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Investment Management Alert

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The European Securities and Markets Authority (ESMA) issued a consultation paper on 23 July 2015 in respect of the proposed guidelines on remuneration (UCITS Remuneration Guidelines) regarding the remuneration principles under Directive 2009/65/EC (UCITS Directive and UCITS Remuneration Requirements), as amended by Directive 2014/91/EU (UCITS V).

UCITS Remuneration Requirements

The UCITS Remuneration Requirements include a broad range of requirements, including the need to have in place a formally adopted remuneration policy that is consistent with, and promotes, sound and effective risk management, the deferral of at least 40 per cent of any bonus for at least three years, a prohibition on guaranteed bonuses (save in exceptional circumstances and in respect of the first year of employment only) and a requirement to pay at least 50 per cent of any bonus in noncash instruments (the effect of which should be to align interests with the UCITS and to incentivise the staff to act in a manner consistent with the sound risk management objectives).

Scope

As the name suggests, the UCITS Remuneration Requirements will apply to a firm authorised as a UCITS management company (or a self-managed UCITS) (a UCITS Manager). The UCITS Remuneration Requirements will apply to "*any benefit of any type paid by the [UCITS Manager]" to its "identified staff."*[1]

Application to the Delegates of UCITS Managers

However, the definition of "identified staff" also extends to any delegate of the UCITS Manager conducting investment management activities under the delegation arrangement with the UCITS Manager. As a result, "identified staff" includes those categories of the delegate's staff whose professional activities have a material impact on the risk profiles of the UCITS managed by the UCITS Manager.

The UCITS Remuneration Requirements will be applied on a "look-through" basis to delegates of the UCITS Manager carrying out investment management activities in respect of the UCITS that the UCITS Manager manages.

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1 Staff members falling into the following categories of staff: senior management; risk takers; control functions (i.e., staff members responsible for risk management, compliance, internal audit and similar functions within a management company); and any employee receiving total remuneration that falls into the remuneration bracket of senior management and risk takers (i.e., including any employee whose total compensation equals at least that of the lowest paid member of senior management or risk taker) whose professional activities have a material impact on the management company's risk profile or the risk profiles of the UCITS that it manages.

When the UCITS Manager delegates investment management functions to a third party, it must ensure that:

i. the delegates are subject to regulatory requirements on remuneration that are equally as effective as those applicable under the UCITS Remuneration Guidelines; or
ii. appropriate contractual arrangements are put in place with the delegates in order to ensure that the UCITS Remuneration Requirements are not circumvented.

Such contractual arrangements should cover any payments made to the delegates' identified staff as compensation for the performance of investment management activities on behalf of the management company.

Equally Effective Regulatory Requirements on Remuneration

A delegate that is an investment manager regulated under Directive 2004/39/EC ("MiFID") or Directive 2011/61/EU ("AIFMD") and/or subject to Directive 2013/36/EU and Regulation (EU) No. 575/2013 (together, "CRD IV") will be considered to be subject to regulatory requirements on remuneration that are equal to the UCITS Remuneration Requirements, provided that the identified staff of the entity are subject to the relevant remuneration rules.

However, a delegate that is an investment advisor established outside the EU, including in the United States, and is not subject to any remuneration requirements under the above directives will not be considered to be subject to equivalent remuneration rules.

Effect on US Investment Managers

In effect, this will translate to a requirement that a UCITS Manager ensure that its non-EU delegates, including U.S. investment managers, agree that the internal remuneration arrangements of such non-EU delegate (in respect of the portfolio managers and other relevant staff involved in the management of the assets of the UCITS) are consistent with the UCITS Remuneration Requirements.

If the UCITS Manager does not receive such contractual assurances, it will effectively be required to terminate the delegation arrangement.

Timing

UCITS V is required to be transposed by EU member states by 18 March 2016, at which time the UCITS Remuneration Requirements are expected to take effect across the EU. ESMA aims to provide the final UCITS Remuneration Guidelines ahead of the transposition deadline.

Contact Information

For further information on the UCITS Remuneration Requirements and their application to non-EU investment managers, please contact:

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