Gem Briefing Note 15/4

September 2015

GEM Compliance Consulting

CP 15/27 - UCITS V implementation and other changes to the Handbook affecting investment funds

Introduction

In this Consultation Paper (CP) the FCA sets out three sets of proposals for authorised investment funds:

- Part I looks at the changes required to transpose UCITS (Undertaking for Collective Investment in Transferable Securities) V into UK regulation by 18th March 2016. UCITS V aims to address issues and risks that have emerged since the financial crisis by:
  - strengthening the rules covering the responsibilities of depositaries;
  - introducing remuneration policy requirements for management companies; and
  - ensuring national authorities have a minimum set of powers to investigate and sanction breaches of the Directive.

  Most of the detailed requirements for depositaries and management companies will be set out in the European Commission's (EC's) Level 2 measures, which are yet to be published, as the adoption process has not yet begun. In addition, ESMA (European Securities and Markets Authority) is still required under UCITS V to publish Level 3 guidelines on sound remuneration polices and practices for management companies, and draft technical standards for reporting by national authorities of penalties and measures imposed on management companies.

- Part II describes proposed Handbook changes for the introduction of ELTIFs (European Long-Term Investment Funds - a new type of fund that will invest in assets of a long-term nature, e.g. infrastructure projects and SMEs); and

- Part III proposes low-impact changes to the Handbook to clarify and update rules relating to authorised funds. Part III also mentions areas of regulation that the FCA is keen to explore further with stakeholders:
  - allowing fund managers greater flexibility when temporarily ceasing the acceptance of new subscriptions into a fund (known as 'soft closure');
  - broadening access to UCITS schemes;
  - changes that could be made to the Handbook to "enhance the attractiveness of ELTIFs as a new type of fund for both institutional and retail investors."

Key Messages - Part I

- Level 2 measures are expected to be broadly in line with AIFMD Level 2 Regulation.
- The FCA proposes to introduce a new section to SYSC 19 (SYSC 19E) containing the remuneration requirements for UCITS V.
- The UCITS V Remuneration Code will apply to all management company staff whose activities have a material impact on the risk profiles of the firm or the UCITS under its management.
- Remuneration policies and practices of management companies will need to be consistent with, and promote, effective risk management and have regard to a number of specific issues, such as staff performance and the balance between fixed and variable remuneration.
- Firms will need to comply with SYSC 19E by 18th March 2016.
- BIPRU firms compliant with SYSC 19E will also be viewed as complaint with SYSC 19C.

Key Messages - Part I continued…

- When the management of UCITS consists of more than 50% of a management company's total portfolio, at least 50% of any variable remuneration should consist of non-cash instruments. If the proportion of managed UCITS is less than 50% of the firm's total portfolio, although the minimum level of non-cash instruments doesn't apply, the FCA proposes to introduce specific guidance on an appropriate balance of cash versus non-cash instruments for variable pay.
- The FCA is also proposing guidance in line with the proportionality principle, which will allow certain remuneration principles to be disapplied when the remuneration due to a Code staff member falls below certain minimum thresholds.
- Many UCITS management companies are also full-scope AIFMs, therefore some staff will be subject to both codes and firms will need to be able explain how staff in these instances are remunerated.
- Firms should note that some requirements of the UCTIS Code are unique and others differ from the AIFMD Code. A list of these points is given in the CP.
- UCITS V will require management firms and depositaries to have procedures in place for the internal reporting of potential/actual breaches of the UCITS rules.
- Limited transitional provisions are available for updating the prospectus and KIID.
- The FCA is advising firms that it is considered good practice to publish on a website the additional information regarding remuneration arrangements, as far as it is available.
- Management companies will be obliged to appoint a single depositary and have a written contract in place with the depositary containing a minimum set of contract terms.
- Management companies will also be responsible for ensuring the depositary is eligible to act for it.
- Level 2 measures will contain requirements for independence between the management company and depositary.
- UCITS V uses the MiFID II definition of financial instruments and this will therefore apply to relevant funds from 18th March 2016, before MiFID II comes into effect on 3rd January 2017.

Part II

- ELTIFs will operate within the AIFMD regime and the manager of an ELTIF must be a full-scope AIFM.
- ELTIFs will be authorised as funds and may be marketed to retail investors if the funds and fund managers meet certain conditions.
- Sales of ELTIFs to retail investors must be done on an advised basis, therefore distributors will need to have the relevant Part 4A FSMA permissions and conduct suitability assessments.
- Full-scope AIFMs will need the permission of acting as a manager of an authorised AIF in order to manage an ELTIF. Therefore, full-scope AIFMs will need to vary their permission. However, it is unclear at this stage whether the FCA will require a firm to hold the permission before managing an ELTIF or whether the submission of an appropriate VOP (Variation of Permission) will be sufficient.
- Managers will need to meet specific requirements in order to market ELTIFs to retail investors.
- The FCA will require depositaries of UK ELTIFs to be FCA authorised, however other member states may take a different view, which could allow UK depositaries to be appointed for EEA ELTIFs.
- Managers will be able to take advantage of the AIFMD cross-border passport for management of ELTIFs.
- Rules and guidance relating to ELTIFs will be contained in a new section of the FCA's FUND sourcebook entitled 'European AIF Regimes'.
- The CP also includes proposals for the costs of ELTIF applications (£2,400 for a single fund and £4,800 for an umbrella fund) and the method of calculating FCA periodic fees.
- The FCA believes managers and depositaries of ELTIFs (including those set up as investment management companies) should be within the scopes of the FOS and the FSCS.
- ELTIFs set up as investment companies will be able to trade, or become listed, on a regulated market.

Part III

- In addition to the three areas mentioned in the introduction, on which the FCA wishes to hear stakeholders' views, Part III also sets out relatively low-impact changes to clarify requirements, add flexibility to rules and remove/correct out of dates measures. Some of these proposals are mentioned below.
- A standard Derivatives Risk Management Process (DRMP) reporting template is proposed. Frequency of reporting won't change but the timing of reports will been clarified.
- The FCA proposes rules and guidance encouraging the use of Product Reference Numbers (PRNs) for both sub-funds and stand-alone schemes in investor-facing documents.
- Revised wording setting out the different ways a preliminary charge for a retail authorised fund can be calculated is also suggested.
- Amendments to rules concerning the use of non-UCITS feeder funds to remove unintended restrictions and allow fund managers to make good use of the master feeder structure are proposed.
- Instead of transferring the contents of COLL to FUND, as was originally planned, specific amendments to both FUND and COLL are to be made.
- The removal of out of date provisions relating to Stamp Duty Land Tax, historic pricing, bearer certificates and period closure of unit registers is also recommended.

Next Steps

The next steps for each part of the CP are as follows:

- Part I - the consultation period closes on 9th November 2015 and the FCA intends to publish a Policy Statement (PS) in early 2016. The FCA also hopes to issue a CP on Handbook changes for the European Commissions' proposed Level 2 measures by the end of 2015, however this will depend on when the final Level 2 measures are published.
- Part II - the consultation period closes on 5th October 2015 to enable final rules and guidance to be in place by 9th December 2015, the date the ELTIF Regulation comes into force.
- Part III - the consultation period closes on 7th December 2015 and a PS should be issued sometime in 2016.

The full Consultation Paper can be accessed here.

This note is intended as a summary only. It is not full and/or firm specific advice and it is the responsibility of each regulated firm to ensure they fully consider relevant FCA publications.

For further information, please contact Gem Compliance Consulting Ltd.