

27 September 2012

ESMA
103 Rue de Grenelle
75007 Paris
France

Dear Richard

Consultation Paper: Guidelines on Sound Remuneration Policy under AIFMD

IMA represents the UK-based investment management industry. Our Members include independent asset managers, the investment management arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of over €5 trillion of assets, which are invested on behalf of clients globally.

We fully support the general aim that remuneration policies and practices are consistent with and promote sound and effective risk management and do not encourage excessive risk taking.

However we would favour the application of a broader principles-based approach to ensure the measures can be adapted to fit the circumstances of the firm or funds and the wider group context in which many such firms will be operating.

It is very important to put these guidelines into the wider context of remuneration requirements across the financial sector, and the risks posed by variable remuneration in credit institutions as compared to asset managers.

Against this background, we have a number of concerns with the proposals:

- **Need for consistency with other remuneration guidelines:** Most of our members which will be covered by AIFMD are in asset management groups that comply with the remuneration provisions under CRD III, by virtue of their activities being subject to MiFID. Most will also be within the scope of the UCITS regime, once implemented, and also the forthcoming ESMA proposals on MiFID conduct risk. Many asset management firms operate a single business line, with remuneration schemes operating at a group basis, but where staff will act for a

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range of clients of different firms in the group, which will be subject to different EU financial services directives. It is therefore critical, as ESMA states, that there is a consistent approach for asset managers across all these guidelines. However we do not believe that this has been achieved by the current proposals, because of the different approach with regard to proportionality.

- **Proportionality:** Asset managers invest on behalf of their clients (whether segregated, UCITS or AIFs) and will buy and sell securities generally as long-term investments. They do not undertake trading activities on a proprietary basis, nor generally operate strategies with high portfolio turnover. The CEBS guidelines rightly realise that asset managers generally present less systemic risk than credit institutions, and allow for neutralisation of certain principles for asset managers. The ESMA guidelines should mirror this, to the extent permitted by the L1 text and a purposive interpretation should be applied to proportionality so that there is indeed consistency with the existing CEBS guidelines. We realise that the wording of the L1 text does not allow for such neutralisation across the piece. However our reading, and that of many other commentators, is that it does allow for a similar approach to be taken depending on the risk profile of the AIFM and allows for gradation below the stated percentages in Annex II. It is not clear that this is ESMA's intention, based on paragraph 36 of the paper.
- **Criteria for assessment of proportionality:** our members operate a very wide range of investment vehicles that now fall within the scope of AIFMD. Many of these have no or moderate leverage. Indeed, under any recognised definition of systemic risk, few UK-domiciled AIFs pose such risk and neither do many non-EU AIFs. Whilst we appreciate that the criteria such as size are drawn from the Annex II wording, in reality these criteria are not necessarily drivers of systemic/conduct risk. In our view, national regulators should have discretion to assess how to apply proportionality in relation to the remuneration policies of the AIFMs in their jurisdiction, since they will already be closely monitoring the risk management approach in firms that they supervise. (For instance in the UK this is done for the large majority of our members under the capital adequacy assessment process). AIFMs and national regulators should work closely together to develop remuneration policies tailored to their business and their risk profile.
- **Conflicts:** Unlike with CRD, instrument-based incentives are in the funds and not the firm, and so there will be different standards set by different legislation. This will create many difficulties as asset management staff provide services to multiple funds – AIFs, UCITS and separate accounts. This will potentially create new conflicts which need to be managed – the perceived benefit of incentive alignment (which would seem minimal where multiple funds/accounts are managed) needs to be weighed against the potential bias that a personal interest may give rise to. For instance, given that in many firms, in order to ensure fair treatment of all customers, portfolio managers will in general manage any segregated mandates of a similar strategy side by side with that of an AIF, it could incentivise them to give preference to the funds over the segregated mandates.

To summarise, we are concerned that developing overly specific guidance across individual segments of the industry will result in increasingly complex remuneration

schemes within firms, and will have unintended outcomes. It will also mean that the different schemes will have to be implemented at different times, increasing the complexity. We prefer a principles-based approach, to ensure flexibility to meet the nature, scale and complexity of firms. These principles should be permitted to apply at group level.

