

COMMENT LETTER

February 14, 2013

ICI and ICI Global Comment Letter to the Monetary Authority of Singapore in Response to Consultation Paper on Draft Regulations for Trade Repositories and Clearing Facilities (pdf)

February 14, 2013 Ms. Sui Hui Lim Capital Markets Policy Division Capital Markets Department Monetary Authority of Singapore 10 Shenton Way MAS Building Singapore 079117 Re: Consultation Paper on Draft Regulations Pursuant to the Securities and Futures Act for Trade Repositories and Clearing Facilities Dear Ms. Lim: The Investment Company Institute (“ICI”)¹ and ICI Global² appreciate the opportunity to provide comments on the draft regulations proposed by the Monetary Authority of Singapore (“MAS”) for trade repositories and clearing facilities for over-the-counter (“OTC”) derivatives.³ Our comments focus on the unique issues that U.S. funds that are regulated under the Investment Company Act of 1940 and non-U.S. regulated funds publicly offered to investors (together “Regulated Funds”) face with respect to the collateral and other property they post when engaging in derivatives transactions. Although the MAS consultation does not specifically discuss the manner in which clearing facilities will “hold” customer funds, we write to explain the specific custodial issues that Regulated Funds must address when they engage in derivatives transactions for which MAS regulations on customer collateral may apply. 1 The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$14.2 trillion and serve over 90 million shareholders. 2 ICI Global is the global association of regulated funds publicly offered to investors in leading jurisdictions worldwide. ICI Global seeks to advance the common interests and promote public understanding of global investment funds, their managers, and investors. Members of ICI Global manage total assets in excess of US \$1 trillion. 3 Monetary Authority of Singapore, Consultation Paper on Draft Regulations Pursuant to the Securities and Futures Act for Trade Repositories and Clearing Facilities (Jan. 10, 2013), available at <http://www.mas.gov.sg/~media/MAS/News%20and%20Publications/Consultation%20Papers/MAS%20CP%20for%20SFTRR%20SFCFR%20and%20SFCFTransitionR.pdf>. ICI/ICI Global Letter to Ms. Sui Hui Lim February 14, 2013 Page 2 of 5 Cross-Border Transactions of Derivatives and Coordination of Derivatives Regulations Regulated Funds engage in

derivatives transactions around the world and use derivatives as a means to pursue their stated investment objectives, policies, and strategies for efficient portfolio management purposes. Accordingly, we have a strong interest in the safety and soundness of the derivatives markets, including protection of customer collateral and funds held by clearing houses and their members. For this reason, ICI and ICI Global have a keen appreciation, and have advocated, for the protection of customer collateral and funds, and we appreciate the work of MAS in the areas of segregation and portability of customer money and assets.⁴ As our members engage in derivatives transactions around the world, the laws of other jurisdictions in addition to those of a fund's home country may apply to such transactions. In this regard, we have encouraged international regulators to engage with one another to achieve real and meaningful coordination on how these cross-border transactions should be appropriately regulated.⁵ We welcomed the joint statement by regulators from major jurisdictions, including MAS, in December 2012 on the regulation of cross-border derivatives markets and the recognition by the regulators of the "need to reduce regulatory uncertainty and provide market participants, intermediaries and infrastructures with sufficient clarity on laws and regulations by avoiding, to the extent possible, the application of conflicting rules to the same entities and transactions."⁶ We look forward to further progress in this area, which is critical for global firms.

⁴ In the United States and Europe, we have advocated for strong protections for customer collateral. See Letter from Karrie McMillan, General Counsel, ICI, to Sauntia S. Warfield, Assistant Secretary, Commodity Futures Trading Commission, dated January 14, 2013, available at <http://www.ici.org/pdf/26872.pdf>; Letter from Karrie McMillan, General Counsel, ICI, to David A. Stawick, Secretary, Commodity Futures Trading Commission, dated August 8, 2011, available at <http://www.ici.org/pdf/25388.pdf>; Letter from Karrie McMillan, General Counsel, ICI, to David A. Stawick, Secretary, Commodity Futures Trading Commission, dated January 18, 2011, available at <http://www.ici.org/pdf/24882.pdf>; Letter from Karrie McMillan, General Counsel, ICI, and Dan Waters, Managing Director, ICI Global, to Mr. Steven Maijoor, Chair, European Securities and Markets Authority, dated August 3, 2012, available at <http://www.ici.org/pdf/26368.pdf>.

