well-defined criteria and clearly establish the process for approving, amending, renewing and refinancing to exposures to be securitized as they apply to exposures they hold.[340] AIFMs exposed to securitizations also have to able to demonstrate to the Competent Authorities for each of their individual securitization positions that they have a comprehensive and thorough understanding of those positions and have implemented formal policies and procedures appropriate to the risk profile of the relevant AIF's investments in securitized positions. [341] Corrective action shall be taken by AIFMs where they discovered that the determination and disclosure of the retained interest did not meet the AIFMD requirements or where the retained interest becomes less than 5% and this is not due to the natural payment mechanism of the transaction.[342]

3.2.2. Organizational Requirements

Article 18 AIFMD requires AIFMs, at all times, to have adequate and appropriate human and technical resources that are necessary for the proper management of AIFs.[343] In particular, AIFMs are required to have a compliance[344], internal control[345] and internal audit[346] function.[347] The internal control function includes, in particular, rules for personal transactions.[348] In addition, AIFMs have to have sound administrative and accounting procedures[349] and safeguarding arrangements for electronic data processing.[350]

AIFMs are required to ensure appropriate and consistent procedures to ensure a proper and independent valuation of the assets of the AIF can be performed.[351] The valuation of assets and the calculation of the NAV per unit/share of the AIF shall be laid down in the AIF rules or instruments of incorporation.[352] The NAV per unit/share shall be disclosed to investors and calculated at least once a year.[353] In the case that the AIF is of the open-ended , such

---

[336] Art. 53 AIFMD (Commission) Regulation.
[337] Art. 17(a) AIFMD; Art. 51(1) AIFMD (Commission) Regulation.
[338] Recital 65 AIFMD (Commission) Regulation; Recital 57 CRR; Art. 135(2) Solvency II, Art. 254 Solvency II (Commission) Regulation; D.A. Zetzsche, D. & Eckner, *Securitizations* 613 (D.A. Zetzsche ed, Kluwer 2015).
[339] Art. 53(1) AIFMD (Commission) Regulation.
[340] Art. 52(a) AIFMD (Commission) Regulation. See for other qualitative requirements applying to sponsors and originators: Art. 52(b)-(g) AIFMD (Commission) Regulation.
[341] Art. 53(1) AIFMD (Commission) Regulation.
[342] Art. 54(1) and (2) AIFMD (Commission) Regulation.
[343] Art. 18(1) sub-para. 1 AIFMD.
[344] Art. 61 AIFMD (Commission) Regulation.
[345] Art. 60 AIFMD (Commission) Regulation.
[346] Art. 62 AIFMD (Commission) Regulation.
[347] D.A. Zetzsche & D. Eckner, *Risk Management* 330-331 (D.A. Zetzsche ed, Kluwer 2015).
[348] Art. 63 AIFMD (Commission) Regulation.
[349] Art. 59 AIFMD (Commission) Regulation.
[350] Art. 58 AIFMD (Commission) Regulation; C.f. L.F. Spira & M. Page, *Risk management: The reinvention of internal control and the changing role of internal audit*, 16:4 Accounting, Auditing & Accountability Journal 22 (2003); G.Morgan, *Internal audit role conflict: a pluralist view*, 5(2) Managerial Finance 161 (1979).
[351] Art. 19(1) AIFMD.
[352] Art. 19(2) AIFMD.
[353] Art. 19(3) AIFMD.

valuations and calculations shall also be carried out at a frequency which is both appropriate to the assets held by the AIF and its issuance and redemption frequency.[354]

If the AIF is of the closed-ended type, such valuations and calculations shall also be carried out in case of an increase or decrease of the capital_by the relevant AIF. Valuations and calculations shall be carried out for closed-ended AIFs in case of an increase or decrease in the capital by the relevant AIF.[355]

The valuation function may either be performed by an 'independent'[356] external valuer[357] or the AIFM itself provided that the task is functionally independent from the portfolio management function and other conflicting tasks[358]. External valuers appointed have to, amongst others, be subject to mandatory professional registration, provide sufficient professional guarantees to be perform the relevant function and is qualified and capable of undertaking the valuation function.[359] The depositary may not be appointed as external valuer of the AIF for which it is appointed, unless it functionally and hierarchically separates its depositary function from its task as external valuer and potential conflicts of interests are properly identified, managed, monitored and disclosed to the investors of the AIF.[360] External valuers may not delegate the valuation function to any third party.[361] Where an external valuer is not appointed, the Competent Authorities of the AIFM home Member State may require the AIFM to have its valuation procedure and/or valuations verified by an external valuer or auditor.[362] Where the valuation function is not performed by an independent external valuer, the competent authorities of the home Member State of the AIFM may require the AIFM to have its valuation procedures and/or valuations verified by an external valuer or, where appropriate, by an auditor.

The proper valuation of AIF assets, the calculation and publication of that NAV remains to the responsibility of AIFMs.[363] Notwithstanding this and any contractual arrangements with external valuers, external valuers remain to be liable to the AIFM for any losses suffered by the AIFM as a result of the external valuer's negligence or intentional failure to perform its tasks.[364]

Article 20 AIFMD requires AIFMs that intend to delegate management functions[365] to notify the Competent Authorities of their home Member State and comply with certain requirements.[366] Before an AIFM may delegate any function, two general operating conditions apply. First, AIFMs must objectively justify the entire delegation structure.[367] Non-exhaustive objective reasons include the optimizing of business functions and processes, cost savings, expertise of the delegate in administration/specific makers/investments and access of

---

[354] Art. 19(3) sub-para. 3 AIFMD.
[355] Art. 19(3) sub-para. 3 AIFMD.
[356] Art. 19(8) AIFMD.
[357] Art. 19(4)(a) AIFMD.
[358] Art. 19(4)(b) AIFMD.
[359] Art. 19(5) AIFMD.
[360] Art. 19(4) sub-para. 2 AIFMD.
[361] Art. 19(6) AIFMD.
[362] Art. 19(9) AIFMD.
[363] Art. 19(10) AIFMD.
[364] Art. 19(10) sub-para. 2 AIFMD.
[365] See Annex I AIFMD; See on the scope of the AIFMD delegation regime: T. Partsch & J. Mullmaier, *Delegation* 270-275 (D.A. Zetzsche ed, Kluwer 2015); M. Scheele & H.W. Wielens, *Uitbesteding door beheerders van beleggingsinstellingen en icbe's* 79-92. (Financieel Juridische Reeks, NIBE/SVV, 2014); D. Masson, *Enjeux et impacts de la délégation au sens de la directive AIFM*, 753 Revue Banque (2012).
[366] Art. 20(1) AIFMD; Whether notification or authorization is necessary depends upon the individual Member States. See T. Partsch & J. Mullmaier, *Delegation* 275 (D.A. Zetzsche ed, Kluwer 2015).
[367] Art. 76 AIFMD (Commission) Regulation.

the delegate to global trading capabilities.[368] Second, the delegate must dispose of sufficient resources to perform the respective tasks and the persons who effectively conduct the business of the delegate must be of sufficiently good repute and sufficiently experienced.[369]

General requirements under the AIFMD are to be complied upon delegation to ensure that the AIFM management functions are duly performed. The delegation may not prevent the effectiveness of supervision of the AIFM that implies that the delegate is organized and followed.[370] In addition, the AIFM must demonstrate that a qualified and capable delegate has been selected with all due care that the AIFM is in the position to monitor effectively, that instructions may be given at any time and that the appointment may be withdrawn with immediate effect when this is in the interest of the investors.[371]

The AIFM's liability towards the AIF and its investors shall not be affected by the fact that the AIFM has delegated functions to a third party or by any further sub-delegation.[372] AIFMs may not delegate its functions to the extent that the AIFM cannot be longer considered to be the manager of the AIF to the extent that it becomes 'letter-box entity'.[373]

The delegation of core functions, i.e. portfolio or risk management is allowed if specific requirements besides the general requirements is being complied with. Portfolio management or risk management may only be delegated to authorized/registered and supervised entities or, where that condition cannot be met, with the prior approval of the Competent Authorities of the AIFM home Member State.[374] In addition, portfolio or risk management may only be conferred upon third country entities where a cooperation agreement is in place between the third country and the AIFM home Member State.[375] No (sub-)delegation of portfolio management or risk management shall be conferred on the depositary or to a delegate of the depositary[376] or to any other entity whose interests may conflict with the AIFM or the investors of the AIF[377].

Delegates may sub-delegate any of the functions delegated to it provided that the AIFM consents to the sub-delegation[378], the sub-delegation is notified to the Competent Authorities of the AIFM home Member State[379] and the AIFMD delegation requirements are complied with[380].

3.3. Manager Regulation under the AIFMD/UCITSD 'Product Regulations'

The AIFMD/UCITSD 'product regulations' sets out additional manager regulation to AIFMs and UCITS ManCos that apply on top of the requirements laid down in these directives.

---

[368] Art. 76 AIFMD (Commission) Regulation.
[369] Art. 77 AIFMD (Commission) Regulation.
[370] T. Partsch & J. Mullmaier, *Delegation* 278 (D.A. Zetzsche ed, Kluwer 2015); Art. 79 AIFMD (Commission) Regulation; M. Scheele & H.W. Wielens, *Uitbesteding door beheerders van beleggingsinstellingen en icbe's* 79-92. (Financieel Juridische Reeks, NIBE/SVV, 2014).
[371] Art. 20(1)(f) AIFMD; Art. 75(f) AIFMD (Commission) Regulation.
[372] Art. 20(3) AIFMD; Art. 75(h) AIFMD (Commission) Regulation.
[373] Art. 20(3) AIFMD; Art. 82 AIFMD (Commission) Regulation; T. Partsch & J. Mullmaier, *Delegation* 281 (D.A. Zetzsche ed, Kluwer 2015).
[374] Art. 20(1)(c) AIFMD.
[375] Art. 20(1)(d) AIFMD.
[376] Art. 20(2)(a) AIFMD.
[377] Art. 20(2)(b) AIFMD.
[378] Art. 20(4)(a) AIFMD.
[379] Art. 20(4)(b) AIFMD.
[380] Art. 20(4)(c) AIFMD.

3.3.1. Full AIFMs/UCITS ManCos

The ELTIFR sets out additional manager regulation that applies to the so-called 'full AIFMs', whereas the additional manager regulation laid down in the MMFR applies to both full-AIFMs and UCITS Mancos.

3.3.1.1. ELTIFR

The ELTIFR functions as regulation on top of the framework as established by the AIFMD.[381] In particular, the manager, marketing regulation and corresponding manager and marketing passports as provided by the AIFMD applies to ELTIFs.[382] The ELTIF should be seen as a retail AIF regime[383] for European long-term investments in the real economy[384] in which the general AIFMD regime is supplemented by specific ELTIFR product and marketing regulation[385] that is not only designed for the cross-border marketing to professional, but also to retail investors within the EEA.[386] The ELTIFR, thus, does not impose any additional manager regulation on top of the AIFMD.[387]

3.3.1.2. MMFR

The financial crisis has shown that MMFs can be vulnerable to shocks and amplify risk through the financial system.[388] Investors may redeem invests, especially during stressed market situations, if the prices of assets in which MMFs are invested start to decrease that might force MMFs to sell assets to meet redemption requests.[389] This lead in the crisis to investor runs and caused liquidity difficulties for MMFs that had impact on the financial system as a whole.[390] For this reason, UCITS and AIFs that operate as a MMF have to comply with the MMFR rules mandatorily.[391] The MMFR applies to all MMFs (UCITS and AIFs) that are managed or marketed in the EEA. The MMFR is a regulation that introduces uniform requirements for both UCITS and AIF MMFs.[392] AIFMs and UCITS ManCos are under the MMFR required to comply with additional requirements related to internal credit qualify assessment, liquidity risk management and valuation rules that apply on top of the current requirements for these managers under UCITSD V and AIFMD.[393]

The MMFR requires MMFs to invest in high quality eligible assets.[394] For that reason, the MMFR requires AIFMs and UCITS ManCos that manage and market MMFs to have a prudent internal credit quality assessment in place for determining the credit quality of the eligible assets, such as money market instruments, securitisations in which MMFs invest.[395] This mandatory procedures is meant to limit the over-reliance on credit ratings and use these ratings merely to complement their own assessment of the quality of eligible assets.[396] In addition, MMF UCITS ManCos and AIFMs are required to establish an internal procedure for

---

[381] Recital 10 ELTIFR.
[382] Recital 10 ELTIFR.
[383] See, for instance, Art. 5(1)(d), Art.23(1) and Art. 24(3) ELTIFR.
[384] Recital 3 ELTIFR; Art.1(2) ELTIFR.
[385] Recital 43 ELTIFR sets out that extra marketing rules are required as for the retail investor protection nature of ELTIFs.
[386] Recital 10, 12 ELTIFR.
[387] See Art. 7(2) ELTIFR: '*An ELTIF and the manager of the ELTIF shall comply at all times with the AIFMD*'.
[388] Recital 3 MMFR.
[389] *Ibid.*
[390] Recital 4 MMFR.
[391] Recital 13 MMFR.
[392] Recital 11-13, Art. 4 and 5 MMFR.
[393] Recital 11-13, Art. 4 and 5 MMFR.
[394] Recital 31, Arts 9-16 MMFR.
[395] Recital 31, Art. 19 MMFR.
[396] Recital 31 MMFR.

the selection of credit rating agencies that suit the specific investment portfolio of the MMF and determine the frequency at which MMFs should be monitoring the ratings of those agencies.[397]

To avoid different assessment criteria for evaluating the credit quality of eligible assets, the MMFR establishes minimum criteria for assessment, such as quantitative measures on the issuer of any instruments, balance sheet dynamics and profitability guidelines.[398] A favourable outcome of the assessment should reflect sufficient creditworthiness of the issuer and the credit quality of the instruments issued.[399] The AIFM or UCITS ManCo should document the procedure and the credit quality assessment to develop transparent and coherent assessment procedures that can be monitored and communicated, upon request, to investors and Competent Authorities.[400]

AIFMs and UCITS ManCos managing and marketing MMFs are also obliged to comply with liquidity risk management measures that include a 'know your customer' policy, stress testing and liquidity and redemption gates. To ensure appropriate liquidity management, AIFMs and UCITS ManCos managing MMFs have to establish sound policies and procedures to 'know their investors'.[401] These policies should help AIFMs and UCITS ManCos to have an overview of the MMF's investor base to be able to anticipate large redemptions that MMFs might face. In particular, attention should be paid to the identity of large investors even when represented by nominee accounts, portals or any other indirect buyer.[402]

As part of a prudent risk management, MMFs should, at least bi-annually, conduct stress testing to identify events that could have negative effects on MMFs.[403] Events covered by the stress test include, amongst others, changes in liquidity of portfolio assets, credit risk of assets, levels of redemptions and movements in interest and exchange rates.[404] Managers of MMFs are required to act in order to strengthen the MMF's robustness whenever the results of the testing point out vulnerabilities.[405] In such situations, MMF managers are required to report on vulnerabilities, including an action plan that needs to be submitted to the relevant Competent Authority.

To strengthen the ability of MMFs to face redemptions and prevent MMFs assets from being liquidated at heavily discounted prices, MMF managers are required to hold on a minimum amount of liquid assets that mature daily or weekly.[406] When weekly maturing assets fall below 30% or 10% or when net daily redemptions exceed 10% of the total assets invested in the, MMF managers are required to take measures that include liquidity fees on redemptions, redemption gates and a temporary suspension of redemptions.[407]

MMF managers should ensure that MMFs are valued on a daily basis using mark to market as preferred method.[408] If the market data are not of sufficient quality, such as is the case with OTC derivatives, a mark to model method may be used.[409]

3.3.2. Small AIFMs

---

[397] *Ibid.*
[398] Recital 33, Art. 20 MMFR.
[399] *Ibid.*
[400] Recital 33, Art. 21 MMFR.
[401] Recital 42, Art. 27 MMFR.
[402] *Ibid.*
[403] Recital 43 MMFR.
[404] Recital 43, Art. 28(1) MMFR.
[405] Recital 43, Art. 28(4) MMFR.
[406] Recital 38 MMFR.
[407] Art. 34(1) MMFR.
[408] Recital 44 MMFR.
[409] Recital 44, Art. 29 MMFR.

The EuVECAR/EuSEFR sets out general principles that 'small AIFMs' need to comply with instead of the manager regulation regime under the AIFMD. Although technically not an AIFMD/UCITSD V product regulation, various Member States extend the AIFMD manager regulation in their implementation laws regime to small AIFMs established in their domiciles.

3.3.2.1. EuVECAR/EuSEFR

The marketing passport introduced under the EuVECAR/EuSEFR, in line with the small AIFM regime under the AIFMD, has to comply with a much lower regulatory burden compared to the full-AIFM regime under the AIFMD.[410] The EuVECAR/EuSEFR, however, require small AIFMs that manage EuVECAs or EuSEFs to comply with a minimum set of principles that can be seen as 'manager regulation'.[411]

These principles include the duty that the small AIFM:[412]

- acts honestly, fairly and with due skill and diligence;
- acts in be best interest of the funds and the investors and market integrity;
- ensures fair treatment of investors;
- applies appropriate policies to prevent conflicts of interest;
- is diligent in the selection and ongoing monitoring qualifying portfolio undertakings[413;]
- is fit and proper;
- ensures effective compliance with the law; and
- sets up transparent valuation processes.

3.3.2.2. Small AIFMs: Registration vs. Authorization

The AIFMD requires small AIFMs only to register themselves and to fulfill certain disclosure duties with regard to relevant Competent Authorities.[414] Small AIFMs are (non-) EU AIFMs managing (1) AIFs whose AuM do not exceed a threshold of EUR 100 million, irrespective of whether such AuM are wholly or partly acquired through the use of leverage, or (2) AIFs whose AuM in total do not exceed a threshold of EUR 500 million, provided that such AuM are unleveraged and investors are not granted redemption rights during a period of 5 years.[415] Member States under the AIFMD may impose stricter requirements to small AIFMs as they fall, for the most part, outside of the scope of the AIFMD.[416]

Member States vary in their implementation of the 'small AIFM regime'. Some Member States differentiate between retail and professional AIFs in extending the 'full AIFM regime', whereas other Member States take a 'unified' or 'product-based' approach.

Small AIFMs that market AIFs to professional investors only have to register themselves in Austria, Germany, Luxembourg and the Netherlands.[417] Registration in this regard means

---

[410] European Commission, *Impact Assessment – Proposal for a Regulation of the European Parliament and of the Council on European Venture Capital Funds*, {COM(2011) 860 final} {SEC(2011) 1516 final}; P. Volhard & A. Kruschke, *Die Regulierung von Private Equity Fonds-Manager durch den Europäischen Gesetzgeber - Ausgewählte Aspekte der AIFM-Richtlinie und der VC-Verordnung im Überblick*, 1 Europäisches Wirtschafts- und Steuerrecht 21 (2012).

[411] Art. 7 EuVECAR/EuSEFR; E.P.M Vermeulen & D. Pereira Dias Nunes, *The European Venture Capital Cycle in the Post-AIFMD Era* 593-609 (D.A. Zetzsche ed., Kluwer 2012); M. Scheele, *Europees paspoort voor beheerders van European Venture Capital Funds en Social Entrepreneurship Funds per 22 juli 2013*, 12 Ondernemingsrecht 458-460 (2013); J. Kerkvliet, *Het voorstel voor een verordening inzake Europese Venture capital-fondsen*, 3 V&O 16 (2012).

[412] Art. 7 EuVECAR/EUSEFR.

[413] See for the definition of qualifying portfolio undertakings: Art. 3(1)(d) EuVECAR/EuSEFR.

[414] See Art. 3 AIFMD; Arts 2-5 AIFMD Regulation.

[415] Art. 3(2) AIFMD and Recital 17 AIFMD.

[416] Art. 3(3) AIFMD.

that small AIFMs only need notify national competent authorities of their existence for prudential purposes. The information provided will not be subjected to a full check as under an authorization process. Despite their sole registration requirements, several Member States, demand certain AIFMD provisions to be applicable to small AIFMs. Austria, for example, requires small AIFMs to comply with the duties upon the acquisition of non-listed firms.[418]
Ireland and France require a 'full-authorization' for small-AIFMs regardless whether they are marketed to retail or professional investors.[419] Despite the full-AIFM authorization requirement in France, small AIFMs are derogated from several duties, including the provisions related to valuation, investor information and the duties upon the acquisition of non-listed firms and the requirement to appoint a depositary.[420] Instead, France requires specific disclosure requirements in its AMF-regulation.[421]

Ireland requires a 'light-authorization' for small AIFMs managing Qualified Investor AIF (QIAIF) during the first two years after its initial authorization. During this initial phase, the small AIFM is, on top of the minimum requirements under the AIFMD, is already subjected to many manager regulation provisions of full-AIFMs.[422] Examples include the regulatory minimum capital, fit & properness requirements, organizational requirements and the duty of loyalty and care.[423] Following this initial period of two years, all 'small-AIFMs' need to apply for a full-AIFM authorization.[424]

Several Member States require stricter requirements for small AIFMs marketing retail AIFs. This can be explained by the European approach that requires an authorization for UCITS and ELTIFs that may be both marketed to professional and retail AIFs.[425] Despite of this, there are also Member States that do not require authorization for small AIFMs marketing retail AIFs.
Austria, France and Ireland require such small AIFMs to obtain an authorization.[426] The Netherlands generally requires authorization for small AIFMs marketing retail AIFs.[427] The Netherlands derogates from this general principle if small-AIFMs fall within the scope of its private placement regime.[428] Small AIFMs that manage retail AIFs and do not meet these

---

[417] Austria: § 1 (5) Austrian AIFM Law; Germany: § 2(4) KAGB; Luxembourg: Art. 3(3) Luxembourg AIFM Law; the Netherlands: Art. 2:66a Wft.
[418] Austria: § 1(5) Austrian AIFM Law; Germany: § 2(4) KAGB.
[419] See France: Art. L 214-24 III CMF and Art. 532-9 CMF; Ireland: Central Bank of Ireland, AIF Rulebook, January 2017, Chapter 2 – Qualifying Investor AIF Requirements, Part. III. Additional Provisions Applicable to Qualifying Investor AIFs which have a registered AIFM.
[420] AMF, Guide des mesures de modernisation DIRECTIVE AIFM apportdes mesures de modernisation DIRECTIVE, Juillet 2013, 3 et seq, 21 et seq; C. Clerc, *The AIFMD's Transposition in France* (D.A. Zetzsche ed, Kluwer 2015) ; S. Puel, *France* (D. Busch ed, Oxford 2014).
[421] *Ibid.*
[422] Central Bank of Ireland, AIF Rulebook, January 2017, Chapter 4 - AIF Management Company Requirements, i. Capital requirements, 163, sub 2(d).
[423] See Central Bank of Ireland, AIFMD Questions and Answers, 23th Edition – 03 January 2017, ID 1057.
[424] Central Bank of Ireland, AIF Rulebook, January 2017, Chapter 2 – Qualifying Investor AIF Requirements, Part. III. Additional Provisions Applicable to Qualifying Investor AIFs which have a registered AIFM. .
[425] See Art. 5 UCITSD and Recital 10, 41, 43, Art. 31 ELTIFR.
[426]Austria: § 1 (5), § 48(1) Austrian AIFM Law; France: Art. L 214-24 III CMF and Art. 532-9 CMF; Ireland: Central Bank of Ireland, AIF Rulebook, January 2017, Chapter 1- Retail Investor AIF Requirements, Section 2: Supervisory requirements, i. General Conditions, 1.
[427] Art. 2:66a FSMA; C.W.M. Lieverse & A.B.A.Doodeheefver, *De Nederlandse implementatie van de AIFM-richtlijn*, 10 TvFR 322-325 (2011).
[428] Art. 2:66a FSMA; Small-AIFMs managing AIFs that are not solely marketed to professional investors may, however, make use of this lighter regime when participations are either offered to less than 150 investors or are of a nominal value per participation right or of a consideration per investor of at least EUR 100,000 (retail investors).

requirements are subject to authorization under the AIFMD.[429] Germany generally requires authorization for small AIFMs marketing to retail investors.[430] several types of retail AIFs managed by small-AIFMs. Small AIFMs managing retail AIFs with a limited amount of investors, investing in ecological projects, such as energy associations and closed-funds with less AuM than 100 Mio are exempted of this general authorization requirement.[431] Several provisions of the AIFMD are, however, partly declared applicable to the latter type of closed-funds, such as the duty to appoint a depositary and financial reporting.[432]

Liechtenstein and Luxembourg apply an 'unified approach' towards the manager regulation for small AIFMs.[433] Both their manager regulations do not differentiate between small AIFMs managing professional and retail AIFs. Liechtenstein and Luxembourg, however, differentiate in their product and marketing regulation approach towards retail and professional investors.

Regardless whether small AIFMs manage retail or professional AIFs, Luxembourg[434] only requires only a minimum registration and transparency requirements for small AIFMs.[435] Liechtenstein requires for all small AIFMs a 'light authorization'. Several provisions of the AIFMD apply to small AIFMs, including, amongst others, the appointment of a depositary, rules of conduct of business[436] and delegation.[437] There are several provisions, that however, do not apply, such as the minimum capital requirement for AIFMs, the provisions related to securitizations and the AIFMD remuneration requirements.[438] Part of the organizational requirements of full AIFMs are substituted by the mandatory appointment of authorized administrators by small AIFMs.[439] The mandatory contract needs to arrange requirements regarding the organization of the small AIFM, risk- and liquidity management and administration.[440]

The UK applies a 'product-based approach'.[441] The UK applies a small AIFM[442] that can either be a small authorized AIFM[443] or a small registered AIFM[444]. Small AIFMs managing EuVECAs, internally managed closed-end investment companies and certain property

---

[429] Art. 2:65 FSMA.
[430] § 2 (4a)-(5), 44 bis 48 KAGB. See for exemptions: D.A. Zetzsche, *Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).
[431] § 2(4a) – (5), 44 - 48 KAGB.
[432] § 2(5) KAGB.
[433] G. Dobrauz-Saldapenna, A. Schwertschlag & P. Rosenauer, *The AIFMD's Transposition in Liechtenstein* (D.A. Zetzsche ed, Kluwer 2015); A. Lindemann, *Relocation to Liechtenstein's Investment Fund Centre under the new AIFM-legislation? – A Swiss & UK perspective*, 1 GesKR 58 (2013).T. Partsch & E. Forget, *The Luxembourg Implementation of the AIFMD* (D.A. Zetzsche ed, Kluwer 2015); C. Kremer, M. Eisenhuth, G. Dusemon & C. Martougi, *Luxembourg* (D. Busch ed, Oxford 2014).
[434] Art. 3(3) Luxembourg AIFM Law.
[435] Art. 3(3) Luxembourg AIFM Law; T. Partsch & E. Forget, *The Luxembourg Implementation of the AIFMD* (D.A. Zetzsche ed, Kluwer 2015); C. Kremer, M. Eisenhuth, G. Dusemon & C. Martougi, *Luxembourg* (D. Busch ed, Oxford 2014).
[436] Art. 35 (1) Liechtenstein AIFM Law; G. Dobrauz-Saldapenna, A. Schwertschlag & P. Rosenauer, *The AIFMD's Transposition in Liechtenstein* (D.A. Zetzsche ed, Kluwer 2015);
[437] Art. 3(1) Liechtenstein AIFM Law.
[438] Art. 3(4)-(6) Liechtenstein AIFM Law.
[439] Art. 3(4) (d) Liechtenstein AIFM Law.
[440] Art. 3(6) Liechtenstein AIFM Law.
[441] J.R. Siena & D. Eckner, *The AIFMD's Transposition in the United Kingdom* (D.A. Zetzsche ed, Kluwer 2015); D. Rouch, *United Kingdom* (D. Busch ed, Oxford 2014); E. Lomnicka, *Collective Investment Schemes* (3rd edn., G. Walker & R. Purves eds, Oxford University Press 2014).
[442] FUND 1.3.5. See also for the definition of a 'small AIFM' the FCA Glossary.
[443] FUND 1.3.6. See for the definition of a 'small authorised UK AIFM' the FCA Glossary.
[444] FUND 1.3.7. See for the definition of a 'small registered UK AIFM' the FCA Glossary.

funds.[445] All other small AIFMs have to be authorized. As 'managing an AIF'.[446] The authorization depends upon whether a small AIFM manages an authorized AIF or an unauthorized AIF. Small authorized AIFs that manages authorized AIFs are subjected to COLL, whereas those that manage unauthorized AIFs are not subjected to the pre-AIFMD UK manager regulation under COLL.[447] The requirements under COLL are less strict than under the AIFMD.

3.3.3. Conclusion

The AIFMD/UCITSD 'product regulations' require AIFMs and UCITS ManCos to comply with additional regulation. The ELTIFR sets out additional manager regulation that applies to the so-called 'full AIFMs', whereas the additional manager regulation laid down in the MMFR applies to both full-AIFMs and UCITS Mancos. The 'wrapper nature' requires AIFMs/UCITS ManCos to comply with these standards on top of the manager regulation set out in the AIFMD and UCITSD V.

The EuVECAR/EuSEFR sets out general principles that 'small AIFMs' need to comply with instead of the manager regulation regime under the AIFMD. Although technically not an AIFMD/UCITSD product regulation, various Member States extend the AIFMD manager regulation in their implementation laws regime to small AIFMs established in their domiciles.

3.4. UCITS ManCo

3.4.1. Manager Regulation based on Product Regulation

The authorization of UCITS ManCos under the UCITSD is centered around the 'UCITS' definition.[448] UCITS ManCos may be authorized by their Home Member State for the management of UCITS.[449] Article 6(2) UCITSD for this purpose states that UCITS ManCos may not '*engage in activities other than the management of UCITS , with the exception of the additional management of other collective investment undertaking's'*. Article 6(2) UCITSD refers to the management of UCITS under Annex II UCITSD.

The 'management' of UCITS is further defined in Annex II UCITSD. Annex II UCITSD refers to 'functions included in the activity of collective portfolio management'. Annex II refers to three functions: investment management, administration and marketing.

Unlike the AIFMD, the UCITSD does not define the term 'investment management'. In light of the AIFMD, 'investment management' has to be interpreted as portfolio and risk management.[450] This follows from Recital 21 AIFMD that specifies that 'management of AIFs' should mean 'investment management services'. Article 4(1)(w) defines 'managing AIFs' as performing at least the investment management functions portfolio and risk management. [451]

---

[445] The registration regime of small AIFMs only applies with regard to property funds where (i) the property fund has an FCA authorised CIS operator; and (ii) the property fund does not invest in financial instruments other than shares in any companies through which the property is held and insurance of the property; See FUND 1.3.7.

[446] FUND. 1.3.6.

[447] FUND. 1.3.6. (1); Small AIFMs may, however, at all times opt-in the full AIFMD: FUND. 1.3.6. (2).

[448] See *supra* 2.2.

[449] See definition Home Member State UCITS ManCo: Art.2(1) (c) 'management company's home Member State' means the Member State in which the management company has its registered office'.

[450] See on core activities: D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 194 (D.A. Zetzsche ed, Kluwer 2015).

[451] See Art. 5(5)(d) AIFMD: 'the services referred to in point 1(a) of Annex I without also providing the services referred to in point 1(b) of Annex I or vice versa'; See also Recital 21 AIFMD: *'AIFMs may not be authorized for providing portfolio management without also providing risk management or vice versa*'.

Portfolio management in this regard is to be understood as making investment decisions, i.e. the decision to buy, hold or sell assets, including pre- and post-trade analysis.[452] Risk management under Article 51 UCITSD it the monitoring and measuring of risk of the position and their impact on the risk profile of the portfolio.
The administration function[453] allowed to be performed by the UCITS ManCo is defined by a list of functions in Annex II UCITSD. The administrative function comprises, amongst others, of legal and fund management accounting services[454], custom inquiries[455] and regulatory compliance monitoring[456].

The term marketing is not defined in Annex II UCITSD. Ireland, for example, defines the marketing of UCITS as

> 'a direct or indirect offering or placement of units or shares of a UCITS at the initiative of the UCITS or on behalf of the UCITS to or with investors domiciled or with a registered office in Ireland'.[457]

The purpose of the limitation to 'UCITS management' was to protect investors by granting an optimum level of specialization by UCITS manCos to avoid any additional conflicts of interests.[458] Article 6(2) UCITSD deliberately allowed AIFs to be managed without granting them a European passport. Post-AIFMD this provision needs to be interpreted as obtaining an AIFMD authorization as UCITS ManCo.[459]

3.4.2. Extension UCITS ManCo license to provide additional services

Like under the AIFMD, UCITS ManCos, in addition to the management of UCITS, may be authorized under the laws individual Member States to provide 'individual portfolio management services', including MiFID II portfolio management and pension funds.[460] UCITS ManCos that are additionally authorized to perform 'individual portfolio management services' may also provide 'non-core services' including investment advice[461] and the safekeeping and administration in relation to units of collective investment undertakings[462] UCITS ManCos which extend their authorization to carry out individual portfolio management services and one or more 'non-core services' are subject to certain MiFID II requirements including capital, organizational and conduct of business obligations.[463]

---

[452] D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 196 (D.A. Zetzsche ed, Kluwer 2015).
[453] See for a general overview of 'administration' under the AIFMD: D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 197-200 (D.A. Zetzsche ed, Kluwer 2015).
[454] Annex II, Administration, point a UCITSD V.
[455] Annex II, Administration, point b UCITSD V.
[456] Annex II, Administration, point d UCITSD V.
[457] Central Bank of Ireland, *UCITS authorised in another Member State intending to market units in Ireland*, December 2011, 3.
[458] See also Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20December 1985* ('Vandamme Report'), 22, http://goo.gl/K0iUzv (accessed 13 October 2016).
[459] Art.7(4) AIFMD; See for obtaining an AIFM authorization as UCITS ManCo: D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 169 (D.A. Zetzsche ed, Kluwer 2015); U. Klebeck, U., *Interplay between AIFMD and the UCITSD* 113 (D.A. Zetzsche ed, Kluwer 2015).
[460] Art. 6(3)(a) UCITSD V; Cf. J-P Casey, *Shedding Light on the UCITS-MiFID Nexus and Potential Impact of MiFID on the Asset Management Sector*, ECMI Policy Brief nr. 12, April 2008.
[461] Art. 6(3)(b)(i) UCITSD V.
[462] Art. 6(3)(b)(ii) UCITSD V.
[463] Art. 6(4) UCITSD V.

3.5. UCITS ManCo Authorization and Operational Requirements

3.5.1. Authorization Requirements

There is a strong interconnection between AIFMs and UCITS ManCos that regulate the same core activity of 'investment management'.[464] 'Investment management' relates to UCITS that are 'AIFs', i.e. collective investment undertakings fulfilling the AIF definition criteria, that are authorized and comply with the UCITSD V product regulation.[465] The UCITSD V mandatory product regulation, retail investor character and the absence of a TC regime does not require UCITS ManCos to be regulated differently compared to AIFMs as the agency risks related to 'investment management' carried out by 'management entities' faced by any type of investors are the same.[466]

Unsurprisingly, UCITS ManCos upon authorization under Article 6(2) UCITSD V are subject to similar authorization requirements for the 'management of UCITS' as AIFMs for managing and marketing AIFs under Article 6 AIFMD.[467] Upon authorization, a UCITS ManCo is allowed to provide the 'activity of management of UCITS'[468] under the UCITSD V passporting arrangements.[469] Under Article 7 and 8 UCITSD V, the UCITS ManCo must comply with general authorization conditions that are also to be found for AIFMs.[470] Authorization requirements to be fulfilled by UCITS ManCos include:[471]

- compliance with UCITSD V;[472]
- sufficient initial capital and own funds;[473]
- fit and proper key personnel;[474]
- suitable significant shareholders/members with qualifying holdings;[475]
- the head office and the registered office of the UCITS ManCo are located in the same home Member State;[476]
- avoiding obstacles that prevent the effective exercise of the supervisory functions of Competent Authorities.[477]

3.5.2. Operational Conditions and Organizational Requirements

Apart from the general authorization conditions, UCITSD V requires UCITS ManCo that have obtained an authorization as a UCITS ManCo to comply with general requirements, organizational requirements and provisions governing the delegation of UCITS ManCo functions that are very similar as under the AIFMD. This is unsurprising given that the

[464] U. Klebeck, U., *Interplay between AIFMD and the UCITSD* 113 (D.A. Zetzsche ed, Kluwer 2015).
[465] Annex II UCITSD V.
[466] See Chapter 11, section 1.2.2.
[467] U. Klebeck, U., *Interplay between AIFMD and the UCITSD* 113 (D.A. Zetzsche ed, Kluwer 2015).
[468] See *supra* 3.1.3.3.
[469] See D.A. Zetzsche, D.A. & T.F. Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* (D.A. Zetzsche ed, Kluwer 2015).
[470] See Arts 6 et seq. UCITSD V; Art. 9 IORPD II; Arts 5 et seq. MiFID II; Arts 8 et seq. CRD IV; Arts 14 et seq. Solvency II ; See also Art.4 et seq. EuSEFR, Arts 4 et seq. EuVECAR and Arts 3 et seq. ELTIFR.
[471] Arts 8, 9 AIFMD; D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 216 (D.A. Zetzsche ed, Kluwer 2015).
[472] Art. 7(1) UCITSD V.
[473] Art. 7(1) UCITSD V; UCITS ManCo's are, in contrary to AIFMs, not required to cover potential professional liability risks. See Art. 9(7) AIFMD. See also G. Walker, *The Liability Insurance of the AIFMD* (D.A. Zetzsche ed, Kluwer 2015).
[474] Art. 7(1)(b) UCITSD V.
[475] Arts 8(1) and 11 UCITSD V.
[476] Art. 7(1)(d) UCITSD V.
[477] Art. 7(2) UCITSD V.

general operational conditions and organizational requirements under the AIFMD apply to all AIFMs regardless of the investment strategy, including AIFs that are 'unauthorized UCITS' and the type of management services carried out.[478]

General requirements that are largely the same include general principles such as the duty of care to act 'with due skill, care and diligence'[479] and the duty of loyalty to 'act in the best interests of the AIFs or the investors of the AIFs they manage and the integrity of the market'[480]. Similar as under the AIFMD, the duty of loyalty is embodied in a number of sub-principles that include the requirement to 'act in the best interests of the UCITS or the investors of the UCITS they manage and the integrity of the market'[481] and to maintain a conflicts of interest organization[482] and 'to treat UCITS fairly'[483].

The duty of care requires UCITS ManCo to act 'with due skill, care and diligence'[484] and requires UCITS ManCo to employ an adequate organization[485], comply with UCITSD V[486] and treat investors equally[487]. Similar as under the AIFMD, UCITSD V specifies these general principles in a number of provisions related to remuneration[488], conflicts of interests[489], risk management[490] and the investment in securitization provisions[491]. Unlike the AIFMD, UCITS ManCos are not required to perform liquidity management.[492] This can be explained by the fact that the AIFMD proportionally applied the operational conditions and organizational requirements to AIFMs that manage liquid, illiquid and highly leveraged AIFs, whereas UCITS ManCos are restricted by the UCITSD V product regulation to only manage 'liquid' UCITS.[493]

Similar as for AIFMs, Article 12 UCITSD V requires UCITS ManCos, at all times, to have adequate and appropriate human and technical resources that are necessary for the proper management of UCITS.[494] In particular, UCITS ManCos are required to have a compliance[495], internal control[496] and internal audit[497] function.[498] The internal control function includes, in

---

[478] D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 221 (D.A. Zetzsche ed, Kluwer 2015).
[479] Art. 14(1) UCITSD V; Cf. Art. 12(1) AIFMD.
[480] Art. 14(1)(e) UCITSD V; Art. 22 UCITSD (Commission) Directive; Cf. Art. 12(1)(e) AIFMD; Art. 17 AIFMD (Commission) Regulation.
[481] Art. 14(1)(e) UCITSD V; Art. 22 UCITSD (Commission) Directive; Cf. Art. 12(1)(e) AIFMD; Art. 17 AIFMD (Commission) Regulation.
[482] Art. 14(1)(d) UCITSD V; Chapter III UCITSD (Commission) Directive; Cf. Art. 14 AIFMD and Arts 30 et seq. AIFMD (Commission) Regulation.
[483] Art. 14(1)(d) UCITSD V; Cf. Art. 12(1)(f) AIFMD.
[484] Art. 14(1)(b) UCITSD V; Art. 12(1) AIFMD.
[485] Art. 14(1)(c) UCITSD V; Art. 4 UCITSD (Commission) Directive; Cf. Art. 12(1)(c) AIFMD Art. 57 AIFMD (Commission) Regulation.
[486] Art. 14(1)(e) UCITSD V; Cf. Art. 12(1)(e) AIFMD.
[487] Art. 14(1)(d) and (e) UCITSD V; Art. 12(1)(f) AIFMD.
[488] Arts 14a and 14b UCITSD V; Cf. Art. 13 AIFMD.
[489] Art. 14(1)(d) UCITSD V; Cf. Art. 14 AIFMD, Arts 30-37 AIFMD (Commission) Regulation;
[490] Art. 51 UCITSD V, Chapter VI UCITSD (Commission) Directive; Cf. Art. 15 AIFMD, Arts 38-45 AIFMD (Commission) Regulation.
[491] Art. 50(a) UCITSD V; Art. 17 AIFMD, Arts 50-56 AIFMD (Commission) Regulation.
[492] Cf. Art. 16 AIFMD; Arts 46-49 AIFMD (Commission) Regulation.
[493] See for these 'types of funds': D.A. Zetzsche, *Scope of the AIFMD* 82 (D.A. Zetzsche ed, Kluwer 2012); Cf. Arts 91-93 Liechtenstein AIFM Law.
[494] Cf. Art. 18(1) sub-para. 1 AIFMD.
[495] Art. 10 UCITSD (Commission) Directive; Cf. Art. 61 AIFMD (Commission) Regulation.
[496] Art. 9 UCITSD (Commission) Directive; Cf. Art. 60 AIFMD (Commission) Regulation.
[497] Art. 11 UCITSD (Commission) Directive; Cf. Art. 62 AIFMD (Commission) Regulation.
[498] See D.A. Zetzsche & D. Eckner, *Risk Management* 330-336 et seq. (D.A. Zetzsche ed, Kluwer 2015).

particular, rules for personal transactions.[499] In addition, UCITS ManCos have to have sound administrative and accounting procedures[500] and safeguarding arrangements for electronic data processing[501]. No valuation policy is required to be adopted by UCITS ManCos due to the fact that UCITS are required to be periodically valued.[502]

The strong interconnection between 'management entities', i.e., the AIFM and the UCITS ManCo, that perform the same core activity of 'investment management'[503] is not only reflected in the operational and organizational requirements but also in the delegation regimes of both AIFM and UCITS ManCo functions.[504] The AIFM delegation regime is being modelled after the UCITS ManCo delegation regime.[505] The AIFMD (Commission) Regulation, however, specifies the AIFM delegation regime in detail, whereas no equivalent detailed measures for the UCITS ManCo delegation regime is in place. The reading of the AIFMD (Commission) regulation clarifying various provisions of the AIFM delegation regime, however, should be applied to equivalent requirements of the UCITS ManCo delegation regime to maintain a level playing field between UCITSD V and the AIFMD.[506]

3.5.3. Conclusion

There is a strong interconnection between the AIFMD and UCITSD that regulate the same core activity of 'investment management'.[507] 'Investment management' relates to UCITS that are 'AIFs', i.e. collective investment undertakings fulfilling the AIF definition criteria, that are authorized and comply with the UCITSD V product regulation.[508] The UCITSD V mandatory product regulation, retail investor character and the absence of a TC regime does not require UCITS ManCos to be regulated differently compared to AIFMs as the agency risks related to 'investment management' carried out by 'management entities' faced by any type of investors are the same.[509]

Nevertheless, the scope of the AIFMD includes liquid, illiquid and substantially leveraged AIFs[510], whereas the UCITSD only regulates 'liquid AIFs' complying with specific product regulation under the UCITSD. The broader scope of the AIFMD explains that AIFMs are targeted to more organizational requirements as to accommodate the larger scope of collective investment undertakings.

The strong interconnection between the AIFMD, UCITSD V, MiFID II and IORPD II in regulating 'investment management' has resulted in cross-sectoral regulation of 'investment management regulation'. AIFMs and UCITS ManCos may under the AIFMD and UCITSD V be, when complying with extra requirements, be permitted by Member States to be authorized for individual portfolio management, including those of pension funds and IORPs, as well.[511]

---

[499] Art. 11 UCITSD (Commission) Directive; Cf. Art. 63 AIFMD (Commission) Regulation.
[500] Chapter 2, Section 2 UCITSD (Commission) Directive; Cf. Art. 59 AIFMD (Commission) Regulation.
[501] Art. 7 UCITSD (Commission) Directive Cf. Art. 58 AIFMD (Commission) Regulation.
[502] See Art. 85 UCITSD V; Cf. Art. 19 AIFMD.
[503] See Annex II UCITSD See Annex I AIFMD.
[504] U. Klebeck, U., *Interplay between AIFMD and the UCITSD* 113 (D.A. Zetzsche ed, Kluwer 2015); See on the AIFM delegation regime: M. Scheele & H.W. Wielens, *Uitbesteding door beheerders van beleggingsinstellingen en icbe's* 79-92. (Financieel Juridische Reeks, NIBE/SVV, 2014).
[505] See *supra* 3.2.2.
[506] U. Klebeck, U., *Interplay between AIFMD and the UCITSD* 115 (D.A. Zetzsche ed, Kluwer 2015).
[507] U. Klebeck, U., *Interplay between AIFMD and the UCITSD* 113 (D.A. Zetzsche ed, Kluwer 2015).
[508] Annex II UCITSD V.
[509] See Chapter 11, section 1.2.2.
[510] See A. Ang, S. Gorovyy, & G. van Inwegen, *Hedge Fund Leverage*, http://ssrn.com/abstract=1635284 (accessed 3 July 2015).
[511] See Art. 6(4)(a) AIFMD; Art. 6(3)(a) UCITSD V.

In addition, the AIFMD allows AIFMs to be 'co-authorized' as a UCITS ManCo under UCITSD V. UCITS ManCos may, however, not be authorized as AIFMs as their organizational requirements are less strict than for AIFMs under the AIFMD.

By introducing a cross-sectoral framework for 'investment management regulation' under the AIFMD and UCITSD V, both AIFMs and UCITS ManCos are able to achieve significant economies of scale.[512]

3.6. The AIFMD/UCITSD V Depositary

Depositary regulation is under both the AIFMD and UCITSD V largely the same.[513] This is unsurprising given the fact that that manager regulation under both directives are largely similar and both UCITS ManCos and AIFMs manage collective investment undertakings that fulfill the same additional characteristics. Depositaries under both directives carry out largely the same (safekeeping and controlling) tasks and apply similar delegation and depositary liability regimes.[514]

Unsurprisingly, the mere difference between both directives is the reach of the scope and the 'retail investor nature' under UCITSD V.[515] UCITS are authorized 'liquid AIFs'[516], whereas the scope of the AIFMD includes liquid, illiquid and substantially leveraged AIFs.[517] The larger scope of the AIFMD is not only reflected in additional requirements for AIFMs compared to UCITS ManCos, but also in the depositary regulation applicable.

The AIFMD, for instance, allows a larger amount of eligible entities to be appointed. Depending upon the specific Member State implementation[518], Member States may chose credit institutions, central banks or 'other legal entities'[519], such as investment firms and CSDs (mostly established as credit institution anyway) to be appointed as a depositary under UCITSD V.[520] To the contrary, the AIFMD allows credit institutions, investment firms and UCITSD V depositaries to be appointed for liquid AIFs. Prime brokers that are established as credit institutions, investment firm or UCITSD V depositary may be appointed for substantially leveraged AIFs[521], whereas, depending upon the particular Member State implementation[522], Member States may allow trustee's, notaries or investment firms under national law to be appointed for illiquid AIFs.[523]

---

[512] See Recital 21 AIFMD refers to the exercise of portfolio management, in addition to, the management of AIFs, but does not make reference to the economies of scope and scale; See for the exercise of MiFID II portfolio management: Art. 6(4)(a) AIFMD.

[513] Paragraph phd.

[514] I. Riassetto, *Dépositaires - Quelles différences entre la directive OPCVM V et la directive AIFM?,* 4 RD Bancaire et Financier (2014); K. Lachgar, *From the UCITS Directive to the transposition of AIFMD: exegesis of evolutions's depositary activity in Europe*, Joly Bourse (2014); I. Riassetto, *La clarification des obligations et de la responsabilité des dépositaires par la directive OPCVM V,* 98 Revue Lamy Droit des Affaires 31 (2014); I. Riassetto, *Le nouveau régime applicable aux dépositaires issu de la directive OPCVM V*, 3 Bulletin Joly Bourse 113 (2015).

[515] See for these 'types of funds': D.A. Zetzsche, *Scope of the AIFMD* 82 (D.A. Zetzsche ed, Kluwer 2012); Cf. Arts 91-93 Liechtenstein AIFM Law.

[516]See *supra* 3.5.3.

[517] See *supra* 2.1.

[518] Art. 23(2) UCITSD V.

[519] Art. 23(2)(c) sub-para. 1 UCITSD V.

[520] See Chapter 4, section 3.2.

[521] D.A. Zetzsche, *(Prime) Brokerage* 580-590 (D.A. Zetzsche ed, Kluwer 2015); See for the prime broker as a sub-custodian: Chapter 4, section 10.2.2.

[522] D.A. Zetzsche, *Fondsregulierung im Umbruch – ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, ZBB 22 (2014).

[523] Art. 21(3)(c) sub-para. 3 AIFMD.

The scope of both the AIFMD and UCITSD V also leads to differences concerning the location where depositaries are required to be established/located in. The UCITSD V only covers EEA collective investment undertakings, whereas the scope of the AIFMD includes both EEA and non-EEA collective investment undertakings.[524] Both directives require depositaries for EEA collective investment undertakings to be established in the EEA domicile in which the undertaking is established. AIFMs for certain non-EEA AIFs may appoint a third country depositary given that certain additional criteria, on top of the AIFMD, are fulfilled. Third country depositaries under the AIFMD need, for instance, to be equivalent to EEA credit institutions and investment firms. In addition, prudential regulation and supervision to which they are subjected need to be 'effectively enforced', the depositary needs to fulfill the so-called '3C's'[525] and the depositary needs to contractually subject itself to the AIFMD liability regime.[526]

Depositaries under both directives carry out largely the same safekeeping and controlling tasks, delegation and depositary liability regime.[527] Nevertheless, the scope of both directives still leads to some differences.

The safekeeping tasks are under both the AIFMD and UCITSD V differentiating between financial instruments held in custody and other assets.[528] This is logical as AIFs/UCITS under both the AIFMD and UCITSD V may directly or indirectly invest in both types of assets. In addition, the controlling tasks under both directives are the same. In practice, however, the safekeeping and controlling tasks under, in particular, the AIFMD are to be applied proportionately.[529] Although under UCITSD V, UCITS ManCos may manage liquid UCITS that even include 'Newcits'[530], the variety of AIFs under the AIFMD is much larger. The AIFMD includes illiquid, liquid and substantially leveraged AIFs.[531] The depositary under the AIFMD, in particular, is a 'chameleon' that changes its colours depending upon the type of AIF concerned. Depending upon the type of AIF/UCITS managed, the depositary has to proportionally apply both the safekeeping and controlling tasks.

The safekeeping task of the depositary dealing with UCITS and liquid AIFs, for instance, is likely to be more focused on financial instruments that can be held in custody, whereas the safekeeping of assets of illiquid AIFs largely or exclusively consists of the record-keeping of

---

[524] See *supra* 2.1. and 2.2.

[525] See D.A. Zetzsche & T.F. Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* (D.A. Zetzsche ed, Kluwer 2015).

[526] I. Riassetto, *Dépositaires - Quelles différences entre la directive OPCVM V et la directive AIFM?,* 4 RD Bancaire et Financier (2014) ; K. Lachgar, *From the UCITS Directive to the transposition of AIFMD : exegesis of evolutions's depositary activity in Europe*, Joly Bourse (2014); I. Riassetto, *La clarification des obligations et de la responsabilité des dépositaires par la directive OPCVM V,* 98 Revue Lamy Droit des Affaires 31 (2014); I. Riassetto, *Le nouveau régime applicable aux dépositaires issu de la directive OPCVM V*, 3 Bulletin Joly Bourse 113 (2015).

[527] I. Riassetto, *Dépositaires - Quelles différences entre la directive OPCVM V et la directive AIFM?,* 4 RD Bancaire et Financier (2014).

[528] Art. 21(8)(b) AIFMD; Art. 22(5)(b) UCITSD V.

[529] Cf. Article 93(3) AIFMD (Commission) Regulation; The same applies to UCITS. See Article 4(3) UCITSD V (Commission) Regulation.

[530] Amenc, N. & Sender, S, *Are Hedge Fund UCITS the Cure-All?* (EDHEC-Position Paper 2010); K.R. Johannsen, *Jumping the gun: hedge funds in search of capital under UCITS IV*, 5 Brooklyn Journal of Corporate, Financial & Commercial Law 473 (2011); R. Pozen, *The case for labelling Newcits as complex*, Financial Times (18 December 2011); V. Prais & M. Giralt, *Have we been there before? Are Newcits what UCITs are intended to be?*, 25:10 Butterworths Journal of International Banking and Financial Law 605 (2010); N. Tuchschmid, E. Wallerstein & A. Zanolin, *Will Alternative Ucits Ever be Loved Enough to Replace Hedge Funds?*, http://dx.doi.org/10.2139/ssrn.1686055 (accessed 3 July 2015); J. Kayser & G. Schlikker, *Alternative Investmentstrategien im UCITS-Format – ein Überblick*, Absolut|report 52 (2009).

[531] D.A. Zetzsche, *Scope of the AIFMD* 82 (D.A. Zetzsche ed, Kluwer 2012).

'other assets'.[532] Although having mostly an open-end nature, the depositary's safekeeping tasks of assets of substantially leveraged AIFs are of often of a 'hybrid' nature. AIFMs managing substantially leveraged AIFs often appoint (prime) brokers for the re-hypothecation of financial instruments (that can be held in custody). Re-hypothecated financial instruments are qualifying as 'other assets', whereas financial instruments that are not hypothecated often qualify as 'financial instruments that can be held in custody'. The safekeeping task for this type of AIFs is, thus, of a 'hybrid' nature as the depositary carries out both safekeeping tasks and in doing so functions as an additional risk management tool in mitigating counterparty risk.[533]

The same 'chameleon' nature is to be found in applying the controlling task of, in particular, the AIFMD depositary. The UCITS and liquid AIFs controlling tasks are being applied in the fullest extent as the liquid nature of both require intensive 'control' of the behaviour of the AIFM/UCITS as the investment portfolio is changing all the time. The controlling function for these types of funds can, thus, be seen as the 'traditional depositary role' in which the safekeeping and controlling task are closely aligned. The depositary role is fundamentally different for illiquid AIFs, such as real estate and private equity AIFs. The investment portfolio is not changing on an ongoing basis. As such, not only the focus on investment in 'other assets', but also the investment/trading frequency allows the appointment of depositary that is not a credit institution or investment firm that merely performs the record-keeping of the illiquid assets and that only has to perform the controlling tasks not on a daily, but on a quarterly, semi-annual or yearly basis.[534]

Another source of differences in depositary regulation between the AIFMD and UCITSD V lies in the difference of the investor protection nature between the two directives. UCITSD V is focused on retail investor protection[535], whereas the AIFMD has a main focus on professional investors.[536] This is, in particular, to be noted in various Member State implementations of UCITSD V related to the eligible entities, the depositary's delegation and liability regime.[537]

Under the German and Luxembourg UCITSD V implementation only credit institutions are allowed to be appointed as depositaries, whereas under their AIFMD implementations also, for instance, investment firms are eligible.[538] Another example of the retail investor protection nature relates to the standards of delegation applying to the re-hypothecation of assets that is more strict under UCITSD V and the prohibition of the contractual discharge of liability under the UCITSD V depositary liability regime.[539]

The AIFMD and UCITSD V depositary regulation regimes are, thus, largely the same given the scope and manager regulation under the AIFMD and UCITSD V. The larger scope of the AIFMD that includes not only liquid, but also illiquid and highly leveraged AIFs and the retail investor nature of UCITSD V, however, have led to some differences related to, in

---

532 Art. 21(8) AIFMD; Art. 22(5) UCITSD V.

533 Re-hypothecated financial instruments are on the balance sheet of the prime broker to which AIFMs/AIFs on behalf of their investors have a contractual claim, whereas financial instruments held in custody have a more 'in rem' nature.

534 See, for instance, for the asset valuation controlling task: Recital 108 AIFMD (Commission) Regulation; Recital 6 UCITSD V (Commission) Regulation.

535 See N. Moloney, *EC Securities Regulation* 250(1st edn., Oxford University Press 2002).

536 Art. 1(2)(a) UCITSD V; Cf. Art. 4(1)(ag) and (aj) AIFMD; Art. 6 EuVECA/EuSEF Regulation; Art. 5 ELTIFR.

537 The eligible entities under the German and Luxembourg UCITSD V implementation laws are, for instance, restricted to credit institutions. See for Germany: § 87 KAGB; See for Luxembourg: Art. 15 law of 17 December 2010 relating to undertakings for collective investment.

538 See Chapter 4, section 3.

539 Art. 24(3) UCITSD V.

particular, the eligible entities, practical application of functions and the UCITSD V depositary delegation and liability regime.

3.7. Conclusion

Under the AIFMD/UCITSD V, financial intermediaries, including AIFMs/UCITS ManCos and depositaries, play a pivotal role in fund governance.

There is a strong interconnection between the AIFMD and UCITSD that regulate the same core activity of 'investment management'.[540] 'Investment management' relates to UCITS that are 'AIFs', i.e. collective investment undertakings fulfilling the AIF definition criteria, that are authorized and comply with the UCITSD V product regulation.[541] The UCITSD V mandatory product regulation, retail investor character and the absence of a TC regime does not require UCITS ManCos to be regulated differently compared to AIFMs as the agency risks related to 'investment management' carried out by 'management entities' faced by any type of investors are the same.[542]

Nevertheless, the scope of the AIFMD includes liquid, illiquid and substantially leveraged AIFs, whereas the UCITSD only regulates 'liquid AIFs' complying with specific product regulation under the UCITSD. The broader scope of the AIFMD explains that AIFMs are targeted to more organizational requirements as to accommodate the larger scope of collective investment undertakings.

The strong interconnection between the AIFMD, UCITSD V, MiFID II and IORPD II in regulating 'investment management' has resulted in cross-sectoral regulation of 'investment management regulation'. AIFMs and UCITS ManCos may under the AIFMD and UCITSD V be, when complying with extra requirements, be permitted by Member States to be authorized for individual portfolio management, including those of pension funds and IORPs, as well.[543]
In addition, the AIFMD allows AIFMs to be 'co-authorized' as a UCITS ManCo under UCITSD V. UCITS ManCos may, however, not be authorized as AIFMs as their organizational requirements are less strict than for AIFMs under the AIFMD.
By introducing a cross-sectoral framework for 'investment management regulation' under the AIFMD and UCITSD V, both AIFMs and UCITS ManCos are able to achieve significant economies of scale.[544]

The AIFMD/UCITSD 'product regulations' require AIFMs and UCITS ManCos to comply with additional regulation. The ELTIFR sets out additional manager regulation that applies to the so-called 'full AIFMs', whereas the additional manager regulation laid down in the MMFR applies to both full-AIFMs and UCITS Mancos. The 'wrapper nature' requires AIFMs/UCITS ManCos to comply with these standards on top of the manager regulation set out in the AIFMD and UCITSD V.

The EuVECAR/EuSEFR sets out general principles that 'small AIFMs' need to comply with instead of the manager regulation regime under the AIFMD. Although technically not an AIFMD/UCITSD product regulation, various Member States extend the AIFMD manager regulation in their implementation laws regime to small AIFMs established in their domiciles.

The AIFMD and UCITSD V depositary regulation regimes are largely the same given the scope and manager regulation under the AIFMD and UCITSD V. The larger scope of the

---

[540] U. Klebeck, U., *Interplay between AIFMD and the UCITSD* 113 (D.A. Zetzsche ed, Kluwer 2015).
[541] Annex II UCITSD V.
[542] Chapter 11, section 1.2.2.
[543] See Art. 6(4)(a) AIFMD; Art. 6(3)(a) UCITSD V.
[544] See Recital 21 AIFMD refers to the exercise of portfolio management, in addition to, the management of AIFs, but does not make reference to the economies of scope and scale; See for the exercise of MiFID II portfolio management: Art. 6(4)(a) AIFMD.

AIFMD that includes not only liquid, but also illiquid and highly leveraged AIFs and the retail investor nature of UCITSD V, however, have led to some differences related to, in particular, the eligible entities, practical application of functions and the UCITSD V depositary delegation and liability regime.

4. Product Regulation

The AIFMD and UCITSD V are built upon a regulatory cocktail comprising of intermediary, product and sales regulation. The main focus under the AIFMD is on so-called 'intermediary regulation', whereas the UCITSD has not only intermediary but complements this by 'product regulation'.

The AIFMD does not focus on regulating the portfolio composition financial products. The idea is that regulators are to slow to regulate each new product due to the innovative speed and force of the financial industry.[545] Instead, focusing on regulating intermediaries, including AIFMs and depositaries, ensures that only skilled and honest people are employed by financial intermediaries that are required by EEA legislation to have sufficient resources.[546] The recent intermediary regulation approach touches upon the behavior of the market actors (source) and only addresses the possible adverse consequences of the product to a limited extent.

This modern 'intermediary regulation' approach has been gradually extended to and complements the original 'product regulation' approach under UCITSD I. Due to difficulties in examining how UCITS ManCos and their depositaries in the EEA were regulated, the harmonization in these initiatives focused on harmonizing the product and merely subjected the intermediaries involved to 'principles-based' regulation.[547] The rationale behind 'product regulation' is that by limiting the portfolio composition to certain assets and restricting the distribution of these UCITS to certain investors, UCITS ManCos are not able to market UCITS that are considered to be 'jeopardizing' investors.

The main focus under the AIFMD is on so-called 'intermediary regulation', whereas the UCITSD complements this approach by 'product regulation'. For this reason, it is both not necessary and also too cumbersome to regulate the legal forms in which AIFs and UCITS are required to be established in on the European level. Despite the increasing focus on intermediary regulation under both the AIFMD and UCITSD V, Member States still require AIFMs managing retail AIFs and UCITS ManCos managing UCITS to comply with 'investor-specific product regulation', i.e. product regulation that limits retail AIFs and UCITS in their portfolio composition. This seems to have two reasons. Investor-specific product regulation aims to provide retail investor protection and defines the scope of the specific AIFMD/UCITSD V product regulations.

This section continues to explain in further detail why the AIFMD, UCITSD V and the respective 'AIFMD/UCITSD V product regulations' do not regulate the legal forms in which AIFs/UCITS are established in. In addition, investor-specific product regulation under UCITSD V and the respective 'AIFMD/UCITSD V product regulations' will be addressed.

---

[545] See D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D.A. Zetzsche ed., Kluwer 2015), 127; See also J.-P., Casey & K. Lannoo, *The Mifid Revolution: A Policy View*, 7 Competition and Regulation in Network Industries 519 (2006); see also A. Cygan & E. Szyszczak, *The Controversy and Confusion over Mifid*, 25 International Financial Law Review 14-21 (August 2006).

[546] See D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* 127 (D.A. Zetzsche ed, Kluwer 2015).

[547] See J. Black, *Forms and Paradoxes of Principles Based Regulation*, LSE Law, Society and Economy Working Papers No. 13 (2008).

4.1. General Product Regulation: Legal Forms

Legal forms are not explicitly regulated under the AIFMD and UCITSD V. For this reason, first the discretion to regulate legal forms for Member States under the AIFMD and UCITSD V is being discussed. Second, various Member State implementations of the legal forms addressed in the AIFMD and UCITSD V are being addressed. Finally, the concept of legal form neutrality and the irrelevancy of the legal title of the AIF/UCITS property is being elaborated.

4.1.1. Legal forms under the AIFMD and UCITSD V

The scope of both the AIFMD and UCITSD V are legal form neutral.
Recital 6 and Article 2(2)(b) AIFMD state that for the scope of the AIFMD it is of no significance '*whether the AIF is constituted under the law of contract, under trust law, under statute, or has any other legal form*'. Similarly, UCITSD V also applies a legal form neutral approach. Under Article 1(3) UCITSD V, UCITS

> 'may be constituted in accordance with contract law (as common funds managed by management companies), trust law (as unit trusts), or statute (as investment companies'.[548]

Furthermore, the UCITSD V facilitates (cross-border) mergers between all types of UCITS whether they are contractual, corporate or unit trusts.[549] Member States are, thus, not required to provide for new legal forms of UCITS to implement the UCITSD merger regime.[550]

The scope of the legal forms that Member States may use, is under the AIFMD broader than under UCITSD V. UCITSD V allows common funds, unit trusts and investment companies, whereas the AIFMD allows also '*any other legal form*'. In practice, Member States in their AIFMD implementations, apart from the three legal forms under UCITSD V, offer the (investment) limited (liability) partnership.[551] Liechtenstein[552], Ireland, Malta[553] and the UK[554] even offer al four legal forms under the AIFMD.[555]

4.1.1.1. Common funds

Common funds are mostly common in Member States that do not have trust law. AIFs and UCITS are organized by means of (tripartite) agreements with trust elements.[556] The fund manager concludes with the investors identical portfolio management agreements that is governing the tripartite relationship of the investors towards the fund manager and the

[548] See also Recital 12 UCITSD that refers, with regard to portfolio management, to the mangement of unit trusts/common funds or investment companies).
[549] Recital 27 UCITSD; Art. 38 UCITSD.
[550] *Ibid.*
[551] Investment limited liability partnerships do not only offer limited liability to limited, but also to the general partners. See Art.8 Liechtenstein AIFM Law, Art. 6 Liechtenstein UCITS Law.
[552] G. Dobrauz-Saldapenna, A. Schwertschlag & P. Rosenauer, *The AIFMD's Transposition in Liechtenstein* (D.A. Zetzsche ed, Kluwer 2015).
[553] J. Falzon, C.P. Buttigieg & M. Chetcuti, *The AIFMD's Transposition in Malta* (D.A. Zetzsche ed, Kluwer 2015).
[554] J.R. Siena & D. Eckner, *The AIFMD's Transposition in the United Kingdom* (D.A. Zetzsche ed, Kluwer 2015); D. Rouch, *United Kingdom* (D. Busch ed, Oxford 2014).
[555] D.A. Zetzsche, *Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).
[556] See in the Netherlands an analysis of the the common fund (fonds voor gemene rekening): J.W.P.M. van der Velden, *Beleggingsfondsen naar Burgerlijk recht* (Kluwer 2008); C.M. Grundmann-van de Krol, *Bescherming crediteuren beleggingsfonds: "trust" in artikel 16a Wtb*, 14 Ondernemingsrecht 486-488 (2005).

depositary for the purpose of investment management on behalf of the collective investors.[557] This tripartite relationship in common contractual fund is traditionally characterized by the concept of the investment triangle[558]. A manager is responsible for discretionary investment management, whereas the assets purchased on behalf of the fund is being (separately) safe-kept by a depositary (custodian[559]). The custodian/depositary is only allowed the power of disposal of the assets by the manager to the extent the manager complies with the investment policy as laid down in the constitutive documents. The investors are, upon subscription, only required to invest and pay for the initial and ongoing costs set out in the agreement with the manager. In addition, investors in very limited occasions, such as mergers, might have voting rights. The constitutive documents sets out, amongst others, the investment policy, the valuation policy, the conditions for issue/redemption and the suspension thereof, the costs, investor information, limitation of manager control of the investors and the requirements regarding amendments of mergers/demergers and liquidation of the fund.[560]

Most Member States have embedded the 'common contractual fund' as default legal form in statute. In addition, the provisions in statute are throughout the Member State laws characterized by two important elements that normal tripartite agreements solely based upon private law due to the absence of legal personality do not have: limited liability and asset segregation.[561] Instead of being personally liable for, investors are typically 'co-owners' that may redeem their proportional share back to the fund under the conditions set out in the constitutive documents.

The Netherlands, however, is an example of a jurisdiction which has not embedded the common contractual fund in regulatory law. Instead, this legal form is only defined for tax purposes.[562] Consequently, these two elements are not provided for in the law.[563] For that purpose, the Netherlands, under certain conditions, requires a legal entity that serves as a 'safekeeping entity'. This legal person mandated by law is the legal owner of the assets of the fund. The safekeeping entity ensures asset segregation by means of a ranking of claims.[564] The safekeeping entity may, in the absence of possible adverse effects, serve as a safekeeping entity for multiple funds. The absence of a legal requirement that mandates a single safekeeping entity for each individual fund leads to two adverse consequences in practice.

---

[557] See, for example, for AIFs in Liechtenstein: Art.7(1) Liechtenstein AIFM Law.

[558] K. Ohl, *Die Rechtsbeziehungen innerhalb des Investment-Dreiecks* (1989); D.Zetzsche. *Prinzipien der kollektiven Vermögensanlage* § 21 (Mohr Siebeck 2015); D.A. Zetzsche. *Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?*, in *Financial Markets in Transition* 337 (Birkmose et al. eds, Kluwer Law 2012); N. Seegebarth. *Stellung und Haftung der Depotbank im Investment-Dreieck* (2004).

[559] Pre-AIFMD, all Dutch AIFs were not require to appoint a depositary within the meaning of Art.21 AIFMD. S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2015); See also S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013).

[560] See, for example, for AIFs in Liechtenstein: Art. 7(2) Liechtenstein AIFM Law.

[561] See Art. 7(1) Liechtenstein AIFM Law.

[562] Art. 2(1)(f), (3) Dutch Corporate Tax Act.

[563] C.M. Grundmann-van de Krol, *Bescherming crediteuren beleggingsfonds: "trust" in artikel 16a Wtb*, 14 Ondernemingsrecht 486-488 (2005); J.W.P.M. Van der Velden, *Fondsen voor gemene rekening: wel of geen maatschap?,* 4 TvFR 139 (2015); See also J.W.P.M. van der Velden, *Beleggingsfondsen naar burgerlijk recht* (Kluwer 2008); J.W.P.M. van der Velden, *Babylonische Bewaarders*, 17 Ondernemingsrecht 173 (2009); J.W.P.M. van der Velden, C.J. Groffen & N.B. Spoor, *Beleggingsinstelling* (D. Busch, D. Doorenbos, C.M. Grundmann, et al., Kluwer 2012); M. Hoekstra, *Van bewaarder naar AIFMD depositary – Een inkijkje in de veranderende rol van de bewaarder bij beleggingsinstellingen*, 10 TvFR 365 (2012); C.W.M. Lieverse, *De bewaarder oude stijl en de bewaarder nieuwe stijl: de taken, aansprakelijkheden en het samenspel* 461-474 (D. Busch & M.P. Nieuwe Weme eds, Kluwer 2013).

[564] J.C.A.Tonino, *Vermogensscheiding in het wetsvoorstel ter implementatie van de AIFM-richtlijn: nog steeds op zee, land in zicht?*, 10 TvFR 352-369 (2012).

Firstly, an AIFM that has chosen not to appoint a safekeeping entity at all may lead to personal liability for any obligations that arise out of the fund due to the fund possible qualifying as a (common) partnership under Dutch law. Secondly, appointing such an entity for multiple AIFs/UCITS may lead to spillover effects due to improper asset segregation as creditors of the one fund may have a claim on the assets belong to another fund.

Fortunately, most Member States prevent these issues by requiring limited liability for investors and asset segregation, i.e. the segregation of assets from the assets of the individual investors, the fund manager and the depositary as a default rule for common funds.

4.1.1.2. Unit Trust

Ireland, Liechtenstein and the UK allow UCITS and AIFs to be established as unit trusts. The internal organization of units trusts is, similarly to common funds, established on the basis of the concept of the investment triangle. The unit trust can be seen as a common contractual fund in which the tripartite relationship is governed on the basis of the trust deed. The unit trust as such does not have legal personality. Instead, the fund manager or depositary, established as legal entity[565] acting for the fund act as a trustee that is the legal owner of the fund and the individual investors are the economic owners. Trust law requires the assets to be segregated of the assets of the trustee.[566] This requirement is fulfilled by the depositary that safekeeps the assets distinct from the assets of the manager and depositary. The unit trust, typically, is a subtype of the trust in which the fiduciary duties under trust law are not owed individually, but to the investors collectively.[567]

4.1.1.3. Investment company

UCITS and AIFs are in most Member States allowed to be established as an investment company.[568] Its development has been historically slowed down by the introduction of corporate tax in many jurisdiction after world war II and the legal restrictions on share repurchases. The agency costs deriving from the separation of ownership and control led to a formalized default structure in which the board of directors (one-tier structure: executive board members) is responsible for the daily management of the company and the supervisory board (one-tier structure: non-executive board members) are responsible for supervising the board of directors (executive board members).[569] The contractual nature of the governance relationship between investors, fund managers and the depositary, however, does not completely fit into this model. In company law, the board has the primacy in making corporate decisions. AIFs and UCITS, however, delegate the portfolio and risk management, i.e. the two core functions, to an external AIFM/UCITS ManCo. The function of the board of directors and the supervisory board is, thus, substituted by external AIFMs/UCITS ManCo that are monitored by internal governance (risk management) and external parties such as competent authorities, auditors and depositaries. For this purpose, many Member States, such as Liechtenstein, allow investment companies to derogate from strict requirements that do not fit into fund governance. In Liechtenstein, examples include formal restrictions on the establishment, representation, the appointment of a supervisory board and share repurchases.

---

[565] This is the reason why UCITS ManCos and AIFMs are required to be established as a legal entity under the AIFMD. See D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 211 (D.A. Zetzsche ed, Kluwer 2015).

[566] See D.A Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 19 A I 3 (Mohr Siebeck 2015).

[567] See D.A. Zetzsche & D. Eckner, *Risk Management* 374 et seq. (D.A. Zetzsche ed, Kluwer 2015).

[568] See in Germany: C. Fischer & T. Friedrich, *Investmentaktiengesellschaft und Investmentkommanditgesellschaft unter dem Kapitalanlagegesetzbuch*, ZBB 153 (2013).

[569] A. Krug, *Investment Company as Instrument: The Limitations of the Corporate Governance Regulatory Paradigm*, 86 S. Cal. L. Rev. 263 (2013).

4.1.1.4. (limited) (liability) partnerships

Partnerships are a popular legal form for (closed-end) AIFs.[570] The flexibility of partnership law governing the tripartite relationship between investors, AIFMs and depositaries and the general approach of treating them as tax transparent[571] explain the popularity of this type of legal form. Examples, include the German investment-KG[572], the Dutch 'commandaire vennootschap'[573] and the Luxembourg socieéte en commandite spéciale[574]. There are, however, differences between various types of (limited) (liability) partnerships. In the Netherlands, for instance, the commanditaire vennootschap used for AIFs is based upon general commercial law, whereas the German investment-KG and Luxembourg socieéte en commandite spéciale are based upon an 'enabling approach'.[575]

Partnership law in a number of jurisdictions restricts the transferability of units/shares. In Germany and the Netherlands, for example, one can become a member of the partnership nor transfer its membership without the consent of all other partners.[576] Several Member States, such as Liechtenstein, have introduced 'investment limited (liability) partnerships' in which the partnership agreement may derogate from the transferability restriction in general partnership law. Partnerships may in the Netherlands and Liechtenstein even issue units which would qualify as a 'security' under the PR and, consequently, may be listed on regulated markets.[577]

4.1.2. Member State Implementations under AIFMD and UCITSD V

As discussed above, Member States under their UCITSD implementations use unit trusts, common funds and investment companies, whereas, on top of that, the (limited) (liability) partnership is also used under their respective AIFMD implementations.

Member States do not only differ in the types of legal forms that they are offering. The respective legal forms also differ in the extent Member States rely upon private and regulatory law in regulating them. Austria and the Netherlands, for instance, have not introduced any specialized tailor-made legal forms of AIFs and UCITS.[578] Instead, they completely rely upon

---

[570] Cf. C. Windbichler, *Eine Internationale Landkarte der Personengesellschaften (einschließlich juristische Personen und Gesamthand)*, ZGR 110 (2014).
[571] The Netherlands is an exemption. Generally, partnerships are treated as opaque for tax purposes. Only AIFs that require the permission of other investors as a condition for entry into the fund is treated as tax transparent. See S.N. Hooghiemstra, *The AIFMD's Transposition in the Netherlands* (D.A. Zetzsche ed, Kluwer 2015).
[572] T. Emde, *The AIFMD's Transposition in Germany (*D.A. Zetzsche ed, Kluwer 2015); M. Casper, *Die Investmentkommanditgesellschaft: große Schwester der Publikums-KG oder Kuckuckskind?*, 179 ZHR 44 (2015).
[573] S.N. Hooghiemstra, *The AIFMD's Transposition in the Netherlands* (D.A. Zetzsche ed, Kluwer 2015); Liechtenstein: Art. 15 Liechtenstein AIFM Law.
[574] See T. Partsch & E. Forget, *The Luxembourg Implementation of the AIFMD* (D.A. Zetzsche ed, Kluwer 2015);
[575] Enabling approach means that Member States in their lawmaking realize that general company and commercial law does not suit fund governance. For that reason, specific legal forms tailor-made for fund governance are established in regulatory law that are might be partly based upon legal forms used in domestic company and partnership law. See D.A. Zetzsche & C.D. Preiner, *Das liechtensteinische AIFM-Gesetz: Die erste Umsetzung der europäischen AIFM-Richtlinie*, RiW, 265 (2013).
[576] See for Germany: § 161(2), 105(3) HGB, § 719(3) BGB; See also D.A. Zetzsche, *Die Irrelevanz und Konvergenz des Organisationsstatuts von Investmentfonds*, 111 ZvglRWiss 371 (2012).
[577] See for the Netherlands: S.N. Hooghiemstra, *The AIFMD's Transposition in the Netherlands* (D.A. Zetzsche ed, Kluwer 2015); Liechtenstein: Art. 15 Liechtenstein AIFM Law.
[578] See, for the Netherlands: S.N. Hooghiemstra, *The AIFMD's Transposition in the Netherlands* (D.A. Zetzsche ed, Kluwer 2015); See for Austria: J. Nicolussi, *The AIFMD's Transposition in Austria* (D.A. Zetzsche ed, Kluwer 2015).

general private law, such as company and contract law.[579] At the other hand, several Member States have specialized tailor-made legal forms for AIFs and UCITS. Liechtenstein, for example, regulates the unit trust, investment company, limited (liability) partnership and common funds in its AIFM and UCITS Law.[580] The specialized legal forms in those laws have as common principle that they regard the internal governance between the manager, investors and depositary as of contractual nature.[581] The constitutive documents of all legal forms have to agree upon, amongst others, the investment policy, the valuation policy, the conditions for issue/redemption and the suspension thereof, the costs, investor information, limitation of manager control of the investors and the requirements regarding amendments of mergers/demergers and liquidation of the fund.[582] In the absence of agreeing upon these elements in the constitutive documents, Liechtenstein contract and company law is applicable as a default rule.[583] The specialized legal forms in Liechtenstein for AIFs and UCITS in their external governance towards their creditors are all having the 'corporate' characteristic[584] of catering for limited liability and asset segregation.[585]

Other Member States take a position in between. Luxembourg SIFs[586], for example, refer to general company law, whereas limited partnerships under Luxembourg law either can be structured on the basis of its partnership law (société en commandite simple and société en commandite par actions), whereas, on top of that, it has introduced upon its AIFMD implementation a specialized regime for investment limited partnerships.[587]

4.1.3. Legal form neutrality under the AIFMD and UCITSD V

Legal form neutrality under the UCITSD and AIFMD is clearly being observed in the material definitions of the UCITS and AIF as defining criteria for the personal scope of the respective directives. The UCITSD and the AIFMD are applicable regardless whether the undertaking is established as a unit trust, common fund, investment company or (limited) (liability) partnership.[588] The irrelevance of the legal form is clearly evidenced by the UCITSD merger regime in which investment companies, common funds and investment companies, irrespective of its legal form, may merge with one another. The legal form neutrality embedded in these directives has been also transposed to the 'AIFMD product regulations'. The ELTIFR, MMFR, EuSEFR and EuVECAR all reference for their personal scope to the AIF definition.[589] For the AIFMD and the AIFMD product regulations other

---

[579] D.A. Zetzsche*, Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).

[580] Art. 6-14 Liechtenstein AIFM Law; Art. 4-7 Liechtenstein UCITS Law; D.A. Zetzsche & C.D. Preiner, C., *Das liechtensteinische AIFM-Gesetz: Die erste Umsetzung der europäischen AIFM-Richtlinie*, RiW, 265 (2013).

[581] See E. Wallach, *Die Regulierung von Personengesellschaften im Kapitalanlagegesetzbuch*, ZGR 289 (2014).

[582] See Art.7(3), 8(3), 9(3), 11 Liechtenstein AIFM Law; Art. 5(3), 6(3), 7(3) Liechtenstein UCITS Law.

[583] See Art. 7(2), 8(2), 9(2) Liechtenstein AIFM Law; Art. 5(2), 6(2), 7(2) Liechtenstein UCITS Law.

[584] See D.A. Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 24-26 (Mohr Siebeck 2015).

[585] See Art.7(1), 8(1), 9(1), 11 Liechtenstein AIFM Law; Art. 5(1), 6(1), 7(1) Liechtenstein UCITS Law.

[586] Art. 26 SIF Law.

[587] The Luxembourg common limited partnership (société en commandite simple) and partnership limited by shares (sociötö en commandite par actions) were modernized and the special limited partnershpi (société en commandite spéciale) was introduced. See T. Partsch & E. Forget, *The Luxembourg Implementation of the AIFMD* (D.A. Zetzsche ed, Kluwer 2015); C. Kremer, M. Eisenhuth, G. Dusemon & C. Martougi, *Luxembourg* (D. Busch ed, Oxford 2014).

[588] Art. 1(3) UCITSD V; Art. 2(2)(b) AIFMD.

[589] D.A. Zetzsche & C.D. Preiner, *Was ist ein AIF?*, 45 Zeitschrift für Wirtschafts- und Bankrecht 2101 (2013); S.N. Hooghiemstra, *Wat is een beleggingsinstelling onder de AIFM-richtlijn?*, 3 Ondernemingsrecht 24 (2014); M.C.A. van den Nieuwenhuijzen & M.W.Galjaart, *De reikwijdte van de AIFM Richtlijn* 247-257 (F.G.B. Graaf, R.H. Maatman & L.J. Silverentand eds, Kluwer 2012); K. Loritz & K. Uffmann, *Der Geltungsbereich des*

criteria than the legal form are determining the scope of application, such as whether investors qualify as retail or professional investors and whether the AIF is open or closed-end.[590]

Liechtenstein has gone even beyond the legal form neutrality approach of the European legislator of the UCITSD and AIFMD. It offers all four common legal forms for AIFs and UCITS and applies for both the European corporate law doctrine[591] of the separation of statutory and real seat.[592] Regardless of the legal form chosen, Liechtenstein allows Liechtenstein AIFs and UCITS to be established in a legal form according to the private law of another state under the condition that the legal form chosen can be subordinated under the Liechtenstein AIFM law and complies with the provisions contained therein. Liechtenstein UCITS and AIFs may, for example, be established under the trust law in Malta. Such UCITS and AIFs would have to comply with the regulatory provisions applying to unit trusts under the Liechtenstein AIFM law. Maltese trust law would, however, continue to apply to UCITS/AIFs under the condition that the unit trust will be registered in the commercial register in Liechtenstein.[593] The registration duty serves as to avoid conflicts between foreign and Liechtenstein trust laws.[594]

4.1.4. The Irrelevance of the Legal Title under the AIFMD and UCITSD V

The legal ownership matter is very complicated for UCITS and retail AIFs.[595] The European implementations of these directives in various Member States do not show a consistent pattern. For UCITS/AIFs established in the corporate form, UCITS/AIFs have the legal title of the assets invested in and the investor a proportional claim as shareholders. For AIFs/UCITS that are not established in the corporate form, Member States have different solutions. Some Member States grant the legal title of the assets invested in to the UCITS ManCos and AIFMs, whereas other Member States grant the legal title to investors as 'co-owners' or the depositary. Recent research indicates that it is indifferent to whom the legal title of the assets invested in for non-corporate AIFs/UCITS is attributed.[596] Non-corporate AIFs/UCITS might be established as common fund, investment limited (liability) partnership or unit trusts.[597] Regardless of to whom the legal title is formally being attributed, the eventual outcome is under all non-corporate legal forms employed the same. Investors do not have legal, but economic ownership. This is the result of private law arrangements being replaced by regulatory law in the form of the AIFMD/UCITSD V that makes the legal title matter unimportant. Both the AIFMD and UCITSD V require a so-called 'investment triangle' model

Kapitalanlagegesetzbuches(KAGB) und Investmentformen außerhalb desselben – Erste Überlegungen, auch zum Auslegungsschreiben der BaFin vom 14.6.2013, WM 2193 (2013).

[590] D.A. Zetzsche, *Die Irrelevanz und Konvergenz des Organisationsstatuts von Investmentfonds*, 385, 386 ZvglRWiss 371 (2012).

[591] See S.N. Hooghiemstra, *De fiscale woonplaatsproblematiek van abi´s onder de AIFM-richtlijn*, 4 MBB 129 (2015).

[592] D.A. Zetzsche & C.D. Preiner, C., *Das liechtensteinische AIFM-Gesetz: Die erste Umsetzung der europäischen AIFM-Richtlinie*, RiW, 265 (2013).

[593] Art. 8(6) Liechtenstein AIFM Law.

[594] See D.A. Zetzsche, *Die Irrelevanz und Konvergenz des Organisationsstatuts von Investmentfonds*, 111 ZvglRWiss 388 (2012).

[595] An earlier version of this paragraph has been published in: H. van Meerten & S.N. Hooghiemstra, *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions*, https://ssrn.com/abstract=2993991 (accessed 4 July 2017).

[596] Cf. J.W.P.M. van der Velden, *Hoofdstuk 25 Beleggingsinstelling en aansprakelijkheid in het zicht van de nieuwe regelgeving*, in *Aansprakelijkheid in de Financiële Sector* 976-977 (D. Busch, C.J.M. Klaassen & T.M.C. Arons, Kluwer Law 2013).

[597] D.A. Zetzsche, *Die Irrelevanz und Konvergenz des Organisationsstatus von Investmentfonds*, ZVglRWiss 111, 371 (2012); D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* § 19 (Mohr Siebeck 2015).

to be employed.[598] The investment triangle involves an AIFM/UCITS ManCo, a depositary and the joint investors. When the legal title is attributed to the AIFM/UCITS ManCo or the depositary on behalf of the UCITS/AIF or its investors, the assets formally are part of the legal entity in which the AIFM/UCITS ManCo or the depositary is established in. The latter intermediaries, however, are under regulatory law limited in 'abusing' their power as legal owner. The AIFMD/UCITSD V require AIFMs and UCITS ManCos to perform 'investment management', marketing or administration on behalf of the AIFs/UCITS they manage regardless of the legal form of the AIF/UCITS or the legal title of the assets. The mandatory appointment of a depositary ensures that the assets of the AIF/UCITS are (administratively) segregated from the assets of (1) other clients, including other UCITS/AIFs, IORPs or individual investment portfolios and (2) the operational assets belonging to the UCITS ManCo/AIFM and the depositary itself. This is being done by the depositary that keeps financial instruments that can be held in custody in accounts that can be separately identified. The depositary keeps record of those assets that cannot be held in custody. The role of the depositary, thus, ensures that the assets of AIFs/UCITS are at all times to be separately identifiable of the assets of the UCITS ManCo/AIFM, the depositary itself and the individual investors investing in the UCITS/AIF. Member States providing for 'common funds', i.e. contractually established AIFs/UCITS, determine in their implementation laws that investors are 'co-owners' of the invested assets. Co-ownership in this regard, however, should not be seen as 'co-ownership' under the property laws of individual Member States.[599] If this would be the case, this would lead to undesirable situations in which individual investors would be able to 'claim' assets at all times. Instead, 'co-ownership' should be understood as economical ownership of 'pooled assets' under regulatory law to which investors are collectively legally entitled under the premise that the entry and exit from the fund takes place under the conditions set out in the fund rules. The 'pooled assets' are again to be held by a depositary. The investment triangle is, thus, a 'trust system' in which legal and economical ownership are split under the regulatory laws of both Anglo Saxon and Continental legal traditions and in which the legal ownership of intermediaries and the power derived from it are mitigated by the fund rules, as well as, any formal 'co-ownership' of the joint investors. In property law terms, the absolute ('erga omnes' rights of the legal ownership is being relativized by the fund rules ('in personam rights'). The depositary plays an essential role in administrative asset segregation as to ensure limited liability for the investors and keeping the assets as independent 'asset patrimony' insulated from the private creditors of the depositary, UCITS ManCos/AIFMs and their clients.

4.1.5. Conclusion

Legal forms are not explicitly regulated under the AIFMD and UCITSD V. For this reason, the legal forms under the AIFMD and UCITSD V, various Member State implementations, the concept of legal form neutrality and the irrelevancy of the legal title of the AIF/UCITS property were being discussed.

UCITSD V allows Member States use unit trusts, common funds and investment companies, whereas, on top of that, the (limited) (liability) partnership is also used under their respective AIFMD implementations.

---

[598] See D.A. Zetzsche, *Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?*, in *The European Financial Market in Transition* (H. S. Birkmose, M. Nevillie & K. E. SØrensen eds., Kluwer 2012); See S.N. Hooghiemstra, *Depositary Regulation* 480 (D.A. Zetzsche ed, Kluwer 2015).

[599] D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* § 24 C. I. 1. (Mohr Siebeck 2015).

Member States do not only differ in the types of legal forms that they are offering. The respective legal forms also differ in the extent Member States rely upon private and regulatory law in regulating them. Austria and the Netherlands, for instance, have not introduced any specialized tailor-made legal forms of AIFs and UCITS.[600] Instead, they completely rely upon general private law, such as company and contract law.[601] At the other hand, several Member States have specialized tailor-made legal forms for AIFs and UCITS. Liechtenstein, for example, regulates the unit trust, investment company, limited (liability) partnership and common funds in its AIFM and UCITS Law.[602]

Legal form neutrality under the UCITSD and AIFMD is clearly being observed in the material definitions of the UCITS and AIF as defining criteria for the personal scope of the respective directives. The UCITSD and the AIFMD are applicable regardless whether the undertaking is established as a unit trust, common fund, investment company or (limited) (liability) partnership.[603] For the AIFMD and the AIFMD product regulations other criteria than the legal form are determining the scope of application, such as whether investors qualify as retail or professional investors and whether the AIF is open or closed-end.[604]

Finally, it is irrelevant whether the legal title of the AIF/UCITS property has been assigned to the AIFM/UCITS ManCo, the AIF/UCITS itself or 'co-ownership' of the joint investors.
The investment triangle under the AIFMD/UCITSD V is a 'trust system' in which legal and economical ownership are split under the regulatory laws of both Anglo Saxon and Continental legal traditions and in which the legal ownership of intermediaries and the power derived from it are mitigated by the fund rules, as well as, any formal 'co-ownership' of the joint investors. In property law terms, the absolute ('erga omnes' rights of the legal ownership is being relativized by the fund rules ('in personam rights'). The depositary, thus, plays an essential role in administrative asset segregation as to ensure limited liability for the investors and keeping the assets as independent 'asset patrimony' insulated from the private creditors of the depositary, UCITS ManCos/AIFMs and their clients.

4.2. Investor-specific Product Regulation

Despite the increasing focus on intermediary regulation under both the AIFMD and UCITSD V, Member States still require AIFMs managing retail AIFs and UCITS ManCos managing UCITS to comply with 'investor-specific product regulation', i.e. product regulation that limits retail AIFs and UCITS in their portfolio composition. Investor-specific product regulation aims to provide retail investor protection and defines the scope of the specific AIFMD/UCITSD V product regulations. Retail investor protection is aimed to be targeted under UCITSD V and the Member State implementations of retail AIFs under Article 43 AIFMD. Investor-specific product regulation under ELTIFR and EuVECAR/EuSEFR both aim to protect HNWIs that are a specific category of 'AIFMD retail investors'[605] and to define the scope of lex specialis rules applying to AIFMs and UCITS ManCos. In contrary, portfolio

---

[600] See, for the Netherlands: S.N. Hooghiemstra, *The AIFMD's Transposition in the Netherlands* (D.A. Zetzsche ed, Kluwer 2015); See for Austria: J. Nicolussi, *The AIFMD's Transposition in Austria* (D.A. Zetzsche ed, Kluwer 2015).
[601] D.A. Zetzsche*, Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).
[602] Art. 6-14 Liechtenstein AIFM Law; Art. 4-7 Liechtenstein UCITS Law; D.A. Zetzsche & C.D. Preiner, C., *Das liechtensteinische AIFM-Gesetz: Die erste Umsetzung der europäischen AIFM-Richtlinie*, RiW, 265 (2013).
[603] Art. 1(3) UCITSD V; Art. 2(2)(b) AIFMD.
[604] D.A. Zetzsche, *Die Irrelevanz und Konvergenz des Organisationsstatuts von Investmentfonds*, 385, 386 ZvglRWiss 371 (2012).
[605] See *infra* 5.1 on the differences between HNWIs, professional and retail investors under the AIFMD, UCITSD and AIFMD/UCITSD V product regulations.

composition rules have as its primary purpose to define the scope of the MMFR. These rules have as its purpose to target general investor protection and systematic risk concerns applying to UCITS, professional and retail AIFs.[606]

This section continues to explain in further detail the investor-specific product regulations under UCITSD V, the AIFMD and the respective 'AIFMD/UCITSD V product regulations'.

4.2.1. UCITSD V

The UCITSD regulatory design of the investment policy is designed to support its open-end function. For that purpose, the UCITSD investment policy had originally as their primary objective to invest in transferable securities and other liquid assets.[607]

The introduction of UCITSD III and the Commission Eligible Assets Directive widened the scope of the UCITSD investment policy.[608] Currently, eligible assets do not only cover transferable securities[609] and money-market instruments[610], but also instruments embedding a derivate element[611], derivative instruments[612], (open-ended) collective investment schemes[613], depositary with credit institutions[614], financial indices[615] and other liquid assets.[616] Asset classes, such as commodities, property an real estate are generally not permitted.[617] UCITS may, however, to some extent gain exposure to these asset classes through financial indices.[618] The UCITS investment policy regime also allows up to 10% in unlisted securities (trash quote).[619] Its eligible investment regime is contemplated with rules on risk management[620], diversification[621], concentration[622], limits on borrowing[623] and the prohibition on lending[624]. UCITS, for example, may only invest a maximum of 10% of their NAV in transferable securities and money market instruments issued by the same body.[625] Further diversification requirements (risk spreading as referred to in the UCITSD) relate to, amongst others, unlisted securities[626], control rules[627], index tracking funds[628], government securities[629], cash and deposits[630], investment in (open-end) collective investment schemes[631] and other general rules.[632]

---

[606] Recital 6 MMFR.
[607] Art. 50 UCITSD V.
[608] See UCITSD III (Product Directive).
[609] Art. 50(1)(a) UCITSD V.
[610] Art. 50(1)(b) and (c) UCITSD V.
[611] Art. 50(1)(g) UCITSD V.
[612] Art. 50(1)(g) UCITSD V.
[613] Art. 50(1)(e) UCITSD V.
[614] Art. 50(1)(f) UCITSD V.
[615] Art. 53 UCITSD V.
[616] Cf. Art. 50a UCITSD V.
[617] Art. 50(2)(b), (3) UCITSD V.
[618] Art. 50(1)(e) UCITSD V; Committee of European Securities Regulators, *CESR's advice to the European Commission on clarification of definitions concerning eligible assets for investments of UCITS*, 06-005, January 2006.
[619] Art. 50(2)(a) UCITSD V.
[620] Art. 51 UCITSD V.
[621] Art. 52(1) UCITSD V.
[622] Art. 52(2) UCITSD V.
[623] Art. 83 UCITSD V.
[624] Art. 88 UCITSD V.
[625] Art. 52(2) UCITSD V.
[626] Art. 50(2)(a) UCITSD V.
[627] Art. 56(1) UCITSD V.
[628] ESMA/2014/937.
[629] Art. 52(3) UCITSD V.
[630] Art. 52(1)(b) UCITSD V.

Diversification requirements also seek to avoid concentration risk by requiring calculating 'position exposure' to underlying investments with the exposure from direct investments.[633] UCITS may borrow up to 10% of NAV for temporary purposes[634] and lending is prohibited.[635]

4.2.2. Professional vs. Retail AIFs

The AIFMD does not regulate the structure or the portfolio composition of AIF portfolios managed by AIFMs at the European level.[636] The original absence of product regulation was explained by the difficulty for an extensive harmonization due to the very diverse fundtypes that are to be found amongst EEA Member States.[637] The AIFMD, therefore, allowed Member States to apply their own (pre-AIFMD) product regulation with regard to the AIFs that are established in their Member State.[638] Nevertheless, Member States have to refrain from imposing additional requirements to AIFs that are being marketed on the basis of a marketing passport available under the AIFMD. Inbound passported AIFs being marketed to professional investors under the AIFMD, thus, do not need to comply with the product regulation that is applicable to AIFs.

Despite of the difficulties found by ESMA in mapping fundtypes along EEA Member States[639], the ELTIFR, EuVECAR, EuSEFR and the MMFR, nevertheless, have established four distinctive regulations with harmonized product regulation for AIFs. The discussed rationale for not imposing specific product regulation, thus, only applies to all other AIFs outside the scope of these regulations.

The majority of the Member States have fundtypes in place for AIFs that fall outside of the scope of the 'AIFMD/UCITSD Product Regulations'.[640] Liechtenstein and the Netherlands are in this regard an exemption. In those Member States, AIFMs only have to fulfill the provisions which are relevant for the AIF offered, such as the limitation of leverage on the basis of risk management. Marketing (and manager) regulation remain the primary source of investor protection measures in those Member States.

Most Member States, however, provide to some extent mandatory fundtypes.In Germany the product regulations of the KAGB vary depending upon whether the AIF is open or closed-end and whether the AIF is being marketed to professional (Special funds) or retail investors (public AIF).[641] Limited product regulation is provided for open-end special AIFs, whereas for closed-end AIFs[642] there is no product regulations defined. [643] The KAGB only imposes minimum restrictions on open special AIFs[644]. No catalogue exists on admissible assets. It entails the following types: General Domestic special AIF (Allgemeine Inländische Spezial

---

[631] Art. 55(1) UCITSD V.
[632] Art. 55 UCITSD V.
[633] Recital 42 UCITSD V, Art. 52(1) sub-paragraph 2 UCITSD V.
[634] Art. 83(2) UCITSD V.
[635] Art. 88 UCITSD V.
[636] Recital 10 AIFMD.
[637] See ESMA/2012/117, No. 20; See also D.A. Zetzsche & C.D. Preiner, *Scope of the AIFMD* 82 (D.A. Zetzsche ed, Kluwer 2015).
[638] Recital 10 AIFMD.
[639] See ESMA/2012/117, No. 20.
[640] See D.A. Zetzsche, *Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).
[641] T. Emde, *The AIFMD's Transposition in Germany (*D.A. Zetzsche ed, Kluwer 2015); B. Weiser & M. Hüwel, *Verwaltung alternativer Investmentfonds und Auslagerung nach dem KAGB-E*, 19 Betriebs-Berater 1091, 1097 (2013); T. Paul & C. Schmies, *Germany* (D. Busch ed, Oxford 2014).
[642] § 285-292 KAGB.
[643] It is only required that assets can be evaluated. See § 285, 286 KAGB.
[644] § 273-292 KAGB.

AIF)[645], Hedge funds (Hedgefonds)[646], Special AIFs with fixed investment conditions (Spezial-AIF mit festem Anlagebedingungen).[647] To the contrary, public AIFs are restricted to fundtypes. Examples in the area of (open-end) public AIFs[648] are Mixed investment undertakings (Gemischte Sondervermögen)[649], Other investment undertakings (Sonstige Sondervermögen)[650] Fund of Hedgefunds (Dach-Hedgefonds)[651] and Real estate funds (Immobilien-Sondervermögen).[652] The KAGB contains a catalogue of admissible assets for closed public AIF.[653] In addition, the KAGB allows investment undertakings without risk-spreading (one-object-funds; Ein-Objekt AIF).[654] Investments in one-object-funds are only admissible with a minimum investment of EUR 20,000 and the qualification as semi-professional investor.[655]

Similarly, the UK provides product regulation for AIFs. Generally, the UK categorizes Authorized and Unauthorised AIFs. Authorized AIFs include Non-UCITS Retail Schemes (NURS) and Qualified Investor Schemes. Unauthorised AIFs are unregulated CIS and internally/externally managed non-CIS AIFs. The pre-AIFMD NURS and QIS are being maintained post-AIFMD. NURS, for instance, may invest in asset classes such as real estate and unregulated CIS. The NURS regime, however, requires an investment limit per asset class of 35% of the total AuM.

Similar as for UK AIFs, Ireland provides product regulation for Qualifying Investor AIFs (professional investors) and Retail Investor AIFs. Qualifying Investor AIFs are sub-divided in specific categories that further set out product regulation for Money market Qualifying Investor AIFs.[656] Sub-types with further detailed product regulation is also available for Retail Investor AIFs, including, amongst others, Venture or development capital, private equity Retail Investor AIFs, Money market Retail Investor AIFs and Real Estate Retail Investor AIFs.[657] France dcan be classified by AIFs by nature and AIFs by object. The AIFs by nature are categorized by various retail AIFs[658] that are partly based upon the legal form in which

---

[645] § 282 KAGB.
[646] § 283 KAGB.
[647] § 284 KAGB
[648] § 214-272 KAGB; All fundtypes of the InvG have been adopted, except the employee participation funds (Mitarbeiterbeteiligungs-Sondervermögen) and occupational pension funds (Altersvorsorge-Sondervermoegen) have been adopted with (partial) adaptions.
[649] § 218 et seq. KAGB.
[650] § 220 et seq. KAGB.
[651] § 225 et seq. KAGB.
[652] § 230 et seq. KAGB.
[653] § 261 KAGB.
[654] § 262 Abs. 2 KAGB; Cf. R.H. Maatman, *Een beleggingsinstelling met één deelnemer: contradictio in terminis?,* 5 TvE 95-102 (1999).
[655] L. Schubert & A. Schuhmann, *Die Kategorie des semiprofessionellen Anlegers nach dem Kapitalanlagegesetzbuch,* 47 BKR 45 (2015).
[656] These can be Short-Term Money Market Funds, Money Market Funds or Short-Term Money Market Funds – valuation on the basis of amortized cost. See Ireland: Central Bank of Ireland, AIF Rulebook, January 2017, Chapter 2 – Qualifying Investor AIF Requirements, Part. II. Specific Fund-Type Requirements, 1. Money market Qualifying Investor AIFs.
[657] See Central Bank of Ireland, AIF Rulebook, January 2017, Chapter 2 – Retail Investor AIF Requirements, Part. II. Specific Fund-Type Requirements; M. Jackson & D. Counihan, *Ireland* (D. Busch ed, Oxford 2014).
[658] Retail AIFs include : general purpose investment funds *(Les fonds d'investissement à vocation générale*; Art. L214-24-24 CMF, Article 422-2 et seq. AMF Règlement général); Private equity funds (FCPR/FIP/FCPI) (*Les fonds de capital investissement* - FCPR / FCPI/FIP; Art. 214-27 CMF, Art. 422-120-1 AMF Règlement general); Real estate funds (OPCI, SCPI) (*Les organismes professionnels de placement collectif immobilier* – OPCI ; L214-35 CMF, Art. 422-121 et seq. AMF Règlement general) (pre-AIFMD: OPCI und OPCI RFA SEL); Real estate investment company (*Les sociétés civiles de placement immobilier* – SCPI ; L214-86 et seq., L214-114 et seq. CMF, Art. 422-189 et seq., 422-223 et seq. AMF Règlement general); Investment companies with fixed

those AIFs are established and four categories of AIFs marketed to professional investors[659]. Various venture capital companies (SCR), amongst others, qualify as AIFs by object. France also provides other types of collective investment vehicles (autres placements collectives), such as employee participation funds (les fonds d'épargne salariale) and securitization vehicles (les organisms de titrisation) that do not fall within the scope of the AIFMD and UCITSD V.[660]

The product regulations of Member States also require in various ways minimum diversification.[661] First, diversification may be a requirement embodied in the fundtype regulated. Following Article 1(2) UCITSD V, UCITS means an undertaking (…) which operates on the principle of risk spreading. Similarly, Luxembourg (SIF)[662] and the UK (QIS)[663] and four fundtypes in France[664] require diversification on the basis of risk-spreading requirements.[665] Second, diversification may be required on the basis of the national implementation of the AIF definition under the AIFMD. Malta, for example, requires AIFs to be a collective investment schemes that has the characteristic of operating according to the principle of risk spreading.[666] Third, Member States require diversification for open-end AIFs. Ireland, for instance, for the VCC and Germany for the open-end Investment-AG/-KG.[667] In this, regard diversification enables AIFs to fulfill their redemption orders. Finally, some Member States have 'marketing-based' diversification duties. Germany, for instance, requires the general principle of risk spreading for all retail AIFs.[668]

---

capital (SICAF) (*Les sociétés d'investissement à capital fixe* – SICAF ; L214-127 CMF) and Funds of alternative funds *(Les fonds de fonds alternatifs* ; L214-139ff. CMF, Art. 422-250ff. AMF Règlement general) (pre-AIFMD: OPCVM de fonds alternatifs).

[659] Professional AIFs that are required to be authorized include general purpose AIFs *(Les fonds professionnels à vocation générale* ; L214-143 et seq., Art. 423-1 et seq. AMF Règlement général) (pre-AIFMD: OPCVM ARIA EL und SEL) and real estate AIFs (*OPCI professionnels*; L214-148 et seq. CMF, Art. 423-12 et seq. AMF Règlement général) (pre-AIFMD : OPCI RFA EL). Professional AIFs that are required to be registered include professional investor funds (*Les fonds professionnels spécialisés* ; L214-154 et seq. CMF, Art. 423-16 AMF Règlement général) (pre-AIFMD: OPCVM contractuels + FCPR contractuels) and venture capital funds *(les fonds professionnels de capital investissement ;* L214-159 et seq. CMF, 423-37 AMF Règlement général) (pre-AIFMD: FCPR allégés).

[660] See L214-163 et seq, L214-167 et seq CMF.

[661] D.A. Zetzsche*, Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).

[662] Circulaire CSSF 07/309, Concerne: répartition des risques dans le contexte des fonds d'investissement spécialisés (« FIS »), 3 août 2007.

[663] 8.4.2 COLL.

[664] See general purpose investment funds *(Les fonds d'investissement à vocation générale*; Art. R214-32-25 CMF) and private equity funds (*Les fonds de capital investissement* - FCPR / FCPI/FIP; Art. R214-35 et seq. CMF, R214-32-25); The latter only applies to FCPRs and not to FCPIs and FIPs as they are exempted (R214-48 CMF and R214-66 CMF); Real estate funds (OPCI, SCPI) (*Les organismes professionnels de placement collectif immobilier* – OPCI ; Art. R214-81 a R214-128 CMF) and professional investor funds (*Les fonds professionnels spécialisés ;* Art. R214-202 et seq. CMF, R214-32-35 CMF).

[665] See in Germany: D: § 243 KAGB for real estate AIFs; See in France: professional investor funds (*Les fonds professionnels spécialisés*; Art. R214-202 et seq. CMF); real estate AIFs (*OPCI professionnels*; Art. R214-200 ff. CMF) and Investment companies with fixed capital (SICAF) (*Les sociétés d'investissement à capital fixe* – SICAF ; Art. D214-179 et seq. CMF). See for NURS and FAIFs in the UK:COLL 5.6 and 5.7.

[666] See, for example, in Malta: Art. 2 Abs. 1 Chapter 370 Investment Services Act.

[667] § 10, 125 KAGB.

[668] See § 214, 262 KAGB.

Not all Member States require for AIFs diversification. The Netherlands and Liechtenstein are examples of the latter.[669] Retail investors investing in undiversified AIFs are in these Member States only protected by investor information.[670]

4.2.3. 'AIFMD/UCITSD V Product Regulations'

All AIFMD/UCITSD V product regulations, including the MMFR, ELTIFR and EuVECAR/EuSEFR contain portfolio composition rules.

4.2.3.1. MMFR

The MMFR promotes the integrity and stability of the internal market by ensuring a mandatory investment policy that enables MMFs to immediately redeem investors.[671] The MMFR does not allow any collective investment undertaking to be established, marketed or managed in the EEA, unless it has been authorized as AIF or UCITS under the regulation.[672] MMFs[673] need to fulfill the obligations concerning the investment policies of the MMFR. For this purpose, MMFs authorized under the UCITSD are entirely exempted from the mandatory investment policy rules.[674] Given the lex specialis character of the MMFR, any national product regulation of AIFs shall also be derogated. The MMFR product regulation regime consists of certain types of MMFs (features of MMFs) and portfolio composition rules.

Under the MMFR, three types of MMFs are introduced: variable net asset value MMF (VNAV MMF)[675], constant net asset value MMF (Public Debt CNAV MMF)[676] and low volatility net asset value MMF (LVNAV MMF)[677].

First, VNAV MMFs refers to MMFs which use mark to market accounting to value their assets as the preferred accounting method.[678] The NAV of these MMFs vary by a slight amount, due to the changing value of the assets and, in the case of an accumulating fund, by the amount of income received.[679] This implies that a MMF with an unchanging NAV is, by definition, a CNAV MMF, but a fund with a NAV that varies may be an accumulating CNAV or a distributing or accumulating VNAV.

Second, Public Debt CNAV MMFs have the objective of preserving the capital of the investment while ensuring a high degree of liquidity[680] and invest 99.55% of their assets in qualifying government debt.[681] The majority of these MMFs aims to maintain its distributing shares at a 'constant' value of for example USD 1, EUR 1 or GBP 1, by using an amortized cost basis of accounting for the value of its underlying portfolio of money market instruments.[682] Finally, LVNAV MMF allows an MMF to issue and redeem units at a constant net asset value (CNAV) as long as this is within 20bp of its actual NAV, based on the amortized cost accounting approach for assets maturing within 90 days.[683]

---

[669] See for Liechtenstein: G. Dobrauz-Saldapenna, A. Schwertschlag & P. Rosenauer, *The AIFMD's Transposition in Liechtenstein* (D.A. Zetzsche ed, Kluwer 2015); See for the Netherlands: S.N. Hooghiemstra, *The AIFMD's Transposition in the Netherlands* (D.A. Zetzsche ed, Kluwer 2015).
[670] *Ibid.*
[671] Recital 6 MMFR.
[672] Art. 4 MMFR.
[673] See designation as MMF under Art. 6 MMFR.
[674] Art. 8(2) MMFR.
[675] Art. 2(14) MMFR.
[676] Art. 2(11) MMFR.
[677] Art. 2(12) MMFR.
[678] Recital 44 MMFR.
[679] Art. 2(14) MMFR.
[680] Recital 45 MMFR.
[681] Art. 2(11) MMFR.
[682] Recital 45 MMFR.
[683] Art. 2(12) MMFR.

The MMFR also distinguishes between short-term and standard MMFs. Short-term MMFs, may be either VNAV or CNAV MMFs, have a residual maturity of less than 397 days[684], whereas standard MMFs are allowed to invest in longer-term instruments than short-term MMFs. The residual maturity of the latter may not exceed two years. Standard MMFs can only be VNAV MMFs.[685]

MMFs of any type are only allowed to invest in a limited amount of eligible assets[686], including money market instruments[687], deposits with credit institutions[688], financial derivative instruments[689], reverse repurchase agreements[690] and the units or shares of other MMFs[691]. Each of the specific characteristics of the separate categories financial assets has been further defined in the MMFR. MMFs are prohibited from investing assets other than eligible assets[692] under the MMFR and may not undertake investment activities, including[693] short-selling money market instruments[694]and gaining direct or indirect exposure to equity or commodities.[695] MMFs are also prohibited from entering into agreements that encumber the assets of the MMF, such as securities lending or borrowing agreements[696] and the borrowing and lending of cash.[697]

The MMFR, additionally, requires diversification of certain investments, including, amongst others, an investment maximum of 5% of assets in a single issuer and 10% of assets in deposits made with the same credit institution.[698] Finally, the MMFR requires at all times a concentration limit of 10% of the money market instruments issued by a single body, excluding those issued by central, regional or local authorities or the EU central bank.[699]

4.2.3.2. ELTIF

Full-AIFMs under the ELTIFR may market EEA AIFs, available for marketing to all types of investors, that are investing in long-term investments in the real economy.[700]

In order to ensure this, an ELTIF may only be authorized under ELTIFR if it complies with the ELTIFR rules and restrictions on the investment policy.

The investment policy of an ELTIF is restricted to investing in 'eligible investment assets'[701] or UCITS assets[702].

Eligible investments include, amongst others, participations, such as equity[703] or quasi-equity[704], debt instruments in qualifying portfolio undertakings and loans provided to them.[705]

---

[684] Art. 2(14) MMFR.
[685] Art. 2(15) MMFR.
[686] Art. 9 MMFR.
[687] Art. 10 MMFR.
[688] Art. 12 MMFR.
[689] Art. 13 MMFR.
[690] Art. 14, 15 MMFR.
[691] Art. 16 MMFR.
[692] Art. 9(2)(a) MMFR.
[693] Art. 9(2) MMFR.
[694] Art. 9(2)(b) MMFR.
[695] Art. 9(2)(c) MMFR.
[696] Art. 9(2)(d) MMFR.
[697] Art. 9(2)(e) MMFR.
[698] Art. 17(1) and (2) MMFR.
[699] Art. 18 MMFR.
[700] Recital 4 ELTIFR.
[701] Art. 10 ELTIFR.
[702] UCITS assets are the assets that a UCITS is allowed to invest in under Art.50(1) UCITSD V; See Art. 9(1)8b) ELTIFR.
[703] Equity means an ownership interest in a qualifying portfolio undertaking, represented by the shares or other forms of participation in the capital of that undertaking issued to its investors. See Art. 2(4) ELTIFR.

Eligible investments are restricted to qualifying portfolio undertakings. These are undertakings, other than a collective investment[706] or financial undertaking[707] which are not admitted on a regulated marketed or MTF[708] or are admitted with a market capitalization less than EUR 500 million.[709] Any of these undertakings may not be established in a country listed by the FATF as non-cooperative jurisdiction and may have signed an agreement for the effective exchange of information in tax matters.[710]

Eligible investments in qualifying portfolio undertakings are restricted to diversification and concentration provisions. An ELTIF must invest at least 70% of its capital in eligible investment assets.[711] It shall invest, amongst others, in no more than 10% of its capital istruments issued by, or loans granted to, any single qualifying portfolio undertakings, the capital of a single real asset[712] and units or shares of any single ELTIF, EuVECA or EuSEF.[713] Under the concentration rules, ELTIFs may not acquire more than 25% of the units of ELTIF, EuVECA or EuSEF[714] and need to respect the concentration limits for UCITS assets under the UCITSD[715].

Several investment restrictions apply to ensure the integrity of ELTIFS and prevent that its investment strategy and objectives is not endangered by risks other than expected from long-term investments.[716] For that purpose, ELTIFs are prohibited to short sell assets[717], take direct or indirect exposure to commodities[718], enter into securities lending, borrowing repurchase transactions and equivalent agreements that affects more than 10% of the assets of the ELTIF[719] and use financial derivate instruments for investment purposes[720].[721]

ELTIFs may only borrow cash under certain restrictions, such as it represents no more than 30% of the value of the capital of the ELTIF[722] and is used to invest in eligible investment assets if the cash or cash equivalents of the ELTIF are not sufficient to invest in those assets.[723]

4.2.3.3. European Venture Capital Funds/European Social Entrepreneurship Funds

[704] Quasi-equity means any type of financial instrument where the return on the instrument is linked to the profit or the loss of the qualfying portfolio undertaking and where repayment upon default is not secure. See Recital 20 and Art. 2(5) ELTIFR.

[705] Recital 17 ELTIFR; See Art. 10 ELTIFR.

[706] See D.A. Zetzsche & C.D. Preiner, *Was ist ein AIF?*, 45 Zeitschrift für Wirtschafts- und Bankrecht 2101 (2013); S.N. Hooghiemstra, *Wat is een beleggingsinstelling onder de AIFM-richtlijn?*, 3 Ondernemingsrecht 24 (2014).

[707] Art. 11(1)(a) ELTIFR.

[708] Art. 11(1)(b) ELTIFR.

[709] Art. 11(1)(b) ELTIFR.

[710] Art. 11(1)(c) ELTIFR.

[711] Art. 13(1) ELTIFR.

[712] Art. 2(6) ELTIFR.

[713] Art. 13(2) ELTIFR.

[714] Art. 15(1) ELTIFR.

[715] Art. 9(1) and 15(2) ELTIFR.

[716] Recital 14 ELTIFR.

[717] Art. 9(2)(a) ELTIFR.

[718] Art. 9(2)(b) ELTIFR.

[719] Art. 9(2)(c) ELTIFR.

[720] Art. 9(2)(d) ELTIFR.

[721] See Recital 14, Art. 9(2) ELTIFR.

[722] Art. 16(1)a) ELTIFR.

[723] Art. 16(1)(b) ELTIFR.

The EuVECAR and the EuSEFR lay down uniform investment policy rules for managers of collective investment undertakings[724] that wish to market qualifying venture capital or social entrepreneurship funds in the EEA.[725] Qualifying venture capital/social entrepreneurship funds are established in the EEA[726] intends to invest at least 70% of its aggregate capital contributions and uncalled committed capital in assets that are qualifying investments. Qualifying investments are equity, quasi-equity instruments, securitized, unsecured loans or shares of a qualifying portfolio undertaking and units or shares of other qualifying portfolio undertakings.[727] The substantially different definitions of qualifying portfolio undertakings under the EUVECAR and the EuSEFR mark the difference in application between the two regulations. Two common elements under both definitions require that an EEA or TC undertaking is not admitted to trading on a regulated market or multilateral trading facility[728], is not listed as Non-Cooperative Country by the FATF and an information exchange agreement between the states of the small AIFM and the AIF is in place.

The other requirements are different between the two regulations. The EuVECAR requires qualifying undertakings[729] to employ less than 250 people, to be an SME[730]
and not to qualify as a collective investment undertaking[731] or another financial institution[732].

The EuSEFR requires qualifying undertakings to:[733]

- have as the primary objective to produce measurable, positive social impacts[734];
- have predefined procedures and rules that determine the distribution of profits to shareholders and owners and ensure that this does not undermine its primary objective;
- be managed in an accountable and transparent way.

---

[724] Art. 3(a) EuVECAR; Art. 3(1)(a) EuSEFR refers to the AIF definition under the AIFMD; See also: European Commission, *Impact Assessment – Proposal for a Regulation of the European Parliament and of the Council on European Social Entrepreneurship Funds*, {COM(2011) 862 final} {SEC(2011) 1513 final}.

[725] Art. 1 EuVECAR/EuSEFR; See L. Siering & A. Izzo-Wagner, *'Praktische Hürden' der EuVECA-Verordnung*, BKR 242 (2014); L. Siering & A. Izzo-Wagner, *Die EuVECA-VO – eine Sackgasse der Verwaltungspraxis? – Die aktuelle Aufsichtspraxis als großes Problem für die Venture Capital Branche*, BKR 101 (2015). See also:European Securities and Markets Authority, *Q&A on the Application of the EuSEF and EuVECA Regulations*, 11 November 2014, ESMA/2014/1354.

[726] Art. 3(b)(iii) EuVECAR; Art. 3(1)(b)(iii) EuSEFR.

[727] Art. 3(e) EuVECAR/EuSEFR.

[728] Art. 3(d)(i) EuVECAR; Art.3 (d)(i) EuSEFR.

[729] Art. 3(d)(i) EuVECAR.

[730] The annual turnover may not exceed 50 million EUR or have an annual balance sheet of more than 43 million EUR. See Art. 3(d)(i) EuVECAR; See also: European Commission, *The new SME definition - User guide and model declaration of 26 June 2012*, http://ec.europa.eu/enterprise/policies/sme/files/sme_definition/sme_user_guide_en.pdf (accessed 3 July 2015).

[731] Collective investment undertakings are not the European level either UCITS or AIFs. This provision should, thus, be read as that the portfolio undertakings may not be an AIF or a UCITS. See D.A. Zetzsche & C.D. Preiner, *Was ist ein AIF?*, 45 Zeitschrift für Wirtschafts- und Bankrecht 2101 (2013).

[732] Art. 3(d)(iii) EuVECAR lists examples, such as credit institutions, investment firms, insurance undertakings a financial holding company and a mixed-activity holding company and references to the respective definitions in European acts.

[733] Art. 3(1)(d) EuSEFR; European Securities and Markets Authority, *Final Report - ESMA's technical advice to the European Commission on the delegated acts of the Regulations on European Social Entrepreneurship Funds and European Venture Capital Funds*, 16 February 2015, ESMA/2015/227.

[734] Art. 3(1)(d)(ii) EuSEFR refers to, amongst others, the provisions of services or goods to vulnerable or marinalised, disadvantaged or excluded persons. The objective has to be set out in the instruments, such as Art.s of association, statutes or any other rules or instruments of corporation establishing the business.

Small AIFMs managing EuSEFs are, furthermore, required to employ procuedres to measures the positive social impact to which the portfolio undertaking has committed itself.[735] Depending upon the objective chosen, the procedures shall set out indicators for each EuSEF managed according to which the social objective is being measured.[736] Indicators shall be, amongst others, employment and labour markets, public health and safety.[737]

4.2.4. Conclusion

Despite the increasing focus on intermediary regulation under both the AIFMD and UCITSD V, Member States still require AIFMs managing retail AIFs and UCITS ManCos managing UCITS to comply with 'investor-specific product regulation', i.e. product regulation that limits retail AIFs and UCITS in their portfolio composition. On the EEA level, this is 'investor-specific product regulation' as the restriction in portfolio composition only seems to target retail AIFs and UCITS that are by definition required to be marketed to both retail and professional investors ('general public'). In addition, the ELTIFR and EuVECAR/EuSEFR that are targeting so-called HNWIs also restrict the portfolio composition of the ELTIFR, EuVECAs and EuSEFs being marketed to these types of investors. Investor-specific product regulation, thus, seems to have two objectives: (1) providing retail investor protection and (2) defining the scope of the specific AIFMD/UCITSD V product regulations in which intermediary regulation is fully or partially substituted by intermediary regulation to restrict AIFMs/UCITS ManCo in offering certain AIFs/UCITS to investors on a cross-border basis in the EEA.[738]

4.3. Conclusion

The AIFMD and UCITSD V are built upon a regulatory cocktail comprising of intermediary, product and sales regulation. The main focus under the AIFMD is on so-called 'intermediary regulation', whereas the UCITSD complements this approach by 'product regulation'. For this reason, it is both not necessary and also too cumbersome to regulate the legal forms in which AIFs and UCITS are required to be established in on the European level. Instead, Member States are allowed to regulate their own legal forms. The systematic nature of the AIFMD and UCITSD V require these legal forms, however, to cater for limited liability and asset partitioning to fit in the governance under these two directives. The Member State implementations providing for these two features in all their legal forms, including unit trusts, investment companies, common funds and investment (limited) liability partnerships explains why the AIFMD and UCITSD V allow for legal form neutrality.

Despite the increasing focus on intermediary regulation under both the AIFMD and UCITSD V, Member States still require AIFMs managing retail AIFs and UCITS ManCos managing UCITS to comply with 'investor-specific product regulation', i.e. product

---

[735] Art. 10 EuSEFR.

[736] The European Commission is empowered to adopt delegated acts in this respect. So far, no measures have been adopted. ESMA, however, has given already its final view on what measures to adopt. See European Securities and Markets Authority, *Final Report – ESMA's technical advice to the European Commission on the delegated acts of the Regulations on European Social Entrepreneurship Funds and European Venture Capital Funds*, 3 February 2015, 2015/ESMA/227; See for the consultation: European Commission, *Consultation Document – Review of the European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF) Regulations*, http://ec.europa.eu/finance/consultations/2015/venture-capital-funds/docs/consultation-document_en.pdf (accessed 3 February 2017).

[737] Art. 10(a) EuSEFR.

[738] J.A. McCahery & E. P. Vermeulen, *Corporate Governance of Non-Listed Companies* (Oxford University Press 2008).

regulation that limits retail AIFs and UCITS in their portfolio composition. On the EEA level, this is 'investor-specific product regulation' as the restriction in portfolio composition only seems to target retail AIFs and UCITS that are by definition required to be marketed to both retail and professional investors ('general public'). In addition, the ELTIFR and EuVECAR/EuSEFR that are targeting so-called HNWIs also restrict the portfolio composition of the ELTIFR, EuVECAs and EuSEFs being marketed to these types of investors. Investor-specific product regulation, thus, seems to have two objectives: (1) providing retail investor protection and (2) defining the scope of the specific AIFMD/UCITSD V product regulations in which intermediary regulation is fully or partially substituted by intermediary regulation to restrict AIFMs/UCITS ManCo in offering certain AIFs/UCITS to investors on a cross-border basis in the EEA.

5. Disclosure/Sales Regulation

The AIFMD/UCITSD V investment triangle built upon a regulatory cocktail comprising of intermediary, product and disclosure/sales regulation.[739] Disclosure/marketing regulation is the least 'paternalistic'[740] variant of EEA regulation. Although recently disclosure/marketing regulation is being used in conjunction with, in particular, intermediary regulation[741], disclosure/marketing regulation originally had the very neo liberal idea of letting investors/consumers decide for themselves whether a particular financial service/product suits their needs.[742] The primary example of an EEA regulatory initiative merely focusing on disclosure is the PR.

Disclosure and reporting requirements within the AIFMD, UCITSD V and the AIFMD/UCITS product regulations complement intermediary and product regulation. Intermediary regulation ensures that investors can only buy units/shares in AIFs/UCITS that are managed and marketed by competent and trustworthy AIFMs/UCITS ManCos. Product regulation prevents that investors invest in AIF/UCITS' portfolios that do not suit their knowledge and financial background. Disclosure regulation ensures that investors on an ex ante and ongoing basis are enabled to make an informed investment decision, whereas reporting requirements enable Competent Authorities to monitor the AIFMs/UCITS ManCos and the UCITS/AIFs that are on the market.

The AIFMD, UCITSD V and the AIFMD/UCITSD product regulations base their disclosure regulation upon a 'standardization' of categories of investors, including professional investors, retail investors and 'HWNIs'. The disclosure regulation throughout the various initiatives are also based upon this investor classification, whereas reporting requirements primarily depend upon the type of AIF/UCITS marketed.

Prior to discussing the disclosure and reporting requirements under the AIFMD, UCITSD and the AIFMD/UCITSD V product regulations, this section will continue to discuss the various standards used to qualify investors.

---

[739] M. Scheele, *Implementatie van de AIFM-Richtlijn en transparantie* 161-170 (P. Zijp, A. Tillema, P. Rank & H. van Everdingen, Kluwer 2011).

[740] See on paternalism: D.A. Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 8 A. I (Mohr Siebeck 2015).

[741] See, for example, UCITS ManCos and AIFMs under UCITSD V and the AIFMD.

[742] See for behavioral economic studies for PEPPs: European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 47; European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP),* 04 July 2016, EIOPA-16/457, 46.

5.1. Investor Information & Reporting

Disclosure and reporting requirements within the AIFMD, UCITSD V and the AIFMD/UCITS product regulations complement intermediary and product regulation. Disclosure regulation ensures that investors on an ex ante and ongoing basis are enabled to make an informed investment decision, whereas reporting requirements enable Competent Authorities to monitor the AIFMs/UCITS ManCos and the UCITS/AIFs that are on the market.

The AIFMD, UCITSD V and the AIFMD/UCITSD product regulations base their disclosure regulation upon a 'standardization' of categories of investors, including professional investors, retail investors and 'HWNIs'. The disclosure regulation throughout the various initiatives are also based upon this investor classification, whereas reporting requirements primarily depend upon the type of AIF/UCITS marketed.

This section continues to discuss the disclosure and reporting requirements under the UCITSD V, AIFMD, and the AIFMD/UCITSD product regulations.

5.1.1. UCITSD V

UCITS ManCos have to publish for each UCITS a prospectus, an (audited) annual[743] and a half-yearly report.[744] The prospectus under the UCITSD V applies a 'framework approach'.[745] The prospectus must enable investors to make an informed investment decision and to understand the risk profile of the UCITS.[746] Other than under the PR, the substantive content and the liability regime is, however, not harmonized. The prospectus, not being subject to an authorization requirement, must contain minimum information in so far as that information has not already been disclosed in the fund rules or instruments of incorporation annexed to the prospectus.[747] The minimum information to be provided ranges from the issue/redemption policy and the UCITS investment objectives/policy[748] to the tax treatment of the UCITS.[749] Similarly, the annual report and the half-yearly report needs to contain the information as provided for in a schedule of the UCITSD V.[750] The annual report also includes a balance-sheet, a detailed income and expenditure account and a report on the activities of the financial year.The prospectus, annual and half-yearly reports shall not only be provided to the investors but also to the competent authorities of the UCITS home Member State.[751]

Other information needs to be provided related to issue/redemptions and marketing communication applies to UCITS. A UCITS is obliged to publish the NAV at least twice a month, unless a Competent Authority allows them to publish it only once a month.[752] Apart from this, marketing communications need to be identifiable as such and needs to be in line with the information contained in the prospectus and the UCITSD V KIID. It has to specify

[743] Annual reports need to be audited. See Art. 73 UCITSD V.
[744] Art. 8(1) UCITSD V; See for details Arts 68-75 UCITSD V.
[745] N. Moloney, *EC Securities Regulation* 247 (3rd edn., Oxford University Press 2014).
[746] Art. 69 (1) UCITSD V.
[747] See Art. 69(2) UCITSD V; Art .71(1) UCITSD V; See for the minimum information to be provided: Schedule A of Annex I UCITSD V.
[748] Art. 70 UCITSD V.
[749] Schedule A of Annex I UCITSD V.
[750] See Schedule B Annex I for the annual report. See Sections I to IV of Schedule B Annex I UCITSD for the half-yearly report.
[751] Art. 74 UCITSD V.
[752] Art. 76 UCITSD V.

the existence of the latter two and how further information and documents might be obtained by investors.[753]

UCITSD IV introduced the key investor information document (KIID) as a replacement for the simplified prospectus regime.[754] The KIID provides 'key information' for investors and includes information about the essential characteristics of a UCITS. Its form and content has been harmonized to a large extent.[755] The KIID is designed as pre-contractual disclosure and must be written in a concise way and in non-technical language. The content is mandatorily given and includes an identification of the UCITS; the investment objective and investment policy[756]; a risk and reward indicator[757]; past performance information[758] or performance scenarios[759]; costs and associated charges[760] and practical information. The KIID was a landmark reform and served as an example for the PRIIPR. Until the KIID has been reviewed, the KIID will remain in place for UCITS, whereas the PRIIPR applies to retail AIFs.[761]

5.1.2. AIFMD

The disclosure and reporting requirements under the AIFMD can be split into two groups, consisting of the transparency requirements under the AIFMD itself and ancillary disclosure requirements deriving from other European legislative acts. The transparency requirements under the AIFMD requires various disclosure and reporting requirements. Disclosure requirements are aimed at investors to enable them to make an informed investment decision either prior to or after their initial investment.[762] Reporting requirements allow competent authorities to review AIFs from an investor and market protection perspective.[763] The ancillary disclosure and reporting requirements discussed relates to the TPD , PR and the PRIIPR. Finally, the Member State implementations of the AIFMD private placement regimes related to the disclosure and reporting requirements are being discussed.

5.1.2.1. Transparency Requirements under the AIFMD

[753] Art. 77 UCITSD.
[754] G.A.M. Verwilst, *De Europese toekomst van icbe's*, 4 TvFR 109-115 (2007); G.A.M. Verwilst, *De belegger centraal; Europese toezichtrechtelijke ontwikkelingen rond beleggingsproducten*, 10 TvFR 266-274 (2010); C. M., Grundmann-van de Krol, *Beleggingsinstellingen: 'uitdagende' en andere regelgeving op komst*, Ondernemingsrecht 436 (2010); A.R. Filius, & M.R. Hosemann, *Van financiële bijsluiter naar essentiële beleggersinformatie. Ziet u het verschil? Een historisch relaas*, 11/12 TvFR 328-334 (2010); See also: European Securities and Markets Authority, *Consultation paper - Guidelines for the transition from the Simplified Prospectus to the Key Investor Information document* (Consultation paper), 20 July 2010, ESMA/10-672.
[755] See the KIIDR; See also: European Securities and Markets Authority, *Questions and Answers - Key Investor Information Document for UCITS*, 25 September 2012, ESMA/2012/592.
[756] Art. 78(3)(b) UCITSD V; Art. 7 KIIDR.
[757] Art. 78(3)(e) UCITSD V; Art. 8, 9 KIIDR.
[758] Art. 78(3)(c) UCITSD V; Arts 15-18 KIIDR; Committee of European Securities Regulators, *CESR's guidelines on the methodology for the calculation of the synthetic risk and reward indicator in the Key Investor Information Document (2010)*, CESR/10-673; See for criticism: B. Aboulian, *Brussels rejects risk indicator for UCITS*, Financial Times (13 June 2010); A. Baptiste, *Brussels rejects risk indicator for UCITS*, Financial Times (June 2010); F. Schäfer & U. Schäfer, *Anforderungen und Haftungsfragen bei PIBs, VIBs und KIIDs*, ZBB 23 (2013).
[759] Art. 78(3)(c) UCITSD V; Art. 19 KIIDR.
[760] Art. 78(3)(d) UCITSD V; Art. 10 KIIDR.
[761] L. Burn, *KISS, But Tell All: Short-Form Disclosure for Retail Investors*, Capital Markets Law Journal 5 (2010).
[762] D.A. Zetzsche & D. Eckner, *Investor Information and Reporting* 394-398 (D.A. Zetzsche ed, Kluwer 2015).
[763] Cf. D.A. Zetzsche, *Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?*, in *The European Financial Market in Transition* (H. S. Birkmose, M. Nevillie & K. E. SØrensen eds., Kluwer 2012).

The transparency requirements under the AIFMD consist of initial investor information, periodic disclosure, acquisition-related disclosure and reporting requirements and reporting obligations to Competent Authorities.

The AIFMD requires a minimum standard of information (initial investor information document) to be provided to AIF investors both prior and after their initial investment, as well as any material changes thereof.[764] The AIFMD requires key information in the so-called initial investor information to be provided to professional investors.[765] Member States may require more extensive information (in the form of a prospectus) to be provided to retail investors based upon Article 43 AIFMD. The mandatory key information in respect of each AIF provided includes, amongst others, the investment objective and strategy[766], the legal implications of investment contracts[767], the intended leverage and collateral employed[768] and the fees, costs and expenses borne by investors[769].

The AIFM has to inform investors before their initial made of any contractual discharge of liability made in any arrangement by the depositary.[770]

Closed-end AIFs that are required to publish a prospectus under the PR need to include initial investor information in addition to the prospectus either separately or as additional information of the prospectus.[771]

The initial investor information requirement under Article 23(1) AIFMD has been implemented in various ways in Member States. The information required in the initial investor information needs to be provided to professional investors by means of a prospectus in Ireland (QIAIF), Luxembourg, the Netherlands and the UK.[772] This prospectus merely contains the minimum requirements as set out in Article 23(1) and (2) AIFMD for AIFs marketed to professional investors in Luxembourg and the Netherlands.[773] Ireland and the UK require for their QIAIFs additional information in their prospectus on top of the minimum information as laid down in the AIFMD.[774] Liechtenstein does not regulate anything on top of the minimum requirements in the AIFMD. Regardless whether marketed to professional or retail investors, Germany subjects closed-end AIFs[775] to the minimum requirements of the AIFMD and the PR.[776] Open-end AIFs are subject to the same prospectus requirements as UCITS.[777]

---

[764] Art. 23(1) AIFMD.

[765] See for criticism on the format, publication, accessibility and frequency of publishing the initial investor information: D.A. Zetzsche & D. Eckner, *Investor Information and Reporting* 394-398 (D.A. Zetzsche ed, Kluwer 2015).

[766] Art. 23(1)(a) AIFMD.

[767] Art. 23(1)(c) AIFMD.

[768] Art. 23(1)(e) AIFMD.

[769] Art. 23(1)(i) AIFMD.

[770] Art. 23(2) AIFMD.

[771] Art. 23(3) AIFMD.

[772] Ireland: Central Bank of Ireland, AIF Rulebook, January 2017, Chapter 2 - Qualifying Investor AIF Requirements, Section 3: Prospectus Requirements; Netherlands: Following Art. 4:371 FSMA, all AIFMs are required to provide professional AIFs with a prospectus. Nevertheless, its content is for professional AIFs limited to the information contained in Art. 23(1) and (2) AIFMD; Luxembourg: the same applies to SIFs and SICARs. See Art. 52 et seq. SIF Law and Art. 23 et seq. SICAR Law. UK: COLL. 8.3. (for Qualified Investor Schemes). See also S. 85 FSMA 2000. In addition, The Financial Services and Markets Act 2000 ((Financial Promotion) Order 2005 (2005 No. 1529) is applicable.

[773] Art. 115 j Market Conduct Supervision Financial Enterprises.

[774] Ireland: Central Bank of Ireland, AIF Rulebook, January 2017, Chapter 2- Qualifying Investor AIF Requirements, Section 3: Prospectus requirements; UK: COLL 8.3.

[775] K. Wagner, *Geschlossene Fonds gemäß dem KAGB*, ZfBR 113 (2015).

[776] K. Wagner, *Aktuelle Fragen und Probleme bei Publikumspersonengesellschaften*, NJW 198 (2013).

[777] § 164, 297 KAGB

Article 23(3) AIFMD requires an AIFM to publish a prospectus in accordance with PR for closed-end retail AIFs. Annex XVI Prospectus Regulation sets out the material requirements for 'undertakings of collective investment' that needs to be complied with. The information contained in the initial investor information document under Article 23(1) and (2) AIFMD need to be either disclosed separately or as additional information in the prospectus.[778]

The AIFMD allows the individual Member States under Article 43 AIFMD to require stricter requirements than the initial investor information for retail investors.[779] Austria, Germany, France, Liechtenstein, Ireland, Luxembourg and the Netherlands require AIFMs to provide retail investors of open-end AIFs with a prospectus that contains, in addition to the initial investor information, dadditional information that is (partially) based upon the content of the UCITS-prospectus.[780]

The AIFMD requires AIFMs, in addition to the initial investor information, to periodically disclose an annual report[781] and additional periodical and ad-hoc disclosure on the liquidity, risk measures and leverage employed by the AIF[782].

An AIFM is required to publish an audited annual report[783] that shall be provided to investors on request.[784] It shall be made available to the competent authorities of the home Member States of the AIFM and the home Member State of the AIF.[785] If an AIFM is required to publish an annual financial report under the TPD, the information required under the AIFMD annual report shall be published separately or as part of the annual financial report.[786] The key high-level principles approach[787] is chosen that requires the annual report to include a balance-sheet or a statement of assets and liabilities[788], an income and expenditure account for the financial year[789], a report on the activities of the financial year[790], any material changes[791] and remuneration paid by the AIF[792].

---

[778] Art. 23(3) AIFMD.
[779] Art. 43 AIFMD.
[780] Germany: § 316(1) KAGB, § 164(1), § 268(1), § 316(1) KAGB; UK:
COLL 4.1.1 and 4.2.2. (for authorized CIS); France : general purpose investment funds (fonds d'investissementà vocation generale ; Art. 422-71 AMF Regl. gen.) ; private equity funds (FCPR/FIP/FCPI) (*Les fonds de capital investissement* - FCPR / FCPI/FIP; Art. 422-120-1 AMF Règlement general); Real estate funds (OPCI, SCPI) (*Les organismes professionnels de placement collectif immobilier* – OPCI; Art. 422-178 AMF Règlement general); Real estate investment company (*Les sociétés civiles de placement immobilier* – SCPI ; Art. 422-189 AMF Règlement general) and Funds of alternative funds *(Les fonds de fonds alternatifs* ; Art. 422-250 AMF Règlement general; Liechtenstein: Ireland: Central Bank of Ireland, AIF Rulebook, January 2017, Chapter 2, Section 3: Prospectus Requirements; Art. 105 Liechtenstein AIFM Law; Luxembourg: Art. 150 OCP Law (UCITS-like Prospectus for 'part II-funds'); Netherlands: Art. 4:371 Wft; § 134 InvFG (Special Funds are exempted, in particular, 'other funds' for which only a KIID has to be provided). See also T. Emde, *The AIFMD's Transposition in Germany (*D.A. Zetzsche ed, Kluwer 2015); J. Nicolussi, *The AIFMD's Transposition in Austria* (D.A. Zetzsche ed, Kluwer 2015); T. Partsch & E. Forget, *The Luxembourg Implementation of the AIFMD* (D.A. Zetzsche ed, Kluwer 2015); C. Kremer, M. Eisenhuth, G. Dusemon & C. Martougi, *Luxembourg* (D. Busch ed, Oxford 2014); S.N. Hooghiemstra, *The AIFMD's Transposition in the Netherlands* (D.A. Zetzsche ed, Kluwer 2015).
[781] Art. 22 AIFMD.
[782] Art. 23(4) and (5) AIFMD.
[783] Art. 22(3) sub-paragraph 2 AIFMD.
[784] Art. 22(1) AIFMD.
[785] Art. 22(1) AIFMD.
[786] Art. 22(1) sub-paragraph 2 AIFMD.
[787] ESMA/2011/379, Ch. VIII.I; See Art. 107 AIFMD Commission Regulation.
[788] Art. 22(2)(a) AIFMD; Art.104(1) AIFMD Commission Regulation.
[789] Art. 22(2)(b) AIFMD; Art. 104(2) AIFMD Commission Regulation.
[790] Art. 22(2)(c) AIFMD; Art. 105 AIFMD Commission Regulation.
[791] Art. 22(2)(d) AIFMD; Art. 106 AIFMD Commission Regulation.
[792] Art. 22(2)(e) and (f) AIFMD; Art. 107 AIFMD Commission Regulation.

The content of the annual report is not completely harmonized as the accounting information given may either be prepared in accordance with the accounting standards of the home Member State or third-country where the AIF is established.[793] The content and accessibility of the annual report are also based upon the high-level principles approach and may vary.[794]

Article 23(4) AIFMD requires, in addition to the initial investor information and the annual report, certain information to be published periodically to investors. The information required to be disclosed concerns the liquidity, risk measures and leverage employed by the AIF[795]. The AIFM shall disclosure the percentage of the AIF's assets which are illiquid[796] and any new arrangements made for managing the liquidity of the AIF[797] , as well as, the risk profile of individual AIFs and the risk management systems employed by the AIFM[798]. AIFMs managing or marketing AIFs that employ leverage, in addition, have to disclose on a regular basis the changes to the maximum level of leverage employed, the reuse of collateral or any guarantees under leveraging arrangements[799] and the total amount of leverage employed by individual AIFs[800].

The AIFMD does not mandate any periodic disclosure to be published by AIFMs. AIFMs under the AIFMD are required to be established as a legal person[801]. National accounting standards, as well as, the national implementation of the TPD and European company law directives may, however, be applicable.[802]

AIFMs managing AIFs that acquire control of non-listed companies and issuers have to comply with a number of extra disclosure and reporting requirements.[803]
Inspired by the TPD, AIFMs managing an AIF that acquires, disposes of or holds shares of a non-listed company have to notify the competent authorities of the home Member State of the proportion of voting rights of the non-listed company held by the AIF if proportions reaches, exceeds or falls certain thresholds.[804]

The AIFM shall notify upon acquiring control over a non-listed company[805] provide the non-listed company, the shareholders of the non-listed company that are known to the AIFM and the competent authorities of the home Member State of the AIFM with additional information.[806] The additional information shall concern the resulting situation in terms of voting rights, the conditions under which control was acquired and the date on which control

---

[793] Art. 22(3) AIFMD; D.A. Zetzsche & D. Eckner, *Investor Information and Reporting* 405-407 (D.A. Zetzsche ed, Kluwer 2015).
[794] D.A. Zetzsche & D. Eckner, *Investor Information and Reporting* 404-407 (D.A. Zetzsche ed, Kluwer 2015).
[795] Art. 23(4) and (5) AIFMD.
[796] Art. 23(4)(a) AIFMD.
[797] Art. 23(4)(b) AIFMD.
[798] Art. 23(4)(c) AIFMD.
[799] Art. 23(5)(a) AIFMD.
[800] Art. 23(5)(b) AIFMD.
[801] Arts 2(2)(c), 4(1)(b) AIFMD; D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 211 (D.A. Zetzsche ed, Kluwer 2015).
[802] D.A. Zetzsche & D. Eckner, *Investor Information and Reporting* 407-408 (D.A. Zetzsche ed, Kluwer 2015).
[803] The substantive scope of these requirements is determined by Art. 26 AIFMD. Art. 26 AIFMD further defines what is the 'acquisition of control' and what companies are considered to be 'non-listed companies'; See also: M. Viciano-Gofferje, *Neue Transparenzanforderungen für Private Equity Fonds nach dem Kapitalanlagegesetzbuch*, BB 2506 (2013).
[804] Art. 27(1) AIFMD.
[805] Control is defined under Art.26(5) AIFMD as acquiring more than 50% of the voting rights of the companies; See W. Weitnauer, *Das Übernahmesonderrecht des KAGB und seine Auswirkungen auf die Private-Equity-Branche*, AG 672 (2013).
[806] Art. 27(2) AIFMD.

was acquired.[807] The AIFM shall request the board of directors of the acquired company to inform the employees' representatives or the employees themselves of the acquisition of control.[808]

Upon the acquisition of control, the AIFM shall not only notify the constituencies mentioned above but shall also disclose additional information to them.[809]. The AIFM shall make available the identity of the AIFM(s) managing the AIFs that acquired control, a policy of preventing and managing conflicts of interests and the policy of external and internal communication relating to the company as regards the employees.[810]

Disclose intentions regarding the future business of the non-listed and inform the board of directors, the employee representatives or the employees of the repercussions on and conditions of employment[811] and provide them with information on the financing of the acquisition.[812]

Specific provisions apply to the annual report of AIFs that exercise control of non-listed companies.[813] The annual report of either the non-listed company or AIF shall include a fair review of the development of the company's business[814]. This requirement applies, in addition to, the normal requirements applying for the AIF annual report under Article 22 AIFMD.

The investor information is complemented by reporting obligations to competent authorities. AIFMs are under the AIFMD required to report regulatory to Competent Authorities of their home Member State.[815] They shall provide information on the main instruments in which the AIFs it manages is trading, on markets of which it is a member or where it actively trades, and on the principle exposures and concentrations of each of the AIFs it manages.[816]

Reporting obligations under the AIFMD relate to the AIFM and the AIFs it manages.[817] AIFMs have to report information on the liquidity, risk measures, leverage employed, main categories of assets and the results of the stress tests[818] of the AIFs they manage.[819]
Apart from this, AIFMs shall, on request, provide an annual report of each AIFs it manages and on a quarterly basis a detailed list of all AIFs which the AIFM manages.[820]

Specific reporting applies for AIFMs managing AIFs that employ leverage on a substantial basis.[821] Reporting obligations concern the overall level of leverage and a break-down between leverage arising from the borrowing of cash, financial derivatives and the reuse of AIF assets under arrangements.[822] Competent authorities of the AIFM home Member State

---

[807] Art. 27(3) AIFMD.
[808] Art. 27(4) AIFMD; D.A. Zetzsche, D., *Anteils- und Kontrollerwerb an Zielgesellschaften durch Verwalter alternativer Investmentfonds*, NZG 1164 (2012).
[809] Art. 28(1) AIFMD; J.B. Huizink, *Informatieverplichtingen voor beheerders van beleggingsinstellingen bij een controlerend belang* 44-58 (N.B. Spoor, M. Tausk, J.B. Huizink & R.P. Raas, Kluwer 2012).
[810] Art. 28(2) AIFMD.
[811] Art. 28 (3), (4) AIFMD.
[812] Art. 28(5) AIFMD. Examples, such as the important events that have occurred since the end of the financial year, are mentioned in Art.29(2)(a)-(c) AIFMD.
[813] Art. 29 AIFMD.
[814] Art. 29(2) AIFMD.
[815] Art. 24(1) AIFMD.
[816] Art. 24(1) sub-paragraph 2 AIFMD.
[817] D.A. Zetzsche & D. Eckner, *Investor Information and Reporting* 408 (D.A. Zetzsche ed, Kluwer 2015); See Art. 24(2) and (3) AIFMD.
[818] Art. 24(2)(e) AIFMD; See also Arts 15(3)(b) and 16(1) AIFMD.
[819] Art. 24(2) AIFMD.
[820] Art. 24(3) AIFMD.
[821] Art. 24(4) AIFMD.
[822] Art. 24(4) AIFMD; Art. 110(4) AIFMD (Commission) Regulation.

may require additional information for the purpose of effectively monitoring systematic risks.[823]

5.1.2.2. Ancillary European Disclosure/Reporting Requirements

There are ancillary European disclosure and reporting requirements laid down in the PR, TPD and the PRIIPR that apply to AIFs.

The PR does not apply to 'units issued by collective investment undertakings other than the closed-end type'.[824] Under Article 2(p) PR 'collective investment undertaking other than the closed-end type' are unit trusts and investment companies[825] that have the following characteristics:

- they raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors;[826]
- their units are, at the holder's request, repurchased or redeemed, directly or indirectly, out of their assets.[827]

The first indent of the recently introduced 'collective investment undertaking' definition diverges from the definition that was in place under Art. 2(1)(o) Prospectus Directive.[828] The Prospectus Directive referred to unit trusts and investment companies that have as their objective to collectively invest in capital provided by the 'public' and that operate on the principle of risk-spreading. Assumed is that the term 'public' was being derived from UCITSD V. At the time of the adoption of the Prospectus Directive, the AIFMD was not yet in place. The PR took the AIF and UCITS definitions into account and amended this by referring to the 'raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors' instead.[829] The first indent under the Prospectus Directive, thus, referred to liquid UCITS-alike retail AIFs and UCITS, whereas, theoretically, the first indent under the PR refers to AIFs and UCITS in general. Although the first indent under both the Prospectus Directive and the newly adopted PR do not use the same terminology, both only apply to offers that are not 'solely made to qualifying investors'. Under the first indent of both the Prospectus Directive and PR definition, 'professional AIFs' are not 'solely marketing to qualified investors' and, thus, by any means excluded from both the scope of the Prospectus Directive and the PR.

In addition, 'open-end AIFs' and UCITS are excluded from the scope of the Prospectus Directive and PR.[830] Those investment companies and unit trusts are excluded under the scope of the Prospectus Directive and PR that repurchase or redeem units/shares at the request of the investors.[831] Important to note is that both the PR and Prospectus Directive are not only limited to closed-end AIFs, but to AIFs in general. UCITSD V has its own lex specialis prospectus regime.[832] Although open-end AIFs are excluded from the PR scope, Member

---

[823] Art. 24(5) AIFMD.
[824] Art. 1(2)(a) PR.
[825] Remarkable is that Art. 2(p) PR does not refer to (limited) (liability) partnerships and common contractual funds.
[826] Art. 2(p)(i) PR.
[827] Art. 2(p)(ii) PR.
[828] See for the Prospectus Directive: C.M., Grundmann-van de Krol, *New EC Prospectus Directive and the Lamfalussy Process*, 1 European Company Law 32-35 (2004); See also D. Fischer-Appelt, *Prospectus Directive amendments – discussion of key changes*, Law and Financial Markets Review 490 (2010).
[829] Art. 2(p)(i) PR.
[830] See C.M. Grundmann-van de Krol, *Europees kader: Prospectusrichtlijn en de relatie met andere Europese richtlijnen* 73-130 (B. Bierens, C.M. Grundmann-van de Krol, D.J.K. Lemstra & T.M. Stevens, Kluwer 2011).
[831] Art. 2(p)(ii) PR; See also Art. 2(1)(o)(ii) Prospectus Directive.
[832] Art. 68(1) UCITSD V.

States have the discretion under Article 43 AIFMD to extend the PR or UCITSD prospectus requirements to open-end AIFs. Nevertheless, Article 23(3) AIFMD only requires AIFMs to publish a prospectus in accordance with the PR for closed-end AIFs. The inconsistency between the PR and the AIFMD has, thus, led to differences in investor protection.

The prospectus obligation under the PR, however, only applies to closed-end AIFs that issue 'securities'.[833] In this regard, there is a conflict between the disclosure requirements in the PR and the AIFMD. The AIFMD makes reference to the 'professional client' definition under MiFID II[834], whereas the definition of 'securities' under the PR implementation laws vary but are at least standardized, fungible and transferable.[835] The AIF units/shares, thus, have to qualify as 'securities'.

