



European Securities and
Markets Authority

Final report

Guidelines on sound remuneration policies under the AIFMD



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Acronyms used

| | |
|-----------------|---|
| AIF | Alternative Investment Fund |
| AIFM | Alternative Investment Fund Manager |
| AIFMD | Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 ¹ |
| EBA | European Banking Authority |
| ESMA | European Securities and Markets Authority |
| UCITS | Undertakings for Collective Investment in Transferable Securities |
| UCITS Directive | Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast) ² |

¹ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:174:0001:0073:EN:PDF>.

² <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0032:0096:EN:PDF>

I. Executive Summary

Reasons for publication

Annex II of the AIFMD establishes a set of rules (largely inspired from the provisions of Directive 2006/48/EC, the “CRD”) with which AIFMs have to comply when establishing and applying the remuneration policies for certain categories of their staff. Article 13(2) of the AIFMD requires ESMA to develop guidelines on sound remuneration policies which comply with Annex II of the AIFMD. This final report sets out the final text of the guidelines on remuneration policies required by the AIFMD.

Contents

Section II sets out the feedback statement to the consultation paper (ESMA/2012/406) previously published by ESMA.

Annex I includes the cost-benefit analysis.

Annex II comprises the opinion of the Securities and Markets Stakeholder Group.

Annex III contains the full text of the final guidelines.

Next steps

The guidelines in Annex III will be translated into the official languages of the EU, and the final texts will be published on the ESMA website. The deadline for reporting requirement dates will be two months after the publication of the translations. The guidelines will apply from 22 July 2013, subject to the transitional provisions of the AIFMD.

II. Feedback Statement

1. ESMA received 32 responses to the consultation paper (CP) on guidelines on sound remuneration policies under the AIFMD (ESMA/2012/406). Responses were received from investment fund managers (and their associations), associations of private equity, venture capital and real estate companies and associations of insurers and bankers, banks, law firms and lawyers' associations.

General comments

2. Several respondents stressed the need to ensure consistency between the guidelines on sound remuneration policies under the AIFMD (hereinafter "AIFMD Guidelines") and other remuneration guidelines, while taking into account the specificities of the different business models: these respondents mentioned that in the future many firms would have to apply at least four sets of remuneration guidelines, namely the AIFMD Guidelines, ESMA guidelines focused on remuneration policies of investment firms from an investor protection point of view (hereinafter "MiFID Guidelines"), the Guidelines to be issued by ESMA under UCITS V and the CEBS Guidelines on remuneration of 2010 (hereinafter "CEBS Guidelines"). One respondent recommended the inclusion of guidance on the scope of application of the AIFMD to firms that are already affected by equivalent measures such as the FSA's Remuneration Code. Another respondent added that it would be unfortunate to have to revisit the AIFMD Guidelines and the UCITS V Level 1 text in order to incorporate any additions in the text of the CRD which is currently being revisited and on which both are based.

3. Other general comments included:

- i) Clarifications are needed on how the MiFID Guidelines will feed into the AIFMD Guidelines. One asset management association was of the opinion that the MiFID Guidelines should apply to AIFMs only insofar as they perform MiFID services and ancillary services.
- ii) The rules should focus less on imposing bank-style regulation for AIFMs and focus more on the specificities of the asset management sector: in particular, considering the fact that most AIFMs will be medium or small companies run by their owners which do not have complex governance structures and that hedge fund investors understand the risk levels associated with alternative investment funds (which are disclosed to them in the relevant offering document) in a way that banking clients and customers would not. Furthermore, unlike certain other financial institutions, asset managers are both agents and fiduciaries that are engaged specifically to take disclosed risks with their clients' assets, and only as permitted under fund laws and the agreed investment objectives and guidelines, which is markedly different from taking risks with a financial services firm's own assets.
- iii) Dividends paid to an AIFM's shareholders (and profit allocations to partners or members of AIFMs structured as LLPs or limited partnerships) who are otherwise Identified Staff (as defined in the CP) are not remuneration and are therefore not subject to the AIFMD Guidelines. However, in the event that such payments are considered remuneration, an asset managers' association asked ESMA to consider the fact that the profits of such entities are required for tax purposes to be allocated to the members or partners each year, whether or not the profits are distributed; thus, a requirement to defer payment of any such amount will result in an unfunded tax obligation for the relevant member or partner.

- iv) Remuneration requirements should be less stringent for UCITS management companies and UCITS managers need no obligation beyond existing disclosure requirements.

ESMA's response: ESMA is of the view that the AIFMD Guidelines should contribute to the cross-sectoral alignment of the remuneration provisions; further to the consultation on the draft guidelines some amendments have been introduced in order to ensure an additional tailoring of the relevant requirements to take into account the specificities of the asset management industry (see the following sections for more details on the changes introduced in the final AIFMD Guidelines further to the feedback received from the consultation).

The scope of application of the MiFID Guidelines will be determined under a separate work stream. In general, the draft MiFID Guidelines published by ESMA are focused on ensuring investor protection when investment services are provided under MiFID. Specifically, it is envisaged that the MiFID Guidelines will assist investment firms that provide MiFID services in meeting relevant conflict of interest and conduct of business obligations arising from MiFID. In this context, the MiFID Guidelines are only relevant to those AIFMs performing the additional MiFID activities under Article 6(4) of the AIFMD. Given that the MiFID Guidelines are not applicable to other AIFMs and there are no provisions in the AIFMD guidelines which contradict the MiFID Guidelines, ESMA considered that there was no need to introduce any specific additional alignment of the provisions.

For the final approach followed by ESMA on the application of the AIFMD Guidelines to payments of dividends, see ESMA's response under Q2 below.

Background

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.

