

UCITS 5 DIRECTIVE

- Guide for Asset Management Companies -

Foreword

In the run-up to the transposition into French law of Directive 2014/91/EU of 23 July 2014, also known as “UCITS 5”, the AMF is seeking to provide asset management companies with answers to the main questions concerning the impact of this Directive and its transposition on their business.

The present document is not exhaustive¹. It incorporates factors that could change in line with the final legislative and regulatory provisions after transposition as well as level 2 and 3 measures stemming from the Directive. It may be updated and added to in due course.

[Directive 2014/91/EU of 23 July 2014](#), or “UCITS 5”, was published in the Official Journal of the European Union on 28 August 2014. It amends [Directive 2009/65/EC](#) of 13 July 2009, also known as “UCITS 4”.

What will change

UCITS 5 is not intended to make any fundamental reforms to UCITS 4. It specifically addresses the following:

- the function of the depositary, notably in terms of mission and responsibilities,
- asset management company remuneration policies, and
- the sanctions to which they may be liable,

with the aim of harmonising these rules with those introduced by [Directive 2011/61/EU](#) of 8 June 2011, known as the AIFM Directive, which was transposed into French law in July 2013.

What will not change

Measures stemming from UCITS 4, notably:

- UCITS authorisation rules,
- asset management companies’ obligations,
- UCITS mergers,
- UCITS investment policy obligations (eligible assets, diversification rules, etc.),
- master-feeder structures and investor information obligations,

are not subject to any amendment.

UCITS 5 has to be transposed into French law by 18 March 2016, and the new rules emerging from transposition will take effect immediately on that date. A [delegated regulation](#), a level 2 text intended to implement the Directive and published on 17 December 2015, is currently subject to rights to object by the European Parliament and Council. The delegated regulation is directly applicable and should not enter into force before the autumn of 2016.

¹ The Guide does not discuss UCITS 5 provisions relating to sanctions.

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I. Entry into force

SICAVs or asset management companies acting on behalf of a UCITS that appoint or have appointed before 18 March 2016 an institution as their depositary that does not meet the conditions of admission to the activities of depositary have to designate an institution that does meet these conditions by 18 March 2018.

II. The depositary's activities

The main measures concerning the depositary's activities are an enhancement in its rules to the same level as those for AIF depositaries and supplementary protection for retail investors.

A. Alignment with the AIFM Directive

UCITS 5 is intended to harmonise the rules applicable to the depositary's activities with those stated in the AIFM Directive.

The key change is the requirement in UCITS 5 for the depositary to monitor UCITS cash flows ("cash monitoring") by reconciling all cash movements. The depositary must ensure that all the payments made by investors for subscription to UCITS units or shares have been received and that all of the cash in the UCITS is accounted for in cash accounts opened in the name of the UCITS, the asset management company acting on behalf of the UCITS or the depositary.

A return obligation is also provided for. In the event of the loss of a financial instrument held as an asset of the UCITS in custody, the depositary must return to the UCITS a financial instrument of an identical type or the corresponding amount, unless it can prove that the loss has arisen as a result of an external event beyond its reasonable control and whose consequences would have been unavoidable despite all reasonable efforts to avoid them. Further detail will be provided in the delegated regulation.

B. Supplementary protection

For UCITS intended for retail investors, UCITS 5 contains additional requirements in terms of:

- Investor protection against the depositary's insolvency

In order to ensure a high degree of investor protection, only certain entities can be authorised to act as depositaries. Eligible entities are limited to the Banque de France, Caisse des Dépôts et Consignations, credit institutions whose registered office is in France, investment firms whose registered office is in France and whose capital is no lower than the level calculated according to Articles 315 or 317 of the Regulation (EU) 575/2013 of the European Parliament and Council of 26 June 2013, and branches on French territory of credit institutions whose registered office is in a member state of the European Union or a party to the European Economic Area other than France.

Moreover, the Directive states that creditors of the depositary or the third party to whom the custody of the UCITS assets has been delegated may not pursue claims on the assets of a UCITS in the custody of this depositary or third party.