In order to fall within the scope of the PR, closed-end AIFs are required to market their units/shares to investors that do not qualify as 'qualified investors'[836] under the PR. The definition of 'qualified investors' under the PR diverges from the profession investor definition under the AIFMD.[837] Both the 'professional investor' and 'qualified investor' definition are based upon the professional client definition under MiFID II.[838] The difference, however, is that the AIFMD applies a substance over form assessment of the professional client definition under MiFID II. The status of the investor at the moment of the purchase determines whether an investor is a professional or a retail investor. On the contrary, the 'qualified investor' definition under the PR refers to the definitions of eligible counterparties, 'per sé' and 'eligible' professional clients under MiFID II. The PR is, thus, fully aligned with the investor qualification under MiFID II.[839]

Those closed-end AIFs that fall within the scope of the PR have to publish a prospectus that complies with the material requirements of a prospectus under the Prospectus Regulation. The PR demands similar information as the IIID under the AIFMD. The AIFMD, however, requires information on valuation and systematic risk, whereas under the PR this is not required. There are, thus, inconsistencies in the investor disclosure required under the AIFMD and the PR that will need to be resolved in the future. Open-end AIFs will under such an initiative be required to provide at least the information as set out under the PR. This could be in the form of an amendment of the PR scope that would also include open-end AIFs or a requirement for Member States to apply the UCITSD V prospectus to open-end AIFs.[840]

AIFMs that qualify as an issuer[841] of securities in closed-end AIFs[842] or manage AIFs that exercise control over issuers of securities listed on regulated markets fall under the scope of the TPD[843].[844]

AIFMs qualifying as an issuer are obliged to comply with periodic information requirements[845] under Articles 4 et seq. TPD that include interim management statements,

[833] Arts 2(e) and 3(1) PR.
[834] Art. 4(1)(ag) AIFMD.
[835] Cf. Art. 15 Liechtenstein AIFM Law.
[836] Arts 1(4)(a) and Art. 2(a) PR.
[837] Art. 4(1)(ag) AIFMD.
[838] *Ibid.*
[839] Cf. M.T.G. Schoonewille, *Professionele marktpartijen en gekwalificeerde beleggers - een slag apart*, 4 V&O 72-76 (2007).
[840] D.A. Zetzsche & D. Eckner, *Investor Information and Reporting* 420, 421 (D.A. Zetzsche ed, Kluwer 2015).
[841] Art. 2(1)(d) TPD.
[842] Arts 1(2) and 2(1)(g) TPD.
[843] Art. 1(1) TPD, Art. 9(1), Art. 10(1) TPD.
[844] C.M. Grundmann-van de Krol, *Regulering beleggingsinstellingenen icbe's in de Wft* 355 et seq. (Boom Juridische uitgevers 2013);
[845] Art. 6 TPD.

annual[846] and half-yearly financial reports[847]. Moreover, issuers are required to publish ongoing information regarding major holdings.[848] In particular, issuers that are admitted to trading on a regulated market are required to make public, without delay, any change in the rights attaching to the various classes of shares issued by the issuer itself and giving access to the shares of that issuer.[849] Finally, AIFM as issuers, as part of their ongoing information requirements, have to provide information to their shareholders related to, amongst others, the rights of their shares.[850]

AIFMs that manage AIFs that exercise control over issuers of securities listed on regulated markets are required, as ongoing information requirement, under Articles 9 et seq. TPD to notify the issuers that they are invested in of the acquisition or disposal of major holdings/voting rights.[851]

The duties of AIFMs as issuer and their managed AIFs as controlling shareholders leads to discrepancies between the obligations for closed-end and open-end AIFs. Open-end AIFs do not have to comply with the periodic information requirements, such as laid down in Articles 4 et seq. and 9 et seq. TPD.[852] In addition, the AIFMD, apart from invest disclosure on how to finance acquisitions[853], only obliges open-AIFs to comply with reporting requirements to Competent Authorities related to the acquisition of major holdings.[854] The interplay between the AIFMD and the TPD, thus, leads to discrepancies in the investor disclosure requirements applying to open- and closed-end AIFs.[855]

The PRIIPR requires for all PRIIPs[856] a key information document (KID) to be draw up by PRIIP manufacturers[857] to retail investors[858].[859] Fund managers, generally, manufacture PRIIPs and are, thus, deemed to be PRIIP manufacturers.[860] PRIIPs consist of PRIPs[861] and Insurance-based investment products[862]. The definition of PRIPs (Packaged retail investment products) includes all investments, including SPVs[863], that bear an investment risk are legal form neutral and are not directly purchased.[864] The definition is very broad and includes, amongst others, UCITS and AIFs.

---

[846] Art. 4 TPD.
[847] Art. 5 TPD.
[848] See Arts 9 et seq. TPD.
[849] Art. 16 TPD.
[850] Art. 17(2) TPD.
[851] Arts 9 and 10 TPD.
[852] D.A. Zetzsche & D. Eckner, *Investor Information and Reporting* 421 (D.A. Zetzsche ed, Kluwer 2015).
[853] Art. 28(5) AIFMD.
[854] Following Art. 28(1)(c) AIFMD, the acquired company and its employees also need to be informed, but not the investors of the acquiring AIF.
[855] Cf. D.A. Zetzsche & D. Eckner, *Investor Information and Reporting* 421 (D.A. Zetzsche ed, Kluwer 2015).
[856] Art. 4(3) PRIIPR.
[857] Art. 4(4) PRIIPR.
[858] The retail investor definition includes not only the retail client defined under Art. 4(1) MiFID II, but also a customer under the IMD, now replaced by the IDD, that does not qualify as professional client under MiFID II.
[859] Art. 1 PRIIPR; R.J. Watson & T.W. Beenen, *De PRIIPs-Verordening: essentiële informatie over verpakte beleggingsproducten,* 10 TvFR 383 (2016); See also: European Commission, *Communication from the Commission on Package Retail Investment Products*, http://ec.europa.eu/internal_market/finservices-retail/docs/investment_products/29042009_impact_assessment_en.pdf (accessed 14 January 2017).
[860] See Recital 12 PRIIPR.
[861] Art. 4(1) PRIIPR.
[862] Art. 4(2) PRIIPR.
[863] See for an overview of the SPV definition under CRD IV and the AIFMD and the differences between them: D.A. Zetzsche & T.F. Marte, *Kreditfonds zwischen Anleger- und Systemschutz*, RdF 4 (2015).
[864] Art. 4(1) PRIIPR.

AIFMs and UCITS ManCo qualifying as PRIIP manufacturers and persons advising on, or selling[865], PRIIPs have to provide retail investors with the key information document prior to their investment decision.[866] The KID can, thus, be regarded as pre-contractual information that is a stand-alone and short document of only three A-4 pages[867] that is easy to read and of which its content has been completely harmonized.[868]
The PRIIPR is modelled after the UCITS KIID Regulation and requires the similar type of information.[869] During a transition period of 5 years after entry force, UCITS will continue to use the KIID under the UCITSD. After that transitional period, the KIID provisions UCITSD V and the KIIDR[870] will be repealed. The pre-contractual short-form disclosure provided to retail investors for both UCITS and AIFs after this period in time will, thus, be aligned.[871]

5.1.2.3. Private Placement

Until a delegated act will be adopted by the European Commission, Member States are allowed to maintain their own private placement regimes on the basis of which AIF are allowed to be marketed within their domicile. Private placement regimes, however, should allow non-EEA AIFs to be marketed on the basis of the PR passport. Regimes must also at all times comply with the minimum requirements as laid down in Article 36 and 42 AIFMD and the AIFMD investor information provisions.[872]

Small EEA-AIFMs that fall outside of the scope of the AIFMD marketing passport.[873] A marketing passport for them is available under the EuVECAR/EuSEFAR or the prospectus passport. The EuVECAR/EuSEFAR marketing passport is, however, subject to strict product restrictions. The PR is also only available for (retail) closed-end AIFs.[874] Small AIFMs may, thus, either opt-in the AIFMD and make use of the marketing passports available under the AIFMD and/or the ELTIFR or make use of the private placement regimes of the individual Member States. Small non-EEA AIFMs do not fall under the scope of the Article 3 AIFMD registration. By absence of national regulation, non-EEA AIFMs may market AIFs on the basis of a national private placement regime without complying with the AIFMD.[875]

Full AIFMs may market AIFs on the basis of Article 36 and Art.42 AIFMD. These provisions include minimum requirements that national private placement regimes need to comply with. EEA-AIFMs may market non-EEA AIFs on the basis of Article 36 provided that (§) the AIFM complies with the full AIFMD with the exception of the depositary requirement (depositary-light option), (2) appropriate cooperation arrangements are concluded and (3) the non-EEA AIF is established in a country that is not listed as Non-Cooperative

---

[865] Person selling a PRIIP means 'a person offering or concluding a PRIIP contract with a retail investor'. See Art. 4(5) PRIIPR.
[866] Art. 13(1) PRIIPR.
[867] Art. 6(4) PRIIP Regulation.
[868] Art. 8(3) PRIIPR.
[869] D.A. Zetzsche & D. Eckner, *Investor Information and Reporting* 422-423 (D.A. Zetzsche ed, Kluwer 2015).
[870] See L. Burn, *KISS, But Tell All: Short-Form Disclosure for Retail Investors*, Capital Markets Law Journal 5 (2010).
[871] See G. Schaeken Willemaers, *Client Protection on European Financial Markets – From Inform Your Client to Know Your Product and Beyond: An Assessment of the PRIIPs Regulation, MiFID II/MiFIR and IMD 2*, 4, https://ssrn.com/abstract=2494842 (accessed 26 January 2017).
[872] Art. 22, 23 AIFMD; See D.A. Zetzsche, D.A., *Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).
[873] European Securities and Markets Authority, *Questions and Answers - Application of the EuSEF and EuVECA Regulations*, 31 May 2016, ESMA/2016/774.
[874] See Art. 2(p) PR.
[875] The UK applies the Art.3 AIFMD registration requirement analogous to small non-EEA AIFMs. See J.R. Siena & D. Eckner, *The AIFMD's Transposition in the United Kingdom* (D.A. Zetzsche ed, Kluwer 2015); D. Rouch, *United Kingdom* (D. Busch ed, Oxford 2014).

Country and Territory by the FATF. Non-EEA AIFMs may market AIFs within the EEA provided that the latter two requirements are being fulfilled and the AIFM complies with the minimum investor information requirements[876] and obligations related to AIFs which acquire control of non-listed companies and issuers.[877] Member States are in both occasions allowed to impose stricter rules on the marketing of the AIFs within their domicile.[878] Member States may require AIFMs to comply with, for example, national product regulations. Austria, Germany and France, for instance, require a depositary to be appointed for retail AIFs.[879]

Member States vary in their private placement approaches. Ireland has implemented Art 36 and Article 42 without implementing stricter supplemental rules.[880] The Central Bank of Ireland is granted the power to impose additional conditions or requirements where it considers it necessary for the proper and orderly regulation and supervision of alternative investment fund managers. No such conditions or restrictions have been made so far. The Netherlands allows TC-AIFs managed by Dutch/EEA-AIFMs to be marketed on a private placement basis to professional investors in their territory.[881] The depositary-lite option has, however not been exercised.[882] For the purpose of its Article 42 AIFMD implementation, the Netherlands differentiates between TC-AIFMs that are marketing AIFs from designated states[883] and non-designated states.[884] TC-AIFMs managing AIFs from either designated[885] or non-designated states do not have to obtain an authorization to market AIFs to qualified investors in the Netherlands provided that they comply with the requirements laid down in Article 42 AIFMD.[886] TC-AIFMs marketing AIFs from non-designated states do, however, need to obtain an AIFM authorization in the Netherlands to market AIFs to retail investors.

In line with the PR, Liechtenstein allows a private placement when participations are either offered to less than 150 investors or are of a nominal value per participation right or of a consideration per investor of at least EUR 100,000 (retail investors).[887]

In Luxembourg there is no specific private placement regime. However, it can be interpreted as the opposite of an public offer and by referring to the exemption from the requirement to publish a prospectus under the provisions of the prospectus law. Under Part II of the UCI Law, offers that are made to a small circle of persons are not considered to be public offers or well-informed investors under the Luxembourg SIF and SICAR Law.[888]

Other Member States have implemented strict private placement regimes. Germany does not offer a private placement regime.[889] Both retail and professional AIFs have to comply

---

[876] Art. 22, 23 AIFMD

[877] Art. 26 AIFMD.

[878] Art. 36(2), 42(2) AIFMD; Art.43 AIFMD.

[879] See Art. 36(1)(a) AIFMD.

[880] Art. 37, 43 Irish AIFM Regulations.

[881] The same holds true for EEA-AIFMs marketing EEA-feeder AIFs where the master AIF managed by an EEA-AIFM is an TC-AIF. See Art.36 AIFMD; J. Kerkvliet, *Toegang voor beheerders van beleggingsinstellingen tot de Nederlandse markt, na implementatie van de AIFM-richtlijn*, 1 Onderneming en Financiering 31-42 *(*2012).

[882] See S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2015).

[883] Explanatory notes Dutch AIFMD Implementation Draft Bill, 19 Apr. 2012, 22, 31.

[884] See Art. 1:13b(1),(2) FSMA.

[885] Post-AIFMD, TC-AIFs established in Guernsey, Jersey and the US (only SEC-registered funds) are considered to be from designated states. EEA-AIFs from France, Ireland, Luxembourg, Malta and the UK cannot longer do so.

[886] C.M. Grundmann-van de Krol, *Regulering beleggingsinstellingenen icbe's in de Wft* 166-170 (Boom Juridische uitgevers 2013).

[887] Art. 2:66a FSMA.

[888] Art. 150 OPC Law.

[889] § 317, 322 KAGB.

with German product regulation. AIFs to be marketed into the UK[890] and Austria[891] also have to comply with the respective national product regulations.

5.1.3. The AIFMD/UCITSD V 'product regulations'

The AIFMD 'product regulations' either provide for separate or additional disclosure and reporting requirements.

5.1.3.1. EuVECA/EuSEF

Separate disclosure requirements are contained in the EuSEFR and the EuVECAR. The independent approach can be explained by the fact that these regulations only apply to small AIFMs. In general, it is up to Member States whether or not small AIFMs fall outside of the scope of their national AIFMD implementation and, thus, whether they fall under the reporting and disclosure requirements required by the AIFMD. The EUSEFR/EuVECAR, however, contains a separate disclosure regime specifically aimed at HWNIs and professional investors allowed to invest in these types of AIFs. This separate disclosure regime contains rules related to an annual (financial) report and pre-contractual information

The EuVECAR/EuSEFR lay down uniform rules on disclosure requirements with regard to their investment policy and targets.[892] Annual reports have to be send to the competent authority that contains information about the portfolio composition and activities during the year, profits earned by the fund at the end of its life, the profits distributed during its life and audited financial accounts.[893] The annual report needs to be draw upon in line with existing reporting standards and the terms contractually agreed upon between the small AIFM and its investors.[894] The report is provided to investors on request and any further disclosure may be contractually agreed on.[895] EuVECARs and EuSEFS that are, based upon the TPD[896] required to publish an annual financial report may provide this information either separately or as an additional part of the annual financial report.[897]

Small AIFMs are, in any case, obliged to provide investors with pre-contractual information. The pre-contractual information shall set out, amongst others, information about the investment strategy and objectives of EuVECA/EuSEF[898], the costs and associated charges[899] and the risk/reward profile[900].[901] The pre-contractual information required to be published under the PR or in accordance with national law[902] may choose to provide the pre-contractual information separately or as a part of the prospectus.[903]

5.1.3.2. MMF

---

[890] J.R. Siena & D. Eckner, *The AIFMD's Transposition in the United Kingdom* (D.A. Zetzsche ed, Kluwer 2015); D. Rouch, *United Kingdom* (D. Busch ed, Oxford 2014).
[891]Austria has, however, liberal product regulations under § 1(3) Austrian Real Estate Fund Act and § 163 Austrian Investment Fund Act; J. Nicolussi, *The AIFMD's Transposition in Austria* (D.A. Zetzsche ed, Kluwer 2015).
[892] Recital 31 EuVECAR; Recital 35 EuSEFR.
[893] Art. 12(1) EuVECAR; Art. 13(1) EuSEFR.
[894] Art. 12(1) sub-paragraph 2 EuVECAR; Art. 13(1) sub-paragraph 2 EuSEFR.
[895] *Ibid.*
[896] Art. 4 TPD; See A.N. Krol & C.W.M. Lieverse, *Implementatie van de transparantierichtlijn*, 12 TvFR 401-414 (2008).
[897] Art. 12(3) sub-paragraph 2 EuVECAR; Art. 13(3)(1) sub-paragraph 2 EuSEFR.
[898] Art. 13(1)(c) EuVECAR; Art. 14(1)(c) EuSEFR.
[899] Art. 13(1)(g) EuVECAR; Art. 14(1)(g) EuSEFR.
[900] Art. 13(1)(d) EuVECAR; Art. 14(1)(d) EuSEFR.
[901] Recital 31 EuVECAR; Recital 35 EuSEFR.
[902] See Art. 2(p) PR.
[903] H.W. Hofmeester & S. Swaak, *De prospectusplicht voor beheerders van beleggingsinstellingen*, 10 TvFR 328-333 (2013).

The MMFR sets out additional investor disclosure and reporting requirements on top of the requirements laid down under the AIFMD and UCITSD V.

MMFs shall indicate clearly in any external or internal document, report statement, advertisement letter or any other written evidence issued by its AIFM/UCITS ManCo to investors which type of MMF it is and whether it is a short-term or a standard MMF.[904] In addition to the disclosure required under the AIFMD or UCITSD V, additional disclosure, required to be made on a weekly basis, includes, amongst others, the maturity breakdown of the portfolio, the credit profile and details of the ten largest holdings in the MMF.[905]

Any document used for marketing purposes has to indicate, amongst others, that the MMF is not a guaranteed investment[906], no external support is in place that guarantees the liquidity of the MMF[907] and the risk of loss is to be borne by the investor[908]. No communication may suggest that the investment of the MMF is guaranteed[909] and the investors shall be informed of the valuation methods used by the MMF.[910] Finally, CNAV and LVNAV MMFs shall indicate clearly to (potential) investors the use of amortized cost method and/or of round.[911]

To ensure that Competent Authorities are able to detect, monitor and respond to risks in the MMF market, MMFs, on top of the UCITSD V and MMF reporting requirements, are required to report detailed information to the Competent Authorities on a quarterly basis, including information on portfolio composition, valuation, results of stress tests, portfolio indicators, risk management measures and investor information.[912]

5.1.3.3. ELTIF

ELTIFs marketing regulation consists of transparency requirements that apply on top of the AIFMD and certain additional requirements for ELTIFs targeting retail investors.

ELTIFs are required to publish a prospectus, annual report and, if marketed to retail investors, a KID.ELTIFs should publish a prospectus complying with the PR.[913] In addition, the prospectus must contain the information as specified for the IIID under Article 21 AIFMD. The prospectus has to contain, for example, the investment objectives and strategy of the ELTIF having a long-term nature and the categories of assets in which the ELTIF is allowed to invest.[914] The prospectus must also prominently inform the investors of the level of the different costs borne by investors.[915] ELTIFs may not be marketed without the prior publication of a KID in accordance with the PRIIPR.[916]The prospectus, KID, and other marketing documents must, in particular, inform investors about various aspects of its illiquid nature.[917] In particular, the prospectus shall inform investors about the long-term nature of its investments, the end of the life of the ELTIF, as well as, the investors' right of redemption.[918]

---

[904] Recital 50, Art. 36(1) MMFR.
[905] Recital 50, Art. 36(1) and (2) MMFR.
[906] Art. 36(3)(a) MMFR.
[907] Art. 36(3)(b) MMFR.
[908] Art. 36(3)(c) MMFR.
[909] Art. 36(5) MMFR.
[910] Art. 36(5) sub-para. 1 MMFR.
[911] Art. 36(5) sub-para. 2 MMFR.
[912] Recital 51, Art. 37(2) MMFR.
[913] Recital 41 ELTIFR; Art. 23(3)(b) ELTIFR.
[914] Art. 23(3)(a), (d)-(f) ELTIFR.
[915] Art. 25 ELTIFR.
[916] See for the PRIIPR: *supra* 5.1.2.2.
[917] Art. 23(4) ELTIFR.
[918] Art. 23(4)(a),(b),(d) ELTIFR.

The prospectus and the annual report[919] must be provided to investors and free of charge.[920] Finally, the AIFM managing the ELTIF shall provide additional information relating to the risk management methods chosen upon the request of a retail investor.

ELTIFs that target not only professional but also retail investors have to comply certain additional requirement on top of the marketing requirements laid down in the AIFMD to ensure an appropriate degree of retail investor protection.[921] Extra requirements relate to the facilities available to investors, MiFID-style requirements[922] applying to the AIFMs and its distributors and a various additional retail investor protections.

ELTIF AIFMs should make facilities available for making subscriptions, making payments to unit- or shareholders, repurchasing or redemptions of ELTIF units, as well as, making available the information which the ELTIF (AIFM) is required to provide.[923] By imposing this requirement, the ELTIFR places ELTIFs marketed to retail investors on a level playing field with UCITS.[924]

ELTIF AIFMs are not allowed to directly offer or place units or shares of the ELTIF to retail investors unless the AIFM is licensed for the additional MiFID services investment advice and portfolio management under the AIFMD.[925] Apart from this, the ELTIFR product governance, distribution chain and suitability requirements apply that are modelled after MiFID II.

The ELTIFR also requires AIFMs marketing retail ELTIFs to comply with product governance requirements that are similar to the MiFID II.[926] For that purpose, AIFMs shall establish and apply a specific internal process for the assessment of that ELTIF before it is marketed to retail investors.[927] In its assessment whether the ELTIF is suitable for marketing to retail investors the AIFM has to take into account, at least, the life of the ELTIF and its intended investment strategy.[928]

The ELTIFR also imposes MiFID II-style requirements to the AIFM and its distributors concerning product governance, investment advice and a written warning.

The ELTIFR imposes not only product governance requirements to ELTIF AIFMs but also to its distributors. For this purpose, all information gathered during its internal assessment process shall be communicated to any distributor.[929] This is in line with the product governance requirement under the MiFID II applying to distributors.[930] The term distributor is not further defined in the ELTIFR. The literature assumes that distributors shall mean investment advisers and portfolio managers within the scope of MiFID II.[931] The ELTIFR only allows AIFMs that are additionally authorized for these services to directly distribute ELTIFs to retail investors. Consequently, investment firms only distributing financial

---

[919] Art. 23(5) ELTIFR contains extra information required to embedded in the annual report of the ELTIF on top of those led down in Art.22 AIFMD.
[920] Art. 24(4) ELTIFR.
[921] Recital 43 ELTIFR.
[922] See D.A. Zetzsche & C.D. Preiner, *ELTIFR versus AIFMD* 161-163 (D.A. Zetzsche ed, Kluwer 2015); T. Bühler, *ELTIF – Eine neue Säule der Finanzierung der Europäischen Realwirtschaft*, 3 Recht der Finanzinstrumente 198 (2015); D.A. Zetzsche, *Verordnung über europäische langfristige Investmentfonds (ELTIF_VO) – Langfristigkeit im Sinne der Kleineranleger?*, 6 ZBB 362 (2015).
[923] Art. 26 ELTIFR.
[924] See Art. 92 UCITSD.
[925] See Art. 30(2) ELTIFR; Art. 6(4)(a) and (b)(i) AIFMD.
[926] See Art. 16(3) MiFID II.
[927] Art. 27(1) ELTIFR.
[928] Art. 27(2) ELTIFR.
[929] Art. 27(3) ELTIFR.
[930] Distributors are subjected to MiFID II. See Recital 43 ELTIFR.
[931] See D.A. Zetzsche & C.D. Preiner, *ELTIFR versus AIFMD* 162 (D.A. Zetzsche ed, Kluwer 2015).

instruments are not qualifying as 'distributors' as the distribution of ELTIF (AIF) units/shares is not within the scope of MiFID II.[932] Investment firms, thus, have to comply with the requirements relating to the direct offering or placement of the ELTIFR.
Execution only by AIFMS or distributors to retail investors is only allowed when appropriate investment advice is being provided by either the AIFM or the distributor.[933]
Finally, ELTIFs that exceed 10 years have to issue a clear written statement that the ELTIF is not suitable for retail investors that are unable to sustain such a long-term and illiquid commitment.[934]

The product governance and investment advice requirements are complemented by a suitability test and an investment cap.
A MiFID-style suitability test is required when ELTIFs are directly offered or placed to a retail investor. Article 28 (1) ELTIFR requires the AIFM to obtain information regarding the financial knowledge and experience related to ELTIFs, the investor's financial situation and the investor's investment objectives.[935]

The ELTIFR requires AIFMs to carry out a suitability assessment of retail investors that have a financial instrument portfolio[936] of less than less than EUR 500 000.[937] After having performed a suitability test and having provided appropriate investment advice, the AIFM shall ensure that such investors do not invest an aggregate amount exceeding 10% of the investor's portfolio in ELTIFRs and that the initial amount invested in one or more ELTIFs is not less than EUR 10 000.[938] The ELTIFR, thus, requires diversification by limiting the illiquid investment in ELTIFs by retail investors compared to the liquid financial instrument portfolio. The initial investment and the investment cap ensure that no retail investor is allowed to invest in ELTIFs that has a financial instrument portfolio of less than EUR 100 000. Only 'ELTIF HWNIs'[939] and professionals investors are allowed to invest in ELTIFs, whereas 'true retail investors' are limited to other types of 'retail AIFs'[940] and UCITS.

The ELTIFR, additionally, requires three retail investor protection provisions. The ELTIF's constitutional documents must provide that investors benefit from equal treatment and no preferential treatment shall be granted to any individual or groups of investors.[941] Finally, retail investors must be allowed a cooling off period during the subscription period and for at least two weeks after subscription in which they may cancel their subscription free of charge.[942]

5.1.4. Conclusion

Disclosure and reporting requirements within the AIFMD, UCITSD V and the AIFMD/UCITS product regulations complement intermediary and product regulation. Disclosure regulation ensures that investors on an ex ante and ongoing basis are enabled to make an informed investment decision, whereas reporting requirements enable Competent

---

[932] Art. 25(4) MiFID II prohibits this. See D.A. Zetzsche & C.D. Preiner, *ELTIFR versus AIFMD* 162 (D.A. Zetzsche ed, Kluwer 2015).
[933] Art. 30(1) ELTIFR.
[934] Art. 28(2) ELTIFR.
[935] See also Recital 44 ELTIFR.
[936] The financial instrument portfolio includes cash deposits and financial instruments and excludes any financial instruments that have been given as collateral; See Recital 44 ELTIFR and Art. 30(3) sub-para. 3 ELTIFR.
[937] Art. 30(3) ELTIFR.
[938] Recital 44 ELTIFR and Art. 30(1) ELTIFR.
[939] The ELTIF 'HWNI' definition is different compared to the EuVECAR and EUSEFR. See also *supra* 5.1.3.1.
[940] Art. 43 AIFMD.
[941] Art. 30(4) ELTIFR.
[942] Art. 30(6) ELTIFR.

Authorities to monitor the AIFMs/UCITS ManCos and the UCITS/AIFs that are on the market.

The reporting and, in particular, the disclosure requirements under the AIFMD, UCITSD V and the AIFMD/UCITS product regulations show inconsistencies.

The AIFMD, UCITSD V and the AIFMD/UCITSD product regulations all base their disclosure and, to lesser extent, reporting requirements upon a 'standardization' of categories of investors. The terminology and scope of the definitions of these categories of investors, however, differ throughout these directives/regulations, the PRIIPR and, the TPD and the PR. For instance, the TPD and UCITSD V refer to the 'public', whereas the AIFMD refers to 'professional' and 'retail investors'. In addition, the MiFID II 'professional client' definition diverges from the 'professional investor' definition under the AIFMD as the latter includes all investors that could be registered as professional investors under the AIFMD.[943] The divergence of the terminology used for the qualification of investors, thus, leads to inconsistent disclosure and reporting practices.

The disclosure and reporting requirements under the AIFMD, UCITSD V and the AIFMD/UCITS product regulations show inconsistencies related to closed-end and open-end AIFs, at the one, and retail AIFs at the other hand. Closed-end retail AIFs, for instance, might have the obligation to publish a prospectus under the PR, whereas it depends upon the individual Member State implementations under Article 23 AIFMD whether open-end retail AIFs have to publish a prospectus at all. Under these implementations, Member States require open-end retail AIFs to provide investors merely an IIID, a PR-like prospectus or a UCITSD V prospectus. A solution, as chosen under the ELTIFR, could be to require a UCITSD V/PR prospectus to all retail AIFs and not only closed-end retail AIFs. The PR, TPD and PRIIPR , however, lead to horizontal harmonization of the information provided to retail AIF investors.[944]

5.2. Conclusion

The AIFMD, UCITSD V and the AIFMD/UCITSD product regulations base their disclosure regulation upon a 'standardization' of categories of investors. Although UCITSD V refers to 'the public', the AIFMD refers to professional and retail investors and the EuVECAR/EuSEFR and ELTIFR define various standards of 'well-informed investors' (so-called 'HWNIs'), investor qualification determines whether (1) a certain AIF/UCITS may be offered to a certain investor and (2), if so, what kind of investor information needs to be provided to this 'class of investors'. Generally, three classes of investors are to be identified: retail investors, professional investors and 'HWNIs'. The classification of investors is based upon either financial knowledge or a solid financial background. The precise definitions and requirements the various 'classes of investors' need to meet vary throughout the various directives and regulations. Nevertheless, what they have in common is that the European regulator either requires investors to be aware of their investment or the ability to bear investment losses. The disclosure regulation throughout the various initiatives are also based upon this investor classification, whereas reporting requirements primarily depend upon the type of AIF/UCITS marketed.

Disclosure and reporting requirements within the AIFMD, UCITSD V and the AIFMD/UCITS product regulations complement intermediary and product regulation. Disclosure regulation ensures that investors on an ex ante and ongoing basis are enabled to make an informed investment decision, whereas reporting requirements enable Competent

[943] D.A. Zetzsche & D. Eckner, *Investor Information and Reporting* 425 (D.A. Zetzsche ed, Kluwer 2015).
[944] *Ibid.*

Authorities to monitor the AIFMs/UCITS ManCos and the UCITS/AIFs that are on the market. The reporting and, in particular, the disclosure requirements under the AIFMD, UCITSD V and the AIFMD/UCITS product regulations show, however, inconsistencies that stem from diverging investor qualifications. For instance, the TPD and UCITSD V refer to the 'public', whereas the AIFMD refers to 'professional' and 'retail investors'. In addition, the disclosure and reporting requirements under the AIFMD, UCITSD V and the AIFMD/UCITS product regulations show inconsistencies related to closed-end and open-end AIFs, at the one, and retail AIFs at the other hand. Closed-end retail AIFs, for instance, might have the obligation to publish a prospectus under the PR, whereas it depends upon the individual Member State implementations under Article 23 AIFMD whether open-end retail AIFs have to publish a prospectus at all. The PR, TPD and PRIIPR , however, lead to horizontal harmonization of the information provided to retail AIF investors.[945]

6. Investors as Residual Claimants

Investors under the AIFMD/UCITSD V investment triangle have the position of a residual claimant.[946]

Both the AIFMD and UCITSD V under the investment triangle establish a separation of investments and management that is a key characteristic of asset management that has two features.

First, the discretionary investment management carried out by the AIFM and the UCITS ManCo imply that investments are carried out on behalf of the investors whereas the residual interest to the earnings to the asset portfolio and the assets of the AIFM/UCITS ManCo are legally separated.[947] The segregation of operational assets to which AIFMs/UCITS ManCos are entitled and investment assets belonging to the AIF/UCITS investors is being preserved by the safekeeping task of the depositary by means of custody or recordkeeping depending upon the nature of the assets involved.[948]

Second, there is separate ownership for those asset patrimonies. The shareholders of the AIFMs/UCITS ManCos are entitled to the cash flows of these AIFMs/UCITS ManCos, whereas the asset patrimony of the individual AIFs/UCITS are, depending upon the legal structure, legally or economically owned[949] by their investors.[950] The separation of investments and management established by the segregation of assets of the depositary separates only the asset patrimonies of the AIFMs/UCITS ManCos, at the one, and the asset patrimony of the AIFs/UCITS to which the investors are collectively economically/legally entitled. Investments are, thus, carried out on behalf of the investors whereas the residual interest to the earnings to the asset portfolio and the assets of the AIFMs/UCITS ManCos itself are legally separated. The requirement of 'collective investment' under the

---

[945] D.A. Zetzsche & D. Eckner, *Investor Information and Reporting* 425 (D.A. Zetzsche ed, Kluwer 2015).
[946] E.F. Fama & M.C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327, 333 (1983); Cf. B.S. Black, *Corporate Law and Residual Claimants*, http://escholarship.org/uc/item/5746q7pj (accessed 11 May 2017).
[947] See J. Morley, *The Separation of Investments and Management*, 29 April 2013, https://corpgov.law.harvard.edu/2013/04/29/the-separation-of-investments-and-management/ (accessed 30 April 2017). After the publication of the amended working paper, John Morley refers to 'the separation of fund and management' but only attributes this to investment funds. See J. Morley, *The Separation of Funds and Managers*, 123YALE L.J. 1228 (2014).
[948] See Art. 21(8)AIFMD; Art. 22(5)UCITSD V; Annex I s. B MiFID I/II. Annex I CRD IV.; Art. 34(1), (2) IORPD II.
[949] See IOSCO 1996, 6.
[950] See *supra* 4.1.4.

AIFMD/UCITSD V implies that investors and members bear residual risk. AIF/UCITS investors are residual claimants in the sense that they bear the full investment risk and are satisfied after the right of the AIFM/UCITS ManCo and depositary to reimbursed themselves from the fund of debts that incurred to the AIF/UCITS or to the investor.AIFs/UCITS are, however, required to be established as a legal form that arranges (1) the limited liability of the investors and (2) the segregation of AIF/UCITS assets related to the asset patrimonies of the individual investors. Limited liability established by the legal forms employer ensures that investors are not personally liable for any of the debts of the AIFs/UCITS, their depositaries or UCITS ManCos/AIFMS, other than for the amount invested in the AIF/UCITS and for any unpaid amount on their units/shares in the AIF/UCITS, unless contractually agreed or consented to.[951] In addition, the legal form ensures that AIF/UCITS asset patrimony is segregated from the asset patrimonies of the individual investors. Limited liability nor the segregation of assets of this type can be established by the administrative asset segregation of the safekeeping function of the depositary. The legal form in which AIFs/UCITS is, thus, a precondition for collective investment undertakings in which multiple investors are involved.

AIFM or UCITS ManCos have the exclusive authority to perform discretionary portfolio management over the AIFs/UCITS or to delegate this.[952] Apart from this, AIFMs or UCITS ManCos are allowed to carry out portfolio managements for multiple AIFs, UCITS, IORPs and individual investors. AIFs, UCITS under the separation of ownership do not cater for any formal rights of control over AIFMs or UCITS ManCos.[953]

The separation of investments and management benefits AIF/UCITS investors by limiting their control over the discretionary asset management performed by AIFM or UCITS ManCos and the exposure to their profits and liabilities.[954]

In turn, investors under their investment contracts concluded with the AIFM/UCITS ManCo agree upon their exit right. The type of exit rights that individual investors have depends upon the type of AIF/UCITS. Typically, investors in open-end AIFs/UCITS have the right to redeem their shares/units back the fund on a periodical basis at the price of the NAV or, in case of liquidation, the liquidation proceeds.[955] Closed-end AIFs do not offer this possibility. Depending upon the specific fund conditions, investors of these types of AIFs may sell their share/units to other investors. AIFMs/UCITS ManCos are allowed to terminate, under certain regulatory conditions[956], their discretionary management contract with an AIF/UCITS.

AIF/UCITS investors are, thus, residual claimants of AIFS/UCITS in the sense that they bear the full investment risk and are satisfied after the right of the AIFMs/UCITS ManCos, depositary/custodian have reimbursed themselves from the fund of debts that incurred to the AIF/UCITS or to the investor.[957]

---

[951] H. Hansmann, R. Kraakman & R. Squire, *Law and the Rise of the Firm*, 119 HARV. L. REV. 1335, 1336 (2006).

[952] See D.A. Zetzsche & C.D. Preiner, *Scope of the AIFMD* 52, 53 (D.A. Zetzsche ed, Kluwer 2015); ESMA/2013/611, 3, 4, 6; D. Frase, *Overview* 4,5 (D. Frase ed., Sweet & Maxwell 2011).

[953] See D.A. Zetzsche, *Die Irrelevanz und Konvergenz des Organisationsstatus von Investmentfonds*, ZVglRWiss 111, 371 (2012);

[954] Morley argues that for AIFs and UCITS there could be minor complications for this model. Feeder funds, for example, take contributions indirectly from their investors. In addition, there might by an overlap between AIFs, UCITS and their managers if the latter invests itself in the funds he manages. See J. Morley, *The Separation of Funds and Managers*, 123YALE L.J. 1228 (2014).p.

[955] D.A. Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 38 D. (Mohr Siebeck 2015).

[956] *Ibid.*

[957] W. Bals, *Die ökonomische Position von Anteilinhabern offener Immobilienfonds: eine Analyse* (Peter Lang Verlag 1994).

7. Conclusion

Under European investment law, the fiduciary relationships between AIFMs/UCITS ManCos, the investors and depositaries, i.e. the 'investment triangle', is being regulated by 'intermediary', 'product' and 'disclosure/reporting' regulation. The AIFMD/UCITSD V intermediary regulation targets the authorization and organizational rules that apply to AIFMs/UCITS ManCos and depositaries. Product regulation relates to the legal forms in which AIFs/UCITS are allowed to be established and the investment portfolios in which (specific types of) AIFs/UCITS under the respective legislative acts are allowed to invest in, whereas disclosure (marketing)/reporting regulation stipulates the investor information and reporting requirements that AIFMs and UCITS ManCos are required to provide to investors and competent authorities.

Based upon a systematic interpretation of the AIFMD and UCITSD V, both UCITS and AIFs are qualifying as collective investment undertakings that raise capital, from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors.[958] AIFs may be illiquid, substantially leveraged or liquid collective investment undertakings, whereas UCITS are open-ended, mandatorily required to be authorized and AIFs are solely marketed based upon the AIFMD marketing passport to professional investors. UCITS are, nevertheless, 'AIFs' that are authorized under UCITSD V.

Under the AIFMD/UCITSD V, financial intermediaries, including AIFMs/UCITS ManCos and depositaries, play a pivotal role in fund governance.

There is a strong interconnection between the AIFMD and UCITSD that regulate the same core activity of 'investment management'.[959]

The strong interconnection between the AIFMD, UCITSD V, MiFID II and IORPD II in regulating 'investment management' has resulted in cross-sectoral regulation of 'investment management regulation'. AIFMs and UCITS ManCos may under the AIFMD and UCITSD V be, when complying with extra requirements, be permitted by Member States to be authorized for individual portfolio management, including those of pension funds and IORPs, as well.[960]

In addition, the AIFMD allows AIFMs to be 'co-authorized' as a UCITS ManCo under UCITSD V. UCITS ManCos may, however, not be authorized as AIFMs as their organizational requirements are less strict than for AIFMs under the AIFMD.

By introducing a cross-sectoral framework for 'investment management regulation' under the AIFMD and UCITSD V, both AIFMs and UCITS ManCos are able to achieve significant economies of scale.[961]

The AIFMD and UCITSD V depositary regulation regimes are largely the same given the scope and manager regulation under the AIFMD and UCITSD V. The larger scope of the AIFMD that includes not only liquid, but also illiquid and highly leveraged AIFs and the retail investor nature of UCITSD V, however, have led to some differences related to, in particular, the eligible entities, practical application of functions and the UCITSD V depositary delegation and liability regime.

The AIFMD and UCITSD V are built upon a regulatory cocktail comprising of intermediary, product and sales regulation. Under the AIFMD and UCITSD V, Member States are given a large amount of discretion to regulate their own legal forms. The systematic

---

[958] Art. 4(1) AIFMD.

[959] U. Klebeck, U., *Interplay between AIFMD and the UCITSD* 113 (D.A. Zetzsche ed, Kluwer 2015).

[960] See Art. 6(4)(a) AIFMD; Art. 6(3)(a) UCITSD V.

[961] See Recital 21 AIFMD refers to the exercise of portfolio management, in addition to, the management of AIFs, but does not make reference to the economies of scope and scale; See for the exercise of MiFID II portfolio management: Art. 6(4)(a) AIFMD.

nature of the AIFMD and UCITSD V require these legal forms, however, to cater for limited liability and asset partitioning to fit in the governance under these two directives. The Member State implementations providing for these two features in all their legal forms, including unit trusts, investment companies, common funds and investment (limited) liability partnerships explains why the AIFMD and UCITSD V allow for legal form neutrality.

Despite the increasing focus on intermediary regulation under both the AIFMD and UCITSD V, Member States still require AIFMs managing retail AIFs and UCITS ManCos managing UCITS to comply with 'investor-specific product regulation', i.e. product regulation that limits retail AIFs and UCITS in their portfolio composition.

Investor-specific product regulation seems to have two objectives: (1) providing retail investor protection and (2) defining the scope of the specific AIFMD/UCITSD V product regulations in which intermediary regulation is fully or partially substituted by intermediary regulation to restrict AIFMs/UCITS ManCo in offering certain AIFs/UCITS to investors on a cross-border basis in the EEA.

The AIFMD, UCITSD V and the AIFMD/UCITSD product regulations base their disclosure regulation upon a 'standardization' of categories of investors. Generally, three classes of investors are to be identified: retail investors, professional investors and 'HWNIs'. The precise definitions and requirements the various 'classes of investors' need to meet vary throughout the various directives and regulations. The disclosure regulation throughout the various initiatives are also based upon this investor classification, whereas reporting requirements primarily depend upon the type of AIF/UCITS marketed.

Disclosure and reporting requirements within the AIFMD, UCITSD V and the AIFMD/UCITS product regulations complement intermediary and product regulation. Disclosure regulation ensures that investors on an ex ante and ongoing basis are enabled to make an informed investment decision, whereas reporting requirements enable Competent Authorities to monitor the AIFMs/UCITS ManCos and the UCITS/AIFs that are on the market. The reporting and, in particular, the disclosure requirements under the AIFMD, UCITSD V and the AIFMD/UCITS product regulations show, however, inconsistencies that stem from diverging investor qualifications.

Investors under the AIFMD/UCITSD V investment triangle have the position of a residual claimant in the sense that they bear the full investment risk and are satisfied after the right of the asset manager, depositary/custodian have reimbursed themselves from the fund of debts that incurred to the AIF/UCITS or to the investor.[962]

---

[962] E.F. Fama & M.C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327, 333 (1983); Cf. B.S. Black, *Corporate Law and Residual Claimants*, http://escholarship.org/uc/item/5746q7pj (accessed 11 May 2017).

Chapter 9 The Optional Investment Triangle under IORPD II

1. The Optional Investment Triangle

The same three pillars as under the AIFMD and UCITSD V are optionally to be observed in IORPD II. The (optional) investment triangle under IORPD II arises from the separation of investments and management and the split of the savings decision from ownership. The latter is a further development in the historical development of capitalism from the former and a product of social and labour laws.[1] IORPs are mandatorily required by social and labour laws to prevent members, i.e. employees, to spend a too big portion of their labour income on consumption. Together with the income derived from first and third pillar pension provision, mandatorily imposing retirement income by means of IORPs have to guarantee a sufficient income upon retirement for the 'working class'.[2]

On the level of the IORP, a similar separation of investments and management as under the AIFMD and UCITSD V takes place. The establishment of an IORP leads to asset partitioning that serves a slightly different purpose. The asset partitioning on the level of the IORP is established for two reasons.

First, the asset partitioning insulates the assets owned by the beneficiaries from the employer's creditors. The assets of the beneficiaries are vested in a separate asset patrimony to prohibit IORPs from exposing the members/beneficiaries' assets to the operational activities of the employer. The latter could turn into severe risks when an employer is running into cash-flow difficulties that might run into a insolvency.[3] The separation of the savings decision from ownership on the level of the IORP allows the employer together with social partners (trading unions) to place conditions on the members' residual interest to the assets.

Second, the establishment effectively insulates the operational assets of the IORP (governing body) and their personal creditors, if the IORP is a pension provider and/or serving different schemes, from the assets to which the members/beneficiaries have a residual interest. IORP governing bodies are entrusted with the discretionary authority to administrate the IORP' assets on behalf of the IORP members.[4] Members are by means of their labour contract concluded with the employer attached to these conditions. They do not have any control nor any substitutes control. Various Members States allow members, however, to vote for employee representatives on the level of the IORP.[5] The governing body of an IORP is, however, vested with the power to resolve conflicts amongst multiple members without any interference. Limited by the internal governance of the IORP that incorporates the negotiation of the social partners, the IORP governing body may adjust the contributions from members and the distribution to them.[6] IORP members are, thus, obliged to invest their money and IORP governing bodies act as a fiduciary on behalf of the members that do not have direct control over the investment decisions being made. The members and beneficiaries

---

[1] Commission of the European Communities, *Communication from the Commission to the Council – Supplementary Social Security Schemes: The Role of Occupational Pension Schemes in the Social Protection of Workers and their Implications for Freedom of Movement*, SEC(91) 1332 final, 22 July 1991, 12.
[2] *Ibid*, 5.
[3] See, for example, the Maxwell fraud: J. Solomon, *Corporate Governance and Accountability* 51, 52 (John Wiley & Sons, Ltd 2007).
[4] D. Fox, *Defined Benefit Pension Trusts: Asset Partitioning and the Residual Interest,* University of Cambridge Faculty of Law Research Paper No. 10/03*,* 12.
[5] See *infra* 3.1.2.2.
[6] See *infra* 7.2.4.2.

owning/benefiting from invest are not the same that manage the IORP (the IORP governing body).[7]Agency problems, i.e. conflicts of interest, in IORPs arise due to the separation of investments and management in IORPs. The most prominent risk common to all IORPs is fraud and misappropriation of IORP assets by the IORP governing body/plan sponsor The IORP governing body/plan sponsor may, for example, borrow money from the IORP. The Maxwell case in the UK highlights this problem.[8] IORP assets were used to buy shares to manipulate share prices of insolvent subsidiaries of the holding company that established the IORP.[9] Similarly, IORP assets could be used to buy shares of the plan sponsor that owns the IORP governing body.[10] In addition, asset manager to which discretionary management has been delegated could do this.[11] Finally, plan sponsors may use IORP assets as 'internal financing' by pushing the IORP governing body to invest in in the assets of the company that established the IORP.[12]

IORPD II deals with these (agency) problems by imposing an (optional) investment triangle that plays a key role in the protection of the member's assets. IORP governing bodies, delegated asset managers are required to comply with intermediary regulation that regulates their conduct.[13] In addition, IORP governing bodies have to provide members with appropriate information both upon entering the scheme and on an ongoing basis (disclosure).[14] Product regulation, i.e. the legal form in which the IORP is established, ensures additional investor protection. Finally, a depositary/custodian is (optionally) appointed that safekeeps the IORP' assets. They safeguarding the interests of members by safekeeping the entrusted assets and monies of the IORP and, if required, performing a series of controls on behalf of the joint members.[15]

2. Defining an IORP

IORPD II lays down rules for the taking-up and pursuit of activities carried out by IORPs.[16] According to IORPD II[17], an IORP is

> 'an institution, irrespective of its legal form, operating on a funded basis, established separately from any sponsoring undertaking or trade for the purpose of providing retirement benefits in the context of an occupational activity on the basis of an agreement or a contract agreed:
>
> - individually or collectively between the employer(s) and the employee(s) or their respective representatives, or

[7] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 7.
[8] J. Solomon, *Corporate Governance and Accountability* 51, 52 (John Wiley & Sons, Ltd 2007).
[9] *Ibid.*
[10] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 10.
[11] Commission of the European Communities, Communication from the Commission to the Council – Supplementary Social Security Schemes: The Role of Occupational Pension Schemes in the Social Protection of Workers and their Implications for Freedom of Movement, SEC(91) 1332 final, 22 July 1991, 6.
[12] Commission of the European Communities, Communication from the Commission to the Council – Supplementary Social Security Schemes: The Role of Occupational Pension Schemes in the Social Protection of Workers and their Implications for Freedom of Movement, SEC(91) 1332 final, 22 July 1991, 12.
[13] See *infra* 3.1.3.4.
[14] See *infra* 5.
[15] See *infra* 3.2.
[16] Art. 1 IORPD II.
[17] Art. 6(1) IORPD II.

- with self-employed persons or their association(s), in compliance with the legislation of the home and host Member States.
- and which carries out activities directly arising therefrom'.

The IORP-definition together with a list of exempted schemes, optional application to life insurance undertakings and the optional application to small pension institutions and statutory schemes constitute the scope of the IORPD II.[18]

2.1. Constitutive elements of the IORP-definition

Considering the minimum degree of harmonization, IORPD II allows Member States to specify which institutions are to be considered IORPs under their domestic laws.[19] The definition took into account various different national systems within the EEA.[20] By doing so, it relies upon various constitutive elements that ascertain a minimum degree of harmonization.

2.1.1. Legal Form Neutrality

IORPD II applies to IORPs irrespective whether they have legal personality or not. [21] During the review of IORPD I, it was shown that the legal forms applied by Member States differ widely. Member States allow IORPs to be established based upon trust, corporate (foundation) and contractual structures.[22] Incorporated IORPs are not only established as a public or private limited liability companies, but also as associations, foundations and cooperatives.[23]

The directive, however, applies to institutions that are limited to activities in connection with retirement benefits and related activities.[24]The principle of substance over form is applied and Member States are free to choose the legal form of an IORP. The IORPD II only differentiates for the purpose of the Directive between IORPs with and without legal personality. IORPs that have legal personality must apply the IORPD II directly. For IORPs without legal personality, Member States may choose to apply it to the IORP of the (financial) institutions that manage and act on behalf of such an IORP, including a board of trustees or other fiduciaries.[25] For financial institutions that are exclusively exempted from the IORPD II, including insurance undertakings, investment firms, credit institutions and UCITS ManCos, this implies that the IORP itself would have to be registered or authorized irrespective of its legal form.[26]

2.1.2. Pre-funding as sole Financing Method of an IORP

---

[18] Arts 3-5 IORPD II; K. Lannoo, *The Draft Pension Funds Directive and the Financing of Pensions in the EU,* 21 The Geneva Papers on Risk and Insurance Issues and Practice 114-126 (1996).
[19] S. Arnot, *Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision: A Legal Commentary* 6, http://www.pensionseurope.eu/system/files/IORP%20I%20-%20legal%20commentary%20on%20the%20Pension%20Funds%20Directive.pdf (accessed 4 October 2016).
[20] *Ibid.*
[21] Art. 2(1) IORPD II.
[22] See *infra* 4.1.
[23] *Ibid.*
[24] Art. 6(1) IORPD II.
[25] Art. 2(1) IORPD II.
[26] S. Arnot, *Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision: A Legal Commentary* 6, http://www.pensionseurope.eu/system/files/IORP%20I%20-%20legal%20commentary%20on%20the%20Pension%20Funds%20Directive.pdf (accessed 4 October 2016).

Financing methods of schemes providing retirement benefits are historically very different.[27] Three types are to be distinguished: pre-funding, book reserves and pay-as-you-go.
Pre-funding was, prior to the IORPD I, the most common funding method of pension schemes and under the IORPD II the only financial method allowed for IORPs.[28] Contributions are managed by a IORP for the exclusive benefit of its members and held in a fund which is separate from the employing company. The accumulated capital, including investment returns, are deemed sufficient to meet pension liabilities. The level of retirement benefits in a fund depends upon the function of the scheme.[29] IORPs may either be construed as defined benefit, where the retirement income is depends upon the average salary, or defined contribution, where the pension enjoyed by beneficiaries is based upon the return on contributions invested.[30]

An alternative approach is allowed by some Member States, such a Germany.[31] The method of book reserves, instead of investing paid contributions, firms retain the contributions and pay pensions out of their balance sheet.[32] To protect workers from the firms' insolvency, the schema is backed up by an insolvency insurance scheme.[33]

The pay-as-you-go method is typical for statutory (1st pillar) pension systems, but rather uncommon in the occupational pension domain. Similar as under the book reserves method, no capital reserves are accumulated to finance pension liabilities.[34] Instead, the contributions paid by employees are used to directly pay out the benefits of the current ex-employees that enjoy their pension.

2.1.3. Separation from Sponsoring Undertakings

An IORP shall be 'established separately from any sponsoring undertaking or trade'. This element of the IORP-definition is elaborated in more detail in Article 8 IORPD II. This Article requires a legal separation between the sponsor undertaking[35]. This requirement is aimed at protecting members from the bankruptcy of the sponsoring undertaking, in order that the assets of the IORP are not distributed to any other creditors of the sponsoring undertaking.[36]

2.1.4. Providing Retirement Benefits

---

[27] Commission of the European Communities, *Communication from the Commission to the Council – Supplementary Social Security Schemes: The Role of Occupational Pension Schemes in the Social Protection of Workers and their Implications for Freedom of Movement*, SEC(91) 1332 final, 22 July 1991, 8.
[28] *Ibid.*
[29] K. Lannoo, *The Draft Pension Funds Directive and the Financing of Pensions in the EU,* 21 The Geneva Papers on Risk and Insurance. Issues and Practice 78.
[30] *Ibid.*
[31] Art. 2(2)(e) IORPD II.
[32] B. Nürk & A. Schrader, From pension reserves to pension funds: An opportunity for the German financial market 6, https://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000017124/From_pension_reserves_to_pension_funds.pdf (accessed 4 October 2016).
[33] *Ibid,* 12.
[34] S. Arnot, *Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision: A Legal Commentary* 8, http://www.pensionseurope.eu/system/files/IORP%20I%20-%20legal%20commentary%20on%20the%20Pension%20Funds%20Directive.pdf (accessed 4 October 2016).
[35] 'sponsor undertaking' is under Art. 6(3) IORPD II defined as: 'any undertaking or other body, regardless of whether it includes or consists of one or more legal or natural persons, which acts as an employer or in a self-employed capacity or any combination thereof and which offers a pension scheme or pays contributions to an IORP'.
[36] See Art. 8 IORPD II; See S. Arnot, *Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision: A Legal Commentary 19*, http://www.pensionseurope.eu/system/files/IORP%20I%20-%20legal%20commentary%20on%20the%20Pension%20Funds%20Directive.pdf (accessed 4 October 2016).

The activities of the IORP must under IORPD II be limited to providing retirement benefits. The definition of what constitutes 'retirement benefits' is, for this purpose, very broad.[37] It includes retirement benefits which are related to employment in the form of an entitlement of payment during the entire remaining life after pension, but also temporary benefits (example: sickness) or lump-sum benefits.[38]

2.1.5. Occupational Activity

Income in retirement is usually academically considered to be based upon the 'three pillars' of which income from the first represents statutory pension schemes, the second occupational pension schemes and the third individual retirement provision through savings, life assurance contracts, as well as, investments.[39] Although 'occupational activity' has not been defined, the definition of the 'sponsoring undertaking' referring to a body which acts 'as an employer or in a self-employed capacity' clearly indicates that the 'retirement benefits in the context of an occupational activity' are relating to retirement from employment or self-employment.[40]

2.1.6. Agreement or Contract

On the basis of an agreement or a contract agreed either between employers and employees, or with self-employed persons intends to include not only employer-employee schemes, but also those which provide for benefits to self-employed persons.[41]

IORPD II, thus, covers a wide range of groups, including employees, or individual employees within one company to all employees of a Member State in the case of nation-wide collective agreements creating a compulsory IORP. IORP scan, thus, be set up for a whole sector or industry of the economy. IORPs, however, may also be limited to particularly provisions, for example, electricians or doctors if all other constitutive elements of the IORP-definition are fulfilled.[42]

2.1.7. Carrying out Activities Directly Arising Therefrom

IORP activities that are directly arising from the provision of retirement benefits arising from such an agreement or contract also are included in the IORP-definition.[43] All ancillary services necessary for fulfilling this services are, thus, included in this definition.

---

[37] H. Van Meerten, A. van den Brink & S.A. de Vries, *Regulating Pensions: Why the European Union Matters (*Netspar Discussion Paper) 38, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1950765 (accessed 4 October 2016).

[38] *Ibid.*

[39] Commission of the European Communities, *Communication from the Commission to the Council – Supplementary Social Security Schemes: The Role of Occupational Pension Schemes in the Social Protection of Workers and their Implications for Freedom of Movement*, SEC(91) 1332 final, 22 July 1991, 4.

[40] Art. 6(3) IORPD II; S. Arnot, *Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision: A Legal Commentary* 15, http://www.pensionseurope.eu/system/files/IORP%20I%20-%20legal%20commentary%20on%20the%20Pension%20Funds%20Directive.pdf (accessed 4 October 2016).

[41] S. Arnot, *Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision: A Legal Commentary* 15, http://www.pensionseurope.eu/system/files/IORP%20I%20-%20legal%20commentary%20on%20the%20Pension%20Funds%20Directive.pdf (accessed 4 October 2016).

[42] Commission of the European Communities, *Communication from the Commission to the Council – Supplementary Social Security Schemes: The Role of Occupational Pension Schemes in the Social Protection of Workers and their Implications for Freedom of Movement*, SEC(91) 1332 final, 22 July 1991, 5.

[43] See also Art. 7 IORPD II; S. Arnot, *Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision: A Legal Commentary* 15, http://www.pensionseurope.eu/system/files/IORP%20I%20-%20legal%20commentary%20on%20the%20Pension%20Funds%20Directive.pdf (accessed 4 October 2016).

2.2. Schemes Exempted under IORPD II

Various institutions are exempted from the scope of IORPD II. At the one hand, this includes institutions that would otherwise satisfy the IORP definition under Article 6(1) IORPD II. At the other hand, it serves legal certainty as to identify what institution do not satisfy the criteria of the IORP-definition. Institutions excluded by the IORPD II, include social-security schemes, several financial institutions. Apart from these institutions, institutions operating on a pay-as you-go basis and not providing legal rights to benefits for employees and book reserve schemes are excluded.

2.2.1. Institutions Managing Social-Security Schemes

The IORPD II excludes institutions that manage social-security schemes which are covered by European legislation.[44] The IORPD II excludes all first pillar pension schemes.

2.2.2. Financial Institutions covered by EEA Regulation

Several financial institutions are already regulated under EEA regulation. The IORPD II does not prevent under Art. 2 IORPD II them from offering services to IORPs.[45] The IORPD II, however, aims at preventing distortion of competition. The institutions exempted are, amongst others, Institutions covered by insurance Directives. UCITS, investment firms, AIFM/AIFs and credit institutions Member States under Article 4 IORPD II, however, may apply optionally certain provisions of the IORPD to life insurance undertakings where they are carrying on the business of occupational retirement provision, i.e. managing the IORP of a sponsor undertaking.[46]

2.2.3. Institutions which Operate on a Pay-as You-Go Basis

Pay-as-you-go schemes are not subjected to the IORPD II. The IORPD II was not designed to include non-funded schemes. These schemes would require another type of prudential regulation.[47]

2.2.4. Institutions where Employees of the Sponsoring Undertakings have no Legal Rights to Benefits

Schemes of which its members have no legal rights to benefits do not fall within the scope of the IORPD because they are subjected to statutory insolvency insurance.[48]

2.2.5. Book-Reserve Schemes

Like pay-as-you-go institutions, book reserve schemes are excluded from the scope of IORPD II. They are applied in, amongst other Member States, Germany.[49] Following the view of the European Commission, the book reserve financing method allow companies to much discretion to use the assets which over its future pension liabilities. Although the membership

---

[44] Regulation (EC) 883/2004 and (EC) No 987/2009 of the European Parliament and of the Council.
[45] Recital 24 IORPD II.
[46] European Commission, *Proposal for a directive of the European Parliament and of the Council on the activities of institutions for occupational retirement provision* (/* COM/2000/0507 final - COD 2000/0260 */), 12.
[47] S. Arnot, *Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision: A Legal Commentary* 8, http://www.pensionseurope.eu/system/files/IORP%20I%20-%20legal%20commentary%20on%20the%20Pension%20Funds%20Directive.pdf (accessed 4 October 2016).
[48] See Recital 28 IORPD II; See also European Commission, *Proposal for a directive of the European Parliament and of the Council on the activities of institutions for occupational retirement provision* (/* COM/2000/0507 final - COD 2000/0260 */).
[49] Recital 28 IORPD II.

of an insurance scheme would subject the liabilities to appropriate guarantees.[50]The European Commission, trefore, does not see the freedoms provided by the IORP to be neccessary. Book schemes, thus, are thus geographically scattered as they cannot make use of the European passport.

2.3. Application to Institutions operating Social-Security Schemes

IORPs could also simulatiously operate compulsory emplyoement-related schemes which are considered to be social-security schemes. The non-compuslroy occupational retirement business would then be subjected to the IORPD II.[51] This as to avoid a distortion of competition.[52]

The simulations operation is only allowed under the condition that the liabilities and the corresponding assets relating to the IORP shall be ring-fenced from the compulsory employment-related social-security schemes.[53] This prevents the situation in which IORP would need to cross-subsidy social-security schemes.[54] This would put the members of these type of IORPs schemes ast a disadvantage compared to IORPs that solely run 2nd pillar schemes. In this context, the term 'ring-fencing' is not defined in the IORPD II. In practice, this would refer to separating the funds and accounts as to avoid the blending of the funds of the 2nd pillar scheme with the social security scheme and vice versa.[55] The ring-fencing may be established administratively or legally. IORPD II leaves this to the Member States as the establishment of a separate legal person as a form of ring-fencing does not guarantee the separation of assets.[56] It could still be that beneficiaries could have proprietorial rights of the sets of assets belonging to different legal persons. Neither is an organizational separation required as staff and personnel can operate through different legal schemes.[57] Also this is in line with the legal persons that are allowed to be used under the IORPD II. IORPs may be formed under contract, agreement, trust deeds or rules. At least, ring-fencing shall imply in practice that separate accounts for contributions, expenses, investments, taxation issues and benefits for both type of schemes shall be held.[58]

2.4. Optional Application IORPD II

The IORPD II provides several discretionary options for Member States to subject other institutions (partly) under the IORPD II that are subsequently discussed.

---

[50] European Commission, *Proposal for a directive of the European Parliament and of the Council on the activities of institutions for occupational retirement provision* (/* COM/2000/0507 final - COD 2000/0260 */), 8.
[51] Art. 3 IORPD II.
[52] S. Arnot, *Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision: A Legal Commentary* 9, http://www.pensionseurope.eu/system/files/IORP%20I%20-%20legal%20commentary%20on%20the%20Pension%20Funds%20Directive.pdf (accessed 4 October 2016).
[53] Art. 3 IORPD II.
[54] S. Arnot, *Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision: A Legal Commentary* 9, http://www.pensionseurope.eu/system/files/IORP%20I%20-%20legal%20commentary%20on%20the%20Pension%20Funds%20Directive.pdf (accessed 4 October 2016).
[55] *Ibid.*
[56] Cf. Recital 38 IORPD I; Commission of the European Communities, Commission Communication to the European Parliament pursuant to the second subparagraph of Article 251(2) of the EC Treaty concerning the common position of the Council on the adoption of a directive on the activities and supervision of institutions offering occupational retirement provision services, SEC(2002) 1215 final, 14 November 2002, 11.
[57] S. Arnot, *Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision: A Legal Commentary* 11, http://www.pensionseurope.eu/system/files/IORP%20I%20-%20legal%20commentary%20on%20the%20Pension%20Funds%20Directive.pdf (accessed 4 October 2016).
[58] Art. 7 sub-para. 2 IORPD II.

2.4.1. Optional Application Life Insurance Undertakings

Member States are also allowed to optionally extend several provisions[59] of IORPD II to life-insurance undertakings that provide occupational-retirement provision business, i.e. are managing the occupational pension scheme of a sponsoring undertaking. Again, the assets and liabilities related to shall be ring-fenced from all other type of business.[60] Apart from being ring-fenced, the occupational retirement provision business shall also be managed and organized separately, and with no possibility of a transfer.[61]Member States decide how this should be obtained. The IORPD II itself, however, does not require a separate legal entity to be established for this purpose.

2.4.2. Optional Application Small IORPs

The IORPD II contains a de-minimis threshold. IORPs that operate schemes that have less than 100 members in total are not mandatory subjected to the IORPD II.[62] This serves two purposes.[63] Small IORPs are unlikely to operate on a cross-border basis and, second, it prevents an excessive burden for Competent Authorities.[64] The exemption, thus, applies to those IORPs that would otherwise fall within the scope of IORPD II based upon Article 2(1) and Article 5 IORPD II. Small IORPs are, however, entitled to appoint a depositary/custodian or asset manager from another Member State.[65] Exempted IORPs may not make use of the IORP European passport.[66] They may, however, 'opt-into' the complete IORP regime under which they could make use of the advantages of exercising cross-border activities. They would, however, need to comply with all provisions that the IORPD II requires.[67]

2.4.3. Option: IORPs Guaranteed by a Public Authority

IORPs of which its benefits are guaranteed by a public body may be exempted by its Member States to not apply parts of IORPD II to these type of IORPs.[68] Those IORPs, must be making occupational retirement provision under statute and pursuant to legislation.[69]

These statutes could be seen as rules that result from a collective agreement between social partners and which require the force of law.[70] the guarantee would provide at least equivalent protection for the scheme members. The IORP European passport, nevertheless, does only apply to IORPs that apply IORPD II fully. Exempted IORPs could, thus, again opt-into the full IORPD II to make use of the European passport. Member States may choose to apply Articles 1 to 8 IORPD II, the investment rules and the rules related to the appointment of an asset manager and depositary/custodian.

---

[59] Art. 4 IORPD II. See Arts 9-14, 19-23(2), Arts. 24-28, Arts. 29-40 and Arts 41-58 IORPD II.
[60] Art. 4 IORPD II.
[61] Art. 4 IORPD II.
[62] Art. 5 IORPD II.
[63] S. Arnot, *Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision: A Legal Commentary* 13, http://www.pensionseurope.eu/system/files/IORP%20I%20-%20legal%20commentary%20on%20the%20Pension%20Funds%20Directive.pdf (accessed 4 October 2016).
[64] See Recital 34 IORPD II.
[65] Recital 27 IORPD II.
[66] Art. 11 IORPD II.
[67] Only a few Member States apply this exemption at all. See CEIOPS-OP-03-08 final, 7.
[68] Art. 5 sub-para. 2 IORPD II; The provisions that Member States may choose not to apply include Arts 1-8, Art. 19, Arts 32-35 IORPD II.
[69] Art. 5 sub-para. 2 IORPD II.
[70] S. Arnot, *Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision: A Legal Commentary* 14, http://www.pensionseurope.eu/system/files/IORP%20I%20-%20legal%20commentary%20on%20the%20Pension%20Funds%20Directive.pdf (accessed 4 October 2016).

2.5. The IORP-definition Debate – Academic Criticism

The IORP-definition has not been amended under IORPD II. Its broad scope has, however, already under IORPD I lead to academic criticism.[71] This criticism mainly amounted tot he IORP-definition being so broad that almost all institutions that provide occupational retirement benefits fall within its scope.[72] These might include pension funds, (life) insurance companies and 'investment funds'. The criticism related to three important points.

First, the Member State option to apply the IORPD II to (life) insurance companies is givnging rise to competitive distortions.[73] Insurers carrying out occupational retirement business of which the Member States have exercised this option are subject to less rigid capital requirements than insurance undertakings exercising this business in Member States that have not exercised this option. Consequently, there is already for years the demand of the insurance sector to extend the solvency II capital requirements under the IORPD II[74], whereas the 'pension fund' sector opposes this.[75]

Second, the IORPD II does not include PAYG and book reserves schemes. This is criticized as, especially, PAYG schemes are similar to many DB IORP schemes, as pension commitments are paid by the contributions made by employers and employees.[76] The protection of the pension beneficiary seems also to be similar. Regardless of whether a DB IORP, a PAYG or book reserve scheme is involved, the pension promises are all secured in the same way: they have to be backed by the plan sponsor and protection is in place in case the sponsor undertaking is insolvent.[77] Not applying the IORPD II to PAYG and book reserve schemes results in the latter two not having to be funded, whereas (DB) IORPs need to be fully funded.[78]

Third, the IORPD II for IORPs that are not having legal personality might lead to a collusion of laws. The IORPD II is in that case applicable to the institution that operates the scheme.[79] Normally, this is a financial institution that is excluded itself from the scope of the

---

[71] H. Van Meerten, *The scope of the EU 'Pensions'-Directive: Some Background and Solutions for Policymakers* (U. Neergaard, E. Szyszcak, J.W. van de Gronden & M. Krajewski eds, T. M. C. Asser Press 2013).

[72] H. Van Meerten, *The scope of the EU 'Pensions'-Directive: Some Background and Solutions for Policymakers* (U. Neergaard, E. Szyszcak, J.W. van de Gronden & M. Krajewski eds, T. M. C. Asser Press 2013); H. Van Meerten, A. van den Brink & S.A. de Vries, *Regulating Pensions: Why the European Union Matters (*Netspar Discussion Paper) 38, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1950765 (accessed 4 October 2016).

[73] H. Van Meerten & B. Starink, *Impediments to an Internal Market for Institutions for Occupational Retirement Provision*, 6 European Company Law 7 (2010). See also: B. Starink, B. & H. van Meerten, *Cross-border obstacles and solutions for pan-European pensions*, 1 EC Tax Review 30 (2011).

[74] M. Lechkar, H. van Meerten & O. Nijenhuis, *The Solvency II Directive: An Innovative New Regime, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1511582 (accessed 5 October 2016);* H. van Meerten, *Vrij Verkeer Van Diensten: Solvency II Basic en de Verplichtstelling*, 7/8 TvFR 290 (2012).

[75] H. Van Meerten, A. van den Brink & S.A. de Vries, *Regulating Pensions: Why the European Union Matters (*Netspar Discussion Paper) 39*,* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1950765 (accessed 4 October 2016).

[76] H. Van Meerten, A. van den Brink & S.A. de Vries, *Regulating Pensions: Why the European Union Matters (*Netspar Discussion Paper) 40*,* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1950765 (accessed 4 October 2016).

[77] T. Tongxuan, *Understanding the Defined Benefit versus Defined Contribution Choice*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=755064 (accessed 5 October 2016).

[78] H. Van Meerten, A. van den Brink & S.A. de Vries, *Regulating Pensions: Why the European Union Matters (*Netspar Discussion Paper) 40*,* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1950765 (accessed 4 October 2016).

[79] See Art. 2(1) IORPD II.

IORPD II. The local social/labour laws normally applicable to IORPs itself, on top of, the prudential rules of the financial institutions will be applied to them.[80]

2.6. The Role of IORPs in European Asset Management Law

2.6.1. IORPs versus Insurance Undertakings

There are some differences between IORPS, at the one hand, and insurance undertakings, at the other hand.[81]

IORPs have a social and employment context. In some member states, such as the Netherlands, the social partners are responsible for negotiating the terms to which IORPs should abide.[82] To a lesser extent, social and labour laws apply to the occupational pensions business carried out by insurance undertakings.[83] The difference between IORPs and insurance undertakings is, however, reflected also by how IORPs are funded and established.[84] Within the IORP domain employers are both involved in the funding and the establishment of IORPs. IORP beneficiaries are also frequently on the the IORP's governing bodies. This is not the case in the insurance domain.

Employees and employers in the IORP domain have more extensive commitments than insurance undertakings. Both member contributions and the contributions of the employer are sources of capital for IORPs. Both parties can be required to provide additional capital in the event of shortfall. In some mutual insurance undertakings this is also the case. Apart from this, IORPs may also address this issue by reducing benefits or via (intergenerational) risk sharing . This is not the case in the insurance comain. Finally, some member states protect IORP members and beneficiaries in the event of employer insolvency by pension protection schemes.[85]

2.6.2. Differences IORPs, UCITS, AIFs & Investment Firms

IORPS are also unique as opposed to AIFs, UCITS and MiFID discretionary mandates.[86]

First, the membership in an IORP is mandatory, whereas investors are free to invest in either AIFs or UCITS. One could argue that these elements are in contradiction with the main elements of collective investment schemes, i.ie. providing investment opportunities through capital markets. Whereas IORPs are providing retirement savings are based upon an occupational activity of members. They are also free to appoint an asset manager that discretionary invests on behalf of them. The access to IORPs is linked to an employment between the member and the plan sponsor (employer).[87]

The second difference is that IORPs are established by employers or groups thereof (e.g. industry associations) and labour or professional associations either jointly or separately. AIFs or UCITS are established by a sponsor.

---

[80] H. Van Meerten, A. van den Brink & S.A. de Vries, *Regulating Pensions: Why the European Union Matters (*Netspar Discussion Paper) 40, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1950765 (accessed 4 October 2016).
[81] EIOPA-BOS-12/015, 9, 10.
[82] B. Ebbinghaus & T. Wiß, *Taming Pension Fund Capitalism in Europe: Collective and State Regulation in Times of Crisis,* 17 Transfer - The European Review of Labour and Research 1 (2010).
[83] EIOPA-BOS-12/015, 9, 10.
[84] *Ibid.*
[85] D. Fox, *Defined Benefit Pension Trusts: Asset Partitioning and the Residual Interest,* University of Cambridge Faculty of Law Research Paper No. 10/03, 12.
[86] EIOPA-BOS-12/015, 19.
[87] See 'Occupational pension plans' under OECD, Private Pensions: OECD Classification and Glossary, Pensions Glossary.

Third, the investment in a UCITS, AIFs or the assets to be invested in by a discretionary asset manager solely rely upon a personal choice by an investor. This opposed to the choice by the employee of the institution providing the scheme. An IORP may be administered directly by the IORP itself or by a pension provider, such as a pension fund or a financial institution. Under the UCITSD and AIFMD, the undertakings for collective investment need mandatorily to be operated by a professional management company.

Finally, under the IORPD II, employers and employees are contributing to the IORP scheme, whereas under AIF, UCITS and MiFID discretionary mandates employers do not contribute.[88]

2.7. Conclusion

These IORP definition is, thus, very broadly defined. This has led to the situation that the IORP-definition comprises almost all institutions that provide occupational retirement benefits, including pension funds, insurance companies and investment funds.[89]

3. Intermediary Regulation

Under IORPD II, intermediary regulation regulates the IORPD II governing body and the depositary/custodian.

3.1. The IORPD II Governing Body & the System of Governance

3.1.1. The Governing Body

The OECD Guidelines for Pension Fund Governance[90] requires the appointment of a governing body, clear identification of responsibilities, the accountability of the governing body, the suitability of the members of the governing body and the possibility to appoint/outsource an auditor, an actuary and a custodian.[91] The absence of the legal competence of the EU to harmonize European pensions has led to a compromised solution. The appointment, the responsibilities and the accountability of the governing body towards its members has been completely left over to the individual Member States. IORPD II, however, has sets out an effective system of governance that provides for sound and prudent management of IORPs by their governing bodies. Governance requirements including general requirements, the carrying out of key functions and the outsourcing of these are regulated on the European level.

3.1.2. Member State Governance Requirements

3.1.2.1. The Appointment of the Governing Body

Under Article 20 IORPD II, Member States are requires to ensure that the 'administrative, management or supervisory body' of the IORP has the ultimate responsibility under national law for compliance with IORPD II. IORPD II requires the governance regulations of the individual Member States to designate for every IORP a governing body that is responsible

[88] EIOPA-BOS-12/015, 20.
[89] H. Van Meerten, A. van den Brink & S.A. de Vries, *Regulating Pensions: Why the European Union Matters* (Netspar Discussion Paper) 38, 39, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1950765 (accessed 4 October 2016).
[90] OECD, *OECD Guidelines for Pension Fund Governance*, https://www.oecd.org/finance/private-pensions/34799965.pdf (accessed 5 October 2016).
[91] See also EIOPA-BOS-12/015, 380.

for the operation and oversight of the IORP.[92] IORPD II refrains from defining 'governing body' but instead refers to the 'administrative, management or supervisory body' of the IORP as there are big differences in the nature of governing bodies of IORPs within the EEA.93

Generally, IORPs are established in the corporate, foundation, trust or the contractual form.[94] The governing body of corporate and foundational type of IORPs are typically persons or a committee of persons internal to the governance structure of the IORP.[95] In Belgium, IORPs are established as institutions under civil law[96] and the board of directors is the internal governing body of the IORP that has been assigned with the decision making on the general policy of the IORP.[97] The corporate IORPs SEPCAVs and ASSEPs in Luxembourg , for example, are represented by the board of directors as governing body.[98] Although no specific requirement for any legal form is embedded in Dutch law, Dutch IORPs that are established as pension funds are almost exclusively established as a foundation. An IORP established as a pension fund may either be structured with a one-tier or the two-tier board.[99] The board of directors or the executive board members are responsible for responsible for managing the pension fund, whereas the supervisory board or the non-executive board members have a supervisory role.[100]

IORPs established in the form of a trust and contractual form are typically appointing an external governing body, such as trustee(s) for IORPs in the trust and financial companies for contractual IORPs. In Ireland and the UK, trustees are the governing body of the IORP. In both Member States, any individual or incorporated body may be appointed as a trustee other than persons that are prohibited from acting as trustees, such as undischarged bankrupt persons and persons convicted of offences involving fraud or dishonesty.[101] In both Member States, the trustees appointed may be individual trustees, corporate trustees or a combination of both.[102] In Ireland, individual trustees are usually trustees that are selected and appointment by the employer from its management or outside professionals (accountants, actuaries) and those appointed by scheme members or after the consultation with scheme

---

[92] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 10.

[93] EIOPA-BOS-12/015, 383.

[94] See *infra* 4.1.

[95] See *infra* 3.1.1.

[96] Art. 9 Law of 27 October 2006 on the supervision of institutions for occupational retirement provision.

[97] Art. 27, 28 Law of 27 October 2006 on the supervision of institutions for occupational retirement provision.

[98] See for SEPCAVs: Art. 50 et seq. Law of 10 August 1915 on commercial companies; See for ASSEPs: Art. 39 Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; SEPCAVs may only be set up for defined contribution schemes and as such resemble a large similarity to AIFs. The role of the board of directors is, therefore, rather limited. In contrast, ASSEPs may be set up for defined contribution and defined benefit schemes. The board of directors manages the ASSEP's affairs and represents it in all legal and judicial acts.

[99] See http://www.toezicht.dnb.nl/2/50-201968.jsp (accessed 17 July 2017).

[100] *Ibid.*

[101] Ireland: Art. 59a Social Welfare and Pensions Act 2005; See also The Pensions Authority, Trustee Handbook, 5th Edition, 45; UK: The Pensions Regulator, *Trustee Guidance*, December 2007, 'Who can be a trustee?'; Section 29 Pensions Act 1995 (Persons disqualified for being trustees).

[102] Ireland: The Pensions Authority, *Trustee Handbook*, 5th Edition, 45-46 , http://www.pensionsauthority.ie/en/Trustees_Registered_Administrators/Trustee_Handbook_.pdf (accessed 21 February 2017).; UK: The Pensions Regulator, *Trustee Guidance*, December 2007, 'Who can be a trustee?'.

members, such as retired employees.[103] In the UK, auditors and actuaries, however, are prohibited to be appointed as a trustee.[104] Corporate trustees in both Ireland and the UK are specialist firms providing IORP trustee services.[105] In Ireland an independent management committee may be set up under the IORP trust deed to which some of the functions of the IORP, such as payment of benefits, are delegated. [106]

In Portugal and Spain, IORPs are set up in the contractual form and financial intermediaries are the external governing body. In both Portugal and Spain the governing body can be an insurance undertaking or a pension fund management company that is authorized under national law and whose sole purpose is the management of the IORP.[107]

The governance regulations in Portugal and Spain also require the establishment of a supervisory body (Comissão de acompanhamento do plano de pensões) that supervises the governing body.[108] The separation of responsibilities in the governing body is to ensure compliance with the duty of loyalty/care of the pension management company (monitor the monitor).[109]

The IORPD II 'governing body', thus, captures, a large variety of 'administrative, management or supervisory bodies' of IORPs that operate as governing bodies of IORPs throughout the EEA.

3.1.2.2. The Participation of Members in the Management of the IORP

The IORPD II is without prejudice to the role of social partners in the management of the IORP.[110] The IORPD, thus, recognizes the participation of members in the management of the IORP. Whether and to what extent members of the governing body of an IORP can be held accountable by representatives of IORP members and beneficiaries is, however, left to the Member States to decide. The IORPD II recognizes the role of social partners in the management of the IORP as the occupational character of the IORP makes membership compulsory or automatic as a part of the employment contract concluded.[111] Members and beneficiaries do not have any discretion in choosing a different IORP except if they change jobs. Governance regulations throughout the Member States, therefore, provide for participation of members in the management of the IORP. Member States have various forms of member representation in the governing body as a 'substitute' for the exit right of

---

[103] The Pensions Authority, *Trustee Handbook*, 5th Edition, 45-46 , http://www.pensionsauthority.ie/en/Trustees_Registered_Administrators/Trustee_Handbook_.pdf (accessed 21 February 2017).

[104] Section 27 Pensions Act 1995.

[105] The Pensions Authority, *Trustee Handbook*, 5th Edition, 45-46 , http://www.pensionsauthority.ie/en/Trustees_Registered_Administrators/Trustee_Handbook_.pdf (accessed 21 February 2017).

[106] *Ibid.*

[107] Spain: Art. 20 Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulacila de los Planes y Fondos de Pensiones and Art. 4 Real Decreto 304/2004, de 20 de febrero, por el que se aprueba el Reglamento de planes y fondos de pensiones; Portugal: Art. 32, 38 Decreto-Lei n.o 12/2006 de 20 de Janeiro .

[108] Portugal: Art. 53 Decreto-Lei n.o 12/2006 de 20 de Janeiro (Comissão de acompanhamento do plano de pensões) ; Spain: Art. 13 Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulacila de los Planes y Fondos de Pensiones (comisión de control).

[109] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 10.

[110] Art. 20(2) IORPD II.

[111] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 13.

members.[112] The common purpose is to exercise oversight responsibilities to ensure that the IORP is run in line with the interests of the IORP members and beneficiaries. Member States, however, differ in the way how members and beneficiaries are represented in the IORP governing body. In particular, member representation partly depends upon the legal form of the IORP employed in individual Member States.

Members and beneficiaries of corporate IORPs in Belgium and Luxembourg are represented in the management of the IORP by means of the board of directors and a general meeting. In Belgium, the general meeting consists of sponsoring undertakings, members or beneficiaries and their representatives as their members.[113]In the general meeting decisions are taken concerning the organization of the IORP[114], such as the appointment and removal of directors, the amendment of the articles of association, the approval of annual accounts and the ratification of management agreements with sponsoring undertakings.[115] Employees may also be represented either in the board of directors, 'other operational bodies'[116] or by means of a social committee[117]. In Luxembourg, the by-laws of the (corporate) SEPCAV and ASSEP (association) allow for a large freedom in which way the representation of members and beneficiaries on the board of directors structured.[118] SEPCAVs may either be structured in a way in which members and beneficiaries in addition to sponsors are represented on the board of directors itself or in independent social committees.[119] Associates of ASSEPs are usually representatives of the sponsor of the IORP or the employer and representatives of staff and beneficiaries.[120] In both SEPCAVs and ASSEPs, members and beneficiaries are (indirectly) represented by a general meeting of shareholders/associates.[121] The general meeting considers for SEPCAVs, in particular, amendments of the articles of association, whereas for ASSEPs also the appointment and dismissal of directors, the approval of the accounts and the dissolution of the ASSEP is subject to a resolution of the general meeting.[122]

---

[112] See *infra* 6.2.

[113] Art. 14 Law of 27 October 2006 on the supervision of institutions for occupational retirement provision.

[114] Art. 13 Law of 27 October 2006 on the supervision of institutions for occupational retirement provision .

[115] Art. 20 Law of 27 October 2006 on the supervision of institutions for occupational retirement provision .

[116] The establishment of 'other operational bodies' is laid down in the articles of associations and has as the purpose to avoid adverse consequences of employee representatives of several foreign branches of the sponsor undertaking getting involved in the general management of the IORP affecting the members of the other members to which they are not affiliated.

[117] These committees are typically set up as external bodies to the IORP in host Member States. Unless provided by the articles of association, these bodies have no decision-making power but have as their principal task to ensure compliance with the relevant provisions of the social and labour legislation applicable to the IORP in their host Member States. See Art. 34 sub-para. 1 Law of 27 October 2006 on the supervision of institutions for occupational retirement provision .

[118] Luxembourg for Finance, *Luxembourg International Pension Vehicles*, 9, http://www.alfi.lu/sites/alfi.lu/files/file/Setting-up-inLuxembourg/LFF_PENSION_FUND_INT_DEF_03_08.pdf

[119] *Ibid*, 5.

[120] *Ibid*, 6.

[121] See for SEPCAVs: Arts 6(5), 7(1) and 14 Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; See for ASSEPs: Arts 29-33 Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.

[122] See Arts 6(5) and 29 Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.

Although no specific requirement for any legal form is embedded in Dutch law, Dutch pension funds[123] are almost exclusively established as a foundation. An IORP established as a pension fund may either be structured under the one-tier or the two-tier model (Joint Model and Independent Model).[124] The board of directors or the executive board members are responsible for managing the pension fund, whereas the supervisory board or the non-executive board members have a supervisory role.[125] The participation of members in the management of the IORP in the Netherlands depends upon the board model chosen.[126] Members may either be directly represented on the board of directors (or supervisory body)[127] and/or indirectly by means of supervision carried out by means of an accountability/stakeholders body with representatives of members and beneficiaries.[128]

IORPs established as a trust in Ireland and the UK require direct member participation by means of the selection of persons for appointment as trustee. In Ireland member participation in the selection of persons for appointment as trustees is required for specific types of IORPs.[129] Section 62 Pensions Act 1990 and its delegated regulation require arrangements for member participation to be made upon discussions between the employer and representatives of the members. The discussions between these two parties will have to lead to an agreement upon the number of trustees and the selection procedure.[130] In the UK, trustees may be appointed by members. Trustees are, generally, the representatives of the employer, members and beneficiaries.[131] One third of the trustees appointed should be nominated by the representatives of the employees.[132]

IORPs in Spain and Portugal that are established in the contractual form do employ a system of member and beneficiary representation by means of 'independent monitoring bodies'.[133] In Spain, this independent monitoring body of the IORP is the 'comisión de control'. The 'comisión de control' consists of a majority of representatives of the promoter and representatives of members.[134]Similarly, the Portuguese monitoring committee ('Comissão de acompanhamento do plano de pensões') also consists of member

[123] See http://www.toezicht.dnb.nl/2/50-201968.jsp.
[124] Arts 99-114 Wet van 7 december 2006 houdende regels betreffende pensioenen (Pensioenwet).
[125] Arts 99-114 Wet van 7 december 2006 houdende regels betreffende pensioenen (Pensioenwet).
[126] Art. 99 Wet van 7 december 2006 houdende regels betreffende pensioenen (Pensioenwet).
[127] The two-tier Joint Model (het paritaire model), the one-tier board Inverse Mixed Model (het omgekeerde gemengd model) and the one-tier board Joint Mixed Model (het paritaire gemengd model) are models that have stakeholders on the board of directors. See Stichting van de Arbeid, Code of the Dutch Pension Funds, 1 January 2014, 42-44.
[128] The Joint Mixed Model, the two-tier independent model and the one-tier board Independent Mixed Model are board models with independent parties on the board and in supervisory roles.[128] Employees, employers and beneficiaries are, however, represented by an external stakeholders' body. See Stichting van de Arbeid, Overzicht Principes voor Goed Pensioenfondsbestuur, A. Bestuur.
[129] IORPs need to qualify as a 'relevant scheme'. Generally, relevant schemes are IORPs that have 50 or more members. See 'relevant scheme' under S.I. No. 376/1996:
Occupational Pension Schemes (Member Participation in the Selection of Persons for Appointment as Trustees) (No. 3) Regulations 1996.
[130] S.I. No. 376/1996: Occupational Pension Schemes (Member Participation in the Selection of Persons for Appointment as Trustees) (No. 3) Regulations 1996.
[131] Section 16-21 Pensions Act 1995; A. Hudson, *Equity and Trusts* 995-997 (Routledge 2015).
[132] Section 16 Pensions Act 1995.
[133] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 13.
[134] Art. 7(2) Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulacila de los Planes y Fondos de Pensiones; Art. 30-32 Real Decreto 304/2004, de 20 de febrero, por el que se aprueba el Reglamento de planes y fondos de pensiones.

representatives, participants and beneficiaries.[135] The latter shall be ensured to represented not less than a third of the monitoring committee.[136]

3.1.2.3. The Responsibilities of the Governing Body

The responsibilities of the governing bodies differ from Member State to Member State. Despite of this, the carrying out of the responsibilities of the governing bodies all are subjected to the same overarching common conduct of business legal principles: the duty of loyalty and care. The duty of loyalty and care are of fiduciary nature and are either applicable to governing boards on the basis of private law governing the legal form employed and/or regulatory law.

3.1.2.4. General Conduct of Business Principles

The duty of loyalty and care are general conduct of business principles to which governing bodies under national regulation are subjected to.

The duty of loyalty has as its purpose to avoid 'misappropriation' by the governing body.[137] The duty of loyalty applicable to governing boards is either based on private law or on private law and regulatory law. The duty of loyalty mainly is pronounced either by means of a general duty to act in the best interest of members, participants and beneficiaries, a general or specific duties to avoid conflicts of interests or both. In Luxembourg, for example, the duty for the governing bodies (board of directors) of SEPCAVs and ASSEPs to act in the best interest of members and beneficiaries and to avoid conflicts of interests is entirely left over to its Companies Act.[138]

Similarly, in Ireland and the UK the duty to act in the best interests of the members and beneficiaries and is based upon general trust law.[139] The general duty to avoid conflicts of interest is in Ireland subject to mere trust law, whereas in the UK it is a regulatory duty as well.[140] Apart from this, the Irish and UK Pension Acts contain specific conflicts of interests

---

[135] Art. 53(2) Decreto-Lei n.o 12/2006 de 20 de Janeiro.

[136] *Ibid.*

[137] See T. Frankel, Fiduciary Law – Analysis, Definitions, Duties, Remedies over History and Cultures (Fathom Pub. Co. 2008); See in the context of AIFMs: D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 226 et seq. (D.A. Zetzsche ed, Kluwer 2015).

[138] See Arts 6(1), 34 Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; Arts 53, 58, 59 Law of 10 August 1915 on commercial companies .

[139] Ireland: The Pensions Authority, *Trustee Handbook*, 5th Edition, 48, http://www.pensionsauthority.ie/en/Trustees_Registered_Administrators/Trustee_Handbook_.pdf (accessed 21 February 2017); The Pensions Authority, *So you're a pension scheme trustee – A brief guide to your duties andresponsibilities,*5-6, http://www.pensionsauthority.ie/en/LifeCycle/Information_Booklets/So_you%E2%80%99re_a_pensions_scheme_trustee_.7239.shortcut.pdf; M. Hutch, *Pension Fund Supervisory Methods in Ireland* (OECD Private Pensions Series No. 6, 2004); UK: The Pensions Regulator, *Governance and administration of occupational defined contribution trust-based pension schemes* (Draft code of practice no. 13, July 2013), 35-36, http://www.thepensionsregulator.gov.uk/docs/regulating-dc-pension-schemes-code-of-practice-consultation.pdf (accessed 5 October 2016).

[140] Ireland: The Pensions Authority, *Trustee Handbook*, 5th Edition, 48, http://www.pensionsauthority.ie/en/Trustees_Registered_Administrators/Trustee_Handbook_.pdf (accessed 21 February 2017); The Pensions Authority, *So you're a pension scheme trustee – A brief guide to your duties andresponsibilities,*5-6, http://www.pensionsauthority.ie/en/LifeCycle/Information_Booklets/So_you%E2%80%99re_a_pensions_scheme_trustee_.7239.shortcut.pdf; In the UK, conflicts of interests are, apart from general trust law, also part of regulatory law. See Section 39 Pensions Act 2004.

rules. Ireland, for instance, requires board members to disclose their conflicts of interests[141], whereas in the UK trustees have to be independent and may not be the auditor or actuary of an IORP scheme.[142]

In the Netherlands, the duty of care derives both from private and regulatory law depending upon what legal form is being used for IORPs established as a pension fund. The regulatory duty to act in the best interests of members and beneficiaries and the general duty to avoid conflicts of interest is, however, applicable to all types of pension fund IORPs regardless of the legal form in which the IORP is established.[143]

IORPs in Portugal and Spain that can only be established in the contractual form are exclusively represented by insurance companies and pension fund management companies. For this purpose, the duty of loyalty derives in both Member States from regulatory law.[144]

Another common principle amongst Member States is the duty of care and its sub-principles, including adequate organization, compliance and the equal treatment of beneficiaries.

The adequate organization requirement is pronounced by the required to employ sufficient resources, such as the amount of board members, at the Member State and the key functions including internal control, internal audit, the appointment of the actuary and the outsourcing regime on the European level.[145]

Compliance is also a common sub-category of the duty of care required to be performed by IORP governing boards as to promote the best interests of the members and beneficiaries. [146] In Belgium and the Netherlands, for instance, IORP governing boards have a regulatory duty to comply with the law.[147] In Ireland and the UK, the duty of compliance derives from common trust law.[148] The trustee needs to comply with are 'fiduciary' duties that require the trustee to act in line with the trust deed and rules, acting in the best interests of the scheme beneficiaries and acting prudently, responsibly and honestly.[149]

Finally, some Member States require the equal treatment of members. No member, regardless whether man or women or occupational status may receive a preferential treatment over the other.[150]

3.1.2.5. The Responsibilities of the Governing Body under national Member State Laws

---

[141] Section 21 Pensions Act 1990.
[142] Section 22, 23, 27 Pensions Act 2004.
[143] Art. 33 Wet van 7 december 2006 houdende regels betreffende pensioenen (Pensioenwet); Stichting van de Arbeid, Overzicht Principes voor Goed Pensioenfondsbestuur, A. Bestuur.
[144] See Art. 22 Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulacila de los Planes y Fondos de Pensiones; See Art. 32, 34, 35 Decreto-Lei n.o 12/2006 de 20 de Janeiro.
[145] Art. 21 IORPD II.
[146] Belgium: Art. 22 Law of 27 October 2006 on the supervision of institutions for occupational retirement provision; Ireland: The Pensions Authority, *Trustee Handbook*, 5th Edition, 88-116, http://www.pensionsauthority.ie/en/Trustees_Registered_Administrators/Trustee_Handbook_.pdf (accessed 21 February 2017); The Netherlands: Art. 33 Wet van 7 december 2006 houdende regels betreffende pensioenen (Pensioenwet); Stichting van de Arbeid, Overzicht Principes voor Goed Pensioenfondsbestuur, A. Bestuur; Spain: Art. 81(1)(a), (f),(g) Real Decreto 304/2004, de 20 de febrero, por el que se aprueba el Reglamento de planes y fondos de pensiones.
[147] Belgium: Art. 28 Law of 27 October 2006 on the supervision of institutions for occupational retirement provision; Netherlands: Art. 33 Wet van 7 december 2006 houdende regels betreffende pensioenen (Pensioenwet); Stichting van de Arbeid, Overzicht Principes voor Goed Pensioenfondsbestuur, A. Bestuur.
[148] A. Hudson, *Equity and Trusts* 995-997 (Routledge 2015).
[149] *Ibid*, 994.
[150] See Ireland: Part VII Pensions Act 1990; UK: Section 62, 63 Pensions Act 1995.

Governance regulations of the individual Member States define what operational and oversight responsibilities governing bodies of IORPs have.[151] Moreover, Member States may decide to limit the functions performed by the governing body and to require to delegate certain tasks, such as asset management, to delegates.[152] IORPD II leaves the discretion to the Member States to either take a 'one-size fits all' or a 'limited functions approach'.[153]
The common main responsibilities of the governance regulations of the national implementation laws include:

- the investment of IORP assets in accordance with the prudent man principle;[154]
- the maintenance of an adequate level of funding to meet liabilities and perform guarantees (DB and hybrid schemes);[155]
- disclose information to IORP members and beneficiaries;[156] and
- ensuring compliance with laws and regulations.[157]

Other tasks in Member States include the collection of member contributions[158], record keeping[159], asset-liability management[160], asset allocation[161] and benefits payment[162].

---

[151] See J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 11.
[152] See for the IORP outsourcing regime: *infra* 3.1.3.4.
[153] *Ibid.*
[154] Art. 19 IORPD II; Belgium: Art. 22 Law of 27 October 2006 on the supervision of institutions for occupational retirement provision; Ireland: Section 59 Pensions Act 1990; The Pensions Act specifies that the trustees shall provide for the proper investment of the resources of the scheme in accordance with the Occupational Pension Scheme (Investment) Regulation 2006 to 2007 (S.I No. 294 of 2006 and S.I. No. 188 of 2007) (the "Investment Regulations") and, subject to those regulations, the rules of the scheme; Spain: Art. 81a Real Decreto 304/2004, de 20 de febrero, por el que se aprueba el Reglamento de planes y fondos de pensiones; UK: Section 33, 35, 36 Pensions Act 1995.
[155] Art. 14 IORPD II; See Ireland: The Pensions Authority, *Trustee Handbook*, 5th Edition, 88-116, http://www.pensionsauthority.ie/en/Trustees_Registered_Administrators/Trustee_Handbook_.pdf (accessed 21 February 2017); Portugal: Art. 33(a) Decreto-Lei n.o 12/2006 de 20 de Janeiro.
[156] Title IV Information to be given to Prospective Members, Members and Beneficiaries IORPD II; See Belgium: Art. 22 Law of 27 October 2006 on the supervision of institutions for occupational retirement provision; Ireland: The Pensions Authority, *Trustee Handbook*, 5th Edition, 88-116, http://www.pensionsauthority.ie/en/Trustees_Registered_Administrators/Trustee_Handbook_.pdf (accessed 21 February 2017);
[157] Belgium: Art. 22 Law of 27 October 2006 on the supervision of institutions for occupational retirement provision; Ireland: The Pensions Authority, *Trustee Handbook*, 5th Edition, 88-116, http://www.pensionsauthority.ie/en/Trustees_Registered_Administrators/Trustee_Handbook_.pdf (accessed 21 February 2017); ; The Netherlands: Art. 33 Wet van 7 december 2006 houdende regels betreffende pensioenen (Pensioenwet); Stichting van de Arbeid, Overzicht Principes voor Goed Pensioenfondsbestuur, A. Bestuur; Spain: Art. 81(1)(a), (f),(g) Real Decreto 304/2004, de 20 de febrero, por el que se aprueba el Reglamento de planes y fondos de pensiones; UK: The Pensions Regulator, *Governance and administration of occupational defined contribution trust-based pension schemes* (Draft code of practice no. 13, July 2013), 35-36, http://www.thepensionsregulator.gov.uk/docs/regulating-dc-pension-schemes-code-of-practice-consultation.pdf (accessed 5 October 2016).
[158] Ireland: Section 59 Pensions Act 1990: Portugal Art. 33(d) Decreto-Lei n.o 12/2006 de 20 de Janeiro; Spain: Art. 81(1)(d) Real Decreto 304/2004, de 20 de febrero, por el que se aprueba el Reglamento de planes y fondos de pensiones ; UK: Section 49 Pensions Act 1995;
[159] Ireland: Section 59 Pensions Act 1990; Portugal: Art. 33(g) Decreto-Lei n.o 12/2006 de 20 de Janeiro; Spain: Art. 81(1)(b) Real Decreto 304/2004, de 20 de febrero, por el que se aprueba el Reglamento de planes y fondos de pensiones; UK: Section 49 Pensions Act 1995;
[160] Portugal: Art. 33(a) Decreto-Lei n.o 12/2006 de 20 de Janeiro; Spain: Art. 81(1)(b) and Art. 81a(1) Real Decreto 304/2004, de 20 de febrero, por el que se aprueba el Reglamento de planes y fondos de pensiones.

In Portugal and Spain, the respective supervisory committees also do have 'board responsibilities' that go beyond merely controlling the IORP governing board.[163] The supervisory committees, inter alia, verifies compliance of the IORP governing board with, amongst others, the implementation of the investment policy, funding responsibilities.[164] In addition, the monitoring committee advises on transfer proposals and other significant changes in the constitutive documents[165], gives advice on the appointment of the actuary, auditor[166] and exercises any function assigned to it by the IORP governing board[167]. Finally, in Spain the supervisory committee has got assigned monitoring functions related to the employment plan.[168]

3.1.3. IORPD II Governance Requirements

The IORPD II sets out a governance framework for IORPs to ensure an effective system of governance that provides for sound and prudent management of their activities.[169] The European harmonization of the system of governance concerns general requirements, key functions, documents concerning governance and outsourced activities under the condition of the principle of proportionality[170].

3.1.3.1. General Requirements: Fit & Proper Management and a Sound Remuneration

The IORP governing board needs to fulfil requirements related to a fit and proper management and a remuneration policy.[171]

Persons that are 'effectively running the IORP' are subject to fit & proper requirements.[172] Not only the governing body, but also the persons or entities who are carrying out key functions, including risk management internal control, internal audit and actuarial activities,

---

[161] Belgium: Art. 22 Law of 27 October 2006 on the supervision of institutions for occupational retirement provision; Portugal: Art. 33(b) Decreto-Lei n.o 12/2006 de 20 de Janeiro; Spain: Art. 81(1)(g) Real Decreto 304/2004, de 20 de febrero, por el que se aprueba el Reglamento de planes y fondos de pensiones; UK: Section 36 Pensions Act 1995.

[162] Belgium: Art. 22 Law of 27 October 2006 on the supervision of institutions for occupational retirement provision; Ireland: Section 59 Pensions Act 1990;UK: Section 49 Pensions Act 1995; Portugal: Art. 33(d) Decreto-Lei n.o 12/2006 de 20 de Janeiro.

[163] Portugal Art. 53(5) Decreto-Lei n.o 12/2006 de 20 de Janeiro; Spain: Art. 81 Real Decreto 304/2004, de 20 de febrero, por el que se aprueba el Reglamento de planes y fondos de pensiones.

[164] Portugal Art. 53(5)(a) Decreto-Lei n.o 12/2006 de 20 de Janeiro; Spain: 7(1)(a) Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulacila de los Planes y Fondos de Pensiones.

[165] Portugal Art. 53(5)(b) and (c) Decreto-Lei n.o 12/2006 de 20 de Janeiro; 7(1)(d), (e) Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulacila de los Planes y Fondos de Pensiones.

[166] Portugal Art. 53(5)(d) Decreto-Lei n.o 12/2006 de 20 de Janeiro; Spain: 7(1)(b) Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulacila de los Planes y Fondos de Pensiones.

[167] Portugal Art. 53(5)(e) Decreto-Lei n.o 12/2006 de 20 de Janeiro; Spain: 7(1)(e) Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulacila de los Planes y Fondos de Pensiones.

[168] Art. 29 Real Decreto 304/2004, de 20 de febrero, por el que se aprueba el Reglamento de planes y fondos de pensiones.

[169] Art. 21 IORPD II.

[170] Art. 21(2) IORPD II.

[171] Arts 22, 23 IORPD II.

[172] Art. 22 IORPD II.

and delegates of the governing body have to comply with the fit and proper management requirements.[173] The requirement to be fit means that these persons need to have the qualifications, knowledge and experience that are collectively adequate in carrying out their tasks.[174] The word 'collectively' points out, for instance, that stakeholder representatives in a governing body of an IORP do not individually need to have the qualifications, knowledge and experience, but that the requirement applies to the governing body as a whole. The requirement to be proper demands the abovementioned persons and entity to be of good repute.[175]

IORPs are required to establish and apply a sound remuneration policy for those persons who effectively run the institution, perform key functions and other categories of staff whose professional activities have a material impact on the risk profile of the IORP.[176] The remuneration policy requirement is based upon general principles as some IORPs do not employ staff but use staff from a sponsoring undertaking to fulfil their duties.[177]

3.1.3.2. Key Functions

IORPD II requires Member States to have in place certain key functions that are already common under the Member State IORPD I implementation laws.[178] The Key functions required under the IORPD include the risk-management function, an internal audit function, an internal control function and, if required, an actuarial function.[179]

IORPs are required to adopt strategies, processes and reporting procedures necessary to identify, measure, monitor and report to the governing body the risks to which the IORPs is exposed.[180] The risk-management system must be well-integrated in the organizational structure of the IORP.[181] The risk management organization also has to take into account the differences the risk sharing mechanism of the IORP.[182] The risk management system shall be adjusted depending upon whether the IORP, members and beneficiaries or the employer bears risks.[183] Outsourced activities and the decisions and controls regarding those functions are required to be an integral part of the risk-management system. Examples include underwriting and reserving[184], asset-liability management[185], investment[186], insurance and other risk-mitigation techniques.[187]

IORPs are required to have an internal control functions that includes administration and accounting procedures, an internal control framework and appropriate reporting arrangements.[188] Compliance is part of an effective internal control system.[189] IORPD II also

---

[173] Art. 22(1) IORPD II.
[174] Art. 22(1)(a) IORPD II.
[175] Art. 22(1)(b) IORPD II.
[176] Art. 23(1) IORPD II.
[177] EIOPA-BOS-12/015, 385.
[178] Art. 24 IORPD II; See also OECD, *Recommendation on the Core Principles of Occupational Pension Regulation*, June 2009, Principle 2.
[179] Art. 24(1) IORPD II.
[180] Art. 25(1) IORPD II; OECD/IOPS, *Good Practices for Pension Funds' Risk Management Systems*, January 2011.
[181] Art. 25(1) sub-para. 2 IORPD II.
[182] EIOPA-BOS-12/015, 403.
[183] Art. 25(3) IORPD II.
[184] Art. 25(2)(a) IORPD II.
[185] Art. 25(2)(b) IORPD II.
[186] Art. 25(2)(c) IORPD II.
[187] Art. 25(2)(f) IORPD II.
[188] Art. 25(1) IORPD II; See also OECD, *Recommendation on the Core Principles of Occupational Pension Regulation*, June 2009, Principle 6; OECD, *OECD Guidelines for Pension Fund Governance*, Principle 9, https://www.oecd.org/finance/private-pensions/34799965.pdf (accessed 5 October 2016); OECD/IOPS, *Good*

the compliance function to be assigned to a compliance officer.[190] The function, however, does not necessarily need to be an internal function but may be delegated.[191]

IORPs have to establish an internal audit function that includes an evaluation of the adequacy and the effectiveness of the internal control function and other (key functions) of the IORP governance, including any activities outsourced.[192] The internal audit function may be assigned to an internal auditor or to a delegated auditor.[193] The internal audit function, however, shall be objective ad independent from other functions.[194] This implies that the persons or entities performing this function may not be involved in the management of the IORP.[195] IORPD II leaves it open whether the internal audit function is required to report the findings to the IORP governing body[196] and whether the internal audit function contains a whistle-blowing requirement to inform the respective Competent Authorities in cases the IORP governing body does not take remedial action in time.[197]

Where the IORP carries biometric risks or provides investment guarantees, the IORPD II mandatorily requires an actuarial function.[198] DC schemes that are 'pure' and where there are no investment guarantees and biometric risk involved are exempted from this requirement.[199] IORPD II requires, at least, one person, inside or outside the institution to be responsible for carrying out the actuarial function.[200] This provision accommodates the IORPD I Member State implementing laws under which IOPRs are required to have two actuaries: one executing the actuarial tasks and another external actuary that performs a controlling (oversight) task.[201] Actuaries are under IORPD II requires to coordinate and oversee[202], check the appropriateness of the methodologies[203] and the underlying data[204] used in the calculation of the technical provisions of an IORP. In addition, actuaries are required to inform the IORP governing body concerning the reliability and the adequacy of the calculation of technical provisions[205] and contribute the effective implementation of the risk management system[206].

Practices for Pension Funds' Risk Management Systems, January 2011; See also OECD, *The OECD Pension Funds' Risk Management framework: regulation and supervisory oversight*, February 2010.

[189] Art. 25(2) IORPD II; See EIOPA-BOS-12/015, 419.

[190] See EIOPA-BOS-12/015, 420.

[191] Art. 31 IORPD II.

[192] Art. 27 (1) IORPD II; OECD, *Recommendation on the Core Principles of Occupational Pension Regulation*, June 2009, Principle 2.; OECD, *OECD Guidelines for Pension Fund Governance*, Principle 6, https://www.oecd.org/finance/private-pensions/34799965.pdf (accessed 5 October 2016); The internal audit function: OECD/IOPS, *Good Practices for Pension Funds' Risk Management Systems*, January 2011, Good Practice 6 (control and monitoring mechanisms).

[193] See EIOPA-BOS-12/015, 425-426.

[194] Art. 24(2) IORPD II.

[195] See EIOPA-BOS-12/015, 427.

[196] *Ibid.* 427.

[197] *Ibid*, 428.

[198] Art. 27 IORPD II; OECD, *Recommendation on the Core Principles of Occupational Pension Regulation*, June 2009, Principle 6; See also OECD/IOPS, *Good Practices for Pension Funds' Risk Management Systems*, January 2011, Good Practice 3 (Funding and Solvency Risk Control) and Good Practice 6 ('whistleblowing' responsibilities for actuaries).

[199] EIOPA-BOS-12/015, 433.

[200] Art. 27(2) IORPD II.

[201] EIOPA-BOS-12/015, 432.

[202] Art. 27(1)(a) IORPD II.

[203] Art. 27(1)(b) IORPD II.

[204] Art. 27(1)(c) IORPD II.

[205] Art. 27(1)(e) IORPD II.

[206] Art. 27(1)(h) IORPD II.

Finally, the actuary is required to express an opinion on the overall underwriting policy and insurance arrangements of IORPs having such a policy.[207]

3.1.3.3. Documents concerning governance

IORPs perform an own risk assessment and have disclosure duties.[208]

IORPs are required to carry out a risk assessment and to produce a risk evaluation for pensions.[209] The risk evaluation has as its objective to support the governing body in evaluating risks to which the IORP operated is subjected to.[210] The documentation of the assessment has to be taken into account in the strategic decisions of the IORP.[211]Moreover, it encourages the trust of stakeholders in the IORP.[212]

For that purpose, the Competent Authority has to lay down specific rules to specify the structure and information to be included in the risk evaluation for pensions.[213] A risk evaluation shall have to be performed every three years or upon any significant change in the risk profile of the IORP or pension scheme as operated by the IORP.[214]

The Competent Authorities, in this regard, have to take into account the specific nature of the activities of the IORPs concerned. For pure DC IORPs, for instance, the risk evaluation functions more as a self-assessment tool whether the investment and risk objectives have been met.[215] The quantitative and qualitative assessment of technical provisions is limited as capital requirements only have to cover against operational risks. Article 28 IORPD II, thus, requires in general a risk evaluation for all types of IORPs shall include an own risk assessment integrated into the management process and the decision-making process of the institution[216] and the effectiveness of the risk management of the IORP[217]. Compliance with the requirement for technical provisions and the degree to which the risk profile deviates from the assumptions underlying solvency capital requirements consists of information that shall be primary relevant for DB and hybrid IORPs.[218]

Disclosure duties for the IORP governing body include annual accounts, reports and the publication a statement of investment policy principles.

The governing body has the duty of disclosure of annual accounts and annual report for each scheme operated by the IORP.[219] The information provide has to give a true and fair view of the IORP' assets, liabilities and financial position.[220] The information contained in the annual accounts and reports has to be consistent, comprehensive, fairly prevented and approved by those persons required under national law.

IORPs are also required to prepare, at least every three years, or upon any significant change in the investment policy a review a written statement of investment-policy principles.[221] The statement has, at least, to contain matters such as any investment risk measurement methods,

---

[207] Art. 27(1)(f) and (g) IORPD II.
[208] Arts 28-30 IORPD II.
[209] Art. 28(1) IORPD II.
[210] EIOPA-BOS-12/015, 410; The risk evaluation is based upon the Own Risk and Solvency Assessment (ORSA) under Art. 45 Solvency II.
[211] Art. 28(4) IORPD II.
[212] EIOPA-BOS-12/015, 410.
[213] Art. 28(1) IORPD II.
[214] Art. 28(1) sub-para. 2 IORPD II.
[215] EIOPA-BOS-12/015, 411.
[216] Art. 28(2)(a) IORPD II.
[217] Art. 28(2)(b) IORPD II.
[218] Art. 28(2)(d) IORPD II.
[219] Art. 29 IORPD II.
[220] *Ibid*.
[221] Art. 30 IORPD.

the risk management processes implemented and the strategic asset allocation with regard to the nature and duration of pension liabilities.[222]

3.1.3.4. Outsourcing

The outsourcing of key functions, including internal control, internal audit and actuarial activities, and investment management may ensure that those tasks are carried out by persons and entities that have the relevant expertise and may enhance the protection from the plans sponsors.[223] Outsourcing, however, creates also new agency problems that might run counter to the interest of the IORP.[224] Apart from the fit & properness requirements under IORPD II, a specific IORPD II outsourcing regime is designed to combat those conflicts of interests. A general outsourcing regime applies to key functions outsourced, whereas specific 'suitability'[225] and outsourcing requirements applies to investment management delegates.

Member States may permit or require IORPs to entrust any abovementioned key functions or any other IORP activities, in whole or in part, to third parties operating on behalf of those IORPs.[226] The words 'may' and 'permit or require' indicates that Member States may implement this provision threefold. Firstly, Member States may not allow any key functions and other IORP activities to be outsourced at all. Secondly, Member States seem to have the discretional choice in permitting (specific) key functions or any other IORP activities to be delegated. Finally, Member States may (mandatorily) require IORPs to outsource specific key functions, such as investment management[227], to persons with relevant expertise.[228] The IORPD II, thus, provides a minimum degree of harmonization in which it guarantees that the IORP governing body fulfills at least a 'nexus of contract position' in which it remains the ultimate responsibility for compliance of any key functions or any other activities.[229]
Governing bodies ensure the proper functioning of the outsourced activities through carrying out due diligence upon the initial appointment of the service provider and on an ongoing basis.[230] Outsourcing is at all times subject to various general principles. Any outsourcing may not lead to:[231]

- impairing the quality of the system of governance of the IORP;[232]
- increase of operational risk;[233]
- impair the ability of the Competent Authorities to monitor the compliance of IORPs under
- IORPD II;[234] and
- undermine a continuous and satisfactory service to members and beneficiaries.[235]

---

[222] *Ibid.*
[223] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 15, 16.
[224] S.C.J.J. Kortmann & R.H. Maatman, *Uitbesteding door vermogensbeheerders*, 9 Ondernemingsrecht 311-318 (2005).
[225] Only AIFMs, UCITS ManCos, Solvency II insurers and investment firms may act as delegates for the purpose of investment management under Art. 32 IORPD II.
[226] Art. 31 IORPD II.
[227] *Organisation* for *Economic Co-operation* and *Development, Guidelines on Pension Fund Asset Management,* http://www.oecd.org/dataoecd/59/53/36316399 (accessed 14 January 2017).
[228] EIOPA-BOS-12/015, 442.
[229] Art. 31(2) IORPD II.
[230] Art. 31(4) IORPD II.
[231] Art. 31(3) IORPD II.
[232] Art. 31(3)(a) IORPD II.
[233] Art. 31(3)(b) IORPD II.
[234] Art. 31(3)(c) IORPD II.
[235] Art. 31(3)(d) IORPD II.

Outsourcing shall take place by means of a written outsourcing agreement between the governing body and the service provider that serves as a legally enforceable document.[236] Competent Authorities shall be notified upon the initial outsourcing of key functions and other critical or important functions or activities and may request information from the governing body and its delegates about any outsourced activities.[237]

Many IORPs do not have the specialist knowledge for carrying out asset management. Prior to IORPD II, some Member States require asset management only to be carried out by entities that are authorized to act as investment managers.[238] In these Member States the IORP governing body are only permitted to carry out investment management if it has obtained a specific authorization.[239]

Under IORPD II, Member States may not restrict IORPs for appointing third-parties for the management of the IORP investment portfolio that are authorized to perform this function under MiFID II, UCITSD V, AIFMD, CRD IV and Solvency II.[240]
The discretionary management of IORPs is not a core regulatory activity that is harmonized on the European level. The AIFMD, MiFID II, UCITSD, Solvency II all do exclude this activity from the scope of the respective directives.[241]

Member States under the AIFMD and UCITSD may, however, allow for an additional authorization for the non-core service of managing IORP investment portfolios or extend the MiFID portfolio manager requirements to financial intermediaries managing such portfolios.[242] Member States, such as Spain and Portugal, however, have designed their own separate regime for financial service providers that may obtain an authorization under national law to perform the management of IORP portfolios.[243]

Member States, thus, have discretion in this regard. Member States are at all times, however, required to allow outsourcing of investment management to entities that are authorized to perform this function under MiFID II, UCITSD V, AIFMD, CRD IV and Solvency II[244] , whereas for all other activities and key functions they have a discretionary choice under their laws to permit the outsourcing of specific activities or not.

3.2. The Depositary/Custodian

---

[236] Art. 31(5) IORPD II; See also: OECD/IOPS, *Good Practices for Pension Funds' Risk Management Systems*, January 2011 requires pension funds to conclude written contracts with their delegates.
[237] See. Art. 31(6) and (7) IORPD II.
[238] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, 10, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016).
[239] *Ibid*, 15.
[240] Art. 32 IORPD II.
[241] See Recital 18 IORPD II; Art. 2(3)(b) and (e) AIFMD; Recital 34, Art. 2(1)(i) MiFID II and the definition of UCITS under Art. 1(2) UCITSD V. IORPs and pension funds are not listed as falling outside the scope of UCITSD. They do not fall under the UCITS definition as they do not fulfill the 'open-end requirement' under the UCITS criteria. Moreover, the UCITSD V, unlike the AIFMD, is not mandatorily to be applied. The AIFMD, however, mandatorily applies to those managers of collective investment undertakings that qualify under the UCITS definition but have not obtained an authorization under the UCITSD.
[242] Art. 6(4)(a) AIFMD and Art. 6(3)(a) UCITSD V.
[243] Spain: Art. 20 Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulacila de los Planes y Fondos de Pensiones and Art. 4 Real Decreto 304/2004, de 20 de febrero, por el que se aprueba el Reglamento de planes y fondos de pensiones; Portugal: Art. 32, 38 Decreto-Lei n.o 12/2006 de 20 de Janeiro .
[244] Art. 32 IORPD II.

The depositary/custodian regime under the IORPD II is a hybrid regime. It contains elements of the AIFMD/UCITSD V depositary and the CRD IV/MiFID II custodian regime. IORPD II leaves it completely up to individual Member States whether one or more depositaries or custodians are required to be appointed. This was a compromised political solution for dealing with all different types of IORPs throughout the EEA.[245] Regardless of this, Member States may, however, not restrict IORPs from appointing credit institutions, investment firms, AIF and UCITS depositaries to be appointed as a depositary/custodian. The harmonized types of eligible entities is logical as both depositaries and custodians have the safekeeping task as their primary task and these eligible entities are suitable for dealing with the risk related to this task. The IORPD II provides a regulatory framework in which minimum harmonization for both the performance of the safekeeping and controlling task is aimed to be achieved.[246] The IORPD II does, however, not make a choice between a full-fledged depositary regime as under the AIFMD and UCITSD V nor does it target plain custodians. The IORPD II, for example, does not require the single appointment of a depositary for those Member States that decide to compulsory require a depositary to be appointed for their IORPs.[247] Nor does IORPD II require a 'third-party depositary' that ensures a minimum degree of independence from the IORP governing body in performing controlling tasks.[248] The 'custodian' part of the IORPD II regime is reflected in the delegation and liability regime. Custodians under CRD IV and MiFID II are, unlike AIFMD/UCITSD V depositaries, not responsible for having an overview of all assets in the custody holding chain.[249] Depositaries are under the AIFMD/UCITSD V required to comply with stricter delegation and liability requirements as they keep an overview of all AIF/UCITS assets to perform its controlling task.

Essentially, IORPD II leaves not only the appointment of depositaries and custodians but also a lot of discretion to extend the AIFMD/UCITSD V 'third-party depositary requirements', delegation and liability regime to IORPD II depositaries.

4. Product Regulation

Product regulation under IORPD II consists of legal forms, the 'prudent person rule' and quantitative restrictions.

4.1. Legal Forms under IORPD II

IORPs are institutions that may be set up in any legal form.[250] This is confirmed by Article 6(2) IORPD II that defines a pension scheme operated under an IORP as 'a contract, an agreement, a trust deed or rules stipulating which retirement benefits are granted and under which conditions'. Member States, thus, have the sole discretion in stipulating the type of legal form in which (a pension scheme of) an IORP may be established. A mapping exercise of CEIOPS (predecessor of EIOPA)[251] has shown that IORPS are typically established in four main legal forms.[252] The corporate and foundation type of IORPs have legal personality and

[245] See Chapter 5, section 2.1.
[246] See Chapter 5, section 3.4.
[247] Art. 33 IORPD II.
[248] See Art. 35 IORPD II.
[249] See Chapter 6, section 2.2.
[250] Art. 6(1) IORPD II.
[251] See CEIOPS-OP-03-08 final, Annex 3 – legal form of the IORP.
[252] See also J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 5.

an internal governing body[253], whereas IORPs established in the trust or contractual form do not have legal personality and, typically, have external governing bodies.[254]

4.1.1. Internal Governing Body

IORPs of the corporate and foundation type have an internal governing body that is derived from their legal personality and capacity. Depending on whether the corporate form has a one-tier or two-tier structure, the persons which are effectively running the IORP (governing body) are the board of directors or executive directors (one-tier structure). The governing body owes a fiduciary duty to the IORP members. Corporate and foundation type IORPs in most Member States have a single board of directors. Representatives are chosen by employers and employees jointly. Germany and the Netherlands are an exception and have a two-tier structure.[255]

4.1.1.1. Corporate IORPs

IORPs are throughout the Member States established in a wide variety of different corporate forms. They show, however, two common features: the IORP under the corporate form has legal personality and the IORP members have legal title to the pension assets or capital.[256]
Some Member States offer a limited amount of corporate forms in which IORPs may be established. In Austria, for example, are established as joint stock companies (Pensionskasse)[257]. In Belgium, as mutual insurance associations (OVV: Onderlinge Verzekeringsvereniging) and non-profit organizations (VZW: Vereniging Zonder Winstoogmerk).[258]

To the contrary, Liechtenstein and Luxembourg offer a larger variety of corporate forms. In Liechtenstein, IORPs may be, apart from joint stock companies, be established as European joint stock company, cooperative society and European cooperative societies.[259] Luxembourg even offers a bigger choice by having the Co-operative company (organised as a limited company), Association of mutual insurances (Association d'assurances Mutuelles) and the Non-profit making association (Association d'assurances mutuelles).[260] Other corporate forms offered are the Savings company with variable capital (sepcav) Societe d'epargne pension a

[253] The initial Draft IORPD II used the term 'governing body'. The final version of IORPD II refers to 'persons who effectively run the institution'. See Art. 22 IORPD II.
[254] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 5; J. Ashcroft, J. Yermo & F. Stewart, *Regulatory and supervisory context for occupational pension provision* 9 (P. Thornton & D. Fleming eds, Cambridge University Press 2011); F. Kessler, *The Governance of Supplementary Pension Schemes and the Role of the Employee Representatives: A Story of Paradoxes* 295 (O. Kaufmann & S. Hennion, Springer 2011).
[255] J. Ashcroft, J. Yermo & F. Stewart, *Regulatory and supervisory context for occupational pension provision* 9 (P. Thornton & D. Fleming eds, Cambridge University Press 2011).
[256] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 15, 16.
[257] § 6 Bundesgesetz vom 17. Mai 1990 über die Errichtung, Verwaltung und Beaufsichtigung von Pensionskassen (Pensionskassengesetz – PKG).
[258] Art. 9 Law of 27 October 2006 on the supervision of institutions for occupational retirement provision.
[259] Art. 7(a) Pensionsfondsgesetz.
[260] Arts 5 and 25Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.

capital variable (sepcav) and the Pension savings association (assep) Association d'epargne-pension.[261]

4.1.1.2. Foundations

IORPs established as a foundation are also legal entities with legal personality. Unlike the corporate type of IORPs, the IORP members, generally, do not have legal title to the assets of the IORP. Exceptions may be the insolvency of the employer or the liquidation of the scheme.[262] IORPs established as foundations are present in Liechtenstein[263] and the Netherlands.[264]

4.1.2. External Governing Body

IORPs established in the contractual or trust form consist of a segregated pool of assets without legal personality and are, therefore, governed by a separate (legal) entity that can be regarded as an external governing body.[265]

4.1.2.1. Trust Form

IORPs established as trusts. Trusts do not have legal personality nor do IORP members have legal title to the IORP assets, except in some Member States under specific circumstances such as an insolvency of the employer and the liquidation of the scheme.[266] Instead, the trustee has legal title to the assets. The trust is, thus, similar as the foundation. It has, however, not an internal governing body but the assets are administered by a trustee in the interest of the members that are the members under the trust deed.[267] The trustee may be a legal entity itself, but can be seen as an external governing body as it is not an internally institutionalized governing body but appointed by the trust deed. The safekeeping of the IORP assets by a depositary/custodian segregates the assets from the trust of all other assets administrated by the trust and the own assets of the trustee. The trust is the only legal form available for IORPs in Ireland, Malta and the UK.[268]

4.1.2.2. Contractual Form

Similarly, contractual IORPs do not have legal personality. Members, however, have legal title to the assets of the IORP.[269] Contractual IORPs are typically managed by credit institutions, insurance companies, AIFMs/UCITS ManCos or specialized pension fund

---

[261] Arts 5 and 25Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.

[262] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, 15, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016).

[263] Art. 7(a) Pensionsfondsgesetz.

[264] http://www.toezicht.dnb.nl/2/50-201968.jsp.

[265] F. Kessler, *The Governance of Supplementary Pension Schemes and the Role of the Employee Representatives: A Story of Paradoxes* 295 (O. Kaufmann & S. Hennion, Springer 2011).

[266] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 5.

[267] J. Ashcroft, J. Yermo & F. Stewart, *Regulatory and supervisory context for occupational pension provision* 9 (P. Thornton & D. Fleming eds, Cambridge University Press 2011).

[268] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 5.

[269] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 15.

management companies that are established in the statute of several Member States[270]. In Portugal, for example, only these specialized pension fund management companies are allowed to manage IORPs[271], whereas in Spain also other financial institutions, as mentioned above, are allowed.[272] Assets are separately held from the financial institution by a depositary/custodian very similar to AIFs and UCITS. The governing board is, usually, part of the board of directors of the financial institution managing the IORP.[273] In Spain, however, a separate supervisory board is required to control the board of directors of a specific financial institution that manages an IORP.[274]

The large variety of the legal forms employed is due to the fact that on the basis of the TFEU IORPs as a 'product' can only be marginally harmonized as pension funds as such fall outside of the scope of the TFEU and the European Union does not have the competence to regulate this on the European level.[275] Instead, the 'internal market' was used to harmonize IORPs, but the limited extent of harmonization has resulted in various legal forms that are part of the legal tradition and tax regulations of the individual Member States. Despite this plurality of legal forms, all IORPs authorized/registered may operate on the basis of a European passport under the IORP throughout the EEA. This can be explained by the legal neutral approach of the IORPD II. Regardless of the legal form employed, the intermediary regulation applying to IORP governing bodies, delegated assets managers and depositaries/custodians and their duties towards each other and the IORP members are the same. Similar as under the AIFMD/UCITSD V, IORP legal forms merely provide for the limited liability of the IORP members and the segregation of assets from the employer, the individual IORP members and the operational assets of the IORP, asset manager and the depositary/custodian.

4.2. The IORPD II Prudent Person Rule & Quantitative Restrictions

4.2.1. The Prudent Person Rule

IORPD requires IORPs to invest in accordance with the 'prudent person' rule.[276] The prudent person rule has been chosen as general standard instead of a detailed investment policy as research prior to the IORPD I indicated that IORPs in countries with quantitative restrictions had lower investment returns.[277] The IORPD does not provide a definition of the 'prudent person rule'. The literature, however, in this regard assumes that the prudent person rule is

---

[270] Portugal: Art. 53 Decreto-Lei n.o 12/2006 de 20 de Janeiro (Comissão de acompanhamento do plano de pensões) ; Spain: Art. 13 Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulacila de los Planes y Fondos de Pensiones (comisión de control).

[271] Portugal: Art. 32, 38 Decreto-Lei n.o 12/2006 de 20 de Janeiro.

[272] Spain: Art. 20 Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulacila de los Planes y Fondos de Pensiones and Art. 4 Real Decreto 304/2004, de 20 de febrero, por el que se aprueba el Reglamento de planes y fondos de pensiones.

[273] J. Ashcroft, J. Yermo & F. Stewart, *Regulatory and supervisory context for occupational pension provision* 9 (P. Thornton & D. Fleming eds, Cambridge University Press 2011).

[274] Spain: Art. 13 Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulacila de los Planes y Fondos de Pensiones.

[275] H. Van Meerten, A. van den Brink & S.A. de Vries, *Regulating Pensions: Why the European Union Matters (*Netspar Discussion Paper), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1950765 (accessed 4 October 2016).

[276] Art. 19(1) IORPD II.

[277] European Commission, *Proposal for a directive of the European Parliament and of the Council on the activities of institutions for occupational retirement provision* (/* COM/2000/0507 final - COD 2000/0260 */), 136-144; See also Recital 8, 16, 47, 32 IORPD II.

focused on the conduct of the IORP (governing board) as an investor.[278] Investments carried out by the IORP governing board should be done 'prudently', i.e. as someone would do when investing on his own behalf.[279] The rule focusses on the process of setting out the IORPs investment policy.[280] The investment policy has to be construed by the IORP governing body based on a theoretical bases that justifies the investment based upon a transparent decision making process that can be verified and is applies on a consistent basis.[281] The assessment should be based not on individual investments, but on the composition of the investment portfolio as a whole.[282] The assets shall be invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole.[283] The IORP governing body may, however, also delegate investment management.[284] The role of the IORP governing body should, thus, be understood as it has the overarching responsibility for the oversight and supervision of the investment process and the detailed investment management.[285] IORPD II elaborates the prudent person rule by two sub-principles: the freedom of asset allocation and the best interests of members and beneficiaries.

4.2.1.1. Freedom of Asset Allocation

The first sub-principle of the prudent person rule is the freedom of asset allocation. The prudent person rule, other than quantitative limits, allows for freedom of asset allocation that suits the precise nature and duration of the liabilities of IORPs.[286] This principle is further implemented by the prohibition of the IORPD for Member States to require IORPs to invest in particular categories of assets[287] and subject the investment decisions of IORPs or its investment managers to any kind of prior approval or systematic notification requirements[288] The governing body of an IORP, thus, has the freedom of determining the investment policy of an IORP.

4.2.1.2. Best Interests of Members/Beneficiaries

The second sub-principle requires the assets of the IORP to be invested in the best interests of its members and beneficiaries.[289] Potential conflicts of interests have to be resolved by the governing body or any investment management delegate by making the investment in the sole

[278] E.P. Davis, *Prudent person rules or quantitative restrictions? The regulation of long-term institutional investors' portfolios*, 2 Journal of Pension Economics and Finance 157 (2002).
[279] P. Laaper, *Uitbesteding in de financiële sector - in het bijzonder van vermogensbeheer door pensioenfondsen* 90 (kluwer 2015).
[280] E.P. Davis, *Prudent person rules or quantitative restrictions? The regulation of long-term institutional investors' portfolios*, 2 Journal of Pension Economics and Finance 157 (2002); P. Laaper, *Uitbesteding in de financiële sector - in het bijzonder van vermogensbeheer door pensioenfondsen* 90 (kluwer 2015).
[281] R.H Maatman, *Het pensioenfonds als vermogensbeheerder* 232 (Deventer: Kluwer 2004).
[282] See P. Laaper, *Uitbesteding in de financiële sector - in het bijzonder van vermogensbeheer door pensioenfondsen* 91 (kluwer 2015); See R.H. Maatman, *Beleggen volgens de 'prudent person'-regel*, 17 Ondernemingsrecht 645 (2003).
[283] Art. 19(1)(c) IORPD II.
[284] Art. 32 IORPD II.
[285] EIOPA-BOS-12/015, 292.
[286] Recital 45 IORPD II.
[287] Art. 19(4) IORPD II.
[288] Art. 19(5) IORPD II.
[289] Art. 19(1)(a) IORPD II.

interest of members and beneficiaries.[290] IORPD II, thus, emphasizes the duty of loyalty/care for the investments made on behalf of its members and beneficiaries.[291]

4.2.2. IORPD II Investment Restrictions

4.2.2.1. IORPD II

Despite of the prudent person rule being of fiduciary nature, the IORPD also contains specific investment restrictions of both qualitative and quantitative nature.[292]

Two restrictions in the IORPD are of qualitative nature. First, IORPs shall predominantly invest on regulated markets.[293] Assets not admitted to trading on regulated markets must, in any event, be kept to prudent levels.[294] Second, IORPD II demands the avoidance of risk concentration.[295] In general, IORPs have to diversify in such a way to avoid excessive reliance on any particular assets, issuer or group of undertakings and accumulations of risk in the portfolio as a whole.[296] In doing so, the IORPs has to avoid excessive risk concentration by not investing in too many assets that are issued by the same issuer or by issuers belonging to the same group.[297]

IORPD II contains also two restrictions of quantitative nature. First, investment in derivatives is only allowed for the facilitation of efficient portfolio management and not for investment (leverage) purposes.[298] Second, the investment in the sponsor undertaking shall not more than 5% of the portfolio or 10% in undertakings belonging to the same group as the sponsor undertaking.[299] The latter to mitigate conflicts of interest and minimize the correlation between human and financial capital. Any investment in a sponsor undertaking is, however, subjected to the general prudent man rule that requires the IORP governing board to have solid reasoning for investing in the sponsor undertaking in the first place.[300] Member States may, however, decide to not apply the latter two restrictions of quantitative nature to government bonds.[301]

4.2.2.2. IORPD II Member State Implementations

The prudent person rule may be complemented by quantitative rules of the Member States.[302] Most Member States have quantitative investment limits to complement the prudent person rule.[303] Depending upon the type of IORP, this is logical. DB and hybrid schemes in which the IORP or the sponsor undertaking bears substantial investment risk the protection of members is guaranteed by technical provisions[304] and solvency requirements[305]. The

---

[290] *Ibid*.

[291] Maatman holds that the prudent person rule shows remarkable similarities with the 'prudent investor rule' in trust law. See R.H. Maatman, *Beleggen volgens de 'prudent person'-regel*, 17 Ondernemingsrecht 645 (2003); R.H Maatman, *Het pensioenfonds als vermogensbeheerder* 236-240 (Deventer: Kluwer 2004).

[292] P. Laaper, *Uitbesteding in de financiële sector - in het bijzonder van vermogensbeheer door pensioenfondsen* 106, 107 (kluwer 2015).

[293] Art. 19(1)(d) IORPD II.

[294] *Ibid.*

[295] Art. 19(1)(f) sub-para. 1 IORPD II.

[296] *Ibid.*

[297] Art. 19(1)(f) sub-para. 2 IORPD II.

[298] Art. 19(1)(e) IORPD II.

[299] Art. 19(1)(g) IORPD II.

[300] R.H Maatman, *Het pensioenfonds als vermogensbeheerder* 232 (Deventer: Kluwer 2004).

[301] Art. 19(1)(g) sub-para. 3 IORPD II; See for criticism: P. Laaper, *Uitbesteding in de financiële sector - in het bijzonder van vermogensbeheer door pensioenfondsen* 109, 110 (kluwer 2015).

[302] Art. 19(6) IORPD II.

[303] See CEIOPS-OP-03-08 final, 11.

[304] EIOPA-BOS-12/015, 292.

[305] *Ibid*, 295-296.

investment risk in full DC IORPs are borne by members. A solvency regime nor capital requirements protect members from investment risks undertaken by the IORP. Supplementing quantitative limits are used on a large scale to compensate for that.[306]

5. Disclosure

IORPD II requires specific disclosure duties towards members/beneficiaries and Competent Authorities.

5.1. Information given to Members and Beneficiaries

The information given under the IORPD ensures that prospective members, members and beneficiaries are supported in their decision-making throughout the various phases comprising of pre-enrolment, membership and post-retirement.[307] Members shall, in particular, be informed about pension entitlements[308], risks and guarantees[309], and costs[310].[311] Hybrid and DC schemes shall provide additional information on the investment profile[312], any available options and the past performance.[313]

5.1.1. Prospective Members

The information that shall, at least[314], be provided to prospective members depends upon whether the members have to take an individual decision and whether they bear investment risks.[315] Prospective members who have to take an individual decision need to be information about the relevant features of the institutions, the kind of benefits and a reference to where further information is available.[316] Prospective members not taking an individual decision to join the IORP scheme need to be informed regarding their investment options and, for DC/hybrid schemes, the system of governance of the institution.[317] Information to DC/hybrid scheme prospective members should include information on investment options and the costs incurred.[318]

5.1.2. Members

A pension benefit statement setting out standardized key information about a pension scheme should be given to members.[319] The statement should facilitate the understanding of pension entitlements.[320] Members are, similarly, informed about risk and guarantees[321] and costs[322] in a

[306] See CEIOPS-OP-03-08 final, 11.
[307] Recital 63 IORPD II.
[308] Art. 37(1)(b) IORPD II.
[309] Art. 37(1)(e) IORPD II.
[310] Art. 37(1)(h) IORPD II.
[311] Recital 63, Art. 37 IORPD II.
[312] Art. 37(1)(g) IORPD II.
[313] Recital 63, Art. 37 IORPD II.
[314] Art. 36(1) IORPD II.
[315] Art. 41 IORPD II.
[316] Art. 41 (1) IORPD II.
[317] Art. 41(3) IORPD II.
[318] Art. 41(2) IORPD II.
[319] Recital 66, Art. 38 and 39 IORPD II.
[320] Recital 66 IORPD II.
[321] Art. 39 (5)(c) IORPD II.
[322] Art. 39 (5)(fb) IORPD II.

concise way. The statement shall also include additional information on the investment profile[323], any available options and past practical information[324].

5.1.3. Beneficiaries

During the pay-out phase, beneficiaries should periodically receive information about major material changes on their benefits and corresponding payment options.[325] This is particularly important when a significant level of investment risk is borne by beneficiaries in the pay-out phase.[326]

5.1.4. Additional Information to be given on request to Members and Beneficiaries

Members, beneficiaries and their representatives may on request be provided by additional information. This information may concern the annual accounts and the annual reports[327], the statement of investment policy principles[328], assumptions on the contributions and pension projections[329] and information on the assumed annuity rate, the type of provider and the duration of the annuity.[330] Members, in addition, may request detailed and substantial information on the the level of benefits in case of cessation of employment[331].

5.2. Information provided to Competent Authorities

On the basis of Article 50 IORPD II, the Competent Authorities of the home member state of any IORP may require at any time information about all business matters or business documents.[332] They also may supervise relationships between IORPs and delegates[333] and request information[334] when IORPs have outsourced any key functions or other activities to delegates in such a way that it influences the financial situation of the IORP in a material way. Competent Authorities may also request various documents, such as the statement of investment-policy principles, the annual accounts/reports and all other documents necessary for the purpose of their supervision.[335] In addition, they may lay down what documents they consider to be necessary for the purpose of supervision, including, amongst others, internal interim reports[336], evidence of consistency with the investment-policy principles[337] and evidence that contribution[338] have been paid as planned.[339] On-site inspections may be made at the IORP's premises and its delegates to verify whether activities are carried out in accordance with the supervisory rules.[340]

---

[323] Art. 37(1)(c) IORPD II.
[324] Art. 40 IORPD II.
[325] Recital 68, Art. 43 IORPD II.
[326] Art. 43 IORPD.
[327] Arts 29, Art. 44(a) IORPD II.
[328] Arts 30, Art. 44(b) IORPD II.
[329] Art. 44(c) IORPD II.
[330] Arts 40(1)(c).
[331] Art. 40(1)(d) IORPD II.
[332] Art. 50(1)(a) IORPD II.
[333] Art. 50(1)(b) IORPD II.
[334] Art. 50(1)(f) IORPD II.
[335] Art. 50(1)(c) IORPD II.
[336] Art. 50(1)(d)(i) IORPD II.
[337] Art. 50(1)(d)(iv) IORPD II.
[338] Art. 50(1)(d)(v) IORPD II.
[339] Art. 50(1)(d) IORPD II.
[340] Art. 50(1)(e) IORPD II.

6. Members, Beneficiaries and the Employer as Residual Claimants

The interests of members of an IORP are similar as to those of investors under the AIFMD, UCITSD and MiFID II. On a closer look, however, the status of members as a residual claimant of the IORP and the residual character of their claims seems to be different compared to investors under the AIFMD, UCITSD and the MiFID II.[341]

Similarly, the separation of investments and management concept also applies to IORPs.[342] IORPs are operated on the basis of asset partitioning and(third-party) management. Assets are being segregated to avoid that the IORP assets are being exposed to the personal creditors of the IORP governing body and the employer's business activities.[343] Under the AIFMD, UCITSD V and MiFID II, the investors for whom third-party management is exercised, generally, bear the risks, i.e. the gains and losses of the investments in the assets on behalf of them. They, thus, benefit from the returns on the investments of the assets being invested in them on their behalf. Their claims are being residual as they are being satisfied once the prior claims of the (collective) asset manager and depositary/custodian have been paid.

The residual claimant position of IORP members, however, is less obvious. This is the result of the different types of pension frameworks that are present in Europe and the fact that pension schemes can either be of a DB or a DC nature. [344] Depending upon the nature of the IORP, either the members and beneficiaries or the employer are having the strongest residual interest in the IORP.

6.1. The Nature of IORPs in Europe

The vast plurality of pension frameworks in Europe are broadly divided up in two types.[345] First, IORPs that are set up as an legal entity that resemble insurance companies as they are bearing liabilities with their own balance sheet. These types of IORPs are subject to technical provisions with regard to their own funds to bear biometric risks or to guarantee a certain level of benefits or investment performance. The second type of IORPs are, typically, established by the sponsor. The sponsor, in most cases the employer, bears biometric and investment risks. Most Member States provide for (a combination) of both types of IORPs.

There is a vast variety of different types of IORPs performing different types of schemes. Schemes of IORPs of either types can, however, in general terms be classified as a DB a DC IORP or a hybrid (carrying both elements). In (pure) DC IORPs, sponsors or/and IORPs itself do not underwrite the biometric and investment risk of the IORP.[346] The contributions paid by employers and/or employees are defined for the amount of years of employment rather than the benefits paid out to the beneficiaries. The benefits depend upon the contributions and the investment performance of the assets of those contributions. DC IORPs, thus, cannot go into deficit as whatever the outcome of the investments will be the members of DC IORPs do not get guaranteed any level of income upon retirement.[347] The principal risk takers are, thus, the members and beneficiaries of the IORP. The governance regulations applying to DC IORPs

---

[341] D. Fox, *Defined Benefit Pension Trusts: Asset Partitioning and the Residual Interest,* University of Cambridge Faculty of Law Research Paper No. 10/03, 16.
[342] See Chapter 11, section 1.2.1.
[343] *Ibid.*
[344] H. Van Meerten, *Pensions Reform in the European Union: Recent Developments after the Implementation of the IORP Directive***,** 14 Pensions: An International Journal 4 (2009).
[345] *Ibid.*
[346] See for Art. 27 IORPD II on the appointment of an actuary: 'where the institution itself provides cover against biometric risks or guarantees either an investment performance or a given level of benefits Member States (…)'.
[347] D. Fox, *Defined Benefit Pension Trusts: Asset Partitioning and the Residual Interest,* University of Cambridge Faculty of Law Research Paper No. 10/03, 6 et seq.

as of a more simplistic nature than of DB schemes. Particularly important governance issues under IORPD II include the general governance regulation imposed on the IORP governing body[348], the appointment of a depositary[349], the disclosure provided to members and beneficiaries[350] and the reporting to any relevant Competent Authority[351].

In DB and hybrid IORPs, the sponsor (employer or multiple employers) or the IORP insures beneficiaries (to some extent) against financial or biometrical risks.[352] Not the contributions, but the benefits paid are predefined and based on the final or average wage and the length of employment. DB and hybrid, thus, have the possibilities to go into deficit. A deficit occurs when an actuarial valuation of the IORP liabilities to its members and beneficiaries exceeds the value of the IORP assets that are available to fund them.[353] Any deficits leads to an obligation of the employer or IORP to re-balance the funds available by entering into a recovery plan. A recovery plan might be, for instance, to increase employer's the rate of contributions. The residual obligation is on the IORP and the employer to keep the IORP funded so that it can provide for the liabilities towards its members and beneficiaries.

DB and hybrid plans under the IORPD II require additional regulatory provisions to be complied. Examples include the technical provisions[354] to be complied with to ensure full funding and the appointment of an actuary to evaluate future liabilities and the funding of the IORP.[355]

6.2. IORP Members as Residual Claimants

The participants in an IORP are being referred to as 'members'. Their economic/legal ownership and limited liability in the IORP resembles a similar position as investors of AIFs, UCITS and, to a lesser extent, discretionary mandates. They are not being referred to as investors as they have a different position concerning the exit rights they are entitled to and the degree in which they bear investment risks.[356]

6.2.1. Legal versus economic ownership

Similar as investors of AIFs and UCITS, the position of members is indifferent with regard to the question to whom the legal ownership of the IORP assets has been assigned to. Legal ownership might be attributed to members as regulatory co-owners, to the IORP itself (corporate, foundation), an external trustee or an external pension fund management company. The constitutive documents of the IORP and the indirect holding model prevent that members are legal owners of the IORP assets. De facto, members in an IORP are not allowed under the IORP constitutive documents to claim their stake of assets out of the IORP as they wish.[357] For example, members that are the co-owners of an IORP are not co-owners under the property law of the Member State concerned. Instead, they are co-owners under

---

[348] See *infra* 3.1.1.
[349] Art. 33 IORPD II.
[350] See Title IV Information to be given to Prospective Members, Members and Beneficiaries IORPD II;
[351] Art. 50 IORPD II.
[352] See, for example, Art. 27(1) IORPD II: 'where the institution itself provides cover against biometric risks or guarantees either an investment performance or a given level of benefits Member States (…)'.
[353] D. Fox, *Defined Benefit Pension Trusts: Asset Partitioning and the Residual Interest,* University of Cambridge Faculty of Law Research Paper No. 10/03, 6 et seq.
[354] See Title II – Quantitative Requirements IORPD II.
[355] Art. 27 IORPD II.
[356] H. van Meerten, & E. Schmidt, *Compulsory membership of pension schemes and the free movement of services in the EU,* 19 European Journal of Social Security 2 (2017).
[357] *Organisation* for *Economic Co-operation* and *Development, Guidelines for the Protection of Rights of Members and Beneficiaries in Occupation Pension Plans,* http://www.oecd.org/dataoecd/16/33/34018295.pdf (accessed 14 January 2017).

regulatory law that only enjoy the share of the IORP assets under the conditions as set out in the IORP constitutive documents.

6.2.2. Asset Partitioning

The separation of investment and management concept applicable to IORP leads to asset partitioning. Asset partitioning is effectively provided for under the constitutive documents of IORPs and the asset segregation applied by any depositary/custodian effectuates the shielding of asset patrimonies of the different constituencies of the IORP, the various schemes operated by an IORP and limited liability. Asset partitioning results from 'shielding the asset patrimony' and 'shielding the owners' (limited liability).[358]

6.2.2.1. Shielding

The shielding[359] of assets under the constitutive documents of the IORP involves the demarcation of a pool of assets that are distinct from other assets owned, singly or jointly, by the IORP members, IORP (governing body), external service providers, such as depositaries and custodians and of which the IORP itself is acting through its internal or external governing body.[360] The separation of investment and management leads also to a 'separate patrimony' as a result of the asset segregation applied by the depositary amongst different schemes operated by the same IORP.

Shielding leads to two essential components. First, the creditors of the IORP rank ahead of the claims of the beneficiaries whether the IORP is going concern or being liquidated. The governing body and delegates have the right to reimburse themselves from the IORP assets and to be paid remuneration for their service before the beneficiaries' fixed (DB IORPs) or variable claims (DC IORPs) have to be met.[361] Second, shielding provides that the IORP members and personal creditors cannot withdraw their share of IORP assets, thus, forcing the IORP to sell assets or to liquidate. This 'liquidation protection' protects the going concern value of the IORP.[362] The IORP governing body gets assigned to have the authority to administrate the IORP, bonds the assets of the IORP and to bring lawsuits on the contracts entered into by the IORP.[363]

6.2.2.2. Limited Liability

Limited liability is the second component of 'asset partitioning' that is a default term under the constitutive documents of the IORP that protects the IORP assets from the claims of the

---

[358] J. Armour, H. Hansmann & R. Kraakman, *The Essential Elements of Corporate Law*, Oxford Legal Studies Research Paper No. 20/2009, 10.

[359] *Ibid*, 6.

[360] M. Jensen & W. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 Journal of Financial Economics 305 (1976); See also A. Alchian & H. Demsetz, *Production, Information Costs, and Economic Organization*, 62 American Economic Review 777 (1972).

[361] D. Fox, *Defined Benefit Pension Trusts: Asset Partitioning and the Residual Interest,* University of Cambridge Faculty of Law Research Paper No. 10/03, 17.

[362] R.H. Sitkoff, *Trust Law as Fiduciary Governance Plus Asset Partitioning* 428(L. Smith ed., Cambridge University Press, 2013); J. Armour, H. Hansmann & R. Kraakman, *The Essential Elements of Corporate Law*, Oxford Legal Studies Research Paper No. 20/2009. 7; Organization for Economic Co-Operation and Development, *OECD Guidelines for Pension Fund Governance*, https://www.oecd.org/finance/private-pensions/34799965.pdf (accessed 5 October 2016).

[363] See also J. Armour, H. Hansmann & R. Kraakman, *The Essential Elements of Corporate Law*, Oxford Legal Studies Research Paper No. 20/2009, 7, 8; R.H. Sitkoff, *Trust Law as Fiduciary Governance Plus Asset Partitioning*, Harvard University Law & Economics Discussion Paper No. 711, http://ssrn.com/abstract=1962856 (accessed 5 October 2016).

IORP's creditors.[364] Limited liability is, thus, 'owner shielding'[365], the converse of shielding the asset patrimony, that protects the assets of the IORP from the creditors of the IORP members.[366] Together, they enable 'asset partitioning' ensuring the separation of investment and management.

The position of members and beneficiaries as claimants on the assets of the IORP seems to be similar to AIF and UCITS investors. The residual character of their claims, however, depends upon the type of IORP. Members under a full DC scheme have residual interest in the fullest sense, whereas hybrid and DB schemes provide a (certain degree of) investment guarantee.[367]

6.2.3. Residual Claims: Investment risk vs. Investment Guarantee

The residual character of the claim of the members depends upon whether an IORP is operated as a DC, DB or hybrid scheme.

Members of full DC IORPS are not entitled to any defined level of benefits upon retirement. The IORP simply invests the contributions that members and employers made during the accumulation phase and assets are invested in the market. There is a direct correlation between the value of the assets invested in the market and the liabilities of the IORP owed to the member. Members in full DC IORPs bear the entire investment risk from the assets that are invested in the market. Benefits and losses from net capital and income returns on the investment of the IORP assets are entirely born by the members. The residual interests of members under a full DC scheme are just as much residual claimants as the investors in an AIF, UCITS or under a discretionary mandate.

The residual claim of beneficiaries of full DB and hybrid IORPs depends upon the degree of 'investment guarantees' given. DC IORPs are entitling their beneficiaries a certain level of income from the IORP upon retirement. Beneficiaries are only having a residual interest in a slight sense. There is no direct correlation between the value of the investments made over the accumulation period and the retirement income. Beneficiaries do not benefit from a rise of value of the IORP assets invested and are also sheltered to a large degree from any fall in asset values. Beneficiaries are, however, paid a proportion of whatever income the investment of the assets of the IORP have yielded.

Hybrid IORPs are neither full DB or full DC IORPs, but have characteristics of both. There are many different types of hybrid IORPs throughout the EEA. Examples include career average schemes, combination hybrids, self-annuitizing DC scheme, final salary lump sum schemes, underpin arrangements, cash balance schemes and fixed benefit/benefit unit schemes.[368] It goes beyond the topic of this book to explain all the different types. A common characteristic of all these different examples is that hybrid IORPs share the risks between employers and members/beneficiaries. The degree of the residual interest of a member/beneficiary in such a scheme, thus, depends upon the degree of investment risk being born by the members/beneficiaries.

6.3. Employers as Residual Claimants

---

[364] J. Armour, H. Hansmann & R. Kraakman, *The Essential Elements of Corporate Law*, Oxford Legal Studies Research Paper No. 20/2009, 9.
[365] *Ibid*, 9.
[366] *Ibid*, 10.
[367] D. Fox, *Defined Benefit Pension Trusts: Asset Partitioning and the Residual Interest,* University of Cambridge Faculty of Law Research Paper No. 10/03, 17.
[368] The Pensions Board, *A Guide to Hybrid Pension Schemes*, http://www.pensionsauthority.ie/en/LifeCycle/Private_pensions/Hybrid_pension_schemes/ (accessed 5 October 2016).

The employer usually pays the bigger part of the contributions in either a DB, hybrid or DC IORP scheme. Employees only pay a fixed proportion of their wages as contributions in the relevant IORP scheme. This does not make the employer a residual claimant. But with a DB IORP, the employer's residual interest is mainly to bear a residual liability to underwrite the claim of the members against the IORP. The risk of a rise of fall in the value of the IORP assets is allocated to the employer rather than to the employee. Members are preferred creditors rather than residual claimants. The employer is responsible for keeping DB IORPs funded. If the IORP scheme falls in deficit, then the residual burden is on the employer to make sure that the IORP is being brought in balance with a recovery plan. Deficits depreciate the value of the employers' assets, divers resources away from investment in the business to fund liabilities of the IORP. The position of the employer as a residual claimant, however, is different compared those of investors under the AIFMD, UCITSD and MiFID II. Employers bear residual liabilities but do not directly have a residual upside claim to the IORP to recover the net value of the IORP assets. Instead, the only benefit is that the value of agreed contributions from the side of the employer is being kept to a minimum so contributions are being kept to a minimum.

