Recent Developments in UCITS: Part II

By Claire Cummings and Helen Busby

This is the second part in a three-part series on recent developments relating to UCITS. This second part provides a brief overview of the most important changes introduced by UCITS V.

**UCITS V**

The changes set out in UCITS V were prompted by the financial crisis and the subsequent need to strengthen financial markets. The Madoff fraud, in particular, highlighted the fact that the UCITS Directive has been transposed into national laws in divergent ways and failed to secure the safe and level playing field that the European Commission had planned. The depositary provisions of the AIFMD influenced the Commission's thinking in the area of depositary responsibilities and liability and the Commission recognised that the protection offered to retail investors in UCITS should, as a minimum, be equivalent to the protection offered to institutional investors under the AIFMD.

In reality, the standard of conduct imposed on depositaries under UCITS V is more stringent than the equivalent prudential standards imposed on depositaries under the AIFMD. In drawing up the amendments, the Commission sought to ensure that depositaries had a duty to act solely in the interests of the UCITS and its investors.

**Eligibility to Act as a Depositary**

The UCITS rules on the role of depositaries have not changed since the first UCITS Directive was adopted in 1985. UCITS V affirms the principle of a single depositary (so that one fund cannot have several depositaries) and that the appointment must be evidenced in writing. It also defines the circumstances in which a depositary's safe-keeping duties can be delegated to a sub-custodian (bringing the rules in this regard in line with those applicable under the AIFMD).

Those entities that are capable of acting as UCITS depositaries are: (i) a national central bank; (ii) a credit institution authorised in accordance with CRD IV; and (iii) an authorised legal entity that is subject to certain capital adequacy requirements under the Capital Adeq...
prove that the loss was due to an 'external event beyond
amount. The only exception is where the depositary can
instrument of an identical type or of the corresponding
be obliged to promptly return to the UCITS a financial
instruments held in custody are lost. The depositary will
AIFMD, UCITS V imposes strict liability in the event that
liability standard across the EU. In common with the
instruments held in custody and in doing so to harmonise the
UCITS V aims to clarify what the depositary's liability
will be in the event of the loss of a financial instrument
that is held in custody and in doing so to harmonise the
UCITS with the AIFMD. Delegation will need to be ob-
sets of a UCITS scheme by depositaries are more restric-
tions. Second, the provisions relating to the reuse of as-
demand that will potentially onerous requirement on depositar-
custodian, this strict liability will apply under UCITS V,
even where the loss occurred with the sub-custodian.
facilities is held in custody and in doing so to harmonise the
UCITS V (like the AIFMD) aims to set down a list of uni-
form rules harmonising the core safe-keeping and over-
ights functions of depositaries across the EU. These du-
sions that do not designate a management company.
units performing controlled functions and one employees receiving total
practices that are consistent with sound and effective
risk management. These categories of staff include
senior management and risk takers. These rules will also apply to UCITS investment compa-
ies that do not designate a management company.
remuneration policies promote sound and effective risk manage-
AIFMD requires UCITS to ensure that in the event of the insolvency of the de-
positary, the assets held on behalf of the UCITS will not
be discharged where assets are transferred to a sub-
recipients (even where the loss occurred with the sub-
Grandfathering period, during which UCITS will be per-
required to use a depositary that is non-compliant, but ev-
emphasised in accordance with the law and instruments of
The new provisions on delegation effectively align
depositary's creditors.
be included in the UCITS pro-
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certainty is that the depositary can
proposition in accordance with the law and instruments of
functions directly overseen by a remuneration
committees; and (iv) carrying out the instructions of
vested only if it is sustainable according to the finan-
customer as an ongoing basis. Other are monitoring functions to be delegated to a
depositary's creditors. (The depositary's own assets
are not available to the deposi-
responsibility under UCITS V than the equivalent provisions un-
control and with consequences that were
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set out the duties of a de-
management company and the UCITS it manages and
business strategy, objectives, values and interests of the
business unit or UCITS concerned and of the
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and justified according to the performance of the
business unit, the UCITS and the individual con-
cerned and

(iv) subject to the legal structure of a UCITS and its
rules, a substantial portion (at least 50 percent) of
any variable remuneration must consist of units of the
UCITS concerned or equivalent ownership interests
or share-linked instruments or non-cash instruments,
unless the management of the UCITS accounts for
more than 50 percent of the total portfolio managed by
the management company, in which case the 50 per-
cent will not apply.

Article 14b sets out a number of stipulated principles re-

quiring a minimum scale of administrative sanctions and
fines across EU member states; a minimum list of sanctioning criteria; and
an obligation upon regulators and management
companies to establish whistle-blowing mechanisms. It also should be noted that UCITS V amends UCITS IV to ensure that a regulator is entitled to see existing tele-
phone and data traffic records held by a telecommuni-
cations operator, a UCITS, a management company, an
investment company or a depositary where a “reason-
able suspicion” exists that those records relate to the
subject matter of the inspections and may be relevant to
prove a breach of the UCITS V Directive.

Sanctions

Conclusion

Global custodians have indicated that they are likely to
consider reducing the risk associated with taking on
third party liabilities by investing in local custody net-
works in those markets where they do not already have
a presence.

Our next and final part in this series will provide a brief
discussion of UCITS VI.

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