4. A number of respondents pointed out that asset managers may exercise different activities subject to different remuneration rules, and that these activities may be exercised by the same personnel working on different product lines falling under different directives while receiving a single remuneration package covering all work performed. Taking this into account, these respondents stressed the importance of applying consistent principles of remuneration (including the scope of application, i.e. personnel covered) across those different pieces of legislation. At the same time, these respondents welcomed ESMA's efforts to adapt the remuneration principles to the specificities of the asset management sector as compared to the banking sector and recommended the adoption of a principles-based approach for the AIFMD Guidelines that would leave enough flexibility to meet the nature, scale and complexity of the firms to which they apply (some of the members of one of these asset managers' associations recommended that this principles-based approach should be set out in a horizontal measure and not in the different pieces of legislation).
5. A hedge fund managers' association highlighted the differences between hedge fund managers and asset managers in general and banks, which in their view warranted a differentiated regulatory approach for developing the AIFMD Guidelines: this respondent mentioned, inter alia, that investors in hedge funds (i) seek particular risk exposure, which is not the case for bank depositors or money market fund investors and (ii) fully understand the risks involved in making hedge fund investments and have the ability and resources to anticipate and manage the risks associated with those investments. Given the approach chosen (i.e. to develop the AIFMD Guidelines on the basis of the structure used for the CEBS Guide-

lines), this respondent recommended taking great care to ensure that the structures imposed are actually appropriate to AIFM remuneration.

6. Notwithstanding the fact that ESMA's approach considers the specificities of the asset management sector, a private equity and venture capital asset managers' association expressed some concerns that ESMA did not sufficiently take into account the different business models (e.g. hedge funds, real estate, private equity and venture capital): in their view, one of the most important concerns of investors in private equity and venture capital vehicles is the alignment of interests and this is achieved through the carried interest model which should not be compromised by the AIFMD Guidelines.
7. Another respondent suggested that ESMA should create a set of single financial sector remuneration guidelines that apply to all entities subject to regulation under CRD, AIFMD, UCITS and MiFID.

ESMA's response: Given that the feedback received did not substantially question the approach chosen by ESMA for the development of the AIFMD Guidelines, ESMA decided not to change its approach.

As for the request to take into account the specificities of the asset management industry, please see the previous response.

ESMA does not consider that a single set of remuneration guidelines for all entities subject to CRD, AIFMD, UCITS and MiFID is currently feasible, particularly in light of the fact that the CRD is currently subject to review and the UCITS Directive is also being amended in order to include, inter alia, new remuneration requirements. Since these legislative changes have not yet been adopted, it is not possible to create a single set of remuneration guidelines applying to CRD, AIFMD, UCITS and MiFID entities. In any event, the various guidelines focus on different underlying issues (e.g. CEBS guidelines focus on prudential issues, MiFID guidelines focus on investor protection issues etc); as such, ESMA considers that the various sets of guidelines are complementary while applying consistent principles.

Structure of the Guidelines

8. While agreeing that inevitably certain remuneration requirements will apply to the AIFM as a whole, a hedge funds managers' association disagreed with the conclusion reached in paragraphs 14 to 17 of the CP on the basis that the Level 1 text explicitly limits the application of the remuneration rules to the Identified Staff and nowhere in the Level 1 text is there any mention of certain requirements applying on a firm-wide basis. Several other asset managers' associations mentioned that there was no basis for the proposed approach that some of the principles stated in Annex II of the AIFMD should apply to AIFMs and their staff as a whole while others apply only to Identified Staff: therefore, these respondents requested the removal of any distinction between general and specific requirements for risk alignment so that AIFMs and competent authorities could determine themselves to which Identified Staff the remuneration principles should apply. Two respondents argued that a distinction between general and specific requirements would lead to the situation that the general requirements for risk alignment would also apply to those categories of staff whose activities have no connection with the risk profile of the AIFM or the AIF (e.g. receptionists, caretakers, secretaries, etc.).
9. Some asset managers' associations suggested introducing a European materiality threshold under which the remuneration rules would not be applicable and only variable remuneration above that threshold would be covered by the rules. One of these associations specified that the threshold should be set up as an absolute amount (for instance EUR 200,000) and/or as a relative percentage (for instance bonuses exceeding 50% of the total remuneration).

10. Another asset managers' association mentioned that paragraph 17 of the CP said that an AIFM-wide application of the specific risk alignment requirements is strongly recommended, but this appears confusing or inconsistent with the CRD where the requirements have already been interpreted on a group-wide basis.

ESMA's response: ESMA considered that the principles related to the general requirements on governance of remuneration apply by their nature to the AIFM as a whole and, therefore, did not change its approach on this point (which is consistent with the one followed under the CEBS Guidelines in relation with the CRD rules). As for the general requirements on risk alignment, ESMA saw merit in no longer providing for their mandatory application to the AIFM as a whole. However, ESMA considered it appropriate to strongly recommend a wider application of them to the AIFM as a whole with an obligation to be able to demonstrate to competent authorities why these requirements have been applied to the Identified Staff only. As for the specific requirements on risk alignment, ESMA did not change the approach followed in the CP and the mandatory application of these requirements should relate to the Identified Staff only; a voluntary application of certain of these requirements is strongly recommended in accordance with the approach taken in the CEBS Guidelines in relation to the CRD rules.

ESMA did not take into account the request to introduce a materiality threshold since this would have the effect of limiting the scope of application of the AIFMD Level 1 rules, which do not provide for any threshold for the application of the rules on variable remuneration.

Scope of the Guidelines

Which remuneration?

