Title: Transposition of the amended Undertakings for Collective Investments in Transferable Securities (UCITS V) Directive **IA No:** **Lead department or agency:** HM Treasury **Other departments or agencies:** Financial Conduct Authority	**Impact Assessment (IA)** **Date:** 29/**04/2015** **Stage:** Consultation **Source of intervention:** EU **Type of measure:** Secondary legislation **Contact for enquiries:** Sussie Moran - 0207 270 1983

Summary: Intervention and Options

RPC Opinion: GREEN

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, Two-Out?**	**Measure qualifies as**
-48.36m	-48.36m	5.4	No	NA

What is the problem under consideration? Why is government intervention necessary?

The amending EU Directive for Undertakings for Collective Investments in Transferable Securities Directive (UCITS V) (2014/91/EU) required all Member State government to transpose it into national law by 18 March 2016. It sets common EU regulatory standards for UCITS investment funds that required the UK Government to make changes to its existing law and regulations for UCITS funds. The changes to the UCITS regime have been prompted by governments in response the financial crisis, seeking to secure stable financial markets. The amendments in UCITS V specifically deal with depositary functions, remuneration policies, and sanctions for failure to comply with the Directive.

What are the policy objectives and the intended effects?

UCITS V amendments to the current legislative framework should raise standards of protection for EU UCITS investors. In particular, the strengthening and harmonisation of the UCITS depositary regime means clients' assets will be better protected. HM Treasury's policy objective is to achieve compliance with the UCITS V Directive while keeping to a minimum the impact on the UK investment management sector. The Directive is expected to have a moderate impact on industry. Many of the UCITS V requirements will be familiar to the firms that fall under the Directive's scope as they are similar to existing legislation. UCITS V aims to bring in to line those Member States without firm rules on depositories, remuneration and sanctions.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Option 1. Amend existing UK law and regulatory rules to meet the Directive's requirements, ensuring that the transposing measures do not go further than these requirements (i.e. avoiding gold-plating);
Option 2. Do nothing and fail to transpose the UCITS V Directive.

Option 2 has been discounted. As this is an EU Directive, the UK has a treaty obligation to transpose it into national law. Option 1 is preferred as there is little flexibility in how UCITS V should be implemented, and other than ensuring minimum harmonisation, HM Treasury made no substantive policy choices while drafting the implementing statutory instrument. Option 1 has the benefit of working alongside the existing regulatory system designed to meet the requirements of the UK investment market.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 03/2021

Does implementation go beyond minimum EU requirements?			No		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY: ______________________ Date: ______________

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2016	PV Base Year 2016	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -325.56	**High:** -39.37	**Best Estimate:** -48.36

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	39.372		0	**39.372**
High	114.450	1	27.750	**325.56**
Best Estimate	43.792		0.6	**48.36**

Description and scale of key monetised costs by 'main affected groups'

The best estimate for overall compliance with the directive has been obtained by totalling the best estimated costs of the depositaries and remuneration provisions for year 1 (transition) and 9 subsequent years (10 years total). HMT predict the best estimate to be at the lower end of the above low-high cost range. This is because the majority of firms comply with provisions that are similar to those under UCITS V. The majority of costs incurred are expected to be during the transitional period.

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	0		0	**0**

Description and scale of key monetised benefits by 'main affected groups'

It has not been possible to quantify the benefits of the Directive. See benefit sections of the cost/benefit analysis.

Other key non-monetised benefits by 'main affected groups'

There are a number of non-monetised benefits by implementing the UCITS V Directive. These broadly fall under enhancing consumer protection and financial stability. The EU UCITS regime has developed into a respected international brand ensuring a high degree of investor protection. The UCITS V changes will improve the UCITS brand and provide significant benefits to both the industry and investors.

Key assumptions/sensitivities/risks **Discount rate**

The main assumptions surround the ability of the changes to depositaries and remuneration policies in promoting financial stability and decreasing risk associated with UCITS funds.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			**In scope of OITO?**	**Measure qualifies as**
Costs: 5.4	**Benefits:** 0	**Net:** -5.4	No	NA

Evidence Base (for summary sheets)

Background.

UCITS stands for Undertakings for Collective Investments in Transferable Securities. UCITS are a type of regulated investment fund. The existing UCITS Directive sets out common rules for this type of investment fund (including rules on investment policy, risk management and investor disclosure). Funds that meet these rules may be marketed across the EU based on home state authorisation.

The original UCITS Directive was adopted in 1985 and aimed to offer greater business and investment opportunities for both industry and investors by integrating the EU market for retail investment funds. The Directive sets out a harmonised regulatory framework for investment funds that invest in certain classes of assets, providing high levels of investor protection and a basis for the cross-border sale of these funds.

The UCITS Directive has been key to the development of the European investment fund industry. The UCITS brand is recognised worldwide and, due to its regulated status and emphasis on investor protection, over 70 non-EU jurisdictions permit the distribution of UCITS products into their markets – making UCITS a global benchmark and genuine marketing success story. At the end of March 2015 the assets under management of UCITS funds globally were over EUR 8.277 trillion, representing 65% of all investment fund assets in Europe (source: EFAMA Quarterly Statistical Release, No. 61). In the UK, there are currently c.150 authorised management companies in the UK and 11 authorised depositaries of UCITS funds. Depositaries are responsible for the safekeeping of the assets of a UCITS fund and monitoring many of its activities.

In July 2009, the European Commission launched a wide-ranging public consultation on the UCITS depositary function. The objective of the consultation paper was to gather evidence to clarify and strengthen the regulation and supervision of UCITS depositaries (among other operational aspects of UCITS funds), with a view to consolidate the level of protection of UCITS investors, further strengthen the UCITS brand and attract investment. Submissions to the consultation paper suggested reforms in the areas of fund depositaries, remuneration, and national sanction regimes.

Following the consultation, the European Commission formally proposed a reform of the UCITS Directive, commonly referred to as UCITS V. UCITS V amends the previous version of the UCITS Directive, known as UCITS IV, which came into force in the UK in July 2011.

UCITS V is an EU Directive and the UK, like other Member States, is obligated under the treaty to transpose it into national law. The transposition deadline was 18 March 2016. UCITS V is a minimum harmonising directive, which means the UK has discretion to impose stricter standards. In the case of administrative sanctions, our existing legislation and rules already give effect to the directive requirements, and in some cases go further. In relation to the remainder of the provisions, HM Treasury has decided (wherever possible) not to go beyond the minimum requirements imposed by the directive.

On 23 June 2016, the EU referendum took place and the people of the United Kingdom voted to leave the European Union. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period the Government will continue to negotiate, implement and apply EU legislation. The outcome of these negotiations will determine what arrangements apply in relation to EU legislation in future once the UK has left the EU. The assumptions used in this impact assessment have been chosen accordingly.

Interaction with relevant EU funds legislation

The two primary European Directives that directly set the framework for collective investment schemes in the UK are the UCITS Directive and the Alternative Investment Fund Managers Directive (AIFMD):

- The UCITS Directive sets out requirements for collective investment schemes that are established and located in the EU and suitable for retail investors.

- AIFMD, which came into force on 22 July 2013, regulates the managers (Alternative Investment Fund Managers – 'AIFMs') of Alternative Investment Funds (AIFs), which are generally addressed to professional investors. It is also possible in the UK to have a retail scheme which does not fall within the UCITS regime, referred to as a non-UCITS retail scheme, or NURS. A NURS will constitute an AIF for the purposes of the AIFMD.