Regardless of IORPs being established as (full) DB or DC schemes, the duty of care and fiduciary duties of loyalty are being owed by the governing board to the members and beneficiaries and not to the employer.[369] Members and beneficiaries have the power to hold governing board members accountable for the exercise of discretions. Members are permitted to hold governing board members accountable even though their residual interests in DB schemes are limited. Interests of members are deemed to be to coincide and leaving members and beneficiaries to hold the governing board accountable is enough. In addition, IORP governing boards that act in the interest of their members and beneficiaries and manage IORPs well lead to fully funded IORPs that meet the liabilities of the IORP and, thus, act in the residual interest of the employer. Finally, the employer is only the residual claimant of the IORP in the sense that the only direct benefit is that the value of the contributions invested will be on such a degree that it leads to lower contribution for employers. The general ideal behind is that IORPD implementation laws do not intend to give the employer any positive financial claim from the establishment of an IORP. The law, thus, does not have as its object to convert any direct financial benefit on the employer. Employers are, thus, not in the position to have a positive claim against the trust assets. Therefore, employers do not have the right to hold IORP governing board members accountable for their duties of care and fiduciary loyalty owed to the IORP members and beneficiaries. The residual interests of the employer are, thus, reflected in the direct or indirect representation in the IORP governing board along the member representatives.

6.4. Member Representation as Substitute for Exit Rights

The occupational nature of IORPs does not provide for exit rights. Exit rights are limited in IORPs to portability that can only be triggered upon an employee changing jobs and switching to the IORP scheme of the new employer. An IORP established by an employer may, however, establish different IORP schemes that vary in risk-return characteristics and allow their employees to choice between these different schemes. Members, however, do not have an exit right as AIF/UCITS investors and investors of discretionary mandates.

Members are, in governance terms, forced to remain loyal.[370] Instead of an exit right, members are based upon social and labour laws directly or indirectly represented in the

[369] See *supra* 3.1.2.4.

[370] A.O. Hirschmann, *Exit, Voice and Loyalty. Responses to Decline in Firms, Organizations and States* (Harvard University Press 1970).

decisions made by IORP governing boards. Employers, especially in hybrid and full DB IORPs, may also be directly or indirectly represented in the IORP governing board in conjunction with the representatives of members and representatives.

7. The Compulsory Appointment of a Depositary for all IORPs as a Solution?

Under the IORPD II, IORPs are mandatory required to appoint a depositary, whereas it is left over to the individual Member States whether mixed and full DB IORPs are required to mandatory appoint a depositary.[371]

The delineation between full DC and other types of IORPs is based upon the EIOPA consideration[372] that Members bear the full investment risk and that, therefore, the controlling tasks of a depositary performed add additional value. Hybrid and full DB IORPs , to the contrary, fully or partially guarantee the benefits paid to members upon retirement. The investment risk is, thus, (partially) born by the IORP and/or the employer.

This delineation is remarkable as none of the Member States upon implementing the IORPD I in their national laws delineated for the purpose of the compulsory appointment of a depositary/custodian between (full) DC, hybrid and (full) DB IORPs.[373] Liechtenstein and Luxembourg, for example, required for IORPs that may operate DC, hybrid and DC IORPs a depositary to be appointed.[374] Belgium, France and Malta required for all types of IORPs custodian to be appointed, whereas other Member States, including, amongst others, Denmark, did not require a mandatory depositary or custodian for any type of IORP.[375]
The differences in Member State implementations are a result of the lack of a European legal basis to fully harmonize the IORPs and pension funds present in various Member States.

Despite of this, the question pops up whether and to what extent, particularly full DB and hybrid IORPs can be compared to AIFs and UCITS that would justify a compulsory appointment of all types of IORPs on the European level. The question to what extent IORPs/pension funds may be compared to AIFs and UCITS have been dealt with in a line of European and national case law dealing whether IORPs/pension funds qualify the VAT exemption of 'the management of special investment funds as defined by Member States' under Art. 135(1)(g) VATD. The relevant considerations of this line of case law and its relevance for the question whether depositaries should be compulsory appointed for all types of IORPs will be subsequently discussed.

7.1. Legal framework: the VAT exemption of the management of common investment funds

7.1.1. The VAT Exemption under the European VATD

[371] See Art. 31(1) and (2) IORPD II.
[372] EIOPA-BOS-12/015, 427.
[373] See Chapter 12, section 4.1.1.
[374] Art. 12 Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung ; Luxembourg: Art. 18 (1) and Art. 42 (1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (SEPCAV) et d'association d'épargne-pension (ASSEP) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.
[375] Consolidated Supervision of Company Pension Funds Act (Consolidated Act no. 1017 of 24 October 2005); Pensions Act (Consolidated Act no. 939 of 15 September 2004).

Art. 135(1)(g) VATD requires Member States to grant a VAT exemption to 'the management of special investment funds as defined by Member States'.

The interest for any IORPs is that if it qualifies as a special investment fund the IORP is not charged any VAT on investment services provided to them. Asset managers providing these services, however, have a genuine interest in these services not being exempt from VAT as VAT paid by them related to the 'the management of special investment funds as defined by Member States' would be irrecoverable for them. The relevant question for both parties is, thus, whether and to what extent IORPs qualify as 'special investment funds as defined by Member States'.

7.1.2. The VAT position of IORPS

Under the VATD 'special investment funds' is not defined. This is confirmed by the CJEU in Case C-424/11 *Wheels.*[376] It was decided in this case that the VATD leaves it up to the Member States to define the meaning of 'special investment funds'[377].[378] The power to define thereby accorded to the Member States is, however, limited by the prohibition on undermining the very terms of the exemption that are employed by the European legislation.[379] Members States, thus, only have the power to define, in its domestic law, the funds which meet the definition of 'special investment funds'.[380]

7.1.2.1. The European Definition 'Special Investment Fund'

The CJEU has elaborated the definition of 'special investment funds' in the *Abbey National*[381] and *Claverhouse*[382] case to a larger extent. It has reiterated that Member States have to define the meaning of 'special investment funds' in compliance with the objectives of the VATD and with the principle of fiscal neutrality inherent in the common system of VAT.[383] For that purpose, the VAT exemption should apply to any 'investment fund' in which assets are pooled and which have the characteristics of funds that constitute 'special investment funds' or is sufficiently comparable with the latter to be in competition with them.[384]

7.1.2.2. UCITS and AIFs as 'special investment funds'

The CJEU has confirmed in its case law that both UCITS and AIFs as European institutions for collective investment have to be regarded as 'special investment funds'.

The predecessor of the current VATD was already adopted prior to the harmonization of investment funds and, in particular, UCITSD I.[385] For that reason, Member States were allowed to determine that investment funds regulated at national level and subject to licensing and oversight rules aiming to protect investors qualified within the definition of 'special

---

[376] See CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 16.
[377] See CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 16; CJEU (Judgment of 4 May 2006), Case C-169/04), *Abbey National*, ECLI: EU:C:2006:289, para. 40, 41; CJEU (Judgment 28 June 2007), Case C-363/05, *Claverhouse,* ECLI: EU:C:2007:391, para. 43.
[378] CJEU (Judgment of 4 May 2006), Case C-169/04), *Abbey National*, ECLI: EU:C:2006:289, para. 38, 39; CJEU (Judgment 28 June 2007), Case C-363/05, *Claverhouse,* ECLI: EU:C:2007:391, para. 19, 20.
[379] See CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 16; CJEU (Judgment 28 June 2007), Case C-363/05, *Claverhouse,* ECLI: EU:C:2007:391, para. 21.
[380] See CJEU (Judgment 28 June 2007), Case C-363/05, *Claverhouse,* ECLI: EU:C:2007:391, paras 41-43.
[381] CJEU (Judgment of 4 May 2006), Case C-169/04), *Abbey National*, ECLI: EU:C:2006:289.
[382] CJEU (Judgment 28 June 2007), Case C-363/05, *Claverhouse,* ECLI: EU:C:2007:391.
[383] See CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 18; CJEU (Judgment 28 June 2007), Case C-363/05, *Claverhouse,* ECLI: EU:C:2007:391, para. 22, 43.
[384] CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 22.
[385] CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 41; CJEU (Judgment of 4 May 2006), Case C-169/04), *Abbey National*, ECLI: EU:C:2006:289, para. 40, 55; CJEU (Judgment 28 June 2007), Case C-363/05, *Claverhouse,* ECLI: EU:C:2007:391, para. 32.

investment funds' under the VATD.[386] The CJEU and its Advocate Generals have struggled over time to define whether UCITS have to be regarded as 'special investment funds' as the VATD gave little guidance as to the content of the term 'special investment funds'.[387] The CJEU, however, confirmed in *Wheels* that that 'funds which constitute undertakings for collective investment in transferable securities within the meaning of the UCITS Directive are special investment funds'.[388] UCITS, thus, supersede the power of national Member States to define the term 'special investment funds' in the VATD.[389] It was considered that the first and second recital in the UCITSD I indicates that the EU legislator wished to coordinate the law to harmonize the conditions and enhance competition between these types of collective investment undertakings.[390] The introduction of the UCITSD I was, thus, the first attempt on the EU level to harmonize collective investment undertakings and, thus, limited the discretion of the Member States to define special investment funds under the VATD.[391] Member States' power to define was, thus, partly superseded by the UCITS harmonization at the EU level.[392] The concept of 'special investment funds' within the meaning of the VATD was, therefore, after the introduction of the UCITSD I determined both by EU law and by national law.[393]
The CJEU, thus, held that UCITS subject to specific State supervision and funds which, without being collective investment undertakings within the meaning of the VATD, display characteristics identical to theirs and thus carry out the same transactions or, at least, display features that are sufficiently comparable for them must be regarded as exempt special investment funds within the meaning of the VATD.[394] Only those investment funds that are subject to specific State supervision can be subject to the same conditions of competition and appeal to the same circle of investors, however, may be eligible for the VAT exemption.[395]

The CJEU confirmed that AIFs (real estate funds) also fall within the scope of the VAT exemption for 'management of investment funds as defined by Member States' within the meaning of Article 13B(d)(6) VATD.

The CJEU stated in line with its previous case law that the power of Member States to define what constitutes a term 'special investment fund' are limited by the principle of fiscal neutrality and the objectives of the VATD.[396] For this purpose, not only UCITS, but also collective investment undertakings that are comparable with UCITS in term of potential competition and subject to state supervision qualify as 'special investment funds'.

AIFs have to qualify as 'special investment funds' if they are comparable with UCITS in term of potential competition. According to settled CJEU case-law, the principle of fiscal

---

[386] CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 42.
[387] CJEU (Judgment 13 March 2014), Case C-464/12, *ATP Pension Service,* ECLI:EU:C:2014:139, para. 37; See also CJEU (Judgment of 4 May 2006), Case C-169/04), *Abbey National*, ECLI: EU:C:2006:289, para. 55, 61, 64, 65.
[388] CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 23; CJEU (Judgment 28 June 2007), Case C-363/05, *Claverhouse,* ECLI: EU:C:2007:391, para. 50; CJEU (Judgment 13 March 2014), Case C-464/12, *ATP Pension Service,* ECLI:EU:C:2014:139, para. 46; CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 36.
[389] CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 39.
[390] CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 43.
[391] CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 44, 45.
[392] CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 46.
[393] *Ibid.*
[394] CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 47; CJEU (Judgment 13 March 2014), Case C-464/12, ATP Pension Service, ECLI:EU:C:2014:139, para. 46, 47.
[395] CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 48.
[396] CJEU (Judgment 13 March 2014), Case C-464/12, *ATP Pension Service,* ECLI:EU:C:2014:139, para. 64.

neutrality precludes treating similar supplies of services differently for VAT purposes.[397] A precondition is that these services have to be in competition with each other. The decisive criteria that matters is the interest investors derive from their investments.[398] AIFs are comparable to UCITS as they raise and pool capital by several investors who bear the risk connected with the management of the assets with a view to derive a profit either be the distribution to all investors by a dividend or the increase in the value of their holding.[399] The CJEU, thus, explicitly stated that the legal form, the existence of redemption rights and the types of investments invested in are not decisive for AIFs to be regarded as 'special investment funds', provided that the collective investment undertaking (AIF) is subject to specific State supervision in the Member State concerned.

The CJEU in *Fiscale Eenheid* decided that the discretion of the Member States in determining what collective investment undertakings can be regarded as 'special investment funds' is superseded by further harmonization of specific State supervision of investment funds. The CJEU in that case held that the UCITSD does not only recognize UCITS but also other collective investment undertakings.[400] State supervision may, thus, arise from the UCITSD, AIFMD or from national law. The CJEU, however, explicitly states that the AIFMD represents at EU level a further step in the harmonization of specific State supervision of investments.[401] AIFs, thus, generally classify as 'special investment funds' within the meaning of Article 13B(d)(6) VATD.

Funds which – without being UCITS (or AIFs)– display characteristics identical to those of UCITS (and AIFs) and which display features that are sufficiently comparable for them to be in competition with such undertakings must also be regarded as special investment funds.[402] After the adoption of the UCITSD and AIFMD, these 'funds' being assessed by the CJEU and national courts are, in particular, IORPs.

The idea of UCITS, AIFs and comparable funds being treated as special investment funds is that the objective of exempting the VAT connected with the management of special investment funds is, in particular, to support investment through UCITS and AIFs by excluding the cost of VAT and ensuring that the role played by VAT is fiscally neutral as regards the choice between direct investment in securities and investment through a UCITS or a AIF.[403] The principle of fiscal neutrality precludes economic operators carrying out the same transactions from being treated differently in relation to the levying of VAT.[404]

7.2. Competing Special Investment Funds

---

[397] See CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 63; See also the judgment in *Wheels Common Investment Fund Trustees and Others*, C-424/11, EU:C:2013:144, para. 21.

[398] See CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 63.

[399] *Ibid*, para. 64.

[400] **See CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 61, 62; See also Art. 19(1)(e) and Art. 24 UCITSD V.**

[401] **CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 61, 62.**

[402] CJEU (Judgment 13 March 2014), Case C-464/12, *ATP Pension Service,* ECLI:EU:C:2014:139, para. 47; CJEU (Judgment 28 June 2007), Case C-363/05, *Claverhouse,* ECLI: EU:C:2007:391, paras 48-51; CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 24.

[403] See for UCITS: CJEU (Judgment 13 March 2014), Case C-464/12, *ATP Pension Service,* ECLI:EU:C:2014:139, para. 43;CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 19.

[404]CJEU (Judgment 13 March 2014), Case C-464/12, ATP Pension Service, ECLI:EU:C:2014:139, para. 44; CJEU (Judgment of 7 March 2013), Case C-424/11, Wheels, ECLI: EU:C:2013:144, para. 20.

The CJEU has in its settled case-law set out four criteria to assess whether a 'fund' (read: IORP) displays the characteristics identical to those of UCITS (and AIFs).[405] The following elements are essential for comparing IORPs to UCITS for the purposes of fiscal neutrality under the exemption analyzed:[406]

- the IORP has to be subjected to state supervision.
- IORPs have to be solely funded (whether directly or indirectly) by persons to whom the retirement benefit is to be paid (i.e. the pension customers)
- beneficiaries have to pool their funds according to the principle of risk-spreading;
- the members must bear the investment risk.

Only the management services of IORPs that fulfill these four criteria cumulatively and, thus, qualify as special investment funds are VAT exempt.

7.2.1. State Supervision

The State supervision requirement dates back prior to UCITSD I in which period solely Member States were allowed to determine that investment funds regulated at national level and subject to licensing and oversight rules aiming to protect investors qualified within the definition of 'special investment funds' under the VATD.[407]

This requirement, however, requires to be determined what constitutes 'State supervision'. Following paragraph 42 *Fiscale eenheid X,* state supervision needs to be considered regulation that subjects funds to licensing and oversight rules with the aim to protect investors.

Although not explicitly confirmed by the CJEU so far, the IORPD II imposes prudential and conduct of business rules on institutions for occupational retirement provision. IORPs, provided that they fulfill the other three cumulative criteria, thus, qualify as the third type of harmonized 'special investment funds' within the meaning of the VATD.

7.2.2. Funding

The second criterion is that contributions/investments in IORPs in order to qualify as a 'special investment fund' must be paid by the members paid by the member(or at least in his name and on his behalf), that he benefits from the proceeds of his investments and that he also bears investment risks.[408] IORPs are institutions that operate on a funded basis. Pay-as-you go schemes are explicitly left out of the scope of the IORPD. All types of IORPs fulfil this criterion.

7.2.3. Risk-spreading

IORPs are required by Article 19 IORPD II to invest in accordance with the 'prudent person' rule.[409] The assets of the IORP have to be invested in the best interests of the members and beneficiaries.[410] In particular, Article 19(1)(f) IORPD II requires the invested assets to be both properly diversified in such a way as to avoid excessive reliance on any particular asset, issuer or group of undertakings and accumulations of risk in the portfolio as a whole and not the expose the IORP to excessive risk concentration. All types of IORPs, thus, fulfill the requirement to risk-spreading.

---

[405] CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 41.
[406] See CJEU (Judgment 13 March 2014), Case C-464/12, ATP Pension Service, ECLI:EU:C:2014:139, paras 61-64.
[407] CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 42..
[408] CJEU (Judgment 13 March 2014), Case C-464/12, *ATP Pension Service*, ECLI:EU:C:2014:139, para. 54, 59.
[409] See *infra* 4.2.1.
[410] Art. 19(1)(a) IORPD II.

7.2.4. *Investment Risk*

All types of IORPs fulfill the three abovementioned requirements. Similar as to the question whether a depositary needs to be appointed under the IORPD II, the decisive element whether a particular IORP qualifies as a 'special investment funds as defined by Member States', thus, depends upon the question whether the beneficiaries bear the risk of the investment.[411] In *ATP*, the CJEU held that pension customers bear investment risk in defined contribution (otherwise known as money purchase) IORPs and that IORPs of this type are, therefore, qualifying as 'special investment funds'.[412] Management services connected to defined benefit pensions were found by the CJEU in *Wheels* not to qualify as 'special investment funds' as beneficiaries that bear investment risk and, thus, fell outside of the VAT fund management exemption.[413] IORPs are allowed to add an insurance element (guaranteed benefit) to the extent that the insurance element is an ancillary aspect of the essential characteristics of contributions paid to pension funds.[414] Essentially, the question to what extent the insurance element is an ancillary aspect is, thus, a question concerning the attribution of risk. The larger the insurance element is, the less risk will be borne by the beneficiaries and vice versa.

7.2.4.1. Definition Investment Risk

The CJEU in judging upon a series of cases whether IORPs qualify as 'special investment fund' within the meaning of the VATD has not defined into detail what 'investment risk' is. In *ATP*, the CJEU held that 'the essential characteristic of a special investment fund is the pooling of assets of several beneficiaries, enabling the risk borne by those beneficiaries to be spread over a range of securities'.[415] The CJEU only requires the risk of the pooling of assets of several beneficiaries to be borne by those beneficiaries. The *ATP*, thus, does not require that the investment risk materializes. Essentially, the question is, thus, whether the IORP beneficiaries are bearing the IORP investment risk upon the materialization of investment risk. Regardless of whether IORPs are full DC, hybrid or full DB IORPs, two ways in how investment risks are materializing are the risk of the non-indexation of pension benefits and the risk of a reduction benefit redesign (direct or indirect reduction of IORP plan obligations). The relevant question popping up is whether not only full DC and hybrid IORPs, but also the beneficiaries of full DB IORPs are bearing investment risks.

7.2.4.2. Non-indexation as Investment Risk?

A narrow interpretation of investment risk is 'the possibility for an beneficiary to lose some or all of the original investment'.[416] This definition excludes the risk of indexation cuts as this can within this definition only be regarded as a loss in an economic sense and not as the loss of 'some or all of the original investment'. Within a broader definition of investment risk, indexation cuts can be seen as an investment risk as indexation cuts lead to the risk that the benefits in the pay-out phase have lost its purchasing power. In the Netherlands, the Advocate General in *Stichting Pensioenfonds* has claimed that this broader interpretation of investment risk needs to be applied for two reasons.[417] The long duration of the pension agreement between the employee and the employer and the promise of indexed pension benefits imply the expectation of positive investment results justify the application of the broader definition

[411] CJEU (Judgment 13 March 2014), Case C-464/12, ATP Pension Service, ECLI:EU:C:2014:139, para. 64; See also A-G Opinion (15 March 2016), Stichting Pensioenfonds, ECLI: NL:PHR:2016:91, para. 7.13.
[412] CJEU (Judgment 13 March 2014), Case C-464/12, ATP Pension Service, ECLI:EU:C:2014:139, para. 64.
[413] CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 14.
[414] CJEU (Judgment 13 March 2014), Case C-464/12, ATP Pension Service, ECLI:EU:C:2014:139, para. 57, 59.
[415] *Ibid*, para. 51.
[416] A-G Opinion (15 March 2016), *Stichting Pensioenfonds*, ECLI: NL:PHR:2016:91, para. 7.15.
[417] *Ibid*, para. 7.15.

of 'investment risk'. In a DB plan the benefit paid to beneficiaries is equal to the number of years worked, multiplied by the member's salary at retirement, multiplied by the accrual rate.[418] The final accrued amount is available as a monthly pension or a lump sum.

Nominal benefits promised, however, may have limited purchasing power as during the long duration of the pension agreement benefits may have been subject to the inflation during a couple of decades. Generally, indexation may be based upon the average price or the average wage increase. The effect of ten years of non-indexation of pension benefits of a 55 year old employee in the Netherlands may lead to a 18% purchasing power loss.[419]
The impact of non-indexation on the final benefits in the pay-out phase, thus, have been concluded by the Advocate General to be an investment risk that has to be borne by the members of an IORP.[420]

Full DB IORPs distinguish between guaranteed (which in practice means: nominal) pension entitlements and conditional rights to indexation linked to wage or price inflation. Currently, almost all full DB IORPs are providing for conditional rights to indexation linked to wage of price inflation. Positive investment returns are primarily used by full DC IORPs to improve its funding ratio. If the funding ratio is sufficient, IORPs may index the wage or price inflation.If, however, due to adverse circumstances, the funding ratio of an IORP falls below what is legally mandated, IORPs are subjected to a recovery plan.[421] The recovery plans mandated by several European Member States may include reducing or eliminating indexation, increasing contributions or renegotiating the guaranteed pension entitlement with the trading unions.[422] Beneficiaries under a full DB scheme, thus, are only having a residual interest in a slight sense as they do not automatically benefit or suffer from a rise or fall of the value of the investment returns of the IORP assets.[423]

7.2.4.3. Indirect Investment Risk

Beneficiaries under (full) DB IORP schemes, thus, have only a residual interest in a slight sense. The investment risk being born is an 'indirect investment risk'. Depending upon the funding ratio of an IORP, an investment loss does not directly lead to a an indexation or benefit cut. Investment losses on the longer run, especially in unfavorable economic times, may, however, materially may lead to a proportional cut of benefits for their participants. The exact way in how the indirect investment risk materializes depends upon the choice of how risks are (intergenerational) shared in defined benefits.[424] Beneficiaries, thus, bear an indirect investment risk that may be intergenerational shared that may not materialize instantly but in a later point in time.

7.2.4.4. To what extent do Members need to bear Investment Risk?

---

[418] T. Piketty, *Capital in the Twenty-First Century* 99 (The Belknap Press of Harvard University Press 2014).
[419] A-G Opinion (15 March 2016), *Stichting Pensioenfonds*, ECLI: NL:PHR:2016:91, para. 7.15.
[420] *Ibid*, para. 7.19.
[421] J. Bikker & P. Vlaar, Conditional indexation in defined benefit pension plans, DNB Working Paper No. 86 (January 2006), 5; See for the recovery plan in the Netherlands: Art. 135 Wet van 7 december 2006 houdende regels betreffende pensioenen (Pensioenwet); See CJEU (Judgment of 7 March 2013), Case C-424/11, Wheels, ECLI: EU:C:2013:144, para. 14.
[422] J. Bikker & P. Vlaar, Conditional indexation in defined benefit pension plans, DNB Working Paper No. 86 (January 2006), 5; See, for example, in the Netherlands: Art. 135 Wet van 7 december 2006 houdende regels betreffende pensioenen (Pensioenwet); See in the UK the statutory protection of members 'subsisting rights' (Section 67 and 67a Pensions Act 1995).
[423] D. Fox, *Defined Benefit Pension Trusts: Asset Partitioning and the Residual Interest,* University of Cambridge Faculty of Law Research Paper No. 10/03, 7.
[424] J. Bikker & P. Vlaar, Conditional indexation in defined benefit pension plans, DNB Working Paper No. 86 (January 2006), 2, 4.

The question is whether the indirect investment risk borne by members is enough to conclude that investment risk is being borne by members of full DB IORPs.

The VAT case law of the CJEU on IORPs has not specified whether and to what extent members not to bear the investment risk in order for IORPs to benefit of the management VAT exemption.[425] The CJEU, however, made considerations that defined benefit IORPs do not qualify as IORPs in which members bear investment risks, whereas DC IORPs do qualify as IORPs in which investment risks are born by its members.

In *Wheels*, the IORP was a DB IORP in which the employer was obliged to make up for any funding deficits.[426] If the employer does not, or is unable to do so, the benefits received by members are reduced.[427] The CJEU in this case, however, held that DB IORPs do not fall within the VAT management exemption as members within of these type of IORPs

'do not bear the risk arising from the management of the investment fund in which the scheme's assets are pooled, unlike private investors with assets in a collective investment undertaking'.[428]

The CJEU held that DB IORPs are not sufficiently comparable with UCITS (and AIFs) not to be in competition with them for two reasons.[429] First, the risk born by its members is not the same as those borne by private investors in UCITS (and AIFs) as the pension received by their members does not depend upon the value of the IORP's assets and the investment performance. In contrary, it is defined in advance on the basis of the length of service and the salary in the pension agreement with the employer.[430] Second, DB IORPs differ from UCITS (and AIFs) from the employer's point of view.[431] The employer is not in the same situation comparable to UCITS and AIF investors, even though he bears the investment risks as the contribution paid by the employer as a result of funding deficit is a means by which the employer complies with his legal obligations owed to his employees.[432]

In contrary, the CJEU held for DC IORPs in which the return to the employee depended upon the yield realized by the pension fund's investments[433] and the employer was not required to make any supplementary payments[434] that the IORP qualified as an 'special investment fund'. The CJEU distinguished the DC IORP from the DB IORP in *Wheels* as the members in *Wheels* did not bear the risk arising from the management of the IORP in which the IORP's assets were pooled.[435] By contrast, the DC IORP in *ATP* was funded by the persons to whom the retirement benefit is to be paid and those persons bear the investment risk.[436]

Despite these two cases, it is in Belgium current practice that all types of IORPs qualify for the VAT management exception.[437] Similarly, in the Netherlands a broad interpretation of investment risk required for the VAT management exemption was considered by the Advocate General in *Stichting Pensioenfonds*. The Advocate General considered that a DB

---

[425] A-G Opinion (15 March 2016), *Stichting Pensioenfonds*, ECLI: NL:PHR:2016:91, para. 7.24.
[426] See CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 9,10,14.
[427] CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 14.
[428] CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 27.
; See also CJEU (Judgment 28 June 2007), Case C-363/05, *Claverhouse,* ECLI: EU:C:2007:391, para. 50.
[429] CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 26.
[430] *Ibid*, para. 27.
[431] *Ibid*, para. 28.
[432] *Ibid.*
[433] CJEU (Judgment 13 March 2014), Case C-464/12, ATP Pension Service, ECLI:EU:C:2014:139, para. 38.
[434] *Ibid*.
[435] CJEU (Judgment 13 March 2014), Case C-464/12, ATP Pension Service, ECLI:EU:C:2014:139, para. 52; See also CJEU (Judgment of 7 March 2013), Case C-424/11, Wheels, ECLI: EU:C:2013:144, para. 27-29.
[436] CJEU (Judgment 13 March 2014), Case C-464/12, ATP Pension Service, ECLI:EU:C:2014:139, para. 52.
[437] A-G Opinion (15 March 2016), Stichting Pensioenfonds, ECLI: NL:PHR:2016:91, para. 5.3.

IORP qualifies under the VAT management exemption as the employer only is required to make any supplementary payments with a maximum of 2.5%, whereas the rest of the investment risk is borne by the IORP members. The Advocate General considered that in DB IORPs did not qualify under the VAT management exemption as the retirement did not *'depend at all'* on the investment performance.[438] In *Stichting Pensioenfonds* the risk of non-indexation and benefit cuts were being born by the IORP members and, therefore, the Advocate General considered the investment risk criterion to be fulfilled.[439]

Despite of the *Wheels* and *ATP*, Member States still considerably vary in their interpretation of what type of IORP qualifies for the VAT management exemption.

7.3. Lessons to be learned from the VAT European Case Law for the Compulsory IORP Depositary Appointment

The VAT cases held by the CJEU have shown that, indeed, investment risk is the primary criterion to be fulfilled in order to judge whether an IORP is sufficiently comparable to a UCITS or AIF and, therefore, the appointment of a depositary should be compulsory.

For the purpose of the appointment of a depositary, the IORPD II differentiates between IORPs in which members 'fully bear the investment risk' and IORPs in which members and beneficiaries do not fully bear the investment risk.[440] Article 33(1) IORPD II does not define what is 'investment risk'. Under Article 27 IORPD II, an actuary is required for IORPs that 'provides cover against biometric risks or guarantees either an investment performance or a given level of benefits'. Under Article 33(1) IORPD II, thus, seems to suggest that members fully bear the investment risk if an IORP does not guarantee either an investment performance or a given level of benefits. In line with the VAT CJEU cases, IORPD II requires a full 'direct investment risk[441] to be borne by IORP members in order to allow Member States to require a compulsory depositary to be appointed. IORP members and beneficiaries, thus, have to have a residual interest in the sense that they automatically benefit or suffer from a rise or fall of the value of the investment returns of the IORP assets.[442]

In line with the interpretation of Member States of the VAT CJEU cases, the compulsory appointment of depositaries for hybrid and full DB IORPs is likely to vary from Member State to Member State. The extension of the VAT management exemption on the basis of their interpretation of investment risk in, for example, Belgium and the Netherlands to hybrid and DB IORPs shows that various Member States consider members of these IORPs to bear the operational risks of the investment performance. For the same reasons, Member States vary in their compulsory depositary requirement for hybrid and DB IORPs under their IORPD I implementation laws and this is unlikely to change under the IORPD II Member State implementation laws.

Given the broad definition of IORPs under IORPD II, giving Member States the discretion to require a compulsory depositary or custodian to be appointed seems, indeed, to be the only practical solution.

8. Conclusion

---

[438] See A-G Opinion (15 March 2016), *Stichting Pensioenfonds*, ECLI: NL:PHR:2016:91, para. 7.30; CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 27.

[439] See A-G Opinion (15 March 2016), *Stichting Pensioenfonds*, ECLI: NL:PHR:2016:91, para. 7.30.

[440] See Art. 33(1) and (2) IORPD II.

[441] See *supra* 7.2.4.3.

[442] D. Fox, *Defined Benefit Pension Trusts: Asset Partitioning and the Residual Interest,* University of Cambridge Faculty of Law Research Paper No. 10/03, 7.

The same three pillars as under the AIFMD and UCITSD V are optionally to be observed in IORPD II. The (optional investment triangle under IORPD II arises from the separation of investments and management.

IORPD II deals with these (agency) problems by imposing an (optional) investment triangle that plays a key role in the protection of the member's assets. IORP governing bodies, delegated asset managers are required to comply with intermediary regulation that regulates their conduct.[443] In addition, IORP governing bodies have to provide members with appropriate information both upon entering the scheme and on an ongoing basis (disclosure).[444] Product regulation, i.e. the legal form in which the IORP is established, ensures additional investor protection. Finally, a depositary/custodian is (optionally) appointed that safekeeps the IORP' assets. They safeguarding the interests of members by safekeeping the entrusted assets and monies of the IORP and, if required, performing a series of controls on behalf of the joint members.[445]

[443] See *infra* 3.1.3.4.
[444] See *infra* 5.
[445] See *infra* 3.2.

CHAPTER 10 The (Virtual) Investment Triangle – MiFID II

1. The (Virtual) Investment Triangle

Unlike the AIFMD and UCITSD V, MiFID II allows but does not mandatorily require an independent custodian to be appointed. Clients under MiFID II may either choose to use a 'third-party custodian' or allow an investment firm to safekeep assets on their behalf. It is, thus, ultimately up to the clients' discretion whether a 'full' or 'virtual' investment triangle is in place that provides checks and balances.[1]

Within the (virtual) investment triangle, an investment firm may provide several investment services/activities to clients in which for investment law purposes 'execution-only' services[2], investment advice[3] and portfolio management[4] are the most important ones.[5] Investment firms in their capacity, thus, act as agents of clients. The agency nature of the investment services/activities provided may contain 'fiduciary' elements depending upon whether the investment firm provides 'execution-only' services, investment advice or portfolio management.[6] The agency nature of 'execution-only' services is the strongest as this investment service only consists of the execution or reception and transmission of client orders with or without ancillary services. Clients request a specific investment without receiving investment advice or portfolio management services. The sole discretion lies with the client. Clients receiving investment advice service are in a stronger fiduciary relationship as they remain ultimate discretion over their investment decision but are influenced by the advice. Investment firms providing portfolio management have a highly fiduciary nature as the asset manager holds the discretionary authority to make investment decisions unilaterally on behalf of the client within the limits of the investment policy as laid down in the clients' mandate.[7] To the contrary of investors under the AIFMD, UCITSD V and IORPD II, the investment firm acts as a fiduciary on behalf of individual investors that, however, have control over the investment decisions being made. Investors are allowed to give investment

---

[1] See for an explanation of the term 'virtual investment triangle': D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* 132 (D.A. Zetzsche ed, Kluwer 2015); I. Crespi-Hohl, *Neuere Tendenzen im Bereich der Verantwortlichkeit der Depotbank gegenüber ihrem Kunden bei Beizug eines externen Vermögensverwalters*. (Schulthess Verlag 2003).

[2] See Annex I, s. A No. 1 and No. 2 MiFID I/II; Art. 25(4) MiFID II.

[3] Art. 4(4) MiFID II; See also: P. Giudici, *Independent Financial Advice* (D. Busch & G. Ferrarini eds, Oxford 2017).

[4] Art. 4(1) No. 8 MiFID II.

[5] See D. Zolb & D. Fischer, *Haftung der Depotbank bei externer Vermögensverwaltung* (Dike 2008)*;* M. Zollinger, M., *Rechts- und Haftungsverhältnisse in der Dreiecksbeziehung Depotbank – Kunde – externer Vermögensverwalter (Financial Intermediary),* http://www.markus-zollinger.ch/wp-content/uploads/Markus_Zollinger_SeminarBankenrecht_Thema-20.pdf (accessed 12 May 2017).

[6] L.S. Sealy, *Fiduciary Relationships*, 69 Cambridge Law Journal 69-72 (1962); T. Frankel, *Fiduciary Duties* 127-132 (P. Newman ed, Macmillan 1998); D.A. DEMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 879 Duke Law Journal 908 (1988); R. Cooter & & B.J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences* , 66 New York University Law Review 1045 (1991).

[7] See H. Assmann, *Finanzportfolioverwaltung*, in *Wertpapierhandelsgesetz* (H.D. Assmann & U. Schneider eds, 6th edn., Dr. Otto Schmidt 2012).

directions to the investment firm.[8] The relationship between investment firms providing portfolio management is, thus, fiduciary with an agency element.

While investing, investors are exposed to the risk of investment firms that are acting as a custodian alongside the provision of investment services/activities. Most custodians are credit institutions or investment firms providing investment services/activities along this ancillary service as 'custody business' itself hardly generates profits.[9]

The parallel provision of investment services/activities and ancillary services increases the risk the risk of the loss or diminution of client assets, or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.[10] MiFID II deals with this agency problem by requiring investment firms acting as a 'custodian' to comply with a safeguarding of client assets regime, i.e. organizational requirements minimizing these risks.[11] Unlike the AIFMD and UCITSD V, do not require investment firms authorized to act as 'custodians' that exercise additional oversight duties. The latter can be explained as MiFID II only concerns individual investor relationships in which only the client assets of a single client are effected by the investment services/activities provided by investment firms. The absence of collective action problems under MiFID II compared to the AIFMD, UCITSD V and IORPD II means that leaving the 'monitoring function' solely up to the responsibility of the individual investors is more cost-effective. Individual investors are, thus, deemed by the law to be able to monitor their own assets based upon the information provided to them.[12] This 'own responsibility' under MiFID II leaves investors the discretion to appoint another investment firm as custodian than the one who provides 'execution-only', investment advice or portfolio management to them. Nevertheless, investment firms providing solely investment services/activities to individual clients may be acting as a 'custodian' to other clients. Depending upon whether a client chooses a third-party custodian and/or investment firms are authorized to safekeep assets as ancillary service, MiFID II demands a 'full investment triangle or a 'virtual investment triangle'. For this purpose, MiFID II requires investment firms to comply with intermediary regulation, product governance and oversight rules and disclosure duties.

2. Investment Firm under MiFID II

Article 5 MiFID II requires investment firms for the provision of investment services and/or the performance of investment activities to be authorized. The authorization may also cover one or more of the ancillary services set out in Section B of Annex I MiFID II.[13]

---

[8] D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D.A. Zetzsche ed, Kluwer 2015), 122, 123.

[9] European Commission, Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186), 13.

[10] Art. 2(1)(f) MiFID II (Commission) Directive. they must introduce adequate organizational arrangements to minimize the risk of the loss or diminution of client assets, or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.

[11] See Art. 16(2)-(10) MiFID II; Art. 2 et seq. MiFID II (Commission) Directive; See J.P. Casey & K. Lannoo, *The MiFID revolution* (Cambridge University Press (2009).

[12] Art. 24(4) MiFID II.

[13] Art. 6(1) MiFID II; C.M. Grundmann-van de Krol, *The Markets in Financial Instruments Directive and Asset Management* (D. Busch & D.A. DeMott eds, Oxford 2012); J.P. Casey, & K. Lannoo, *The Mifid Revolution: A Policy View*, 7 Competition and Regulation Network Industries 515 (2006).

Under Article 4(1)(1) MiFID II, an 'investment firm means 'any legal person[14] whose regular[15] occupation or business[16] is the provision of one or more investment services to third parties[17] and/or the performance of one or more investment activities on a professional basis[18]'.[19]

An investment firm within the meaning of MiFID II provides one or more investment services to third parties and/or performs one or more investment activities.[20] MiFID II does not define the term 'investment service' nor 'investment activity' but provides a list that contains 'investment services and activities'. Investment services and activities within the scope of MiFID II include, amongst others portfolio management, investment advice and 'execution-only services'.[21] These services and activities, however, only qualify as 'investment services and activities' if they relate to any of the financial instruments listed in Section C of Annex I MiFID II.[22] Examples of financial instruments, amongst others, include transferable securities and money-market instruments.[23]

The authorization of an investment firm may cover one or more of the ancillary services set out in Section B of Annex I MiFID II.[24] Ancillary services include, inter alia, Safekeeping and administration of financial instruments for the account of clients, granting credits or loans to investors to allow him to carry out a transaction in one or more financial instruments and for exchange services connected to the provision of investment services.[25]

2.1. Investment Advice

Article 4(4) MiFID II 'investment advice' means

---

[14] European law does not define what a 'legal person' is. This matter is left over to the Member State implementation of the MiFID I/II. See also for AIFMs: D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 211 (D.A. Zetzsche ed, Kluwer 2015).

[15] The term 'regular' should in this regard be read in conjunction with the exemptions set out in Art. 2(1)(c) MiFID II that excludes services that are that are provided incidentally in the course of other activity. Incidentally should be read in the context of the MiFID II as a service that arises out and is linked to the main activity of a legal entity, but it does not represent a major part of the entity's activities; See J. Hamilton*, Markets in Financial Instruments Directive (MiFID):Broad Reforms to EU Financial Services Regulation* 6 (Kluwer 2007).

[16] According to Recital 12 MiFID II, the purpose of the exemption for investment services incidental to a professional activity is to exclude from MiFID II scope activities that, if carried out on a professional basis, would constitute the provision of an investment service or activity. Generally, it is seen as a feature of an occupation or business the provision of investment services/activities for which the firm is remunerated; BaFin, Merkblatt Finanzportfolioverwaltung (2014), Nr. 3 ('Erlaubnispflicht der Finanzportfolioverwaltung').

[17] Indirectly, the criterion what constitutes a 'third party' has been defined by recital 18 MiFID II. Not considered as being third parties are persons that administer their own asset and undertakings that are do not provide and investment services or perform investment activities other than dealing on own account in financial instruments. Other examples of entities not qualifying as 'third parties' may be entities providing businesses solely for their parent undertakings, for their subsidiaries, or for other subsidiaries of their parent undertakings.

[18] The term 'professional basis' is not defined by the MiFID II. it implies that the legal entity must have a large degree in specialization in performing the type of investment services/activities. That the investment service/activity is not incidentally provided may be a main indicator that the legal entity performs these services/activities on a professional basis. See BaFin, Merkblatt Finanzportfolioverwaltung (2014), Nr. 1(e) ('Keine Tatbestandsmäßigkeit insbesondere bei Tätigkeit im engsten Familienkreis').

[19] A. Cygan & E. Szyszczak, *The Controversy and Confusion over Mifid*, 25 International Financial Law Review 14 (2006).

[20] Article 4(1)(1) MiFID II.

[21] Investment services and activities' means any of the services and activities listed in Annex I Section A MiFID II relating to any of the instruments listed in Annex I Section C MiFID II.

[22] Art. 4(1) No. 2 MiFID II.

[23] Annex I, Section C MiFID II.

[24] J.P. Casey & K. Lannoo, *The MiFID Revolution*, ECMI Policy Brief No. 3 (November 2006).

[25] Annex I, Section B MiFID II.

> ‘the provision of personal recommendations to a client, either upon its request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments’.

For the purpose of the definition of investment advice, that recommendation must be presented as suitable for that person or must be based on a consideration of the circumstances of that person.[26]

Under MiFID II, a personal recommendation is a recommendation that is made to a person in his capacity as an investor or potential investor, or in his capacity as an agent for an investor or personal investor.[27] A recommendation requires an adviser to express his opinion on the course of action to be taken by the investor.[28] This implies a value judgment on the investment decision to be made by the investor and not the mere provision of information. That recommendation shall be presented as suitable for that person, or shall be based on a consideration of the circumstances of that person, and shall constitute a recommendation to:[29]

- to buy, sell, subscribe for, exchange, redeem, hold or underwrite a particular financial instrument;
- to exercise or not to exercise any right conferred by a particular financial instrument to buy, sell, subscribe for, exchange, or redeem a financial instrument.

A recommendation shall not be considered a personal recommendation if it is issued exclusively to the public.[30]

2.2. ‘Execution-only’

Under Article 25(4) MiFID II ‘execution-only’ is referred to the investment service/activity that relates to the execution or reception and transmission of client orders with or without ancillary services related to one or more financial instruments.[31]

The execution of orders on behalf of clients is a service by means of which the intermediary on behalf of clients purchases or sells one or more financial services in the various trading venues.[32] The service includes the conclusion of agreements to sell financial instruments issued by an investment firm or a credit institution at the moment of their issuance.[33]

The reception and transmission of orders is a service by mean of which the intermediary, having received a purchase or sale order from the client, instead of carrying it out personally, sends it to another intermediary for execution.[34] The business of reception and transmission of

---

[26] Art. 4 MiFID II (Commission) Regulation.
[27] CESR/10-293, 7; P. Buck-Heeb, *Anlageberatung nach der MiFID II*, ZBB (2014).
[28] BaFin, Gemeinsames Informationsblatt der Bundesanstalt für Finanzdienstleistungsaufsicht und der Deutschen Bundesbank zum Tatbestand der Anlageberatung, (2013).
[29] Art. 4 MiFID II (Commission) Regulation; CESR/10-293, 7.
[30] Art. 4 MiFID II (Commission) Regulation.
[30] Art. 4 MiFID II (Commission) Regulation.
[30] Art. 4 MiFID II (Commission) Regulation; CESR/10-293, 7.
[31] Annex I, Section A Nr. 1and 2 MiFID II.
[32] Article 4(5) MiFID II
[33] Article 4(5) MiFID II
[34] Recital 80, Article 25(4) MiFID II; See for a the view of Consob: http://www.consob.it/mainen/target/investors/education/investment_services/index.html (accessed 29 September 2016).

orders should also include bringing together two or more investors, thereby bringing about a transaction between those investors.[35]

'Execution-only', thus, refers to two investment services related to transactions executed by investment firms upon the request of a client where the firm does not give advice on the merits of the transaction.[36]

2.3. Portfolio Management

Portfolio management as investment service is being defined under MiFID II as

> 'managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments'.[37]

2.3.1. Managing Portfolios

The term 'managing portfolios' is not defined under MiFID II. In the light of the AIFMD, the term 'management' could be dynamically interpreted as portfolio management (investment management) and risk management.[38] Portfolio management refers to the investment decision itself that includes the decision to buy, hold or sell assets on behalf of clients on a discretionary client-by-client basis.[39] Risk management under MiFID II is merely an 'operational condition' and not a 'defined activity'. Nevertheless, it can be argued that carrying out the regulatory activity of portfolio management implies that risk management is being carried out.[40]

2.3.2. Client-by-Client Basis

The management under MiFID II constitutes only portfolio management if the investment firm carries the management of portfolio's given by clients on a discretionary client-by-client basis. A portfolio is commonly used to describe a pool of client assets that are managed by an asset manager.[41] The term 'client-by-client basis' has, however, not been defined by MiFID II. In Germany, 'client-by-client basis' is being interpreted as to include situations that involve the assets of both individual and multiple clients in a single portfolio being managed.[42] Assets of individual clients may, thus, for efficiency purposes be individually managed, combined or run in tandem.[43] This can be done by letting investment firms manage the assets of two or more clients in parallel by following exactly the same investment strategy (parallel accounts).The assets of multiple individual clients may be managed as 'one portfolio'. They may, however, not be blended by pooling the assets of multiple individual

---

[35] Recital 44 MiFID II.
[36] See FCA Handbook Glossary on 'execution-only transaction'.
[37] Art. 4(1) No. 8 MiFID II; H. Assmann, *Finanzportfolioverwaltung*, in *Wertpapierhandelsgesetz* (H.D. Assmann & U. Schneider eds, 6th edn., Dr. Otto Schmidt 2012).
[38] Annex I Nr. 1AIFMD.
[39] See for the AIFMD: D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* (D.A. Zetzsche ed, Kluwer 2015), 162.
[40] This is not included under the AIFM. See Annex I No. 2 AIFMD and Article 6(5)(c) AIFMD; The term ' (portfolio) management' needs, however, to be delineated from the portfolio management definition under the UCITSD V that requires administrative activities to be carried out. See D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D.A. Zetzsche ed, Kluwer 2015), 126.
[41] D. Frase, *Portfolio Assets* 362 (D. Frase ed., Sweet & Maxwell 2011); It is commonly used to describe a pool of client assets that are managed by an asset manager; See also D.A Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 2, 100 (Mohr Siebeck 2015).
[42] BaFin, Merkblatt Finanzportfolioverwaltung (2014), Nr. 1(a) ('Verwaltung einzelner Vermögen'); Bundesverwaltungsgericht, Urteile vom 22.09.2004, BverwG 6C 29.03, und 24.02.2010, BVerwG 8 C 10.09).
[43] D. Frase, *Overview* 4 (D. Frase ed., Sweet & Maxwell 2011).

clients in one account.[44] Such a pooled account would lead to the legal blending of assets and, thus, a pooled risk/return as under the AIF definition under the AIFMD and, thus, the obligation to obtain an authorization as AIFM.[45]

2.3.3. One or More Financial Instruments

The MiFID II portfolio of clients must include one or more financial instruments. The wording of MiFID II does not require that the portfolio of customers exclusively consists of financial instruments. Various legislators have confirmed that portfolio's may, besides financial instruments, also consist other assets to fulfill this criterion.[46]

2.3.4. Mandate

Portfolio management has to be provided by an investment firm in accordance with mandates given by clients to manage individual portfolios of assets according to the investment objectives and other terms agreed upon in the mandate.[47] The term 'mandate' has not been defined by MiFID I/II. Following the EUCJ, a mandate, irrespective of its private law qualification, includes all types of contracts that, embed the duty to invest the client's assets in accordance with an agreed investment strategy, one or more financial instruments and be carried out on a discriminatory, client-by-client basis.[48]

Important matters, such as the appointment of the portfolio manager, the portfolio to be managed, the investment objectives of the client, the terms of the mandate, the discretion of the portfolio manager, delegation, provisions related to liability and the arrangements for termination of the contract would need to be arranged in the mandate.[49]

2.3.5. Discretionary Management

Portfolio management requires the 'discretionary' management of portfolio's.[50] The criterion 'discretionary' management excludes investment services/activities that are exclusively carried out on the basis of clients' instructions, such as 'execution-only' services.

Discretionary management is characterized by the fact that the investment firm may use their own judgment (discretion) to decide which investments to buy and sell and also when to do so. The investment firm does not need to await the consent of its client for its decisions or to obtain any approval of the investment decision before the firm implements them.[51] The discretion relates to factors such the type of investments, the markets being invested in, but also whether to adopt a long or short-term strategy, the level of risk taken and the degree of leverage employed.[52] The investment objectives and the restrictions are defining the scope of the mandate contract. It is also being agreed upon that the investment firm has complete discretion to buy, sell, retain, otherwise deal with the portfolio on behalf of the client. To that

---

[44] D.A Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 3, 128 (Mohr Siebeck 2015); L. Schäfer, *Fund Governance*, 27, 72-77 (Duncker & Humblot 2009).

[45] See D.A Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 3, 103 (Mohr Siebeck 2015).

[46] BaFin, Merkblatt Finanzportfolioverwaltung (2014), Nr. 1(b) ('in Finanzinstrumenten angelegt').

[47] Art. 58 Level 2 MiFID II (Commission Regulation; See also D. Frase, *Legal Nature of the Client Relationship* 68 (D. Frase ed., Sweet & Maxwell 2011); See also: L. van Setten, *The characteristic features of an institutional investment mandate* 26 (Oxford 2009).

[48] See EUCJ C-356/00 (EC: EU:C:2002:703) on the concept of 'managing portfolios of investments' within the meaning of the ISD.

[49] D. Frase, *Legal Nature of the Client Relationship* 62 (D. Frase ed., Sweet & Maxwell 2011).

[50] Investment firms delegating investment management to third parties may also fulfill the criterion of 'discretionary' management. See BaFin, Merkblatt Finanzportfolioverwaltung (2014), Nr. 1(d) ('Mit entscheidungsspielraum'); See also Bundesverwaltungsgericht, Urteil vom 22.09.2004, BVerwG 6 C 29.03.

[51] D. Frase, *The Management Contract* 32 (D. Frase ed., Sweet & Maxwell 2011).

[52] D. Frase, *The Management Contract* 33 (D. Frase ed., Sweet & Maxwell 2011).

extent, the investment firm may conclude transactions, negotiate and execute transactions with counterparty and act as it deems to be appropriate.[53] The discretionary power is often subjected to client instructions. This is usually included in the mandate agreement that includes a description for the giving and the acknowledgment of client instructions.[54] Instructions in this regard may concern the mandate itself by means of amending or supplementing the terms of the mandate or ad hoc instructions related to matter within the scope of the mandate.[55] The terms of the mandate negotiated, thus, concern the (written) instructions/notices of clients in respect of any decision a portfolio manager makes on behalf of the client of its managed account.[56] The most important provision to be negotiated is whether or not the client needs to be mandatorily consulted with the client for any determined transaction.[57] Whether or not the investment firm is obliged to accept the instructions depends upon the terms of the mandate. In any case the instructions must be adequate and non-ambiguous and reasonable.[58] If the client has negotiated that he may give the investment firm instructions, it depends upon the residual discretionary powers as laid down in the mandate on a case-to-case basis whether the criterion 'discretionary' management is still fulfilled.

The investment firm, thus, has discretion regarding the investment objectives restrictions that are agreed on a client-to-client basis that are agreed upon in the mandate.

3. Intermediary Regulation – Investment Firms

MiFID II requires investment services/activities to be provided by investment firms in a professional way. Similar as to AIFMs and UCITS ManCos, investment firms are subject to a comprehensive set of authorization and operating requirements, including conduct of business rules.[59]

3.1. Authorization and Organizational Requirements

Investment firms have to comply with general requirements that are common to financial intermediaries in European financial law and specific requirements aimed at the provision of investment services/activities and ancillary services.[60]

3.1.1. General Requirements

Article 5 MiFID II lays down the general requirements that constitute the 'common organizational denominator' of investment firms.[61] This includes measures requiring the

---

[53] D. Frase, *Legal Nature of the Client Relationship* 66, 67(D. Frase ed., Sweet & Maxwell 2011).
[54] D. Frase, *Legal Nature of the Client Relationship* 68(D. Frase ed., Sweet & Maxwell 2011).
[55] D. Frase, *Legal Nature of the Client Relationship* 68(D. Frase ed., Sweet & Maxwell 2011).
[56] C.M. Grundmann-van de Krol, *The Markets in Financial Instruments Directive and Asset Management* (D. Busch & D.A. DeMott eds, Oxford 2012), 73.
[57] See, for example on the elements of a recommended written agency agreement in France (mandat de gestion de portefeuille): Association Francaise de Gestino Financiere (AFG) : Code of Ethics for collective Investment Schemes and Individual Investment Management Mandates.
[58] D. Frase, *Legal Nature of the Client Relationship* 69-71 (D. Frase ed., Sweet & Maxwell 2011).
[59] J.H. Binder, *Governance of Investment Firms under MiFID II* (D. Busch & G. Ferrarini eds, Oxford 2017); D. Busch, *Corporate Governance volgens MiFID II, 12* TvFR 446-457 (2015); See also R. Price, *Overview of organisational and conduct of business requirements* 102-122 (M. Elderfeld ed, City & Financial Publishing 2007).
[60] D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* (D.A. Zetzsche ed, Kluwer 2015), 865.
[61] European Commission, *Background Note accompanying Draft Commission Directive implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for*

establishment of a organization structure that clearly assigns responsibilities, employ personnel with the rights skills, knowledge and experience, establish adequate systems to safeguarding information and ensure business continuity.[62] General requirements include:[63]

- fit & proper senior management;[64]
- minimum capital requirements that vary upon the type of investment service/activity and ancillary service provided;[65]
- a business plan;[66]
- adequate risk organization;[67]
- sound third-country relationships;[68] and
- reliable significant shareholders.[69]

Investment firms are also required to be a member of an investor compensation scheme under the ICSD that protects investors that use investment services by providing compensation in case where investment firms are unable to return investor assets as, for example, a result of fraud or negligence.[70] The ICSD harmonizes and clarifies the conditions of national schemes and puts in place a borrowing mechanism among national schemes.[71]

Specific organizational requirements that complement the general requirements are laid down by Article 16 MiFID II.

3.1.2. Specific Requirements

Specific requirements include compliance, risk management internal audit, complaints handling, personal transactions, outsourcing and the safeguarding of client assets.

3.1.2.1. Compliance, Risk Management, Internal Audit

Investment firms are subject to compliance[72], risk management and internal audit that ensure the proper management and operation of the firm.[73] Senior management of the investment firm is ultimately responsible for these functions. Article 22, 23 and 24 MiFID II (Commission) Regulation set out the detailed provisions to be complied with. Article 22 MiFID II (Commission) Regulation requires investment firms to establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the firm to comply with its obligations under MiFID II. Investment firms are required to appoint a

---

investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive, February 2006, 6 et seq.

[62] M. Raffen, *Conduct of business rules - organisational requirements* 123-144 (M. Elderfeld ed, City & Financial Publishing 2007).

[63] D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* (D.A. Zetzsche ed, Kluwer 2015), 865.

[64] Art. 9(a) MiFID II.

[65] See D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D.A. Zetzsche ed, Kluwer 2015), 127.

[66] Art. 7(2) MiFID II.

[67] Art. 7(2) MiFID II.

[68] Art. 10(2) MiFID II.

[69] Art. 10 MiFID II.

[70] Art. 14 ICSD.

[71] Recital 4 ICSD.

[72] J. Gottmers, & E.J. Weller, *De compliance functie na invoering van MiFID en Wft* 304-317 (A.J.C.C.M. Loonen et al., NIBE-SVV 2008).

[73] European Commission, *Background Note accompanying Draft Commission Directive implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive*, February 2006, 7.

compliance officer which operates independently[74] that is responsible for the coordination of the firm's compliance policies and procedures and reporting to senior management.[75]Article 23 MiFID II (Commission) Regulation requires investment firms to establish, implement and maintain adequate risk management policies and procedures which identify the risks relating to the firm's activities, processes and systems, and where appropriate, set the level of risk tolerated by the firm.[76] Finally**,** Article 24 MiFID II (Commission) Regulation requires investment firms to establish an internal audit function that is separate and independent from other functions and activities of the investment firm and ensures sound internal control mechanisms.[77]

3.1.2.2. Complaints handling

Investment firms are under Article 26 MiFID II (Commission) Regulation required to maintain effective and transparent procedures for the reasonable and prompt handling of clients' or potential clients' complaints. Investment firms are required to keep a record of the complaints received and the measures taken for their resolution.[78]

3.1.2.3. Personal Transactions

Article 16(2) MiFID II (Commission) Regulation requires investment firms requires investment firms to adopt appropriate rules governing personal transactions by 'relevant persons'.[79] This provision seeks to prevent conflicts of interests that might arise from employees misusing inside information through personal transactions.[80] The personal transactions requirement complements the MAD II/MAR.

3.1.2.4. Outsourcing

Under Article 16(5) MiFID II investment firms may outsource the performance of operational functions[81], i.e. functions that are critical for the provision of continuous and satisfactory service to clients, to third parties provided that it undertakes due diligence prior to delegation and monitors the delegate on an ongoing basis to avoid additional operational risk.[82] Article 16(5) MiFID II also prevents 'letterbox-entities' by requiring that the outsourcing of important operational functions may not be undertaken in such a way as to impair materially the quality of its internal control and the ability of the supervisor to monitor the firm's compliance with all obligations.[83] Article 31 MiFID II (Commission) Regulation lays down the condition under which investment firms are permitted to outsource important operational

---

[74] Art. 22(2) MiFID II (Commission) Regulation.
[75] Art. 22(2) MiFID II (Commission) Regulation.
[76] European Commission, *Background Note accompanying Draft Commission Directive implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive*, February 2006, 7.
[77] *Ibid*.
[78] Art. 26 MiFID II (Commission) Regulation.
[79] See for 'relevant persons': Art. 28 MiFID II (Commission) Regulation.
[80] European Commission, *Background Note accompanying Draft Commission Directive implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive*, February 2006, 8 et seq.
[81] See Art. 30 MiFID II (Commission) Regulation for the scope of critical and important operational functions.
[82] Art. 16(5) MiFID II; E.P.M. Joosen, *Uitbesteding van werkzaamheden* (D. Busch & C.M. Grundmann-van de Krol eds, Kluwer 2009).
[83] Art. 31(1) MiFID II (Commission) Regulation.

functions that fully reflect the current international regulatory standards.[84] Additional measures apply to investment firms delegating the management of retail client portfolios to TC-investment firms.[85] In such cases, the investment firm needs to ensure that the delegate is duly authorized to provide such services and appropriate cooperation agreements are in place between the relevant Competent Authorities.[86]

3.1.2.5. Safeguarding of Client Assets

MiFID II requires investment firms to make 'adequate arrangements' to safeguard client assets.[87] The MiFID II safeguarding of client assets regime applies to both credit institutions and investment firms that provide investment services/activities, in addition to, the ancillary service of the safekeeping and administration of financial instruments for others.[88] This regime aims to ensure that adequate arrangements are taken by investment firms to avoid the risk of diminution to, or loss of client assets is minimized.[89] MiFID II regulates the safeguarding of client financial instruments and funds that are held by the investment firms itself.[90] For this purpose, the investment firm has record-keeping obligations to be able to identify client' assets and has to comply with organizational requirements to minimize operational risks.[91] In addition, investment firms are required to put in place arrangements to ensure that client' assets are safeguarded to meet the objectives of the safeguarding of client financial instruments and funds when client financial instruments and/or funds are deposited with a third parties.[92] MiFID II also places strict conditions on the use of client financial instruments by the investment firm and its delegates and prevents the inappropriate use of TTCAs and SFTs.[93]

3.2. Operating Conditions and the Protection of Clients

Article 24 MiFID II imposes a duty of loyalty on all investment firms.[94] Investment firms, when providing investment services and ancillary services to clients, have to act honestly, fairly[95] and professionally in accordance with the best interests of its clients and comply with

---

[84] European Commission, *Background Note accompanying Draft Commission Directive implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive*, February 2006, 10, 11.
[85] Art. 32 MiFID II (Commission) Regulation.
[86] Art. 32 MiFID II (Commission) Regulation.
[87] Art. 16(8), (9) and (10) MiFID II.
[88] See *infra 2.3.5.*
[89] European Commission, *Background Note accompanying Draft Commission Directive implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive*, February 2006, 11.
[90] Art. 16(8), (9) and (10) MiFID II.
[91] Art. 16(8) MiFID II/Art. 13 (7) MiFID I; In the case of Art. 13 MiFID I, CESR (now ESMA) had been designed as the relevant specialist group and, accordingly, advised that Art. 13 MiFID I should require a custodian to separate its own assets from those of its clients. See K.M. Löber, *The Developing EU Legal Framework for Clearing and Settlement of Financial Instruments*, European Central Bank – Legal Working Paper Series, No. 1 (February 2006), 27.
[92] Art. 3, 4 MiFID II (Commission) Directive.
[93] Art. 16(10) MiFID II.
[94] K.W.H. Broekhuizen, *Klantbelang, belangenconflict en zorgplicht* (Boom Juridische Uitgevers 2017); F.F. Nagelkerke & L. Nijkamp, *Inwerkingtreding MiFID - invloed beroep cliënt op de zorgplicht van een beleggingsonderneming?,* 21 Juridisch Up to Date 9-13 (2007).
[95] R. Price, *Conduct of business standards - fair dealing with clients* 151-159 (M. Elderfeld ed, City & Financial Publishing 2007).

the assessment of suitability and appropriateness and reporting to clients rules.[96] This 'open standard'[97] is specified in an investor protection regime that specifies a number of fiduciary obligations and information requirements towards clients. The MiFID II investor protection provisions have to be applied in light of the risks that are born by different types of investors. For this purpose, various conduct of business obligations distinguishes between the provisions applying to retail clients, professional clients and eligible counterparties.

3.2.1. Conflicts of Interests

Article 16(3) MiFID II requires investment firms to maintain and operate effective organizational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest as from adversely affecting the interests of its clients.[98] Article 23 MiFID II and Article 33 MiFID II (Commission) Regulation define various relevant conflicts of interests, such as the conflicts of interest between investment firms and their clients or between clients that arise in providing investment services/activities and ancillary services.[99] Investment firms are required to establish, implement and maintain an effective conflicts of interest policy set out in writing and appropriate to the size and organization of the firm and the nature, scale and complexity of its business.[100] Article 34(3) MiFID II (Commission) Regulation require persons involved in different activities where conflicts of interest arise to carry out activities with an adequate degree of independence. This shall be effected by measures that ensure the degree of independence.[101] Article 23(2) and (3) MiFID II require to 'identify, manage and disclosure' to comply with conflict of interests that cannot be otherwise remedied. Finally, investment firms have to keep a record of services or activities giving rise to detrimental conflict of interest.[102]

3.2.2. Inducements

Under Article 16(3), 23 and 24 MiFID II, other than where an investment firm is providing independent advice or portfolio management, the payment of fees or commissions and other non-monetary benefits between firms and advisory firms have to be carefully considered to ensure they are not an inducement and, therefore, do not create any conflicts between a firm and its clients.[103] In addition, firms where applicable, must also inform clients on how the

---

[96] Art. 24(1) MiFID II; L. Enriques, L., & M. Gargantini, *The Overarching Duty to Act in the Best Interest of the Client in MiFID II* (D. Busch & G. Ferrarini eds, Oxford 2017).

[97] M. Kruithof, *Conflicts of Interest in Institutional Asset Management: Is the EU Regulatory Approach Adequate?,* 31, http://ssrn.com/abstract=871178 (accessed 30 September 2016); L. Enriques, Conflicts of Interest in Investment Services: The Price and Uncertain Impact of MiFID's Regulatory Framework (G. Ferrarini & E. Wymeersch eds., Oxford University Press 2006); A. Crockett, T. Harris, F.S. Mishkin & E.N.White, *Conflicts of Interest in the Financial Services Industry: What Should We Do About Them?*, 5 Geneva Reports on the World Economy (2003).

[98] S. Grundmann, *Conflicts of Interest* (D. Busch & G. Ferrarini eds, Oxford 2017); See also: K.W.H. Broekhuizen, *Regulering van belangenconflicten* (D. Busch & C.M. Grundmann-van de Krol eds, Kluwer 2009); L. Enriques, *Conflicts of Interest in Investment Services: The Price and Uncertain Impact of MiFID's Regulatory Framework* (G. Ferrarini & E. Wymeersch eds., Oxford University Press 2006).

[99] European Commission, *Background Note accompanying Draft Commission Directive implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive*, February 2006, 12.

[100] Art. 34 MiFID II (Commission) Regulation.

[101] Art. 16(1) MiFID II.

[102] Art. 35 MiFID II (Commission) Regulation.

[103] L. Silverentand, L., J. Sprecher, & L. Simons, *Inducements* (D. Busch & G. Ferrarini eds, Oxford 2017); See also: M.H. du Marchie Servaas, *Inducements* 165-180 (F.M.A. 't Hart ed, NIBE-SVV 2007).

fee/commission/non-monetary benefit can be transferred to them.[104] Investment firms providing investment advice on an independent basis or portfolio management are prohibited from retaining any fees, commission, monetary or non-monetary benefits received from third parties. MiFID II excludes minor non-monetary benefits that are capable of enhancing the quality of service provided to a client and are of a scale and nature such that they could not be judged to impair compliance with the investment firm's duty to act in the best interest of the client.[105]

3.2.3. Client Classification

Under MiFID II, the conduct of business rules required to be complied with depends upon the investor qualification. MiFID II categorizes (per sé and elective) professional, retail clients and eligible counterparties.[106]

Retail clients in this regard are defined as clients who are not professional clients.[107] Professional clienst are defined as clients meeting the criteria in Annex II MiFID II.[108] Professional clients under Annex II MiFID are clients that have the experience, knowledge and expertise to make their own investment decisions and the ability to assess risks. Annex II MiFID II for this purpose defines 'per sé professional clients' and 'elective professional clients'.[109] The per sé professional clients are categories of clients who are considered to be professionals under MiFID II. Per sé professional clients are listed and include financial intermediaries authorized under regulatory law, such as credit institutions and insurance companies, large undertakings meeting criteria regarding their balance sheet, net turn over and own funds and institutional investors.[110] Although these clients are considered professional investors they may, on request, be treated as a non-professional (retail) investor.[111] Retail clients may be treated as professional clients on request (elective professional investors). Technically speaking, all retail clients may opt-into a waiver of protection afforded by MiFID II. Annex II MiFID II, however, only considers the treatment as professional client valid if the investment firm after an assessment of the expertise, experience and knowledge of the client envisaged that the client is capable of making investment decisions and understands the risks involved.[112] Investment firms may honour

---

[104] Art. 12 MiFID (Commission Directive.
[105] Art. 24(7)(b) and (8) MiFID II.
[106] See on client classification: D. Smith & S. Leggett, *Client classification* 65-73 (C. Skinner ed, John Wiley & Sons 2007); K.W.H. Broekhuizen & L.J. Silverentand, *Ken uw cliënt, cliëntenclassificatie en de MiFID*, 11 TvFR 276-285 (2006); R. Pretorius & E. Redmore, *A level playing field... But not between directives?,* http://www.lexology.com/library/detail.aspx?g=d385bc43-fc07-42ea-ac6d-aa800860bf35 (accessed 9 February 2017); L.J. Silverentand, *Cliëntenclassificatie* (D. Busch & C.M. Grundmann-van de Krol eds, Kluwer 2009). Villeneuve, T.H. de, *Cliëntenclassificatie onder MiFID* 61-79 (F.M.A. 't Hart ed, NIBE-SVV 2007).
[107] Art. 4(11) MiFID II; M. Eggen & C. Staub, *Kundensegmentierung – Panacea oder Abschied vom mündigen Anleger?*, 1 GesKR 55 (2012).
[108] Art. 4(10) MiFID II
[109] R.P.Raas, *Beleggingsondernemingen, ken uw cliënt!* (D. Busch & C.M. Grundmann-van de Krol eds, Kluwer 2009).
[110] Annex II, I. Categories of client who are considered to be professionals, MiFID II.
[111] *Ibid.*
[112] Annex II, II. Clients who may be treated as professionals on request, MiFID II; F.M.A. 't Hart, *Het 'ken-uw-cliënt'-beginsel bezien* 80-99 (A.J.C.C.M. Loonen et al., NIBE-SVV 2008); See also F.M.A. 't Hart, *Ken-uw-cliënt* (F.M.A. 't Hart ed, NIBE-SVV 2007); Dreimüller, B.C., *MiFID en het 'know your customer'-beginsel. De huidige zorgplicht gaat te ver!*, 3 TvFR 62-72 (2007); B.C. Dreimüller, *MiFID en het 'know your customer'-beginsel. De huidige zorgplicht gaat te ver!*, 3 TvFR 62-72 (2007).

such a request if the client has carried out transactions of significant size at an high average frequency, the size of the client's financial instrument portfolio exceeds EUR 500,000 and/or the client works or has worked in the financial sector for at least one year in a professional position.

Finally, MiFID II recognizes the category of 'eligible counterparties', i.e. professional financial intermediaries. Art. 30(2) MIFID II recognizes, amongst others, investment firms, credit institutions and insurance companies, other financial institutions authorized under EEA law, national governments and public bodies as eligible counterparties. Investment firms dealing with eligible counterparties are exempted from complying with a number of conduct of business rules under MiFID II.[113]

3.2.4. Suitability and Appropriateness Tests

MiFID II requires investment firms to obtain information about the client's characteristics and objectives.[114] The information required to be obtained and assessed is classified in three different regimes: a suitability[115], an appropriateness test and 'execution-only'. The regime depends upon the type of investment service provided and the type of financial instruments that are involved.[116]

When providing investment advice or portfolio management an investment firm has to carry out a suitability test.[117] Such investment firms are required to obtain necessary information regarding the client's or potential client's knowledge, experience, financial situation and investment objectives to recommend (potential) clients investment services and financial instruments that are suitable to them.[118] The suitability test is lighter for professional clients as they have knowledge and experience with regard to transactions and these clients are able to bear financially the risk of losses related to investment.[119] Where an investment firm does not obtain the information required to perform a suitability test, the investment firm may not recommend investment services or financial instruments to the client or potential client.[120]

Investment firms that provide other investment services than portfolio management and investment advice are required to perform an 'appropriateness test'.[121] These investment firms have to ask the (potential) client to provide information regarding that person's knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the investment firm to assess whether the investment service or product envisaged is appropriate for the client.[122] Where the investment firm considers the product or service not appropriate to the client or the client provides insufficient

---

[113] See Art. 30(1) MiFID II.

[114] European Commission, *Background Note accompanying Draft Commission Directive implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive*, February 2006, 20.

[115] Cf. Joint Forum, *Customer Suitability in the Retail Sale of Financial Services,* http://www.bis.org/publ/joint20.pdf (accessed 14 January 2017).

[116] *Ibid*.

[117] Art. 25(2) MiFID II; Art. 54 and 55 MiFID II (Commission) Regulation.

[118] Art. 25(2) MiFID II; Art. 54 and 55 MiFID II (Commission) Regulation.

[119] European Commission, *Background Note accompanying Draft Commission Directive implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive*, February 2006, 20.

[120] Art. 54(8) MiFID II (Commission) Regulation.

[121] Art. 25(1) MiFID II; Art. 55 and 56 MiFID II (Commission) Regulation.

[122] *Ibid.*

information to determine this, the investment firm has to warn the client but may still provide the service or product in question.[123]

Investment firms providing 'execution-only' services, excluding the granting of credits or loans[124] that do not comprise of existing credit limits of loans, current accounts and overdraft facilities of clients do not have to perform a suitability and appropriateness test provided that certain conditions are satisfied.[125] One of the conditions is that the investment service/activity relates to financial instruments that are either listed shares, money market instruments, bonds or other forms of securitized debt, UCITS funds or other non-complex financial instruments.[126]

3.2.5. Best Execution

Investment firms have to take all sufficient steps to obtain the best possible result for their clients.[127] In doing so, the investment firm must take into account factors such as price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order.[128] For that purpose, investment firms need to implement an execution policy, provide information to clients, monitor effectiveness procedure and manage own dealings.[129]

3.2.6. Order Handling

Investment firms are obliged to handle their client order in a manner that ensures that the interests of the clients will be adequately protected.[130] For that reason, MiFID II requires investment firms authorized to execute client orders to implement procedures and arrangements which provide for the prompt, fair and expeditious execution of client orders, relative to other client orders or the trading interests of the firm.[131] Investment firms have to satisfy general principles such as on aggregation and allocation of client order when carrying out client orders.[132]

3.2.7. Record-Keeping

Investment firms are under Article 16(6) MiFID II required to keep records of all services, activities and transactions undertaken by it which shall be sufficient to enable the competent authority to fulfil its supervisory tasks and to perform the enforcement actions under this Directive. Records have to be kept in relation to: client orders, decisions to deal, transactions and client agreements, information to assess suitability.[133] The records kept ascertain that the

---

[123] Art. 25(3) sub-par. 2 and 3 MiFID II.
[124] Annex I, Section B No. 1 MiFID II.
[125] Art. 25(4) MiFID II.
[126] Art. 25(4)(a) MiFID II.
[127] Recital 91, Art. 27 MiFID II; See B. Bierens, *'Best execution' volgens MiFID: nieuwe gedragsregels met betrekking tot de uitvoering van orders*, 3 Ondernemingsrecht 8-16 (2008); B. Bierens, *De verplichting tot optimale uitvoering ('best execution')* 111-135 (F.M.A. 't Hart ed, NIBE-SVV 2007); K.W.H. Broekhuizen & L.J. Silverentand, *Best execution ingevolge de MiFID*, 1/2 TvFR 32-45 (2008); K.W.H. Broekhuizen, *Best execution* 64-79 (A.J.C.C.M. Loonen et al., NIBE-SVV 2008); D. Busch, *Best execution* (D. Busch & C.M. Grundmann-van de Krol eds, Kluwer 2009).
[128] Recital 91, Art. 27 MiFID II; Art. 64 MiFID II (Commission) Regulation.
[129] Recital 91, Art. 27 MiFID II; Art. 64-66 MiFID II (Commission) Regulation.
[130] European Commission, *Background Note accompanying Draft Commission Directive implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive*, February 2006, 28.
[131] Art. 28 MiFID II; Art. 67-70 MiFID II (Commission) Regulation.
[132] Art. 67-70 MiFID II (Commission) Regulation.
[133] Arts 67-70 MiFID II (Commission) Regulation.

investment firm complies with all obligations including those with respect to clients or potential clients and to the integrity of the market.[134]

4. 'Product Regulation': Product Oversight Governance and Intervention Rules

MiFID II does not contain any 'product regulation'.[135] Instead, MiFID II contains 'product governance' as ex ante preventive measure and 'product intervention' rules as ex post control.[136]

4.1.1. Product Governance Rules

MiFID II introduces a product governance regime that applies to the product development and sales process.[137] MiFID II delineates between requirements targeting to product manufacturers[138] and product distributors.

Investment firms in their role as product manufacturers need to comply with product governance policies and procedures as part of their organizational requirements.[139] Product manufacturers have to maintain, operate and review a product approval process.[140] The product approval process ensures that financial instruments sold are designed, the relevant risks are assessed and that the intended distribution strategy is consistent with the identified target market.[141] Product manufacturers shall insurance that the financial instruments are regularly reviewed to assess whether they remain to be consistent with the identified target market.[142] Product manufacturers shall make available to product distributors all information relevant to the financial instrument and the product approval process.[143]

---

[134] Art. 16(6) MiFID II; Arts 72-76 MiFID II (Commission) Regulation.

[135] Zetzsche and Marte take the view that the distinction between UCITSD V and AIFMD, at the one, and the MiFID II, at the other hand, loses its importance because of product governance rules. See D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D.A. Zetzsche ed, Kluwer 2015), 131; See for the product governance and intervention regime also: N. Moloney, *EC Securities Regulation* 825-832, 883-885 (3rd edn., Oxford University Press 2014); D. Busch, *Product Governance and Product Intervention* (D. Busch & G. Ferrarini eds, Oxford 2017); G. Schaeken Willemaers, *Product Intervention: A European Perspective*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1989817 (accessed 3 July 2015).

[136] D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D.A. Zetzsche ed, Kluwer 2015), 131.

[137] G. Schaeken Willemaers, *Client Protection on European Financial Markets – From Inform Your Client to Know Your Product and Beyond: An Assessment of the PRIIPs Regulation, MiFID II/MiFIR and IMD 2*, http://ssrn.com/abstract=2494842; T. Möllers & M. Poppele, *Paradigmenwechsel durch MiFID II: divergierende Anlegerleitbilder und neue Instrumentarien wie Qualitätskontrolle und Verbote*, ZGR - Zeitschrift für Unternehmens- und Gesellschaftsrecht 437, 453 (2013); Cf. V. Colaert, *Building Blocks of Investor Protection: All-Embracing Regulation Tightens Its Grip*, https://ssrn.com/abstract=2943985 (accessed 14 January 2017); V. Colaert, *MiFID II in Relation to Other Investor Protection Regulation: Picking Up the Crumbs of a Piecemeal Approach*, 3 https://ssrn.com/abstract=2942688 (accessed 14 January 2017).

[138] Cf. Joint Committee, *Joint Position of the European Supervisory Authorities on Manufacturers' Product Oversight & Governance Processes*, https://eiopa.europa.eu/Publications/Administrative/JC_2013_77__POG___Joint_Position_.pdf (accessed 14 January 2017).

[139] Art. 16(3) MiFID II.

[140] Art. 16(3) sub-para. 2 MiFID II.

[141] Art. 16(3) sub-para. 3 and Art. 24(2) MiFID II.

[142] Art. 16(3) sub-para. 4 MiFID II.

[143] Art. 16(3) sub-para. 5 MiFID II

Product distributors[144] are required to obtain information related to the product approval process and to understand the characteristics and the identified target market of each financial instrument.[145] They are the link between the manufacturers and the ultimate client and have to understand both the product characteristics and the need of the clients. Product distributors are also required to regularly review whether the financial product remain consistent with the identified target market and the distribution strategy.[146]

Chapter III MiFID II (Commission) Directive sets out details related to the product governance rules that target both product manufacturers and distributors. The product governance obligations for manufacturers include procedures and arrangements related to governance and the oversight of product design and the manufacturing process[147], managing conflicts of interests[148], identifying the target market[149], the assessment of the risks, the charging structure[150], information to be provided to distributors and the regular review of products.[151] The product governance obligations for distributors relate to the range of financial instruments issued by themselves or other firms and services they intend to offer or recommend to clients and include measures to ensure that the products and services are in accordance with the identified target market[152], the compliance reports of the management bodies[153] and the regular review of products[154].

4.1.2. Product Intervention Rules

The product governance regime is complemented by product intervention powers[155] serving as ex-post control[156] on the EEA level.[157] MiFIR entrusts these powers to ESMA in relation to financial instruments[158], the EBA in relation to structured deposits[159] and to the Competent Authorities of the individual Member States[160].

The Competent Authorities of individual Member States may prohibit or restrict the marketing or distribution of a particular instrument (including structured deposits)[161] or any

---

[144] Art. 16(3) sub-para. 6 MiFID II refers to investment firms offering or recommending financial instruments which it does not manufacture.
[145] Art. 16(3) sub-para. 6 MiFID II.
[146] Art. 16(3) sub-para. 6 MiFID II.
[147] Art. 9(1) MiFID II (Commission) Directive.
[148] Art. 9(2) and (3) MiFID II (Commission) Directive.
[149] Art. 9(1) and (9) MiFID II (Commission) Directive.
[150] Art. 9(12) MiFID II (Commission) Directive.
[151] Art. 9 MiFID II (Commission) Directive; Draft MiFID II (Commission) Directive, 4.
[152] Art. 10(1) and (2) MiFID II (Commission) Directive.
[153] Art. 10(3) MiFID II (Commission) Directive.
[154] Art. 10(3) MiFID II (Commission) Directive.
[155] Art. 10(5) MiFID II (Commission) Directive.
[156] See D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D.A. Zetzsche ed, Kluwer 2015), 131.
[157] Recital 29, Arts 39-43 MiFIR; T. Möllers & M. Poppele, *Paradigmenwechsel durch MiFID II: divergierende Anlegerleitbilder und neue Instrumentarien wie Qualitätskontrolle und Verbote*, ZGR - Zeitschrift für Unternehmens- und Gesellschaftsrecht 454 et seq (2013); N. Moloney, *The European Securities and Markets Authority and Institutional Design for the EU Financial Market – A Tale of Two Competences: Part (2) Rules in Action*, 12 European Business Organization Law Review 177-225 (2011); G. Schaeken Willemaers, *Product Intervention: A European Perspective*, http://ssrn.com/abstract=1989817 (accessed 29 September 2016); A. Cahn & H. Mühler, *Produktintervention nach MiFID II: Eingriffsvoraussetzungen und Auswirkungen auf die Pflichten des Vorstands von Wertpapierdienstleistungsunternehmen*, BKR - Zeitschrift für Bank- und Kapitalmarktrecht 45 (2013).
[158] See Art. 40(1) MiFIR.
[159] See Art. 41 MiFIR
[160] Art. 42(1) MiFIR;
[161] Art. 42(1)(a) MiFIR.

type of financial practice[162] in or from that Member State.[163] Competent Authorities of individual Member States may only take action if it satisfied on reasonable grounds.[164] Action may only be taken if there are, for example, significant investor protection concerns, threats to the orderly functioning and integrity of financial markets or stability of the whole or part of the financial system that are not sufficiently addressed by existing regulatory requirements and improved supervision or enforcement.[165] The action undertaken has to be proportionate given the risk, sophistication of investors or market participants and the effect of the action on investors and the market participants.[166] Before exercising any powers, Competent Authorities of individual Member States are obliged to consult Competent Authorities in other Member States that might be significantly affected by the intervention and take into account whether any action will have a discriminatory effect on services or activities provided from another Member State.[167]

Both EBA and ESMA may, instead of action undertaken by Competent Authorities of individual Member States, prohibit or restrict the marketing or distribution of a particular instrument (including structured deposits) or any type of financial practice in or from that Member State.[168]Any action may be exercised either on an EEA-wide basis or with regard to a particular Member State. Powers by EBA and ESMA can be used on the same 'reasonable grounds' as for national Competent Authorities.[169] EBA and ESMA may, however, only address issues at hand if national Competent Authorities of individual Member States have failed to adequate resolve the issue.[170] In taking measures, both ESMA and EBA have to ensure that the action will not detrimentally affect the efficiency of the market or detrimentally affect investors in a disproportionate manner to the benefits of exercising the power or create a risk of regulatory arbitrage.[171] The MiFID II product intervention powers are complementing similar powers that are introduced under the IDD and the PRIIPR.

5. Disclosure and Reporting Requirements

5.1. Information provided to Clients

Article 24(4) MiFID II requires investment firms to provide certain information to (potential) clients, such as information on the investment firm and its services[172], on financial instruments[173] and proposed investment strategies[174], execution venues, all costs and charges[175] and its terms of business (in a client agreement)[176].[177] All information, including

[162] Art. 42(1)(b) MiFIR.
[163] Art. 42(1) MiFIR; Art. 21 MiFID II (Commission) Regulation II.
[164] Art. 42(2) MiFIR.
[165] Art. 42(2)(a) and (b) MiFIR.
[166] Art. 42(2)(c) MiFIR.
[167] Art. 42(2)(d) and (e) MiFIR.
[168] See Art. 40(1)(a) and (b) and Art. 41(1)(a) and (b) MiFIR; Art. 19 and 20 MiFID II (Commission) Regulation II.
[169] Art. 40(2) and 41 (2) MiFIR.
[170] See Art. 40(2)(c) and Art. 41(2)(c) MiFIR.
[171] See Art. 40(3)(a) and (b) and Art. 41(3)(a) and (b) MiFIR.
[172] Art. 24(4) MiFID II; Art. 47 MiFID II (Commission) Regulation. Also information concerning safeguarding of client financial instruments or client funds should be provided. See Art. 49 MiFID II (Commission) Regulation.
[173] Art. 24(4) MiFID II; Art. 48 MiFID II Commission) Regulation.
[174] Art. 24(4) MiFID II.
[175] Art. 24(4) MiFID II; Art. 50 MiFID II(Commission) Regulation.

marketing communications, addressed by the investment firm to clients or potential clients shall be fair, clear and not misleading.[178] This information shall also include specific information related to investment advice, financial instruments and costs and charges.

Before investment advice may be given to clients, investment firms must inform their clients whether the advice to be provided is independent or non-independent, based on a broad or restricted range of financial instruments and whether the investment firm provides the client with a periodic assessment of the suitability of the financial instruments recommended to that client.[179]

Information on financial instruments must contain appropriate guidance/warnings of the risks associated with investment in the instruments, indicate whether the instrument is intended for retail or professional clients and take account the MiFID II product governance requirements.[180]

Information on all costs and associated charges must include information related to investment and ancillary services, including the cost of advice, where relevant, the cost of the financial instrument recommended or marketed to the client and how the client may pay for it, also encompassing any third-party payments.[181] All costs and charges should be aggregated so the client understands the overall cost as well as the cumulative effect on the return of the investment and where the client so requests, an itemized breakdown shall be provided.[182]

Client information shall be provided in a comprehensible form in such a manner that (potential) clients are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and take investment decisions on an informed basis.[183]

5.2. Reporting to Clients

Following Article 25(6) MiFID II investment firms have to provide clients with adequate reports on the investment services provided in a durable medium. These reports include period communications to clients and have to take into account the type and the complexity of the financial instruments involved, the nature of the investment service provided to clients and, where applicable, the costs associated with the transactions and services on behalf of the client.[184] Section 4 MiFID II (Commission) Regulation requires various reports to be provided to clients, including reporting to clients related to the execution of orders (other than for portfolio management[185], portfolio management[186], eligible counterparties[187], additional obligations for portfolio management or contingent liability transactions[188] and statements of

---

[176] Art. 24(3) MiFID II; Art. 46 MiFID II (Commission) Regulation; A.R. Filius & M.R. Hosemann, *De cliëntenovereenkomst* 50-63 (A.J.C.C.M. Loonen et al., NIBE-SVV 2008).

[177] M. van Eersel & G.P. Roth, *Informatieverplichtingen van beleggingsondernemingen jegens de financiële consument* 100-124 (A.J.C.C.M. Loonen et al., NIBE-SVV 2008); R.E. van Esch, *MiFID en het verschaffen van informatie aan beleggers via internet* 1/2 TvFR 17-22 (2008); F.R.H. van der Leeuw & M. Ris, *Informatieverstrekking* (D. Busch & C.M. Grundmann-van de Krol eds, Kluwer 2009).

[178] See Article 24(3) MiFID II; Art. 44 MiFID II (Commission) Regulation; R. Price, *Conduct of business standards - information requirements* 243-246 (M. Elderfeld ed, City & Financial Publishing 2007).

[179] Art. 24(4)(a) MiFID II; Art. 52 and 53 MiFID II(Commission) Regulation.

[180] Art. 24(4)(b) MiFID II; See *supra* 4.1.1.

[181] Art. 24(4)(c) MiFID II; Art. 50 MiFID II(Commission) Regulation.

[182] Art. 24(4)(c) sub-para. 2 MiFID II; Art. 50 MiFID II(Commission) Regulation.

[183] Art. 24(5) MiFID II.

[184] Art. 25(6) MiFID II.

[185] Art. 59 MiFID II (Commission) Regulation.

[186] Art. 60 MiFID II (Commission) Regulation.

[187] Art. 61 MiFID II (Commission) Regulation.

[188] Art. 62 MiFID II (Commission) Regulation.

client financial instruments or client funds.[189] The obligations under Section 4 MiFID II (Commission) Regulation apply to both professional and retail clients.

In respect of execution of orders other than for portfolio management, investment firms have to promptly provide the client, in a durable medium, with the essential information concerning the execution of that order[190] or send a notice to the client in a durable medium confirming execution of the order as soon as possible[191]. In addition to these requirements, investment firms have to supply clients, on request, with information about the status of his order[192]. This reporting obligation applies to all clients (including professional client and eligible counterparties). Investment firms may, however, agree with eligible counterparties different standards for the content and timing of reports than those applicable for professional and retail clients.[193]

Investment firms carrying out portfolio management have to provide their clients with a periodic statement on the activities carried out on behalf of that client unless such a statement is provided by another person.[194] The periodic statement required shall provide a fair and balanced review of the activities undertaken and of the performance of the portfolio during the reporting period and includes, amongst others, information about types of financial instruments allowed in the client portfolio, benchmark performance and management objectives, risks and constraints on discretion.[195]

Additional reporting obligations for portfolio management or contingent liability transactions apply.[196] Asset managers are obliged to report to the client where the value of the portfolio depreciates by 10%, and by further multiples of 10%.[197] Investment firms holding retail client accounts that include leveraged financial instruments or other contingent liability transactions, also have to report to the client when an instrument depreciates by 10% or multiples of 10% from its initial value.[198]

Finally, Article 63 MiFID II (Commission) Regulation requires investment firms holding client financial instruments and funds to send each client a statement detailing, amongst others, the financial instruments an funds held by the investment firm for the client. Statements are to be provided to clients at a minimum of quarterly intervals and can be requested more frequently.[199]

6. Investors as Residual Claimants

Investors under the MiFID II (virtual) investment triangle have the position of a residual claimant.[200] Similar as under the AIFMD and UCITSD V, MiFID II establishes a separation of investments and management that is a key characteristic of European asset management

---

[189] Art. 63 MiFID II (Commission) Regulation.
[190] Art. 59(1)(a) MiFID II (Commission) Regulation.
[191] Art. 59(1)(b) MiFID II (Commission) Regulation.
[192] Art. 59(2) MiFID II (Commission) Regulation.
[193] Art. 61 MiFID II (Commission) Regulation.
[194] Art. 60(1) MiFID II (Commission) Regulation
[195] Art. 60(2) MiFID II (Commission) Regulation.
[196] Art. 62 MiFID II (Commission) Regulation.
[197] Art. 62(1) MiFID II (Commission) Regulation.
[198] Art. 62(2) MiFID II (Commission) Regulation.
[199] Art. 63(1) MiFID II (Commission) Regulation.
[200] E.F. Fama & M.C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327, 333 (1983); Cf. B.S. Black, *Corporate Law and Residual Claimants*, http://escholarship.org/uc/item/5746q7pj (accessed 11 May 2017).

law.[201]

First,the residual interest to the earnings to the asset portfolio and the assets of the investment firm are legally separated.[202] The segregation of operational assets to which investment firms are entitled and investment assets belonging to the individual investors is being preserved by the safekeeping task of the custodian by means of custody or recordkeeping depending upon the nature of the assets involved.[203]

Second, there is separate ownership for those asset patrimonies. The shareholders of the investment firm are entitled to the cash flows of these firms, whereas the asset patrimony of the investment assets are legally or economically owned[204] by their investors.[205] Irrespective whether the investment relationship under MiFID II qualifies as 'execution-only', investment advice based or portfolio management, investors bear residual risk. They are residual claimants in the sense that they bear the full investment risk and are satisfied after the right of the investment firm and custodian to reimbursed themselves from the fund of debts that incurred to the investment portfolio of the investor. The accounts held by the (third-party) custodian ensure (1) the limited liability of investors and (2) the segregation of the asset patrimonies of the individual investors.

In the relationship between investors and investment firms providing agency financial services having an individual investment nature under MiFID II the 'limitation of control' resulting from the separation of investments and management is substituted by exit, voice and loyalty related to the services agreement they entered into. When concluding, for example, an 'execution-only' or an investment advice contract with an investment firm under MiFID II, investors remain to have the full discretion over the investments they make.[206] They may choose to direct and 'voice' their wishes to investment firms. Based upon the performance of the investment firm, investors may choose to exit by means of terminating their services contract or stay 'loyal'. The same holds true for investors under portfolio management contracts concluded with the difference that this service has a higher 'fiduciary element'. Investors, however, remain to have the right to give 'investment directions'.

7. Conclusion

Under European investment law, the agency relationships between investment firms, investors and optional third-party custodians, i.e. the (virtual) 'investment triangle', is being regulated by 'intermediary', 'product governance/intervention' and disclosure duties regulation.

Within the (virtual) investment triangle, an investment firm may provide several investment services/activities to clients in which for investment law purposes 'execution-only' services[207], investment advice[208] and portfolio management[209] are the most important ones.[210]

---

[201] See Chapter 11, section 1.2.1.2.
[202] See J. Morley, *The Separation of Investments and Management*, 29 April 2013, https://corpgov.law.harvard.edu/2013/04/29/the-separation-of-investments-and-management/ (accessed 30 April 2017). After the publication of the amended working paper, John Morley refers to 'the separation of fund and management' but only attributes this to investment funds. See J. Morley, *The Separation of Funds and Managers*, 123YALE L.J. 1228 (2014).
[203] See Art. 21(8)AIFMD; Art. 22(5)UCITSD V; Annex I s. B MiFID I/II. Annex I CRD IV.; Art. 34(1), (2) IORPD II.
[204] See IOSCO 1996, 6.
[205] See *supra* 4.1.4.
[206] See for execution-only: See Annex I, s. A No. 1 and No. 2 MiFID I/II; Art. 25(4) MiFID II; See for investment advice: Art. 4(4) MiFID II.
[207] See Annex I, s. A No. 1 and No. 2 MiFID I/II; Art. 25(4) MiFID II.

MiFID II intermediary regulation targets the authorization and organizational rules that apply to investment firms when providing several investment services/activities to clients in which for investment law purposes 'execution-only' services[211], investment advice[212] and portfolio management[213] are the most important ones.[214]The absence of a collective investment nature implies that no legal forms nor any standardized investment portfolios are in place, such as is the case under the AIFMD and UCITSD V. Instead, MiFID II introduces 'product governance' that applies to the product development and sales process.[215]MiFID II delineates between requirements targeting to product manufacturers[216] and product distributors. Investment firms in their role as product manufacturers need to comply with product governance policies and procedures as part of their organizational requirements.[217] Product distributors[218] are required to obtain information related to the product approval process and to understand the characteristics and the identified target market of each financial instrument.[219]

While investing, investors are exposed to the risk of investment firms that are acting as a custodian alongside the provision of investment services/activities. Most custodians are credit institutions or investment firms providing investment services/activities along this ancillary service as 'custody business' itself hardly generates profits.[220]

The parallel provision of investment services/activities and ancillary services increases the risk the risk of the loss or diminution of client assets, or of rights in connection with those

---

[208] Art. 4(4) MiFID II; See also: P. Giudici, *Independent Financial Advice* (D. Busch & G. Ferrarini eds, Oxford 2017).

[209] Art. 4(1) No. 8 MiFID II.

[210] See D. Zolb & D. Fischer, Haftung der Depotbank bei externer Vermögensverwaltung (Dike 2008); M. Zollinger, M., Rechts- und Haftungsverhältnisse in der Dreiecksbeziehung Depotbank – Kunde – externer Vermögensverwalter (Financial Intermediary), http://www.markus-zollinger.ch/wp-content/uploads/Markus_Zollinger_SeminarBankenrecht_Thema-20.pdf (accessed 12 May 2017).

[211] See Annex I, s. A No. 1 and No. 2 MiFID I/II; Art. 25(4) MiFID II.

[212] Art. 4(4) MiFID II; See also: P. Giudici, *Independent Financial Advice* (D. Busch & G. Ferrarini eds, Oxford 2017).

[213] Art. 4(1) No. 8 MiFID II.

[214] See D. Zolb & D. Fischer, *Haftung der Depotbank bei externer Vermögensverwaltung* (Dike 2008)*;* M. Zollinger, M., *Rechts- und Haftungsverhältnisse in der Dreiecksbeziehung Depotbank – Kunde – externer Vermögensverwalter (Financial Intermediary),* http://www.markus-zollinger.ch/wp-content/uploads/Markus_Zollinger_SeminarBankenrecht_Thema-20.pdf (accessed 12 May 2017).

[215] G. Schaeken Willemaers, *Client Protection on European Financial Markets – From Inform Your Client to Know Your Product and Beyond: An Assessment of the PRIIPs Regulation, MiFID II/MiFIR and IMD 2*, http://ssrn.com/abstract=2494842; T. Möllers & M. Poppele, *Paradigmenwechsel durch MiFID II: divergierende Anlegerleitbilder und neue Instrumentarien wie Qualitätskontrolle und Verbote*, ZGR - Zeitschrift für Unternehmens- und Gesellschaftsrecht 437, 453 (2013); Cf. V. Colaert, *Building Blocks of Investor Protection: All-Embracing Regulation Tightens Its Grip*, https://ssrn.com/abstract=2943985 (accessed 14 January 2017); V. Colaert, *MiFID II in Relation to Other Investor Protection Regulation: Picking Up the Crumbs of a Piecemeal Approach*, 3 https://ssrn.com/abstract=2942688 (accessed 14 January 2017).

[216] Cf. Joint Committee, *Joint Position of the European Supervisory Authorities on Manufacturers' Product Oversight & Governance Processes*, https://eiopa.europa.eu/Publications/Administrative/JC_2013_77__POG___Joint_Position_.pdf (accessed 14 January 2017).

[217] Art. 16(3) MiFID II.

[218] Art. 16(3) sub-para. 6 MiFID II refers to investment firms offering or recommending financial instruments which it does not manufacture.

[219] Art. 16(3) sub-para. 6 MiFID II.

[220] European Commission, Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186), 13.

assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.[221] MiFID II deals with this agency problem by requiring investment firms acting as a 'custodian' to comply with a safeguarding of client assets regime, i.e. organizational requirements minimizing these risks.[222]

Unlike the AIFMD and UCITSD V, do not require investment firms authorized to act as 'custodians' that exercise additional oversight duties. The latter can be explained as MiFID II only concerns individual investor relationships in which only the client assets of a single client are effected by the investment services/activities provided by investment firms. The absence of collective action problems under MiFID II compared to the AIFMD, UCITSD V and IORPD II means that leaving the 'monitoring function' solely up to the responsibility of the individual investors is more cost-effective.

Similar as under the AIFMD and UCITSD V, MiFID II product governance and disclosure requirements are based upon a 'standardization' of categories of investors. Generally, three classes of investors are to be identified: retail clients, professional clients and eligible counterparties. Disclosure regulation and reporting requirements under MiFID II are also based upon this investor classification. Disclosure and reporting requirements complement intermediary and product governance regulation. Disclosure regulation ensures that investors on an ex ante and ongoing basis are enabled to make an informed investment decision, whereas reporting requirements enable Competent Authorities to monitor investment intermediaries that are on the market.

Investors under MiFID II have the position of a residual claimant in the sense that they bear the full investment risk and are satisfied after the right of the investment firm and, if applicable, third-party custodian have reimbursed themselves from the fund of debts that incurs to the accounts of the investor.[223]

---

[221] Art. 2(1)(f) MiFID II (Commission) Directive. they must introduce adequate organizational arrangements to minimize the risk of the loss or diminution of client assets, or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.

[222] See Art. 16(2)-(10) MiFID II; Art. 2 et seq. MiFID II (Commission) Directive; See J.P. Casey & K. Lannoo, *The MiFID revolution* (Cambridge University Press (2009).

[223] E.F. Fama & M.C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327, 333 (1983); Cf. B.S. Black, *Corporate Law and Residual Claimants*, http://escholarship.org/uc/item/5746q7pj (accessed 11 May 2017).

CHAPTER 11 The Investment Triangle as Common Governance Framework in European Investment Law

Investor and market protection were previously addressed as the two main objectives to be achieved by depositaries and custodians.[1] Depositaries and custodians, however, are the legal nexus of a broader common governance framework in European investment law addressing these two objectives also referred to as the (virtual/optional)[2] investment triangle.[3] Throughout the AIFMD, UCITSD V, IORPD II and MiFID II the governance is characterized as an (virtual/optional) investment triangle involving an 'investment intermediary', such as an AIFM, UCITS ManCo, investment firm or IORP (governing board), a depositary/custodian and investors/members. The investment triangle involving the 'asset management law directives', i.e. the AIFMD, UCITSD V, MiFID II (portfolio management), and IORPD II is of a fiduciary nature[4], whereas in this chapter 'execution-only' and investment advice based investment relationships are being referred to as 'agency financial services under MiFID II'.

This chapter proceeds by explaining why the investment triangle is being applied throughout the European investment law directives from a law and economics perspective. It continues to explain why the investment triangles under the respective directives cater for (fiduciary/agency) governance and asset partitioning that is to be achieved by intermediary, product and sales/marketing regulation. It concludes by explaining that the depositary/custodian is a fundamental pillar under European investment law.

---

[1] D.A. Zetzsche, *Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?*, in *The European Financial Market in Transition* (H. S. Birkmose, M. Nevillie & K. E. SØrensen eds., Kluwer 2012); G. Miller, *Essential Papers on the Economics of Financial Law*, NYU Law and Economics Research Paper No. 16-01 (2016).

[2] See for the (virtual) investment triangle: I. Crespi-Hohl. *Neuere Tendenzen im Bereich der Verantwortlichkeit der Depotbank gegenüber ihrem Kunden bei Beizug eines externen Vermögensverwalters* (Schulthess Verlag 2003); M. Zollinger, *Rechts- und Haftungsverhältnisse in der Dreiecksbeziehung Depotbank – Kunde – externer Vermögensverwalter (Financial Intermediary),* http://www.markus-zollinger.ch/wp-content/uploads/Markus_Zollinger_SeminarBankenrecht_Thema-20.pdf (accessed 12 May 2017); S. Fuchs, *der Portfolio-Manager in der Global-Custody-Beziehung – Partner oder Störenfried*, (Haupt Verlag 2004); D. Zolb & D. Fischer. *Haftung der Depotbank bei externer Vermögensverwaltung* (Dike 2008); See for the (optional) investment triangle: R.H Maatman, *Het pensioenfonds als vermogensbeheerder* 232 (Deventer: Kluwer 2004).

[3] The 'investment triangle' is a concept that first appeared in the investment funds domain in Germany ('Das Anlagedreieck'. See M. Reiss, *Pflichten der Kapitalanlagegesellschaft und der Depotbank gegenüber dem Anleger und die Rechte des Anlegers bei Pflichtverletzungen* (Duncker & Humblot 2006); N. Seegebarth, *Stellung und Haftung der Depotbank im Investment-Dreieck* (Peter Lang 2004); K. Ohl. *Die Rechtsbeziehungen innerhalb des Investment-Dreiecks* (Duncker & Humblot 1989); T. Amman. *Aufgaben und Verantwortung der Depotbank im KAG Unter besonderer Berücksichtigung der Umstände bei Zahlungsunfähigkeit der kollektiven Kapitalanlage* (VDM Verlag Dr. Müller 2011) O. Sachtleber. *Zivilrechtliche Strukturen von open-end-Investmentfonds in Deutschland und England* (Bank- und Kapitalmarktrecht, 2011); G. Müller. Die Rechtsstellung der Depotbank im Investmentgeschäft nach deutschem und schweizerischem Recht (Neckar-Druck- u. Verl. Ges.1969); Zetzsche refers for corporate AIFs/UCITS to the 'investment square' in which, besides the Management Company, investors and depositary also the board of directors of the corporate form are, mostly passively, involved in fund governance ('Das Anlageviereck').

[4] SeeT. Frankel, *Fiduciary Law*, 71 Ca. L. Rev. 795 (1983); D.A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879; J. Edelman, *When Do Fiduciary Duties Arise?*, 126 L.Q. REV. 302 (2010); S.F. Gibbon, *Fiduciary Relationships Are Not Contracts,* 82 MARQ. L. REV. 303 (1999); R. Flannigan, *The Economics of Fiduciary Accountability*, 32 DEL. J. CORP. L. 393 (2007); T. Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209 (1995); P. B. Miller, *Justifying Fiduciary Duties*, 58 MCGILL L.J. 969 (2013); R.C. Nolan, *Controlling Fiduciary Power*, 68 CAMBRIDGE L.J. 293 (2009); J.C. Shepherd, *Towards a Unified Concept of Fiduciary Relationships*, 97 L.Q. REV. 51 (1981); E.J. Weinrib, *The Fiduciary Obligation*, 25 U. TORONTO L.J. 1 (1975).

1. A Law and Economics Theory of the Investment Triangle under European Investment Law

An economic theory of the investment triangle under European investment law refines the understanding of this concept. The purpose of this is to explain the varying role of depositaries, at the one, and custodians, at the other hand, in European investment law from a law and economics perspective. To this end, first, the investment triangle from a transaction cost theory perspective will be addressed before the (fiduciary/agency governance) and asset partitioning of the investment triangle will be discussed.[5]

1.1. The Investment Triangle: A Transaction Cost Theory

Throughout the AIFMD, UCITSD V, IORPD II and MiFID II the governance is characterized as an (virtual/optional)[6] investment triangle involving an 'investment intermediary', such as an AIFM, UCITS ManCo, investment firm or IORP (governing board), a depositary/custodian and investors/members.[7]

The investment triangle is the answer to the fiduciary/agency relationships that exist under the various European investment law directives.[8] The first relationship is between the 'investment intermediary' and the investors/members. The second between the 'investment intermediary' and the depositary/custodian and the third between the depositary/custodian and the investors/members.[9] There is not a fiduciary/agency relationship in place under UCITSD V, the AIFMD and IORPD II 'among investors/members' themselves as the legal form under these directives is established for asset partitioning reasons and setting out 'common terms' to which investors/members are, on an individual basis, equally bound.[10]

The investment triangle as common division of labour taking place under European investment law is explained by Clark's seminal paper the 'Four Stages of Capitalism'.[11] This paper, together with the differences in fiduciary/agency relationships and collective versus individual investment relationship explains that the investment triangle throughout the European investment law directives is a common structure with 'varied particulars'.[12] Under the European investment laws, the underlying three (fiduciary/agency) relationships reflect different contexts throughout the sector-specific directives. The flexibility of the investment triangle explains its success and application in European investment laws. Across the various directives, intermediary regulation, product regulation and sales regulation as common

---

[5] Cf. H. Hansmann & U. Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 New York University Law Review 434 (1998).

[6] I. Crespi-Hohl. *Neuere Tendenzen im Bereich der Verantwortlichkeit der Depotbank gegenüber ihrem Kunden bei Beizug eines externen Vermögensverwalters* (Schulthess Verlag 2003); R.H Maatman, *Het pensioenfonds als vermogensbeheerder* 232 (Deventer: Kluwer 2004).

[7] Cf. D.A. Zetzsche, *The Anatomy of European Investment Fund Law*,https://ssrn.com/abstract=2951681 (accessed 16 April 2017).

[8] D.A. Zetzsche, *Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?*, in *The European Financial Market in Transition* (H. S. Birkmose, M. Nevillie & K. E. SØrensen eds., Kluwer 2012);

[9] *Ibid.*

[10] D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* § 38 D. (Mohr Siebeck 2015); Cf. 'a number of investors' under the AIFMD: ESMA/2013/611, 7; M. Olson, *The logic of collective action: public goods and the theory of groups* (Harvard University Press 1971); R. Hardin, *Collective action* (Baltimore 1982).

[11] R.C. Clark, *The Four Stages of Capitalism*, 94 *Harvard Law Review* 561 (1981).

[12] R.H. Sitkoff, *An Economic Theory of Fiduciary Law* 197 (A.S. Gold & P.B. Miller eds., Oxford University Press 2014).

regulatory pillars of European investment law have been adapted to fit the particulars of the agency problems that underly the sectoral-specific fiduciary/agency problems at stake.[13] This explains why the terminology for 'investment intermediaries', depositaries/custodians and investors/members are labelled differently, albeit under the investment triangle the constituencies fulfil an equivalent role. Before these differences in the section 'investment triangle as (fiduciary) governance plus asset partitioning' will be explained, this section briefly explains the four stages of capitalism as to highlight why the investment triangle is a common governance structure under European investment law. This section concludes by explaining the economic rationale behind the differences in sectoral-specific investment triangles throughout the AIFMD, UCITSD V, IORPD II and MiFID II on the basis of the difference of agency costs under the sectoral-specific European investment laws on the basis of fiduciary versus agency relationships and collective and individual investment.

1.1.1. Explaining the Investment Triangle as Common Governance Structure: The Four Stages of Capitalism

Investment law in economic terms and its governance implications can be explained by Clark's seminal paper 'Four Stages of Capitalism' of Clark.[14] The paper describes the development of capitalism and the law from an historical perspective based upon the economic theory of the division of labour.[15] As the title of the paper suggests, Clark defines four stages of capitalism.[16]

1.1.1.1. Four Stages of Capitalism

In the first stage, entrepreneurs launch business operations. Entrepreneurs are the 'promoter, investor, manager' in one.[17] There is no separation of ownership and control. Instead, entrepreneurs are the capital providers and also make the business decisions with regard to their businesses that are launched. The law in this phase was aimed at protecting the one entrepreneur from the other.[18]

The second stage was characterized by the split of entrepreneurship into ownership and control.[19] The latter was the result of the invention of the publicly held corporation.[20] Corporate law was developed to embed the publicly held corporation in the law as a default 'contractual' statute[21] catering for legal personality, limited liability, transferable shares,

---

[13] Cf. U. Klebeck, *Interplay between AIFMD and the UCITSD* 120 (D.A. Zetzsche ed, Kluwer 2015); D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* 129 (D.A. Zetzsche ed, Kluwer 2015); D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* 865 (D.A. Zetzsche ed, Kluwer 2015).

[14] R.C. Clark, *The Four Stages of Capitalism*, 94 *Harvard Law Review* 561 (1981).

[15] A. Smith, An Inquiry into the Nature and Causes of the Wealth of Nations (Oxford University Press 1976 (reprint)), http://files.libertyfund.org/files/220/0141-02_Bk.pdf (accessed 12 May 2017).

[16] See for another paper suggesting a'fifth stage', i.e. pension fund as activist shareholders: G.L. Clark & T. Hebb, Pension *Fund Corporate Engagement: The Fifth Stage of Capitalism*, 59 Relations industrielles 142 (2004).

[17] R.C. Clark, *The Four Stages of Capitalism*, 94 *Harvard Law Review* 572 (1981).

[18] R.C. Clark, *The Four Stages of Capitalism*, 94 *Harvard Law Review* 570 (1981); Cf. H. Hansmann, *The Ownership of Enterprise* (Belknap Press 1996).

[19] A.A. Berle & G.C. Means, *The Modern Corporation and Private Property* (The McMillan Company 1932); E.F. Fama & M.C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 312, 317-18 (1983).

[20] R.C. Clark, *The Four Stages of Capitalism*, 94 *Harvard Law Review* 570 (1981); O. Williamson, *Corporate Governance,* 93 Yale Law Journal 1197 (1984).

[21] F.H. Easterbrook & D.R. Fischel, *The Corporate Contract*, 89 *Columbia Law Review* 1416 (1989); M. J. Whincop, *Nexuses of Contracts, the Authority of Corporate Agents, and Doctrinal Indeterminacy: From Formalism to Law and Economics*, 20 U.N.S.W. L.J. 274 (1997);

delegated management and investor ownership.[22] The separation of ownership and control allowed the professionalization of the management of the modern corporation. In addition, the invention of the 'separate legal personality' lead to asset partitioning that shielded of the assets of the corporation from the creditors of the individual shareholders and managers of the corporation.[23] Creditors of the firms were, thus, provided with incentives to grant firms with more credit.[24] Shareholders were protected by limited liability and vested with controlling rights over the delegated management and the right to receive the corporation's net earnings.

The third stage splitted the capital ownership function into the decision to supply capital funds and active investment management leading to a professionalization of the latter.[25] Financial intermediaries both providing discretionary asset management and investment funds specialized in the process of choosing investments.[26] Investors are, however, very little involved as they took advantage of the knowledge regarding portfolio management and issuers of professionalized asset managers.[27]

The fourth stage led to the splitting from the savings decision from ownership, i.e. the possession of beneficial claims in issuers and the decision to save.[28] The latter is a result of the post-World War II development in which almost all modern states mandatory require employees to take part in occupational pension plans.[29] Decisions about the pension plans, i.e. the decision whether and how much to safe are being negotiated by union representatives and corporations on behalf of the employees.[30] The savings function is, thus, splitted as labour unions and employers decide mutually upon the extent to which their income is saved and, thus, decide how much of their income is left of present consumption opposed to future consumption.[31] IORPs, as professional savings planners, rarely perform the investment function themselves, but in practice delegate this (partly) to professional asset managers, insurance companies in conjunction with advice provided by investment advisory firms.[32]

M. Klausner, *Corporations, Corporate Law, and Networks of Contracts,* 81 *Virginia Law Review* 757-852 (1995); H. Hansmann, *Corporation and Contract*, 8 American Law and Economics 1-19 (2006), https://ssrn.com/abstract=1095570 (accessed 11 May 2017); K. Ayotte & H. Hansmann, *Legal Entities As Transferable Bundles of Contracts*, 111 MICH. L. REV. 715, 721 (2013).

[22] J. Armour, H. Hansmann, R. Kraakman, *The Essential Elements of Corporate Law: What is Corporate Law?*, https://ssrn.com/abstract=1436551 (accessed 11 May 2017); F.H. Easterbrook & D.R. Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1991); R. Kraakman, *The Anatomy of Corporate Law: a comparative and functional approach* (Oxford University Press 2004).

[23] See R.B. Thompson, *Agency Law and Asset Partitioning*, 71 U. Cin. L. Rev. 1321 (2002); L.C. Backer, *The Autonomous Global Corporation: On the Role of Organizational Law beyond Asset Partitioning and Legal Personality,*41 Tulsa Law Journal 101 (2006).

[24] P. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 University of Chicago Law Review 499 (1976); In this regard, Halpern et al. state that a limited liability regime will, in many cases, create incentives for owners to exploit a moral hazard and transfer uncompensated business risks to creditors. See P. Halpern, M. Trebilcock & S. Turnbull, *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L.J. 117, 148 (1980).

[25] R.C. Clark, *The Four Stages of Capitalism*, 94 *Harvard Law Review* 564 (1981).

[26] See D.A. Zetzsche & C.D. Preiner, *Scope of the AIFMD* 52, 53 (D.A. Zetzsche ed, Kluwer 2015); ESMA/2013/611, 3, 4, 6; D. Frase, *Overview* 4,5 (D. Frase ed., Sweet & Maxwell 2011).

[27] See N. Moloney, *EC Securities Regulation* (3rd edn., Oxford University Press 2014).

[28] R.C. Clark, *The Four Stages of Capitalism*, 94 *Harvard Law Review* 565 (1981).

[29] R.C. Clark, *The Four Stages of Capitalism*, 94 *Harvard Law Review* 566 (1981).

[30] F. Kessler, *The Governance of Supplementary Pension Schemes and the Role of the Employee Representatives: A Story of Paradoxes* 295 (O. Kaufmann & S. Hennion, Springer 2011).

[31] E. Perotti / A. Schwienbacher, The Political Origin of Pension Funding, https://papers.tinbergen.nl/07004.pdf (accessed 15 May 2017).

[32] Cf. R.H. Maatman, *Is mandatory outsourcing welcome?,* https://www.ipe.com/is-mandatory-outsourcing-welcome/www.ipe.com/is-mandatory-outsourcing-welcome/17548.fullarticle (accessed 15 May 2017).

1.1.1.2. The Characterization of the European Investment Law Directives into the Four Stages of Capitalism

The AIFMD, UCITSD V, MiFID II (portfolio management) and IORPD II can all be characterized as European investment law directives that require the separation of the the investment decision from ownership (stage 3). In contrary, execution-only investors would only be subject to the agency costs deriving from the separation of ownership and control of the modern widely held corporation (stage 2). Investors benefitting from investment advice under MiFID II could be classified as a hybrid between the 2nd and 3th stage of capitalism.[33] There is no strict separation from the investment decision from ownership. The investment decision is only influenced by the investment adviser but ultimately taken by the investor itself. The same holds true for 'execution-only' transactions.[34] IORPD II requires both the separation from the investment decision from ownership and goes even further by splitting the savings from the ownership function (stage 4). The scope of the European investment law directives and the common governance framework of the investment triangle is, thus, mainly to be characterized by the common denominator of the 'separation of investments and management'[35].

1.1.2. Agency Costs under European Investment Law

European Investment Law mainly addresses the agency costs under the third and fourth stage of capitalism. Agency problems are very prominent under European investment law as investors/members delegate tasks related to specialist financial services to an agent from which they benefit as a principle and they are freed to undertake another activity.[36] Investment intermediaires might pursue their own interests that are not necessarily aligned with those of the principle.[37] The costs of the losses and misalignment are referred to as agency costs.[38] The agency costs arising out of the fiduciary or agency character of financial services cannot be anticipated in advance due to the problem of 'incomplete contracting'.[39] The fiduciary and agency nature of the financial services industry results in the inability of investors/members as

---

[33] Investment advice literature. Art. 4(4) MiFID II;Art. 4 MiFID II (Commission) Regulation; BaFin, *Gemeinsames Informationsblatt der Bundesanstalt für Finanzdienstleistungsaufsicht und der Deutschen Bundesbank zum Tatbestand der Anlageberatung* (2013).

[34] Article 25(4) MiFID II

[35] See J. Morley, *The Separation of Investments and Management*, 29 April 2013, https://corpgov.law.harvard.edu/2013/04/29/the-separation-of-investments-and-management/ (accessed 30 April 2017). After the publication of the amended working paper, John Morley refers to 'the separation of fund and management' but only attributes this to investment funds. See J. Morley, *The Separation of Funds and Managers*, 123
YALE L.J. 1228 (2014).

[36] J-J Laffont & D. Martimort, *The Theory of Incentives: The Principal-Agent Model*, https://gnunet.org/sites/default/files/Laffont%20%26%20Martimort%20-%20The%20Theory%20of%20Incentives.pdf (accessed 11 May 2017); J. Pratt & R. Zeckhauser, R, *Principals and Agents: The Structure of Business* (Harvard Business School 1985); R.H. Sitkoff, *An Economic Theory of Fiduciary Law* 197 (A.S. Gold & P.B. Miller eds., Oxford University Press 2014).

[37] M. Kruithof, *Conflicts of Interest in Institutional Asset Management: Is the EU Regulatory Approach Adequate?,* 31, http://ssrn.com/abstract=871178 (accessed 14 January 2017)

[38] R.H. Sitkoff, *An Agency Costs Theory of Trust Law,* 89 Cornell Law Review 621 (2004).

[39] I. Ayres & R. Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 *Yale Law Journal* 87 (1989); P. Aghion & P. Bolton, An Incomplete Contracts Approach to Financial Contracting' (1992), 59 Review of Economic Studies 473 (1992); O. Hart, Financial Contracting, 39 Journal of Economic Literature 1079-1100 (2001); I. Ayres, Making a Difference: The Contractual Contributions of Easterbrook and Fischel, 59 University of Chicago Law Review 1391 (1992);

principles to closely monitor their agents as they often lack the skills to do so.[40]

Agency costs and other contingencies that cannot be fully anticipated by means of contracts results in transaction costs.[41] The two main transaction costs are a possible insolvency of financial intermediaries and agency costs. The investment triangle implemented through intermediary, product and sales regulation as common regulatory pillars of European investment law, aims to mitigate transaction costs arising from a possible insolvency of financial intermediares and agency costs arising out of the three (fiduciary/agency) relationships that exist under the various investment law directives. The first relationship is between the 'investment intermediary' and the investors/members.[42] The second between the 'investment intermediary' and the depositary/custodian[43] and the third between the depositary and investors/members.[44]

The type of agency costs as a result of the 'four stages of capitalism' underlying the sectoral-specific European investment laws depends upon whether the type of relationships under the investment triangle can by classified as more of an agency or a fiduciary nature.[45] In addition, whether sectoral-specific European investment laws address agency costs resulting from individual or collective investment relationships, i.e. do investors/members have a 'pooled return'[46] determines the extent of the agency costs for investors/members.[47] These two factors form the law and economics foundation of the differences of intermediary, product and sales regulation in the optional, virtual and investment triangle that seeks to protect investors/members.[48]

1.1.2.1. Fiduciary versus Agency Relationships

The European investment law directives requires the investment triangle to be implemented through intermediary, product and sales regulation as common regulatory pillars. The investment triangle is, however, a common structure with 'varied particulars'.[49] Across the various directives, intermediary regulation, product regulation and sales regulation as common regulatory pillars of European investment law have been adapted to fit the particulars of the fiduciary/agency problems that underly the sectoral-specific fiduciary/agency problems at stake.

The first element that determines the nature of the investment triangle, is whether and to what extent the relationships under the investment triangle within a sectoral-specific investment law directive are of a fiduciary or agency nature.[50]

---

[40] G.S. Alexander, *A Cognitive Theory of Fiduciary Relationships*,85 CORNELL L. REV. 767 (2000); O. Hart, *Firms Contracts and Financial Structure (*Clarendon Press 1995).

[41] R.H. Sitkoff, *An Agency Costs Theory of Trust Law,* 89 Cornell Law Review 621 (2004).

[42] See M. Reiss, *Pflichten der Kapitalanlagegesellschaft und der Depotbank gegenüber dem Anleger und die Rechte des Anlegers bei Pflichtverletzungen* (Duncker & Humblot 2006).

[43] Art. 21(1) AIFMD; Art. 22(1) UCITSD V; See M. Reiss, *Pflichten der Kapitalanlagegesellschaft und der Depotbank gegenüber dem Anleger und die Rechte des Anlegers bei Pflichtverletzungen* (Duncker & Humblot 2006); N. Seegebarth, *Stellung und Haftung der Depotbank im Investment-Dreieck* (Peter Lang 2004).

[44] D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* § 38 D. (Mohr Siebeck 2015).

[45] P.J. Dalley, *A Theory of Agency Law*, U. PITT. L. REV. 495, 497 (2011); E.F. Fama, *Agency Problems and the Theory of the Firm*, 88 J.POL. ECON. 288, 289 (1980) ('The firm is viewed as a set of contracts').

[46] See under the AIFMD: ESMA/2013/611, 6 et seq.

[47] Cf. P.J. Dalley, *A Theory of Agency Law*, U. PITT. L. REV. 495, 497 (2011); E.F. Fama, *Agency Problems and the Theory of the Firm*, 88 J.POL. ECON. 288, 289 (1980) ('The firm is viewed as a set of contracts').

[48] Cf. IOSCO 2003, 6; See Chapter 7, section 1.

[49] R.H. Sitkoff, *An Economic Theory of Fiduciary Law* 197 (A.S. Gold & P.B. Miller eds., Oxford University Press 2014).

[50] R. Cooter & B.J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045 (1991).

'Fiduciaries' and 'agents' are distinct roles in financial contracting in which the law, in particular, European investment law, ensures that transactions made are fair from an ethical perspective. Boatright defines a fiduciary as

> 'a person who has been entrusted with the care of another's property or assets and who has a responsibility to exercise discretionary judgement in this capacity solely in this other person's interest.'[51]

Fiduciaries, such as, the later to be discussed AIFMs and MiFID II portfolio managers, provide valuable services for individuals that are unable to manage their own assets. As such, the fiduciary is part of a fiduciary relationship within the governance model of the investment triangle, in which investors/members are a beneficiary. Fiduciaries have the duty to act in the best interest of their investors/members as beneficiaries.[52] For that purpose, fiduciaries are required to comply with the duty of loyalty and care.[53] The duty of care requires fiduciaries to act in the best interest of investors/members and to avoid taking any personal advantage of the relationship.[54] In addition, the assets entrusted to, for example AIFMs, as fiduciaries should be managed with 'due care', i.e. the care that a reasonable, prudent person would exercise.[55] An extraordinary level of care is not required, but fiduciaries are expected to avoid negligence.[56]

Boatright defines 'agents' as 'a party that has been engaged to act on behalf of another, called the principle'.[57] 'Agency relations' exist due to the need to rely on others for specialized knowledge and skills.[58] An example, is a broker under MiFID II.[59] An agent is an 'extension' of the principle with the duty to use his expertise for the principle's benefit.[60] Agents, such as brokers, might work as directed.[61] This is, however, not always possible and, thus, the task of an agent, as well as a fiduciary, are open-ended.[62] Similar as to fiduciaries, agents are required to comply with a duty of loyalty and care under European investment

[51] J.R. Boatright, *Ethics in Finance* 39 (Wiley-Blackwell 2014).
[52] R. Cooter & & B.J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences* , 66 New York University Law Review 1045 (1991).
[53] See, for example, for investment firms under MiFID: Art. 24(7)(b) and (8) MiFID II; For AIFMs/UCITS Mancos: Art. 12 AIFMD, Art. 14 UCITSD V; Cf. Art. 20 IORPD II for IORPs; See, for example, for depositaries under the AIFMD/UCITSD V: Article 21(10) AIFMD; Art. 25(2) sub.para 1 UCITSD V; See Art. 33(6) and (7) IORPD II for IORP depositaries/custodians; R.H. Sitkoff, *Other Fiduciary Duties: Implementing Loyalty and Care* (R. H. Sitkoff, E.J. Criddle & Paul B. Miller eds., Oxford University Press, forthcoming 2017); D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 226 (D.A. Zetzsche ed, Kluwer 2015); See also: W.A. Gregory, *The Fiduciary Duty of Care: A Perversion of Words*, 38 Akron Law Review 181 (2005); J. Velasco, *How Many Fiduciary Duties are There in Corporate Law*, 83 Southern California Law Review 1231 (2010).
[54] J.R. Boatright, *Ethics in Finance* 40 (Wiley-Blackwell 2014).
[55] See Art. 12 AIFMD; Cf. J. H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 IOWA
L. REV. 641 (1996).
[56] Cf. the 'negligence' for depositary liability: S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013).
[57] J.R. Boatright, *Ethics in Finance* 41 (Wiley-Blackwell 2014)..
[58] J. Pratt & R. Zeckhauser, R, *Principals and Agents: The Structure of Business* (Harvard Business School 1985).
[59] *See* A.B. Laby, *Selling Advice and Creating Expectations: Why Brokers Should Be Fiduciaries*, 87 WASH. L. REV. 707, 775 (2012).
[60] J.R. Boatright, *Ethics in Finance* 41 (Wiley-Blackwell 2014).
[61] R.H. Sitkoff, *The Fiduciary Obligations of Financial Advisors Under the Law of Agency* 27 Journal of Financial Planning 42 (2014).
[62] J.R. Boatright, *Ethics in Finance* 41 (Wiley-Blackwell 2014).

law.[63] These duties are, however, not as inclusive as the duties of a fiduciary as the role of an agent is usually narrower than of a fiduciary.[64]

Now the differences of the fiduciary and agency nature of the actors involved will be reviewed for the relationships between the 'investment intermediary' and the investors/members, the 'investment intermediary' and the depositary/custodian[65] and the depositary/custostian and the investors/members under the various sector-specific investment law directives.[66]

In the relationship between the 'investment intermediary' and the investors/members the AIFMD, UCITSD V, IORPD II and MiFID II (portfolio management) have a fiduciary nature, whereas this relationship is to be characterized as 'agency' for 'execution-only and investments based upon investment advice under MiFID II.[67]

Within the investment triangle, an AIFM/UCITS ManCo holds the discretionary authority to make investment decisions unilaterally on behalf of the fund (the joint investors). By investing money, AIFM/UCITS ManCo are acting as a fiduciary on behalf of investors that do not have direct control.

Under IORPD II, IORP governing bodies act as a fiduciary on behalf of the members that do not have direct control over the investment decisions being made. The members and beneficiaries owning/benefiting from invest are not the same that manage the IORP (the IORP governing body).[68]

Within the (virtual) investment triangle, an investment firm may provide several investment services/activities to clients in which for investment law purposes 'execution-only' services[69], investment advice[70] and portfolio management[71] are the most important ones.[72]

Investment firms in their capacity, thus, act as agents of clients. The agency nature of the investment services/activities provided may contain 'fiduciary' elements depending upon whether the investment firm provides 'execution-only' services, investment advice or portfolio management.[73] The agency nature of 'execution-only' services is the strongest as this investment service only consists of the execution or reception and transmission of client orders with or without ancillary services. The sole discretion lies with the client.

Investment firms providing portfolio management have a highly fiduciary nature as the

---

[63] See, for example; R.H. Sitkoff, *Other Fiduciary Duties: Implementing Loyalty and Care* (R. H. Sitkoff, E.J. Criddle & Paul B. Miller eds., Oxford University Press, forthcoming 2017).

[64] J.R. Boatright, *Ethics in Finance* 41 (Wiley-Blackwell 2014).

[65] Art. 21(1) AIFMD; Art. 22(1) UCITSD V; See M. Reiss, *Pflichten der Kapitalanlagegesellschaft und der Depotbank gegenüber dem Anleger und die Rechte des Anlegers bei Pflichtverletzungen* (Duncker & Humblot 2006); N. Seegebarth, *Stellung und Haftung der Depotbank im Investment-Dreieck* (Peter Lang 2004).

[66] R. Hardin, *Collective action* (Baltimore 1982).

[67] See for execution-only: See Annex I, s. A No. 1 and No. 2 MiFID I/II; Art. 25(4) MiFID II; See for investment advice: Art. 4(4) MiFID II; Cf. D. Busch, *Agency and Principal Dealing under MiFID* https://ssrn.com/abstract=2899751(accessed 15 May 2017).

[68] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 7.

[69] See Annex I, s. A No. 1 and No. 2 MiFID I/II; Art. 25(4) MiFID II.

[70] Art. 4(4) MiFID II.

[71] Art. 4(1) No. 8 MiFID II.

[72] C.M. Grundmann-van de Krol, *The Markets in Financial Instruments Directive and Asset Management* (D. Busch & D.A. DeMott eds, Oxford 2012).

[73] L.S.Sealy, *Fiduciary Relationships*, 69 Cambridge Law Journal 69-72 (1962); T. Frankel, *Fiduciary Duties* 127-132 (P. Newman ed, Macmillan 1998); D.A. DEMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 879 Duke Law Journal 908 (1988); R. Cooter & & B.J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences* , 66 New York University Law Review 1045 (1991).

asset manager holds the discretionary authority to make investment decisions unilaterally on behalf of the client within the limits of the investment policy as laid down in the clients' mandate.[74] To the contrary of investors under the AIFMD, UCITSD V and IORPD II, the investment firm acts as a fiduciary on behalf of individual investors that, however, have control over the investment decisions being made. Investors are allowed to give investment directions to the investment firm.[75] The relationship between investment firms providing portfolio management is, thus, fiduciary with an agency element. The differences in the fiduciary and agency nature of the relationship between investment intermediaries and investors/members has an influence on the intermediary, product and sales regulation in the sector-specific European investment law directives.

The relationship between the investment intermediary and the depositary/custodian can also have a fiduciary or agency nature.

The relationship between AIFMs/UCITS ManCos and the depositary is to be characterized as fiduciary. The AIFMs/UCITS ManCo is required to perform due diligence on behalf of the joint investors upon appointing a depositary, whereas the depositary is plays a key role in the protection of the investor's assets, as a result of the assigned responsibilities to keep the assets safe and exercise oversight duties over them.[76] The fiduciary nature is expressed in the 'mutual control' that AIFMs/UCITS ManCos and depositaries under the AIFMD and UCITSD V are required to perform.

The relationship is not as clear cut under IORPD II. Under IORPD II, IORPs may be under the implementation laws of the individual Member States required to appoint a custodian, a depositary or nothing at all.[77] The relationship can be of a fiduciary nature in the case a depositary is required to be appointed, whereas mandatory custodians have more an agency nature.

The relationship under MiFID II is also not clear cut. The investor has the discretion to decide whether the investment firm may both provide investment services/activities and custody services or whether the investor appoints a 'third-party custodians'.[78] In either case, no oversight duty towards the investment firm is required to be performed. This explains why investment firms may be simultaneously appointed for providing investment services/activities and as a custodian.[79] Nevertheless, individual investors decide whether they enter into a 'custody contract' with the investment firm, whether they contract a third-party custodian themselves or whether the investment firm acts as an agent by contracting a third-party custodian on their behalf.[80]

Again the relationship between depositaries and investors under the AIFMD is characterized as a fiduciary relationship. Although the investors under the AIFMD nor UCITSD V have a direct contractual relationship with the depositary, depositaries perform

---

[74] See Chapter 10, section 2.3.

[75] D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* 122, 123 (D.A. Zetzsche ed, Kluwer 2015).

[76] D.A. Zetzsche, *Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?*, in *The European Financial Market in Transition* (H. S. Birkmose, M. Nevillie & K. E. SØrensen eds., Kluwer 2012); Cf. R.H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 53-54 (1986).

[77] Art. 33(1) and (2) IORPD II.

[78] Oxera, *The Role of Custody in European Asset Management*, 20, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx (accessed 7 October 2016).

[79] See Recital 38, Art. 1(3) MiFID II

[80] Oxera, *The Role of Custody in European Asset Management*, 20, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx (accessed 7 October 2016).

oversight duties on their behalf towards the AIFMs/UCITS ManCos and delegated asset managers.[81]

The depositary/custodian regime under the IORPD II is a hybrid regime. It contains elements of the AIFMD/UCITSD V depositary and the CRD IV/MiFID II custodian regime. IORPD II leaves it completely up to individual Member States whether one or more depositaries or custodians are required to be appointed. This was a compromised political solution for dealing with all different types of IORPs throughout the EEA.[82] Depending on whether a depositary or custodian is appointed the relationship is to be classified as fiduciary or of agency nature.

MiFID II deals with this agency problem by requiring investment firms acting as a 'custodian' to comply with a safeguarding of client assets regime, i.e. organizational requirements minimizing these risks.[83] Unlike the AIFMD and UCITSD V, do not require investment firms authorized to act as 'custodians' that exercise additional oversight duties. The latter can be explained as MiFID II only concerns individual investor relationships in which only the client assets of a single client are affected by the investment services/activities provided by investment firms.[84]

The relationship amongst investors/members under all European investment law directives is neither to be characterized as an agency nor as a fiduciary relationship. Unlike under corporate law, nor investors nor members do have a voting right and, thus, there are no majority/minority conflicts to be resolved amongst investors/members.[85] Investors/members conclude individual contracts under MiFID II, the AIFMD and UCITSD V with the 'investment intermediary'. Under the AIFMD and UCITSD V, investors 'contract in' the common terms set out by the legal forms in which the AIFs/UCITS are established.[86] Similarly, members under IORPD II are individually bound by common terms set out by the legal form in which the IORP is established based upon their occupation.[87] Collective investments, thus, do not create agency/fiduciary relationships amongst investors/members. Instead, the agency/fiduciary relationships between the 'investment intermediary' and investors/members, the 'investment intermediary' and the depositary/custodian and the investors/members and the depositary/custodian are affected by the 'pooled risk/return' under collective investment relationships.

The differences in intermediary, product and sales regulation under the European investment law directives, thus, arise as a result of the different nature of collective and individual investment.

1.1.2.2. Collective versus Individual Investment

The difference between the collective and individual investment nature of the sector-specific European investment law directives also has an influence on the intermediary, product and

---

[81] Art. 21(1) AIFMD; Art. 22(1) UCITSD V.

[82] See Chapter 5, section 2.1.

[83] See Art. 16(2)-(10) MiFID II; Art. 2 et seq. MiFID II (Commission) Directive.

[84] S.N. Hooghiemstra, *Wat is een beleggingsinstelling onder de AIFM-richtlijn?*, 3 Ondernemingsrecht 24 (2014);

[85] H. Cronqvist & M. Nilsson, *Agency Costs of Controlling Minority Shareholders* (2003), 38 Journal of Financial and Quantitative Analysis 695-719 (2003); A. Dyck, & L. Zingales, *Private Benefits of Control: An International Comparison,* 59 Journal of Finance 537 (2004); C. Sundaramurthy & D.W. Lyon, *Shareholder Governance Proposals and Conflicts of Interests Between Inside and Outside Shareholders*, 10 J. MANAG. ISSUES 30 (1998).

[86] Cf. Recital 6, Art. 2(2)(b) AIFMD, Art. 1(3) UCITSD V.

[87] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 13.

disclosure regulation of specific directives. The collective investment nature, as opposed to the individual investment nature, is characterized by the 'pooled return' nature of collective investment relationships.[88]

AIFMs, UCITS Mancos under the AIFMD and UCITS Manco, for example, required to treat investors equally under the intermediary regulation to which they are subjected.[89]

Under the AIFMD, UCITSD V and IORPD II, AIFs, UCITS and IORPs are to be established in a legal form as to obtain asset partitioning amongst the investors/members.[90] To the contrary, the MiFID II individual investment nature only requires investment firms to comply with product oversight governance rules.[91]

In addition, the collective investment nature of the AIFMD and UCITSD V require a depositary to perform 'third-party monitoring' towards the AIFM/UCITS ManCo, whereas under MiFID II custodians do not have an equivalent monitoring role.[92] The latter can be explained as MiFID II only concerns individual investor relationships in which only the client assets of a single client are effected by the investment services/activities provided by investment firms. The absence of collective action problems under MiFID II compared to the AIFMD, UCITSD V and IORPD II means that leaving the 'monitoring function' solely up to the responsibility of the individual investors is more cost-effective.[93]

Not only the scope of the European investment law directives, but also the fiduciary and agency nature, at one, and the collective versus individual investment nature of European investment law directives have an impact on how the intermediary, product and sales regulation under the sector-specific investment triangle regulate the relationship between 'investment intermediaries', depositaries/custodians and investors/members.

1.2. The Investment Triangle as (Fiduciary/agency) Governance Plus Asset Partitioning

The investment triangles throughout the European investment directives are to be characterized as a hybrid of '(fiduciary/agency) governance' and 'asset partitioning'. This section first explains the law and economics behind the structural separation of investments and management as core feature of the investment triangle under the various directives. It concludes by explaining the function of (fiduciary/agency) governance and asset partitioning that is established under these directives.

---

[88] See on the 'pooled return' under the AIFMD: ESMA/2013/611, 6 et seq.

[89] See, example, Art. 12(1)(f) AIFMD: 'No investor in an AIF shall obtain preferential treatment, unless such preferential treatment is disclosed in the relevant AIF's rules or instruments of incorporation'.

[90] See for the legal forms:Recital 6 and Article 2(2)(b) AIFMD; Article 1(3) UCITSD V; Art. 6(2) IORPD II; G.V. Rauterberg, *Agency Law as Asset Partitioning*, https://ssrn.com/abstract=2641646 (accessed 11 May 2017); See also: G.R. Elgueta, *Divergences and Convergences of Common Law and Civil Law Traditions on Asset Partitioning: A Functional Analysis*, http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=1352&context=jbl (accessed 15 May 2017).

[91] Joint Committee, *Joint Position of the European Supervisory Authorities on Manufacturers' Product Oversight &GovernanceProcesses*, https://eiopa.europa.eu/Publications/Administrative/JC_2013_77__POG__ _Joint_Position_.pdf (accessed 14 January 2017); Assets are, however, required to be preserved under the 'MiFID II safeguarding client assets regime; See Art. 16(2)-(10) MiFID II; Art. 2 et seq. MiFID II (Commission) Directive.

[92] H. Dietzi, *Die Verantwortlichkeit der Bank gegenüber einem Kunden für Handlungen eines von diesem eingesetzten Vermögensverwalters*, 5 SZW 193 (1997); A. De Beer, *Die Verantwortlichkeit der Bank gegenüber einem Kunden für Handlungen eines von diesem eingesetzten Vermögensverwalters – Eine Replik*, SZW 125 (1998); R. Watter, *Über die Pflichten der Bank bei externer Vermögensverwaltung*, 10 AJP/PJA 1174 (1998).

[93] M. Olson, *The logic of collective action: public goods and the theory of groups* (Harvard University Press 1971); R. Hardin, *Collective action* (Baltimore 1982).

1.2.1. *The Investment Triangle as Structural Separation of Investments and Management*

All European investment laws have as a common characteristic that they apply the concept of structural separation of investments and management (the investment triangle).[94] This requirement consists of two features. First, the investment assets of investors and members and the assets of the 'investment intermediaries', such as investment firms, AIFMs, UCITS ManCos and IORP governing boards are required by all sectoral-specific European investment law directives to be segregated into two separate sets of asset patrimonies.[95] The second features that the a combination of organizational and regulatory law requires is the separate ownership for those asset patrimonies.[96]

Asset segregation by the depositary/custodian throughout all these directives are at all times preserved by means of the safekeeping function, i.e. custody or recordkeeping depending upon the nature of the assets involved.[97]

The asset patrimony that is legally/economically owned[98] by investors under MiFID II and UCITSD V largely consists of liquid financial instruments that can be held in custody.[99] AIFs, such as AIFs under the ELTIFR[100] or EuVECAR[101], may also invest in non-liquid assets.[102] IORPs invest in both liquid and non-liquid assets[103].The assets belonging to the asset managers under MiFID II, IORPD II, the AIFMD or UCITSD V and brokers, investment advisers under MiFID II are of operational nature and may include employees, offices and office equipment.

Asset managers as fiduciaries under MiFID II, IORPD II, the AIFMD or UCITSD V have the exclusive authority to perform discretionary portfolio management or to delegate this. Apart from this, these asset managers are allowed to carry out portfolio managements for multiple AIFs, UCITS, IORPs and individual investors at the same time. The same holds true for brokers and investment advisers that are agents under MiFID II.[104]

The difference between fiduciaries and agents under European investment law is that fiduciaries, such as AIFs and UCITS, typically, do not provide investors with any formal rights of control over AIFMs or UCITS ManCos. The separation of investments and management and the occupational nature of IORPs also do not grant members with any formal right of control towards IORP governing bodies, whereas IORP governing bodies and

---

[94] Cf. H. Hansmann & U. Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 New York University Law Review 434 (1998).

[95] See Art. 21(11)(d)(iii) AIFMD; Art. 22a(3) UCITSD V; Art. 2(1)(a) MiFID II (Commission) Directive/Art. 16(1)(a) MiFID I (Commission) Directive.

[96] H. Hansmann, *Ownership and Organizational Form*, http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.461.5180&rep=rep1&type=pdf (accessed 11 May 2017).

[97] See Art. 21(8)AIFMD; Art. 22(5)UCITSD V; Art. 34 IORPD II; Annex I s. B MiFID I/II. Annex I CRD IV.

[98] See IOSCO 1996, 6.

[99] See U. Klebeck, *Interplay between AIFMD and the UCITSD* 120 (D.A. Zetzsche ed, Kluwer 2015); D.A. Zetzsche, D.A. & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* 120 (D.A. Zetzsche ed, Kluwer 2015).

[100] See Chapter 8, section 4.2.3.2.

[101] See Chapter 8, section 4.2.3.3.

[102] See for the investment policy of EuVECAs: Art. 3(a) EuVECAR; See also Art. 3(1)(a) EuSEFRand see for ELTIFs: Recital 4, Art. 10 ELTIFR.

[103] See Art. 19 IORPD II.

[104] Cf. A.B. Laby, *Selling Advice and Creating Expectations: Why Brokers Should Be Fiduciaries*, 87 WASH. L. REV. 707, 775 (2012); R.H. Sitkoff, *The Fiduciary Obligations of Financial Advisors Under the Law of Agency* 27 Journal of Financial Planning 42 (2014).

investors under MiFID II have a limited right to direct the investment policy in the asset management contract concluded with their MiFID II portfolio manager.[105]

The separation of investments and management benefits both 'investment intermediaries' and depositaries/custodians, at the one, and investors/members, at the other hand, as the separation of investments and management under the investment triangle limits the control over the fiduciary and agency services provided and the exposure.[106]

This section starts with explaining the concept of the structural separation of investments and management. It continues by explaining that a key characteristic of fiduciary relationships is exit as substitute for control, whereas agency relationships either have, apart from exit, also the possibility of voice'.[107] It concludes by explaining the scale of scope and economies as the major benefit for 'investment intermediaries', depositaries/custodians and investors/members of applying the structural separation of investments and management under the investment triangle.

1.2.1.1. Explaining the Separation of Investments and Management

The law adopted the desirable separation of investments and management throughout the European investment law directives as it maximizes the value for investors/members, investment intermediaries and depositaries/custodians.[108] The European investment law directives, on top of private and/or organizational law[109], require two points two be addressed: the allocation residual control[110] and residual earnings over the assets invested in and the partitioning of the operational assets, as opposed to, the legal/beneficial ownership of the assets invested in.[111]

The first objective is achieved by limiting the rights of investors/members to control their investment intermediaries and depositaries/custodians. The second objective is obtained by limiting the exposure of investors/members to the residual earnings and liabilities of their respective investment intermediaries and depositaries/custodians.[112]

The separation of ownership of the separate asset patrimonies leads to limitation of residual earnings and residual control.The separation ownership limits individual investors/members in their exposure to their investment intermediaries and depositary/custodian.[113] The separation of the ownership of the two asset patrimonies, i.e. the ownership of the operational and investment assets limits exposure of the residual earnings (the profits) of investment intermediaries and depositaries/custodians to the shareholders of

[105] Cf. C.W.M.Lieverse, C.W.M.., *The Scope of MiFID II* (D. Busch & G. Ferrarini eds, Oxford 2017).
[106] Morley argues that for AIFs and UCITS there could be minor complications for this model. Feeder funds, for example, take contributions indirectly from their investors. In addition, there might by an overlap between AIFs, UCITS and their managers if the latter invests itself in the funds he manages. See J. Morley, *The Separation of Funds and Managers*, 123 YALE L.J. 1228 (2014) (analyzing economic consequences of the legal structure of investment funds).
[107] A.O. Hirschman, *Exit, Voice and Loyalty. Responses to Decline in Firms, Organizations and States (*Harvard University Press 1970).
[108] See also J. Morley, *The Separation of Investments and Management*, 29 April 2013, https://corpgov.law.harvard.edu/2013/04/29/the-separation-of-investments-and-management/ (accessed 30 April 2017).
[109] H. Hansmann, *Organizational Law as Asset partitioning,* 44 European Economic Review 807, 817 (2000).
[110] M. Becht, P. Bolton & A. Roell, *Corporate Governance and Control* (2004), http://ssrn.com/abstract=343461 (accessed 11 May 2017).
[111] See on residual earnings/liabilities: E.F. Fama & M.C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327, 333 (1983).
[112] Cf. B.S. Black, *Corporate Law and Residual Claimants*, http://escholarship.org/uc/item/5746q7pj (accessed 11 May 2017).
[113] H. Hansmann & R. Kraakman, *The Essential Role of Organizational Law,* 110 Yale Law Journal 387(2000).

these intermediaries only.[114] The separation of ownership also limits the residual control of investors/members with regard to the investment intermediaries and depositaries/custodians.[115] Only the shareholders of the intermediaries and not the (legal/economical) owners of the assets invested in are allowed to exercise control over their investment intermediaries and depositaries/custodians and their operational assets.

The separation of the asset patrimonies that are owned by the investment intermediaries and depositaries/custodians, at the one hand, and investors/members at the other hand, limits the exposure of the investment intermediaries and depositaries/custodians to the liabilities and creditors of the investors/members.[116] The asset partitioning required by the law accomplishes that the creditors of the various investment intermediaries and depositaries/custodians cannot claim the investment assets belonging to the investors/members.[117] The separation of investments and management is, thus, limiting the exposure of investors/members to the profits and liabilities of investment intermediaries and depositaries/custodians and limit the control investors/members exercise over them. It ensures that investors/members only are exposed to the performance of the underlying invested assets minus the service fees paid to investment intermediaries and depositaries/custodians. Due to economies of scope and scale arising from the operation of simultaneous business lines by investment intermediaries and depositaries/custodians, these service fees are lower and less impacting investment returns than than the operational costs if investors/members would be a direct shareholder of the investment intermediary (and/or depositary/custodian).

For three reasons, the investment triangle preserves the separation of investment and management.[118] First, investors/members under the asset management law directives (fiduciary nature) have rights of exit that provide a substitute for control and investors investing on the basis 'agency financial services under MiFID II' may make use of exit, voice and loyalty. Second, the separation of investment and management caters for the insulation from liabilities and risks related to the investment intermediaries and depositaries/custodians. Investors and members are only exposed to the risks of the assets that invest in and not to the operational assets of their investment intermediaries and depositaries/custodians.[119] Third, the separation of investment and management leads to economies of scope and scale for both investment intermediaries and depositaries/custodians.[120] These will now be subsequently discussed.

1.2.1.2. Exit, voice, loyalty for Agency Services versus Exit as Substitute for Control for Fiduciary Services

---

[114] See on the definition of 'residual earnings': S.J. Grossman & O.D. Hart, *The costs and benefits of ownership: A theory of vertical and lateral integration,* 94 Journal of Political Economy 691-719 (1986); *See* E.F. Fama & M.C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327, 333 (1983); Cf. J. Armour & M.J. Whincop, *The Proprietary Foundations of Corporate Law*, 27 OXFORD J.LEGAL STUD. 429, 445-46 (2007).

[115] Is defined as 'the right to control all aspects of the asset that have not been explicitly given away by contract. See S.J. Grossman & O.D. Hart, *The costsand benefits of ownership: A theory of vertical and lateralintegration,* 94 Journal of Political Economy 691-719 (1986); H. Hansmann, *Ownership and Organizational Form*, http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.461.5180&rep=rep1&type=pdf (accessed 11 May 2017).

[116] See , for Dutch premium pension institutions, for instance: A. Boutens, *Rol pensioenbewaarder en bescherming van deelnemers in een PPI*, 6 TPV 23 (2012); R.K. Tj. J. Smits, *Vermogensscheiding bij premiepensioeninstellingen*, 1 V&O 1 (2012).

[117] H. Hansmann & R. Kraakman, *The Essential Role of Organizational Law,* 110 Yale Law Journal 387(2000); B.T.B. Siemers, *Een afgescheiden vermogen voor subfondsen – Een stap terug?,* 10 TvFR 326-328 (2011).

[118] See J. Morley, *The Separation of Funds and Managers*, 123 YALE L.J. 1228 (2014).

[119] *Ibid.*

[120] R.B. Thompson, *Agency Law and Asset Partitioning,* 71 U. Cin. L. Rev. 1321 (2002).

The structural separation of investments and management under the European asset management law directives and the 'agency financial services under MiFID II' limits investors/members in the rights of control over investment intermediaries and depositaries/custodians. Under the asset management law directives, this limitation is the result of the financial services agreement concluded by investors with AIFMs, UCITS ManCos and MiFID II portfolio managers under the AIFMD, UCITSD V and MiFID II and the occupational nature of the relationship between members and the IORPD governing boards. Similarly, AIFMs, UCITS ManCos and IORP governing boards enter into agreements on behalf of their investors/members with depositaries/custodians. Investors concluding portfolio management arrangements with MiFID II portfolio managers either conclude a contract with custodians themselves or let the investment firm do that on their behalf. Investors/members, thus, are never shareholders of investment intermediaries nor of their depositaries/custodians acting on their behalf. The same holds true for the relationship between investors and investment firms providing agency financial services under MiFID II and their custodians.

Unlike investors in companies, investors/members under the European investment law directives, apparently, do not value voting rights as a control mechanism.[121]

This can be explained by the fact that both the relationship between investors/members, at the one hand, and their investment intermediaries and depositaries/custodians, at the other hand, under the European asset management law directives is of non-perpetual nature.[122] The same holds true for the relationship between investors and investment firms providing agency financial services under MiFID II. Instead, these relationships are easier to exit/terminate than in ordinary companies. It should be noted that there are slight differences between the fiduciary nature of the relationship of investors/members under the European asset management law directive, at the one, and the investors and investment firms providing agency financial services under MiFID II, at the other hand. The exit rights of investors under the European asset management law directives are a substitute for control.[123] Investors and IORPs on behalf of their members may withdraw/remove their assets from the control of an asset manager. The way, however, in how exit substitutes for control varies across the European asset management law directives. In the relationship between investors and investment firms providing agency financial services under MiFID II this 'limitation of control' is substituted by exit, voice and loyalty related to the services agreement they entered into. The key characteristic of fiduciary services under European investment law is that the fiduciary 'investment intermediary', such as AIFMs, UCITS ManCos, and MiFID portfolio managers under the AIFMD, UCITSD V and MiFID, receive a mandate from their investors to discretionary manage the assets on behalf of their investors.[124] The mandate contract does not grant investors residual control over their fiduciary investment intermediaries, i.e. does not grant residual control over the operational assets of the (fiduciary) investment intermediary by being an equity investor of the (fiduciary) investment intermediary. To go even further, the discretionary nature of the mandate even requires investors to give up a large

---

[121] Cf. F.H. Easterbrook & D.R. Fischel, *Voting in Corporate Law* (1983), 26 Journal of Law and Economics 395-427 (1983); T. Nenova, *The Value of Corporate Voting Rights and Control: A Cross-Country Analysis*, 68 Journal of Financial Economics 325-351 (2003); R.B. Thompson & P.H. Edelman*, Corporate Voting*, 62 Vanderbilt Law Review 127 (2009).

[122] See on the perpetual concept: J. Armour, H. Hansmann, R. Kraakman, *The Essential Elements of Corporate Law: What is Corporate Law?*, https://ssrn.com/abstract=1436551 (accessed 11 May 2017);

[123] See Hirschman on Exit, Voice, and Loyalty:A.O. Hirschman, *Exit, Voice and Loyalty. Responses to Decline in Firms, Organizations and States (*Harvard University Press 1970).