- The reutilisation of assets for which the depositary has custody

The UCITS assets for which the depositary has custody may not be reused by the depositary or any third party to which the custody function has been delegated, for their own account. Reuse comprises any transaction of assets held in custody including, but not limited to, transferring, pledging, selling and lending.

Exceptionally, the reuse of assets by the depositary is permitted if it is for the account of the UCITS, if it is on the instruction of the UCITS asset management company, if it benefits the UCITS and, if it involves collateral cover, is in the unit holders' interests.

It follows that unlike the AIFM Directive, which authorises the AIF depositary to do so with the prior agreement of the AIF or its management company, it will no longer be possible for the UCITS depositary or a delegated entity to effect own-account securities transactions, for example, on the basis of assets held in custody.

- The depositary's liability in the event of the loss of a financial instrument held in custody

In contrast with the AIFM Directive, UCITS 5 prohibits the depositary from contractual exemption from liability in relation to the custody of financial instruments.

- Delegating custody

Like the AIFM Directive, UCITS 5 permits the depositary to delegate the custody function for AIF or UCITS securities to a central securities depositary.

UCITS 5 explains² that its own delegation of custody rules have to be respected in this case. These rules will be retained in the transposition of the Directive.

Note that all the detail over the depositary's missions and responsibilities is provided in the level 2 draft regulation published on 17 December 2015. The regulation is unlikely to come into force before the autumn of 2016, however.

C. Key points

1. The concept of the management body

UCITS 5 defines the **management body** of the management company or the depositary as *“the body with ultimate decision-making authority in a management company, investment company or depositary, comprising the supervisory and the managerial functions, or only the managerial function if the two functions are separated. Where, according to national law, the management company, investment company or depositary has in place different bodies with specific functions, the requirements laid down in this Directive directed at the management body or at the management body in its supervisory function shall also, or shall instead, apply to those members of other bodies of the management company, investment company or depositary to whom the applicable national law assigns the respective responsibility.”*

This concept is used to apply a series of contractual obligations; the management body and its members are required to be of good repute, competent and independent. UCITS 5 also defines the management body's missions, responsibilities and applicable penalties.

Given the very general definition of **“management body”** in the European legislation and the way it passes the task of defining the applicable rules to national law, the concept has to take account of French company law when it is transposed. This means that the body or bodies that can be described as management bodies within the sense of UCITS 5 have to be identified for each type of French company.

According to the definition, when the company has a single body that undertakes both the supervisory and managerial functions, that body is necessarily the management body within the meaning of the Directive. When the company has two distinct bodies, with one assuming the managerial function and the other the supervisory function, only the managerial body is subject to these rules. It follows that bodies responsible only for supervision within management companies or depositaries, these typically being supervisory boards, are not “management bodies”.

The “management body” for the depositary or the asset management company, or for the UCITS when management has not been delegated, is the body that:

- (1) has the ultimate decision-making power within the UCITS, depositary or asset management company;
- (2) carries out the managerial and supervisory functions, or solely the managerial function when these two roles are separated.

² cf. Recital 21, UCITS 5.

In practice, when the conditions defined in (1) and (2) are met, the management body refers to:

- a) Members of the board of directors, members of the management board, the managing director of a *société anonyme* public limited company and any other person or member of a body exercising equivalent responsibilities in any other type of company;
- b) The persons effectively managing the investment firm within the meaning of Article L. 532-2 §4 of the Monetary and Financial Code, the credit institution within the meaning of Article L. 511-13 or the asset management company within the meaning of Article L.532-9 II §4 not already included under a) above.

2. Independence between the management company and the depositary

The delegated regulation includes rules to ensure the asset management company's independence from the depositary. Specifically, it explains when a member of the asset management company's management body can be a member of the depositary's management body and vice versa.