So funds in the UK are, broadly speaking, either UCITS or AIFs and are regulated separately under either the UCITS Directive or AIFMD. Many of the provisions in UCITS V on depositaries and on remuneration bring UCITS into line with AIFMD. This means that UK firms subject to the AIFMD are already complying with requirements that are broadly comparable with the rules laid out in UCITS V and/or they are familiar with the requirements, which should ease compliance. However, certain requirements are new and/or go beyond those set out in AIFMD. These will require firms to incur costs. The costs and benefits of these measures are discussed in more detail below.

Further, the requirements for minimum national sanctions under UCITS V are already in place under the provisions set out in the Financial Services and Markets Act 2000 (FSMA). Thus, we do not expect firms to have to make any changes or incur any additional costs or benefits as a result of these measures.

Problem under consideration and rationale for change

Following the financial crisis, the European Commission concluded that the UCITS Directive was no longer sufficient to safeguard and support the European fund industry and the needs of European investors. Core elements of the Directive did not function effectively. In particular, concerns had been raised around existing regimes for depositaries, remuneration and sanctions, as set out below.

Depositaries

For investor safety, UCITS assets are held by a separate company known as a depositary, which also checks the fund manager's activities (e.g. whether they properly follow the fund's investment strategy).

A UCITS depositary is an entity that is independent from the UCITS fund and the UCITS fund's investment manager. The independence of a depositary is necessary because the depositary essentially acts both as a supervisor of a UCITS fund (overseeing certain fund transactions such as subscriptions and redemptions) and as a custodian over the fund's assets. While the fund manager makes investment decisions for the fund, the depositary is in charge of holding the fund's assets in custody on behalf of investors. The assets of the UCITS are segregated from the assets of both the depositary and the manager. Therefore, the UCITS assets are protected in case of a default by the manager or the depositary. This is a crucial pillar of investor protection in the UCITS framework.

In addition, while the safekeeping of investors' assets is a core task of the depositary, the depositary also performs certain oversight functions. These functions include:

- verifying that a UCITS fund's sales, repurchase and redemption of units or shares is carried out in accordance with applicable laws;
- verifying that the net asset value of units is calculated in line with national laws and fund rules; and
- ensuring that transactions of the fund manager comply with all applicable laws and that transactions involving the fund's assets are carried out within the relevant time periods.

UCITS provisions on depositaries have remained unchanged since the UCITS Directive first came into force in 1985. Since then, however, the investment environment for UCITS has evolved; fund portfolios are increasingly diverse and international, they are often complex and can be held in custody outside the EU (for example, in emerging markets).

Previous UCITS Directives only set out high-level requirements on the depositary and its liability towards investors when things go wrong. However, events such as the Madoff fraud, where investors incurred huge losses due in part to failures of the depositary function in certain jurisdictions, have shown that these requirements have been interpreted differently across Europe, so investors do not always have the same standards of protection. Such cases highlighted that there can be serious consequences if there are no adequate measures in place to prevent conflict of interest issues when allowing a company to act as both fund manager and depositary. Similar problems could arise when delegating these roles to the same third party or sub-custodian. The following concerns were identified:

- UCITS funds are aimed at retail investors and should offer the highest level of investor protection. At present, however, the regime governing depositaries of UCITS is less stringent than that which applies to AIFs under AIFMD and it is also applied unevenly across Europe.

  Ensuring that consumers' assets are safeguarded by depositaries that meet minimum standards in terms of prudential regulation, capital requirements and effective supervision is a core objective of the UCITS V Directive. It is also crucial that a UCITS depositary is able to fulfil its duties. UCITS V seeks to address these issues by requiring the appointment of a single, independent depositary to each UCITS fund, so that the depositary has clear oversight across the UCITS assets. To ensure depositaries are sufficiently robust, UCITS V also includes specific requirements as to who can be appointed as a depositary and that the appointment of a depositary must be evidenced by a written contract, confirming minimum standards of operation;

- as the European Commission highlighted in its impact assessment on the Directive, holding assets through sub-custodians has become increasingly common. Under the current regime, it is unclear what duties a depositary has in the selection and supervision of the sub-custodian. It is therefore legally uncertain across the EU as to what extent a depositary is liable for losses at the sub-custodian level. UCITS V therefore sets out rules on how and when depositaries can delegate activities to third parties, specifying that delegation of activities does not mean they can pass on their responsibilities to others; and

- the European Commission's UCITS V impact assessment concluded that a 'strict liability' standard that obligates depositaries to return instruments lost in custody irrespective of fault or negligence is both conducive to ensuring a high level of investor protection and to achieving a uniform standard across the EU.

Prior to the amendments in UCITS V, the existing UCITS Directive did not contain any rules to cover these issues. Harmonising these rules will benefit retail investors by reducing uncertainty and ensuring they can continue to trust UCITS, whether marketed across borders or not.

Remuneration

The European Commission highlighted issues surrounding the remuneration of fund managers and institutions. The fallout from the financial crisis demonstrated that in some cases, remuneration and performance incentive schemes in financial institutions exacerbated the impact and scale of the crisis by contributing to decision making in the short term, without acknowledging potential long term repercussions of those decisions. This increased the incentive for taking excessive risk.

UCITS V seeks to introduce measures that align the incentives of managers and investors. UCITS V aims to make management companies of UCITS subject to remuneration requirements which are broadly in line with those applicable to managers under AIFMD.

Sanctions

Lack of enforcement of EU rules in one Member State may have significant implications for the stability and functioning of the financial system in another Member State. It is therefore necessary to ensure a consistent and effective application of EU rules in all Member States – this in turn requires supervisors to be able to deploy sanctioning regimes that are sufficiently convergent and strict, so as to act as a deterrence.

Following the crisis, the European Commission and the Committees of Supervisors (now the European Supervisory Authorities) carried out analysis of national sanction regimes. The analysis found a number of weaknesses throughout existing systems that may impact the application of EU legislation. Compromised effectiveness of financial supervision may ultimately affect competition, stability and integrity of financial markets and consumer protection. The European Commission therefore suggested putting in place common minimum standards in its Communication of 9 December 2010: 'Reinforcing sanctioning regimes in the financial sector'. These proposals reinforce and standardise the approach to national sanctioning regimes. The common minimum standards have been included throughout recent EU legislative proposals that include the Capital Requirements Directive IV, Markets in Financial Instruments Directive, the Market Abuse Regulation, and Transparency Directive. They are therefore also applied in UCITS V, which will help to standardise sanctions applied across the sector. As the level of the sanctions are already enforced in other financial services legislation, it is expected that the sanctions laid out under UCITS V will have minimal impact on UK industry, as many firms will already be subject to the existing domestic sanctions laid out in FSMA and by the FCA. The policy objectives and implications of the National Sanction Regime provisions laid out under UCITS V are discussed later in this impact assessment.

(For further discussion, see the Commission's Impact Assessment: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012SC0185&from=EN, pp. 5-7).

Policy Proposals

UCITS V introduces a number of targeted reforms to the UCITS Directive with the objective of updating the legislative framework to ensure the safeguarding of UCITS fund operations across the EU, to lower risk surrounding the management of UCITS funds, and to build consumer protection and trust in the market. Overall, this will further improve the reputation of UCITS as a global brand that is highly attractive to investors.

