

## Comments

On ESMA's Consultation paper "Guidelines on sound remuneration policies under the AIFMD" – ESMA/2012/406

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VGF Verband Geschlossene Fonds e.V.

Association of Non-Tradeable Closed-End Funds

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## I. Preliminary remarks

VGF<sup>1</sup> would like to express its thanks for the opportunity to comment on ESMA's Consultation paper "Guidelines on sound remuneration policies under the AIFMD" – ESMA/2012/406. Some of our remarks are not covered from ESMA's particular questions. Nonetheless we wanted to draw ESMA's attention on our perspective of the key issues. Furthermore, our answers are only focussed on the questions with relevance for Non-Tradeable Closed-End Funds.

As background information we shall repeat that Non-Tradeable Closed-End Funds have thus far remained outside the scope of European capital market regulations. Under German capital market supervisory law there is a provision regarding the drafting and approval of sales prospectuses. There are also industry standards such as the obligation to compile track records (annually published records of all results of all funds under management) and membership of the Non-Tradeable Closed-End Funds ombudsman. Adherence to these standards is an essential prerequisite of membership of the VGF. The AIFM Directive will, therefore, be the first European regulatory regime to be applicable on German Non-Tradeable Closed-End Funds. The requirements of the Directive pose a major challenge for the companies in this market, who will have to adjust to a new operating context. We are pleased to submit our proposals and comments, which we hope may pave the way to practical, effective, economically feasible solutions.

We encourage ESMA to take into account all the different business models which are in the scope of the AIFMD. We shall repeat that Non-Tradeable Closed-End Funds are so far a niche product in the AIFM regime. Although they are defined as AIF, their legal structure, their management tasks, their systemic relevance, their risks, and investors differ widely from almost all other fund models affected by the AIFMD.

Non-Tradeable Closed-End Funds are partnerships in which the capital provided by several investors is pooled to invest in assets like real estate, shipping, aviation or renewable energy. The fund usually invests in a single asset which is clearly defined in advance. Although ESMA still owes further clarification towards the key concepts of

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<sup>1</sup> VGF Verband Geschlossene Fonds e.V. (Association of Non-Tradeable Closed-End Funds) represents the interests of providers of non-tradeable closed-end funds (NTCEFs) in Germany. Through its 63 members, the association represents some EUR 140 billion (portfolio of assets under management), managed in around 3.300 funds. Related to the total market in Germany with a fund volume of some EUR 199 billion, the association therefore represents about 70 % of the NTCEF market. Further information is available at: [www.vgf-online.de](http://www.vgf-online.de).

AIFM and a clearer definition of an AIFM, we work on the assumption that a subsidiary of the issuing house will be viewed as an AIFM.

The issuing houses design and put together the fund structure: They set up the investment company by drawing up a partnership agreement appropriate to the fund, they acquire the investment object and they ensure all the necessary contracts (e.g. partnership agreement, purchase/lease contract) are signed. The fund closes, when the predefined amount of money is collected from the investors. After this, there is the asset manager whose principal task lies in managing the fund asset, e.g. the property manager or vessel owner. But – and this is the important difference to other open-ended fund structures – the management of a typical Non-Tradeable Closed-End Funds is specifically not authorised to buy or sell the asset. Decisions of this type may only be made by the General Meeting. This is why strictly speaking, there is no portfolio management in Non-Tradeable Closed-End Funds, as the fund usually focuses on a single asset which is management throughout the lifetime of the fund.

**We would urge ESMA to take into account that managers of Non-Tradeable Closed-End Funds do not have any impact on material changes of the fund, especially not towards buying or selling the asset. When elaborating Guidelines on remuneration, it is important for ESMA to consider that for the lack of this decision-making ability these AIFM cannot even act risk driven. Hence without any crucial risk there is nothing that could be paid in a ratio to the risk.**

With this in mind the industry fears that setting up remuneration policies and maybe even RemCos only increase administration and therefore cause higher costs without any noteworthy added value for the industry, the supervisory authorities or the investors. We think that in cases where fund managers cannot even make decisions in a more or less risky way, ESMA should consider an absolute minimum of regulatory obligation that the AIFMD claims.

**Furthermore it is very important to clarify how variable remuneration should work in Non-Tradeable Closed-End Funds. ESMA's approach towards employees' contributions in AIFs is simply unworkable for funds that are closed at the beginning of the lifetime and cannot be easily reopened only for remuneration reasons. ESMA needs to elaborate a feasible solution for these cases.**

Finally we need to highlight at this very first stage that change in the remuneration policies always go along with deep intervention in labour law. We ask ESMA to bear in mind that renegotiations and maybe even dismissals of labour contracts automatically lead to higher costs. Thus employees have trusted in their labour contracts, their

remuneration and their pensions. Therefore we need to find adequate transposition periods or grandfathering clauses in order to protect employees against unexpected and material changes in their labour contracts.

