UCITS V remuneration guidelines - ESMA takes a "proportionate" approach

UCITS managers breathed a collective sigh of relief yesterday following the publication of ESMA's Consultation Paper on UCITS remuneration guidelines.

There had been fears that ESMA might have followed the EBA's conservative approach to proportionality in its consultation on the CRD IV remuneration code. Instead ESMA has differentiated the UCITS sector from credit institutions and taken an industry friendly approach by preparing guidelines which are broadly similar to those applicable to AIFMs. Annex I to the paper provides a mark-up of the proposed UCITS V guidelines against those for AIFMs.

Key requirements

In summary the draft UCITS V guidelines require that in relation to senior management, risk takers, control functions and certain other staff members of the firm:

- the level of base salary and discretionary bonus should be appropriately balanced;
- at least 50 per cent of any discretionary bonus should consist of units of the UCITS concerned;
- at least 40 per cent of any discretionary bonus should be deferred for at least three years; and
- malus or clawback provisions apply (the last three bullets are known as the "pay-out process rules").

Proportionality

The above rules are subject to the principle of proportionality such that they are to be complied with to the extent relevant to the size and complexity of the business. The FCA will publish a consultation paper on the implementation of UCITS V which will provide more colour on when the FCA considers it proportionate for firms to disapply the pay-out process rules. It is likely that the proportionality factors such as the assets under management thresholds prescribed by the FCA may be different for UCITS managers as compared to AIFMs.

Delegates

As under AIFMD, the UCITS remuneration guidelines must be contractually imposed on delegate investment managers unless the delegate is already subject to remuneration requirements which are equally as effective as the UCITS requirements. ESMA proposes that the CRD IV and AIFMD requirements should be considered to be equally as effective but is silent on whether the remuneration provisions, to which those firms still within scope of CRD III, should be treated in the same way. Within Europe many delegate investment managers are MiFID firms but fall outside the scope of CRD IV. Therefore, if ESMA does not consider those firms as subject to an equivalent regime, the UCITS remuneration requirements will need to be contractually imposed on such delegates.

Interplay between remuneration regimes

Where staff activities mean that they would be covered by more than one remuneration regime, ESMA proposes that firms can either apply remuneration regimes on a pro rated basis, based on objective criteria such as time spent, or they can apply the remuneration principles which are most effective for achieving the outcomes of discouraging excessive risk, taking - a "highest common denominator" approach.

Timing

The guidelines are stated to be effective from 18 March 2016. However, given that this will be part way through firms' remuneration year, we anticipate that the FCA will clarify in its consultation paper that the guidelines will take effect from the first full remuneration year following that date.

The ESMA consultation closes on 23 October 2015 with a view to publication of its final report in Q1 2016 in advance of the 18 March 2016 UCITS V implementation date.

Next steps

UCITS managers will need to determine which members of staff will be caught by the UCITS remuneration guidelines and prepare a remuneration framework in line with the guidelines. Once the FCA consultation paper is published, UCITS managers will be able to consider whether proportionality is likely to apply to them such that the pay-out process rules can be disapplied. UCITS managers will also need to review arrangements with delegates to determine what (if any) remuneration regime such delegates are subject to and to consider whether they need to be contractually required to comply with the UCITS remuneration guidelines.

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