Carried interest

11. A private equity and venture capital asset managers' association made several comments on the approach taken in relation to "carried interest"; these may be summarised as follows:
- i) The association pointed out that "carried interest" in a private equity/venture capital (PE/VC) context is not "remuneration" in any ordinary sense of the word. This respondent argued that the definition of "carried interest" in Article 4(1)(d) of the AIFMD is inconsistent with the PE/VC model, since carried interest does not represent "compensation for the management of the AIF" (for which the AIFM is compensated by way of a separate management fee that provides a regular income to meet operational costs), but is a share in the gains realised from an AIF's underlying investments allocated to the AIFM or related individuals or vehicles. However, the same respondent agreed that "carried interest" should be taken into consideration in the manner proposed in the CP for the satisfaction of the alignment of interests and other criteria of Annex II of the AIFMD.
 - ii) The association noted that there is no provision in the AIFMD which expressly captures carried interest in the definition of remuneration; on the contrary, paragraph 2 of Annex II makes an explicit distinction between "remuneration" versus "any amount paid directly by the AIF itself, including carried interest". Therefore, this respondent encouraged ESMA to avoid formulations which suggest that "remuneration" is necessarily "in exchange for professional services rendered by the AIFM staff" or by way of "compensation for management of the AIF" and suggested adding the following wording in paragraph 10 of the draft guidelines in the CP in order to

prevent any attempt to avoid the AIFMD remuneration principles on the basis of a narrow construction of the language used:

“[...] solely for purposes of Annex II, remuneration consists of all forms of payments or benefits paid by the AIFM to identified staff of the AIFM, including payments of carried interest made by the AIF and any transfer of units or shares of the AIF, in exchange for professional services rendered by the AIFM’s identified staff to the AIFM, and these guidelines apply also to carried interest to the extent that the AIFM’s identified staff participate in it”.

12. A hedge fund managers’ association disagreed 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; this respondent considered carried interest as a profit share accrued to individuals rather than the firm and only the latter should be included in the scope of the remuneration rules.

ESMA’s response: ESMA considered that the definition of “carried interest” is given in Article 4(1)(d) of the AIFMD and, therefore, there is no room for introducing any alternative definition in the AIFMD Guidelines. However, ESMA saw merit in clarifying that the inclusion of “carried interest” in the notion of remuneration is relevant solely for the purposes of the AIFMD 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.

13. Several asset managers’ associations agreed with the considerations on the scope of the AIFMD Guidelines.
14. A hedge fund managers’ association noted that dividends paid to an AIFM’s shareholders (and profit allocations to partners or members of AIFMs structured as LLPs or limited partnerships) who are otherwise Identified Staff are not remuneration and should therefore not be subject to the AIFMD Guidelines. Therefore, this respondent asked that “(i) partners in an AIFM that is organised as a limited liability partnership or a limited partnership and (ii) employees who are shareholders of an AIFM that is organised as a limited liability company” should be treated in the same way as dividends paid to partners of banks according to paragraph 17 of the CEBS Guidelines (i.e. exempted).
15. Along the same lines, a private equity and venture capital asset managers’ association pointed out that most of the PE/VC AIFMs are owner-managed businesses structured as a partnership, limited liability partnership or similar and requested the addition of a paragraph similar to paragraph 17 of the CEBS Guidelines, which should read as follows:

“Consideration must also be given to the position of sole proprietorships, partnerships and similar structures. Returns on equity and similar interests, depending on the legal structure of the institution or entity, are not covered by these guidelines (unless they represent a vehicle for circumvention)”.

ESMA’s response: ESMA saw merit in including some clarifications on the treatment of dividends or similar distributions that partners receive as owners of an AIFM and decided to add an additional paragraph in the AIFMD Guidelines along the lines of the wording in paragraph 17 of the CEBS Guidelines.

Paragraph 19

16. A private equity and venture capital asset managers' association asked for clarification of the references to “*ancillary payments or benefits that are part of a general, non-discretionary, AIFM-wide policy and pose no incentive effects*” and suggested that these payments or benefits include such things as health club memberships, health, disability or life insurance, home leave allowances etc.

ESMA's response: ESMA preferred not to include any reference to specific examples of payments that should be considered ancillary in order to leave room for the assessment of the specific circumstances of each case.

Paragraph 20 – Carried interest

17. Some respondents disagreed with the statement in paragraph 20 of the CP that only “pro rata” returns on investment should be excluded from the definition of carried interest since under Article 4(1)(d) of the AIFMD “carried interest” is defined to exclude “any share in the profits of the AIF accrued to the AIFM as a return on any investment [...] into the AIF” (emphasis added).
18. An asset manager argued that the guidelines should recognize that the principle of long-term risk-alignment can be met with other types of carried interest vehicle (e.g. under a specific performance target agreed with investors, which materialises only if performance hits a certain level and at the end of the AIF's lifetime).
19. A respondent objected to the statement that returns on investments funded by a loan should not be excluded from treatment as carried interest if the loan has not been (fully) reimbursed by the time the return is paid. This respondent argued that returns on investment may be paid over an extended period, and it would not make sense to apply this test when the first returns are received. Therefore, they should only be excluded from treatment as carried interest if and to the extent the loan is forgiven by an AIFM.

ESMA's response: ESMA did not change its approach on the returns which are excluded from the definition of “carried interest” and, therefore, not covered by the AIFMD Guidelines. In ESMA's view the proposed solution is in line with the Level 1 provisions to the extent that it is intended to add guidance on the notion of return on investment into the AIF. ESMA considered that excluding from the notion of “carried interest” investments funded by a loan is not appropriate since an actual disbursement should be necessary in order to make an investment.

Paragraph 23

20. A private equity and venture capital asset managers' association recommended that anti-avoidance provisions should be limited to arrangements “which aim at artificially evading the requirements of AIFMD” and should not be applied more broadly.