HM Treasury's priority when implementing the UCITS V Directive is to ensure that these high-level objectives are delivered whilst avoiding 'gold-plating' and ensuring that UCITS V has minimal impact on industry. Where the FCA is responsible for implementing the requirements under the Directive, they have taken an 'intelligent copy-out' approach, whereby they are seeking to implement the Directive in full without going further than that the Directive text wherever possible.

The policy objectives and their intended effects for each of these key areas are discussed in detail below. This is then followed by a consideration of the UK's approach to implementation.

Depositaries

The policy proposals for each of the key areas of depositaries provisions are as follows:

1. 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. The European Commission's UCITS V impact assessment concluded that 'both credit institutions and regulated investment firms provide sufficient guarantees in terms of prudential regulation, capital requirements and effective supervision to act as UCITS depositaries'. As most UCITS depositaries in the UK are already credit institutions or regulated investment firms, the impact of the UCITS V policy is expected to have minimal impact on UK industry.

Of the 11 UK depositaries, there are currently 3 non-bank depositaries that are already subject to specific capital resources requirements laid out in the FCA handbook, which go beyond the level of requirements under UCITS V. The FCA are responsible for the implementation of these provisions and propose to retain the current level of capital requirements as they bring into line non-bank requirements with the requirements for bank depositaries and offer a better level of investor protection.

In addition, to ensure UCITS V depositary requirements are met, UCITS V also specifies that the appointment of a depositary shall be evidenced by a written contract and that depositaries must have a uniform list of oversight duties established in contractual form. Currently, the oversight function performed by depositaries is uneven across the EU. Ensuring fund managers are performing their role appropriately provides an important level of consumer protection, so introducing harmonised minimum standards will guard against investor detriment. These provisions will require firms to reissue contracts in a similar fashion to AIFMD.

To ensure that the depositary has an overview of all the assets of the UCITS fund and that both fund managers and investors have a single point of reference in the event that problems occur, the Directive also requires the appointment of a single depositary responsible for the full oversight of the assets of the UCITS fund. This is already standard practice in the UK so will not impact on existing business models.

It is worth stressing that all depositaries currently authorised by the FCA and the PRA will retain their permissions. The FCA are responsible for implementing this aspect of the Directive and do not intend to restrict the existing population of firms who can act as depositaries and implementing UCITS V will allow non-bank depositaries (i.e. firms authorised as depositaries which are not credit institutions) to continue providing their services.

2. Delegation of custody

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). The aim of these measures is to align conditions of duties delegated to a sub-custodian across UCITS and AIFMD because this ensures a consistent approach across fund types and ensures clarity for investors surrounding delegation rules no matter the activities of the fund. The aim of these measures is to safeguard against improper use of the fund's assets, strengthening investor protection. The European Commission's UCITS V impact assessment concludes that the delegation of custody should be governed by rules on diligence in selecting and appointing a sub-custodian, and on the ongoing monitoring of the sub-custodian. The intended effect of this is to ensure good practice oversight and therefore strengthen investor protection.

3. Liability

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. UCITS V seeks to introduce a harmonised liability standard that obligates depositaries to return instruments lost in custody irrespective of fault or negligence. This will ensure a high level of investor protection and help achieve a uniform standard across the EU. Again, achieving a uniform standard across the EU will help to further enhance UCITS funds reputation globally. Unlike the AIFMD, UCITS V does not allow depositaries to transfer liability for losses to a delegate in any circumstances.

The majority of implementation duties for the Depositary provisions will fall to the FCA, as outlined above. HM Treasury has transposed the remaining provisions in its statutory instrument, including relevant updates to FSMA and secondary legislation, where necessary.

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. The proposed requirements in the UCITS Remuneration Code are broadly similar to those in the AIFMD Remuneration Code because of the similarities of the risks and the incentives in the two sectors. In general, implementing the remuneration principles under UCITS V will therefore standardise the approach to remuneration across industry.

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, and will not conflict with the management company's duty to act in the best interest of the fund. The aim is to minimise incentives for fund managers to take excessive levels of risk as this can have a negative impact on investors (i.e. financial losses) and cause wider concerns such as financial destabilisation. It could also negatively impact the reputation of the UCITS brand, and therefore have the wider effect of restricting industry growth;

- include the fixed and variable components of salaries and discretionary pension benefits. The intended effect of this is to ensure complete transparency surrounding remuneration policies, which is important because investors should understand their investment manager's performance incentives;

- align with the business strategy, objectives and values of the management company, the UCITS under management and the investors in such UCITS, and will seek to avoid conflicts of interest; and

- 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. Again, this aims to ensure full transparency of the companies' practices to investors.

The remuneration provisions in UCITS V apply to:

- senior management;
- risk taking roles;
- 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 profile of the management company or the UCITS that they manage.

UCITS V requires UCITS management companies to comply with a detailed list of principles when establishing and maintaining their remuneration policies and practices. In particular, UCITS management companies must:

- balance fixed and variable remuneration components appropriately and ensure that they have the option of paying no variable remuneration;
- only pay guaranteed variable remuneration in the first year following a new hire and even then only in exceptional circumstances;
- use both non-financial and financial criteria to assess performance in the context of a multiyear framework with an adjustment mechanism capable of integrating all types of current and future risks;
- only pay variable remuneration if it is sustainable according to the UCITS Manager's financial situation as a whole. It must be considerably contracted where either the UCITS Manager or the UCITS concerned performs badly;
- defer between 40 – 60% of variable remuneration over a three to five year period, subject to the over-riding requirements that the deferral period is: (1) appropriate in view of the holding period recommended to the UCITS' investors, and (2) correctly aligned with the nature of the risk of the UCITS in question;
- pay a substantial portion (of at least 50%) of the variable remuneration component in non-cash instruments such as units of the UCITS concerned, equivalent ownership instruments or other instruments with equally effective incentives. Where the management of UCITS accounts for less than 50% of the total portfolio managed by the UCITS Manager the 50% minimum does not apply, but the obligation to pay a substantial portion of variable remuneration in non-cash instruments remains. However, this is subject to the UCITS legal structure, its fund rules or instruments of incorporation;
- link early termination payments to performance; and
- hold discretionary pension benefits in non-cash instruments for five years if a staff member leaves before retirement. Following retirement, UCITS Managers must also pay discretionary benefits in the form of non-cash instruments which must be subject to a five year retention period.

The above provisions are to be implemented by the FCA through amendments to their rules.

Similarly to other EU legislation, the UCITS Directive allows a proportionate approach in the application of the remuneration principles. The Directive states that management companies shall comply with the remuneration principles *'in a way and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities'*. (Please see Article 14b(1) of the UCITS Directive).

The principle of proportionality is a cornerstone of the UCITS Directive. Proportionality ensures a consistent application of the underlying principles that govern remuneration, allowing for the alignment between long-term risk and individual reward. This ensures a close correlation of a firm's remuneration policies and practices with its prudential and conduct risk profile. Pursuant to the proportionality principle, UCITS Managers need only comply with the principles in a way and to an extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities.

Given the similar wording on proportionality in the UCITS Directive, the AIFMD and other EU legislation, the FCA consider it appropriate to take the same approach for management companies of UCITS. The FCA are proposing specific guidance allowing the disapplication of certain remuneration principles when the remuneration paid to a member of the UCITS Remuneration Code staff falls below certain minimum thresholds. This proposal will reduce any unnecessary burden on smaller-size firms across industry.