[124] J.W.P.M. Van der Velden, *Civielrechtelijke aspecten van fondsen voor gemene rekening*, 6 Vastgoed Fiscaal en Civiel 6 (2011).

degree of control over their investment assets by allowing (fiduciary) investment intermediaries in what assets on behalf of them is being invested.[125] Investors under the MiFID II, the AIFMD, UCITS ManCo have an exit right that substitutes for control. Under IORPD II, members do not have an exit right and, therefore, employee representatives are involved in voicing members concerns to the IORP governing board that, in turn, exercises the 'exit as substitute for control' in relation to delegated asset managers on behalf of their members. Exit as substitute for control will now be subsequently discussed for investors under MiFID II, the AIFMD/UCITSD V and IORPD II.

The value of control rights for investor in relation to their portfolio manager under MiFID II discretionary mandate relationships is diminished by the right to give investment instructions[126] and (the relatively easy opportunity of terminating the mandate contract.[127] This relationship is characterized by a fiduciary and individual investment nature. Mandate contracts, in contrast to AIFs and UCITS, grant investors the right of to give their asset manager investment instructions. The discretionary nature of the investment mandate, however, prevents that investors can exercise full control over the investment decisions taken.

The second reason why investors do not value control rights is that he termination (exit) of the discretionary mandates concluded by an asset manager and individual investor diminishes the value of control over them. Although private law considerations considering the termination of such a mandate varies from jurisdiction to jurisdiction, it can be generally said that the termination is a relatively easy exit. In France, for example, the client may terminate the mandate at any time by either the client and the asset manager even when its duration has been fixed, unless the termination is improper.[128] Similarly, Germany requires all discretionary mandate agreements to contain the unlimited right of termination for the client if the asset manager has unlimited discretion.[129] Spain also allow a mandate to be revoked by both the asset manager and client at any time.[130] In Spain, asset managers and investors may agree upon the terms, conditions and consequences of termination.[131] Many mandates have embedded a reasonable prior notice clause in the contract, as well as, related costs.[132] The Netherlands, to the contrary, only allows private individuals to terminate the contract of mandate at any time.[133] It is not possible to deviate from this contractually. Investors acting in the course of a business or profession may, however, only terminate mandate agreement for an indefinite term if there is a serious reason for that.[134] The relatively easy termination of the mandate agreement, thus, enables investors to withdraw their assets relative fast and remove them from the asset managers' control. Both the right to give investment directions and the easy possibility of terminating the mandate contract diminish the value of control for investors in discretionary mandate relationships.

The degree to which exist substitutes control varies throughout UCITSD V, the AIFMD and IORPD II. The demand for control even further varies throughout the AIFMD for liquid,

[125] See Nr. 12 c) in: ESMA/2013/611, 6 et seq.; See D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 205-206 (D.A. Zetzsche ed, Kluwer 2015).
[126] See Chapter 10, section 2.3.5.
[127] Mübert, P.O., *The eclipse of contract law in the investment firm-client-relationship: the impact of the MiFID on the law of contract from a German perspective* 297-321 (G. Ferrarini & E. Wymeersch, Oxford 2006).
[128] Arts 2004 et seq CC; See also Art. 314-61 AMF General Regulation: Termination any time; A. Couret, P. Goutay & B. Zabala, *France* (Busch & DeMott eds, Oxford University Press 2012).
[129] M. Casper & C. Altgen, *Germany* (Busch & DeMott eds, Oxford University Press 2012).
[130] Art. 279 Spanish Commercial Code.
[131] *S. Ruiz-Bachs and E. Diaz-Ruiz, Spain* (Busch & DeMott eds, Oxford University Press 2012).
[132] D. Bush & L.J. Silverentand, *The Netherlands* (Busch & DeMott eds, Oxford University Press 2012).
[133] Art. 7:408(3) BW; Art. 7:413(1) BW.
[134] Art. 7:408(2) BW.

illiquid and substantial leveraged AIFs.[135]

The mandatory open-end character and corresponding daily/weekly redemption right of UCITS are a core feature of the UCITSD V retail investor protection regime.[136] Unitholders/shareholders of a UCITS are entitled to redeem their shares/units for a pro rata portion of the UCITS' assets upon redemption. UCITS investors, thus, do not require control as they can easilz remove their assets away from the UCITS ManCo control. The redemption rights enable the share/unit prices to be always equal to the NAV of the UCITS.

Similar European product regulation is not in place for AIFs.[137] Product regulation outside the scope of the EuVECAR/EuSEFR and the ELTIFR is left over to the individual Member States.[138] Some Member States have created specialized UCITS-like retail investor AIF regimes, whereas others do not provide for any product regulation at all.[139]

The degrees to which liquid AIFs provide for redemption rights, thus, either is based upon Member State specific product regulation or specified in the constitutional documents of the legal form chosen. Generally, liquid AIFs provide for redemption rights varying from a daily to a weekly, monthly or even quarterly basis.

In contrast to ordinary companies, the need to control is diminished as the NAV pricing allow investors to make use of their redemption rights. A large amount of investors making the decision to redeem their stake out of the fund influences the reputation of the AIFM and UCITS ManCo. They have, thus, the incentive to perform well to attract new investors for their funds. Investors are reluctant to bear the collective action costs for exercising control.[140] On the basis of the theory of the firm and subsequent economic literature this might be explained by the fact that open-end AIFs/UCITS do not make any specific investments that are 'locked-in' the company.[141] The exercise of exit rights may, however, be influenced by load fees, taxation, the lack of sophistication, resources and time.[142] The redemption and liquidations rights of invests in open-end AIFs and UCITS, thus, reduces the value for exercising residual control as shareholders by means of exercising their voting rights.[143]

In contrary, AIFs that are substantially leveraged (hedge funds) are usually construed in accordance with the open-end principle. The open-end character is, however, constrained. Hedge funds typically allow for monthly or quarterly redemptions. Sometimes these types of AIFs also require a minimum invest period of one year and investors might be required to retain a portion of assets in side pockets after redemption. Similar to private equity AIFs,

---

[135] See for this classification of AIFs: D.A. Zetzsche, *Scope of the AIFMD* 82 (D.A. Zetzsche ed, Kluwer 2012).
[136] See Art. 1(2)(b) UCITSD V; Q. Curtis & J. Morley, *Taking Exit Rights Seriously: Why Governance and Fee Litigation Don't Work in Mutual Funds*, 120 YALE L.J. 84 (2014) (analyzing the functional impact of mutual fund exit rights on the conduct of fund investors).
[137] Although the EuSEFR/EuVECAR and the ELTIFR are containing product regulation for AIFs, they are not providing for European product regulation for AIFs that is comparable with the UCITS redemption rights policy; See, for example, Recital 35, Art. 18ELTIFR on redemption policy.
[137] Art. 34(1) MMFR.
[138] See D.A. Zetzsche, *Scope of the AIFMD* (D.A. Zetzsche ed, Kluwer 2015).
[139] See section on the investment policy of AIFs: Chapter 8, section 4.2.
[140] M. Olson, *The logic of collective action: public goods and the theory of groups* (Harvard University Press 1971); R. Hardin, *Collective action* (Baltimore 1982).
[141] J. Armour, H. Hansmann, R. Kraakman, *The Essential Elements of Corporate Law: What is Corporate Law?*, https://ssrn.com/abstract=1436551 (accessed 11 May 2017); F
[142] J. Morley, *The Separation of Funds and Managers*, 123
YALE L.J. 1228 (2014) (analyzing economic consequences of the legal structure of investment funds).
[143] See L. Zingales, *What Determines the Value of Corporate Votes?*, 110 Quarterly Journal of Economics, 1047-1073 (1995); F.H. Easterbrook & D.R. Fischel, *Voting in Corporate Law* (1983), 26 Journal of Law and Economics 395-427 (1983); T. Nenova, *The Value of Corporate Voting Rights and Control: A Cross-Country Analysis*, 68 Journal of Financial Economics 325-351 (2003); R.B. Thompson & P.H. Edelman, *Corporate Voting*, 62 Vanderbilt Law Review 127 (2009).

hedge funds typically also suspend redemptions in the case of emergency. Exit rights are, thus, slightly weaker than for UCITS, but might be comparable to other types of open-end AIFs. Control rights are limited contractually as most hedge funds establish themselves as (investment) limited partnerships.[144] Hedge funds established under any other legal form limit the control of investors. Redemption rights, thus, also diminishes the value for control in hedge funds.

Illiquid AIFs require substantially more control than UCITS, liquid and substantial leveraged AIFs. Illiquid AIFs can be divided in two groups: closed-end AIFs that are perpetual and closed-end AIFs that are liquidated after a fixed period of time.[145]

Private-equity funds, for example, are established for a period of usually 10 years after which the fund will be liquidated and the proceeds are being paid out to its investors. The minimum investment period is in closed-end AIFs usually at least one year. The closed-ended of these types of AIFs do not provide for exit rights as open-end AIFs. In the case of closed-end AIFs, it is not unusual that investors after redemption are required to retain a portion of their assets in a so-called 'side-pocket'.[146] Further limitations on redemptions may be emergencies that are embedded in the constitutional documents as a reason for AIFMs to suspend redemptions.[147]Apart from the limitations in redemption rights, the theory of the firm literature may explain why investors of private equity investing in illiquid assets demand bigger contractual protections in the constitutional documents and control rights.[148] Investments are in closed-end AIFs illiquid locked-in for a longer period of time than for open-end AIFs. Control rights required are, however, still limited compared to ordinary companies. The latter can be explained by the fact that private equity AIFsare liquidated after a fixed period of time, whereas ordinary companies abide by the perpetuity principle. AIFMs have to compete on the capital market for investors to raise capital for their newly established closed-end AIFs. Voting rights granted to investors are, thus, severely limited for closed-end AIFs. Apart from this, 'PE-depositaries'[149], i.e. investor-representative bodies, lawyers or civil notaries often have the right to veto a limited amount of matters, such as conflict of interest actions.[150] Exit substitutes control in private equity AIFs, thus, to a limited extent compared to liquid, substantially leveraged AIFs and UCITS.

AIFs that are construed as perpetual closed-end funds do not offer redemption rights, nor any other form of exit. This type of AIF, thus, offers no exit and voice as they do not offer the shareholder control of ordinary companies either. The latter explains the unpopularity and the discount at which these fund trade.[151]

The degree to which exist substitutes control varies throughout UCITSD V and the AIFMD and, in particular, for various types of funds, including liquid, illiquid and substantial leveraged AIFs.[152]

On the contrary, members under IORPD II do not have an exit right and, therefore,

---

[144] E.P.M. Vermeulen & J.A. McCahery, *Corporate Governance of Non-Listed Companies*, (Oxford University Press 2008).

[145] They may, based upon the constitutional documents, already be liquidated earlier by means of a qualified majority shareholder vote.

[146] See for 'side-pockets': Klebeck, U., *Liquidity Management and Side Pockets* (D.A. Zetzsche ed, Kluwer 2015).

[147] *Ibid.*

[148] E.F. Fama, *Agency Problems and the Theory of the Firm*, 88 J.POL. ECON. 288, 289 (1980)

[149] Art. 21(3)(c) sub-para. 3 AIFMD.

[150] J. Wroldsen, *The Social Network and the Crowdfund Act: Zuckerberg, Saverin and Venture Capitalists' Dilution of the Crowd*, https://ssrn.com/abstract=2141015 (accessed 15 Mai 2017).

[151] D.K. Patro, K. Piccotti, R. Louis & W. Yangru, *Exploiting Closed-End Fund Discounts: A Systematic Examination of Alphas* https://ssrn.com/abstract=2468061 (accessed 15 Mai 2017).

[152] D.A. Zetzsche, *Scope of the AIFMD* 82 (D.A. Zetzsche ed, Kluwer 2012).

employee representatives are involved in voicing members concerns to the IORP governing board that, in turn, exercises the 'exit as substitute for control' in relation to delegated asset managers on behalf of their members. The limitation of control rights for members in IORPs have two sources: the separation of investments and management and the split of the savings decision from ownership. The latter is a further development in the historical development of capitalism from the former and a product of social and labour laws. IORPs are mandatorily required by social and labour laws to prevent members, i.e. employees, to allocate a too big portion of their labour income on consumption. Together with the income derived from first and third pillar pension provision, mandatorily imposing retirement income by means of IORPs have to guarantee a sufficient income upon retirement for the 'working class'.[153]

On the level of the IORP, a parallel to the separation of investments and management takes place. The establishment of a legal form leads to asset partitioning that serves a different purpose. The asset partitioning on the level of the IORP is established for two reasons. First, the establishment effectively insulates the operational assets of the IORP and their personal creditors from the assets to which the members have a residual interest. Second, the asset partitioning insulates the assets owned by the members from the employer's creditors. The assets of the members are vested in a separate asset patrimony to prohibit IORPs from overexposing the members' assets to the operational activities of the employer. The latter could turn into severe risks when an employer is running into cash-flow difficulties that might run into an insolvency.[154]

The separation of the savings decision from ownership on the level of the IORP, thus, allows the employer together with social partners (trading unions) to place conditions on the members' residual interest to the assets. Members are by means of their labour contract attached to these conditions. They do not have any control nor any substitutes control. Various Members States allow members, however, to vote for employee representatives on the level of the IORP. The governing body of an IORP is, however, vested with the power to resolve conflicts amongst multiple members without any interference. Limited by the internal governance of the IORP that incorporates the negotiation of the social partners, the IORP governing body may adjust the contributions from members and the distribution to them.

The separation of 'investment' and 'management' takes place in the relationship between the IORP governing body and the asset managers appointed by them. Generally, Member States vest the power to decide upon investment decisions with IORP governing bodies.[155] De facto, investment management is, however, delegated to professionalized assets managers.[156] IORPs may appoint for this purpose UCITS ManCos, credit institutions or investment firms.[157] The assets managed on behalf of the members are safekept separate from the assets of both the IORP governing body and the designated asset manager(s) appointed.[158] The IORP governing body, thus, concludes a mandate portfolio management contract, within the scope of MiFID II, with the designated asset manager. The governing body represents the

---

[153] Commission of the European Communities, *Communication from the Commission to the Council – Supplementary Social Security Schemes: The Role of Occupational Pension Schemes in the Social Protection of Workers and their Implications for Freedom of Movement*, SEC(91) 1332 final, 22 July 1991, 5.
[154] See, for example, the Maxwell fraud: J. Solomon, *Corporate Governance and Accountability* 51, 52 (John Wiley & Sons, Ltd 2007).
[155] D. Fox, *Defined Benefit Pension Trusts: Asset Partitioning and the Residual Interest,* University of Cambridge Faculty of Law Research Paper No. 10/03, 12.
[156] Commission of the European Communities, *Communication from the Commission to the Council – Supplementary Social Security Schemes: The Role of Occupational Pension Schemes in the Social Protection of Workers and their Implications for Freedom of Movement*, SEC(91) 1332 final, 22 July 1991, 6.
[157] Art. 32 IORPD II.
[158] See D. Fox, *Defined Benefit Pension Trusts: Asset Partitioning and the Residual Interest,* University of Cambridge Faculty of Law Research Paper No. 10/03, 12.

members. The limits on control of the IORP governing body are, thus, de facto the same as for the discretionary mandate discussed above. IORP governing bodies diminish the value of residual control and earnings on behalf of their members as they are able to relative easily terminate the mandate contract (exit).

In the relationship between investors and investment firms providing agency financial services having an individual investment nature under MiFID II this 'limitation of control' is substituted by exit, voice and loyalty related to the services agreement they entered into. When concluding, for example, an 'execution-only' or an investment advice contract with an investment firm under MiFID II, investors remain to have the full discretion over the investments they make.[159] They may choose to direct and 'voice' their wishes to investment firms. Based upon the performance of the investment firm, investors may chose to exit by means of terminating their services contract or stay 'loyal'. This is logical as investment advice based investment relationships are a 'hybrid' between the second and third-stage of capitalism and investors that use 'execution-only' services are classified as belonging to the second stage of capitalism. In this way, investors might be in the position as shareholder under company law.

The key difference in the relationship between investors/members and investment intermediaries acting as fiduciaries and agents is that investors have an exit right that substitutes for control in fiduciary relationships, whereas they may chose for exit, loyalty and voice in agency relationships.

1.2.1.3. Economies of Scope and Scale

The structural separation of investment and management allows investment intermediaries, depositaries/custodians and investors/members to benefit from 'scale of economies' and 'repeat players'.

The separation of investment and management allows both investment intermediaries providing agency financial services under MiFID II and asset management under the European asset management law directives, such as AIFMs, UCITS ManCo and MiFID II portfolio managers to operate for various AIFs, UCITS, IORPs and individual investors simultaneously. For this reason, the European investment law directives require investment intermediaries and depositaries/custodians to guarantee a high level of specialism.[160]

The activities of AIFMs and UCITS ManCos are, for example, restricted to the core-activities of portfolio and risk management and several non-core activities, including administration, marketing and asset related services.[161] External AIFMs may, additionally, obtain an authorization under UCITSD V to manage UCITS and vice versa.[162]Additionally, AIFMs and UCITS ManCos may be obtaining a special authorization to provide the service of individual portfolio management, investment advice, safekeeping, technical administration and the transmission of orders.[163]The separation of investment and management, thus, allows investment intermediaries and depostiaries/custodians throughout European investment law to

---

[159] See for execution-only: See Annex I, s. A No. 1 and No. 2 MiFID I/II; Art. 25(4) MiFID II; See for investment advice: Art. 4(4) MiFID II.
[160] This was the reason for not allowing UCITS ManCos under UCITSD I for also operating as an insurance company. See Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Vandamme Report'), 5, http://goo.gl/K0iUzv (accessed 13 October 2016).
[161] See Annex I No. 1 and 2 AIFMD; Annex II UCITSD V; D.A. Zetzsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* 205-206 (D.A. Zetzsche ed, Kluwer 2015).
[162] Art. 6(2) AIFMD; Art. Art. 6(2), (3) UCITSD V; See A. Böhme, *Die Vertretung der extern verwalteten Investmentkommanditgesellschaft*, BB (2014).
[163] *Ibid.*

exploit economies of scope and scale by not only operating various lines of business but also for multiple clients at the same time. The latter benefits clients as it leads to lower fees and higher returns.[164]

At the same time, this concept allows both investment intermediaries and depositaries/custodians to be 'repeat players'.[165] Asset management is, for example, characterized by repetitive limited life cycles. As opposed to ordinary companies, investors may terminate their asset management agreement or AIFs, UCITS might be liquidated. If MiFID II portfolio's, AIFMs or UCITS ManCos would only act for a single client, they would have to be liquidated after the termination of an asset management agreement or the exit of an investor. The same holds true for agency financial services, such as 'execution-only' services and investment advice under MiFID II.

The separation of investment and management allows both intermediaries intermediaries and depositaries/custodians to be going concern and prevents the inefficient re-assembling of operational assets upon starting a 'new life cycle'.

1.2.2. (Fiduciary/Agency) Governance

The underlying idea of regulating the governance of investment intermediaries and depositaries/custodians is to enable them to act for both their organization and their investors/members while the agency costs arising from the separation of investment and management are minimized.[166] Both fiduciary/agency investment intermediaries and depositaries/custodians owe a regulatory fiduciary duty to act in the best of the interest of their investors/members minimizing transaction costs.[167] This fiduciary obligation fills the gap of the 'incomplete contracting problem' under European investment law that service contract cannot foresee all details of all possible contingencies that warrant transaction costs.[168] The fiduciary obligation consists of the duty of loyalty and care that induces investment intermediaries and depositaries/custodians to act in the best interest of their investors/members. This fiduciary obligation has been embedded in, the later to be discussed, intermediary regulation under the sector-specific European investment law directives. The operational requirements are adapted to the fiduciary/agency and collective/individual nature of the specific relationship between investors/members and, in particular, the investment intermediaries regulated under that directive.[169]

These two core duties are necessary as both investment intermediaries and depositaries/custodians may under the European investment law directives operate different lines of business to a multitude of clients. Inevitably, investment intermediaries, such as AIFMs, UCITS ManCos and MiFID II portfolio managers, and depostiaries/custodians have scarce resources. They are confronted with the question how they should allocate their

---

[164] H. Hansmann, *Ownership and Organizational Form*, http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.461.5180&rep=rep1&type=pdf (accessed 11 May 2017).
[165] J. Morley, *The Separation of Funds and Managers*, 123YALE L.J. 1228 (2014)
[166] R.H. Sitkoff, *The Economic Structure of Fiduciary Law*, 91 Boston University Law Review 1041 (2011), http://ssrn.com/abstract=1782999 (accessed 9 May 2017); P.J. Dalley, *A Theory of Agency Law*, U. PITT. L. REV. 495, 497 (2011); E.F. Fama, *Agency Problems and the Theory of the Firm*, 88 J.POL. ECON. 288, 289 (1980) ('The firm is viewed as a set of contracts'); Cf. J.H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 Yale L.J. 627 (1995).
[167] *Ibid.*
[168] R.H. Sitkoff, *Trust Law as Fiduciary Governance Plus Asset Partitioning* 431 (L. Smith ed., Cambridge University Press 2013); Cf. F.J. Easterbrook & D.R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993).
[169] E. Rasmusen, *Agency Law and Contract Formation*, 6 AMER. REV.L. & ECON. 369 (2004).

resources amongst the various business lines and clients. The resolution of conflicting interests is, thus, a core feature of the separation of investments and management. The latter, however, also provides exit rights, and limits on residual interests and control that resolve for the largest part conflicts of interests and make it acceptable for investors/members.[170]

In the first place, exit rights ensures the pareto optimality of the allocation of the conflicted resources. Exit rights enable investors to exit that leads to an allocation of resources in which no investor is worse off. Investors may trigger an exit if they foresee potential conflicts of interests. The latter may damage the reputation of investment intermediaries and depositaries/custodians preventing an unfavourable resolution of conflicts of interest.

Second, the limits on control resolves conflicts of interests. For example, investors and IORPs do not have a residual interest in their investment intermediaries and depositaries/custodians They are not shareholders and, thus, there are no intra-shareholder conflicts amongst investors/members. The limit on residual interests prevents that investment intermediaries and depositaries/custodians allocate the most resources to the investor that is the majority shareholder. Instead, investment intermediaries, in particular, likely allocate the most resources to the investor that is willing to pay the highest fees and, thus, is valuing the services the most. Fees instead of a shareholder relationship is the primary tool for resolving conflicts of interest as assigning control to investors does not work when investors are heterogenous, i.e. they all want their investment intermediaries to devote as much resources to them.[171]

Finally, the limitation of residual interest over conflicts of interest of the investment intermediaries and depositaries/custodians aligns the control rights exercised by the investment intermediaries and depositaries/custodians with the efficient resolution of conflicts of interest. The shareholders of the asset managers require the highest return possible. They demand the investment intermediaries and depositaries/custodians to devote most of their resources to the investor that based upon the disclosure provided by the latter and his right to exit is willing to pay the highest fees and attract most investors. The latter leads to a situation in which investment intermediaries and depositaries/custodiansare primarily dealing with resolving conflicts of interests themselves in the most efficient way.

1.2.3. Asset Partitioning

The effect on the rights of third parties with respect to the investment property versus the personal property of the investment intermediaries and the depositary/custodian is being addressed by asset partitioning. Asset partitioning under the European investment law directives leads to limited liability for investors/members[172] and asset segregation.[173]

The separation of investment and management limits the exposure to the creditors of the investment intermediaries, depositaries/custodians and their residual earnings. The common denominator is that European investment law achieves this by creating two separate asset patrimonies: the operational assets to which the shareholders of the investment intermediaires and depositaries/custodians are exposed and the investment assets 'owned' by the

---

[170] See on a comparison between the resolution of conflicts of interests in the fund industry and products: J. Morley, *The Separation of Funds and Managers*, 123YALE L.J. 1228 (2014) (analyzing economic consequences of the legal structure of investment funds).

[171] See S. Levmore, *Monitors and Freeriders in Commercial and Corporate Settings*,92 YALE LAW JOURNAL 49 (1982); A.A. Alchian & H. Demsetz, *Production, Information Costs, and Economic Organization,* 62 Am. Econ. Rev. 777 (1972).

[172] Hansmann and Kraakman reconceptualize limited liability as owner shielding: H. Hansmann, R. Kraakman & R. Squire, *Law and the Rise of the Firm*, 119 HARV. L.
REV. 1335, 1336 (2006).

[173] R.B. Thompson, *Agency Law and Asset Partitioning,* 71 U. Cin. L. Rev. 1321 (2002).

investors/members.[174] The latter only wants to be exposed to the variable risks related to their investment assets and insulate themselves for the risks of the operational assets by means of the service contract concluded between the investment intermediaries and the investors the IORP governing body on behalf of their members. The service contract insulates this risk by agreeing upon a reimbursement with the investment intermediary and depositary/custodian. For AIFMs, UCITS ManCos and MiFID II portfolio managers, typically, the fixed fee is based upon the AuM and a contractually limited variable fee (performance fee). This insulates investors and members from liabilities and risks related to the asset manager. Investors and IORP members are only exposed to the risks of the assets that invest in and not to the operational assets of their investment intermediary (and depositary/custodian).[175] Asset partitioning provides limits, thus, the exposure to the liabilities and creditors of the investment intermediaries and depositaries/custodians, whereas the required insulation of risk only requires separate ownership of the asset patrimonies, i.e. the insulation of residual earnings of the asset managers.

The separation of investment and management is also necessary as the operation of various lines of business for a multitude of clients could lead to spill-over effects of liabilities and residual earnings spilling over from the one business line and investor to the other. The limitation of the exposure of investors and IORPs to the creditors and residual earnings of the investment intermediary and depositary/custodian prevents that risks of other clients that are uncorrelated influence the investment result that individual investors wish for when investing.

2. Intermediary, Product and Sales Regulation as Common Regulatory Pillars of European Investment Law

The investment triangles under the respective European investment law directives cater for (fiduciary) governance and asset partitioning that is to be achieved by intermediary, product and sales/marketing regulation.[176] Before explain these three regulatory tools in detail, the common regulatory objective of the European investment law directives and the 'communicating vessels' element between these three types of regulation will be discussed.

2.1. Regulatory Objective: Investor and Market Protection

Joint underlying objectives of regulation explain the investment triangle under European investment law as a common structure. All European investment law directives try to achieve (1) investor protection (2) market protection (systematic risks) and, to a lesser extent, (3) stakeholder protection.[177]

The structural separation of investments and management, at the one hand, increases investor protection, whereas, at the other hand, it increases conflicts of interests.[178] The structural separation increases investor protection as the resulting asset partitioning and

---

[174] See D.A. Zetzsche, *Die Irrelevanz und Konvergenz des Organisationsstatus von Investmentfonds*, ZVglRWiss 111, 371 (2012); D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* § 19 (Mohr Siebeck 2015).

[175] See J. Morley, *The Separation of Funds and Managers*, 123YALE L.J. 1228 (2014).

[176] Parts of this section have been adapted from: H. van Meerten & S.N. Hooghiemstra, *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions*, https://ssrn.com/abstract=2993991 (accessed 4 July 2017).

[177] R.H. Weber, *Mapping and Structuring International Financial Regulation – A Theoretical Approach,* http://www.zora.uzh.ch/25932/ (accessed 15 May 2017); D.A. Zetzsche, *The Anatomy of European Investment Fund Law*, https://ssrn.com/abstract=2951681 (accessed 16 April 2017).

[178] Cf. M. Kruithof, *Conflicts of Interest in Institutional Asset Management: Is the EU Regulatory Approach Adequate?,* 31, http://ssrn.com/abstract=871178 (accessed 14 January 2017);

limited liability decreases fraud[179] and negative consequences of any default of the 'investment intermediary'.[180] At the other hand, the structural separation leads to 'repeat players' and 'economies of scale' as 'investment intermediaries' may operate several lines of business simultaneously that enhance conflicts of interest.

In achieving these objectives, the fiduciary governance and asset partitioning under these directives are, thus, established by intermediary, product and market/sales regulation.[181]

2.2. Intermediary, Product Regulation and Marketing/Sales Regulation as 'Communicating Vessels'

Intermediary, product and marketing/sales regulation are under the European investment law directives 'communicating vessels'. They are built upon a regulatory cocktail comprising of intermediary, product and sales regulation.

Within this regulatory cocktail, the European legislature has the focus on so-called 'intermediary regulation'. Initiatives, such as the AIFMD and MiFID II, do not focus on regulating financial products. The idea is that regulators are to slow to regulate each new product due to the innovative speed and force of the financial industry.[182] Instead, focusing on regulating intermediaries ensures that only skilled and honest people are employed by financial intermediaries that are required by EEA legislation to have sufficient resources.[183] The recent intermediary regulation approach touches upon the behavior of the market actors (source) and only addresses the possible adverse consequences of the product to a limited extent.

This modern 'intermediary regulation' approach follows up and complements the 'older' 'product regulation' approach that was popular during the 80s, 90s and the early 2000s.. The IORPD I and UCITSD I are examples of the 'product regulation' approach. Due to difficulties in examining how fund managers and the governing bodies of IORPs and their depositaries/custodians in the EEA were regulated, the harmonization in these initiatives focused on harmonizing the product and merely subjected the intermediaries involved to 'principles-based' regulation.[184] The rationale behind 'product regulation' is that by regulating the manufacturing and distribution of financial products, financial intermediaries are not able to market financial products that are jeopardizing consumers/investors.

Disclosure/marketing regulation is the least 'paternalistic'[185] variant of EEA regulation. Although recently disclosure/marketing regulation is being used in conjunction with, in

---

[179] See, for example, Securities and Exchange Commission, *SEC Charges Hedge Fund Managers with Fraud Involving Valuation of Side Pocket Investment*, http://www.sec.gov/litigation/litreleases/2010/lr21699.htm (accessed 3 July 2015).

[180] D.A. Zetzsche, *Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?*, in *The European Financial Market in Transition* (H. S. Birkmose, M. Nevillie & K. E. SØrensen eds., Kluwer 2012).

[181] D.A. Zetzsche, *The Anatomy of European Investment Fund Law*, https://ssrn.com/abstract=2951681 (accessed 16 April 2017).

[182] See D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* 127 (D.A. Zetzsche ed, Kluwer 2015); See also J.-P., Casey & K. Lannoo, *The Mifid Revolution: A Policy View*, 7 Competition and Regulation in Network Industries 519 (2006); see also A. Cygan & E. Szyszczak, *The Controversy and Confusion over Mifid*, 25 International Financial Law Review 14-21 (August 2006).

[183] See D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* 127 (D.A. Zetzsche ed, Kluwer 2015), 127.

[184] See J. Black, *Forms and Paradoxes of Principles Based Regulation*, LSE Law, Society and Economy Working Papers No. 13 (2008).

[185] See on paternalism: D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* § 8 A. I (Mohr Siebeck 2015).

particular, intermediary regulation[186], disclosure/marketing regulation originally had the very neo liberal idea of letting investors/consumers decide for themselves whether a particular financial service/product suits their needs.[187] The primary example of an EEA regulatory initiative merely focusing on disclosure is the PR. Pre-AIFMD, certain closed-end AIFs were only required on the EEA level to provide a prospectus to its (retail) investors.[188]

The modern European investment law directives, i.e. the AIFMD, UCITSD V, MiFID II and IORPD II combine the best of the 'three worlds'. These directives establish a comprehensive regulatory framework comprising of intermediary, product and sales regulation.[189] Other than product regulation under UCITSD I and IORPD I, the AIFMD, UCITSD V, IORPD II and MiFID II do not focus anymore in solely regulating financial products to deal with the 'symptoms' of the adverse consequences of the involvement of intermediaries on the European financial markets. The product regulation under UCITSD V and the 'AIFMD/UCITSD V product regulations', including the MMFR, ELTIFR and EuVECAR/EuSEFR have now as its purpose to define the scope of the respective directives/regulations rather than the traditional approach under EEA legislation of substituting intermediary regulation by product regulation to restrict investment intermediaries in offering certain financial products/services to investors on a cross-border basis in the EEA.

Intermediary, product and sales/amarketing regulation, thus, combine the best of 'three worlds'. The focus of the legislator is, however, recently on intermediary and disclosure/marketing regulation.

Now this section will continue in more detail in how intermediary, product and sales/marketing regulation address the agency/fiduciary problems under the investment triangle.

2.3. Intermediary Regulation

Intermediary regulation, i.e. the regulation of investment intermediaries and depositaries/custodians under the European investment law directives focusses on investor protection and market protection.[190] Investor protection is being addressed by specifying the duty of loyalty/care within the intermediary regulation of these directives that prevents misappropriation, conflicts of interest and requires the fiduciary/agent to act in the 'best' interest of investors/members.[191] In addition, intermediary regulation addresses market

---

[186] See, for example, UCITS ManCos and AIFMs under UCITSD V and the AIFMD.

[187] See for behavioral economic studies for PEPPs: European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 47; European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP),* 04 July 2016, EIOPA-16/457, 46.

[188] Member States, however, could 'goldplate' these EEA requirements. Closed-end AIFs were pre-AIFMD, for instance, completely exempted from any intermediary and product regulation under the Investmentgesetz in Germany. AIFMs only had disclosure duties towards investors; See D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* § 16 A. IV. 2. (Mohr Siebeck 2015).

[189] See D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* 127 (D.A. Zetzsche ed, Kluwer 2015).

[190] N. Moloney, *Regulation of the Market and Intermediaries: Global Comparison and Contrast - What is Best Practice?: Recent Developments in UK and European Union Market and Intermediary Regulation*, 5 Macquarie Journal Business Law 1 (2008).

[191] R.H. Sitkoff, *Trust Law as Fiduciary Governance Plus Asset Partitioning* 431 (L. Smith ed., Cambridge University Press 2013).

protection by requiring investment intermediaries and depositaries/custodians to comply with prudential regulation as to avoid adverse consequences of insolvencies and systematic risk.[192]

In doing so, intermediary regulation on the EEA level shows remarkable cross-sectoral consistencies.[193] This is, in particular, to be seen in the common authorization and organizational requirements to be observed throughout, for example, MiFID II, the AIFMD and UCITSD V.

Credit institutions, AIFMs, UCITS ManCos and depositaries/custodians have to comply with general (authorization and) organizational requirements that are common to financial intermediaries in European financial law and specific requirements aimed at the provision of financial services/activities and products.[194]

General organizational requirements require the establishment of an organizational structure that clearly assigns responsibilities, employ personnel with the rights skills, knowledge and experience, establish adequate systems to safeguarding information and ensure business continuity.[195] General organizational requirements include:[196]

- fit & proper senior management;
- minimum capital requirements that vary upon the type of financial service/product provided;
- a business plan;
- adequate risk organization;
- sound third country relationships; and
- reliable significant shareholders.

Specific organizational requirements complement general requirements. These include, for example, compliance, risk management internal audit, complaints handling, personal transaction and delegation/outsourcing.[197]

By requiring certain common organizational and operational requirements upon authorization, the EEA legislature ensures that only fit & proper financial intermediaries are active on the European markets that are required by sectoral legislation to be highly specialized in the financial services/products they are, with certain exceptions in the asset management domain[198], offering.[199]

---

[192] See, for instance, J. Mackintosh, *Lehman collapse puts prime broker model in question*, Financial Times (24 September 2008); G. O. Aragon & P. E. Strahan, *Hedge Funds as Liquidity Providers: Evidence from the Lehman Bankruptcy* (August 2009), http://www.nber.org/papers/w15336 (accessed 30 September 2012); See also *Bear Stearns, S. Chaplinsky, Bear Stearns and the Seeds of its Demise*, Darden Case No. UVA-F-1574.

[193] D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* 865 (D.A. Zetzsche ed, Kluwer 2015); D.A. Zetzsche, *The Anatomy of European Investment Fund Law*, https://ssrn.com/abstract=2951681 (accessed 16 April 2017).

[194] *Ibid.*

[195] European Commission, *Background Note accompanying Draft Commission Directive implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive*, February 2006, 6 et seq.

[196] D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* 865 (D.A. Zetzsche ed, Kluwer 2015).

[197] C.M. Grundmann-van de Krol, *The Markets in Financial Instruments Directive and Asset Management* (D. Busch & D.A. DeMott eds, Oxford 2012).

[198] UCITS ManCos and AIFMs are allowed to discretionary manage IORPs and individual portfolio's under the AIFMD and UCITSD V. Nevertheless, MiFID II, AIFMD and UCITSD V all regulate the core business of 'investment management'. Another exception are credit institutions that are 'automatically' recognized as investment firms under MiFID II. See Art. 1(3) MiFID II and Annex 1 CRD IV.

[199] A legal entity that obtained an authorization as UCITS ManCo is, for example, for that reason prohibited from obtaining a license as an insurance undertaking. See Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment inTransferable Securities – Commentary on the*

Financial intermediaries do, however, provide different types of financial services and products with different risk profiles. This is, in particular, highlighted in operating conditions in which some requirements are common throughout sectoral EEA legislation, but the main part of the conditions are business specific.

Sectoral EEA legislation, for instance, imposes a duty of loyalty on all EEA financial intermediaries. Financial intermediaries, when providing financial services/products to investors/members, have to act honestly, fairly and professionally in accordance with the best interests of its investors/members and comply with information duties to investors/members.[200] This 'open standard'[201] is specified in an investor protection regime that specifies a number of fiduciary obligations and information requirements towards investors/members.

For AIFMs, UCITS ManCos and investment firms, the operating conditions, however, also diverge on the basis of the risks that are born by different types of investors. For this purpose, various conduct of business obligations distinguish between the provisions applying to retail investors and professional professional.[202]

Financial intermediaries do provide different types of financial/services and products with different risk profiles. This is highlighted in different operating conditions, for example, in the solvency rules that applies to them. Credit institutions and investment firms acting as depositaries/custodians, take, when re-hypothecating and delegating safekeeping, principle risk[203] and are, therefore, subjected to capital requirements that underlie the ordinary contractual claims of investors towards them. To the contrary, AIFMs/UCITS ManCos and investment firms, for example, act as a mere service intermediary providing investment management, risk management, administration and marketing service to their customers. In this capacity, they act as a service intermediary and do not take principle risk themselves. Instead, the investors fully bear the investment risks of the AIFs/UCITS in which they are invested in.

2.4. Product Regulation

Under the European investment law directives that targeted collective investments, such as the AIFMD, UCITSD V and IORPD II, 'product regulation' was introduced that targets both (fiduciary) governance and asset partitioning. Product regulation' targets the manufacturing of financial products so that 'investment intermediaries' are not able to market financial products that are jeopardizing investors. For individual investment relationships under MiFID II, the product oversight and governance rules ensure that appropriate and suitable investment products are marketed to individual investors.

Although no fiduciary/agency relationship is in place amongst investors/members under

---

provisions of Council Directive 85/611/EEC of 20December 1985 ('Vandamme Report'), 3, http://goo.gl/K0iUzv (accessed 14 January 2017).

[200] Art. 24(1) MiFID II.

[201] M. Kruithof, *Conflicts of Interest in Institutional Asset Management: Is the EU Regulatory Approach Adequate?,* 31, http://ssrn.com/abstract=871178 (accessed 14 January 2017); L. Enriques, *Conflicts of Interest in Investment Services: The Price and Uncertain Impact of MiFID's Regulatory Framework* (G. Ferrarini & E. Wymeersch eds., Oxford University Press 2006); A. Crockett, T. Harris, F.S. Mishkin & E.N.White, *Conflicts of Interest in the Financial Services Industry: What Should We Do About Them?*, 5 Geneva Reports on the World Economy (2003).

[202] See, for instance, for retail AIFs: Art. 43 AIFMD. See for the implementation of this provision: D.A. Zetzsche*, Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).

[203] See on principle risk: S.L. Schwarcz, *Intermediary Risk in a Global Economy*, 6 Duke Law Journal 1541 (2001).

the European investment law directives, product regulation is needed to protect investors under the AIFMD, UCITSD V and IORPD II. Product regulation for collective investment purposes addresses (fiduciary) governance and asset partitioning issues that are not possible to be achieved for a plurality of investors that invest in a 'pooled risk/return'. Fiduciary governance and asset partitioning throughout these directives are adressed by (1) a standardized investment policy and (2) legal forms.

2.4.1. A Standardized Investment Policy: (Fiduciary) Governance

All investment relationships under the AIFMD, UCITSD V and IORPD II are 'individually contracted into'.[204] The 'individual contracts' directly or indirectly[205] relate to the 'common terms' that arranges the general terms and conditions under which the moneys are invested into on behalf of the collective investors/members. Amongst a number of issues, the investment policy is being set out. Unlike for MiFID II portfolio management, the investment policy under, in particular, the AIFMD and UCITSD V cannot be individually agreed upon between investors and asset managers. For this reason, the policy is embedded in the common terms of the legal form in which the AIF or UCITS is employed.[206] Under the IORPD II, the investment policy is being determined by the (internal/external) governing board that either invests the monies by themselves or delegates the task to do this on behalf of the members to MiFID II portfolio managers.[207]

Using the analogy of cars, taxis and buses the difference between collective and individual investment relationships can be explained.[208] 'Execution-only' services can be characterized by a car. The individual investor determines his investment policy and executes his policy to his own discretion. Investment advice based relationships are like a car in which a navigation system is used. The navigation system proposes the directions to be taken. However, the 'driver' decides by himself what direction is ultimately taken. MiFID II portfolio management relationships are like taxis. The taxi driver agrees upon the destination to be driven. The driver and investor, however, mutually agree upon this and the driver is prone to investor instructions. The investment policy under the AIFMD and UCITSD V is similar to a bus. The investor decides what bus he takes. The ultimate destination and stops are, however, set out by a busplan to which all passengers ('investors') commit themselves when stepping into the bus.

In the fiduciary relationship between the investors and, in particular, AIFMs and UCITS Mancos is adressed by intermediary, product and sales/marketing regulation. Although these three are 'communicating vessels', product regulation by means of restrictions in the investment policies to be invested, partially, are a substitute for the intermediary regulation to which AIFMs and UCITS Mancos are subjected to. The investment restrictions and portfolio compositions, limit the discretionary investment decisions that AIFMs and UCITS Mancos may make. Under UCITSD V, the MMFR, ELTIFR and EuVECAR/EuSEFR standardizes

---

[204] Commission of the European Communities, *Communication from the Commission to the Council – Supplementary Social Security Schemes: The Role of Occupational Pension Schemes in the Social Protection of Workers and their Implications for Freedom of Movement*, SEC(91) 1332 final, 22 July 1991, 4.

[204] Art. 6(c) IORPD II; S. Arnot, *Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision: A Legal Commentary* 15, http://www.pensionseurope.eu/system/files/IORP%20I%20-%20legal%20commentary%20on%20the%20Pension%20Funds%20Directive.pdf (accessed 4 October 2016).

[205] *Ibid.*

[206] Cf.Recital 6, Art. 2(2)(b) AIFMD, Art. 1(3) UCITSD V.

[207] Art. 32 IORPD II.

[208] This basic idea is adapted from: D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* § 25 C. II. 1 (Mohr Siebeck 2015).

and tailors the portfolio composition rules for certain standardized types of investors, such as 'HWNIs'[209], professional and retail investors.[210] Product regulation relating to investment policy, thus, (partially) substitutes intermediary regulation. This is, in particular, the case under the EuVECAR/EuSEFR in which managers comply with product regulation, but are not subjected to the vast amount of intermediary and marketing/disclosure regulation under the AIFMD. In addition, the portfolio composition rules under the MMFR and ELTIFR also determine the scope of the special type of intermediary, product and marketing/disclosure regulation that apply, on top of the AIFMD/UCITSD V, to AIFMs/UCITS Mancos and depositaries of these types of AIFs/UCITS.

2.4.2. Legal Forms: Asset Partitioning for Collective Investment Relationships

The regulation of the investment policy is not regulated under all European investment law directives. In particular, for professional investors under the AIFMD. The reasoning that the investment portfolio composition part of product regulation is a substitute for intermediary and marketing/sales regulation is, especially, applicable to UCITS and AIFs marketed to retail investors and 'HNWIs'.[211] Nevertheless, 'legal forms' as the second component of product regulation is always applicable to AIFs, UCITS and IORPs. The reason is that asset partitioning and limited liability related to collective investments cannot be merely established by means of the asset segregation provided throughout the European investment law directives. The asset segregation rules under the directives applies to the financial instruments and cash accounts of particular AIFS, UCITS and IORPs. Investors/members are, however, collectively entitled to these accounts. Asset partitioning amongst investors/members needs to be established by means of a legal form. For this reason, legal forms in which IORPs, UCITS and AIFs are established, as a minimum, always cater for limited liability asset segregation and determine how these assets are being distributed. Legal forms, thus, do not regulate the (fiduciary) governance element of the European investment law directives, but establishes asset partitioning under the structural separation of investment and management for collective investment relationships.

2.5. Marketing & Sales Regulation

Disclosure/marketing regulation is the least 'paternalistic'[212] variant of EEA regulation. Investors are informed in the pre-contractual phase and on an ongoing basis.[213] Under MiFID II, investors are informed on an individual basis.[214] The type of information provided depends upon the investor qualification as eligible counterparty, retail or professional investors.[215] Disclosure duties for the IORP governing body include annual accounts, reports and the publication a statement of investment policy principles.[216] UCITSD V, the AIFMD and the PR regulate the marketing/sales regulation for collective investment undertakings.[217] Similar

---

[209] Chapter 8, section 4.2.3.3.
[210] Cf. Art. 4(1)(ag) and (aj) AIFMD; Art.6 EuVECA/EuSEF Regulation; Art.5 ELTIFR.
[211] Cf. D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* 127 (D.A. Zetzsche ed, Kluwer 2015).
[212] See on paternalism: D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* § 8 A. I (Mohr Siebeck 2015).
[213] P.G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62:3 The University of Chicago Law Review 1047 (1995).
[214] Chapter 10, section 5.
[215] Art. 4(10) and (11) MiFID II.
[216] Chapter 9, section 5.
[217] D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* 867, 868 (D.A. Zetzsche ed, Kluwer 2015).

as for investors under MiFID II, the investor qualification carried out by, in particular, AIFMs determines the type of information to be provided to investors.[218] In general, the degree of investor protection provided to professional and 'HNWI' investors is less compared to retail investors.[219] Usually, annual accounts and information on material changes have to be provided to professional investors.[220] In addition, key investor (information) documents to retail investors have to be provided under the KIID regulation for UCITS and under the PRIIPR for retail AIF investors.[221] Finally, a prospectus is to be published for retail investors under the AIFMD Member State implementations and under the PR for non-qualified investors that do not fall under any of the exemptions.[222]

The investor protection offered by marketing/disclosure regulation depends upon the degree of sophistication investors (members) involved.

2.6. ESFS

In the domain of supervision, there is an increasing cross-sectoral consistency between the measures laid down in the European investment law directives for national Competent Authorities related to information exchange and sanctions.[223] The establishment of the ESFS[224] in 2011 has added another dimension to efficient enforcement of the tools of the various Competent Authorities at hand.[225]

2.7. The Investment Triangle, European Passport and the Development of European Financial Centres

The structural separation of investment and management under the European investment law directives is regulated by the European investment law directives by means of intermediary, product and marketing/sales regulation. The European passport concept applies to each type of regulation throughout the directives.

The (maximum) harmonization required for investment intermediaries and custodians throughout the EEA has resulted in a European passport for these intermediaries under the European investment law directives. Under the AIFMD and UCITSD V a cross-border management passport is in place for AIFMS and UCITS Mancos that may, when complying with a set of additional MiFID II and UCITSD V requirements, also manage UCITS, individual investor and IORP investment portfolios.[226] In addition, investment intermediaries and credit institutions may, as ancillary service, make use of a 'custodian passport'.[227] The presumed limited harmonization of the depositary under the AIFMD and UCITSD V and IORP governing boards explain the absence of an intermediary passport.[228]

---

[218] Chapter 8, section 4.2 and 5.
[219] Cf. Art. 43 AIFMD.
[220] Cf. Art. 73 UCITSD V.
[221] L. Burn, *KISS, But Tell All: Short-Form Disclosure for Retail Investors*, Capital Markets Law Journal 5 (2010).
[222] Art. 1(4)(b) PR.
[223] See D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* 867, 868 (D.A. Zetzsche ed, Kluwer 2015).
[224] See Chapter 3, section 3.4.2.2.
[225] E. Wymeersch, Eddy, *Europe's New Financial Regulatory Bodies*, 5, http://ssrn.com/abstract=1813811 (accessed 8 October 2016); E. Wymeersch, *The institutional reforms of the European Financial Supervisory System, an interim Report,* WP 2010-01 (2010).
[226] See Art. 6(4)(a) AIFMD; Art. 6(3)(a) UCITSD V.
[227] Annex I s. A MiFID I/II; Annex I Nr. 12 CRD IV.
[228] See H. van Meerten & S.N. Hooghiemstra, *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions*, https://ssrn.com/abstract=2993991 (accessed 4 July 2017).

Under the AIFMD, the AIF marketing passport is based upon a harmonization of AIFMs, whereas under UCITSD V this is based upon a harmonization of UCITS as a product. Given the absence of a fully harmonized regime for EuVECA/EuSEF managers, the marketing passport under EuVECAR/EuSEFR is also based upon product regulation[229], whereas the other 'AIFMD/UCITSD V product regulations', including the ELTIFR and MMFR are based upon the management and marketing passports that underlie the AIFMD and, for the MMFR, also UCITSD V.[230]

The prospectus under the PR functions as marketing passport for retail closed-end AIFs that are managed by 'small' AIFMs.[231] The scale of economies of the European passports granted under the European investment laws directives that to cross-sectoral specialization across sectors and the development of financial centers.[232] Member States may be centers for fund and asset management, depositaries, risk management and also for specific types of investment funds. Ireland and Luxembourg, for example, have developed themselves as hubs of the establishment of UCITS and AIFs[233], whereas the Netherlands has specialized itself in private equity and venture capital AIFs.[234] Each of the EEA Member States has, thus, the chance to prosper in a specific field based upon a list of factors other than the harmonized legal factors under EEA legislation.[235]

3. The Role of the Depositary/custodian as Fundamental Pillar under European Investment Law

The depositary/custodian is a fundamental pillar under European investment law. They serve as a solution for fiduciary/agency governance and establish the underlying structural separation of investments and management. The role they play in governance depends upon whether they are active as fiduciary/agent and whether they play a role in collective or individual relationships. For both agency and fiduciary services under individual investment relationships established under MiFID II they serve as a 'custodian'. For agency services, such as brokerage and investment-advice based investments this is logical as the ultimate discretion of investments made lies with investors.[236] The fiduciary nature of MiFID II portfolio management does not justify a monitoring role[237] of the 'custodian' on behalf of investors as discretionary management is under the cheapest cost avoider theory more efficiently to be done by investors themselves.[238] The fiduciary and collective investment

[229] M.S.A. van Dam, M.S.A. & C.W.M. Lieverse, *De Venture Capital Verordening*, 6 TvFR 201-204 (2013).
[230] C.M. Grundmann-van de Krol, *Voorstel Verordening geldmarktfondsen* ("MMFs"), 18 Ondernemingsrecht 103 (2014); C.M. Grundmann-van de Krol, *Voorstel Verordening Europese langetermijninvesteringsfondsen*, 16 Ondernemingsrecht 591 (2013).
[231] Article 23(3) AIFMD.
[232] D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* 869 (D.A. Zetzsche ed, Kluwer 2015).
[233] See for Ireland: M. Jackson & D. Counihan, *Ireland* (D. Busch ed, Oxford 2014); T. Partsch & E. Forget, *The Luxembourg Implementation of the AIFMD* (D.A. Zetzsche ed, Kluwer 2015); See also: D. Clarkson, S. Jaecklin & K. Kaczmarski, *Domiciles of Alternative Investment Funds* (Oliver Wyman 2014).
[234] See S.N. Hooghiemstra, *The AIFM's Transposition in the Netherlands* (D.A. Zetzsche ed, Kluwer 2015).
[235] D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* 869 (D.A. Zetzsche ed, Kluwer 2015); Cf. D.A. Zetzsche, D.A. & T.F. Marte, *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* 474 (D.A. Zetzsche ed, Kluwer 2015).
[236] See, for instance, Art. 4(4) MiFID II.
[237] U. Häde, *Jenseits der Effizienz: Wer kontrolliert die Kontrolleure?*, Europäische Zeitschrift für Wirtschaftsrecht 662 (2011).
[238] K.D. Logue & J.B. Slemrod, *Of Coase, Calabresi, and Optimal Tax Liability,* Law & Economics Working Papers Law & Economics Working Papers Archive: 2003-2009, University of Michigan Law School Year 2009,

nature under the AIFMD, UCITSD V and the IORPD II depositary implementation in various Member States justifies a 'custody-plus' solution in which 'custodians' are entrusted with both a safekeeping and monitoring/controlling role towards the discretionary asset managers and their delegates.[239]

This monitoring/controlling role explains the differences observed in custodian and depositary regulation under European investment law directives. The regulation of custodians under MiFID II, for example, is merely focused on the 'passive asset partitioning role'.[240] The regulation of custodians under, in particular, MiFID II, thus, concentrate on 'asset partitioning' by means of safekeeping, administration, asset segregation and the prevention of the erosion of the legal/economic ownership of investors related to assets safekept by establishing safeguards related to the re-use of assets and delegation to untrustworthy and non-solvent sub-custodians.[241]

For mere safekeeping, administration and asset segregation performed by custodians less regulation is need to be in place than for depositaries that, in addition to this role, also have an 'monitoring function'.[242]

The monitoring function related to asset managers and its delegates requires the prevention of extra conflicts of interest that arise out of possible 'group structures' in which both depositaries and asset managers are present under the same umbrella.[243] To prevent this, measures are in place that prevent conflicts of interest in these 'group structures'.[244] In addition, depositaries, mainly, have to ensure that the investments executed by asset managers and their delegates complies with the investment policy agrees upon. This key characteristic, amongst others, requires depositaries to have an overview of the whole 'intermediary holding chain' in relation to the assets safekept for AIFs, UCITS and IORPs.[245] This explains why multiple custodians may be appointed under, for instance, MiFID II, whereas a single depositary is required to be appointed under the AIFMD, UCITSD V and IORPD Member State implementations that functions as a 'prime custodian'.[246] This 'prime custodian' role implicates that other custodians may only safekeep assets on behalf of a particular UCITS, AIF or IORP upon becoming a sub-custodian of the depositary under a detailed delegation regime.[247] This preserves that depositaries maintain an overview of all assets and that they are ensured that they will not miss out on part of the assets when performing their monitoring role towards asset managers and their delegates.[248] At the other hand, multiple custodians appointed under MiFID II and CRD IV do not prevent the 'asset partitioning' role they have under the investment triangle.[249]

3, http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1097&context=law_econ_archive (accessed 17 August 2016 2016); G. Calabresi, *The Costs of Accidents: A Legal and Economic Analysis (*Yale University Press 1970).

[239] Art. 21(9) AIFMD; Art. 22(3) UCITSD V; Art. 35 IORPD II.

[240] Art. 2(1)(a) MiFID II (Commission) Directive.

[241] Art. 21(11) AIFMD; Art. 22a UCITSD V; Cf. Art. 34(4) IORPD II.

[242] D.A. Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 21 (Mohr Siebeck 2015).

[243] See Art. 26b UCITSD V; See for Member States in which the same is applied for AIFs: ESMA/2014/1417, ESMA/2014/1183.

[244] European Commission, *Undertakings for collective investment in transferable securities – amended Directive (UCITS V): Frequently asked questions*, MEMO/14/198, 15 April 2014, Question 2. What is a UCITS depositary?

[245] European Commission, *Consultation Paper on the UCITS Depositary Function and on the UCITS Managers' Remuneration (December 2010)*, MARKT/G4 D (2010) 950800, 19, 20.

[246] Art. 21(11) AIFMD; Art. 22a UCITSD V; Cf. Art. 34(4) IORPD II.

[247] *Ibid.*

[248] Art. 21(9) AIFMD; Art. 22(3) UCITSD V; Art. 35 IORPD II.

[249] Cf. IORPs that are, depending upon the implementation of Art. 33(1) and (2) IORPD II in a specific Member State, allowed to appoint a MiFID II/CRD IV custodian.

This explanation is in line with business practice. The same custodians perform, simultaneously a role as a custodian under CRD IV and MiFID II and as a depositary under the AIFMD and UCITSD V. Depositary regulation is, thus, in line with the depositary service offered and labelled in the market as 'custody-plus'.

Nevertheless, IORP depositaries are regulated as a 'hybrid' under IORPD II and it, essentially, depends upon individual Member State implementations whether and to what extent the prevention of conflicts of interest for depositary is well accommodated.[250] This is remarkable as IORPD II targets collective investments and 'fiduciary' intermediaries within an (optional) investment triangle. This inconsistency with the AIFMD and UCITSD V may be explained for two reasons. First, not all members of IORPs bear (full) investment risk.[251] Moreover, IORPD II considers the compliance functions offered by the legal forms in which IORPs are established in, such as trustees and board of directors, to be offering 'equivalent protection' for members.[252] The next chapter addressing the historical development of depositaries/custodians explains in more detail why more convergence in this domain is likely to be expected in the future.

4. Conclusion

The investment triangle under the European investment law directives has emerged as a result of minimizing transaction costs. The common structure arose as a result of the 'four stages of capitalism'. The European investment law directives are to be characterized under these four stages of capitalism. MiFID II 'execution-only' service are to be classified as stage 2, i.e. the separation of ownership of control. The provision of capital and the investment decision still are to the discretion of the investor. On contrary, investors assign the investment decisionmaking to a professional asset manager under the AIFMD, UCITSD V, MiFID II (portfolio management) and IORPD II. This is to be characterized as 'separation of investments and management' in which the investment decision and provision of capital are split. Investment advice is a hybrid between the two. As a result of the different nature of the financial services under the 'four stages of capitalism' different agency costs arise under the European investment law directives. These differences depend throughout the directives on whether the relationships are to be characterized as 'fiduciary' or 'agency' and whether the services involved has a collective or individual investor nature.

The European investment law directives are characterized by the structural separation of investments and management. This structural separation ensures that investors/members have limited liability and that their investment assets are segregated from the operational assets of the intermediaries involved. Under the AIFMD and UCITSD V, the loss of control is substituted by an exit right for investors that depends upon whether, in particular, the AIF is has an liquid, illiquid or substantially leveraged nature.[253] Under IORPD II, members do not have an exit right.[254] Instead, representatives perform a duty of oversight with regard to the IORP governing board.[255] Investors using 'execution-only' and investment advice services still may make use of exit, loyalty and voice.

The structural separation of investment and management has as the advantage for investors/members that 'investment intermediaries' and depositaries/custodians may operate

---

[250] Art. 33(7) IORPD II.
[251] Art. 33(1) and (2) IORPD II.
[252] Art. 35(3) IORPD II.
[253] D.A. Zetzsche, *Scope of the AIFMD* 82 (D.A. Zetzsche ed, Kluwer 2012).
[254] See Chapter 9, section 6.2.
[255] F. Kessler, *The Governance of Supplementary Pension Schemes and the Role of the Employee Representatives: A Story of Paradoxes* 295 (O. Kaufmann & S. Hennion, Springer 2011).

simultaneous business lines that leads to scale of economies and lower costs to be born by them. In turn, the structural separation also leads to conflicts of interest that are only partly being resolved by the alignment of interests that are resulting from remuneration packages for 'investment intermediaries'.[256]

European investment law addresses in two ways the conflict of interests that arise from the structural separation of investments and management under the investment triangle.[257] First, it imposes detailed 'secondary rules' of loyalty and care related to the powers and duties of the investment intermediaries, at the one, and depositaries/custodians, at the other hand and the corresponding rights of the investors/members with respect to their investment property against these intermediaries (governance).[258] Second, the effect on the rights of third parties with respect to the investment property versus the personal property of the investment intermediaries and the depositary/custodian (asset partitioning). These two are together the core domain of European investment law.[259]

The investment triangles under the respective European investment law directives cater for (fiduciary) governance and asset partitioning that is to be achieved by intermediary, product and sales/marketing regulation.

Joint underlying objectives of regulation explain the investment triangle under European investment law as a common structure. All European investment law directives try to achieve (1) investor protection (2) market protection (systematic risks) and, to a lesser extent, (3) stakeholder protection.[260] In achieving these objectives, the fiduciary governance and asset partitioning under these directives are, thus, established by intermediary, product and market/sales regulation.[261]

Investor protection is being addressed by specifying the duty of loyalty/care within the intermediary regulation of these directives that prevents misappropriation, conflicts of interest and requires the fiduciary/agent to act in the 'best' interest of investors/members.[262] In addition, intermediary regulation addresses market protection by requiring investment intermediaries and depositaries/custodians to comply with prudential regulation as to avoid adverse consequences of insolvencies and to avoid systematic risk.[263]

Intermediary, product and marketing/sales regulation are under the European investment law directives 'communicating vessels'. They are built upon a regulatory cocktail comprising of intermediary, product and sales regulation.

Although no fiduciary/agency relationship is in place amongst investors/members under the European investment law directives, product regulation is needed to protect investors under the AIFMD, UCITSD V and IORPD II. Product regulation for collective investment

---

[256] Cf. E.P.M. Vermeulen & J.A. McCahery, *Corporate Governance of Non-Listed Companies*, (Oxford University Press 2008).
[257] T.W. Merrill & H.E. Smith, *The Property/Contract Interface*, 101 COLUM. L. REV. 773 (2001).
[258] R.H. Sitkoff, *Trust Law as Fiduciary Governance Plus Asset Partitioning* 431 (L. Smith ed., Cambridge University Press 2013).
[259] *Ibid.*
[260] D.A. Zetzsche, *Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?*, in *The European Financial Market in Transition* (H. S. Birkmose, M. Nevillie & K. E. SØrensen eds., Kluwer 2012); R.H. Weber, *Mapping and Structuring International Financial Regulation – A Theoretical Approach,* http://www.zora.uzh.ch/25932/ (accessed 15 May 2017).
[261] D.A. Zetzsche, *The Anatomy of European Investment Fund Law*, https://ssrn.com/abstract=2951681 (accessed 16 April 2017).
[262] R.H. Sitkoff, *Trust Law as Fiduciary Governance Plus Asset Partitioning* 431 (L. Smith ed., Cambridge University Press 2013).
[263] See, for instance, J. Mackintosh, *Lehman collapse puts prime broker model in question*, Financial Times (24 September 2008); G. O. Aragon & P. E. Strahan, *Hedge Funds as Liquidity Providers: Evidence from the Lehman Bankruptcy* (August 2009), http://www.nber.org/papers/w15336 (accessed 30 September 2012); See also *Bear Stearns, S. Chaplinsky, Bear Stearns and the Seeds of its Demise*, Darden Case No. UVA-F-1574.

purposes addresses (fiduciary) governance and asset partitioning issues that are not possible to be achieved for a plurality of investors that invest in a ‘pooled risk/return’. Fiduciary governance and asset partitioning throughout these directives are addressed by a standardized investment policy and legal forms. The investment restrictions and portfolio compositions, limit the discretionary investment decisions that AIFMs and UCITS Mancos may make. Legal forms as the second component of product regulation is always applicable to AIFs, UCITS and IORPs. The reason is that asset partitioning and limited liability related to collective investments cannot be merely established by means of the asset segregation provided throughout the European investment law directives.

The investor protection offered by marketing/disclosure regulation complements intermediary and product regulation and depends upon the degree of sophistication investors (members) involved.

The modern European investment law directives, i.e. the AIFMD, UCITSD V, MiFID II and IORPD II combine the best of the ‘three worlds’. These ‘worlds’ are facilitated by the ESFS that has been established in 2011 to guarantee efficient supervisory practices.

The European investment law directives establish a comprehensive regulatory framework comprising of intermediary, product and sales regulation.[264] The degree of (cross-sectoral) harmonization throughout the directives, allows Member States to compete and specialize in particular sectors without competing on a ‘race to the bottom’ basis with other European Member States. The concept of the investment triangle, thus, fosters the development of European financial centers. The depositary/custodian plays a nexus role by preserving the basic essence of the structural separation between investments and management throughout the European investment law directives.

[264] See D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* 127 (D.A. Zetzsche ed, Kluwer 2015).

C. Systematic Explanation - Conclusion

The difference between 'depositaries' and 'custodians' is that depositaries, apart from safekeeping, also perform oversight duties.[1] In this regard, it should be noted that the AIFMD and UCITSD V require mandatorily a depositary to be appointed, MiFID I/II a custodian to be appointed[2], whereas IORPD II leaves it up to the Member States whether a depositary/custodian is appointed at all and if so, whether either a depositary or custodian must be appointed.[3] There are, thus, not only differences between 'depositaries' and 'custodians', but also between various types of 'depositaries' throughout sectoral EEA legislation.

This is the result of how the different European investment law directives deal with the 'structural separation of investments and management'. The 'investment assets' legally/beneficially owned by investors/members and the 'operational assets' legally/beneficially owned by 'investment intermediaries' and 'depositaries'/'custodians' form two separate 'asset patrimonies'. European investment law establishes this structural separation by means of warranting an (optional/virtual) 'investment triangle' to be in place that involves an 'investment intermediary', depositary/custodian and investors/members. This 'triangle' regulates (fiduciary/agency) governance and asset partitioning.

The structural separation limits 'residual control' that is beneficial for all constituencies in European investment law. It allows 'investment intermediaries' and 'depositaries'/'custodians' to exploit economies of scope and scale by conducting various business lines simultaneously, whereas it allows investors/members to benefit from lower fees. For this reason, assets are partitioned in two separate assets patrimonies by means of the segregation duty that comes along with the safekeeping task of depositaries/custodians.

The structural separation, however, also leads to agency costs. The (virtual/optional) investment triangle under European investment law regulates this by requiring 'investment intermediaries' and 'depositaries/custodians' to be regulated under intermediary regulation, financial products such as AIFs, UCITS and PEPPs, are subject to product regulation, whereas disclosure/sales/marketing regulation ensures that investors/members are adequately informed. Depositaries/custodians are, thus, merely one investor protection mechanism in the investment triangle that regulates the agency costs resulting from the structural separation of investments and management under the European investment law directives.

The different role that depositaries and custodians play are, in particular, different in (fiduciary/agency) governance. This can be explained by a *systematic interpretation* of the depositary throughout European investment law. Depositaries are required by European investment laws, such as the AIFMD, UCITSD V, IORPD II and the proposed PEPPR that are characterized by 'investment intermediaries' that conduct discretionary investment management. Investors/members directly or indirectly give a mandate to these 'investment intermediaries' to carry out investment management on their behalf without having the ultimate control in how their assets should be invested. Depositaries have an oversight duty in checking compliance of the investment decision made with the agreed investment policy. This is a marginal check. European investment law directives that do not regulate investment relationships that have a 'fiduciary' but 'agency' nature, such as execution-only and investment-advice based investment relationships under MiFID II, do not require a depositary

[1] International Organization of Securities Commission, *Standards for the Custody of Collective Investment Schemes' Assets – Final Report*, FR 25/2015, November 2015, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD512.pdf (accessed 14 April 2017).
[2] Recital 32, Art. 22(1) UCITSD V; Art. 21(1) AIFMD.
[3] Art. 33(1) and (2) IORPD II.

to be appointed. Instead, a custodian is appointed under these directives. In addition, depositaries are required to be appointed under European investment law directives that have a 'collective investment nature'. The oversight duty under the AIFMD, UCITSD V, IORPD II and proposed PEPPR prevents collective action problems in monitoring 'investment intermediaries' and, generally, is the 'cheapest solution' (cheapest cost avoider theory). Under investment relationships in which there is not 'pooled return/risk', only individual investors are affected by investment decisions made by 'investment intermediaries'. For this reason, individual investors are easily able to serve their own interests by giving investment directions/orders to these intermediaries and the oversight duty performed by depositaries is not warranted. For this reason, custodians are used in these investment relationships. Moreover, depositaries are only appointed under those European directives in which investors bear the 'full investment risks'. This implies that 'investment intermediaries' as agents are conducting investment management on behalf of investors/members in which the latter bear the full risk. No guarantee or claim is in place, such as for deposit-taking activity or insurances under CRD IV and Solvency II that grants consumers a claim on their balance sheet.

The systematic explanation does not explain why there are still differences to be found amongst sectoral depositary laws, such as in the AIFMD and UCITSD V that both regulate collective investment undertakings. This has a historical explanation that will be addressed in the next chapter.

PART III - Depositaries vs. Custodians

D. Historical Explanation

Despite ‘depositaries’ fulfilling a similar role throughout the European investment law directives, still inconsistencies between the various depositary regimes are to be observed. These differences have an historical explanation.

Chapter 12 The Historical Development of the Custodian and the Depositary under the European Investment Laws

Although the depositary performs under UCITSD V, AIFMD and IORPD II a similar role, still differences are being observed between UCITS depositaries and the AIF depositaries, at the one, and IORP depositaries, at the other hand. These differences have an *historical explanation*. Upon the adoption of the AIFMD depositary regime, the regime has served as an example for the regimes adopted under UCITSD V, IORPD II and the proposed PEPPR. This development, however, is not yet completed. Still some relics are to be found of the 'old' regimes. This chapter describes the development of regulation in the 'depositary' and 'custodian' domain prior to the adoption of the AIFMD, UCITSD V and IORPD II. The chapter concludes by predicting that 'depositary' regimes will likely be harmonized to a larger extent under the predominant 'contractual governance' model that was first introduced under the AIFMD.

1. The Development of 'Custodian Regulation'

An 'ancillary' European passport for 'custodians' was being introduced under the Second Banking Directive and ISD. Under both the Second Banking Directive and ISD, the 'safekeeping and administration of securities' could be provided as a so-called 'ancillary service'. Credit institutions that were authorized for 'core services', such as deposit taking and lending[1], could be, additionally, authorized for acting as a custodian alongside these 'core services'. The ISD built upon this framework by allowing investment firms to be authorized for the ancillary service 'safekeeping and administration of financial instruments for the account of clients' in connection with investment services and activities, such as, amongst others, portfolio management and investment advice.[2] Throughout the updates of the Second Banking Directive to CRD IV and the ISD to MiFID II the safekeeping and administration of securities remained to be an 'ancillary service' for which no separate authorization procedure nor a 'stand-alone' European passport is in place.[3] Various Member States that still have a national custodian regime, such as Ireland and Luxembourg, have based their laws applicable to national custodians upon MiFID II and CRD IV.

MiFID II and MiFIR have also introduced a TC regime under which TC firms may act as a custodian in the EEA.

2. The 'Depositary' under UCITSD I-IV

2.1. The Depositary Regime under UCITSD I-IV

Until the adoption of UCITSD V, the UCITSD depositary regime was still based upon the 1985 version of the original Directive. The pre-FSAP minimum harmonization approach in this directive only defined a minimum set of principle-based obligations that left Member

[1] Annex List of Activities subject to Mutual Recognition, Nr. 12 'safekeeping and administration of securities ' Second Banking Directive; Annex I s. C, Nr. 1 'safekeeping and administration in relation to one or more of the instruments listed in Section B ' ISD.

[2] Currently: Annex I s. A MiFID I/II.

[3] See Chapter 6, section 2.1.

States free for regulate many aspects of the depositary function.[4] In particular, along the debate of the depositary passport, investor protection issues regarding the UCITSD I-IV depositary regime were discussed, including the entities eligible, the depositary's organizational rules, functions, delegation and liability regime.

2.1.1. *The Compulsory Appointment of a 'Depositary'*

The function of the depositary was adopted in the original UCITSD I and dates back to 1985. It followed the recommendations of the 1970s, and the consequent implementation of those in certain Member State laws[5], in which a third-party depositary was recommended for (contractual) collective investment schemes.[6]

Under Article 7 UCITSD I the 'unit-trust assets' and under Article 14(1) UCITSD I the 'investment company's assets' had to be entrusted to a 'depositary' for safe-keeping.

UCITSD I-IV allowed for a depositary exemption for specific cases of listed investment companies.[7] This was an unpopular option granted to Member States under the condition that 'equivalent investor protection' to UCITS that had appointed a depositary was guaranteed.[8] This option was provided for under UCITSD I-IV as listed investment companies were considered to cater for more investor protection than unlisted UCITS as they are subjected to special obligations arising from their listed status and regular review by Competent Authorities.[9] Moreover, the degree of investor sophistication of investors that are active on the stock market for this type of UCITS was considered to be higher than for investors that are not active on the stock market.[10] This option could, however, only be provided by Member States to their investment companies under the condition that units are marketed 'exclusively' through a regulated market (at least 80% shares listed) and all transactions take place at the prices quotes by the regulated market.[11]

Listed investment companies that under the UCITSD I-IV Member State laws were exempted from appointing a depositary must, however:[12]

- state the methods of calculation of the NAV of their units in their articles of association; and

---

[4] European Commission, *Completing the Internal Market: White Paper from the European Commission to the European Council COM(85)310 Final*, 2,http://europa.eu/documents/comm/white_papers/pdf/com1985_0310_f_en.pdf (accessed 16 April 2017). European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186),* 52; European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016).

[5] D.A. Zetzsche. *Prinzipien der kollektiven Vermögensanlage* § 21 C. II. (Mohr Siebeck 2015).

[6] See Organisation for Economic Co-operation and Development, *Standard Rules for the Operations of Institutions for Collective Investment in Securities* (1971), [C (71) 234].

[7] Art. 14(4)(5) UCITSD I.

[8] See for Luxembourg: C. Kremer & I. Lebbe, *Collective Investment Schemes in Luxembourg: Law and Practice* (Oxford 2014); See for Liechtenstein: Art. 34 UCITSG (August 2011 version).

[9] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Van Damme Report'), 36, http://goo.gl/K0iUzv (accessed 13 October 2016).

[10] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Van Damme Report'), 36, http://goo.gl/K0iUzv (accessed 13 October 2016).

[11] Art. 14(5) UCITSD I.

[12] *Ibid.*

- establish a NAV and communicate them to the Competent Authorities at least twice a week and publish them, under review of an independent auditor, twice a month.

All UCITS other than 'listed investment companies' fulfilling these criteria were required to appoint a compulsory 'depositary'.[13]

The main problem, however, was that UCITSD I-IV did not define the term 'depositary'. UCITSD IV referred under Article 2(1)(a) UCITSD IV to 'an institution entrusted with the duties set out in Articles 22 and 32 and subject to the other provisions laid down in Chapter IV and Section 3 of Chapter V'. The minimum harmonization of the depositary under UCITSD I-IV led to large differences in Member State implementations regarding the eligible entities, its organizational requirements, the safekeeping and controlling task, the delegation and liability regime. The minimum harmonization of the depositary under UCITSD I-IV led to different interpretations of what constitutes a 'depositary'. Prior to discussing the resulting different governance models[14] , the differences in Member State implementations regarding the eligible entities, its organizational requirements, the safekeeping and controlling task, the delegation and liability regime will be discussed.

2.1.2. *Eligible Entities and Organizational Requirements*

Eligible entities under the UCITSD I-IV implementation laws of individual Member States were only required to furnish

> 'sufficient financial and professional guarantees to be able to effectively pursue its business as depositary and meet to pursue its business as depositary and meet the commitments inherent to that function.'[15]

Although at the time of the adoption of UCITSD I the majority of the Member States required credit institutions (or banks)[16] to be appointed as an depositary[17], each Member State had established different criteria. Apart from credit institutions, Member States also allowed investment firms and insurance companies to safekeep assets.[18] The latter was remarkable considering the fact that insurance companies at the time of the UCITSD I adoption were considered not to eligible as either UCITS ManCos or depositaries.[19] Member States also varied in their approach whether their eligible entities needed to obtain a special license as custodian from their Competent Authority to be able to act as a custodian.[20]

Against the background of the UCITSD IV heterogeneous list of entities, depositaries are also subjected to different legal forms, organizational and conduct of business requirements. Considering that this for financial intermediaries in Europe has largely been harmonized

---

[13] See Art. 14(4)(5) UCITSD I.

[14] See *Infra* 2.2.

[15] *Ibid.*

[16] This relates to institutions that are authorized under the non-harmonized laws of Member States to exercising banking functions under national regulations that do not have as a principle business deposit taking activity. See Chapter 6, section 4..

[17] At the time of the UCITSD I adoption, amongst others Austria, Czech Republic, Germany, Italy, Liechtenstein, Luxembourg and Portugal had this requirement. See FEFSI, *Position Paper on Depositaries*, 2, 22 (6 November 2002).

[18] At the time of UCITSD I adoption, France, Finland and Ireland. See FEFSI, *Position Paper on Depositaries*, 2, 22 (6 November 2002).

[19] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Van Damme Report'), 27, http://goo.gl/K0iUzv (accessed 13 October 2016).

[20] Member States that required this were, amongst others, Austria, Germany, Czech Republic, Luxembourg, and the UK. See FEFSI, *Position Paper on Depositaries*, 2, 22 (6 November 2002).

throughout European legislation (horizontal harmonization)[21], there were concerns related to the diverging requirements related to the legal structure own capital and conflicts of interest.[22] UCITSD I did not necessarily require a depositary to be a legal person.[23] Persons authorized to carry out regulated business could also be a depositary.[24] This was acceptable in the UK, where an authorized person (including companies) could also exercise the depositary function.[25] Most depositaries were, however, credit institutions and investment firms that are required by the CRD IV and MiFID II to be incorporated legal entities.[26] In addition, research indicated that capital requirements show strong dispersion among (1) across all categories of depositaries and (2) within one category of depositaries, such as credit institutions.[27] Across all categories, the range was between EUR 113.000 and 100 million. Within the category of credit institutions, the capital requirements varied between EUR 5 and 100 million.

Finally, UCITSD I-IV incorporated very few safeguards related to conflicts of interest for depositaries. The directive adopted the principle of separation of both functions: both function cannot be exercised by the same legal entities. Apart from that, both must act 'independently and solely in the interest of unit-holders'.[28] There were, however, not technical safeguards for interpreting its interpretation. The European Commission has in this regard identified two types of relationships as the main sources of conflicts of interests: the relationship between (1) the depositary and the UCITS ManCo and (2) the relationship between the UCITS and the depositary.[29]

Management companies and depositaries may be independent or integrated within a group.[30] Already during the UCITSD I preparation phase the question arose whether depositaries should not only be legal but also economically or finally independent.[31] The example was brought up that they could be linked by a common administration or management, substantial (in)direct shareholders or other financial interests that could impede depositaries from being independent.[32] Ultimately, UCITSD I adopted that UCITS ManCo's and depositaries must act independently and solely in the interest of the unit holders.[33]

---

[21] See D.A. Zetzsche, *The AIFMD and the Joint Principles of European Asset Management Law* 865 (D.A. Zetzsche ed, Kluwer 2015).
[22] Cf. ESMA/2014/1183, 18; ESMA/2014/1417,
[23] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Van Damme Report'), 26, http://goo.gl/K0iUzv (accessed 13 October 2016).
[24] *Ibid.*
[25] FEFSI, *Position Paper on Depositaries*, 2 (6 November 2002).
[26] Cf. Art. 5 MiFID II; C.M. Grundmann-van de Krol, *The Markets in Financial Instruments Directive and Asset Management* (D. Busch & D.A. DeMott eds, Oxford 2012). Cf. Art. 3(1) point 1 CRD IV/Art. 4(1) point 1 CRR.
[27] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004, 6; FEFSI, *Position Paper on Depositaries*, 2 (6 November 2002).
[28] See ESMA/2014/1183, 16-56.
[29] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004, 8-9.
[30] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004, 9.
[31] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Van Damme Report'), 29, http://goo.gl/K0iUzv (accessed 13 October 2016).
[32] *Ibid.*
[33] See Art. 10(2) UCITSD I.

During the adoption of the UCITSD V the issue became more prominent.[34] It was, indeed, highlighted in a mapping exercise that Member States took diverging approaches. Approaches varied by having implemented literally UCITSD I-IV, thus, not having any special provisions addressing this type of conflicts of interests[35], imposing restrictions regarding the common management/supervision of depositaries and management companies and/or restrictions regarding cross-shareholdings.

Antagonism also existed in the relationship between the UCITS and the depositary. Some Member States set up a list of transactions with closely linked entities.[36] Other Member States took different approaches by introducing conduct of business rules addressing conflict of interest rules and disclosure.[37]

Unsurprisingly, the European Commission came in its Communication in 2004 to the conclusion that apart from harmonizing the eligible depositary entities, harmonization would be required for operating conditions for depositaries (requirement on internal organization and resources, capital requirements and minimum financial resources to meet organizational standards set by regulations.[38]

2.1.3. *The UCITSD I-IV Depositary Functions*

Following UCITSD I, the depositary has been entrusted with the safekeeping of assets and a number of oversight functions to ensure compliance of the UCITS ManCo managing the assets.[39]

2.1.3.1. The Safekeeping of Assets

Safekeeping of the assets of a UCITS was the primary responsibility of a depositary under UCITSD I-IV.[40] UCITSD I-IV did, however, not clarify this function and the responsibility assigned to the depositary. It was not clear whether the safekeeping function was only encompassed the mere safekeeping of the assets as an obligation towards the UCITS ManCo and the investors or also included the exercise of prudential control over sub-custodians?[41] Depending on the understanding of the safekeeping function, the law imposes different requirements regarding the depositary organization and business model.[42]

---

[34] European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186),* 72.

[35] Art. 10 UCITSD I.

[36] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 9.

[37] Cf. ESMA/2014/1183, 17.

[38] *Ibid.*

[39] See Art. 7 and 14 UCITSD.

[40] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 7.
; European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, 22, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016).

[41] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004, 7.

[42] European Commission, *Appendices to the report on Investment Fund Market Efficiency*, July 2006, 57, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/annex_efficiency_en.pdf (accessed 7 April 2017);

According to the Van Damme commentary, the safekeeping function encompasses the everyday administration of the UCITS assets, including the collection of dividends, interest payments, subscription charges…).[43]

The Greenpaper and Report on investment fund market efficiency, however, concluded that the safekeeping function, with the absence of the depositary's liability, was relatively similar across the EEA.[44] The Report in its analysis of the UCITSD I depositary functions concluded that that the general concept of safekeeping partly depended upon the the granted possibility of delegating the safekeeping function and the liability for lost assets.[45]
Depending upon the view taken, the safekeeping function included the administration, surveillance over sub-custodians and the segregation of assets.[46]

It concluded that the administration along the safekeeping function also implied the preservation of rights and the delivery of obligations attached to assets held under custody (shareholders' rights, tax returns, etc).[47] Member States, *inter alia,* mentioned in the inquiry the following examples:[48]

- informing clients of: corporate actions, tax returns, events affecting the client's rights, and the execution of trades;
- verifying the number and nature of the assets held in safekeeping;
- ensuring the segregation of assets (with a CSD); and
- checks on the clearing & settlement of trades.

Based upon this, the Investment Fund market Efficiency Report concluded that safekeeping was relatively similar across the EEA.[49] The delegation and liability regime were, however, were not considered to be harmonized.[50]

2.1.3.2. The Controlling Function

Apart the safekeeping of assets, UCITSD I-IV assigned the depositary with a key role in controlling the operation of UCITS.[51] Due to its safekeeping function, the depositary is uniquely positioned to perform control over the UCITS ManCo. The safekeeping function

---

[43] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Van Damme Report'), 23, 24, http://goo.gl/K0iUzv (accessed 13 October 2016).
[44] European Commission, *Appendices to the report on Investment Fund Market Efficiency*, July 2006, 54, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/annex_efficiency_en.pdf (accessed 7 April 2017).
[45] European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, 22, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016).
[46] *Ibid.*
[47] *Ibid.*
[48] European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, 23, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016).
[49] European Commission, *Appendices to the report on Investment Fund Market Efficiency*, July 2006, 54, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/annex_efficiency_en.pdf (accessed 7 April 2017).
[50] European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, 22, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016).
[51] Arts 7 and 14 UCITSD I.

enables the depositary to be involved on a daily basis with a UCITS fund.[52] No transaction (trading, rebalancing) regarding the assets of UCITS can be carried out without its passive or active involvement.[53] The controls were assigned by UCITSD I to the depositary as a board of directors or trustee, as opposed to the depositary, would only be able to intervene on an ad-hoc and ex-post basis.[54] This would be technically assigning an agent that is involved in the day-to-day monitoring that is safekeeping and, therefore, more costly and would also imply agency issues. The coexistence of these two functions of very different nature were assigned to ensure high standards of investor protection.[55] Sound management and administration of UCITS was ensured by a depositary exercising a range of 'micro-controls' at the level of the UCITS preventing malpractices by UCITS ManCos.

The depositary under UCITSD I-IV had to ensure that 'micro-controls' were carried out in accordance with the law and the fund rules.[56] This implied that the depositary was required to take the steps necessary to carry out these micro-controls properly as an obligation of means not an obligation of result.[57] These 'micro-controls', included:[58]

- the sale, issue, repurchase sale, issue, re-purchase, redemption and cancellation of units effected on behalf of a unit trust or by a UCITS management company;[59]
- the timely remittance of the unit trust's assets ;
- the application of a UCITS income.[60]

To the contrary of investment companies, two extra controlling functions had to be carried out by a depositary of a unit trust/common fund.[61] A depositary of a unit trust also had to carry out the instructions of the UCITS ManCo, unless they conflict with the law or the fund rules and the compliance of the calculation of the value of units with the law.[62]

There were two reasons for assigning less control to the investment company's controls.[63] First, the shareholders are to exercise control over the management by taking part in its general meeting of shareholders, whereas the unit-holders of a unit trust cannot.[64] Second, the

---

[52] European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, 23, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016).
[53] *Ibid.*
[54] See cf. the controlling duties under other governance models: International Organization of Securities Commissions, *Examination of Governance for Collective Investment Schemes – Final report, Part I*, June 2006.
[55] European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, 23, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016).
[56] Art. 7, 14 UCITSD I.
[57] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Van Damme Report'), 25, http://goo.gl/K0iUzv (accessed 13 October 2016).
[58] Art. 7, 14 UCITSD I.
[59] Art. 7(3)(a); Art. 14 UCITSD I.
[60] Art. 7(3)(c); Art. 14 UCITSD I.
[61] See Art. 7(3)(d), (e) UCITSD I. See also Art. 14(3) UCITSD I.
[62] Art. 7(3)(b) & Art. 14 UCITSD I.
[63] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Van Damme Report'), 33, http://goo.gl/K0iUzv (accessed 13 October 2016).
[64] *Ibid.*

risks of conflicts of interests between the UCITS ManCo and the shareholders are not of the same kind as that between the unit-holders and the unit-holders.[65]

In this regard, the Report of the Expert Group on Investment Fund Market Efficiency concluded that the biggest problem for not granting a European passport to depositaries was that the control function of the depositary differed widely across Member States.[66] Two reasons caused this problem. First, the pre-FSAP minimum harmonization approach of the UCITSD I and, second, different approaches were applied by Member States towards the depositary's tasks of corporate UCITS.[67]

The minimum harmonization approach of the UCITSD I-IV caused Member States to develop different depositary models throughout the EEA. Some Member States provided a rather general description of the monitoring obligations that were directly derived from the UCITSD I.[68] The monitoring function was 'copied' without elaborating this in detail how this should be achieved.[69] Other Member States, 'gold-plated'[70] the depositary function by imposing additional or reinforced controls upon the depositary.[71] The latter Member States considered the depositary as a gatekeeper and entrusted the depositary with a whistleblower function.[72] Examples of additional and reinforced controls, included:[73]

- the representation of the investors' interests in:
    - the legal establishment of the fund;
    - change of the UCITS ManCo;
    - fund restructurings, including mergers or liquidations.
- auditing of the UCITS portfolio and accounting methods of the UCITS, including the approval of:
    - the assets statement;
    - annual report on the compliance of the UCITS ManCo with applicable rules and regulations.

---

[65] *Ibid.*

[66] European Commission, *Report of the Expert Group on Investment Fund Market Efficiency*, July 2006, 27, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/efficiency_en.pdf (accessed 7 April 2017).

[67] *Ibid.*

[68] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004, 8.

[69] FEFSI mentioned Austria, Finland, Portugal and the UK as examples. See FEFSI, *Position Paper on Depositaries*, 4 (6 November 2002).

[70] Directorate General for Internal Policies, '*Gold-plating*' *in the EAFRD – To what extent do national rules unnecessarily add to complexity and as a result, increase the risk of errors*?, IP/D/ALL/FWC/2009-056, 27 February 2014, http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/490684/IPOL-JOIN_ET%282014%29490684_EN.pdf(accessed 14 January 2017); W. Voermans, *Gold-plating and double banking: an overrated problem?* 79-88 (H. Snijders & S. Vogenauer eds.Sellier European Law Publishers 2009).

[71] European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, 23, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016); The Czech Republic, France, Ireland, Italy, Norway and Luxembourg were mentioned by FEFSI. See FEFSI, *Position Paper on Depositaries*, 3-4 (6 November 2002).

[72] European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, 23, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016).

[73] Adapted from: European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, 23, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016).

- whistleblower function towards auditors and Competent Authorities in the case of irregularities;
- checks on execution prices and due diligence regarding counterparties;
- other additional controls, such as executing actions on behalf of clients, such as claims vis-à-vis the UCITS ManCo.

Member States also under their UCITSD I implementations applied different approach towards the depositary's tasks of corporate UCITS. Some Member States, such as Ireland[74] and Luxembourg[75], followed the UCITSD I-IV approach by not assigning the general and NAV compliance function to the depositary. Other Member States, including Liechtenstein[76] and the Netherlands[77], assigned all the UCITSD I controlling duties to both corporate and non-corporate UCITS.[78] Austria and Germany did so as well. They, however, only allowed UCITS to be established as a contractual fund.[79]

The differing approaches of Member States is unsurprising. Some Member States would have liked to restrict the depositary solely to the safekeeping of the assets of an investment company, whereas others clearly did not follow the UCITSD reasoning that company law would validly complement the control exercised by the unit trust depositary.[80]

Both differing controlling functions and the different approach towards legal form neutrality have, thus, resulted in different 'depositary' models throughout Member States.[81]

2.1.4. *The UCITSD I-IV Delegation Regime*

The UCITSD I-IV depositary regime had a very unclear approach towards delegation of the depositary's tasks. UCITSD I stipulated that

> 'a depositary's liability shall not be affected by the fact that it has entrusted to a third party all or some of the assets in its safe-keeping'.[82]

---

[74] See S. 19, S. 37 S.I. No. 78/1989 - European Communities (Undertakings For Collective Investment in Transferable Securities) Regulations, 1989. Ireland in its UCITSD IV implementation, however, did not make any difference anymore between the controlling tasks of depositaries appointed for corporate and non-corporate UCITS: Part 5 and 6 S.I. No. 352/2011 - European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011.

[75] See C. Kremer & I. Lebbe, *Collective Investment Schemes in Luxembourg: Law and Practice* (Oxford 2014).

[76] S. Zwiefelhofer, *Das liechtensteinische Recht betreffend die Investmentunternehmen verglichen mit dem schweizerischen Anlagefonds* 47 (Schulthess 2002).

[77] Art. 5 Wet toezicht beleggingsinstellingen.

[78] In the Netherlands non-corporate UCITS are common funds. See S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2012). In Liechtenstein, UCITS were under UCITSD I for the largest part established as unit trusts. After the introduction of the UCITSD IV in 2011, Liechtenstein introduced the common fund as well. See D.A. Zetzsche & C.D. Preiner, *Das liechtensteinische AIFM-Gesetz: Die erste Umsetzung der europäischen AIFM-Richtlinie*, RiW, 265 (2013).

[79] See for Germany: T.M.J. Möllers, *Umfang und Grenzen des Anlegerschutzes im Investmentgesetz - Der Trennungsgrundsatz und die Grenzen der Aufrechnung im InvG*, 9 BKR 353 (2011); See for Austria: C. Knauder, *Der Trennungsgrundsatz im österreichischen Investmentfondsrecht im Wandel der Zeit*, 61 ZFR 103 (2013).

[80] Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Van Damme Report'), 33, http://goo.gl/K0iUzv (accessed 13 October 2016); European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30. March 2004, 8.See, for instance, the Netherlands that, until the adoption of the AIFMD, did not require a depositary for corporate AIFs. See S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2012).

[81] See *infra* 2.2.

[82] Art. 9 UCITSD I.

UCITSD I-IV, however, did not elaborate the conditions applicable to delegation of functions of the depositary. Consequently, Member States took different approaches regarding:[83]

- the type of functions that could be delegated by the depositary;
- the nature of the sub-custodian;
- the due diligence to be expected in selecting sub-custodians;
- locational restrictions applying to sub-custodians.

2.1.4.1. Functions

Unlike UCITSD V, the UCITSD I-IV delegation regime did not define the type of functions that could be delegated by the depositary.[84] UCITSD I-IV, however, referred to the delegation of safekeeping. Two problems were identified with the UCITSD I-IV depositary delegation regime.[85] First, safekeeping had not been clarified and it was, thus, not clear what assets were considered to be assets that could be held in custody, what assets were considered to be only held through a position-keeping book and whether to what extent financial collateral agreements influence the status of assets considered to be in custody or not.[86] Second, the UCITSD I-IV depositary delegation regime did not explicitly prohibit the delegation of other depositary duties than safekeeping.[87] Member State approaches differed in this regard. Germany[88] and France[89], for instance, prohibited the delegation of controlling tasks by the depositary. Austria[90] and the Netherlands[91] had formally no restrictions in place, whereas in the UK[92] the depositary of a UCITS was allowed to delegate any depositary function to any person subjected to restrictions towards the type of sub-custodians. Safekeeping or controlling functions, for instance, could not be delegated to the ICVC any director of the ICVC or an authorized fund manager.[93] Ireland[94] and Liechtenstein[95], for example, did not explicitly prohibit the delegation of supervisory tasks by statute. Their laws, however, referred to sub-custodians as delegates exercising the safekeeping function.

2.1.4.2. Nature of the Sub-Custodian

Some Member States under their implementation of the UCITSD I-IV depositary delegation regime restricted the use of delegation to certain depositary duties, whereas others focused on

---

[83] European Commission, *Working Document of the Commission Services (DG Markt), Consultation Paper on the UCITS Depositary Function*, July 2009, 7,http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/consultation_paper_en.pdf (accessed 7 April 2017).

[84] Art. 7(2) and Art. 14 UCITSD I.

[85] See European Commission, Consultation Paper on the UCITS Depositary Function …, Markt/G4 D (2010) 950800.

[86] Cf. T. Moroni & L. Wibbeke, *OGAW V: Die Sprunglatte für OGAW-Verwahrstellen liegt höher*, 3 Recht der Finanzinstrumente 187.

[87] See Art. 7 and 14 UCITSD I.

[88] Germany: § 12a, § 24 InvG.

[89] France: 323-15 AMF Regulation (January 2011).

[90] Austria: no restrictions § 39-45 InFG (January 2011).

[91] S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013).

[92] COLL 6.6.15 (4)

[93] *Ibid.*

[94] S. 18(2), S. 37(2) S.I. No. 78/1989 - European Communities (Undertakings For Collective Investment in Transferable Securities) Regulations, 1989.

[95] Art. 33(4) UCITSG (August 2011 version).

S.I. No. 78/1989 - European Communities (Undertakings For Collective Investment in Transferable Securities) Regulations, 1989

the conditions that needed to be met before depositary duties could be delegated.[96] The latter Member States both imposed limitations regarding the nature of the sub-depositary, due diligence requirements and its location.

Sub-custodians were, for instance, in Germany required to be a CSD, domestic or foreign credit institution or a foreign custodian that exercises the functions of a central depositary of securities and is subject to public or equivalent supervision concerning investor protection.[97] Apart from this, the sub-custodian had to have a legal status equivalent to that provided by the Germany Custody Act and its national law should not impact the right of the depositary to request delivery of the assets.[98] After the introduction of the AIFMD, Germany imposed the AIFMD delegation regime to UCITS depositaries.[99]

Similarly, UCITS depositaries in Italy could only delegate to sub-custodians that were Italian or foreign:[100]

- banks;
- investment firms authorized to hold clients' assets;
- other entities authorized to perform depositary functions which are subject to prudential regulation; and
- equivalent entities of which its obligations are guaranteed by a bank or an investment firm belonging to the same group.

Sub-depositaries were subjected to the consent of the UCITS ManCo, which was assumed when possible delegates were laid down in the depositary contract between the depositary and UCITS ManCo.[101]

To the contrary, Spain did not restrict the type of eligible sub-custodians. Instead they required that sub-custodians had to be a CSD member.[102] This implied that sub-custodians could not further delegate safekeeping in the intermediary holding chain.[103]

2.1.4.3. Due Diligence

The due diligence that was expected in the selecting of sub-custodians upon delegation the safekeeping function differed from Member State to Member State.[104] According to Article 3(3) Austrian Custody Act, the depositary in Austria was responsible for the appointment of a sub-custodian with due diligence even if its liability had been contractually limited. Spanish UCITS depositaries were also required to apply standards of due diligence and ongoing monitoring. Upon the time of appointment, Spanish depositaries have to establish due

---

[96] European Commission, *Working Document of the Commission Services (DG Markt), Consultation Paper on the UCITS Depositary Function*, July 2009, 11, http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/consultation_paper_en.pdf (accessed 7 April 2017).

[97] Germany: § 24 InvG.

[98] *Ibid.*

[99] See Capitolo VIII Modalita Di Subdepositao dei Beni Dell'OICR, Provvedimento Della Banca D'Italia Dell' 8 Maggio 2012, Regolamento sulla gestione collecttiva del risparmio La Banca D'Italia.

[99] Committee of European Securities Regulators, *Mapping of duties and liabilities of UCITS depositaries (2010)*, CESR/09-175, 78.

[100] *Ibid.*

[101] *Ibid.*

[102] Art. 5(2) Orden EHA/596/2008, de 5 de marzo, por la que se regulan determinados aspectos del régimen jurídico del depositario de instituciones de inversión colectiva, y se concreta el contenido de los estados de posición.

[103] Committee of European Securities Regulators, *Mapping of duties and liabilities of UCITS depositaries (2010)*, CESR/09-175, 110, 111.

[104] *Ibid*.

diligence procedures to monitor the sub-custodian on an ongoing basis and to ensure that no asset disposal is carried out without the depositary's permission.[105] In Ireland, depositaries had to ensure asset segregation and maintain appropriate internal controls to identify all assets and the relationship should be set out in a formal contract[106] In Italy, banking regulation required depositary banks to carefully assess its fitness to efficiently perform the duty. Regulation does not set out minimum content regarding sub-custody agreements. The segregation of assets was at all times required to be preserved.[107] In the Netherlands, the 'depositary' was required to ensure that: [108]

- the sub-custodian at all times can report on its performance;
- the depositary can give instructions to its sub-custodians and suspend its activities;
- the sub-custodian can adhere to all requirements imposed upon the depositary.

2.1.4.4. Locational Restrictions

The UCITSD I-IV was equally silent on the delegation conditions that apply to third country sub-custodians. Regulation on these delegations are as important as no global custodian is able to cover all jurisdictions on its own and UCITS increasingly seek to invest in third country jurisdictions.[109] Some Member States, such as Germany and Spain required additional requirements to be fulfilled by foreign sub-custodians.

In Germany, a third party sub-custodian was, prior to the KAGB, under the German Custody Act considered to be subject to equivalent levels of regulation and supervision, if a third-country custodian or credit institution
applied asset segregation and accepted to comply with par. 4 German Custody Act.[110] The latter had to be confirmed by a so-called 'three-point point declaration' in which the sub-custodian declared that: [111]

- in the future they will credit securities in the accounts of and on behalf of customers;
- security collateral agreements could only be established on the basis of the safekeeping and administration of securities and the depositary would be notified of security collateral agreements being established on behalf of third parties; and
- without permission of the depositary, the sub-custodian may not sub-delegate the safekeeping of assets.

---

[105] Art. 5(2) Orden EHA/596/2008, de 5 de marzo, por la que se regulan determinados aspectos del régimen jurídico del depositario de instituciones de inversión colectiva, y se concreta el contenido de los estados de posición.
[106] UCITS Notices – Undertakings for Collective investment in Transferable Securities Authorised under European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2003, April 2008, UCITS 4.3 Undertakings for Collective Investment in Transferable Securities, Trustees - duties and conditions.
[107] Capitolo VIII Modalita Di Subdepositao dei Beni Dell'OICR, Provvedimento Della Banca D'Italia Dell' 8 Maggio 2012, Regolamento sulla gestione collecttiva del risparmio La Banca D'Italia.
[108] Committee of European Securities Regulators, *Mapping of duties and liabilities of UCITS depositaries (2010)*, CESR/09-175, 78.
[109] European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186),* 17.
[110] See BaFin, Rundschreiben 6/2010 (WA) zu den Aufgaben und Pflichten der Depotbank den § 20 ff. invG, § IV Drittverwahrung, 2. Ausland.
[111] *Ibid*.

In Spain also additional requirements applied to foreign sub-custodians where the use of omnibus accounts was allowed. The depositary had to carry out an assessment on the credit quality of the sub-custodian and client asset segregation.[112]

2.1.5. *The UCITSD I-IV Depositary Liability Regime*

The Madoff case resulted in concerns related to the diverging depositary liability regimes under UCITSD I-IV.[113]

The preparatory works leading to the AIFMD and UCITSD V have proven that the UCITSD I-IV liability regime had resulted in different approaches taken by Member States regarding the liability in case of the depositary's improper performance and upon delegation.[114]

When performing its safekeeping and controlling duties, different liability regimes applied throughout the EEA for 'depositaries' failing to perform their duties ('improper performance'). Member States, in particular, diverged in relation to:[115]

- the interpretation of what is considered to be 'improper performance';
- who should be liable for any loss of assets?;
- the scope of depositary liability (when assets are lost by a sub-custodian); and
- the burden of proof.

Member States had different interpretations of what constituted 'improper performance'. Improper performance could relate to the failure of the depositary to perform its duties related to the safekeeping and/or controlling duties. Improper performance of the controlling duties, in most Member States, lead to civil and/administrative liability of the depositary.[116]

Member States diverged to a larger extent as to the depositary liability for a loss of financial instruments that could be held in custody.[117] Some Member States, such as France[118], applied a 'guarantor liability'[119] to their depositaries requiring full compensation

---

[112] Art. 5(4) Orden EHA/596/2008, de 5 de marzo, por la que se regulan determinados aspectos del régimen jurídico del depositario de instituciones de inversión colectiva, y se concreta el contenido de los estados de posición.

[113] G.N. Gregoriou & F.S. Lhabitant, *Madoff: A Riot of Red Flags* (EDHEC-Position Paper 2009

[114] CESR/09-781, 12-15.

[115] Derived from: CESR/09-781, 12-15.

[116] European Commission, *Working Document of the Commission Services (DG Markt), Consultation Paper on the UCITS Depositary Function*, July 2009, 6 ,http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/consultation_paper_en.pdf (accessed 7 April 2017).

[117] *Ibid.*

[118] See S. Dussart, F. Rodriguez et M. Thouch, *La restitution des actifs par le dépositaire,* Joly Bourse 542 (2008); I. Riassetto & A. Prüm, *La fonction de conservation du dépositaire, source de responsabilité civile, note sous Paris, 1ère Ch., Section H, 8 avril 2009, no. 2008/22218*, 3 Joly Bourse 191, §I-A-2 (2009); M. Storck, *Particularisme de l'obligation de restitution incombant au dépositaire*, RTD com. 573, § I-B (2010); I. Riassetto, *Obligation de restitution du dépositaire d'OPCVM*, 4 RD Bancaire et Financier Comm. 161, point 1-B (July 2010); S. Gaouaoui, *Conservation d'actifs, la Cour d'appel entérine la responsabilité des dépositaires*, 1025 Option finance 10 (2009); Ph. Goutay, *Obligation de restitution des dépositaires : les arrêts du 8 avril 2009 de la Cour d'appel de Paris*, 2 RD Bancaire et Financier 166 (2009); P. Guilhaumaud, *La responsabilité civile du dépositaire d'OPCVM*, 25 Banque et Droit 551 (1992); M. Karlin, *Responsabilité des teneurs de compte conservateurs*, 2 RD Bancaire et Financier étude 8 (2009).

[119] Also referred to as an obligation of results, i.e. a strict obligation to return all assets entrusted to a depositary. See J.R. Siena, *Depositary Liability: A Fine Mess and How to Get Out of It* 568-569 (D.A. Zetzsche ed, Kluwer 2015); M. Pierrat, *De la distinction entre obligations de moyens et obligations de resultat: pile ou face?* 15 Journal des Tribunaux 61 et seq (2011); See also S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013).

for lost financial instruments.[120] Other Member States, including Germany and the Netherlands[121], only applied an 'obligation of means', i.e. a liability standard that lead to compensation when the depositary failed to exercising proper due diligence over financial instruments that were lost when held in custody.[122] Similar as under the AIFMD and UCITSD V, Member States applying a 'guarantor liability', however, mainly applied these to lost financial instruments held in custody and not to the loss of 'other assets'.[123]

Nevertheless, the differences in liability standards related to the safekeeping function also had impact on the liability of depositary for lost assets of assets held by sub-custodians.

Member States applying an 'obligation of means', such as Germany and the Netherlands, solely held the depositary liability for a loss of assets at depositary level and the failure of conducting proper due diligence over their sub-custodians, Member States applying an 'obligation of result' to the loss of financial instruments held in custody, however, also attributed the loss of financial instruments held in custody by any of its sub-custodians to the depositary.[124] Consequently, the burden of proof in Member States applying an 'obligation of result' to depositaries for lost financial instruments that could be held in custody was attributed to the depositary, whereas in Member States applying an 'obligation of means' investors and the UCITS concerned needed to proof their claim for any losses suffered as a result of the depositary's failure to perform properly their custody function.[125]

Taken these differences, it is unsurprising that the AIFMD and UCITSD V liability regime applicable to depositaries has been strengthened compared to the UCITSD I-IV depositary liability regime.[126]

2.1.6. *Conclusion*

Until the adoption of UCITSD V, the UCITSD depositary regime was still based upon the 1985 version of the original Directive. The pre-FSAP minimum harmonization approach in this directive only defined a minimum set of principle-based obligations that left Member States free for regulate many aspects of the depositary function.[127] The absence of a clear

---

[120] C. Clerc, *The AIF Depositary's Liability for Lost Assets* 528 (D.A. Zetzsche ed, Kluwer 2015).
[121] See S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013).
[122] J.R. Siena, *Depositary Liability: A Fine Mess and How to Get Out of It* 568-569 (D.A. Zetzsche ed, Kluwer 2015).
[123] Cf. the depositary liability regime under UCITSD V and the AIFMD: Chapter 4, section 8; See also C. Clerc, *The AIF Depositary's Liability for Lost Assets* 528 (D.A. Zetzsche ed, Kluwer 2015).
[124] See J.R. Siena, *Depositary Liability: A Fine Mess and How to Get Out of It* (D.A. Zetzsche ed, Kluwer 2015), 568-569 ; S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013); ; European Commission, *Working Document of the Commission Services (DG Markt), Consultation Paper on the UCITS Depositary Function*, July 2009, 5 .,http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/consultation_paper_en.pdf (accessed 7 April 2017).
[125] European Commission, *Working Document of the Commission Services (DG Markt), Consultation Paper on the UCITS Depositary Function*, July 2009, 6 ,http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/consultation_paper_en.pdf (accessed 7 April 2017).
[126] See G.N. Gregoriou & F.S. Lhabitant, *Madoff: A Riot of Red Flags* (EDHEC-Position Paper 2009); S. Gene, *Luxembourg Called On to "Brush Up" Governance*, Financial Times, Fund Management Supplement, (26 January 2009); P. Skypala, *UCITS Victory Soured by Madoff Scandal*, Financial Times, Fund Management Supplement, (19 January 2009), 6; P. Hollinger, B. Hall & N. Tait, *Grand Duchy Hits Back at Madoff*, Financial Times (14 January 2009), 23; P. Hollinger & J. Chung, *Madoff Affair Sparks Demand for Revamp of Investment Fund Rules*, Financial Times, (13 January 2009), 15.
[127] European Commission, *Completing the Internal Market: White Paper from the European Commission to the European Council COM(85)310 Final*, 2,http://europa.eu/documents/comm/white_papers/pdf/com1985_0310_f_en.pdf (accessed 16 April 2017).

definition of the 'depositary' and the limited degree of harmonization related to the entities eligible, the depositary's organizational rules, functions, delegation and liability regime left a large degree of discretion to individual Member States to adopt different types of 'depositary governance structures'.

2.2. UCITSD I-IV 'Depositary' Governance Structures

The absence of a depositary definition[128] and the minimum harmonization nature of the depositary function under UCITSD I-IV resulted in various UCITS governance structures in which the 'depositary's tasks were assigned to different types of 'independent oversight entities' that could considered to be a 'depositary' under UCITSD IV.[129] Depending upon the individual Member State implementation, Member States could require both safekeeping and controlling duties to be fully performed by the appointed depositary or allow one or both tasks to be fully delegated to third parties, whereas the appointed depositary would remain to be 'liable'.[130] Moreover, the option was left to the Member States under UCITSD I-IV to require the appointment of two or more 'depositaries' in order to take account of the situation prevailing in some Member States.[131]

Independent oversight entities that could be appointed for carrying out the depositary functions were structured differently for various legal forms under UCITSD IV Member State implementations. UCITSD I-IV made the distinction for depositary obligations between investment companies, at the one, and unit-trusts and common funds, at the other hand.[132] Nevertheless, in practice, three broad types of governance structures could be recognized: the corporate, contractual and trust model.[133]

2.2.1. *Corporate Model*

The role of the depositary for investment companies was the same under UCITSD I-IV as for the depositary appointed for the unit trust/common UCITS depositaries. Depositaries were entrusted with safekeeping and controlling tasks. Depositaries appointed for investment companies, however, did not have to ensure the value of units to be calculated nor was it required to check that the instructions it received from the UCITS ManCo were in compliance

---

European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186),* 52; European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016).

[128] UCITSD IV referred under Article 2(1)(a) UCITSD IV to 'an institution entrusted with the duties set out in Articles 22 and 32 and subject to the other provisions laid down in Chapter IV and Section 3 of Chapter V'.

[129] International Organization of Securities Commissions, *Examination of Governance for Collective Investment Schemes - Independence Criteria, Empowerment Conditions and Functions to be performed by the 'Independent Oversight Entities', Part II*, February 2007.

[130] Cf. C. Clerc, *The AIF Depositary's Liability for Lost Assets* (D.A. Zetzsche ed, Kluwer 2015).

[131] For contractual/unit trusts and investment companies: Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Van Damme Report'), 26, 33, http://goo.gl/K0iUzv (accessed 13 October 2016).

[132] Arts 7 and 14 UCITSD I.

[133] See cf. the controlling duties under other governance models: International Organization of Securities Commissions, *Examination of Governance for Collective Investment Schemes – Final report, Part I*, June 2006.

with the law and investment company's articles of association.[134]

According to the 'Van Damme Report', the monitoring law of the investment company's depositary under UCITSD I-IV was more limited as these two controlling tasks were considered to be adequately protected by company law.[135] First, board of directors were considered to be able to exercise control through general meetings towards the UCITS Manco, whereas this was not the case for UCITS established as a unit-trust or common fund.[136] Second, the conflict of interest between an investment company and a UCITS ManCo is because of this reason not of the same nature as for contractual and unit-trust UCITS.[137]

Similar as of ICA 1940 in the US, some Member States preferred to investment company's depositary role to be restricted to the safekeeping of assets.[138] This was, however, not laid down in the final UCITSD I version.[139] Member States, however, could under the minimum depositary harmonization established under UCITSD I-IV opt to let both the depositaries of investment companies and common/unit-trust UCITS perform the same controlling duties, hence, establishing a level playing field for all types of depositaries. Some Member States, such as Liechtenstein, opted for such a coherent approach, whereas other Member States, such as Luxembourg, allowed its depositaries for investment companies to comply with the minimum controlling tasks laid down by UCITSD I-IV.[140] UCITSD I-IV allowed, thus, Member States the discretion to implement a 'board of directors model' similar for corporate IORPs under IORPD I/II[141] or a 'corporate depositary model'. The 'board of directors model' is a governance model, such as in Luxembourg, in which the board of directors is solely responsible for ensuring compliance of the UCITS Manco's actions with the law and articles of association of the investment company.[142] Under the 'board of directors model' the 'depositary' has more the role of a 'compulsory prime custodian'[143] To the contrary, the German UCITSD I-IV implementation was an example of a 'corporate depositary model' in which the compliance task was shared among the UCITS board of directors and the controlling duties performed by the depositary.[144]

Beyond the IOSCO governance standards, UCITSD I-IV allowed for a depositary exemption for specific cases of listed investment companies.[145]

The 'corporate depositary model' may under the AIFMD and UCITSD V still be applied,

---

[134] See UCITSD I; Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Van Damme Report'), 32, http://goo.gl/K0iUzv (accessed 13 October 2016).

[135] J. Winter, *Rapport Commissie Modernisering Beleggingsinstellingen*, December 2004, 43, http://parlis.nl/pdf/bijlagen/BLG4479.pdf (accessed 16 April 2017).

[136] *Ibid.*

[137] *Ibid.*

[138] A.B.R. Lancellotta, P.A. Pike & P.S. Stevens, *Fund Governance: A Successful, Evolving Model,* 10(3) Virginia Law & Business Review 455-489 (2016); C. Randall, *Fiduciary Duties of Investment Company Directors and Management Companies Under the Investment Company Act of 1940*, 31 Oklahoma Law Review 635 (1978).

[139] C.P. Buttigieg**,** *The Development of the EU Regulatory and Supervisory Framework applicable to UCITS: A Critical Examination of the Conditions and Limitations of Mutual Recognition***,** March 2014, 74, http://sro.sussex.ac.uk/48285/1/Buttigieg%2C_Christopher_P..pdf (accessed 7 April 2017).

[140] See C. Kremer & I. Lebbe, *Collective Investment Schemes in Luxembourg: Law and Practice* (Oxford 2014).

[141] See *infra* 4.2.1.

[142] C. Kremer & I. Lebbe, *Collective Investment Schemes in Luxembourg: Law and Practice* (Oxford 2014).

[143] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004, 7.

[144] See International Organization of Securities Commissions, *Examination of Governance for Collective Investment Schemes – Final report, Part I*, June 2006.

[145] Art. 15(2) UCITSD I.

whereas the 'board of directors model' and the listed investment company depositary exemption have been eradicated under the AIFMD and UCITSD V.

2.2.2. *The Contractual/Unit Trust Model*

UCITSD I-IV classified the 'contractual model' and 'unit-trust model' as set out by IOSCO[146] as a joint category. Nevertheless, the practical UCITSD I-IV depositary implementations do implement it in two distinct ways.

2.2.2.1. The Contractual Model

The 'contractual model', i.e. the depositary appointed for common UCITS funds was a model applied by a large amount of Member States with the 'continental legal tradition'[147], such as Germany[148].The 'contractual' model does not have a 'trustee'[149] nor a board of directors that can ensure legal compliance of the UCITS ManCos actions with the law and fund rules. Instead, a depositary is required to be appointed that has a full overview of the custody holding chain and is under strict conditions allowed to delegate safekeeping tasks. The full overview of the custody holding chain under this model allows the depositary to perform controlling tasks towards the UCITS ManCo. The controlling tasks, typically, are not allowed to be delegated by the depositary under the 'contractual model'.[150]

2.2.2.2. The Trust Model

The 'trust model' is a model under the UCITSD I-IV Member State implementations in which the independent oversight entity[151], i.e. the 'trustee' holding the legal title of the fund assets as an independent entity exercises controlling duties towards a UCITS ManCo, whereas the safekeeping is fully delegated to, mostly, credit institutions that perform the safekeeping task. Not requiring a single depositary, such as currently the AIFMD and UCITSD V, that may only under a strict delegation regime delegate (a part of) the safekeeping task, accommodated the 'trust model' under UCITSD I-IV. The Netherlands was an example that applied this model in practice. The so-called 'safekeeping entity' (bewaarentiteit) under Dutch law was a legal entity appointed for contractual UCITS that held the legal title on behalf of the joint investors to establish limited liability and asset segregation.[152] This

---

[146] International Organization of Securities Commissions, *Examination of Governance for Collective Investment Schemes – Final report, Part I*, June 2006.

[147] Marc Kruithof, *Deugdelijk Bestuur van Instellingen voor Collectieve Belegging (ICB):Governance als Invulling van de Loyauteit*, January 22 2007, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=961778 (16 April 2017).

[148] T.M.J. Möllers, *Umfang und Grenzen des Anlegerschutzes im Investmentgesetz - Der Trennungsgrundsatz und die Grenzen der Aufrechnung im InvG*, 9 BKR 353 (2011); See for the Netherlands: C.M. Grundmann-van de Krol, *Bescherming crediteuren beleggingsfonds: "trust" in artikel 16a Wtb*, 14 Ondernemingsrecht 486-488 (2005); See also:C.M. Grundmann-van de Krol, *De 'governance' van beleggingsinstellingen*, 6 TvOB 225-232 (2005); E.M. Jong & J.W. Winter, *Corporate governance voor beleggingsinstelling*, 3 TvE 29-35 (2004).

[149] See for definitions of 'custodians', 'depositaries' and 'trustees': International Organization of Securities Commissions, *Standards for the Custody of Collective Investment Schemes' Assets - Final Report,* November 2015, FR25/2015, 19, 20, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD512.pdf (accessed 16 April 2017).

[150] See for instance, the AIFMD and UCITSD V that are now applying the 'contractual model' to UCITS regardless of the legal form employed.

[151] International Organization of Securities Commissions, *Examination of Governance for Collective Investment Schemes - Independence Criteria, Empowerment Conditions and Functions to be performed by the 'Independent Oversight Entities', Part II*, February 2007.

[152] C.M. Grundmann-van de Krol, *Bescherming crediteuren beleggingsfonds: "trust" in artikel 16a Wtb*, 14 Ondernemingsrecht 486-488 (2005); W.A.K. Rank & B.Bierman, , *Aangaan van verplichtingen voor rekening van een FGR: aansprakelijkheid en verhaal*, 9 TvFR 299-310 (2008).

'safekeeping entity' acted similar as a 'trustee' in Anglo-Saxon jurisdictions by performing the controlling task on behalf of the joint investors, whereas the full safekeeping function was delegated to a specialized custodian.[153] This was accommodated under Dutch law as Dutch law copied the UCITSD I-IV in its law without any national goldplating[154] that left the industry with a large amount of discretion.[155]

The harmonized safekeeping task and the establishment of a strict delegation and liability regime under the AIFMD and UCITSD I-IV have eradicated this model.[156]

2.3. UCITSD V: Towards a Contractual Governance Model

UCITSD V adopted the 'contractual model' for all types of UCITS. Under this model the 'corporate depositary model' is also applied. Nevertheless, UCITSD V has introduced a level playing field depositary regime applying regardless of the legal entity in which the UCITS is established in.[157] To this extent, the eligible depositary entities, the safekeeping and monitoring obligations, the delegation and liability regime have been harmonized to such an extent that it accommodates the 'contractual model'.[158] Depositaries under UCITSD V are required to have an overview over all assets safekept in the custody holding chain in order to effectively perform a monitoring function over the UCITS ManCo. This effective overview results in stricter delegation and liability requirements as is the case for custodians under CRD IV and MiFID II that do not have an overview of the whole custody holding chain of assets of a particular client. A similar development is to be observed under the AIFMD.[159]

2.4. Conclusion

The function of the depositary was adopted in the original UCITSD I and dates back to 1985. It followed the recommendations of the 1970s, and the consequent implementation of those in certain Member State laws[160], in which a third party depositary was recommended for (contractual) collective investment schemes.[161] Under Article 7 and 14(1) UCITSD I, all UCITS were required to appoint 'depositary' for safe-keeping.[162] UCITSD I left Member States the option to exempt listed investment companies that complied with certain requirements from the compulsory depositary appointment.

UCITSD IV referred under Article 2(1)(a) UCITSD IV to 'an institution entrusted with the duties set out in Articles 22 and 32 and subject to the other provisions laid down in Chapter IV and Section 3 of Chapter V'. UCITSD I-IV, however, left over to individual Member

---

[153] See R.K. Th.J Smits, *De AIFMD-bewaarder; praktische gevolgen voor Nederlandse beleggingsinstellingen*, 11 V&O 200-204 (2012); J.W.P.M. van der Velden, *Babylonische Bewaarders*, 17 Ondernemingsrecht 173 (2009); Cf. the Dutch trust model for premium pension institutions (IORPs): R.K. Th.J Smits, *Vermogensscheiding bij premiepensioeninstellingen*, 1 V&O 1 (2012).

[154] Directorate General for Internal Policies, '*Gold-plating*' *in the EAFRD – To what extent do national rules unnecessarily add to complexity and as a result, increase the risk of errors*?, IP/D/ALL/FWC/2009-056, 27 February 2014, http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/490684/IPOL-JOIN_ET%282014%29490684_EN.pdf(accessed 14 January 2017); W. Voermans, *Gold-plating and double banking: an overrated problem?* 79-88 (H. Snijders & S. Vogenauer eds.Sellier European Law Publishers 2009).

[155] C.M. Grundmann-van de Krol, *Bescherming crediteuren beleggingsfonds: "trust" in artikel 16a Wtb*, 14 Ondernemingsrecht 486-488 (2005).

[156] See Chapter 4.

[157] S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2015).

[158] See *infra* 5.

[159] S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2015).

[160] D.A. Zetzsche. *Prinzipien der kollektiven Vermögensanlage* § 21 C. II. (Mohr Siebeck 2015).

[161] See Organisation for Economic Co-operation and Development, *Standard Rules for the Operations of Institutions for Collective Investment in Securities* (1971), [C (71) 234].

[162] See Art. 8(2)(3) UCITSD I.

States what 'institutions' under 'public control' would be eligible as a depositary.[163] In addition, the safekeeping duty was not further defined and the delegation and liability regimes were also left largely to the discretion of the UCITSD I-IV Member State implementations.[164] The 'safekeeping duty' for Dutch depositaries, for instance, was for contractual UCITS understood as 'holding the legal title on behalf of the joint investors'[165], whereas in the majority of Member States, such as Germany, for example, the safekeeping task was seen as performing the custodian task.[166] Finally, the depositary's delegation and liability also did not clarify whether and to what extent UCITS depositary's were responsible for carrying out the entrusted safekeeping and controlling task themselves.

The absence of a depositary definition[167] and the minimum harmonization nature of the depositary function under UCITSD I-IV resulted in various UCITS governance structures in which the 'depositary's tasks were assigned to different types of 'independent oversight entities' that could considered to be a 'depositary' under UCITSD IV.[168] In practice, three broad types of governance structures could be recognized: the corporate, contractual and trust model.[169] Under the corporate model, some Member States allowed a 'corporate depositary model' and others a 'board of directors model' to be employed. The 'corporate depositary model' allowed both the board of directors and a depositary to carry out controlling duties towards the UCITS ManCo, whereas under the 'board of directors model' the board of directors of the UCITS investment company solely performed the controlling task and the 'depositary' was, de facto, a 'compulsory prime custodian'. Under the contractual model, a 'trustee'[170] nor a board of directors that can ensure legal compliance of the UCITS ManCos actions with the law and fund rules was in place.[171] Instead, a depositary was required to be appointed for both the safekeeping and controlling task that had a full overview of the custody holding chain and was under strict conditions allowed to delegate safekeeping tasks. Finally, the 'trust model' was a model under the UCITSD I-IV Member State implementations in which the independent oversight entity[172], i.e. the 'trustee' holding the legal title of the fund assets as an independent entity exercises controlling duties towards a UCITS ManCo, whereas the safekeeping is fully delegated to, mostly, credit institutions that perform the safekeeping task.

---

[163] See for common funds: Art. 8(2) UCITSD I; for investment companies: Art. 15(2) UCITSD I.

[164] Committee of European Securities Regulators, *Mapping of duties and liabilities of UCITS depositaries (2010)*, CESR/09-175.

[165] J.W.P.M. van der Velden, *Babylonische Bewaarders*, 17 Ondernemingsrecht 173 (2009).

[166] See for Germany: T.M.J. Möllers, *Umfang und Grenzen des Anlegerschutzes im Investmentgesetz - Der Trennungsgrundsatz und die Grenzen der Aufrechnung im InvG*, 9 BKR 353 (2011); See for the Netherlands: C.M. Grundmann-van de Krol, *Bescherming crediteuren beleggingsfonds: "trust" in artikel 16a Wtb*, 14 Ondernemingsrecht 486-488 (2005).

[167] UCITSD IV referred under Article 2(1)(a) UCITSD IV to 'an institution entrusted with the duties set out in Articles 22 and 32 and subject to the other provisions laid down in Chapter IV and Section 3 of Chapter V'.

[168] International Organization of Securities Commissions, *Examination of Governance for Collective Investment Schemes - Independence Criteria, Empowerment Conditions and Functions to be performed by the 'Independent Oversight Entities', Part II*, February 2007.

[169] See cf. the controlling duties under other governance models: International Organization of Securities Commissions, *Examination of Governance for Collective Investment Schemes – Final report, Part I*, June 2006.

[170] See for definitions of 'custodians', 'depositaries' and 'trustees': International Organization of Securities Commissions, *Standards for the Custody of Collective Investment Schemes' Assets - Final Report,* November 2015, FR25/2015, 19, 20, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD512.pdf (accessed 16 April 2017).

[171] See D.A. Zetzsche, *(Prime) Brokerage* (D.A. Zetzsche ed, Kluwer 2015).

[172] International Organization of Securities Commissions, *Examination of Governance for Collective Investment Schemes - Independence Criteria, Empowerment Conditions and Functions to be performed by the 'Independent Oversight Entities', Part II*, February 2007.

Upon the adoption of UCITSD V, only the 'contractual model' and 'corporate depositary model' are allowed to be applied.

3. Pre-AIFMD Depositary/Custodian Regimes

Prior to the AIFMD, AIFs had been regulated by national regulatory regimes, which varied across Member States.[173] The approach towards AIFs of most Member States had been borrowed from UCITSD I-IV. Like under the UCITSD I-IV, national regulatory regimes for AIFs in the pre-AIFMD era typically regulated the establishment (product regulation), marketing and management of AIFs.[174] Many Member States also required the structural separation of the AIFM and depositary introduced by the UCITSD I-IV in 1985 for AIFs.[175] The extent the investment triangle as regulatory concept[176] that had been adopted differed from Member State to Member State. This had two main reasons. First, Member States differed in the regulatory scope of their national laws applying to AIFs, AIFMs and depositaries.[177] Second, the degree in which the investment triangle as regulatory concept was established throughout Member State differed as some Member States took an integrated approach in their regulation of collective investment undertakings (AIFs and UCITS), whereas other Member States had a product-based approach in which the approach towards depositaries depended upon 'fundtype'[178], i.e. the default 'product-type' (investment policy) and legal form employed by the AIF.

Some Member State, thus, subjected their pre-AIFMD liquid (non-UCITS 'mutual funds'), illiquid (real estate, venture capital and private equity funds) AIFs and AIFs applying substantial leverage (hedge funds) to a larger or lesser extent to the UCITS (depositary) regulatory regime, whereas the mandatory appointment, eligibility and the tasks of a depositary in other Member States varied per fundtype. It is obvious that the eligibility, tasks, delegation and liability of depositaries in the pre-AIFMD domain varied to an even larger extent than has been previously set out in this chapter for UCITS depositaries. The national AIF depositary regimes, however, were in quite some Member States modelled after their UCITSD I-IV depositary implementations. The issues faced were, thus, similar. For that reason, this chapter does not set out in detail the differences in the pre-AIFMD depositary rules. Instead, this chapter highlights the differences in scope of regulatory law and its impact on the regulation of pre-AIFMD depositaries. In addition, the non-compulsory depositary (custodian), the integrated and product-based approach in Member States will be addressed. Finally, this section concludes by explaining the AIFMD's 'contractual governance approach' towards depositaries.

3.1. The Diverging Scope of Pre-AIFMD Fund Regimes

---

[173] PricewaterhouseCoopers, *The realization of non-harmonized investment funds in the European Union: Prepared for European Commission DG Internal Market and Services*, http://ec.europa.eu/internal_market/investment/docs/other_docs/annex_non-harmonized_funds.pdf (accessed 3 July 2015).

[174] D.A. Zetzsche, *The Anatomy of European Investment Fund Law*, https://ssrn.com/abstract=2951681 (accessed 30 May 2017).

[175] J. Morley, *The Separation of Funds and Managers*, 123YALE L.J. 1228 (2014).

[176] D.A. Zetzsche, *Introduction* 15-17 (Kluwer 2015).

[177] See for an overview of the regulatory scope of various Member States prior to the AIFMD: E. Wymeersch, Alternative Investment Fund Regulation (Kluwer 2012).

[178] See for the terminology 'fundtype': D.A. Zetzsche, *Fondsregulierung im Umbruch – ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, ZBB 22 (2014).

The depositary/custodian regimes pre-AIFMD varied from Member State to Member State. This was due to the fact that AIFs were regulated on the national level. The scope of AIF regimes also differed from Member State to Member State. In the Netherlands, for example, most AIFs were exempted from the scope of the regulatory regime, whereas in France AIFs were regulated to a very large extent. The scope of regulatory law influenced the mandatory appointment of depositaries/custodians. Those AIFs exempted from the scope of regulatory law were not required to mandatory appoint depositaries/custodian. For the purpose of a better understanding of the pre-AIFMD depositary/custodian regimes throughout the EEA, the pre-AIFMD scope of regulatory regimes for AIFs in a couple of Member States will first be addressed.

3.1.1. *Austria*

The regulation of AIFs in Austria were covered by a number of legislative acts.[179] Open-end AIFs were established under co-ownership under the Austrian Investment Fund Act 2011.[180] The Austrian Investment Fund Act covered three types of AIFs: special funds (Spezialfonds)[181], other funds (Sonstige Fonds)[182] and Pension Funds (Pension Fonds)[183].[184] Special funds were required to be held by no more than 10 unit holders. The minimum amount invested by natural person was EUR 250,000. Other funds were characterized by its liberal investment policy (investment limits and diversification) and were used to establish fund of hedge funds and venture capital funds.[185] Single hedge funds were not permitted under Austrian law.[186]

Open-end real estate funds were regulated by the Austrian Real Estate Investment Funds Act[187], whereas the Austrian Equity Participation Funds Act was the legal basis for private equity and venture capital funds. The latter, however, did not include corporate private equity and venture capital funds.[188] For this reason, the majority of the private equity and venture capital funds fell outside the scope of regulatory law and, therefore, were only required to comply with Austrian company law.[189]

3.1.2. *France*

---

[179] Bundesgesetz über Investmentfonds (InvFG), BGBl. I 2011/77 (‘Austrian Investment Fund Act’); Bundesgesetz über Immobilienfonds (ImmoInvFG), BGBl. I Nr. 80/2003 (‘Austrian Real Estate Investment Funds Act’); Bundesgesetz vom 18. Februar 1982 über die Errichtung und Verwaltung von Beteiligungsfonds (Beteiligungsfondsgesetz), BGBl. I Nr. 111/1982 (‘Austrian Equity Participation Funds Act’).
[180] See J. Nicolussi, *Austria* 674 (D.A. Zetzsche ed, Kluwer 2012); See for the post-AIFMD situation: J. Nicolussi, *The AIFMD’s Transposition in Austria* (D.A. Zetzsche ed, Kluwer 2015).
[181] § 163-165 Austrian Investment Fund Act.
[182] § 166-167 Austrian Investment Fund Act.
[183] § 168-174 Austrian Investment Fund Act.
[184] J. Nicolussi, *Austria* 673 (D.A. Zetzsche ed, Kluwer 2012).
[185] J. Nicolussi, *Austria* 675 (D.A. Zetzsche ed, Kluwer 2012).
[186] See FMA Austria, *Hedge-Fonds: Bedeutung am Finanzplatz Österreich und regulatorischer Rahmen: Stand 16.11.2005* 76, http://www.fma.gv.at/typo3conf/ext/dam_download/secure.php?u=0&file=1942&t=1341897968&hash=c6c8f6ab4a8c35d7725a9f7a8c7e1cf5 (accessed 26 May 2017); See G. Dobrauz & P. Rosenauer, *Side Pockets als spezielle Instrumente zur außerordentlichen Liquiditätssteuerung von Fund of Hedge Funds*, 2 Zeitschrift für Finanzmarktrecht 65 (2010).
[187] § 1 Austrian Real Estate Investment Funds Act’
[188] *Ibid.*
[189] See J. Nicolussi, *Austria* 678 (D.A. Zetzsche ed, Kluwer 2012).

Prior to the AIFMD, France had a wide range of AIF fundtypes (referred to as non-coordinated UCITS; OPCVM non-coordinée).[190] Generally, France classified the different categories of AIFs based upon whether AIFs were required to be authorized or registered and the type of investors, i.e. the general public, professional investors or HNWIs, to which the AIF was allowed to be marketed to[191]. Non-coordinated 'UCITS' could be either classified as (1) authorized retail AIFs, (2) authorized AIFs marketed to professional investors and (3) registered AIFs marketed to professional investors and HNWIs.

The first category of authorized retail AIFs[192] comprised 'general purpose investment funds'[193] and venture capital funds.[194] The second category authorized AIFs marketed to professional investors included investment funds with liberalized investment policy (OPCVM a règles d'investissement alleges; ARIA), such as simple ARIA, Leveraged ARIA (ARIAEL) and funds of hedge funds (ARIA of alternative funds).[195] Finally, the third category registered AIFs marketed to professional investors and HNWIs were only subject to registration (OPCVM déclarés reserves a certains investisseurs). This type of AIFs included contractual AIFs, contractual FCPR and FCPRs with fewer regulatory restrictions.[196]

3.1.3. *Germany*

The Investment Act (InvG) only regulated AIFs of open-ended nature leaving closed-end not to be covered by the Investment Act.[197] The Investment Act included both professional AIFs (Spezialfonds) and retail (Publikumsfonds). Special funds could only be held by a limited number of institutional investors and were allowed to invest in all assets classes that the Investment Act provided.

The most important retail AIFs (Publikumsfonds) were the open-end real estate funds. Other retail types, including, amongst others, the mixed fund (gemischte sondervermögen), miscellaneous funds (Sonstige Sondervermögen) and funds of hedge funds (Dach-Hedgefonds) received little attention in practice.[198] Single hedge funds could not be marketed to the public, but were allowed to use leverage and short sales.[199]

Closed-ended funds were for the largest part only regulated under German private law law.[200] Examples of funds not regulated by the Investment Act included closed-end real estate and private equity funds. Some types of venture capital and private equity funds were (partly)

---

[190] C. Clerc & J. Deege, *France* (D.A. Zetzsche ed, Kluwer 2012); Cf. S. Puel, *France* (L. Van Setten & D. Busch eds, Oxford 2014); See C. Clerc, *The AIFMD's Transposition in France* (D.A. Zetzsche ed, Kluwer 2015).

[191] A. Couret, *France (*E. Wymeersch ed, Kluwer 2012); C. Clerc & J. Deege, *France* 724 (D.A. Zetzsche ed, Kluwer 2012).

[192] L. 241-28-L. 214-32 CMF.

[193] L. 214-27 CMF.

[194] Venture capital funds were known as FCPIs (fonds communs de placement placement a risques) and included innovation funds (fonds communs de placement dans l'innovation; FCPIs) and regional investment funds (fonds d'investissement de proximité); C. Clerc & J. Deege, *France* 724 (D.A. Zetzsche ed, Kluwer 2012).

[195] A. Couret, *France* 113 *(*E. Wymeersch ed, Kluwer 2012);

[196] C. Clerc & J. Deege, *France* 724 (D.A. Zetzsche ed, Kluwer 2012).

[197] S. Staat, *Germany* (D.A. Zetzsche ed, Kluwer 2012); D.A. Zetzsche. *Prinzipien der kollektiven Vermögensanlage* § 15 A. IV. 2 A) (Mohr Siebeck 2015); T. Paul & C. Schmies, *Germany* (L. Van Setten & D. Busch eds, Oxford 2014).

[198] See T. Paul & C. Schmies, *Germany* 184 (L. Van Setten & D. Busch eds, Oxford 2014); See T. Emde, *The Transposition of the AIFMD in Germany* (D.A. Zetzsche ed, Kluwer 2015).

[199] See H. Fleischer & J. Hupka, *Germany* 197 *(*E. Wymeersch ed, Kluwer 2012).

[200] D.A. Zetzsche. *Prinzipien der kollektiven Vermögensanlage* § 15 A. IV. 2 b) (Mohr Siebeck 2015).

regulated under the Private Equity and Venture Capital Act.[201] These two laws were, however, hardly used in practice.[202]

3.1.4. *Ireland*

Prior to the AIFMD, Irish AIFs were regulated by various product regulations and fundtypes.[203] Product regulations applicable to the AIF concerned depended upon the legal form employed. AIFs could be established as investment company[204], unit trust[205], a common contractual fund[206] or an investment limited partnership[207].[208]
On top of these product regulations, the NU Notices[209] regulated the specific fundtype in which a particular AIF could be classified. 'Regulated AIFs' included non-UCITS retail funds, QIFs ('qualified investor fund') and PIFs ('professional investor fund'). AIFs could also be 'unregulated AIFs'.

The fundtype non-UCITS retail funds applied to all AIFs with a minimum subscription of less than EUR 100,000.[210] The investment diversification and borrowing restrictions, however, were very similar to UCITS.[211] The availability of the UCITS marketing passport led to fund sponsors preferring UCITS funds over non-UCITS retail funds.[212] QIFs and PIFs that targeted qualifying and professional investors applied a more liberal investment policy regime.[213]

The Irish Central Bank on request could allow PIFs on a case-by-case basis to derogate from the non-UCITS retail AIF investment restrictions and risk spreading rules.[214] To qualify as PIF, a minimum subscription of EUR 100,000 was required.[215] There was not a definition of 'professional investors'. All investors that could afford themselves the minimum subscription were considered to be professional investors. The Irish Central Bank, in practice, did not completely exempt PIFs from the non-UCITS retail AIF restrictions, but applied a rule of thumb of granting PIFs twice the latitude that was granted to non-UCITS retail AIFs.[216]

---

[201] See H. Fleischer & J. Hupka, *Germany* 197 (E. Wymeersch ed, Kluwer 2012).
[202] D.A. Zetzsche. *Prinzipien der kollektiven Vermögensanlage* § 15 A. IV. 2 A) (Mohr Siebeck 2015).
[203] S. Horan, *Ireland* (D.A. Zetzsche ed, Kluwer 2012); See for post-AIFMD fundtypes: M. Jackson & D. Counihan, *Ireland* (L. Van Setten & D. Busch eds, Oxford 2014).
[204] Part XIII of the Companies Act 1990.
[205] Units Trusts Act 1990.
[206] Investment Limited Partnership Act 1994.
[207] Investment Funds, Companies and Miscellaneous Provisions Act 2005.
[208] Post-AIFMD, the ICAV was added to the available types of legal forms for AIFs. M. Jackson & D. Counihan, *Ireland* (L. Van Setten & D. Busch eds, Oxford 2014).
[209] Central Bank of Ireland, *NU Series of Notices – Conditions imposed in relation to Collective Investment Schemes Other than UCITS*, May 2013, https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/Funds/Non-UCITS/nu-series-of-notices.pdf?sfvrsn=2 (accessed 28 May 2017).
[210] Central Bank of Ireland, *NU 12 Schemes marketing solely to professional investors,* https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/Funds/Non-UCITS/nu-series-of-notices.pdf?sfvrsn=2 (accessed 28 May 2017).
[211] Central Bank of Ireland, *NU 13 General Investment Restrictions*, https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/Funds/Non-UCITS/nu-series-of-notices.pdf?sfvrsn=2 (accessed 28 May 2017).
[212] See M. Jackson & D. Counihan, *Ireland* 238 (L. Van Setten & D. Busch eds, Oxford 2014).
[213] Cf. Central Bank or Ireland, *AIF Rulebook,* March 2017, https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/funds-service-providers/aifm/AIFM/aif-rulebook-march-2017-%28002%29.pdf?sfvrsn=2 (accessed 28 May 2017).
[214] Central Bank, *NU 12 Schemes marketing solely to professional investors,* https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/Funds/Non-UCITS/nu-series-of-notices.pdf?sfvrsn=2 (accessed 28 May 2017).
[215] *Ibid.*
[216] See M. Jackson & D. Counihan, *Ireland* 238 (L. Van Setten & D. Busch eds, Oxford 2014).

QIFs were automatically granted a derogation from the general investment and borrowing restrictions applying to non-UCITS retail AIFs (the default investment restrictions).[217] QIFs were only allowed to be marketed to qualifying investors that met the initial minimum subscription requirement of EUR 100,000 and satisfied the 'qualifying investor' criteria of NU 24 Notice.[218] The liberal investment policy made QIFs the preferred vehicle for highly leveraged (hedge)funds, private equity, venture capital and real estate AIFs.[219]

Private equity and real estate funds were typically established as regulated AIFs. Unregulated AIFs could be established on the basis of the Limited Partnership Act 1907. Unauthorized (unit) trust structure were not available and the restrictions of repurchasing outstanding shares under general Irish company law prevented unregulated AIFs from establishing themselves as an ordinary Irish company.[220] Similarly, regulated AIFs established under the Investment Limited Partnership remained to be the preferable structure for private equity and venture capital AIFs as Limited Partnerships under the Limited Partnership Act were only allowed to have 20 limited partners.[221]

3.1.5. *Italy*

Italy only allowed AIFs that were falling within the scope of one of its fundtypes to be marketed to investors.[222] Fundtypes provided under Italian law depended upon, inter alia, the investment policy, investor category and whether the fund was open- or closed-ended.[223]

The Italian TUF provided for five types of AIFs: (1) non-harmonized open-ended funds (fondi non armonizzati aperti)[224], (2) closed-ended AIFs (fondi comuni mobiliari chiusi)[225], (3) funds reserved for special categories of investors (fondi riservati)[226], (iv) guaranteed funds (fondi garantiti)[227] and (4) speculative funds (fondi speculativi)[228].

Non-harmonized open-ended funds (AIFs) were Italian retail AIFs that could be seen as non-UCITS retail schemes (known in the UK as NURS) of which the investment policies and restrictions were similar but more liberal compared to UCITS.[229]

Closed-end AIFs, including real estate AIFs, were AIFs that invested at least 10% of their assets in, amongst others, real estate and claims.[230]

Reserved funds, either open- or closed-end AIFs were AIFs that were reserved for special categories of investors, including credit institutions, investment companies, financial entities and other entities/persons that were qualified in dealing with financial matters.[231] The

---

[217] Central Bank of Ireland, *NU 24 Schemes which market solely to Qualifying Investors and which are not bound by the limits relating to Investment Objectives and Policies as set out in these Notices,* https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/Funds/Non-UCITS/nu-series-of-notices.pdf?sfvrsn=2 (accessed 28 May 2017).
[218] *Ibid.*
[219] See M. Jackson & D. Counihan, *Ireland* 237 (L. Van Setten & D. Busch eds, Oxford 2014).
[220] *Ibid.*
[221] Could be extended to 50. See the Partnership Act 1907.
[222] G. Stefanin & F. della Scala, *Italy* (D.A. Zetzsche ed, Kluwer 2012); R. Lener, *Italy (*E. Wymeersch ed, Kluwer 2012); These fundtypes are maintained in the Italian AIFMD implementation. See F. Crocenzi, *Italy* 277 (L. Van Setten & D. Busch eds, Oxford 2014); See also R. Lener & C. Petronzio, *The AIFMD's Transposition in Italy* (D.A. Zetzsche ed, Kluwer 2015).
[223] Title 5, Chapter 3 Regulation 8 May 2012.
[224] Art. 9 Regulation 8 May 2012.
[225] Art. 12bis Regulation 8 May 2012.
[226] Art. 15b Regulation 8 May 2012.
[227] Art. 15bis Regulation 8 May 2012.
[228] Art. 16 Regulation 8 May 2012.
[229] G. Stefanin & F. della Scala, *Italy* (D.A. Zetzsche ed, Kluwer 2012).
[230] Title 5, Chapter 3, Section 5 Regulation 8 May 2012.
[231] Title 5, Chapter 3, Section 6 Regulation 8 May 2012.

investment policy and diversification requirements were relaxed compared to other types of funds.[232]

Guaranteed funds were either open-end or closed-end AIFs and were allowed to be marketed to both retail and professional investors.[233] The investment policy of guaranteed funds was subject to strict requirements including investment policy limitations and diversification requirements. The main character of these funds was that this type of AIF guaranteed a minimum return on the basis of, for instance, derivative agreements with credit institutions or other financial intermediaries.[234]

Speculative funds were AIFs with less than 200 investors that were retail/professional investors investing at least EUR 500,000 in the AIF.[235] Prior to the AIFMD, these AIFs were not subject to any other restrictions regarding its investment policy other than its constitutive documents.[236]

3.1.6. *Liechtenstein*

Under the 2005 Investment Undertakings Act and Ordinance Liechtenstein had two types of AIFs:[237] 'investment undertakings for other values' (even with increased risk) and 'investment undertakings for real estate'.[238]

Investment undertakings for other values were allowed to invest in volatile illiquid investments that were difficult to valuate and had limited risk diversification.[239] Examples of permissible investments included precious metals, commodities, and derivative financial instruments.[240]

'Investment undertakings for other values with increased risk' had a higher risk profile on the basis of their investment policy.[241] In comparison with the former type of AIF, they required special licensing conditions, checks, a description of their investment policy and investment risk.[242]

Real estate AIFs were allowed to invest in real estate based upon the principle of diversification.[243]

Either of these AIFs could be exempted from several Investment Undertakings Act provisions if they qualified as 'investment undertakings for qualified investors', including:[244]

- authorization requirement;[245]
- obligation to draw up full and simplified prospectuses;[246]
- obligation to draw up a half-yearly report;[247]

---

[232] *Ibid.*
[233] Art. 15*bis* Regulation 8 May 2012.
[234] *Ibid.*
[235] Title 5, Chapter 3, Section 7 Regulation 8 May 2012.
[236] *Ibid.*
[237] Art. 2(1)(a) Investment Undertakings Act;D.A. Zetzsche. *Prinzipien der kollektiven Vermögensanlage* § 15 A. IV. 4 (Mohr Siebeck 2015); P.A. Wirth &D. Erny, *Der Fondsplatz Liechtenstein im internationalen Vergleichmit der Schweiz und Luxemburg* (Luzern 2010); See for the definitions of investment fund and company: Art. 4(1)(a) and (b) Investment Undertakings Act.
[238] Cf. G. Dobrauz-Saldapenna & C. Tettamanti, *Liechtenstein* (D.A. Zetzsche ed, Kluwer 2012); Post-AIFMD: G. Dobrauz-Saldapenna, A. Schwertschlag & P. Rosenauer, *The AIFMD's Transposition in Liechtenstein* (D.A. Zetzsche ed, Kluwer 2015).
[239] Art. 42(2) Investment Undertakings Act.
[240] Art. 42(2) Investment Undertakings Act.
[241] Art. 44 Investment Undertakings Act.
[242] Art. 44 Investment Undertakings Act.
[243] Art. 45 Investment Undertakings Act.
[244] Art. 28 Investment Undertakings Ordinance.
[245] Art. 28(1)(a) Investment Undertakings Ordinance.
[246] Art. 28(1)(b) Investment Undertakings Ordinance.

- obligation to compile an inventory of assets in the business report;[248]
- publication obligation.[249]

AIFs that were exclusively marketed to qualified investors qualified as 'investment undertakings for qualified investors'.

3.1.7. *Luxembourg*

Prior to the AIFMD, Luxembourg allowed regulated AIFs to be established by means of three fund structures: Part II Funds, SIFs and SICARs.[250]

AIFs (UCIs other than UCITS) were governed by Part II of the UCI Luxembourg law of 17 December 2010 unless they were established on the basis of the SIF or SICAR Law.[251] UCIs could be established as open- or closed-end AIF and their investment policy was not limited by types of eligible assets.[252] The eligible assets were, however, subject to prior authorization by the CSSF.[253] UCIs other than UCITS were required to comply with diversification requirements[254] and possible restrictions applied to UCIs adopting alternative investment strategies.[255]

SIFs[256] were authorized AIFs that do not limit the eligibility of asset classes nor apply any other restrictions by means of a risk diversification obligation. SIFs were, thus, allowed to pursue all investment strategies.[257] Investors allowed to invest in SIFs were, however, restricted to (1) institutional, (2) professional and (3) well-informed investors.[258] SIFs were, thus, used in practice for both hedge funds and private equity.[259]

SICARs[260] (sociéte d'investissement en capital risque) were investment companies investing in risk capital.[261] They were only be marketed to well-informed investors.[262] Its investment policy was aimed at investing in risk capital and the direct or indirect contribution to the development or listing of entities in which it invested.[263] SICARs were not allowed to invest in hedge funds and listed securities.[264]

---

[247] Art. 28(1)(c) Investment Undertakings Ordinance.
[248] Art. 28(1)(d) Investment Undertakings Ordinance.
[249] Art. 28(1)(e) Investment Undertakings Ordinance.
[250] D.A. Zetzsche. *Prinzipien der kollektiven Vermögensanlage* § 15 A. IV. 1 (Mohr Siebeck 2015); T. Partsch & E. Havrenne, *Luxembourg* (D.A. Zetzsche ed, Kluwer 2012); I. Lebbe & P.E. Partsch, *Luxembourg (*E. Wymeersch ed, Kluwer 2012); Cf. C. Kremer, M. Eisenhuth, G. Dusemon & C. Martougi, *Luxembourg* 318 (L. Van Setten & D. Busch eds, Oxford 2014).
[251] Circulars and regulations issued by the CSSF complemented the regulatory framework by clarifying the implementation of different legal provisions governing the supervised entities.
[252] They could be established as a SICAV, SICAF, SARL, SCS or FCP; See D.A. Zetzsche. *Prinzipien der kollektiven Vermögensanlage* § 15 A. IV. 1 (Mohr Siebeck 2015).
[253] See I. Lebbe & P.E. Partsch, *Luxembourg* 262 *(*E. Wymeersch ed, Kluwer 2012).
[254] Risk diversification requirements were determined by IML Circular n° 91/75.
[255] Specific restrictions concerning funds adopting an alternative investment strategy were contained in CSSF Circular n° 02/80.
[256] I. Lebbe & P.E. Partsch, *Luxembourg* 263 *(*E. Wymeersch ed, Kluwer 2012).
[257] C. Kremer, M. Eisenhuth, G. Dusemon & C. Martougi, *Luxembourg* 320 (L. Van Setten & D. Busch eds, Oxford 2014); I. Lebbe & P.E. Partsch, *Luxembourg* 263, 264 *(*E. Wymeersch ed, Kluwer 2012).
[258] I. Lebbe & P.E. Partsch, *Luxembourg* 263 *(*E. Wymeersch ed, Kluwer 2012).
[259] *Ibid.*
[260] I. Lebbe & P.E. Partsch, *Luxembourg* 265 *(*E. Wymeersch ed, Kluwer 2012).
[261] Art. 1 SICAR Law 2007.
[262] Art. 2(1) SICAR Law 2007.
[263] I. Lebbe & P.E. Partsch, *Luxembourg* 264 *(*E. Wymeersch ed, Kluwer 2012).
[264] *Ibid.*

Luxembourg allowed also allowed certain types of private equity AIFs to be established as a commercial corporate vehicle referred to as SOPARFI (société de participations financières). A SOPARFIs general purpose was to hold and manage financial participations in other undertakings and was subject to the law of 10 August 1915 on commercial companies.265 This was a so-called 'unregulated AIF'.

3.1.8. *The Netherlands*

In the Netherlands all AIFs that were exclusively marketed to 'qualified investors' only[266] were exempted[267] from regulatory law.[268] The Dutch regulatory regime prior to the AIFMD prohibited an AIFM from offering units/shares in an (retail) AIF (*beleggingsinstelling*) in the Netherlands (or, in the case of an investment company without a separate manager, the investment company) without having an authorization granted by the Dutch Financial Market Authority (*Autoriteit Financiële Markten*, AFM).[269]

An AIF[270] was defined as either an investment company (*beleggingsmaatschappij*) or a contractual fund (*beleggingsfonds*). Investment companies and contractual funds qualified as AIFs if they 'requested or acquired funds other goods for collective investment in order to have the unit-holders share in the return on the investments'.[271] Funds, such as private equity funds (including buy-out and venture capital funds) undertaking entrepreneurial activities, therefore, did not qualify as AIFs and were, consequently, not obliged to be authorized under the FMSA.[272]

AIFs not exclusively being marketed to 'qualified investors' still could benefit from broad exemptions under the Exemption Regulation FMSA (*Vrijstellingsregeling Wft*)[273] exemptions. Offerings of units/shares in retail AIFs marketed to fewer than 100 persons and shares or units of the fund with a minimum denomination of EUR 100,000. or which could only be acquired against a minimum consideration of EUR 100,000 were also exempted from the authorization requirement.

Most AIFs in the Netherlands, including hedge and private equity funds, which were marketed in the Netherlands prior to the AIFMD were entitled to rely upon the abovementioned exemptions. AIFs that were offered on the basis of an exemption still had to comply with specific selling restrictions and standardized mandatory warnings (the so called

[265] SOPARFIs were generally structured under the 1915 Company Law as corporate partnerships limited by shares (société en commandite par action; SCA), public limited liablity companies (société anonyme ; SA), private limited liability companies (société à responsabilité limitée ; SARL), common limited partnerships (société en commandie simple ; SCS) and special limited partnerships (société en commandite spéciale ; SCSp).
[266] See Art. 1:12(1) FMSA (old). The term 'qualifying investor' (*gekwalificeerde belegger*) is defined in Art. 1:1 FMSA.
[267] AIFMs and AIFs were exempted from manager and product regulation.
[268] This paragraph has been earlier published in: S.N. Hooghiemstra, *The Netherlands* (D.A. Zetzsche ed, Kluwer 2012).
[269] Post-AIFMD the regime has changed significantly. See K. Groffen & B. Spoor, *Netherlands* (L. Van Setten & D. Busch eds, Oxford 2014); See also S.N. Hooghiemstra, *The AIFMD's Transposition in the Netherlands* (D.A. Zetzsche ed, Kluwer 2015).
[270] Art. 1:1 FMSA (old) referred to an AIF as an investment company (*beleggingsmaatschappij*) or a contractual fund (*beleggingsfonds*).
[271] See for a definition on investment company (*beleggingsmaatschappij*) and contractual fund (*beleggingsfonds*) Art. 1:1 FMSA (old).
[272] See for a more detailed explanation Groffen, Spoor & van der Velden, 468-471. See also J. den Hamer & L. Ait Youss, *Ondernemen of beleggen?*, VGR 132 (2010).
[273] Regulation of 15 November 2006 (Official Gazette 23 Nov. 2006, no. 229) (old).