Our responses to some of the questions in the paper are set out in the attached. We would welcome the opportunity to discuss our key concerns and other suggestions with ESMA.

Yours sincerely

A handwritten signature in black ink, reading "Alwine Jones". The signature is written in a cursive, flowing style with a large initial 'A'.

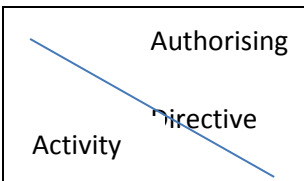
Alwine Jones
EU and International Regulation

Q1: Do you agree with the approach suggested above for developing the present Guidelines? If not, please state the reasons for your answer and also suggest an alternative approach.

Overall, we are fully supportive of the principle of risk aligned remuneration structures. However we are concerned that a fragmented and overly detailed silo approach to implementation will result in multiple sources of remuneration regulation and extremely complex remuneration structures. These may not meet regulators' overall policy intentions and in some cases result in asset managers being subject to more complex requirements than banks.

The proposals would lead to a **patchwork of regulation**. Many IMA members have MiFID investment managers, AIFMs and UCITS managers in their groups, and the current FSA Remuneration Code has been implemented at group level and applies to all staff and all firms within the UK Consolidation Group. Staff will typically perform roles for more than one entity within the group, across segregated mandates, AIFs and UCITS. Accordingly the remuneration of those staff is potentially subject to multiple sources of remuneration regulation.

It should be possible to ensure that there is one firm wide remuneration policy (not a fragmented patchwork of policies at various boards). But in fact UK groups may be subject to four or more sets of guidelines as set out in the chart below. These will also be implemented over differing timescales, requiring multiple changes to remuneration policies over the coming years.

	MiFID	AIFMD	UCITS
Collective Management	N/A	ESMA AIFMD Remuneration Guidelines	Expected ESMA UCITS V Remuneration Guidelines
Portfolio Management	EBA (CEBS) CRD Guidelines AND Proposed guidelines from ESMA	Proposed guidelines from ESMA	Proposed guidelines from ESMA

It is also important that the approach to **proportionality** is consistent across the piece, and in particular these guidelines take into account the wider context of remuneration requirements across the financial sector, and the risks posed by variable remuneration in credit institutions as compared to asset managers, for example:

- Asset managers invest on behalf of their clients (whether segregated, UCITS or AIFs) and will buy and sell securities generally as long term investments. They do not undertake trading activities on a proprietary basis nor generally operate strategies with high portfolio turnover. This contrasts with the risks that are carried on a credit institution's balance sheet through proprietary trading. Should an asset manager fail, there is a strong likelihood of continuity in the investment arrangements of any client - rather than demanding a liquidation or other controlled wind down as with a credit institution.
- The nature and extent of risks that an individual portfolio manager at an asset management firm may take with any particular client's assets are invariably addressed and constrained by agreed investment objectives and guidelines. These may detail asset allocations and benchmarks and may also prohibit or restrict certain investments or markets from being accessed. In many cases these mandates will not have been set with the participation of the individual manager. Existing regulatory and contractual obligations already ensure that asset managers maintain systems and controls to prevent and detect non-compliance with investment mandates and this provides a strong control over excessive risk-taking.
- The reference point against which the size of the bonus pool for variable remuneration is assessed is a highly certain figure in asset management firms and much more so than experience shows has been the case with trading entities such as investment banks. Where the variable remuneration paid by an asset manager is based upon performance, then the type of performance that is measured reflects real value that has been captured for the clients. It is not, as in some business models, mere turnover or the totality of sales where the ultimate profitability is yet to be determined.

For these reasons, the CEBS guidelines rightly realise that asset managers generally present less systemic risk than credit institutions, and allow for neutralisation of certain principles for asset managers. The ESMA guidelines should mirror this to the extent permitted by the L1 text, and a purposive interpretation should be applied to proportionality so that there is indeed consistency with the existing CEBS guidelines.

