

# UCITS V Legislative Tracker

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## The Simmons & Simmons UCITS V Legislative Tracker

This Legislative Tracker provides you with an update on the UCITS V Directive, setting out:

- a high level background to, and summary of the main aims of, the UCITS V Directive
- a table of the key dates in the process of agreeing the Level 1 text (with links to the relevant documents)
- a table setting out what is currently known about the consultation process for Level 2 / Level 3 measures and
- an annex setting out what specific Level 2 / Level 3 measures ESMA must develop, the timing of ESMA's work (where known) and which ESMA document (discussion paper, consultation paper or Final Report) deals with each measure.

## Background

Since the **Undertakings for the Collective Investment in Transferable Securities (UCITS) Directive** was adopted in 1985, it has been revised and amended several times but the rules on depositaries remained unchanged. This left room for different approaches to develop among the Member States of the EU as to the scope of a depositary's duties and liability for negligent performance, meaning that UCITS investors faced uneven levels of protection in different jurisdictions. The consequences of this came to the fore following the bankruptcy of Lehman Brothers International Europe and the Madoff fraud in 2008.

The financial crisis of 2008 also revealed that the remuneration and incentive schemes commonly applied within financial institutions could, themselves, be seen as exacerbating the crisis by contributing to short-term decision making and creating incentives for excessive risk taking. Finally, the European Commission's (the Commission) analysis of national sanctioning regimes showed a number of weaknesses, with a negative impact on the effectiveness of financial supervision and, ultimately, on competition, integrity of financial markets and consumer protection.

In response to these developments, the Commission put forward wide ranging proposals aimed at rebuilding consumer trust in Europe's financial markets. This package included a further revision of the UCITS Directive, known as UCITS V.

## Summary

The revised **Undertakings for the Collective Investment in Transferable Securities** (commonly referred to as **UCITS V Directive**) (the Directive) introduces a number of significant amendments to the UCITS IV Directive, principally in the areas of (a) remuneration, (b) depositaries and (c) administrative sanctions, with the aim of more closely aligning the UCITS regime with that under the AIFMD.

In terms of remuneration, the new obligations under UCITS V will apply to the management body of any UCITS established within the EU (i.e., its management company, if one is appointed, or the fund itself, through its board and other functionaries where it is "self-managed"). The Directive requires the management body to establish and apply remuneration policies and practices which (i) are consistent with, and promote, sound risk managements and (ii) do not encourage risk taking inconsistent with the risk profile or rules of the UCITS.

For each UCITS, a single depositary must be appointed with responsibility for oversight, monitoring and safekeeping functions. The depositary will have to act honestly, fairly, professionally, independently and solely in the interest of the investors in the UCITS. The Directive also prohibits reuse by the depositary of UCITS assets which are held in custody (except in certain specified circumstances) and makes the depositary of a UCITS to all intents and purposes strictly liable to the UCITS and to its unit holders for the loss of financial instruments by the depositary or by a third party to whom the depositary has delegated custody.

The Directive became effective on **18 March 2016**.



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## Where are we in the process?

Table 1: Key stages in development of Level 1 text

| Level 1 Text                        | Date                 |
|-------------------------------------|----------------------|
| <i>Commission Proposal</i>          | 03 July 2012         |
| <i>European Parliament position</i> | 03 July 2013         |
| <i>Council General Approach</i>     | 04 December 2013     |
| <i>Political Agreement</i>          | 19 March 2014        |
| <i>European Parliament adoption</i> | 15 April 2014        |
| <i>European Council adoption</i>    | 23 July 2014         |
| <i>Publication in OJ</i>            | 28 August 2014       |
| Entry into force                    | 17 September 2014    |
| <b>Effective Date</b>               | <b>18 March 2016</b> |