'Wild West Warning'). When applicable, these had to be inserted in the fund documentation, prospectuses and marketing materials.[274]

3.1.9. *Spain*

Prior to the AIFMD, Spanish AIFs could be set up as either 'financial', real-estate or private equity/venture capital AIFs.[275]

'Financial AIFs' were Spanish mutual funds that do not apply the UCITS limitations on investments. They could be set up as open-ended investment companies (sociedades de inversión de capital variable; SICAVs)[276] or a common fund (fondos de inversión; FI)[277].

Real estate AIFs in Spain had as their main investment purpose real estate assets. They could be established as closed-ended real estate Investment companies (sociedades de inversión inmobiliaria, SII)[278] and real estate investment funds (fondos de inversión inmobiliaria; FII).[279]

Private equity/venture capital AIFs was a fundtype that was allowed to invest in non-listed companies that were of a non-financial and non-real estate nature.[280] They could be established as private equity/venture capital investment companies (sociedades de capital-riesgo; SCR) and private equity/venture capital funds (fondos de capital-riesgo; FCR).[281] In addition to the basic financial, real-estate or private equity/venture capital AIFs, hedge funds (IIC de inversión libre; IICIL)[282] and funds of hedge funds(IIC de IIC de inversión libre; IICIICIL)[283] could be set up.

3.1.10. *UK*

Prior to the AIFMD, the UK 's definition of 'collective investment scheme' was very broadly defined.[284] The scope of this definition was, however, reduced by a number of exemptions, including, amongst others, bodies corporate that are not open-ended investment companies.[285] The latter would be, for example, closed-ended funds organized as investment trust companies and venture capital trusts.[286] Apart from this, the UK only required a limited amount of funds to be authorized. There were so-called 'regulated schemes' and 'unregulated schemes'.[287] Regulated schemes included authorized unit trust schemes ('AUTs')[288], open-ended investment companies ('OEICs')[289] and recognized schemes[290].

---

[274] The FMSA, with exception of Part 1, Art. 3:7, and Chapters 5.1, 5.3, 5.4 and 5.5. were not applicable to these AIFM/AIFs.
[275] R.P. Laguna, *Spain (*E. Wymeersch ed, Kluwer 2012); See for the Spanish AIFMD implementation: K. S. Ruiz-Bachs & E. Diaz-Ruiz, *Spain* (L. Van Setten & D. Busch eds, Oxford 2014).
[276] Art. 32, 33 Spanish Fund Law (Law 35/2003).
[277] Art. 3 Spanish Fund Law (Law 35/2003).
[278] Art. 37 Spanish Fund Law (Law 35/2003).
[279] Art. 38 Spanish Fund Law (Law 35/2003).
[280] Spanish Private Equity Law (Law 25/2005).
[281] Art. 1 Spanish Private Equity Law (Law 25/2005).
[282] Art. 33bis Spanish Private Equity Law (Law 25/2005).
[283] Art. 33ter Spanish Private Equity Law (Law 25/2005).
[284] S. 235FSMA, s 235; See also J. Greig, *United Kingdom* (D.A. Zetzsche ed, Kluwer 2012).
[285] The Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 (SI 2001/1062); H. McVea, *United Kingdom (*E. Wymeersch ed, Kluwer 2012); Cf. D. Rouch, *United Kingdom* (L. Van Setten & D. Busch eds, Oxford 2014).
[286] D. Rouch, *United Kingdom* 126 (L. Van Setten & D. Busch eds, Oxford 2014); See also J.R. Siena & D. Eckner, *The AIFMD's Transposition in the United Kingdom* (D.A. Zetzsche ed, Kluwer 2015).
[287] D.A. Zetzsche. *Prinzipien der kollektiven Vermögensanlage* § 15 A. IV. 3 (Mohr Siebeck 2015).
[288] Authorised unit trusts (AUTs) established under trust law and authorized by the FCA under S. 243 FSMA.
[289] Open-end investment companies (OEICs), also known as investment companies with variable capital (ICVCs). These are established and authorized by the FCA under the Open-End Investment Companies Regulations 2001 (SI 2001/1228).

In practice, this implied that, in order to be authorized in the UK, an AIF (OEIC or AUT) had to qualify as a non-UCITS retail scheme (NURS) (including a NURS operating as a fund of alternative investment funds (FAIF))[291] or a qualified investor scheme (QIS).[292]

AIFs in the UK could also be unregulated funds that were not authorized or 'recognized by the regulator' (although the fund manager would typically be authorized or regulated).[293] Common unregulated fund structures include unauthorized unit trusts[294], limited partnerships[295] and investment trusts[296].

3.1.11. *Conclusion*

The scope of the pre-AIFMD AIF regimes varied from Member State to Member State. Some Member States, such as France, regulated AIFs and AIFMs to a large extent, whereas others, such as the Netherlands, hardly regulated these at all. The scope of regulatory law influenced the mandatory appointment of depositaries/custodians. The AIFs exempted from the scope of regulatory law were not required to appoint depositaries/custodians.

3.2. Pre-AIFMD Depositary/Custodian Regimes

Pre-AIFMD depositary/custodian regimes varied in the degree in which the investment triangle as regulatory concept was established throughout Member States.[297] A few Member States did not require the appointment of a depositary.[298]

Some Member States took an integrated approach in their regulation of collective investment undertakings (AIFs and UCITS), whereas other Member States had a product-based approach in which the approach towards depositaries depended upon 'fundtype'[299], i.e. the default 'product-type' (investment policy) and legal form employed by the AIF. The role between AIFMs, prime brokers and depositaries also depended heavily upon the (product) regulation of substantially leveraged AIFs.[300]

3.2.1. *No Depositary Requirement for AIFs*

The Netherlands served as an example of a Member State in which no depositary requirement for regulated and non-regulated AIFs was being applied.[301] Prior to the AIFMD,

---

[290] COLL 1A.1.3 G.
[291] H. McVea, *United Kingdom* 258-259 (E. Wymeersch ed, Kluwer 2012.
[292] H. McVea, *United Kingdom* 260 (E. Wymeersch ed, Kluwer 2012.
[293] D.A. Zetzsche. *Prinzipien der kollektiven Vermögensanlage* § 15 A. IV. 3 b) (Mohr Siebeck 2015).
[294] Unit trusts that have not been authorized by the FCA under S. 243 FSMA.
[295] A limited partnership is a partnership registered in accordance with the Limited Partnerships Act 1907.
[296] D.A. Zetzsche. *Prinzipien der kollektiven Vermögensanlage* § 15 A. IV. 3 b) (Mohr Siebeck 2015).
[297] Prior to the AIFMD, the French provisions relating to UCITS depositaries, for example, also applied to AIF depositaries (Art. L. 214-24-1 CMF). The French regulation applicable to depositaries was set forth in the sections of the French Monetary and Financial Code relating to UCITS (Art. L. 214-10 et seq. CMF) and in Art. 323-1 et seq. AMF Regulation.
[298] S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013).
[299] See D.A. Zetzsche, *Fondsregulierung im Umbruch – ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, ZBB 22 (2014).
[300] European Commission, *Report of the Alternative Investment Expert Group - Managing, Servicing and Marketing Hedge Funds in Europe*, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/hedgefunds_en.pdf (accessed 29 May 2017).
[301] This paragraph has been earlier published in: S.N. Hooghiemstra, *The Netherlands* (D.A. Zetzsche ed, Kluwer 2012).

the mandatory appointment of a *bewaarder* was mistakenly being seen as a 'depositary' in Dutch legal practice.[302] The Dutch *bewaarder* under the FMSA was- in contrast to UCITS - only obliged to be appointed by AIFMs that were managing contractual AIFs.[303] The *bewaarder* was a legal person functioning as an SPV, that held the legal title to and administrated the assets in which an AIF invested.[304] Assets of contractual funds were to be held by this entity exclusively for that contractual fund if there was a real risk under the investment policy of the common fund concerned and the common fund and the equity capital of the depositary were insufficient to cover all claims.[305] The *bewaarder,* thus, functioned as a trustee of contractual AIFs by holding the legal title to its assets and was not entrusted with the safekeeping and controlling duties within the meaning of Article 21 AIFMD.[306] The safekeeping of financial instruments that can be held in custody was in practice being delegated to credit institutions.[307] The Dutch FSMA did not require equivalent controlling tasks, such as those referred to in Article 21 AIFMD, to be exercised by the *bewaarder* nor by the credit institution appointed as custodian.

3.2.2. *One-size Fits all Approach*

France, Italy, Liechtenstein and Spain subjected all their AIFs to the coherent UCITS depositary regulatory framework.[308] The abovementioned depositary requirements of these Member States did not differentiate on the basis of the legal form and investment policy employed for AIFs. The depositaries responsibility and liability in these Member States did not vary for AIFs regardless whether they were investing in liquid, illiquid assets or substantial leverage.[309] They applied a one-size-fits all approach towards depositaries.

Common requirements regarding the depositary regulatory framework included:[310]

- the obligation to appoint a single depositary for all types AIFs;[311]
- the eligibility of credit institutions (and investment firms) as a depositary;[312]

---

[302] Van der Velden referred to the different interpretation of the 'depositary' in Dutch legal practice compared to other European Member States as a 'babylonian confusion of tongues': J.W.P.M. van der Velden, *Babylonische bewaarders*, 17 Ondernemingsrecht 173(2009).
[303] S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013).
[304] Art. 4:44, 4:45 FMSA (old). See S.N. Hooghiemstra, *The Netherlands* (D.A. Zetzsche ed, Kluwer 2012).
[305] This ranking of claims preserves the segregation of the AIF's assets from the estate of the participants, the AIFM and the depositary (SPV) itself. See Art. 4:45 FSMA (old).
[306] S.N. Hooghiemstra, *The AIFMD's Transposition in the Netherlands* (D.A. Zetzsche ed, Kluwer 2015).
[307] Only credit institutions may exercise the safekeeping tasks under the Dutch implementation of MiFID I/II. The *bewaarder* was for UCITS mandatorily to be appointed for both corporate and contractual UCITS. Unlike for AIFs, the *bewaarder* was, however, assigned to perform controlling duties, whereas the safekeeping could be fully delegated to a credit institution acting as a custodian. See J.W.P.M. Van der Velden, *Beleggingsfondsen naar Burgerlijk recht* 129-185 (Kluwer 2008).
[308] France: Art. L. 214-10 et seq. CMF; Germany: :§ 20(1)et seq. Investment Act;
Italy: Art. 47(1) Consolidated Law on Finance (2012 version);Spain: Art. 58(1) Spanish Fund Law (Law 35/2003).
[309] See D.A. Zetzsche, *Scope of the AIFMD* 82 (D.A. Zetzsche ed, Kluwer 2012).
[310] Remarkably these Member States have in common that their asset management industries have historically strong roots in the banking industry. See D.A. Zetzsche, *(Prime) Brokerage* 496, 497 (D.A. Zetzsche ed, Kluwer 2012); See also: M. Kruithof, *Deugdelijk Bestuur van Instellingen voor Collectieve Belegging (ICB): Governance als Invulling van de Loyauteit*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=961778 (16 April 2017).
[311] France: L. 214-10 CMF; Germany:§ 20(1),(2) Investment Act;Italy: Art. 47(1) Consolidated Law on Finance (2012 version).
[312] France: Art. L214-24-5 CMF; Germany:§ 20(1),(2) Investment Act; Italy: Art. 47(2) Consolidated Law on Finance (2012 version); Liechtenstein: Art. 30(1) Investment Undertakings Act;Spain: Art. 58(1) Spanish Fund Law (Law 35/2003).

- the safekeeping of all the AIFs' assets;[313]
- the verification of the AIFM's compliance with the law (UCITS contractual fund controlling duties);[314] and
- (absolute) responsibility over the AIF's assets and the sub-custodian network.[315]

Like for UCITS, the compulsory appointment of a depositary for AIFs ensures that at any time a comprehensive and up-to-date overview can be made of all assets that belong to the AIF and reduces the risk of fraud and operational risks of AIFs.[316] Despite of this, France, Italy, Liechtenstein and Spain had been using the same limitedly harmonized depositary regulatory framework for AIFs as for pre-UCITSD V UCITS.[317] The same divergent approach in these Member States as regard to which entities were allowed to act as a depositary, the duties and responsibilities that depositaries had and under which conditions these responsibilities could be delegated and the liability for lost assets caused legal uncertainty and different levels of investor protection in the EEA for AIFs as for UCITSD in the pre-UCITSD V.[318]

3.2.3. *Product-based Approach*

Member States, including Austria, Germany, Ireland, Luxembourg and the UK took a product-based approach. The tasks and responsibilities of the depositary in these Member States were to a larger or lesser extent based upon the legal form and investment policy (liquid, illiquid, substantial leverage employed) of the AIF concerned.

3.2.3.1. Austria

Austria had a separate depositary regime for the three types of AIFs covered under the Investment Fund Act (InFG 2011), at the one hand, and the open-end real estate funds, at the other hand.[319] The Austrian UCITS depositary regulatory framework was being imposed on special funds (Spezialfonds)[320], other funds (Sonstige Fonds)[321] and Pension Funds (Pensionsfonds)[322].The Real Estate Fund act provided for open-end Real Estate Funds (§ 35 Immobilien-Investmentfondsgesetz).[323] The Real Estate Fund act demanded for these type of AIFs a credit institution authorized to safekeep financial instruments that can be held in custody.[324] Similarly as under the Investment Fund Act, the depositary was responsible for the safekeeping of assets of the open-end real estate AIF, cash management and controlling tasks

---

[313] France: Art. L. 214-10 CMF; Germany: § 24 Investment Act;Italy: Art. 48(2) Consolidated Law on Finance (2012 version).TUF (2012 version); Liechtenstein: Art. 31(1) Investment Undertakings Act; Spain: Art. 60bis, 62bis Spanish Fund Law (Law 35/2003).

[314] France: L. 214-10 CMF; Italy: Art. 48(3) Consolidated Law on Finance (2012 version).TUF (2012 version); Liechtenstein: Art. 31(2) Investment Undertakings Act; Spain: Art. 60 Spanish Fund Law (Law 35/2003).

[315] France: Art. L214-24-5 CMF, Art. 323-14(1), Art. 323-15 AMF Regulation; Germany: BaFin, Rundschreiben 6/2010 (WA) zu den Aufgaben und Pflichten der Depotbank den § 20 ff. invG, § IV Drittverwahrung, 2. Ausland; Italy: Title 5, Chapter 8 Regulation 8 May 2012; Liechtenstein: Art. 31(5) Investment Undertakings Act; Spain: Art. 60bis, 62bis Spanish Fund Law (Law 35/2003).

[316] See EIOPA-BOS-12/015, 465.

[317] See *supra* 2.1.

[318] *Ibid.*

[319] The Investment Fund Act covered three types of AIFs: special funds (Spezialfonds), other funds (Sonstige Fonds) and Pension Funds.

[320] § 164 (2) Investment Fund Act.

[321] § 167 Investment Fund Act.

[322] § 168 Investment Fund Act.

[323] This separate depositary regime is post-AIFMD only applicable to the extent the AIFMD is not applicable to these AIFs.

[324] § 35(1) The Real Estate Fund act; See also § 1(1) nr. 5 Austrian Banking Act.

including, amongst others, the verification of the AIFM's compliance with the law.[325] Specific controlling tasks related to open-end real estate AIFs were assigned to the depositary of this type of AIFs by requiring, for instance, that various legal acts, such as the purchase of real estate, may only be undertaken by the AIFM under the premise that prior consent had been given by the depositary.[326]

The appointment of a depositary for non-corporate private equity and venture capital funds under the Austrian Equity Participation Funds Act was no compulsory under the Austrian Equity Participation Funds Act.[327] The Act required depositaries that were (optionally) appointed to be to be responsible for the issues and redemptions of the fund.[328] In addition, the AIF annual accounts needed to be disclosed to the depositary and the other obligations for depositaries had to be laid down in the fund rules.[329]

Corporate private equity and venture capital funds fell outside of the scope and were not required to appoint any depositary at all.[330]

3.2.3.2. Germany

Germany had a 'one-size fits all' all approach towards the tasks and duties of UCITS and open-end AIF depositaries.[331] Single hedge funds AIFMs were, however, given the opportunity to appoint a prime broker instead of a depositary. Apart from this, depending upon the investment policy employed, AIFs had extra controlling duties[332], whereas closed-end funds had no depositary requirement at all.[333] The extra controlling duties, included legal acts for which AIFMs needed to obtain permission of the depositary prior to taking a decision regarding, including, amongst others, the sale and purchase of real estate (open-end real estate AIFs), taking upon credit on behalf of the AIF and the investment in bank deposits.[334]

3.2.3.3. Ireland

Similarly as Germany, Ireland had a 'one-size fits all' all approach towards the eligibility, tasks and duties of UCITS and AIF depositaries.[335] Depositary regulation, however, partly depended upon the legal form (unit trust, investment company, investment limited

---

[325] § 35(2) The Real Estate Fund act.
[326] § 4(4) The Real Estate Fund act.
[327] § 7(5) Austrian Equity Participation Funds Act refers to '*Bedient sich die Beteiligungsfondsgesellschaft einer Depotbank*', i.e. if a depositary for the AIF is appointed.
[328] § 9,15Austrian Equity Participation Funds Act.
[329] *Ibid.*
[330] See J. Nicolussi, *Austria* 674 (D.A. Zetzsche ed, Kluwer 2012).
[331] § 20-29 Investment Act applied to both UCITS and (open-end) AIFs.
[332] See § 26 Investment Fund Act.
[333] These fell out of the scope of the Investment Act.
[334] § 26 Investment Act.
[335] The Central Bank even refers in its depositary section to the non-UCITS notices by stating that '*obligations* (regarding the depositary) *are derived directly from provisions of the non-UCITS CIS legislation* (…)'. See Central Bank of Ireland, *NU 6 Trustees – eligibility criteria,* https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/Funds/Non-UCITS/nu-series-of-notices.pdf?sfvrsn=2 (accessed 28 May 2017); See also: Central Bank of Ireland, *NU 7 Trustees – duties and conditions,* https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/Funds/Non-UCITS/nu-series-of-notices.pdf?sfvrsn=2 (accessed 28 May 2017); See for UCITS: Central Bank of Ireland, *UCITS 3 Trustees - eligibility criteria*, http://ballybunioncapital.com/wp-content/uploads/2014/05/downloads/UCITSNotices.pdf (accessed 29 May 2017); See also: Central Bank of Ireland, *UCITS 4 Trustees – duties, supervisory and reporting requirements and conditions*, http://ballybunioncapital.com/wp-content/uploads/2014/05/downloads/UCITSNotices.pdf (accessed 29 May 2017).

partnership) in which the AIF was established.[336] Cumulative obligations for depositaries in the various product regulations were being provided for unit trusts (Unit Trusts Act 1990)[337], investment limited partnerships (Investment Limited Partnership Act, 1994)[338] and the common contractual fund (Investment Funds, Companies and Miscellaneous provisions Act 2005)[339]. No extra obligations on top of the regular AIF/UCITS depositary regimes applied to investment companies.[340] The depositaries for those funds were merely stipulated by the UCITS and non-UCITS notices. The (non-)UCITS notices, however, considered the 'duties and obligations' of a depositary under the various product regulations to be 'essentially the same'.[341] The AIFs under the non-UCITS notices included only PIFs, NURs and QIFs. All other types were not regulated and did not require to appoint a depositary.

3.2.3.4. Luxembourg

The tasks and responsibilities of pre-AIFMD depositaries in Luxembourg depended upon both the fundtype (UCIs, SIFs, SICARs) and the legal form (corporate vs. non-corporate AIFs).[342]

The depositary role for UCIs (non-UCITS) was largely based upon the specific Luxembourg pre-UCITSD V implementation. Depositaries of UCIs had 'facultative' safekeeping[343] and controlling functions.[344] As for UCITS, the UCI depositary controlling functions depended upon the legal form in which the UCI was established. The 2010 UCI Act contained general obligations imposed on depositaries of both corporate and contractual AIFs and additional obligations were imposed on the depositary of an FCP. The general controlling functions related to the issue and redemption of units in UCIs, the timely remittance of transactions and the allocation of the UCI income. Depositaries of contractual (FCPs) were

[336] See for the specific duties and obligations of a 'trustee': the Unit Trusts Act 1990 and the Companies Act 1990 (Part XIII) and of a 'custodian' under the Investment Limited Partnerships Act 1994 and the Investment Funds Act 2005;

[337] In particular, the duties of a Trustee under the Unit Trusts Act 1990.

[338] The duties of ancustodian under the: Investment Limited Partnership Act, 1994, Part IV Administration.

[339] Fund (Investment Funds, Companies and Miscellaneous provsions Act 2005, Part 2.

[340] Companies Act, 1990 Part XIII.

[341] See Central Bank of Ireland, *NU 6 Trustees – eligibility criteria,* https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/Funds/Non-UCITS/nu-series-of-notices.pdf?sfvrsn=2 (accessed 28 May 2017); See also: Central Bank of Ireland, *NU 7 Trustees – duties and conditions,* https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/Funds/Non-UCITS/nu-series-of-notices.pdf?sfvrsn=2 (accessed 28 May 2017); See for UCITS: Central Bank of Ireland, *UCITS 3 Trustees - eligibility criteria*, http://ballybunioncapital.com/wp-content/uploads/2014/05/downloads/UCITSNotices.pdf (accessed 29 May 2017); See also: Central Bank of Ireland, *UCITS 4 Trustees – duties, supervisory and reporting requirements and conditions*, http://ballybunioncapital.com/wp-content/uploads/2014/05/downloads/UCITSNotices.pdf (accessed 29 May 2017).

[342] The existing depositary regime will be maintained, to a large extent, for Part II UCIs, SIFs and SICARs which do not fall, or fall only partially, within the scope of the AIFM Law. Some adjustment to the existing depositary regime is made. In particular, regarding the entities to be appointed. In addition, the obligations depend upon legal form. See T. Partsch & E. Forget, *The Luxembourg Implementation of the AIFMD* (D.A. Zetzsche ed, Kluwer 2015).

[343] C. Kremer & I. Lebbe, *Collective Investment Schemes in Luxembourg: Law and Practice* nr. 6.641. (Oxford 2014); Following Circular 91/75 the safekeeping of all or part of the assets of a Luxembourg UCI could either be entrusted with the depositary itself or with any other delegate designated by the UCI in agreement with the depositary.

[344] See Art. 90 UCI 2010 Law (FCPs; common funds) making reference to Art. 18(1),(2)(a),(c), (d), €, 19,20,21 UCI 2010 Law; See Art. 95 (SICAVs; investment companies) referring to to Art. 33(1)-(3), 34(2) UCI 2010 Law; See also Art. 99(6) (UCIs which have not been constituted as common funds or SICAVs) refering to Art. 33(1)-(3), 34(2) UCI 2010 Law.

assigned the checking the compliance of the AIFMs instructions whether they conflict with the law or fund rules[345].[346]

The more extensive controlling obligations for FCPs (contractual AIFs) was justified as unit holders of contractual UCIs needed additional protection because of their passive role in the management of the FCP compared to the shareholders of SICAVs[347] (investment companies).[348] The same delegation and liability regime as for UCITSD I-IV depositaries applied.[349]

The pre-AIFMD SIF and SICAR were, to make them more suitable for AIFs established for professional investor, relieved from exercising the controlling functions. Other than the exercise of controlling functions, the eligibility, tasks and responsibilities, delegation and liability regime were identical to those of the pre-UCITSD V Luxembourg depositary regime.[350]

3.2.3.5. UK

Under the UK pre-AIFMD regime, the only types of AIFs that were required to appoint a depositary were NURS[351] and QIS[352]. Unauthorized collective investment schemes, including unauthorized unit trusts[353] and open-end investment companies[354], were not required to appoint a depositary. Trustees of unauthorized unit trusts held the legal owner of the unit trust' assets and have specific (fiduciary) duties under the trust deed of the unit trust and general law.[355] In short, duties included, amongst others, ensuring compliance with the trust deed, acting as a custodian or entrusting this function to a third party, maintaining register of unit holders and replacing the unit trust' managers.[356] AIFs falling outside of the scope of the collective investment scheme definition[357], such as investment trust (companies)[358] and other closed-ended corporate AIFs[359], were not required to appoint a depositary at all. Although

---

[345] Arts 18(2)(c) and 90, UCI 2010 Law.

[346] Depositaries of contractual UCITS were, additionally, entrusted with the obligation of the calculation of the NAV resulting from Art. 18(2)(b) UCI 2010 Law. Art. 90 2010 UCI Law, however, does not contain a reference to Art. 18(2)(b) 2010 UCI Law.

[347] The mandatory UCITSD IV depositary agreement, however, did not apply to depositaries of UCI SICAVs. Art. 95 UCI 2010 Law only referred to Art. 33(1)-(3) and Art. 34(2) UCI 2010 Law; The same depositary provisions were applicable to UCIs that had not been constituted as common funds or SICAVs. See Art. 99(6) UCI 2010 Law.

[348] See C. Kremer & I. Lebbe, *Collective Investment Schemes in Luxembourg: Law and Practice* nr. 6.686 (Oxford 2014).

[349] See for an overview on the delegation regime: C. Kremer & I. Lebbe, *Collective Investment Schemes in Luxembourg: Law and Practice* 6.666-6.671, 6.681-6.685 (Oxford 2014);; See for an overview on the liability regime: C. Kremer & I. Lebbe, *Collective Investment Schemes in Luxembourg: Law and Practice* 6.710 (Oxford 2014).

[350] See Art. 8-10 SICAR 2004 Law; See also Art. 16-19 SIF 2007 Law. See for the pre-AIFMD SIF's depositary: Y. Lacroix & L. Tristan, *Parties and service providers involved in specialized investment funds' in specialized Investments Funds* 71 *(*Arendt & Medernach, 2007).

[351] COLL 6.6.12R.

[352] COLL 8.5.4R.

[353] Macfarlanes, *Collectives Investment Schemes – The law and practice* 601-603 (London 2009).

[354] Macfarlanes, *Collectives Investment Schemes – The law and practice* 426-431, 603 (London 2009).

[355] General law is being referred to as the Trustee Act 1925 and the Trustee Act 2000; J.R. Siena & D. Eckner, *The AIFMD's Transposition in the United Kingdom* 811(D.A. Zetzsche ed, Kluwer 2015).

[356] Macfarlanes, *Collectives Investment Schemes – The law and practice* 302-305 (London 2009).

[357] Macfarlanes, *Collectives Investment Schemes – The law and practice* 419-426 (London 2009).

[358] Macfarlanes, *Collectives Investment Schemes – The law and practice* 307-313 (London 2009).

[359] D.A. Zetzsche. *Prinzipien der kollektiven Vermögensanlage* § 15 A. IV. 3 (Mohr Siebeck 2015); D. Rouch, *United Kingdom* 126, 144 (L. Van Setten & D. Busch eds, Oxford 2014).

those types of unauthorized AIFs still appointed (regulated) custodians for safekeeping their assets.[360]

The UK pre-UCITSD-V regime was also applicable to AIFs that were authorized as NURS and QIS.[361] Depositaries had both safekeeping and controlling tasks. The safekeeping task involved all of the scheme property (other than tangible movable property). The task also included settlement[362], administrating scheme property in registered form[363], custody and controlling documents of title to scheme property[364] and ensuring that any transaction in derivatives or a forward transaction was entered into so as to ensure that any resulting benefit was received by the depositary.[365] In addition, the depositary was responsible for the collection of income due to be paid for the account of the authorized fund.[366] Like the AIFMD/UCITSD V, the safekeeping function, thus, included both custody and the recordkeeping of assets that could not be held in custody.[367]

Depositaries of QIS and NURS were also assigned a number of controlling tasks.[368] Depositaries of NURS had in the first place to ensure that a NURS was managed by an AIFM in accordance with the COLL provisions on investment and borrowing powers (investment policy/limitation)[369] that related to dealing[370], valuation/pricing[371] and income[372].
Special controlling tasks applied to NURS AIFs investing in immovable property. Consent of the depositary was required to be obtained by an AIFM for the acquisition or disposal of immovable property.[373] Correspondingly, AIFMs could be required by the depositary to cancel or restore transactions that were not in compliance with COLL and the fund rules.[374]
The depositary of NURS/QIS was allowed to delegate tasks on the basis of general MiFID I/II delegation regime.[375] No regulations applied to the eligibility, standards of due diligence of a sub-custodian.[376]

3.2.4. *Depositaries/Custodians for AIFs Employing Substantial Leverage*

Prior to the AIFMD, different relationships between AIFMs, depositaries/custodians and prime brokers were established in the EEA. The role and function of the prime broker in these relationships depended heavily upon the (product) regulation of hedge funds.

---

[360] D. Rouch, *United Kingdom* 126 (L. Van Setten & D. Busch eds, Oxford 2014).
[361] Macfarlanes, *Collectives Investment Schemes – The law and practice* 605-606 (London 2009).
[362] NURS: COLL 6.6.12R (1)(a); QIS: COLL 8.5.4R (2)(a).
[363] NURS: COLL 6.6.12R (1)(b). QIS: COLL 8.5.4R (2)(c).
[364] NURS: COLL 6.6.12R (1)(c); QIS: COLL 8.5.4R (2)(d).
[365] NURS: COLL 6.6.12R (1)(d); QIS: COLL 8.5.4R (2)(e).
[366] NURS: COLL 6.6.12R (2) QIS: COLL 8.5.4R (2)(f).
[367] COLL 6.6.12R (1)(c) and COLL 8.5.4R(2)d) referred to the 'control documents of title to the scheme property other than for transactions in derivatives or forward transactions'. The latter two types of assets, thus, fell outside of the scope of 'safekeeping' within the meaning of COLL 6.6.12R.
[368] See also: NURS: COLL 6.6.4R; COLL 6.6.14R (1), (2); QIS: COLL 8.5.4R(2)(g).
[369] COLL 5 (Investment and borrowing powers).
[370] COLL 6.2 (Dealing).
[371] COLL 6.3(Valuation and pricing).
[372] COLL 6.8. (Income: accounting, allocation and distribution).
[373] COLL 6.6.10R (2).
[374] COLL 6.6.10R (3); The depositary may do so if it is of the opinion that an acquisition of property involves the evidence of title being kept in custody or a person other than the depositary and the depositary cannot be reasonably be expected to accept the responsibility which would otherwise be placed upon it if itwere to permit custody by that other person. See COLL 6.6.10R (4).
[375] 6.6.15 R (4) COLL.
[376] See for the UK: Committee of European Securities Regulators, *Mapping of duties and liabilities of UCITS depositaries* (2010), CESR/09-175.

Some Member States allowed prime brokers to act as a counterparty and a custodian at the same time (the traditional hedge fund model).[377] These Member States did not regulate hedge funds directly, but indirectly regulated the prime broker any other service providers of the (offshore) hedge funds. Assets were in these offshore jurisdictions allowed the flexibility to allow AIFMs to determine whether (unencumbered) assets were to be held in the prime brokerage account by prime brokers providing counterparty services or by means of a custody account either held by the prime broker itself or by an independent third-party custodian.[378]

Member States applying the 'depositary model' had an authorization requirement for hedge funds and required an independent depositary to be appointed.[379] Member States only allowed one depositary for all of the AIF's assets to be appointed that had to safekeep all of the AIF's assets whether they were held by the prime broker with vested securities rights or not.[380] As long as the title was retained by the AIF, the assets were considered to be held in custody.[381] In addition, control rights in relation to the AIFM always had to be exercised. Under this model, prime brokers were required to be appointed as a sub-custodian.[382]

Member States applying the 'hybrid model' also required hedge funds to appoint an independent depositary/custodian.[383] These Member States, however, did not require all assets to be held by a single depositary that had to safekeep all of the AIF's assets.[384] Under this 'hybrid model', Member States allowed the AIF's assets to be held both by the prime broker's and the depositary's (sub-)custody network. Assets which were provided to the prime broker by means of a collateral agreement did not fall within the custody obligation of the depositary/custodian. Member States applying this model allowed a depositary or a custodian to appoint the prime broker as a sub-custodian (sub-custody model) or an AIFM to directly appoint the prime broker itself as a depositary/custodian (the AIFM model).

Despite these models applied, Member States differed regarding the:

- compulsory requirement for an independent depositary/custodian;
- re-hypothecation limits as opposed to disclosure for privately negotiated business terms;
- the liability incurred by an independent depositary/custodian for the loss of assets by a prime broker.

Now these three models will be discussed in more detail.

3.2.4.1. The traditional Hedge Fund-model

---

[377] D.A. Zetzsche, *The AIFMD's (Prime Brokerage)* 494 (D.A. Zetzsche ed, Kluwer 2015); European Commission, *Report of the Alternative Investment Expert Group - Managing, Servicing and Marketing Hedge Funds in Europe*, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/hedgefunds_en.pdf (accessed 29 May 2017).

[378] K. Jud, *Das Prime Brokerage-Geschäft mit Hedge Funds* (Haupt 1996); L. Silverentand & P. Zijp, *The Draft Directive on Alternative Investment Fund Managers* (M. Berman ed., 2nd edn, RiskBooks 2010). R. R. Lindsey, *What are Prime Brokers?* (M. Berman ed., 2nd edn, Risk Books 2010).

[379] D.A. Zetzsche, *The AIFMD's (Prime Brokerage)* 496 (D.A. Zetzsche ed, Kluwer 2015).

[380] J. Siena, *Depositary Liability – A Fine Mess and How to Get Out of It* 466 (D.A. Zetzsche, Kluwer 2015).

[381] J. Siena, *Depositary Liability – A Fine Mess and How to Get Out of It* 478 et seq. (D.A. Zetzsche, Kluwer 2015).

[382] France: Art. L214-24-5 CMF, Art. 323-14(1), Art. 323-15 AMF Regulation; Italy: Title 5, Chapter 8 Regulation 8 May 2012; Spain: Art. 60bis, 62bis Spanish Fund Law (Law 35/2003).

[383] D.A. Zetzsche, *The AIFMD's (Prime Brokerage)* 497 (D.A. Zetzsche ed, Kluwer 2015).

[384] See, for example: Germany: BaFin, Rundschreiben 6/2010 (WA) zu den Aufgaben und Pflichten der Depotbank den § 20 ff. invG, § IV Drittverwahrung, 2. Ausland;

In EEA-Member States, such as the UK and, to a lesser extent, the Netherlands[385], and , outside the EEA the US, hedge funds constituted collective investment schemes that were usually outside jurisdictional reach of their respective supervisory laws. This was because they were located in a jurisdiction which was recognized as having 'adequate supervision'[386] or they were within the scope of an exemption rule.[387]

For this reason, hedge funds marketed in the Netherlands and the UK were located in the BVI, Bermuda and the Cayman Islands.[388] Under the traditional hedge fund model used, there was no requirement for a domestic depositary/custodian and the AIFM was free to appoint the prime broker directly.[389] The traditional hedge fund model allowed the flexibility to allow AIFMs to determine whether (unencumbered) assets were to be held in the prime brokerage account by prime brokers providing counterparty services or by means of a custody account either held by the prime broker itself or by an independent third-party custodian.[390] The prime broker acting as an custodian was responsible for the sub-custodian network, i.e. selecting and monitoring any sub-custodians.

Despite of a lack of regulation in the Netherlands and the UK of the 'product', hedge fund managers, prime brokers and fund administrator were regulated in these Member States.

The UK nor the Netherlands targeted prime brokers directly to legislation. Dutch and UK investment banks providing prime brokerage activities fell within the investment bank's general permission to arrange deals in investments under MiFID I/II.[391] As such, prime brokers could provide custodial services as an ancillary service to hedge funds. However, AIFMs in these countries were also free to appoint one or more independent custodians.[392] In both countries, providing merely custodian services was a regulatory activity prior to the adoption of the AIFMD. However, the flexibility left over to AIFMs to structure hedge funds in these countries allowed them full contractual freedom in determining whether only a prime broker or an independent depositary/custodian would hold assets on behalf of the hedge fund in custody. Furthermore, the AIFM could contractually agree with the prime broker to what extent the prime broker could hold assets that could be held in custody, take collateral over these assets and re-hypothecate them.[393] The AIFM could also determine whether or not the custodian (depositary) would exercise an oversight role over the AIFM or whether or not it would appoint an administrator to take over such a role.[394]

Outside the EEA, the US, prior to the Dodd Frank Act, did not regulate directly the 'product' hedge funds either.[395] Prime broker were appointed by the investment advisor that

---

[385] This was only to the extent that hedge funds were set up and exclusively marketed to qualified investors. Hedge funds that were marketed to retail investors and its managers needed to obtain an authorization. Contractual funds needed to appoint a depositary, whereas corporate funds were exempted from this obligation.

[386] See S.N. Hooghiemstra, *The Netherlands* (D.A. Zetzsche ed, Kluwer 2012).

[387] S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013); See K. Groffen & B. Spoor, *Netherlands* (L. Van Setten & D. Busch eds, Oxford 2014).

[388] D.A. Zetzsche, *The AIFMD's (Prime Brokerage)* 494 (D.A. Zetzsche ed, Kluwer 2015).

[389] H. McVea, *United Kingdom* 351-354 (E. Wymeersch ed, Kluwer 2012); H. Ordower, *United States* (E. Wymeersch ed., Kluwer 2012).

[390] K. Jud, *Das Prime Brokerage-Geschäft mit Hedge Funds* (Haupt 1996).

[391] Cf. D. Busch, *Agency and Principal Dealing under MiFID*, https://ssrn.com/abstract=2899751 (accessed 31 May 2017).

[392] H. McVea, *United Kingdom* 351-354 (E. Wymeersch ed, Kluwer 2012); See S.N. Hooghiemstra, *The Netherlands* (D.A. Zetzsche ed, Kluwer 2012).

[393] J. Siena, *Depositary Liability – A Fine Mess and How to Get Out of It* 478 et seq. (D.A. Zetzsche, Kluwer 2015).

[394] N. Amenc & S. Sender, *The European Fund Management Industry Needs a Better Grasp of Non-Financial Risks* 41-43 (EDHEC-Risk Institute 2010).

[395] H. Wegman, *Investor Protection. Towards Additional EU Regulation of Investment Funds?* 204-208 (Kluwer 2015).

was responsible for the collateral agreement as well.[396] In addition, the investment advisor was also responsible for the appointment of a custodian , whereas the custodian was not required to exercise any controlling duties towards the investment advisor.[397] Under the traditional US hedge fund model, however, the investment advisor was being supervised by the sponsor of the hedgefund. Moreover, the investment advisor was being supervised by an independent administrator and a board of directors of the investment company within the firm.[398]

Post-AIFMD, the traditional hedge fund model is no longer in the EEA allowed.[399]

3.2.4.2. The Depositary Model

Liechtenstein, Italy, Spain and France, borrowed the structural separation of the AIFM and the depositary from the UCITSD I and applied it to hedge funds.[400] They required a single depositary to be appointed to safekeep all the assets of a hedge fund and verify the AIFM's compliance with the law.[401]

France, Italy, Liechtenstein and Spain allowed a prime broker to be appointed for hedge funds.[402] Under the depositary model applied by these Member States, the prime broker, however, had to be mandatorily appointed as a sub-custodian by the depositary.[403] The depositary, thus, controlled the prime brokerage relationship. The depositary was liable towards the AIFM and each unit holder and had to monitor the amount of AIF's assets and verify the collateral released in favour of the prime broker by the hedge fund.[404]

Prime brokerage relationships slightly varied from Member State to Member State. In Italy, for example, the prime brokerage agreement between the AIFM and had to be delivered to the Bank of Italy for prior approval. In managing AIFs (fondi speculativi), AIFMs using 'prime brokers' (parties offering a range of integrated services, such as loans, security lending, custody, etc.) were required to only appoint intermediaries as prime brokers that were subject to suitable forms of prudential supervision with high standing and proven sector experience.[405]

Other Member States, such as Liechtenstein, only required the depositary to take reasonable care and skill in appointing and monitoring the prime broker as a sub-custodian.[406] This implied that they were not liable for the fraud and failure of any of their sub-custodians.

---

[396] D.A. Zetzsche. *Prinzipien der kollektiven Vermögensanlage* § 21 C. II (Mohr Siebeck 2015).
[397] *Ibid.*
[398] N. Amenc & S. Sender, *The European Fund Management Industry Needs a Better Grasp of Non-Financial Risks* 41-43 (EDHEC-Risk Institute 2010).
[399] See D.A. Zetzsche, *The AIFMD's (Prime Brokerage)* 496 (D.A. Zetzsche ed, Kluwer 2015).
[400] D.A. Zetzsche, *The AIFMD's (Prime Brokerage)* 496 (D.A. Zetzsche ed, Kluwer 2012); This model also applied in Switzerland. See Amman, T., *Aufgaben und Verantwortung der Depotbank im KAG Unter besonderer Berücksichtigung der Umstände bei Zahlungsunfähigkeit der kollektiven Kapitalanlage* (VDM Verlag Dr. Müller 2011).
[401] France: L. 214-10 CMF; Germany:§ 20(1),(2) Investment Act; Italy: Art. 47(1) Consolidated Law on Finance (2012 version).
[402] France: A. Couret, *France* 113 (E. Wymeersch ed, Kluwer 2012); Italy: Art. 35(3) Regulation on the organisation and intermediary procedures providing investment services or collective investment management services; Liechtenstein: D.A. Zetzsche, *The AIFMD's (Prime Brokerage)* 496 (D.A. Zetzsche ed, Kluwer 2012); Spain: R.P. Laguna, *Spain* 282, 283-284, 287-288, 292-293 (E. Wymeersch ed, Kluwer 2012).
[403] D.A. Zetzsche, *The AIFMD's (Prime Brokerage)* 496 (D.A. Zetzsche ed, Kluwer 2012);
[404] Regulation 8 May 2012, Titel V, Ch. III. S. VI. See R. Lener, *Italy* 242 (E. Wymeersch ed, Kluwer 2012); R. Lener & C. Petronzio, *The AIFMD's Transposition in Italy* 638-639, 641 (D.A. Zetzsche ed, Kluwer 2015).
[405] Art. 35(3) Regulation on the organisation and intermediary procedures providing investment services or collective investment management services.
[406] Liechtenstein: Art. 31(5) Investment Undertakings Act;

France and Italy, however, required their depositaries to have an absolute control over the hedge fund's assets and the sub-custodian network.[407] Already prior to the introduction of the AIFMD, French depositaries, for example, had an absolute legal duty to re-deliver assets to the hedge fund in the event of fraud or failure of any of its sub-custodians regardless whether it had performed due diligence upon appointment with due care and skill.[408] France imposed a guarantor liability over their depositaries even if depositaries had no control over the prime broker's sub-custodian network.[409] French depositaries were, however, able to contractually discharge themselves of liability.[410] Italy was less strict than France and attributed a burden of proof to the depositary.[411] Italian depositaries could, however, exonerate themselves from liability if they could prove that the losses could not have been avoided by proper due diligence.[412] Italy did not allow its depositaries to contractually discharge liability to their prime broker as sub-custodians.[413] This was, however, not prohibited in any of the abovementioned Member States.[414]

The depositary model, as applied in France, served as an example for the AIFMD.[415]

3.2.4.3. The 'Hybrid' Model

Germany, Ireland and Luxembourg applied a 'hybrid' model in which a depositary/custodian was required to be appointed for hedge funds.[416] The hedge fund's assets were, however, not necessarily required to be held in the custody network of the depositary. Germany, Ireland and Luxembourg apply a 'hybrid' model as these Member States all provided AIFMs the option for either holding the assets through the prime brokers (sub-)custody network (the direct AIFM model) or through the depositary's (sub-)custody network (the sub-custodian model).[417]

The 'hybrid' model was, however, slightly applied differently in Germany, Ireland and Luxembourg.

In Germany, hedge fund managers were required to appoint a depositary that complied with § 20-29 Investment Act (Investmentgesetz) and the Banking Act (Kreditwesensgesetz). A full investment triangle was required to be established for hedge funds.[418]

§112(3) Investment Act provided the opportunity for hedge fund AIFMs[419] (the AIFM model) or depositaries to appoint a prime broker as a sub-custodian (the sub-custodian

---

[407] France: Art. L214-24-5 CMF, Art. 323-14(1), Art. 323-15 AMF Regulation; Italy: Title 5, Chapter 8 Regulation 8 May 2012.

[408] France: Art. L214-24-5 CMF, Art. 323-14(1), Art. 323-15 AMF Regulation.

[409] C. Clerc, *The AIF Depositary's Liability for Lost Assets* 528 (D.A. Zetzsche ed, Kluwer 2015).

[410] *Ibid.*

[411] See for the Italy: Committee of European Securities Regulators, *Mapping of duties and liabilities of UCITS depositaries* (2010), CESR/09-175;

[412] Committee of European Securities Regulators, *Mapping of duties and liabilities of UCITS depositaries* (2010), CESR/09-175; European Commission, *Report of the Alternative Investment Expert Group - Managing, Servicing and Marketing Hedge Funds in Europe*, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/hedgefunds_en.pdf (accessed 29 May 2017).

[413] *Ibid.*

[414] The depositary bears, however, a counterparty risk in this model. If assets are lost due to a insolvency oft he prime broker, the prime broker's duty to indemnify the depositary will be a subordinated ordinary claim.

[415] C. Clerc, *The AIF Depositary's Liability for Lost Assets* 528 (D.A. Zetzsche ed, Kluwer 2015).

[416] D.A. Zetzsche, *The AIFMD's (Prime Brokerage)* 497 (D.A. Zetzsche ed, Kluwer 2015).

[417] *Ibid.*

[418] See H. Fleischer & J. Hupka, *Germany* 189 (E. Wymeersch ed, Kluwer 2012).

[419] § 112 Investment Act referred to 'Sondervermögen mit zusätzlichen Risiken'.

model). Eligible to be appointed as a prime broker were EEA and OECD institutions that were subjected to effective prudential regulation and an investment credit rating.[420]
Under the 'AIFM model', the AIFM appointed the prime broker directly. When appointing a prime broker, the option was left open to AIFMs to include the depositary as part of a tri-partite agreement. The liability for the AIFM and depositary depended upon whether only the AIFM and the prime broker concluded the prime brokerage agreement or whether a depositary was involved as well.

Under the 'AIFM model', the AIFM was only liable to the extent that the prime broker was acting as its agent.[421] The depositary was not involved in appointing the prime broker, thus, the depositary could only liability for negligent due diligence performed upon the appointment of the prime broker. The situation was different under tri-partite agreements in which depositaries had to be asked for permission by the AIFM regarding the prime broker appointment. At any time, depositaries could, however, be held liable for their negligent performance of controlling duties towards the AIFM.

Under the sub-custodian model, the depositary was liable for the prime broker as sub-custodian under § 112(3) sub-paragraph 2 Investment Act.

Regardless what model was applied, Germany limited the assets to be provided as collateral in the prime broker account of the prime broker to 110% of the value of the obligations of the AIF towards the prime broker. [422] This 10% haircut functions was allowed to be used as buffer against asset depreciation of the collateral provided by the AIFM to the prime broker. The AIFM has, thus, a maximum of 10% counterparty risk. All other assets were required to be held by the prime broker either in an internal or an external custody account.

Ireland allowed for professional investor funds ('PIF') and qualifying investor funds ('QIF') to appoint a prime broker[423]. Following, Guidance Note 2/11, the Irish Financial Services Regulatory Authority upon the appointment of a prime broker required the trustee/custodian of a hedge fund to ensure that assets of those hedge funds were held within the depositary/trustee's custody network and non-cash assets to be held readily identifiable and segregated from the assets of the depositary. The Irish Financial Services Regulatory Authority, thus, recognized that the depositary could enter into agreements in which assets could be transferred out of the depositary's custody network.

By adopting Guidance Note 2/11, a 'hybrid model' had been created in which a depositary was required to appoint a prime broker as a sub-custodian for all assets of PIF/QIFs other than assets pledged, lent, re-hypothecated or otherwise utilized by the prime broker. The prime broker could, however, take a 'charge' over these assets, which was not limited to those assets held in custody.[424] For merely holding 'other assets' the prime broker was solely allowed to act as a counterparty. The assets provided as collateral to a prime broker by PIFs were not allowed to exceed 140% of the level of the PIF's indebtedness[425] to the prime broker. For

---

[420] §112 (3) Investment Act.

[421] Zentraler Kreditausschuss, *Erläuterungen zur„Auslegung des Bundesministeriums der Finanzen zur Thematik Primebroker nach dem Investmentgesetz“,* 1 Juni 2004, 4.

[422] *Ibid.*

[423] Central Bank of Ireland, *NU 7 Trustees – duties and conditions,* https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/Funds/Non-UCITS/nu-series-of-notices.pdf?sfvrsn=2 (accessed 28 May 2017).

[424] See Central Bank or Ireland, *Professional collective investment schemes: Appointment of prime brokers and related issues*, Guidance Note 2/11, December 2011, 4. See also Central Bank of Ireland, *NU 7 Trustees – duties and conditions,* https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/Funds/Non-UCITS/nu-series-of-notices.pdf?sfvrsn=2 (accessed 28 May 2017).

[425] 'Indebtedness' can include all obligations of the CIS to the prime broker under any arrangement including accrued fees, provided they are actual indebtedness and not potential exposures, and, moreover, are subject to the

QIFs there was no limit provided that the extent to which assets are available to the prime broker were fully disclosed in the prospectus.

AIFM were only allowed to appoint prime brokers regulated by a recognized regulatory authority that had shareholders' funds in excess of Euro 200 million.[426] For 'other' assets passed outside of the depositary's custody network, the depositary/trustee had to monitor compliance on an ongoing basis with a number of requirements to manage counterparty risk, such as, amongst others, receiving a daily report on assets held by the prime broker concerning 'other assets' held and the reconciliation of these positions with its own records.[427]

In Luxembourg, hedge funds were primarily be organized as SIFs[428] or UCIs ('Part II funds')[429]. The safekeeping of assets for both funds had to be entrusted to a Luxembourg based credit institution.[430] UCIs were required to apply the 'depositary model' in which depositaries appointed prime brokers as sub-custodian.[431]

For SIFs a custodian was required to be appointed that did not have to comply with the stricter depositary rules applying to UCIs.[432] The required custodian had merely a safekeeping and no controlling function towards the AIFM. CSSF Circular 08/372 clarified that the custodian's responsibility included accepting the prime broker chosen by the SIF. The custodian was responsible for ensuring that the prime broker was subject to financial supervision recognized as equivalent to EU legislation and was also a reputable institution.

The custodian in its relationship with the prime broker had to be able to monitor at any time the assets of the SIF. The custodian had, thus, the duty towards the investors to carry out due diligence upon the appointment of the prime broker and ongoing due diligence to ensure that assets are being kept safe well by the prime broker. The assets were, however, not required to be kept safe by the custodian's sub-custodian network. The network of the prime broker could also be used. The overall responsibility for the safekeeping of SIF assets remained with the custodian, whereas the daily administration of SIFs established as common funds could be contractually delegated to the prime broker. Hence, custodians were also allowed to contractually transfer their liability to prime brokers.

If the custodian deemed the prime broker no to be longer able to fulfil its supervisory tasks in relation with the SIF's assets, the custodian had, however, the right to intervene. Finally, corresponding risks related to the involvement of the prime broker were required to be disclosed in the marketing documents of the SIF.

---

right of set off required. See Central Bank or Ireland, *Professional collective investment schemes: Appointment of prime brokers and related issues*, Guidance Note 2/11, December 2011, 3.

[426] Central Bank or Ireland, *Professional collective investment schemes: Appointment of prime brokers and related issues*, Guidance Note 2/11, December 2011, 4.

[427] *Ibid*, 5, 6.

[428] SIFs were primarily regulated by the law of 1915 on commercial companies (Law of 10 August 1915 on commercial companies, Mémorial A n 90 of 30 October 1915. No specific investment restrictions are applicable to SIFs pursuing hedge funds strategies. Only the general restrictions in the CSSF Circular 07/309 applied. See I. Lebbe & P.E. Partsch, *Luxembourg* 263 (E. Wymeersch ed, Kluwer 2012).

[429] Considerable restrictions, however, are applicable to Part II funds that want to pursue hedge fund strategies. See CSSF Circular 02/80. See for other restrictions applying to Part II funds the 2002 Law, IML Circular 91/75 clarifying the UCI legal framework; IML Circular 97/136 on financial information to be provided ; CSSF Circular 02/77 on the protection of investors in case of nav calculation errors or breaches of investment rules; CSSF Circular 02/7 which sets out specific rules applying to Part 2 funds pursuing alternative investment strategies. See also CSSF Circular 08/371 on the electronic submission of prospectusses and financial reports (the latter applies to UCIs and SIFs).

[430] Arts 16(3), 34(2) SIF Law; Arts 1(2), 17(3), 34(2) UCI Law.

[431] The controlling functions include the NAV calculation, the issue, redemption and cancellation of units, the timely remittal of consideration regarding the fund's assets, the compliance with investment restrictions, etc. See Art. 90(2), 95 (1b), 99 (6bis) UCI Law.

[432] Art. 16-19 SIF Law.

Under the AIFMD, the 'depositary model' modelled after France has been introduced that has significantly altered the market practice of the Member States that applied the 'hybrid model'

3.3. The AIFMD Contractual Governance Structure

The AIFMD adopted the 'contractual model' for all types of AIFs. Under this model, the 'corporate depositary model' is also applied. Similar as UCITSD V, the AIFMD has introduced a level playing field depositary regime applying regardless of the legal entity in which the AIF is established in.[433] To this extent, the eligible depositary entities, the safekeeping and monitoring obligations, the delegation and liability regime have been harmonized to such an extent that it accommodates the 'contractual model'.[434]

On contrary to the UCITSD V depositary regime, the obligations under the AIFMD, however, are proportionally applied depending upon the type of AIF for which the depositary is appointed. For 'illiquid AIFs', such as private equity, venture capital and real estate AIFs, a 'PE-depositary' may be appointed, whereas for substantially leveraged AIFs a 'prime broker' may be appointed as a depositary. The obligations regarding depositaries, however, apply irrespective of the legal form that is employed for an AIF.

3.4. Conclusion

The differences in the scope of regulating AIFs and AIFMs and Member States pursuing the integrated or product-based approach led to even bigger differences in depositary regulation than under the pre-UCITSD V national depositary regimes. The lack of harmonization on the European led to fragmentation as regards the regulatory scope as regards provisions governing the authorization of AIFs, its AIFMs and depositaries.

This problem was exacerbated by the scope of regulatory law. Member States varied in the extent that they regulated AIFs under regulatory or merely based upon private law. On top of this, Member States applied a 'one-size-fits-all' or a product based approach. Some Member States, including France, Italy, Liechtenstein, Spain, had a 'one-size-fits-all' approach. These Member States all their AIFs to a coherent depositary regulatory framework. Their depositary laws did not differentiate on the basis of the legal form and investment policy employed for an AIF. The depositaries responsibility and liability in these Member States did not vary for AIFs regardless whether they were investing in liquid, illiquid assets or whether they employed substantial leverage. Member States, including Austria, Germany, Ireland, Luxembourg and the UK took a product-based approach. The tasks and responsibilities of the depositary in these Member States were to a larger or lesser extent based upon the legal form and investment policy (liquid, illiquid, substantial leverage employed) of the depositaries. This led to inefficiencies and created a barrier for hindering the development of a European depositary passport.

The AIFMD resolves these issues by introducing a clear AIF definition and a depositary regime that applies irrespective of the legal form employed by AIFs. The duties of depositaries, however, are proportionally applied depending upon whether AIFs are liquid, illiquid or employ substantial leverage.

4. Depositaries and Custodians under IORPD I

---

[433] S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2015).

[434] See *infra* 5.

4.1. The IORPD I National Depositary/Custodian Regimes

In 2003, the European legislature adopted IORPD I that was intended to create an internal market for occupational retirement provisions.[435] The IORPD I lays down minimum standards on the funding of pension schemes, the types of investments pensions that may be made and allows cross-border management of pension plans.[436]

IORPD I left it up to the Member States whether or not to make the appointment of a depositary or a custodian compulsory.[437] Unlike UCITSD V and the AIFMD, the eligibility, the functions, delegation and the liability were not specified by IORPD I.[438] This led to a heterogeneous list of entities eligible as a depositary/custodian performing different functions across Member States.[439] The latter was, especially, problematic as IORP depositaries/custodians could on a cross-border basis offer services to foreign IORPs. Similar as for UCITSD V and the AIFMD, investor protection concerns related to the appointment, eligibility, functions and liability of depositaries/custodians in preparation for IORPD II were being reviewed to ensure a more consistent approach throughout the EEA.[440]

4.1.1. *The Compulsory Appointment of a Depositary/Custodian*

IORPD I left the discretion to regulate depositaries/custodians almost entirely up to the Member States. Art. 19(2) sub-paragraph 2 IORPD I stated that

> 'Member States shall not restrict institutions from appointing, for the custody of their assets, custodians established in another Member State and duly authorised in accordance with Directive 93/22/EEC or Directive 2000/12/EC, or accepted as a depositary for the purposes of Directive 85/611/EEC.The provision referred to in this paragraph shall not prevent the home Member State from making the appointment of a depositary or a custodian compulsory.'

Article 19(2) IORPD I left it up to Member States whether a depositary, a custodian or no depositary/custodian at all had to be compulsory appointed. An inquiry into the IORPD I implementation regulations in the EEA points out that there are considerable differences in this regard throughout the EEA.

In a large number of EEA Member States, including, amongst others, the Baltic states[441], Italy[442], Liechtenstein[443], Luxembourg[444] and Spain[445] a (single) depositary was mandatorily

---

[435] H. Van Meerten & B. Starink, *Impediments to an Internal Market for Institutions for Occupational Retirement Provision*, 6 European Company Law 7 (2010).

[436] H. Van Meerten, *The scope of the EU 'Pensions'-Directive: Some Background and Solutions for Policymakers* (U. Neergaard, E. Szyszcak, J.W. van de Gronden & M. Krajewski eds, T. M. C. Asser Press 2013);

[437] Art. 19(2) sub-para. 2 IORPD I.

[438] See CEIOPS-OP-03-08 final, 55.

[439] *Ibid.*, 56.

[440] Cf. European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186),* 52.

[441] Estonia: § 5, Funded Pensions Act, 14 April 2004, RT I 2004, 37, 252; § 92(3) Investment Funds Act, 14 April 2004, RT I 2004, 36, 251; Latvia: Art. 21(1) Law on Private Pension Funds, 05.06.1997; Lithuania: Art. 32(1) Occupational Pension Law, Nr. XI-1678 , 2011-11-17, Official Gazette., 2011, no. 146-6824 (2011-12-01).

[442] Art. 7(1) Decreto Legislativo 5 dicembre 2005, n. 252 "Disciplina delle forme pensionistiche complementari" pubblicato nella *Gazzetta Ufficiale* n. 289 del 13 dicembre 2005 - Supplemento Ordinario n. 200.

to be appointed. In some other Member States, such as , Austria[446], Bulgaria[447] and Cyprus[448], there was a mandatory requirement to appoint either a depositary or a custodian. In Belgium[449], Croatia[450], France[451], and Malta[452] the appointment of a custodian was required, whereas in Member States, such as Denmark[453], Germany[454], Iceland[455], Ireland[456], the Netherlands[457], Norway[458], Sweden[459] and the UK[460] there was no mandatory requirement to appoint a depositary/custodian but the appointment could be made by an IORP on a voluntary basis. In for about half of all Member States more than one depositary/custodian was allowed to be appointed.[461] Of the countries solely allowing a single entity to be appointed, almost all only allowed a depositary to be appointed. There were, thus, not only considerable differences between Member States in appointing depositaries/custodians, but also whether only one or more entities were allowed to be appointed.

4.1.2. *Entities Eligible as a Depositary and Its Organizational Requirements*

4.1.2.1. Eligible Entities

Under IORPD I the European legislator laid down a list of eligible depositaries. Under Article 19(2) IORPD I:

> 'Member States shall not restrict institutions from appointing, for the custody of their assets, custodians established in another Member State and duly authorized in accordance with

---

[443] Art. 12 Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung.
[444] Art. 18 (1) and Art. 42 (1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (SEPCAV) et d'association d'épargne-pension (ASSEP) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.
[445] Art. 82(1) Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.
[446] § 26. Bundesgesetz vom 17. Mai 1990 über die Errichtung, Verwaltung und Beaufsichtigung von Pensionskassen (Pensionskassengesetz - PKG), BGBl. Nr. 281/1990.
[447] Art. 123a (4) Social Insurance Code (Title, am. – SG, iss. 67 in 2003).
[448] Art. 38(2)(a) Law to provide for the establishment, recording, supervision of funds and professional pension benefits and for related matters, 208 (I) / 2012.
[449] Art. 92 Wet betreffende het toezicht op de instellingen voor [bedrijfspensioenvoorziening] Belgisch Staatsblad, 10 november 2006; The law does not explicitly prohibit to appoint more than one entity.
[450] See Art. 79(1) The Mandatory and Voluntary Pension Funds Law of 7 May 1999; The appointment of one or more custodians to be appointed it not explicitly prohibited.
[451] Art. R. 342-5 Décret no 2006-740 du 27 juin 2006 relatif aux retraites professionnelles supplémentaires.
[452] B.6 Custody of Retirement Fund's Assets, B.6.1 General Conditions, Directives for Occupational Retirement Schemes, Retirement Funds and related Parties under the Special Funds (Regulation) Act, 2002.
[453] Consolidated Supervision of Company Pension Funds Act (Consolidated Act no. 1017 of 24 October 2005); Pensions Act (Consolidated Act no. 939 of 15 September 2004).
[454] Gesetz über die Beaufsichtigung der Versicherungsunternehmen (Versicherungsaufsichtsgesetz - VAG).
[455] Art. 5 Act on Mandatory Pension Insurance and on the Activities of Pension Funds No. 129, 23 December 1997; Legislative document No. 1359, 133rd. session of the legislature, Topic/Title 568 Occupational retirement funds (EEA-directives). Act No. 78 of 30 March 2007 -Act Respecting Occupational Retirement Funds.
[456] A trustee is required under Irish law to appoint an actuary and an auditor, however, it has no obligation to appoint an custodian on behalf of an pension fund. See Pensions Act, 1990.
[457] Wet van 7 december 2006 houdende regels betreffende pensioenen (Pensioenwet).
[458] Act 24 November 2000 no. 81 on Defined Contribution Occupational Pension; Act 21 December 2005 no. 124 on Compulsory Occupational Pension; Act 24 March 2000 no. 16 on Defined Benefit Occupational Pension.
[459] Law (1998: 293) on foreign insurers and pension funds in Sweden.
[460] S. 47(3) Pensions Act 1995.
[461] See CEIOPS-OP-03-08 final, 56.

Directive 93/22/EEC or Directive 2000/12/EC, or accepted as a depositary for the purposes of Directive 85/611/EEC.'

Member States could not restrict IORPs from appointing depositaries/custodians that were credit institutions, investment firms or UCITS depositaries[462].[463] The focus of the list of eligible depositaries/custodians was to ensure freedom of services provided by depositaries/custodians for IORPs throughout the EEA on the basis of a 'de facto depositary passport', i.e. the concept of 'mutual recognition'.[464]

For this reason, eligible entities were chosen amongst financial intermediaries which were already subjected to widely harmonized licensing and business organizational requirements under EEA law. Despite of this the CEIOPS (now EIOPA) Occupational Pensions Committee in 2006 decided to examine the eligible entities appointed throughout Member States.[465]

Based on the research outcome of the questionnaire, it was concluded that there were considerable differences with regards to the typology of eligible depositaries/custodians throughout Member States.[466]

A closer look into the IORPD I implementation regulations in the EEA showed that in a large number of European Member States, credit institutions[467] and investment firms[468] were the most common eligible entities to be appointed as depositaries.[469]
Nevertheless, in some Member States, apart from credit institutions and investment firms, the role of the depositary/custodian could also be entrusted to UCITS depositaries or other financial institutions.[470]

Despite the focus of determining the list of eligible depositaries/custodians under IORPD I was to ensure freedom of services, several Member States also allowed domestic entities to be appointed.[471] This discretion was, possibly, justified on a grammatical interpretation of the

---

[462] Art. 19(2) IORPD I referred to 'UCITSD I-IV depositaries'.
[463] Art. 19(2) IORPD I.
[464] See Chapter 2, section 1.3.
[465] CEIOPS-OP-03-08 final, 56.
[466] *Ibid.*
[467] See for instance: Austria : § 26. Bundesgesetz vom 17. Mai 1990 über die Errichtung, Verwaltung und Beaufsichtigung von Pensionskassen (Pensionskassengesetz - PKG), BGBl. Nr. 281/1990; Belgium: Art. 92 Wet betreffende het toezicht op de instellingen voor [bedrijfspensioenvoorziening] Belgisch Staatsblad, 10 November 2006*;* Croatia: Art. 2 Nr. 13 The Mandatory and Voluntary Pension Funds Law of 7 May 1999; Hungary: § 50(1), (4)(a) CXVII 2007. Law occupational pensions and institutions; Italy : Art. 7(1) Decreto Legislativo 5 dicembre 2005, n. 252 "Disciplina delle forme pensionistiche complementari" pubblicato nella *Gazzetta Ufficiale* n. 289 del 13 dicembre 2005 - Supplemento Ordinario n. 200 ; Liechtenstein: Art. 12(1) Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung (Pensionsfondsgesetz; PFG).
[468] See for instance: Art. 38(2)(a) Law to provide for the establishment, recording, supervision of funds and professional pension benefits and for related matters, 208 (I) / 2012; Luxembourg : Art. 19 (1) and art. 43 (1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.
[469] CEIOPS-OP-03-08 final, 56.
[470] Some Member States allowed all of the mentioned entities in Art. 19(2) IORPD I to be appointed. See Art. 38(2)(a) Law to provide for the establishment, recording, supervision of funds and professional pension benefits and for related matters, 208 (I) / 2012; Luxembourg : Art. 19 (1) and art. 43 (1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.
[471] See for instance: Malta: A.1.1.5 The Special Funds (Regulation) Act, 2002 and the Registration Requirements; Poland: Art. 158(1) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Spain: Art. 82 Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

wording 'Member States shall not restrict institutions from appointing' implying that also entities authorized under national law could be eligible.[472]

Art. 19 IORPD I allowed IORPs to appoint 'for the custody of their assets, custodians established in another Member State'. 'For the custody of their assets' was differently interpreted throughout Member States. Most Member States that compulsory required depositaries/custodians to be appointed, allowed institutions to appoint their depositaries/custodians in another Member State 'for the custody of their assets'.[473] These Member States, apparently took the view that depositaries are a type of 'custodian'.

Member States such as Hungary[474], Poland[475], Slovakia[476] and Spain[477] restricted the appointment of their depositaries to domestic credit institutions. This was in line with the UCITSD I-V/AIFMD approach of requiring only depositaries to be appointed that either have a registered office (or a branch) in the Member State of that IORP. Apart from this, Slovakia also accepted branches of EEA credit institutions.[478] In this regard, it was remarkable that Liechtenstein[479] and Malta[480] also explicitly allowed non-EEA institutions under several conditions to be appointed as a depositary (Liechtenstein) and custodian (Malta).

The issue of introducing a locational restriction for depositaries under IORPD II was raised by stakeholders under IORPD II but not elaborated upon.[481]

There were, thus, considerable differences across Member States in relation to the type of entities that were allowed to be appointed as a depositary/custodian under their national IORPD I implementation laws.

4.1.2.2. Organizational Requirements

Similar to UCITSD I-IV, the IORP heterogeneous list of entities had led to different organizational and conduct of business requirements to which depositaries and custodians were subjected to.[482]

In particular, IORPD I did not contain specific rules regarding the incompatibility and conflicts of interests between the depositary/custodian, IORP and asset managers. This has led to a fragmented landscape of general requirements imposed to depositaries/custodians amongst Member States. Some Member States imposed a general duty of loyalty, whereas others required conflict of interest rules or the depositary/custodian to be independent with regard to the asset manager or the IORP itself.

IORPD I did not contain specific rules regarding the independence of the depositary/custodian with regard to the asset manager or the IORP itself. The IORPD I

---

[472] Art. 19(2) IORPD I.

[473] See for example Luxembourg: Art. 19 (1) and art. 43 (1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.

[474] § 50(1), (4)(a) CXVII 2007.

[475] Art. 158(1) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds.

[476] Art. 99 (2) Act on the Old-Age Pension Saving Scheme.

[477] Art. 82 Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

[478] Art. 99 (2) Act on the Old-Age Pension Saving Scheme.

[479] Art. 12(1) Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung (Pensionsfondsgesetz; PFG).

[480] Malta: A.1.1.5 The Special Funds (Regulation) Act, 2002 and the Registration Requirements.

[481] EIOPA, Summary of Comments on Consultation Paper: Response to the Call for Advice on the review of the IORP Directive 2003/41/EC: second consultation - EIOPA-CP-11/006, EIOPA-BoS-12/016, 15 February 2012, Comment 58 (ADEPO).

[482] See *supra* 2.1.2.

implementation laws of Member States, such as amongst others, Luxembourg[483], Malta[484] and Spain[485] required that the depositary/custodian must act independently and solely in the interest of the participants/beneficiaries. The technical safeguards were, however, diverse and limited. Some Member States only required a general duty of loyalty[486], whereas other Member States required only conflict of interest rules[487] either with or without an additional general duty of loyalty and care[488].

Conflicts of interest rules targeted the relationship between the depositary/custodian and the IORP itself and those with the asset manager. In the relationship between IORPs and depositaries/custodians, some Member States did not allow the depositary/custodian or an affiliated entity, to invest on its own account or to conduct other activities which are likely to create antagonism between the commercial interest of the depositary/custodian and the interests of the participants of the IORP.[489] In many Member States, the IORPD I implementation laws only contained a general prohibition intended to prevent conflicts of interests, whereas in other Member States various approaches, along such a general rule, coexist. Some Member States, such as Croatia, Hungary, Poland and Spain, for example, introduced a list of transactions with closely linked entities (affiliated party transactions) which were prohibited, in addition, to other governance mechanisms, e.g. conduct of business rules and disclosure.[490] In other Member States, including Poland and Spain, the depositary/custodian acting on behalf of a IORP could not borrow from the IORP nor may the depositary/custodian invest in the pension fund or the pension fund invest in the depositary/custodian[491], whereas other Member States did not address these kind of specific transactions at all.[492] Apart from this, Croatia and Poland did not allow the

---

[483] Art. 22 and art. 46 Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.

[484] B.6 Custody of Retirement Fund's Assets, B.6.1 General Conditions, Paragraph 6.1.8. ; B.6.3 Duties, paragraph 6.3.1.

[485] Art. 4(3) Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

[486] Lithuania : Article 33 (1) Occupational Pension Law Nr. XI-1678 , 2011-11-17, Official Gazette., 2011, no. 146-6824 (2011-12-01); Luxembourg : Art. 22 and art. 46 Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; Malta: B.6 Custody of Retirement Fund's Assets, B.6.1 General Conditions, Paragraph 6.1.8; B.6.3 Duties, paragraph 6.3.1; Slovakia: § 56c(1) Act on Supplementary Pension Savings.

[487] Poland: Art. 158 (3)-(5) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds.

[488] Slovenia Art. 263(4)ACT About the Pension and Disability Insurance (IPDI-2); Arts 178(1), 180 Investment funds and management company (ZISDU-2); Spain: Arts. 4(3), 85B Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

[489] Cf. European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004.

[490] Croatia: Art. 53(3), 72, 74(1) The Mandatory and Voluntary Pension Funds Law of 7 May 1999. No general conflicts of interest provision; Hungary: § 50 (5) CXVII 2007. Law occupational pensions and institutions; Poland: Art. 158 (3)-(5) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Spain: Art. 85B Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

[491] Poland: Art. 158 (3)-(5) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Spain: Art. 85B Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

[492] Lithuania : Article 33 (1) Occupational Pension Law Nr. XI-1678 , 2011-11-17, Official Gazette., 2011, no. 146-6824 (2011-12-01); Luxembourg : Art. 22 and art. 46 Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association

depositary/custodian to be integrated within a group with the pension company.[493] Croatia, Poland, and Slovenia go as far as prohibiting common shareholding or common supervisory board/director memberships.[494] Additional flanking safeguard practices to be found in IORPD I implementation laws vary from rules on legal and capital links to 'Chinese Walls'.[495]

In the relationship between IORPs and asset managers, IORPD I/ did not require the legal independence between asset managers and the depositary/custodian.[496]

In most Member States, asset managers were, thus, allowed to be independent or, in line with the continental tradition, part of a group comprising of, amongst others, the depositary.[497] However, an 'group-integration' of a depositary/custodian as not allowed in all Member States. In Romania there was a general prohibition of group-integration[498], whereas in Latvia the IORP ManCo was allowed to be a related person of a depositary, but subject to the requirement of a hierarchical separation of functions.[499] Nevertheless, in Member States not providing for lex specialis rules related to this conflict of interest between the custodian and IORP were required to comply with the delegation, safeguard of client assets, duty of loyalty and conflicts of interest prohibitions as laid down for asset managers under MiFID I.[500]

4.1.3. *The IORPD I Depositary/Custodian Functions*

IORPD I did not specify the functions of depositaries/custodians. Article 19(2) IORPD I only made reference to the appointment of 'custodians' 'for the custody of their assets'. Depending upon the specific IORPD I Member State implementation, Member States required either a compulsory depositary[501], custodian[502] or no depositary/custodian at all[503] to be appointed.

---

d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; Malta: B.6 Custody of Retirement Fund's Assets, B.6.1 General Conditions, Paragraph 6.1.8; B.6.3 Duties, paragraph 6.3.1; Slovakia: § 56c(1) Act on Supplementary Pension Savings.

[493] Croatia: Art. 15(1), 79(2) The Mandatory and Voluntary Pension Funds Law of 7 May 1999; Poland: Art. 158 (3)-(5) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds.

[494] Croatia: Art. 15(1), 79(2) The Mandatory and Voluntary Pension Funds Law of 7 May 1999; Poland: Art. 158 (3)-(5) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Slovenia: Art. 263(4) Act About the Pension and Disability Insurance (IPDI-2); Art. 178(1) Investment funds and management company (ZISDU-2).

[495] See Croatia: Art. 15(1), 79(2) The Mandatory and Voluntary Pension Funds Law of 7 May 1999. Poland: Art. 158 (3)-(5) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Slovenia: Art. 263(4)ACT About the Pension and Disability Insurance (IPDI-2);
180 Investment funds and management company (ZISDU-2); Spain: Art. 85B Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

[496] See Art. 19(2) IORPD I.

[497] Cf. See ESMA/2014/1183, 17.

[498] Art. 127(2) Mandatory Pensions Law (2nd pillar) Law no.411/2004.

[499] See Article 14 (14) Law on Private Pension Funds 05.06.1997.

[500] C.M. Grundmann-van de Krol, *The Markets in Financial Instruments Directive and Asset Management* (D. Busch & D.A. DeMott eds, Oxford 2012).

[501] Liechtenstein: Art. 12 Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung; Luxembourg: Art. 18 (1) and Art. 42 (1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (SEPCAV) et d'association d'épargne-pension (ASSEP) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu ; Spain : Art. 82(1) Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

[502] Belgium: Art. 92 Wet betreffende het toezicht op de instellingen voor [bedrijfspensioenvoorziening] Belgisch Staatsblad, 10 november 2006; The law does not explicitly prohibit to appoint more than one entity; France: R. 342-5 Décret no 2006-740 du 27 juin 2006 relatif aux retraites professionnelles supplémentaires; Malta: B.6 Custody of Retirement Fund's Assets, B.6.1 General Conditions, Directives for Occupational Retirement Schemes, Retirement Funds and related Parties under the Special Funds (Regulation) Act, 2002.

Generally, however, Member States requiring a compulsory depositary required safekeeping and a number of oversight functions to be fulfilled, whereas compulsory custodians only had to fulfil a safekeeping task. In this regard, the absence of any minimum harmonization related to the functions led to even a large variation of these tasks as observed for depositaries under UCITDS I-IV.[504]

4.1.3.1. The Safekeeping of Assets

IORPD I did not specify the content of the responsibility regarding the safekeeping function of an depositary/custodian. A mapping exercise made by CEIOPS (predecessor EIOPA) revealed that the safekeeping duty is understood in different ways across Europe.[505] Some Member States in their implementation laws only referred to the 'the custody of financial instruments', whereas others differentiated for the purpose of the safekeeping task between financial instruments that can be held in custody and assets that cannot be held in custody and should be monitored by means of recordkeeping.

Most Member States, such as, amongst others, Belgium[506], Italy[507], Liechtenstein[508] and Luxembourg[509] referred with the safekeeping duty to the traditional custody function of a depositary/custodian. Although the depositary in Italy, Liechtenstein and Luxembourg had the task to perform oversight duties, even the safekeeping of the IORP depositary in these countries was primarily aimed at the assets which could be registered in the depositary's books. These assets comprise of financial instruments that can be registered in a security-account ('book-entry securities') and, depending upon the jurisdiction concerned[510], the financial instruments that can be physically delivered to the depositary. In practice, the duty of safekeeping depended upon the definition of what constitutes a 'financial instrument' and the protection offered under the national transfer of custody laws.[511] The duty of safekeeping in these Member States was, however, limited to the custody of financial instruments. The recordkeeping for 'other assets that cannot be kept in custody' by the depositary/custodian depended in these Member States upon the depositary/custodian contract concluded.

Similar as to the current IORPD II, AIFMD and UCITSD V, other Member States, including the Czech Republic[512], Estonia[513] and Spain[514] differentiated for the purpose of the

---

[503] See, for example: Germany: Gesetz über die Beaufsichtigung der Versicherungsunternehmen (Versicherungsaufsichtsgesetz - VAG); Ireland: Pensions Act, 1990; The Netherlands: Wet van 7 december 2006 houdende regels betreffende pensioenen (Pensioenwet); Sweden: Law (1998: 293) on foreign insurers and pension funds in Sweden; UK: S. 47(3) Pensions Act 1995.

[504] CEIOPS-OP-03-08 final, 56.

[505] *Ibid.*

[506] Art. 92 Wet betreffende het toezicht op de instellingen voor [bedrijfspensioenvoorziening] Belgisch Staatsblad, 10 november 2006.

[507] Art. 7(1) Decreto Legislativo 5 dicembre 2005, n. 252 "Disciplina delle forme pensionistiche complementari" pubblicato nella *Gazzetta Ufficiale* n. 289 del 13 dicembre 2005 - Supplemento Ordinario n. 200.

[508] Art. 12(1) Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung (Pensionsfondsgesetz; PFG).

[509] Art. 18 (1) and art. 42 (1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.

[510] Not all jurisdictions allow non-dematerialized financial instruments to be issued anymore. See M. Haentjens, *Harmonisation of Securities Law: Custody and Transfer of Securities in European Private Law* 131-172 (Private Law in European Context Series 2007).

[511] S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013).

[512] § 38, 39 Act No. 426/2011 Coll., on pension savings ; § 88, 89 Participating funds pursuant to Act No. 427/2011 Coll., on additional pension savings.

[513] § 92, § 95(1) Investment Funds Act 14 April 2004.

safekeeping task between financial instruments that can be held in custody and assets that cannot be held in custody and should be monitored by means of recordkeeping.[515]

Member States that assigned both the custody and bookkeeping function to the depositary/custodian, generally, did not specify the bookkeeping function in detail. Bulgaria, Czech Republic and Spain referred to the duty of recordkeeping for depositaries.[516] Estonia required the depositary to 'organize the safekeeping of other assets', Latvia to the 'keeping of original documents relating to monetary assets' and Romania to 'receive and secure the records relative to all assets of the private pension fund' and 'to keep the records regarding the transferable securities in the form of intangibles representing the assets of the private pension fund'.[517]

Unlike under the AIFMD, UCITSD V and IORPD II, the function of recordkeeping of non-custody assets for the depositary to remain informed on an ongoing basis and to be able to update its inventory was, thus, largely unspecified.[518]Almost all Member States, however, required that financial instruments have to be registered in a segregated financial instruments account.[519] In the Czech Republic and Spain the segregation obligation was not prominent.[520] Although CSDs of which depositaries are members preserve legal and beneficial ownership rights, supplementing the custody duty with a segregation requirement is general perceived as to provide an additional layer of protection for beneficiaries upon an default of the depositary. Segregation at the depositary level may be an additional assistance in distinguishing the assets held at a particular IORP at any time from the depositary's own assets.[521]

Despite convergence in this domain, fragmentation of the regulatory framework regarding the safekeeping task had led to inconsistencies in the approaches taken across different Member States.

---

[514] Art. 82, 83 Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.
[515] Art. 34(2) IORPD II; Art. 21(8)(b) AIFMD; Art. 22(5)(b) UCITSD V.
[516] Bulgaria: Art. 123a (1), (4) Social Insurance Code
(Title, am. – SG, iss. 67 in 2003); Czech Republic: § 38, 39 Act No. 426/2011 Coll., on pension savings; Spain : Art. 82 Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.
[517] Latvia: Art. 21(1) Law on Private Pension Funds 05.06.1997; Romania : 134a Mandatory Pensions Law (2nd pillar) Law no.411/2004.
[518] Some Member States, such as the Estonia and Spain referred to 'register in its record', whereas the Czech republic referred to 'up-to-date inventory'; Czech Republic: § 38, 39 Act No. 426/2011 Coll., on pension savings; Estonia: § 92, § 95(1) Investment Funds Act 14 April 2004; Spain : Art. 83 Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.
[519] See for instance: Austria : § 26. Bundesgesetz vom 17. Mai 1990 über die Errichtung, Verwaltung undBeaufsichtigung von Pensionskassen (Pensionskassengesetz - PKG), BGBl. Nr. 281/1990; Belgium: Art. 92 Wet betreffende het toezicht op de instellingen voor [bedrijfspensioenvoorziening] Belgisch Staatsblad, 10 november 2006; Croatia: Art. 80(1) The Mandatory and Voluntary Pension Funds Law of 7 May 1999; Italy: Art. 7(1) Decreto Legislativo 5 dicembre 2005, n. 252 "Disciplina delle forme pensionistiche complementari" pubblicato nella *Gazzetta Ufficiale* n. 289 del 13 dicembre 2005 - Supplemento Ordinario n. 200; Liechtenstein: Art. 12(1) Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung; Luxembourg: Art. 18 (1) and art. 42 (1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; Portugal: Art. 48 Ministério das Finanças e da Administração Pública-Decreto-Lei n.o 12/2006 de 20 de Janeiro.
[520] Czech Republic: § 38, 39 Act No. 426/2011 Coll., on pension savings; Spain: Art. 82, 83 Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.
[521] European Commission, Consultation Paper on the UCITS Depositary Function …, Markt/G4 D (2010) 950800.

4.1.3.2. The Controlling Function

Various Member States required in their IORPD I implementations the appointment of a 'depositary'.[522]

Art. 19 IORPD I did not enumerate any minimum requirements regarding controlling tasks that a depositary must undertake. Consequently, the oversight tasks required varied from Member State to Member State. The principal task of depositaries in almost all Member States was the carrying out of instructions of the IORP, unless the instructions conflict with the applicable national law or the IORP rules.[523] Other controlling functions frequently observed throughout the IORPD I implementation laws related to:

- ensuring that in transactions involving an IORP or pension scheme's assets any consideration is remitted to it within the usual time limits;[524]
- ensuring that income produced by assets is applied in accordance with the rules of the IORP;[525]
- ensuring that the NAV calculation is done correctly and in compliance with the law;[526]

---

[522] See, for example: Liechtenstein: Art. 12 Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung; Luxembourg: Art. 18 (1) and Art. 42 (1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (SEPCAV) et d'association d'épargne-pension (ASSEP) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu ; Spain : Art. 82(1) Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

[523] See Czech Republic § 39(1)(e) Act No. 426/2011 Coll., on pension savings; Estonia: § 95(5) Investment Funds Act 14 April 2004; Hungary: § 50(4) CXVII 2007 Law occupational pensions and institutions; Italy: Art. 38(1)(a) Decreto Legislativo 5 dicembre 2005, n. 252"Disciplina delle forme pensionistiche complementari"; Latvia: Art. 21(6) 05.06.1997 Law on Private Pension Funds; Liechtenstein: Art. 12(2) Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung (Pensionsfondsgesetz; PFG); Lithuania: Art. 33(1) Nr. 3 Occupational PensionLaw *Nr.* XI-1678 *, 2011-11-17, Official Gazette., 2011, no. 146-6824 (2011-12-01)*; Luxembourg: Art. 18(2)(a) and art. 42(2)(a) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu ; Poland: Art. 159(1) Nr. 4 Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds
Portugal: Art. 49(2)(a) Ministério das Finanças e da Administração Pública- Decreto-Lei n.o 12/2006 de 20 de Janeiro ; Romania: Art. 134(f) Mandatory Pensions Law, Law no.411/2004 (2nd pillar); Slovakia: Art. 102(2)(a) Act on the Old-Age Pension Saving Scheme; Spain Art. 83(3)(b) Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

[524] Czech Republic § 39(1)(f) Act No. 426/2011 Coll., on pension savings; Estonia: § 95(3) Investment Funds Act 14 April 2004; Italy: Art. 38(1)(b) Decreto Legislativo 5 dicembre 2005, n. 252 "Disciplina delle forme pensionistiche complementari"; Latvia: Art. 21(5) 05.06.1997 Law on Private Pension Funds; Lithuania: Art. 33(1) Nr. 2 Occupational PensionLaw *Nr.* XI-1678 *, 2011-11-17, Official Gazette., 2011, no. 146-6824 (2011-12-01)*; Luxembourg : Arts 18(2)(a), 42(2)(a) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu ; Poland: Art. 159(1) Nr. 6 Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Slovakia: Art. 102(2)(g) Act on the Old-Age Pension Saving Scheme.

[525] Estonia: § 95(2) Investment Funds Act 14 April 2004; Lithuania: Art. 33(1) Nr. 5 Occupational PensionLaw Nr. XI-1678 , 2011-11-17, Official Gazette., 2011, no. 146-6824 (2011-12-01); Slovakia: Art. 102(2)(f)Act on the Old-Age Pension Saving Scheme; Luxembourg : Arts 18(2)(b), 42(2)(b) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; Portugal: Art. 49(2)(b) Ministério das Finanças e da Administração Pública- Decreto-Lei n.o 12/2006 de 20 de Janeiro;
Slovakia: Art. 102(2)(f)Act on the Old-Age Pension Saving Scheme.

[526] Czech Republic § 39(1)(d), (i) Act No. 426/2011 Coll., on pension savings; Estonia: § 95(2) Nr. 4 Investment Funds Act 14 April 2004; Italy: Art. 38(1) (a-bis) Decreto Legislativo 5 dicembre 2005, n. 252 "Disciplina delle forme pensionistiche complementari"; Lithuania: Art. 33(1) Nr. 2 Occupational PensionLaw *Nr.* XI-1678 ,

- ensuring that the issue and redemption of the IORP's units is carried out in accordance with the national regulation.[527]

Less common oversight functions in national laws included:

- the reception of member payments and pension payment to beneficiaries;[528]
- the countersigning of contracts for the purchase of the property, or the property is needed for a contract of mandate;[529] and
- the involvement/approval of the depositary in checking compliance relating to setting up an IORP, amending the articles of associations and the liquidation process.[530]

Apart from this, various Member States required their depositaries to properly monitor the cash flows of the IORP. In most Member States the cash management function consisted of booking all the IORP's cash in separate accounts.[531] Most IORP depositaries appointed are credit institutions and as such authorized for accepting reclaimable funds.[532] Other depositaries, such as investment firms or other entities authorized for the depositary function, similar to the AIFMD, UCITSD V and MiFID II may only book the cash at a credit institution in an account either opened in the name of the IORP itself, the governing body of the IORP or the depositary acting on behalf of the IORP.[533]

Besides the cash booked in separate accounts, in some Member States, such as Luxembourg and Malta, the depositary must ensure that all payments made by or on behalf of members/beneficiaries have been received.[534] This may be cash consisting of the reception of

---

2011-11-17, Official Gazette., 2011, no. 146-6824 (2011-12-01); Luxembourg : Arts 18(2)(c), 42(2)(c) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; Poland: Art. 159(1) Nr. 1 Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Art. 51(1) Mandatory Pensions Law, Law no.411/2004 (2nd pillar); Romania: Art. 134(c) Mandatory Pensions Law, Law no.411/2004 (2nd pillar); Slovakia: Art. 102(2)(b)Act on the Old-Age Pension Saving Scheme.

[527] Estonia: § 95(1) Nr. 4 Investment Funds Act˙ 14 April 2004; Italy: Art. 38(1) (a) Decreto Legislativo 5 dicembre 2005, n. 252 "Disciplina delle forme pensionistiche complementari" ; Lithuania: Art. 33(1) Nr. 1 Occupational PensionLaw *Nr.* XI-1678 *, 2011-11-17, Official Gazette., 2011, no. 146-6824 (2011-12-01)*; Poland: Art. 159(1) Nr. 3 Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Spain Art. 83(3)(c) Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

[528] See, for example, in Luxembourg for the 'reception of member payments': Luxembourg : Arts 19(2)(d), 43(2)(d) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; Lithuania: Art. 33(1) Nr. 1 Occupational PensionLaw *Nr.* XI-1678 *, 2011-11-17, Official Gazette., 2011, no. 146-6824 (2011-12-01)*; See for the pension payment to beneficiaries, for example, Portugal: Art. 49(2)(c) Ministério das Finanças e da Administração Pública- Decreto-Lei n.o 12/2006 de 20 de Janeiro; See for both: Spain Art. 83(3)(d) Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

[529] See Hungary: § 50(4)(f) CXVII 2007 Law occupational pensions and institutions.

[530] Poland: Art. 159(1) Nr. 7 Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Spain: Art. 83(3)(a) Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

[531] See, for instance, Czech Republic § 40(1)(a), (c) Act No. 426/2011 Coll., on pension savings; Estonia: § 99(2) Nr. 3 Investment Funds Act˙ 14 April 2004; Hungary: § 50(2), (4)(a) CXVII 2007 Law occupational pensions and institutions; Latvia: Art. 21(1) 05.06.1997 Law on Private Pension Funds; Poland: Art. 159(1) Nr. 7 Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds;

[532] CEIOPS-OP-03-08 final, 56.

[533] Cf. Art. 21(7) AIFMD; Art. 22(4)(a) UCITSD V; Art. 2, 4(1) MiFID II (Commission) Directive; Art. 54 CSDR.

[534] Luxembourg: Art. 18(2)(d) and art. 42(2)(d) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-

premium payments made by the employer and/or participant/member, the transfer of participant funds or other payments.[535]

By being responsible for booking cash in separate accounts either at an account with the depositary itself or an account opened by a third party, depositaries are able to identify changes in the IORP's assets with the periodic cash statements and the consistency of its own records of cash positions with that of the IORP.[536]

4.1.4. *Delegation under IORPD I*

IORPD I does not elaborate any conditions which are applicable to the delegation of functions by IORP depositaries/custodians. Quite some Member States did not impose any specific conditions on the delegation of the depositary/custodian.[537] Member States that did regulate the delegation of depositary/custodian tasks took different approaches regarding:[538]

- the type of functions that could be delegated by the depositary/custodian;
- the nature of the sub-custodian;
- locational restrictions applying to sub-custodians; and
- the due diligence to be expected in selecting sub-custodians.

4.1.4.1. Functions

A considerable amount of Member States imposed limitations as to the types of activities, which may be delegated by depositaries/custodians. Luxembourg, Poland, Portugal, Slovakia,[539] however, only allow safekeeping to be fully or partially delegated, whereas Spain[540] allows, along safekeeping, also cash management to be delegated.

To the contrary, Bulgaria[541], the Czech Republic[542], Estonia[543] and Romania[544] did not restrict the delegation of any depositary/custodian tasks. In these Member States all specific

---

pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu ; Malta: B.6 Custody of Retirement Fund's Assets, B.6.4. Custody of Assets, 6.4.3-6.4.11, Directives for Occupational Retirement Schemes, Retirement Funds and related Parties under the Special Funds (Regulation) Act, 2002.

[535] See Estonia: § 92(1), 95(5) Investment Funds Act 14 April 2004; Portugal: Art. 49(2)(c) Ministério das Finanças e da Administração Pública- Decreto-Lei n.o 12/2006 de 20 de Janeiro; Spain Art. 83(2) Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

[536] Cf. Art. 21(7) AIFMD; Art. 22(4)(a) UCITSD V; Art. 2, 4(1) MiFID II (Commission) Directive; Art. 54 CSDR.

[537] See, for example: Austria: Art. 39 (1) Banking Act; Bulgaria: Art. 123b(3) Social Insurance Code(Title, am. – SG, iss. 67 in 2003); Croatia: Art. 80(3) The Mandatory and Voluntary Pension Funds law of 7 May 1999; Czech Republic: § 41 (12) Act No. 426/2011 Coll., on pension savings; Lithuania: Art. 32(2) Law *Nr.* XI-1678 , *2011-11-17, Official Gazette., 2011, no. 146-6824* (2011-12-01); Luxembourg: Art. 18 (3) and Art. 20 Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; Poland: Art. 160(3) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Romania: Art. 136(2) Mandatory Pensions Law (2nd pillar) Law no.411/2004; Slovakia: § 56 (4) Act on Supplementary Pension Savings.

[538] European Commission, *Working Document of the Commission Services (DG Markt), Consultation Paper on the UCITS Depositary Function*, July 2009, 7,http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/consultation_paper_en.pdf (accessed 7 April 2017).

[539] Luxembourg: Art. 18 (3) and Art. 20 Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; Poland: Art. 160(3) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Portugal: Art. 36Ministério das Finanças e da Administração Pública- Decreto-Lei n.o 12/2006 de 20 de Janeiro.

[540] Spain Art. 83(2) Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

[541] Bulgaria: Art. 123b(3) Social Insurance Code(Title, am. – SG, iss. 67 in 2003).

depositary/custodian tasks, such as safekeeping, oversight function and cash management were allowed to be delegated.

The prerequisites for the delegation of functions to depositaries/custodians posed another issue. Most Member States allowed IORPs to delegate all functions to the depositary/custodian.[545] In Hungary there was a general ban on the delegation of the 'core function of asset management[546], whereas in Spain[547] there was a general ban of delegating any IORP tasks to depositaries, unless functions were functionally and hierarchically separated. Nonetheless, the IORP implementation of various Member States required the governing body of the IORP to 'act in the best interests of the IORPs participants' and delegation did not affect the liability towards the participants for the tasks to be performed by the governing body of the IORP.[548]

There was, thus, no consistency between the limitations as to the types of activities that could be delegated to and by depositaries/custodians and many Member States did not clearly distinguish between the depositary's/custodian' safekeeping and oversight duties.

4.1.4.2. The Nature of the Sub-Custodian and Locational Restrictions

Member States also had introduced limitations as regards the nature of eligible sub-custodians and their locations. The purpose of this was to ensure that the sub-custodian was subject to appropriate or equivalent level of prudential supervision and regulation.[549]

Austria[550] and Germany[551] required, along with an explicit due diligence duty, the delegate to be an authorized custodian. Instead, Lithuania, Estonia and Slovenia allowed all depositary tasks to be delegated to an entity that was subjected to appropriate or an equivalent level of supervision. However, also the type of conditions in this area did very. Lithuania limited the delegates of a depositary to 'other custodians of pension assets' and Estonia to sub-custodians that were 'suitable', i.e. had a good business structure and expertise and was subject to

---

542 Czech Republic: § 41 (12) Act No. 426/2011 Coll., on pension savings.
543 Estonia: § 98(1), (2) Investment Funds Act˙ 14 April 2004 (depositary).
544 Romania: Art. 136 (1) Mandatory Pensions Law (2nd pillar) Law no.411/2004.
545 See Bulgaria: Art. 123b(3) Social Insurance Code(Title, am. – SG, iss. 67 in 2003); Croatia: Art. 80(3) The Mandatory and Voluntary Pension Funds law of 7 May 1999; Czech Republic: § 41 (12) Act No. 426/2011 Coll., on pension savings; Lithuania: Art. 32(2) Law *Nr.* XI-1678 *, 2011-11-17, Official Gazette., 2011, no. 146-6824* (2011-12-01); Luxembourg: Art. 18 (3) and Art. 20 Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; Poland: Art. 160(3) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Romania:Art. 136(2) Mandatory Pensions Law (2nd pillar) Law no.411/2004; Slovakia: § 56 (4) Act on Supplementary Pension Savings.
546 Hungary: § 50(5) CXVII 2007. Law occupational pensions and institutions.
547 Spain Art. 83(2) Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.
548 See Bulgaria: Art. 123b(3) Social Insurance Code(Title, am. – SG, iss. 67 in 2003); Croatia: Art. 80(3) The Mandatory and Voluntary Pension Funds law of 7 May 1999; Czech Republic: § 41 (12) Act No. 426/2011 Coll., on pension savings; Lithuania: Art. 32(2) Law *Nr.* XI-1678 *, 2011-11-17, Official Gazette., 2011, no. 146-6824* (2011-12-01); Luxembourg: Art. 18 (3) and Art. 20 Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; Poland: Art. 160(3) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Romania:Art. 136(2) Mandatory Pensions Law (2nd pillar) Law no.411/2004; Slovakia: § 56 (4) Act on Supplementary Pension Savings.
549 Cf. Art. 21(11) AIFMD; Art. 22a UCITSD V.
550 § 3(1) DepotG (Austrian).
551 § 3(1) DepotG (German).

effective prudential regulation, whereas Slovenia referred to banks and entities that had been authorized in the EEA or in third-countries for providing custody services. Slovenia even required, amongst others, the depositary needs to obtain written consent from the management companies.[552]

4.1.4.3. Due Diligence

Member States requiring depositaries/custodians to comply with a delegation regime differed in the due diligence requirements to be applied.

Italy[553] and Croatia[554], for instance, subjected the delegation of depositary tasks to a prior authorization by their national Competent Authorities. Competent Authorities could, thus, check on a case-to-case basis whether delegation arrangements provided enough investor protection. Apart from this, Croatia only allowed delegation of 'a part of its activities to another legal entity'. They required, thus, an indirect 'letter-box prohibition'.[555]

Other Member States did not require a prior authorization. Instead, delegation arrangements were subject to the freedom of contract. Member States required their depositaries/custodians, however, to conduct either *implicit* or *explicit* due diligence. In general, Member States required their depositaries/custodians to review whether possible delegates:

- have the appropriate business organization and expertise for the delegated tasks performed;
- are subject to 'effective prudential regulation';
- segregated assets/monies from their own and their clients assets/monies.

Bulgaria[556], Czech Republic[557] and Liechtenstein[558] allowed for a so-called 'implicit due diligence'. Due diligence upon a delegation of functions by the depositary/custodian was not directly required. Instead, depositaries/custodians delegating their tasks were implicitly required to perform due diligence to exempt itself from any liability upon delegating their tasks to sub-custodians.

Austria[559] and Germany[560], however, explicitly required custodians to prudentially select sub-custodians. They both held depositaries liable even if they had contractually transferred liability to a sub-custodian.[561]

The depositary/custodian delegation regimes under the IORPD I implementation laws, thus, varied from Member State to Member State.

4.1.5. *The IORPD I Depositary/Custodian Liability Regime*

552 Slovenia: Art. 263(4) Act About the Pension and Disability Insurance (IPDI-2).

[553] Art. 38(3) Decreto Legislativo 5 dicembre 2005, n. 252, "Disciplina delle forme pensionistiche complementari", pubblicato nella *Gazzetta Ufficiale* n. 289 del 13 dicembre 2005 - Supplemento Ordinario n. 200.

[554] Art. 80(3) The Mandatory and Voluntary Pension Funds Law of 7 May 1999; The appointment of one or more custodians to be appointed it not explicitly prohibited.

[555] See, for example, Art. 20 AIFMD for the delegation of AIFM tasks.

[556] Art. 123b Social Insurance Code(Title, am. – SG, iss. 67 in 2003).

[557] § 41 (12) Act No. 426/2011 Coll., on pension savings ; § 92 (6) participating funds pursuant to Act No. 427/2011 Coll., on additional pension savings.

[558] Art. 12 (3) Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung (Pensionsfondsgesetz; PFG); See also Arts 7(1)(m), 35 BankG.

[559] § 3(3) DepotG (Austrian) ; See also Art. 39 (1) Banking Act.

[560] § 3(2) DepotG (germany).

[561] § 3(3) DepotG (Austrian) ; See also Art. 39 (1) Banking Act; § 3(2) DepotG (germany).

IORPD I did not specific the IORP depositary/custodian liability regimes. Under IORPD I, there were in Europe divergent approaches associated to the depositary when the depositary/custodian fails to either perform its safekeeping or oversight duties or when the depositary/custodian or any of its sub-custodians default. The liability of the depositary was, thus, not clear and this is partly due to the fact that the obligations of the IORP depositary in itself have not been clearly regulated on the European level. Some Member States, such as Czech Republic applied a so-called 'strict' liability regime whereas most other Member States took the position that an loss of assets does not necessarily imply an unjustifiable failure of the depositary/custodian.[562] Similar as under UCITSD I-IV, Member States, in particular, diverged in relation to:[563]

- the interpretation of what is considered to be 'improper performance';
- who should be liable for any loss of assets?;
- the scope of depositary liability (when assets are lost by a sub-custodian); and
- rights of the IORP, members and beneficiaries against the IORP depositary.

4.1.5.1. 'Improper Performance'

The interpretation of what is considered to be an 'improper performance' was unclear. Most Member States did not differentiate between the tasks performed in case of wrong performance of the depositary duties at the depositary level for the liability.[564] For the purpose of the liability regime no difference was made between either a loss of financial instruments held in custody and the recordkeeping of assets that cannot be held in custody, at the one hand, and the infringement of oversight duties at the other hand. The liability of the depositary was, thus, not clear and this is partly due to the fact that the obligations of the IORP depositary in itself have not been clearly regulated on the European level.

4.1.5.2. Liability for lost Assets

The liability regime for lost assets was differing across Member States. Some Member States, such as Czech Republic apply a so-called 'strict' liability regime[565], where the depositary is immediately liable for any assets lost (obligation of result), whereas most other Member States took the position that an loss of assets does not necessarily imply an unjustifiable failure of the depositary/custodian (obligation of means).[566]

---

[562] § 41 (12)-(14) Act No. 426/2011 Coll., on pension savings.
[563] Derived from: CESR/09-781, 12-15.
[564] Czech republic: § 41 (12)-(14) Act No. 426/2011 Coll., on pension savings; Estonia: § 103(2) Investment Funds Act, 14 April 2004;Italy: Art. 38(2) Decreto Legislativo 5 dicembre 2005, n. 252 "Disciplina delle forme pensionistiche complementari" pubblicato nella *Gazzetta Ufficiale* n. 289 del 13 dicembre 2005 - Supplemento Ordinario n. 200; Lithuania: Art. 33(4) Occupational Pension Law, Nr. XI-1678 , 2011-11-17, Official Gazette., 2011, no. 146-6824 (2011-12-01); Luxembourg: Arts 20, 44(1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu ; Malta: Par. 6.1.6, B.6 Custody of Retirement Fund's Assets, B.6.1 General Conditions; Poland: Art. 160(2)-(3) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Portugal: Arts 37(3),(4), 51 Ministério das Finanças e da Administração Pública- Decreto-Lei n.o 12/2006 de 20 de Janeiro; Slovenia: Art. 263(4) ACT About the Pension and Disability Insurance (IPDI-2); Spain: Art. 83(2) Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.
[565] Czech republic: § 41 (12)-(14) Act No. 426/2011 Coll., on pension savings.
[566] Estonia: § 103(2) Investment Funds Act, 14 April 2004; Italy: Art. 38(2) Decreto Legislativo 5 dicembre 2005, n. 252 "Disciplina delle forme pensionistiche complementari" pubblicato nella *Gazzetta Ufficiale* n. 289 del 13 dicembre 2005 - Supplemento Ordinario n. 200; Lithuania: Art. 33(4) Occupational Pension Law, Nr. XI-1678 , 2011-11-17, Official Gazette., 2011, no. 146-6824 (2011-12-01); Luxembourg: Arts 20, 44(1) Loi du 13

Consequently, the Czech Republic required an 'inverted' burden of proof for the depositary, whereas other Member States required the IORP, members/beneficiaries to proof that the depositary/custodian breached its duties (negligence).[567]

4.1.5.3. Liability Depositary/Custodian in Cases of Delegation

The differences between Member States applying the 'obligation of result' and the 'obligation of means' was also reflected in the liability of depositaries/custodians in the case of delegation.

Luxembourg, Poland, Portugal, Slovakia, however, allowed the safekeeping of depositaries/custodians to be fully or partially delegated. [568] In all of these Member States delegation did not affect the depositary's/custodian' liability.[569] Some Member States also allowed other depositary tasks to be delegated. Estonia, for example, held depositaries liable for the failure to perform ex ante and ongoing due diligence in selecting an sub-custodian, unless more stringent requirements were agreed upon in a depositary contract.[570]

Most Member States did not restrict depositaries to contractually transfer depositary liability to a sub-custodian. [571]Poland and Slovenia, however, explicitly excluded in their laws that liability for the non or improper performance of statutory duties of a depositary/custodian could not be contractually transferred or excluded upon a delegation.[572]

4.1.5.4. Rights of the IORP, Members and Beneficiaries Against the IORP Depositary/Custodian

Another important aspect in which Member States differed was whether beneficiaries/members of an IORP were allowed to directly or indirectly claim the liability of

---

juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; Malta: Par. 6.1.6, B.6 Custody of Retirement Fund's Assets, B.6.1 General Conditions; Poland: Art. 160(2)-(3) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Portugal: Arts 37(3),(4), 51 Ministério das Finanças e da Administração Pública- Decreto-Lei n.o 12/2006 de 20 de Janeiro; Spain: Art. 83(2) Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

[567] *Ibid.*

[568] Luxembourg: Arts 20, 44(1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; Poland: Art. 160(2)-(3) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Portugal: Arts 37(3),(4), 51 Ministério das Finanças e da Administração Pública- Decreto-Lei n.o 12/2006 de 20 de Janeiro; Slovakia: Art. 103 Act on the Old-Age Pension Saving Scheme.

[569] *Ibid.*

[570] Estonia: § 103(2) Investment Funds Act' 14 April 2004.

[571] Czech republic: § 41 (12)-(14) Act No. 426/2011 Coll., on pension savings; Italy: Art. 38(2) Decreto Legislativo 5 dicembre 2005, n. 252 "Disciplina delle forme pensionistiche complementari" pubblicato nella *Gazzetta Ufficiale* n. 289 del 13 dicembre 2005 - Supplemento Ordinario n. 200; Lithuania: Art. 33(4) Occupational Pension Law, Nr. XI-1678 , 2011-11-17, Official Gazette., 2011, no. 146-6824 (2011-12-01); Luxembourg: Arts 20, 44(1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu; Malta: Par. 6.1.6, B.6 Custody of Retirement Fund's Assets, B.6.1 General Conditions; Portugal: Arts 37(3),(4), 51 Ministério das Finanças e da Administração Pública- Decreto-Lei n.o 12/2006 de 20 de Janeiro; Slovakia: Art. 103 Act on the Old-Age Pension Saving Scheme.

[572] Poland: Art. 160(2)-(3) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Slovenia: Art. 263(4) ACT About the Pension and Disability Insurance (IPDI-2); Spain: Art. 83(2) Real Decreto 304/2004, de 20 de Febrero, por el que se aprueba el Reglamento de Planes y Fondos de Pensiones.

a depositary/custodian. In some Member States members/beneficiaries could invoke liability of a depositary/custodian depending upon the legal form in which the IORP is established.[573] The Lithuanian, Polish and Portuguese implementation of IORPD I did not explicitly regulate this issue.[574] Luxembourg explicitly holds the depositary liable to only the IORP members[575], whereas Czech Republic, Estonia, Italy and Slovenia held the depositary liable to both the beneficiaries and IORP.[576]

Similar as to UCITSD I-IV, the IORPD I depositary/custodian liability regimes varied from Member State to Member State.

4.2. IORPD I/II Governance Structures

Similar to the development under UCITSD I-IV, the absence of a compulsory depositary/custodian appointment under IORPD I/II[577] and the minimum harmonization nature of the custodian/depositary function under IORPD I have resulted in various IORP governance structures in which the 'depositary's tasks were assigned to different types of 'independent oversight entities' that are considered to offer 'equivalent protection' under IORPD II.[578]

Depending upon the individual IORPD I/II Member State implementation, Member States could require the compulsory appointment of a depositary or custodian or not require a depositary/custodian at all.[579] UCITSD I-IV served for many Member States that required the compulsory appointment of a depositary as an example of how to regulate the depositary function.[580] As the tasks and role of the depositary was unclear under UCITSD I-IV this resulted in an even more fragmented landscape as IORPD I did not contain any harmonization regarding the functions to be performed. The safekeeping and controlling duties could under Member State laws be fully performed by the appointed depositary or one or both tasks could be allowed to be fully delegated to third parties, whereas the appointed depositary would remain to be 'liable'.[581] Moreover, the option was left to the Member States under IORPD I/II to require the appointment of two or more 'depositaries' in order to take account of the situation prevailing in some Member States.[582] Similar problems were to be observed throughout the Member State laws that required a 'prime custodian' to be appointed.[583]

---

[573] See, for example, Luxembourg: V. Naveaux & R. Graas, *Direct action by investors against a UCITS depositary – a short-lived landmark ruling?,* 7 Capital Markets Law Journal 455 (2012).

[574] Lithuania: Art. 33(4) Occupational Pension Law, Nr. XI-1678 , 2011-11-17, Official Gazette., 2011, no. 146-6824 (2011-12-01); Poland: Art. 160(2)-(3) Act of 28 August 1997 Law on the Organisation and Operation of Pension Funds; Portugal: Arts 37(3),(4), 51 Ministério das Finanças e da Administração Pública- Decreto-Lei n.o 12/2006 de 20 de Janeiro; Slovakia: Art. 103 Act on the Old-Age Pension Saving Scheme.

[575] Luxembourg: Arts 20, 44(1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu;

[576] Czech republic: § 41 (12)-(14) Act No. 426/2011 Coll., on pension savings; Italy: Art. 38(2) Decreto Legislativo 5 dicembre 2005, n. 252 "Disciplina delle forme pensionistiche complementari" pubblicato nella *Gazzetta Ufficiale* n. 289 del 13 dicembre 2005 - Supplemento Ordinario n. 200; Estonia: § 103(2) Investment Funds Act 14 April 2004; Slovenia: Art. 263(4) ACT About the Pension and Disability Insurance (IPDI-2).

[577] See Art. 33(1) and (2) IORPD II.

[578] Chapter 5, section 4.

[579] See Chapter 9, section 7.

[580] See *supra* 2.1.

[581] See *supra* 4.1.5.; Cf. C. Clerc, *The AIF Depositary's Liability for Lost Assets* (D.A. Zetzsche ed, Kluwer 2015).

[582] See *supra* 4.1.1.

[583] Cf. *supra* 2.2.1.

Throughout the EEA, Member States operate different kinds of IORPs[584] and a variety of legal forms, including IORPs with legal personality, in the contractual or in the trust form.[585] Within each of these legal forms employed, it is possible to identify different monitoring structures that are implemented in the IORPD I/II Member State laws to ensure that the effective safekeeping of IORP assets and the oversight of fiduciary and regulatory obligations are effectively performed.[586]

4.2.1. *IORPs with Legal Personality*

The oversight function of IORPs that are established in the corporate or foundation form[587] is either performed solely by a board of directors (Board of Directors Model) or a board of directors and a depositary (Depositary Model).

The Board of Directors Model is being employed for pure DC IORPs (premium pension institutions; premiepensioeninstelling)[588] and DB IORPs (pension fund; pensioenfonds in the Netherlands. Under this model, the board of directors of the IORP plays a central role in the governance structure. The board of directors of the premium pension institution decides on the pension scheme, the investment policy, compliance with regulations (funding, investment policy, disclosure, governance requirements) and is responsible and represents the pension fund in all internal and external matters.[589] In particular, the board of directors is in this model primary responsible for overseeing at a first level the asset manager, the custodian and other service providers, as well as, for monitoring conflicts of interest arising out of the separation of ownership and management.[590] The (executive members of the) board of directors of the premium pension institution, generally, appoint an asset manager for portfolio management[591] and a custodian for the safekeeping of the IORP assets[592].

The board of directors is subject to fiduciary duties, such as the duties of loyalty and care.[593] In particular, it has to establish a risk management organization and its members are subject to fitness and properness requirements.[594] Depending upon whether a one-tier or two-tier structure is employed either the supervisory board or, in a one-tier structure, non-executive board members monitor the board of directors (executive board members).[595]

In the Board of Directors Model, the board of directors is, therefore decisive in performing the oversight duties towards the asset manager to ensure protection of members/beneficiaries' interest.

---

[584] See Chapter 9, section 2.

[585] See Chapter 9, section 4.1.2.

[586] IOSCO, Examination of Governance for Collective Investment Schemes – Final Report, Part I, p. 6.

[587] See Chapter 9, section 4.1.1.

[588] R.H. Maatman & A. Steneker, *De premiepensioeninstelling*, 12 Ondernemingsrecht 482-491 (2009).

[589] Art. 33 Pensioenwet; Stichting van de Arbeid, Overzicht Principes voor Goed Pensioenfondsbestuur, A. Bestuur.

[590] Art. 33 Pensioenwet; Art. 42 Wet verplichte beroepspensioenregeling.

[591] No compulsory delegation of portfolio management is in place in the Netherlands. It is, however, common practice to appoint an asset manager. See M. van der Westen, Survey: More than 83% of Dutch pension assets under fiduciary management, IPE 3 Januari 2014, http://www.ipe.com/survey-more-than-83-of-dutch-pension-assets-under-fiduciary-management/10000711.fullarticle (Accessed 28 July 2016).

[592] The appointment of a custodian is not compulsory, but common practice. See P. Laaper, *Uitbesteding in de financiële sector - in het bijzonder van vermogensbeheer door pensioenfondsen* (kluwer 2015), 57-60, 211.

[593] Art. 33 Pensioenwet; Stichting van de Arbeid, Overzicht Principes voor Goed Pensioenfondsbestuur, A. Bestuur.

[594] See Art. 2:54h Wft.

[595] In the Netherlands, premium pension institutions may either be established as a public limited company, private limited company, a foundation or a *Societas Europaea: Art.* 3:19a Wft.

In Liechtenstein (Pensionsfonds), Luxemburg (SEPCAVs/ASSEPs) DC and other types of IORPs are established in the corporate form.[596] In contrary to the Netherlands, Liechtenstein and Luxembourg, however, require apply the Depositary Model, i.e. they require their corporate DC and other types of IORPs to appoint a depositary.[597] The depositary is responsible for the oversight of the IORP and its asset managers, as well as, for the safekeeping of the IORP assets.[598] Under the Liechtenstein and Luxembourg legal framework the board of directors is responsible for the daily management of the IORP.[599] The IORPs are a legal person in its own right and the board of directors can act on behalf of the IORP.[600] The board of directors are, amongst others, responsible for the investment policy, disclosure, the monitoring and supervision of delegates, prevent conflicts of interests and ensure compliance with the IORP policies and procedures.[601]

Under the Depositary Model, the depositary may, thus, be compared, but not said to be performing equivalent activities exercised by the board of the directors under the previous model.

4.2.2. *The Trust Model*

In Ireland and the UK, DC and other types of IORPs are exclusively established in the trust form and governed by the trust deed.[602] The trust deed has no legal capacity in itself and a trustee is, therefore, appointed under the deed to carry out the daily management as the IORP governing body.[603] Apart from this, trustees have the rights and duties under trust law for ensuring compliance with investor protection rules.[604] Trustees are required by law to do the oversight function and oversee the (asset manager's) activities to ensure it meet the objectives

---

596 See Chapter 9, section 4.1.1.

597 Liechtenstein: Art. 12 Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung (Pensionsfondsgesetz; PFG); Luxembourg: Arts 18 (1) and 42 (1) Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu

598 Liechtenstein: Art. 12 Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung (Pensionsfondsgesetz; PFG); Luxembourg: Arts 18-22 and 42-46 Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu

599 Liechtenstein: Art. 12 Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung (Pensionsfondsgesetz; PFG); Luxembourg: Arts 5 and 25 Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu

600 See Liechtenstein: Art. (7)(1)(a) Gesetz vom 24. November 2006 betreffend die Aufsicht über Einrichtungen der betrieblichen Altersversorgung (Pensionsfondsgesetz; PFG); Luxembourg: Arts 6 and 27 Loi du 13 juillet 2005 relative aux institutions de retraite professionnelle sous forme de société d'épargne-pension à capital variable (sepcav) et d'association d'épargne-pension (assep) et portant modification de l'article 167, alinéa 1 de la loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu.

601 See Chapter 9, section 3.1.

602 Ireland: The Pensions Authority, *So you're a pension scheme trustee – A brief guide to your duties and responsibilities,*5http://www.pensionsauthority.ie/en/LifeCycle/Information_Booklets/So_you%E2%80%99re_a_pensions_scheme_trustee_.7239.shortcut.pdf (Accessed 30 July 2016); UK: The Pensions Regulator, *Trustee Guidance*, December 2007, 'Who can be a trustee?'.

603 Ireland: The Pensions Authority, *So you're a pension scheme trustee – A brief guide to your duties and responsibilities,*5http://www.pensionsauthority.ie/en/LifeCycle/Information_Booklets/So_you%E2%80%99re_a_pensions_scheme_trustee_.7239.shortcut.pdf (Accessed 30 July 2016); UK: The Pensions Regulator, *Trustee Guidance*, December 2007, 'Who can be a trustee?'.

604 Ireland: The Pensions Authority, Trustee Handbook, 5th Edition, 11; UK: UK: The Pensions Regulator, *Trustee Guidance*, December 2007, 'The trustees' duties and powers'.

and requirements of the regulators.[605] Trustees are also responsible for holding the assets of the trusts for members/beneficiaries that are beneficially entitled to them.[606] Trustees usually delegate the safekeeping function to a third-party custodian either directly or indirectly through an asset manager.[607] If not being delegated to a custodian, trustees have to make arrangements in place for holding the scheme's assets. They are, however, prevented from delegating their oversight duties as this would be detrimental for investor protection.

The Trust Model is equivalent to the Depositary Model as the trustee is responsible for both the oversight of the IORP and the safekeeping of its assets. Unlike the depositary, however, the trustee is not necessarily exercising both oversight and safekeeping function at the same time but delegates the latter to a third-party custodian.

4.2.3. *The Contractual Model*

In Portugal and Spain, IORPs are set up in the contractual form and financial intermediaries, such as a bank, insurance company or a pension fund management company, are the external governing body responsible for the daily management of the IORP.[608] This type of IORP is characterized by employers directly setting up an IORP scheme with pension providers without any intervention of trustees or equivalent representation of an internal governing body.[609] A direct contractual relationship is established between the members and the private pension providers.[610]

The governing body of the IORP is, thus, the same as that of the private pension provider. For this purpose, the governance regulations in Portugal and Spain require some key responsibilities to be shared with a separate oversight committee that also supervises the governing body.[611] The separation of responsibilities in the governing body is to ensure compliance with the duty of loyalty/care of the pension management company (monitor the monitor).[612] A depositary in Portugal and Spain is required to be appointed to exercise oversight of the IORP and the IORP activities as well as for the safekeeping of the IORP assets.[613]

4.3. IORPD III: Towards a Contractual Governance Model

---

[605] Ireland: The Pensions Authority, *So you're a pension scheme trustee – A brief guide to your duties andresponsibilities,*5http://www.pensionsauthority.ie/en/LifeCycle/Information_Booklets/So_you%E2%80%99re_a_pensions_scheme_trustee_.7239.shortcut.pdf; UK: The Pensions Regulator, *Trustee Guidance*, December 2007, 'Advisers required by law'.

[606] Ireland: The Pensions Authority, *Trustee Handbook*, 5th Edition, 70; UK: The Pensions Regulator, *Trustee Guidance*, December 2007, 'Advisers required by law'.

[607] Ireland: The Pensions Authority, *Trustee Handbook*, 5th Edition, 70; UK: The Pensions Regulator, *Trustee Guidance*, December 2007, 'Advisers required by law'.

[608] Portugal : Arts 32, 38 Decreto-Lei n.o 12/2006 de 20 de Janeiro; Spain: Art. 20 Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulación de los Planes y Fondos de Pensiones.

[609] F. Stewart & J. Yermo, *Pension Fund Governance: Challenges and Potential Solutions*, OECD Working Papers on Insurance and Private Pensions No. 18 (June 2008), 29.

[610] F. Stewart & J. Yermo, *Pension Fund Governance: Challenges and Potential Solutions*, OECD Working Papers on Insurance and Private Pensions No. 18 (June 2008), 31.

[611] Portugal: Art. 53 Decreto-Lei n.o 12/2006 de 20 de Janeiro ; Spain: Art. 13 Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulación de los Planes y Fondos de Pensiones.

[612] J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 10.

[613] Portugal : Art. 49 Decreto-Lei n.o 12/2006 de 20 de Janeiro ; Spain: Art. 83 Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulación de los Planes y Fondos de Pensiones.

Under IORPD I/II the same governance models are currently used as was the case under the pre-AIFMD and the UCITSD I-IV depositary regimes. The reason for this is that both the IORPD I and IORPD II allow Member States to compulsory require a 'depositary' or 'custodian' to be appointed for IORPs.[614] In addition, IORPD II also contains an 'equivalent protection regime' for IORPs that either do not have appointed a 'custodian' or 'depositary' whether this is compulsory required or not.[615] The type of model allowed to be applied by IORPs are, essentially, based upon the preference of the Member States in implementing IORPD I/II.

It would make sense in any future IORPD III to reconsider this and compulsory require Member States either to opt for a compulsory 'custodian' or 'depositary' to be appointed. In this way, consistency could be achieved by requiring the proposed MiFID II stand-alone 'custodian' regime to be applied for 'compulsory custodians'. The UCITSD V depositary regime could serve as a model for Member States that would opt for a 'compulsory depositary'. This suggestion would lead to more convergence in regulation applying to 'custodians' and 'depositaries' in the development towards a full 'contractual governance model' on which a cross-sectoral depositary passport could be based.

4.4. Conclusion

IORPD I laid down minimum standards related to 'custodians' and 'depositaries'. IORPD I left it up to the Member States whether or not to make the appointment of a depositary or a custodian compulsory.[616] Unlike UCITSD V and the AIFMD, the eligibility, the functions, delegation and the liability were not specified by IORPD I.[617] Similar as for UCITSD V and the AIFMD, investor protection concerns related to the appointment, eligibility, functions and liability of depositaries/custodians in preparation for IORPD II were being reviewed to ensure a more consistent approach throughout the EEA.[618]

The discretion left to Member Stats under IORPD I/II to require IORPs to appoint a compulsory 'depositary' or 'custodian' also has an impact on the governance employed by IORPs. Throughout the EEA, Member States operate different kinds of IORPs[619] and a variety of legal forms, including IORPs with legal personality, in the contractual or in the trust form.[620] Within each of these legal forms employed, it is possible to identify different monitoring structures that are implemented in the IORPD I/II Member State laws to ensure that the effective safekeeping of IORP assets and the oversight of fiduciary and regulatory obligations are effectively performed.[621] Unlike under the AIFMD and UCITSD V, the 'contractual model', thus, is not established for IORPs yet. Instead, the IORPD II Member State implementations decide what governance forms may be employed for their IORPs. To ensure consistency with the AIFMD, UCITSD V and proposed PEPPR, it would make sense in any future IORPD III to reconsider this and compulsory require Member States either to opt for a compulsory 'custodian' or 'depositary' to be appointed. In this way, consistency could be achieved by requiring the proposed MiFID II stand-alone 'custodian' regime to be

---

[614] See Article 33(1) and (2) IORPD II.
[615] See Chapter 13, section 4.2.
[616] Art. 19(2) sub-para. 2 IORPD I.
[617] See CEIOPS-OP-03-08 final, 55.
[618] Cf. European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012) 350) (SWD(2012) 186),* 52.
[619] See Chapter 9, section 2.
[620] See Chapter 9, section 4.1.2.
[621] IOSCO, Examination of Governance for Collective Investment Schemes – Final Report, Part I, p. 6.

applied for ‘compulsory custodians’. The UCITSD V depositary regime could serve as a model for Member States that would opt for a ‘compulsory depositary’. This suggestion would lead to more convergence in regulation applying to ‘custodians’ and ‘depositaries’ in the development towards a full ‘contractual governance model’ on which a cross-sectoral depositary passport could be based.

5. Conclusion

Although the depositary performs under UCITSD V, AIFMD and IORPD II a similar role, still differences are being observed between UCITSD V and the AIFMD, and IORPD II, at the other hand. These differences have an *historical explanation*.

The role depositaries played for mutual funds (now UCITS) and other types of investment funds was, prior to the UCITSD V and AIFMD also partly depended upon the legal form in which a fund was established. Post-AIFMD still some relics are to be observed for AIFs that proof this statement. Upon the adoption of the UCITSD I, depositary legislation was also legal form depended. The role and function of the depositary depended upon whether a UCITS was contractual/trust-based or corporate-based. The depositaries for the latter types of UCITS were exempted from certain depositary duties.

Upon the adoption of UCITSD V and the AIFMD, funds are being for the purpose of depositary regulation are regarded as ‘one-size fits all’ based upon legal form neutrality. Under globalization and the increasing role of technology, regardless of the legal form in which funds are established, an AIFM/UCITS ManCo and depositary having an safekeeping and oversight role are to be appointed. The pre-dominant contractual form can be explained by the fact that trustee/supervisory/governing boards cannot compete in terms of costs and quality with carrying out the oversight duties by means of manual work in comparison to the highly advanced technology-based systems which are employed by professional depositaries. The pre-dominant contractual-based form, thus, will be dominant in terms of depositary regulation.

Differences between in terms of depositary regulation between the AIFMD and UCITSD V, at the one, and IORPD, at the other hand, can thus be explained based upon an historical explanation. Till now, UCITSD V and AIFMD have substituted to a larger extent private, trust and corporate law arrangements than that the IORPD I/II has done so far in the IORP domain. The former two types are subjected to a larger degree of European legislation in which also ‘investment intermediaries’ and depositaries as intermediaries and the general governance framework has been regulated to a larger degree.

The difference in treatment of depositaries between UCITSD V and AIFMD, at the one, and IORPD II, at the other hand, cannot be justified in terms of investor protection.

D. Historical Explanation - Conclusion

Despite ‘depositaries’ fulfilling a similar role throughout the European investment law directives, still inconsistencies between the various depositary regimes are to be observed. These differences have an *historical explanation*. Prior to the adoption of the AIFMD and UCITSD V, different governance models were being employed for AIFs and UCITS. The ‘one-size fits all’ based upon legal form neutrality has not always been in place. Instead, contractual, corporate and trust governance models were in place. Under the contractual model, depositaries were assigned a monitoring role towards AIFMs and UCITS ManCos, whereas under the trust and corporate model this monitoring role was fully or partly assigned to the trustee and the board of directors. The AIFMD and UCITSD V introduced the ‘contractual governance model’ for all types of AIFs and UCITS. This can be explained by the fact that trustee/supervisory/governing boards cannot compete in terms of costs and quality with carrying out the oversight duties by means of manual work in comparison to the highly advanced technology-based systems which are employed by professional depositaries. Although under IORPD I/II still discretion is left to Member States to allow IORPs to employ the corporate and trust model, the legal form neutral approach under the proposed PEPPR shows that the contractual-based form will be dominant in terms of depositary regulation in the future.

PART III - Conclusion

Part III aimed to define what a depositary is and whether and to what extent depositaries and custodians differ. This served two purposes. First, Part III clarifiedwhether a difference in treatment of depositaries, at the one, and custodians, at the other hand, throughout European investment law is justified from an investor protection perspective. Second, Part III seeks to find out whether common regulatory principles for depositaries and custodians, similar as for asset managers that conduct investment management under the European investment law directives, are to be found that would possibly justify a cross-sectoral European depositary passport. To this end, the application of the legal interpretation methods of *Von Savigny* on the study of positive norms of the depositary in European investment law, including the grammatical, teleological, systematic and historical explanation were applied in defining depositaries and custodians.

A. Grammatical Explanation

European investment law nor the Member State implementations of the AIFMD, UCITSD V, IORPD II and MiFID I/CRD IV contain consistent definitions of what 'depositaries' and 'custodians' are. This leads to confusion as to the similarities and differences between 'depositaries' and 'custodians' on the European and national level.

No common definition is found in European law of what 'depositaries' and 'custodians'[1] are. The European Commission in a Commission Communication reviewing possible developments on the regulation of UCITS depositaries defined custodians as

> 'an entity entrusted with the safekeeping and administration of securities and other financial assets on behalf of others, and may moreover provide additional services, including clearing and settlement, cash management, foreign exchange and securities lending'.

Although not directly targeted, the CRD IV and MiFID II regulate credit institutions and investment firms that provide the service of 'safekeeping and administration of securities/financial instruments' as an ancillary service.[2] 'Investor CSDs' partly provide similar services as 'custodians' under CRD IV and MiFID II. The core services provided under the CSDR, however, delineate 'investor CSDs' from 'custodians'. By reviewing credit institutions, investment firms, national custodians, 'investor CSDs' and the MiFID II client asset requirements, the review of MiFID II, CRD IV, the CSDR and corresponding Member State implementations highlighted that the credit institutions, investment and national custodians are to be seen as 'custodians'.

The AIFMD, UCITSD V and IORPD II contain 'lex specialis' provisions targeting 'depositaries'. Depositaries under the AIFMD and UCITSD V are 'institutions that are entrusted with the safekeeping of assets and oversight of compliance with the fund rules and applicable law'.[3] Under IORPD II, 'depositaries' may be appointed for the safe-keeping of assets or for safe-keeping of assets and oversight duties in accordance with the IORPD II

---

[1] European Commission, Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments, COM(2004) 207 final, 30 March 2004, 7, 14, 26.
[2.] Annex I Nr. 12 CRD IV.
[3] Cf. Art. 2(23) PEPPR.

depositary regime.[4] The meaning of a ‘depositary’ under both Article 33(1) and (2) IORPD II for both full DC and other types of IORPs should, however, be read as either a ‘custodian’ or an ‘UCITSD V/AIFMD depositary’.[5]

The additional monitoring/controlling duty of depositaries has led to ‘lex specialis’ depositary regulation that facilitates the different role that depositaries play in ‘fiduciary governance’. These ‘lex specialis provisions’ to be found in the AIFMD, UCITSD V, IORPD II and the proposed PEPPR relate to:

- the mandatory appointment of a single depositary;[6]
- the legal independence of the depositary and the IORP (governing board) and related requirements;[7]
- the eligible entities required to be appointed and the organizational requirements applicable to them (depending upon the UCITSD V Member State implementation: credit institutions, investment firms, and ‘other legal entities’);[8]
- the re-use of assets;[9]
- the safekeeping duties;[10]
- the oversight duties;[11]
- the delegation regime;[12] and
- the depositary’s liability regime.[13]

B. Teleological Explanation

Despite of the differences between how the depositary is being regulated throughout European investment law and in the implementation of the Member States, common principles, however, argue in favour of the introduction of an AIF/UCITS or even a cross-sectoral depositary passport.

Depositaries under the AIFMD/UCITSD V perform a safekeeping and oversight role and custodians under CRD IV, MiFID II and on the national level merely a safekeeping role. Despite of this, the same entities that within individual Member States that act as a depositary perform mainly safekeeping under MIFID II and safekeeping (and oversight duties) under IORPD II. At the same time, they are subjected to the same custody transfer laws that determine the legal scope of the safekeeping function. The author holds that this is the case because depositary law is an specialized area of custody law. The depositary is, thus, a ‘specialized custodian‘.

A *teleological explanation* of the depositary throughout the European investment law directives explains this. By imposing an depositary/custodian, the law seeks to protect investors, preserve the stability of the financial system and ensure market integrity.

The authorization, conduct of business rules, prudential regulation, supervision and enforcement of credit institutions, investment firms and ‘equivalent other entities’ are considered under the various European directives to be appropriately addressing the investor and market protection risks related to the safekeeping function of custodians and depositaries. The notion of ‘depositary’ under IORPD II, UCITSD V and the AIFMD is wider than the

---

[4] Art. 33(2) IORPD II.
[5] EIOPA-BOS-12/015, 471.
[6] Art. 22(1) UCITSD V; Art. 21(1) AIFMD; Art. 33(1) and (2) IORPD II; Art. 41(1) PEPPR.
[7] See Arts 25, 26b UCITSD V; Art. 21 UCITSD V (Commission) Regulation; Art. 33(7) IORPD II.
[8] Art. 23(2) UCITSD V; Art. 21(3) AIFMD; Art. 33(3) IORPD II.
[9] Art. 21(11)(d)(iv) AIFMD; Art. 22(7) UCITSD V.
[10] Art. 22(5) UCITSD V; Art. 21(8) AIFMD; Art. 34 IORPD II; Art. 41(3) PEPPR.
[11] Art. 22(3) UCITSD V; Art. 21(9) AIFMD; Art. 35 IORPD II; Art. 41(4) PEPPR.
[12] Art. 22a UCITSD V; Art. 21(11) AIFMD; Art. 34(4) IORPD II; Art. 41(3) PEPPR.
[13] Art. 24(1) UCITSD V; Art. 21(12) AIFMD; Art. 34(4) IORPD II; Art. 41(3) PEPPR.

notion of pure ‘custodian’[14]. For this reason, IORPD II, UCITSD V and the AIFMD require additional conducts of business rules to be fulfilled for depositaries that in their capacity of acting as a custodian perform oversight duties. Depositary law is, thus, a separate area of law applying on top of the ‘general law’ applying to credit institutions, investment firms or ‘other equivalent legal entities’ authorized to act as a custodian.

C. Systematic Explanation

The difference between ‘depositaries’ and ‘custodians’ is that depositaries, apart from safekeeping, also perform oversight duties.[15] In this regard, it should be noted that the AIFMD and UCITSD V require mandatorily a depositary to be appointed, MiFID I/II a custodian to be appointed[16], whereas IORPD II leaves it up to the Member States whether a depositary/custodian is appointed at all and if so, whether either a depositary or custodian must be appointed.[17] There are, thus, not only differences between ‘depositaries’ and ‘custodians’, but also between various types of ‘depositaries’ throughout sectoral EEA legislation.

This is the result of how the different European investment law directives deal with the ‘structural separation of investments and management’. The ‘investment assets’ legally/beneficially owned by investors/members and the ‘operational assets’ legally/beneficially owned by ‘investment intermediaries’ and ‘depositaries’/’custodians’ form two separate ‘asset patrimonies’. European investment law establishes this structural separation by means of warranting an (optional/virtual) ‘investment triangle’ to be in place that involves an ‘investment intermediary’, depositary/custodian and investors/members. This ‘triangle’ regulates (fiduciary/agency) governance and asset partitioning.

The structural separation limits ‘residual control’ that is beneficial for all constituencies in European investment law. It allows ‘investment intermediaries’ and ‘depositaries’/’custodians’ to exploit economies of scope and scale by conducting various business lines simultaneously, whereas it allows investors/members to benefit from lower fees. For this reason, assets are partitioned in two separate assets patrimonies by means of the segregation duty that comes along with the safekeeping task of depositaries/custodians.

The structural separation, however, also leads to agency costs. The (virtual/optional) investment triangle under European investment law regulates this by requiring ‘investment intermediaries’ and ‘depositaries/custodians’ to be regulated under intermediary regulation, financial products such as AIFs, UCITS and PEPPs, are subject to product regulation, whereas disclosure/sales/marketing regulation ensures that investors/members are adequately informed. Depositaries/custodians are, thus, merely one investor protection mechanism in the investment triangle that regulates the agency costs resulting from the structural separation of investments and management under the European investment law directives.

The role that depositaries and custodians play are, in particular, different in (fiduciary/agency) governance. This can be explained by an *systematic interpretation* of the depositary throughout European investment law. Depositaries are required by European investment laws, such as the AIFMD, UCITSD V, IORPD II and the proposed PEPPR that

---

[14] European Commission, Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries {C(2015) 9160 final}, Annex 4.

[15] International Organization of Securities Commission, *Standards for the Custody of Collective Investment Schemes’ Assets – Final Report*, FR 25/2015, November 2015, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD512.pdf (accessed 14 April 2017).

[16] Recital 32, Art. 22(1) UCITSD V; Art. 21(1) AIFMD.

[17] Art. 33(1) and (2) IORPD II.

are characterized by ‘investment intermediaries’ that conduct discretionary investment management. Investors/members directly or indirectly give a mandate to these ‘investment intermediaries’ to carry out investment management on their behalf without having the ultimate control in how their assets should be invested. Depositaries have an oversight duty in checking compliance of the investment decision made with the agreed investment policy. This is a marginal check. European investment law directive that do not regulate investment relationships that have a ‘fiduciary’ but ‘agency’ nature, such as execution-only and investment-advice based investment relationships under MiFID II, do not require a depositary to be appointed. Instead, a custodian is appointed under these directives. In addition, depositaries are required to be appointed under European investment law directives that have a ‘collective investment nature’. The oversight duty under the AIFMD, UCITSD V, IORPD II and proposed PEPPR prevents collective action problems in monitoring ‘investment intermediaries’ and, generally, is the ‘cheapest solution’ (cheapest cost avoider theory). Under investment relationships in which there is not ‘pooled return/risk’, only individual investors are affected by investment decisions made by ‘investment intermediaries’. For this reason, individual investors are easily able to serve their own interests by giving investment directions/orders to these intermediaries and the oversight duty performed by depositaries is not warranted. For this reason, custodians are used in these investment relationships. Moreover, depositaries are only appointed under those European directives in which investors bear the ‘full investment risks’. This implies that ‘investment intermediaries’ as agents are conducting investment management on behalf of investors/members in which the latter bear the full risk. No guarantee or claim is in place, such as for deposit-taking activity or insurances under CRD IV and Solvency II that grants consumers a claim on their balance sheet.

The systematic explanation does not explain why there are still differences to be found amongst sectoral depositary laws, such as in the AIFMD and UCITSD V that both regulate collective investment undertakings. This has a historical explanation that will be adressed in the next chapter.

D. Historical Explanation

Despite ‘depositaries’ fulfilling a similar role throughout the European investment law directives, still inconsistencies between the various regimes are to be observed. In the ongoing harmonization trend. These differences have an *historical explanation*. Prior to the adoption of the AIFMD and UCITSD V, different governance models were being employed for AIFs and UCITS. The ‘one-size fits all’ based upon legal form neutrality has not always been in place. Instead, contractual, corporate and trust governance models were in place. Under the contractual model, depositaries were assigned a monitoring role towards AIFMs and UCITS ManCos, whereas under the trust and corporate model this monitoring role was fully or partly assigned to the trustee and the board of directors. The AIFMD and UCITSD V introduced the ‘contractual governance model’ for all types of AIFs and UCITS. This can be explained by the fact that trustee/supervisory/governing boards cannot compete in terms of costs and quality with carrying out the oversight duties by means of manual work in comparison to the highly advanced technology-based systems which are employed by professional depositaries. Although under IORPD I/II still discretion is left to Member States to allow IORPs to employ the corporate and trust model, the legal form neutral approach under the proposed PEPPR shows that the contractual-based form will be dominant in terms of depositary regulation in the future.

The differences between ‘depositaries’ and ‘custodians’ throughout EEA sectoral laws and the ‘joint principles’ under which European and TC European passports are granted, will be taken into account in Part IV to assess under what conditions an AIF/UCITS depositary passport or even a ‘cross-sectoral depositary passport’ could be introduced under European investment law.

PART IV - Towards a Cross-Sectoral Depositary Passport

This thesis takes the viewpoint that an AIF/UCITS depositary passport or even a 'cross-sectoral' depositary passport should be introduced. To that end, Part I pointed out the inconsistencies of the policy of the European Commission on a sectoral and cross-sectoral basis in granting a European/TC passport to 'depositaries. Part II studied the EEA's approach towards the cross-border provision of financial services. In particular, the 'joint principles' under which European and TC European passports are granted were highlighted. Part III held that the cornerstones of the European passport for financial intermediaries, such as custodians and depositaries are the 'single rulebook', 'home country control' and the ESFS. Similarly, TC passports are based upon the 'internal dimension' and 'external dimension'. The 'internal dimension' is based upon the four freedoms and the 'external dimension' upon internal law commitments and EEA secondary law. EEA secondary law requires TC financial intermediaries to be subject to 'equivalent' regulation and supervision. 'Equivalent regulation' is achieved by requiring TC intermediaries to comply with EEA secondary legislation and/or a 'centralized equivalency assessment'. This is complemented by 'legal representation in the EEA', cooperation agreements and information exchange that have to be in place between relevant Competent Authorities. Part III reviewed whether the differences between depositary regulation throughout sectors, at the one, and the regulation of 'custodians', at the other hand, justifies the difference in treatment in granting a European/TC passport. Von Savigny's interpretation methods, including the grammatical, teleological, systematic and teleological method, were used in order to verify these differences. Part II concluded that depositaries are 'custodians', i.e. financial intermediaries performing the safekeeping and administration of financial instruments, that perform additional 'controlling/monitoring' duties. This additional task could justify the difference in treatment for the purpose of introduction of an European/TC passport between AIF/UCITS depositaries, at the one, and MiFID II/CRD IV 'custodians', at the other hand. Part IV sets out what is necessary to introduce a cross-sectoral depositary passport for EEA and TC financial intermediaries. For this purpose, Part IV takes into account the differences between 'depositaries' and 'custodians' throughout sectoral EEA secondary laws and the 'joint principles' under which European and TC European passports are granted to EEA and TC financial intermediaries.

Chapter 13 Towards the Introduction of a Cross-Sectoral European Depositary Passport in European Investment Law

Part I has set out the current 'depositary passport paradox'. Part II clarified the conditions under which European/TC passports are granted to EEA and TC financial intermediaries. Part III the differences between 'depositaries', at the one, and 'custodians', at the other hand, throughout European sectoral legislation. This chapter, on the basis of the outcome of the preceding Parts, advocates in favour of the case for introducing not only an AIF/UCITS depositary but a 'cross-sectoral European depositary passport' in European investment law. To this end, this chapter takes into account the differences between 'depositaries' and 'custodians', the problems and inconsistencies related to the 'European depositary passport paradox' and 'investor protection concerns' in setting out the conditions for introducing such a passport under a proposed 'custody plus' solution. Depositaries are regarded as 'custodians', that, in addition to, the safekeeping of financial instruments also perform 'controlling/monitoring duties'. For this reason, the 'safekeeping task' of 'custodians' and 'depositaries' is proposed to be regulated on a 'cross-sectoral' basis under a MiFID II 'stand-alone' regime, whereas the 'controlling/monitoring tasks' and the particularities of 'depositaries' are left over to the sectoral legislation. A proposal is made in this chapter to achieve 'cross-sectoral consistency' for these sectoral depositary regimes. The chapter concludes by predicting what role 'depositaries' and 'custodians' will play in the unleashing 'blockchain revolution'.

1. A Cross-Sectoral Passport for European Depositaries and Custodians – The 'Custody Plus' Solution

The introduction of a (full) passport for UCITS/AIFs depositaries would imply that several separate legal regimes applying to custodians and depositaries would exist that all would entitle a custodian/depositary to provide the safekeeping of assets (and controlling duties) on a cross-border basis. Depositaries/custodians would, however, comply with different legal standards, whereas the core activity of safekeeping assets in the intermediary holding chain and its corresponding risks are the same.[1] A streamlined cross-sectoral European passport for depositaries/custodians willing to provide cross-border services to IORPs, UCITS, AIFMs, PEPPs and investment firm clients (MiFID II) could, therefore, lead to a further reduction of operational costs and achieve economies of scale.[2] Such a passport could be modelled after the 'Cross-Sectoral Investment Management Passport' currently in place. The basic foundation of the passport would be a 'stand-alone' custodian that would be regulated under MiFID II. This would restrict eligible depositaries/custodians to credit institutions/investment firms and allow for cross-sectoral consistency of the intermediary regulation applying to all depositaries/custodians appointed under European investment law

[1] Chapter 7, section 2.2.1.
[2] C.P. Buttigieg, *The Development of the EU Regulatory and Supervisory Framework applicable to UCITS: A Critical Examination of the Conditions and Limitations of Mutual Recognition*, March 2014, 66, http://sro.sussex.ac.uk/48285/1/Buttigieg%2C_Christopher_P..pdf (accessed 7 April 2017).

1.1. The 'EEA Cross-Sectoral Investment Management Passport' as an Example

Recently, UCITSD (IV) , the AIFMD and MiFID II have introduced legislation that allows a single 'asset manager' complying with a proportional set of legal standards to manage AIFs, individual portfolios, UCITS and IORPs on the basis of a 'cross-sectoral management passport'.[3] In addition, the PEPPR allows 'asset managers' that have an AIFM, UCITSD V, MiFID II or IORP authorization to 'manufacture or distribute PEPPs' as a PEPP provider.[4]

The 'cross-sectoral management passport' is based upon the rationale that 'asset managers' under the abovementioned sectoral legislation all perform investment/portfolio and risk management as core tasks.[5] For this reason, 'asset managers' willing to exploit economies of scope and scale by operating several business lines simultaneously are, under specific conditions, not required to comply with all sectoral requirements in full. Instead, the 'cross-sectoral management passport' is built upon a proportional system in which the authorization for the provision of 'portfolio management' of AIFMs/UCITS ManCos under the AIFMD or UCITSD V substitutes for a full-fledged 'portfolio management' authorization under MiFID II. Moreover, AIFMs complying with a couple of UCITS ManCo related requirements may have a 'dual license' under which they have an AIFM and UCITS ManCo 'management passport'.[6] The AIFM, MiFID II and UCITS ManCo authorizations are also recognized under IORPD II and the proposed PEPPR under which AIFMs, investment firms and UCITS ManCos may act as delegated investment manager and as 'PEPP providers'.[7] The proportional regime is designed upon the two 'core functions' of asset managers. The AIFMD, UCITSD V and MiFID II, however, vary in the scope and, therefore, in the type of 'asset managers' that are to be authorized under these directives.[8] MiFID II is primarily focused on 'financial instruments', UCITSD V on financial instruments and liquid financial assets, whereas the AIFMD captures liquid, illiquid and leveraged AIFs. For this reason, the proportional 'cross-sectoral investment management passport' does not allow UCITS ManCos and MiFID II portfolio managers to manage AIFMs without applying for a full-fledged AIFM authorization.

Modelled after this concept, indeed, a proportional 'cross-sectoral depositary passport' could be built upon the core activities of the safekeeping of assets and the performance of oversight duties. All depositaries and custodians perform at least the safekeeping of assets as a minimum. Essentially, depositaries are custodians that perform, in addition to the safekeeping of assets, oversight duties.[9] For this reason, a 'cross-sectoral depositary passport' could be built on the basis of an harmonized authorization regime for custodians on the basis of the regulatory activity 'safekeeping of assets', whereas on the sectoral level a cross-sectoral consistent set of legislation applies additionally for custodians that act as depositaries. This

---

[3] Portfolio management and risk management are both considered to be 'investment management'. See Point 1(a) and (b) Annex I and Art. 4(1)(w) AIFMD and Annex II, Article 6(2) UCITSD V. See also D.A. Zetzsche & D. Eckner, *Risk Management* 336 et seq. (D.A. Zetzsche ed, Kluwer 2015); See also Allen & Overy, *Alternative Investment Fund Managers Directive: Allen & Overy Briefing Paper No. 9 AIFMD, UCITSD and MiFID: Interactions and Overlaps*, http://www.allenovery.com/archive/Documents/Legacy/62666.pdf (accessed 3 July 2015).

[4] Art. 5 PEPPR.

[5] See, for example, Chapter 8, 3.1.1.

[6] U. Klebeck, *Interplay between AIFMD and the UCITSD* (D.A.Zetzsche ed, Kluwer 2015).

[7] See for AIFMs and UCITS ManCos: Chapter 8, section 3.1.4 and 3.4.2.; See for IORPs: Chapter 9, section 3.1.3.4; See also Art. 5 PEPPR.

[8] D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D.A. Zetzsche ed, Kluwer 2015); U. Klebeck, *Interplay between AIFMD and the UCITSD* (D.A.Zetzsche ed, Kluwer 2015).

[9] See Chapter 7, section 2.2.1.3.

solution is being referred to in this dissertation as 'Custody Plus' as this terminology is used in practice for custodians that are appointed as AIF/UCITS/IORP depositaries.

1.2. The Basic Foundation of the Cross-Sectoral Depositary Passport: The MiFID II 'Stand-Alone' Custodian

1.2.1. *Considerations on a Cross-Sectoral European/TC Depositary Passport*

Currently, MiFID II/CRD IV allows Member States to regulate 'custodians' as 'stand-alone' regulatory activity.[10] Consistent with the general principles of the European passport, these 'stand-alone' custodians regulated on the national level are not allowed to make use of the European passport granted under MiFID II or CRD IV.[11] The safekeeping and administration of securities/financial of financial instruments may as an 'ancillary service' only be passported along 'core' investment services/activities.[12]

On the contrary, IORPD II grants a 'de facto' European depositary passport[13] to 'UCITSD V depositaries' that may, depending upon the UCITSD V Member State implementations, be credit institutions, central banks or 'another legal entity'.[14] These 'other legal entities' may, amongst others[15], be entities that are regulated under national law.[16] IORPD II, thus, facilitates a 'de facto' European IORP depositaries passport for entities regulated on the national level 'through the backdoor'.[17] Similarly, the proposed PEPPR allows all 'entities' to be appointed as a depositary under its 'lex specialis regime' regardless whether these 'entities' are EEA, TC or entities regulated on the national level. Allowing TC and national regulated entities to provide services on a cross-border basis is contrary to the joint principles of the European passport.[18] Under EEA secondary law, the European passport and the overarching principle of 'mutual recognition' are based upon two cornerstones: the 'single rulebook', i.e. a thick set of harmonized rules of a specific sector and a coordinated institutional framework for financial supervision comprising of 'home state control' and the ESFS that allows host Member States to defer supervision to home Member States and ESAs.[19]

In order to establish a 'cross-sectoral European depositary passport', the entities allowed to be appointed as custodian and depositary would, thus, need to be limited to entities regulated under EEA secondary law. For this purpose, either a 'stand-alone regime' or an 'existing regime' could be used. The existing MiFID II regime seems to be the most appropriate regime. This would be logical as most depositaries/custodians currently used are credit institutions and investment firms.[20] Introducing a 'cross-sectoral depositary passport' with

---

[10] See Chapter 6, section 2.1.
[11] See Chapter 3, section 3.
[12] See Chapter 6, section 2.1.
[13] See Chapter 2, section 1.3.
[14] See Chapter 5, section 3.2.2.3.
[15] See for 'another legal entity': Chapter 4, section 3.2.3.
[16] See Chapter 4, section 3.2.3.4.
[17] This includes UCITSD V depositaries under Irish and Maltese law that are full subsidiaries of TC parent undertakings and only fulfill the minimum conditions set out under UCITSD V. See Chapter 2, section 1.2.1.
[18] Chapter 3, section 3.
[19] N. Moloney, *Brexit, the EU and its Investment Banker: Rethinking 'Equivalence' for the EU Capital Market*, LSE Legal Studies Working Paper No. 5/2017, 5, https://ssrn.com/abstract=2929229 (accessed 18 June 2017).
[20] European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions* (COM(2012) 350) (SWD(2012) 186), 32,33.

MiFID II as 'basic foundation' under the 'custody plus' solution would lead to 'vertical' and 'horizontal consistency'. It would lead to 'vertical consistency' as limiting custodians and depositaries to be appointed to credit institutions and investment firms under MiFID II leads to consistency throughout sectoral legal initiatives. Under UCITSD V, for instance, Germany and Luxembourg, restrict eligible entities to 'credit institutions'[21], whereas in the Netherlands credit institutions, investment firms and 'other legal entities' are allowed to be appointed as a UCITS depositary.[22] It would also lead to horizontal consistency. In Austria and Germany, for instance, credit institutions and investment firms may be appointed as AIF depositaries, whereas credit institutions may only be appointed as 'custodians' and UCITS depositaries.[23] Limiting custodians and depositaries, with the exception of 'PE-depositaries'[24], to credit institutions and investment firms, thus, leads to vertical and horizontal consistency that would be a solid foundation of a 'cross-sectoral depositary passport'.[25] The 'custody' part of 'custody plus' regulating the safekeeping of assets of depositaries and custodians could be regulated in MiFID II, whereas the 'plus' part regulating the oversight duties and related governance could be regulated on a sectoral basis. Obviously, this solution would lead to many advantages. As almost all depositaries and custodians are credit institutions or investment firms a 'cross-sectoral depositary passport' could be introduced at little cost. Moreover, the harmonization of the 'custodian' part and only leaving the 'depositary' over to sectoral legislation would lead to lower compliance costs for those entities seeking to offer depositary/custody services on a cross-sectoral basis. Finally, no considerations on a TC regime would need to be made as simply the MiFID II TC regime would apply to 'custodians' and the current TC regimes for depositaries under the sectoral regulations would be remain to be in place.[26]

Upgrading the safekeeping and administration to a 'full-fledged' MiFID II investment service/activity and limiting eligible depositaries to these entities are not a new idea. The European Commission made with its MiFID II and UCITSD V proposal and the AIFMD already an attempt. Ultimately, however, this idea was under the MiFID II and UCITSD V proposal being revoked. This leaves us the question why this idea has been revoked and what could be done to overcome the problems related to such an introduction.