Granted that the specific reference to neutralisation is not in the L1 text, nonetheless we believe that the wording in paragraph 1 of Annex II '*AIFMs shall comply with the following principles in a way and to the extent that is appropriate*' is sufficiently flexible to allow certain quantitative aspects of the principles to be disapplied for certain AIFMs, and to take the percentages in Annex II to be a cap rather than a minimum.

As an alternative, Paragraph 7 of the Consultation paper confirms that the principles on remuneration set out in the CRD are substantially equivalent to those set out in the AIFMD. Therefore where an asset management group subject to the CRD has implemented a remuneration policy in line with the CRD and the CEBS 2010 guidance, we believe there are strong arguments to suggest that compliance with the CRD on a group wide basis will satisfy compliance with the AIFMD requirements.

This approach would be consistent with the overall regulatory aim of ensuring alignment across the wider financial services industry, as the firm already applies the remuneration policies on a group wide basis. The alternative approach of having multiple remuneration code requirements deriving from each directive, applying to the same group and in many cases the same individual, results in an unworkable outcome.

By way of example, in operating as an integrated firm, the investment management teams will provide investment management services to a range of clients and funds. In order to ensure fair treatment of clients and equitable allocation of investment decisions, clients are typically aggregated together with other clients of the same mandate type. So you can have a composite of clients which may constitute segregated investment management mandates; pooled funds consisting of UCITS; and AIFs. An investment decision on any security purchase or sale will be taken across that composite of clients, subject to any specific client mandate restrictions. It would be impracticable to have a remuneration policy that was divided by reference to the fund structures managed by the portfolio managers. For example, where a portfolio manager has 1 AIF to manage amongst a composite of 10 clients, would 10% of his remuneration be based on the AIFMD remuneration code principles, and should that split be based on numbers of clients or assets under his or her management, which will of course vary over time?

IV. Scope of the Guidelines

Q4: Do you agree that the AIFMD remuneration principles should not apply to fees and commissions received by intermediaries and external service providers in case of outsourced activities?

Yes.

Q5: Notwithstanding the fact that the provisions of the AIFMD seem to limit the scope of the principles of remuneration to those payments made by the AIFM or the AIF to the benefit of certain categories of staff of the AIFM, do you consider that the AIFMD remuneration principles (and, therefore, these Guidelines) should also apply to any payment made by the AIFM or the AIF to any entity to whom an activity has been delegated by the AIFM (e.g. to the remuneration of a delegated investment manager)?

We certainly do not consider that the AIFM remuneration principles should be applied to the payments made to service providers/ delegated investment managers. This is not contemplated in the Directive. Level 1 makes it clear that the Guidelines apply to remuneration of AIFMD staff. It would be illogical to apply the principles to a fee payable to an entity, which is typically a percentage rate management fee and/or in some cases may include an element calibrated to the performance of the funds and in all cases is fully disclosed to potential investors in terms of any prospectus or offering documentation.

Q6: Do you consider that payments made directly by the AIF to the AIFM as a whole (e.g. payment of a performance fee or carried interest) shall be considered as payments made to the benefit of the relevant categories of staff

of the AIFM and, therefore, fall under the scope of the AIFMD remuneration rules (and, therefore, of these Guidelines)?

No. In fact, we do not agree with the definition of carried interest which refers to shares in the profits accrued to the **AIFM** – i.e. more in the nature of a performance fee. We regard carried interest as 'skin in the game' i.e. profit share accrued to individuals rather than the firm. The latter should be included in the scope of these rules; the former should not.

Q7: Do you agree with the categories of staff identified above which should be subject to the remuneration principles set out in the Guidelines? If not, please state the reasons for your answer and also suggest an alternative approach.

We do not agree that staff '*responsible for heading the portfolio management, administration, marketing and HR*' should automatically be in scope.

