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Press release | 25.02.2014

Investment fund rules (UCITS)

Deal improves investor protection against reckless risk taking

The European Parliament and Council today reached agreement on draft EU legislation on investment funds (the UCITS V directive), a sector that is valued at almost €6.3 trillion. The legislation, which is being shepherded through the European Parliament by Green draftsperson/rapporteur Sven Giegold, will now enter into law following final endorsement by Parliament and Council. The revised directive covers remuneration and bonus policies, depository functions, obligations and sanctions. Commenting on the outcome, **Sven Giegold** stated:

“Today's deal will deliver greater protection for investors, as well as taking steps to reduce reckless risk taking in the investment fund sector. The revised legislation includes important provisions on remuneration that will ensure the interests of investors are better reconciled with those of fund managers. The new rules combine stricter liability provisions for depositories, with stronger sanctions. The strengthening of existing regulations, and a more European approach, will make it more difficult to circumvent the rules. The stricter rules on depositories will ensure fraudulent schemes, like the Madoff case, cannot occur in Europe.

"The introduction of a procedure for secure access by whistleblowers to the European Securities and Markets Authority is a significant development. This will provide a formal route for insiders to report abuses without disclosing their identity."

Background details of the final agreement on the UCITS V directive:

Remuneration:

50% of the variable part of pay will have to be in shares of the managed UCITS fund. In addition, 40% of variable remuneration will have to be deferred for at least three years. In the case of very high bonuses, 60% will have to be deferred. Unfortunately, these provisions will not apply to third parties to whom functions have been delegated. Instead, the European Securities and Markets Authority will draft guidelines on the scope of staff that shall be covered by these remuneration principles to limit circumvention of the remuneration rules by outsourcing the asset management to third countries.

Under the final agreement, it will only be possible to include shares of the UCITS directly concerned, to account for the provisions on variable remuneration, but not shares in the management company or its parent, as some EU governments wanted. This would have rewarded fund managers for increasing profits of the management company rather than the value of the funds they manage.

The legislation fails to tackle the problem of performance fees for management companies, which are opaque and a rip-off for investors, unfairly reducing their income from funds. Stronger rules on these areas were blocked by liberal and conservative MEPs during an earlier vote in the European Parliament. This must definitely be regarded as a missed opportunity.

Depositories and securities lending:

Only a limited number of institutions will be considered eligible as depositories, as originally proposed by the EU Commission and supported by Parliament. Along with credit institutions and central banks, only sufficiently-capitalised and supervised authorities can be licensed to act as depositories. Proposals from the Greens to place strict conditions on the collateral required for securities' lending of assets from UCITS was accepted by all parties.

Lobby-driven proposals to allow exemptions from the liability provisions for depositories, where they delegate to sub-custodians in third countries, were not included.

Sanctions:

There will be harmonised administrative sanctions, with maximum penalties of at least €5 million or 10% of the turnover of the corporation, and of at least €5 million for individuals. The EP wanted higher sanctions, in line with the levels set in the EU's market abuse legislation, but EU governments and the German ministry of finance in particular opposed this. The provisions on sanctions include suspension of authorisation and temporary or permanent ban from fund management for the perpetrators of fraud.

If member states want to introduce criminal sanctions instead of the administrative sanctions proposed in the legislation, they can only do so within the first two years following the entry into force of the legislation. This provision was insisted on by MEPs.

Whistleblowers:

Green proposals introducing secure channels for whistleblowers in all national competent authorities as well as with the European Securites and Markets Authority have been included. This could encourage whistleblowers to complain about regulatory capture of national supervisors. It is the first time such provisions on whistleblowers have been included in financial services legislation.

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Responsible MEPs

Sven Giegold

Member

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