1.2.2. *Credit institutions & Investment Firms as Full-Fledged MiFID II Custodians*

Under the original MiFID II proposal, the safekeeping and administration of financial instruments for the account of clients was proposed to be upgraded to a full-fledged investment service.[27] Following this proposal, any firm providing the service of safekeeping and administration of financial instruments for the account of clients would have be on a stand-alone basis subject to a separate authorization procedure.[28] This would have implied that under MiFID II, compared to MiFID I, not every investment firm,[29] but merely those

[21] Germany: § 87 KAGB; Luxembourg; Art. 17(3) OPC law 2010
[22] Art. 4:62n(b) Wft.
[23] Austria: § 164(2), § 167(1) InvFG 2011; Germany: § 87 KAGB.
[24] Chapter 4, section 3.1.6.
[25] Cf. C.P. Buttigieg, The Alternative Investment Fund Managers Directive in Malta: Past, Present … What Next?, https://ssrn.com/abstract=2602750 (accessed 7 April 2017).
[26] See for the AIFMD TC depositary regime: Chapter 4, section 5.
[27] See See Annex I s. B MiFID II proposal.
[28] *Ibid*.
[29] Generally speaking, the MiFID II custody rules apply to all 'MiFID II investment firms', such as brokers, dealers, asset managers and advisers. See D. Frase, *Custody*, in *Law and Regulation of Investment Management* 276 (D. Frase ed., Sweet & Maxwell 2011).

entities with an authorization for safekeeping would have been eligible as a depositary. This proposal was, however, not adopted in the final version of MiFID II. This was the result of from mixed responses from various industry players to a questionnaire on MiFID II/MiFIR. The respondents that argued against the upgrade mainly argued that a reclassification would in any case not enhance investor protection for the following main reasons.[30] First, the safekeeping and administration of financial instruments for the account of clients carried out by entities holding securities accounts for their clients, whether custodians or CSDs, are already regulated under EEA legislation.[31] Most custodian banks within the EEA are subject to authorization either as investment firms and/or as credit institutions under MiFID I/II and CRD IV, whereas CSDs are regulated under the CSDR.[32] Second, various respondents argued that the safekeeping and the provision of custody services differ significantly from the trading and distribution of financial instruments targeted by MiFID I/II.[33] A few respondents mentioned, for instance, that applying the suitability[34], assessment of appropriateness[35] or the best execution duty[36] to custody services would be inappropriate.[37]

These arguments, however, rather seem to be a product of the lobbying industry. Indeed, almost all custodians are already regulated under MiFID II and CRD IV. This is, however, not a valid argument for not upgrading the safekeeping and administration of financial instruments for the account of clients to an investment activity/service. Under the ISD, 'ancillary' services were introduced as these services were not yet harmonized on the European level. Till valid considerations for the harmonization of those services were made, a European 'ancillary' passport would be granted for these services under the condition that investment firms were authorized for 'core' investment services/activities.[38] De facto, the MiFID II prudential regime was, thus, seen as a sufficient degree of harmonization to grant these services an ('ancillary') European passport. In fact, the 'ancillary passport' for custodians introduced upon the adoption of the Second Banking Directive and the ISD have led to market consolidation of custodians in Europe.[39] Credit institutions and investment firms

---

[30] Safekeeping should remain an 'ancillary service' under MiFID II: CSD services, including safekeeping, should be regulated under the upcoming CSD regulation instead, Position paper, CSDA response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012; Question 3, EBF response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.

[31] Question 3, CSDA response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012; Question 3, EBF response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.

[32] See Chapter 6.

[33] Question 3, EBF response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.

[34] Art. 19(4) MiFID I/ Art. 25 MiFID II; See for ESMA Guidelines on certain aspects of the MiFID suitability requirements: ESMA/2012/387 and on the consultation: ESMA/2011/445; Question 3, British Banker's Association response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012; Blackrock response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.

[35] Art. 19(5) MiFID I/ Art. 25(2) of MiFID II; See also question 3, EFAMA response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012; Question 3, Bundesverband Investment and Asset Management response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012; Question 3, Investment Management Association response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.

[36] Art. 21 MiFID I/ Art. 27 MiFID II; Question 3, British Banker's Association response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.

[37] Question 3, CSDA response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012; Question 3, ALFI response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.

[38] See on the ISD: historical development of 'ancillary services': Chapter 12, section 1.

[39] See European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions* (COM(2012) 350) (SWD(2012) 186), 32,33.

have pushed custodians merely regulated on the national level out of the market.[40] Credit institutions and investment firms were under the 'ancillary passports' able to exploit economies of scope and scale in the market for 'custodians'. These 'ancillary custodian passports' led to the competitive advantages arising from operational and cost benefits and, therefore, credit institutions and investment firms not only increasingly dominated the 'custodian' market, but also the 'depositary market'. Credit institutions, investment firms and 'local custodians' were all facing the same restrictions and obstacles under the UCITSD I-V and (pre-) AIFMD depositary regimes. Credit institutions and investment firms were, however, able to obtain cost advantages in horizontally integrating their business activities as they benefitted from the 'ancillary passports' in which they could act throughout Europe as a 'custodian'.[41] This gradually emerged business practice is also currently to be observed throughout the EEA Member State laws. Most Member States do not regulate 'custody' as 'stand-alone' activity under national laws as almost all custodians/depositaries are investment firms and credit institutions under MiFID II and CRD IV.[42] Those Member States that do so regulate these entities as 'national investment firms' based upon their MiFID II implementations.[43]

It would, thus, make sense to regulate the safekeeping and administration of financial instruments for the account of clients under MiFID II. MiFID II would be better suited to regulate this compared to CRD IV as both investment firms and credit institutions fall within its scope.[44] Upgrading of the safekeeping and administration of financial instruments for the account of clients under MiFID II to an investment service/activity, thus, ensures a level playing field in terms of investor protection measures across all Member States.[45]

1.2.3. *Credit institutions & Investment Firms as ('Cross-Sectoral')Eligible Depositary Entities*

The planned MiFID II upgrade of 'custodianship' was also reflected in the AIFMD and the UCITSD V proposal. The AIFMD and the UCITSD V planned to introduce a 'closed list of eligible entities' that together with the MiFID II upgrade of 'custodianship' would provide the foundation for a European depositary passport for AIFs and UCITS to be introduced in the future.[46] The considerations made upon limiting the eligible entities were separately discussed from the MiFID II upgrade of 'custodianship'. Despite the fact that the upgrade politically failed, UCITSD V still could have limited the eligible entities to credit institutions and investment firms. A MiFID II upgrade of 'custodianship' would not have been constitutional for this. Despite of this, the European Commission decided for different reasons otherwise.

Under the original plan to slowly pave the way towards an AIF/UCITS depositary passport, (liquid) AIFs were under the AIFMD allowed to appoint credit institutions, investment firms and 'UCITSD IV depositaries'.[47] The latter was a 'grandfathering clause'[48]

---

[40] See European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004, 6.
[41] Chapter 3, section 1.1.1.
[42] See Chapter 6, section 4.
[43] Chapter 6, section 4.1.
[44] Recital 38, Art. 1(3) MiFID II.
[45] Question 3, Bank of New York Mellon response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.
[46] See, for example, Recital 36 AIFMD.
[47] For illiquid and highly leveraged AIFs also 'PE-depositaries' and prime brokers that classify under one of the eligible entities are allowed.

that was planned to be phased out under UCITSD V by limiting eligible UCITS depositaries to credit institutions and investment firms.[49] Under this approach, the (liquid) AIFs and UCITS would both only be allowed to appoint credit institutions and investment firms as depositaries. After having received Position Papers of EFAMA and the EBF during the UCITSD V consultation, the European Commission decided, however, not to introduce a 'closed list of eligible entities' under UCITSD V.[50] Although the European Commission did not officially published its considerations, the reasons set out in these Position Papers may serve as a guideline.

EFAMA stated in its Position Paper that

> 'the eligibility to provide depositary services should not be restricted to credit institutions and MiFID firms subject to CRD requirements but should also remain open to other types of institutions which are currently authorized to act as depositaries in their jurisdiction provided that they are subject under their national law to similar conditions, in particular in terms of prudential regulation and ongoing supervision'.[51]

In addition, the EBF held that the majority of its members in civil law countries were in favour of the 'closed list of entities', whereas EBF members of common law countries believed that UCITSD I-IV depositaries should continue to be allowed to be appointed as UCITSD V depositaries.[52]

Not adopting the 'closed list of entities' under UCITSD V, however, had a large impact on the fragmented sectoral depositary landscape. Under a dynamic interpretation of UCITSD V[53], some Member States in their AIFMD implementation still allow UCITS depositaries to be appointed. In addition, the IORPD II and proposed PEPPR ('lex specialis') depositary regimes also allow UCITSD V depositaries to be appointed.[54] Under IORPD II and the proposed PEPPR UCITSD V depositaries regulated on the national level do have a 'de facto' European passport. This is contrary to the principle of the European passport concept in which financial intermediaries are required to be subject to the 'single rulebook' and the European coordinated approach towards financial supervision.[55]

Recently literature also considers credit institutions and investment firms to be the most suitable eligible entities for several reasons.[56] The structural separation required between AIFMs and UCITS ManCos and depositaries required under the AIFMD and UCITSD V is based upon the idea that managerial risks related to fraud and insolvency are being mitigated

---

48. European Commission, *Working Document of the Commission Services (DG Internal Market and Services) – Consultation Paper on the UCITSD Depositary Function and on the UCITS Managers' Remuneration*, MARKT/G4 D (2010) 950800, 14 December 2010, 16.

49 Art. 23(3) UCITSD V proposal.

50 European Banking Federation, *EBF Position on UCITS V*, 5, http://www.ebf-fbe.eu/uploads/D1425F-2012-Final%20EBF%20position%20on%20UCITS%20V.pdf (accessed 29 August 2016); European Fund and Asset Management Association, *EFAMA Position Paper on the legislative proposal of the Commission amending Directive 2009/65/EC ("UCITS V"),* 4, www.efama.org/Publications/Public/UCITS/12-4040_EFAMA position paper on UCITS V.pdf (accessed 29 August 2016).

51 European Fund and Asset Management Association, *EFAMA Position Paper on the legislative proposal of the Commission amending Directive 2009/65/EC ("UCITS V"),* 4, www.efama.org/Publications/Public/UCITS/12-4040_EFAMA position paper on UCITS V.pdf (accessed 29 August 2016).

52 European Banking Federation, *EBF Position on UCITS V*, 5, http://www.ebf-fbe.eu/uploads/D1425F-2012-Final%20EBF%20position%20on%20UCITS%20V.pdf (accessed 29 August 2016).

53 See Chapter 4, section 3.1.3.

54 See for 'depositaries' under IORPD II: Chapter 5, section 3.2.2.3.; See for depositaries under the PEPPR: *infra* section 4.3.2.2.

55 Chapter 3, section 3.

56 D.A. Zetzsche, *Prinzipien der kollektiven Vermögensanlage* § 24 C.I. 2. (Mohr Siebeck 2015).

by requiring a third-party depositary to be appointed. The third-party depositary requirement, however, only makes sense when a depositary is able to safekeep of the fund's assets, depositaries are less prone to insolvency than UCITS ManCos and AIFMs and the AIF/UCITS' assets are properly segregated from all other assets.[57] Credit institutions and investment firms are, in particular, the most suitable eligible depositary entities as the EEA regulated CRR capital requirements to which they are subjected to significantly reduce the insolvency risks of these entities. Although UCITSD V requires 'another legal entity' regulated under the national level are also to comply with the 'own funds' requirement under the CRR, they fall outside of the scope of the CRR capital requirements.[58] In addition, they are only subject to minimum requirements regarding infrastructure[59], experience[60], administrative and accounting procedures[61], internal control mechanisms[62], risk management procedures[63] and arrangements to prevent conflicts of interest[64] These requirements, however, do not constitute a 'single rulebook' that is commonly required under sectoral legislation upon granting an European passport. Apart from this, these 'another legal entities' regulated on the national level also do not fall under any coordinated institutional framework for financial supervision comprising of 'home state control' and the ESFS that allows host Member States to defer supervision to home Member States and ESAs.[65] For that reason, limiting depositaries to credit institutions and investment firms would ensures a level playing field in terms of investor protection measures across all sectoral depositary regimes.[66]

1.3. The Depositary as 'Custody plus' under Sectoral Regulations

Depositaries are, apart from 'PE-depositaries'[67], custodians that safekeep assets and perform oversight duties. The MiFID II 'stand-alone' custodian regime would adequately address investor and market protection concerns related to the safekeeping task.

Nevertheless, the additional monitoring task assigned to depositaries reflects that the role of a depositary goes beyond that of a mere custodian.[68] The monitoring tasks is the result of the fiduciary and collective investment nature of the AIF, UCITS, IORP and the proposed PEPPR[69]. Custodians are mainly appointed for investment relationships with an agency and individual investment nature, such as 'execution-only' services[70], discretionary portfolio management[71] and investment advice based investment relationships[72].[73] In terms of governance, custodians mainly cater for asset segregation and limited liability, whereas

---

[57] *Ibid.*
[58] Chapter 4, section 3.2.3.
[59] Art. 23(2)(c) sub-para. 2(a) UCITSD V.
[60] Art. 23(2)(c) sub-para. 2(g) and (h) UCITSD V.
[61] Art. 23(2)(c) sub-para. 2(c) UCITSD V.
[62] Art. 23(2)(c) sub-para. 2(b) and (c) UCITSD V.
[63] Art. 23(2)(c) sub-para. 2(c) UCITSD V.
[64] Art. 23(2)(c) sub-para. 2(d) UCITSD V.
[65] N. Moloney, *Brexit, the EU and its Investment Banker: Rethinking 'Equivalence' for the EU Capital Market*, LSE Legal Studies Working Paper No. 5/2017, 5, https://ssrn.com/abstract=2929229 (accessed 18 June 2017).
[66] Question 3, Bank of New York Mellon response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.
[67] See Chapter 4, section 3.1.6.
[68] Chapter 11, section 1.2.2.
[69] The mandatory investment options under the proposed PEPPR, require a 'collective investment undertaking' as PEPP scheme under a PEPP. See Chapter 10, section 1.1.2.2.
[70] Chapter 10, section 2.2.
[71] Chapter 10, section 2.3.
[72] Chapter 10, section 2.1.
[73] See Chapter 11, section 1.1.2.2.

depositaries play a more prominent role in 'fiduciary governance' under the common concept of the investment triangle.[74] Depositary regulation can, thus, be seen as a separate area of law. For this reason, depositary regulation has on the national and (partly) the European level always been based upon a reference to eligible entities that were usually the entities authorized to act as a custodian, whereas 'lex specialis' rules addressed the 'fiduciary governance' role of depositaries. The AIFMD, for instance, makes reference to credit institutions and investment firms that may be authorized as a 'custodian' under European law.[75] Similarly, many Member States historically on the national level referred to credit institutions (and investment firms) for depositaries appointed for AIFs, UCITS, IORPs and PPPs.[76] On top of this, sectoral depositary regulation requires 'lex specialis' provisions to be fulfilled related to:

- the mandatory appointment of a single depositary;[77]
- the legal independence of the depositary and the IORP (governing board) and related requirements;[78]
- the eligible entities required to be appointed and the organizational requirements applicable to them (depending upon the UCITSD V Member State implementation: credit institutions, investment firms, and 'other legal entities');[79]
- the re-use of assets;[80]
- the safekeeping duties;[81]
- the oversight duties;[82]
- the delegation regime;[83] and
- the depositary's liability regime.[84]

The 'custody plus' solution proposed is, thus, consistent with how depositaries till now have been regulated on the national and European level.

The 'fiduciary governance' role of depositaries varies from sector to sector as investor protection concerns slightly differ throughout these sectors. For this reason, the 'custody plus' solution suggested in this dissertation proposes to introduce a common legislative framework for custodians under MiFID II, whereas specific depositary provisions reflecting the fiduciary governance of a specific sector remain to be regulated on the sectoral level under the AIFMD, UCITSD V, IORPD II and PEPPR. To increase the efficiency and lower the compliance burden, depositary provisions on the sectoral level should be 'horizontally' harmonized wherever possible. Only such an approach could ensure an effective introduction of a 'cross-sectoral depositary passport'.

2. 'Custodianship' a Stand-alone Investment Service/Activity under MiFID II

The 2011 MiFID II proposal may serve as guidance for how 'custodianship' as 'stand-alone' investment service/activity could be defined and what authorization/operational requirements such investment firms would be required to fulfil.

[74] See Chapter 11, section 1.2.2.
[75] Art. 21(3) AIFMD.
[76] See Chapter 12.
[77] Art. 22(1) UCITSD V; Art. 21(1) AIFMD; Art. 33(1) and (2) IORPD II; Art. 41(1) PEPPR.
[78] See Arts 25, 26b UCITSD V; Art. 21 UCITSD V (Commission) Regulation; Art. 33(7) IORPD II.
[79] Art. 23(2) UCITSD V; Art. 21(3) AIFMD; Art. 33(3) IORPD II.
[80] Art. 21(11)(d)(iv) AIFMD; Art. 22(7) UCITSD V.
[81] Art. 22(5) UCITSD V; Art. 21(8) AIFMD; Art. 34 IORPD II; Art. 41(3) PEPPR.
[82] Art. 22(3) UCITSD V; Art. 21(9) AIFMD; Art. 35 IORPD II; Art. 41(4) PEPPR.
[83] Art. 22a UCITSD V; Art. 21(11) AIFMD; Art. 34(4) IORPD II; Art. 41(3) PEPPR.
[84] Art. 24(1) UCITSD V; Art. 21(12) AIFMD; Art. 34(4) IORPD II; Art. 41(3) PEPPR.

2.1. Defining 'Custodianship' as Stand-Alone Investment Service/Activity

The proposed MiFID II already showed in 2011 how 'custodianship' as a 'stand-alone' investment service/activity could be regulated. The MiFID II proposal inserted the following definition under Annex I Section A under the list of investment services/activities:

> 'safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management'.[85]

This definition is the same definition that was adopted in the final MiFID II with the exception of the exclusion of the 'maintaining securities accounts at the top tier level'. The current definition used define the 'safekeeping and administration of financial instruments' as an 'ancillary service' could be used as an overall broad definition on which the stand-alone investment service/activity could be based.

During the consultation phase, a revised MiFID II version stated in Recital 113a that

> 'the Commission should put forward a proposal for a regulation on securities law further specifying the definition of safekeeping and administration of financial instruments'.[86]

Apparently, the 'safekeeping and administration of financial instruments' was desired to be defined to a larger extent. For that purpose, the safekeeping definition, as defined in detail under the AIFMD, UCITSD V, IORP II and proposed PEPPR could be used.[87] Based upon this, 'safekeeping' can take the form of custody, for 'financial instruments that can be held in custody', or record keeping for 'other assets'.[88] Depending upon the political desirability of the Member States, the MiFID II 'stand-alone' investment service/activity could include only the 'safekeeping of financial instruments that can be held in custody' or the safekeeping of both 'financial instruments that can be held in custody' and 'other assets'. The first approach would fit in the profile of a custodian and fits in better with the scope of MiFID II that applies to 'financial instruments'. The second approach fits in better with the depositary regimes under sectoral regulation and the approach taken by Ireland, Malta and the UK in implementing the 'depositary-lite model'[89] under Article 36 AIFMD.

Member States may on the basis of Article 36 AIFMD for a transitional period of time exempt EEA-AIFMs from appointing an Article 21 AIFMD depositary.[90] Instead, however, Article 36 AIFMD obliges Member States to require EEA-AIFMs to ensure that one or more entities are appointed to carry out depositary duties mentioned under Article 21(7)–(9) AIFMD.[91] For this purpose, Ireland, for instance, requires entities providing the safekeeping function, including both the custody as the record keeping tasks, to be authorized under the Investment Intermediaries Act 1995.[92] Malta[93] and the UK[94] take the same approach.

---

85. This ancillary service includes custodianship and related services, such as cash/collateral management and excludes maintaining securities accounts at the top tier level. See Annex I s. B MiFID I/II.

86 See http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2012-0406+0+DOC+XML+V0//EN#top (accessed 7 July 2017).

87 D.A. Zetzsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D.A. Zetzsche ed, Kluwer 2015).

88 Art. 22(5) UCITSD V; Art. 21(8) AIFMD; Art. 34 IORPD II; Art. 41(3) PEPPR.

89 Chapter 4, section 2.1.4.

90 *Ibid.*

91. Art. 36(1)(a) AIFMD.

92. *Ibid.*

93. SLC 1.03, Part BIV: Part BIV: *Standard Licence Conditions applicable to Investment Services Licence Holders* which *qualify* as *Custodians*, *Investment Services Rules* for *Investment Services Licence Holders* ; See

In either approach taken, the 'safekeeping' definition chosen could benefit from definitions of, amongst others, 'financial instruments that can be held in custody' and 'other assets' as defined in detail under the AIFMD and UCITSD V.[95]

2.2. Authorization Requirements & Operational Conditions

'Custodians' will be required to comply with the regular MiFID II authorization requirements, general and specific organizational requirements. Under Article 13(2) MiFID II 'custodians' are required to establish adequate policies and procedures sufficient to ensure compliance of the firm, including its managers, employees and tied agents and appropriate rules governing personal transactions by such persons. In addition, specific organizational features are required regarding risk management and internal audit, outsourcing, conflicts of interests and the safeguarding of client assets.[96] These procedures aim to avoid operational risks, conflict of interest and adequate protection of clients assets.[97] Currently, the 'safeguarding of client assets regime' applies to all investment firms regardless whether they are authorized for providing 'custodianship' as 'ancillary' service or not. The safeguarding of client assets regime will, thus, under this proposal continue apply to investment firms regardless whether the firm is authorized as a 'stand-alone' 'custodian' or not.

During the MiFID II proposal consultation phase a few respondents mentioned that applying the suitability[98], assessment of appropriateness[99] and the best execution requirements[100] to stand-alone custodians would be inappropriate.[101] MiFID II could, indeed, include a provision that exempts 'stand-alone' investment firms from complying with these requirements. This should, however, not be considered into great detail. Almost all custodians that will be authorized under MiFID II will combine this authorization with the authorization of one or more other investment and ancillary services/activities. This will be the case as 'custodianship' in itself is a low margin business.[102]

MFSA, Feedback statement further to industry responses to MFSA Consultation Document dated 18 September 2013 on the introduction of the depositary lite provisions, 2.1.1. [I]. Feedback Statement.

94. See FCA, *Frequently Asked Questions: Q9: Does an Article 36 custodian require a Part 4A permission for acting as depositary of an AIF?*, http://www.fca.org.uk/firms/markets/international-markets/aifmd/depositaries, (accessed 15 Jun. 2015); FCA, *Implementation of the Alternative Investment Fund Managers Directive*, PS 13/5, 39 (2013).

95 See Chapter 4, section 6.2.

96 C.W.M. Lieverse, C.W.M., *The Scope of MiFID II* (D. Busch & G. Ferrarini eds, Oxford 2017).

97 See Art. 16(2)-(10) MiFID II.

98 Art. 19(4) MiFID I/ Art. 25 MiFID II; See for ESMA Guidelines on certain aspects of the MiFID suitability requirements: ESMA/2012/387 and on the consultation: ESMA/2011/445; Question 3, British Banker's Association response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012; Blackrock response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.

99 Art. 19(5) MiFID I/ Art. 25(2) of MiFID II; See also question 3, EFAMA response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012; Question 3, Bundesverband Investment and Asset Management response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012; Question 3, Investment Management Association response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.

100 Art. 21 MiFID I/ Art. 27 MiFID II; Question 3, British Banker's Association response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.

101 Question 3, CSDA response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012; Question 3, ALFI response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.

102 European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions* (COM(2012) 350) (SWD(2012) 186), 32,33.

The sectoral depositary regime will provide 'lex specialis' provisions that may fully or partially substitute the general and specific organizational requirements to which 'MiFID II custodians' are subjected to.

3. The Depositary as 'Custody plus' under Sectoral Regulations

'Depositaries' may play a slightly different role under the various sectoral regulations. For this reason, the specifics of depositaries as compared to mere custodians is suggested to be left over to regulation at the sectoral level. Nevertheless, a 'cross-sectoral depositary passport' is only cost effective if sectoral regulations are aligned to the extent that the role played by the depositary on the sectoral elvel is similar. For this reason, this section makes suggestions to align the AIFMD, UCITSD V, IORPD II and PEPP ('lex specialis') depositary regimes.

3.1. The AIFMD & UCITSD V Depositary Regime– Towards Alignment?

The AIFMD and UCITSD V depositary regimes are based upon the same 'post-Madoff' considerations and constitute the most sophisticated regimes.[103] For the purpose of the introduction of a cross-sectoral depositary passport, both regimes are, apart from the current eligible entities available, sufficiently harmonized. The UCITSD V depositary regime, however, was adopted a couple of years later. This is reflected in the slightly different approach taken under UCITSD V. UCITSD V, in comparison to the AIFMD, contains stricter (retail investor protection) depositary provisions related to, in particular, the:[104]

- requirement to provide an inventory of assets;[105]
- independence of the management/investment company and the UCITS depositary;[106]
- prohibition on right of use / re-hypothecation of assets;[107]
- client asset protection on insolvency of the depositary or a sub-custodian;[108]
- strict liability for a loss of custody assets;[109] and
- redress of investors against the depositary.[110]

In the light of a 'cross-sectoral depositary passport', it is desirable to aim for the approximation of depositary laws on a sectoral (vertical harmonization) and cross-sectoral (horizontal harmonization) basis. Apart from the stricter liability for a loss of custody assets and the prohibition on the right of use, the differences in depositary provisions between the AIFMD and UCITSD V seem not to be justified on the basis of retail protection. Extending considerations made under UCITSD V to AIFMD could be considered for the provisions under UCITSD V related to the:[111]

- requirement to provide an inventory of assets;[112]
- investor insolvency protection;[113]

---

[103] Chapter 4, section 1.
[104] *T. Dolan, UCITS V brings convergence of the depositary role with AIFMD***,** 1 JIBFL 64B (2015).
[105] Art. 22(6) UCITSD V.
[106] See Art. 26b UCITSD V; Art. 21 UCITSD V (Commission) Regulation.
[107] Art. 22(7) UCITSD V.
[108] Art. 22(8) UCITSD V.
[109] Art. 24 UCITSD V.
[110] Art. 24 UCITSD V.
[111] *T. Dolan, UCITS V brings convergence of the depositary role with AIFMD***,** 1 JIBFL 64B (2015).
[112] Art. 22(6) UCITSD V.

– independence of the management/investment company and the UCITS depositary;[114]
– client asset protection on insolvency of the depositary or a sub-custodian;[115] and
– redress of investors against the depositary.[116]

This would lead to more cross-sectoral consistency. Moreover, a couple of other considerations could be made. Prime brokers, for instance, should be continued to be allowed to be appointed as a depositary under the AIFMD. Only those prime brokers would, however, under the proposal made in this chapter that are authorized under MiFID II as a custodian.[117] In addition, the AIFMD prime broker provisions targeting the prime broker as a counterparty and depositary should apply *mutandis mutatis* to UCITS.[118] UCITS, compared to AIFs, are restricted in applying leverage.[119] Nevertheless, so-called 'Newcits'[120] are appointing prime brokers and, for that reason, cross-sectoral consistency would be desirable.[121] Furthermore, the 'PE depositary' lex specialis provisions could be considered to remain in place.[122] In this regard, the large variety of Member State implementations would make it desirable to require a MiFID II 'investment firm-light' to be appointed.[123] Under the AIFMD, a couple of lex specialis provisions for 'PE depositaries' could be inserted that would require the appointment of a MiFID II custodian that is exempted from complying with 'onerous' MiFID II provisions related to the CRR capital requirements and conduct of business rules. Such an exemption could be based upon the Luxembourg and UK 'PE-depositary regimes'. The Luxembourg regime would serve as an example of the 'investment firm-light', whereas the UK regime related to 'proportional capital requirements' could be considered.[124] Depending upon the extent that 'PE-depositaries' safekeep 'financial instruments that can be held in custody' such an investment firm-light is subject to a lesser or larger part of the CRR capital requirements. 'PE-depositaries' exclusively safekeeping 'other assets' could be exempted from applying most CRR capital requirements. Finally, the AIFMD TC regime would remain in place.[125] TC MiFID II custodians as eligible entities would be required to be assessed in the light of the provisions adopted. No such a regime would need to be considered for UCITS depositaries as a TC regime for UCITS is not (yet) in place.

By taking into account these considerations, the AIFMD and UCITSD V could be approximated to a larger extent lowering compliance costs for those custodians seeking to use the 'cross-sectoral depositary passport'.

---

[113] European Securities and Markets Authority, *Opinion - Asset segregation and application of depositary delegation rules to CSDs*, 20 July 2017, ESMA34-45-277.
[114] See Art. 26b UCITSD V; Art. 21 UCITSD V (Commission) Regulation.
[115] Art. 22(8) UCITSD V.
[116] Art. 24 UCITSD V.
[117] Currently, prime brokers appointed as depositary under the AIFMD are also required to be an 'eligible entity'. See Chapter 4, section 3.1.4.2.
[118] See for more considerations made in this domain: Chapter 4, section 3.2.3.3.
[119] Chapter 8, section 4.2.1.
[120] EDHEC Risk Institute, *Are Hedge Fund UCITS the Cure-All?* (EDHEC-Position Paper 2010).
[121] See also T. Moroni & L. Wibbeke, *OGAW V: Die Sprunglatte für OGAW-Verwahrstellen liegt höher*, 3 Recht der Finanzinstrumente 187 (2015)..
[122] Chapter 5, section 3.1.6.
[123] *Ibid.*
[124] Luxembourg:Art. 26-1 Law of 5 April 1993 on the financial sector, as amended on 12 june 2013; UK: FUND 3.11.12 R; FUND 3.11.12 R; FUND 3.11.14 R: See also the Glossary Definition FCA: 'Part 4a Permission' and 'acting as trustee or depositary of an AIF' and 'own funds'. (FUND 3.11.12-14); See also: [124] D.A. Zetzsche, *Fondsregulierung im Umbruch – ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, ZBB 22 (2014).
[125] Chapter 4, section 5.

3.2. The IORPD II Depositary Regime – A Proposal

The IORPD II 'depositary regime' is not as sophisticated as the AIFMD and UCITSD V regimes. The reason for this is that the IORPD II regime aims to target both 'custodians' and 'depositaries'. The different roles of both in 'fiduciary governance' renders a consistent regime integrating both an impossible task. This is reflected in the quality of the regime currently in place.[126] In the light of the introduction of a cross-sectoral depositary passport, considerations would have to be made to ensure consistency of the IORPD II regime with the AIFMD and UCITSD V depositary regimes.

The primary reason for the current inconsistent IORPD II 'depositary' regime is that the IORP itself is broadly defined and can take the form of an 'investment fund', insurance company or 'pension fund'.[127] For this reason, large discretion is given to Member States in compulsory requiring depositaries and custodians to be appointed.[128] It could be considered, as was the case under the original IORPD II proposal, that Member States have mandatorily to require a compulsory depositary for 'full DC IORPs' in which members bear full investment risk.[129] This would be consistent with AIFs and UCITS as most full DC IORPs are, de facto, occupational 'investment funds'. Full DC IORPs could, however, also offer (occupational) unit-linked insurances in which an AIF or UCITS is embedded that already requires the appointment of a depositary. As was suggested in the IORPD II proposal amendments, the adverse effect of any possible 'duplication' of the depositary requirement for these unit-linked insurances exclusively investing in an AIF/UCITS could prevented by inserting an 'IORP pooling structure exemption'.[130] All other IORPs than full DC IORPs are under the CJEU VAT case law'[131] not considered to be comparable with AIFs and UCITS as members do 'not fully bear investment risk'.[132] Considerations regarding a compulsory depositary/custodian requirement for these IORPs should, therefore, be left over to the individual Member States.

A hybrid depositary/custodian sectoral IORPD II regime would need to be considered. The UCITSD V depositary regime should be considered for IORPs that (are required to) appoint a depositary and the MiFID II 'stand-alone' custodian regime for IORPs appointing custodians. This would lead to consistency between MiFID II custodians, at the one, and the AIFMD, UCITSD V and PEPPR depositary regimes.
The UCITSD V depositary regime should be considered due to its 'retail investor protection nature'.

Applying a UCITSD V depositary regime to all IORPs for which a depositary is required to be appointed ensures a level playing field related to, amongst others:

- the mandatory appointment of a single depositary;[133]
- the legal independence of the depositary and the IORP (governing board) and related requirements;[134]

---

[126] See for an overview and criticism: Chapter 5.
[127] See Chapter 9, section 2.
[128] Art. 33(1), (2) IORPD II.
[129] See Chapter 9, section 7; See also R.M.J.M de Greef, *Herziening IORP richtlijn – Een verbetering?* , 50 TPV 27 (2016).
[130] Chapter 5, section 2.6.
[131] See Chapter 9, section 7.2.4.4.
[132] See Chapter 9, section 7.2.4.
[133] Art. 22(1) UCITSD V; Cf. Art. 21(1) AIFMD.
[134] See Arts 25, 26b UCITSD V; Art. 21 UCITSD V (Commission) Regulation.

- the eligible entities required to be appointed and the organizational requirements applicable to them (depending upon the UCITSD V Member State implementation: credit institutions, investment firms, and 'other legal entities');[135]
- the safekeeping duties;[136]
- the oversight duties;[137]
- the delegation regime;[138] and
- the depositary's liability regime.[139]

The oversight duties would be allowed to be proportionally applied. In particular, the duties related to subscriptions/redemptions, the valuations of share/unit pricing and cash management could be irrelevant for IORPs.[140] No 'equivalency regimes' would be in place for IORPs that do not appoint a custodian/depositary for the safekeeping of assets nor for IORPs that do not have appointed a depositary for oversight duties.[141] This reason for this is that IORPs do not have the same prudential standards to safekeep assets as professional custodians/depositaries.[142] In addition, IORPs for which no depositary for oversight duties is appointed do not have to have a specific obligation to 'ensure that the tasks, otherwise subject to oversight by depositaries, are being duly performed within the IORP'.[143] Such a task is already part of the IORP's risk management organization required under IORPD II.[144]

The proposed hybrid depositary/custodian regime would fit in under the sectoral AIFMD, UCITSD V and proposed PEPPR depositary regimes.

3.3. The PEPPR Proposed Depositary Regime – An Alternative Proposal

The European Commission published on 29 June 2017 a PEPPR proposal.[145] The proposal seeks to introduce a voluntary (third-pillar) European personal pension product (PEPP) regime that complements existing national personal pension schemes.[146] For that purpose, it establishes an European market for personal pension products that is based on a harmonized framework that is flexible and enables different providers to offer a variety of products that suits their business model.[147] The PEPPR proposal introduces a PEPP 'product passport'. For this purpose, the PEPPR proposes to regulate not only the PEPP as a product and the distribution/marketing process[148], but also its providers[149], distributors[150] and

[135] Art. 23(2) UCITSD V; Cf. Art. 21(3) AIFMD.
[136] Art. 22(5) UCITSD V; Cf. Art. 21(8) AIFMD.
[137] Art. 22(3) UCITSD V; Art. 21(9) AIFMD.
[138] Art. 22a UCITSD V; Cf. Art. 21(11) AIFMD.
[139] Art. 24(1) UCITSD V; Cf. Art. 21(12) AIFMD.
[140] See Chapter 5, section 3.4.3.
[141] See for the 'equivalency' regime for IORPs that do not have appointed a 'depositary' for the safekeeping of assets: Chapter 5, section 4.1. ; See for the 'equivalency' regime for IORPs that do not have appointed a 'depositary' for oversight duties: Chapter 5, section 4.2.
[142] See for the criticism on this regime: Chapter 5, section 4.1.2.
[143] See Art. 35(3) IORPD II.
[144] See for the risk management organization required to be applied by IORPs: Chapter 9, section 3.1.3.2.
[145] Parts of this section have been earlier published in: H. van Meerten & S.N. Hooghiemstra, *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions*, https://ssrn.com/abstract=2993991 (accessed 4 July 2017).
[146] European Commission, *Proposal for a Regulation of the European Parliament and of the Council on a pan-European Personal Pension Product (PEPP){SWD(2017) 243} {SWD(2017) 244}*, 1.
[147] See on an 'internal market for PEPPs': H. van Meerten & S.N. Hooghiemstra, *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions*, 32, https://ssrn.com/abstract=2993991 (accessed 4 July 2017).
[148] Chapter IV PEPPR.

depositaries[151].[152] The proposed PEPPR depositary regime consists of a 'sectoral-based' and a 'lex specialis' regime that is based upon depositary regulation under IORPD II.

It is, however, unexpected that the depositary regime as proposed will be finally adopted PEPPR. For that reason, an alternative proposal will be considered. For that purpose, first the current sectoral-based and 'lex specialis' depositary regimes under the proposed PEPPR will be reviewed. Considerations made related to the 'cross-sectoral depositary passport' will also be taken into account.

3.3.1. *The Scope of the PEPP 'Sectoral' and 'Lex Specialis' Depositary Regime*

The type of PEPP provider and the agreed 'PEPP scheme' under which a PEPP is provided[153] determines whether a depositary needs to be appointed under the 'sectoral-based' or the 'lex specialis regime'.

3.3.1.1. PEPP provider

Under Article 41 PEPPR, PEPP providers that are IORPs or investment firms authorized for portfolio management or investment advice are required to 'appoint one or more depositaries for the safekeeping of assets and oversight duties'.

All other PEPP providers are only required under the PEPPR to appoint a depositary if this is required under the sectoral legislation that is applicable to them. The sectoral approach, thus, applies to the following 'financial undertakings' (PEPP providers):

- credit institutions authorized under CRD IV;[154]
-insurance undertakings authorized under Solvency II[155] that are engaged in direct life insurances;[156]
-UCITS investment companies/ManCos authorized under UCITSD V;[157] and
-AIFMs authorized under the AIFMD.[158]

3.3.1.2. The Definition of the PEPP, PPPs & PEPP Schemes

The scope of the PEPP 'sectoral-based' regime also depends upon the type of 'PEPP scheme' under the PEPP definition.

PEPPs are under Article 2(2) PEPPR defined as:

> 'a long-term[159] savings <u>personal pension product</u>[160], which is provided under an <u>agreed PEPP scheme</u>[161] by a regulated financial undertaking[162] authorized under Union law to manage collective or individual

---

[149] 'provider of a PEPP' or 'PEPP providers' are financial undertakings authorized to manufacture a PEPP and distributing it. See Art. 2(14) PEPPR.
[150] 'distributor of a PEPP' or 'PEPP distributor' means a financial undertaking authorized to distribute PEPPs not manufactured by it, as well as an insurance, reinsurance or ancillary insurance intermediary. See Art. 2(15) PEPPR.
[151] Art. 41 PEPPR.
[152] See for an overview of the governance: H. van Meerten & S.N. Hooghiemstra, *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions*, 42 et seq, https://ssrn.com/abstract=2993991 (accessed 4 July 2017).
[153] 'PEPP provision' means the manufacturing and distribution of a PEPP. See Art. 2(6) PEPPR.
[154] Art. 5(1)(a) PEPPR.
[155] Art. 5(1)(b) PEPPR.
[156] Direct life insurances as defined in Art. 2(3) and Annex II Solvency II; See also Art. 5(1)(b) PEPPR.
[157] Art. 5(1)(e) PEPPR.
[158] Art. 5(1)(f) PEPPR.
[159] See Recital 2 PEPPR.

investments or savings, and subscribed to voluntarily[163] by an individual PEPP saver[164] in view of retirement, with no or strictly limited redeemability[165]'.

Without going in too much detail, two elements are relevant for the purpose of the scope of the PEPPR 'sectoral-based' depositary regime: the definitions of a 'personal pension product' and 'an agreed PEPP scheme'.

Article 2(1) PEPPR defines 'personal pensions products' as products which:[166]

- are based on a contract between an individual saver and an entity on a voluntary basis;[167]
- has an explicit retirement objective;[168]
- provides for capital accumulation until retirement with only limited possibilities for early withdrawal before retirement;[169] and
- provides an income on retirement.[170]

The abovementioned financial undertakings authorized under Article 4 PEPPR are allowed to manufacture and distribute products under their respective sectoral legislations that comply with the 'common features' under the 'personal pension products' definition.

Although the PEPPR does not specify what products comply with this definition, a mapping exercise of EIOPA in the road towards the PEPPR proposal showed that various insurance- and investment-based PPPs could fulfill the PPP definition.

Under Solvency II, personal pension plans of which the conditions are agreed upon between the insurer and the consumer and hybrid insurance or investment products with an accumulation approach for pension purposes would qualify as 'PPP' under the PEPPR. The latter includes investment-based insurance products (IBIPs) that are typically unit-linked products[171] and insured pensions[172].

Non-insurance EEA and non-EEA third-pillar retirement products could also fulfill this definition.

EEA products offered that could qualify under this definition include UCITS and retail AIFs[173] directly offered under the UCITSD V and AIFMD or 'wrapped' in another product such as a (hybrid) personal pension plan. In addition, IORPs are allowed to provide not only

---

[160] See H. van Meerten & S.N. Hooghiemstra, *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions*, 17-26, https://ssrn.com/abstract=2993991 (accessed 4 July 2017).
[161] Art. 2(4) PEPPR.
[162] Art. 5(1) PEPPR.
[163] See Art. 2(1)(a) PEPPR.
[164] See Art. 2(3) PEPPR.
[165] Art. 2(1)(c), 45-50 PEPPR.
[166] See for a detailed discussion on the meaning of these elements: H. van Meerten & S.N. Hooghiemstra, *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions*, 17-26, https://ssrn.com/abstract=2993991 (accessed 4 July 2017).
[167] Art. 2(1)(a) PEPPR.
[168] Art. 2(1)(b) PEPPR.
[169] Art. 2(1)(c) PEPPR.
[170] Art. 2(1)(d) PEPPR.
[171] European Commission, *Commission Staff Working Document of 11 April 2013: Consumer protection in third-pillar retirement products,*7, http://ec.europa.eu/dgs/health_food-safety/dgs_consultations/ca/docs/swd_consumer_protection_thirds_pillar_pensions_en.pdf (Accessed 14 January 2017).
[172] The OECD defines this category as pension plans offered by insurers and consisting exclusively of insurance products. See J. Yermo, *Revised Taxonomy for Pension Plans, Pension Funds and Pension Entities*, October 2002, Section 2.2., http://www.oecd.org/pensions/private-pensions/2488707.pdf (accessed 14 January 2017).
[173] Art. 43 AIFMD.

occupational but also personal pension plans.[174] Finally, credit institutions may under CRD IV offer savings products used for retirement income purposes.[175] The products and providers of these non-insurance are regulated on the EEA level.

On the national level, non-occupational pension funds (voluntary Pension Funds) and (hybrid) personal pension plans based on various types of commercial investment products, such as UCITS and retail-AIFs are also being offered that may fulfill the 'PPP' definition under the PEPPR.

The 'personal pension products' discussed are limited to PPPs under Article 2(2) PEPPR that are provided under an agreed 'PEPP scheme'. A 'PEPP scheme' under Article 2(4) PEPPR is defined as

> 'a contract, an agreement, a trust deed or rules stipulating which retirement benefits are granted and under which conditions on the basis of an individual retirement savings plan agreed with a PEPP provider'.

The PEPP scheme definition is based upon Article 6(2) IORPD II. For that reason, it seems to be logical that 'pension schemes' under Article 6(2) IORPD II qualify as 'PEPP schemes' under Article 2(4) PEPPR.

Under Article 1(3) UCITSD V, UCITS are undertakings that

> 'may be constituted in accordance with contract law (as common funds managed by management companies), trust law (as unit trusts), or statute (as investment companies)'.

Similarly, AIFs under Article 2(2)(b) AIFMD may be

> 'constituted under the law of contract, under trust law, under statute, or has any other legal form'.

Given these definitions, UCITS and AIFs also seem to qualify as 'PEPP schemes'.

Taking into account the investment rules for PEPP savers under which up to five investment options are required to be offered to PEPP savers[176] under the PEPPR, 'PEPP schemes' seem to be 'collective investment undertakings'.[177] The PEPP individual retirement savings plan agreed between an individual PEPP saver and a PEPP provider, thus, always embeds a 'PEPP scheme' under which the investment options are legally construed.[178] The PEPP proposal does not currently exclude any type of PPPs that comply with the PEPPR that may be offered to PEPP savers nor the 'PEPP scheme' that such a PPP must embed. 'PEPP schemes' may, thus, not only be AIFs, UCITS and IORPs that are regulated on the European level, but also 'PEPP schemes' that are regulated on the national level. Voluntary pension funds that are, (in part) subject to a UCITS-like national regime, exclusively regulated on the

---

[174] European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products,* 16 May 2013, EIOPA/13/241, 9, 10; EIOPA, in this regard, notes that applying the different set of rules to personal and occupational pension products might in practice place an unnecessary burden upon the IORP provider.

[175] 'Banksparen', for example, in the Netherlands are deposits that may be linked to the purchase of annuities on retiring. See European Commission, *Commission Staff Working Document of 11 April 2013: Consumer protection in third-pillar retirement products,*7, http://ec.europa.eu/dgs/health_food-safety/dgs_consultations/ca/docs/swd_consumer_protection_thirds_pillar_pensions_en.pdf (Accessed 14 January 2017).

[176] Arts 34-39 PEPPR.

[177] For this reason, IORPs are exempted under the AIFMD. See Chapter 8, section 2.1.3.

[178] Art. 2(4) PEPPR.

national level could be qualifying as a 'PEPP scheme'.[179] Voluntary pension funds are 'collective investment undertakings' that are regarded under the AIFMD as 'pension scheme' and for this reason fall outside of the scope of the AIFMD.[180] Such funds are neither required to apply for an UCITS authorization as the UCITSD V is an optional regime. All 'collective investment undertakings' that fulfill the AIF definition that are authorized UCITS and exempt under the AIFMD fall within the scope of the AIFMD. For this reason, it is unlikely that any other national schemes could qualify as 'PEPP scheme' under the PEPPR.

IORPs, AIFs, UCITS and voluntary pension funds qualify as 'PEPP scheme' and, when complying with the PPP definition, also as PPP under a PEPP. All PEPPs, thus, directly or indirectly invest through the investment options offered under IORPs, AIFs, UCITS and voluntary pension funds as PPP or as 'PEPP scheme'. Directly by investing in IORPs, AIFs, UCITS and voluntary pension funds as a PEPP in which they qualify as PPP and 'PEPP scheme' simultaneously or as part of another PPP, such as, amongst others, direct insurances and national PPPs that embed them as part of the PPP offered under the PEPP.[181] The scope of the 'lex specialis PEPPR depositary regime' is, thus, determined on the basis of investment firms and IORPs as PEPP providers, whereas the appointment of and the depositary regime applicable under the 'sectoral-based PEPPR depositary regime is being determined on the basis of the type of provider, PPP and 'PEPP scheme' on which the PEPP offered is based.

3.3.2. *The PEPPR 'Lex Specialis Depositary Regime'*

The PEPP 'lex specialis' depositary regime is partly based upon IORPD II and regulates the appointment of the depositary, its safekeeping and oversight duties, delegation and liability regime.

3.3.2.1. The Mandatory Depositary Appointment

The PEPP 'lex specialis' depositary regime applies to IORPs and investment firms as PEPP providers.[182] Under the 'lex specialis' regime they are required to 'appoint one or more depositaries for the safekeeping of assets and oversight duties'.[183]

Recital 41 PEPPR considers the introduction of the mandatory appointment of depositaries for these PEPP providers as necessary for the protection consumers as the sectoral legislation applying to IORPs and investment firms does not 'provide for the appointment of a depositary'. This consideration is confusing as Article 33 IORPD II provides for a 'depositary regime'. This explanation should, however, be seen in the light of the tasks of the depositary under the PEPPR 'lex specialis' regime.[184] Under Article 41 PEPPR, a depositaries is

---

[179] See *infra* 4.3.1.2.

[180] Recital 8, Art. 2(3)(e) AIFMD; See also AIFMD Q&A European Commission, ID 1148; See in the UK: Question 2.32, PERG 16.2, ' is a pension scheme covered? No. Neither an occupational pension scheme nor a personal pension scheme is covered. PERG 16.6 (Exclusions) sets out the relevant exclusions. The breadth of the wording in recital (8) of AIFMD shows that these exclusions should be interpreted broadly so as to cover both sorts of scheme. In addition, a pension scheme is sufficiently well established as a category of investment to mean that if AIFMD intended to catch pension schemes it would have made that clear. However, a scheme is not excluded from being an AIF just because all its investors are themselves pension schemes benefitting from an exclusion'; S.N. Hooghiemstra, *Wat is een beleggingsinstelling onder de AIFM-richtlijn?*, 3 Ondernemingsrecht 24 (2014).

[181] European Commission, *Commission Staff Working Document of 11 April 2013: Consumer protection in third-pillar retirement products,*9, http://ec.europa.eu/dgs/health_food-safety/dgs_consultations/ca/docs/swd_consumer_protection_thirds_pillar_pensions_en.pdf (Accessed 14 January 2017).

[182] Recital 41 and Arts 5(1), 41(1) PEPPR.

[183] Art. 41(1) PEPPR.

[184] Arts 2(23), 41 PEPPR.

entrusted with the safekeeping of assets and oversight duties, whereas under IORPD II Member States have the discretion to require a 'depositary' to be appointed for the safekeeping of assets or the safekeeping of assets and oversight duties or not to require a 'depositary' at all.[185] MiFID II does not require the appointment of a depositary at all. For this reason, it was considered that the PEPPR framework could require a depositary

> 'to avoid fraud or custody risk in the management (or valuation) of assets, as well as to ensure that assets of scheme are not lost in case of bankruptcy of the PEPP provider'.[186]

The depositary comes in addition to, amongst others, the risk mitigation mechanism that applies to the PEPP investment option.[187]

The 'detailed explanation' of the European Commission that accompanies the PEPPR proposal explains that the mechanism for the mandatory appointment of the depositary is only required under the 'lex specialis' regime 'in the case of a PEPP scheme where PEPP savers and PEPP beneficiaries fully bear the investment risk'.[188] Unlike Article 33(1) IORPD II, Recital 41 and Article 41 PEPPR do not make any reference to this nor does the proposal explain what 'fully bear the investment risk' means. It is, thus, unclear whether this requirement should be applied in practice. If applicable, it should, however, be interpreted in line of the interpretation of 'fully bear the investment risk' under IORPD II.[189]

Finally, allowing 'one or more depositaries to be appointed' under Article 41 PEPPR is inconsistent with the rationale of the 'single' compulsory depositary under the AIFMD and UCITSD V.[190] The AIFMD and UCITSD V require a 'single' depositary to be appointed as this ensures that the depositary has a comprehensive overview of all assets safekept for a single AIF/UCITS that is necessary to perform both the inventory of all assets and the correct performance of the depositary's oversight duties.[191]

3.3.2.2. Eligible Entities & Organizational Requirements

The 'lex specialis' depositary regime under Article 41 PEPPR requires a 'depositary' to be required. Article 2(23) PEPPR defines a depositary as

> 'an <u>institution</u> charged with the safe-keeping of assets and oversight of compliance with the fund rules and applicable law'.

Any 'institution' may be appointed under Article 41 PEPPR. Institutions may be EEA, national or TC entities.[192] Not regulating the entities eligible as a depositary is inconsistent with the depositary regimes under the AIFMD, UCITSD V and IORPD II.[193] The absence of this could result in a large variety of entities that would be allowed to be appointed under the

---

[185] Art. 33(1), (2) PEPPR.
[186] European Commission, *Commission Staff Working Document – Impact Assessment accompanying the document Proposal for a Regulation of the European Parliament and of the Council on a pan-European Personal Pension Product (PEPP)and Commission Recommendation on the tax treatment of personal pension products, including the pan-European Personal Pension Product* {COM(2017) 343}{C(2017) 4393}{SWD(2017) 244}, SWD(2017) 243, 115.
[187] *Ibid.*
[188] European Commission, *Proposal for a Regulation of the European Parliament and of the Council on a pan-European Personal Pension Product (PEPP){SWD(2017) 243} {SWD(2017) 244}*, 13.
[189] See Chapter 9, section 7.2.4.4.
[190] Cf. art. 2(1)(a) UCITSD IV.
[191] EIOPA-BOS-12/015, 465.
[192] See Chapter 2, section 1.4.
[193] Art. 23(2) UCITSD V; Art. 21(3) AIFMD; Art. 33(3) IORPD II.

laws of the individual Member States as was the case under UCITSD I-IV.[194] The Dutch IORP 'premium pension institutions' could, for instance, provide PEPPs with a 'pensioenbewaarder' ('safekeeping entity') as a depositary.[195] These institutions under Dutch law do not provide the same degree of investor protection standards as the conduct of business and prudential standards for AIF and UCITS depositaries under the AIFMD and UCITSD V.[196] This problem is exacerbated by the fact that, contrary to the joint principles of the European passport for EEA financial intermediaries[197], institutions may be appointed throughout the EEA on a cross-border basis without any restrictions.[198] Similarly, allowing TC institutions to be appointed without any centralized equivalence assessment similar to AIF depositaries is inconsistent with the EEA's approach towards TC intermediaries providing services within the EEA.[199]

For the appointment of the depositary and the execution of its tasks, 'institutions' have to comply with the IORPD II depositary rules on the written contract for the transmission of relevant information[200], a general duty of loyalty/care[201] and conflicts of interest[202]. Considering the AIFMD and UCITSD V comparable depositary function, IORPD II is rather unspecified.[203] The IORPD II minimum harmonization approach towards depositaries is based upon the discretion of Member States to require depositaries or custodians to be appointed under their IORPD II Member State implementations.[204] In particular, Article 41 PEPPR and Article 33(7) IORPD II do not require the appointment of an 'independent' depositary as is the case for UCITSD V depositaries.[205] Theoretically, the PEPP provider may act as provider, distributor and depositary under the condition that

> 'the depositary has functionally and hierarchically separated the performance of the depositary tasks from its other potentially conflicting tasks'.

This is allowed for CRD IV and MiFID custodians, but not for AIF and UCITS depositaries.[206] Finally, the IORPD II nor the PEPPR depositary rules specify in detail these tasks to the same extent as the level 2 measures under the AIFMD and UCITSD V.

The final PEPPR version, thus, will have to require harmonized EEA eligible entities to prevent problems that came up during the Madoff affaire.[207]

3.3.2.3. The PEPPR Depositary Regime

The PEPPR 'lex specialis' depositary regime refers for the safekeeping of assets, the oversight duties, delegation and the depositary's liability to the IORPD II depositary regime.

For the safekeeping of assets the same regime is introduced for PEPPs under Article 41 PEPPR as is currently applicable for IORP, UCITS and AIF depositaries.[208] The regime

---

[194] See Chapter 12, section 2.1.2.
[195] See , for Dutch premium pension institutions, for instance: A. Boutens, *Rol pensioenbewaarder en bescherming van deelnemers in een PPI*, 6 TPV 23 (2012); R.K. Tj. J. Smits, *Vermogensscheiding bij premiepensioeninstellingen*, 1 V&O 1 (2012).
[196] See Chapter 12, section 4.1.2.1.
[197] See Chapter 3, section 3.
[198] See Chapter 2, section 1.4.
[199] See Chapter 3, section 6.
[200] Art. 33(5) IORPD II.
[201] Art. 33(6) IORPD II.
[202] Art. 33(7) IORPD II.
[203] See Chapter 5, section 3.
[204] Art. 33(1) and (2) IORPD.
[205] See Chapter 4, section 4.4.
[206] Art. 23(2) UCITSD V; Art. 21(3) AIFMD; Art. 33(3) IORPD II.
[207] See S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013).

requires financial instruments that can be held in custody to be held in custody, whereas records have to be kept for 'other assets'.[209]

Apart from the safekeeping of assets, the PEPPR 'lex specialis' depositary requires oversight duties to be performed related to the 'compliance with the fund rules and applicable law'. The description of the oversight duties under the PEPPR depositary definition is confusing as Article 41(4) PEPPR makes reference to Article 35(1) IORPD II for the oversight duties that go beyond merely the 'compliance task'. Article 35(1) IORPD II requires depositaries to:

- carry out instructions of the PEPP, unless they conflicts with national law or the PEPP's rules;[210]
- ensure that in transactions involving the assets of a PEPP relating to a PEPP scheme any consideration is remitted to the PEPP within the usual limits;[211] and
- ensure that income produced by assets is applied in accordance with the rules of the PEPP.[212]

Again, the IORPD II nor the PEPPR depositary rules specify in detail these tasks to the same extent as the level 2 measures under the AIFMD and UCITSD V.

The PEPP depositary's delegation and liability regime refer to those applicable to depositaries under IORPD II. This delegation and depositary liability regime is based upon UCITSD I-IV and inconsistent with the considerations that laid to the detailed delegation and liability regimes under the AIFMD and UCITSD V.[213] The same issues as appeared during the Madoff fraud might come up when this regime will make it to the final PEPPR draft.[214]

It would have, thus, been better to base the PEPPR 'lex specialis' depositary regime on the UCITSD V depositary regime instead of the IORPD II depositary regime.

3.3.3. *The PEPPR 'Sectoral Depositary Regime'*

The PEPP 'sectoral depositary regime' applies to all other PEPP providers than IORPs and investment authorized for portfolio management and investment advice.[215] The 'sectoral regime' is (partially) based upon EIOPA's advice[216] that for the use of depositaries the sector-specific requirements on the use of depositaries would reflect the best the PEPP provider's characteristics and business model.[217]

Although the PEPPR does not make any reference to the 'sectoral depositary regime', de facto, this regime is being applied. EIOPA's advice on this point may, however, provide some guidance on this point. For the purpose of its advice on depositaries, EIOPA considered products under UCITSD V/AIFMD, Solvency II, CRD IV, MiFID II (asset managers) and IORPD II. Products regulated by national law, such as voluntary pension funds, were, however, not being considered. Considering the scope of the 'lex specialis regime' applying

---

[208] Art. 41(3) PEPPR; Art. 34(1) IORPD II; Art. 22(5) UCITSD V; Art. 21(8) AIFMD.
[209] Art. 41(3) PEPPR; Art. 34(1), (2) IORPD II.
[210] Art. 41(4) PEPPR; Art. 35(1)(a) IORPD II.
[211] Art. 41(4) PEPPR; Art. 35(1)(b) IORPD II.
[212] Art. 41(4) PEPPR; Art. 35(1)(c) IORPD II.
[213] See Chapter 12, section 2.1.5 and 2.1.6.
[214] See Chapter 12, section 2.
[215] Art. 41(1) PEPPR.
[216] European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 22.
[217] *Ibid.*

to IORP and investment firm PEPP providers, the depositary requirements related to UCITSD V/AIFMD, Solvency II, CRD IV and products regulated under national law.

3.3.3.1. AIFs/UCITS

The depositary is an important risk mitigation tool and mandatorily required under the AIFMD and UCITSD V.[218] EIOPA sees depositaries for AIF/UCITS-based PEPPs as a

> 'specific organizational or governance measure for funds that relates to the legal form of the fund (as collective investments, where assets remain property of investors'.[219]

The depositary in the separation of investment and management under these laws provides for asset partitioning and limited liability. The safekeeping of the assets of an fund ensures that the assets of the investors are being administratively segregated from the assets of the AIFM/UCITS ManCo, the depositary itself and other investors. As a result, investors cannot be held liable for creditor claims other than the claims on the common fund property. Investors investing in AIFs and UCITS bear the full investment risk and, therefore, the depositary is exercising a number of controlling duties on top of the safekeeping function to overcome the agency problem gap left by the discretionary management of assets by the asset manager. The pooled risk undertaken by the collective investors does not only imply an agency relationship between the collective investors and the (collective) asset manager, but also amongst the investors itself. The control duties performed by the depositary on behalf of the joint investors is in line with the cheapest cost avoider theory and overcomes the free riding problem. Under the AIFMD and UCITSD V, a depositary, thus, reduces the risk of misappropriation and insolvency motivated by investors remaining the '*owners*'.[220]

3.3.3.2. Solvency II & CRD IV

For PEPPs that are based upon products under Solvency II and CRD IV/CRR no depositary is required to be appointed. Credit institutions, (re)insurance undertakings, unlike AIFMs/UCITS ManCos, take principal risk[221], do not act as a mere service intermediary and are, therefore, subjected to capital requirements that underlie the ordinary contractual claims of consumers towards them. No depositary is required as misappropriation nor bankruptcy leads to a shift in the ranking of the ordinary contractual claims towards these intermediaries that take principal risk.

3.3.3.3. National PPPs/PEPP Schemes under the PEPPR

The PEPP initiative requires PEPP providers to be an intermediary regulated under one of the European legal acts. The PEPPR, however, does not prevent PEPP providers from manufacturing and distributing PEPPs under the PEPP (product) passport that have PPPs or agreed 'PEPP schemes' that are regulated on the national level.

---

[218] European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP),* 04 July 2016, EIOPA-16/457, 21, 22.
[219] *Ibid*, 21.
[220] Depending upon the jurisdiction involved the legal title of the AIF/UCITS assets may be the AIFM/UCITS ManCo, depositary or, if having legal personality, the fund itself. D.A. Zetzsche, *Die Irrelevanz und Konvergenz des Organisationsstatus von Investmentfonds*, ZVglRWiss 111, 371 (2012). 'Ownership', however, should be understood as having legal ownership or a contractual priority claim based upon regulatory law that resembles, to a large extent, legal ownership and ranks ahead of all other claims towards the fund property. See IOSCO 1996, 13; S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013).
[221] S.L. Schwarcz, *Intermediary Risk in a Global Economy*, 6 Duke Law Journal 1541 (2001).

National laws may, for instance, allow AIFMs and UCITS ManCos that qualify as PEPP providers to manufacture and distribute PEPPs based upon voluntary pension funds that are regulated under national law. Various Member States offer, 3rd pillar national voluntary pension funds that are based upon UCITS and contain similar prudential elements to the management company (PEPP provider), the depositary and similar investor protection measures to the pension funds (e.g. pre-contractual information, ongoing information, selling practices, caps on fees charged by management companies). These prudential regimes are, however, primarily based upon the national implementation of the UCITSD I-IV provisions that only contained minimum harmonization leading to huge differences related to various regulatory requirements related to, for example, the depositary regimes of these type of voluntary pension funds.[222]

Not excluding national PPPs/PEPP schemes under the PEPPR, thus, leads to inconsistencies under the PEPP 'sectoral' depositary regime as the regulation applicable depends upon the national law regulating the product. Although these national products are required to comply with the PEPPR, this does offer resolve the non-level playing field for depositaries.

3.3.3.4. Conclusion

If a sector-specific approach for the use of depositaries would be pursued in the final draft the scope of the sectoral depositary regime should be limited to EEA regulated PPPs/PEPP schemes under the PEPPR. Under such an approach, no considerations would have to be made whether or not a depositary should be required to be appointed for PEPPs as this issue is already solved at the level of the sector specific legislations. The sectoral approach also prevents a 'double depositary requirement' as this approach, for instance, would not require insurance undertakings acting as PEPP providers to appoint a depositary for life insurances offered. Underlying investment options that would include UCITS or (retail) AIFs, however, would require the appointment of a depositary. In the case that the final PEPPR version pursues in including PPPs/PEPP schemes regulation on the national level, such as voluntary pension funds, a lex specialis depositary regime based upon UCITSD V should be considered for PPPs/PEPP schemes that are similar to AIFs/UCITS. Such a regime would reflect, indeed, the business model of PEPPs the best.

3.3.4. *The PEPPR Depositary Regime - Lex Ferenda*

The proposed PEPPR depositary regimes show inconsistencies related to their scope and application. Two types of solutions could overcome these problems.

First, the PEPPR depositary regime could be fully 'sectoral-based' under the prerequisite that the PPPs/PEPP schemes' that underlie the PEPP are limited to EEA regulated products

[222] See for the depositary regimes of these 'AIFMD pension funds' for which no European legislation is applicable: Czech Republic: § 88-92 427/2011 Coll. LAW on supplementary pension savings, November 6, 2011; § 38 -41 426/2011 Coll. on retirement savings Law November 6, 2011; Hungary: § 76 *Act LXXXII* of *1997* on *Private Pensions* and *Private Pension Funds (*Voluntary pension fund); Estonia:§ 92-96 Estonian Investment Funds Act (voluntary pension fund); Spain : Article 21 Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulación de los Planes y Fondos de Pensiones (personal pension fund); Poland: Chapter 16 Depositary , Act of 28 August 1997 Law on Organisation and Operation of Pension Funds (open pension fund); Portugal: Decreto-Lei n.o12/2006 de 20 de Janeiro, CAPÍTULO II Depositários (individual membership of open pension funds; See also: Discussion Paper on a possible EU-single market for personal pension products, Annex 1 - Examples of (pure) Personal Pension Plans/Products in EU Member States, 37 et seq.

provided by the 'financial undertakings' authorized under sectoral EEA legislation.[223] The question whether a depositary should be appointed and what depositary legislation applies would be left over to the sectoral approach for the PPP/PEPP scheme underlying a PEPP. No national PPPs/PEPP schemes would be allowed under the PEPPR and such a sectoral approach related to depositaries would ensure full consistency with the depositary approaches under the AIFMD, UCITSD V and IORPD II.

Second, a PEPPR depositary regime could be introduced that is not based upon the 'PEPP provider' but on the PEPP scheme underlying the provided PEPP.
sectoral approach would apply to EEA PEPP schemes, whereas a 'lex specialis' depositary regime would require national PEPP schemes that are similar to AIFs/UCITS and in which 'PEPP savers and PEPP beneficiaries fully bear the investment risk'[224] to apply the UCITSD V depositary regime.

All EEA PEPP schemes would under the alternative proposal be required to appoint a depositary if the sectoral laws to which they are subjected requires such an appointment, whereas for national 'PEPP schemes' that are similar to AIFs/UCITS and in which 'PEPP savers and PEPP beneficiaries fully bear the investment risk'[225] the appointment would need to be required on the basis 'lex specialis' criteria. All national and EEA PEPP schemes required to appoint a depositary would be required to apply the UCITSD V depositary regime to ensure a level playing field. For that purpose, the question would need to be answered for what national 'PEPP schemes' a depositary would be useful and, more specific, under which conditions a depositary and what type of depositary for these schemes would be required to be appointed.

This approach has as an advantage that it accommodates the apparent desire to include national products as PPPs/PEPP schemes under the PEPPR. The disadvantage is that designing 'lex specialis' criteria upon which the national PEPP scheme depositary requirement would be highly complex. The European Commission seems to have a clear policy objective to allow national PPPs to convert themselves into PEPPs.[226] For that reason, it is highly likely that 'lex specialis' criteria for the compulsory appointment of a depositary for national PEPP schemes would need to be considered. This paragraph sets out how such a regime could look like and how this fits in the proposal to introduce a 'cross-sectoral depositary passport'.

3.3.4.1. Scope of the Proposed PEPPR Depositary Regime

A PEPPR depositary regime could be introduced that is not based upon the 'PEPP provider' but on the PEPP scheme underlying the provided PEPP. This suggestion is consistent with the AIFMD and UCITSD V that also require depositaries to be appointed on the basis of the 'product' and not on the basis of the 'provider'. The inconsistency of the 'provider-based' approach can also be seen in the PEPPR proposal. Article 41(1) PEPPR adopted the 'provider-based' approach, as was suggested by EIOPA, whereas the European Commission

---

[223] See for this suggestion on so-called 'eligible third-pillar products': H. van Meerten & S.N. Hooghiemstra, *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions*, 17 et seq., https://ssrn.com/abstract=2993991 (accessed 4 July 2017).
[224] European Commission, *Proposal for a Regulation of the European Parliament and of the Council on a pan-European Personal Pension Product (PEPP){SWD(2017) 243} {SWD(2017) 244}*, 13.
[225] *Ibid.*
[226] Art. 7(2) PEPPR: 'existing personal pension products may be converted into "PEPPs" following authorisation by EIOPA'.

refers in its detailed explanation attached to the proposal to a 'PEPP scheme-based' approach.[227] The explanation highlights that

> 'chapter VI establishes the mechanism for appointing a depositary in the case of a PEPP scheme where PEPP savers and PEPP beneficiaries fully bear the investment risk'.[228]

Considering this, a 'PEPP scheme' based depositary requirement would be more suitable. All EEA PEPP schemes would be required to appoint a depositary if the sectoral laws to which they are subjected requires such an appointment, whereas for national 'PEPP schemes' the appointment would need to be required on the basis of 'lex specialis' criteria. For that purpose, the question would need to be answered for what national 'PEPP schemes' a depositary would be useful and, more specific, under which conditions a depositary and what type of depositary for these schemes would be required to be appointed.

3.3.4.2. The Utility of a Depositary for National PEPP Schemes

The utility of a depositary has proven itself for UCITS, (retail) AIFs and IORPs. Depending upon whether PEPP will be restricted to merely European products or includes also products regulated at the national level, the PEPP initiative may fully or partly rely upon the criteria for the mandatory appointment of a depositary under sectoral European regulation. PEPPs based upon a PEPP scheme regulated under European legislation may benefit from the considerations made for the appointment of a depositary in that domain. The sectoral approach also prevents from a 'double depositary requirement' as this approach, for instance, would not require providers to appoint a depositary for life insurances offered. Underlying investment options investing in an UCITS, IORP or (retail) AIF, however, do include the appointment of a depositary.

The depositary under these laws provides for asset partitioning and limited liability. The safekeeping of the assets ensures that the assets of the investors are being administratively segregated from the assets of the AIFM, UCITS ManCo or IORP governing board, the depositary itself and other investors/members. As a result, investors cannot be held liable for creditor claims other than the claims on the common fund property. Investors investing in AIFs and UCITS bear the full investment risk and, therefore, the depositary is exercising a number of controlling duties, on top of the safekeeping function, to overcome the agency problem gap left by the discretionary management of assets by the AIFM/UCITS ManCo. The control duties performed by the depositary on behalf of the joint investors is in line with the cheapest cost avoider theory and overcomes the free riding problem.[229] This also applies to full DC IORPs.[230] The appointment of a depositary is, thus, useful for national products that can be regarded to be similar to AIFs, UCITS and full DC IORPs.

3.3.4.3. A Proposal for a Depositary Requirement for National PEPP Schemes

---

[227] European Commission, *Proposal for a Regulation of the European Parliament and of the Council on a pan-European Personal Pension Product (PEPP){SWD(2017) 243} {SWD(2017) 244}*, 13.
[228] *Ibid.*
[229] See on the 'cheapest cost avoider theory': K.D. Logue & J.B. Slemrod, *Of Coase, Calabresi, and Optimal Tax Liability,* Law & Economics Working Papers Law & Economics Working Papers Archive: 2003-2009, University of Michigan Law School Year 2009, 3, http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1097&context=law_econ_archive (accessed 17 August 2016 2016); G. Calabresi, *The Costs of Accidents: A Legal and Economic Analysis (*Yale University Press 1970); See also on the 'free riding problem': M. Olsen, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Harvard University Press 1971) (describing that the free rider problem results in a disincentive to act because any shareholder may decide to save itself the cost of acting in the belief that other shareholders will do so); R. Hardin, *Collective action* (Routledge 1982).
[230] Chapter 9, section 7.

To ensure consistency with the AIFMD, IORPD and UCITSD V a depositary requirement ensuring the integrity of the investor assets would need to be imposed for PEPP schemes regulated under national laws that are similar to AIFs and UCITS, This type of PEPP scheme would need to comply with the retail UCITSD V depositary regime in order to ensure consistency with the depositary regimes under UCITSD V, AIFMD and IORPD II. For that purpose, it needs to be discussed what criteria need to be defined under which condition a national product can be regarded to be similar to AIFs, UCITS and full DC IORPs. Both the CJEU case law defining 'special investment funds' or assessing national products on the basis of the AIF definition could provide a solution for this problem.

For purpose of the discretionary management VAT exemption, a line of CJEU case law has defined criteria that pension funds need to fulfill in order to qualify as a 'special investment fund'.[231] AIFs and UCITS are at all times deemed to be a 'special investment fund'.[232] The CJEU has four criteria to determine whether the services of managing and administering those funds should be exempt from VAT. The customers to whom the retirement benefits are to be paid must solely fund the voluntary pension fund, the customers bear the investment risks, the fund contains the pooled contributions of multiple pension customers and the fund applies the principle of risk spreading.[233] The problem with these criteria is that the CJEU case law criteria are not always clear as the tax neutrality principle is the overarching principle in the light of which these four criteria are assessed by the CJEU.[234] The criteria of what is an AIF, a UCITS or an IORP would, thus, provide for better criteria whether or not a national product is similar and should be required to appoint a depositary. The problem with the IORP under the IORPD II is that members do not always bear full investment risk and for that reason individual Member States may decide for (full) DC, DB, as well as, hybrid IORPs whether a depositary should is mandatorily required. A UCITS is essentially an AIF for which no (optional) authorization has been obtained under the AIFMD, whereas various PEPP schemes under national law, such as voluntary pension funds, are essentially based upon UCITSD I-IV and fulfill all criteria of an AIF except for the 'pension scheme' carve-out embedded in the AIFMD.

For that purpose, the PEPPR could require all non-EEA regulated PEPP schemes that would qualify under the AIF definition as collective investment undertakings that are undertakings (1) raising capital of (2) a number of investors that (3) is being invested in accordance with a predefined investment policy (4) on behalf of those investors to appoint a UCITSD V depositary.[235] The assessment of the PEPP scheme would take place on the basis of the AIF definition under the AIFMD in which the 'pension scheme' exemption would need to be disregarded.[236] The latter exemption is the reason why these national products do not fall under the scope of the AIFMD. a depositary, however, only need to be appointed for qualifying 'PEPP schemes' in which 'PEPP savers and PEPP beneficiaries fully bear the investment risk'.[237] For full DC PEPP schemes, the PEPPR could determine that a 'UCITSD V depositary' would need to be appointed. No special provision for PEPPs with investment firms as PEPP providers would be warranted as such PEPPs under this proposal would be

---

[231] See CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 16; CJEU (Judgment of 4 May 2006), Case C-169/04), *Abbey National*, ECLI: EU:C:2006:289, para. 40, 41; CJEU (Judgment 28 June 2007), Case C-363/05, *Claverhouse,* ECLI: EU:C:2007:391, para. 43.
[232] CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 42.
[233] See in more detail: Chapter 9, section 7.2.
[234] See A-G Opinion (15 March 2016), *Stichting Pensioenfonds*, ECLI: NL:PHR:2016:91.
[235] See for the criteria: AIF definition: Chapter 8, section 2.1.
[236] S.N. Hooghiemstra, *Wat is een beleggingsinstelling onder de AIFM-richtlijn?*, 3 Ondernemingsrecht 24 (2014).
[237] *Ibid.*

required to have a depositary for AIFs, UCITS and IORPs as PEPP scheme and national PEPP schemes fulfilling the material AIF definition. The PEPPR would, thus, need to require the appointment of a depositary for EEA products for which sectoral legislation demands such an appointment and national PEPP schemes that fulfill the material AIF definition. This, however, does not answer the question what type of depositary regime would be required.

3.3.4.4. The PEPPR 'UCITSD V Depositary Regime

The sectoral and 'lex specialis' rules together determine whether a depositary would need to be appointed under the PEPPR. This approach, however, leads to an uneven level playing field for depositaries as the sectoral depositary regime vary throughout the sectoral regulations. Moreover, PEPP schemes, based upon national law, such as national voluntary pension fund regimes are being established on the national level after UCITSD I was being introduced. The implementation of UCITSD V for UCITS might lead to depositary regimes being unilaterally adapted in individual Member States for their voluntary pension funds. However, this depends upon the individual Member States. Not adapting the national regimes would lead to a situation in which a fragmented depositary landscape for voluntary pension funds would exist and would also result in an uneven playing field for PEPPs embedding a (retail) AIF and UCITS, at the one hand, and voluntary pension funds, at the other hand. In addition, the minimum harmonization of the IORPD II depositary regime on which the proposed PEPPR 'lex specialis' depositary regime is based, is inconsistent with the AIFMD and UCITSD V depositary regimes.

The retail nature of the PEPP initiative and the fact that national PEPP schemes, such as voluntary pension funds, are based upon the UCITSD I-IV would render the UCITSD V depositary regime to be the most suitable depositary regime. Applying the UCITSD V depositary regime to PEPP schemes that are under the sectoral and 'lex specialis' rules required to appoint a depositary would overcome these problems. The UCITSD V depositary regimes substitutes for the 'material depositary regimes' that PEPP schemes are required to comply with on the sectoral level. To that end, the final version of Article 41 PEPPR could make reference to the UCITSD V depositary provisions in which the obligations targeted to 'UCITS ManCos' should apply to the 'PEPP provider'. Similarly, provisions targeting 'UCITS' should apply to the 'PEPP (scheme)'. Applying a UCITSD V depositary regime to all PEPP schemes for which a depositary is required to be appointed ensures a level playing field related to, amongst others:

- the mandatory appointment of a single depositary;[238]
- the legal independence of the depositary and the provider and related requirements;[239]
- the eligible entities required to be appointed and the organizational requirements applicable to them (depending upon the UCITSD V Member State implementation: credit institutions, investment firms, and 'other legal entities');[240]
- the safekeeping duties;[241]
- the oversight duties;[242]
- the delegation regime;[243] and
- the depositary's liability regime.[244]

[238] Art. 22(1) UCITSD V; Cf. Art. 21(1) AIFMD.
[239] See Arts 25, 26b UCITSD V; Art. 21 UCITSD V (Commission) Regulation.
[240] Art. 23(2) UCITSD V; Cf. Art. 21(3) AIFMD.
[241] Art. 22(5) UCITSD V; Cf. Art. 21(8) AIFMD.
[242] Art. 22(3) UCITSD V; Art. 21(9) AIFMD.
[243] Art. 22a UCITSD V; Cf. Art. 21(11) AIFMD.
[244] Art. 24(1) UCITSD V; Cf. Art. 21(12) AIFMD.

The oversight duties would be allowed to be proportionally applied. In particular, the duties related to subscriptions/redemptions, the valuations of share/unit pricing and cash management could be irrelevant for PEPPs that are, for instance, unit-linked insurances.

Under its Impact Assessment, the European Commission already considered that

> 'the PEPP framework could require an independent depositary function (based on UCITS or IORP II) to avoid fraud or custody risk in the management (or valuation) of assets, as well as to ensure that assets of scheme are not lost in case of bankruptcy of the PEPP provider'.[245]

Instead of taking the UCITSD V, the proposed PEPPR took IORPD II as a 'template' for the PEPPR 'lex specialis' depositary regime.[246] The choice for UCITSD V is a better one considering the fact that is harmonized to a larger extent due to the level 2 depositary provisions implementing the level 1 framework that are absent under IORPD II. In addition, IORPD II is designed for Member States that either implement a 'custodian' or a 'depositary' regime under their IORPD II implementation laws, whereas the PEPPR clearly aims for a 'full-fledged' depositary regime as in the AIFMD and UCITSD V.

If the proposals in the dissertation regarding the 'cross-sectoral depositary passport' would be adopted the MiFID II 'custodian' custodian provisions and the 'custody-plus' provisions under UCITSD V would apply to PEPPs required to appoint a depositary.

3.3.5. *Conclusion*

The proposed PEPPR depositary regime consists of a 'sectoral-based' and a 'lex specialis' regime that is based upon depositary regulation under IORPD II. A stand-alone 'lex specialis' depositary regime under the proposed Article 41 PEPPR is required for IORP and investment firm PEPP providers. The proposed PEPP 'sectoral depositary regime' applies to all other PEPP providers[247] and is (partially) based upon EIOPA's advice[248] that for the use of depositaries the sector-specific requirements on the use of depositaries would reflect the best the PEPP provider's characteristics and business model.[249] It is, however, unexpected that the depositary regime as proposed will be adopted under the final version of the PEPPR. The proposed PEPPR depositary regimes related to the scope of the compulsory appointment of the depositary and the IORPD II 'lex specialis' PEPPR depositary regime are inconsistent with the AIFMD and UCITSD V depositary regimes. The scope of the proposed 'lex specialis' and 'sectoral-based' PEPPR depositary regimes is based upon the type of PEPP providers and not upon the agreed 'PEPP scheme' under the PEPP. This leaves the appointment of a depositary for PEPP schemes regulated on the national levels over to national law that often require a UCITSD I-IV depositary to be appointed that does not adhere to the modern AIFMD/UCITSD V depositary standards. Moreover, the IORPD II based

---

[245] European Commission, *Commission Staff Working Document – Impact Assessment accompanying the document Proposal for a Regulation of the European Parliament and of the Council on a pan-European Personal Pension Product (PEPP)and Commission Recommendation on the tax treatment of personal pension products, including the pan-European Personal Pension Product* {COM(2017) 343}{C(2017) 4393}{SWD(2017) 244}, SWD(2017) 243, 115.

[246] Art. 41 PEPPR.

[247] Art. 41(1) PEPPR.

[248] European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 22.

[249] European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 22; European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP),* 04 July 2016, EIOPA-16/457, 22.

regime required under the 'lex specialis' proposed PEPPR regime is inconsistent with the AIFMD and UCITSD V as well. The proposed PEPPR requires an AIF/UCITS type of depositary to be appointed, whereas the IORPD II regime is a hybrid custodian/depositary regime in which there is a large amount of discretion left to Member States in their IORPD II implementations.

To overcome these issues, this section proposed a PEPP depositary regime that is not based upon the 'PEPP provider' but on the PEPP scheme underlying the provided PEPP. All EEA PEPP schemes would be required to appoint a depositary if the sectoral laws to which they are subjected requires such an appointment, whereas for national 'PEPP schemes' the appointment would need to be required on the basis of the AIF definition under the AIFMD in which the 'pension scheme' exemption would need to be disregarded.[250] Applying the UCITSD V depositary regime to EEA and national PEPP schemes that are required to appoint a depositary would ensure a level playing field for PEPP depositaries.

4. The Cross-Sectoral Depositary Passport & The Blockchain Revolution

The 'cross-sectoral' depositary passport proposed, is based upon the 'intermediary holding model'[251], i.e. the current method of holding and transferring securities by means of 'intermediaries' such as depositaries and custodians.[252] Settlement under this model is highly complex. It is expected that in the coming years 'blockchain settlement', i.e. settlement through DLT, will gradually replace settlement under the 'intermediary holding model'.[253] Blockchain allows (crypto-)securities to be directly transferred from sellers to buyers or from collateral providers to collateral takers.[254] Some experts suggest that no securities accounts and no intermediaries, such as depositaries and custodians, will be necessary for this.[255] The high (systematic) importance of securities holding and settlement makes it, however, likely that blockchain networks/platforms for securities holding and settlement will be required by the legislator to be only accessible to authorized market participants. Depositaries/custodians will, thus, in the blockchain revolution have to evolve through the 'intermediary era' to the

[250] S.N. Hooghiemstra, *Wat is een beleggingsinstelling onder de AIFM-richtlijn?*, 3 Ondernemingsrecht 24 (2014).
[251] Chapter 6, section 2.2.; See also *infra* Chapter 13, section 5.1.2.
[252] P. Paech, *Integrating Global Blockchain Securities Settlement with the Law - Policy Considerations and Draft Principles*, 3,4, https://ssrn.com/abstract=2792639 (accessed 20 July 2017).
[253] Deutsche Bank, *NeMA Asia round up: Can Custodian Banks win in the Blockchain Phenomenon*, December 2015, http://cib.db.com/insights-and-initiatives/flow/nema-asia-round-up-can-custodian-banks-win-in-the-blockchain-phenomenon.htm#gsc.tab=0 (accessed 20 July 2017); J. Condos,W.H . Sorrell & S.L. Donegan, *Blockchain Technology: Opportunities and Risks*, http://legislature.vermont.gov/assets/Legislative-Reports/blockchain-technology-report-final.pdf (access 20 July 2017); P. Walsh, *Regulator warns of blockchain settlement usage* (19 January 2017), Global Custodian https://www.globalcustodian.com/Technology/Regulator-warns-of-blockchain-settlement-usage/ (accessed 20 July 2017).
[254] *Ibid.*
[255] G. Prisco, *The Blockchain Could Make Existing Securities Industry Players Redundant, Says BNP Paribas Analyst (*6 July 2015), https://bitcoinmagazine.com/articles/blockchain-make-existing-securities-industry-players-redundant-says-bnp-paribas-analyst-1436212815/ (accessed 20 July 2017); M. Harwood-Jones, *Blockchain and T2S: A potential disruptor*, https://www.sc.com/BeyondBorders/wp-content/uploads/2016/06/2016-06-16-BeyondBorders-Report-SCB_Nema_Block-Chain-Paper-Final.pdf (accessed 20 July 2017).

‘Fintech’ and the ‘TechFin’ era.[256] Settlement through ‘decentralized autonomous organizations could mark the ‘final stage of disintermediation’.

4.1. From ‘Physical Certificates’ and ‘Intermediation’ to ‘Blockchain Settlement’

The future role of depositaries/custodians and their ‘safekeeping task’ in the ‘blockchain revolution’ can only be understood when reviewing the development from ‘physical certificates’ and ‘intermediation’ to ‘blockchain settlement’.

4.1.1. *Physical Certificates*

Prior to the invention of ‘physical’ certificates, there were merely mutual obligations between fund providers and receivers.[257] The invention of ‘physical’ certificates led to problems related to the legal and economic terms of these certificates, transferability[258], negotiation and novation.[259]

Standardization in the market for securities led to harmonization of legal and economic terms of securities resulting in ‘fungibility’, i.e. securities that are not separately identifiable due to same legal and economic terms applied to them. Transferability and assignment, however, posed a major problem. Upon selling securities on the secondary market, buyers would need to verify whether sellers were empowered to dispose of these securities (negotiation) and whether the securities were encumbered or unencumbered. Finally, the ‘bundle of mutual personal obligations’ of securities had an intangible nature and, therefore, were required to be transferred by assignment.

To overcome these problems, two concepts of securities settlement that are still used today were developed: the delivery of a physical certificate or the transfer of securities through register entries.[260]

The delivery of a physical certificate was based in civil law jurisdictions upon Von Savigny’s ‘fictitious’ ‘incorporation theory’ for physical certificates that helped to transform the intangible nature of the ‘bundle of mutual personal obligations’ into making securities ‘tangible’.[261] The intangible ‘bundle of mutual personal obligations’ of securities were embedded into the tangible nature of physical certificates allowing transferors and transferees to benefit from the property law delivery mechanism applying to tangibles that ensured bona fide/good faith acquisition.[262] This ensured that the delivery of the physical certificate would transfer the certificates property and attached rights.

---

[256] See on ‘Fintech’, ‘TechFins’ and the differences between the two: D.A. Zetzsche, R.P. Buckley, D.W. Arner & J.N. Barberis, *From FinTech to TechFin: The Regulatory Challenges of Data-Driven Finance*, European Banking Institute Working Paper Series 2017 - No. 6, https://ssrn.com/abstract=2959925 (accessed 10 July 2017).

[257] P. Paech, *Integrating Global Blockchain Securities Settlement with the Law - Policy Considerations and Draft Principles*, 4, https://ssrn.com/abstract=2792639 (accessed 20 July 2017).

[258] Transferability concerns the process of the transfer; See J. Benjamin, *Interests in Securities* 65-67.(Oxford University Press 2000).

[259] P. Paech, *Securities, Intermediation and the Blockchain - An Inevitable Choice between Liquidity and Legal Certainty?*, 4-6, https://ssrn.com/abstract=2697718 (access 20 July 2017).

[260] *Ibid*, 5.

[261] E. Micheler, *Property in Securities – A Comparative Study* 149 et seq. (Cambridge University Press 2007); R. Zimmerman, *Savigny’s Legacy: Legal History, Comparative Law, and the Emergence of a European Legal Science*, 112 LQR 575 (1996).

[262] See, eg., E. Micheler, *The Legal Nature of Securities: Inspirations from Comparative Law,* 131-149. (L. Gullifer & J. Payne eds, Hart Publishing 2010);

Registered entries also smoothened the transfer of securities. The integrity of an issue was preserved by a (shareholder/bondholder) register. The register was a perfect mechanism for ensuring integrity and recording encumbrances to protect any future buyers. The (shareholder/bondholder) register was initially kept by the issuer himself.[263] The introduction of registered securities, however, soon paved the way for CSDs that professionalized this function for public secondary market trading that led to 'intermediation'.[264]

4.1.2. *Intermediation*

Due to higher trading volumes, settlement based upon the delivery of physical certificates and the transfer of securities through register entries proved to be too cumbersome. CSDs[265] in every Member State emerged that were responsible for the integrity of security issues by issuers and securities settlement was immobilized and later dematerialized.[266] Following the improved transferability of securities, the concept of securities intermediation emerged in which custodians and depositaries administer ('safekeep') securities holdings and effect transactions for their clients through a cascade of accounts leading to a so-called 'root account' with a CSD.[267]

4.1.2.1. Legal Consequences of 'Intermediation'

'Intermediation' had various legal consequences for the way how securities are held and transactions were conducted.[268]

First, 'intermediation' had effect on the way how securities were transferred. The emergence of CSDs removed the necessity to physically transfer bearer security certificates. Bearer securities, thus, de facto also became 'registered securities' as they were evidence by a credit entry in the securities accounts held with their custodian/depositary. Registered securities in issuer books no longer recorded investor names but the names of the custodian/depositary that held directly an account in the CSD in the chain of intermediated securities.[269]

Second, 'intermediation' led to the 'pooling' of securities holdings. Custodians and depositaries held their clients' securities through accounts with other custodians in 'omnibus accounts', i.e. accounts with fungible securities.[270] Fungible securities of a specific kind belonging to multiple clients of a single depositary/custodian were held in a 'single bulk account' with another custodian in the depositary's/custodians' name. Due to 'intermediation' securities could, thus, not be traced back to any individual investors. Third, 'intermediation' led to so-called 'mirrored accounts'.[271] Investors held securities in the account held with their

---

[263] M. Yates and G. Montagu, *The Law of Global Custody* 20 (3rd ed. Tottel, Haywards Heath 2009).
[264] See Chapter 6, section 2.2.1.
[265] See on the current role of CSDs: Chapter 6, section 2.2.1.1.
[266] *Ibid.*
[267] Chapter 6, section 3.1.1.
[268] P. Paech, *Securities, Intermediation and the Blockchain - An Inevitable Choice between Liquidity and Legal Certainty?*, 7-9, https://ssrn.com/abstract=2697718 (access 20 July 2017); See also: The Giovanni Group, *Cross-border Clearing and Settlement Arrangements in the European Union*, http://ec.europa.eu/internal_market/financial-markets/docs/clearing/first_giovannini_report_en.pdf (accessed 3 July 2015); The Giovanni Group, *Second Report on EU Clearing and Settlement Arrangements*, http://ec.europa.eu/internal_market/financial markets/docs/clearing/second_giovannini_report_en.pdf (accessed 3 July 2015).
[269] L. Thévenoz, *Intermediated Securities, Legal Risk, and the International Harmonization of Commercial Law*, 13 Stanford Journal of Law, Business & Finance 384-452 (2008); L. Thévenoz, *Who holds (Intermediated) Securities? Shareholders, Account Holders, and Nominees?,* 3-4 Uniform Law Review 845-859 (2010).
[270] See Chapter 6, section 2.2.1.
[271] P. Paech, *Securities, Intermediation and the Blockchain - An Inevitable Choice between Liquidity and Legal Certainty?*, 9, https://ssrn.com/abstract=2697718 (access 20 July 2017).

direct intermediary. The same securities were, however, held on behalf of them through different accounts held with different custodians throughout the intermediary holding chain. The length of the average chain for specific kind of securities led to enormous complexities.

4.1.2.2. Rights 'in rem', Rights 'in personam' & The Role of Depositaries/Custodians

The evolution towards an intermediary holding chain led to an increase of liquidity as it improved the transferability of securities. The legal certainty provided by the 'incorporation theory' applied by most continental Member States to physical certificate securities, however, got lost upon the introduction of 'intermediation'. The legal nature of the rights that account holders have related to accounts held with custodians and depositaries depends upon the position in the holding chain and the national law applicable to these accounts. National laws grant 'full/shared property rights', right sui generis or an equitable interest to account holders.[272] Private international law and the ongoing increasingly cross-jurisdictional nature of intermediary holding chains has led to a very complex system in which the precise rights of account holders are difficult to determine.[273]

Account holders, generally, do not have an 'erga omnes' property right over the book-entry securities held in their accounts. Book-entry securities are, unlike physical certificates, intangible. Moreover, the 'erga omnes' character of property law grants the proprietor the right of (1) careless interference with the right[274] and (2) the right to do with the asset whatever the proprietor pleases.[275] Both conditions seem not to be fulfilled by investor rights related to book-entry securities held in accounts. Under the contract concluded between the account holder (investor) and provider (custodian/depositary), the account provider segregates the securities from its own securities and securities belonging to other clients. This seems to suggest that securities held can be enforced 'erga omnes'. Only the direct depositary/custodian, however, owes duties to the investor and not the other custodians throughout the holding chain.[276] In addition, clients that are account holders may only enforce their rights towards their direct custodian/depositary and not to the other custodians throughout the intermediary holding chain. Investors as account holders, thus, have a claim related to the book-entries made in their accounts towards their direct custodian/depositary that, in turn, have claims as an account holder against its own direct custodian throughout the holding chain, etc. The 'direct link' between issuers and investors, thus, got lost upon the era of 'intermediation'.[277]

'Intermediation' has led to problems related to 'client asset protection' and 'investor rights'.

Client asset protection upon entering the 'intermediation' era became a problem. Although 'intermediation' increased transferability, it also led to 'intermediary risk'[278], i.e. the risk that

---

[272] European Commission, *EU Consultation Document 'Legislation on Legal Certainty of Securities Holding and Dispositions'. DG Markt G2 MET/OT/acg D(1010) 768690,* 7, http://ec.europa.eu/finance/consultations/2010/securities/docs/consultation_paper_en.pdf (accessed 8 August 2016);

[273] E. Micheler, P.E., *Custody Chains and Asset Values,* http://ssrn.com/abstract=2539074 (accessed 9 July 2017); E. Micheler, *Intermediated Securities and Legal Certainty,* LSE Law, Society and Economy Working Papers No. 3 (2014), 3-7;

[274] See also C.W. Mooney, *Property beyond negotiability*, 12 Cardozo Law Review, 305, 398-99(1990).

[275] S. Douglas & B. McFarlane, *Defining Property Rights* 219 (J. Penner & H.E. Smith eds., Oxford University Press 2013).

[276] P. Paech, *Securities, Intermediation and the Blockchain - An Inevitable Choice between Liquidity and Legal Certainty?*, 20, https://ssrn.com/abstract=2697718 (access 20 July 2017).

[277] E. Micheler, P.E., *Custody Chains and Asset Values,* http://ssrn.com/abstract=2539074.

[278] See S.L. Schwarcz, *Intermediary Risk in a Global Economy*, 6 Duke Law Journal 1541 (2001).

client securities are, for instance, misappropriated by the intermediary or lost upon an intermediary's insolvency.[279] The risks are borne by the intermediary's clients. For that reason, MiFID II, CRD IV, national custodian and sectoral depositary laws require custodians/depositaries to comply with certain conduct of business rules as to ensure that client' assets are safekept prudentially in segregated accounts to minimize intermediary risks related to fraud and misappropriation.[280] Insolvency risk is very prominent upon exercising the right of reuse and the delegation of safekeeping tasks by depositaries/custodians.[281] For this reason, the capital requirements imposed to depositaries/custodians under the CRR ensure that depositaries/custodians are sufficiently capitalized and insolvencies are avoided.

European and international intermediary regulation targeting depositaries/custodians are complemented by national legal regimes related to the 'legal certainty of securities holding and disposition'. These national regimes seek to ensure a 'proprietary element' to the, by nature, intangible securities held in segregated account to ensure that securities do not fall within the estate of the custodian/depositary that holds the account upon insolvency.[282] Moreover, adding the 'proprietary element' by laws regulating the legal certainty of securities holding and disposition' ensures that 'intangible securities' ensures the negotiation and bona fide/good faith acquisition of securities as for 'tangibles'. Co-existing heterogeneous regimes have developed in this domain. This leads to numerous problems due to the cross-border nature of intermediated securities. Initiatives on the international and European level to harmonize national laws in this domain, including the Geneva Securities Convention and the European proposed SLD have all failed. Client asset protection targeting intermediary risk is, thus, inevitable to deal with the undesirable consequences of 'intermediation'.

The second problem that arose in the 'intermediation' era is the exercise of investor rights. Investors are often not able to exercise rights, such as voting rights, due to the 'disconnection' between the issuer and the investor in the securities holding chain or operational difficulties in exercising those rights.[283] The national legal regimes related to the 'legal certainty of securities holding and disposition may attribute the legal title of securities, for instance, to intermediaries that are not the 'economic owners'. In addition, those investors that are correctly identified as legal owner may face difficulties in exercising their rights operationally.[284] Every custodian throughout the relevant holding chain related to a specific type of security will need to pass on information related to the exercise of voting rights back and forth in order to make voting operationally possible.[285] This renders the exercise of voting rights as burdensome and costly. The SRD I and SRD II did not offer an adequate solution for this problem.[286] Blockchain seems to offer a solution for both the problems by allowing for

---

[279] See Chapter 7, section 2.2.1.
[280] *Ibid.*
[281] Chapter 7, section 2.2.1.
[282] M. Haentjes, *Clearing and Settlement –Ways Forward*, 5 Journal of International Banking Law and Regulation (2011)
[283] E. Micheler, P.E., *Custody Chains and Asset Values,* http://ssrn.com/abstract=2539074; P. Dupont, *Rights of the account holder relating to securities credited to its securities account*, 90-104. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013); H.P. Conac, *Rights of the investor*, 105-134. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013).
[284] D.A. Zetzsche, *Shareholder Passivity, Cross-Border Voting and the Shareholder Rights Directive*, https://ssrn.com/abstract=1120915 (accessed 10 July 2017).
[285] *Ibid.*
[286] D.A. Zetzsche, *Virtual Shareholder Meetings and the European Shareholder Rights Directive - Challenges and Opportunities*, https://ssrn.com/abstract=996434 (accessed 10 July 2017); C. Strenger & D.A. Zetzsche, *Corporate Governance, Cross-Border Voting and the Securities Law Directive – Enhancing Investor Engagement through Standardization*, https://ssrn.com/abstract=2188374 (accessed 10 July 2017).

the 'reestablishment of the link between investors and issuers'.[287] Platforms may be set up to allow for the holding and disposal of securities and the exercise of corporate voting rights (on a cross-border basis).[288]

4.1.3. DTL – Blockchain

Blockchain was introduced with the Bitcoin network already quite some years ago.[289] Not until recently, however, awareness arose amongst regulatory and financial intermediaries of how blockchain technology may be applied in financial services.[290] Blockchain is a decentralized distributed database that is used to maintain a continuously growing list of entitlements by means of records that are referred to as 'blocks' (distributed ledger).[291] The 'blocks' may be identified based upon a 'public key' that is the 'address' on the blockchain. Assets or ownership of assets may be tokenized, i.e. digitally represented by a digital code referred to as 'token', and sent across the network with the 'public key' identifying the transacting blocks in which the assets/ownership are recorded.[292] Private keys give the 'block owners' access to their digital (tokenized) assets.

The data recorded in the blockchains is incorruptible due to a built-in 'consensus mechanism' in which transactions are validated on a P2P basis. The latter allows transactions to take place without the involvement of third-parties (disintermediation).[293] The trading of entitlements may be complemented by contracts that may be partially or fully enforced without human interaction. Blockchain technology is suitable for , amongst others, the issuing, settlement and trading of securities (partly) replacing intermediaries such as CCPs and settlement systems. This section, however, focusses on its application for the holding and disposal of securities.

4.1.3.1. Distributed ledgers & the Disintermediation of the Intermediated Securities Holding Chain

---

[287] E. Micheler, *Custody chains and asset values: why crypto securities are worth contemplating*, 3 Cambridge Law Journal 1-6 (2015).

[288] See for a suggestion on the regulation of blockchain platforms for the holding and disposal of securities: P. Paech, *The Governance of Blockchain Financial Networks*, LSE Legal Studies Working Paper No. 16/2017, https://ssrn.com/abstract=2875487 (accessed 20 July 2017); See for the suggestion on the introduction of a (blockchain) voting platform: C. Strenger & D.A. Zetzsche, *Corporate Governance, Cross-Border Voting and the Securities Law Directive – Enhancing Investor Engagement through Standardization* https://ssrn.com/abstract=2188374 (accessed 20 July 2017); C. van der Elst / A. Lafarre, *Bringing the AGM to the 21st Century: Blockchain and Smart Contracting Tech for Shareholder Involvement*, European Corporate Governance Institute (ECGI) - Law Working Paper No. 358/2017, https://ssrn.com/abstract=2992804 (accessed 10 July 2017).

[289] M.F.M. van den Berg, J.W.P.M. van der Velden & Mr. C.W.M. Vergouwen, *De Bitcoin-verzekering. Een kans voor de financiële sector om klantbelang centraal te stellen in innovatieve productontwikkeling?*, 5 MvV 128 (2014).

[290] Euroclear/Oliver Wyman, *Blockchain in Capital Markets – The Prize and the Journey*, February 2016, http://www.dltmarket.com/docs/BlockchainInCapitalMarkets-ThePrizeAndTheJourney.pdf (accessed 20 July 2017.

[291] P. Paech, *The Governance of Blockchain Financial Networks*, LSE Legal Studies Working Paper No. 16/2017, 2, https://ssrn.com/abstract=2875487 (accessed 20 July 2017).

[292] International Organization of Securities Commissions, *IOSCO Research Report on Financial Technologies (Fintech)*, February 2017, 51, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD554.pdf (accessed 20 July 2017).

[293] M. Mainelli & M. Smith, *Sharing ledgers for sharing economies: an exploration of mutual distributed ledgers (aka blockchain technology),* http://www.zyen.com/Articles/Journal%20of%20Financial%20Perspectives%20-%20Sharing%20Ledgers%20for%20Sharing%20Economie....pdf (accessed 20 July 2017).

Blockchain is based upon the concept of the 'distributed ledger' that affects 'intermediation' and the relationships between depositaries/custodians and their clients. A 'distributed ledger', also referred to as 'shared ledger', is a decentralized database that is accessible and controlled by multiple 'nodes ('users').[294] A key feature of 'distributed ledgers' is that there is no central third-party, such as financial intermediaries, or centralized data storage. Instead, the system is based upon a P2P network and a 'consensus mechanism', as discussed in more detail in the next paragraph, is used to ensure replication and validation of the data in the ledger. Blockhain DLT systems may be public or private. DLT systems, however, do not need necessarily to be based upon blockchain for secure and valid distributed consensus.[295]

Blockchain has the potential to lead to the 'disintermediation' of the 'intermediated securities holding chain'.[296] Traditionally, the 'intermediated securities holding chain' is based upon bilateral relationships throughout the chain. CSDs preserve the integrity of securities issues and may be set up centralized or decentralized networks.[297] In centralized networks, CSDs are the single trusted intermediary that records all transactions and provide the central register of all acquisitions and dispositions of securities holdings.[298] Decentralized networks are based upon records made by both CSDs and their account holders. CSDs in these networks only record the acquisition and disposition of securities made by the depositaries/custodians as account holders, whereas the accounts held with these intermediaries record the transactions of the 'end-investors'.[299] Under both systems, the 'client-intermediary' relationship is targeted by financial regulation.

Blockchain DLT has the potential to re-establish the 'direct link' between investors and issuers that got lost upon the era of 'intermediation'. The use of blockchain could overcome the problems related to the use of intermediaries as third-parties andthe 'decentralized/centralized' (cascade) records made in the current client-intermediary relationships related to the holding, acquisitions and dispositions of securities holdings.

Blockchain distributed records has network users ('nodes') that all maintain a complete record of past transactions related to the 'blocks' that are validated. Nodes are updated on a continues basis with the records of transactions validated. Blockchain is, thus, a decentralized network for which no intermediaries, client-intermediary relationships and client accounts are necessary. All records related to the 'blocks' in the P2P network are held by the participants. Nodes may, however, be authorized financial intermediaries acting in their own name on behalf of their clients and, thus, allowing clients outside the network. The decentralized nature of blockchain allows for 'disintermediation'. The re-establishment of the 'direct link' between investors and issuers overcomes the abovementioned problems related to the

---

[294] International Organization of Securities Commissions, *IOSCO Research Report on Financial Technologies (Fintech)*, February 2017, 48, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD554.pdf (accessed 20 July 2017).

[295] Government Office for Science, *Distributed Ledger Technology beyond block chain – A report by the UK Government Chief Scientific Adviser*, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/492972/gs-16-1-distributed-ledger-technology.pdf (accessed 11 July 2017).
See also: http://www.blockchaintechnologies.com/blockchain-definition (accessed 11 July 2017).

[296] The Financial Industry Regulatory Authority, *Distributed Ledger Technology: Implications of Blockchain for the Securities Industry,* January 2017, https://www.finra.org/sites/default/files/FINRA_Blockchain_Report.pdf (accessed 20 July 2017).

[297] P. Paech, *Securities, Intermediation and the Blockchain - An Inevitable Choice between Liquidity and Legal Certainty?*, 8, https://ssrn.com/abstract=2697718 (access 20 July 2017).

[298] P. Paech, *Market Needs as Paradigm: Breaking Up the Thinking on EU Securities Law,* LSE Law, Society and Economy Working Papers 11/2012, https://www.lse.ac.uk/collections/law/wps/WPS2012-11_Paech.pdf (accessed 21 July 2017).

[299] P. Paech, *The Governance of Blockchain Financial Networks*, LSE Legal Studies Working Paper No. 16/2017, 6, https://ssrn.com/abstract=2875487 (accessed 20 July 2017).

acquisition/disposal of securities, 'pooling' and 'mirrored accounts' of the 'intermediation era'. Blockchain allows the transition from an uncoordinated 'multitude of records' related to the same assets in the current intermediated securities holding chain to a 'single record'[300] held amongst all nodes.[301] A settlement system based upon blockchain DLT, thus, allows for faster and less complications compared to the current model.

4.1.3.2. The 'Consensus mechanism'

Blockchain DLT relies upon a 'consensus mechanism' and 'blocks' that substitute for 'third-party verification'. In the traditional intermediated securities holding chain, depositaries/custodians are entrusted with keeping records as client trust them ex-ante on the basis of their authorization and supervision under (European) financial laws and ex-post due to judicial control.[302]

On the contrary, blockchain relies entirely upon a 'consensus mechanism' to ensure that transactions are correctly executed and accurately recorded.[303] On the basis of a mathematical-probabilistic approach also known as 'consensus-algorithms' used by all notes in the P2P network 'consensus' is established amongst nodes regarding the correctness of the execution of the transactions. Once a transaction has been validated by the nodes, these are locked in as a 'block' of code and inserted in a chain of sequential and intertwined sets.[304] These blocks cannot be changed after validation. Essentially, this system is based upon 'wisdom of the crowd'[305] and designed for permissionless DLT, i.e. open systems that have not restriction on participation and the right to access the data in the ledger, transact and participate in the validation process as 'node'.[306] The 'consensus mechanism' is designed for DLT systems, such as Bitcoin, as no 'node' is able to control the validation process. The financial services are now, however, primarily using 'privately shared systems between financial intermediaries that are authorized by the platform operator(s) to join the system.[307] These 'permissioned DLT systems' depart from the original blockchain 'consensus mechanism' and requires trust among the nodes involved. These platforms are required to set out rules on the admission of new participants and what 'nodes' are allowed to be involved in the verification process. Due to the systematic importance of the acquisition and disposition of securities held, it is expected that regulators will not allow permissionless DLT systems. In

---

[300] G.W. Peters & E. Panayi, *Understanding Modern Banking Ledgers through Blockchain Technologies: Future of Transaction Processing and Smart Contracts on the Internet of Money*, 24, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2692487.
[301] P. Paech, *The Governance of Blockchain Financial Networks*, LSE Legal Studies Working Paper No. 16/2017, 9, https://ssrn.com/abstract=2875487 (accessed 20 July 2017).
[302] *Ibid*, 9, 10.
[303] International Organization of Securities Commissions, *IOSCO Research Report on Financial Technologies (Fintech)*, February 2017, 48, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD554.pdf (accessed 20 July 2017).
[304] S. Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, 1-4, https://bitcoin.org/bitcoin.pdf (accessed 21 July 2017) ; G.W. Peters & E. Panayi, *Understanding Modern Banking Ledgers through Blockchain Technologies: Future of Transaction Processing and Smart Contracts on the Internet of Money*, 2-9, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2692487; E. Wall and G. Malm, *Using Blockchain Technology and Smart Contracts to Create a Distributed Securities Depository*, 5-23 at http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=8885750&fileOId=8885765 (accessed 21 July 2017).
[305] J. Surowiecki, *The Wisdom of Crowds* (Anchor Books 2005).
[306] International Organization of Securities Commissions, *IOSCO Research Report on Financial Technologies (Fintech)*, February 2017, 50, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD554.pdf (accessed 20 July 2017).
[307] G.W. Peters & E. Panayi, *Understanding Modern Banking Ledgers through Blockchain Technologies: Future of Transaction Processing and Smart Contracts on the Internet of Money*, 6, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2692487.

the future, the regulation to be expected for blockchain platforms in this domain will set out financial regulation, similar to regulated markets, MTFs and OTFs[308] under MiFID II, in which the platform and its operators are required to be authorized but the precise operating rules will be regulated based upon mandatorily principles to be arranged for in the platform rules. In this domain, Paech has suggested that on the basis of already existing EEA instruments, such as those applicable to financial collateral, settlement finality and the winding-up of banks, the platform will need to settle rules relate to, amongst others:[309]

- the law applicable to crypto-securities and collateral;
- the relationship between the platform finality rules and the law; and
- legal rules on the crypto-securities used as financial collateral.

The future of depositaries and custodians will, thus, be based upon a combination of public and private law targeting the platform (operator) and sectoral existing EEA legislation applying to the 'nodes' permitted to join the network, operate and verify transactions.

4.1.3.3. Smart Contracts

Smart contracts are computer programs written on a distributed ledger, such as blockchain, that automatically execute contractual duties upon a 'triggering event'.[310] The transaction executed will be recorded in a 'block' on the distributed ledger.

Nick Szabo already defined 'smart contracts' in 1994 as:

> 'a computerized transaction protocol that executes the terms of a contract. The general objectives are to satisfy common contractual conditions (such as payment terms, liens, confidentiality, and even enforcement), minimize exceptions both malicious and accidental, and minimize the need for trusted intermediaries. Related economic goals include lowering fraud loss, arbitrations and enforcement costs, and other transaction costs.'

Smarts contracts are, thus, 'smart' as they are based upon algorithms that are triggered upon an expected input and outcome that is known when the contract is being designed. As both are already ex ante identified, smart contracts reduce costs as there are no risks of post-contractual or undiscovered pre-contractual disagreements.[311] Smart contracts are executed autonomously but depend on reference data that must be reliable.[312] In the era of 'intermediation' data related to, for instance, shareholding records may be changed upon human intervention. Blockchain, thus, is a reliable data source as recorded 'blocks' cannot be altered upon the intervention of any intermediary. Transactions concluded are, thus, automatic and immutable. The problem with 'smart contracts' is that they cannot anticipate the 'gap

---

[308] See J.M. Mendoza & E.P.M. Vermeulen, *Towards a New Financial Market Segment for High Tech Companies in Europe* (H.S. Birkmose, M. Neville & K.E. Sørensen eds., Kluwer 2011).

[309] See Annex – Principles for a global and European legal framework for crypto-securities in: P. Paech, *Integrating Global Blockchain Securities Settlement with the Law - Policy Considerations and Draft Principles*, 3,4, https://ssrn.com/abstract=2792639 (accessed 20 July 2017).

[310] *Ibid.*, 11.

[311] Oliver Wyman/ J.P. Morgan, *Unlocking Economic Advantage with Blockchain – A Guide for asset managers*, http://www.the-blockchain.com/docs/joint-report-by-jp-morgan-and-oliver-wyman-unlocking-economic-advantage-with-blockchain-A-Guide-for-Asset-Managers.pdf (access 20 July 2017).

[312] M. Mainelli & M. Smith, *Sharing ledgers for sharing economies: an exploration of mutual distributed ledgers (aka blockchain technology),* http://www.zyen.com/Articles/Journal%20of%20Financial%20Perspectives%20-%20Sharing%20Ledgers%20for%20Sharing%20Economie....pdf (accessed 20 July 2017).

filling', i.e. 'knowing the unknowns', that are common in traditional contract law.[313] Traditional contracts, thus, remain to exist. Transactions that are, however, executed and performed in high numbers in which the possible input and outcome are ex ante known may benefit substantially from smart contracts.[314] Smart contracts are, thus, highly efficient for market transactions and are currently being explored for, amongst others, the trading of securities, settlement, clearing and corporate actions.[315]

Smart contracts 'execise human discretion from contract execution'.[316] This 'determining character' renders the performance of these contracts as 'unstoppable'. Traditional 'dumb' contracts embedding 'smart contracts' may, however, mitigate this effect by fulfilling the 'gap filling role', whereas all input and output that can already be anticipated is incorporated in a referenced 'smart contract'.[317] Another development is that 'smart contracts' may make use of 'oracles'. 'Traditional smart contracts' are merely based upon the predefined information available at the distributed ledger. 'Oracles' may are a source of information outside the blockchain on which the smart contract is based that is provided by 'third party services'.[318] The correctness of the information provided falls outside the scope of the blockchain 'consensus mechanism'. Instead, the information relies upon 'trusted' Fintech/TechFin companies that may in the future be required to be authorized under European financial law.[319] The nature of smart contracts and the fact that many blockchain platforms in the future will be possibly required to be 'permissioned DLTs' render the complete elimination of financial intermediaries to be unlikely.

4.1.3.4. Decentralized Autonomous Organizations

Theoretically, smart contracts can be combined in a 'decentralized autonomous organization'.[320] These are decentralized structures in which multiple smart contracts are operating autonomously on the basis of rules and mechanisms programmed into them.[321] These organizations do not have 'centralized management' and have the potential to implement the organizational theory of corporations as 'bundles of contracts' without then need to incorporate traditional business (legal) entities.[322] These organizations do not need the

---

[313] Lacore et al., *European Regulatory Initiative Report Tokens As Novel Asset Class*, July 2017, 14, http://www.gongxiangcj.com/phpqrcode/upload/c82dedeee198d332b524d9328d74c86a.pdf (accessed 21 July 2017).

[314] *Ibid*., 15.

[315] International Organization of Securities Commissions, *IOSCO Research Report on Financial Technologies (Fintech)*, February 2017, 52, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD554.pdf (accessed 20 July 2017).

[316] M. . Raskin, *The Law of Smart Contracts*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2842258 (accessed 21 July 2017).

[317] K. O'Hara, *Smart Contracts – Dumb Idea*, The Digital Citizen, March/April 2017, http://ieeexplore.ieee.org/stamp/stamp.jsp?arnumber=7867719 (accessed 21 July 2017); C. Lim, T.J. Saw & C. Sargeant, *Smart Contracts: Bridging the Gap Between Expectation and Reality,* https://www.law.ox.ac.uk/business-law-blog/blog/2016/07/smart-contracts-bridging-gap-between-expectation-and-reality (accessed 21 July 2017).

[318] See https://blockchainhub.net/blockchain-oracles/ (accessed 21 July 2017).

[319] See European Parliament, *European Parliament resolution of 17May 2017 on FinTech: the influence of technology on the future of the financial sector (2016/2243(INI))*, http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+P8-TA-2017-0211+0+DOC+PDF+V0//EN (access 20 July 2017).

[320] C. Jentzsch, *Decentralized Autonomous Organization to Automate Governance*, https://download.slock.it/public/DAO/WhitePaper.pdf (accessed 21 July 2017).

[321] P. Paech, *The Governance of Blockchain Financial Networks*, LSE Legal Studies Working Paper No. 16/2017, 12, https://ssrn.com/abstract=2875487 (accessed 20 July 2017).

[322] Jensen, M.C. & Meckling, W.H., *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976).

involvement of their ‘creators’ after being established. It is even expected that these organizations may enter into contractual relationships entering into (smart) contracts with third parties on an autonomous and self-executing basis.[323]

A ‘democratic humanless venture capital structure’ established in 2016 that was named ‘THE DAO’ showed that these organizations are technically possible. Although the organization raised 150 million USD, 50 million USD was diverted by a malicious node that led to the abandonment of the project.[324] Further development of smart contracts and decentralized autonomous organizations as a ‘substitute’ for limited liability companies may, however, lead to autonomous self-governing organizations, including platforms for the holding and disposal of securities.

4.2. The Future of Depositaries & Custodians – From ‘Intermediary’ to ‘Nodes’ and ‘Operators’ in ‘Fintech’ & ‘Oracle Data Providers’ in ‘TechFin’ Platforms

Recently, a number of US states have passed state legislation that allow the right to issue and trade shares on a blockchain platform.[325] Various companies and exchanges are now experimenting how blockchain as DLT could improve the current issuance, execution and settlement legal framework for securities. This leads to the question what the future is of depositaries and custodians. It is expected that roles played by depositaries and custodians will not disappear but transform from an ‘intermediary’ in the intermediated securities holding chain to ‘nodes’ and ‘platform operators’ in the ‘Fintech era’ and TechFins providing information and data services as ‘oracles’ for ‘smart contracts’ in the ‘TechFin era’. The final stage of development might lead to ‘settlement decentralized autonomous organizations’.

4.2.1. The Road towards ‘Crypto-Securities’

Both the upcoming ‘Fintech’ and ‘TechFin era’ require the legal recognition of ‘crypto-securities’. Recently, a number of US states have adopted laws that regulate share issues in the form of ‘crypto-securities’ on blockchain networks.[326] This has initiated the discussion in a number of other countries how crypto-securities would need to be regulated. It clear that the road towards crypto-securities involves a similar development as the transformation of physical certificate securities to ‘global certificates’ and dematerialized book-entry securities.[327] Until crypto-securities have been fully embraced throughout the world, a dual system of intermediated securities and blockchain DLT will be in place. This development depends upon the legal recognition of ‘crypto-securities’ in legal systems around the world. Recently, the direct issue of securities as ‘crypto-securities’ have been recognized by Delaware, Arizona and a couple of other US states.[328] The emergence of full crypto-securities

---

[323] A. Wright & P. De Filippi, *Decentralized Blockchain technology and the Rise of Lex Cryptographia*,, 56 https://papers.ssrn.com/sol3/papers.cfm?abstract_ id=2580664 (accessed 21 July 2017).

[324] J.I. Wong & I. Karr, *Everything you need to know about the Ethereum “Hard Fork”,* 12, http://qz.com/730004/everything-you-need-to-know-about-the-ethereum-hard-fork/ (accessed 21 July 2017).

[325] J.D. Caytas, *Blockchain in the U.S. Regulatory Setting: Evidentiary Use in Vermont, Delaware, and Elsewhere*, https://ssrn.com/abstract=2988363 (accessed 20 July 2017).

326 *Ibid.*

327 D. Chan, F. Fontan, S. Rosati & D. Russo, *The Securities Custody Industry*, European Central Bank Occasional Paper Series No. 69, August 2007.

328 J.D. Caytas, *Blockchain in the U.S. Regulatory Setting: Evidentiary Use in Vermont, Delaware, and Elsewhere*, https://ssrn.com/abstract=2988363 (accessed 20 July 2017); Cf. European Commission, *Consultation Document – Fintech: A More Competitive and Innovative European Financial Sector*, https://ec.europa.eu/info/sites/info/files/2017-fintech-consultation-document_en_0.pdf (accessed 20 July 2017);

issues is necessary to create a securities settlement framework that replaces the current intermediated securities holding chain. Till then, a dual system will be in place that likely has two other types of crypto-securities.[329] First, there will be crypto-securities in place that were previously book-entries in the intermediated securities holding chain.[330] A legal system will need to be in place to provide guidance in this transformation. Second, CSDs, depositaries and custodians may set up private blockchain security settlement platforms in which current book-entries held by the participants ('nodes') will be 'tokenized' in a permissioned blockchain network. The latter provides efficiency advantages. It does, however, not take away the problems related to 'pooling' and 'mirrored accounts' that currently exist in the intermediated securities holding chain. Nevertheless, it may initiate disintermediation in the 'Fintech era'.

4.2.2. From the 'Intermediary' to the 'Fintech Era'

The example of 'intermediated crypto-securities'[331] marks the possible beginning of the 'Fintech era'.

Recently, a variety of terminology has been used, including 'Fintech', 'Regtech' and 'Techfin' to point at the development of technology in financial services.[332] It is useful to briefly point out the differences. Fintech takes financial processes and applies technology.[333] 'Regtech' is 'regulatory technology' used by financial services providers for regulatory compliance[334], whereas 'TechFins' are taking financial processes and data and apply that to financial services.[335] Fintechs are the 'incumbents' and TechFins are data-driven 'innovators'.

See also Financial Conduct Authority, *Discussion Paper – Discussion Paper on distributed ledger technology*, DP 17/3, April 2017, https://www.fca.org.uk/publication/discussion/dp17-03.pdf (accessed 20 July 2017).

329 P. Paech, *Integrating Global Blockchain Securities Settlement with the Law - Policy Considerations and Draft Principles*, 3,4, https://ssrn.com/abstract=2792639 (accessed 20 July 2017).

330 Cf. K. Low & E.G.S. Teo, *Legal Risks of Owning Cryptocurrencies*, https://ssrn.com/abstract=2856137 (accessed 20 July 2017).

[331] P. Paech, *Integrating Global Blockchain Securities Settlement with the Law - Policy Considerations and Draft Principles*, 4, https://ssrn.com/abstract=2792639 (accessed 20 July 2017).

[332] Z. Soo, *TechFin: Jack Ma Coins Term to Set Alipay's Goal to Give Emerging Markets Access to Capital*, South China Morning Post (2 December 2016), http://www.scmp.com/tech/article/2051249/techfinjack-ma-coins-term-set-alipays-goal-give-emerging-markets-access (accessed 20 July 2017); See C. Skinner, *Is It FinTech or TechFin (Part I)*, Digitalist Magazine (7 January 2016), http://www.digitalistmag.com/customer-experience/2016/01/07/fintech-or-techfin-03925833 (accessed 20 July 2017) and *Is It FinTech or TechFin (Part II)*, Digitalis Magazine (11 January 2016), http://www.digitalistmag.com/resource-optimization/2016/01/11/fintech-or-techfin-2-03926161 (accessed 20 July 2017).

[333] J. Barberis, *From FinTech to TechFin: Data Is the New Oil, Asian Banker* (16 May 2016),http://www.theasianbanker.com/updates-and-articles/from-fintech-to-techfin:-data-is-the-new-oil (accessed 20 July 2017); See also R. Shea, *FinTech versus TechFin: Does Technology Offer Real Innovation or SimplyImprove What is Out There?*, Thompson Reuters (26 July 2016), https://blogs.thomsonreuters.com/financial-risk/fintech-innovation/fintech-versus-techfin-technology-offerreal-innovation-simply-improve/ (accessed 20 July 2017).

[334] J. Cave, *Get with the Program: Fintech Meets Regtech in the Light-Touch Sandbox*, https://ssrn.com/abstract=2944249 (accessed 20 July 2017); D.W. Arner, J. Barberis & R.P Buckley, *The Evolution of Fintech: A New Post-Crisis Paradigm?* https://ssrn.com/abstract=2676553 (accessed 20 July 2017); D.W. Arner, J. Barberis & R.P. Buckley, *Fintech, RegTech and the Reconceptualization of Financial Regulation*, http://www.fsroundtable.org/wp-content/uploads/2017/05/Douglas-W.-Arner-FinTech-RegTech-and-the-Reconceptualization.pdf (accessed 20 July 2017).

[335] D.A. Zetzsche, R.P. Buckley, D.W. Arner & J.N. Barberis, *From FinTech to TechFin: The Regulatory Challenges of Data-Driven Finance*, European Banking Institute Working Paper Series 2017 - No. 6, 9,https://ssrn.com/abstract=2959925 (accessed 10 July 2017); R. Shea, *Fintech versus techfin: does technology offer real innovation or simply improve what is out there?*, Thomson Reuters (26 July 2016) , https://blogs.thomsonreuters.com/financial-risk/fintechinnovation/ fintech-versus-techfin-technology-offer-real-innovation-simply-improve/ (Accessed 20 July 2017).

'Intermediated crypto-securities'[336] mark the beginning of the 'Fintech era' in issuing, executing and settling securities transactions. Blockchain platforms running 'intermediated crypto-securities' simply improve with technology 'what is out there'. Depositaries and custodians may be part of these platforms as platform operators and nodes.

Platforms will have a different nature as 'Bitcoin' as these platforms will likely be targeted by regulation and, for that reason, be 'permissioned DLT systems' instead of 'permissionless DLT systems'. These 'private settlement platforms' may be operated by CSDs, depositaries and custodians and slowly pave the way for 'vertical consolidation' in which CSD services, at the one, and depositary/custodian services, at the other hand, will be consolidated.[337] In the permission DLT network, regulators might require for these networks that participants ('nodes') have an authorization as depositary/custodian or CSD. The reason for this is that in 'permissioned DLT' networks the consensus mechanism does not operate in the same way as for 'permissionless' DLT networks. The 'trust' embedded in the consensus mechanism in 'permissionless' DLT networks does not work in the same way. Complementary intermediary regulation may solve this issue. Transactions related to a specific sector on the platform could be 'controlled' related to the sectoral legislation for which an authorization is obtained. Financial intermediaries may benefit from the European passport and TC firms from the TC regulations that apply in the specific sector. Requiring sectoral (intermediary) legislation for intermediaries concluding a specific type of transactions on such platforms ensure that no or a limited amount of platform regulation would be required. Competent Authorities may be an active 'full node' so that they can get a copy of the records made and may supervise the platform and its operator. Slowly, the process will transition towards the 'TechFin era' in which the focus is not on (intermediary) regulation targeting platform operators and nodes, but on the regulation targeting platforms.

4.2.3. The Blockchain & the TechFin Era

The full transformation to issues of crypto-securities may mark the beginning of the 'TechFin era'. The issuing, execution and settlement is likely to have entered a large degree of 'disintermediation'. Securities issues are done by issuers directly in blockchain. CSDs and depositaries/custodians will have transformed into 'TechFins', i.e. data-driven start-ups/intermediaries that deliver 'trustworthy' data as 'oracle data providers' through smart contracts and/or nodes'. Niche services provided may, for instance, include the safekeeping of the private key of accounts and the provision of the application layer over the blockchain.[338]

The focus of regulation in this era is likely to be on platforms that are under European regulation setting out legislation applicable to transactions. Due to defragmented legislation throughout the world it is unlikely that a 'worldwide settlement platform' will be possible in the foreseeable future. Agreements may, however, be entered into on the international political level to ensure access of EEA TechFins and settlement platforms in third countries.

4.2.4. Settlement Decentralized Autonomous Organizations- The Final Stage of Disintermediation?

The final stage of development may be marked by decentralized (autonomous) organizations that are set up as 'settlement network' and consist of a 'bundle of smart contracts'. Smart

---

[336] P. Paech, *Integrating Global Blockchain Securities Settlement with the Law - Policy Considerations and Draft Principles*, 4, https://ssrn.com/abstract=2792639 (accessed 20 July 2017).

[337] Morgan Stanley, *Global Insight: Blockchain in Banking: Disruptive Threat or Tool?* (20 April 2016), http://www.the-blockchain.com/docs/Morgan-Stanley-blockchain-report.pdf (accessed 20 July 2017).

[338] G. Prisco, *The Blockchain Could Make Existing Securities Industry Players Redundant, Says BNP Paribas Analyst (*6 July 2015), https://bitcoinmagazine.com/articles/blockchain-make-existing-securities-industry-players-redundant-says-bnp-paribas-analyst-1436212815/ (accessed 20 July 2017).

contracts may continue to include 'oracles' or equivalent provisions to allow for the flexibility of 'dumb contracts' and incorporate information outside of the network into the decentralized (autonomous) organization. The decentralized (autonomous) organizations might contract with other decentralized (autonomous) organizations, third-parties and TechFins autonomously. Before that stage will be reached many legal issues, however, will need to be considered.

5. Conclusion

This chapter, on the basis of the outcome of the preceding Parts, advocates in favour of the case for introducing not only an AIF/UCITS depositary but a 'cross-sectoral European depositary passport' in European investment law.

The introduction of a (cross-sectoral) depositary passport would, thus, enable depositaries to offer their services on the European level and to consolidate services on a cross-sectoral and cross-border basis.

Notwithstanding the benefits of introducing an AIF/UCITS depositary passport, a European passport for UCITS and AIF depositaries has so far been multiple times considered, but not introduced due to investor protection concerns.[339] MEP Perreau de Pinninck in 1993 after the introduction of the 'ancillary European passport' under the ISD and Second Banking Directive considered that a European depositary passport for UCITS should not be introduced for two reasons.[340] First, it was considered that the depositary function was going beyond mere performing the 'custodian' function under the ISD and Second Banking Directive. Second, the depositaries in the UCITS domain had not been harmonized to effectively perform the controlling function.

Prior to introducing an AIF/UCITS or cross-sectoral depositary passport the question would, thus, need to be answered whether the differences between depositaries and custodians justify the locational restriction applicable to AIF/UCITS depositaries. Furthermore, it should be verified whether AIF, UCITS, IORP and PEPP are sufficiently harmonized or what should be done to make the introduction of a cross-sectoral passport acceptable.

A 'de facto European depositary passport' is granted to IORP and PEPP depositaries, whereas this is not available for AIF/UCITS depositaries. This is highly remarkable as depositaries perform the same functions with the same underlying investor protection objective. This inconsistency can be rightfully called an 'European depositary passport paradox' as the eligible entities and, in particular, the depositary function itself under the AIFMD and UCITSD V has been harmonized to a much larger extent than under the IORPD II and the proposed PEPPR.[341]

The AIFMD 'transitional relief' regime'[342] suggests that the duties, delegation and depositary's liability regime are sufficiently harmonized on the European level for the introduction of a European passport. Under this regime, credit institutions appointed as an AIF depositary are allowed to be appointed under a 'mutual recognition regime' provided that the AIF home Member State in which the AIF is established for which the depositary is appointed has implemented this option in its AIFMD implementation laws.[343] Giving the

[339] See Chapter 2, section 1.2.
[340] European Parliament, *Report of the Committee on Legal Affairs and Citizen's Rights on the 1993 UCITS Proposal*, A5-0268/1993, 1 October 1993, http://goo.gl/rRSdJO (accessed 7 April 2017).
[341] See for the AIFMD/UCITSD V depositary regime: Chapter 4; See for the IORPD II depositary regime: Chapter ; See for the proposed PEPPR depositary regime: *infra* section 4.3.
[342] See Chapter 2, section 1.2.2.2.
[343] *Ibid.*

similarities under the UCITSD V depositary regime, similar considerations could be made regarding the introduction of a UCITSD V depositary passport.

This seems to suggest that the introduction of a 'cross-sectoral depositary passport' would require full harmonization of the depositary as a financial intermediary and also the harmonization of the PEPP/IORP depositary duties, delegation and liability standards would be necessary for a consistent approach.

Similarly as for the 'management company passport' discussion, custodians already upon the introduction of ISD enjoyed an ('ancillary') European passport. As a compromise of introducing the European 'management passport' under UCITSD IV and the AIFMD, the depositary remained to be required to be established in the UCITS/AIF home Member State.

Modelled after this concept, indeed, a proportional 'cross-sectoral depositary passport' could be built upon the core activities of the safekeeping of assets and the performance of oversight duties. All depositaries and custodians perform at least the safekeeping of assets as a minimum. Essentially, depositaries are custodians that perform, in addition to the safekeeping of assets, oversight duties.[344] For this reason, a 'cross-sectoral depositary passport' could be built on the basis of an harmonized authorization regime for custodians on the basis of the regulatory activity 'safekeeping of assets', whereas on the sectoral level a cross-sectoral consistent set of legislation applies additionally for custodians that act as depositaries. This solution is being referred to in this dissertation as 'Custody Plus' as this terminology is used in practice for custodians that are appointed as AIF/UCITS/IORP depositaries.

The 'cross-sectoral' depositary passport proposed, is based upon the 'intermediary holding model'[345], i.e. the current method of holding and transferring securities by means of 'intermediaries' such as depositaries and custodians.[346] Settlement under this model is highly complex. It is expected that in the coming years 'blockchain settlement', i.e. settlement through DLT, will gradually replace settlement under the 'intermediary holding model'.[347] Blockchain allows (crypto-)securities to be directly transferred from sellers to buyers or from collateral providers to collateral takers.[348] Some experts suggest that no securities accounts and no intermediaries, such as depositaries and custodians, will be necessary for this.[349] The high (systematic) importance of securities holding and settlement makes it, however, likely that blockchain networks/platforms for securities holding and settlement will be required by the legislator to be only accessible to authorized market participants. Depositaries/custodians will, thus, in the blockchain revolution have to evolve through the 'intermediary era' to the

---

[344] See Chapter 7, section 2.2.1.3.

[345] Chapter 6, section 2.2.; See also *infra* Chapter 13, section 5.1.2.

[346] P. Paech, *Integrating Global Blockchain Securities Settlement with the Law - Policy Considerations and Draft Principles*, 3,4, https://ssrn.com/abstract=2792639 (accessed 20 July 2017).

[347] Deutsche Bank, *NeMA Asia round up: Can Custodian Banks win in the Blockchain Phenomenon*, December 2015, http://cib.db.com/insights-and-initiatives/flow/nema-asia-round-up-can-custodian-banks-win-in-the-blockchain-phenomenon.htm#gsc.tab=0 (accessed 20 July 2017); J. Condos,W.H . Sorrell & S.L. Donegan, *Blockchain Technology: Opportunities and Risks*, http://legislature.vermont.gov/assets/Legislative-Reports/blockchain-technology-report-final.pdf (access 20 July 2017); P. Walsh, *Regulator warns of blockchain settlement usage* (19 January 2017), Global Custodian https://www.globalcustodian.com/Technology/Regulator-warns-of-blockchain-settlement-usage/ (accessed 20 July 2017).

[348] *Ibid.*

[349] G. Prisco, *The Blockchain Could Make Existing Securities Industry Players Redundant, Says BNP Paribas Analyst (*6 July 2015), https://bitcoinmagazine.com/articles/blockchain-make-existing-securities-industry-players-redundant-says-bnp-paribas-analyst-1436212815/ (accessed 20 July 2017); M. Harwood-Jones, *Blockchain and T2S: A potential disruptor*, https://www.sc.com/BeyondBorders/wp-content/uploads/2016/06/2016-06-16-BeyondBorders-Report-SCB_Nema_Block-Chain-Paper-Final.pdf (accessed 20 July 2017).

‘Fintech’ and the ‘TechFin’ era.[350] Settlement through ‘decentralized autonomous organizations could mark the ‘final stage of disintermediation’.

[350] See on ‘Fintech’, ‘TechFins’ and the differences between the two: D.A. Zetzsche, R.P. Buckley, D.W. Arner & J.N. Barberis, *From FinTech to TechFin: The Regulatory Challenges of Data-Driven Finance*, European Banking Institute Working Paper Series 2017 - No. 6, https://ssrn.com/abstract=2959925 (accessed 10 July 2017).

PART IV - CONCLUSION

The ‘custody plus solution’ offered in Part IV resolves the issues raised under Part I-III. First, it offers a consistent approach towards the cross-border provision of services and ‘locational restrictions’ for both depositaries and custodians on a sectoral and cross-sectoral basis. Second, the solution takes into account the differences between ‘depositaries’ and ‘custodians’, at the one, and the role of the depositary throughout the various sectoral EEA legislations, at the other hand. The suggested ‘stand-alone’ custodian under MiFID II regulates the ‘safekeeping function’ for both ‘depositaries’ and ‘custodians’, whereas the sectoral depositary regimes take into account the various roles played by depositaries on the sectoral level. Third, the ‘custody plus solution’ offers a level playing field for depositaries and custodians as the European and TC passport regime for depositaries/custodians is suggested to be regulated under MiFID II. Finally, the solution also fits in the role that ‘depositaries’ and ‘custodians’ will play in the unleasing ‘blockchain revolution’.

Chapter 14 Conclusion

This book seeks to find out whether a 'cross-sectoral'[1] depositary passport should be introduced which allows depositaries to perform cross-border services for not only IORPs and clients under MiFID II, but also for AIFs and UCITS. The author takes the view in this book that not introducing an European passport for depositaries is a disregard of the fundamental freedom of services which characterizes the creation of an internal market for international financial services in the European Economic Area that cannot be justified in terms of investor protection (thesis).

Consequently, this book explores the question whether depositaries in European investment law should be allowed to enjoy the right of a cross-sectoral European passport. In supporting this thesis, this dissertation seeks to answer this question by the following sub-questions:

- what inconsistencies in attributing an European depositary passport are to be found in European investment law?
- to what extent do financial intermediaries have to be harmonized on the EEA level to obtain a European passport?
- do the differences between depositaries and custodians justify the difference in treatment?
- what preconditions need to be fulfilled to introduce a European AIF/UCITS depositary passport and/or a cross-sectoral European depositary passport?

These questions need to be answered before a full European AIF and UCITS depositary passport and, eventually, a cross-sectoral depositary passport can be introduced.

PART I

What inconsistencies in attributing an European depositary passport are to be found in European investment law?

In practice, the same investment firms and credit institutions are acting as a custodian for discretionary mandates and 'execution only'2 services under MiFID II/CRD IV, a depositary under the AIFMD/UCITSD V and a depositary/custodian under IORPD II. The European investment laws, i.e. MiFID II, CRD IV, the AIFMD, UCITSD V and IORPD II are inconsistent in granting a depositary/custodian passport to these depositaries/custodians. They are both inconsistent throughout the directives and on a cross-sectoral basis. On a cross-sectoral basis, MiFID II and CRD IV have an 'ancillary' European passport for 'custodians' in place.[3] To the contrary, the AIFMD and UCITSD V require the depositary of UCITS and EEA-AIFs to be established in the UCITS/EEA-AIF home Member State,[4] whereas the same entities acting as a depositary/custodian under IORPD II have a 'de facto' European passport.[5] Not only are the European investment laws inconsistent throughout the directives, also the directives itself are inconsistent. The AIFMD, for example, differentiates between a strict locational requirement for EEA-AIFs, whereas there is a 'quasi-depositary passport regime' in

---

[1] European law had the tendency to first harmonize various sectors, such as the insurance and banking sector. Currently, European law not only harmonizes legislation within a certain sector but also harmonizes the legislative standards throughout various sectors as to ensure consistency.
[2] See Annex I, s. A No. 1 and No. 2 MiFID I/II; Art. 25(4) MiFID II.
[3] Annex I Nr. 12 CRD IV; Annex I s. A MiFID I/II.
[4] Art. 21(5) AIFMD and Art. 23(1) UCITSD V.
[5] Article 33(3) IORPD II.

place for depositaries appointed for TC-AIFs.[6] The inconsistency in granting a European passport for depositaries under the European investment law directives lead to a 'European depositary passport paradox'.

For a better understanding of all legal issues related to the European depositary passport, it is of importance to examine the debate upon the European depositary passport in a historical context. For this purpose, the concerns raised upon introducing such a passport during the adoption of the various UCITS directives, the AIFMD, the ISD/MiFID I/II and IORPD I/II have been studied. The 'ancillary European passport' for investment firms and credit institutions under MiFID II and CRD IV has never been updated to a full-fledged investment service as concerns have been raised related to the scope of 'safekeeping and administration' and, in practice, such a 'low margin service' is only being offered in connection with other investment services/activities. The non-harmonization in this area will, however, also in the future remain to raise a number of questions as to whether the European legal framework for custodians needs to be further harmonized and strengthened to ensure a level playing field in terms of investor protection measures across all Member States.[7] The adoption of the CSDR might help in clarifying the scope of such an initiative.

Notwithstanding the benefits of introducing a depositary/custodian passport, a European passport for UCITS and AIF depositaries has so far been multiple times considered, but not introduced. MEP Perreau de Pinninck after the introduction of the 'ancillary European passport' under the ISD and Second Banking Directive considered that a European depositary passport for UCITS should not be introduced for two reasons.[8] First, it was considered that the depositary function was going beyond mere performing the 'custodian' function under the ISD and Second Banking Directive. Second, the depositaries in the UCITS domain had not been harmonized to effectively perform the controlling function. This reasoning, however, does not explain why currently not a depositary passport has been introduced under the substantially harmonized depositary function under the AIFMD and UCITSD V. Nor does this reasoning explain why depositaries and custodians under IORPD II enjoy a 'de facto European passport' under a minimum harmonized regime and why the AIFMD grants transitional relief for credit institutions and a quasi-depositary passport for TC-AIFs. For this reason, Part II set out under what conditions an European/TC passport could be granted to (AIF/UCITS) depositaries, whereas Part III addressed to what extent depositaries and custodians are different.

PART II

To what extent do financial intermediaries have to be harmonized on the EEA level to obtain a European passport?

Part II studied the EEA's approach towards the cross-border provision of financial services in more detail. In particular, the conditions under which European and TC European passports are granted to EEA and TC financial intermediaries have been studied as to determine under what conditions a (cross-sectoral) European/TC passport could be granted to 'depositaries' and 'custodians'.

---

[6] See also C.P. Buttigieg, *The Case for A European Depositary Passport*, http://studylib.net/doc/13128849/the--case--for--a--european-...-passport (accessed 7 April 2017); See also S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2015).

[7]. Question 3, Bank of New York Mellon response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.

[8] European Parliament, *Report of the Committee on Legal Affairs and Citizen's Rights on the 1993 UCITS Proposal*, A5-0268/1993, 1 October 1993, http://goo.gl/rRSdJO (accessed 7 April 2017).

EEA law in regulating financial intermediaries has an 'internal' and 'external dimension'.The so-called 'internal dimension' is regulated by EEA secondary law that is based upon the four freedoms and regulates the cross-border provisions of financial services in the internal market by EEA financial intermediaries. The 'external dimension' regulates the cross-border provisions of financial services in the internal market by TC financial intermediaries and is based upon international law commitments and EEA secondary law.

EEA law in regulating both the 'internal' and 'external dimension' has as its purpose to establish an internal market for financial services that enhances market efficiency and leads to economies of scale and scope. Authorization and notification requirements under European passport arrangements, for example, only need to be fulfilled in one Member State while having a large market to offer their financial products and services without worrying about multiple authorization application and the establishment of subsidiaries that would have led to a duplication of legal costs. Prices in an EEA internal market for financial services decline as fixed costs are shared amongst a larger client base.[9] Firms may organize themselves anywhere in the EEA, in small and big Member States and, as a result, have the potential to maximize their efficiency and become more competitive. In addition to reducing transaction costs, financial institutions from either smaller or bigger EEA Member States may market products and services to all of the European Union's 500 million citizens resulting in more revenue.

The market access that an internal market facilitates may create negative externalities, such as the insolvency of financial intermediaries or fraud, that is particularly fuelled by 'risk asymmetry'.[10] Member States might be inclined by political and economic motivations to stimulate their financial services/products that are 'produced' in their Member State (production state) by subjecting their financial intermediaries and products to a minimum set of regulation and/or lax enforcement of the regulatory framework in place.[11] If those products and services are primarily marketed outside of that home Member State, the positive effects of lax regulation and supervision are being enjoyed by the home Member State as 'production state', whereas the negative effects of that are to be borne by 'distribution states', i.e. the host Member States. For this reason, prudential regulation is in place that intends to ward off any externalities resulting from 'risk asymmetry'. In the past, this has led to a large degree of legal fragmentation posing hurdles to the cross-border provision of financial intermediaries that could not be resolved by the 'four freedoms' due to the 'prudential carve-out' that justifies the infringements on the freedom movement of capital and establishment.

The 'prudential carve-out' under the 'four freedoms' impeded the establishment of an internal market for the cross-border provision of financial services in the internal market solely based upon negative integration. Instead, positive integration by means of secondary legislation was established. The evolution since the 1980s was characterised by a gradual increase in detailed EEA financial law harmonization, more centralized rulemaking and implementation of the EEA legal framework for the cross-border provision financial services. This ultimately resulted in 'joint principles', i.e. regulatory conditions, under which EEA financial intermediaries were granted a 'European passport'.

The so-called 'European passport' is at the heart of the EEA system for financial services. It is a general concept which lays down the conditions for the 'mutual recognition' principle.

---

[9] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 56 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[10] See D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 61 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014); D.A. Zetzsche, *Competitiveness of Financial Centers in Light of Financial and Tax Law Equivalence Requirements* 401-402 (R.P. Buckley, E. Avgouleas & D.W. Arner eds., Cambridge University Press 2016).

[11] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 62-63 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

The general idea is that financial products or services that are 'produced' (and marketed) in a 'home Member State' may, under conditions set out in European legislative acts, be marketed throughout the internal market without incurring further conditions imposed by 'host Member States'.[12] The concept of the European passport is now widespread and commonly used to enhance the development of the EEA internal market for financial intermediaries that are active in a wide range of sectors. [13] The European passport and the overarching principle of 'mutual recognition' are based upon two cornerstones: the 'single rulebook', i.e. a thick set of harmonized rules, and a coordinated institutional framework for financial supervision comprising of 'home state control' and the ESFS that allows host Member States to defer supervision to home Member States and ESAs.[14] The European passport as regulatory tool is unique and not to be found in any other multilateral, regional or bilateral forms of cooperation on the international level.[15] The reason for this is the degree of centralized rulemaking and supervision on the EEA level on which the regulatory tool is based.[16]

Along the development of the European passport as primary regulatory concept for EEA financial intermediaries, the EEA developed its 'external dimension', i.e. the conditions under which TC financial intermediaries may provide financial services in the internal market. TC financial intermediaries are not subject to the same centralized rulemaking and supervision as EEA financial intermediaries. Moreover, the harmonization of financial regulation on the international level varies from sector to sector. Banking and insurance legislation are harmonized to a large degree, whereas other sectors, such as asset management, are hardly harmonized. For this reason, the EEA determines in EEA secondary legislation whether and to what extent TC financial intermediaries may provide certain services within the EEA.

The regulation of TC financial intermediaries that want to offer cross-border financial services in the internal market is based upon the same 'law and economics' considerations as the regulation of EEA financial intermediaries. The 'external dimension', at the one hand, offers benefits in terms of market efficiency and economies of scale and scope. At the other hand, however, the possible 'risk asymmetry' externalities resulting from granting market access are even bigger than for EEA financial intermediaries. In imposing regulation to these TC financial intermediaries in warding off externalities, international law obligations ensure that TC financial intermediaries are not treated on a discriminatory basis. The European Commission is representing the entire EU in a so-called common commercial policy to ensure a consistent approach. The obligations on the international law level that have to be taken into account when regulating TC financial intermediaries are laid down in the GATS, obligations arising from the EEA and EFTA treaty and bilateral trade agreements concluded between the European Commission and third countries.

---

[12] Host Member State do have some competences: See Recital 2, 7, Art. 86 MiFID II, Recital 4 CRD IV, Recital 85 Solvency II and Art. 21 UCITSD V ('reporting requirement for UCITS ManCos'). See on literature related to MiFID I/II: P. Casey & K. Lannoo, The MiFID Revolution, ECMI Policy Brief No. 3 (November 2006); J.P. Casey & K. Lannoo, *The MiFID revolution* (Cambridge University Press (2009); G. Ferrarini & E. Wymeersch, *Investor protection in Europe: corporate law making*, *the MiFID and beyond* (Oxford University Press 2006); International Organisation of Pension Supervisors, *Supervision of Pension Intermediation*, http://www.iopsweb.org/WpNo17Web.pdf (accessed 14 January 2017).

[13] An earlier version of this section has been earlier published in: H. van Meerten & S.N. Hooghiemstra, *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions,* Working Paper Utrecht University 2017/1.

[14] N. Moloney, *Brexit, the EU and its Investment Banker: Rethinking 'Equivalence' for the EU Capital Market*, LSE Legal Studies Working Paper No. 5/2017, 5, https://ssrn.com/abstract=2929229 (accessed 18 June 2017).

[15] P.H Verdier, *Mutual Recognition in International Finance*, 52 Harvard International Law Journal 56 (2011).

[16] International Organization of Securities Commissions, *IOSCO Task Force on Cross-Border Regulation – Final Report*, FR 23/2015, (2015), 31 et seq.

The 'prudential carve-out' under both the 'four freedoms' and GATS prevents the establishment of an 'internal market with external dimension' for financial services.[17] Already upon the introduction of the First Banking Directive, it was recognized that only market access conditions in EEA secondary law could lead to the establishment of an 'internal market with an external dimension'.

The tendency of adopting a TC approach in secondary law has several advantages. First, a coordinated approach strengthens the position of the EU in international financial governance.[18] The centralized and coordinated approach at the EU level ensures an influential position in negotiating financial regulation on the international level. Second, the centralized foreign commercial policy towards third country market access leads to a level playing field for small and big Member States.[19] Big Member States have a stronger position not only in international financial governance, but could also negotiate market access in third countries on better terms. Finally, a coordinated approach of the internal market as huge 'distribution target' for offshore financial centers reduces the regulatory gap between 'production' and 'distribution states'. EEA financial regulation, whether third countries are bound to it or not on a bilateral basis, has an extraterritorial effect on third countries as being regarded as 'non-equivalent' on the EEA level forecloses market access.

The EEA's equivalency concept in overcoming 'risk asymmetry' has, however, to abide by the rules related to the external dimension of the four freedoms and the obligations arising out of GATS in regulating:

- EEA financial intermediaries with an external dimension;
- TC financial intermediaries within the EEA; and
- EEA financial intermediaries within third countries.

TC financial intermediaries, usually, enter the internal market by either establishing an EEA subsidiary or acquiring 'qualifying holdings'[20] and 'close links'[21] in EEA financial intermediaries.[22] EEA subsidiaries may then be authorized under the respective EEA sectoral legislative acts[23], whereas EEA financial intermediaries in which a 'qualifying holding' or 'close link' is acquired may have already done so. EEA law preserves the internal market by demanding compliance with EEA 'qualifying holding' and delegation requirements. EEA law also requires groups and conglomerates to comply with the EEA requirements related to consolidated supervision and conglomerates.

---

[17] J. Marchetti, *The GATS Prudential Carve-Out* 280-286 (P. Delimatsis & N. Herger eds., Kluwer 2011).

[18] N. Moloney, *The EU in International Financial Governance*, 1 Russell Sage Journal of the Social Sciences 138-152(2017).

[19] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 80 et seq. (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[20] 'Qualifying holding' under various sectoral EEA legislative acts means a direct or indirect holding in an investment firm which represents 10 % or more of the capital or of the voting rights or a holding which makes it possible to exercise a significant influence over the management of the EEA financial intermediary in which that holding subsists; See for precise definitions: Art. 4(2) Nr. 12 MiFID II; Art. 4(1)(ah) AIFMD; See for a less detailed definition: Art. 2(1)(i) UCITSD V; Art. 13 Nr. 21 Solvency II; Art. 4 Nr. 36 CRR.

[21] 'Close links' under various sectoral EEA legislative acts means a situation in which two or more natural or legal persons are linked by participation in the form of ownership, direct or by way of control, of 20 % or more of the voting rights or capital of an undertaking; See Art. 2(1)(i), (4) UCITSD V; Art. 4(1)(e) AIFMD; Art. 4 Nr. 38 CRR; Art. 4(2) Nr. 26 MiFID II.

[22] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 81 et seq. (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[23] For example: the AIFMD, UCITSD V, MiFID II, CRD II or Solvency II.

Solely allowing EEA firms to be active within the internal market would be contrary to the GATS.[24] For this reason, EEA law intends to offer a legal framework for TC firms that want to provide services within the EEA to avoid externalities that would put investor protection, the market integrity or the financial system in the EEA as a whole at risk. To this end, the EEA principle of 'mutual recognition' in the form of the equivalency of TC regulatory and supervisory frameworks is required by sectoral EEA secondary legislation to be in place in such a way that TC firms have access to the EEA. The TC regimes regulating this vary from sector to sector as some sectors, such as banking and insurance, are harmonized to a larger extent at the international level than other sectors (for example, asset management). For this reason, some EEA secondary laws require TC firms to comply with 'stand-alone authorizations', whereas others grant access to the EEA on the basis of 'central negotiation' or even grant a European passport to TC financial intermediaries.

Originally, market access of EEA financial intermediaries in third countries was based upon bilateral and international treaties concluded by individual Member States or, to the extent there was an EEA legislative initiative with an 'external dimension', the European institutions.[25] A disadvantage of this was the fragmented landscape of market access for EEA financial intermediaries in third countries. Since an amendment of the Treaty of Nice, the EU common commercial policy became an exclusive competence of the EU.[26] To this end, various EEA secondary laws grant the European Commission a 'negotiation mandate' to ensure that EEA financial intermediaries are granted market access in third countries on a reciprocal basis.

The regulation of TC financial intermediaries that want to offer cross-border financial services in the internal market is based upon the 'internal dimension', i.e. the 'four freedoms', and the external dimension that includes international law commitments and EEA secondary law. The equivalency of TC regulatory and supervision regimes to which TC financial intermediaries are subjected to serve the basis of 'equivalency' that is required to be in place upon market access in the internal market. In addition, equivalency in EEA secondary law requires 'legal representation' in the EEA by means of subsidiaries, branches or 'legal representatives' to ensure compliance with EEA law. Both are complemented by cooperation and information exchange agreements that are required to be in place between the relevant Competent Authorities. Moreover, the European Commission and ESA's have a role in centralized rulemaking and supervision and, finally, TC financial intermediaries are subject to 'judicial control'.