It should be left to firms to assess whether these staff fall within the category of other risk takers – in many cases individuals who may fall within this description will be acting for a firm as an agent for the AIF, along with other clients' of the manager, arranging for the execution of orders, or making decisions within the parameters of a pre-defined mandate and risk management framework. These individuals will typically be acting for a firm governed by CRD and its remuneration principles and therefore we would argue that where there is a delegation to an external manager, governed by remuneration rules, the AIFM principles on remuneration should be disapplied.

V. Proportionality principle

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.

Whilst we appreciate that the criteria are drawn from the Annex II wording, in reality these criteria are not necessarily drivers of systemic/conduct risk. It is also very important to ensure consistency with CRD and that the Guidelines reflect the Level 1 text which we believe clearly allows for neutralisation and allows for gradation below the stated percentages in Annex II.

In our view, national regulators should have discretion to assess how to apply proportionality in relation to the remuneration policies of the AIFMs in their jurisdiction, since they will already be closely monitoring the risk management approach in firms that they supervise.

For instance in the UK FSA do this for the majority of our members as part of the capital adequacy assessment process. This requires FSA to:

- review the arrangements, strategies, processes and mechanisms implemented by a firm to comply with prudential and systems and controls

- requirements, and with requirements imposed by or under the regulatory system and evaluate the risks to which the firm is or might be exposed;
- determine whether the arrangements, strategies, processes and mechanisms implemented by the firm and the capital held by the firm ensures a sound management and coverage of these risks ; and
- (if necessary) requires the firm to take the necessary actions or steps at an early stage to address any failure to meet the requirements referred to above.

Where these types of controls are already in place, AIFMs and national regulators should work closely together to develop remuneration policies tailored to their business and their risk profile.

VI. AIFMs being part of a group

Q12: Do you agree that there is a need for consistency in the potential application of different requirements for AIFMs which belong to a group subject to other principles?

Yes – which is why we are concerned about the proposed patchwork of regulation which will not result in a consistent approach, given the different approaches to proportionality and neutralisation between the ESMA and the CEBS guidelines with regard to asset managers. (See answer to 1 above).

Q13: Do you agree that the proposed alignment of the CRD and AIFMD remuneration provisions will reduce the existence of any conflicting remuneration requirements at group level for AIFMs whose parent companies are credit institutions subject to the CRD? If not, please state the reasons for your answer and provide quantitative details on any additional costs implied by the proposed approach.

No: the proposals conflict with those for asset managers under CRD – see answers to 1 above. It is critical to have a consistent approach, and this should be flexible and proportionate as are the CEBS Guidelines for MiFID investment firms. Many AIFMs will operate within wider asset management groups, where the group will be subject to the CRD remuneration requirements, and operates only one business line, namely asset management. This would be different to that of an asset manager within a wider banking or insurance group where there will be more than one business line. One approach (see above) might be where an asset management group has already implemented a group-wide policy under CRD, this should be deemed AIFMD compliant (subject to reviewing the scope of identified staff). Again, the application to groups should, we believe, be left to national regulators because they will have greater understanding of group structures and risk management processes in the groups they supervise. Our members have less difficulty with a principles-based approach as applies to them under CRD.

VII. Financial situation of the AIFM (Annex II, paragraph 1(o) of the AIFMD)

Q15: Do you agree with the above principle aimed at preserving the soundness of the AIFM's financial situation? If not, please state the reasons for your answer and also suggest an alternative approach.

We agree with the principle that the AIFM's financial situation should not be adversely affected by the overall pool of variable remuneration that will be awarded for that year, and firms should therefore operate with sufficient flexibility in terms of the setting of that variable pool. However we believe the current proposals could in fact have the opposite effect.

It is critical that asset management firms can operate flexibly in terms of setting the variable pool of remuneration. The main driver of profit variation for asset managers is market movement – rather than risk levels or write offs. Increasing the fixed remuneration will increase the fixed overheads of the business and in many cases the capital of the business and decrease flexibility. The ability to flex variable remuneration has enabled asset managers to survive in adverse market conditions. A requirement to fix the balance between variable and fixed could be pro-cyclical, in that firms would have to have higher fixed remuneration which would make them less resilient.