ESMA's response: see below ESMA's response under Q5.

Q3: Do you see any benefit in setting a quantitative or qualitative threshold at which the portion of the payment made by the AIF exceeding the pro-rata investment return for the investment made by the relevant staff members is transformed into carried interest? If yes, please make suggestions on the threshold to be used.

21. Several respondents did not see a benefit in setting such a threshold and mentioned that this would be entirely artificial and difficult to define.

ESMA's response: Taken into consideration the feedback received, ESMA decided not to set any threshold.

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?

22. A very large number of respondents agreed that the AIFMD remuneration principles should not apply to fees and commissions received by intermediaries and external service providers in case of outsourced activities.
23. A private equity and venture capital asset managers' association also mentioned that it was not clear when the non-core activities of an AIFM should be construed as being "outsourced" and/or when it is appropriate that an AIFM should have responsibility for, or influence over, the remuneration policy of a supplier, which may be separately regulated in another jurisdiction.

ESMA's response: see ESMA's response under Q5 below.

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)?

24. A very large number of respondents were of the opinion that the Level 1 text limits the scope of the principles of remuneration to those payments made by the AIFM to the benefit of the Identified Staff and remuneration policies and practices should not be required to cover staff of any entity to which the AIFM has delegated activities.
25. Several of the aforementioned respondents explained that the entities to which portfolio management has been delegated will in most cases already be subject to remuneration requirements (however, on this point, an asset managers' association mentioned that it is not sure that entities receiving the delegation of portfolio management by an AIFM will always be subject to remuneration requirements for their employees). Another asset managers' association also mentioned that there is a risk of giving an excessive advantage to non-EU AIFMs compared to EU AIFMs: since remuneration rules do not apply to non-EU AIFMs which market non-EU AIFs without a passport, as long as EU AIFMs can delegate outside the EEA without remuneration rules being applied on the delegates' fees, non-EU AIFMs do not benefit from any comparative advantage in this respect.
26. Some respondents added that the relevant fees are already fully disclosed to potential and existing investors in the prospectus or offering documentation as well as the financial report of the AIFs.
27. A private equity and venture capital asset managers' association noted that, as a practical matter, in many cases an AIFM will have no power to impose remuneration policies on its delegates and the appropriate controls over delegation by an AIFM are established in Article 20 of the Level 1 text, which makes no provision about the remuneration arrangements employed by delegates. In order to address any concerns of avoidance of the AIFMD remuneration rules through vehicles or methods which aim at

artificially evading those rules, this respondent suggested to clarify as follows who are “the staff of the AIFM” (of which a subset are “Identified Staff”):

“any natural person who is employed or appointed by the AIFM in connection with the AIFM’s performance of its portfolio management or risk management functions, whether under a contract of service or a contract for services or otherwise, but excluding arm’s-length service providers”.

28. Furthermore, a hedge fund managers’ association added that a different approach would have the effect that in case of delegated investment managers domiciled outside the EU the remuneration requirements would have an extraterritorial reach. Another respondent also mentioned that if an AIFM decides to delegate part of the portfolio management to a third country entity, this entity will not have to comply with the AIFMD Guidelines.

ESMA’s response: Notwithstanding the feedback received, ESMA considered it appropriate to change its approach and to insert a specific provision according to which either (i) the entities to which portfolio management or risk management activities have been delegated should be subject to regulatory requirements on remuneration that are equally as effective as those applicable under the AIFMD Guidelines or (ii) appropriate contractual arrangements should be put in place in order to ensure that there is no circumvention of the remuneration rules. This revised approach is justified with a view to the remuneration rules not being circumvented through the delegation of activities to external service providers. The approach is also compatible with the Level 1 provisions to the extent that it is not intended to directly impose the remuneration rules on third party delegates, but to ensure that through the delegation of activities the relevant Level 1 rules are not circumvented.

Furthermore, a specific reference to the risk of circumvention arising from the outsourcing of activities to entities that fall outside the scope of the AIFMD has been added to the AIFMD Guidelines.

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)?

29. Several respondents disagreed that payments made directly by the AIF to the AIFM as a whole should be considered as payments made to the benefit of the relevant categories of staff of the AIFM. Some of them mentioned that the Level 1 text does not provide scope for payments made by the AIF to the AIFM as a whole (rather than directly to an individual AIFM staff) to be brought within the AIFMD Guidelines. An asset managers’ association explained that for many groups the relevant categories of staff will in many cases be providing services to a range of firms and clients within the group and not just to a single AIF or group of AIFs. A hedge funds asset managers’ association argued that paragraph 2 of Annex II of the AIFMD states that the remuneration rules apply to all remuneration paid by the AIFM or directly by the AIF itself “made to the benefits of those categories of staff [...]”. The latter respondent added that the CP also does not take into account the fact that the AIFM may be required to pay some amount to one or more sub-advisers.
30. Several respondents considered that a distinction should be drawn between a management fee paid by the AIF to the AIFM on the one hand, and remuneration paid to individual staff members (which covers different product lines on which they work) on the other; one of these respondents argued that it is impossible to consider payments made by an AIF to the AIFM as payments made to the benefit of certain

categories of staff. Two respondents mentioned that the CP does not take into account the fact that other costs and expenses beyond remuneration of AIFM staff must come out of amounts received by the AIFM from the AIF.

31. A private equity and venture capital asset managers' association mentioned that it was not clear what ESMA contemplated with this question and suspected that the question might have been posed in light of the (in its view) deficient definition of "carried interest" in Article 4(1)(d) of the AIFMD, which assumes that carried interest is only paid by the AIF to the AIFM whereas, in some cases, carried interest is in fact distributed directly by the AIF to Identified Staff.

