UCITS V update

European Parliament votes down bonus cap by a narrow majority

Investment Management
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On 3 July 2013 the European Parliament adopted its position on the UCITS V proposal with a number of significant amendments but ultimately voted down the bonus cap at 100% of fixed salary by a narrow majority of 7 votes.

Given that the Parliament ultimately rejected some of the more controversial elements, agreement between the EU institutions could be easier to reach.

The European Parliament also rejected the proposed limitation of variable performance fees to UCITS marketed exclusively to professional investors.

A further controversial element to be rejected was the proposal to introduce deductions in the case of underperformance equivalent to the additional remuneration for outperformance of the benchmark.

Given that the Parliament ultimately rejected some of the more controversial elements, agreement between the EU institutions could be easier to reach. The trilogue negotiations between the Parliament, Council of Ministers and Commission are expected to commence at some stage in Autumn 2013.

If agreement is not reached by the European elections in May 2013, the possibility of a fresh proposal with further changes is opened up. However, it is expected that the Commission would not want to see further delays, as this will create an undesirable divergence with AIFMD standards.

Management company fees and costs

The Parliament remains focused on management company fees and costs and some of the changes that have been adopted could still have a significant impact on fee models.

Under the adopted text, remuneration paid from the fund to management companies should, like the remuneration paid by management companies to their staff, be consistent with sound and effective risk management and with the interests of investors.

Variable remuneration should be considerably contracted where subdued or negative financial performance of the UCITS occurs, taking into account both current compensation and reductions in payouts of amounts previously earned, including through malus or clawback arrangements.

The Parliament also calls for the Commission to assess which are the common product related costs and expenses in the member states for retail investment products. The Commission should conduct a consultation exercise and an impact assessment, and should put forward a legislative proposal if a need for further harmonisation is identified, according to the Parliament.

Key changes adopted by the European Parliament

The Parliament has retained a further number of key amendments proposed by its Economic and Monetary Affairs Committee:

The range of staff in scope of the remuneration policy has been widened.

- The range of staff in scope has been widened to include any employee and any other members of staff who are decision takers, fund managers and “persons who take real investment decisions”, including investment policy advisors and analysts and senior management.
- Guaranteed variable remuneration should not only be exceptional but should not be a part of prospective compensation plans.
- “Comprehensive, accurate and timely disclosure of information about remuneration to all stakeholders” should be required. Details of remuneration policies should be disclosed in the Key Investor Information Document (KIID).
- At least 25% of variable remuneration should be deferred over a 3 to 5 year period (lower than the 40% threshold under the Commission’s proposal and AIFMD). As under the Commission draft and AIFMD, this threshold would rise to 60% in the case of “particularly high” variable remuneration.
- Employees, as well as independent board members, should sit on the remuneration committee and executive members of management should not determine the remuneration policy.
- ESMA should supervise the enforcement of remuneration guidelines by competent authorities.
- ESMA is requested to provide guidance on how to apply different sectoral remuneration policies to the same employees (e.g. AIFMD, CRD and MiFID).

Depositary regime

Key depositary rules remain the same, including a new definition of “safekeeping” distinguishing between custody duties and asset monitoring duties and a new level of new “strict liability” for assets held in custody. In the event of loss anywhere in the sub-custody network “custody assets” must be returned by the depositary “without undue delay”.

The Parliament wants to ensure that under no circumstances could a UCITS investor suffer loss as a result of a sub-custodian failure. It has requested that the Commission analyse in which situations the failure of a UCITS depositary or a sub-custodian could lead to losses to UCITS unit holders. In the case of potential loss to the investor, the Parliament requires an extension of existing investor compensation schemes to cover insurance or some kind of compensation scheme which covers the custodian against the failure of a sub-custodian.

The Parliament text also states that financial instruments held in custody should not be reused by the depositary or by any third party to whom the custody function has been delegated. This includes use of any financial instruments delivered in one transaction in order to collateralise another, including transferring, pledging, selling and lending.

Sanctions regime

The UCITS V proposals provide for a minimum catalogue of administrative sanctions and measures including public sanctions, suspensions and fines. National regulators are to publish details of sanctionable offences outlining the nature of the breach and the party involved. Whistle-blowing mechanisms for national regulators and management companies are included in the measures as well. The Parliament wants to set the limit for sanction fines at up to ten times the amount of profits gained or losses avoided due to the breach, where those can be determined.

Next steps

The text adopted on 3 July 2013 has become the European Parliament‘s basis for engagement in discussions to agree a final draft UCITS V Directive with the Council of Ministers and the European Commission. There is still some way to go yet in terms of that process, however, UCITS V is a key priority to ensure that UCITS investors are afforded at least the same protections as investors under AIFMD. UCITS V is due to be progressed in the Autumn of 2013 and if agreed in Q 4 2013/Q 1 2014 the Directive will likely be implemented in Q4 2015/Q1 2016.

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