SJ – n° /Div.

Mr Mohamed Ben Salem
Senior Policy Advisor
General Secretariat
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

10th December, 2014

Re. : **ASSOCIATION FRANCAISE DE LA GESTION (AFG)'s comments regarding IOSCO Consultation Report on the Custody of Collective Investment Schemes' Assets**

Dear Mr Ben Salem,

The ASSOCIATION FRANCAISE DE LA GESTION FINANCIERE (AFG) – the French Asset Management Association[1] – would like to thank the International Organization of Securities Commissions (IOSCO) for providing the opportunity to submit comments regarding the Consultation Report on the Custody of Collective Investment Schemes' Assets ("the Report").

[1] The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. Our members include 413 management companies. They are entrepreneurial or belong to French or foreign banking or insurance groups. AFG members manage more than 3,000 billion euros in the field of investment management as of end December 2013, making in particular the Paris Fund Industry a leader in Europe for the financial management of collective investments. In the field of collective investment, our industry includes – beside UCITS – the whole range of Alternative Investment Funds (AIFs), such as regulated hedge funds/funds of hedge funds, private equity funds, real estate funds, securitization funds, as well as socially responsible investment funds and employee saving schemes. AFG is of course an active member of the European Fund and Investment Management Association (EFAMA) and of PensionsEurope. AFG is also an active member of the International Investment Funds Association (IIFA).

## General comments

We welcome the publication of the Report and support IOSCO's general aim to provide Principles against which both the industry and regulators can assess the quality of regulation and industry practices concerning the custody of CISs' assets.

In France, the fund custody regime has always been very strict.

In the EU, the fund custody regime has been progressively enhanced, decade after decade, first through the UCITS Directive, most recently through UCITS 5, and also through the AIFM Directive regarding non-UCITS funds. Let us stress that in Europe, fund depositaries, beyond their mere role regarding custody itself, have a key role to play in the monitoring of the compliance by the asset manager of fund rules. Last, through the two European fund Directives, the role of the depositary has been clarified, and its responsibilities have been reinforced in order to ensure that the assets of investment funds – and in turn of the end-investors – benefit from a sufficient level of protection.

Based on this European experience, we think in particular as crucial that at worldwide level the respective duties, responsibilities and powers of asset management companies and depositaries should be further clarified, e.g. regarding the prohibition for custodians to take selling decisions on the fund assets, or regarding the prohibition for asset managers to self-custody the fund assets they manage.

Furthermore, we urge authorities to rapidly implement IOSCO principles in order to gain harmonisation that would increase investor protection worldwide.

## Detailed comments

### Q1:

Regarding the Market update and related recent trends mentioned by the Report, we agree with them but would like to underline a few other significant trends as well.

In particular, since the last version of IOSCO Principles, issued in 1996, two significant phenomena have developed worldwide.

First, in terms of geography of investments in CIS portfolios, the asset management companies invest fund assets more and more on a cross-border basis, and even more and more on a worldwide basis.

Second, the asset management companies have also become more and more cross-border, and some of them even global, in terms of marketing and search of clients.

For these two reasons, it is key to harmonise as far as possible the requirements applicable to custody worldwide, in order to make sure that local discrepancies applicable to custody regulation do not generate an unclear and uneven playing field:

- in terms of investor protection: lower requirements in custody generate lower investor protection. But as more and more funds are marketed on a cross-border basis, this risk of lower investor protection would be expanded from the scope of local investors to the wider scope of foreign investors which would be marketed on a cross-border basis;

- in terms of regulatory costs: lower requirements in custody generate less costs, and might therefore give an advantage to some asset managers' centers as compared to others, by generating lower costs which would then attract investors unfairly to the expense of other asset managers' centers which require higher regulatory standards for the custody of CIS assets.

So, in order to ensure both a better level playing field among investors which are equally marketed for local CIS and foreign CIS, and a better level playing field among asset managers worldwide, harmonising the requirements for CIS assets' custody should be central in the action of IOSCO through its upgraded Principles.

