UCITS V: Sanctions

The UCITS V Directive ("**UCITS V**") amends the regulatory framework for Undertakings for Collective Investment in Transferable Securities ("**UCITS**") to address issues relating to the depositary function, manager remuneration and administrative sanctions. UCITS V was published in the Official Journal of the EU on 28 August 2014, and EU member states had until 18 March 2016 to transpose the directive into national law. Ireland was one of the first EU member states to implement UCITS V.

UCITS V principally focuses on three main areas, namely: (i) depositaries; (ii) remuneration; and (iii) sanctions. This factsheet discusses the UCITS V provisions governing sanctions.

Overview of UCITS V Provisions on Sanctions

UCITS V seeks to harmonise across member states the administrative penalties in respect of infringements of national provisions transposing the UCITS Directive. It does so in particular by:

- setting out a list of minimum types of administrative penalties and other administrative measures applicable to infringements of the UCITS Directive; and
- providing a list of the criteria which member states must take into consideration when determining the type and level of administrative sanctions to impose.

The UCITS V provisions on sanctions also deal with: mutual legal assistance; whistleblowing; and supervisory reporting.

Why is UCITS V concerned with sanctions?

The financial crisis gave rise to concerns that financial market rules are not uniformly enforced across the EU, raising the risks of ineffectiveness and regulatory arbitrage.

In 2010, following a cross-sectoral review of the coherence, equivalence and actual use of sanctioning powers in the member states, the European Commission (the "**Commission**") published a communication on reinforcing sanctioning regimes in the financial services sector. In that communication, the Commission identified a number of divergences and weaknesses in national sanctioning regimes.

In 2011, the Commission circulated a questionnaire addressed to the European Securities and Markets Authority ("**ESMA**"), as well as to members of the European Securities Committee, regarding the enforcement of the UCITS Directive. Replies to that questionnaire again revealed divergent sanctioning regimes.

As a result, the Commission proposed amendments to the UCITS Directive which generally seek to strengthen its provisions on sanctions, as well as to increase the harmonisation of administrative sanctions across member states and promote more effective enforcement of the UCITS requirements.

What types of infringements of the UCITS Directive must be penalised?

UCITS V requires that breaches of the main investor protection safeguards in the UCITS Directive be subject to penalties. These include breaches relating to: authorisation requirements; notification / information requirements relating to the holding structure of a management company; and requirements relating to organisational rules / rules of conduct and requirements relating to the general activities of UCITS.

Does UCITS V require member states to impose criminal sanctions for infringement of the UCITS Directive?

No, member states may impose either criminal or administrative sanctions for an infringement of national provisions transposing the UCITS Directive. In other words, if a member state imposes criminal sanctions for a breach of the UCITS Directive, it is not required to

provide for an administrative sanction for the same breach. However, any administrative sanctions imposed must be effective, proportionate and dissuasive.

Where a member state opts to impose administrative penalties, on whom must these penalties be imposed?

Member states must ensure that the members of the management body and other responsible natural persons can be subject to administrative penalties for infringement of the provisions applying to UCITS, management companies, investment companies or depositaries.

What criteria should be taken into account when determining the type and level of applicable administrative penalties?

Member states must ensure that national competent authorities ("**NCAs**") take into account all relevant circumstances when deciding the type and level of administrative penalties to impose, including: the gravity and duration of the breach; the degree of responsibility of the person responsible; that person's financial strength; the importance of the profits gained or losses avoided as well as the damage to other persons; the functioning of markets or the wider economy; the level of cooperation received; any previous breaches; and remedial measures taken to prevent re-occurrence of the breach.

What types of administrative penalties must apply to a breach of the UCITS Directive?

Under UCITS V, member states must ensure that the range of penalties available to NCAs for a breach of the UCITS Directive includes the following:

- a public statement which identifies the person responsible and the nature of the breach;
- an order requiring the person responsible to cease the conduct and to desist from a repetition of that conduct;
- suspension / withdrawal of the authorisation of the management company or the UCITS, where applicable;
- a temporary or, for repeated serious breaches, a permanent ban against a member of the management or investment company's management body or any other natural person who is held responsible, from exercising management functions in those or in other such companies; and
- pecuniary penalties.