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.

This sanction regime applies to a catalogue of breaches of the main investor protection safeguards in the UCITS Directive. Key incidents that lead to penalties being incurred will arise when:

- the activities of UCITS are pursued without authorisation;
- the business of a management or investment company is carried out without authorisation, or where authorisation has been obtained through false statements;
- a qualifying holding in a management company exceeds or falls below certain thresholds without notifying the competent authority;
- failing to notify the competent authority at least annually of the names of shareholders and members possessing qualifying holdings and the size of these holdings;
- failing to comply with structural, organisational and procedural arrangements imposed by UCITS V;
- failing to comply with requirements related to delegation of a management or investment company's functions to third parties;
- failing to employ a risk management process; or
- failing to disclose relevant information to investors as required by UCITS V.

For those individuals who breach the rules, the administrative sanctions will include:

- a permanent or temporary ban from fund management;
- suspension of authorisation;
- a fine of up to EUR 5 million; and
- additionally, companies could be fined 10% of their annual turnover or alternatively at least twice the amount of the benefit gained from the infringement, where this is determinable.

All UCITS firms and depositaries authorised in the UK will already be subject to the minimum sanctions imposed by UCITS V, because the sanctions listed above replicate sanctions that are already available to the FCA, as provided for by existing UK legislation under FSMA, which are enforced through FCA rules. Indeed the sanctions powers presently available to the FCA for breaches of the UCITS Directive go beyond those minimum sanctions set out in UCITS V, so HM Treasury does not need to specifically implement the UCITS V sanctions in its regulations. It is therefore expected that sanctions under UCITS V will have minimal impact on industry. Any effects of imposing these sanctions are unlikely to be felt by UK firms unless they are breaking the law, in which case it is right to be held accountable for improper conduct and/or practices. However, it is still important at an EU level to bring the UCITS Directive sanctions into line with other existing legislative sanctions, as it promotes the strength of the UCITS brand, ensures investor protection is uniform across industry, and will bring into line any Member States who do not currently have strict sanction regimes.

The UK's approach to implementing the UCITS V Directive

In terms of division of implementation duties, HM Treasury is responsible for the parts of the UCITS V Directive that are more structural in nature. HM Treasury's statutory instrument contains provisions to transpose the directive requirements as to depositary liability for loss of financial instruments, obligations on the FCA as regards sharing of information and reporting of infringements, publication of penalties for contravention of the directive and certain miscellaneous provisions. HM Treasury has also developed requirements relating to protection of UCITS assets in the case of depositary insolvency. Where applicable, the statutory instrument updates FSMA and relevant secondary legislation to put into effect the directive requirements alongside the existing domestic framework.

Where possible HM Treasury has sought to minimise the impact on industry while implementing the Directive in full.

The FCA is responsible for implementing the majority of the rules that directly impact consumers and industry. This includes the parts of the Directive that are more technical in nature and which require changes or additions to FCA rules, including:

- the general obligations applicable to the depositary;
- the duties of the depositary in dealing with potential conflicts of interest;
- the obligation of the management company to appoint a single depositary;
- the eligibility criteria to act as a depositary, for firms that are neither national central banks nor credit institutions;
- the cash monitoring, safekeeping and oversight functions of the depositary;
- delegation of the safekeeping function;
- reuse of the assets of the UCITS by the depositary;
- remuneration requirements applicable to the management company;
- disclosure requirements (changes in the information to be included in the prospectus, annual report and Key Investor Information Document (KIID)); and
- whistleblowing requirements applicable to the depositary and the management company.

In their consultation, published on 3 September 2015, the FCA proposed transposing the requirements in an 'intelligent copy-out approach' by adhering to the wording of the UCITS V Directive as closely as possible when drafting the relevant provisions in the FCA handbook. The FCA are not, as far as possible, going beyond the requirements of the directive or 'gold-plating'. This is consistent with the approach taken when transposing the AIFMD. Please see the relevant sections of this impact assessment for a discussion of implementation approaches for the depositary, remuneration and national sanction regime provisions.

Where a management company has been appointed before 18 March 2016 to act as a depositary that would not meet the new UCITS V requirements, the UCITS V Directive permits these companies to retain their depository services until 18 March 2018. The FCA will transpose this transitional provision into their rules. The FCA has also proposed to allow for an additional transition period that will allow firms to comply with the remuneration requirements starting from the first full performance period commencing after 18 March 2016. There will also be a transitional period for management companies to comply with some of the disclosure requirements and for depositaries to comply with the proposed new capital resources requirements. This has the aim of easing the implementation process for industry.

Under the UCITS V Directive, the European Commission is empowered to adopt delegated acts (commonly referred to as the 'Level 2' measures), which will set out most of the detailed requirements that fund management firms and depositaries will need to comply with. When previously writing the consultation paper and the consultation stage impact assessment, the Level 2 measures had not been set. HM Treasury took the decision to publish the consultation without the Level 2 measures because at the time there was no indication of when the measures would be set, and it was unlikely that the Level 2 measures would have an impact on those aspects of the Directive being implemented by HM Treasury. By waiting for the Level 2 measures to be set before going to consultation, HM Treasury would have run the risk of not being able to implement the Directive by the deadline of 18 March 2016.

The Level 2 measures (Commission Delegated Regulation (EU) 2016/438 of 17 December 2015 supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries) was adopted on 17 December 2015 and published in the Official Journal of the European Union on 24 March 2016. It enters into force on 13 April 2016 and applies from 13 October 2016. The Level 2 measure under UCITS V sets out the independence requirements between the management company and the depositary, as well as the steps to be taken by any third-party delegated custodian to protect the assets of the UCITS in case of insolvency. The level 2 measures also cover most of the operational requirements applicable to depositaries, in particular, details of:

- what should be covered in the contract between the management company and the depositary;
- safekeeping, oversight and cash monitoring requirements;
- liability for losses of financial instruments and of the cases in which such liability could be discharged; and
- due diligence requirements applicable to depositaries and of the segregation requirements when the safekeeping function has been delegated.

As the Level 2 measures were adopted on 17 December 2015, HM Treasury has been seeking views on their impact since closing the consultation. Where HM Treasury has received relevant information on the impact of the Level 2 measures, it has been included in the below Cost/Benefit Analysis of this Impact Assessment.

It is worth noting that the FCA leads on the implementation of the Level 2 delegated regulations. Therefore, the FCA will be consulting further on their approach to implementing the provisions for the UCITS V Level 2 delegated regulations.

Results of the Consultation

HM Treasury published a consultation on the transposition of UCITS V on 23 October 2015. The consultation ran for 8 weeks and closed on 17 December 2015. The consultation included the draft statutory instrument and pre-consultation stage Impact Assessment. Stakeholders were asked to provide responses to questions on the approach to HM Treasury's implementation of the directive in the draft statutory instrument, as well as the overall costs to industry that are likely to be incurred by complying with the directive as a whole.

HM Treasury received four responses to the consultation, including from stakeholder bodies representing investment managers, alternative investment managers and depositaries/trustees. Three of the four responses were directly responding to the consultation document published by HM Treasury. The fourth response provided HM Treasury with a copy of the issues raised to the FCA in a response to their consultation on UCITS V implementation. This response dealt only with remuneration policy, which does not fall under HM Treasury's implementation duties.

