

November 2015

UCITS V
***New depositary role,
new remuneration
rules for managers,
new administrative
sanctions***

Executive Summary

This new Directive will align the depositary's duties and liabilities and the managers' remuneration requirements, with the requirements of the Alternative Investment Fund Managers Directive (AIFMD). However, differences will remain that will need to be closely monitored to ensure full compliance with the new rules. UCITS V will also create a new sanctions regime, thus strengthening the fear of sanction and the reputational risk for industry players.

These changes have significant implications for UCITS depositaries, managers, third party administrators, investors, auditors, and regulators. The "go-live" of UCITS V is 18 March 2016.

New depositary's role

The Madoff fraud and the Lehman Brothers insolvency have focused regulators' attention on the depositary role. In addition to safekeeping assets, depositaries are required to ensure that all transactions (e.g. subscriptions, redemptions and cancellations of units) made by or on behalf of UCITS funds are carried out in accordance with the law and the fund documentation. Crucially, depositaries must act independently and solely in the interest of the investors to effectively discharge this role.

Requirements for the appointment of the depositary:

Under the new rules, a UCITS will need to appoint a single depositary among a list of entities eligible to act as UCITS depositaries, i.e. national central banks, credit institutions and other legal entities which (i) are authorised to provide depositary activities, (ii) are subject to prudential supervision and (iii) to CRD IV capital adequacy requirements. Furthermore, UCITS V does not create a "depositary passport". The depositary to be appointed will need to be located in the same Member State as the UCITS one. In addition, the appointment of the depositary will need to be evidenced by a written contract entrusting the depositary with the safekeeping, oversight and cash flow monitoring functions.

Depositary duties:

Definition of safekeeping: UCITS V defines the activities and responsibilities related to safekeeping in line with the AIFMD definition.

Safekeeping functions: the new regime will introduce a distinction between (i) custody duties relating to financial instruments (such as securities) that can be held in custody and (ii) asset monitoring duties relating to "other assets" (such as derivatives contracts). The depositary's duties in respect of "other assets" will be confined to ownership verification and record keeping duties.

Harmonised oversight functions: unlike today, the new regime will introduce a uniform list of oversight duties irrespective of the legal form taken by the UCITS (i.e. SICAV or FCP). Thus, the depositary will have to perform the following duties for any type of UCITS:

- control of issue, repurchase, redemption and cancellation of shares/units;
- control of the NAV calculation;
- control that the consideration to the fund's transactions is remitted within the usual time limits;
- compliance with the investment restrictions;
- control that the UCITS' income is applied correctly.

Cash flow monitoring: the depositary will be responsible for the proper monitoring of the UCITS cash flows and in particular, it will:

- ensure subscription and monies are properly received by the UCITS;
- ensure that all cash is properly booked in segregated accounts opened in the name of the Management Company or the UCITS.

Delegation: the new regime will also restrict delegation of depositary tasks to safekeeping duties. The delegation rules will largely be aligned with the conditions and requirements for such delegation existing under AIFMD. However the two main differences between the UCITS V regime and the AIFMD regime are that (i) the liability of the depositary could not be contractually excluded or limited under UCITS V and that (ii) UCITS' prospectuses will need to contain a description of any safekeeping function delegated, the identification of the delegate and the identification of any conflict of interest that may arise from such delegation.

Depository liability regime:

Liability: as a general rule, the depository will remain liable for any loss suffered by the UCITS and/or by investors as a result of any breach of its duties.

UCITS V will also create a strict liability regime in case UCITS' assets held in custody are lost. In case of loss of financial assets held in custody, by the depository or its delegates, the depository will indeed be obliged to return identical financial instruments or a corresponding amount of assets (where fungible) to the UCITS without undue delay. Last, the depository will bear the burden of proof to demonstrate that it has performed its duties in accordance with the required standards.

Investors' rights of action against the depositaries: the new rules will also give the same rights to all UCITS investors, allowing them to sue depositaries, either directly or indirectly through the Management Company, based on the legal nature of the relationship between the depository, the Management Company and the investors.

New remuneration rules for managers

UCITS V will introduce the requirement for UCITS Management Companies and self-managed UCITS to put in place remuneration policies and procedures designed to prevent conflicts of interest and discourage risk-taking inconsistent with the risk profile of the managed UCITS.

Governance: the management body of the Management Company will be required to establish, maintain and approve the remuneration policy. Significant Management Companies will be required to establish a remuneration committee to exercise independent and competent judgement on remuneration policies and practices. Members of the remuneration committee shall not perform any executive functions in the Management Company. Remuneration of the senior officers in control functions shall be overseen by the remuneration committee. Also, the implementation of the remuneration policy will have to be reviewed, at least annually by the control functions.

Identified staff: under the new regime, "identified staff" to whom the remuneration policy will apply will include (i) senior managers, (ii) risk takers, (iii) control functions, and (iv) any employee receiving total remuneration in the bracket of senior managers and risk takers, whose activities have a material impact on the UCITS' risk profile.

Remuneration structures: UCITS managers remuneration structures will be required to include:

- rules for conducting performance assessment based on financial and non-financial criteria;
- rules for deferral, retention and payment in instruments of variable remuneration;
- rules for guaranteed variable remuneration;
- rules for payments related to termination of employment;
- rules on pension benefits.

Proportionate application: UCITS managers will be able to benefit from flexibility allowing for the sound application of the remuneration policies in a manner proportionate to the size, internal organisation as well as the nature, scale and complexity of the activities carried out by the manager and the fund.

Third parties in scope: by delegation, the same remuneration rules shall apply, in a proportionate manner to any third party which takes investment decisions that affect the risk profile of the UCITS as a result of delegation.

New administrative sanctions

UCITS V provides a catalogue of breaches to be sanctioned. These sanctions will include public statements, suspension or withdrawal of the Management Company authorisation and maximum administrative pecuniary sanctions. Fines will amount to at least twice the amount of the benefit deriving from the breach or:

- for legal persons up to at least EUR 5,000,000 or 10% of its total turnover;
- for natural persons up to at least EUR 1,000,000.

EU regulators will publish any administrative sanction on their official website and will maintain such publication for a period of at least five years. Furthermore, ESMA will maintain a central database of all sanctions communicated to it by national competent authorities. It will publish all sanctions in an annual report and will add a reference to any penalty or sanctions to the list of Management Companies available on its website.

Finally, UCITS V requires Member States to establish mechanisms encouraging the reporting of potential or actual breaches of the national provisions implementing the directive internally and externally to the regulator, including secure communication channels for the reporting of such breaches ("whistle-blowing").

How we can help

- We can perform an impact analysis of the new depository, remuneration and sanction rules on your business.
- We can review your depository agreements and remuneration policies to perform a diagnostic on the basis of the new rules.
- We can keep you updated through our 3W regulatory watch services.

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