PART III

Do the differences between depositaries and custodians justify the difference in treatment?

Part III aimed to define what a depositary is and whether and to what extent depositaries and custodians differ. This served two purposes. First, Part III clarified whether a difference in treatment of depositaries, at the one, and custodians, at the other hand, throughout European investment law is justified from an investor protection perspective. Second, Part III seeks to find out whether common regulatory principles for depositaries and custodians, similar as for

[24] See *supra* 4.4.
[25] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 67 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).
[26] Art. 3(1)(e) TFEU.

asset managers that conduct investment management under the European investment law directives, are to be found that would possibly justify a cross-sectoral European depositary passport. To this end, the application of the legal interpretation methods of *Von Savigny* on the study of positive norms of the depositary in European investment law, including the grammatical, teleological, systematic and historical explanation, were applied in defining depositaries and custodians.

A. Grammatical Explanation

European investment law nor the Member State implementations of the AIFMD, UCITSD V, IORPD II and MiFID II/CRD IV contain consistent definitions of what 'depositaries' and 'custodians' are. This leads to confusion as to the similarities and differences between 'depositaries' and 'custodians' on the European and national level.

No common definition is found in European law of what 'depositaries' and 'custodians'[27] are. The European Commission in a Commission Communication reviewing possible developments on the regulation of UCITS depositaries defined custodians as

> 'an entity entrusted with the safekeeping and administration of securities and other financial assets on behalf of others, and may moreover provide additional services, including clearing and settlement, cash management, foreign exchange and securities lending'.

Although not directly targeted, the CRD IV and MiFID II regulate credit institutions and investment firms that provide the service of 'safekeeping and administration of securities/financial instruments' as an ancillary service.[28] 'Investor CSDs' partly provide similar services as 'custodians' under CRD IV and MiFID II. The core services provided under the CSDR, however, delineate 'investor CSDs' from 'custodians'. By reviewing credit institutions, investment firms, national custodians, 'investor CSDs' and the MiFID II client asset requirements, the review of MiFID II, CRD IV, the CSDR and corresponding Member State implementations highlighted that credit institutions, investment firms and national custodians are to be seen as 'custodians'.

The AIFMD, UCITSD V and IORPD II contain 'lex specialis' provisions targeting 'depositaries'. Depositaries under the AIFMD and UCITSD V are 'institutions that are entrusted with the safekeeping of assets and oversight of compliance with the fund rules and applicable law'.[29] Under IORPD II, 'depositaries' may be appointed for the safekeeping of assets or for safekeeping of assets and oversight duties in accordance with the IORPD II depositary regime.[30] The meaning of a 'depositary' under both Article 33(1) and (2) IORPD II for both full DC and other types of IORPs should, however, be read as either a 'custodian' or an 'UCITSD V/AIFMD depositary'.[31]

The additional monitoring/controlling duty of depositaries has led to 'lex specialis' depositary regulation that facilitates the different role that depositaries play in 'fiduciary governance'. These 'lex specialis provisions' to be found in the AIFMD, UCITSD V, IORPD II and the proposed PEPPR relate to:

---

[27] European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004, 7, 14, 26.
[28] Annex I Nr. 12 CRD IV.
[29] Cf. Art. 2(23) PEPPR.
[30] Art. 33(2) IORPD II.
[31] EIOPA-BOS-12/015, 471.

- the mandatory appointment of a single depositary;[32]
- the legal independence of the depositary and related requirements;[33]
- the eligible entities required to be appointed and the organizational requirements applicable to them (depending upon the UCITSD V Member State implementation: credit institutions, investment firms, and 'other legal entities');[34]
- the re-use of assets;[35]
- safekeeping duties;[36]
- oversight duties;[37]
- the delegation regime;[38] and
- the depositary's liability regime.[39]

B. Teleological Explanation

Despite of the differences between how the depositar is being regulated throughout the European investment law directives and in the implementation of the Member States, common principles, however, argue in favour of the introduction of an AIF/UCITS or even a cross-sectoral depositary passport.

Depositaries under the AIFMD/UCITSD V perform a safekeeping and oversight role and custodians under CRD IV, MiFID II and on the national level merely a safekeeping role. Despite of this, the same entities that within individual Member States act as a depositary perform mainly safekeeping under MiFID II and safekeeping (and oversight duties) under IORPD II. At the same time, they are subject to the same custody transfer laws that determine the legal scope of the safekeeping function. The author holds that this is the case because depositary law is a specialized area of custodian law. The depositary is, thus, a 'specialized custodian'.

A *teleological explanation* of the depositary throughout the European investment law directives explains this. By imposing an depositary/custodian, the law seeks to protect investors, preserve the stability of the financial system and ensure market integrity.

The authorization, conduct of business rules, prudential regulation, supervision and enforcement of credit institutions, investment firms and 'equivalent other entities' are considered under the various European directives to be appropriately addressing the investor and market protection risks related to the safekeeping function of custodians and depositaries. The notion of 'depositary' under IORPD II, UCITSD V and the AIFMD is wider than the notion of pure 'custodian'[40]. For this reason, IORPD II, UCITSD V and the AIFMD require additional conduct of business rules to be fulfilled for depositaries that in their capacity of acting as a custodian perform oversight duties. Depositary law is, thus, a separate area of law applying on top of the 'general law' applying to credit institutions, investment firms or 'other equivalent legal entities' authorized to act as a custodian.

C. Systematic Explanation

---

[32] Art. 22(1) UCITSD V; Art. 21(1) AIFMD; Art. 33(1) and (2) IORPD II; Art. 41(1) PEPPR.
[33] See Arts 25, 26b UCITSD V; Art. 21 UCITSD V (Commission) Regulation; Art. 33(7) IORPD II.
[34] Art. 23(2) UCITSD V; Art. 21(3) AIFMD; Art. 33(3) IORPD II.
[35] Art. 21(11)(d)(iv) AIFMD; Art. 22(7) UCITSD V.
[36] Art. 22(5) UCITSD V; Art. 21(8) AIFMD; Art. 34 IORPD II; Art. 41(3) PEPPR.
[37] Art. 22(3) UCITSD V; Art. 21(9) AIFMD; Art. 35 IORPD II; Art. 41(4) PEPPR.
[38] Art. 22a UCITSD V; Art. 21(11) AIFMD; Art. 34(4) IORPD II; Art. 41(3) PEPPR.
[39] Art. 24(1) UCITSD V; Art. 21(12) AIFMD; Art. 34(4) IORPD II; Art. 41(3) PEPPR.
[40] European Commission, *Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries* {C(2015) 9160 final}, Annex 4.

The difference between 'depositaries' and 'custodians' is that depositaries, apart from safekeeping, also perform oversight duties.[41] In this regard, it should be noted that the AIFMD and UCITSD V require a mandatory depositary to be appointed and MiFID II a custodian to be appointed[42], whereas IORPD II leaves it up to the Member States whether a depositary/custodian is appointed at all and if so, whether either a depositary or custodian must be appointed.[43] There are, thus, not only differences between 'depositaries' and 'custodians', but also between various types of 'depositaries' throughout sectoral EEA legislation.

This is the result of how the different European investment law directives deal with the 'structural separation of investments and management'. The 'investment assets' legally/beneficially owned by investors/members and the 'operational assets' legally/beneficially owned by 'investment intermediaries' and 'depositaries'/'custodians' form two separate 'asset patrimonies'. European investment law establishes this structural separation by means of warranting an (optional/virtual) 'investment triangle' to be in place that involves an 'investment intermediary', depositary/custodian and investors/members. This 'triangle' regulates (fiduciary/agency) governance and asset partitioning.

The structural separation limits 'residual control' that is beneficial for all constituencies in European investment law. It allows 'investment intermediaries' and 'depositaries'/'custodians' to exploit economies of scope and scale by conducting various business lines simultaneously, whereas it allows investors/members to benefit from lower fees. For this reason, assets are partitioned in two separate asset patrimonies by means of the segregation duty that comes along with the safekeeping task of depositaries/custodians.

The structural separation, however, also leads to agency costs. The (virtual/optional) investment triangle under European investment law regulates this by requiring 'investment intermediaries' and 'depositaries/custodians' to be regulated under intermediary regulation, financial products, such as AIFs, UCITS and PEPPs, are subject to product regulation, whereas disclosure/sales/marketing regulation ensures that investors/members are adequately informed. Depositaries/custodians are, thus, merely one investor protection mechanism in the investment triangle that regulates the agency costs resulting from the structural separation of investments and management under the European investment law directives.

The role that depositaries and custodians play are, in particular, different in (fiduciary/agency) governance. This can be explained by an *systematic interpretation* of the depositary throughout European investment law. Depositaries are required by European investment laws, such as the AIFMD, UCITSD V, IORPD II and the proposed PEPPR that are characterized by 'investment intermediaries' that conduct discretionary investment management. Investors/members directly or indirectly give a mandate to these 'investment intermediaries' to carry out investment management on their behalf without having the ultimate control in how their assets should be invested. Depositaries have an oversight duty in checking compliance of the investment decision made with the agreed investment policy. This is a marginal check. European investment law directive that do not regulate investment relationships that have a 'fiduciary' but 'agency' nature, such as execution-only and investment-advice based investment relationships under MiFID II, do not require a depositary to be appointed. Instead, a custodian is appointed under these directives. In addition, depositaries are required to be appointed under European investment law directives that have

[41] International Organization of Securities Commission, *Standards for the Custody of Collective Investment Schemes' Assets – Final Report*, FR 25/2015, November 2015, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD512.pdf (accessed 14 April 2017).
[42] Recital 32, Art. 22(1) UCITSD V; Art. 21(1) AIFMD.
[43] Art. 33(1) and (2) IORPD II.

a ‘collective investment nature’. The oversight duty under the AIFMD, UCITSD V, IORPD II and proposed PEPPR prevents collective action problems in monitoring ‘investment intermediaries’ and, generally, is the ‘cheapest solution’ (cheapest cost avoider theory). Under investment relationships in which there is not ‘pooled return/risk’, only individual investors are affected by investment decisions made by ‘investment intermediaries’. Individual investors are easily able to serve their own interests by giving investment directions/orders to these intermediaries and the oversight duty performed by depositaries is not warranted. For this reason, custodians are used in these investment relationships. Moreover, depositaries are only appointed under those European directives in which investors bear ‘full investment risks’. This implies that ‘investment intermediaries’ as agents are conducting investment management on behalf of investors/members in which the latter bear the full risk. No guarantee or claim is in place, such as for deposit-taking activity or insurances under CRD IV and Solvency II, that grants consumers a claim on their balance sheet.

The systematic explanation does not explain why there are still differences to be found amongst sectoral depositary laws, such as in the AIFMD and UCITSD V that both regulate collective investment undertakings. This has a historical explanation.

D. Historical Explanation

Despite ‘depositaries’ fulfilling a similar role throughout the European investment law directives, still inconsistencies between the various regimes are to be observed. In the ongoing harmonization trend. These differences have an *historical explanation*. Prior to the adoption of the AIFMD and UCITSD V, different governance models were being employed for AIFs and UCITS. The ‘one-size fits all’ based upon legal form neutrality has not always been in place. Instead, contractual, corporate and trust governance models were in place. Under the contractual model, depositaries were assigned a monitoring role towards AIFMs and UCITS ManCos, whereas under the trust and corporate model this monitoring role was fully or partly assigned to the trustee and the board of directors. The AIFMD and UCITSD V introduced the ‘contractual governance model’ for all types of AIFs and UCITS. This can be explained by the fact that trustee/supervisory/governing boards cannot compete in terms of costs and quality with carrying out the oversight duties by means of manual work in comparison to the highly advanced technology-based systems which are employed by professional depositaries. Although under IORPD I/II still discretion is left to Member States to allow IORPs to employ the corporate and trust model, the legal form neutral approach under the proposed PEPPR shows that the contractual-based form will be dominant in terms of depositary regulation in the future.

PART IV

What preconditions need to be fulfilled to introduce a European AIF/UCITS depositary passport and/or a cross-sectoral European depositary passport?

Part IV, on the basis of the outcome of the preceding Parts, advocated in favour of introducing not only an AIF/UCITS depositary but a ‘cross-sectoral European depositary passport’ in European investment law. The introduction of a (cross-sectoral) depositary passport would enable depositaries to offer their services on the European level and to consolidate services on a cross-sectoral and cross-border basis.

Notwithstanding the benefits of introducing an AIF/UCITS depositary passport, a European passport for UCITS and AIF depositaries has so far been multiple times considered, but not introduced due to investor protection concerns.[44] MEP Perreau de Pinninck in 1993 after the introduction of the 'ancillary European passport' under the ISD and Second Banking Directive considered that a European depositary passport for UCITS should not be introduced for two reasons.[45] First, it was considered that the depositary function was going beyond mere performing the 'custodian' function under the ISD and Second Banking Directive. Second, the depositaries in the UCITS domain had not been harmonized to effectively perform the controlling function.

Prior to introducing an AIF/UCITS or cross-sectoral depositary passport Part IV answered whether the differences between depositaries and custodians justify the locational restriction applicable to AIF/UCITS depositaries. Furthermore, Part IV clarified whether AIF, UCITS, IORP and PEPP depositaries are sufficiently harmonized and, if not, what should be done to make the introduction of a cross-sectoral passport acceptable.

A 'de facto European depositary passport' is granted to IORP and PEPP depositaries, whereas this is not available for AIF/UCITS depositaries. This is highly remarkable as depositaries perform the same functions with the same underlying investor protection objective. This inconsistency can be rightfully called an 'European depositary passport paradox' as the eligible entities and, in particular, the depositary function itself under the AIFMD and UCITSD V has been harmonized to a much larger extent than under IORPD II and the proposed PEPPR.[46]

The AIFMD 'transitional relief' regime'[47] suggests that the duties, delegation and depositary's liability regime are sufficiently harmonized on the European level for the introduction of a European passport. Under this regime, credit institutions appointed as an AIF depositary are allowed to be appointed under a 'mutual recognition regime' provided that the AIF home Member State in which the AIF is established, has implemented this option in their AIFMD implementation laws.[48] Giving the similarities under the UCITSD V depositary regime, similar considerations could be made regarding the introduction of a UCITSD V depositary passport.

This seems to suggest that the introduction of a 'cross-sectoral depositary passport' would require full harmonization of the depositary as a financial intermediary and also the harmonization of the PEPP/IORP depositary duties, delegation and liability standards would be necessary for a consistent approach.

Similar as for the 'management company passport' discussion, custodians already upon the introduction of ISD enjoyed an ('ancillary') European passport. As a compromise of introducing the European 'management passport' under UCITSD IV and the AIFMD, the depositary remained to be required to be established in the UCITS/AIF home Member State.

Modelled after this concept, indeed, a proportional 'cross-sectoral depositary passport' could be built upon the core activities of the safekeeping of assets and the performance of oversight duties. All depositaries and custodians perform at least the safekeeping of assets as a minimum. Essentially, depositaries are custodians that perform, in addition to the safekeeping of assets, oversight duties.[49] For this reason, a 'cross-sectoral depositary passport' could be

---

[44] See Chapter 2, section 1.2.
[45] European Parliament, *Report of the Committee on Legal Affairs and Citizen's Rights on the 1993 UCITS Proposal*, A5-0268/1993, 1 October 1993, http://goo.gl/rRSdJO (accessed 7 April 2017).
[46] See for the AIFMD/UCITSD V depositary regime: Chapter 4; See for the IORPD II depositary regime: Chapter 5; See for the proposed PEPPR depositary regime: *infra* section 4.3.
[47] See Chapter 2, section 1.2.2.2.
[48] *Ibid.*
[49] See Chapter 7, section 2.2.1.3.

built on the basis of an harmonized authorization regime for custodians performing the regulatory activity 'safekeeping of assets', whereas on the sectoral level a cross-sectoral consistent set of legislation applies additionally for custodians that act as depositaries. This solution is being referred to in this dissertation as 'Custody Plus' as this terminology is used in practice for custodians that are appointed as AIF/UCITS/IORP depositaries.

Part IV proposes a 'cross-sectoral' depositary passport based upon the 'intermediary holding model'[50], i.e. the current method of holding and transferring securities by means of 'intermediaries' such as depositaries and custodians.[51] Settlement under this model is highly complex. It is expected that in the coming years 'blockchain settlement', i.e. settlement through DLT, will gradually replace settlement under the 'intermediary holding model'.[52] Blockchain allows (crypto-)securities to be directly transferred from sellers to buyers or from collateral providers to collateral takers.[53] Some experts suggest that no securities accounts and no intermediaries, such as depositaries and custodians, will be necessary for this.[54] The high (systematic) importance of securities holding and settlement makes it, however, likely that blockchain networks/platforms for securities holding and settlement will be required by the legislator to be only accessible to authorized market participants. Depositaries/custodians will, thus, in the blockchain revolution have to evolve through the 'intermediary era' to the 'Fintech' and the 'TechFin' era. Settlement through 'decentralized autonomous organizations could mark the final stage of 'disintermediation'.

---

[50] Chapter 6, section 2.2.; See also Chapter 13, section 5.1.2.

[51] P. Paech, *Integrating Global Blockchain Securities Settlement with the Law - Policy Considerations and Draft Principles*, 3,4, https://ssrn.com/abstract=2792639 (accessed 20 July 2017).

[52] Deutsche Bank, *NeMA Asia round up: Can Custodian Banks win in the Blockchain Phenomenon*, December 2015, http://cib.db.com/insights-and-initiatives/flow/nema-asia-round-up-can-custodian-banks-win-in-the-blockchain-phenomenon.htm#gsc.tab=0 (accessed 20 July 2017); J. Condos,W.H . Sorrell & S.L. Donegan, *Blockchain Technology: Opportunities and Risks*, http://legislature.vermont.gov/assets/Legislative-Reports/blockchain-technology-report-final.pdf (access 20 July 2017); P. Walsh, *Regulator warns of blockchain settlement usage* (19 January 2017), Global Custodian https://www.globalcustodian.com/Technology/Regulator-warns-of-blockchain-settlement-usage/ (accessed 20 July 2017).

[53] *Ibid.*

[54] G. Prisco, *The Blockchain Could Make Existing Securities Industry Players Redundant, Says BNP Paribas Analyst (*6 July 2015), https://bitcoinmagazine.com/articles/blockchain-make-existing-securities-industry-players-redundant-says-bnp-paribas-analyst-1436212815/ (accessed 20 July 2017); M. Harwood-Jones, *Blockchain and T2S: A potential disruptor*, https://www.sc.com/BeyondBorders/wp-content/uploads/2016/06/2016-06-16-BeyondBorders-Report-SCB_Nema_Block-Chain-Paper-Final.pdf (accessed 20 July 2017).

Samenvatting

Dit boek beoogt te onderzoeken of een cross-sectoraal *depositary* paspoort ontwikkeld zou kunnen worden. Met een dergelijke cross-sectoraal *depositary* paspoort zouden *depositaries* tegelijkertijd grensoverschrijdend diensten zouden kunnen aanbieden aan niet alleen IORPs en cliënten van beleggingsondernemingen, maar ook aan AIFs en UCITS.

De auteur is van mening dat het niet introduceren van een Europees *depositary* paspoort voor AIFs en UCITS in strijd is met de vrijheid van vestiging en dienstverlening waarop de interne markt voor financiële dienstverlening op gebaseerd is. Een dergelijke inbreuk op de vier vrijheden kan niet worden gerechtvaardigd vanuit het oogpunt van beleggersbescherming.

Dit boek beantwoordt de centrale onderzoeksvraag of een cross-sectoraal *depositary* paspoort in het Europese financieel recht zou moeten worden geïntroduceerd.

Deze centrale onderzoeksvraag werd beantwoord aan de hand van de volgende deelvragen:

- welke inconsistenties zijn er te vinden in het toebedelen van een Europees *depositary* paspoort in het Europese financieel recht?
- in hoeverre dienen financiële intermediairs te zijn geharmoniseerd in de EU (EER) om een Europees paspoort van de Europese wetgever toebedeeld te krijgen?
- rechtvaardigen de verschillen tussen *depositaries* en *custodians* het verschil in behandeling door de Europese wetgever aangaande het Europees paspoort?
- aan welke voorwaarden dient te worden voldaan om een Europees AIF/UCITS *depositary* paspoort of een Europees cross-sectoraal *depositary* paspoort in het Europese financieel recht te introduceren?

DEEL I

Welke inconsistenties zijn er te vinden in het toebedelen van een Europees depositary paspoort in het Europees financieel recht?

In de praktijk fungeren dezelfde beleggingsondernemingen en kredietinstellingen als een *custodian* onder MiFID II/CRD IV, als een *depositary* onder de AIFMD/UCITSD V en als een *depositary/custodian* onder IORPD II. MiFID II, CRD IV, de AIFMD, UCITSD V en IORPD II zijn echter inconsistent ten aanzien van het toebedelen van een Europees paspoort aan deze *depositaries/custodians* vanuit niet alleen een cross-sectoraal perspectief maar ook op sectoraal niveau. Vanuit cross-sectoraal perspectief bevatten MiFID II en CRD IV een Europees 'nevendiensten' paspoort voor '*custodians*'.[1] Daarentegen vereisen de AIFMD en UCITSD V dat een *depositary* moet zijn gevestigd in de lidstaat van herkomst van de AIF/UCITS,[2] terwijl dezelfde kredietinstellingen en beleggingsondernemingen die als een depositary/custodian onder IORPD II optreden, beschikken over een 'de facto' Europees paspoort.[3] Niet alleen zijn bovengenoemde richtlijnen inconsistent vanuit een cross-sectoraal perspectief, maar ook op sectoraal niveau. De AIFMD bevat, bijvoorbeeld, strikte vestigingsregels voor EER-AIFs, terwijl *depositaries* die worden aangesteld voor niet-EER-AIFs over een 'quasi-*depositary* paspoort' beschikken.[4] De inconsistentie in het toebedelen

---

[1] Bijlage I, Nr. 12, CRD IV; Bijlage I, s. A MiFID II.
[2] Art. 21(5) AIFMD en Art. 23(1) UCITSD V.
[3] Article 33(3) IORPD II.
[4] C.P. Buttigieg, *The Case for A European Depositary Passport*,

van een Europees *depositary* paspoort onder het Europees financieel recht zorgt voor een 'Europees *depositary* paspoort paradox'.

Voor het verkrijgen van een helder overzicht van de problematiek die speelt omtrent het Europees *depositary* paspoort is het belangrijk om het debat omtrent het paspoort te beschouwen vanuit een historisch perspectief. Deel I bestudeert de redenen waarom een Europees *depositary* paspoort al dan niet ten tijde van het aannemen van de diverse UCITS richtlijnen, de AIFMD, de Beleggingsdienstenrichtlijn/MiFID II en IORPD II op sectoraal niveau is geïntroduceerd. Zo is het Europees 'nevendiensten' paspoort voor '*custodians*' onder MiFID II/CRD IV nooit geupgrade naar een Europees paspoort voor het 'bewaren en beheren van financiële instrumenten voor rekening van cliënten' als '*stand-alone*' beleggingsdienst/-activiteit. Hiervoor waren twee redenen. Ten eerste bestond er onduidelijkheid over de reikwijdte van het begrip 'bewaren en beheren van financiële instrumenten voor rekening van cliënten'. Ten tweede bestond er in de praktijk de behoefte niet voor een dergelijke update aangezien de nevendienst een '*low margin service'* is en zodoende in de praktijk altijd door kredietinstellingen en beleggingsonderneming samen met andere beleggingsdiensten/-activiteiten wordt aangeboden. Echter, door het niet harmoniseren van deze dienst blijven er op Europees vlak vragen bestaan of het juridisch kader voor *custodians* op Europees vlak verder dient te worden geharmoniseerd om een Europees *level playing field* te bieden vanuit het oogpunt van beleggersbescherming.[5] De aanname van de CSDR biedt hierbij eventueel hulp bij het verduidelijken van de reikwijdte van het MiFID II '*custodianship'* begrip.

Ondanks de schaalvoordelen die een AIF/UCITS *depositary* paspoort kan bieden, is een dergelijk paspoort op Europees vlak meerdere malen overwogen, maar uiteindelijk niet geïntroduceerd. Voormalig lid van het Europees parlement Perreau de Pinninck heeft na de introductie van het Europees 'nevendiensten' paspoort onder de Beleggingsdienstenrichtlijn en Tweede Bankenrichtlijn overwogen dat een Europees *depositary* paspoort voor UCITS omwille van twee redenen niet geïntroduceerd moest worden.[6] Ten eerste beargumenteerde Perreau de Pinninck dat de functies van een UCITS *depositary* meer omvat dan die van een '*custodian*' onder de Beleggingsdienstenrichtlijn en Tweede Bankenrichtlijn. Ten tweede waren UCITS *depositaries* nog niet in voldoende mate op Europees vlak geharmoniseerd om effectief onder een paspoort de toezichthoudende taak van deze *depositaries* te kunnen uitoefenen.

Deze argumenten verklaren echter niet waarom tot op heden nog geen Europees *depositary* paspoort is geïntroduceerd onder het substantieel geharmoniseerd *depositary* regime dat werd geïntroduceerd door de AIFMD en UCITSD V. Ook valt uit deze twee argumenten niet op te maken waarom *depositaries* en *custodians* onder IORPD II over een 'de facto Europees paspoort' beschikken, terwijl *depositaries/custodians* onder deze richtlijn in minder mate zijn geharmoniseerd dan AIF/UCITS *depositaries.* Ten slotte verklaren deze argumenten niet waarom kredietinstellingen onder het 'AIFMD transitie *depositary* regime' wel over een optioneel Europees paspoort en waarom onder de AIFMD *depositaries* die voor een niet-EER-AIF worden aangesteld over een 'quasi-*depositary* paspoort' beschikken. Om deze redenen bestudeert Deel II welke vereisten zouden moeten, worden vervuld zodat een Europees of derde landen paspoort voor (AIF/UCITS) zou kunnen, worden geïntroduceerd en Deel III in hoeverre *depositaries* en *custodians* van elkaar verschillen.

---

http://studylib.net/doc/13128849/the--case--for--a--european-...-passport (accessed 7 April 2017); Zie also S.N. Hooghiemstra, *Depositary Regulation* (D.A. Zetzsche ed, Kluwer 2015).

[5.] Question 3, Bank of New York Mellon response to the MiFID/MiFIR II questionnaire of MEP Markus Ferber – 12 January 2012.

[6] European Parliament, *Report of the Committee on Legal Affairs and Citizen's Rights on the 1993 UCITS Proposal*, A5-0268/1993, 1 October 1993, http://goo.gl/rRSdJO (accessed 7 April 2017).

Deel II

In hoeverre dienen financiële intermediairs te zijn geharmoniseerd in de EU (EER) om een Europees paspoort van de Europese wetgever toebedeeld te krijgen?

Deel II bestudeerde de systematiek van de geharmoniseerde financieelrechtelijke toezichtsregels ten aanzien van de vrijheid van vestiging en van (grensoverschrijdende) financiële dienstverlening binnen de EER. Hierbij werd met name aandacht besteed aan de voorwaarden waaronder een Europees en 'derde landen' paspoort aan EER en derde landen financiële intermediairs onder het Europees financieel recht wordt toebedeeld. Dit diende om vast te kunnen stellen onder wat voor voorwaarden een '*stand-alone*' Europees en 'derde landen' paspoort aan '*depositaries*' en '*custodians*' onder het Europees financieel recht zou kunnen worden geïntroduceerd.

De Europese geharmoniseerde financieelrechtelijke toezichtsregels die financiële intermediairs reguleert, hebben een 'interne' en een 'externe dimensie'. De zogenaamde 'interne dimensie' omvat het Europees secundair recht dat is gebaseerd op de 'vier vrijheden' en het positieve recht dat op sectoraal niveau de systematiek van de voorhanden zijnde Europese paspoorten reguleert die EER financiële intermediairs in staat stellen zich in een andere EER lidstaat te vestigen dan wel financiële dienstverlening grensoverschrijdend aan te bieden. De 'externe dimensie' van het Europees financieel recht reguleert de vestiging en het aanbieden van grensoverschrijdende financiële dienstverlening door financiële intermediairs uit derde landen binnen de EER en bestaat uit het Europees secundaire recht en verplichtingen die voorkomen uit het internationaal recht.

Zowel de 'interne' als de 'externe dimensie' van Europees financieelrechtelijke toezichtsregels hebben als doel een een interne markt voor financiële dienstverlening tot stand te brengen die bijdraagt aan marktefficiëntie en schaalvergroting.

Vergunning- en notificatievereisten onder de systematiek van het Europees paspoort van de verschillende sectorale regelingen hoeven, bijvoorbeeld, slechts enkel in de lidstaat van herkomst te worden vervuld. Dit zorgt voor een enorme kostenreductie omdat financiële intermediairs, na het vervullen van deze vereisten, zich in andere EER lidstaten mogen vestigen dan wel hun financiële producten en dienstverlening grensoverschrijdend in alle overige EER lidstaten mogen aanbieden zonder hiervoor in deze lidstaten een nieuwe vergunning te hoeven aanvragen.

Ook zorgt de interne markt voor financiële dienstverlening voor lagere prijzen voor deze diensten omdat de vaste kosten van intermediairs kunnen worden opgebracht door een grotere afzetmarkt.[7] Financiële intermediairs kunnen zich de onder systematiek van het Europees paspoort overal in de EER vestigen. Theoretisch maakt het zelfs hierbij niet uit of ze zich in kleine of in grote lidstaten vestigen. Dit leidt tot een competitievere en efficiëntere Europese markt voor financiële dienstverlening. Naast het reduceren van transactiekosten, biedt de systematiek van het Europees paspoort financiële intermediairs van zowel kleine als grote lidstaten de mogelijkheid om financiële producten en dienstverlening grensoverschrijdend aan meer dan 500 miljoen mensen aan te bieden.

De systematiek van het Europees paspoort kan, naast de bovengenoemde voordelen, ook een aantal negatieve gevolgen hebben. Het aan de systematiek van het Europees paspoort ten

[7] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 56 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

grondslag liggende ‘asymmetrisch risico’ kan de kans op insolventies van en fraude door financiële intermediairs vergroten.[8] Lidstaten kunnen namelijk door politieke en economische motieven ertoe geneigd zijn de financiële dienstverlening/producten die vanuit hun land grensoverschrijdend in andere EER lidstaten worden aangeboden (‘productiestaat’) te stimuleren door lokale financiële intermediairs slechts marginaal te reguleren en/of laks toezicht uit te oefenen.[9] Lidstaten van herkomst kunnen hiertoe geneigd zijn bij financiële producten en dienstverlening die voornamelijk in andere lidstaten worden gedistribueerd. In dat geval worden de voordelen, zoals hogere belastinginkomsten en werkgelegenheid, exclusief genoten door de lidstaat van herkomst als ‘productiestaat’, terwijl de negatieve gevolgen, zoals insolventies van en fraude door deze financiële intermediairs, voornamelijk gedragen worden door de de lidstaten waarin deze financiële dienstverlening/producten worden aangeboden (‘distributiestaten’).

Om de negatieve gevolgen van het aan de systematiek van het Europees paspoort ten grondslag liggende ‘asymmetrisch risico’ te vermijden, bevatten de Europese sectorale regels geharmoniseerde financieelrechtelijke toezichtsregels. Het Europese raamwerk van toezichtregels op sectoraal niveau zorgt ervoor dat er geen cumulerend bolwerk van regels in de verschilende Europese lidstaten ontstaat waaraan financiële intermediairs die grensoverschrijdend actief zijn binnen een bepaalde sector moeten voldoen. In het verleden leidde het ontbreken van een Europese aanpak op het gebied van financieel recht tot een lappendeken van regels die ervoor zorgden dat financiële intermediairs op sectoraal niveau nauwelijks financiële diensten/producten in andere lidstaten konden aanbieden. De beperking van de vrijheid van dienstverlening en vestiging die hieruit voortvloeide kon niet met een beroep op de ‘vier vrijheden’ worden opgelost doordat het prudentieel recht consumentenbescherming beoogt en dit daarom een rechtvaardigingsgrond vormt voor een inbreuk op de deze vrijheden.

Prudentieel toezicht als rechtsvaardigingsgrond voor een inbreuk op de ‘vier vrijheden’ onder het VWEU zorgde ervoor dat belemmeringen die grondslag lagen aan de ontwikkeling van een interne markt voor financiële dienstverlening niet door negatieve integratie konden worden weggenomen. In plaats daarvan werd positieve integratie nagestreefd op basis van het Europese secundair recht.

De weg naar een volledige integratie van de interne markt voor financiële dienstverlening begon in de jaren 80 en werd gekenmerkt door een toenemende mate van Europese wetgeving die de wetgeving van de lidstaten op dit terrein beoogde te harmoniseren. Geleidelijk leidde dit tot meer wetgeving en toezicht op Europees vlak op het gebied van financiële dienstverlening die uiteindelijk zouden resulteren in een aantal ‘gemeenschappelijke principes’ op basis waarvan de systematiek van het Europees paspoort voor EER financiële intermediairs onder de verschillende sectorale richtlijnen is gebaseerd.

De systematiek van het ‘Europees paspoort’ vormt de kern van de geharmoniseerde Europees financieelrechtelijke toezichtsregels die de vrijheid van vestiging en van (grensoverschrijdende) financiële dienstverlening binnen de EER regelt. De systematiek van ‘Europees paspoort’ is een algemeen concept die de voorwaarden uiteenzet voor het Europese principe van ‘wederzijdse erkenning’. De achterliggende gedachte is dat financiële producten en diensten die in de lidstaat van herkomst worden ‘geproduceerd’ (en gedistribueerd) onder de voorwaarden zoals uiteengezet in Europese financieelrechtelijke toezichtsregels mogen

[8] Zie D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 61 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014); D.A. Zetzsche, *Competitiveness of Financial Centers in Light of Financial and Tax Law Equivalence Requirements* 401-402 (R.P. Buckley, E. Avgouleas & D.W. Arner eds., Cambridge University Press 2016).

[9] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 62-63 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

worden gedistribueerd in de gehele EER zonder dat de 'lidstaten van ontvangst' verdere voorwaarden aan markttoegang, zoals een additionele vergunning, mogen stellen.[10] De systematiek van het 'Europees paspoort' is nu een algemeen wijdverbreid concept dat in vrijwel alle sectorale Europees financieelrechtelijke toezichtsregels wordt gebruikt om een interne markt voor financiële intermediairs in de betreffende sectors te bewerktstelligen. Het Europees paspoort en het overkoepelende beginsel van wederzijdse erkenning zijn gebaseerd op twee pijlers: het *'single rulebook'*, een set geharmoniseerde Europees financieelrechtelijke toezichtsregels, en een gecoördineerd Europees toezichtstelsel voor de financiële sector die bestaat uit '*home state control'* en de 'ESFS'.[11] De systematiek van het 'Europees paspoort' is uniek en een vergelijkbare systematiek is niet te vinden in andere multilaterale, regionale of bilaterale vormen van samenwerking op internationaal niveau.[12] De reden hiervoor is de verregaande mate van samenwerking op het gebied van regelgeving en toezicht op Europees vlak waarop deze systematiek is gebaseerd.[13]

Naast de ontwikkeling van het 'Europees paspoort' voor EER financiële intermediairs, vond tegelijkertijd de ontwikkeling van de 'external dimensie' van het Europese financieel recht plaats, dat wil zeggen de voorwaarden waaronder financiële intermediairs uit derde landen zich binnen de EER mogen vestigen of (grensoverschrijdende) financiële diensten mogen aanbieden.Financiële intermediairs uit derde landen zijn in het land van herkomst niet onderworpen aan de Europees financieelrechtelijke toezichtsregels en het gecoördineerde Europees toezichtstelsel voor de financiële sector. Bovendien verschilt de harmonisatiegraad van financiële regelgeving op internationaal terrein van sector tot sector. De regelgeving voor banken en verzekeraars is op internationaal terrein in hoge mate geharmoniseerd, terwijl dit voor andere sectoren, zoals de regulering van *asset management,* nauwelijks het geval is. Omwille van deze reden bepaalt het Europees secundair recht of en, zo ja, onder welke condities financiële intermediairs uit derde landen zich binnen de EER mogen vestigen of binnen de EER financiële diensten mogen aanbieden.

De Europese regulering van financiële intermediairs uit derde landen die zich willen vestigen of financiële diensten willen aanbieden in de EER is gebaseerd op dezelfde '*law and economics'* overwegingen als de systematiek van het Europees paspoort voor EER financiële intermediairs. Enerzijds zorgt de 'externe dimensie' van de interne markt voor voordelen in de vorm van marktefficientie en schaalvergroting. Anderzijds zijn de mogelijke negatieve gevolgen van 'asymmetrische risico's' die voortkomen uit de toegang tot de interne markt van financiële intermediairs uit derde landen groter dan die van EER financiële intermediairs. Financiële intermediairs uit derde landen zijn in het land van herkomst niet onderworpen aan dezelfde financieelrechtelijke toezichtsregels en het toezicht dat van toepassing is op EER financiële intermediairs.

Om negatieve gevolgen te vermijden stelt het Europees secundair recht 'lex specialis' voorwaarden aan het vestigen of verlenen van financiële diensten door financiële intermediairs uit derde landen in de EER. Hierbij is de Europese wetgever echter gebonden

---

[10] Lidstaten van ontvangst hebben enkele bevoegdheden: Zie Overweging 2, 7, Art. 86 MiFID II, Overweging 4 CRD IV, Overweging 85 Solvency II and Art. 21 UCITSD V . Zie voor literatuur omtrent MiFID I/II: P. Casey & K. Lannoo, The MiFID Revolution, ECMI Policy Brief No. 3 (November 2006); J.P. Casey & K. Lannoo, *The MiFID revolution* (Cambridge University Press (2009); G. Ferrarini & E. Wymeersch, *Investor protection in Europe: corporate law making*, *the MiFID and beyond* (Oxford University Press 2006); International Organisation of Pension Supervisors, *Supervision of Pension Intermediation*, http://www.iopsweb.org/WpNo17Web.pdf (accessed 14 January 2017).

[11] N. Moloney, *Brexit, the EU and its Investment Banker: Rethinking 'Equivalence' for the EU Capital Market*, LSE Legal Studies Working Paper No. 5/2017, 5, https://ssrn.com/abstract=2929229 (accessed 18 June 2017).

[12] P.H Verdier, *Mutual Recognition in International Finance*, 52 Harvard International Law Journal 56 (2011).

[13] International Organization of Securities Commissions, *IOSCO Task Force on Cross-Border Regulation – Final Report*, FR 23/2015, (2015), 31 et seq.

aan internationaalrechtelijke verplichtingen die ervoor zorgen dat deze intermediairs niet worden gediscrimineerd.

De Europese Commissie vertegenwoordigt het gemeenschappelijke handelsbeleid van de EU in betrekkingen met derde landen om een consistente benadering te waarborgen. Bij het reguleren van financiële intermediairs uit derde landen moet de Europese wetgever zich houden aan internationaalrechtelijke verplichtingen die voortvloeien uit GATS en de verplichtingen die voortvloeien uit het EER, het EFTA verdrag en bilaterale handelsverdragen die zijn afgesloten tussen de Europese Commissie en derde landen.

Het prudentieel toezicht als rechtsvaardigingsgrond voor inbreuken op de 'vier vrijheden' onder het VWEU en de GATS belemmerde de ontwikkeling van een 'interne markt met een externe dimensie' voor financiële dienstverlening.[14] Al ten tijde van de aanname van de Eerste Bankenrichtlijn was de Europese wetgever zich er al van bewust dat slechts op basis van markttoegangsregels voor financiële intermediairs uit derde landen in het Europees secundair recht een'interne markt met een externe dimensie' kon worden gecreëerd.

Een dergelijke aanpak ten aanzien van financiële intermediairs uit derde landen heeft verschillende voordelen. Ten eerste versterkt een centrale aanpak de onderhandelingspositie van de EU/EER in internationale financieelrechtelijke organen.[15] Ten tweede leidt het gemeenschappelijke handelsbeleid op Europees vlak dat vertegenwoordigd wordt door de Europese Commissie tot een *level playing field* voor de markttoegang van EER financiële intermediairs uit zowel kleine en grote lidstaten in derde landen.[16] Zonder een dergelijke gecoördineerde Europese aanpak zouden grote lidstaten die zich in een betere onderhandelingspositie bevinden, gunstigere markttoegangscondities kunnen uitonderhandelen met derde landen dan kleine lidstaten. Ten slotte leidt een gecoördineerde aanpak op Europees vlak ertoe dat de grote interne markt door *offshore* financiële centra worden gezien als een doelmarkt die ervoor zorgt dat de reguleringskloof tussen 'productie' en 'distributie staten' wordt gedicht. Europees secundair recht verleent namelijk geen markttoegang aan financiële intermediairs uit derde landen die niet onderworpen zijn aan het Europese financiële toezichtsrecht of die onderworpen zijn aan financieel toezichtsrecht in derde landen die in de EER als 'niet-equivalent' worden beschouwd.

De regels ten aanzien van derde landen equivalentie in het Europees financieel toezichtsrecht helpen bij het beteugelen van de negatieve gevolgen van 'asymmetrische risico's' moeten voldoen aan de 'externe dimensie' van de vier vrijheden en de verplichtingen die voortvloeien uit GATS. Deze regels reguleren:

- EER financiële intermediairs met een 'externe dimensie';
- derde landen financiële intermediairs met markttoegang in de EER; en
- EER financiële intermediaries met markttoegang in derde landen.

Derde landen financiële intermediairs hebben verschillende mogelijkheden tot marktoegang in de interne markt. Ze kunnen in de interne markt toetreden door een dochtermaatschappij in de EER op te zetten, een 'gekwalificeerde deelneming'[17] of 'nauwe

---

[14] J. Marchetti, *The GATS Prudential Carve-Out* 280-286 (P. Delimatsis & N. Herger eds., Kluwer 2011).

[15] N. Moloney, *The EU in International Financial Governance*, 1 Russell Sage Journal of the Social Sciences 138-152 (2017).

[16] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 80 et seq. (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[17] Een 'gekwalificeerde deelneming' onder diverse Europese financieel recht richtlijnen/verordeningen betekent het rechtstreeks of middellijk bezitten van een deelneming in een abi-beheerder van ten minste 10 % van het kapitaal of van de stemrechten dan wel van een deelneming die de mogelijkheid inhoudt een invloed van betekenis uit te oefenen op de bedrijfsvoering van de abi-beheerder waarin wordt deelgenomen; Zie: Art. 4(2)

banden'[18] in een EER intermediair te acquireren.[19] Voor EER dochtermaatschappijen die worden opgezet, dient onder de toepasselijke EER sectorale wetgeving[20] een vergunning te worden aangevraagd, terwijl EER financiële intermediairs waarin een 'gekwalificeerde deelneming' of 'nauwe banden' wordt geacquireerd waarschijnlijk al ten tijde van acquisitie over de relevante vergunning beschikt. Europees secundair recht beschermt de interne markt door eisen te stellen aan financiële intermediairs uit derde landen die een 'gekwalificeerde deelneming' of 'nauwe banden' acquireren en EER financiële intermediairs die aan dergelijke intermediairs taken uitbesteden. Europees secundair recht vereist ook dat bepaalde sectorale groepen, zoals bank- en verzekeringsgroepen, en conglomeraten waarin financiële intermediairs uit derde landen zijn opgenomen aan Europees recht op dit gebied voldoen.

Markttoegang tot de interne markt alleen toestaan aan EER financiële intermediairs zou in strijd zijn met de GATS. Om deze reden bevat het Europees secundair recht op sectoraal niveau verschillende regimes waaraan financiële intermediairs uit derde landen die zich willen vestigen in de EER of financiële diensten willen aanbieden in de EER moeten voldoen zodat mogelijke negatieve gevolgen hiervan voor beleggers en het financiële systeem als geheel uitblijven. Het Europees financieel toezichtsrecht verleent markttoegang aan financiële intermediairs uit derde landen onder de voorwaarden dat zij voldoen aan de eisen die in de derde landen regimes ('equivalentie regimes') op sectoraal niveau aan hen worden gesteld. De derde landen regimes op sectoraal niveau verschillen van sector tot sector. De benadering ten aanzien van financiële intermediairs uit derde landen hangt onder andere af van de mate waarin het recht in een bepaalde sector op internationaal vlak is geharmoniseerd. Het bank- en verzekeringsrecht is, bijvoorbeeld, op internationaal vlak in verregaande mate geharmoniseerd, terwijl harmonisatie van het vermogensbeheerrecht op internationaal vlak nog in de kinderschoenen staat. Aangezien de sectorale derde landen regimes aanknopen bij de harmonisatie op internationaal vlak, zijn er grote verschillen te zien in benadering tussen de verschillende sectoren. Het Europees secundair recht in de ene sector, zoals Solvency II, vereist een 'stand-alone' vergunningplicht van een branch in de EER, terwijl in andere sectoren markttoegang wordt verleend aan financiële intermediairs uit derde landen op basis van een 'derde landen paspoort'.

Oorspronkelijk was de markttoegang van EER financiële intermediairs in derde landen gebaseerd op bilaterale en internationale verdragen die individuele lidstaten afsloten met derde landen of, in het geval van Europese regelgeving met een 'externe dimensie', de Europese instituties met derde landen.[21]

Een nadeel van deze aanpak was het ongelijke speelveld wat betreft markttoegang van EER financiële intermediairs in derde landen. Een amendement van het Verdrag van Nice zorgde ervoor dat het Europese gemeenschappelijke handelsbeleid een exclusieve EU competentie werd.[22] Diverse richtlijnen/verordeningen onder het Europees financieel recht kennen een expliciet 'onderhandelingsmandaat' aan de Europese Commissie toe om ervoor te

---

Nr. 12 MiFID II; Art. 4(1)(ah) AIFMD; Zie voor een minder gedetailleerde definitie: Art. 2(1)(i) UCITSD V; Art. 13 Nr. 21 Solvency II; Art. 4 Nr. 36 CRR.

[18] Het begrip 'nauwe banden' is onder de diverse Europese financieel recht richtlijnen/verordeningen gedefineerd als een situatie waarin twee of meer natuur

lijke of rechtspersonen verbonden zijn door een deelneming in de vorm van een zeggenschapsband, 'duurzame verbondenheid' of 20 % of meer van de stemrechten of het kapitaal van een onderneming; Zie Art. 2(1)(i), (4) UCITSD V; Art. 4(1)(e) AIFMD; Art. 4 Nr. 38 CRR; Art. 4(2) Nr. 26 MiFID II.

[19] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 81 et seq. (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[20] For example: the AIFMD, UCITSD V, MiFID II, CRD II or Solvency II.

[21] D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 67 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

[22] Art. 3(1)(e) VWEU.

zorgen dat alle EER financiële intermediairs onder dezelfde voorwaarden markttoegang tot derde landen krijgen al dan niet op basis van het beginsel van wederkerigheid.

De regulering van financiële intermediairs uit derde landen onder het Europees financieelrechtelijk toezichtsrecht is gebaseerd op de 'interne dimensie' van het Europees financieel recht, dat wil zeggen de 'vier vrijheden', en de 'externe dimensie' die bestaat uit internationaalrechtelijke verplichtingen en het Europees secundair recht. Het Europese recht dat markttoegang van financiële intermediairs reguleert, is gebaseerd op het het beginsel van 'equivalentie'. Dit houdt in dat zowel het financieel toezichtsrecht waaraan financiële intermediairs uit derde landen onderworpen zijn als het toezicht op deze intermediairs 'equivalent' moet zijn voordat toegang tot de interne markt wordt verleend. Dit beginsel is op sectoraal niveau op verschillende wijzen geïmplementeerd. Voor sectoren die op internationaal niveau in verregaande mate geharmoniseerd zijn, zoals het banken- en het verzekeringsrecht, bevatten Europese richtlijnen/verordeningen een zogenaamd *equivalency assessment* die door een ESA wordt uitgevoerd. Voor sectoren waarbij er sprake is van geen of een beperkte mate van harmonisatie op internationaal vlak, zoals het vermogensbeheerrecht, zijn afhankelijk van de mate van harmonisatie, financiële intermediairs uit derde landen geheel of gedeeltelijk onderworpen aan het toepasselijke Europees financieel recht van de desbetreffende sector. Daarnaast vereist het Europese secundaire recht 'juridische vertegenwoordiging' in de EER. Afhankelijk van de mate van internationale harmonisatie van een bepaalde sector, wordt op sectoraal niveau de vestiging van een dochtermaatschappij, branch of de aanstelling van een andersoortige '*legal representative'* vereist die *compliance* met het Europese financieel toezichtsrecht waarborgt. Daarbij vereist het beginsel van 'equivalentie' dat er samenwerkings- en informatieuitwisselingsovereenkomsten tussen de relevante autoriteiten worden afgesloten. Ten slotte spelen de Europese Commissie en de ESA's een belangrijke rol bij equivalentie beoordelingen en is Europese markttoegang van financiële intermediairs uit derde landen onderworpen aan de jurisdictie van het HvJ-EU.

Deel III

Rechtvaardigen de verschillen tussen depositaries en custodians het verschil in behandeling door de Europese wetgever aangaande het Europees paspoort?

Deel III beoogt te definiëren wat een *depositary* is en aan te geven in hoeverre *depositaries* en *custodians* van elkaar verschillen. Ten eerste verduidelijkt deel III of een verschil in behandeling in het Europees financieel recht van *depositaries,* enerzijds, en *custodians,* anderzijds gerechtvaardigd is vanuit beleggersbeschermingsperspectief. Ten tweede wordt in Deel III nagegaan of er gemeenschappelijke principes in de regulering van *depositaries* en *custodians* te vinden zijn, zoals voor vermogensbeheerders onder de AIFMD, UCITSD V, MiFID II en IORPD II, op basis waarvan een cross-sectoraal *depositary* paspoort ontwikkeld zou kunnen worden. Met behulp van de juridische interpretatiemethoden van Von Savigny, met inbegrip van de grammaticale, teleologische, systematische en historische methode, definieert Deel wat een een *depositary* in het Europees financieel recht is en in hoeverre *depositaries* en *custodians* van elkaar verschillen.

A. Grammaticale Interpretatie

De richtlijnen onder het Europees financieel recht noch de AIFMD, UCITSD V, IORPD II, MiFID II en CRD IV lidstaat implementaties bevatten een consistente definitie van de

begrippen '*depositaries*' en '*custodians*'. Dit leidt tot verwarring op zowel Europees als nationaal vlak in hoeverre *depositaries* en *custodians* van elkaar verschillen.

De Europese Commissie heeft in haar '*Communication*' in 2004 betreffende de ontwikkelingen op het vlak van UCITS '*custodians*' gedefinieerd als

> *'an entity entrusted with the safekeeping and administration of securities and other financial assets on behalf of others, and may moreover provide additional services, including clearing and settlement, cash management, foreign exchange and securities lending'.*

CRD IV en MiFID II reguleren kredietinstellingen en beleggingsondernemingen die het 'bewaren en beheren van financiële instrumenten voor rekening van cliënten' als 'nevendienst' aanbieden.[23]

'*Investor CSDs*' onder de CSDR bieden vergelijkbare diensten aan als '*custodians*' onder CRD IV and MiFID II. De kerndiensten onder CSDR onderscheiden '*investor CSDs'* van '*custodians*'. Onderzoek naar MiFID II, CRD IV en CSDR en de corresponderende lidstaat implementaties laat zien dat kredietinstellingen, beleggingsondernemingen en vergelijkbare entiteiten gereguleerd onder nationaal recht als '*custodians*' aan te merken zijn.

De AIFMD, UCITSD V en IORPD II bevatten 'lex specialis' bepalingen die '*depositaries*' reguleren. '*Depositaries*' onder de AIFMD en UCITSD V zijn 'instellingen die belast zijn met de bewaring van activa en het uitvoeren van een reeks toezichthoudende taken ten behoeve van beleggers'.[24] Onder IORPD II, kunnen lidstaten een '*depositary*' voorschrijven voor slechts de bewaring van active of voor de bewaring van activa en de vervulling van toezichttaken overeenkomstig het IORPD II *depositary* regime.[25] Het *depositary* begrip onder Artikel 33(1) en (2) IORPD II voor zowel IORPs waarbij deelnemers en pensioengerechtigden het volledige beleggingsrisico dragen als IORPs waarbij dit niet het geval is, moet worden gelezen als een '*custodian*' of een 'UCITSD V/AIFMD *depositary*'.[26]

De additionele vervulling van toezichthoudende taken door *depositaries* heeft geleid tot 'lex specialis' *depositary* regulering onder de ricthlijnen van het Europees financieel recht die de speciale rol van *depositaries* in '*fiduciary governance'* faciliteert. De 'lex specialis' *depositary* regulering die te vinden is onder de AIFMD, UCITSD V, IORPD II en de voorgestelde PEPP verordening omvatten:

- de verplichte benoeming van één individuele *depositary*;[27]
- de onafhankelijkheidseisen van de *depositary*;[28]
- de entiteiten die als *depositary* kunnen optreden en toepasbare prudentiële eisen (afhankelijk van de UCITSD V implementatie: kredietinstellingen, beleggingsondernemingen en 'andere instellingen');[29]
- een gebruiksrecht;[30]
- de bewaring van activa;[31]
- het uitvoeren van een reeks toezichthoudende taken;[32]
- delegatie;[33] en

---

[23]. Bijlage I Nr. 12 CRD IV.
[24] Cf. Art. 2(23) PEPPR.
[25] Art. 33(2) IORPD II.
[26] EIOPA-BOS-12/015, 471.
[27] Art. 22(1) UCITSD V; Art. 21(1) AIFMD; Art. 33(1) and (2) IORPD II; Art. 41(1) PEPPR.
[28] Zie Art. 25, Art. 26b UCITSD V; Art. 21 UCITSD V (Commission) Regulation; Art. 33(7) IORPD II.
[29] Art. 23(2) UCITSD V; Art. 21(3) AIFMD; Art. 33(3) IORPD II.
[30] Art. 22(7) UCITSD V; Art. 21(11)(d)(iv) AIFMD.
[31] Art. 22(5) UCITSD V; Art. 21(8) AIFMD; Art. 34 IORPD II; Art. 41(3) PEPPR.
[32] Art. 22(3) UCITSD V; Art. 21(9) AIFMD; Art. 35 IORPD II; Art. 41(4) PEPPR.
[33] Art. 22a UCITSD V; Art. 21(11) AIFMD; Art. 34(4) IORPD II; Art. 41(3) PEPPR.

- aansprakelijkheid.[34]

B. Teleologische Interpretatie

Ondanks de verschillen in de wijze waarop *depositaries* worden gereguleerd onder de richtlijnen in het Europees financieel recht en de corresponderende lidstaat implementaties pleiten gemeenschappelijke principes voor de invoering van een AIF/UCITS of zelfs een cross-sectoraal *depositary* paspoort.

Depositaries onder de AIFMD en UCITSD V zijn instellingen die belast zijn met de bewaring van activa en het uitvoeren van een reeks toezichthoudende taken ten behoeve van beleggers. Daarentegen zijn *custodians* onder CRD IV, MiFID II en het nationaal recht van de individuele lidstaten slechts belast met het bewaren (en beheren) van activa. *Depositaries* en *custodians* zijn echter beiden onderworpen aan dezelfde wetten betreffende het giraal effectenverkeer die de reikwijdte van de bewaarfunctie medebepalen. Dit is het geval omdat een *depositary* een gespecialiseerde *custodian* is.

Een *teleologische verklaring* van de *depositary* onder de richtlijnen van het Europees financieel recht verklaart dit. Door het (verplicht) voorschrijven van een *custodian/depositary* streeft het recht na beleggers te beschermen en de stabiliteit/marktintegriteit van het gehele financiële systeem te waarborgen.

De voorschriften ten aanzien van de vergunningverlening, bedrijfsuitoefening, prudentiële eisen, bevoegde autoriteiten, administratieve straffen en rechtsmidden van kredietinstellingen, beleggingsondernemingen en 'andere instellingen' adresseren onder de verschillende richtlijnen beleggersbescherming- en marktrisico's ten aanzien van de bewaartaak van *depositaries* en *custodians*. Het takenpakket van *depositaries* onder de IORPD II, UCITSD V en de AIFMD is breder dan die van een '*custodian*'[35] onder MiFID II en CRD IV. Om deze reden vereisen IORPD II, UCITSD V en de AIFMD aanvullende gedragsregels voor *depositaries* die voornamelijk verband houden met de toezichthoudende taken van de *depositary*. Het *depositary* recht onder de Europese financieel recht richtlijnen is dus een afzonderlijk rechtsgebied dat als 'lex specialis' fungeert bovenop de 'lex generalis' die onder CRD IV en MiFID II van toepassing is op kredietinstellingen, beleggingsondernemingen en vergelijkbaar nationaal recht voor 'andere instellingen' die een vergunning hebben om als *custodian* te mogen optreden.

C. Systematische Interpretatie

Het verschil tussen '*depositaries*' en '*custodians*' is dat *depositaries*, behalve de bewaring van activa, ook een reeks toezichthoudende taken ten behoeve van beleggers' uitoefenen.[36] Hierbij moet worden opgemerkt dat onder de AIFMD and UCITSD V de benoeming van een *depositary* verplicht is[37], MiFID II de aanstelling van een derde-partij *custodian* aan de cliënt overlaat[38], terwijl IORPD II het overlaat aan de individuele lidstaten om te bepalen of een

---

[34] Art. 24(1) UCITSD V; Art. 21(12) AIFMD; Art. 34(4) IORPD II; Art. 41(3) PEPPR.

[35] European Commission, *Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries {C(2015) 9160 final}*, Annex 4.

[36] International Organization of Securities Commission, *Standards for the Custody of Collective Investment Schemes' Assets – Final Report*, FR 25/2015, November 2015, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD512.pdf (accessed 14 April 2017).

[37] Art. 22(1) UCITSD V; Art. 21(1) AIFMD; Art. 33(1) and (2) IORPD II; Art. 41(1) PEPPR.

[38] Overweging 32, Art. 22(1) UCITSD V; Art. 21(1) AIFMD.

depositary/*custodian* moet worden benoemd.[39] Er zijn dus niet alleen verschillen tussen '*depositaries*' en '*custodians*', maar ook tussen de '*depositaries*' zelf onder de verschillende Europese financieel recht richtlijnen.

Deze verschillen op sectoraal niveau zijn het resultaat van de manier waarop de verschillende Europese financieel recht richtlijnen omgaan met de 'structurele scheiding tussen beleggingen en beheer'. Onder deze structurele scheiding vormen de activa toebehorend aan het 'beleggingsvermogen' van beleggers/deelnemers en de 'operationele activa' toebehorend aan de betrokken intermediairs aparte doelvermogens. Hierbij is het'beleggingsvermogen' juridisch/economisch eigendom van de beleggers/deelnemers en de 'operationele activa' juridisch/economisch eigendom van de intermediairs die betrokken zijn bij de beleggingen, zoals vermogensbeheerders, beleggingsondernemingen, pensioenfondsen enerzijds en '*depositaries*'/'*custodians*' anderzijds.

De richtlijnen in het Europees financieel recht etableren deze structurele scheiding door middel van een (optionele/virtuele) 'beleggingsdriehoek', een tri-partite *governance* structuur, die bestaat uit intermediairs die betrokken zijn bij de beleggingen, zoals beheerdersmaatschappijen, vermogensbeheerders, beleggingsondernemingen en pensioenfondsen, *depositaries*/*custodians* en beleggers/deelnemers. Deze tri-partite *governance* structuur die te vinden is onder de AIFMD, UCITSD V, MiFID II, IORPD II en de voorgestelde PEPP verordening, reguleert, enerzijds, de (*fiduciary/agency*) *governance* en , anderzijds, vermogenscheiding.

De 'structurele scheiding tussen beleggingen en beheer' beperkt de zeggenschap ('*residual control*') van beleggers/deelnemers ten aanzien van de operationele activa van de betrokken intermediairs aangezien zij geen aandeelhouder van de intermediairs zijn, maar slechts een aanspraak hebben op het doelvermogen dat door deze intermediairs wordt beheerd. Deze beperking heeft voordelen voor zowel de intermediairs als de beleggers/deelnemers. Enerzijds zorgt dit ervoor dat de intermediairs die betrokken zijn bij de beleggingen en '*depositaries*'/'*custodians*' schaalvoordelen kunnen behalen door verschillende diensten parallel aan te bieden aan diverse cliënten. Anderzijds kunnen de hiermee gepaard gaande kosten worden uitgesmeerd over een grote hoeveelheid cliënten dat resulteert in lagere kosten voor cliënten. Dit is de reden waarom de operationele vermogensbestanddelen die toebehoren aan de intermediairs en de vermogensbestanddelen van het beleggingsvermogen van cliënten door de Europese financieel recht richtlijnen in verschillende doelvermogens wordt ondergebracht die wordt gecreëerd door de vermogensscheidingsplicht als onderdeel van de bewaartaak van *depositaries*/*custodians*.

De beperking van de zeggenschap van beleggers/deelnemers ten aanzien van de betrokken intermediairs onder de 'structurele scheiding tussen beleggingen en beheer' leidt tot agentschapskosten. De (optionele/virtuele) 'beleggingsdriehoek' onder de richtlijnen in het Europees financieel recht beteugelen dit door voor de betrokken intermediairs en '*depositaries*/*custodians*' te onderwerpen aan specifieke gedrags- en prudentiële regels ('intermediairsregulering'), financiële producten, zoals AIFs, UCITS en PEPPs, bloot te stellen aan 'productregulering' (regels ten aanzien van rechtsvormen en beleggingsportfolio's) en tegelijkertijd door middel van informatievereisten beleggers/deelnemers adequaat te informeren. *Depositaries*/*custodians* zijn dus slechts een onderdeel van het beleggersbeschermingsregime van de 'beleggingsdriehoek' onder de richtlijnen van het financieel recht die de agentschapskosten onder de 'structurele scheiding tussen beleggingen en beheer' beteugelen.

De verschillen tussen *depositaries* and *custodians* zijn met name te zien in de rol die ze innemen in de (*fiduciary/agency*) *governance* onder de (optionele/virtuele)

[39] Art. 33(1) and (2) IORPD II.

'beleggingsdriehoek'. Dit kan worden verklaard op basis van een *systematische interpretatie* van de *depositary* onder de richtlijnen van het Europees financieel recht. De verplichte benoeming van een *depositary* onder richtlijnen, zoals de AIFMD, UCITSD V, IORPD II en de voorstelde PEPP verordening, wordt gekarakteriseerd door intermediairs, zoals beheermaatschappijen en vermogensbeheerders, die voor rekening van cliënten discretionair vermogensbeheer voeren. Beleggers/deelnemers verlenen, direct of indirect, een mandaat aan deze intermediairs om vermogensbeheer voor hun rekening te voeren binnen een overeengekomen beleggingsbeleid zonder dat zij finale zeggenschap hebben over hoe hun vermogen wordt belegd. Om deze reden is de benoeming van een *depositary* onder deze richtlijnen verplicht die een reeks van toezichthoudende taken uitoefent en onder andere controleert of het uitgeoefende discretionaire beheer in overeenstemming is met het overeengekomen beleggingsbeleid. Dit is slechts een marginale controle. De richtlijnen onder het Europees financieel recht die beleggingdiensten/activiteiten reguleren die geen 'fiduciair', maar een 'agentschapskarakter' hebben, zoals '*execution-only*' dienstverlening en beleggingsadvies onder MiFID II, vereisen geen verplichte benoeming van een *depositary.* In plaats daarvan biedt de beleggingsonderneming die beleggingsdiensten/activiteiten voor een cliënt uitoefent *in-house custody services* aan of wordt op voorspraak van de cliënt een derde-partij *custodian* aangesteld. Daarnaast zijn *depositaries* vereist onder de richtlijnen van het Europees financieel recht die een 'collectief beleggingskarakter' hebben. De reeks van toezichthoudende taken die door de *depositary* onder de AIFMD, UCITSD V, IORPD II en de voorgestelde PEPP verordening vermijden *collective action* problemen in het toezichthouden op beleggingsmaatschappijen en andere intermediairs en een verplichte benoeming is ook de goedkoopste oplossing onder de *cheapest cost avoider* theorie. Voor beleggingsdiensten/activiteiten die worden aangeboden door intermediairs waarbij er geen sprake is van een 'gepoold vermogen/opbrengst' bij het aankopen, aanhouden of verkopen van beleggingsactiva, wordt er door de richtlijnen van het Europees financieel recht niet vereist dat een *depositary* moet worden benoemd. De reden hiervoor is dat door het individuele beleggingskarakter van deze beleggingsdiensten/activiteiten individuele beleggers door het geven van beleggingsinstructies aan intermediairs zelf finale zeggenschap over hun beleggingen hebben. De reeks van toezichthoudende taken die door *depositaries* wordt uitgeoefend, is dus overbodig voor relaties met een individueel beleggingskarakter. Dit is de reden dat voor beleggingsrelaties met een individueel beleggingskarakter *custodians* worden gebruikt. Ten slotte zijn *depositaries* alleen vereist onder de richtlijnen van het Europees financieel recht waarbij beleggers/deelnemers de volledige beleggingsrisico's dragen. Dit impliceert dat de relatie niet mag worden gekenmerkt door een beleggingsgarantie of andersoortige aanspraak van beleggers/deelnemers/consumenten op de balans van een intermediair, zoals bij opvorderbare gelden onder CRD IV of verzekeringen onder Solvency II.

De systematische interpretatie van *depositaries* verklaart niet waarom er nog steeds verschillen te vinden zijn in de Europese sectorale regulering van *depositaries*, zoals de AIFMD en UCITSD V, die alletwee collectieve beleggingsinstellingen reguleren. Dit laatste heeft een historische reden die nu zal worden geadresseerd.

D. Historische Interpretatie

Ondanks dat '*depositaries*' een vergelijkbare rol vervullende onder de verschillende richtlijnen van het Europees financieel recht, zijn er nog steeds inconsistenties tussen de sectorale *depositary* regimes. Deze verschillen kunnen worden verklaard op basis van een historische interpretatie van de *depositary* in het Europees financieel recht. Voordat de AIFMD en UCITSD V waren aangenomen, waren er verschillende *governance* modellen die voor AIFs en UCITS werden gebruikt. Een '*one-size fits all'* benadering op basis van

rechtsvormneutraliteit bestond nog niet. In plaats daarvan hanteerden AIFs en UCITS, afhankelijk van de beschikbare rechtsvormen in de individuele lidstaten, een contractueel, *corporate*- of *trust*- *governance* model. Onder het contractuele model was doorgaans de benoeming van een *depositary* verplicht die, naast de bewaartaak, ook een reeks van toezichthoudende taken ten aanzien van AIFMs en UCITS beheermaatschappijen uitoefende. Onder het *trust* en het *corporate*-model werd deze reeks van toezichthoudende taken volledig of gedeeltelijk uitgeoefend door de *trustee* of het bestuur van de beleggingsmaatschappij. Met de introductie van de AIFMD en UCITSD V werd het contractueel *governance* model, onafhankelijk van de rechtsvorm, verplichtgesteld voor alle typen AIFs en UCITS. Weliswaar bleven *trustees* en besturen van beleggingsmaatschappijen bestaan, maar de reeks van toezichthoudende taken werden exclusief door de *depositary* uitgeoefend. De verregaande taken en bevoegdheden van AIFMs en UCITS beleggingsmaatschappijen en *depositaries* marginaliseerden de rol van deze *trustees* en besturen van beleggingsmaatschappijen. Weliswaar bestaan zij nog formeel, maar *de facto* is hun rol zo klein dat feitelijke alle *governance* modellen onder UCITSD V en de AIFMD als contractueel *governance* model kunnen worden getypteerd. Dit kan worden verklaard op grond van het feit dat *trustees* en het bestuur/raad van commissarissen in het uitoefenen van de toezichthoudende taken niet op basis van kwaliteit en kosten kunnen concurreren met *depositaries.* De toezichthoudende taken werden door *trustees* en het bestuur/raad van commissarissen 'manueel' en op een 'ex-post' basis uitgeoefend, terwijl *depositaries* deze taken met geautomatiseerde IT-systemen uitoefenen. Alhoewel IORPD I/II het aan individuele lidstaten overlaat om het *corporate*- en *trustee*-model te gebruiken, laat de rechtsvorm neutrale beandering onder de voorgestelde PEPP verordening zien dat de rol van de *depositary* onder het contractuele model het dominante *governance* model in de toekomst zal zijn in het Europees financieel recht.

Deel IV

Aan welke voorwaarden dient te worden voldaan om een Europees AIF/UCITS depositary paspoort of een Europees cross-sectoraal depositary paspoort in het Europese financieel recht te introduceren?

Deel IV, op basis van de uitkomst van de voorgaande delen, pleit niet alleen voor de introductie van een AIF/UCITS *depositary* paspoort, maar ook voor een cross-sectoraal Europees *depositary* paspoort in het Europees financieel recht. De introductie van een (cross-sectoraal) *depositary* paspoort stelt *depositaries* onder alle richtlijnen in staat om hun diensten grensoverschrijdend in de EER aan te bieden en ook om hun *business model* te consolideren.

Ondanks de mogelijke economische voordelen van de introductie van een AIF/UCITS *depositary* paspoort, is een dergelijk paspoort meerdere keren overwogen maar niet geïntroduceerd uit hoofde van beleggingsbescherming.[40] MEP Perreau de Pinninck in 1993 na de introductie van het Europees 'nevendiensten' paspoort voor '*custodians*'[41] onder de Beleggingsdienstenrichtlijn en de Tweede Bankenrichtlijn dat een Europees UCITS *depositary* paspoort niet zou moeten worden geïntroduceerd om twee redenen.[42] Ten eerste overwoog hij dat de reeks van toezichthoudende taken ervoor zorgt dat het takenpakket van

[40] Zie Hoofdstuk 2, paragraaf 1.2.
[41] Annex I Nr. 12 CRD IV; Annex I s. A MiFID II.
[42] European Parliament, *Report of the Committee on Legal Affairs and Citizen's Rights on the 1993 UCITS Proposal*, A5-0268/1993, 1 October 1993, http://goo.gl/rRSdJO (accessed 7 April 2017).

depositaries breder is dan die van een '*custodian*'[43]. Ten tweede stelde hij dat UCITS *depositaries* niet voldoende waren geharmoniseerd om effectief de reeks van toezichthoudende taken grensoverschrijdend te kunnen uitoefenen.

Voordat Deel IV de vraag beantwoordt onder welke condities een AIF/UCITS of cross-sectoraal Europees *depositary* paspoort kan worden geïntroduceerd, beantwoordde Deel IV, in navolging van de bevindingen van MEP Perreau de Pinninck, de vraag of de verschillen in regulering tussen *depositaries* en *custodians* de strikte vestigingsregels voor AIF/UCITS *depositaries* rechtvaardigen. Tevens is het belangrijk om te onderzoeken of AIF, UCITS, IORP and PEPP *depositaries* op Europees vlak voldoende zijn geharmoniseerd om de introductie van een cross-sectoraal *depositary* acceptabel te maken, en zo niet, welke additionele condities daarvoor eventueel vervuld zouden moeten worden.

IORPD II en de voorgestelde PEPP verordening bevatten een 'de facto Europees *depositary* passport' voor IORP en PEPP *depositaries*, terwijl een Europees paspoort niet beschikbaar is voor AIF en UCITS *depositaries.* Dit is opmerkelijk omdat *depositaries* onder de AIFMD en UCITSD V nagenoeg dezelfde bewaartaak en toezichthoudende functies uitoefenen als de IORPD II en PEPP *depositaries.* Vanuit het perspectief van beleggersbescherming zorgt de inconsistentie in het toebedelen van een Europees *depositary paspoort* onder de richtlijnen in het Europees financieel recht voor een 'Europees *depositary* paspoort paradox'.

De instellingen die als *depositary* kunnen optreden en de functies van de *depositary* onder de AIFMD en UCITSD V zijn in een veel grotere mate geharmonisserd dan onder IORPD II en de voorgestelde PEPP verordening, terwijl de twee laatst genoemde regimes over een 'de facto Europees *depositary* passport' beschikken.[44]

Het AIFMD 'transitie *depositary* regime'[45] suggereert dat de taken, uitbesteding en aansprakelijkheid van *depositaries* op Europees vlak voldoende zijn geharmoniseerd om een AIF/UCITS *depositary* paspoort te kunnen introduceren. Onder dit 'transitie regime' hadden lidstaten de optie om in hun AIFMD implementatie toe te staan dat voor hun AIFs kredietinstellingen uit een andere lidstaat op grond van het principe van 'wederzijdse erkenning*'* als *depositary* werden aangesteld.[46] Gezien de gelijkenissen tussen de AIFMD en UCITSD V *depositary* regimes, zou onder dezelfde voorwaarden een UCITSD V *depositary* paspoort kunnen worden geïntroduceerd.

Het AIFMD 'transitie *depositary* regime'[47] suggereert dat een 'cross-sectoraal *depositary* passport' zou kunnen worden geïntroduceerd onder de voorwaarden dat de instellingen die als *depositary* kunnen optreden, de taken en de regels omtrent uitbesteding en aansprakelijkheid van een *depositary* (cross-) sectoraal vlak zijn geharmoniseerd om een consistente aanpak te waarborgen.

Het invoeren van een cross-sectoraal *depositary* paspoort is vergelijkbaar met de discussie omtrent de invoering van het UCITSD IV 'beheerderspaspoort'. Voor de invoering van dit paspoort bezaten beleggingsondernemingen die portefeuillebeheer aan cliënten onder de Beleggingsdienstenrichtlijn/MiFID I aanboden een Europees paspoort, terwijl UCITS beheermaatschappijen die ook portefeuille- en risicobeheer uitoefenden voor UCITS niet over een dergelijk paspoort beschikten. Het besef dat deze twee kernactiviteiten door zowel

---

[43] European Commission, *Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries {C(2015) 9160 final}*, Annex 4.
[44] Zie voor het AIFMD/UCITSD V *depositary* regime: Hoofdstuk 3; Zie voor het IORPD II *depositary* regime: Hoofdstuk 4;
[45] Zie Hoofdstuk 2, paragraaf 1.2.2.2.
[46] *Ibid.*
[47] Zie Hoofdstuk 2, paragraaf 1.2.2.2.

beleggingsondernemingen die onder MiFID I/II portefeuillebeheer aan cliënten aanbieden als beheermaatschappijen onder de AIFMD/UCITSD V en vermogensbeheerders onder IORPD II worden uitgeoefend, leidde tot de invoering van een (cross-sectoraal) beheerderspaspoort onder UCITSD IV. De situatie voor *depositaries* onder de AIFMD en UCITSD V is hiermee vergelijkbaar. *Custodians* beschikken sinds de invoering van de Beleggingsdienstenrichtlijn en de Tweede Bankenrichtlijn over een Europees 'nevendiensten' paspoort, terwijl *depositaries* onder de AIFMD en UCITSD V hier niet over beschikken. Dit reden hiervoor is dat het niet introduceren van een *depositary* paspoort als een belangrijke voorwaarde werd gezien om tijdens de invoering van het beheerderspaspoort onder UCITSD IV en later ook de AIFMD beleggersbescherming te waarborgen. *Depositaries* waren zodoende ook onder de UCITSD V en AIFMD vestigingsregels verplicht om in de UCITS/AIF lidstaat van herkomst te worden benoemd.

Naar voorbeeld van het (cross-sectoraal) beheerderspaspoort onder de AIFMD en UCITSD V, zou een proportioneel 'cross-sectoraal *depositary* paspoort' kunnen worden ontwikkeld op basis van de bewaartaak van *depositaries* en *custodians.* In essentie zijn *depositaries custodians* die, behalve de bewaartaak, ook een reeks van toezichthoudende taken uitoefenen.[48] Om deze reden zou een 'cross-sectoraal *depositary* passport' kunnen worden ontwikkeld op basis van een geharmoniseerd vergunningregime onder MiFID II die de bewaartaak van *depositaries* en *custodians* harmoniseert, terwijl op sectoraal vlak een, vanuit cross-sectoraal oogpunt, consistente set met regels hierbovenop van toepassing is op *custodians* die op sectoraal niveau (ook) als *depositary* worden benoemd. In dit boek wordt voor deze oplossing de term 'Custody Plus' gebruikt omdat deze term ook in de praktijk wordt gehanteerd voor *custodians* die als AIF/UCITS/IORP *depositaries* worden benoemd.

Deel IV stelt een 'cross-sectoraal' *depositary* paspoort voor op basis van het '*intermediary holding model'*.[49] Onder dit model worden effecten door financiële intermediairs, zoals *depositaries* en *custodians,* bewaard en overgedragen.[50] *Settlement* is onder dit model erg complex. Het is de verwachting dat in de komende jaren het huidige '*intermediary holding model'* langzaam zal worden vervangen door '*blockchain settlement*' (*settlement* door *distributed ledger* technologie).[51] Met behulp van *blockchain* kunnen (*crypto-*)effecten zonder tussenpersonen worden overgedragen van verkopers naar kopers en van zekerheidsgevers naar zekerheidsnemers.[52] Sommige experts suggereren dat door *blockchain* intermediairs, zoals *depositaries* en *custodians,* overbodig zullen worden.[53] Omwille van het vermijden van systeemrisico's, zullen *blockchain* netwerken/platformen die het houden en overdragen van

---

[48] Zie Hoofdstuk 6, paragraaf 2.2.1.3.

[49] Hoofdstuk 5, paragraaf 2.2..

[50] P. Paech, *Integrating Global Blockchain Securities Settlement with the Law - Policy Considerations and Draft Principles*, 3,4, https://ssrn.com/abstract=2792639 (accessed 20 July 2017).

[51] Deutsche Bank, *NeMA Asia round up: Can Custodian Banks win in the Blockchain Phenomenon*, December 2015, http://cib.db.com/insights-and-initiatives/flow/nema-asia-round-up-can-custodian-banks-win-in-the-blockchain-phenomenon.htm#gsc.tab=0 (accessed 20 July 2017); J. Condos,W.H . Sorrell & S.L. Donegan, *Blockchain Technology: Opportunities and Risks*, http://legislature.vermont.gov/assets/Legislative-Reports/blockchain-technology-report-final.pdf (access 20 July 2017); P. Walsh, *Regulator warns of blockchain settlement usage* (19 January 2017), Global Custodian https://www.globalcustodian.com/Technology/Regulator-warns-of-blockchain-settlement-usage/ (accessed 20 July 2017).

[52] *Ibid.*

[53] G. Prisco, *The Blockchain Could Make Existing Securities Industry Players Redundant, Says BNP Paribas Analyst (*6 July 2015), https://bitcoinmagazine.com/articles/blockchain-make-existing-securities-industry-players-redundant-says-bnp-paribas-analyst-1436212815/ (accessed 20 July 2017); M. Harwood-Jones, *Blockchain and T2S: A potential disruptor*, https://www.sc.com/BeyondBorders/wp-content/uploads/2016/06/2016-06-16-BeyondBorders-Report-SCB_Nema_Block-Chain-Paper-Final.pdf (accessed 20 July 2017).

effecten faciliteren in de toekomst waarschijnlijk vergunningplichtig worden gesteld. Ook is een mogelijkheid dat de wetgever niet een vergunning voor platformen zelf vereist, maar in plaats daarvan verlangt dat marktparticipanten over een vergunning onder prudentieel recht beschikken. Naar verwachting zal de rol van *depositaries/custodians* in de transitie van het huidige 'intermediairs tijdperk' naar het '*Fintech*' en '*TechFin*' tijdperk evolueren.[54] *Settlement* door middel van zogenaamde '*decentralized autonomous organizations*' zou kunnen leiden tot de laatste '*disintermediation*' fase.

[54] Zie voor 'Fintech', 'TechFins' en de verschillen tussen die twee: D.A. Zetzsche, R.P. Buckley, D.W. Arner & J.N. Barberis, *From FinTech to TechFin: The Regulatory Challenges of Data-Driven Finance*, European Banking Institute Working Paper Series 2017 - No. 6, https://ssrn.com/abstract=2959925 (accessed 10 July 2017).

Bibliography

A

Aboulian, B., *Brussels rejects risk indicator for UCITS*, Financial Times (13 June 2010).

Abrams, C.*, The Investment Services Directive - who should be the principal regulator of cross-border services?*, 2 European Financial Services Law 317 (1995).

Acharya, V., et al. *Prologue: A Bird's Eye View. The Financial Crisis of 2007-2009: Causes and Remedies* (V. Acharya & M. Richardson eds., Wiley 2009).

Aghion, P. & Bolton, P., *An Incomplete Contracts Approach to Financial Contracting'* (1992), 59 Review of Economic Studies 473 (1992).

Aikman, J.S., *When Prime Brokers Fail: The Unheeded Risk to Hedge Funds, Banks, and the Financial Industry* (Bloomberg 2010).

Akerlof, G.A., *The Market for Lemons: Quality Uncertainty and the Market Mechanism*. In: *Quarterly Journal of Economics*. Band 84, Nr. 3, 1970, 488–500.

Alchian, A. & Demsetz, H., *Production, Information Costs, and Economic Organization*, 62 American Economic Review 777 (1972).

Alchian, A.A. & Demsetz, H., *Production, Information Costs, and Economic Organization,* 62 Am. Econ. Rev. 777 (1972).

Alexander, G.S., *A Cognitive Theory of Fiduciary Relationships*,85 CORNELL L. REV. 767 (2000).

Alexander, K., *Reforming the Structure of the EU Banking Sector* (D. Busch & G. Ferrarini, Oxford 2015).

Alexander, K., *The World Trade Organization and Financial Stability: The Balance between Liberalisation and Regulation in the GATS*, 9, https://www.repository.cam.ac.uk/handle/1810/225211 (accessed 6 June 2017).

Alford, D., *The Lamfalussy Process and EU Bank Regulation: Preliminary Assessment and Future Prospects'*, 21 Journal of International Banking Law and Regulation 59 (2006).

Allen & Overy, *Alternative Investment Fund Managers Directive: Allen & Overy Briefing Paper No. 9 AIFMD, UCITSD and MiFID: Interactions and Overlaps*, http://www.allenovery.com/archive/Documents/Legacy/62666.pdf (accessed 3 July 2015).

Allen & Overy, *Alternative Investment Fund Managers Directive: Allen & Overy Briefing Paper No. 7 Impact on Prime Brokers*, http://www.allenovery.com/archive/Documents/Legacy/62666.pdf (accessed 15 August 2016).

Alternative Investment Expert group set up by the EC, *Report of the Alternative Investment Expert Group: Managing, Servicing and Marketing Hedge Funds in Europe*, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/hedgefunds_en.pdf (accessed 3 July 2015).

Alternative Investment Management Association, *AIMA Position Paper UCITS V*, September 2012, http://giegold.korova.co/wp-content/uploads/2012/10/UCITS-V-AIMA-Position-Paper.pdf.pdf (accessed September 2012).

Amel, D., Barnes, C., Panetta, F. & Salleo, C., *Consolidation and efficiency in the financial sector: a review of the international evidence*, 28 Journal of Banking and Finance 2493-2519 (2004).

Amenc, N. & Sender, S, *The European Fund Management Industry Needs a Better Grasp of Non-Financial Risks* 41-43 (EDHEC-Risk Institute 2010).

Amenc, N. & Sender, S, *Are Hedge Fund UCITS the Cure-All?* (EDHEC-Position Paper 2010).

Amenc, N., Focardi, S., Goltz, F., Schröder, D. & Tang, L., *EDHEC-Risk European private wealth management survey*, EDHEC (2010).

Amman, T., *Aufgaben und Verantwortung der Depotbank im KAG Unter besonderer Berücksichtigung der Umstände bei Zahlungsunfähigkeit der kollektiven Kapitalanlage* (VDM Verlag Dr. Müller 2011).

Ang, A., Gorovyy, S. & van Inwegen, G., *Hedge Fund Leverage*, http://ssrn.com/abstract=1635284 (accessed 3 July 2015).

Aragon, G.O. & Strahan, P.E., *Hedge Funds as Liquidity Providers: Evidence from the Lehman Bankruptcy* (August 2009), http://www.nber.org/papers/w15336 (accessed 30 September 2012).

Aramendía, M.J., *Third Country Rules for Alternative Investments: Passport flexibility comes at a price*, ECMI Commentary nr. 27, 16 december 2010.

Armour, J. & Whincop, M.J., *The Proprietary Foundations of Corporate Law*, 27 OXFORD J.LEGAL STUD. 429, 445-46 (2007).

Armour, J., Hansmann, H. & Kraakman, R., *The Essential Elements of Corporate Law*, Oxford Legal Studies Research Paper No. 20/2009, 10.

Armour, J., Hansmann, H., Kraakman, R., *The Essential Elements of Corporate Law: What is Corporate Law?*, https://ssrn.com/abstract=1436551 (accessed 11 May 2017).

Arnaboldi, F., *Deposit Guarantee Schemes – A European Perspective* (Springer 2014).

Arner, D.W., Barberis, J. & Buckley, R.P., *Fintech, RegTech and the Reconceptualization of Financial Regulation*, http://www.fsroundtable.org/wp-content/uploads/2017/05/Douglas-W.-Arner-FinTech-RegTech-and-the-Reconceptualization.pdf (accessed 20 July 2017).

Arner, D.W., Barberis, J. & Buckley, R.P., *The Evolution of Fintech: A New Post-Crisis Paradigm?* https://ssrn.com/abstract=2676553 (accessed 20 July 2017).

Arnot, S., *Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision: A Legal Commentary* 6, http://www.pensionseurope.eu/system/files/IORP%20I%20-

%20legal%20commentary%20on%20the%20Pension%20Funds%20Directive.pdf (accessed 4 October 2016).

Arrow, K.J., *The Economics of Agency* 37-51 (J.W. Pratt & R.J. Zeckhauser eds., (Harvard Business School Press 1985).

Ashcroft, J. Yermo, J. & Stewart, F., *Regulatory and supervisory context for occupational pension provision* 9 (P. Thornton & D. Fleming eds, Cambridge University Press 2011).

Assmann, H., *Finanzportfolioverwaltung*, in *Wertpapierhandelsgesetz* (H.D. Assmann & U. Schneider eds, 6th edn., Dr. Otto Schmidt 2012).

Association for Financial Markets in Europe, *Post Trade explained - The role of post-trade services in the financial sector*, February 2015, 12.

Association of the Luxembourg Fund Industry, *ALFI contribution to the CESR consultation paper on UCITS management company passport,* http://www.alfi.lu/de/publications-statements/alfi-statements/alfi-response-cesr-consultation-paper-09-624 (accessed 8 July 2017).

Athanassiou, P., *The AIFM Directive: an overview of the final rules*, 26 Journal of International Banking Law and Regulation 237 (2011).

Avgouleas, E., *The New EC Financial Markets Legislation and the Emerging Regime for Capital Markets*, 23 Yearbook of European Law 321 (2004).

Awrey, D., *The limits of EU hedge fund regulation*, 5 Law and Financial Markets Review 119 (2011).

Ayotte, K. & Hansmann, H., *Legal Entities As Transferable Bundles of Contracts*, 111 MICH. L. REV. 715, 721 (2013).

Ayres, I. & Gertner, R., *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 *Yale Law Journal* 87 (1989).

Ayres, I., *Making a Difference: The Contractual Contributions of Easterbrook and Fischel*, 59 University of Chicago Law Review 1391 (1992).

B

Backer, L.C., *The Autonomous Global Corporation: On the Role of Organizational Law beyond Asset Partitioning and Legal Personality,*41 Tulsa Law Journal 101 (2006).

BaFin, *Auslegungsschreiben zum Anwendungsbereich des KAGB und zum Begriff des Investmentvermögens*, Q 31-Wp 2137-2013/0006, 9 März 2015.

BaFin, *Hinweise zur Erlaubnispflicht von Investmentclubs und ihrer Geschäftsführer nach § 32 KWG*, Q 31-QF 2100-2008/0003, 9 Juni 2011.

BaFin, *Merkblatt Depotgeschäft - Hinweise zum Tatbestand des Depotgeschäfts*, 6 Januar 2009.

BaFin, *Merkblatt zu den Anforderungen an Treuhänder als Verwahrstelle nach § 80 Absatz 3 KAGB*, WA 41-Wp 2137-2013/0080, 18 July 2013.

Bailey, R.E., *The Economics of Financial Markets* 22 (Cambridge University Press 2005).

Bals, W., *Die ökonomische Position von Anteilinhabern offener Immobilienfonds: eine Analyse* (Peter Lang Verlag 1994).

Bande, A., *Banking Integration in the EU:a process marked by a battle between systems*, https://www.utwente.nl/en/bms/pa/staff/donnelly/Thesis%20-%20A%20%20Bande%2020%2008%2012.pdf (accessed 7 April 2017).

Baptiste, A., *Brussels rejects risk indicator for UCITS*, Financial Times (June 2010).

Barberis, J., *From FinTech to TechFin: Data Is the New Oil, Asian Banker* (16 May 2016), http://www.theasianbanker.com/updates-and-articles/from-fintech-to-techfin:-data-is-the-new-oil (accessed 20 July 2017).

Barbour, I. & Hostalier, K., *The Concept of Securitisation* (F. J. Fabozzi & M. Choudhry eds, Wiley 2004).

Basel Committee on Banking Supervision, *Basel III: A global regulatory framework for more resilient banks and banking systems*, December 2010.

Bäuml, S., *Investmentvermögen im neuen Kapitalanlagegesetzbuch* (Teil I) (2013).

Baur, G. & Boegl, M., *Die neue europäische Finanzmarktaufsicht – Der Grundstein ist gelegt*, Zeitschrift für Bank und Kapitalmarktrecht 177 (2011).

Baur, G., Boegl, M. & Kämmerer, J. A., *Das neue Europäische Finanzaufsichtssystem (ESFS) – Modell für eine europäisierte Verwaltungsarchitektur?*, Neue Zeitschrift für Verwaltungsrecht 1281 (2011).

Becht, M., Bolton, P. & Roell, A., *Corporate Governance and Control* (2004), http://ssrn.com/abstract=343461 (accessed 11 May 2017).

Beck, T., Demirgüç-Kunt, A. & Levine, R., *Law and Finance: Why Does Legal Origin Matter?,* 31 Journal of Comparative Economics 653 (2003).

Beer A. de, *Die Verantwortlichkeit der Bank gegenüber einem Kunden für Handlungen eines von diesem eingesetzten Vermögensverwalters – Eine Replik*, SZW 125 (1998).

Benediktsdottir, S., Danielsson, J. & Zoega, G.*, Lessons from a collapse of a financial system*, https://www.tcd.ie/Economics/assets/pdf/version-20-ben-dan-zoega-revised.pdf (accessed 14 January 2017).

Benink, H.A., *Financial Integration in Europe* 8 (Springer 1993)

Benjamin, J., *Interests in Securities* 65-67.(Oxford University Press 2000).

Berg, M.F.M. van den, Velden, J.W.P.M. van der & Vergouwen, C.W.M., *De Bitcoin-verzekering. Een kans voor de financiële sector om klantbelang centraal te stellen in innovatieve productontwikkeling?*, 5 MvV 128 (2014).

Bergervoet, M., *De impact van de AIFM Richtlijn voor derde landen en in het bijzonder voor Curaçao*, 4 TvFR 120 (2014).

Bergervoet, M., *De impact van de AIFM Richtlijn voor derde landen en in het bijzonder voor Curaçao*, 4 TvFR 120 (2014).

Berghuis, W. H., *Ontstaan en ontwikkeling van de Nederlandse beleggingfondsen tot 1914* (Van Gorcum 1967).

Berle, A.A. & Means, G.C., *The Modern Corporation and Private Property* (The McMillan Company 1932).

Bierens, B., *'Best execution' volgens MiFID: nieuwe gedragsregels met betrekking tot de uitvoering van orders*, 3 Ondernemingsrecht 8-16 (2008).

Bierens, B., *De verplichting tot optimale uitvoering ('best execution')* 111-135 (F.M.A. 't Hart ed, NIBE-SVV 2007).

Bikker, J. & Vlaar, P. Conditional indexation in defined benefit pension plans, DNB Working Paper No. 86 (January 2006).

Binder, J.H., *Governance of Investment Firms under MiFID II* (D. Busch & G. Ferrarini eds, Oxford 2017).

Bismuth,R., *Financial Sector Regulation and Financial Services Liberalization at the Crossroads: The Relevance of International Financial Standards in WTO Law*, 44 Journal of World Trade 489 (2010).

Black, B.S., *Corporate Law and Residual Claimants*, http://escholarship.org/uc/item/5746q7pj (accessed 11 May 2017).

Bloch, B. & von der Crone, H.C., *Operative Gesellschaft oder kollektive Kapitalanlage? – Entscheid des Schweizerischen Bundesgerichts 2C_571/2009 vom 5. November 2010 i.S. Eidgenössische Finanzmarktaufsicht gegen Dr. A. & Co VIII Sachwert-Beteiligung Kommanditgesellschaft*, 2 SZW 214 (2011).

Boatright, J.R., *Ethics in Finance* 5 (Wiley-Blackwell 2014).

Bogdandy, A. van & Windsor, J., *Annex on Financial Services* 618–639 (R.Wolfrum, P. Stoll and C. Feinäugle eds., Martinus Nijhoff 2008).

Bogdandy, A. von, *Founding Principles* (A. Von Bogdandy & J. Bast, eds., Hart Publishing 2010).

Böhme, A., *Die Vertretung der extern verwalteten Investmentkommanditgesellschaft*, BB (2014).

Bollars, A., *Being a responsible host: supervising foreign-owned banks* 3-15 (D.D. Evanoff & G.G. Kaufman eds., World Scienitific Publishing Co. 2005).

Borio, C. & Drehmann, M., *Towards an Operational Framework for Financial Stability: "Fuzzy" Measurement and Its Consequences* http://www.bis.org/publ/work284.htm (accessed 5 June 2017).

Bossche, P. van den, *The Law and Policy of the World Trade Organization, Text, Cases and Materials* chapter 4 (Cambridge 2005).

Boswijk, P., Jansen, O.J.D.M.L. & Widdershoven, R.J.G.M., *Transnationale samenwerking tussen toezichthouders in Europa*, https://www.wodc.nl/binaries/1532b-volledige-tekst_tcm28-69614.pdf (accessed 9 February 2017).

Boutens, A., *Rol pensioenbewaarder en bescherming van deelnemers in een PPI*, 6 TPV 23 (2012).

Bradley, C., *Consumers of Financial Services and the Multi-Level Regulation in the European Union*, papers.ssrn.com/abstract=1132366 (accessed 9 February 2017).

Bratton, W.W. & J.A. McCahery, J.A., *Regulatory Competition, Regulatory Capture, and Corporate Self-Regulation*, http://scholarship.law.upenn.edu/faculty_scholarship/1365 (accessed 15 July 2017).

Broekhuizen, J. Ph. & den Hamer, J., *Voorgang implementatie toezicht op alternative investment fund managers*, Tijdschrift Vastgoedrecht 9 (2012).

Broekhuizen, J.Ph. & den Hamer, J., *Toezicht op alternative fund managers*, Tijdschrift Vastgoedrecht 73 (2010).

Broekhuizen, K.W.H. & L.J. Silverentand, *Best execution ingevolge de MiFID*, 1/2 TvFR 32-45 (2008).

Broekhuizen, K.W.H. & L.J. Silverentand, *Ken uw cliënt, cliëntenclassificatie en de MiFID*, 11 TvFR 276-285 (2006).

Broekhuizen, K.W.H. & W.A.K. Rank, *Grensoverschrijdende dienstverlening* 230-243 (A.J.C.C.M. Loonen et al., NIBE-SVV 2008)

Broekhuizen, K.W.H. & Rank, W.A.K., *Het Europees paspoort voor beleggingsondernemingen* 255-271 (D. Busch, D.R. Doorenbos, C.M. Grundmann-van de Krol, R.H. Maatman, M.P. Nieuwe Weme & W.A.K. Rank, Kluwer 2007).

Broekhuizen, K.W.H. *Klantbelang, belangenconflict en zorgplicht* (Boom Juridische Uitgevers 2017).

Broekhuizen, K.W.H., *Best execution* 64-79 (A.J.C.C.M. Loonen et al., NIBE-SVV 2008).

Broekhuizen, K.W.H., *Regulering van belangenconflicten* (D. Busch & C.M. Grundmann-van de Krol eds, Kluwer 2009).

Bruni, L., Gilli, M. & Pelligra, V., *Reciprocity: theory and facts,* 55 International Review of Economics 1-11 (2008).

Bryce, N., *Hedge Funds, Liquidity and Prime Brokers,* 3 Fordham Journal of Corporate &Financial Law 4 (2008)

Buck-Heeb, P., *Anlageberatung nach der MiFID II*, ZBB (2014).

Bühler, T., *ELTIF – Eine neue Säule der Finanzierung der Europäischen Realwirtschaft*, 3 Recht der Finanzinstrumente 198 (2015).

Búrca, G. de, *Unpacking the Concept of Discrimination in EC and InternationalTrade Law* 181–195 (C. Bernard & J. Scott eds., Hart 2002).

Burn, L., *KISS, But Tell All: Short-Form Disclosure for Retail Investors*, Capital Markets Law Journal 5 (2010).

Busch, D. & van der Velden, J. W., *Aansprakelijkheid en verhaal bij Fondsen voor Gemene Rekening*, Financieel Recht 161 (2009).

Busch, D., *Best execution* (D. Busch & C.M. Grundmann-van de Krol eds, Kluwer 2009).

Bush, D. & Silverentand, L.J., *The Netherlands* (Busch & DeMott eds, Oxford University Press 2012).

Busch, D. & Silverentand, L.J.., *The Netherlands* (D. Busch & D.A. DeMott eds, Oxford 2012).

Busch, D., *Vermogensbeheer (*Kluwer 2014).

Busch, D. & Van Setten, L., *The European AIFMD* (D. Busch ed, Oxford 2014).

Busch, D. & van Setten, L.D., *Alternative Investment Funds in Europe – Law and Practice* (Oxford 2014)

Busch, D., *Corporate Governance volgens MiFID II,* 12 TvFR 446-457 (2015).

Busch, D., *MiFID II/MiFIR: nieuwe regels voor beleggingsondernemingen en financiële markten* (Kluwer 2015).

Busch, D., *Governance of the Single Resolution Mechanism* (D. Busch & G. Ferrarini, Oxford 2015).

Busch, D. & Ferrarini, G., *A Banking Union for a Divided Europe: An Introduction* (D. Busch & G. Ferrarini, Oxford 2015).

Busch D. & Ferrarini, G., *Introduction* (D. Busch & G. Ferrarini eds, Oxford 2017).

Busch, D. & Louisse, M., *MiFID II/MiFIR's Regime for Third-Country Firms* (D. Busch & G. Ferrarini eds, Oxford 2017).

Busch, D. & Louisse, M., *MiFID II/MiFIR's Regime for Third-Country Firms* (D. Busch & G. Ferrarini eds, Oxford 2017).

Busch, D., *Agency and Principal Dealing under MiFID*, https://ssrn.com/abstract=2899751 (accessed 31 May 2017).

Busch, D., *Product Governance and Product Intervention* (D. Busch & G. Ferrarini eds, Oxford 2017).

Busch, D., *Agency and Principal Dealing under MiFID*, https://ssrn.com/abstract=2899751 (accessed 15 May 2017).

Butter, F.A.G. den, *Managing Transaction Costs in the Era of Globalization* 58 (Edward Elgar Publishing 2012).

Buttigieg C, *The Alternative Investment Fund Managers Directive in Malta: Past, Present … What Next?* (January 2015), http://goo.gl/bqvugC (accessed 3 July 2015).

Buttigieg, C.P., *The 2009 UCITS IV Directive: A Critical Examination of the Framework for the Creation of a Broader and More Efficient Internal Market for UCITS,* https://ssrn.com/abstract=2137202 (accessed 7 April 2017).

Buttigieg, C.P., *The Alternative Investment Fund Managers Directive in Malta: Past, Present … What Next?*, https://ssrn.com/abstract=2602750 (accessed 7 April 2017).

Buttigieg, C.P., *The Case for A European Depositary Passport*, http://studylib.net/doc/13128849/the--case--for--a--european-...-passport (accessed 7 April 2017).

Buttigieg, C.P., *The Development of the EU Regulatory and Supervisory Framework applicable to UCITS: A Critical Examination of the Conditions and Limitations of Mutual Recognition***,** March 2014, 66, http://sro.sussex.ac.uk/48285/1/Buttigieg%2C_Christopher_P..pdf (accessed 7 April 2017).

C

Cahn, A. & Mühler, H., *Produktintervention nach MiFID II: Eingriffsvoraussetzungen und Auswirkungen auf die Pflichten des Vorstands von Wertpapierdienstleistungsunternehmen*, BKR - Zeitschrift für Bank- und Kapitalmarktrecht 45 (2013).

Calabresi, G., *The Costs of Accidents: A Legal and Economic Analysis* (Yale University Press 1970).

Calmann, J., *The Common Market: the Treaty of Rome explained* (Blond 1967).

Camara, P., *The AIFM's Governance and Remuneration Committees: The Impact of the AIFMD* (D.A.Zetzsche ed, Kluwer 2015).

Caruana, J., *Systemic risk: how to deal with it?* (BIS 2010).

Casey, J.P. & Lannoo, K., *The MiFID Revolution*, ECMI Policy Brief No. 3 (November 2006).

Casey, J.-P. & Lannoo, K., *The Mifid Revolution: A Policy View*, 7 Competition and Regulation Network Industries 515 (2006).

Casey, J-P., *Shedding Light on the UCITS-MiFID Nexus and Potential Impact of MiFID on the Asset Management Sector*, ECMI Policy Brief nr. 12, April 2008.

Casey, J.P. & Lannoo, K., *The MiFID revolution* (Cambridge University Press (2009).

Casper, M. & Altgen, C., *Germany* (Busch & DeMott eds, Oxford University Press 2012).

Casper, M., *Die Investmentkommanditgesellschaft: große Schwester der Publikums-KG oder Kuckuckskind?*, 179 ZHR 44 (2015).

Cave, J., *Get with the Program: Fintech Meets Regtech in the Light-Touch Sandbox*, https://ssrn.com/abstract=2944249 (accessed 20 July 2017).

Caytas, J.D., *Blockchain in the U.S. Regulatory Setting: Evidentiary Use in Vermont, Delaware, and Elsewhere*, https://ssrn.com/abstract=2988363 (accessed 20 July 2017).

Chan, D., Fontan, F., Rosati, S. & Russo, D., *The Securities Custody Industry*, European Central Bank Occasional Paper Series No. 69, August 2007.

Central Bank of Ireland, *AIFMD* (Q&A), 23th Edition, 3 January 2017 2017, ID 1057.

Central Bank of Ireland, *Consultation on carrying out depositary duties in accordance with Article 36 of the AIFMD*, 2014.

Central Bank of Ireland, *Feedback Statement on CP78: Consultation on carrying out depositary duties in accordance with Article 36 of the AIFMD,* Consultation Paper CP 78, 2014.

Central Bank of Ireland, *Guidance Note 2/11 -Professional collective investment schemes: Appointment of prime brokers and related issues*, December 2011.

Central Bank of Ireland, *Guidance Note on Completing and Submitting an Application for Authorisation Under Section 10 of the Investment Intermediaries Act,1995 (as amended) excluding Restricted Activity Investment Product Intermediaries*, January 2012.

Central Bank of Ireland, *Guidance on Client Asset Regulation for Investment Firms*, March 2015, https://www.centralbank.ie/pressarea/pressreleases/Documents/150330%20Guidance%20on%20Client%20Asset%20Regulations%20for%20Investment%20Firms.pdf. (accessed 21 February 2017).

Central Bank of Ireland, *NU Series of Notices – Conditions imposed in relation to Collective Investment Schemes Other than UCITS*, May 2013, https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/Funds/Non-UCITS/nu-series-of-notices.pdf?sfvrsn=2 (accessed 28 May 2017).

Central Bank of Ireland, *NU Series of Notices -Conditions imposed in relation to Collective Investment Schemes Other than UCITS*, www.centralbank.ie (accessed 3 July 2015).

Central Bank of Ireland, *UCITS authorised in another Member State intending to market units in Ireland*, December 2011.

Central Bank or Ireland, *Professional collective investment schemes: Appointment of prime brokers and related issues*, Guidance Note 2/11, December 2011.

Central Bank, *NU 12 Schemes marketing solely to professional investors,* https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/Funds/Non-UCITS/nu-series-of-notices.pdf?sfvrsn=2 (accessed 28 May 2017).

Central Bank, *NU 13 General Investment Restrictions*, https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/Funds/Non-UCITS/nu-series-of-notices.pdf?sfvrsn=2 (accessed 28 May 2017).

Central Bank, *NU Series of Notices – Conditions imposed in relation to Collective Investment Schemes Other than UCITS*, May 2013, https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/Funds/Non-UCITS/nu-series-of-notices.pdf?sfvrsn=2 (accessed 28 May 2017).

Champion, C., Appendices to the report on Investment Fund Market Efficiency, *Facilitating UCITS Mergers* , 9,

http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/annex_efficiency_en.pdf (accessed 22 August 2016).

Champion, C., *Investment Fund Market Efficiency*, 24, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/annex_efficiency_en.pdf (accessed 22 August 2016).

Chance, D. M., Grant, K. & Morsland, J., *Risk Management in Managing Investment Portfolios: A Dynamic Process* (Maginn ed., 3rd edn., Wiley 2007).

Christian, C.D., *UCITS outside Europe* 450 (D. Frase ed., Sweet & Maxwell 2011).

Ciani, D., *European Investment Funds: The UCITS Directive of 1985 and the Objectives of the Proposal for a UCITS II Directive*, 4(2) Journal of Financial Regulation and Compliance 150-156 (1996).

City, *Prime Custody: Asset Protection & Operational Simplicity,* http://citi.com/icg/global_markets/prime_finance/docs/Citi_PFinance_Custody_White_Paper_Feb_2010.pdf(accessed 3 September 2016).

Clark, G.L. & Hebb, T., Pension *Fund Corporate Engagement: The Fifth Stage of Capitalism*, 59 Relations industrielles 142 (2004).

Clark, R.C., *The Four Stages of Capitalism*, 94 *Harvard Law Review* 561 (1981).

Clarkson D., Jaecklin, S. & Kaczmarski, K*., Domiciles of Alternative Investment Funds* (Oliver Wyman 2014).

Clarotti, P., *The harmonization of legislation relating to credit institutions*, 19 Common Market Law Review 245(1982).

Clerc, C. & Deege, J., *France* (D.A. Zetzsche ed., Kluwer 2012).

Clerc, C., *The AIF Depositary's Liability for Lost Assets* (D.A.Zetzsche ed, Kluwer 2015).

Clerc, C., *The AIFM's Duties upon the Acquisition of Non-listed Firms* (D.A.Zetzsche ed, Kluwer 2015).

Clerc, C., *The AIFM's Transposition in France* (D.A.Zetzsche ed, Kluwer 2015).

Clerc, C., *The AIFMD's Transposition in France* (D.A. Zetzsche ed, Kluwer 2015).

Clifford Chance, *Single Market Update Services*, 9 Journal of Internal Banking and Financial Law 457 (1996).

Clouth, P., *Anlegerschutz. Grundlagen aus Sicht der Praxis*, 177 ZHR 112 (2013).

Coase, R.H., *The Problem of Social Cost*, 3 Journal of Law and Economics 1 (1960).

Colaert, V., *Building Blocks of Investor Protection: All-Embracing Regulation Tightens Its Grip*, https://ssrn.com/abstract=2943985 (accessed 14 January 2017).

Colaert, V., *MiFID II in Relation to Other Investor Protection Regulation: Picking Up the Crumbs of a Piecemeal Approach*, 3 https://ssrn.com/abstract=2942688 (accessed 14 January 2017).

Commission of the European Communities, *Commission Staff Working Document – The external Dimension of the Single Market Review accompanying document to the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions*, *A single market for the 21st century Europe,* {COM(2007) 724 final} {SEC(2007) 1517} {SEC(2007) 1518}{SEC(2007) 1520} {SEC(2007) 1521},http://ec.europa.eu/citizens_agenda/docs/sec_2007_1519_en.pdf (accessed 21 April 2017).

Commission of the European Communities, *Communication from the Commission to the Council – Supplementary Social Security Schemes: The Role of Occupational Pension Schemes in the Social Protection of Workers and their Implications for Freedom of Movement*, SEC(91) 1332 final, 22 July 1991, 12.

Commission of the European Communities, *Completing the Internal Market: An Area without Internal Frontiers—The progress Report Required by Article 8B of the Treaty*, COM (88) 650 final, 17 November 1988.

Commission of the European Communities, *Directive of the European Parliament and the Council on Alternative Investment Fund Managers and amending Directives 2004/39/EC and 2009/…/EC*, Brussels, 30.4.2009, COM(2009) 207 final, 2009/0064 (COD), {SEC(2009)576}{SEC(2009)577}.

Commission of the European Communities, *Report from the Commission – Treatment Accorded in third countries to community credit institutions, insurance companies and investment firms*, 29 June 1995 COM(95) 303 final.

Commission of the European Communities, *Report from the Commission – Treatment Accorded in third countries to community credit institutions, insurance companies and investment firms, 15 July 1992 SEC (92) 1342 final.*

Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the provisions of Council Directive 85/611/EEC of 20 December 1985* ('Vandamme Report'), 5, http://goo.gl/K0iUzv (accessed 13 October 2016).

Committee of European Banking Supervisors, *Call for technical advice on the effectiveness of a minimum retention requirement for securitizations*, https://www.eba.europa.eu/documents/10180/16106/Advice.pdf (accessed 3 July 2015).

Committee of European Insurance and Occupational Pensions Supervisors, *Initial review of key aspects of the implementation of the IORP directive*,31 March 2008, CEIOPS-OP-03-08.

Committee of European Securities Regulators, *Consultation Paper - CESR's guidelines for supervisors regarding the transitional provisions of the amending UCITS Directives (2001/107/EC and 2001/108/EC)*, CESR/04-434, October 2004.

Committee of European Securities Regulators, *CESR's Advice on Clarification of Definitions concerning Eligible Assets for Investments of UCITS: Consultation Paper*, 05-064b, March 2005.

Committee of European Securities Regulators, *CESR's advice to the European Commission on the UCITS Management Company Passport*, October 2008, CESR/08-867, 9-11.

Committee of European Securities Regulators, *CESR's guidelines on the methodology for the calculation of the synthetic risk and reward indicator in the Key Investor Information Document (2010)*, CESR/10-673.

Committee of European Securities Regulators, *CESR's advice to the European Commission on clarification of definitions concerning eligible assets for investments of UCITS*, 06-005, January 2006.

Committee of European Securities Regulators, *Covering letter: Advice to the Commission on the UCITS Management Company Passport*, CESR08-067, 31 October 2008.

Committee of European Securities Regulators, *Guidelines for supervisors regarding the transitional provisions of the amending UCITS Directives (2001/107/EC and 2001/108/EC),* CESR/04-434b (2005).

Committee of European Securities Regulators, *Mapping of duties and liabilities of UCITS depositaries (2010)*, CESR/09-175.

Committee of European Securities Regulators, *The Passport under MiFID - Recommendations for the implementation of the Directive 2004/39/EC and Statement on practical arrangements regarding the late transposition of MiFID*, October 2007, CESR/07-337b.

Committee of European Securities Regulators,, *Advice to the Commission: UCITS Management Company Passpor*t, CESR08-867, October 2008.

Conac, H.P., *Rights of the investor*, 105-134. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013).

Condos, J., Sorrell, W.H. & Donegan, S.L. *Blockchain Technology: Opportunities and Risks*, http://legislature.vermont.gov/assets/Legislative-Reports/blockchain-technology-report-final.pdf (access 20 July 2017).

COOConnect, *What Prime Custody is doing to Prime Brokerage*, http://cooconnect.com/online-magazine/what-prime-custody-doing-prime-brokerage (accessed 3 September 2016).

Cooter, R. & Freedman, B.J., *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045 (1991).

Cossy, M., *Determining "Likeness" under the GATS: Squaring the Circle?,* www. wto.org/english/res_e/reser_e/ersd200608_e.pdf. (accessed 5 June 2017).

Cottier, T. & Molinuevo, M., *Article V GATS* 146 (R. Wolfrum, P. Stoll & C. Feinäugle eds., Martinus Nijhoff, 2008).

Couret, A., *France (*E. Wymeersch ed., Kluwer 2012).

Couret, A., Goutay, P. & Zabala, B., *France* (Busch & DeMott eds, Oxford University Press 2012).

Courvoisier M. & Schmitz, R., *Grenzfälle kollektiver Kapitalanlagen*, Schweizerische Zeitschrift für Wirtschafts- und Finanzmarktrecht 407 (2006).

Craig, P.P. & Búrca, G. de, *EU Law: Text, Cases, and Materials* 369 (Oxford University Press 2015, 6th Edition).

Crespi-Hohl, I., *Neuere Tendenzen im Bereich der Verantwortlichkeit der Depotbank gegenüber ihrem Kunden bei Beizug eines externen Vermögensverwalters*. (Schulthess Verlag 2003).

Crocenzi, F., *Italy* (L. Van Setten & D. Busch eds, Oxford 2014).

Crockett, A., Harris, T., Mishkin, F.S., & White, E.N., *Conflicts of Interest in the Financial Services Industry: What Should We Do About Them?*, 5 Geneva Reports on the World Economy (2003).

Cronqvist, H. & Nilsson, M., *Agency Costs of Controlling Minority Shareholders* (2003), 38 Journal of Financial and Quantitative Analysis 695-719 (2003);

Crouhy, M., Galai, D. & Mark, R., *Risk Management* (McGraw-Hill 2001).

Curtis, Q. & Morley, J., *Taking Exit Rights Seriously: Why Governance and Fee Litigation Don't Work in Mutual Funds*, 120 YALE L.J. 84 (2014).

Cygan, A. & Szyszczak, E., *The Controversy and Confusion over Mifid*, 25 International Financial Law Review 14 (2006).

D

Dalley, P.J., *A Theory of Agency Law*, U. PITT. L. REV. 495, 497 (2011).

Dam, M.S.A. van & Lieverse, C.W.M., *De Venture Capital Verordening*, 6 TvFR 201-204 (2013).

Davey, W. & Pauwelyn, J., *MFN Unconditionality: A Legal Analysis of the Concept in View of Its Evolution in the GATT/WTO Jurisprudence with Particular Reference to the Issue of "Like Product* 13–50 (T. Cottier, P. Mavroidis and P. Blatter eds., University of Michigan Press, 2000).

Davies, E., Dufour, A. & Scott-Quin, B., *The MiFID: Competition in a new European equity market* 163-197 (G. Ferrarini & E. Wymeersch, Oxford 2006).

Davis, E.P. *Prudent person rules or quantitative restrictions? The regulation of long-term institutional investors' portfolios*, 2 Journal of Pension Economics and Finance 157 (2002).

Deerenberg, E.M., *Vergunningen, Europees paspoort en toezicht* 19-30 (F.M.A. 't Hart ed, NIBE-SVV 2007).

Dejmek, P., *The EU Internal Market for Financial Services—A Look at the First Regulatory Responses to the Financial Crisis and a View to the Future*, 15 Columbia Journal of European Law 455 (2009).

Delmont, D.P., *Managing Hedge Fund Risk and Financing – Adapting to a New Era* 7 (Wiley 2011).

Deloitte, *AIFMD Implementation – Depositary webinar*, 11, http://www2.deloitte.com/content/dam/Deloitte/ie/Documents/FinancialServices/investmentmanagement/aifmd_depositary_webinar.pdf (accessed 3 September 2016).

DeMott, D.A., *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879.

Den Hamer, J. & Ait Youss, L., *Ondernemen of beleggen?*, VGR 132 (2010).

Detienne, J., *La liberté d'établissement des banques et des autres établissments financiers*, Revue de la Banque, 290-295(1974).

Deutsche Bank, *NeMA Asia round up: Can Custodian Banks win in the Blockchain Phenomenon*, December 2015, http://cib.db.com/insights-and-initiatives/flow/nema-asia-round-up-can-custodian-banks-win-in-the-blockchain-phenomenon.htm#gsc.tab=0 (accessed 20 July 2017).

Dietrich, D., *Transaction cost economics and beyond: towards a new economics of the firm* (Routledge 1994).

Dietzi, H., *Die Verantwortlichkeit der Bank gegenüber einem Kunden für Handlungen eines von diesem eingesetzten Vermögensverwalters*, 5 SZW 193 (1997).

Dimopoulos, A., *Re-thinking the European Constitution in an Enlarged European Union,* https://www.pravo.unizg.hr/_download/repository/Rethinking_Subsidiarity_and_the_Balance_of_Powers_in_the_EU_in_Light_of_the_Lisbon_Treaty_and_Beyond_-_Simona_Constantin%5B1%5D.pdf (accessed 21 June 2017).

Directorate General for Internal Policies, '*Gold-plating*' *in the EAFRD – To what extent do national rules unnecessarily add to complexity and as a result, increase the risk of errors*?, IP/D/ALL/FWC/2009-056, 27 February 2014, http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/490684/IPOL-JOIN_ET%282014%29490684_EN.pdf(accessed 14 January 2017).

Directorate General for Internal Policies, *Consumer Protection Aspects of Financial Services*, IP/A/IMCO/ST/2013, 07 February 2014, http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/507463/IPOL-IMCO_ET%282014%29507463_EN.pdf (accessed 14 January 2017).

Dobrauz, G., & Rosenauer, P., *Side Pockets als spezielle Instrumente zur außerordentlichen Liquiditätssteuerung von Fund of Hedge Funds*, 2 Zeitschrift für Finanzmarktrecht 65 (2010).

Dobrauz-Saldapenna, G. & Tettamanti, C., *Liechtenstein* (D.A. Zetzsche ed, Kluwer 2012).

Dobrauz-Saldapenna, G., Schwertschlag, A. & Rosenauer, P., *The AIFMD's Transposition in Liechtenstein* (D.A.Zetzsche ed, Kluwer 2015).

Dobrauz-Saldapenna, G., Schwertschlag, A. & Rosenauer, P., *The AIFMD's Transposition in Liechtenstein* (D.A. Zetzsche ed, Kluwer 2015).

Doelder, J. & Jansen, I.M., *Een nieuw Europees toezichtraamwerk,* 1/2 TvFR 17 (2010).

Dolan, T., *UCITS V brings convergence of the depositary role with AIFMD*, 1 JIBFL 64B (2015).

Dougan, M., *Minimum Harmonization and the Internal Market*, 37 Common Market Law Review 853, 866 (2000).

Douglas, S. & McFarlane, B., *Defining Property Rights* 219 (J. Penner & H.E. Smith eds., Oxford University Press 2013).

Dreimüller, B.C., *MiFID en het 'know your customer'-beginsel. De huidige zorgplicht gaat te ver!*, 3 TvFR 62-72 (2007).

Duffie, D., *The Failure Mechanics of Dealer Banks*, Journal of Economic Perspectives 51 to 72 (2010).

Dupont, P., *Rights of the account holder relating to securities credited to its securities account*, 90-104. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013).

Dussart, S., F. Rodriguez, F. & Thouch, M., *La restitution des actifs par le dépositaire,* Joly Bourse 542 (2008).

Dyck, A. & Zingales, L., *Private Benefits of Control: An International Comparison,* 59 Journal of Finance 537 (2004).

E

Easterbrook, F.H. & Fischel, D.R., *Voting in Corporate Law* (1983), 26 Journal of Law and Economics 395-427 (1983).

Easterbrook, F.H. & Fischel, D.R., *Limited Liability and the Corporation*, 52 UNIV. CHI.L. REV. 89 (1985).

Easterbrook, F.H. & Fischel, D.R., *The Corporate Contract*, 89 *Columbia Law Review* 1416 (1989).

Easterbrook, F.H. & Fischel, D.R., *The Economic Structure of Corporate Law* (Harvard University Press 1991).

Easterbrook, F.H. & Fischel, D.R., *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993).

Ebbinghaus, B. & Wiß, T., *Taming Pension Fund Capitalism in Europe: Collective and State Regulation in Times of Crisis,* 17 Transfer - The European Review of Labour and Research 1 (2010).

Edelman, J., *When Do Fiduciary Duties Arise?*, 126 L.Q. REV. 302 (2010).

Edward, D., *Establishment and Services : An Analysis of the Insurance Cases*, 12 European Law Review 231 (1987).

Eeckhout, P., *EU External Relations Law* (Oxford University Press 2011).

Eersel, M. van & G.P. Roth, *Informatieverplichtingen van beleggingsondernemingen jegens de financiële consument* 100-124 (A.J.C.C.M. Loonen et al., NIBE-SVV 2008).

Eggen, M. & Staub, C., *Kundensegmentierung – Panacea oder Abschied vom mündigen Anleger?*, 1 GesKR 55 (2012).

Ehring, L., *De Facto Discrimination in World Trade Law. National and Most- Favoured-Nation Treatment – or Equal Treatment?,* 36 Journal of World Trade 921 (2002).

Eichhorn, J. & Klebeck, U., *Drittstaatenregulierung der MiFID II und MiFIR*, 3 Recht der Finanzinstrumente 1 (2014).

Einsele, D., *Wertpapier als Schuldrecht: Funktionsverlust von Effektenurkunden, international Rechtsverkehr* (Tübingen: Mohr Siebeck 1995).

Eisenhardt, K.M. *Agency Theory: An Assessment and Review*, 14 Academy of Management Review 57-74 (1989).

Elst, C. van der & Lafarre, A., *Bringing the AGM to the 21st Century: Blockchain and Smart Contracting Tech for Shareholder Involvement*, European Corporate Governance Institute (ECGI) - Law Working Paper No. 358/2017, https://ssrn.com/abstract=2992804 (accessed 10 July 2017).

Emde, T., *The AIFMD's Transposition in Germany (*D.A.Zetzsche ed, Kluwer 2015).

Emde, T., *The Transposition of the AIFMD in Germany* (D.A. Zetzsche ed, Kluwer 2015).

Emerson, M., *Which model for Brexit?*, CEPS Special Report, October 2016, https://www.ceps.eu/system/files/SR147%20ME%20Which%20model%20for%20Brexit.pdf (accessed 17 February 2017).

Enderli, D., *Kreditgeschäft von Hedge Funds* 30 to 49 (Master Thesis, Universität St. Gallen 19 Mai 2008).

Enriques, L., & Gargantini, M., *The Overarching Duty to Act in the Best Interest of the Client in MiFID II* (D. Busch & G. Ferrarini eds, Oxford 2017).

Enriques, L., *Conflicts of Interest in Investment Services: The Price and Uncertain Impact of MiFID's Regulatory Framework* (G. Ferrarini & E. Wymeersch eds., Oxford University Press 2006).

Esch, R.E. van, *MiFID en het verschaffen van informatie aan beleggers via internet* 1/2 TvFR 17-22 (2008).

Euroclear/Oliver Wyman, *Blockchain in Capital Markets – The Prize and the Journey*, February 2016, http://www.dltmarket.com/docs/BlockchainInCapitalMarkets-ThePrizeAndTheJourney.pdf (accessed 20 July 2017.

European Banking Federation, *EBF Position on UCITS V*, 5, http://www.ebf-fbe.eu/uploads/D1425F-2012-Final%20EBF%20position%20on%20UCITS%20V.pdf (accessed 29 August 2016).

European Central Bank, *T2S Framework Agreement*, https://www.ecb.europa.eu/paym/t2s/pdf/csd_FA/T2S_Framework_Agreement_Schedules.pdf (accessed 9 August 2016).

European Commission, *Appendices to the report on Investment Fund Market Efficiency*, July 2006, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/annex_efficiency_en.pdf (accessed 7 April 2017).

European Commission, *Background Note accompanying Draft Commission Directive implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive*, http://ec.europa.eu/internal_market/securities/docs/isd/dir-2004-39-implement/dir-backgroundnote_en.pdf (accessed 14 February 2016).

European Commission, *Call For Evidence regarding Private Placement Regimes in the EU*, April 2007, http://ec.europa.eu/internal_market/investment/docs/consultations/private_placement_en.pdf.

European Commission, *Commission Communication - Financial Services: Building a Framework of Action,* COM (98) 625 final, 28 October 1998.

European Commission, *Commission Communication - Financial Services: Implementing the Framework for Financial Services Markets: Action Plan*, COM (1999) 232 final, 11 May 1999.

European Commission, *Commission decisions on the adequacy of the protection of personal data in third countries*, http://ec.europa.eu/justice/policies/privacy/thridcountries/index_en.htm (accessed 18 June 2016).

European Commission, *Commission proposes improved EU framework for investment funds*, IP/08/1161,16 July 2008.

European Commission, *Commission Staff Working Document – Executive Summary to the Impact Assessment Report*, 17 July 2008, SEC(2008) 2341, {SEC(2008) 2340}.

European Commission, *Commission Staff Working Document – Impact Assessment accompanying the document Proposal for a Regulation of the European Parliament and of the Council on a pan-European Personal Pension Product (PEPP)and Commission Recommendation on the tax treatment of personal pension products, including the pan-European Personal Pension Product* {COM(2017) 343}{C(2017) 4393}{SWD(2017) 244}, SWD(2017) 243.

European Commission, *Commission Staff Working Document of 07 March 2012 (SWD(2012) 22) accompanying the Proposal for the CSDR: Impact Assessment*, (COM(2012) 73) (SWD(2012) 23), 7, http://ec.europa.eu/internal_market/investment/docs/alternative_investments/fund_managers_impact_assessment.pdf (accessed 29 August 2016).

European Commission, *Commission Staff Working Document of 11 April 2013: Consumer protection in third-pillar retirement products,*7, http://ec.europa.eu/dgs/health_food-safety/dgs_consultations/ca/docs/swd_consumer_protection_thirds_pillar_pensions_en.pdf (Accessed 14 January 2017).

European Commission, *Commission Staff Working Document of 12 July 2005* (SEC(2005) 947) - *Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf (accessed 8 August 2016).

European Commission, *Commission Staff Working Document of 17 July 2008 (SEC(2008) 2340)* - *Impact Assessment Report on Private Placement*, 17 July 2008, SEC(2008) 2340,{SEC(2008) 2341}.

European Commission, *Commission Staff Working Document of 3 July 2012 (SWD(2012) 185 final): accompanying the Proposal for the UCITSD V: Impact Assessment*, http://eur-lex.europa.eu/legal content/EN/TXT/PDF/?uri=CELEX:52012SC0185&from=EN (accessed 27 July 2016).

European Commission, *Commission Staff Working Document of 30 April 2009 (SEC(2009) 576) accompanying the Proposal for the AIFM-Directive: Impact Assessment*, http://ec.europa.eu/internal_market/investment/docs/alternative_investments/fund_managers_impact_assessment.pdf (accessed 3 July 2015).

European Commission, *Commission Staff Working Document of 7 March 2012* (*SWD(2012) 22 final) accompanying the Proposal for a Regulation of the European Parliament and of the Council on improving securities settlement in the European Union and on Central Securities Depositories (CSDs) and amending Directive 98/26/EC{COM(2012) 73 final}: Impact Assessment,*9, http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012SC0022&from=EN (accessed (8 August 2016).

European Commission, *Communication from the Commission on Package Retail Investment Products*, http://ec.europa.eu/internal_market/finservices-retail/docs/investment_products/29042009_impact_assessment_en.pdf (accessed 14 January 2017).

European Commission, *Communication from the Commission to the Council and to the European parliament – Regulation of UCITS depositaries in the Member States: review and possible developments*, COM(2004) 207 final, 30 March 2004, 7, 14, 26.

European Commission, *Communication from the Commission to the European Parliament and the Council - Upgrading the investment services directive* , (93/22/EEC) /* COM/2000/0729 final */.

European Commission, *Completing the Internal Market: White Paper from the European Commission to the European Council*, COM(85)310 Final, 14 June 1985, http://europa.eu/documents/comm/white_papers/pdf/com1985_0310_f_en.pdf (accessed 7 April 2017).

European Commission, *Consultation Document - Legislation on Legal Certainty of Securities Holding and Dispositions. DG Markt G2 MET/OT/acg D(1010) 768690,* http://ec.europa.eu/finance/consultations/2010/securities/docs/consultation_paper_en.pdf (accessed 8 August 2016).

European Commission, *Consultation Document – Review of the European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF) Regulations*, 2015/ESMA/227, http://ec.europa.eu/finance/consultations/2015/venture-capital-funds/docs/consultation-document_en.pdf (accessed 3 February 2017).

European Commission, *Consultation Document - Undertakings for Collective Investment in Transferable Securities (UCITS)Product Rules, Liquidity Management, Depositary, Money Market Funds, Long-term Investments*, July 2012, http://ec.europa.eu/finance/consultations/2012/ucits/docs/ucits_consultation_en.pdf (accessed 13 October 2016).

European Commission, *Consultation Paper on the UCITS Depositary Function and on the UCITS Managers' Remuneration*, 14 December 2010, MARKT/G4 D (2010) 950800, 15, http://ec.europa.eu/finance/consultations/2010/ucits/docs/consultation_paper_en.pdf.

European Commission, *ECOFIN Council – Regulation of European Securities Markets – Terms of reference for the Committee of Wise Men*, 17 July 2000.

European Commission, *Europe a World partner: the External Dimension of the Single Market*, 21(10) Bulletin of the European Communities (1988), http://aei.pitt.edu/1770/1/World_partner_1988.pdf (accessed 21 April 2017).

European Commission, *Explanatory Memorandum - Proposal for a Directive on Investment Services in the Securities Field: Proposal for a Council Directive on investment services in the securities field*, (COM(88) 778 – syn 176).

European Commission, *Exposure Draft - Initial orientations for discussion on possible adjustments to the UCITS Directive: Merger*, 14, http://ec.europa.eu/finance/investment/docs/ucits-directive/poolingexposurel_en.pdf (accessed 22 August 2016).

European Commission, *Exposure Draft - Initial orientations for discussion on possible adjustments to the UCITS Directive: Pooling*, 3, http://ec.europa.eu/finance/investment/docs/ucits-directive/poolingexposurel_en.pdf (accessed 22 August 2016).

European Commission, *Exposure Draft - Initial orientations for discussion on possible adjustments to the UCITS Directive: Management Company Passport*, 4, http://ec.europa.eu/internal_market/investment/docs/legal_texts/orientations/mcpexposure_en.pdf (accessed 8 July 2017).

European Commission, *Feedback on public consultation on UCITS V*, http://ec.europa.eu/finance/consultations/2010/ucits/docs/summary_of_responses_en.pdf (accessed 22 February 2017).

European Commission, *Feedback Statement - Summary of Responses to UCITS Depositary's Consultation Paper*, 9, http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/feedback_statement_en.pdf (accessed 22 February 2017).

European Commission, *Final Report of the Committee of Wise Men on the Regulation of European SecuritiesMarkets, Brussels*, 15 February 2001.

European Commission, *Green Paper on Financial Services Policy (2005 - 2010),* COM (2005) 177.

European Commission, *Green Paper on the Enhancement of the EU Framework for Investment Funds of 12 July 2005 COM(2005) 314 final.*

European Commission**,** *Impact Assessment - Accompanying document to the Proposal for a Directive .../.../EU of the European Parliament and of the Council on Deposit Guarantee Schemes [recast] and to the Report from the Commission to the European Parliament AND to the Council Review of Directive 94/19/EC on Deposit Guarantee Schemes*, COM(2010) 368 COM(2010) 369 SEC(2010) 835**, /*** SEC/2010/0834 final ***/.**

European Commission, *Impact Assessment – Commission Delegated Regulation supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries*, {C(2015) 9160 final}.

European Commission, *Impact Assessment – Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions*, (COM(2012) 350) (SWD(2012) 186).

European Commission, *Impact Assessment – Proposal for a Regulation of the European Parliament and of the Council on European Venture Capital Funds*, {COM(2011) 860 final} {SEC(2011) 1516 final}.

European Commission, *Impact Assessment – Proposal for a Regulation of the European Parliament and of the Council on European Social Entrepreneurship Funds*, {COM(2011) 862 final} {SEC(2011) 1513 final}.

European Commission, *Preliminary orientations for revision of the Investment Services Directive (ISD),* IP/01/1055, July 2011.

European Commission, *Preliminary orientations for revision of the Investment Services Directive (ISD), IP/01/1055*, July 2011, Annex 1: Definition and Scope of Investment Services Directive, 6.

European Commission, *Press release- Single Resolution Mechanism to come into effect for the Banking Union*, 31 December 2015.

European Commission, *Private Placement Regimes in the EU- Summary Report of Workshops organized by DG Internal Market and Services January 15th and February 7th 2008*, http://ec.europa.eu/finance/investment/index.htm (accessed 14 October 2016);

European Commission, *Proposal for a Regulation of the European Parliament and of the Council on a pan-European Personal Pension Product (PEPP){SWD(2017) 243} {SWD(2017) 244}*, 1.

European Commission, *Public Consultation on Central Securities Depositaries (CSDs) and on the Harmonisation of certain aspects of securities settlement in the European Union, DG Markt G2 D(201)8641*, http://ec.europa.eu/finance/consultations/2011/csd/docs/consultation_csd_en.pdf (accessed 8 August 2016).

European Commission, *Report of the Alternative Investment Expert Group - Managing, Servicing and Marketing Hedge Funds in Europe*, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/hedgefunds_en.pdf (accessed 29 May 2017).

European Commission, *Report of the Expert Group on Investment Fund Market Efficiency*, July 2006, http://ec.europa.eu/internal_market/investment/docs/other_docs/reports/efficiency_en.pdf (accessed 7 April 2017).

European Commission, *Request for assistance: UCITS Management Company Passport,* MARKT/G4/PS/D(2008), 16 July 2008.

European Commission, *Request to ESMA for Technical Advice on possible Delegated Acts and Implementing Acts concerning the Regulation on Markets in Financial Instruments and amending Regulation [EMIR] on OTC Derivatives, Central Counterparties and Trade Repositories [MiFIR((EC) No XX/2014] and the Directive on Markets in Financial Instruments in repealing Directive 2004/39/EC (MiFID (EC) No XX/2014),* 23 April 2014, 19.

European Commission, *The new SME definition - User guide and model declaration of 26 June 2012*, http://ec.europa.eu/enterprise/policies/sme/files/sme_definition/sme_user_guide_en.pdf (accessed 3 July 2015).

European Commission, *Undertakings for collective investment in transferable securities – amended Directive (UCITS V): Frequently asked questions*, MEMO/14/198, 15 April 2014.

European Commission, *White Paper - Financial Services Policy 2005-2010*, http://ec.europa.eu/internal_market/finances/docs/white_paper/white_paper_en.pdf (accessed 26 June 2017).

European Commission, *White Paper of 15 November 2006 (COM (2006) 686 final) on enhancing the single market framework for investment funds*, http://ec.europa.eu/internal_market/securities/docs/ucits/whitepaper/whitepaper_en.pdf (accessed 3 July 2015).

European Commission, *Working Document of the Commission Services (DG Markt), Consultation Paper on the UCITS Depositary Function*, July 2009, http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/consultation_paper_en.pdf (accessed 24 July 2017).

European Commission, *Working Document of the Commission Services (DG Internal Market), Consultation Paper on Hedge Funds*, http://ec.europa.eu/internal_market/consultations/docs/hedgefunds/consultation_paper_en.pdf (accessed 3 July 2015).

European Fair Trade Association, *EEA Agreement*, http://www.efta.int/eea/eea-agreement.aspx (accessed 3 July 2015).

European Fair Trade Association, *The EFTA States*, http://www.efta.int/about-efta/the-efta-states.aspx (accessed 3 July 2015).

European Fund and Asset Management Association, *EFAMA Position Paper on the legislative proposal of the Commission amending Directive 2009/65/EC ("UCITS V"),* 4, www.efama.org/Publications/Public/UCITS/12-4040_EFAMA position paper on UCITS V.pdf (accessed 29 August 2016).

European Fund and Asset Management Association, *EFAMA Reply to Consultation Paper on ESMA's Draft Technical Advice to the European Commission on Possible Implementing Measures of the Alternative Investment Fund Manager's Directive*, http://www.efama.org/Publications/Public/AIFMD/11-4059_EFAMA%20Reply%20to%20ESMA%20Cons%20AIFMD%20Level%202.pdf (accessed 3 July 2015).

European Insurance and Occupational Pensions Authority, *2015 Market development report on occupational pensions and cross-border IORPs,* July 2015, EIOPA-BoS-15/144 09.

European Insurance and Occupational Pensions Authority, *Call for Advice from European Insurance and Occupational Pensions Authority (EIOPA) for the Review of Directive 2003/41/EC (IORP II),* https://eiopa.europa.eu/Publications/Requests%20for%20advice/20110409-CfA-IORPII-final.pdf (accessed 27 July 2016).

European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001.

European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products,* 16 May 2013, EIOPA/13/241.

European Insurance and Occupational Pensions Authority, *EIOPA's Advice to the European Commission on the review of the IORP Directive 2003/41/EC* (Final report), 15 February 2012, EIOPA-BOS-12/015.

European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP),* 04 July 2016, EIOPA-16/457.

European Parliament, *Report of the Committee on Legal Affairs and Citizen's Rights on the 1993 UCITS Proposal*, A5-0268/1993, 1 October 1993, http://goo.gl/rRSdJO (accessed 7 April 2017).

European Parliament, *European Parliament resolution of 17May 2017 on FinTech: the influence of technology on the future of the financial sector (2016/2243(INI))*, http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+P8-TA-2017-0211+0+DOC+PDF+V0//EN (access 20 July 2017).

European Principal Traders Association*, Special Report Series: Third Country Firms Under MiFID II*, 25. Juni 2014, http://www.futuresindustry.org/downloads/Special%20report%20seven%2025% 20June%20-%20Third%20country%20firms%20under%20MiFID%20II.pdf (accessed 18 June 2017).

European Securities and Markets Authority, *Advice to the European Parliament, the Council and the Commission on the application of the AIFMD passport to non-EU AIFMs and AIFs* ESMA/2016/1140, 12 September 2016.

European Securities and Markets Authority, *Advice to the European Parliament, the Council and the Commission on the application of the AIFMD passport to non-EU AIFMs and AIFs*, ESMA/2015/1236, 30 July 2015.

European Securities and Markets Authority, *Application of the EuSEF and EuVECA Regulations* (Q&A), 26 March 2014, ESMA/2014/311.

European Securities and Markets Authority, *Application of the EuSEF and EuVECA Regulations (Q&A)*, 31 May 2016, ESMA/2016/774.

European Securities and Markets Authority, *Call for evidence on AIFMD passport and third country AIFMs (Consultation paper)*, 7 November 2014, ESMA/2014/1340.

European Securities and Markets Authority, *CESR's response to the European Commission's consultation on the UCITS depositary function* (Final report), 28 September 2009, ESMA/09-781.

European Securities and Markets Authority, *CESR's response to the European Commission's consultation on the UCITS depositary function of 16 September 2009 (CESR/09-781)*, http://www.esma.europa.eu/system/files/09_781.pdf (accessed 19 July 2015).

European Securities and Markets Authority, *Consultation paper - ESMA's draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive in relation to supervision and third countries* (Consultation paper), 23 August 2011, ESMA/2011/270.

European Securities and Markets Authority, *Consultation paper - Guidelines for the transition from the Simplified Prospectus to the Key Investor Information document* (Consultation paper), 20 July 2010, ESMA/10-672.

European Securities and Markets Authority, *Consultation paper – Guidelines on sound remuneration policies under the AIFMD*, 28 June 2012, ESMA/2012/406..

European Securities and Markets Authority, *Discussion paper on Key concepts of the Alternative Investment Fund Managers Directive and types of AIFM*, 23 February 2012, ESMA/2012/117.

European Securities and Markets Authority, *ESMA's technical advice to the European Commission on delegated acts required by the UCITS V Directive* (Final report), 28 November 2014, ESMA 2014/1417.

European Securities and Markets Authority, *Final Report - Draft regulatory technical standards on types of AIFMs*, 2 April 2013, ESMA/2013/413.

European Securities and Markets Authority, *Final Report - ESMA's technical advice to the European Commission on the delegated acts of the Regulations on European Social Entrepreneurship Funds and European Venture Capital Funds*, 16 February 2015, ESMA/2015/227.

European Securities and Markets Authority, *Final Report – ESMA's technical advice to the European Commission on the delegated acts of the Regulations on European Social Entrepreneurship Funds and European Venture Capital Funds,* 3 February 2015, 2015/ESMA/227.

European Securities and Markets Authority, *Final report - ESMA's technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive*, 16 November 2011, ESMA/2011/379.

European Securities and Markets Authority, *Guidelines for competent authorities and UCITS management companies – Guidelines on ETFs and other UCITS issues*, 1 August 2014, ESMA/2014/937.

European Securities and Markets Authority, *Guidelines on asset segregation under the AIFMD*, 1 December 2014, ESMA/2014/1326.

European Securities and Markets Authority, *Guidelines on key concepts of the AIFMD*, 24 May 2013, ESMA/2013/600.

European Securities and Markets Authority, *Guidelines on key concepts of the AIFMD*, 19 December 2012, ESMA/2012/845.

European Securities and Markets Authority, *Opinion - General principles to support supervisory convergence in the context of the United Kingdom withdrawing from the European Union*, ESMA42-110-433, 31 May 2017.

European Securities and Markets Authority, *Q&A on the Application of the EuSEF and EuVECA Regulations*, 11 November 2014, ESMA/2014/1354.

European Securities and Markets Authority, *Questions and Answers - Application of the EuSEF and EuVECA Regulations*, 31 May 2016, ESMA/2016/774.

European Securities and Markets Authority, *Questions and Answers - Key Investor Information Document for UCITS*, 25 September 2012, ESMA/2012/592.

European Securities and Markets Authority, *Opinion - Asset segregation and application of depositary delegation rules to CSDs*, 20 July 2017, ESMA34-45-277.

European Securities Market Authority, *Final Report -MiFID II/MiFIR draft Technical Standards on authorisation, passporting, registration of third country firms and cooperation between competent authorities*,29 June 2015, ESMA/2015/1006.

European Securities Markets Authority, *Guidelines on key concepts of the AIFMD*, 13 August 2013, ESMA/2013/611.

Ewing, A. The Single Market of 1992: Impliciations for Banking and Investment Services in the EC, 13 Hastings Int'L & Compl. L. Rev. 453 (1990).

F

Falzon, J., Buttigieg, C.P., & Chetcuti, M., *The AIFMD's Transposition in Malta* (D.A.Zetzsche ed, Kluwer 2015).

Fama, E.F. & Jensen, M.C., *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327, 333 (1983).

Fama, E.F., *Agency Problems and the Theory of the Firm*, 88 J.POL. ECON. 288, 289 (1980)

FEFSI, *Position Paper on Depositaries*, 4-5 (6 November 2002).

Ferran, E. & Babis, V.S.G., *The European Single Supervisory Mechanism*, University of Cambridge Faculty of Law Research Paper No. 10 (2013).

Ferran, E., & Alexander, K., *Can Soft Law Bodies be Effective? Soft Systemic Risk Oversight Bodies and the Special Case of the European Systemic Risk Board,* https://ssrn.com/abstract=1676140 (accessed 16 February 2017).

Ferran, E., *Building an EU Securities Market* (Cambridge University Press 2004).

Ferran, E., *European Banking Union: Imperfect, But it Can Work* (D. Busch & G. Ferrarini, Oxford 2015).

Ferran, E*., Understanding the New Institutional Architecture of EU Financial Market Supervision,* Paper No. 29/2011 (2011).

Ferrarini, G. & Chiarella, L., *Common Banking Supervision in the Eurozone: Strengths and Weaknesses,* ECGI - Law Working Paper No. 223/2013 (2013).

Ferrarini, G. & Recine, F., *The Single Rulebook and the SSM: Should the ECB Have More Say in Prudential Rule-making*? (D. Busch & G. Ferrarini, Oxford 2015).

Ferrarini, G., & E. Wymeersch*, Investor protection in Europe: corporate law making, the MiFID and beyond* (Oxford University Press 2006).

Filius, A.R. & Hosemann, M.R., *De cliëntenovereenkomst* 50-63 (A.J.C.C.M. Loonen et al., NIBE-SVV 2008).

Filius, A.R. & Hosemann, M.R., *Van financiële bijsluiter naar essentiële beleggersinformatie. Ziet u het verschil? Een historisch relaas*, 11/12 TvFR 328-334 (2010).

Financial Action Task Force on Money Laundering (FATF), *International Standards on combating money laundering and the financing of terrorism, The FATF Recommendations*, February 2012, http://www.fatfgafi. org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf (accessed 18 June 2017).

Financial Action Task Force on Money Laundering (FATF), *Methodology for assessing technical compliance with the FATF Recommendations and the Effectiveness of AML/CFT systems*, February 2013, http://www.fatfgafi.org/media/fatf/documents/methodology/FATF%20Methodology%2022%20Feb%202013.pdf (accessed 18 June 2017).

Financial Action Task Force on Money Laundering (FATF*), Procedures for the FATF Fourth Round of AML/CFT mutual evaluations*, October 2013, http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF-4th-Round-Procedures.pdf (accessed 18 June 2017).

Financial Action Task Force, *About the Non-Cooperative Countries and Territories (NCCT) Initiative*, http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/more/aboutthenon-cooperativecountriesandterritoriesncctinitiative.html (accessed 3 July 2015).

Financial Action Task Force, *The FATF Recommendations – International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation* (FATF 2012).

Financial Conduct Authority, *Implementation of the Alternative Investment Fund Managers Directive*, PS 13/5, June 2013.

Financial Conduct Authority, *Discussion Paper – Discussion Paper on distributed ledger technology*, DP 17/3, April 2017, https://www.fca.org.uk/publication/discussion/dp17-03.pdf (accessed 20 July 2017).

Finanzmarktaufsicht Liechtenstein, *FAQ Umsetzung AIFMG (Stand 27.08.2013),* 7, http://www.fma-li.li/no_cache/finanzintermediaere/bereich-wertpapiere/verwalter-alternativer-investmentfonds/faq.html?cid=3093&did=2447&sechash=2e2eae02 (accessed 17 February 2017).

Finanzmarktaufsicht Liechtenstein, *Frequently Asked Questions zur Anwendung des Alternative Investmentfonds Manager – Gesetzes (AIFMG),* https://www.fma.gv.at/typo3conf/ext/dam_download/secure.php?u=0&file=10522&t=1390046444&hash=d5551f99506d886130f02ce328f74bbc (accessed 26 January 2017).

Fink, C., *PTAs in Services: Friends or Foes of the Multilateral Trading System?*126 (J. Marchetti and M. Roy eds., Cambridge University Press, 2008).

Fisch, J. & Wilkinson-Ryan, T., *Why Do Retail Investors Make Costly Mistakes? An Experiment on Mutual Fund Choice*, 162 U. Pa. L. Rev. 605 (2013–2014).

Fischer, C. & Friedrich, T., *Investmentaktiengesellschaft und Investmentkommanditgesellschaft unter dem Kapitalanlagegesetzbuch*, ZBB 153 (2013).

Fischer-Appelt, D., *Prospectus Directive amendments – discussion of key changes*, Law and Financial Markets Review 490 (2010).

Fischer-Appelt, D., *The European Securities and Market Authority: the beginnings of a powerful European securities authority?,* 1 Law and Financial Markets Review 21-32 (2011).

Fitchew, G., *Political Choices* 4 (R.M. Buxbaum, G. Herzig, A. Hirsch & K.J. Hopt eds., De Gruyter 1991).

Flannigan, R., *The Economics of Fiduciary Accountability*, 32 DEL. J. CORP. L. 393 (2007).

FMA Austria, *Hedge-Fonds: Bedeutung am Finanzplatz Österreich und regulatorischer Rahmen: Stand 16.11.2005* 76, http://www.fma.gv.at/typo3conf/ext/dam_download/secure.php?u=0&file=1942&t=1341897968&hash=c6c8f6ab4a8c35d7725a9f7a8c7e1cf5 (accessed 9 July 2012).

Fortado, L., *Lehman segregated accounts appeal may delay hedge fund payouts*, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a2g8ad6oSj4Q (accessed 3 July 2015).

Fox, D., *Defined Benefit Pension Trusts: Asset Partitioning and the Residual Interest,* University of Cambridge Faculty of Law Research Paper No. 10/03, 12.

Frankel, T., *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209 (1995).

Frankel, T., *Fiduciary Law – Analysis, Definitions, Duties, Remedies over History and Cultures* (Fathom Pub. Co. 2008).

Frankel, T., *Fiduciary Law*, 71 Ca. L. Rev. 795 (1983).

Frase, D. *Overview* 4 (D. Frase ed., Sweet & Maxwell 2011).

Frase, D., *Custody*, in *Law and Regulation of Investment Management* (D. Frase ed., Sweet & Maxwell 2011).

Fridriksson, I., *The banking crisis in Iceland in 2008*, http://www.bis.org/review/r090226d.pdf (accessed 14 January 2017).

Fuchs, S., *der Portfolio-Manager in der Global-Custody-Beziehung – Partner oder Störenfried*, (Haupt Verlag 2004).

G

Gaouaoui, S., *Conservation d'actifs, la Cour d'appel entérine la responsabilité des dépositaires*, 1025 Option finance 10 (2009).

Gardella, A., *Bail-in and the Financing of the SRM* (D. Busch & G. Ferrarini, Oxford 2015).

Gasser, J. & Schwingshackl, M., *Asset Protection through Liechtenstein Annuities and Life Insurance*, (M. Gantenbein & M.A. Mata eds., John Wiley & Sons 2008).

Gauzès, J.-P., *Focus on AIFMD: The AIFM Directive*, Luxembourg Fund Review 18 (2011).

Geiger, H., *Transnational Supervisory Recognition: a Macro-Jurisdictional Overview* (J. Burling, S.C. Chambers & K. Lazarus eds., Edward Elgar 2012).

Gelauf, G., *Subsidiarity and Economic Reform in Europe* (Springer 2008).

Gene, S., *Luxembourg Called On to* "*Brush Up*" *Governance*, Financial Times, Fund Management Supplement, (26 January 2009).

Gerner-Beuerle, C., *United in diversity: maximum versus minimum harmonization in EU securities regulation*, 3 Capital Markets Journal 317 (2012).

Gibbon, S.F. *Fiduciary Relationships Are Not Contracts,* 82 MARQ. L. REV. 303 (1999).

Gilson, R. & Kraakman, R., *Market Efficiency after the Financial Crisis: It's Still a Matter of Information Costs*, 100 Va. L. Rev. 313 (2014).

Giudici, P., *Independent Financial Advice* (D. Busch & G. Ferrarini eds, Oxford 2017).

Gkoutzinis, A., *International Trade in Banking Services and the Role of the WTO: Discussing the Legal Framework and Policy Objectives of the General Agreement on Trade in Services and the Current State of Play in the Doha Round of Trade Negotiations*, 39 International Lawyer 877 (2005).

Global Fund Media, *AIFMD Depositary Models 2014 – Special Report,* http://www.hedgeweek.com/sites/default/files/GFM_AIFMD_14.pdf (accessed 3 September 2016).

Goodhart, C., et al., *Financial Regulation: Why, how and where now?* 5 (Routledge 1998).

Goodhart, C., *The Central Bank and the financial system* 434(Palgrave Macmillan UK 1995).

Gortsos, Ch.V., *The Supervision of Financial Conglomerates under European Financial Law (Directive 2002/87/EC)*, 25 Banking & Financial Law Review 295-313 (2010).

Gottmers, J. & Weller, E.J. *De compliance functie na invoering van MiFID en Wft* 304-317 (A.J.C.C.M. Loonen et al., NIBE-SVV 2008).

Goutay, Ph., *Obligation de restitution des dépositaires : les arrêts du 8 avril 2009 de la Cour d'appel de Paris*, 2 RD Bancaire et Financier 166 (2009).

Government Office for Science, *Distributed Ledger Technology beyond block chain – A report by the UK Government Chief Scientific Adviser*, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/492972/gs-16-1-distributed-ledger-technology.pdf (accessed 11 July 2017).

Grabitz E. & Hilf, M., *Das Recht der Europäischen Union* (C.H. Beck 2009).

Grant Thornton, *Alternative Investment Fund Managers Directive (AIFMD) - The Depositary and Prime Broker (PB) Operating Model Dilemma*, http://www.grant-thornton.co.uk/Global/Publication_pdf/AIFMD.pdf (accessed 3 September 2016).

Greef, R.M.J.M de, *Herziening IORP richtlijn – Een verbetering?* , 50 TPV 27 (2016).

Greene, E.F., *Beyond Borders: Time To Tear Down the Barriers to Global Investing,* 48 HARV. INT'L L.J. 92 (2007).

Gregoriou, G. N. & Lhabitant, F.-S., *Madoff: A Riot of Red Flags* (EDHEC-Position Paper 2009).

Gregory, W.A., *The Fiduciary Duty of Care: A Perversion of Words*, 38 Akron Law Review 181 (2005).

Greig, J., *United Kingdom* (D.A. Zetzsche ed, Kluwer 2012).

Groffen, C. J, Spoor, N.B. & van der Velden, J. W., *Hoofdstuk 13 Beleggingsinstellingen*, in *Onderneming en Financieel Toezicht* (D. Busch ed., Kluwer 2010).

Groffen, C.J. & Spoor, B., *Netherlands* (L. Van Setten & D. Busch eds, Oxford 2014).

Groffen, C.J., *UCITS V implementatie in Nederland*, 3 TvFR 114 (2016).

Gros, D., *The Economics of Brexit: It's not about the Internal Market*, https://www.ceps.eu/publications/economics-brexit-it%E2%80%99s-not-about-internal-market (accessed 14 January 2017).

Grossman, S.J. & Hart, O.D., *The costs and benefits of ownership: A theory of vertical and lateral integration,* 94 Journal of Political Economy 691-719 (1986).

Grundmann, S., *Conflicts of Interest* (D. Busch & G. Ferrarini eds, Oxford 2017).