These rules state that:

- no person may at the same time be both a member of the management body of the management company and a member of the management body of the depositary;
- no person may at the same time be both a member of the management body of the management company and an employee of the depositary;
- no person may at the same time be both a member of the management body of the depositary and an employee of the management company or the investment company;
- where the management body of the management company is not in charge of the supervisory functions within the company, no more than one-third of the members of its body in charge of the supervisory functions shall consist of members who are at the same time members of the management body, the body in charge of the supervisory functions or employees of the depositary;
- where the management body of the depositary is not in charge of the supervisory functions within the depositary, no more than one-third of the members of its body in charge of the supervisory functions shall consist of members who are at the same time members of the management body of the management company, or the body in charge of the supervisory functions of the management company or of the investment company or employees of the management company or of the investment company.

Note that these rules apply between the depositary and the asset management company **or** the SICAV **when management has not been delegated**.

It follows that members of the asset management company's management body can also be members of the SICAV's management body without falling foul of the new independence rules in the delegated regulation. That said, asset management companies and SICAVs must ensure that such arrangements do not create difficulties in the context of their own conflict of interests policies.

3. Independence rules relating to groups

The delegated regulation also provides independence rules relating to boards of directors and the supervisory role when the asset management company and the depositary belong to the same group:

- where the management body of the management company and the management body of the depositary are also in charge of the supervisory functions within the respective companies, at least one-third of the members or two persons, whichever is lower, on the management body of the management company and on the management body of the depositary shall be independent;
- where the management body of the management company and the management body of the depositary are not in charge of the supervisory functions within the respective companies, at least one-third of the members or two persons, whichever is lower, on the body in charge of the supervisory functions within the management company and within the depositary shall be independent.

The delegated regulation states that independence is determined with reference to the roles of the individuals concerned in each company forming part of a group.

D. Implications for asset management companies

From a practical standpoint...

For transitional purposes, the rules state that “SICAVs or asset management companies acting on behalf of a UCITS that designate or have designated before 18 March 2016 an institution as their depositary that does not meet the requirements of Article L. 214-10-1 of the Monetary and Financial Code as worded in this order must designate an institution that does meet these conditions by 18 March 2018.”

Note that these provisions solely concern eligibility for the role of depositary.

Two situations can therefore be distinguished:

1. that relating to the period between the entry into force of provisions stemming from UCITS 5 on 18 March 2016 and the entry into force of the delegated regulation in the autumn of 2016,
2. that relating to the period after the delegated regulation enters into force.

1. The period between the entry into force of national rules stemming from the transposition of UCITS 5 and the entry into force of the delegated regulation

The provisions of UCITS 5 are applicable from 18 March 2016 onwards, this being the date UCITS 5 enters into force. They are applicable to all existing UCITS.

That said, for UCITS in existence at 18 March 2016, depositaries are allowed a transition period (i.e. until 18 March 2018) to achieve compliance with the new depositary eligibility conditions stemming from the transposition of the Directive. This transition period does not apply to new UCITS, which have to designate a depositary that meets the new eligibility requirements.

Details of the new regime will be provided in the delegated regulation, for direct application.

For UCITS created after 18 March 2016, and ahead of changes to agreements signed with the depositary linked to the implementation date for the delegated regulation, UCITS authorisation will be based on a commitment from the depositary, via the acceptance letter provided for in AMF instruction 2011-19³, to fulfil its missions in compliance with the UCITS Directive.

2. Upon the entry into force of the delegated regulation

The provisions of the delegated regulation will be directly applicable six months after the regulation enters into force.

It follows that asset management companies belonging to a group that also includes a depositary should carefully examine the new independence rules and the potential and by no means negligible impacts of the delegated regulation to ensure they comply with these provisions from that time onwards.

Lastly, UCITS 5 states that regulatory documentation must include information about the depositary and mention any delegated custody functions. It also has to list any delegated and sub-delegated parties and identify any conflicts of interest liable to arise from such arrangements.

AMF instruction 2011-19 relating to authorisation procedures, the provision of a KIID and a prospectus, and periodic information on French UCITS and foreign UCITS marketed in France will shortly be updated to take account of these developments.

³ The instruction relating to authorisation procedures, the provision of a KIID and a prospectus, and periodic information on French UCITS and foreign UCITS marketed in France.