## II. Answers to particular ESMA questions

**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 feel the need for further clarification towards ancillary payments. It remains unclear which payments ESMA intends to leave outside the scope. We therefore like to ask ESMA to define more clearly what it means and especially to what extent ancillary payments can be used among the regular payment.

**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?**

We totally agree with this assumption.

**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 neither see any legal justification for this approach nor believe in any further benefit. As the AIFM remains responsible for delegated tasks and liable for errors of the delegate, a further identification and if needed a material influence on the delegate's payments seems inappropriate.

**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)?**

Payments of the AIF to the AIFM are not necessary equitable to remuneration. On the contrary, payments e.g. management fees compensate a specific service of the AIFM and cannot automatically be broken down to individual staff members. Therefore we do not see the reason for this understanding.

**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 believe that heads of administration, marketing and human resources regularly do not have any impact on the risk profile or the performance of any managed AIF. The burden of proof should therefore be the other way around. If at all, we suggest considering this staff as possibly other risk takers.

**Q8: Please provide qualitative and quantitative data on the costs and benefits that the rules proposed in this Section IV (Scope of the Guidelines) would imply.**

We cannot deliver data towards the costs by now. Nonetheless the impact of the remuneration rules will be indeed costly. We urge ESMA to take into the characteristics of Non-Tradeable Closed-End Funds as described in our preliminary remarks. Along these, ESMA Guidelines should follow the principles of proportionality as determined in Art. 13 (2) AIFMD and Annex II. Especially the application of new remuneration policies for existing staff could cause material cost burdens for the industry. Changes in labour contracts will cause further costs and administrative efforts. Although we do not know any numbers it will in any case cause more than marginal costs. Thus, transposition rules and periods or even grandfathering should seriously be taken into account.

**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.**

We do agree with this proposal.

**Q10: Do you agree with the clarifications proposed above for the application of the proportionality principle to the AIFM's categories of staff? If not, please state the reasons for your answer and also suggest an alternative approach.**

We do agree with this proposal.

**Q11: Please provide qualitative and quantitative data on the costs and benefits that the rules proposed in this Section V (Proportionality principle) would imply.**

With reference to answer 8, we cannot deliver any of this data. Anyhow we fear a material burden of costs and therefore would urge EMSA to find clear and adequate transposition rules and periods or even grandfathering rules.

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

If at all, the involvement of shareholders should only be measured in accordance with national corporate law.

**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.**

We do not agree with ESMA's analysis towards the significance of AIFM. The AIFMD owes any further clarification to which or what the AIFM is significant. As the AIFMD mainly addresses systemically relevant managers and activities ESMA's assumption should take into account these factors. We agree in minimum limit to define significance. But the simple number of EUR 250 million seems arbitrary. As always the single use of a quantitative threshold leads to inappropriate results. Hence, other criteria are needed to further define significance. We suggest a criterion of how big is the (systemic) role of the AIFM in the market. Furthermore the number of employees could indicate the need to establish a RemCo. We believe that even small companies with only a few staff might break the threshold easily although a RemCo do not seem to be necessary. Therefore we see the need for more qualitative benchmarks to define whether a RemCo is needed or not.

**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.**

We would agree on this, if ESMA takes into account towards whom the AIFM is significant (please mind answer 19).

**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.**

With reference to answer 8, we cannot deliver any of this data. Anyhow we fear a material burden of costs and therefore would urge EMSA to find clear and adequate transpositions rules and periods or even grandfathering rules. We do not believe that the RemCo could deliver any benefit for the business model of Non-Tradeable Closed-End Funds or could generate any return of investment at all.

**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.**

Please mind answer 19.

**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.**

We ask ESMA for clarification of how many people the RemCo should consist of.

**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.**

As the investors of the AIF receive all necessary information towards the remuneration in the annual report another direct reporting from the RemCo to the AIF would affect double information and double costs.

**Q29: Please provide qualitative and quantitative data on the costs and benefits that the rules proposed in this Section VIII (Governance of remuneration) would imply.**

With reference to answer 8, we cannot deliver any of this data. Anyhow we fear a material burden of costs and therefore would urge EMSA to find clear and adequate transposition rules and periods or even grandfathering rules.



**Q31: Do you consider appropriate to add any further guidance on the payments related to the early termination of a contract? If yes, please provide suggestions.**

We think it is important to keep up the freedom of contract in labour law, when it comes to termination of contracts. Likewise private settlements should be possible in the future to decrease potential judicial disputes.