Also, the same logic which applies to variable remuneration in the banking sector does not apply to agency business where the profits/losses are crystallised.

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.

The role of the management body of the AIFM has to be interpreted in the context of any position it may have in a group context where there will potentially be a management body of the ultimate parent, with responsibility for the overall remuneration policy of the group. The guidelines on governance of the remuneration policy must also have sufficient flexibility to address different legal structures such as partnerships.

VIII. Governance of remuneration

Q18: Do you agree with the guidelines above on the shareholders' involvement in the remuneration of the AIFM?

We have no difficulty with the principle of shareholder involvement – where there are shareholders. Indeed this is already covered across the piece in the UK by legislation and regulation for listed companies. However most of our members are not listed.

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.

No. A pragmatic outcomes-based approach should be taken here. We are particularly concerned with the statement that AIFMs with less than EUR 250m AUM will not need to

establish a Remuneration Committee. If this means that all AIFM above that will need a Remco, then the vast majority will be caught, including those which are sub-threshold.

Most asset management firms operate one business line (asset management) and look at remuneration governance at a group level and have structured remuneration oversight in line with CRD at that group level. To require a subsidiary company remuneration committee with prescription on independent challenge would not add any tangible benefit to stakeholders. Therefore the example of a subsidiary of a credit institution not needing a RemCo because there will be one for the group needs to be extended to other groups.

Also, sufficient flexibility needs to be provided to accommodate the differing legal structures of our member firms. So, for instance, the reference to independence causes concern if this means that firms need NEDs. Some of our members have adopted governance structures where they do not feel it necessary or appropriate to have NEDs within their group. In line with the proportionality principle, they should not be required to appoint NEDs solely to meet RemCo requirements, provided the RemCo meets the spirit of the requirements.

As a general point, we would favour a national approach here - since this could take account of the local corporate governance regimes and local organisational structures.

Q20: Do you agree that in assessing whether or not an AIFM is significant, consideration should be given to the cumulative presence of a significant size, internal organisation and nature, scope and complexity of the AIFM's activities? If not, please provide explanations and alternative criteria.

See our answer to Q9.

Q21: Please provide quantitative data on the costs and benefits that the proposed criteria to determine whether a RemCo has to be set up would imply.

See answer to Q19.

It is essential that for those asset managers which are required to have a RemCo, this should be done at group level, since asset managers operate one business line, with staff potentially carrying out activities for multiple legal entities within the group, including MiFID firms, AIFMs and UCITs ManCos. To have separate RemCos for these companies would not only be extremely costly, it would not add any benefit to that which a Group RemCo would bring.

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.

See answer to 20 above. We agree that it is not possible to provide an exhaustive list of examples of AIFMs which need not establish a RemCo, however, the use of two examples is too narrow. Moreover, the EUR 250m figure is arbitrary and too low (the vast majority of AIFMs would be caught and some AIFMs which would be out of scope

could be caught). In addition, hard figures create difficulties for firms, at or near the limit, with potential fluctuations above or below the threshold.

Instead, we recommend removing any examples leaving flexibility within firms and competent authorities to interpret the requirements appropriately. And, as noted above, any RemCo should be established at group level.

Q23: Do you agree with the principles relating to the composition of the RemCo? Please provide quantitative data on the costs and benefits that the proposed principles on the composition of the RemCo would imply.

No – see answer to Q19. The principles relating to the composition of the RemCo should be sufficiently flexible to accommodate different business models. A particular issue is with independence: what does this mean? Many of our members do not have NEDs. Also, paragraph 77 places an unnecessary burden in terms of competence: will it be practical that the majority of members of a RemCo will have ‘*expertise and experience with regard to the mechanisms for aligning the remuneration structure to the AIFM’s risk and capital profiles*’?

Q24: Do you see any need for setting out additional rules on the composition of the RemCo?

No.

Q25: Do you agree with the role for the AIFM’s RemCo outlined above? If not, please provide explanations.

