FS Regulatory Brief

EU banker bonus cap is near final –

Asset manager cap for UCITS under consideration

March 2013

Banker bonus cap

The EU's bonus cap for bankers as part of CRD IV is nearly final with the further political agreement reached on March 20th. The cap is now set to go to the European Parliament for expected passage in mid-April.[1]

Although the text has not been released, we understand that a key point from the latest agreement is that the cap will only apply to compensation for performance after January 1, 2014. The cap is not expected to apply to bonuses paid out in 2014 in relation to 2013 performance, as had been a large concern.

Asset manager bonus cap proposal

Meanwhile, a draft proposal also moved forward to cap bonuses of certain asset managers, which was under consideration by Members of the European Parliament (MEPs) on the Economic and Monetary Affairs Committee. It now goes to the full Parliament for an expected vote in April on whether to call for three-party negotiations with EU member states and the European Commission.

The cap applies to the EU's undertakings for collective investments in transferable securities ("UCITS"), which manage assets for retail investors and control about €6 trillion in funds. The lead MEP stated that the asset manager cap would "complement" the banker cap by ensuring it "cannot be circumvented and providing for a level playing field." This UCITS proposal is separate from the Alternative Investment Fund Managers Directive (AIFMD) proposal which affects alternative investment funds such as hedge funds and private equity funds.[2]

The proposal is effectively the European Parliament's opening position regarding UCITS asset managers' pay and starts the process to finalize the remuneration provisions within the UCITS V directive. If passed, these new restrictions will have major implications for incentive compensation at these asset management businesses, as well as non-EU businesses managing UCITS products. The proposed amendments limit incentive compensation under UCITS V more onerously than the compensation restrictions under AIFMD, and under CRD III and the recently amended CRD IV.[3]

We believe that the most likely effective implementation date for the UCITS proposal would be January 1, 2015. For firms with a December year-end, this means that pay earned during the 2014 performance year would likely be subjected to UCITS V rules and the cap.

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[1] See PwC **FS Regulatory Brief – *Bonus Cap Advances in the EU* (March 2013).**

[2] AIFMD remuneration restrictions for hedge fund managers and private equity fund managers are described in the following: http://www.pwc.com/gx/en/asset-management/aifmd/assets/pwc-aifmd-for-hedge-fund-managers.pdf and http://www.pwc.com/gx/en/asset-management/aifmd/assets/pwc-aifmd-for-private-equity.pdf.

[3] For CRD IV, see note 1.

Proposed asset manager restrictions

The following is our understanding of the key requirements under the proposed amendments to the directive that will apply to "*Identified Staff*" (defined further below):

- Bonuses would not exceed fixed compensation. Unlike similar provisions in CRD IV affecting bankers, we understand that UCITS bonuses may not exceed fixed compensation even if shareholder approval is provided. Further:
  - At least 50% of variable compensation would be delivered in the form of units in the funds, unless UCITS products make up less than 50% of the total portfolio of the management company. This is similar to requirements set out in the AIFMD.
  - At least 25% of variable compensation would be deferred over a period in the context of the lifecycle and redemption policy of the UCITS funds. This percentage would rise to 60% where variable remuneration is "particularly high". This 25% proposal is lower than the 40% in both CRD III and AIFMD.
- The remuneration policy of the management company would be owned and overseen by a supervisory body that is independent from those in executive functions. Large, complex firms would operate a remuneration committee which includes employee representatives (this is a similar requirement to that set out in the CRD IV text).
- Disclosure relating to remuneration practices would be made available to all stakeholders. This differs from the AIFMD disclosure rules which require disclosure to investors through the fund accounts.

Implicated asset management staff

The rules will apply to so-called "*Identified Staff*". We understand that the proposal would include temporary and contract staff, as well as permanent employees at fund and sub-fund level. Unlike CRD IV or AIFMD these employees would include:

- Fund managers;
- Other persons who take investment decisions that affect the risk position of the fund and those who can influence them; and
- Senior management, risk takers, personnel in control functions, or any other employee or other staff receiving total remuneration that falls within the remuneration bracket of senior management and decision takers and whose professional activities have a material impact on the risk profiles of the management companies or of UCITS they manage.

The asset management industry had, up to this point, managed to escape many stringent compensation rules. Although most firms in the sector were caught by CRD III, all but a very small number of individuals have avoided being subject to the more prescriptive rules (e.g., on deferral, receiving remuneration in shares, etc). Similarly, the alternatives sector is set to be subjected to these types of rules starting in July by way of AIFMD; however, it is likely that the number of firms and individuals subject to the more prescriptive rules will be limited (although it is not finalized yet).

The proposed UCITS V definition of Identified Staff is far more explicit that in various prior directives and would extend the number of Identified Staff significantly in most firms across senior management, front, middle and back office. The prior definition of Identified Staff had been heavily principles-based, and most asset management firms have justifiably been able to limit the number of Identified Staff in their businesses to a relatively small proportion that genuinely have a material influence over the risk profile of the firm.

Additional information

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