⁵ See Letter from Karrie McMillan, General Counsel, ICI, and Dan Waters, Managing Director, ICI Global, to David Stawick, Secretary, Commodity Futures Trading Commission, dated Aug. 23, 2012 (commenting on cross-border application of the Commodity Exchange Act to transactions conducted outside the United States), available at <http://www.ici.org/pdf/26408.pdf>; Letter from Karrie McMillan, General Counsel, ICI, and Dan Waters, Managing Director, ICI Global, to Wayne Byres, Secretary General, Basel Committee on Banking Supervision, Bank for International Settlements, and David Wright, Secretary General, International Organization of Securities Commissions, dated Sept. 27, 2012 (commenting on proposed margin requirements for uncleared derivatives and on the need to coordinate requirements internationally), available at <http://www.ici.org/pdf/26529.pdf>; Letter from Karrie McMillan, General Counsel, ICI, to Gary K. Van Meter, Acting Director, Farm Credit Administration, Alfred M. Pollard, General Counsel, Federal Housing Financing Agency, Mary J. Miller, Assistant Secretary for Financial Markets, U.S. Department of the Treasury, Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation, Jennifer J. Johnson, Secretary, Federal Reserve Board, dated July 11, 2011, available at <http://www.ici.org/pdf/26529.pdf>.

⁶ Joint Press Statement of Leaders on Operating Principles and Areas of Exploration in the Regulation of the Cross-Border OTC Derivatives Market (Dec. 4, 2012), available at <http://www.sec.gov/news/press/2012/2012-251.htm>

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In the context of cleared swaps, which are specifically addressed by the MAS consultation, there are numerous questions for cross-border transactions. For example, if a particular swap were mandated for clearing by one regulator but no central counterparty in the other jurisdiction cleared that instrument, how would the

counterparties comply with the clearing requirements? At the same time, how would a swap be cleared in a situation where both jurisdictions require a swap to be cleared according to their own laws? As a practical matter, we do not think it would be possible to clear a transaction twice or to clear separate legs of a swap. Also, to comply with the clearing requirement, would a swap counterparty be subject to the rules of the clearing jurisdiction regarding customer collateral or margin for cleared swaps? How would the counterparties comply with the customer fund protection rules of different jurisdictions if the rules are not consistent or are conflicting? Without a clear agreement among regulators on a framework for how cross-border swaps transactions will be regulated by multiple jurisdictions, global firms will face significant burdens in implementing a worldwide compliance system.

Interplay between Derivatives Regulation and Fund Regulation

In addition to potentially conflicting and/or duplicative requirements imposed on counterparties, many Regulated Funds around the world must reconcile these derivatives requirements with the securities regulations and limitations to which they are subject as Regulated Funds. In this letter, we focus on one issue shared by many Regulated Funds – legal restrictions on how collateral for these funds may be custodied and maintained. We are concerned that the requirements for customer property being developed for derivatives around the world may potentially be inconsistent with or may not take into consideration the unique requirements imposed on Regulated Funds on where and how fund collateral must be custodied and maintained. In an effort to raise these issues for your consideration, ICI and ICI Global are providing information regarding the specific custodial requirements to which Regulated Funds in the United States, Hong Kong and Europe are subject. In an appendix to this letter, we describe the custodial requirements for funds regulated under the laws of the United States, Hong Kong and Ireland (Undertakings for Collective Investment in Transferable Securities). We request that MAS be mindful of these types of requirements in drafting its derivatives regulations so that Regulated Funds that engage in derivative transactions that would be subject to MAS' regulations can still satisfy the custodial obligations to which they are subject under their home jurisdiction. In the MAS consultation, Division 2 of Part III of the draft regulation – Customers' Money and Other Assets – would impose requirements on clearing houses that hold customer money. The draft, however, does not discuss which entity will actually hold customer assets or whether alternative custodial arrangements for the customer assets would be permissible. We request that MAS also permit, as an option within its derivatives regulatory framework, the use of a third-party custodian to hold collateral of a Regulated Fund, which is a common method Regulated Funds may use to hold collateral for swaps transactions. A third-party custodian may be a bank or other financial institution in the local jurisdiction. Third-party custodial arrangements provide for the custodian to assume certain responsibilities with respect to safeguarding the interests of both counterparties, including ICI/ICI Global Letter to Ms. Sui Hui Lim February 14, 2013 Page 4 of 5 maintaining custody of the collateral, and being involved in effecting the transfer of funds and securities between the two parties. This arrangement helps to avoid market disruptions in the case of a default by a counterparty or other event necessitating access to the collateral. This structure also can help prevent fraud and misappropriation of collateral. We also understand that, depending on the bankruptcy laws, third-party custodians may keep the collateral bankruptcy-remote of intermediaries that hold funds on behalf of customers. Given the restrictions on the types of entities that can hold collateral or other assets of a Regulated Fund as described in the appendix, we believe that a third-party custodian arrangement should be a permissible option to hold customer funds. * * * * *