Another trend to be mentioned regards the increasing role to be given to CCPs through regulations. On that point as well, we consider that as to the role of CCPs, their rules and the level of segregation they offer should be harmonised at international level.

**Q2 and Q3:**

In Europe, the role of custodians with respect to CIS assets and the term "segregation" in relation to the safekeeping/custody of CIS assets are comprehensively defined by the UCITS and AIFM Directives and related pieces of European legislation – that our members (i.e. the France-based asset management companies) fully endorse and comply with.

Segregation applies in our view at two different levels. On one hand the depositary should maintain individual accounts for each CIS and on the other hand, the depositary as custodian should open accounts in the books of the sub-custodians and/or CSD at least for all CIS omnibus segregated from own account of the depositary and all other non-CIS clients.

**Q4 and Q5:**

Regarding the mention by IOSCO of "*holding non-standard asset such as physical commodities (e.g. gold bullion), financial derivative instruments, private placements, wine, arts, etc.*", we agree that there are special considerations or operational issues to be considered. Indeed, the modalities must be adapted to the nature of the assets.

However, it is for the asset management company to find - with the custodian - the most appropriate solution to ensure a sufficient monitoring of the existence of the non-standard assets mentioned by IOSCO.

Additional remark: we don't understand why private placements (mentioned by IOSCO) should be considered as non-standard assets.

We would suggest IOSCO to raise the particular approach for non-standard assets **as an additional IOSCO Principle, which would become IOSCO Principle 10: *"Regarding holding non-standard assets such as physical commodities, non-centrally cleared financial derivative instruments, wine or arts, special proportionate considerations must be discussed between the asset management company acting as the responsible entity and the relevant custodian".***

**Q6:**

Regarding derivative instruments, we think that the EU legislation, through the UCITS Directive and the AIFM Directive, has found appropriate solutions under the form of record-keeping.

Regarding collateral arrangements, the increasing role given to CCPs should be taken into account. In addition, a strict difference should be drawn between pledge and full transfer of property, both being authorized.

**Q7:**

We agree that administration / ancillary services *might* be part of the role of a custodian, but we don't see the legitimacy to make them mandatory for custodians. In addition, if these functions of administration /ancillary services are performed by a custodian, two prerequisites should be the avoidance of conflicts of interest and the search for cost efficiency.

**Q8:**

Regarding the key risks associated with the custody of CIS assets, we agree with the list of risks mentioned by IOSCO.

Another important point has to be mentioned: **a custodian should not be empowered, by law or by contractual agreement with the asset management company, to sell CIS assets - whichever the circumstances are. Selling CIS assets is the sole responsibility of the relevant asset management company. Moreover, selling CIS assets is part of the core function of money management, assigned to the asset management company. And "rapports de force" between the relevant custodian and asset management company would be probably the main driver for getting contractual derogations to this principle – such derogations becoming then detrimental to small asset management companies.**

**This latter request might be introduced as an additional IOSCO Principle 11: "*the CIS assets' custodian shall not be empowered to buy or sell assets being part of the relevant CIS assets' portfolio*".**

**For us, this point is an actual case of risks of misuse of CIS assets, to be added in the list of risks of misuse of CIS assets mentioned on page 6 of the Report.**

**Finally, we consider that the prohibition of re-use by the custodian of the assets except with the explicit agreement of the asset management company (in the framework of general contract or deal by deal) should be added to our suggested additional Principle 11.**

**Q9:**

Yes, there would be merit in requiring the appointment of a single custodian, in order to have certainty over who is ultimately responsible for safekeeping all CIS assets within a given CIS. The requirement of a written contract between depositary acting as custodian should be explicit and it should be mentioned in that agreement how the single custodian organizes sub-custody agreements.

In addition, requiring a single custodian:

- facilitates the overall functioning of the relationship between the asset management company and the custodian

- ensures a global view of assets' custody

- clarifies the responsibility of the custodian on the whole chain.

Ultimately, requiring a single custodian ensures a higher degree of monitoring and safety for investors.