Table 2: Development of Level 2 / Level 3 measures

| CP/DP                                  | Covers                                                                                                                                                                                                                                                     | Expected                                            | Published         | Closed          | Submission to EU Commission                                                                                                                                                                                                       |
|----------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------|-------------------|-----------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| CP:<br><i>ESMA</i><br><i>2014/1183</i> | <p>Depositories: ESMA's technical advice on the content of delegated acts:</p> <p>i) Insolvency protection of UCITS when delegating safekeeping duties to a third party</p> <p>ii) Independence of UCITS management/ investment company and depositary</p> | N/A                                                 | 26 September 2014 | 24 October 2014 | <p>ESMA published <i>Final Report</i> on the technical advice on the delegated acts to the EU Commission on 28 November 2014.</p> <p>The EU Commission's <i>Delegated Regulation</i> was published in the OJ on 24 March 2016</p> |
| N/A                                    | Other depositories issues                                                                                                                                                                                                                                  | No consultation – COM to use ESMA's advice on AIFMD |                   |                 | The EU Commission published a draft <i>Delegated Regulation</i> on 17 December 2015                                                                                                                                               |
| CP:<br><i>ESMA</i><br><i>2015/1172</i> | Consultation on guidelines on sound remuneration principles under the UCITS Directive and AIFMD guidelines                                                                                                                                                 | N/A                                                 | 23 July 2015      | 23 October 2015 | ESMA published its <i>Final Report</i> on 31 March 2016                                                                                                                                                                           |

|     |                                                                           |     |                                                                                                                                                                                      |
|-----|---------------------------------------------------------------------------|-----|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|     |                                                                           |     | ESMA published its final <i>Guidelines</i> on 14 October 2016                                                                                                                        |
| N/A | Technical advice on sanctions                                             |     | ESMA published <i>Final Report</i> on draft ITS on 18 September 2015<br><br>The EU Commission's <i>Implementing Regulation</i> was published in the Official Journal on 26 July 2016 |
| TBC | Review of application of the <b>administrative and criminal sanctions</b> | TBC | 18 September 2017                                                                                                                                                                    |

# Annex

## Level 2 & Level 3 Measures

The Level 1 text of the UCITS V Directive requires ESMA:

- to assist the European Commission develop specific Level 2 measures concerning depositaries issues and sanctions, and
- to develop, itself, certain Level 3 measures concerning remuneration.

Looking at each of the required measures in turn:

### 1. Depositaries Issues

#### (a) The insolvency protection of UCITS assets when delegating custody functions - Article 22a(3)

##### (i) What does Level 1 say?

**Article 1(5)** of the UCITS V Directive inserts a new **Article 22a(3)** within the UCITS IV Directive, which states:

“[t]he functions referred to in **Article 22(5)** [i.e., safekeeping of the assets of the UCITS] may be delegated by the depositary to a third party only where that third party at all times during the performance of the tasks delegated to it:

- (a) ...
- (b) ...
- (c) ...
- (d) takes all necessary steps to ensure that in the event of insolvency of the third party, assets of a UCITS held by the third party in custody are unavailable for distribution among, or realisation for the benefit of, creditors of the third party”.

##### (ii) What is ESMA’s mandate?

**Article 1(10)** of the UCITS V Directive inserts a new **Article 26b** within the UCITS IV Directive, which requires the European Commission to adopt develop draft delegated acts specifying “the steps to be taken by the third party pursuant to (d) of **Article 22a(3)**”.

ESMA has been mandated by the European Commission to provide technical advice to assist it in the development of these delegated acts.

##### (iii) Timing

ESMA consulted on the segregation obligation in its *Call for Evidence (ESMA 2014/1183)*. The consultation period was open from 26 September to 26 October 2014.

ESMA published its *Final Report*, containing its technical advice to the European Commission, on **28 November 2014**.

The Commission adopted a *draft Delegated Regulation* on **17 December 2015**. In the absence of objection from the European Parliament and Council, the *final Delegated Regulation* was published in the Official Journal on **24 March 2016** and entered into force 20 days after publication (i.e., 13 April 2016). The Delegated Regulation will then have effect from **13 October 2016**, six months following entry into force.

## (b) The independence requirement – Article 25(2)

### (i) What does Level 1 say?

**Article 1(8)** of the UCITS V Directive inserts a new **Article 22a(3)** within the UCITS IV Directive, which states:

“[i]n carrying out their respective functions, the management company and the depositary shall act honestly, fairly, professionally, independently and solely in the interest of the UCITS and the investors of the UCITS. In carrying out their respective functions, the investment company and the depositary shall act honestly, fairly, professionally, independently and solely in the interest of the investors of the UCITS”.

### (ii) What is ESMA’s mandate?

**Article 1(10)** of the UCITS V Directive inserts a new **Article 26b** within the UCITS IV Directive, which requires the European Commission to adopt develop draft delegated acts specifying “the conditions for fulfilling the independence requirement referred to in **Article 25(2)**”.