III. Remuneration policies

A. Alignment with the AIFM Directive

Like the AIFM Directive, UCITS 5 focuses on asset management companies' remuneration policies with a view to sound risk management and enabling supervision of employee behaviour in relation to risk-taking.

In this context, UCITS asset management companies will have to establish remuneration policies and practices that are compatible with sound and effective risk management and that apply to all categories of staff whose professional activities have a material impact on the risk profile of the UCITS under management.

The provisions detailed in Article 1 of UCITS 5 are aimed at a framework for the fixed and variable components of salaries and for discretionary pension benefits.

For harmonisation reasons, it mainly copies the provisions of Annex II of the AIFM Directive, these being 20 specific measures including:

- the adoption and review of the remuneration policy by the asset management company's management body in the exercise of its supervisory function, or by its supervisory body when the managerial and supervisory functions are separate;
- supervision by a remuneration committee, if it exists, of the salaries of the senior officer in the risk management and compliance function,
- multiannual assessments of the employees in question,
- the principle that guaranteed variable remuneration is possible only in the exceptional case of hiring of a member of staff, and even then only in the first year;
- an appropriate balance between fixed and variable components;
- the payment of at least 50% of variable remuneration in UCITS units or shares;
- an appropriate retention policy;
- the requirement to defer at least 40% of variable remuneration; and
- making the payment of variable remuneration conditional upon the financial health of the asset management company.

B. Notable differences

UCITS 5 also reinforces certain notions introduced by the AIFM Directive:

- the frequency with which the remuneration policy has to be reviewed will become at least annual for UCITS asset management companies. It is required only to be regular in the AIFM Directive;
- the spreading of variable remuneration over at least three years, compared with three to five years that can be shortened depending on the AIF lifecycle under the AIFM Directive;
- the composition of the remuneration committee, which if it exists must include one or several employee representatives⁴.

The duty of transparency vis-à-vis investors has also been revised to ensure that the UCITS prospectus includes details of the remuneration policy and the identity of the staff responsible for determining remuneration and the composition of the remuneration committee, if one exists. Alternatively, UCITS 5 states that the prospectus can incorporate a summary of this information and provide a link to a website for more details. The KIID must also contain this information.

The annual report must show the aggregate amount of remuneration and breakdowns by fixed and variable components and by staff category.

Note that the European Securities and Markets Authority (ESMA) has been tasked with drafting remuneration policy guidelines for the competent authorities and participants in financial markets. This process is intended to provide details on the implementation of remuneration policy, just as it did in terms of the AIFM Directive.

ESMA held a public consultation on a document ([Consultation Paper : Guidelines on sound remuneration policies under the UCITS Directive, 2015/ESMA/1172](#)) between 23 July and 23 October 2015 but has not yet adopted any definitive text.

⁴ When the management body includes an employee representation.

C. Implications for asset management companies

From a practical standpoint...

UCITS 5 does not require asset management companies that have already been authorised under UCITS 4 to seek a new authorisation from their regulator.

That said, management companies already authorised under UCITS 4 should plan to update their programme of operations to include their remuneration policy in accordance with Article 311-3 of the AMF General Regulation and Instruction 2008-03.

A file should therefore be created in A1 format (update to the basic programme of operations without extension of authorisation), complemented with an *ad hoc* document drafted with reference to ESMA guidelines.

If ESMA takes an approach similar to that retained for the AIFM Directive, the guidelines could state that the compensation policy for the 2017 financial year will be applicable to asset management companies authorised before 31 December 2016, and would therefore cover remuneration paid in 2018. That would require updates of the programme of operations no later than the end of October 2016 to give the AMF time to examine them.

Confirmation of this point will depend on the publication of ESMA's guidelines and their integration in French law.

The information to be contained in the regulatory documentation will have to be included in the programme of operations update to enable concomitant examination by the AMF.

Lastly, on 1 February 2016 ESMA published an updated Q&A on the implementation of the UCITS Directive ([2016/ESMA/181](#)). It includes details on updates to UCITS regulatory documentation following the entry into force of UCITS 5.

IV. Timetable