Yes, where a RemCo is necessary, but these controls can be put in place effectively without the need for a separate Committee.

Q26: Do you agree with the principles above on the process and reporting lines to be followed by the RemCo? If not, please provide explanations.

As already noted it is important that any reporting structure be organised at Group level within an asset management firm.

Q27: Do you consider that the AIFM’s RemCo should provide adequate information about the activities performed not only to the AIFM’s shareholders’ meeting, but also to the AIFs’ shareholders’ meetings? When providing your answer, please also provide quantitative details on the additional costs involved by such requirement.

No. The disclosure requirements under AIFMD require this to be disclosed in the annual report and accounts, and this should be sufficient.

Q28: Do you agree with the above criteria on the remuneration of the control functions? If not, please provide explanations.

We agree that the remuneration of the control functions must be designed to minimise conflicts and must avoid compromising their independence.

X. Specific requirements on risk alignment

Q34: Do you consider these common requirements for the risk alignment process appropriate? If not, please provide explanations and alternative requirements.

We do not agree that ex post risk adjustments should take all **errors** into account. An open and no blame approach to reporting errors should be encouraged. A direct linkage of errors to variable remuneration might encourage non-reporting of errors and an erosion in the firm's compliance culture. A better approach might be to require this only where there has been gross negligence or recklessness on the part of the relevant person.

Q40: Do you agree with the proposal according to which AIFMs should use both quantitative and qualitative measure for the ex-ante risk adjustment? If not, please provide explanations and an alternative proposal.

Any ex ante risk adjustment has to be considered in the context of an asset management firm where fees paid are based upon realised performance (i.e. crystallised), so that investors exiting will receive that realised return. Also, under ESMA guidance, to apply ex ante adjustment at an individual entity level could have unintended consequences where bonus pools are typically created at a group level, and not at entity level (given many staff are providing shared services for multiple firms within the group).

Q42: Do you agree with the types of instruments composing the variable remuneration which have been identified by ESMA? If not, please provide explanations.

Unlike with CRD, instrument-based incentives are in the funds and not the firm. In theory it may make sense to align the interests of the manager with those of the fund, but not in all cases and in practice an overly prescriptive approach to the application of share based awards could give rise to many difficulties.

It will create new conflicts which need to be managed – for instance, given that portfolio managers will often manage segregated mandates as well, it could incentivise them to give preference to the funds over the segregated mandates. And in practice it is unlikely that the individual's own investment horizons and objectives will be directly aligned to those of any one funds or indeed the multiple funds that he/she may manage – take for example a fund manager approaching retirement; so this too could lead to a conflict where the manager's investment behaviour may be indirectly influenced, so that decisions on running the fund are to meet his own lifecycle investment objectives rather than the fund's – and so maybe being overly cautious or taking excessive risks. It will also mean that managers may be reluctant to manage funds in markets which were currently out of favour or underperforming but which are strategically important for the firm and its clients.

In addition, where a firm's overall profitability is determined substantially on market movements and performance of client mandates. If the value of fund shares declines, this will affect the individual's share based element, but will also affect the overall firm revenues, which will have a bearing on bonus pools and remuneration for that individual.

It is difficult to envisage how this will operate in practice where a single individual may manage multiple AIFs, multiple UCITS, multiple separate accounts, and when the funds may be closed ended, or only open to large institutional investors.

In conclusion, appropriate flexibility must be provided to ensure that these unintended consequences can be appropriately managed by firms in the implementation of the requirements.

XI. DISCLOSURE

Article 22 of the Level 1 text requires that remuneration disclosure is made in the annual report. In most cases annual reports for funds will not be made public but will just be sent to investors and to competent authorities as required by Article 22. We do not agree therefore with the statement in paragraph 151 of the Guidelines that there has to be public disclosure, since this clearly goes beyond Level 1.

Finally, the Guidelines should make it clear that the annual reporting requirements under Article 22 come into effect for the first full financial year after the AIFM is granted authorisation under the Directive.