We appreciate the opportunity to share our concerns with MAS regarding the need for derivatives regulations to be compatible with requirements imposed on Regulated Funds by their home country. Specifically, we request that MAS permit the use of arrangements that would allow Regulated Funds engaging in

derivatives transactions subject to MAS' jurisdiction also to satisfy their home country custody requirements. If you have any questions on our comment letter, please feel free to contact the undersigned or Giles Swan at 011-44-203-009-3103, Sarah Bessin at 202-326-5835 or Jennifer Choi at 202-326-5876. Sincerely, /s/ Karrie McMillan /s/ Dan Waters Karrie McMillan Dan Waters General Counsel Managing Director Investment Company Institute ICI Global 202-326-5815 011-44-203-009-3101 kmcmillan@ici.org dan.waters@ici.org cc: The Honorable Gary Gensler The Honorable Bart Chilton The Honorable Scott D. O' Malia The Honorable Jill E. Sommers The Honorable Mark Wetjen ICI/ICI Global Letter to Ms. Sui Hui Lim February 14, 2013 Page 5 of 5 The Honorable Elisse B. Walter The Honorable Luis A. Aguilar The Honorable Troy A. Paredes The Honorable Daniel M. Gallagher

1 APPENDIX The following is a brief summary of the custody requirements for funds publicly offered to investors and regulated in the United States, Hong Kong and Ireland, respectively (together "Regulated Funds"), as well as the requirements with respect to holding collateral at third-party intermediaries outside of the local jurisdiction. As described further below, swap collateral is generally subject to the custody requirements of the jurisdiction in which a Regulated Fund is registered. Where the swap collateral is held outside of the Regulated Fund's home jurisdiction, the collateral also may be subject to additional requirements of the Regulated Fund's home jurisdiction that are designed to ensure that the collateral is held in a manner consistent with the attendant risks of custodying assets in a foreign jurisdiction. These additional requirements vary among the jurisdictions and may require, among other things, fund board of director/trustee approval of the foreign entity as well as ongoing monitoring of the arrangement by the board.

I. U.S. Registered Fund Treatment of Swap Collateral Section 17(f) of the Investment Company Act of 1940 ("ICA") provides that the securities and other assets of U.S. funds that are regulated under the ICA ("U.S. Registered Funds") must be placed in the custody of: 1. a bank meeting certain requirements; 2. a member of a national securities exchange (i.e., a broker-dealer), subject to very restrictive rules of the U.S. Securities and Exchange Commission ("SEC"); or 3. the U.S. Registered Fund itself, in accordance with SEC rules. Nearly all U.S. Registered Funds use a U.S. bank custodian pursuant to a detailed custody agreement designed to address applicable regulatory requirements and business risks. When a U.S. Registered Fund chooses to utilize a bank custodian to custody its assets, it also must maintain with such bank all cash assets.¹ The SEC has adopted a number of custody rules under Section 17(f) to permit U.S. Registered Funds to custody certain assets with non-U.S. banks, non-U.S. securities depositories, or futures commission merchants ("FCMs"), subject to certain conditions.² Rule 17f-5 under the ICA permits U.S. Registered Funds to custody assets (including foreign currencies) that have a primary market outside of the United States with a foreign bank or foreign securities depository. Under Rule 17f-5, the board of directors or trustees of the U.S. Registered Fund retains ultimate responsibility for establishing and monitoring any foreign custodial arrangements and

1 See Inv. Co. Act Rel. No. 6863 (Dec. 6, 1971). 2 Rules 17f-5 (non-U.S. banks), 17f-6 (FCMs), and 17f-7 (non-U.S. securities depositories). 2 must select, contract with, and monitor the "eligible foreign custodian." Rule 17f-5 further provides that an eligible foreign custodian is a foreign entity that is either a regulated bank or a subsidiary of a U.S. bank or bank holding company. Although a board may delegate its authority with respect to foreign custodial arrangements to a U.S. Registered Fund's investment adviser, officer or a U.S. or foreign bank, in doing so the board must: (i) find that it is reasonable to rely on the delegate to perform; (ii) require and obtain periodic reports regarding the foreign custodial arrangements; and (iii) obtain the delegate's agreement to exercise reasonable care, prudence and diligence as would be expected from a person custodying the assets of the U.S. Registered Fund. In addition to Rule 17f-5, Rule 17f-7 under the ICA permits U.S. Registered Funds to custody assets with a foreign securities depository. U.S.

