

European Securities and Markets Authority
Submitted online: www.esma.europa.eu

Dear Sir

We welcome this opportunity to provide feedback on the ESMA AIFMD remuneration guidelines.

By way of background, Hermes is a leading asset manager in the City of London. As part of our Equity Ownership Service (EOS), we also respond to consultations on behalf of a number of pension funds and institutional investors from the US, Australia and Canada, as well as across Europe. We assist these clients to act as good owners of the assets in which they invest. In all, EOS advises clients with regard to assets worth a total of over €100 billion (as of 31 December 2011). As a part of the asset management industry, we are directly influenced by all relevant legislation.

We welcome ESMA's intention to provide enhanced investor protection, as, in our view, this should be the primary consideration of the proposed guidelines. We believe that the goal of enhanced investor protection can be furthered by ensuring appropriate risk alignment of remuneration policies, and by strengthening governance practices in that area. In the same time, we believe the guidelines should provide sufficient clarity on the scope of the applicability of all provisions, avoid creating an undue administrative burden, and allow for meaningful consideration of investor choice and preference.

The current structure of the guidelines requires that AIFs and AIFMs apply the proportionality principle to themselves when determining the particulars of the governance structures dealing with remuneration. While we welcome the fact that a one-size-fits-all approach has not been adopted, we also believe that the principle of proportionality by itself does not necessarily provide the needed clarity or predictability of requirements placed upon AIFMs.



The present situation, where the applicability of certain guidelines is guided by the proportionality principle, with investor involvement predominantly limited to a binding or advisory vote, leaves a wide scope for uncertainty . In our view, expressed investor choice should be allowed to play a broader part, at the very least as a factor informing the application of the proportionality principle.

We explain our views on the different sections of the guidelines in more detail below.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'PL' followed by a stylized flourish.

PAUL LEE
Director

Questions (by section)

Background and scope of guidelines

Q2:Do you agree with the above considerations on the scope of the Guidelines? In particular, do you agree with the clarifications on what should be considered as a remuneration falling into scope and what should be considered an ancillary payment or benefit falling outside the scope of the Guidelines? If not, please state the reasons for your answer and also suggest an alternative approach.

We agree with the alignment of the guidelines to the structure of the CEBS; however it is important to give appropriate weight to the fact that the main objectives of the two instruments differ. As in the AIFMD guidelines overall market stability is secondary to investor protection, more opportunities to involve investor choice should have been included. Furthermore, the current structure lends itself more easily to performing a general assessment of the type dealing with systemic risk, and less to an analysis centred on the individual characteristics of the investor. In a regulatory instrument that emphasises investor protection, more scope for the consideration of the appropriate level of such protection should have been allowed.

In terms of scope, we agree with the regulatory decision to apply a broad definition of remuneration but exclude outsourced activities.

Accordingly, on **Q5**, application of the AIFMD remuneration principles to an outsourced activity would be appropriate only if necessary to ensure investor protection, or if the outsourced activity is a core business activity. On **Q3**, we see no benefit in defining a threshold at which the portion of payment in excess of pro-rata investment return converts into carried interest.

Proportionality principle

The role of the proportionality principle in the application of the guidelines is, in our view, the point that is most in need of further clarification. The criteria of size, internal organisation and nature, scope and complexity of activity are useful, as is the indication that they apply cumulatively. However, some guidance as to their respective weighting and a description of what may be considered borderline in each case would be very helpful.

Another drawback of the application of the proportionality principle as a regulatory approach is its potential for uncertainty. Considering the significant changes to the governance and internal organisation of an AIFMD that may be required under the

guidelines, it is crucial to provide firmer indication of what is and what is not considered acceptable. In that sense, it would be helpful to create a standard that could serve as a starting point for the application of proportionality, such as a hypothetical reasonable market participant.

Q9: Do you agree with the clarifications proposed above for the application of the proportionality principle in relation to the different criteria (i.e. size, internal organisation and nature, scope and complexity of activities)? If not, please state the reasons for your answer and also suggest an alternative approach.

As mentioned in our introductory remarks, we believe investor preference should be allowed some weight in determining proportionality. Furthermore, application of proportionality should also be informed by the type of investor an AIMF is aimed at. While requiring a higher rule density for more complex operations with higher risk levels makes intuitive sense, it is important to keep in mind that appropriate investor protection, and not market stability as such, is the professed primary goal of the guidelines. Appropriate investor protection would require taking into account the investor's level of experience and willingness to take on risk when determining proportionality. Hence, the type of client targeted and serviced by the AIMF in question should be a consideration when establishing the applicability of AIMFD guidelines.

Governance of remuneration

Q17: Do you agree with the proposed split of competences between the members of the management function and those of the supervisory function? If not, please provide explanations.

Q19: Do you agree with the criteria above for determining whether or not a RemCo has to be set up? If not, please provide explanations and alternative criteria.

While we agree that in certain cases, specifically in large organisations with several levels of senior management, a dedicated supervisory function would make sense, clearer guidance is needed in order to be able to determine these cases. The central criteria should be whether a supervisory function, and a remuneration committee are imperative to investor protection in the specific case in hand. Accordingly, if the existing governance structure in a particular entity provides an adequate level of protection, the entity should be allowed the choice to retain this structure. As

mentioned above, some scope to consider client type and client requirements for protection should have been allowed.

Q22:Do you see merits in adding further examples of AIFMs which should not be required to set up a RemCo? If yes, please provide details on these additional examples.

We would welcome further examples of AIFMs which do not fall under the RemCo requirement, particularly descriptions of cases that could be regarded as borderline.

AIFMs being part of a group

We generally agree with aligning regulation for AIFMs that are a part of a credit institution with the CRD. Nonetheless, the different primary objectives of the CRD and the AIFMD make it necessary to avoid modelling AIFMs too closely on the requirements for the credit institution.

Risk alignment

In our view, the risk alignment process described in the guidelines chooses the right performance and risk measurement processes. However, we would have welcomed a discussion on the question of whether this process needs to be adjusted for the case of the owner-manager. Due to the popularity of the LLC structure in the UK, a clarification of the procedure for the needs of these market participants would be very welcome.