ESMA has been mandated by the European Commission to provide technical advice to assist it in the development of these delegated acts.

### (iii) Timing

ESMA consulted on the independence requirement in its *Call for Evidence (ESMA 2014/1183)*. The consultation period was open from 26 September to 26 October 2014.

ESMA published its *Final Report*, containing its technical advice to the European Commission, on **28 November 2014**.

The Commission adopted a *draft Delegated Regulation* on **17 December 2015**. In the absence of objection from the European Parliament and Council, the *final Delegated Regulation* was published in the Official Journal on **24 March 2016** and entered into force 20 days after publication (i.e., 13 April 2016). The Delegated Regulation will then have effect from **13 October 2016**, six months following entry into force.

## 2. Sanctions

### (i) What does Level 1 say?

**Article 1(17)** of the UCITS V Directive inserts a new **Article 99e** within the UCITS IV Directive, which states:

“1. Competent authorities shall provide ESMA annually with aggregated information regarding all penalties and measures imposed in accordance with **Article 99**. ESMA shall publish that information in an annual report.

2. Where the competent authority has disclosed administrative penalties or measures to the public, it shall simultaneously report those administrative penalties or measures to ESMA. Where a published penalty or measure relates to a management company or investment company, ESMA shall add a reference to the published penalty or measure in the list of management companies published under **Article 6(1)**".

**(ii) What is ESMA's mandate**

**Article 1(17)** of the UCITS V Directive inserts a new **Article 99e(3)** within the UCITS IV Directive, which requires ESMA to **develop draft implementing technical standards (ITS)** to determine the procedures and forms for submitting information referred to in **Article 99e(1)** and **(2)**.

**(iii) Timing**

ESMA submitted its *Final Report*, containing draft ITS, to the Commission on **18 September 2015**.

The Commission's *Implementing Regulation* was published in the Official Journal on **26 July 2016**, entering into force 20 days after publication (i.e., 15 August 2016).

### 3. Remuneration

**(i) What does Level 1 say?**

**Article 1(2)** of the UCITS V Directive inserts a new **Article 14a(3)** within the UCITS IV Directive, which states:

"The remuneration policies and practices shall apply to those categories of staff, including senior management, risk takers, control functions and any employee receiving total remuneration that falls within the remuneration bracket of senior management and risk takers whose professional activities have a material impact on the risk profiles of the management companies or of the UCITS they manage".

**Article 1(2)** of the UCITS V Directive also inserts a new **Article 14b** within the UCITS IV Directive, which sets out a series of principles with which management companies must comply when establishing and applying the remuneration policies referred to in **Article 14a**.

**(ii) What is ESMA's mandate?**

**Article 1(2)** of the UCITS V Directive inserts a new **Article 14a(4)** within the UCITS IV Directive, which requires ESMA to **issue guidelines** (Level 3 measures) concerning the persons referred to in **Article 14a(3)** and the application of the principles referred to in **Article 14b**.

ESMA's guidelines must take into account:

- the principles on sound remuneration policies set out in the *European Commission's Recommendation of 30 April 2009 on remuneration policies in the financial services sector*
- the size of the management company and the size of the UCITS that they manage
- their internal organisation and
- the nature, scope and complexity of their activities.

ESMA is required to cooperate closely with the European Banking Authority (EBA) in the development of the guidelines, “to ensure consistency with requirements developed for other financial services sectors, in particular credit institutions and investment firms”.

In addition, **Article 1(2)** of the UCITS V Directive inserts a new **Article 14b(2)** within the UCITS IV Directive which requires ESMA, in close cooperation with EBA, include in its guidelines on remuneration policies provisions on how different sectoral remuneration principles, such as those set out in the AIFMD Directive and AIFMD Level 2 Regulation, are to be applied where employees or other categories of personnel perform services subject to different sectoral remuneration principles.

**(iii) Timing**

ESMA published a *Consultation Paper (2015/ESMA/1172)* on **23 July 2015**. The consultation period closed on **23 October 2015**.

ESMA published its *Final Report (ESMA/2016/411)* on **31 March 2016**.

ESMA's final *Guidelines on sound remuneration policies under the UCITS Directive (ESMA/2016/575)* were translated into the official languages of the EU and published on ESMA's website on **14 October 2016**.

The UCITS Remuneration Guidelines will apply from **1 January 2017**, subject to the transitional provisions stated therein.



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