ESMA's response: Notwithstanding the feedback received, ESMA considered it appropriate to insert a specific provision according to which payments, excluding reimbursement of costs and expenses, which are made directly by the AIF to the AIFM for the benefit of the relevant categories of staff of the AIFM should be considered remuneration whenever they may otherwise result in a circumvention of the relevant remuneration rules. ESMA is of the view that such a revised approach is compatible with the Level 1 text, to the extent that such text does not limit its application to payments directly made to the AIFM's staff, but refers to payments made "to the benefits" of such categories of staff, thus including under the rules also those payments which are directly made to the AIFM, but are to the benefit of the AIFM's staff. ESMA considered it important and justified to insert the aforementioned new provision in order to limit the scope of circumvention of the remuneration rules.

Which entities and which staff to be identified?

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.

32. An asset managers' association requested a consistent approach to Identified Staff under the different remuneration guidelines which will be applicable to asset managers (AIFMD, UCITS, MiFID and CRD). This respondent argued that it would be impossible in practice to apply part of the remuneration guidelines to certain parts of the salary of certain staff members but not to other parts of the salary or other staff members who exercise the same activities, possibly in the same team.
33. Two respondents disagreed with the proposed approach of requiring an AIFM to include certain categories of staff as the Identified Staff unless it is demonstrated that they have no material impact on the AIFM's risk profile: these categories of employee should only be examples of staff that would normally be expected to be included as Identified Staff, without a presumption of inclusion. One of these respondents argued that under the proposed approach AIFMs would have to put extra effort into compiling documentation if they wanted to demonstrate that staff members have no material impact on the risk profile.
34. A hedge funds asset managers' association considered the categories of Identified Staff mentioned in paragraph 26 of the CP as extremely broad and going beyond those identified by either Annex II of the AIFMD or the CRD and asked ESMA to align them with the CRD approach.
35. A private equity and venture capital asset managers' association asked that the proportionality principle apply fully to this item since it is unlikely that many general partners of private equity partnerships running small operations would have staff covering all the functions listed in paragraph 31 of the CP.
36. Furthermore, respondents made the following specific comments on the categories of Identified Staff:

- i) The owners of owner-managed AIFMs should be excluded from the scope of Identified Staff to the extent they are not otherwise persons with a senior management role or Identified Staff; being a partner by itself should not make someone Identified Staff;
- ii) Given the level of alignment between a partner or shareholder who is an employee and the AIFM, the AIF and AIF investors, both (a) partners or members in an AIFM that is organised as a limited liability partnership or limited partnership and (b) employees who own common equity of an AIFM where the AIFM is organised as a limited liability company, should be excluded from the scope of Identified Staff. This should be independent of their share in either the partnership or the common equity;
- iii) Members of the governing body of the AIFM: a respondent asked to limit this category to the “executive members” and to distinguish between those executives who have a material impact on the AIFM risk profile and those who do not;
- iv) Control functions: a request was made to refer to “Heads of control functions” or to “Staff responsible for heading the control functions” instead of “control functions”, also considering that paragraphs 63 to 65 of the draft guidelines in the CP make a distinction between “control function personnel” and “senior staff responsible for heading the control functions”;
- v) Staff responsible for heading the portfolio management, administration, marketing, human resources:
 - it should be left to firms to assess whether these staff fall within the category of other risk takers: in many cases individuals within this description will be acting for a firm governed by CRD as an agent for the AIF and therefore where there is a delegation to an external manager, governed by remuneration rules, the AIFMD principles on remuneration should be disapplied;
 - it should be clarified that with respect to other departments only the responsible staff member (head) should be the Identified Staff and not the team members of the relevant department;
- vi) Other risk takers:
 - concerns were expressed on the examples of staff provided i.e. the persons capable of entering into contracts and taking decisions that materially affect the risk positions of the AIFM or of an AIF it manages (sales persons, individual traders and specific trading desks) and individuals whose activities could potentially have a significant impact on the AIFM’s results and/or balance sheet and/or on the performance of the AIFs they manage: it was argued in many cases these individuals will be acting for a MiFID portfolio manager firm as an agent of the AIF, along with other clients of the manager;
 - a request was made not to include categories of staff, such as the sales persons, who do not have a material impact on the risk profile of the AIFM;
 - a suggestion was made to refer to the possibility that a member of staff of the AIFM will be Identified Staff if they have a material impact on the risk profile of the AIF and/or the AIFM.

ESMA's response: ESMA considered that the categories of staff included as Identified Staff were broadly in line with the ones identified under the CEBS Guidelines and, therefore, did not agree with the feedback received. In particular, ESMA did not agree with the proposal to exclude from the Identified Staff partners and employees who own common equity of an AIFM, also considering the specific treatment to which dividends or similar distributions are subject (see ESMA's response under Q2 above). Furthermore, ESMA recalls that if it is demonstrated that a staff member/category of staff has no material impact on the AIFM's risk profile or on an AIF it manages it should always be possible not to include that member/category in the Identified Staff.

Notwithstanding the feedback received, ESMA saw merit in including in the presumption of inclusion under the Identified Staff not only executive members, but also non-executive members of the governing body. Indeed, ESMA considered that also non-executive members may have an impact on the risk profile of the AIFM.

Finally, ESMA saw merit in clarifying that support staff that, given the nature of their job functions, clearly do not have any connection with the risk profile of the AIFM or the AIF should not be considered risk takers.

