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UCITS V has been voted – what do you need to know?

UCITS V has finally come of age – it has overcome the last hurdles and received the necessary final approval at the plenary session of the European Parliament.

In June 2014, it is expected to be published in the Official Journal and will come into force 20 days after that. It will then need to be transposed into national law by each of the EU Member States.

There would appear to be a minor departure from what is normally considered standard practice in so far as the time frame for transposition has been fixed at 18 months rather than the 24 to which the market is more accustomed.

The key points of UCITS V are similar to those known to the market for some time now under AIFMD

- Depositary bank liability organisation
- Remuneration
- A harmonised sanctions regime.

Often in such cases the devil is in the detail – and in certain respects this is true for UCITS V as well.

Depositary liability

The liability regime has been extended to be aligned with AIFMD and as expected and unlike AIFMD there is no possibility for a contractual transfer of liability.

We can see however a few additional subtle differences compared with AIFMD:

- For example UCITS V requires that entities to which the Depositary delegates safe keeping arrangements must be disclosed in the fund prospectus - AIFMD stopped at “must be disclosed” leaving the choice of media to the AIFM and Depositary.
  As such a UCITS Prospectus will need to be updated every time the Depositary makes a change to its network, which may lead to revisit how they look at the change process in the future – especially when extensive cross-border activity exists within or beyond EU boundaries.

- There is also an additional “tweak” to “grandfathering” provisions. AIFMD for example allowed a 12 months grandfathering period for entities in the scope of the Directive to become compliant - this has almost become a standard that the market now anticipates.
  UCITS V introduces an additional dispensation for depositaries: existing depositaries who do not measure up to the required standards are afforded an additional 24 months after transposition to become compliant.
- The controversy sparked around the role of Central Securities Depositaries in AIFMD with the apparent exemption for such entities to be considered as delegates has been addressed in this Directive. Recital 21 repeats the essence of that exemption but goes on to specify that where the CSD is entrusted with the custody of assets, i.e. where is uses sub-depositaries or provides safe-keeping, then the delegation provisions apply.

For the most part the other Depositary provisions – liability, cash monitoring, re-use of assets etc. align closely with AIFMD with in the case of divergence more severe constraints under UCITS V.

Remuneration

For the Remuneration clauses there are few surprises. The inspiration for the provisions enacted follows the leitmotif that runs through much current financial sector legislation, i.e. perceived alignment of remuneration with the interests of shareholders and discouraging the taking of unconsidered degrees of risk.

As a final compromise, UCITS V stops short of a specific cap on variable remuneration, favouring deferral and claw-back mechanisms in its place. Performance fees are specifically included in variable remuneration and subject to the relevant deferral and composition clauses. Once again proportionality is evoked for certain cases, but overall there is little to surprise either positively or negatively, anyone familiar with the equivalent requirements of UCITS.

ESMA will be solicited to issue guidelines in this field, including the definition of in scope staff, but those guidelines will be non-binding opening the path to local adaptation and interpretation.

Sanctions

The major departure for UCITS V from previous iterations of the UCITS Directive is the section on sanctions.

In fine there is little in these provisions that is much of a surprise and they do not come in place of criminal sanctions which remain at the discretion of Member States. Some aspects represent harmonisation in so far as both companies and individuals fall specifically within the scope of sanction across the EU and sanctions are to be transparent. National competent authorities must publish details on their websites of all sanctions pronounced including the type and nature of the breach, and the identity of the person or entity responsible save where in the case of an individual that disclosure is deemed to be disproportionate or inappropriate. This information must remain public for a period of at least 5 years. Moreover, national competent authorities are required to formally communicate all sanctions pronounced to ESMA – and ESMA is to publish aggregated data in an annual report.

The real innovation, and this is the first time it appears in the EU regulatory framework, is the requirement for Member States to put in place specific procedures to both allow and protect “whistle blowing”. In addition, the Directive requires ESMA to put in place secure communication channels to allow whistle blowers who feel that

their national competent authorities to have not taken or not taken sufficient action to refer the issue directly to ESMA.

It remains to be seen what impact these provisions will have given the wide disparity in size and function of UCITS management companies. This requirement also extends to Depositaries.

We trust this information is of assistance and remain at your disposal for any further questions. Please see also our website for further information on UCITS V developments.

Deloitte experts in regulatory matters offer assistance on specific areas such as impact assessment for your organisation, definition of tailored solution for efficient implementation production as well as management of the UCITS V regulatory developments.

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