**Q10:**

The custodian should segregate assets through individual, separate accounts for each client in its books.

**Q11:**

Yes, the rule of segregation should apply throughout the custody chain, i.e. through the different levels of delegation to sub-custodians.

**Q12:**

The requirement of proper segregation should be combined with an additional requirement of the recognition of the segregation at custodian or sub-custodian level in the event of the insolvency

of the custodian or sub-custodian. The key point is to ensure bankruptcy remoteness both through direct access to the CIS assets and their non "seizability" by any liquidator.

**Q13:**

**We don't agree at all with authorising self-custody of CIS assets. The Madoff case, while Madoff Securities was registered as an investment adviser in the US since 1996 while being allowed to hold the custody of assets, proved that authorising self-custody for asset management companies is highly dangerous. Even after the Madoff case, some regulators, including the SEC to our knowledge, decided not to prohibit an adviser from maintaining custody of its client assets, although for instance the SEC asserted its intent to "*encourage* the use of custodians independent of the adviser to maintain client assets as a best practice whenever feasible."**

**In terms of investor protection, we think that a full prohibition of custody of CIS assets by asset management companies themselves is fundamental. However that does not prevent them to safe keep documents such as deeds or contracts that they could copy to the depositary for assets which are not under custody but registered by the depositary.**

**Q14:**

We agree with the fact that a separate corporate structure for the custodian is an appropriate solution, but not necessarily the need for an independent board - as the notion of "independent board" is not fully clear) - and does not provide as such certain efficiency in the supervision of the CIS management/custody.

Regarding paragraph 63 of the Report, we think that the requirement for the asset management company to disclose both the identity of the custodian and the identities of sub-custodians as well as their respective roles is disproportionate. It is sufficient for investors to know the identity of the custodian/depositary which is responsible, except in cases when the custodian expressly got the acceptance of the fund manager to transfer its responsibility to the sub custodian. A full transparency should then be given to investors.

**Q15:**

No, selection criteria identified by the Report are sufficient.

But we wish to clarify that the asset management company must limit its role and responsibility in checking that the custodian has put in place the right process which allows the custodian to select and monitor appropriately its sub-custodians: it is not for the asset management company to monitor the way the sub-custodians work, nor to challenge the conclusions of the depositary.

**Q16:**

No, there is no need for additional consideration regarding the selection of specialist custodians.

**Q17:**

Regarding the scope of a sub-custodian's liability, we consider that this liability should not be vis-à-vis the responsible entity (i.e. the asset management company), but only vis-à-vis the custodian. The asset management company should have a relationship only with the custodian.

Regarding Principle 8, we ask IOSCO to amend its wording, by replacing "*should formally document*" by "*should sign a written document with the custodian, regarding its relationship with the custodian…"*. It has to be made clear that a written agreement is needed, for the sake of investor protection.

**Q18:**

We don't agree with some requirements as proposed by the Report.

In paragraph 86, we don't agree with the general requirements that:

- the responsible entity should remain cognisant of actual or potential risks facing the custodian,

- the responsible entity should have in place contingency plans for moving CIS assets to another custodian should the necessity arise.

On the first point, the requirement should be assessed on a proportionate basis, as the responsible entity can never ensure to stay cognisant of all actual or potential risks facing the custodian. We suggest that the reference to monitoring the quality of the custodian that must be included in the procedure for selection of a depositary by the management company or the CIS would be sufficient.

On the second point, we consider that the requirement of segregation of the assets of the CIS in the books of the depositary enables a smooth transfer to another custodian and that the difficulties might only come from distant sub custodians. They cannot be anticipated and no planning is practically possible.

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We thank you in advance for your attention to the views expressed above.

If you wish to discuss the contents of this letter with us, please contact myself at +33 1 44 94 94 14 (e-mail: p.bollon@afg.asso.fr), or Stéphane Janin, Head of International Affairs Division, at +33 1 44 94 94 04 (e-mail: s.janin@afg.asso.fr).

Sincerely,

(Signed)

Pierre BOLLON