In summary, the three responses directly relating to HM Treasury's consultation document agreed with HM Treasury's 'copy-out' approach to implementation. The responses agreed with HM Treasury's proposals regarding the transposition of the directive, and with the draft statutory instrument. One respondent agreed with the 'copy out' approach, but stipulated that it could not comment further on those points that would be covered in the Level 2 measures. However, this respondent agreed with the provisions within the draft statutory instrument. Another stakeholder agreed with the 'copy out' approach, stating that it fell into line with the government's Investment Management Strategy paper (paragraph

4.6), which states '*a copy out approach will be adopted wherever possible to implementing European Union legislation in order to simplify the regulatory approach for firms, with any gold plating supported by strong justification*'. This stakeholder also agreed that the draft statutory instrument would correctly implement all of the Directive requirements, and that it agreed with HM Treasury's overall approach to implementing the directive. The third stakeholder agreed with HM Treasury's 'copy out' approach, specifically with regard to the provisions for depositary liability, and stated that the provisions for distributions of assets upon insolvency do not require substantial changes to the law. This response also agreed with HM Treasury's approach to implementing the provisions relating to national sanction regimes, stating that sanctions laid out under existing legislation already go beyond the level of sanctions laid out under UCITS V. Further consideration of the responses to specific consultation questions are considered in the relevant sections of the below cost/benefit analysis.

Introduction to the Benefits of implementing UCITS V

The most significant benefit of UCITS V is to investors. UCITS V is expected to deliver major improvements to safeguarding financial stability and enhancing consumer protection. Both investors and industry have generally welcomed these reforms and the new protections they offer. The benefits of the Directive are difficult to quantify because the scale of the benefits depends on the extent to which risks to proper conduct with regard to investments and, potentially, financial stability risks, are adequately reduced.

In addition, as the Directive introduces important improvements to investor protection and measures to decrease risk associated with fund operations, it is foreseen that UCITS V will enhance the reputation of the UCITS framework, which could in turn increase investment in UCITS.

It is not possible to quantify the extent of the overall benefit that UCITS V will bring to the UCITS fund industry. While HM Treasury expects the increase in investor protection will further strengthen UCITS as a global brand, it is not possible to estimate a figure because it is not a clear-cut, quantifiable benefit; it is instead an indirect benefit of implementing the directive.

Introduction to the Costs of implementing UCITS V

UCITS V will apply to a well-defined group of fund management firms, depositaries, and UCITS funds, operating under the existing UCITS regime, including:

- Approximately 150 firms with a Part 4A permission under FSMA for 'managing a UCITS';
- 11 firms with a Part 4A permission under FSMA for 'acting as a depositary of a UCITS';
- Approx. 1300 UCITS schemes authorised in the UK (this number includes both umbrella and sub-funds).

UCITS funds and depositaries will inevitably incur some costs in order to meet the new requirements imposed by the measures that implement the UCITS V Directive. The Present Value best estimate headline figure for implementing the directive as indicated in this impact assessment is £48,360,000. The majority of this cost will fall to the depositaries industry, as further detailed in the cost/benefit analysis below. To put into context this figure, it is worth taking into account that recent figures indicating the total size of the UK depositaries industry stands at £970,900,008,956, with depositary holdings in UCITS funds comprising £798,740,852,422 (December 2015 figures, funds under management, £ sterling).

Prior to publishing the consultation, HM Treasury considered as best as possible a forecast of the costs and benefits to industry, which were included in the consultation stage impact assessment. During the consultation, HM Treasury requested information from depositaries and UCITS management companies on the changes firms will need to make in order to fully comply with depositary provisions laid out under UCITS V, and how much these changes will cost (including familiarisation costs). HM Treasury envisaged that a number of these would be one-off administrative costs borne by UCITS funds or depositaries when implementing the changes to UCITS regulations. HM Treasury also sought information on the cost of structural changes to fund operations and ongoing governance costs to UCITS funds and/or fund depositaries. These initial forecasts, as well as the further evidence gathered from industry during the consultation, are considered in the cost/benefit analysis below.

Cost/Benefit analysis

Depositaries

Costs

As set out above, firms in the UK already appoint a single depositary and rules on eligibility are already enforced by the FCA.

Types of costs to depositaries

Practical implications of UCITS V provisions for depositaries are expected to be as follows:

- depositary agreements which are currently in place in respect of UCITS Open-Ended Investment Companies (OEICs) are likely to need to be re-papered. As with AIFMD, the depositary community will prepare new template agreements for negotiation;
- UCITS unit trusts may need a depositary agreement for the first time and the existing trust deed is likely to require amendment to give the power for such an agreement to be entered into; and
- the disclosure requirements to investors in the fund prospectus will also need to be updated to reflect the new depositary regime.

In consideration of the above implications, costs to UK depositaries may be incurred where they are required to change their operational or administrative practices in order to comply with the UCITS V Directive. This may include:

- changes to ensure harmonisation of the depositaries' duties. This includes keeping the assets of the UCITS safe, monitoring cash movements to and from the fund, and segregation requirements for assets that are held in custody. This may incur legal and compliance costs;
- depositary contract agreements which are currently in place in respect of UCITS OEICs are likely to need to be refreshed. While it is common to have contracts in place, it is not currently an absolute requirement in the UK and so setting up contractual agreements will incur costs. However, even where there are contracts in place, these will have to be reviewed and updated to meet all the detailed requirements in the UCITS V Regulation. While depositaries should be able to leverage off work carried out for AIFMD, it will still incur costs. The depositary community will prepare new template agreements for negotiation, resulting in administrative costs to depositaries;
- UCITS unit trusts will need a depositary agreement and the existing trust deed may require amendment to give the power for such an agreement to be entered into. This may result in legal and compliance costs;
- when delegating to a sub-custodian, the depositary must continually monitor the actions of the sub-custodian. This may incur ongoing administrative costs;
- the disclosure in the prospectus will also need to be updated to reflect the new depositary regime. This is likely to incur a one-off administrative cost; and
- any familiarisation costs incurred by complying with the UCITS V Directive.

It is worth noting that 10 of the 11 registered depositaries in the UK also operate as depositaries for AIFs. By complying with rules for depositaries under AIFMD, these depositaries are already complying with requirements which are broadly comparable with the rules laid out in UCITS V (or they are at least familiar with the requirements), which should ease implementation.

Where provisions laid out under UCITS V diverge from AIFMD, there may be additional costs for depositaries which are derived from:

- the new limitations on the reuse of assets of the UCITS;
- the ban on the depositary from transferring the liability for losses of financial instruments held in custody (which is allowed in limited circumstances under the AIFMD); and
- the independence and delegation requirements which will be set out in the UCITS V Level 2 measures.

These are costs which the depositary may be able to recoup from higher fee charges to the UCITS fund or the management company.

HM Treasury presented this list of predicted costs to industry in the consultation paper. Responses to the consultation agreed with the types of costs that HM Treasury predicted depositaries would incur. One stakeholder body did not foresee any further type of cost that may be incurred through complying with the depositary provisions. Another stakeholder agreed that all of the potential costs indicated in the consultation would be relevant, but identified two additional costs; those which will be incurred by UCITS managers who are not already Alternative Investment Fund Managers (AIFMs) as changes will be required to their operating models, and costs that will be incurred in keeping abreast of changes to insolvency law in the various jurisdictions in which they hold investments in custody. In view of these points, an update to the scale of these costs is further discussed below.

