



ESMA publishes final guidelines on sound remuneration policies under UCITS V

Overview

The European Securities and Markets Authority (ESMA) published on 31 March 2016 its final guidelines on sound remuneration policies under the UCITS V Directive. This follows the closure of its consultation on the draft guidelines, issued in July 2015. These guidelines will affect retail investment fund managers.

The final UCITS guidelines are mainly unchanged from the draft guidelines and remain largely based on those already issued on remuneration under the AIFMD. There are a few changes, namely:

- **Proportionality.** Revised approach in line with the approach adopted by the EBA under CRD IV, meaning there is no guidance on neutralising the payout process rules.
- **Payment in instruments.** Confirmation that there was an error in the original UCITS V Directive, with the revised approach being in line with the AIFMD.

- **Sectoral rules.** Additional clarity provided on the alternative approaches where multiple regimes apply.
- **Transitional period.** Confirmation that payout process rules come into effect for the first full performance period after 1 January 2017.

The purpose of this alert is to provide a summary of the key developments which may impact remuneration arrangements at affected financial services firms. The full final Guidelines can be found [here](#).

Overview of the guidelines

The UCITS V guidelines on sound remuneration are broadly similar to the AIFMD guidelines, and include the following requirements based on the directive:

- At least 40 to 60% of variable remuneration should be deferred over a period of at least 3 years (annual pro-rata vesting is permitted).
- 50% of variable remuneration should be awarded in instruments (UCITS fund units, equivalent ownership interests or share-linked instruments or equivalent non-cash instruments), to which a post-vesting retention period should be applied.
- Any variable remuneration award is subject to malus and clawback provisions.

There are a number of key differences between AIFMD and UCITS V, which are summarised below.

Key outcomes of the consultation

Proportionality

In order to “ensure consistency with requirements developed for other financial services sectors, in particular credit institutions and investment firms” ESMA has decided to follow an approach which is similar to that adopted by the EBA in relation to proportionality. As a result there is no guidance on the possibility not to apply certain remuneration requirements in their entirety (the payout process rules).

However, in addition to the Guidelines, ESMA has written to the European Commission, Council and European Parliament setting out ESMA’s views on proportionality (for example that the payout process requirements may not be appropriate for small, non-complex fund managers) and calling for further clarity on whether requirements can be neutralised entirely.

Definition of ‘performance fees’

UCITS V specifically includes “performance fees” among the categories of payments that fall within the scope of the remuneration principles in the same way that carried interest falls under the scope of the AIFMD.

ESMA left the definition of “performance fees” broadly unchanged in that they feel “performance fees” should be based on the definition provided in the IOSCO report on fees and expenses of investment funds, i.e. a variable fee linked to the performance of the UCITS. However, it saw merit in clarifying that the definition relates to performance-related payments made by the clients to the management company or the UCITS itself.

Application of different sectoral rules

Where staff perform activities which fall under more than one regime (e.g. UCITS V and CRD IV), the Guidelines remain substantially unchanged in that firms are able to choose from two approaches, depending on which is felt to be more suitable. The two approaches are:

- Sectoral remuneration principles (CRD, AIFMD or UCITS V) should be applied on a pro-rata basis using an objective method of apportionment such as time spent on each activity.
- The sectoral remuneration principles which are deemed to be more effective in discouraging inappropriate risk-taking and aligning the interest of the relevant individuals with those of the investors in the funds or other portfolios they manage, should be applied.

On this second alternative, ESMA have stated that, rather than simply making a choice between CRD IV, AIFMD and UCITS V, the management company should consider carefully, taking into account its specific activities and circumstances, which remuneration principles would be most effective.

This approach could lead to circumstances where CRD IV applies in full (e.g. including the bonus cap to all staff performing services under different sectoral rules) without having line-by-line compliance with the corresponding principles under AIFMD or UCITS V. However, notwithstanding this, where specific requirements of CRD IV conflict with those under AIFMD or UCITS V, the specific sectoral legislation should prevail (e.g. the use of units or shares of the alternative investment fund concerned or units of the UCITS concerned).

Application of rules to delegates

The guidelines relating to delegation remain similar to those found in AIFMD, with the aim of ensuring that the remuneration principles are not circumvented. Firms must therefore ensure that:

- Entities to which investment management is delegated are subject to regulatory requirements that are equally as effective as those found in UCITS V; or
- Appropriate contractual arrangements are in place which prevent circumvention of the remuneration regulations.

The guidance provided by ESMA around what is considered “equally effective” also remains unchanged, namely where, amongst other things:

- The delegate is subject to CRD IV or AIFMD remuneration rules; and
- The delegate staff who are UCITS Identified Staff are subject to the CRD IV or AIFMD rules.

Payment in instruments

The Guidelines confirm that there was an error in the original UCITS V Directive text regarding the payment of variable remuneration in instruments. The correction alters the meaning of the relevant Article and shows that the intention is to impose the non-cash remuneration linked to the performance of funds managed by the manager, except for cases where the management of UCITS is not the major activity of the manager. Therefore management companies may only disapply the payment in instruments requirement where the total net asset value of all the UCITS managed equals less than 50% of the total portfolio managed (i.e. UCITS and AIFs).

Dividends and interest

The guidelines continue to state that neither dividends nor interest should be paid on instruments before vesting.

Transitional period

ESMA has confirmed that the payout process rules do not come into effect until the first performance year after 1 January 2017.

Next steps

The guidelines will be translated into the official languages of the EU member states. National regulators will have two months following the date of publication of the translations to notify ESMA of their intention to comply or not to comply with the Guidelines.

Contact

For more information, please contact Caroline Veris, Maurice Vrolix or Patricia Goddet.

Caroline Veris

Partner Regulatory Risk & Compliance
Tel: + 32 2 800 2306
E-mail: cveris@deloitte.com

Maurice Vrolix

Audit Partner
Tel: + 32 2 800 2145
E-mail: mvrolix@deloitte.com

Patricia Goddet

Director Regulatory Risk & Compliance
Tel: + 32 2 800 2491
E-mail: pgoddet@deloitte.com

[Homepage](#)



[Deloitte Belgium](#)

Berkenlaan 8A, 8B, 8C
1831 Diegem
Belgium

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries and territories, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte's more than 200,000 professionals are committed to becoming the standard of excellence.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this communication, rendering professional advice or services. No entity in the Deloitte network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.

© 2016. For information, contact Deloitte Belgium.

To no longer receive emails about this topic please send a return email to the sender with the word "Unsubscribe" in the subject line.