Registered Funds must only place assets with an “eligible securities depository,” which means that the depository: (i) acts or operates a system for the central handling of securities; (ii) is regulated by a foreign financial regulatory authority; (iii) holds assets for the U.S. Registered Fund on the same terms as those for other participants; (iv) maintains books and records to identify each participant’s assets, segregating the depository’s own assets from those of the participants; and (v) provides periodic reports to participants and undergoes periodic examinations by regulatory authorities. Depending on the agreed-upon terms of a bilateral OTC swap transaction or the margin requirements for cleared swaps, a U.S. Registered Fund may be required to post collateral to support its current payment obligations to its counterparty or to the clearing house, respectively.³ Under the ICA and SEC custody rules outlined above, swap collateral posted by a U.S. Registered Fund is an asset of the U.S. Registered Fund and, therefore, may not be maintained in a manner that is inconsistent with the standards outlined above. For uncleared swap transactions, U.S. Registered Funds generally enter tri-party collateral control agreements (“CCAs”) with their custodian and applicable counterparty to post collateral to satisfy their collateral obligations. Under these arrangements, a fund is able to post margin for the benefit of the counterparty with its own custodian consistent with the custody requirements under Section 17(f) of the ICA. The CSA, together with the CCA, creates a security interest for the benefit of the counterparty in the collateral posted by the U.S. Registered Fund. The CCA includes provisions pursuant to which the counterparty can require delivery of the collateral to the counterparty upon the occurrence of any event under the ISDA Agreement and the CSA giving rise to a right to exercise the counterparty’s rights and remedies with respect to collateral. If a U.S. Registered Fund and its counterparty agree that securities denominated in non-U.S. currencies or traded on non-U.S. markets (“non-U.S. Securities”) are eligible collateral under the CSA, the U.S. Registered Fund’s bank custodian generally will require additional terms to be added to the CCA. These terms provide that the non-U.S. Securities may be held through the bank custodian’s sub- 3 Under the terms of the bilateral International Swaps and Derivatives Association, Inc. (ISDA) Master Agreement (“ISDA Agreement”) and Credit Support Annex (“CSA”), which are the forms generally used to document OTC swap transactions of U.S. Registered Funds (and most other market participants), exposures under OTC swap transactions generally are evaluated on a daily basis. 3 custodian network or with non-U.S. securities depositories (e.g., acknowledgements that the sub- custodian and collateral held by it are not subject to the same legal system). Notwithstanding the use of non-U.S. sub-custodians and securities depositories, all instructions relating to collateral management generally must still flow through the U.S. Registered Fund’s primary bank custodian. For futures and options transactions conducted outside the United States, U.S. Registered Funds typically comply with Rule 17f-6 under the ICA to post collateral with a non-U.S. clearing organization.⁴ Rule 17f-6 generally permits a U.S. Registered Fund to satisfy its margin obligation with a non-U.S. clearing organization by placing and maintaining collateral with a U.S. FCM that has arrangements with certain other entities located outside of the United States. In arranging for the collateral or margin to be placed with a foreign entity, the U.S. FCM must obtain an acknowledgement that the margin is held on the U.S. Registered Fund’s behalf. Arrangements that are consistent with Rule 17f-6 also are permissible for a limited time to satisfy margin requirements in connection with certain interest and credit default swaps cleared outside of the United States pursuant to a SEC staff position.⁵ For swaps other than interest rate and credit default swaps, U.S. Registered Funds that engage in these transactions outside the United States that must be cleared by a non-U.S. clearing organization must post margin required in compliance with Rule 17f-5, i.e., the collateral for these transactions must be maintained with a foreign bank or foreign securities depository. II. Hong Kong Registered Fund Treatment of Swap Collateral Chapter 4.5 of the Hong Kong Code on Unit Trusts and Mutual

Funds ("UT Code") provides that all property of funds authorized by the Hong Kong Securities and Futures Commission ("SFC") for retail distribution in Hong Kong ("Hong Kong Registered Funds") must be held by an SFC-approved trustee or custodian of such funds. If the trustee or custodian is located in Hong Kong, it must be:

- 4 Rule 17f-6 requires that the U.S. Registered Fund's initial margin be maintained by an unaffiliated FCM, which is registered with the Commodity Futures Trading Commission ("CFTC"), pursuant to a written contract that provides: (i) the FCM will comply with the applicable segregation (or similar) requirements of the CFTC (depending on whether the transaction is on a domestic or foreign commodity exchange); (ii) the FCM may place the margin with another FCM, a clearing organization (including a clearing agency for a foreign commodity exchange), or a U.S. or foreign bank, provided, in doing so, the FCM obtains an acknowledgement that the margin is held on the U.S. Registered Fund's behalf; and (iii) the FCM shall promptly furnish copies or extracts of records or other information regarding the U.S. Registered Fund's assets as the SEC may request. Similar to Rule 17f-5 discussed above, the board of directors or trustees of the U.S. Registered Fund retains ultimate responsibility for Rule 17f-6 arrangements with FCMs.
- 5 The SEC staff has provided no-action relief from Section 17(f) of the ICA, and Rule 17f-6 thereunder, to permit U.S. Registered Funds to custody margin requirements with (i) derivatives clearing organizations registered with the CFTC or (ii) a clearing member that is a FCM registered with the CFTC. See Chicago Mercantile Exchange No-Action Letter (pub. avail. Sept. 27, 2012); ICE Clear Credit LLC No-Action Letter (pub. avail. Sept. 27, 2012); LCH Clearnet Limited No-Action Letter (pub. avail. Sept. 27, 2012) (collectively, "Margin Letters"). The Margin Letters provide temporary relief from Section 17(f) of the ICA, and Rule 17f-6 thereunder, until December 31, 2013.
- 4 1. a bank licensed under section 16 of the Hong Kong Banking Ordinance; 2. a trust company subsidiary of such a bank; 3. a trust company registered under the Hong Kong Trustee Ordinance; or 4. a banking institution or trust company incorporated outside Hong Kong that is acceptable to the SFC.
- 6 If a trustee/custodian is located outside of Hong Kong, the SFC must generally be satisfied that the trustee/custodian is either (a) subject to an overseas regulatory authority that carries out regular inspections of the trustee/custodian, or (b) subject to regular review that is generally consistent with SFC requirements.
- 7 Although each trustee/custodian must be SFC-approved, the SFC generally also has to approve the regulatory regime of the trustee/custodian's domicile. A trustee/custodian can nevertheless be approved, even if the regulatory regime has not been approved, if additional documentation (e.g., an auditor's report) is filed with the SFC. Hong Kong Registered Funds are permitted to enter into either listed or OTC derivatives (each of which may be a domestic or foreign trade), provided, inter alia, that OTC derivatives are marked-to-market daily.
- 8 In practice, the treatment of collateral posted in connection with an uncleared or cleared swap depends on the counterparty or clearinghouse. There are two approaches: a title transfer approach, whereby the collateral is transferred from the fund, and a "security interest" approach similar to the approach taken by U.S. Registered Funds. The title transfer approach is somewhat more common in Asia, although market participants note that some regional clearinghouses are developing the capacity to receive margin through either method. The custodial requirements would only apply to the collateral for which title has not been transferred from the Hong Kong Registered Fund. Most Hong Kong Registered Funds also will be domiciled in jurisdictions other than Hong Kong and/or be regulated as Undertakings for Collective Investment in Transferable Securities ("UCITS"), in which case they will be subject to the applicable market practices and regulations of those jurisdictions. We understand that 70% of funds sold in Hong Kong are Luxembourg or Irish UCITS and, for those funds, Luxembourg or Irish UCITS requirements will override local law. In addition to applicable UCITS requirements, ISDA Agreements will impose additional collateral requirements.