What level of pecuniary penalties should apply to a breach of the UCITS Directive?

UCITS V sets out the following provisions in relation to the pecuniary penalties which may be applied by a member state for an infringement of the UCITS Directive:

- in the case of a legal person, the maximum administrative pecuniary sanction must be at least €5,000,000, or 10% of that person's annual turnover;
- in the case of a natural person, the maximum administrative pecuniary sanction must be at least €5,000,000; or
- in the case of both legal and natural persons, by way of alternative to the above maximum pecuniary sanctions, member states may impose maximum sanctions of at least twice the amount of the benefit derived from the infringement.

Are member states required to publish administrative decisions imposing an administrative penalty?

Generally, member states must ensure that NCAs publish any final decision imposing an administrative penalty or measure for a breach of UCITS requirements without undue delay. Publication must include at least information on the type and nature of the breach and the identity of the persons involved. In certain cases, an NCA may either defer publication of a final decision, or publish it anonymously, namely where publication would be disproportionate, or where it would jeopardise the stability of financial markets or an ongoing investigation.

An NCA need not publish a final decision to impose an administrative sanction if it considers deferral or anonymous publication to be insufficient to ensure that: (i) the stability of financial markets would not be put in jeopardy; or (ii) the proportionality of the publication of such decisions with regard to measures which are deemed to be of a minor nature.

To what extent does UCITS V require member states to ensure whistleblower protection?

UCITS V requires both member states and ESMA to establish secure communication reporting channels for those reporting infringements of the UCITS Directive, and to provide for whistleblower protection "at least against retaliation, discrimination and other types of unfair treatment."

In addition, confidentiality must be guaranteed in all cases unless disclosure is required in the context of further investigations or subsequent judicial proceedings. Communication channels must also comply with applicable data protection requirements.

Member states must also require UCITS management companies, investment companies and depositaries to put in place appropriate procedures for their employees to report infringements internally, through a specific, independent and autonomous channel. Whistleblowers who are employees of investment companies, management companies, or depositaries must not be considered to infringe any contractual or other type of restriction on the disclosure of information, or be subject to any kind of liability in relation to the reporting.

Reporting Requirements

UCITS V requires member states / NCAs to provide specified information regarding their implementation of the UCITS V sanctions requirements to the Commission or to ESMA. In particular, NCAs must annually report aggregated information to ESMA on measures and sanctions imposed and inform ESMA of any individual measures and sanctions they have published.

What implications do the UCITS V sanctions provisions have on the Irish UCITS framework?

UCITS V did not significantly amend the existing sanctions regime applying to UCITS and UCITS management companies regulated by the Central Bank of Ireland (the "**Central Bank**"). Specifically, in Ireland, breaches of the legislation implementing the UCITS Directive were already subject to the Central Bank's Administrative Sanctions Regime established under the *Central Bank Act 1942,* which meets the minimum sanctions regime standard required under UCITS V. In addition, protected disclosures of infringments of financial service legislation are provided for in the *Central Bank (Supervision and Enforcement) Act 2013*.

Prior to the implementation of UCITS V in Ireland, the Central Bank published details of all fines imposed under the Administrative Sanctions Procedure, naming the entities and individuals involved. Under the regulations implementing UCITS V, the Central Bank may defer the publication of a decision to impose a sanction or measure, or publish the decision on an anonymous basis, or decide not to publish a decision at all in the circumstances outlined above.

Next Steps

Management companies, self-managed investment companies and depositaries should by now already have whistleblower policies in place. To the extent that this has not occurred, they need to proceed with implementing such policies. Also, to the extent they have not done so already, they will also need to consider how to adapt their internal governance, organisation and control structures to: (i) meet the new requirements on whistleblowing; and (ii) make sure that they will be able to prevent behaviour that will expose them in future to sanctions and the risk of reputational damage due to publication.

Please get in touch with your usual Asset Management and Investment Funds Group contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this briefing note.

Full details of the Asset Management and Investment Funds Group, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team, can be accessed at www.matheson.com.

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