

EXPLANATORY MEMORANDUM TO
THE UNDERTAKINGS FOR COLLECTIVE INVESTMENT IN TRANSFERABLE
SECURITIES REGULATIONS 2016

2016 No. 225

1. Introduction

- 1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

- 2.1 This instrument implements, in Part, Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014, amending Directive 2009/65/EC on the co-ordination of laws, regulations and administrative provisions relating to Undertakings for Collective Investment in Transferable Securities (UCITS) as regards depositary functions, remuneration policies and sanctions (“UCITS V”). These Regulations implement provisions in UCITS V relating to depositaries and sanctions, and impose certain requirements on the Financial Conduct Authority (“FCA” - which is the competent authority in relation to UCITS funds) in relation to information and reporting.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 None.

Other matters of interest to the House of Commons

- 3.2 As this instrument is subject to the negative procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

- 4.1 UCITS stands for Undertakings for Collective Investment in Transferable Securities. UCITS are a type of regulated investment fund. The existing UCITS Directive (2009/65/EC), which UCITS V amends, sets out common rules for this type of investment fund. UCITS V adds additional requirements (relating to depositaries, remuneration and sanctions for breach of the directive) which need to be implemented in the UK.
- 4.2 The existing domestic legislative framework for UCITS funds is largely set out in the Financial Services and Markets Act 2000 (FSMA), the Undertakings for Collective Investment in Transferable Securities Regulations 2011 (the UCITS Regulations) and the Open-Ended Investment Companies Regulations 2001. UCITS funds are regulated by the Financial Conduct Authority (FCA) as the UK competent authority, and the FCA regulates UCITS funds by way of its handbook, which contains a suite of rules applicable to UCITS funds.

4.3 Responsibility for implementation of UCITS V has been split, with HM Treasury implementing the more structural elements of the requirements and the FCA implementing the more detailed rules and requirements upon authorised funds and depositaries.

4.4 A transposition table is submitted with this Explanatory Memorandum.

5. Extent and Territorial Application

5.1 This instrument extends to all of the United Kingdom

5.2 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Economic Secretary to the Treasury, Harriet Baldwin MP, has made the following statement regarding Human Rights:

“In my view the provisions of the Undertakings for Collective Investment in Transferable Securities Regulations 2016 are compatible with the Convention rights”.

7. Policy background

What is being done and why

7.1 The UCITS Directive was adopted in 1985 and proved to be a global success by integrating the EU investment fund market, and providing opportunities for investors and asset managers. However, during the financial crisis, it became apparent that the Directive had been transposed in divergent ways across EU Member States, resulting in inconsistent levels of investor protection. UCITS V introduces rules on depositaries and remuneration, as well as sanctions for breaches of the Directive. This is consistent with other fund legislation and aims to promote investor protection.

7.2 Regarding the provisions for depositaries, UCITS V seeks to address three key aspects of depositary governance and practices. These can be broadly be categorised as:

- **Eligibility to act as a depositary** - UCITS V introduces an exhaustive list of entities eligible to act as a depositary of a UCITS fund. This aims to strengthen consumer protection by ensuring that only institutions that comply with specific safeguards can provide the depositary function.
- **Liability of a UCITS fund’s assets** - Under UCITS V, the depositary is liable to the UCITS fund and to investors for losses by the depositary or third party to whom custody was delegated. This liability measure ensures a greater level of protection to UCITS funds and investors.
- **Delegation of custody of a UCITS fund’s assets** - UCITS V lays out specific conditions in which the depositary’s safekeeping duties may be delegated to a sub-custodian. These are aligned with those conditions that are applicable under the AIFMD (2011/61/EU).

7.3 Regarding provisions for remuneration, UCITS V introduces a requirement for the UCITS management company to implement a remuneration policy that is consistent with sound risk management of the UCITS fund.

7.4 The remuneration principles will seek to:

- Promote sound and effective risk management and will not encourage risk taking that is inconsistent with the risk profile of the UCITS instruments under management.
- Include the fixed and variable components of salaries and discretionary pension benefits to ensure complete transparency surrounding remuneration policies.
- Increase transparency of remuneration by requiring details of the up-to-date remuneration policy in the investor prospectus, and include a total and full breakdown of remuneration for the financial year to be included in the annual report.

These provisions on remuneration are consistent with those imposed by the Alternative Investment Fund Managers Directive.

7.5 Regarding the provisions for national sanction regimes, the policy aim is to achieve minimum harmonisation of sanction regimes by requiring:

- A minimum catalogue of administrative sanctions and measures (including harmonisation of the lower bound of the maximum amounts of administrative fines);
- A minimum list of sanctioning criteria; and
- Competent authorities and management companies to establish whistle-blowing mechanisms.

7.6 These Regulations, made under powers in section 2(2) of the European Communities Act 1972, make amendments to FSMA and the UCITS Regulations in order to transpose certain of the UCITS V requirements relating to depositaries, FCA reporting duties and sanctions for breach of the directive. There are also some minor amendments made to two other statutory instruments to deal with minor technical requirements relating to processing of personal data and protecting whistle-blowers.

8. Consultation outcome

8.1 HM Treasury published its consultation on the implementation of the UCITS V Directive, which included a draft of these Regulation, in October 2015. The consultation ran for 8 weeks and closed on 17 December 2015. HM Treasury received four responses to the consultation. Broadly speaking, the responses agreed with HM Treasury's approach to implementation of the directive, and the draft Statutory Instrument.

9. Guidance

9.1 HM Treasury do not plan to issue guidance on these Regulations. The vast majority of the requirements placed upon UCITS funds and depositaries as a result of UCITS V are contained in the FCA's changes to their regulatory handbook, who have published PS16/2, available at: <https://www.fca.org.uk/news/ps16-02-implementation-of-the-ucits-v-directive>.

10. Impact

10.1 The impact on business is expected to be moderate. This is because many firms already comply with similar provisions laid out under other existing financial services legislation, such as the AIFMD.

- 10.2 There is no impact on the public sector.
- 10.3 There is no impact on charities or voluntary bodies.
- 10.4 An Impact Assessment will at a later date be published alongside the Explanatory Memorandum on the legislation.gov.uk website.

11. Regulating small business

- 11.1 The legislation applies to activities that are undertaken by small businesses.
- 11.2 HM Treasury has no policy choice as to whom the directive applies. HM Treasury are required to transpose the directive such that it applies to all UCITS funds, management companies and depositaries regardless of size.

12. Monitoring & review

- 12.1 The UCITS V Directive is subject to review in 2021. Regulation 6 of these Regulations sets out that HM Treasury must from time to time carry out a review of the instrument, and must publish a report on that review within five years of the instrument coming into force, and thereafter at intervals not exceeding five years.

13. Contact

- 13.1 Sussie Moran at HM Treasury [telephone: 0207 270 1983 or email: Sussie.Moran@HMTreasury.gsi.gov.uk] can answer any queries regarding the instrument.