Scale of costs to depositaries

Generally, industry have raised the issue that it was difficult to produce detailed cost predictions during the consultation period because the Level 2 delegated legislation in the UCITS V Directive (particularly concerning the depositary requirements) had not been produced at the European level. Industry have therefore found it difficult to predict the costs as they do not know the full extent of the measures with which they need to comply. Since the level 2 was adopted on 17 December 2015, HM Treasury has sought further input on the projected costs. Having now considered the level 2 measures, two of the stakeholders that responded to the consultation have confirmed they will not provide detailed cost estimates for this impact assessment.

As a pre-consultation stage estimate, HM Treasury were informed that based on initial and broad estimates for one UK depositary, the costs could be positioned as £3.55 to £3.87 million total cost for that depositary. However this cost estimate was only a one-off implementation total for one depositary and so is not applicable across all UK depositaries. The estimate was based on the depositary's response to the UCITS V Level 1 requirements (including legal costs). Within this, the most notable costs are likely to be incurred when ensuring compliance with asset segregation and chain of custody obligations, as well as the repapering of contracts, further discussed below. While this cost is not indicative of costs to all 11 UK Depositaries, HM Treasury included it as an estimate in the consultation stage Impact Assessment because gave a sense of the scale of costs.

Using this forecast of £3.55 to £3.87 million, the high estimate could be calculated as £3.87 million multiplied by 11 (total number of depositaries), totalling £42.57 million. This figure shall be included in the 'high' estimated total cost on the summary page of this impact assessment. For the low estimate for costs incurred to depositaries, this can be calculated as £3.55 million multiplied by 11, totalling £39.05 million. This figure will be used in calculating the 'low' estimated total cost on the summary page of this impact assessment. The best estimate for total costs to the depositary industry given on the summary pages are calculated from the estimated figure of £3.71 million (the midpoint of the range £3.55-£3.87 million), multiplied by 11 (the total number of UK depositaries), totalling £40.81 million. This figure will be used in calculating the 'best' estimated total cost on the summary page of this impact assessment.

In terms of the scale of costs incurred by depositaries, only one of the four responses referred to the pre-consultation stage scale of costs forecasted by HM Treasury (totalling £40,860,000). As mentioned above, this response – a depositaries stakeholder - agreed with the types of costs that would be incurred, but identified two additional types of costs; namely those costs which will be incurred by UCITS managers who are not already AIFMs, as well as those incurred by keeping abreast of changes to insolvency law. It was also suggested that for each of the 11 depositaries operating in the UK, the costs would vary depending on the depositary's operational model. For any depositary of a UCITS fund that is not a depositary of AIFs (only projected to be 1 of the 11 depositaries operating in the UK) the response noted that costs may be higher if that particular depositary's operational model is not familiar with the similar requirements laid out under the AIFMD. As previously considered, no depositary is expected to cease operations due to the provisions laid out under UCITS V. No depositary has contacted HM Treasury in response to the consultation in order to express such concerns due to excessive costs. This response did not give an indication of what a more accurate cost forecast might be (either on the level of an individual depositary or for the total industry), noting that cost forecasts were difficult to quantify before the level 2 delegated acts were published. HM Treasury has not received any further information regarding scale of costs following a subsequent request for information since the level 2 measures were published on 17 December 2015.

In terms of further analysis conducted since the consultation period, HM Treasury expects a significant cost regarding the depositaries provisions to be comprised of the cost associated with renegotiating and repapering contracts between depositaries and the UCITS management firms. In terms of repapering contracts, to date industry has not provided any estimate of the number of accounts likely to be affected or the total number of accounts held or the total cost forecast of repapering contracts, as this is likely to be sensitive information. It may be the case that once the depositary or management firm has established contractual precedent, costs will be reduced as the framework for papering contracts will be in place. While no cost forecast was indicated by industry, HM Treasury can estimate the costs associated when repapering contracts. It can be forecast that the cost of city lawyers is likely to be in the range of £200-£1000 per hour plus VAT. An approximate minimum estimated timeframe for the renegotiation and repapering of a contract would be 10 billable hours, with extremely complex cases reasonably taking up to 30 billable hours. For the below calculations, VAT has not been included in the final sum because firms can expense the VAT if the legal advice is provided for the activities of the business.

The high estimated total cost can be calculated as £1000 per hour (plus VAT) (for the high end prediction for legal fees) multiplied by 30 (the high end prediction for billable hours), totalling £30,000. For the depositary industry (total no. of depositaries being 11), this would amount to a total of £330,000 (plus VAT). This figure will be included when calculating the ‘high’ estimated total cost to industry in the summary page of this impact assessment.

The low estimated total cost can be calculated as £200 per hour (plus VAT) (for low end prediction for legal fees) multiplied by 10 (the low end prediction for billable hours), totalling £2,000. For the depositary industry (total of 11), this would amount to £22,000 (plus VAT). This figure will be included when calculating the ‘low’ estimated total cost to industry in the summary page of this impact assessment.

For the best estimate, taking the midpoint of £600 per hour plus VAT, and the midpoint of 20 billable hours, it might cost a management company an estimated £12,000 plus VAT to re-establish a contractual agreement with the depositary in order to comply with the UCITS V requirements. For the depositary industry (of which there are 11 operating at present in the UK) this might approximately total £132,000 (11 x £12,000). However, in terms of overall scale, it is not possible to provide a cost-forecast involving the total number of contracts, as HM Treasury has no knowledge of the total number of contracts in operation, and has not received information on this from industry.

The total cost of repapering contracts for the UCITS fund management industry would be higher due to the number of UCITS management firms. For management firms, of which there are approximately 150 operating in the UK, the high estimated figure would be 150 x £30,000 (30 hours x £1,000 high estimate for hourly fee), totalling £4,500,000. The low estimate would be 150 x £2,000 (10 hours x £200 low estimate for hourly fee), totalling £300,000. The best estimate can be calculated by again taking the midpoint of this estimated figure of 150 x £12,000 (20 hours x £600 midpoint for hourly fee), totalling £1,800,000. These high, low, and best estimates have been used to update the headline figures included on page 3 of this impact assessment, with the best estimate for depositary provision costs totalling £42,742,000. The pre-consultation best total estimated cost was £40,860,000.

It is worth noting that these costs are expected to be projected one-off compliance costs to establish a precedent for contracts, and that once depositaries and management firms have in place the framework to comply with the UCITS V provisions, annual costs are expected to be significantly lower in comparison. Industry have not provided a sense of the types of ongoing annual costs, or the scale of the ongoing annual costs. However, HM Treasury expects that ongoing administrative costs will be incurred when establishing contracts with new clients, estimates for the scale of these costs can be taken from the above forecasts for repapering contracts. However, because it is again not possible to predict how many new clients, and therefore how many new contracts will be needed annually, it is not possible to predict the scale of such annual ongoing costs.

For further information on costs related to depositaries it is also worth considering Annex 1 of the FCA's Consultation Paper CP15/27: *UCITS V implementation and other changes to the Handbook affecting investment funds* for further information.