Grundmann-van de Krol, C.M., *New EC Prospectus Directive and the Lamfalussy Process*, 1 European Company Law 32-35 (2004).

Grundmann-van de Krol, C.M., *Bescherming crediteuren beleggingsfonds: "trust" in artikel 16a Wtb*, 14 Ondernemingsrecht 486-488 (2005).

Grundmann-van de Krol, C.M., De 'governance' van beleggingsinstellingen, 6 TvOB 225-232 (2005).

Grundmann-van de Krol, C. M., *Beleggingsinstellingen: 'uitdagende' en andere regelgeving op komst*, Ondernemingsrecht 436 (2010).

Grundmann-van de Krol, C. M., *Koersen door de Wet op het financieel toezicht* (Boom Juridische Uitgevers 2010).

Grundmann-van de Krol, C.M., *Europees kader: Prospectusrichtlijn en de relatie met andere Europese richtlijnen* 73-130 (B. Bierens, C.M. Grundmann-van de Krol, D.J.K. Lemstra & T.M. Stevens, Kluwer 2011).

Grundmann-van de Krol, C.M. & Hijink, J.B.S., *Who is afraid of a single rulebook?* 3-16 (F.G.B. Graaf, R.H. Maatman & L.J. Silverentand eds, Kluwer 2012).

Grundmann-van de Krol, C.M. *Koersen door de Wet op het financieel toezicht* 95-104 (Kluwer 2012).

Grundmann- van de Krol, C.M., *Regulering beleggingsinstellingen en icbe*'*s in de Wft* (Boom Juridische Uitgevers 2013).

Grundmann-van de Krol, C.M., *Voorstel Verordening Europese langetermijninvesteringsfondsen*, 16 Ondernemingsrecht 591 (2013).

Grundmann-van de Krol C.M., *Voorstel Verordening geldmarktfondsen* ("MMFs"), 18 Ondernemingsrecht 103 (2014).

Grundmann-van de Krol, C.M., *Consultatiewetsvoorstel implementatie UCITS V in de Wft*, 49 Ondernemingsrecht 262 (2015).

Gruson, G., *Supervision of Financial Holding Companies in Europe: The EU Directive on Supplementary Supervision of Financial Conglomerates,* 36 *The International Lawyer* 1229-1260 (2002).

Gruson, M., *Foreign Banks and the Financial Holding Company* (M. Gruson & R. Reisner eds., Lexis Nexis Matthew Bender 4th ed. 2003).

Gruson, M., *Supervision of Financial Conglomerates in the European Union,* 198 Journal of International Banking Law and Regulation 363-381, 364 (2004).

Gruson, M., *Consolidated and Supplementary Supervision of Financial Groups in the European Union*, Institute for Law and Finance Johann Wolfgang Goethe- Universität Frankfurt, Working Paper Series No. 19 (2004).

Gruson, M., *Consolidated and Supplementary Supervision of Financial Groups in the European Union*, Der konzern , Teil 1, 65-93, Teil II, 249-265 (2004).

Guðmundsson, M., *The Fault Lines in Cross-Border Banking: Lessons From the Icelandic Case*, OECD Journal Financial Market Trends, Issue 2 (2011).

Guilhaumaud, P., *La responsabilité civile du dépositaire d'OPCVM*, 25 Banque et Droit 551 (1992).

Gunnarsson, E.G., *The Icelandic Regulatory Responses to the Financial Crisis*, 1 European Business Organization Law Review 139 (2011).

H

Haar, B., *Organizing Regional Systems: The EU Example* 160 (N. Moloney, E. Ferran & J. Payne eds., Oxford 2015).

Häde, U., *Jenseits der Effizienz: Wer kontrolliert die Kontrolleure?*, Europäische Zeitschrift für Wirtschaftsrecht 662 (2011).

Haentjes, M., *Clearing and Settlement –Ways Forward*, 5 Journal of International Banking Law and Regulation (2011).

Haentjes, M., *Harmonisation of Securities Law - Custody and Transfer of Securities in European Private Law* 131-172 (Kluwer 2007).

Hahn, M.J., *W.T.O. Rules on Trade in Financial Services: A Victory of Greed over Reason?* 176–205 (R. Grote & T. Marauhn eds., Cambridge University Press, 2006).

Halpern, P., Trebilcock, M. & Turnbull, S., *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L.J. 117, 148 (1980).

Hamstra, I.M., *Gedragsregels voor Nederlandse beleggingsondernemingen handelend met cliënten buiten de Europese Economische Ruimte*, 6 V&O 122-125 (2010).

Hansmann, H. & Kraakman, R., *The Essential Role of Organizational Law,* 110 Yale Law Journal 387(2000).

Hansmann, H. & Mattei, U., *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 New York University Law Review 434 (1998).

Hansmann, H., *Corporation and Contract*, 8 American Law and Economics 1-19 (2006), https://ssrn.com/abstract=1095570 (accessed 11 May 2017).

Hansmann, H., *Organizational Law as Asset partitioning,* 44 European Economic Review 807, 817 (2000).

Hansmann, H., *Ownership and Organizational Form*, http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.461.5180&rep=rep1&type=pdf (accessed 11 May 2017).

Hansmann, H., *The Ownership of Enterprise* (Belknap Press 2000).

Hardin, R., *Collective action* (Baltimore 1982).

Hart, F.M.A. 't, *Het 'ken-uw-cliënt'-beginsel bezien* 80-99 (A.J.C.C.M. Loonen et al., NIBE-SVV 2008).

Hart, F.M.A. 't, *Ken-uw-cliënt* (F.M.A. 't Hart ed, NIBE-SVV 2007).

Hart, O., *Financial Contracting,* 39 Journal of Economic Literature 1079-1100 (2001).

Hart, O., *Firms Contracts and Financial Structure (*Clarendon Press 1995).

Harwood-Jones, M., *Blockchain and T2S: A potential disruptor*, https://www.sc.com/BeyondBorders/wp-content/uploads/2016/06/2016-06-16-BeyondBorders-Report-SCB_Nema_Block-Chain-Paper-Final.pdf (accessed 20 July 2017).

Hatzopoulos, V., *Regulating Services in the European Union* 222 (Oxford University Press 2012).

Hildebrand, P., *Hedge funds and prime broker dealers: step towards a 'best practice proposal'*, Banque de France, Financial Stability Review – Special issue on hedge funds, No. 10 (2007).

Hirschman, A.O., *Exit, Voice and Loyalty. Responses to Decline in Firms, Organizations and States (*Harvard University Press 1970).

Hoecke, M. van, *Do "Legal Systems" Exist? The Concept of Law and Comparative Law* 43-57 (S. Donlan & L. Heckendorn Urscheler eds., Ashgate 2014).

Hoecke, M. van., *Methodology of Comparative Legal Research*, http://rem.tijdschriften.budh.nl/tijdschrift/lawandmethod/2015/12/RENM-D-14-00001#content_RENM-D-14-00001.5738700789 (accessed 24 April 2017).

Hoekstra, M., *Van bewaarder naar AIFMD depositary – Een inkijkje in de veranderende rol van de bewaarder bij beleggingsinstellingen*, 10 TvFR 365 (2012).

Hofmeester, H.W. & Swaak, S., *De prospectusplicht voor beheerders van beleggingsinstellingen*, 10 TvFR 328-333 (2013).

Hohenwarter, D. & Plansky, P.*, Die Kapitalverkehrsfreiheit mit Drittstaaten im Lichte der Rechtssache Holböck,* , SWI 346 (2007).

Hollinger, P. & Chung, J., *Madoff Affair Sparks Demand for Revamp of Investment Fund Rules*, Financial Times, (13 January 2009), 15.

Hollinger, P., Hall, B. & Tait, N., *Grand Duchy Hits Back at Madoff*, Financial Times (14 January 2009), 23.

Hologan, H. & Masson, D., *Les principes d'évaluation applicables aux gestionnaires de fonds alternatifs*, 758 Revue Banque (2013).

Holopainen, H., *Integration of financial supervision*, Bank of Finland Research Discussion Papers12 (2007).

Hooghiemstra, S.N., *The Netherlands* (D.A. Zetzsche ed, Kluwer 2012).

Hooghiemstra, S.N., *Depositary Regulation* (D.A.Zetzsche ed, Kluwer 2012).

Hooghiemstra, S.N., *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013).

Hooghiemstra, S.N. *Wat is een beleggingsinstelling onder de AIFM-richtlijn?*, 3 Ondernemingsrecht 24 (2014).

Hooghiemstra, S.N., *De fiscale woonplaatsproblematiek van abi´s onder de AIFM-richtlijn*, 4 MBB 129 (2015).

Hooghiemstra, S.N., *Depositary Regulation* 480 (D.A.Zetzsche ed, Kluwer 2015).

Hooghiemstra, S.N., *The AIFM's Transposition in the Netherlands* (D.A.Zetzsche ed, Kluwer 2015).

Hooghiemstra, S.N., *The AIFMD's Transposition in the Netherlands* (D.A. Zetzsche ed, Kluwer 2015).

Hooghiemstra, S.N. & Litwin, D., *The Liechtenstein 2011 UCITS Law Opens New Opportunities for Collective Investment Vehicles*, https://www.uni.li/de/neuigkeiten/the-liechtenstein-2011-ucits-law-opens-new-opportunities-for-collective-investment-vehicles (accessed 13 October 2016).

Horan, S., *Ireland* (D.A. Zetzsche ed., Kluwer 2012).

House of Commons, *Treasury Committee, Banking Crisis: The impact of the failure of the Icelandic banks,* Fifth Report of Session 2008-09, 4 April 2009.

Hövekamp, H. & Hugger, G., *Die Reichweite der Haftung der Depotbanken vor dem Hintergrund des Madoff-Skandals* 2015-2028 (S. Grundmann, B. Haar & H. Merkt eds., De Gruyter 2010).

Hudson, A., *Equity and Trusts* 995-997 (Routledge 2015).

Huizink, J.B., *Informatieverplichtingen voor beheerders van beleggingsinstellingen bij een controlerend belang* 44-58 (N.B. Spoor, M. Tausk, J.B. Huizink & R.P. Raas, Kluwer 2012).

Hutch, M., *Pension Fund Supervisory Methods in Ireland* (OECD Private Pensions Series No. 6, 2004).

I

International Association of Insurance Supervisors, *Insurance Core Principles*, November 2015.

International Monetary Fund, *Macroeconomic implications of the United Kingdom leaving the European Union,* IMF Country Report No. 16/169 (2016), https://www.imf.org/external/pubs/ft/scr/2016/cr16169.pdf (accessed 14 January 2017).

International Organisation of Securities Commissions*, Client Asset Protection, Report of the IOSCO Technical Committee (*IOSCO 1996*).*

International Organisation of Securities Commissions, *Objectives and Principles of Securities Regulation*, Part II The Regulator (2003), http://www.legco.gov.hk/yr04-05/english/panels/fa/papers/fa0217cb1-880-9e.pdf (accessed 22 February 2017).

International Organisation of Securities Commissions, *Examination of Governance for Collective Investment Schemes – Final report, Part I*, June 2006.

International Organisation of Securities Commissions, *Examination of Governance for Collective Investment Schemes - Independence Criteria, Empowerment Conditions and Functions to be performed by the 'Independent Oversight Entities',* Part II, February 2007.

International Organisation of Securities Commissions, *Mitigating Systemic Risk - A Role for Securities Regulators: Discussion Paper* (IOSCO 2011).

International Organisation of Securities Commissions, *Methodology – For Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation*, FR 08/11, (2011).

International Organisation of Securities Commission, *Standards for the Custody of Collective Investment Schemes' Assets – Final Report*, FR 25/2015, November 2015, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD512.pdf (accessed 22 April 2017).

International Organisation of Securities Commissions, *IOSCO Task Force on Cross-Border Regulation – Final Report*, FR 23/2015, (2015),

International Organisation of Securities Commissions, *Guidelines for Regulation of Conflicts of Interest Facing Market, Intermediaries"* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD342.pdf (accessed 14 January 2017).

International Organisation of Securities Commissions, *Objectives and Principles of Securities Regulation for market intermediaries,* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf (accessed 14 January 2017).

International Organization of Securities Commissions, *IOSCO Research Report on Financial Technologies (Fintech)*, February 2017, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD554.pdf (accessed 20 July 2017).

Investment Management Association, *Pooling: how can fund managers respond efficiently to different investor needs?,* http://www.theinvestmentassociation.org/assets/files/research/20050701pooling.pdf (accessed 22 August 2016)

J

J.P. Morgan, *J.P. Morgan's Integrated Prime Brokerage and Custody Service – Prime-Custody Solutions*, https://www.jpmorgan.com/cm/BlobServer/PrimeCustody_Solutions.pdf?blobkey=id&blobnocache=true&blobwhere=1320555967068&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs (accessed 3 September 2016).

Jackson, M. & Counihan, D., *Ireland* (L. Van Setten & D. Busch eds, Oxford 2014).

Jans, J.H. & Squintani, L., Aragão, A., Macrory, R. & Wegener, B.W., *'Gold plating' of European Environmental Measures,* 6.4. Journal of European Environmental and Planning Law 417-435 (2009).

Jarreau, J.S., *Interpreting the General Agreement on Trade in Services and the WTO Instruments Relevant to the International Trade of Financial Services: The Lawyer's Perspective* 25 N.C.J. INT'L L. & COM. REG. 1, 8 (1999).

Jensen, M.C. & Meckling, W.H., *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976).

Jentzsch, C., *Decentralized Autonomous Organization to Automate Governance*, https://download.slock.it/public/DAO/WhitePaper.pdf (accessed 21 July 2017).

Johannsen, K. R., *Jumping the gun: hedge funds in search of capital under UCITS IV*, 5 Brooklyn Journal of Corporate, Financial & Commercial Law 473 (2011).

Johnson, S. & Grene, S., *UCITS IV plan could be dropped*, Financial Times (14 April 2008).

Joint Committee, *Joint Position of the European Supervisory Authorities on Manufacturers' Product Oversight & Governance Processes*, https://eiopa.europa.eu/Publications/Administrative/JC_2013_77__POG___Joint_Position_.pdf (accessed 14 January 2017).

Joint Forum, *Customer Suitability in the Retail Sale of Financial Services,* http://www.bis.org/publ/joint20.pdf (accessed 14 January 2017).

Joint Forum, *Principles for the Supervision of Financial Conglomerates*, Bank for International Settlements, September 2012.

Jong, E.M. & Winter, J.W., *Corporate governance voor beleggingsinstelling*, 3 TvE 29-35 (2004).

Joosen, E.P.M., *Uitbesteding van werkzaamheden* (D. Busch & C.M. Grundmann-van de Krol eds, Kluwer 2009).

Jorion, P., *Risk management for hedge funds with position information*, 34 Journal of Portfolio Management 130 (2007).

Jud, K., *Das Prime Brokerage-Geschäft mit Hedge Funds* (Haupt 1996).

Jung, B., *Standard of Review for Jurisprudence on Prudential Measures*, 1 ILSP L.J. 49, 50 (2009).

Jutzi, T., & Feuz, C., *MiFID II, AIFMD und UCITSD: Auswirkungen des EU-Vermögensverwaltungsrechts aufdas grenzüberschreitende Geschäft Schweizer Finanzintermediäre*, Jusletter Next, 25. April 2016, http://www.iwr.unibe.ch/unibe/portal/fak_rechtwis/e_dep_dwr/inst_iwr/content/e36453/e162340/e172868/e172869/files426879/2016_04_25_Jusletter_ger.pdf (accessed 10 June 2017).

K

Kalss, S., *Anlegerinteressen – Der Anleger im Handlungsdreieck von Vertrag, Verband und Markt* (Springer 2001).

Kaminska, I., *Prime custody, and the business of collateral*, Financial Times (13 July 2012).

Kammel, A.J., *Alternative Investment Fund Manager Richtlinie – 'Another European Mess'?*, 1 Österreichisches Bankarchiv 18 (2011).

Kammel, A.J., *Alternative Investmentfonds Manager-Gesetz (AIFMG)&Co – Eine erste Bestandsaufnahme*, 7 Österreichisches Bankarchiv 483 (2013).

Kämmerer, J. A., *Das neue Europäische Finanzaufsichtssystem (ESFS) – Modell für eine europäisierte Verwaltungsarchitektur?*, Neue Zeitschrift für Verwaltungsrecht 1281 (2011).

Kamptner, I., *Auswirkungen der AIFM-Richtlinie auf Spezialfonds*, ÖBA 127 (2013).

Kapstein, E.B., *Governing the Global Economy –International Finance and the State* 136 (Havard University Press 1994).

Karlin, M., *Responsabilité des teneurs de compte conservateurs*, 2 RD Bancaire et Financier étude 8 (2009).

Kaufmann, G. & Scott, K., *What Is Systemic Risk, and Do Bank Regulators Retard or Contribute to It?*, 7:3 The Independent Review 371 (2003).

Kayser, J. & Schlikker, G., *Alternative Investmentstrategien im UCITS-Format – ein Überblick*, Absolut|report 52 (2009).

Keijser T.R.M.P.*, Financiële zekerheidsovereenkomsten*, 11 Ars Aequi 835-840 (2006).

Keijser, T.R.M.P., *A Custodian's Right of Use under Dutch Law?* 40-42 (T. Keijser ed, Report on A 'Right of use' for collateral takes and custodians), Presented to the UNIDROIT Secretariat (2003).

Kerkvliet, J., *De gevolgen van de AIFM Richtlijn voor de Nederlandse private equity-industrie*, 3 *V&O* 55 (2011).

Kerkvliet, J., *Het voorstel voor een verordening inzake Europese Venture capital-fondsen*, 3 *V&O* 16 (2012).

Kerkvliet, J., *Toegang voor beheerders van beleggingsinstellingen tot de Nederlandse markt, na implementatie van de AIFM-richtlijn*, 1 Onderneming en Financiering 31-42 *(*2012).

Kern, A. & Schmidt, A., *The Market in Financial Instruments Directive and Switzerland*, 1 GesKR45 (2012).

Kessler, F., *The Governance of Supplementary Pension Schemes and the Role of the Employee Representatives: A Story of Paradoxes* 295 (O. Kaufmann & S. Hennion, Springer 2011).

Key, S.J., *Financial Integration in the European Community*, Board of Governors of the Federal Reserve System – International Finance Discussion Papers, No. 349 (April 1989), 105-106.

Key, S.J., *Trade Liberalization and Prudential Regulation: The International Framework for Financial Services*, 75 Int. Affairs 61, 63 (1999).

Kind, S. & Haag, S. A., *Der Begriff des Alternativen Investment Fonds nach der AIFM-Richtlinie – geschlossene und private Vermögensanlagegesellschaft im Anwendungsbereich?*, 30 Deutsches Steuerrecht 1526 (2010).

King, M. R. & Maier, P., *Hedge Funds and Financial Stability: Regulating Prime Brokers Will Mitigate Systemic Risks*, 5 Journal of Financial Stability 283 (2009).

Klausner, M., *Corporations, Corporate Law, and Networks of Contracts,* 81 *Virginia Law Review* 757-852 (1995).

Klebeck, U. & Eichhorn, J., *Drittstaatenregulierung der MiFID II und MiFIR*, 3 RdF 1 (2014).

Klebeck, U. & Kolbe, S., *Anlageverwaltung und Finanzmarktaufsicht*, 31:5 Zeitschrift für Wirtschaftsrecht 215 (2010).

Klebeck, U. & Meyer, C., *Drittstaatenregulierung der AIFM-Richtlinie*, Recht der Finanzinstrumente 95 (2012).

Klebeck, U.& Meyer, C., *Drittstaatenregulierung der AIFM-Richtlinie*, Recht der Finanzinstrumente 95 (2012).

Klebeck, U., *Interplay between AIFMD and the UCITSD* (D.A.Zetzsche ed, Kluwer 2015).

Klebeck, U., *Liquidity Management and Side Pockets* (D.A.Zetzsche ed, Kluwer 2015).

Klebeck, U., *Auslagerung von Anlageverwaltungsfunktionen*, 2 Recht der Finanzinstrumente 225 (2012).

Klebeck, U., *Neue Richtlinie für Verwalter von alternativen Investmentfonds?*, 42 Deutsches Steuerrecht 2154 (2009).

Klerk, J.E., & Slange, R., *UCITS V and beyond*, 1/2 TvFR 34-39 (2015).

Knauder, C., *Der Trennungsgrundsatz im österreichischen Investmentfondsrecht im Wandel der Zeit*, ZFR 103 (2013).

Kobbach, J. & Anders, D., *Umsetzung der AIFM-Richtlinie aus Sicht der Verwahrstellen*, NZG 1170 (2012).

Kortleve, N. et al., *European Supervision of Pension Funds: Purpose, Scope and Design*, Netspar Design Papers No. 4 (Oct. 2011), 15-18.

Kortmann, S.C.J.J. & R.H. Maatman, *Uitbesteding door vermogensbeheerders*, 9 Ondernemingsrecht 311-318 (2005).

Kost - de Sevres, N. & Sasso, L., *The new European financial markets legal framework: a real improvement? An analysis of financial law and governance in European capital markets from a micro- and macro-economic Perspective, 7* Capital Markets Law Journal 30 (2011).

KPMG, *The prime brokerage industry: An exploration of evolving standards – operational accountability, internal controls, and transparency*, https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/the-prime-brokerage-business.pdf (accessed 3 September 2016).

Kraakman, R., *The Anatomy of Corporate Law: a comparative and functional approach* (Oxford University Press 2004).

Kraakman, R.H., *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 53-54 (1986).

Kramer, R. & Recknagel, R., *Die AIFM-Richtlinie – Neuer Rechtsrahmen für die Verwaltung alternativer Investmentfonds*, 37 Der Betrieb 2077 (2011).

Kremer, C. & Lebbe, I., *Collective Investment Schemes in Luxembourg – Law and Practice* (2nd edn, Oxford University Press 2014).

Kremer, C. & Seale, T., *Passport benefits may not be worth risk* ,*Financial Times* (London 13 October 2008).

Kremer, C., Eisenhuth, M., Dusemon, G. & Martougi, C., *Luxembourg* (D. Busch ed, Oxford 2014).

Kress, S., *Effizienzorientierte Kapitalmarktregulierung – eine Analyse aus institutionenökonomischer Perspektive* 59 (Wiesbaden 1996).

Krol, A.N. & C.W.M. Lieverse, *Implementatie van de transparantierichtlijn*, 12 TvFR 401-414 (2008).

Krug, A., *Investment Company as Instrument: The Limitations of the Corporate Governance Regulatory Paradigm*, 86 S. Cal. L. Rev. 263 (2013).

Kruithof, M., *Conflicts of Interest in Institutional Asset Management: Is the EU Regulatory Approach Adequate?,* 31, http://ssrn.com/abstract=871178 (accessed 14 January 2017).

Kruithof, M., *Deugdelijk Bestuur van Instellingen voor Collectieve Belegging (ICB): Governance als Invulling van de Loyauteit*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=961778 (16 April 2017).

Kühne, A.O. & Eberhardt, M., *Erlaubnispflicht eines 'Family Office' unter Berücksichtigung des neuen Finanzdienstleistungstatbestandes der Anlageberatung*, 8 Zeitschrift für Bank- und Kapitalmarktrecht 133 (2008).

Kühne, A.-O., *Ausgewählte Auswirkungen der Wertpapierdienstleistungsrichtlinie – MiFiD*, Zeitschrift für Bank- und Kapitalmarktrecht 275 (2005).

Kumpan, C., & Leyens, P., *Conflicts of interest of Financial Intermediaries – Towards a Global Common Core in Conflicts of Interest Regulation,* 1 European Company and Financial Law 72 (2008).

L

Laaper, P., *Uitbesteding in de financiële sector - in het bijzonder van vermogensbeheer door pensioenfondsen* 57-60, 211 (Kluwer 2015).

Labeur, R.E. *Uniform derdelandenbeleid AIFMD: Nog een lange weg te gaan*, 10 TvFR 391-395 (2015).

Labeur, R.E. *Consultatieperikelen beleggersgiro*, 3 TvFR (2016).

Labeur, R.E. & Wit de, T.W.G., *Rondom het nieuws – Haast met herziening Venture Capital Verordening*, 9 TvFR 243 (2016).

Laby, A.B., *Selling Advice and Creating Expectations: Why Brokers Should Be Fiduciaries*, 87 WASH. L. REV. 707, 775 (2012).

Lachgar, K., *From the UCITS Directive to the transposition of AIFMD: exegesis of evolutions's depositary activity in Europe*, Joly Bourse (2014).

Lachgar, K., *Le rôle du dépositaire dans l'ère AIFM: 'business as usual' ou opportunité de différenciation?*, 749 Revue Banque (2012).

Lacroix, Y. & Tristan, L., *Parties and service providers involved in specialized investment funds' in specialized Investments Funds* 71 *(*Arendt & Medernach, 2007).

Laffont, J.J. & Martimort, D., *The Theory of Incentives: The Principal-Agent Model*, https://gnunet.org/sites/default/files/Laffont%20%26%20Martimort%20-%20The%20Theory%20of%20Incentives.pdf (accessed 11 May 2017).

Laguna, R.P., *Spain* (E. Wymeersch ed, Kluwer 2012).

Lamandini, M., *When more is needed: the European financial supervisory reform and its legal basis,* 6 European Company Law 197-202 (2009).

Lancellotta, A.B.R., Pike, P.A. & Stevens, P.S., *Fund Governance: A Successful, Evolving Model,* 10(3) Virginia Law & Business Review 455-489 (2016).

Lang A. & Conyers, C., *Financial Services in EU Trade Agreements*, PE 536.300, European Parliament, Brussels, 2014, 36300_EN.pdf (accessed 19 June 2017).

Langbein, J.H., *The Contractarian Basis of the Law of Trusts*, 105 Yale L.J. 627 (1995).

Langbein, J.H., *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 IOWA L. REV. 641 (1996).

Lannoo, K., *The Draft Pension Funds Directive and the Financing of Pensions in the EU,* 21 The Geneva Papers on Risk and Insurance Issues and Practice 114-126 (1996).

Lannoo, K. & Levin, M., *Securities Market Regulation in the EU -Everything You Always Wanted to Know about the Lamfalussy Procedure*, CEPS Research Report in Finance and Banking, No. 33, (May 2004), 14.

Lannoo, K., *EU Retail Financial market Integration: Mirage Or Reality?*, ECRI Policy Brief No. 3 (June 2008).

Lannoo, K. & Casey, J-P., *Pouring Old Wine into New Skins? Ucits & Asset Management in the EU after MiFID*, CEPS-ECMI Task Force Report, 2008.

Lannoo, K., *Regulatory Challenges for the EU Asset Management Industry*, ECMI Policy Brief, No. 15 (April 2010), https://www.files.ethz.ch/isn/115117/015_Lannoo%20on%20Asset%20Management.pdf (accessed 14 January 2017).

Lannoo, K, *The Great Financial Plumbing: From Northern Rock to Banking Union* 40 (Rowman and Littlefield International 2015).

Lannoo, K., *Brexit and the City,* https://www.ceps.eu/publications/brexit-and-city (accessed 14 January 2017); K. Lannoo*, Britain's Finance Industry Needs the EU*, Wall Street Journal (26 January 2016).

Lannoo, k., *Britain's Finance Industry Needs the EU*, Wall Street Journal (26 January 2016).

Lannoo, K., EU Financial Market Access after Brexit, CEPS Policy Brief, September 2016, https://www.ceps.eu/system/files/Brexit%20and%20the%20financial%20sector_0.pdf (accessed 14 January 2017).

Larosière, J. de, *The High-Level Group on Financial Supervision in the EU*, 25 February 2009, http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf (accessed 26 June 2017).

Lastra, R., *Systemic Risk, SIFIs and Financial Stability*, 6 Capital Markets Law Journal 197 (2011).

Leanza, U., *An Outline of the EEC Discipline on Credit Institutions*, 7 Journal of Regional Policy, 59 (1987).

Lebbe, I. & Partsch, P.E., *Luxembourg (*E. Wymeersch ed., Kluwer 2012).

Lechkar, M. , Meerten, H. van & Nijenhuis, O., *The Solvency II Directive: An Innovative New Regime, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1511582* (accessed 5 October 2016).

Lee, K., *Investor Protection in European Union: Post FSAP Directives and MiFID*, https://ssrn.com/abstract=1339305 (accessed 14 January 2017).

Leeuw, F.R.H. van der & M. Ris, *Informatieverstrekking* (D. Busch & C.M. Grundmann-van de Krol eds, Kluwer 2009).

Legal Certainty Group, *Second Advice of the Legal Certainty Group – Solutions to Legal Barriers related to Post-Trading within the EU*, August 2008.

Legal Certainty Group, *Second Advice on solutions to legal barriers related to post-trading within the EU* (LCG 2008).

Lehmann, M. & C. Manger-Nestler, *Die Vorschläge zur neuen Architektur der europäischen Finanzaufsicht*, 3 Europäische Zeitschrift für Wirtschaftsrecht 87 (2010).

Lehmann, M. & Zetzsche, D.A., *Brexit and the Consequences for Commercial and Financial Relations between the EU and the UK*, https://ssrn.com/abstract=2841333 (accessed 14 January 2017).

Leland, H.E, *Quacks, Lemons, and Licensing: A Theory of Minimum Quality Standards* , 87 Journal of Polical Economy 1328 (1978).

Lener, R., *Italy (*E. Wymeersch ed, Kluwer 2012).

Lener, R. & Petronzio, C., *The AIFMD's Transposition in Italy* (D.A. Zetzsche ed, Kluwer 2015).

Leroux, E. ,*What is a "Service supplied in the exercise of governmental authority" under art. I:3(b) and of the General Agreement on Trade in Services?*, 40 Journal of World Trade 345(2006).

Leroux, E., *Trade in Financial Services under the World Trade Organization*, 36 Journal of World Trade 413 (2002).

Levmore, S., *Monitors and Freeriders in Commercial and Corporate Settings*, 92 Yale Law Journal 49 (1982).

Lewis, A., Pretorius, R. & Radmore, E., *Outsourcing in the financial services sector*, 106 C.O.B. 1 (2013).

Lhabitant, F. S., *Handbook of Hedge Funds* (Wiley 2006).

Lieverse, C.W.M. & Doodeheefver, A.B.A., *De Nederlandse implementatie van de AIFM-richtlijn*, 10 TvFR 322-325 (2011).

Lieverse, C.W.M., *De bewaarder oude stijl en de bewaarder nieuwe stijl: de taken, aansprakelijkheden en het samenspel* 461-474 (D. Busch & M.P. Nieuwe Weme eds, Kluwer 2013).

Lieverse, C.W.M.., *The Scope of MiFID II* (D. Busch & G. Ferrarini eds, Oxford 2017).

Lim, C., Saw, T.J. & Sargeant, C., *Smart Contracts: Bridging the Gap Between Expectation and Reality,* https://www.law.ox.ac.uk/business-law-blog/blog/2016/07/smart-contracts-bridging-gap-between-expectation-and-reality (accessed 21 July 2017).

Lindemann, A., *Relocation to Liechtenstein's Investment Fund Centre under the new AIFM-legislation? – A Swiss & UK perspective*, 1 GesKR 58 (2013).

Lindsey, R.R., *What are Prime Brokers?* (M. Berman ed., 2nd edn, Risk Books 2010).

Lleo, S., *Risk Management: A Review* (W. V. Haslett ed., Wiley 2010).

Llewellyn, D., *The Economic Rationale for Financial Regulation* (FSA 1999).

Löber, K.M., *The Developing EU Legal Framework for Clearing and Settlement of Financial Instruments*, European Central Bank – Legal Working Paper Series, No. 1 (February 2006), 8.

Loff, D. & Klebeck, U., *Fundraising nach der AIFM-Richtlinie und Umsetzung in Deutschland durch das KAGB*, BKR 353 (2012).

Logue, K.D., & Slemrod, J.B., *Of Coase, Calabresi, and Optimal Tax Liability,* Law & Economics Working Papers Law & Economics Working Papers Archive: 2003-2009, University of Michigan Law School Year 2009, 3, http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1097&context=law_econ_archive (accessed 17 August 2016).

Loritz, K. & Uffmann, K., *Der Geltungsbereich des Kapitalanlagegesetzbuches(KAGB) und Investmentformen außerhalb desselben – Erste Überlegungen, auch zum Auslegungsschreiben der BaFin vom 14.6.2013*, WM 2193 (2013).

Low, K. & Teo, E.G.S., *Legal Risks of Owning Cryptocurrencies*, https://ssrn.com/abstract=2856137 (accessed 20 July 2017).

Ludlow, P., *The Making of the European Monetary System: A Case Study of the Politics of the European Community* (Butterworth Scientific 1982).

Lumpkin, S.A., *Risks in Financial Group Structures*, 2 OECD Journal: Financial Market Trends 105-136 (2010).

Luxembourg for Finance, *Luxembourg International Pension Vehicles*, 6, http://www.alfi.lu/sites/alfi.lu/files/file/Setting-upinLuxembourg/LFF_PENSION_FUND_INT_DEF_03_08.pdf.

M

M. Krause & U. Klebeck, *Fonds(anteils)begriff nach der AIFM-Richtlinie und dem Entwurf des KAGB,* 1 RdF 4 (2013).

Maatman, R.H., *Het pensioenfonds als vermogensbeheerder* 232 (Deventer: Kluwer 2004).

Maatman, R.H, *Dutch Pension Funds - Fiduciary Duties and Investing*, Kluwer (Kluwer 2005).

Maatman, R.H. & Steneker, A., *De premiepensioeninstelling*, 12 Ondernemingsrecht 482-491 (2009).

Maatman, R.H., *Beleggen volgens de 'prudent person'-regel*, 17 Ondernemingsrecht 645 (2003).

Maatman, R.H., *Het pensioenfonds als vermogensbeheerder* 232 (Deventer: Kluwer 2004).

Maatman, R.H., *Is mandatory outsourcing welcome?,* https://www.ipe.com/is-mandatory-outsourcing-welcome/www.ipe.com/is-mandatory-outsourcing-welcome/17548.fullarticle (accessed 15 May 2017).

Maatman, R.J., *Een beleggingsinstelling met één deelnemer: contradictio in terminis?,* 5 TvE 95-102 (1999).

Mac Donald, R., *Consolidated Supervision of Banks*, Handbooks in central Banking No. 15, June 1998, 5.

Macfarlanes, *Collectives Investment Schemes – The law and practice* (London 2009)

Mackintosh, J., *Lehman collapse puts prime broker model in question*, Financial Times (24 September 2008).

Maffei, A., *Controverse autour des obligations du dépositaire*, 1 RD Bancaire et Financier étude 8 (2011).

Maggi, R., *MiFID II: Marktzugang, Umsetzung, Handlungsoptionen* (Zürich/Basel/Genf 2014).

Mahoney, P. G., *Mandatory Disclosure as a Solution to Agency Problems*, 62:3 The University of Chicago Law Review 1047 (1995).

Mainelli, M. & Smith, M., *Sharing ledgers for sharing economies: an exploration of mutual distributed ledgers (aka blockchain technology),* http://www.zyen.com/Articles/Journal%20of%20Financial%20Perspectives%20-%20Sharing%20Ledgers%20for%20Sharing%20Economie....pdf (accessed 20 July 2017).

Marchetti, J. & Mavroidis, P., *I Now Recognize You (and Only You) as Equal -An Anatomy of (Mutual) Recognition Agreements in the GATS* 415–443 (I. Lianos and O. Odudu eds., Cambridge University Press 2012).

Marchetti, J. & Mavroidis, P., *Walking the Tightrope between Domestic Policy and Globalization: Market Access, Discrimination and Regulatory Intervention under the GATS* (Mimeo 2006).

Marchetti, J. *The GATS Prudential Carve-Out* 280-286 (P. Delimatsis & N. Herger eds., Kluwer 2011).

Marchie Servaas, M.H. du, *Inducements* 165-180 (F.M.A. 't Hart ed, NIBE-SVV 2007).

Masson, D., *Enjeux et impacts de la délégation au sens de la directive AIFM*, 753 Revue Banque (2012).

Matheson, *AIFMD Factsheet: Prime Brokers,* http://www.matheson.com/images/uploads/publications/AIFMD_Factsheet_Prime_Brokers.pdf (accessed 3 September 2016).

Matthews, B.C., *the Second Banking Directive: Conflicts, Choices, and Long-Term Goals*, 2 Duke Journal of Comparative & International Law 89 (1992).

Mattoo, A., *MFN and the GATS* 51–99(T. Cottier, P. Mavroidis & P. Blatter eds.,University of Michigan Press, 2000)

Mattoo, A., *National Treatment in the GATS. Corner-Stone or Pandora's Box?,* 31 Journal of World Trade 107 (1997).

McAllister-Shepro, M., *Preserving National Regulatory Autonomy in Financial Services: The GATS' Prudential Carve-Out* http://ssrn.com/abstract=2418764 (accessed 5 June 2017).

McCahery, J. A. & Vermeulen, E.P.M., *Corporate Governance of Non-Listed Companies* (Oxford University Press 2008).

McCarthy, M., *How Risk Management Can Benefit Portfolio Managers* (W. V. Haslett ed., Wiley 2010).

McVea, H., *United Kingdom (*E. Wymeersch ed, Kluwer 2012).

Meerten, H. van, *Pensions Reform in the European Union: Recent Developments after the Implementation of the IORP Directive***,** 14 Pensions: An International Journal 4 (2009).

Meerten, H. van & Ottow A.T., *The proposals for the European Supervisory Authorities (ESAs): the right (legal) way forward?,* 1/2 TvFR 5 (2010).

Meerten, H. van & Ottow, A.T., *The proposals for the European Supervisory Authorities (ESAs): the right (legal) way forward?,* 1/2 TvFR 5 (2010).

Meerten, H. van & Starink, B., *Impediments to an Internal Market for Institutions for Occupational Retirement Provision*, 6 European Company Law 7 (2010).

Meerten, H. van, *Vrij Verkeer Van Diensten: Solvency II Basic en de Verplichtstelling*, 7/8 TvFR 290 (2012).

Meerten, H. van, *The scope of the EU 'Pensions'-Directive: Some Background and Solutions for Policymakers* (U. Neergaard, E. Szyszcak, J.W. van de Gronden & M. Krajewski eds, T. M. C. Asser Press 2013).

Meerten, H. van & Schmidt, E., *Compulsory membership of pension schemes and the free movement of services in the EU,* 19 European Journal of Social Security 2 (2017).

Meerten, H. van, A. van den Brink, A. & de Vries, S.A., *Regulating Pensions: Why the European Union Matters (*Netspar Discussion Paper) 38, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1950765 (accessed 4 October 2016).

Meerten, H. van & Hooghiemstra, S.N., *PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions*, https://ssrn.com/abstract=2993991 (accessed 4 July 2017).

Meester, B. de, *Liberalization of Trade in Banking Services – An International and European Perspective* 270 (Cambridge University Press 2014).

Meignen, J-C, *De nieuwe notificatieprocedure voor icbe's onder de Wet op het financieel toezicht nader beschouwd*, 11/12 Tv*FR* 302-315 (2010).

Mendoza, J.M. & Vermeulen, E.P.M., *Towards a New Financial Market Segment for High Tech Companies in Europe* (H.S. Birkmose, M. Neville & K.E. Sørensen eds., Kluwer 2011).

Merrill, T.W. & Smith, H.E., *The Property/Contract Interface*, 101 COLUM. L. REV. 773 (2001).

Micheler, E., *Property in Securities – A Comparative Study* 149 et seq. (Cambridge University Press 2007).

Micheler, E., *The Legal Nature of Securities: Inspirations from Comparative Law,* 131-149. (L. Gullifer & J. Payne eds, Hart Publishing 2010).

Micheler, E., *Intermediated Securities and Legal Certainty,* LSE Law, Society and Economy Working Papers No. 3 (2014).

Micheler, E., *Custody chains and Asset Values: why crypto securities are worth contemplating*, 3 Cambridge Law Journal 1-6 (2015).

Miller, G., *Essential Papers on the Economics of Financial Law*, NYU Law and Economics Research Paper No. 16-01 (2016).

Miller, P.B., *Justifying Fiduciary Duties*, 58 MCGILL L.J. 969 (2013).

Mishkin, F., *Prudential Supervision: Why is it Important and What Are the Issues?* 1-29 (F. Mishkin ed., University of Chicago Press 2001).

Möllers, T. & Poppele, M. *Paradigmenwechsel durch MiFID II: divergierende Anlegerleitbilder und neue Instrumentarien wie Qualitätskontrolle und Verbote*, ZGR - Zeitschrift für Unternehmens- und Gesellschaftsrecht 454 et seq (2013).

Möllers, T., *Auf dem Weg zu einer neuen europäischen Finanzmarktaufsichtsstruktur - Ein systematischer Vergleich der Rating-VO (EG) Nr. 1060/2009 mit der geplanten ESMA-VO*, 8 Neue Zeitschrift für Gesellschaftsrecht 285 (2010).

Möllers, T., *Der Trennungsgrundsatz und die Grenzen der Aufrechnung im InvG*, 9 BKR 353 (2011).

Möllers, T.M.J., *Umfang und Grenzen des Anlegerschutzes im Investmentgesetz - Der Trennungsgrundsatz und die Grenzen der Aufrechnung im InvG*, 9 BKR 353 (2011).

Moloney, N., *EC Securities Regulation* 250(1st edn., Oxford University Press 2002).

Moloney, N., *Investor Protection and the Treaty*: an Uneasy Relationship17-61 (G. Ferrarini, K.J. Hopt & E. Wymeersch eds., Kluwer 2002).

Moloney, N., *New Frontiers in EC Capital Markets Law: From Market Construction to Market Regulation,* 40 CMLR 809 (2003).

Moloney, N., *Regulation of the Market and Intermediaries: Global Comparison and Contrast - What is Best Practice?: Recent Developments in UK and European Union Market and Intermediary Regulation*, 5 Macquarie Journal Business Law 1 (2008).

Moloney, N., *How to Protect Investors: Lessons from the EC and the UK* 139, 152, 162-165 (Cambridge University Press 2010).

Moloney, N., *The European Securities and Markets Authority and institutional design for the EU financial market. A tale of two competences: part (1) rule making*, 12 European Business Organization Law Review 41-86 (2011).

Moloney, N., *The European Securities and Markets Authority and institutional design for the EU financial market. A tale of two competences: part (2) rules in action*, 12 European Business Organization Law Review 177-225 (2011).

Moloney, N., *The Investor Model Underlying the EU's Investor Protection Regime: Consumers or Investors?*, 13 E.B.O.R. 169 (2012).

Moloney, N., *EC Securities Regulation* 216, 217 (3rd edn., Oxford University Press 2014).

Moloney, N., *Banking Union and the Implications for Financial Market Governance in the EU: Convergence or Divergence* (D. Busch & G. Ferrarini, Oxford 2015).

Moloney, N., *Financial services, the EU, and Brexit: an uncertain future for the city?,* 17 German Law Journal 75-82 (2016), http://eprints.lse.ac.uk/67292/1/Moloney_Financial_Services_the_EU_and_Brexit.pdf (accessed 17 February 2017).

Mooney, C.W., *Property beyond negotiability*, 12 Cardozo Law Review, 305, 398-99(1990).

Mooney, C.W., *Law and Systems for Intermediated Securities and the Relationship of Private Property Law to Securities Clearance and Settlement: United States, Japan, and the Unidroit Draft Convention, Bank of Japan*, Institute for Monetary Economic Studies Discussion Paper Series, No. 2008-E.7, http://www.imes.boj.or.jp/research/papers/english/08-E-07.pdf (Accessed 8 August 2016).

Moor, A. de, Perron, C.E. du & Krop, P., *De bevoegdheden van de Nederlandsche Bank inzake Icesave*, https://www.dnb.nl/binaries/Rapport%20DNB-Icesave_tcm46-228434.pdf (accessed 26 June 2017).

Morgan, G., *Internal audit role conflict: a pluralist view*, 5(2) Managerial Finance 161 (1979).

Morgan Stanley, *Global Insight: Blockchain in Banking: Disruptive Threat or Tool?* (20 April 2016), http://www.the-blockchain.com/docs/Morgan-Stanley-blockchain-report.pdf (accessed 20 July 2017).

Morley, J., *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 Yale L.J. 1228 (2014).

Moroni, T. & Wibbeke, L., *OGAW V: Die Sprunglatte für OGAW-Verwahrstellen liegt höher*, 3 Recht der Finanzinstrumente 187 (2015).

Morrison, P., *The Liberalisation of Trade in Financial Services and the General Agreement on Trade in Services*, 5 Singapore Journal of Internal & Comparative Law 599 (2001).

Motani, H., *The proposed EU legislation on securities holding*, 69. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013).

Mübert, P.O., *The eclipse of contract law in the investment firm-client-relationship: the impact of the MiFID on the law of contract from a German perspective* 297-321 (G. Ferrarini & E. Wymeersch, Oxford 2006).

Muelbert, P. & Wilhelm, A., *CRD IV Framework for Banks' Corporate Governance* (D. Busch & G. Ferrarini, Oxford 2015).

Mülbert, P., *Anlegerschutz und Finanzmarktregulierung – Grundlagen*, 177 ZHR 160 (2013).

Müller, G., *Die Rechtsstellung der Depotbank im Investmentgeschäft nach deutschem und schweizerischem Recht* (Neckar-Druck- u. Verl. Ges.1969).

Murphy, J.B., *The philosophy of positive law: foundations of jurisprudence* (Yale University Press 2005).

N

Nagelkerke, F.F. & L. Nijkamp, *Inwerkingtreding MiFID - invloed beroep cliënt op de zorgplicht van een beleggingsonderneming?,* 21 Juridisch Up to Date 9-13 (2007).

Nakamoto, S., *Bitcoin: A Peer-to-Peer Electronic Cash System*, 1-4, https://bitcoin.org/bitcoin.pdf (accessed 21 July 2017).

Naveaux, V. & Graas, R., *Direct action by investors against a UCITS depositary – a short-lived landmark ruling?,* 7 Capital Markets Law Journal 455 (2012).

Nenova, T., *The Value of Corporate Voting Rights and Control: A Cross-Country Analysis*, 68 Journal of Financial Economics 325-351 (2003).

Nicolaïdis, K., *Non-discriminatory Mutual Recognition: An Oxymoron in the New WTO Lexicon?* 267–301 (P. Mavroidis and P. Blatter eds., University of Michigan Press, 2000).

Nicolussi, J., *Austria* 674 (D.A. Zetzsche ed, Kluwer 2012).

Nicolussi, J., *The AIFMD's Transposition in Austria* (D.A. Zetzsche ed, Kluwer 2015).

Niedner, C. & Sawires, A. *Passport Flexibility*, 96 European Lawyer 45(2010).

Nielson, J., *Trade Agreements and Recognition* 155–203 (OECD Publishing 2004).

Nieuwenhuijzen, M.C.A. van den & Galjaart, M.W., *De reikwijdte van de AIFM Richtlijn* 247-257 (F.G.B. Graaf, R.H. Maatman & L.J. Silverentand eds, Kluwer 2012).

Nolan, R.C., *Controlling Fiduciary Power*, 68 CAMBRIDGE L.J. 293 (2009).

Noonan, L., & Brunsden, J., *Banks fear chill wind of 'passport' freeze,* Financial Times, (21 September 2016)

Nürk, B. & Schrader, A., *From pension reserves to pension funds: An opportunity for the German financial market*, 6, https://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000017124/From_pension_reserves_to_pension_funds.pdf (accessed 4 October 2016).

O

O'Hara, K., *Smart Contracts – Dumb Idea*, The Digital Citizen, March/April 2017, http://ieeexplore.ieee.org/stamp/stamp.jsp?arnumber=7867719 (accessed 21 July 2017).

Ohl, K., *Die Rechtsbeziehungen innerhalb des Investment-Dreiecks* (Duncker & Humblot 1989).

Oliver Wyman/ J.P. Morgan, *Unlocking Economic Advantage with Blockchain – A Guide for asset managers*, http://www.the-blockchain.com/docs/joint-report-by-jp-morgan-and-oliver-wyman-unlocking-economic-advantage-with-blockchain-A-Guide-for-Asset-Managers.pdf (access 20 July 2017).

Olsen, M., *The Logic of Collective Action: Public Goods and the Theory of Groups* (Harvard University Press 1971).

Oppitz, M., *Wohin mit den geschlossenen Fonds? – Ein Veranlagungsinstrument zwischen BWG, WAG, KMG, AIFMG und Gewerbeordnung,* 1 Österreichisches Bankarchiv 49 (2014).

Ordower, H., *United States* (E. Wymeersch ed., Kluwer 2012).

Organisation for *Economic Co-operation* and *Development*, *Declaration on Internal Investment and Multinational Enterprises*, 15 I.L.M. 967 (1976).

Organisation for Economic Co-operation and Development, *National Treatment for Foreign-Controlled Enterprises* (Paris: OECD, 1985).

Organisation for Economic Co-operation and Development, *Standard Rules for the Operations of Institutions for Collective Investment in Securities* (1971), [C (71) 234].

Organization for Economic Co-Operation and Development, *The OECD Pension Funds' Risk Management framework: regulation and supervisory oversight*, February 2010.

Organization for Economic Co-Operation and Development / International Organisation for Pension Supervisors, *Good Practices for Pension Funds' Risk Management Systems*, January 2011.

Organization for Economic Co-Operation and Development, *OECD Guidelines for Pension Fund Governance*, https://www.oecd.org/finance/private-pensions/34799965.pdf (accessed 5 October 2016).

Organization for Economic Co-Operation and Development, *OECD Recommendation on Core Principles of Occupational Pension Regulation,* http://www.oecd.org/finance/private-pensions/33619987.pdf (accessed 22 February 2017).

Organisation for Economic Co-operation and Development*, G20 High Level Principles Financial Consumer Protection,* http://www.oecd.org/dataoecd/58/26/48892010.pdf (accessed 14 January 2017).

Organisation for Economic Co-operation and Development*, Guidelines on Pension Fund Asset Management,* http://www.oecd.org/dataoecd/59/53/36316399 (accessed 14 January 2017).

Organisation for Economic Co-operation and Development*, Guidelines for the Protection of Rights of Members and Beneficiaries in Occupation Pension Plans,* http://www.oecd.org/dataoecd/16/33/34018295.pdf (accessed 14 January 2017).

Oxera, *The Role of Custody in European Asset Management*, 22, http://www.oxera.com/Latest-Thinking/Publications/Reports/2002/The-role-of-custody-in-European-asset-management.aspx (accessed 7 October 2016).

P

Paech, P., *Market needs as paradigm – breaking up the thinking on EU securities law*, 22-64. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013).

Paech, P., *Cross-Border Issues of Securities Law- European Efforts to Support the Securities Market with a Coherent Legal Framework, Study prepared for the European Parliament*, http://www.europarl.europa.eu/document/activities/cont/201106/20110606ATT20781/20110606ATT20781EN.pdf (Accessed 8 August 2016).

Paech, P., *Integrating Global Blockchain Securities Settlement with the Law - Policy Considerations and Draft Principles*, 3,4, https://ssrn.com/abstract=2792639 (accessed 20 July 2017).

Paech, P., *Market Needs as Paradigm: Breaking Up the Thinking on EU Securities Law,* LSE Law, Society and Economy Working Papers 11/2012, https://www.lse.ac.uk/collections/law/wps/WPS2012-11_Paech.pdf (accessed 21 July 2017).

Paech, P., *Securities, Intermediation and the Blockchain - An Inevitable Choice between Liquidity and Legal Certainty?*, https://ssrn.com/abstract=2697718 (access 20 July 2017).

Paech, P., *The Governance of Blockchain Financial Networks*, LSE Legal Studies Working Paper No. 16/2017, https://ssrn.com/abstract=2875487 (accessed 20 July 2017).

Panourgias, L., *Banking Regulation and World Trade Law* 83-90 (Hart 2006).

Partsch, T. & Forget, E., *The Luxembourg Implementation of the AIFMD* (D.A.Zetzsche ed, Kluwer 2015).

Partsch, T., & Havrenne, E., *Luxembourg* (D.A. Zetzsche ed, Kluwer 2012).

Partsch, T., *Delegation* (D.A.Zetzsche ed, Kluwer 2015).

Patro, D.K., Piccotti, K., Louis, R. & Yangru, W., *Exploiting Closed-End Fund Discounts: A Systematic Examination of Alphas* https://ssrn.com/abstract=2468061 (accessed 15 Mai 2017).

Paul, T. & Schmies, C., *Germany* (L. Van Setten & D. Busch eds, Oxford 2014).

Peeters, M.G.C.M. & W.A.K. Rank, *Bescherming van rechten van derivatencliënten bij insolventie van een intermediair* 137-176 (Kluwer 2011).

Peleckiene, V., Peleckis, K. & Duzeviciute, G., *New Challenges of Supervising Financial Conglomerates*, 5 Intellectual Economics 298-311 (2011).

Pensions Europe, *Position Paper on the proposal for an IORP II Directive*, 6 October 2014, 19, http://www.pensionseurope.eu/system/files/PensionsEurope%20position%20paper%20IORP%20II.pdf (Accessed 28 July 2016).

Peters, G.W. & Panayi, E., *Understanding Modern Banking Ledgers through Blockchain Technologies: Future of Transaction Processing and Smart Contracts on the Internet of Money*, 24,http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2692487.

Pierrat, M., *De la distinction entre obligations de moyens et obligations de resultat: pile ou face?* 15 Journal des Tribunaux 61 et seq (2011).

Piketty, T., *Capital in the Twenty-First Century* 99 (The Belknap Press of Harvard University Press 2014).

Pope, D.& Garzaniti, L., *Single Market-Making: EC regulation of securities markets*, 14(3) Company Lawyer 44 (1993).

Posner, E., *Agency Models in Law and Economics* 225-243. (E. Posner ed., Foundation Press 2000).

Posner, P., *The Rights of Creditors of Affiliated Corporations*, 43 University of Chicago Law Review 499 (1976).

Pozen, R., *The case for labelling Newcits as complex*, Financial Times (18 December 2011).

Praag, E.J. van, *Het grensoverschrijdend financieel toezicht loopt tegen grenzen aan*, 9 TvFR 259 (2011).

Prais, V. & Giralt, M., *Have we been there before? Are Newcits what UCITs are intended to be?*, 25:10 Butterworths Journal of International Banking and Financial Law 605 (2010).

Pratt, J. & Zeckhauser, R, *Principals and Agents: The Structure of Business* (Harvard Business School 1985).

Pretorius, R. & E. Redmore, *A level playing field... But not between directives?,* http://www.lexology.com/library/detail.aspx?g=d385bc43-fc07-42ea-ac6d-aa800860bf35 (accessed 9 February 2017).

Prew, B., *Six Months To Go For AIFMD - A review of developments in the depositary-lite market,* http://www.thehedgefundjournal.com/node/9183 ((accessed 29 August 2016).

Price, R., *Conduct of business standards - fair dealing with clients* 151-159 (M. Elderfeld ed, City & Financial Publishing 2007).

Price, R., *Conduct of business standards - information requirements* 243-246 (M. Elderfeld ed, City & Financial Publishing 2007).

Price, R., *Overview of organisational and conduct of business requirements* 102-122 (M. Elderfeld ed, City & Financial Publishing 2007).

PricewaterhouseCoopers, *The realization of non-harmonized investment funds in the European Union: Prepared for European Commission DG Internal Market and Services*, http://ec.europa.eu/internal_market/investment/docs/other_docs/annex_non-harmonized_funds.pdf (accessed 3 July 2015).

Prisco, G., *The Blockchain Could Make Existing Securities Industry Players Redundant, Says BNP Paribas Analyst (*6 July 2015), https://bitcoinmagazine.com/articles/blockchain-make-existing-securities-industry-players-redundant-says-bnp-paribas-analyst-1436212815/ (accessed 20 July 2017).

Puel, S., *France* (L. Van Setten & D. Busch eds, Oxford 2014).

Q

Quinn, J., *The Management Company Passport: A New Era of Cross Border UCITS,* http://corkonlinelawreview.com/editions/2011/03/Jolene-Quinn.pdf (accessed 8 July 2017).

R

Raas, R.P., *Beleggingsondernemingen, ken uw cliënt!* (D. Busch & C.M. Grundmann-van de Krol eds, Kluwer 2009).

Raas, R.P., *De AIFM Richtlijn en derde landen* 59-69 (N.B. Spoor, M. Tausk, J.B. Huizink & R.P. Raas, Kluwer 2012).

Rae, D. Mc, *MFN in the GATT and the WTO*, 7 *Asian Journal of WTO & International Health Law and Policy* 1-24 (2012).

Raffen, M., *Conduct of business rules - organisational requirements* 123-144 (M. Elderfeld ed, City & Financial Publishing 2007).

Raffson, D. & Vliet, G. van, *Het Icesave Drama / hoe een handvol IJslanders de financiele wereld uitkleedde. De hebberige bankiers, de falende polititci en de getergde slachtoffers* (Terra 2010).

Rahl, L., *Risk Management for Alternative Investment Strategies* (Wiley 2010).

Randall, C., *Fiduciary Duties of Investment Company Directors and Management Companies Under the Investment Company Act of 1940*, 31 Oklahoma Law Review 635 (1978).

Rank, W.A.K. & Bierman, B., *Aangaan van verplichtingen voor rekening van een FGR: aansprakelijkheid en verhaal*, 9 TvFR 299-310 (2008).

Rank, W.A.K., *Requiem voor het effectenbewaarbedrijf?*, 3 TvFR 70 (2016).

Rank, W.A.K., *Vermogensscheiding* (D. Busch & C.M. Grundmann-van de Krol eds, Kluwer 2009).

Raskin, M., *The Law of Smart Contracts*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2842258 (accessed 21 July 2017).

Rasmusen, E., *Agency Law and Contract Formation*, 6 AMER. REV.L. & ECON. 369 (2004).

Rauterberg, G.V., *Agency Law as Asset Partitioning*, https://ssrn.com/abstract=2641646 (accessed 11 May 2017).

Raz, J., *The Concept of a Legal System* 141 (Clarendon Press 1980).

Rehm, H. & Nagler, J., *Verbietet die Kapitalverkehrsfreiheit nach 1993 eingeführteAuslanderungleichbehandlung?,*15 *Internationales Steuerrecht* 861(2006).

Reiss, M., *Pflichten der Kapitalanlagegesellschaft und Depotbank gegenüber dem Anleger und die Rechte des Anlegers bei Pflichtverletzungen* (Duncker & Humblot 2006).

Riassetto, I. & Prüm, A., *La fonction de conservation du dépositaire, source de responsabilité civile, note sous Paris, 1ère Ch., Section H, 8 avril 2009, no. 2008/22218*, 3 Joly Bourse 191, §I-A-2 (2009).

Riassetto, I., *Obligation de restitution du dépositaire d'OPCVM*, 4 RD Bancaire et Financier Comm. 161, point 1-B (July 2010).

Riassetto, I. *L'obligation de restitution du dépositaire d'OPC en droit Luxembourgeois*, 30 Journal des Tribunaux Luxembourg 167 (2013).

Riassetto, I., *Moyens et procédures adéquats pour la mise en œuvre de l'obligation de contrôle des dépositaires d'OPC*, 10 Bulletin Joly Bourse (2013).

Riassetto, I., *Dépositaires - Quelles différences entre la directive OPCVM V et la directive AIFM?,* 4 RD Bancaire et Financier (2014).

Riassetto, I., *La clarification des obligations et de la responsabilité des dépositaires par la directive OPCVM V,* 98 Revue Lamy Droit des Affaires 31 (2014).

Riassetto, I., *Le nouveau régime applicable aux dépositaires issu de la directive OPCVM V*, 3 Bulletin Joly Bourse 113 (2015).

Riassetto, I., *Responsabilité de la société de gestion et du dépositaire d'un OPC envers les actionnaires d'une société cible, note sous Cass. com. fr. 27 mai 2015*, 4 RD Bancaire et Financier (2015).

Rooke, C.A., *MiFID en custodians: let op extra informatieverplichtingen!,* 1/2 TvFR 43-46 (2008).

Rottwilm, C., *Private Equity 2.0, Manager Magazine*, http://www.manager-magazin.de/finanzen/geldanlage/a-558527.html (accessed 26 January 2017).

Rouch, D., *United Kingdom* (L. Van Setten & D. Busch eds, Oxford 2014).

Ruiz-Bachs, S. & Diaz-Ruiz, E., *Spain* (L. Van Setten & D. Busch eds, Oxford 2014).
Rüttimann, D. & Sprenger, P., *Fondsplatz Liechtenstein*, ST 569 (2012).

Rymenant, S. van., *De Europese maatregelen ter beheersing van de financiële crisis - Een selectie van maatregelen in de Europese banksector*, http://lib.ugent.be/fulltxt/RUG01/001/787/116/RUG01-001787116_2012_0001_AC.pdf (accessed 26 June 2017).

S

Sachtleber, O., *Zivilrechtliche Strukturen von open-end-Investmentfonds in Deutschland und England*. (Bank- und Kapitalmarktrecht, 2011).

Samuel, G., *An Introduction to Comparative Law Theory and Method* 81-82 (Hart Publishing 2014).

Sarna, D. E. Y., *History of Greed: Financial Fraud from Tulip Mania to Bernie Madoff* (Wiley 2010).

Savigny, F.C. von*, System des heutigen Römischen Rechts § 33, A: Auslegung der Gesetze* 213 (Berlin , 1840).

Schaeken Willemaers, G., *Client Protection on European Financial Markets – From Inform Your Client to Know Your Product and Beyond: An Assessment of the PRIIPs Regulation, MiFID II/MiFIR and IMD 2*, 4, https://ssrn.com/abstract=2494842 (accessed 26 January 2017).

Schaeken Willemaers, G., *Product Intervention: A European Perspective*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1989817 (accessed 3 July 2015).

Schäfer, F. & Schäfer, U., *Anforderungen und Haftungsfragen bei PIBs, VIBs und KIIDs*, ZBB 23 (2013).

Schäfer, L., *Corporate Governance bei Kapitalanlagegesellschaften – Fund Governance* (Duncker & Humblot 2009).

Schammo, P., *Equivalence-Based Regulation and EU/EEA Prospectus Law – The Shadow Regime* 493 (D. Prentice & A. Reisberg eds., Oxford University Press 2011).

Scharpf, F.W., *Negative and Positive Integration in the Political Economy of European Welfare States* (G. Marks ed, Sage Publisher 1996).

Schaubach, P., *Family Office: Ein Beitrag zur Begriffsfindung*, 51 Bank-Archiv : Zeitschrift für das gesamte Bank- und Börsenwesen 897 (2003).

Scheele, M. & Wielens, H.W., *Uitbesteding door beheerders van beleggingsinstellingen en icbe's* 79-92. (Financieel Juridische Reeks, NIBE/SVV, 2014).

Scheele, M., *Europees paspoort voor beheerders van European Venture Capital Funds en Social Entrepreneurship Funds per 22 juli 2013*, 12 *Ondernemingsrecht* 458-460 (2013).

Scheele, M., *Implementatie van de AIFM-Richtlijn en transparantie* 161-170 (P. Zijp, A. Tillema, P. Rank & H. van Everdingen, Kluwer 2011).

Scheele, M., *Toezicht op alle beheerders van beleggingsinstellingen vanaf juli 2013*, 15 Ondernemingsrecht 150-160 (2013).

Schim, B.F.L.M. *Giraal effectenverkeer en goederenrecht* (Serie Onderneming en Recht Deel 36).

Schön, W., *Der kapitalverkehr mit Drittstaaten und das international Steuerrecht* 489-501 (R. Gocke, D. Gosch & M. Lang eds., C.H. Beck 2005).

Schoenmaker, D., *The UK Financial Sector and EU Integration after Brexit: The Issue of Passporting*, https://ssrn.com/abstract=2844253 (accessed 14 January 2017).

Schoonewille, M.T.G., *Professionele marktpartijen en gekwalificeerde beleggers - een slag apart*, 4 V&O 72-76 (2007).

Schröder, O. & Rahn, A., *Das KAGB und Private-Equity-Transaktionen –Pflichten für Manager von Private-Equity-Fonds und deren Verwahrstellen*, GWR 49 (2014).

Schubert, L. & Schuhmann, A., *Die Kategorie des semiprofessionellen Anlegers nach dem Kapitalanlagegesetzbuch,* 47 BKR 45 (2015).

Schwarcz, S.L., *Indirectly Held Securities and Intermediary Risk,* 2 Uniform Law Review 283 (2001).

Schwarcz, S.L., *Intermediary Risk in a Global Economy*, 6 Duke Law Journal 1541 (2001).

Schwarcz, S.L., *Systemic Risk*, 97 The Georgetown Law Journal 193 (2008).

Schwartz, D., *European banks tally losses linked to Madoff*, New York Times (17 December 2008), http://www.nytimes.com/2008/12/17/business/worldbusiness/17iht-17exposure.18747038.html?pagewanted=1&_r=1 (accessed 3 July 2015).

Scott, H., *Reducing Systemic Risk through the reform of capital regulatio*n, 13 Journal of International Economic Law 763 (2010).

Securities and Exchange Commission, *SEC Charges Hedge Fund Managers with Fraud Involving Valuation of Side Pocket Investment*, http://www.sec.gov/litigation/litreleases/2010/lr21699.htm (accessed 3 July 2015).

Seegebarth, N., *Stellung und Haftung der Depotbank im Investment-Dreieck* (Peter Lang Verlag 2004).

Seriere, V.P.G. de, *Recovery and Resolution Plans of Banks in the Context of the BRRD and the SRM: Some Fundamental Issues* (D. Busch & G. Ferrarini, Oxford 2015).

Sethe, R. *Das Drittstaatenregime von MiFIR und MiFID II*, 6 SZW/ RSDA 615 (2014).

Setten, L. van & Busch, D., (ed.), *Alternative Investment Funds in Europe* (Oxford University Press 2014).

Setten, L. van, *The characteristic features of an institutional investment mandate* 26 (Oxford 2009).

Shao, C.P., *Taiwan* (E. Wymeersch ed. Kluwer 2012).

Sharipo, J.C., *Investment, Moral Hazard, and Licensing*, 53 Review of Economic Studies 843 (1986).

Shea, R., *FinTech versus TechFin: Does Technology Offer Real Innovation or Simply Improve What is Out There?*, Thompson Reuters (26 July 2016), https://blogs.thomsonreuters.com/financial-risk/fintech-innovation/fintech-versus-techfin-technology-offerreal-innovation-simply-improve/ (accessed 20 July 2017).

Shea, R., *Fintech versus techfin: does technology offer real innovation or simply improve what is out there?*, Thomson Reuters (26 July 2016) , https://blogs.thomsonreuters.com/financial-risk/fintechinnovation/fintech-versus-techfin-technology-offer-real-innovation-simply-improve/ (Accessed 20 July 2017).

Shepherd, J.C., *Towards a Unified Concept of Fiduciary Relationships*, 97 L.Q.REV 51 (1981).

Siekmann, H., *Das neue Europäische Finanzaufsichtssystem - Working Paper Series 40* (Institute for Monetary and Financial Stability 2010).

Siekmann, H., *Die Europäisierung der Finanzmarktaufsicht - Working Paper Series 47* (Institute for Monetary and Financial Stability 2011).

Siemers, B.T.B., *Een afgescheiden vermogen voor subfondsen – Een stap terug?,* 10 TvFR 326-328 (2011).

Siems, M., *Comparative Law* (Cambridge University Press, 2014).

Siena, J.R. & Eckner, D., *The AIFMD's Transposition in the United Kingdom* (D.A. Zetzsche ed, Kluwer 2015).

Siena, J.R., *Depositary Liability: A Fine Mess and How to Get Out of It* (D.A.Zetzsche ed, Kluwer 2015).

Siena, J.R., & Eckner, D., *The AIFMD's Transposition in the United Kingdom* (D.A.Zetzsche ed, Kluwer 2015).

Siering, L. & Izzo-Wagner, A., *'Praktische Hürden' der EuVECA-Verordnung*, BKR 242 (2014).

Siering, L. & Izzo-Wagner, A., *Die EuVECA-VO – eine Sackgasse der Verwaltungspraxis? – Die aktuelle Aufsichtspraxis als großes Problem für die Venture Capital Branche*, BKR 101 (2015).

Silverentand, L.J. & Eerden van der, F.W.J., & Bierman, B, *De concept-richtlijn inzake beheerders van alternatieve beleggingsinstellingen; work in progress*, 9 TvFR 332-342 (2009).

Silverentand, L.J., *Cliëntenclassificatie* (D. Busch & C.M. Grundmann-van de Krol eds, Kluwer 2009).

Silverentand, L. & Zijp, P., *The Draft Directive on Alternative Investment Fund Managers*, in *Hedge Funds and Prime Brokers* (M. Berman ed., 2nd edn, RiskBooks 2010).

Silverentand, L. J., *De AIFM-richtlijn – een stap verder?*, Tijdschrift voor financieel recht 65 (2010).

Silverentand, L.J & Zijp, P., *The Draft Directive on Alternative Investment Fund Managers* (M. Berman ed., 2nd edn, RiskBooks 2010).

Silverentand, L., Sprecher, J., & Simons, L., *Inducements* (D. Busch & G. Ferrarini eds, Oxford 2017).

Singh, M. & Aitken, J., *The (sizeable) Role of Rehypothecation in the Shadow Banking System* (IMF Working Paper 2010), http://www.allenovery.com/archive/Documents/Legacy/62666.pdf (accessed 15 August 2016).

Sip, C.C., *Richtlijn inzake beheerders van alternatieve beleggingsfondsen; gevolgen voor de private-equity industrie*, 3 TOP 78-84 (2011).

Sitkoff, R.H., *An Agency Costs Theory of Trust Law*, 89 Cornell Law Review 621 (2004).

Sitkoff, R.H., *Trust Law as Fiduciary Governance Plus Asset Partitioning* 428 (L. Smith ed., Cambridge University Press 2013).

Sitkoff, R.H., *An Economic Theory of Fiduciary Law* 197 (A.S. Gold & P.B. Miller eds., Oxford University Press 2014).

Sitkoff, R.H., *The Fiduciary Obligations of Financial Advisors Under the Law of Agency* 27 Journal of Financial Planning 42 (2014).

Sitkoff, R.H., *The Economic Structure of Fiduciary Law*, 91 Boston University Law Review 1041 (2011), http://ssrn.com/abstract=1782999 (accessed 9 May 2017).

Sitkoff, R.H., *Other Fiduciary Duties: Implementing Loyalty and Care* (R. H. Sitkoff, E.J. Criddle & Paul B. Miller eds., Oxford University Press, forthcoming 2017).

Sitkoff, R.H., *Trust Law as Fiduciary Governance Plus Asset Partitioning*, Harvard University Law & Economics Discussion Paper No. 711, http://ssrn.com/abstract=1962856 (accessed 5 October 2016).

Skinner, C., *Is It FinTech or TechFin (Part I)*, Digitalist Magazine (7 January 2016),http://www.digitalistmag.com/customer-experience/2016/01/07/fintech-or-techfin-03925833 (accessed 20 July 2017).

Skinner, C., *Is It FinTech or TechFin (Part II)*, Digitalis Magazine (11 January 2016), http://www.digitalistmag.com/resource-optimization/2016/01/11/fintech-or-techfin-2-03926161 (accessed 20 July 2017).

Sklar, R., *Hedges or Thickets: Protecting Investors from Hedge Fund Managers' Conflicts of Interest*, 77:6 Fordham Law Review 3251 (2008-2009).

Skouris, V., *the ECJ and the EFTA Court under the EEA Agreement: A Paradigm for International Cooperation between Judicial Institutions* 123–129 (C. Baudenbacher, P. Tressel & T. Örlygsson eds., Hart Publishing 2005).

Skypala, P., *UCITS Victory Soured by Madoff Scandal*, Financial Times, Fund Management Supplement, (19 January 2009), 6.

Slange, R. & Verwilst, G.A.M., *De aangepaste ICBE-richtlijn. Op naar een verbeterde interne markt voor beleggingsinstellingen*, 10/11 TvFR 332-342 (2008).

Sloman, J., Wride, A., Garratt D., *Economics* 293 (Pearson 2012).

Smith, D. en S. Leggett, *Client classification* 65-73 (C. Skinner ed, John Wiley & Sons 2007).

Smits, R.K. Th.J, *Vermogensscheiding bij premiepensioeninstellingen*, 1 V&O 1 (2012).

Smits, R.K.Th.J., *De AIFMD-bewaarder; praktische gevolgen voor Nederlandse beleggingsinstellingen*, 11 V&O 200-204 (2012).

Solomon, J. *Corporate Governance and Accountability* 51, 52 (John Wiley & Sons, Ltd 2007).

Soo, Z., *TechFin: Jack Ma Coins Term to Set Alipay's Goal to Give Emerging Markets Access to Capital*, South China Morning Post (2 December 2016), http://www.scmp.com/tech/article/2051249/techfinjack-ma-coins-term-set-alipays-goal-give-emerging-markets-access (accessed 20 July 2017).

Spetter, C.D., *Private equity – wat is het en hoe is het gereguleerd in Nederland?,* 2 *Onderneming en Financiering* 52-67 (2013).

Spindler, G. & Tancredi, S., *Die Richtlinie über Alternative Investmentfonds (AIFM-Richtlinie) – Teil I*, 30 Wertpapier-Mitteilungen Zeitschrift für Wirtschafts- und Bankrecht 1393 (2011).

Spindler, G. & Tancredi, S., *Die Richtlinie über Alternative Investmentfonds (AIFM-Richtlinie) – Teil II*, 31 Wertpapier-Mitteilungen Zeitschrift für Wirtschafts- und Bankrecht 1441 (2011).

Spira, L. F. & Page, M., *Risk management: The reinvention of internal control and the changing role of internal audit*, 16:4 Accounting, Auditing & Accountability Journal 22 (2003).

Spoor, N.B. & Franken, J.M.W.M., *De impact van de AIFM Richtlijn op de beleggingsfondsensector*, 6 Bedrijfsjuridische Berichten 20-23 (2011).

Spoor, N.B., *De effecten van de AIFM Richtlijn vanuit een investment management optiek* 144-158 (M.L. Lennarts & J. Roest, Kluwer 2012).

Spoor, N.B., *De AIFM Richtlijn: een tour d'horizon* 9-21 (N.B. Spoor, M. Tausk, J.B. Huizink & R.P. Raas, Kluwer 2012).

Spoor, N.B. & Verwilst, G.A.M., *Beloning van fondsbestuurders*, 1/2 TvFR 45-49 (2014).

Spruk, R., *Iceland's financial and economic crisis: causes, consequences and implications*, https://ssrn.com/abstract=1574296 (accessed 26 June 2017).

Staat, S., *Germany* (D.A. Zetzsche ed., Kluwer 2012).

Starink, B. & van Meerten, H. , *Cross-border obstacles and solutions for pan-European pensions*, 1 EC Tax Review 30 (2011).

Starink, B., *Cross-border obstacles and solutions for pan-European pensions*, 1 EC Tax Rev 30-41 (2011).

Stefanin, G. & Scala, F. della, *Italy* (D.A. Zetzsche ed, Kluwer 2012).

Stefansson, A. & Saethorsson, T., *Cross-border issues in EU Deposit Guarantee Schemes: With a focus on the Icelandic case*, 63-82, http://pure.au.dk/portal-asb-student/files/12991/Thesis_without_Appendix.pdf (accessed 14 January 2017).

Stephenson, S., *GATS and Regional Integration* 509–527 (P. Sauve & R. Stern eds., Brookings Institution Press 2000).

Stewart, F. & Yermo, J., *Pension Fund Governance: Challenges and Potential Solutions*, OECD Working Papers on Insurance and Private Pensions No. 18 (June 2008).

Steyer, R., *White-label funds on rise for DC plans*, Pensions & Investments, October 27, 2014, http://www.pionline.com/article/20141027/PRINT/310279972/white-label-funds-on-rise-for-dc-plans (accessed 8 June 2017).

Storck, M., *Particularisme de l'obligation de restitution incombant au dépositaire*, RTD com. 573, § I-B (2010).

Strenger, C. & Zetzsche, D.A., *Corporate Governance, Cross-Border Voting and the Securities Law Directive – Enhancing Investor Engagement through Standardization*, https://ssrn.com/abstract=2188374 (accessed 10 July 2017).

Strenger, C. & Zetzsche, D.A., *Institutionelle Anleger, Verbesserung der Corporate Governance und Erleichterung der grenzüberschreitenden Stimmrechtsausübung*, AG 397 (2013).

Sundaramurthy C. & Lyon, D.W., *Shareholder Governance Proposals and Conflicts of Interests Between Inside and Outside Shareholders*, 10 J. MANAG. ISSUES 30 (1998).

Surowiecki, J., *The Wisdom of Crowds* (Anchor Books 2005).

T

Tait, N. & Johnson, S., *Brussels drops pan-Europe funds plan*, Financial Times (24 May 2008).

Tausk, M., *De verplichting om een bewaarder te benoemen: alles gaat veranderen* 22-43 (N.B. Spoor, M. Tausk, J.B. Huizink & R.P. Raas, Kluwer 2012).

Technical Committee of International Organization of Securities Commissions, *Private Equity Conflicts of Interest: Final Report*, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD341.pdf (accessed 3 July 2015).

Tegelaar, J. & Haentjes, M., *Brexit: financieelrechtelijke gevolgen*, 74 Bedrijfsjuridische Berichten 257 (2016).

The European Council, *Rhodes 3 December 1988*, http://aei.pitt.edu/1483/1/rhodes_june_1988.pdf (accessed 21 April 2017).

The Financial Industry Regulatory Authority, *Distributed Ledger Technology: Implications of Blockchain for the Securities Industry,* January 2017, https://www.finra.org/sites/default/files/FINRA_Blockchain_Report.pdf (accessed 20 July 2017).

The Giovanni Group, *Cross-border Clearing and Settlement Arrangements in the European Union*, http://ec.europa.eu/internal_market/financial-markets/docs/clearing/first_giovannini_report_en.pdf (accessed 3 July 2015).

The Giovanni Group, *Second Report on EU Clearing and Settlement Arrangements*, http://ec.europa.eu/internal_market/financial markets/docs/clearing/second_giovannini_report_en.pdf (accessed 3 July 2015).

The High-Level Group on Financial Supervision in the EU 2009, *Larosière Report*, http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf (accessed 3 July 2015).

The Pensions Authority, *So you're a pension scheme trustee – A brief guide to your duties andresponsibilities,*5-6, http://www.pensionsauthority.ie/en/LifeCycle/Information_Booklets/So_you%E2%80%99re_a_pensions_scheme_trustee_.7239.shortcut.pdf (accessed 17 February 2017).

The Pensions Authority, *Trustee Handbook*, 5th Edition, 45 , August 2016, http://www.pensionsauthority.ie/en/Trustees_Registered_Administrators/Trustee_Handbook_.pdf (accessed 21 February 2017).

The Pensions Board, *A Guide to Hybrid Pension Schemes*, http://www.pensionsauthority.ie/en/LifeCycle/Private_pensions/Hybrid_pension_schemes/ (accessed 5 October 2016).

The Pensions Regulator, *Governance and administration of occupational defined contribution trust-based pension schemes* (Draft code of practice no. 13, July 2013), 35-36, http://www.thepensionsregulator.gov.uk/docs/regulating-dc-pension-schemes-code-of-practice-consultation.pdf (accessed 5 October 2016).

The Pensions Regulator, *Trustee Guidance*, December 2007.

Thévenoz, L., *Transfer of intermediated securities* 135-159. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013).

Thévenoz, L., *Intermediated Securities, Legal Risk, and the International Harmonization of Commercial Law*, 13 Stanford Journal of Law, Business & Finance 384-452 (2008).

Thévenoz, L., *Who holds (Intermediated) Securities? Shareholders, Account Holders, and Nominees?,* 3-4 Uniform Law Review 845-859 (2010).

Thompson, R.B., *Agency Law and Asset Partitioning*, 71 U. Cin. L. Rev. 1321 (2002).

Thompson, R.B. & Edelman, P.H., *Corporate Voting*, 62 Vanderbilt Law Review 127 (2009).

Tillema, A.J.P., *Enkele opmerkingen over deskundigheid, betrouwbaarheid en integriteit* 239-248 (P. Zijp, A. Tillema, H. Van Everdingen & P. Rank, Kluwer 2011).

Timmerbeil, S. & Spachmüller, D., *Anforderungen an das Risikomanagement nach der AIFM–Richtlinie*, DB 1425 (2012).

Tison, M., *De interne markt voor bank- en beleggingsdiensten* (Intersentia rechtswetenschappen 1999).

Tison, M., *Financial market integration in the post FSAP era. In search of overall conceptual consistency in the regulatory framework* 443-464 (G. Ferrarini & E. Wymeersch, Oxford 2006).

Tison, M., *De bescherming van de beleggers in het kapitaalmarktrecht: de hobbelige weg naar een Europees ius commune*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1142777 (accessed 9 February 2017).

Tollmann, C., Art.2 *Geltungsbereich*, in *AIFM-Richtlinie* 113-114 (F. Dornseifer et al., eds, 1st edn, C.H. Beck 2013).

Tongxuan, T., *Understanding the Defined Benefit versus Defined Contribution Choice*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=755064 (accessed 5 October 2016).

Tonino, J.C.A., *Op zoek naar de grenzen van het AIFMD-activiteitenverbod: beleggingsdienstverlening door een beheerder van een beleggingsinstelling*, 7/8 TvFR 299-305 (2015).

Trachtman, J.P., *Addressing Regulatory Divergence through International Standards: Financial Services* 27–41 (A. Mattoo & P. Sauvé eds., Oxford University Press, 2003).

Trachtman, J.P., *Trade in Financial Services under GATS, NAFTA and the EC: A Regulatory Jurisdiction Analysis* 323–402 (J.P. Trachtman ed., Cameron May 2006).

Tridimas, T., *EU Financial Regulation: Federalization, Crisis Management, and Law Reform* 784-785 (P. Craig & G. de Burca eds., Oxford University Press 2011).

Tripartite Group of Bank & Securities and Insurance Regulators, *The Supervision of Financial Conglomerates*, Bank for International Settlements, July 1995.

Tröger, T.H., *Organizational Choices of Banks and the Effective Supervision of Transnational Financial Institutions*, 48 Texas International Law Journal 177 (2012).

Tröger, T.H., *The Single Supervisory Mechanism – Panacea or Quack Banking Regulation?,* Safe Working Paper No. 27 (2013), https://ssrn.com/abstract=2311353 (accessed 17 February 2017).

Tuchschmid, N., Wallerstein, E. & Zanolin, A., *Hedge Funds and Prime Brokers: The Role of Funding Risk*, http://ssrn.com/abstract=1343673 (accessed 3 September 2016).

Tuchschmid, N., Wallerstein, E. & Zanolin, A., *Will Alternative Ucits Ever be Loved Enough to Replace Hedge Funds?*, http://dx.doi.org/10.2139/ssrn.1686055 (accessed 3 July 2015).

Turner, G., *UCITS Growth Takes Old Problems to New Places*, Financial news, 7 February, 2011.

U

Usher, J.A., *The Evolution of the Free Movement of Capital*, 31Fordham International Law Journal 1533 (2007).

V

Velasco, J., *How Many Fiduciary Duties are There in Corporate Law*, 83 Southern California Law Review 1231 (2010).

Vaplane, H. de, & Yon, J.P., *The concept of integrity in securities holding systems*, 193-214. (H.P. Conac, U. Segna & L. Thévenoz eds, Cambridge 2013).

Velden, J.W.P.M. van der, *Beleggingsfondsen naar Burgerlijk recht* (Kluwer 2008).

Velden, J. W.P.M. van der, *Babylonische bewaarders*, Tijdschrift voor Ondernemingsrecht compleet 17 (2009).

Velden, J.W.P.M. van der, *Civielrechtelijke aspecten van fondsen voor gemene rekening*, 6 Vastgoed Fiscaal en Civiel 6 (2011).

Velden, J.W.P.M. van der, Groffen, C.J. & Spoor, N.B., *Beleggingsinstelling* (D. Busch, D. Doorenbos, C.M. Grundmann, et al., Kluwer 2012).

Velden, J.W.P.M. van der, *Hoofdstuk 25 Beleggingsinstelling en aansprakelijkheid in het zicht van de nieuwe regelgeving*, in *Aansprakelijkheid in de Financiële Sector* 976-977 (D. Busch, C.J.M. Klaassen & T.M.C. Arons, Kluwer Law 2013).

Velden, J.W.P.M. van der, *Fondsen voor gemene rekening: wel of geen maatschap?,* 4 TvFR 139 (2015).

Vermeulen, E.P.M, & Pereira Dias Nunes, D., *The European Venture Capital Cycle in the Post-AIFMD Era* 593-609 (D.A. Zetzsche ed., Kluwer 2012).

Vermeulen, E.P.M. & McCahery, J.A., *Corporate Governance of Non-Listed Companies*, (Oxford University Press 2008).

Verwilst, G.A.M., *De Europese toekomst van icbe's*, 4 TvFR 109-115 (2007).

Verwilst, G.A.M., *De belegger centraal; Europese toezichtrechtelijke ontwikkelingen rond beleggingsproducten*, 10 TvFR 266-274 (2010).

Viciano-Gofferje, M., *Neue Transparenzanforderungen für Private Equity Fonds nach dem Kapitalanlagegesetzbuch*, BB 2506 (2013).

Villeneuve, T.H. de, *Cliëntenclassificatie onder MiFID* 61-79 (F.M.A. 't Hart ed, NIBE-SVV 2007).

Vinuales, J., *The International Regulation of Financial Conglomerates: A Case-Study of Equivalence as an Approach to Financial Integration,* 37 California Western International Law Journal 1-61 (2006).

Visser-Wiggers, S.C.M. de & Kerkvliet, J., *Bent u al AIFMD-proof?,* 5 TOP 29-33 (2014).

Vletter-van Dort, H.M., *Gelijke behandeling van beleggers bij informatieverstrekking* (Kluwer 2001).

Voermans, W., *Gold-plating and double banking: an overrated problem?* 79-88 (H. Snijders & S. Vogenauer eds. Sellier European Law Publishers 2009).

Volhard, P & Kruschke, A., *Die Regulierung von Private Equity Fonds-Manager durch den Europäischen Gesetzgeber - Ausgewählte Aspekte der AIFM-Richtlinie und der VC-Verordnung im Überblick*, 1 Europäisches Wirtschafts- und Steuerrecht 21 (2012).

Voss, T., *Die Securities Law Directive und das deutsche Depotrecht*, 6 Europäisches Wirtschafts- und Steuerrecht 209-211(2010).

Vranken, J.B.M., *Methodology of legal doctrinal research,* https://pure.uvt.nl/ws/files/1296852/Vranken_Methodology_of_legal_doctrinal_research_110118_publishers_embargo1y.pdf (accessed 23 April 2017).

Vugt, Y.O.M. van & Angeren, A.A. van, *Vermogensscheiding: aandachtspunten bij de bescherming van rechten van cliënten*, *6* TvCo 172-176 (2007).

Vuyst, V. de, *Internal governance bij financiele conglomeraten* (Intersentia 2010).

W

Waclawik, E., *Aufsichtsrechtliche Aspekte der Tätigkeit privater Family Offices*, Zeitschrift für Bankrecht und Bankwirtschaft 401 (2005).

Waclawik, E., *Erlaubnispflicht privater Family Offices nach Umsetzung der MiFID?*, Zeitschrift für Wirtschaftsrecht 1341 (2007).

Wagner, K., *Aktuelle Fragen und Probleme bei Publikumspersonengesellschaften*, NJW 198 (2013).

Wagner, K., *Geschlossene Fonds gemäß dem KAGB*, ZfBR 113 (2015).

Walker, G., *The Liability Insurance of the AIFMD* (D.A.Zetzsche ed, Kluwer 2015).

Wall, E. & Malm, G., *Using Blockchain Technology and Smart Contracts to Create a Distributed Securities Depository*, 5-23 at http://lup.lub.lu.se/ luur/download?func=downloadFile&recordOId=8885750&fileOId=8885765 (accessed 21 July 2017).

Wallach, E., *Alternative Investment Funds Managers Directive – ein neues Kapitel des europäischen Investmentrechts*, 2 Recht der Finanzinstrumente 80 (2011).

Wallach, E., *Die Regulierung von Personengesellschaften im Kapitalanlagegesetzbuch*, ZGR 289 (2014).

Walsh, P., *Regulator warns of blockchain settlement usage* (19 January 2017), Global Custodian, https://www.globalcustodian.com/Technology/Regulator-warns-of-blockchain-settlement-usage/ (accessed 20 July 2017).

Wang, Y., *Most-Favoured-Nation Treatment under the General Agreement on Trade in Services – and Its Application in Financial Services*, 30 Journal of World Trade 91(1996);

Warner, E.W., *"Mutual Recognition" and Cross Border Financial Services in the European Community*, 55 *Law and Contemporary Problems* 7-28 (1992), http://scholarship.law.duke.edu/lcp/vol55/iss4/2 (accessed 21 April 2017).

Warren, M.G., *The European Union's Investment Services Directive*, 15 Journal of International Law 186 (1994).

Watson, R.J. & Beenen, T.W., *De PRIIPs-Verordening: essentiële informatie over verpakte beleggingsproducten,* 10 TvFR 383 (2016).

Weatherill, S., *Harmonisation: How Much, How Little?*, 16 European Law Review 533, 539 (2005).

Weatherill, S., *Supply of and Demand forInternal Market Regulation: Strategies, Preferences and Interpretation* 29–60 (N. Shuibne ed., Edward Elgar 2006).

Weber, R.H. & Grünewald, S., *UCITS and the Madoff scandal: liability of depositary banks?,* http://www.zora.uzh.ch/20149/ (accessed 15 May 2017).

Weber, R.H., *Mapping and Structuring International Financial Regulation – A Theoretical Approach,* http://www.zora.uzh.ch/25932/ (accessed 15 May 2017).

Wegman, H., *Investor Protection – Towards Additional EU Regulation of Investment Funds* (Kluwer 2016).

Wei, T. B., *The Equivalence Approach to Securities Regulation*, 225 Northwestern Journal of International Law & Business 1 (2007).

Weinrib, E.J., *The Fiduciary Obligation*, 25 U. TORONTO L.J. 1 (1975).

Weiser, B. & Hüwel, M., *Verwaltung alternativer Investmentfonds und Auslagerung nach dem KAGB-E*, 19 Betriebs-Berater 1091, 1097 (2013).

Weiss, F. & Kaupa, C., *European Union Internal Market Law* 9 (Cambridge University Press 2014)

Weitnauer, W., *Das Übernahmesonderrecht des KAGB und seine Auswirkungen auf die Private-Equity-Branche*, AG 672 (2013).

Whincop, M.J., *Nexuses of Contracts, the Authority of Corporate Agents, and Doctrinal Indeterminacy: From Formalism to Law and Economics*, 20 U.N.S.W. L.J. 274 (1997).

Wiberg, M., *The EU Services Directive: Law or Simply Policy?* 25 (Springer 2014).

Wiggins, R.Z., Wedow, M. & Metrick, A., *European Banking Union B: The Single Resolution Mechanism,* Yale Program on Financial Stability Case Study 2014-5B-V1 (2014).

Wilhelmi, R. & Bassler, M., *AIFMD, Systematic Risk and the Financial Crisis* (D.A.Zetzsche ed, Kluwer 2015).

Williamson, O., *Corporate Governance,* 93 Yale Law Journal 1197 *(*1984).

Wilmarth, A.E., *The dark side of universal banking: Financial conglomerates and the origins of the subprime crisis*, 41 Connecticut Law Review 963-1050 (2009).

Windbichler, C., *Eine Internationale Landkarte der Personengesellschaften (einschließlich juristische Personen und Gesamthand)*, ZGR 110 (2014).

Winter, J., *Rapport Commissie Modernisering Beleggingsinstellingen*, December 2004, 43, http://parlis.nl/pdf/bijlagen/BLG4479.pdf (accessed 16 April 2017).

Wirth, P.A., & Erny, D., *Der Fondsplatz Liechtenstein im internationalen Vergleich mit der Schweiz und Luxemburg* (Luzern 2010).

Wirth, T., Bögli, C. & Valenti, M., *Interne Organisation von Vermögensverwaltern kollektiver Kapitalanlagen*, ST 560 (2012).

Wong, J.I. & Karr, I., *Everything you need to know about the Ethereum "Hard Fork",* http://qz.com/730004/everything-you-need-to-know-about-the-ethereum-hard-fork/ (accessed 21 July 2017).

Woodward, E.S., *Limited Liability in the Theory of the Firm*, 141 Journal of Institutional and Theoretical Economics 601 (1985).

Woolfe, J., *Big Issue to Resolve to Wrap Up the Directive*, Financial Times, Fund Management Supplement, 18 January 2010, 8.

Worley, J.P.S., *UCITS III and the Freedom to Provide Fund Management Services*, http://www.avukati.org/common/fileprovider.ashx?id=633123978903617500 (accessed 8 July 2017).

Wright, A. & Filippi, P. de, *Decentralized Blockchain technology and the Rise of Lex Cryptographia*,, 56 https://papers.ssrn.com/sol3/papers.cfm?abstract_ id=2580664 (accessed 21 July 2017).

Wroldsen, J., *The Social Network and the Crowdfund Act: Zuckerberg, Saverin and Venture Capitalists' Dilution of the Crowd*, https://ssrn.com/abstract=2141015 (accessed 15 Mai 2017).

Wymeersch, E., *The Implementation of the ISD and CAD in National Legal Systems* (G. Ferrarini ed. Kluwer 1998).

Wymeersch, E. (ed.), *Alternative Investment Fund Regulation* (Kluwer 2012).

Wymeersch, E., *Europe's Financial Regulatory Bodies* (H. S. Birkmose, M. Nevillie & K. E. SØrensen eds., Kluwer 2012).

Wymeersch, E., *Banking Union: Aspects of the Single Supervisory Mechanism and the Single Resolution Mechanism Compared,* ECGI - Law Working Paper No. 290 (2015).

Wymeersch, E., *The European Banking Union, a First Analysis,* Financial Law Institute Working Paper Series WP 2012-07 (2012).

Wymeersch, E., *The Single Supervisory Mechanism or 'SSM', Part One of the Banking Union,* European Corporate Governance Institute (ECGI) - Law Working Paper No. 240/2014 (2014).

Wymeersch, E., *The Single Supervisory Mechanism: Institutional Aspects* (D. Busch & G. Ferrarini, Oxford 2015).

Wymeersch, E., *The institutional reforms of the European Financial Supervisory System, an interim Report,* https://ssrn.com/abstract=1541968 (accessed 16 February 2017).

Wymeersch, E., *Europe's New Financial Regulatory Bodies*, 5, http://ssrn.com/abstract=1813811 (accessed 14 January 2017).

Y

Yates, M. & Montagu, G., *The Law of Global Custody* 20 (3rd ed. Tottel, Haywards Heath 2009).

Yeoh, P., *The challenges and implications of systemic risks for financial regulation*, (2010) 31 Company Lawyer 389 (2010).

Yermo, J. & Marossy, A., *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, www.oecd.org/finance/private-pensions/1815934.pdf (accessed 27 July 2016), 7.

Yermo, J., *Revised Taxonomy for Pension Plans, Pension Funds and Pension Entities*, October 2002, Section 2.2., http://www.oecd.org/pensions/private-pensions/2488707.pdf (accessed 14 January 2017).

Yokoi-Arai, M., *GATS' Prudential Carve Out in Financial Services and Its Relation with Prudential Regulation* 57 International and Comparative Law Quarterly 638-640 (2008).

Z

Zaal, P.J. van, *Aanhouden van gelden door beleggingsondernemingen en betaaldienstverleners*, 9 TvFR 226-237 (2010).

Zampetti, A., *Market Access through Mutual Recogntiion: The Promise and Limits of GATS Article VII* 283-306, 305 (P. Sauvé and R. Stern eds., Brookings Institution Press 2000).

Zavvos, G.S., *Towards a European Banking Act*, 25 Common Mkt. L. Rev p. 263 (1988).

Zebregs, B.J.A. *De CSD-verordening in het licht van de Capital Markets Union* (*Ondernemingsrecht* 2017/18).

Zentraler Kreditausschuss, *Erläuterungen zur„Auslegung des Bundesministeriums der Finanzen zur Thematik Primebroker nach dem Investmentgesetz",* 1 Juni 2004.

Zetzsche, D.A, *Shareholder Passivity, Cross-Border Voting and the Shareholder Rights Directive*, 8 Journal of Corporate Law Studies 289 (2008).

Zetzsche, D.A., *Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?*, in *The European Financial Market in Transition* (H. S. Birkmose, M. Nevillie & K. E. SØrensen eds., Kluwer 2012).

Zetzsche, D.A., *(Prime) Brokerage* (D.A.Zetzsche ed, Kluwer 2012).

Zetzsche, D.A. (ed.), *The Alternative Investment Fund Managers Directive. European Regulation of Alternative Investment Funds* (Kluwer 2012).

Zetzsche, D.A., *Die Irrelevanz und Konvergenz des Organisationsstatus von Investmentfonds*, ZVglRWiss 111, 371 (2012).

Zetzsche, D.A., *Das UCITSG und seine Folgen* 24-26 (H. Heiss, A. Kellerhals, A.K. Schnyder & F. Schurr eds., Schriften des Zentrums für liechtensteinisches Recht (ZLR) an der Universität Zürich 2013).

Zetzsche, D.A. & Preiner, C.D., *Was ist ein AIF?*, WM 2101 (2013).

Zetzsche, D.A. & Preiner, C.D., *Das liechtensteinische AIFM-Gesetz: Die erste Umsetzung der europäischen AIFM-Richtlinie*, RiW, 265 (2013).

Zetzsche, D.A., *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* 62-63 (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014).

Zetzsche, D.A., *Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).

Zetzsche D.A., *Introduction* 15-17 (D.A. Zetzsche ed. Kluwer 2015).

Zetzsche, D.A. & Eckner, D. *Appointment, Authorization and Organization of the AIFM* (D.A.Zetzsche ed, Kluwer 2015).

Zetzsche, D.A. & Eckner, D., *Investor Information and Reporting* (D.A.Zetzsche ed, Kluwer 2015).

Zetzsche, D.A. & Eckner, D., *Risk Management* (D.A. Zetzsche ed, Kluwer 2015).

Zetzsche, D.A. & Eckner, D., *Securitizations* (D.A. Zetzsche ed, Kluwer 2015).

Zetzsche, D.A. & Marte, T.F., *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D.A.Zetzsche ed, Kluwer 2015).

Zetzsche, D.A. & Marte, T., *Kreditfonds zwischen Anleger- und Systemschutz*, RdF 4 (2015).

Zetzsche, D.A. & Marte, T.F., *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* 474 (D.A. Zetzsche ed, Kluwer 2015).

Zetzsche, D.A. & Marte, T.F., *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D.A. Zetzsche ed, Kluwer 2015).

Zetzsche, D.A. & Preiner, C.D., *Scope of the AIFMD* (D.A.Zetzsche ed, Kluwer 2015).

Zetzsche, D.A., *(Prime) Brokerage* (D.A.Zetzsche ed, Kluwer 2015).

Zetzsche, D.A., *The AIFMD and the Joint Principles of European Asset Management Law* (D.A.Zetzsche ed, Kluwer 2015).

Zetzsche, D.A., & Marte, T.F., *The AIFMD's Cross-Border Dimension, Third-Country Rules and the Equivalence Concept*, 474 (D. Zetzsche ed, Kluwer 2015).

Zetzsche, D.A., & Preiner,C.D. , *ELTIFR versus AIFMD* (D.A.Zetzsche ed, Kluwer 2015).

Zetzsche, D.A., *Drittstaatenregelungen im EU-Finanzmarktrecht*, in *Finanzmarktregulierung zwischen Innovation und Kontinuität in Deutschland, Europa und Russland* (G. Bachmann ed., Mohr Siebeck 2014).

Zetzsche, D.A., *Introduction* (D.A.Zetzsche ed, Kluwer 2015).

Zetzsche, D.A., *Prinzipien der kollektiven Vermögensanlage* (Mohr Siebeck 2015).

Zetzsche, D.A., *Verordnung über europäische langfristige Investmentfonds (ELTIF-VO) – Langfristigkeit im Sinne der Kleineranleger?*, 6 ZBB 362 (2015).

Zetzsche, D.A., *Competitiveness of Financial Centers in Light of Financial and Tax Law Equivalence Requirements* (R.P. Buckley, E. Avgouleas & D.W. Arner eds., Cambridge University Press 2016).

Zetzsche, D.A., *Aktivlegitimation gemäß § 78, 89 KAGB im Investment-Drei-und –Viereck* (M. Casper, L. Klöhn, W.H. Roth & C. Schmies eds, RWS Verlag 2016).

Zetzsche, D.A. & Preiner, C.D., *Intermediärsrecht* 731-798 (M. Gebauer & C. Teichmann eds, Nomos 2016).

Zetzsche, D.A., *Virtual Shareholder Meetings and the European Shareholder Rights Directive - Challenges and Opportunities*, https://ssrn.com/abstract=996434 (accessed 10 July 2017).

Zetzsche, D.A., *Shareholder Passivity, Cross-Border Voting and the Shareholder Rights Directive*, https://ssrn.com/abstract=1120915 (accessed 10 July 2017).

Zetzsche, D.A., *The Anatomy of European Investment Fund Law*, https://ssrn.com/abstract=2951681 (accessed 16 April 2017).

Zetzsche, D.A. & Preiner, C.D., *Cross-Border Crowdfunding – Towards a Single Crowdfunding Market for Europe*, European Banking Institute Working Paper Series 2017 - No. 8, https://ssrn.com/abstract=2991610 (accessed 26 June 2017).

Zetzsche, D.A., Buckley, R.P., Arner, D.W. & Barberis, J.N., *From FinTech to TechFin: The Regulatory Challenges of Data-Driven Finance*, European Banking Institute Working Paper Series 2017 - No. 6, https://ssrn.com/abstract=2959925 (accessed 10 July 2017).

Zhao Li, *Securities Regulation in the International Environment*, 110-115, http://theses.gla.ac.uk/691/1/2009zhaoliphd.pdf (accessed 14 January 2017).

Zimmerman, R., *Savigny's Legacy: Legal History, Comparative Law, and the Emergence of a European Legal Science*, 112 LQR 575 (1996).

Zingales, L., *What Determines the Value of Corporate Votes?*, 110 Quarterly Journal of Economics, 1047-1073 (1995).

Zippelius, R., *Juristische Methodenlehre* (C.H.Beck 2012).

Zolb, D. & Fischer, D., *Haftung der Depotbank bei externer Vermögensverwaltung* (Dike 2008).

Zollinger, M., *Rechts- und Haftungsverhältnisse in der Dreiecksbeziehung Depotbank – Kunde – externer Vermögensverwalter (Financial Intermediary),* http://www.markus-zollinger.ch/wp-content/uploads/Markus_Zollinger_SeminarBankenrecht_Thema-20.pdf (accessed 12 May 2017).

Zweigert, K. & Kötz, H., *Introduction to Comparative Law* 35 (Clarendon Press 1998).

Zwiefelhofer, S., *Das liechtensteinische Recht betreffend die Investmentunternehmen verglichen mit dem schweizerischen Anlagefonds* (Schulthess 2002).

List of Legal Texts (EU/EEA)

First Council Directive 73/239/EEC of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance, OJ L 228, 16 August 1973, 3 ('First Directive on Non-life Insurance').

First Council Directive 77/780/EEC of 12 December 1977 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions, OJ L 322, 17 December 1977, 30 ('First Banking Directive').

First Council Directive 79/267/EEC of 5 March 1979 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life assurance, OJ L 63, 13 March 1979, 1 ('First Directive on Life Insurance').

Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts as amended by Directive 2009/49/EC of the European Parliament and of the Council of 18 June 2009 as regards certain disclosure requirements for medium-sized companies and the obligation to draw up consolidated accounts, OJ L 164, 26 June 2009, 42 ('Seventh Directive on Company Law').

Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), OJ L 375, 31 December 1985, 3 ('UCITSD I').

Second Council Directive 88/357/EEC of 22 June 1988 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 73/239/EEC, OJ L 172, 4 July 1988, 1.

Council Directive 89/299/EEC of 17 April 1989 on the own funds of credit institutions, OJ L 124, 5 May 1989, 16 ('Own Funds Directive').

Second Council Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC, OJ L 386, 30 December 1989, 1 ('Second Banking Directive).

Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions, OJ L 386, 30 December 1989, 14 ('Solvency Ratio Directive').

Council Directive 92/121/EEC of 21 December 1992 on the monitoring and control of large exposures of credit institutions, OJ 1993 L 29/1, 5 February 1993, 1.

Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and amending Directives 73/239/EEC and 88/357/EEC, OJ L 228, 1 August 1992, 1 ('Third Non-Life Insurance Directive'). (third non-life insurance Directive).

Proposal for a Directive amending Directive 85/611/EEC amending amending Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (ucits), com(93) final – syn 453, 9 February 1993.

Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investments firms and credit institutions, OJ L 141, 11 June 1993, 1 ('CRD I').

Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities feld, OJ L 141, 11 June 1993, 27 ('Investment Services Directive, ISD').

European Parliament and Council Directive 95/26/EC of 29 June 1995 amending Directives 77/780/EEC and 89/646/EEC in the field of credit institutions, Directives 73/239/EEC and 92/49/EEC in the field of non- life insurance, Directives 79/267/EEC and 92/96/EEC in the field of life assurance, Directive 93/22/EEC in the field of investment firms and Directive 85/611/EEC in the field of undertakings for collective investment in transferable securities (UCITS), with a view to reinforcing prudential supervision, OJ L 168, 18 July 1995, 7.

Proposal for a Directive of the European Parliament and of the Council amending Directives 98/78/EC, 2002/87/EC and 2006/48/EC as regards the
supplementary supervision of financial entities in a financial conglomerate, 16 August 2010, COM(2010) 433 final**,** 2010/0232 (COD).

Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems, OJ L 166, 11 June 1998, 45 ('Settlement Finality Directive, SFD').

Directive 98/78/EC of the European Parliament and of the Council of 27 October 1998 on the supplementary supervision of insurance undertakings in insurance groups, OJ L 330, 5 December 1998, 1.

Proposal for a Directive of the European Parliament and of the Council on the activities of institutions for occupational retirement provision (2001/C 96 E/06), COM(2000) 507 final . 2000/0260(COD).

Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, OJ L 126, 26 May 2000, 1.

Directive 2001/107/EC of the Parliament and of the Council of 21 January 2002 amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative relating to undertakings for collective investment in transferable securities (UCITS) with a view to regulating management companies and simplified prospectuses, OJ L 41, 13 February 2002, 20 ('UCITSD III (Manager Directive)').

Directive 2001/108/EC of the European Parliament and of the Council of 21 January 2002 amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), with regard to investments of UCITS, OJ L 41, 13 February 2002, 35 ('UCITSD III (Product Directive)').

Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and

investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council, OJ L 35, 11 February 2003, 1 ('FICOD').

Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), OJ L 96, 12 April 2003, 16 ('Market Abuse Directive, MAD').

Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, OJ L 124, 20 May 2003, 36.

Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003on the activities and supervision of institutions for occupational retirement provision, OJ L 235, 23 September 2003, 10 ('IORPD I').

Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (OJ L 345/64) as amended by Directive 2010/73/EU of the European Parliament and of the Council of 24 November 2010, OJ L 327, 31 December 2003, 1 ('Prospectus Directive, PD').

Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, OJ L 145, 30 April 2004, 1 ('MiFID').

Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, OJ L 142, 30 April 2004, 12 ('Takeover Bid Directive, TBD').

Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements, OJ L 149, 30 April 2004, 1 ('Prospectus Regulation').

Commission Recommendation 2004/383/EC of 27 April 2004 on the use of financial derivative instruments for undertakings for collective investment in transferable securities (UCITS), OJ L 144, 30 April 2004, 33.

Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, OJ L 390, 31 December 2004, 38 ('Transparency Directive, TPD').

Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast), OJ L 177, 30 June 2006, 1 ('Banking Directive, CRD I').

Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast), OJ L 177, 30 June 2006, 201 ('Capital Adequacy Directive, CAD').

Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, OJ L 241, 2 September 2006, 26 (‘MiFID I (Commission) Directive’).

Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347, 1 December 2006, 1 (‘VATD’).

Commission Directive 2007/16/EC of 19 March 2007 implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions, OJ L 79, 20 March 2007, 11 (‘Eligible Assets Directive, EAD’).

Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies, OJ L 184, 14 July 2007, 17 (‘EU Shareholders Rights Directive; SRD’).

Directive 2007/44/EC of the European Parliament and of the Council of 5 September 2007 amending Council Directive 92/49/EEC and Directives 2002/83/EC, 2004/39/EC, 2005/68/EC and 2006/48/EC as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of holdings in the financial sector, OJ L 247, 21 September 2007, 1.

European Parliament and the Council of 6 May 2009, OJ L 146, 10 June 2009, 37 (‘Financial Collateral Directive; FCD’).

Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims, OJ L 146, 10 June 2009, 37 (‘FD’).

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) (recast), OJ L 302, 17 November 2009, 32 (‘UCITSD IV’).

Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management, OJ L 302, 17 November 2009, 97.

Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast), OJ L 335, 17 December 2009, 1 (‘Solvency II’).

Commission Regulation (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website, OJ L 176, 10 July 2010, 1 (‘KIIDR’).

Commission Regulation (EU) No 584/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards the form and content of the standard notification letter and UCITS attestation, the use of electronic communication between competent authorities for the purpose of notification, and procedures for on-the-spot verifications and investigations and the exchange of information between competent authorities, OJ L 176, 10 July 2010, 16.

Commission Directive 2010/42/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards certain provisions concerning fund mergers, master-feeder structures and notification procedure, OJ L 176, 10 July 2010, 28.

Commission Directive 2010/43/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company, OJ L 176, 10 July 2010, 42 ('UCITSD Level 2 (2010/43/EU)').

Directive 2010/73/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, OJ L 327, 11 December 2010, 1.

Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (ESRB), OJ L 331, 15 December 2010, 1 ('ESRBR').

Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ L 331, 15 December 2010, 12 ('EBAR').

Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC, OJ L 331, 15 December 2010, 48 ('EIOPAR').

Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ L 331, 15 December 2010, 84 ('ESMAR').

Council Regulation (EU) No 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board, OJ L 331, 15 December 2010, 162 ('ESRBR ').

Directive 2010/78/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 98/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC and 2009/65/EC in respect of the powers of the European Supervisory Authority (European Banking Authority), the European Supervisory Authority (European Insurance and Occupational Pensions Authority)

and the European Supervisory Authority (European Securities and Markets Authority), OJ L 331, 15 December 2010, 120.

Directive 2011/61/EU of the European Parliament and of the Council 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, OJ L 174, 1 July 2011, 1 ('AIFMD').

Commission Delegated Regulation (EU) No 272/2012 of 7 February 2012 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to fees charged by the European Securities and Markets Authority to credit rating agencies with EEA relevance, OJ L 90, 28.3.2012, 6.

Regulation (EU) No 648/2012 ('EMIR') of the European Parliament and of the council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories Text with EEA relevance, L 201/1, 27 July 2012.

Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision, OJ L 83, 22 March 2013, 1 ('AIFMD (Commission) Regulation').

Regulation (EU) No 447/2013 of the European Parliament and of the Council of 15 May 2013 establishing the procedure for AIFMs which choose to opt in under Directive 2011/61/EU of the European Parliament and of the Council (AIFMD), OJ L 132/1, 16 May 2013.

Regulation (EU) No 448/2013 of the European Parliament and of the Council of 15 May 2013 establishing a procedure for determining the Member State of reference of a non-EU AIFM pursuant to Directive 2011/61/EU of the European Parliament and of the Council, L 132/3, 16 May 2013.

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 June 2013, 1–337 ('CRR').

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 Text with EEA relevance, L 176/338, 27 June 2013 ('CRD IV').

Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds, OJ L 115, 25 April 2013, 1 ('EuVECAR).

Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds, OJ L 115, 25 April 2013, 18 ('EuSEFR').

Regulation (EU) No 694/2014 of the European Parliament and of the Council of 17 December 2013 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to regulatory technical standards determining types of alternative investment fund managers, OJ L 183, 24 June 2014, 18.

Proposal for a Regulation of the European Parliament and of the Council on Money Market Funds (COM/2013/0615- C7-0263/2013 – 2013/0306(COD).

Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014 amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) No 1060/2009, (EU) No 1094/2010 and (EU) No 1095/2010 in respect of the powers of the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority), OJ L 153, 22 May 2014, 1.

Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive), OJ L 173, 12 June 2014, 179 ('MAD II').

Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC, OJ L 173, 12 June 2014, 1 ('MAR').

Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, OJ L 173, 12 June 2014, 84 ('MiFIR').

Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, OJ L 173, 12 June 2014, 349 ('MiFID II').

Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012, OJ L 257, 28 August 2014, 1('CSDR').

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 August 2014, 186 ('UCITSD V').

Regulation (EU) No 1286/2014 of the European Parliament and of the of 26 November 2014 on key information documents for packaged retail and insurance-based investment products, OJ L 352, 9 December 2014, 1 ('PRIIPR').

Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds, OJ L 123, 19 May 2015, 98 ('ELTIFR').

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, OJ L 78/11, 24 March 2016, 1 ('UCITSD V (Commission) Regulation').

Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits, C(2016) 2031 final, 7 April 2016 ('MiFID II (Commission) Directive')).

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, OJ L 78/11, , 24 March 2016, 11 ('UCITSD V (Commission) Regulation')).

Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast), OJ L 26/19, 2 February 2016, 19 ('IDD').

Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC, OJ L 119/1, 4 May 2016, 1 ('GDPR').

Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (recast), OJ L 354/37, 23 December 2016, 37 ('IORPD II').

Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds, OJ L169/8, 30 June 2017, 8 ('MMFR').

Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC, OJ L 168/12, 30 June 2017, 12 ('PR').

Proposal for a Regulation of the European Parliament and of the Council on a pan-European Personal Pension Product (PEPP) COM/2017/0343 final - 2017/0143 (COD) ('PEPPR').

Table of EU Case Law

CJEU (Judgment of 21 June 1974), C-2/74, *Reyners,* ECLI:EU:C:1974:68, paras. 30-31;

CJEU (Judgment of 3 December 1974), C-33-74, *Van Binsbergen,* ECLI:EU:C:1974:131.

CJEU (Judgment 20 February 1979), C-120-78, *Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein*, ECLI:EU:C:1979:42.

CJEU (Judgment of 28 January 1986), C-270/*83, Commission v. France*, ECLI:EU:C:1986:37, para. 18;

CJEU (Judgment of 10 July 1986), C-79/85 *Segers*, ECLI:EU:C:1986:308, para. 13;

CJEU (Judgment of 4 December 1986), C-205/84, *Commission v Germany*, ECLI:EU:C:1986:463, par. 101-102.

CJEU (Judgment 4 December 1986), C 206/84, *Commission v Ireland,* ECLI:EU:C:1986:464, par. 154.

CJEU (Judgment of 4 December 1986), C-220/83 *Commission v France,* ECLI:EU:C:1986:461, par. 134;

CJEU, (Judgment of 24 November 1992), Case C-286/90, *Poulsen and Diva Navigation*, ECLI:EU:C:1992:453, para. 9.

CJEU (Judgment of 13 July 1993), Case C-330/91, *Commerzbank,* ECLI:EU:C:1993:303, para. 13.

A-G Opinion (26 January 1995), *Alpine Investments BV v Minister van Financiën,* ECLI:EU:C:1995:15, para. 44;

CJEU (Judgment of 14 December 1995), Joined cases C-163/94, C-165/94, C-250/94, *Sanz de Lera*, *ECLI:EU:*C:1995:451.

CJEU (Judgment of 12 March 1996), C-441-93), *Panagis Pafitis and others v Trapeza Kentrikis Ellados*, ECLI:EU:C:1996:92, para. 49.

CJEU (Judgment of 16 July 1998), Case C-264/96, *Imperial Chemical Industries,* ECLI:EU:C:1998:370, para. 20; See on the right of secondary establishments of credit institutions:

CJEU (Judgment of 9 March 1999), C-212/97, *Centros,* ECLI:EU:C:1999:126, paras. 26–27; and

CJEU (Judgment of 5 November 2002), C-208/00, *Überseering,* ECLI:EU:C:2002:632, paras. 78–82;

CJEU (Judgment of 23 September 2003), C-452/01, *Ospelt,* ECLI:EU:C:2003:493.

CJEU (Judgment of 30 September 2003), C-167/01, *Inspire Art,* ECLI:EU:C:2003:512, paras. 96–98, 105.

CJEU (Judgment of 5 October 2004), Case C-442/02, *Caixabank France*, ECLI:EU:C:2004:586, paras. 13–14.

CJEU (Judgment 12 October 2004), C-222/02, *Peter Paul and others* v *Germany*, ECLI:EU:C:2004:606, para. 44.

CJEU (Judgment of 15 September 2005), Joined Cases C-281/03 and C-282/03, *Cindu Chemicals BV and Others,* ECLI:EU:C:2005:549.

A-G Opinion (16 March 2006), C-452/04, *Fidium Finanz AG v. Bundesanstalt fur Finanzdienstleistungsaufsicht*, ECLI:EU:C:2006:182, para. 41 et seq.

CJEU (Judgment of 4 May 2006), Case C-169/04), *Abbey National*, ECLI: EU:C:2006:289, para. 40, 41.

CJEU (Judgment of 30 January 2007), C-150/04, *Commission v. Denmark,* ECLI:EU:C:2007:69.

CJEU (Judgment 13 March 2007), C-524/04, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, ECLI:EU:C:2007:161.

CJEU (Judgment of 24 May 2007), C-157/05, *Winfried L. Holböck v. Finanzamt Salzburg-Land*, ECLI:EU:C:2007:297, paras. 40-41;

CJEU (Judgment 28 June 2007), Case C-363/05, *Claverhouse,* ECLI: EU:C:2007:391, para. 43.

CJEU (Judgment 8 September 2009), C-478/07, *Budějovický Budvar v. Rudolf Ammersin GmbH,* ECLI:EU:C:2009:521, para. 106.

CJEU (Judgment of 7 March 2013), Case C-424/11, *Wheels*, ECLI: EU:C:2013:144, para. 16.

CJEU (Judgment 13 March 2014), Case C-464/12, *ATP Pension Service,* ECLI:EU:C:2014:139, para. 37.

CJEU, (Judgment of 9 December 2015), Case C-595/13, *Fiscale Eenheid X,* ECLI: EU:C:2015:801, para. 42.

Index

A

Account keepers 283
Agency problems 317, 456, 505, 508
Alternative Investment Fund (AIF) 1-6, 8-11, 14, 20, 24-32, 34, 42, 46, 48, 86, 94, 124, 127, 128, 138, 147, 149, 150-158, 160-163, 168, 173, 174, 179, 180-195, 198, 201-205, 208, 209-214, 216-219, 221-223, 225, 227-236, 238-241, 250, 253, 258-260, 266, 271, 275, 315, 319, 329, 335-338, 343, 346-348, 350-361, 363, 366, 368-372, 374-376, 378-381, 384, 386, 388, 390, 392, 394, 396, 400, 402, 403, 405-408, 410, 411, 413, 414, 416-424, 428-431, 433, 444, 458, 469, 470, 474, 478, 479, 486, 513, 519, 520, 530, 532-535, 541, 554, 555, 560-563, 565, 566, 567, 569-572, 576, 578-580, 582, 598, 606, 610, 611, 613, 614, 616, 618, 621, 623, 624, 629-631, 633, 636-638, 640, 653, 654, 657, 664, 666-668, 694, 748
  collective investment 4, 15, 16, 20, 22, 33, 36, 39-41, 58, 72, 82, 98, 150, 152, 153, 158, 160, 165, 166-170, 173, 174, 180, 184, 185, 219, 304, 336, 337, 345-351, 354-360, 364-366, 368-370,372, 373, 387, 388, 390-394, 404, 407, 408, 410, 411, 417, 420, 430-432, 443, 444, 457, 472-474, 478, 482, 501, 508, 512, 513, 530, 531, 533, 534, 536, 539, 542, 545, 552, 555, 558, 560, 567-569, 574, 577, 578, 580, 581, 583, 602, 608, 613, 615, 618, 621, 628, 629, 637, 666, 693, 703, 705, 751, 752, 753, 754, 757
  defined investment policy 347, 351-353, 359, 360, 364, 368, 369, 420, 432
  for the benefit of the investors 354
  investment guidelines 354
  number of investors 347, 349, 351, 352, 353, 359, 360, 364, 368, 369, 420, 432, 504, 637
  pooled return 349, 350, 353, 508, 513, 539, 608, 666
  raise capital 347, 349, 350, 352, 359, 360, 365, 367-369, 420, 432, 520
  third-party investment management 349, 351
  undertaking for collective investments 348, 349, 350
Alternative Investment Fund Manager (AIFM) 4, 8, 12-15, 21, 23, 24, 26-28, 85, 86, 106, 107, 112, 123, 124, 127-129, 137-139, 150-157, 162, 163, 168, 171-175, 178, 179, 181, 182-195, 199-205, 208-213, 217-219, 221-223, 227-232, 234-237, 240, 241, 254, 266, 267, 326, 329, 331, 332, 335, 337, 338, 346-348, 350-354, 356, 358-360, 362, 363, 366, 368-376, 379, 380, 382, 383, 384, 385, 386-393, 396-403, 405, 407, 410, 411, 413, 416-419, 421-428, 430, 431, 439, 449, 483, 485, 486, 503, 504, 509, 510, 512, 513, 518, 519, 522, 529, 533, 549, 550, 553, 554, 560, 563, 567-573, 575-581, 589, 595, 603, 612, 623, 629, 631, 633, 636, 637, 640, 687-689, 692, 694, 702, 707, 711, 715, 716, 718-720, 722, 724-726, 730, 733, 734, 736, 738, 739, 742, 744, 748, 756
  core activities 370, 372, 386, 522, 612, 654, 667
  non-core service 43, 371, 373, 457
Ancillary European passport 19, 34, 46, 541, 657
Annual report 355-357, 414, 417-419, 425-427, 455, 548
Another Legal Entity 167
Appropriateness 295, 309-311, 454, 491, 493, 615, 621
Asset managers 9, 16, 17, 44, 107, 109, 148, 250, 278, 291, 316, 331, 332, 335, 336, 343, 344, 347, 348, 350, 357, 360, 435, 480, 506, 512, 514, 518, 521, 524, 525, 530, 534, 586, 588, 600, 605, 612, 614, 632, 648, 663, 730
Asset partitioning 345, 412, 433, 434, 466, 468, 503, 504, 506, 513, 516, 521, 524, 525, 529, 531, 534, 536, 538, 607, 633, 636, 665

shielding 468, 469, 524

B

Beneficiaries 15, 30, 242, 243-245, 252, 255, 256, 259, 261, 262, 267, 268, 352, 434, 437, 440, 443, 446-451, 453, 456, 462, 464-470, 475-477, 479, 509, 587, 590, 592, 596, 597, 599, 601, 630, 635, 636, 637
Bewaarderentiteit 172
Bilateral trade agreements 92, 105, 660
Blockchain 611, 640, 641, 645-650, 652, 654, 656, 668, 696, 698, 725, 729, 730, 733, 745
Board of directors 272-274, 398, 419, 445, 447-449, 459, 461, 503, 535, 547, 556, 557, 559, 578, 599, 600, 604, 608, 666
Brexit 52, 54, 78, 80, 85, 91, 106, 107, 110, 135, 142, 145, 613, 618, 660, 700, 712, 722, 723, 728, 736, 741

C

Central counterparties 184, 334, 756
Cheapest cost avoider theory 4, 636
Client asset protection 152, 328, 333, 622, 623, 643
Client assets 325, 331
Client funds 194, 279, 300-302, 304-306, 310, 331, 334, 337, 350, 497, 499
Closed-end funds 361, 366, 520, 572
Collective action problems 4, 174, 482, 502, 513, 539, 608, 666
Common commercial policy 95
Common Management/Supervision 176
Conflicts of interest 37, 39, 76, 160, 161, 167, 171, 173, 174, 177, 204, 205, 211, 231, 256, 261, 269, 271, 317, 326, 333, 370, 375, 376, 383, 389, 449, 450, 463, 491, 524, 526, 527, 534, 536, 544, 587, 588, 599, 618, 631, 755
Conflicts of interest 317, 587, 721
Conglomerates 75, 108, 112, 113, 117-121, 132, 140, 661, 746
Consensus mechanism 645-647, 649
Consolidated supervision 108, 112-114, 121, 140, 661
Control 4, 33, 43, 56, 65-68, 73, 75, 76, 78, 84, 85, 89, 91, 108, 110, 119, 120, 129, 131, 134, 135, 139, 144-147, 160, 162, 167, 176, 181, 184, 188, 213, 215, 216, 219, 220, 225, 234, 235, 239, 250, 262, 272, 274, 296, 332, 333, 346, 350, 351, 358, 362, 370, 376, 378, 389, 393, 397, 398, 400, 404, 418, 419, 421, 422, 424, 431, 434, 446, 448, 450, 452-454, 456, 461, 481, 489, 495, 496, 500, 505, 507, 510, 514-517, 520, 524, 535, 538, 545-549, 556, 559, 575, 576, 579, 607, 608, 610, 613, 618, 633, 636, 647, 660, 661, 662, 665, 739, 751
Controlling tasks 44, 45, 174, 198, 264, 392, 393, 458, 471, 549, 550, 555, 557, 570, 571, 575, 591
Co-ownership 402
Core services 19, 68, 69, 169, 276, 283-288, 298, 312, 313, 373, 387, 541, 605, 663
Counterparty 161, 233, 238, 336, 338
Credit institutions 25
Cross-border provision of financial services 49-51, 60, 77, 127, 144, 147, 610, 658, 659
Cross-Shareholdings 176
Crypto-securities 650-652
Central Securities Depositary (CSD) 43, 169, 170, 199, 216, 219, 221, 270, 279-288, 293, 296, 308, 312, 326, 330, 546, 551, 615, 642, 652, 747
central maintenance service 283, 284, 285, 286, 288, 312
non-banking-type ancillary services 286
notary service 285
Custodian 3, 10, 12, 13, 16, 17, 19, 25, 29, 32, 33, 43-46, 48, 69, 152, 158, 160, 161, 164, 170-172, 174, 177, 180, 182-186, 198-215, 217, 220, 221, 225, 227, 228, 230, 232-240, 242, 247, 249, 251, 252, 254, 256-258, 268-271, 274-276, 278, 280, 282-284, 287-289, 291, 293, 296, 298, 300, 303, 304, 312, 313, 315, 316, 320- 334, 336, 338, 341, 343-346, 391, 397, 431, 433, 435, 441, 444, 458, 460, 461, 466, 468, 471, 479-482, 490, 500-504, 508, 510, 514, 515, 524, 532-534, 536-539, 541, 543, 550-553, 556, 558-561, 569-571, 573-581, 583-590, 593-599, 601, 602, 606-608, 611, 613, 615, 616, 618, 620-625, 639, 640, 642-644, 652-654, 656, 657, 663-665, 667, 668, 698

Custodianship 1, 43, 44, 260, 270, 276-278, 282, 284, 291, 616, 619, 620, 621
Custody 1, 9, 12, 15, 19, 29, 42, 44, 45, 61, 68, 152, 157, 162, 163, 164, 169, 170, 172, 181, 183, 184-186, 188, 199-206, 208-221, 224-228, 230, 232-235, 237-241, 247, 253, 259, 263, 264, 267, 269, 271, 272, 278, 279, 282, 283, 288-293, 295-298, 304, 315, 320-323, 325-336, 338, 339, 343, 346, 392, 393, 402, 430, 458, 482, 500, 501, 511, 514, 534, 546, 550, 552-554, 557-571, 575-581, 583, 584, 586, 588-590, 595, 596, 606, 611, 614-616, 619, 620, 622, 623, 630, 632, 639, 656, 664, 696, 718, 731
Custody Plus 611, 613, 654, 668

D

Decentralized autonomous organization 649
Delegation 109-111, 198, 266, 327, 366, 379, 380, 549, 593, 597, 732
De-minimis exemption 358
Depositary 1-34, 36-42, 44, 45, 46, 48, 76, 98, 124, 148-225, 227-247, 249, 250, 252-268, 271-275, 277, 313-316, 320-338, 341-347, 362, 363, 369, 379, 380, 384, 385, 391-394, 397, 398, 400, 401, 403, 404, 416, 423, 430-433, 435, 441, 444, 458, 460, 461, 466-468, 471, 476, 479, 480, 482, 501, 503, 504, 508-510, 513-515, 524, 532-534, 536-555, 557, 558, 560, 561, 569-583, 585-627, 629-640, 642-644, 652-654, 656, 657, 662-667, 669, 693, 697, 698, 703, 706, 708, 715, 721, 729, 733, 745, 755, 757
Depositary duties 5, 150, 157, 240, 267, 550, 603, 620, 654, 667
Depositary liability regime 151, 164, 179, 203, 211, 212, 219, 228, 266, 267, 632
Depositary passport paradox 4, 18, 19, 21, 30, 31, 34, 46, 48, 611, 653, 658, 667
Depositary-lite regime 156
Distributed ledger 645, 646, 648, 649, 651, 709
Distribution Member States 51, 56, 142
Duty of loyalty 37, 173, 174, 176, 204, 261, 375, 384, 389, 446, 449, 450, 463, 490, 509, 523, 527, 529, 536, 586-588, 601, 631
Duty of Loyalty 173, 261

E

European Economic Area membership (EEA membership) 106, 107
European Economic Area secondary law (EEA secondary law) 50, 51, 107, 134-136, 138, 140, 144, 146, 147, 610, 613, 659, 661, 662
European Free Trade Association membership (EFTA membership) 107
European Insurance and Occupational Pensions Authority (EIOPA) 11, 13, 15, 30-33, 45, 79, 82, 89, 91, 115, 242, 243, 246-250, 252-258, 260-162, 265, 267, 268, 269, 271, 273, 275, 313, 342, 413, 443-445, 453-456, 458, 462, 463, 471, 527, 571, 585, 586, 589, 606, 627, 628, 630-633, 635, 639, 663, 705, 706
Eligible Assets 181, 361, 404, 695, 754
Eligible entities 4, 5, 8, 13, 22, 25, 27, 29, 32, 38, 41, 45, 152, 159, 160, 162, 164, 167, 168, 171, 225, 241, 247, 257-259, 305, 313, 321, 323, 337, 391, 393-395, 432, 458, 543, 585, 606, 614, 616, 617, 619, 622, 623, 625, 631, 638, 653, 664, 667
European long-term investment fund (ELTIF) 12, 85, 225-227, 229, 358, 361, 363, 364, 366, 367, 369, 375, 381, 384, 386, 388, 393, 394, 400, 403, 405, 408-410, 412, 413, 423, 426-429, 514, 519, 527, 530, 531, 533, 749, 757
European Supervisory Authority (ESA) 82, 84, 88, 90, 134, 142, 143, 146, 342, 662
European System of Financial Supervision (ESFS) 33, 56, 60, 78, 85, 86, 89-92, 139, 145, 147, 341, 532, 537, 610, 613, 618, 660, 688, 718
European depositary Passport 1, 4, 13, 18, 34, 42, 46, 611, 658, 692
European passport 1-5, 7, 8, 10-13, 16, 17, 20, 21, 24, 28, 30, 32, 34-36, 38, 39, 42, 44-46, 48, 50, 52, 54, 55, 60, 64, 66, 68-70, 73-76, 78, 80, 83, 85, 87-91, 109, 112, 121, 125, 127, 130, 132, 141, 144, 145, 147, 156, 178, 242, 277, 288, 290-292, 298, 319, 323, 342, 387, 440, 441,

461, 532, 548, 610, 611, 613, 615, 617, 618, 631, 652-654, 657-660, 662, 667
external dimension 16, 50, 91, 92, 94, 107, 133, 135, 140, 144, 145, 147, 316, 325, 331, 610, 659, 660-662
home state control 73, 78, 618
internal dimension 50, 134, 144, 145, 147, 316, 610, 659, 662
single rulebook 78, 85, 91, 145, 147, 339, 610, 613, 617, 618, 660, 713
European social entrepreneurship funds (EuSEF) 12, 85, 227-229, 354, 358, 363, 364, 375, 383, 386, 388, 394, 400, 403, 405, 408, 411-413, 425, 429, 519, 527, 530, 533, 756
European venture capital funds (EuVECA) 12, 85, 227-229, 358, 363, 364, 375, 383, 386, 388, 394, 400, 403, 405, 408, 411-413, 423, 425, 428, 429, 514, 519, 527, 530, 533, 756

F

Fiduciary relationship 481, 509, 530
Financial center 77
Financial instruments 1, 19, 20, 25, 43, 44, 68, 86, 138, 147, 149, 157, 159, 161-164, 167, 168, 172, 175, 181, 183-187, 192, 200-203, 205, 209, 210, 212-219, 221, 222, 224-226, 228, 230, 233-241, 258-260, 263, 264, 269-271, 276-280, 282, 284, 286, 288, 290-293, 295-305, 307-313, 320-322, 327-330, 332-334, 336, 338, 353, 354, 364, 370, 373, 386, 392, 393, 402, 428, 483-486, 488-499, 501, 514, 528, 531, 541, 553, 554, 565, 570, 571, 589, 590, 596, 605, 610-616, 620, 623, 632, 663, 700, 753, 757, 758
Financial instruments that can be held in custody 164, 183, 209, 210, 213, 228, 230, 234, 235, 237-239, 263, 320, 322, 327, 332, 334, 338, 393, 514, 620
Financial intermediaries 1, 10, 16, 17, 21, 28, 33, 35, 48, 50, 51, 54-56, 59-64, 66, 73-75, 78, 80, 83, 85-92, 94, 95, 105, 108-113, 118, 121, 133-135, 139, 140, 142, 144, 145, 147, 317, 319, 325, 363, 369, 394, 395, 432, 446, 457, 487, 492, 493, 508, 526, 528, 543, 565, 585, 601, 610, 611, 617, 631, 645-647, 649, 657-662
Fintech era 650-652
Flow of Information 182
four stages of capitalism 505, 508, 535
Financial Services Action Plan (FSAP) 72, 73, 75, 78, 82, 83, 85, 131, 541, 548, 554, 723, 742
Full DC IORPs 243, 245, 246, 248, 249, 252, 253, 264, 265, 268, 273, 275, 469, 477, 624, 636
Fully bear the investment risk 245, 252, 479, 630, 635-637
Fundtypes 405-407, 562-564

G

General Agreement on Trade in Services (GATS) 92, 94-105, 107, 108, 121, 125, 135, 136, 660-662, 685, 696, 726, 740, 742, 747
Grounds of the Public Good 74
Group Inclusion 176

H

Hedge funds 160, 233, 367, 368, 371, 392, 519-562, 566, 568, 572, 575-581, 715, 718
Holding companies 113-115, 117-120, 349, 355-357, 362
Home Member State Control 341
High-net-worth individual (HWNI) 428

I

Initial Investor Information Document (IIID) 429
Independence requirements 175, 176, 261
Independent oversight committees 272, 273
Individual portfolios 174, 373, 486, 612
Inducement 491
Information asymmetries 316, 317
Information exchange 51, 124, 127, 132, 134, 136, 138, 146, 147, 157, 178, 411, 532, 610, 662
Insolvency protection 186, 206-208, 622
Intermediary regulation 85, 86, 395, 412, 526
Intermediation 641-644, 646-648
Internal market for financial services 50-55, 57, 60, 84, 92, 93, 144, 659
Inventory of assets 152, 566, 622

Investment advice 19, 31, 68, 159, 174, 278, 373, 387, 427, 428, 481-484, 492, 493, 498, 500-503, 507, 510, 522, 535, 541, 618, 626, 632
Investment firm 31, 36, 44, 65, 68, 69, 108, 109, 112, 114, 125, 158, 161, 163, 164, 166, 171, 174, 179, 226, 241, 260, 262, 269, 277, 278, 282, 288, 289, 292, 295-297, 299-309, 311, 320, 321, 326, 331-333, 336, 337, 373, 374, 391, 393, 481-488, 490-495, 497-500, 502-504, 510, 517, 518, 522, 551, 611, 614, 623, 633, 639, 661, 729
execution-only 4, 481-486, 493, 494, 500, 501, 503, 507, 510, 522, 523, 535, 538, 608, 618, 665
Investment instructions 4, 174, 336, 518
Investment intermediary 4, 345, 503, 504, 508, 510, 516, 517, 525, 526, 538, 607, 665
Investment portfolio 4, 228, 346, 362, 382, 393, 457, 462, 500, 531
Investment services/activities 25, 46, 51, 163, 174, 276, 277, 292, 294, 296-298, 333, 481-483, 486, 487, 490, 491, 500-502, 510, 513, 613, 615, 620, 658
Investment triangle 3, 180, 230, 296, 297, 345-347, 397, 398, 401, 403, 413, 430, 432-435, 480-482, 499, 500, 503, 504, 507-509, 513, 514, 516, 525, 527, 534-536, 538, 560, 569, 579, 607, 619, 665
Investor CSDs 199, 287, 663
Investor protection 3-8, 10, 16, 24, 25, 28, 33, 38, 39, 44, 47, 55, 85, 86, 91, 121, 148, 150, 152, 160, 165, 226, 241, 275, 278, 279, 296, 299, 316, 318, 319, 323, 327, 329, 333, 335, 345, 362, 364, 368, 369, 381, 393, 395, 403, 405, 412, 413, 421, 427, 428, 433, 435, 480, 491, 497, 519, 525, 527, 529, 532, 536, 538, 542, 547, 551, 571, 583, 595, 600, 602, 603, 605, 607, 611, 615, 616, 618, 619, 622, 624, 631, 634, 653, 657, 658, 662, 665, 667
Investor qualification 421, 429, 492, 531
Investors 3, 4, 6-8, 16, 25, 27, 38, 40, 55, 56, 68, 88, 93, 103, 128, 129, 136, 137, 150-157, 161, 165, 172-174, 177, 178, 180, 190, 191, 193, 196-198, 202, 204, 205, 211-213, 217-219, 221-227, 229, 231, 232, 250, 277, 279, 281, 283-287, 315-318, 320, 324-328, 330-332, 334, 336, 340, 342, 344-347, 349-357, 359-361, 364-366, 368-370, 372, 375, 376, 378-380, 382-385, 387-390, 393-401, 403, 407-409, 412-418, 420-422, 424-433, 443, 462, 466, 467, 469, 470, 472-475, 478, 481-485, 488, 491, 492, 497, 500-504, 507, 509, 513-515, 517, 519, 520, 522-524, 526, 527, 529-533, 535, 536, 538, 539, 542, 545, 548, 554, 557, 559, 562-567, 577, 581, 598, 606-608, 622, 623, 629, 633, 636, 637, 642-644, 646, 664-697, 729
IORP governing bodies 327, 331, 332, 434, 435, 461, 480, 510, 514, 521
IORP governing body 253, 262, 332, 434, 447, 454-458, 462, 466-468, 510, 521, 525, 531, 600
external governing body 445, 446, 460, 468, 601
internal governing body 445, 459, 460, 601
IORP members 434, 443, 446, 451, 459-461, 466, 468-470, 479, 525, 598
IORP pooling structure exemption 253, 624
IORPs 1, 2, 4, 9, 10, 14-16, 28, 29, 31, 33, 44, 84, 87, 111, 242, 243, 245, 247, 249, 251-262, 264, 265, 268, 269, 271-275, 313, 320-323, 326, 327, 331-333, 336, 338, 343, 357, 373, 390, 394, 402, 431, 432, 434-448, 450-455, 456-472, 474-479, 506, 509, 511, 513, 514, 517, 521, 522, 524-526, 528, 531, 534, 537, 556, 558, 583, 585-88, 594, 599-602, 604, 606, 608, 611, 612, 619, 624-629, 632, 636-638, 657, 663, 666, 705, 758
book reserve schemes 439, 442
hybrid IORPs 245, 246, 253, 455, 469, 476
occupational activity 438
outsourcing 107, 109, 110, 299, 444, 450, 451, 456, 457, 488, 506, 528, 621, 725
pay-as-you-go schemes 439
pre-funding 436, 437
retirement benefits 244, 435-438, 442, 444, 458, 628, 637
social-security schemes 439, 440
Issuer CSDs 199

L

Lamfalussy procedure 73, 78, 81, 83, 85
Legal form 4, 9, 63, 158, 174, 222-224, 244, 272-274, 348, 350, 356, 362, 368, 369, 396, 397, 399-403, 406, 412, 422, 431, 433, 435, 436, 445, 447-450, 458, 460, 461, 474, 480, 504, 512, 513, 519, 521, 530, 531, 549, 557, 560, 563, 569-573, 582, 598, 603, 604, 608, 628, 633, 666
  common funds 6, 154, 362, 396, 398-400, 402, 403, 412, 433, 549, 555, 559, 573, 574, 581, 628
  investment companies 6, 176, 222, 223, 362, 385, 396, 398, 399, 400, 402, 412, 420, 433, 542, 543, 547, 555, 556, 558, 559, 564, 566, 568, 573, 574, 626, 628
Legal representatives 134, 146, 662
Letter-box entity 199, 380
Lex specialis regime 31, 613, 626, 632
Lex specialis regime 31, 613, 626, 632
Limited liability 9, 172, 223, 396-398, 400, 402, 403, 412, 431, 433, 436, 461, 467, 468, 500, 505, 506, 524, 526, 531, 535, 537, 557, 567, 618, 633, 636, 650
Locational restrictions 2, 16, 19, 21, 24, 28, 31, 32, 321, 550, 593, 656
Loss of financial instruments 214, 229, 332, 338, 554

M

Madoff 41, 150, 212, 224, 266, 267, 317, 324, 553, 554, 622, 631, 632, 712, 715, 716, 735, 736, 739, 745
Manager regulation 9, 363, 372, 380, 381, 383-386, 391, 393, 394, 432
Mandatory appointment 150, 155, 157, 172, 233, 313, 385, 402, 560, 561, 569, 570, 606, 619, 624, 629, 630, 636, 638, 664
Market access 53, 54, 67, 69, 70, 76, 85, 91, 92, 94, 101, 105, 107-109, 132-138, 140-142, 144-146, 659-662
Market integrity 319
Market protection 56, 86, 134, 142, 316, 344, 415, 503, 525, 527, 536, 606, 618, 664
Master-feeder structure 197
Members 30, 176, 178, 242, 243, 245, 252, 253, 255, 256, 261, 262, 267, 268, 277
Merger 196, 197, 396, 400
Money market fund (MMF) 227, 229, 381, 382, 408, 409, 426
Mutual recognition 1, 5, 7, 13, 29, 32, 35, 44, 45, 50, 64, 65-67, 70, 71, 73, 75-78, 80, 91, 93, 94, 121, 135, 139, 145, 178, 297, 319, 585, 613, 653, 659, 662, 667

N

National central banks 165, 167, 168, 322
National treatment 60, 63, 69, 77, 93, 94, 104
Non-banking-type ancillary services 286

O

Omnibus account 202, 221, 307, 326, 331, 332
Open-end funds 366, 368
Other assets' 183, 184, 186, 187, 209, 210, 228, 233, 235, 239, 241, 320, 322, 326, 330, 332, 334, 336, 338, 393, 554, 580, 581, 590, 620, 623, 632
Other Eligible Institutions 159
Outsourcing 489
Oversight duties 13, 29, 30, 32, 45, 149, 151, 157, 172, 182, 188, 190, 198, 209, 233, 234, 240, 243, 245, 247, 249, 251-256, 261, 263-265, 267, 268, 272-275, 313-315, 320-323, 326, 330, 335, 336, 343-346, 482, 502, 511, 538, 589, 594, 596, 599, 601, 603-608, 612, 614, 618, 619, 625, 626, 629-632, 638, 639, 654, 663-667

P

Particulars of the Written Contract 181
PE-depositary 12, 162, 164, 226, 228, 229, 582, 623
Pension Fund Governance 246, 247, 435, 444-446, 448, 451, 453, 454, 456-460, 468, 510, 512, 601, 731, 740, 747
Pension provider 434, 444, 601
PEPP schemes 4, 33, 628, 633, 634-640
Pooled assets 402
Portfolio management 2, 370, 380, 387, 485, 486, 612

Positive integration 51, 60, 77-80, 91, 659
Prime broker 160, 161, 208, 230, 232, 235-239, 712
Prime brokerage relationship' 151
Private placement regime 155
Product governance regime 495, 496
Product governance requirements 427, 498
Product intervention 495-497
Product regulations 12, 151, 380, 386, 394, 395, 400, 403-405, 407, 408, 412-414, 424, 425, 428, 429, 433, 527, 533, 563, 573
Production Member State 55
Professional AIFs 152, 153, 155, 163, 229, 358, 363, 383, 385, 416, 420, 424, 562
Professional clients 492
Professional investors 93, 125, 127, 137, 138, 153, 154, 156, 161, 226, 227, 229, 258, 347, 358, 364, 367-369, 383-385, 393, 401, 403, 405, 406, 412-414, 416, 424, 425, 429, 432, 433, 492, 531, 562, 563, 565, 693
Prospectus 82, 197, 363, 366, 414-417, 420, 421, 423, 425, 426, 427, 429, 430, 527, 532, 533, 581, 753-755, 758
Prudent person rule 259, 458, 461-463
Prudential carve-out 51, 60, 77, 102, 103, 107, 145, 659, 661
Prudential regulation 27, 59, 60, 103, 105, 132, 161, 164, 168, 171, 172, 179, 180, 193, 201, 203, 231, 258, 260, 317, 318, 321, 323, 324, 329, 330, 333, 341, 344, 392, 439, 528, 536, 580, 595, 606, 617, 659, 664

R

Re-hypothecation 152, 226, 230, 234, 300, 310, 328, 393, 576, 622
Residual claimants 431, 469, 470, 500
Residual interest 253, 430, 434, 466, 469, 470, 477, 479, 500, 521, 524
Retail investors 151-155, 226, 358, 364, 369, 381, 384, 385, 403, 405, 413, 414, 416, 417, 422-424, 426-430, 433, 529, 531, 532, 577
Re-use of assets 170, 210, 314, 534, 606, 619, 664
Right of use 152, 204, 221, 232, 328, 622
Risk asymmetry 51, 55-57, 80, 91, 93-95, 108, 135, 136, 145, 659-661
Risk management 2, 3, 26, 86, 88, 107, 109, 112, 119, 120, 160, 165, 167, 171, 230-232, 236, 240, 242, 262, 272, 299, 370-372, 376, 377, 380-382, 386, 389, 393, 398, 404, 405, 418, 426, 427, 452, 453-456, 485, 488, 522, 528, 529, 533, 599, 612, 618, 621, 625, 755

S

Safeguarding of client assets 269, 298, 299, 302, 303, 311, 326, 333, 338, 482, 488, 490, 502, 512, 621
Safekeeping 1-3, 13, 15, 17, 19, 25, 29, 30, 32, 36-38, 41, 43-46, 68, 69, 147, 149, 151, 157-159, 162-164, 166-170, 172, 175, 177, 181-183, 185, 186, 188, 191, 198-209, 211, 213, 217, 219, 228, 231-235, 239-241, 243, 245-248, 250-252, 254, 255, 260-64, 266-268, 270-272, 275-279, 282-284, 286-290, 292-298, 303, 312-315, 320-326, 328-337, 341, 343-346, 373, 387, 391-393, 397, 430, 431, 435, 458, 460, 480, 490, 500, 514, 522, 529, 534, 538, 541, 543, 545, 546, 549-553, 555, 557-559, 570, 571, 573, 575, 581, 582, 589, 590, 593-603, 605-607, 610-616, 618-620, 623, 625, 626, 629-633, 636, 638, 641, 644, 652, 654, 656, 658, 663-665, 667
Safekeeping and administration of securities 19, 38, 43, 159, 270, 276, 277, 278, 283, 290, 297, 312, 313, 320, 323, 325, 334, 341, 541, 605, 613, 663
Safekeeping entity 32, 172, 397, 557, 631
Securities settlement system 169, 199, 285
Securitization 155, 376, 377, 389, 407
Segregation 9, 161, 172, 175, 182, 185, 193, 199, 201-203, 205, 206, 208, 214, 215, 219, 221, 266, 289, 296, 300, 310, 326, 330-332, 337, 339, 397, 398, 400, 402, 403, 430, 461, 468, 500, 514, 524, 531, 534, 537, 538, 546, 552, 553, 557, 570, 590, 607, 618, 623, 665, 707, 708
Self-custody 269-271, 296-298, 333
Separation of investments and management 345, 430, 431, 434, 435, 466, 480, 499, 507, 513-515, 517, 521, 524, 525, 533, 535, 538, 607, 665

Shareholders 68, 86, 109, 129, 140, 174, 222, 223, 286, 287, 293, 324, 350, 351, 362, 366, 375, 388, 401, 411, 418, 422, 427, 430, 447, 488, 500, 505, 506, 515, 517, 524, 528, 544, 546, 547, 574, 581, 636, 754
Single depositary requirement 249, 250
Single rulebook 85, 339, 340, 341
Small AIFMs 383, 386, 394
Smart contracts 648, 649, 653
Special Purpose Acquisition Company (SPAC) 355, 356
Special investment funds 472-476, 637
Stand-alone European passport 20, 541
Sub-custodian 171, 186, 200-202, 205-211, 217, 220, 221, 230, 234, 236-240, 303, 327, 331, 332, 338, 534, 551, 552, 576, 577, 579-581, 597
Suitability 109, 295, 427, 428, 444, 456, 491, 493, 494, 498, 615, 621

T

Third-country passport (TC passport) 51, 125, 144, 147, 610, 656, 658
Third-country depositaries 178
Third-party custodian 296, 481
Third-party depositary requirement 175, 332, 618
Transaction costs 52, 74, 144, 175, 508, 523, 535, 648, 659
Transferable securities 15, 16, 36, 39, 40, 41, 68, 82, 160, 165, 166, 168-170, 183, 185, 186, 228, 354, 360-362, 368, 404, 473, 482, 483, 501, 534, 542, 545, 552, 555, 583, 590, 602, 613, 615, 621, 703, 705, 751-754, 757
Trustees 149, 163, 272-274, 436, 445, 448, 450, 451, 535, 557, 559-601
Title Transfer Collateral Arrangemetns (TTCA) xxx, 210, 299, 309, 310, 329, 334

U

Undertaking for Collective Investment in Transferable Securities (UCITS) 1-11, 13-16, 19-25, 27-42, 45-48, 50, 54, 57, 80, 82, 84-87, 91, 109, 111, 134, 145, 147, 150-152,155, 158, 159, 160, 164-175, 177, 178, 180-208, 212-214, 216, 217, 219, 221-225, 227, 229, 241, 246, 248-251, 253, 257-259, 265, 267, 270, 271, 275, 276, 304, 312, 313, 315, 317-321, 323-327, 329-333, 335-339, 343, 345-347, 354, 355, 358-369, 371-374, 380-382, 384, 386-396, 398-417, 420, 422, 423, 426-33, 436, 439, 443, 444, 456-458, 460, 467, 469-475, 478, 479, 482, 487, 494, 501, 503, 504, 509, 510, 513-515, 517, 519, 520, 522, 523, 525, 527-532, 534, 537, 538, 541-560, 562-564, 566, 568-575, 579, 580, 583, 585, 587, 590, 593, 598, 602-608, 610-618, 621-624, 626-628, 630, 631, 633-640, 653, 654, 657, 658, 660, 663-668, 685-688, 692-696, 698, 700, 702-708, 712, 713, 716, 718-721, 729, 733, 739, 743, 745, 746, 751-55, 757
  diversification 305, 306, 337, 353, 354, 360, 361, 364, 368, 369, 404, 407-409, 410, 428, 561, 563, 565, 566
  exemptions 100, 151, 153, 158, 239, 349, 360, 365, 368, 385, 483, 532, 567, 568, 756
  public 364, 367, 420, 429, 430
UCITS Management Companies (UCITS ManCos) 1-4, 6-9, 20, 31, 35, 39, 50, 80, 85-87, 91, 109, 145, 151, 170, 171, 174-178, 180, 183, 187, 188, 196, 197, 222-224, 327, 331-333, 347, 363, 369, 371, 373, 374, 380-382, 386-392, 394, 395, 398, 401, 403, 412-414, 429-433, 436, 456, 460, 487, 511, 514, 517, 521-523, 525, 527, 528, 529, 543, 547, 557, 559, 604, 608, 612, 617, 633, 634, 638, 660, 666
Unintended use of client financial instruments 308
Unit trust 37, 223, 398, 400, 401, 403, 547, 549, 555, 563, 568, 572, 574

V

Virtual investment triangle 296, 481, 482

Curriculum Vitae

Sebastiaan Hooghiemstra, LL.M. (Amsterdam/Tilburg) is from the 1st of February 2018 onwards an associate at NautaDutilh Luxembourg. Sebastiaan holds Bachelor degrees in International & European law, Dutch law (both With Distinction) and Master degrees in International Business Law and Dutch Law (both With Honours) from Tilburg University. Sebastiaan also holds a Master degree in Tax Law (With Distinction) from VU University Amsterdam.
He publishes on topics in the field of (European) securities, (international) pension, company and tax law. Prior to joining NautaDutilh, he was a Research Associate at the University of Liechtenstein and a Doctoral Candidate at Utrecht University. His advisory work as a Research Associate at the University of Liechtenstein included participation in working groups on the Liechtenstein UCITSD IV, CRD IV and the AIFMD implementation commissioned by the Government of Liechtenstein and the Liechtenstein Financial Market Authority. As a Doctoral Candidate at Utrecht University, Sebastiaan advised the European Commission and EIOPA on a possible regulatory framework for PEPPs and the Dutch Ministry of Finance on the Dutch IORPD II implementation. Sebastiaan has been a lecturer at the University of Utrecht and the University of Liechtenstein and a guest lecturer at the University of Tilburg and the Heinrich Heine University Düsseldorf. He regularly speaks at (international) conferences.