Timing of entry into force of these Guidelines

37. A few respondents suggested that the proposed date of entry into force of the AIFMD Guidelines (i.e. 22 July 2013) should be complemented by a provision allowing for their phased introduction with each AIFM. One of these respondents mentioned that in order to leave more time for the AIFM to modify employment agreements and coordinate with the unions in the different Member States it would be preferable that the AIFMD Guidelines be applicable for each AIFM for the "salary year" following the entry into force of the AIFMD Guidelines (for many asset managers the reporting year follows the calendar year).
38. A couple of respondents claimed that the AIFMD Guidelines should only apply after the manager has been authorised as an AIFM, in accordance with the transitional provisions in Article 61(1) of the AIFMD.

ESMA's response: ESMA considered it appropriate to clarify that the entry into force of the AIFMD Guidelines is subject to the transitional provisions set out at Level 1.

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.

39. An asset managers' association estimated the total effort needed for all implementation activities concerning the proposed AIFMD Guidelines at approximately 30,000 to 50,000 EUR.
40. A private equity and venture capital asset managers' association argued that extending the scope of the rules to capture all forms of remuneration (including carried interest where relevant) would not per se significantly increase the (not insubstantial) burden placed on AIFMs by the AIFMD Guidelines, especially if applied in a proportionate manner. In this respondent's view, the inclusion of carried interest within the scope of the rules will have little, if any, impact on the risk profile of private equity partnerships as it is already aligned with the interests of investors and paid out of investment returns.
41. Another asset managers' association was of the opinion that the application of the AIFMD remuneration rules to groups where the remuneration provisions under the CRD already apply could entail sig-

nificant structural changes and costs in order to correctly identify the staff and activities caught by each remuneration provision under each directive on an individual pro rata basis.

Proportionality principle

Proportionality in general

42. A hedge funds asset managers' association was of the opinion that the "tailoring" approach should mean that, in some circumstances, AIFMs may have regard for each of the guidelines and decide that, subject to the requirements of their home Member State regulator, certain guidelines should apply to a minimal extent. Similarly, a private equity and venture capital asset managers' association pointed out that the proportionality principle, as a general principle of EU law, is capable of applying to each and every principle under Annex II (to the extent that it can be reconciled with the risk profile, risk appetite and strategy of the AIFM and each of the AIFs it manages).
43. A large number of respondents disagreed with the approach in paragraph 36 of the CP that excluded the neutralisation of certain provisions based on proportionality on the basis that, for AIFMs being part of a group, this would lead to the disapplication of certain requirements under the CEBS Guidelines whereas the same requirements could not be neutralised under the AIFMD Guidelines. These respondents also argued the following:
- i) Annex II of the AIFMD explicitly allows neutralisation of principles should they not be appropriate for the AIFM;
 - ii) CEBS Guidelines distinguish between balance-sheet entity firms on the one hand and non-balance sheet 'agency firms' on the other and recognise that asset managers generally present less systemic risk than credit institutions, and allow for neutralisation of certain principles for asset managers.
44. Some other respondents similarly argued that Annex II of the AIFMD requires AIFMs to comply with the remuneration principles "*in a way and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities*" (emphasis added). This wording mirrors the one of the CRD on proportionality on the basis of which CEBS took an approach which is different from the one followed by ESMA in paragraph 36 of the CP which indicates that requirements may only be "tailored"; indeed, paragraph 20 of the CEBS Guidelines clearly mentions that the proportionality principle may lead to certain requirements being "neutralized" if this is reconcilable with the risk profile, risk appetite and the strategy of the firm. Therefore, these respondents invited ESMA to reflect the CEBS' approach in the AIFMD Guidelines. A hedge funds asset managers' association added that the proportionality principle in the Level 1 text is sufficiently flexible to allow certain quantitative aspects of the principles to be disappplied for certain AIFMs and to take the percentages in Annex II of the AIFMD to be a cap rather than a minimum.
45. Two respondents argued that national regulators should have discretion to assess how to apply proportionality in relation to the remuneration policies of the AIFMs in their jurisdiction. Another respondent suggested following an approach similar to the one followed by the FSA under the CRD rules according to which based credit institutions are classified in a specific proportionality level based on the relevant total assets.

46. A private equity and venture capital asset managers' association asked ESMA to include the section of the CP relating to shareholders' involvement (Section VIII.I.C) and the establishment of a remuneration committee (RemCo) (Section VIII.II) in paragraph 37 of the CP which lists the requirements to which proportionality may apply. Another respondent asked ESMA to clarify that the examples in paragraph 37 of the CP represent a non-comprehensive list of requirements which may be tailored.
47. Finally, a respondent considered it disproportionate to require each AIFM to prepare a written explanation for tailored application of the remuneration principles on an item-by-item, line-by-line basis, as required in paragraph 36 of the CP: firms should be expected instead to set out explicitly in the formal remuneration policy approved by the governing body how they have arrived at a tailored application of the principles.

ESMA's response: ESMA saw merit in aligning the provisions of the AIFMD Guidelines with those of the CEBS Guidelines in relation to the disapplication of certain provisions based on proportionality. For this reason, ESMA recognised that although the remuneration principles in Annex II of the AIFMD are applicable to all AIFMs, proportionality may lead, on an exceptional basis and taking into account specific facts, to the disapplication of some requirements. At the same time, ESMA felt it important to set the limits of the possible disapplication of the remuneration provisions (in line with the approach taken in the CEBS Guidelines) and to clarify that disapplication should never be automatically triggered on the basis of the AIFMD guidelines alone. ESMA also clarified that AIFMs should perform an assessment for each of the remuneration requirements that may be disappplied and determine whether proportionality allows them not to apply each individual requirement.

ESMA did not consider it appropriate to rank AIFMs on specific proportionality levels based on their size since the size of an AIFM is only one element to be taken into consideration when applying proportionality (i.e. its internal organisation, nature, scope and complexity of the activities also have to be considered).