Benefits

The UCITS V intends to enhance those safeguards that are already embedded in the UCITS framework. It introduces uniform rules on the current tasks of the depositary, on the conditions and diligence to be applied when delegating these tasks to third parties and on the liability of depositaries. These have the potential to boost investment and increase confidence in the UCITS brand, especially where UCITS are sold across borders. Currently, Member States apply different standards on depositaries, which means that consumers benefit from different levels of protection depending on in which country they have invested.

Harmonising these rules will benefit retail investors by reducing uncertainty and ensuring they can continue to trust UCITS, whether marketed across borders or not. The same holds for rules on remuneration and sanctions. Moreover, enhanced provisions on the delegation of tasks by depositaries, their due diligence, and their liability will provide for greater confidence in UCITS that invest in emerging markets in particular. This could ultimately widen the breadth of investment opportunities for retail investors.

The new rules on depositaries' duties will achieve safeguards against fraud and improper conduct, and are introduced through a series of measures, including:

- specifying that a single depositary should be used for each UCITS fund. This is already standard practice in the UK, but the requirements under UCITS V will improve standardisation across the EU. Appointing a single depositary will ensure that the depositary has an overview of all of the UCITS fund assets and both fund managers and investors will have a single point of reference in the event that problems occur in relation to the safekeeping of assets or the performance of oversight functions. Although already a requirement for UK depositaries, this measure will enhance investor protection and transparency for investors across the EU. The requirement to appoint a single depositary is also already required by AIFMD, and so this further brings into line requirements for depositaries across the industry;
- specifying that the appointment of a depositary shall be evidenced by a written contract, including a uniform list of oversight duties established in contractual form. The benefit of this standardisation will be to ensure a harmonised approach to the depositaries' duties in all Member States irrespective of the legal form of the UCITS. This will guarantee an appropriate level of regulation and ongoing control over depositary practices and conduct, therefore improving investor protection;
- specifying that depositaries should have oversight of and ability to monitor all assets, cash included. This is to prevent against fraudulent cash transfers;
- segregation requirements will also require any financial instruments of a UCITS fund held on the depositary's book to be at all times distinguishable from the depositary's own assets. Separating the depositaries own assets from the UCITS fund assets, and requiring Member States to ensure that assets of the UCITS are not available to a depositary's creditors upon insolvency, will provide an additional layer of protection for investors should the depositary default.

As already discussed, at present there are 11 depositaries in the UK, and due to the similarities in the depositary requirements laid out under AIFMD, many of these depositaries will be familiar with the provisions proposed and may already have procedures and operational arrangements in place that will make it easier to comply with the above UCITS V depositary provisions.

Laying these rules under UCITS V will have the wider benefit of bringing into line the UCITS Directive with other legislation such as AIFMD, and will improve investor protection in those Member States who do not currently have strict rules for depositaries. Laying out these rules under UCITS V will also have the benefit of ensuring that fringe companies cannot act questionably or engage in improper practice or conduct.

It is worth noting that Annex 1 of the FCA's Consultation Paper CP15/27: *UCITS V implementation and other changes to the Handbook affecting investment funds* also considers the benefits of implementing the depositary provisions.

<u>Remuneration.</u>

Costs

Practical implications of implementing the remuneration provisions under UCITS V Directive include the following:

- firms will need to carry out a gap analysis against the remuneration policies they have in place currently under existing regulatory requirements (AIFMD for example) to see what changes need to be made. In many cases management companies do not actually have any direct employees so it is potentially unclear how these rules will apply;
- to the extent that any staff member is to receive remuneration by way of units in the UCITS, firms will need to consider if a new share class will need to be issued and what the terms of that share class should be. It is clear that staff will not be able to vote on any shareholder resolutions, however, as they will be associated with the manager; and
- prospectuses, KIIDs and annual reports will need to be amended to include details of the approach to remuneration.

Responsibility for implementing the remuneration provisions under UCITS V falls to the FCA, who will be taking an 'intelligent copy-out' approach, whereby they will seek to not go further than the minimum requirements laid out in the Directive, where possible.

In consideration of the above implications, costs to UK firms may be incurred through the obligation to assess existing remuneration policies and structures against the requirements of UCITS V. Firms will need to establish changes needed to remuneration structures to ensure they are in line with the principles outlined in UCITS V. This may incur some operational costs. For example, to the extent that any staff member is to receive remuneration by way of units in the UCITS, firms will need to consider if a new share class will need to be issued and what the terms of that share class should be. Prospectuses, KIIDs and annual reports may need to be amended to include details of the approach to remuneration.

HM Treasury consulted on the monetised administrative and operational costs, including familiarisation costs, which may be incurred by the implementation of remuneration provisions under UCITS V. Two of the four responses to the consultation referenced HM Treasury's cost forecasts and agreed with the types of costs that HM Treasury forecast. One of these also forecasted that firms would have to undertake a new proportionality assessment. Two of the responses did not refer to the types of costs at all. None of the responses provided estimations of the costs that would be incurred through operational, familiarisation, or administrative costs.

Prior to publishing the consultation, HM Treasury produced initial estimates of the implementation costs for remuneration provisions by broadly reading across costs incurred due to compliance with the AIFMD. Costs were estimated in this manner because many investment management companies already have in place structures that broadly comply with the UCITS V provisions, however, for those who do not comply, the FCA forecast that costs incurred under UCITS V will be broadly comparable to remuneration costs incurred under AIFMD. None of the responses to the consultation cast doubt on this approach, and so HM Treasury believes it is still appropriate to use these figures as a method of cost estimation.

Therefore to estimate the costs incurred by implementing the remuneration rules, we believe we can broadly read across costs stated by the (then) Financial Services Authority for the implementation of remuneration provisions under AIFMD (see table 1). The range of figures quoted for the remuneration provisions under AIFMD in table 1 represent the highest and lowest costs cited by investment management companies during the consultation process.

Table 1. UCITS V estimated costs for investment managers based on the application of remuneration rules under AIFMD (source: http://www.fsa.gov.uk/static/pubs/cp/cp12-32.pdf).

Costs	**Incremental Costs**					
	One-Off range	**One off** high	**One off** low	**Ongoing (annual)** range	**Ongoing (annual)** high	**Ongoing (annual)** low
For changing: • The way remuneration policies are set; • Systems and controls; • Additional data collection; • General familiarisation costs; • Reporting; and • Record keeping requirements.	£0-£300,000	£300,000	£0	£0-£50,000	£50,000	£0
Issuing an annual remuneration statement	£0-£100,000	£100,000	£0	£0-£30,000	£30,000	£0
Senior Management Board or committee time	NA	NA	NA	£0-£24,000	£24,000	£0
Enhanced risk management function	NA	NA	NA	£0-£31,000	£31,000	£0
Adjusting remuneration structures	£0-£47,000	£47,000	£0	£0-£50,000	£50,000	£0
Total of costs per firm		£447,000	£0		£185,000	£0
Total for industry (x 150 firms)		£67,050,000	£0		£27,750,000	£0

