Regulatory brief

A publication of PwC's financial services regulatory practice

March 2014

EU bonus cap: Restrictions nearly final for asset managers

Overview

On February 25th, the EU's two legislative bodies, the European Parliament (EP) and the European Council (Council), agreed to restrict retail asset managers' bonuses. After going back and forth during 2013, the two bodies settled their differences last month as part of the fifth iteration of the Undertakings for Collective Investments in Transferable Securities Directive (UCITS V). We expect UCITS V to be passed into law by both the EP and Council this spring, and for it to be implemented by EU member states by early 2016.

Most importantly, the Council agreed to not include a bonus cap for managers and advisors of UCITS funds (UCITS funds are similar to US-registered mutual funds).[1] In place of the cap, the Council and EP resolved that at least 50% of bonus amounts must be paid in shares of the fund under management, and at least 40% of bonus amounts must be deferred for three years.

These and other changes generally align UCITS V's remuneration terms with those of the EU's Alternative Investment Fund Managers Directive (AIFMD),[2] thus imposing similar bonus restrictions on EU fund managers regardless of the type of fund being managed. AIFMD's requirements go into effect before UCITS V's do, so as UCITS managers prepare for 2016 implementation they will have opportunity to learn from the experience of alternative fund managers.

The requirement that 50% of bonuses be paid in UCITS shares may impact US managers of UCITS assets particularly hard because US citizens face limits in owning UCITS shares. However, lawmakers may change these terms before passing UCITS V, or subsequent regulation by the European Securities and Markets Authority (ESMA) will more likely do so.

This **Regulatory Brief** provides background on UCITS V, overviews the proposed law's most recent remuneration restrictions, and assesses the potential impact on US managers and advisors of UCITS assets.

---

[1] See PwC's *Regulatory Brief, EU bonus cap: UCITS asset managers narrowly escape bonus limits* (July 2013), which analyzed the EP's objections to the bonus cap in July 2013 and suggested that the Council would ultimately agree.

[2] AIFMD is an EU law that regulates alternative investment funds (e.g., hedge funds) including provisions that restrict bonuses. For more information, see PwC's *Regulatory Brief, EU's AIFMD: Impact on US Asset Managers – New regime starts July 22nd* (June 2013).

Background

The UCITS Directive was first issued in 1985 and has been significantly revised several times since. In July 2012 the European Commission (Commission)[3] issued a proposal for its fifth iteration (UCITS V). The Commission's proposal included provisions that restricted bonuses paid to fund managers, in order to discourage unnecessary risk taking.

The 2012 Commission proposal generally required that (a) the bonus and fixed components of total compensation be "appropriately balanced," (b) at least 50% of the bonus consist of managed fund shares, and (c) at least 40% of the bonus be deferred for at least three years (60% for "particularly high" bonuses). A provision to cap bonuses at 100% of fixed salaries was added to the proposal at a later stage.[4]

In July 2013 the EP voted on the proposal, rejecting the provision to cap bonuses, and lowering the minimum deferral requirement from 40% to 25%.[5] In December 2013, the Council counter-proposed, raising the deferral requirement back to 40% but otherwise accepting the EP's amendments (including the cap removal).

On February 25, 2014, the EP and the Council agreed on the near-final terms of UCITS V, including bonus provisions based on the Council's December 2013 proposal. The documented agreement is not publicly available.

Key UCITS V bonus provisions

The near-final UCITS V package requires fund managers' bonuses to be paid in accordance with a compensation policy adopted and annually reviewed by the Board of Directors, and disclosed publically. The proposal also requires that:

- At least 50% of bonuses consist of the managed UCITS shares, equivalent ownership interest, or share-linked instruments.
- At least 40% of bonuses be deferred for at least three years. In the case of "particularly high" bonus amounts, the minimum deferral must be 60%.

These terms would apply to senior management, risk takers, control functions, and other employees whose earnings are in the senior management bracket. ESMA is tasked with drafting guidelines to identify these employee categories.

Impact on US fund managers

The recent agreement has caused concerns for US-based fund managers and advisors that manage UCITS assets[6] who may be directly impacted by UCITS V's bonus requirements.

In particular, the requirement that at least 50% of bonuses consist of managed fund shares is problematic because UCITS offering documents would generally limit the ability of US managers and advisors to own UCITS shares. This is due to the complex regulatory requirements that the funds must meet in order to market to US citizens. Although the agreement provides flexibility in this area by allowing compensation in "equivalent ownership interest or share-linked instruments" in lieu of UCITS shares, it is not yet clear how complicated these alternative bonus structures will be.

Eleven EU countries, including the UK and Germany, have already called for changes to limit the impact on managers outside the EU. Given that these countries could block the final legislative of UCITS V, last-minute changes are possible.

However, it is more likely that this issue will be addressed by ESMA in subsequent regulations. EU regulators often pragmatically deal with issues that are left open by the EP and the Council.

We expect the impact of UCITS V on US fund managers will ultimately be less burdensome than it currently appears.

---

[3] In the EU, the Commission proposes legislation which must then be passed by the EU's bicameral legislature (composed of the EP and Council).

[4] See PwC's *Regulatory Brief*, *EU banker bonus cap is near final – Asset manager cap for UCITS under consideration* (March 2013).

[5] See note 1.

[6] US managers and advisors currently manage over $1.5 trillion of UCITS assets (about 15% of the market).

Additional information

For additional information about this Regulatory Brief or PwC's Financial Services Regulatory Practice, please contact:

Dan Ryan
Financial Services Regulatory Practice Chairman
646 471 8488
daniel.ryan@us.pwc.com

David Sapin
Financial Services Regulatory Practice Leader
646 471 8481
david.sapin@us.pwc.com

Armen Meyer
Director of Regulatory Strategy
646 531 4519
armen.meyer@us.pwc.com

Contributors: Roozbeh Alavi, Elizabeth Crotty, Ed Donovan, and Scott Olsen.

To learn more about financial services regulation from your iPad or iPhone, click here to download PwC's new Regulatory Navigator App from the Apple App Store.

Follow us on Twitter @PwC_US_FinSrvcs