ESMA did not consider it necessary to add an explicit statement on the application of proportionality to all the principles under Annex II of the AIFMD since the application of proportionality is already determined in the text of the Level 1 provisions (i.e. Annex II of the Directive).

Proportionality with respect to the different characteristics of AIFMs

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.

48. Two asset managers' associations agreed overall with the proposed guidance; one of them asked ESMA to coordinate national regulators in assessing proportionality rules to ensure consistency across the Member States.
49. A private equity and venture capital asset managers' association suggested elaborating on the following criteria relevant to an assessment of proportionality in paragraph 41 of the CP:
- i) the investment strategies employed by the AIFM,
 - ii) the frequency of transactions undertaken for the AIFM,

- iii) the number of AIFs managed by the AIFM,
- iv) the number of investors in those AIFs, and
- v) the extent to which the AIFM is a listed vehicle, a partnership or owner-managed business.

50. A hedge funds asset managers' association disagreed that size is the relevant factor for alignment of interest and mentioned that more relevant factors could be whether the AIFM is a public company (where the Identified Staff will be less aligned in interests with the shareholders) or an owner managed business and whether the AIFM is engaged in proprietary dealing or dealing as agent (which involves less risk). The same respondent mentioned that proportionality should recognise that hedge fund investors are primarily sophisticated investors who are entirely aware of the risk profile they wish to adopt and who explicitly incentivise managers to follow their wishes. It also called for leaving some discretion in the hands of national regulators to apply the principle of proportionality on the basis of additional or other factors.

51. An asset managers' association argued that the listing of an AIFM or AIF would seem to trigger the application of proportionality, due to the additional corporate governance, regulatory and disclosure obligations which a listing entails.

ESMA's response: ESMA considered that certain of the criteria that some of the respondents suggested adding to the content of the guidelines on the relevant criteria for the assessment of proportionality (e.g. the reference to the strategies employed by the AIFM or the listing of the AIFM) were already included in the CP and, therefore, there was no need to add them. As for the other criteria, ESMA did not consider it necessary to include them in the AIFMD Guidelines. ESMA did not see merit in the request to disregard the 'size' criteria when assessing the application of proportionality, since this criterion is specifically mentioned in the text of the AIFMD.

Proportionality with respect of the different categories of staff

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.

52. Several respondents agreed with the criteria proposed, but they requested clarification that these are not exhaustive.

ESMA's response: ESMA saw merit in adding the requested clarification. Furthermore, it considered it appropriate to add the amount of variable remuneration received and the percentage of variable remuneration over the fixed remuneration among the elements to be taken into accounts when considering the structure of remuneration of the staff members.

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

53. A private equity and venture capital asset managers' association considered the proportionality principle to be fundamental for the effective implementation of the AIFMD remuneration rules and mentioned that requiring firms to comply with rules that do not fit with their governance structures would have no benefit for investors and would impose significant costs on firms.

54. An asset managers' association was of the view that the proposed interpretation of the proportionality principle would result in a disproportionate effort, in particular for AIFMs being part of a group.

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?

55. A very large number of respondents agreed on the need for consistency across AIFMD, UCITS, CRD and MiFID.
56. A hedge funds asset managers' association encouraged a disapplication of the rules to foreign subsidiaries until there is consistency in global law.
57. An asset managers' association mentioned the possibility to expand the guidance for AIFMs that are subsidiaries of a credit institution to specifically include AIFMs that are part of non-banking groups. Another asset managers' association welcomed the reference to AIFMs belonging to insurance or other financial groups and not limiting the discussion to banking groups. This respondent also welcomed the statement that the application of the remuneration principles set out in the AIFMD Guidelines by AIFMs which belong to banking groups is equivalent to the respect by such a group of the principles regarding remuneration applicable to the group; however, since this statement is not reflected in the CEBS Guidelines, this respondent asked for a confirmation in this regard from EBA.
58. A respondent mentioned that many asset management groups (as well as banking groups) are covered by CRD and asked why ESMA considers that there should be no exception to the application to any of the AIFMs which are subsidiaries of an asset management firm which is operated as an integrated, single business model. This respondent also mentioned that the proposed approach to implementing AIFMD remuneration rules will result in potentially conflicting requirements, where individuals within the group will be caught by multiple requirements which require specific treatment under each set of rules (MiFID, UCITS and AIFMD).
59. A hedge funds asset managers' association made the following drafting suggestion: paragraph 29 of the draft guidelines should refer to "banking, insurance or investment groups" instead of "banking (or insurance or financial) groups" as it is as likely that an AIFM might be grouped with a MiFID firm as with a credit institution.

ESMA's response: Given the feedback received, ESMA decided to keep the overall approach set out in the CP (which is in line with the CEBS Guidelines, in particular, paragraph 30 thereof). ESMA saw merit in modifying the wording of the AIFMD Guidelines in order to expand the guidance for AIFMs that are subsidiaries of a credit institution to specifically include AIFMs that are part of non-banking groups as well.

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.