The high estimates for the costs to industry of complying with the remuneration provisions (both one-off and ongoing cost estimates), are indicated as such for the purposes of providing a total ‘high’ estimate on the summary pages of this impact assessment. However, HM Treasury does not consider that the totals of £67,050,000 (transitional one-off) and £27,750,000 (ongoing annual cost per year) high estimates for compliance with the remuneration provisions will be incurred by industry in practice. This is because the total cost estimates above are only indicative of overall costs to industry if **all** UK firms (c.150) have insufficient or no remuneration principles in place. However, the majority of firms will already comply with remuneration principles laid out in the FCA handbook or those provided by the Capital Requirements Directive, or the AIFMD. HM Treasury therefore considers it likely that firms will be broadly familiar with the remuneration requirements laid out under UCITS V. Therefore, the total cost estimate stated above is likely to be higher than the costs actually incurred by industry. No stakeholder questioned or disagreed with the scale of the costs associated with remuneration provision compliance. HM Treasury did not receive any further cost estimates from industry during or after the consultation. Along with the high and low estimates, the best estimate for the remuneration provisions was calculated from the AIFMD impact assessment. As there was no disagreement with these cost estimates, HM Treasury still predicts as a best estimate the costs for implementing the remuneration provisions laid out under UCITS V would be in line with those presented in the consultation stage impact assessment. These were calculated by totalling the expected average costs on each cost-type from the AIFMD impact assessment, multiplied by 150 firms:

Costs	One-Off	Ongoing (per year)
Total cost to industry (no. of investment management companies [c.150] x averages of remuneration costs under AIFMD)	£1,050,000	£600,000

The one-off cost forecast and annual ongoing cost figures (high, low, and best estimates), as stated above, have been included when calculating the headline figures of this impact assessment. It is also worth considering Annex 1 of the FCA's Consultation Paper CP15/27: *UCITS V implementation and other changes to the Handbook affecting investment funds* for further cost/benefit analysis on the remuneration provisions.

In terms of the wider impact of the remuneration provisions, HM Treasury is not expecting these costs to impact on other businesses. HM Treasury also does not expect there to be any other additional costs associated with changes to remuneration policies.

Benefits

The requirement for UCITS management companies to have remuneration policies that comply with certain remuneration principles and cover their key staff (those whose professional activities have a material impact on the risk profile of the UCITS), will both promote effective risk management, and will have the benefit of increasing transparency for investors.

National Sanction Regimes.

Costs

Under the FSMA, the FCA already has the power to impose an unlimited fine on any authorised person that they consider has contravened a relevant requirement imposed on them (including a requirement under FSMA, FCA rules or any directly applicable EU provision – this will include contraventions of UCITS directive provisions as transposed by HM Treasury or FCA in legislation or rules). The ability to impose an unlimited fine will remain applicable to those managing a UCITS or acting as a depositary of a UCITS who contravene relevant requirements, including those who undertake controlled (key) functions for those entities. Equally the other administrative sanctions imposed by the regulation, namely public statements, orders requiring the person responsible to cease particular conduct, suspension or withdrawal of authorisation, and temporary or permanent bans, are already available to the FCA under existing domestic powers in FSMA and are enforced through FCA rules. Therefore, the minimum sanctions measures under UCITS V will not impact firms and depositaries in the UK beyond existing UK requirements. HM Treasury received no indication of costs from industry during the consultation period.

Benefits

UCITS V defines a common approach to, and a clear list of, the main breaches of the UCITS Directive. It also lays out the administrative sanctions and measures that Member State competent authorities should be empowered to apply in respect of the main breaches. So, although we do not expect changes to impact UK firms, this common approach towards breaches of the UCITS Directive will ensure consistency across EU UCITS funds and will overall be beneficial to the reputation of UCITS. It will have the benefit of bringing into line those Member States who do not currently have strict sanction regimes enforced in their own legislation. This will ensure standardisation across the EU. It is important to ensure the standardisation of sanction regimes so that no Member State can be unduly lenient towards companies that act with improper conduct or practice, as this would negatively impact investor protection and in turn the overall reputation of the UCITS brand.

Total figures of costs incurred by compliance with UCITS V Directive

	One-off transitional costs			**Ongoing costs per year**		
	Low	High	Best	Low	High	Best
Depositaries Provisions	£39,372,000	£47,400,000	£42,742,000	Not given	Not given	Not given
Remuneration Provisions	£0	£67,050,000	£1,050,000	£0	£27,750,000	£600,000
Total of compliance costs for year	£39,372,000	£114,450,000	£43,792,000	£0	N/A	N/A

1 (transitional costs)						
Nominal total for 9 years subsequent to transitional 1st year (ongoing costs)				£0	£249,750,000	£5,400,000

HM Treasury's high estimate for total transitional costs for year 1 is £114,450,000, with ongoing annual high estimate of £249,750,000 for subsequent 4 years. Therefore across 10 years the nominal total highest estimated cost of the Directive is: £114,450,000 + £249,750,000 = £364,200,000. **The total Present Value high estimate cost is £325,560,000.**

HM Treasury's low estimate for total transitional costs for year 1 is £39,372,000, with ongoing annual low estimate of £0 for subsequent 9 years. Therefore across 10 years the total lowest estimated cost of the Directive to industry is: £39,372,000 + £0 = £39,372,000. **The total Present Value low estimate cost remains at £39,372,000.**

HM Treasury's best estimate for total transitional costs for year 1 is £43,792,000, with ongoing annual best estimate of £2,400,000 for subsequent 9 years. Therefore across 9 years the nominal total best estimated cost of the Directive to industry is: £43,792,000 + £5,400,000 = £49,192,000. **The total Present Value best estimate is £48,360,000.**

These figures have been calculated using the impact assessment calculator with a price base year of 2016 and an appraisal period of 10 years.

<u>Conclusion of Cost/Benefit Analysis</u>

Offsetting the cost of implementing the UCITS V Directive against the overall benefits of securing a more stable UCITS fund market, and therefore overall improvement of UCITS funds' reputation as a highly attractive global brand, is difficult to quantify. The UK asset management industry has over £6.8 trillion in assets under management, many of which are UCITS funds. With only four responses to the consultation in total, HM Treasury is not expecting this Directive to be contentious, and no stakeholder has indicated that they will experience a level of implementation costs such that it becomes problematic to their business. While a best estimate is given in this impact assessment, stakeholder responses to the consultation have indicated that they will not be providing an estimated breakdown of costs that they will incur due to compliance with the Directive.

Again, it is worth also considering Annex 1 of the FCA's CP15/27: *UCITS V implementation and other changes to the Handbook affecting investment funds* for further information on cost/benefit analysis.

Risks and Assumptions

HM Treasury has consulted on the main risks and assumptions associated with implementing the UCITS V Directive. The major foreseen risks and assumptions are as follows:

- **Depositaries.** The main assumptions are based on the ability to decrease risk by implementing the rules for depositaries as laid out by the UCITS V Directive.
- **Remuneration.** The main assumption related to remuneration is that implementation of the UCITS V Directive will successfully ensure that a fund manager's remuneration (and the remuneration of those staff whose professional activities have a material impact on the risk profile of the UCITS) is proportional to performance. Competition for staff in the UCITS fund management market may prevent the application of meritocratic remuneration policies. Additionally, some management companies do not actually have any direct employees, so it is potentially unclear how the rules surrounding remuneration will apply.
- **National Sanction Regimes.** HM Treasury does not anticipate any major risks and assumptions associated with the harmonisation of national sanction regimes.

Wider Impacts

The Directive will affect present and potential UCITS funds, present and potential depositaries of those funds and present and potential investors of UCITS funds. HM Treasury does not anticipate any wider impacts of the UCITS V Directive.