III. Irish UCITS Treatment of

Swap Collateral UCITS authorized by the Irish authorities (“Irish UCITS”) are required to appoint an Irish-based depositary that is responsible for the safekeeping of all of its assets. The Irish depositary will typically appoint a global custodian which in turn appoints foreign sub-custodians in each of the markets where 6 UT Code Section 4.2. 7 UT Code, Appendix G – Guidelines for review of internal controls and systems of trustees/custodians. 8 UT Code Section 8.9(f) 5 the UCITS intends to hold investments. The foreign sub-custodians are required to hold the assets of the UCITS in their safekeeping in accordance with local securities regulations. Irish UCITS regulations impose general principles of oversight and control that apply to Irish depositaries in respect of the safekeeping of assets by foreign sub-custodians (such as the requirement that non-cash assets held by a foreign sub-custodian be segregated from proprietary assets and be held on a fiduciary basis). A UCITS is required to ensure that its exposure to a counterparty does not exceed 5% (in the case of non-EU credit institutions) or 10% (in the case of EU credit institutions) of the Irish UCITS’ net assets. Counterparty exposure is calculated using the positive mark-to-market value of the swap contract.⁹ An Irish UCITS’ exposure to a counterparty may be reduced by collecting collateral from a counterparty. In accordance with the requirements of the Central Bank of Ireland, collateral that is delivered to an Irish UCITS should be transferred to the depositary or its agent for safekeeping.¹⁰ Where collateral is received by an Irish UCITS, ownership of the collateral is typically transferred to the depositary or its agent for safekeeping on behalf of the Irish UCITS under a title transfer arrangement. In these circumstances, the collateral is held subject to the contractual obligation to return equivalent collateral to the counterparty. From discussions with Irish depositaries, we understand that as a matter of practice, collateral that is transferred by counterparties to the ownership of depositaries is held in a collateral account (which is separate from the Irish UCITS’ custody account).¹¹ The requirements of the Central Bank of Ireland are consistent with ESMA’s Guidelines on ETFs and other UCITS Issues (“ESMA’s Guidelines”), which are expected to be implemented at the end of March 2013. ESMA’s Guidelines state that if there is a title transfer of collateral to an Irish UCITS, the collateral received should be held by the depositary for the Irish UCITS.¹² We understand that, because there are no eligibility standards for UCITS sub-custodians, many Irish custodians for Irish UCITS adhere to the Rule 17f-5 standards discussed above. Through amendments to the UCITS laws – UCITS V, the EU intends to harmonize the eligibility criteria for custodians/sub-custodians by limiting the accessibility to credit institutions and regulated investment firms. If an Irish UCITS posts collateral to a counterparty, an Irish depositary may transfer and release from its safekeeping assets of an Irish UCITS to a counterparty for margin purposes. The title to (and ownership of) the collateral is typically transferred to the counterparty of the Irish UCITS pursuant to 9 See UCITS Notice 10.7, paragraph 4, sub para (iii). 10 See UCITS Notice 10.7, paragraph 6. 11 The extent of a depositary’s duties over collateral received under a title transfer arrangement are typically not addressed in the custody agreement, therefore, a collateral management agreement should be entered into to provide clarity over the specific responsibilities of the counterparty and depositary. 12 See “Guideline XII – Management of collateral for OTC financial derivative transactions and efficient portfolio management techniques,” paragraph 40(g). 6 an ISDA Agreement and CSA, which operates to transfer ownership of the collateral to the counterparty. Under a title transfer arrangement, collateral that is transferred to the ownership of the counterparty is no longer subject to the depositary’s safekeeping duties.¹³ A distinction should be made regarding pledge arrangements or other security financial collateral arrangements (“security collateral arrangements”), which do not involve transfer of ownership of collateral that is posted by an Irish UCITS. For these types of collateral arrangements, ownership of the collateral may remain with the depositary or collateral agent, but control or possession of the collateral is passed to the counterparty of the Irish UCITS under the terms of an account

control agreement or similar collateral management agreement. ESMA's Guidelines clarify that Irish UCITS may enter into security collateral arrangements, provided the collateral is held by a third party custodian, which is subject to prudential supervision and is unrelated to the provider of the collateral.¹⁴ For swaps that are cleared with a central clearing counterparty, an Irish UCITS may transfer collateral to the clearinghouse (which may be located in Ireland or in a foreign jurisdiction). An Irish UCITS must manage exposure arising from initial margin posted to a clearing broker relating to cleared derivatives. If the exposure is not protected by client money rules or other similar arrangements to protect the Irish UCITS against the insolvency of the broker, the initial margin posted must not exceed 5% or 10% (where the broker/clearinghouse is a credit institution) of the Irish UCITS' net assets. ¹³ The UCITS' ownership of the collateral (which will have been transferred to the counterparty) is replaced by a contractual right (exercisable subject to the terms of the ISDA and the CSA) for return of equivalent securities/collateral. The primary responsibilities of the depositary relate to recordkeeping duties, and its verification and monitoring of the derivative position with the counterparty. ¹⁴ See "Guideline XII – Management of collateral for OTC financial derivative transactions and efficient portfolio management techniques," paragraph 40(g). Under a financial collateral arrangement, where ownership of the collateral continues to be registered in the name of the depositary and control or possession of the collateral is granted to the counterparty or its agent, the depositary remains the legal owner of the collateral and its safekeeping duties continue to apply.