**Q32: Do you consider that the above guidance is sufficiently broad to cover any kind of hedging strategies that may be pursued by a member of the staff of an AIFM? If not, please provide details on how the scope of the guidance should be enlarged.**

We consider ESMA's guidance as too vague. It should be defined more clearly what hedging strategy is meant. At the moment it is difficult to say what strategy is prohibited and which is allowed.

**Q33: Please provide qualitative and quantitative data on the costs and benefits that the rules proposed in this Section IX (General requirements on risk alignment) would imply.**

With reference to answer 8, we cannot deliver any of this data. Anyhow we fear a material burden of costs and therefore would urge EMSA to find clear and adequate transposition rules and periods or even grandfathering rules.

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

As already mentioned in our preliminary remarks, managers of Non-Tradeable Closed-End Funds can take any risk towards the fund because they do not have any discretion in the decision making process. Employees of the issuing house who design a fund, are often not employees of the fund management, since very different qualities are required. So we shall repeat that for a fund that invests only once at the beginning, the fund's management has no effect on the risk structure at all. This means that currently fund managers of the vast majority of Non-Tradeable Closed-End Funds have simply no effect to the performance of the fund. Likewise this eliminates the need to control these people through a system of compensation or remuneration policies so far.

**Q41: Do you agree with the guidance on the different components to be considered in**

**relation with the deferral schedule for the variable remuneration? If not, please provide explanations and alternative guidance.**

Although we have some understanding for ESMA's approach the impact on tax and accounting remains unclear for Non-Tradeable Closed-End Funds for the moment.

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

We think that this approach is unworkable for Non-Tradeable Closed-End Funds. It will decrease the variable remuneration significantly for two reasons:

1. It remains unclear how this obligation should be fulfilled by Non-Tradeable Closed-End Funds which do not allow any investor to join or leave the fund after it has been closed at the very beginning of the fund's lifetime. We urge ESMA to take this into account. All solutions that come to mind are not feasible, mainly legally but also technically. A direct contribution of the employee in the AIF would therefore only be possible at the very beginning. A re-opening for remuneration reasons or in case of fluctuation in staff is impossible. An own contribution of the AIFM in the AIF, which could pool the remuneration commitments towards the staff is not allowed through the Level 1 text, for reasons of potential conflicts of interests. We kindly ask ESMA for clarification and elaboration of guidance how variable remuneration should work in Non-Tradeable Closed-End Funds at all.

2. Since shares in Non-Tradeable Closed-End Fund cannot be redeemed during the lifetime of the fund they do not appear as a suitable remuneration instrument for employees of the AIFM. The lack of short and medium term availability would shift the date for pay-outs by years or even decades. From an employee's perspective this is totally unacceptable. We ask ESMA for further guidance, how to tackle this very urgent problem.

**Q44: Do you agree with the proposed guidance for the retention policy relating to the instruments being a consistent part of the variable remuneration? If not, please provide explanations and alternative guidance.**

Although we have some understanding for ESMA's approach the impact on tax and accounting remains unclear for Non-Tradeable Closed-End Funds for the moment.

**Q46: Do you agree with the analysis on certain remuneration structures which comply with the criteria set out above? If not, please provide explanations.**

The connection to the liquidation of the funds is inadequate for the business model of Non-Tradeable Closed-End Funds.

**Q48: Please provide qualitative and quantitative data on the costs and benefits that the rules proposed in this Section X (Specific requirements on risk alignment) would imply.**

With reference to answer 8, we cannot deliver any of this data. Anyhow we fear a material burden of costs and therefore would urge EMSA to find clear and adequate transposition rules and periods or even grandfathering rules.

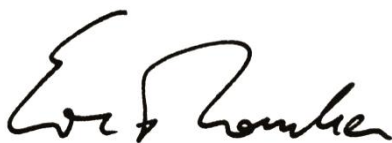
**Q49: Do you consider appropriate to require AIFMs to apply the same level of internal disclosure of remuneration as they apply to their external disclosure? Please state the reasons of your answer.**

We doubt that internal debates about salaries are conducive especially in small and medium sizes companies. Therefore the information should be reduced to the ultimate minimum. On the other hand there is no reason to withhold information that is accessible in the annual report. We suggest ESMA to give guidance towards synchronised approach.

**Q50: Please provide qualitative and quantitative data on the costs and benefits that the rules proposed in this Section XI (Disclosure) would imply.**

With reference to answer 8, we cannot deliver any of this data. Anyhow we fear a material burden of costs and therefore would urge EMSA to find clear and adequate transposition rules and periods or even grandfathering rules.

Brussels, 27 September 2012



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