

# Introducing UCITS VI: Legislative Proposals to Amend UCITS Regime

On 25 November 2021, the European Commission ("Commission") published legislative proposals<sup>1</sup> ("Proposals") to amend the Alternative Investment Fund Managers Directive 2011/61/EU ("AIFMD") and the UCITS Directive 2009/65/EC.

The Proposals form part of a legislative package<sup>2</sup> in which the Commission seeks to deliver on several key commitments in the EU's Capital Markets Union ("CMU") plan.

We have issued a client update<sup>3</sup> on the key AIFMD changes proposed.

The Proposals also contain changes to the UCITS Directive, as considered in this update.

## UCITS VI

This marks the fifth project to substantively update the initial UCITS Directive 85/611/EEC following: (i) the aborted "UCITS II" project; (ii) Directive 2001/108/EC ("UCITS III"); (iii) Directive 2009/65/EC ("UCITS IV") and (iv) Directive 2014/91/EU ("UCITS V"). Hence the reference to "UCITS VI" in the title of this update<sup>4</sup>.

The Proposals contain changes to the UCITS Directive in the following key areas to align the regime more closely with AIFMD:

- Delegation;
- Liquidity risk management;

- Regulatory reporting; and
- Depositaries.

Below is a summary of the proposed changes.

### Delegation

The Proposals do not involve any fundamental changes to the existing UCITS delegation framework which the Commission notes "*allows for the efficient management of investment portfolios and for sourcing the necessary expertise in a particular geographical market or asset class*" and "*contributes to the success of the EU fund and manager labels*."

Rather, the emphasis is on achieving a coherent approach to delegation activities by European investment fund managers (i.e. UCITS management companies and EU alternative investment fund managers ("AIFMs")) and regulators.

Some of the main proposed delegation measures are outlined below. Most are consistent with existing AIFMD requirements or mirror corresponding amendments to AIFMD contained in the Proposals:

### Justifying Delegation

It is proposed that a UCITS management company must be able to objectively justify its entire delegation structure – this is aligned with an existing AIFMD provision.

<sup>1</sup> [https://ec.europa.eu/transparency/documents-register/detail?ref=COM\(2021\)721&lang=en](https://ec.europa.eu/transparency/documents-register/detail?ref=COM(2021)721&lang=en)

<sup>2</sup> [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_21\\_6251](https://ec.europa.eu/commission/presscorner/detail/en/IP_21_6251)

<sup>3</sup> <https://maples.com/en/knowledge-centre/2021/12/aifmd-2-0-european-commission-publishes-legislative-proposals>

<sup>4</sup> On 26 July 2012, the Commission published a [UCITS consultation paper](#) entitled "Product Rules, Liquidity Management, Depositary, Money Market Funds, Long-term Investments". However, this did not result in legislative changes to the UCITS Directive.

## *More Detailed Delegation Rules*

ESMA will be tasked with producing regulatory technical standards ("RTS") providing details on the conditions under which a UCITS management company will be deemed to have delegated its functions to the extent that it breaches the UCITS Directive prohibition from being a "letter-box" entity. These RTS would be expected to align with the existing AIFMD provisions in article 82 of "AIFMD Level 2" (Commission Delegated Regulation EU/231/2013).

## *Information on Resources and Delegation Frameworks in Applications for Authorisation*

It is proposed that applications submitted to national competent authorities ("NCAs") for authorisation as UCITS management companies should provide information on the human and technical resources that the firm will employ, and more detailed information on the management structure and reporting lines. Additional information would also be required on the firm's delegation arrangements and resources for overseeing delegates.

## *Minimum Resources*

It is proposed that every UCITS management company (and self-managed UCITS) must have at least two full-time staff resident in the EU. In practice, this should have no impact on Irish or Luxembourg authorised UCITS management companies, which are already subject to clear and comprehensive local regulatory resourcing requirements.

## *Delegation of MiFID Add-on Services*

The Proposals will extend the scope of the delegation requirements to capture the delegation of ancillary "MiFID add-on services"<sup>5</sup>

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<sup>5</sup> Individual portfolio management (e.g. segregated mandates), investment advice, safe-keeping and administration regarding units in funds.

<sup>6</sup> [google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwjT8dXpidf0AhVPgFwKHUvPCNkQFnoECAQQAQ&url](https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwjT8dXpidf0AhVPgFwKHUvPCNkQFnoECAQQAQ&url)

in addition to primary UCITS management company functions.

## *Regulatory Reporting and Reviews*

The Proposals introduce a reporting regime where all EU NCAs would be obliged to report annually to ESMA any instances where UCITS management companies which they regulate are delegating more portfolio management or risk management functions to entities located in non-EU countries than they are retaining. Related to this, ESMA will, at least every two years, be required to review how NCAs are applying the conditions on delegation and the measures taken to prevent UCITS management companies (which are delegating more portfolio management or risk management functions to entities located in non-EU countries than they are retaining) from becoming letter-box entities.

