Opinion: final stage IA
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Undertakings for Collective Investments in Transferable Securities (UCITS V)

HM Treasury

RPC rating: fit for purpose

The IA is now fit for purpose as a result of the department's response to the RPC's initial review. As initially submitted, the IA was not fit for purpose

Description of proposal

The measure implements the recast EU Undertakings for Collective Investments in Transferable Securities Directive (UCITS V). UCITS are a type of investment fund. The measure aligns the management of UCITS with previous changes to alternative investment funds to provide greater protection for investors, for example by reducing the potential for fraudulent activity. The Directive requires depositories to provide effective oversight of the use of funds, introduces greater transparency around fund managers' remuneration and mandates consistent, convergent and strict national sanctions regimes for non-compliance.

Impacts of proposal

The IA states that the majority of the businesses affected were already subject to the requirements of the Alternative Investment Fund Managers Directive (AIFMD) which are broadly similar to those under UCITS V. However, a number of requirements that go beyond the requirements of the AIFMD are expected to impose costs on business.

Costs

Depositories will be required to ensure that appropriate agreements are in place in relation to the reuse of assets and asset segregation. Existing agreements in respect of UCITS Open-Ended Investment Companies (OEICs) are likely to need to be adjusted ('re-papered'). Unit Trusts may need a depositary agreement for the first time, which will further require modifications to their existing trust deeds. Finally, investor disclosures in share prospectuses will have to be modified to reflect the new regime." They will also face some potential ongoing costs as a result of oversight requirements, especially the need continuously to monitor the activities of sub-custodians. Depositories will also need to familiarise themselves with the changes. However, 10 of the 11 existing depositories in the UK also act as depositories under the AIFMD and are likely to be already undertaking many of these activities. The Department estimates that ensuring compliance with asset segregation/reuse requirements and chain of custody obligations will impose a one-off cost of around £3.7 million on each depository, for a total cost of £40.8 million. This estimate is based on engagement with a depository, and was tested through the consultation.

Depositories and UCITS fund managers will need to repaper contracts to reflect the new requirements. The IA presents ranges for the amount of time and the hourly legal costs it could entail. This results in a range of costs of £0.3 million to £4.5 million. The relatively wide range reflects uncertainty regarding both the time needed on average (estimated to be between ten and thirty hours for each of 150 fund management companies) and the potential legal costs (based on hourly fees of between £200 and £1,000). The department's best estimate is that this will result in a one-off cost of £1.8 million. The IA states that, due to uncertainty over the volume of new contracts in future years and the extent to which the new requirements will be more readily reflected in revised contracts following the repapering exercise, the Department has not estimated ongoing costs for this element of the proposal.

Investment companies will also be required to assess existing remuneration policies and ensure policies are in line with the requirements of the Directive to promote more effective risk management. The majority of the circa 150 investment management businesses are believed to be already compliant with FCA remuneration principles. The IA, however, provides an indicative high-cost scenario on the assumption that all 150 businesses need to undertake a review, make changes to remuneration policies and publish for the first time details on remuneration. The IA stresses that this level of cost is extremely unlikely as it would suggest that investment companies were not complying with existing FCA remuneration principles. This high-cost scenario would involve significant changes to remuneration in firms, with an estimated one-off cost of £67 million and ongoing costs of around £27 million each year. However, the consultation tested the department's assumption that all firms currently comply with the FCA principles; as a result, the only additional costs of the proposal would be those involved in ensuring that review processes are in place and publication of the details. These elements are estimated to impose one-off transition costs of £1 million and ongoing annual costs of £0.6 million. These are the only costs included in the IA in relation to the remuneration provisions of the proposal. The IA also points out that further detail on the potential costs and benefits of the remuneration elements are discussed in the relevant FCA consultation.

The sanctions regime is intended to harmonise sanctions across the EU. Comparable sanctions are already in place in the UK under the Financial Services and Markets Act 2000 (FSMA), so no additional impacts are expected from the implementation of this aspect of the Directive.

Benefits

The IA does not include any monetised benefits, but does provide a qualitative discussion of potential wider benefits, highlighting the significant size of the UCITS fund market (with depository holdings totalling nearly £800 billion). The IA also refers to the relevant detailed FCA consultations that relate to the implementation of UCITS, in which the benefits are discussed further.

The RPC is able to validate the estimated equivalent annual net direct cost to business (EANDCB) of £5.4 million. The measure is an EU proposal showing no evidence of going beyond the minimum requirements, and as such is a non-qualifying regulatory provision that will not score for the business impact target.

Quality of submission

As initially submitted, the IA did not include an estimated EANDCB. The resubmitted IA includes an estimated figure and responds to the concerns raised following the RPC's initial review, so the RPC is now able to verify the EANDCB. In particular, the IA now provides further explanation on why the Department disregarded the extreme high-cost scenario in relation to the remuneration elements when forming its best estimate.

The estimates in the IA are based on limited evidence from business. However, the Department has highlighted its continuing attempts to gain further information from industry. The estimated costs for the eleven affected depositories are based on pre-consultation estimates from a single depository that were not disputed during the formal consultation and other stakeholder engagements. While it would be preferable to have a wider range of sources, the RPC recognises that the efforts described by the Department mean that the figures in the IA represent the best currently available evidence on which the Department can base its estimates.

The RPC also notes that the post-implementation review in respect of UCITS IV appears to have been developed either in parallel or slightly after the IA for UCITS V. It would, however, clearly have been preferable for the review of the previous legislation to have taken place in advance of the development of the UCITS V IA. Learning regarding the previous regulatory requirements should provide an important source of evidence in relation to subsequent appraisals that could help avoid the concerns raised in respect of the limited evidence provided by business. However the post-implementation review also suffers from limited evidence provided by business.

While the additional references to the relevant FCA consultations are helpful, the IA would still benefit from providing further narrative as to why the Department believes it that the benefits of the proposal cannot be quantified. However, many of these impacts are likely to be indirect, so the absence of quantification does not appear to affect the EANDCB in this instance.

Initial departmental assessment

Classification	Out of scope (EU)
Equivalent annual net cost to business (EANCB)	Not provided (initial submission) £5.4 million (final estimate)
Business net present value	-£48.4 million

Societal net present value	-£48.4 million

RPC assessment

Classification	Out of scope (EU)
Equivalent annual net cost to business (EANCB)	£5.4 million
Small and micro business assessment	Not required (EU)

Michael Gibbons CBE, Chairman