Effectively, rather than providing ESMA with *more powers*, the Proposals give ESMA *more information* on delegation arrangements.

Based on the reports from the ESMA reviews, it is proposed that the Commission will (within two and a half years of the revised UCITS Directive entering into force) conduct a further review of the UCITS delegation regime to assess whether it is effectively preventing the operation of letter-box entities within the EU.

## **Liquidity Risk Management**

Following recent recommendations from the European Systemic Risk Board<sup>6</sup> and ESMA<sup>7</sup>, the Proposals introduce a minimum set of harmonised liquidity management tools ("LMTs") across the UCITS and AIFMD regimes and empower fund managers and regulators to use these LMTs in stressed market conditions.

<sup>7</sup>

[https://www.esma.europa.eu/sites/default/files/library/esma34-39-1119-report\\_on\\_the\\_esrb\\_recommendation\\_on\\_liquidity\\_risks\\_in\\_funds.pdf](https://www.esma.europa.eu/sites/default/files/library/esma34-39-1119-report_on_the_esrb_recommendation_on_liquidity_risks_in_funds.pdf)

# UPDATE

The Commission considers the proposed measures will assist in reducing liquidity pressures on funds and mitigating against broader systemic risk implications in market-wide stress situations.

The main measures proposed are outlined below:

## LMTs

A proposed prescribed list of eight LMTs for inclusion in an annex to the UCITS Directive:

<i>Temporary suspensions of subscriptions and redemptions</i>	<i>Swing pricing</i>
<i>Redemption gates</i>	<i>Anti-dilution levy</i>
<i>Redemption notice periods</i>	<i>Redemptions in kind</i>
<i>Redemption fees</i>	<i>Side pockets</i>

## Required LMTs

In addition to being able to temporarily suspend subscriptions and redemptions, UCITS management companies will be required to provide for at least one additional LMT for each UCITS. The selected LMT (one of the following three from the wider list above: (i) redemption gates; (ii) notice periods; or (ii) redemption fees) should be appropriate for the relevant UCITS, taking into account its investment strategy, liquidity profile and redemption policy.

The Commission notes that this will leave the UCITS management company with the final decision on the appropriate LMT to use in any particular case. However, arguably, it would be more closely aligned with the aim of harmonising the LMT framework to require that each UCITS must provide for the application of all eight LMTs.

## Policies and Procedures

UCITS management companies will be required to implement policies and procedures for the use of any LMTs.

## RTS

ESMA will develop RTS: (a) to define and specify the LMTs' characteristics and (b) on criteria for the selection and use of LMTs by UCITS management companies.

## NCA Powers to Require LMT Activation

As an extension of the existing facility of an NCA to direct a temporary suspension of redemptions in a UCITS, the Proposals provide for an NCA to require a UCITS to activate any of the prescribed LMTs where this is considered to be in the interests of the unitholders or of the public.

ESMA will develop RTS on situations where NCAs may exercise these powers.

It is unclear how this would work in practice, from a legal perspective, in a scenario where the UCITS' constitutional document did not provide for the relevant LMT. In order to be effective, it is possible that all UCITS' constitutional documents will need to be updated to factor for this scenario – that is, provide the facility to apply all eight LMTs when required. This would further support the point made above, that it would be more consistent to require that each UCITS must provide for the application of all eight LMTs, rather than only having to provide for two.

## Role of NCAs in other EU Member States

Recognising the impact a UCITS can have in other EU member states where investors are located, the Proposals provide that an NCA in an EU member state where the UCITS is marketed may request that the NCA in the home EU member state of the UCITS require the application of an LMT.

## Regulatory Reporting

To align with the "Annex IV" regulatory reporting currently undertaken by EU AIFMs, under the Proposals, UCITS management companies will be required to regularly report details of the markets and instruments in which it trades on behalf of the UCITS managed to their home EU member state.

ESMA will prepare RTS specifying the details of this reporting.

## Depositaries

Central securities depositaries ("CSDs") are not currently deemed to be delegates of UCITS depositaries. The Commission considers that this can prevent depositaries from performing oversight properly as there may be an absence of a stable flow of information when a fund's assets are being kept by a CSD.

It is therefore proposed to include CSDs in the custody chain<sup>8</sup>, albeit that as they are already regulated, there would not be the usual full due diligence requirement.

## Timing and Next Steps

The Proposals will now be considered by the European Council and the European Parliament and it is anticipated that agreement could be reached by mid-to-end 2022.

The Proposals take the form of an amending directive – meaning that, after formal adoption and publication in the Official Journal of the European Union, each EU member state will be given time (provisionally up to two years) to transpose the new rules into national law. Although EU member states could elect to implement earlier, the rule changes may not be fully in effect until late 2024 or early 2025.

The Maples Group will be working closely with our clients, their international advisers,

industry associations, regulators and governments as the Proposals advance and we will be providing regular updates.

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<sup>8</sup> Unless acting in capacity as issuer as defined in Article 1(e) of Commission Delegated Regulation (EU) 2017/392.

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