60. Some respondents mentioned that the alignment as proposed will not sufficiently reduce conflicting remuneration requirements since, for instance, the proposed AIFMD Guidelines do not allow for neutralisation of requirements which may be neutralised under the CEBS Guidelines. An asset managers' association also mentioned that the proportionality principle should apply to AIFMs in the same way it applies to banks under the CRD.
61. A respondent mentioned that the alignment of the AIFMD remuneration provisions with those of the CRD should take into consideration the different businesses within a group (e.g. asset management, banking, insurance), and the fact that some of these businesses manage proprietary assets versus client assets.
62. A hedge funds asset managers' association asked for clarification on how the differing provisions of the CRD and the AIFMD will be applied in practice, in particular where an AIFM is subject to both the AIFMD at a firm level and the CRD at a group level.
63. A respondent asked for clarification on the application of the guidelines (i) to the remuneration of the staff on non-EU branches of EU AIFMs and (ii) to AIFMs at group, parent company and subsidiary levels, including those established in offshore financial centres.
64. Two respondents mentioned the following:
- i) Paragraph 29 of the CP seems to recognise that AIFMs performing the additional portfolio management activities under Article 6(4)(a) of the AIFMD may at the same time be subject to the AIFMD and to the CRD remuneration rules. These respondents interpret Article 11(1)(d) of the AIFMD as requiring AIFMs authorised to perform discretionary portfolio management services to comply with the CRD, including its remuneration rules. Therefore, they asked ESMA to confirm that AIFMs providing services under Article 6(4) of the AIFMD which comply with AIFMD Guidelines will be deemed to satisfy the CRD remuneration rules.
 - ii) For circumstances where a member of the Identified Staff of a credit institution or investment firm is also a member of the Identified Staff of an AIFM affiliate, only one set of rules should apply in respect of the relevant individual and the group parent institution should be able to choose the most appropriate set of rules. To that extent, these respondents proposed the addition of the following paragraph to the final AIFMD Guidelines:

“If an individual is Identified Staff in respect of two or more entities affiliated with each other, the parent institution may decide to apply only one set of sectoral rules to the remuneration of that member of Identified Staff, taking into account the risks his activities pose to the entities”. One respondent suggested also inserting the words *“separately and together”* at the end of the paragraph.
65. Some respondents asked ESMA to clarify that if a group has adopted a remuneration policy compliant with the CEBS Guidelines, the group remuneration policy should be deemed compliant under the AIFMD, subject to the identification of the Identified Staff. A hedge funds asset managers' association explained that in operating as an integrated firm, the investment management teams will provide investment management services to a range of clients and funds that are typically aggregated together with other clients of the same mandate type (pooled funds of UCITS and AIFs); since an investment decision will be taken across the 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.

ESMA's response: ESMA considered that the proposed guidelines (modified as mentioned in ESMA's response under Q12 above) provided sufficient guidance on how the differing provisions of the CRD and the AIFMD will be applied in practice.

As for the question relating to AIFMs providing services under Article 6(4) of the AIFMD, ESMA considered that these AIFMs are also subject to the CRD provisions on remuneration and to the separate MiFID Guidelines that will be adopted in the future by ESMA. ESMA did not insert any clarification on this point in the AIFMD Guidelines since this will be covered by the scope of application of the aforementioned MiFID Guidelines.

Regarding the request to clarify that if a group has adopted a remuneration policy compliant with the CEBS Guidelines, the group remuneration policy should be deemed compliant under the AIFMD, ESMA did not modify its approach on the basis that there should be no exception to the application of the AIFMD rules to AIFMs, as implicitly recognised also in paragraph 30 of the CEBS Guidelines.

Finally, for members of the Identified Staff of a credit institution or investment firm being also members of the Identified Staff of an AIFM affiliate, ESMA did not agree with the solution proposed by some respondents. ESMA considered that if an individual works for two separate entities (one covered by the CRD and the other covered by the AIFMD), his/her remuneration should be established pro rata based on the services provided to each of the two entities. For the services provided to the CRD entity, the CRD rules should apply, whereas for the services provided for the AIFM entity, the AIFMD rules should apply.

Q14: Please provide qualitative and quantitative data on the costs and benefits that the rules proposed in this Section VI (AIFMs being part of a group) would imply.

66. A private equity and venture capital asset managers' association mentioned that it is not yet practicable to estimate the costs of the proposed rules.

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

67. A few respondents mentioned that the soundness of the AIFM's financial situation is already subject to the capital requirements for the AIFM under the AIFMD. Therefore, these respondents argued that the variable remuneration paid to personnel of an AIFM should be linked to their performance in services towards clients (e.g. management of a particular AIF or UCITS or managed portfolio), not the overall financial situation of the AIFM.

68. A private equity and venture capital asset managers' association mentioned that, to the extent that payments move from the AIF directly to or indirectly to Identified Staff (for example carried interest), its vesting will not have any impact on the balance sheet or financial situation of the AIFM; therefore, it suggested qualifying paragraphs 48 to 51 of the CP so that they apply "*so far as relevant to a particular element of remuneration*".

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.

69. A respondent mentioned that the required deferral of variable remuneration could lead firms to increase the fixed portion of the compensation paid to many types of staff. This respondent also pointed out that constraints on the ability of AIFMs to reward staff appropriately through bonuses would impact on their ability to attract and retain talent.
70. A private equity and venture capital asset managers' association noted that in a private equity context the principles mentioned in the CP are achieved by investors and fund managers through a combination of the management fee and carried interest models which have been designed to achieve a strong alignment of interests between both parties.
71. Two asset managers' associations recommended that the balance between sound financial situation and award of variable remuneration, and the balance between variable to fixed remuneration, should not have any inadvertent pro-cyclical effects on asset managers: such an outcome would give asset managers the very systemic risk that the remuneration policy seeks to mitigate within banking entities.

ESMA's response: Further to the feedback received, ESMA did not change its approach to the extent that the requirement to link the variable remuneration to the financial situation of the AIFM as a whole is foreseen at Level 1 (Annex II, paragraph 1(o) of the AIFMD).

Q16: Please provide qualitative and quantitative data on the costs and benefits that the rules proposed in this Section VII (Financial situation of the AIFM) would imply.

72. A private equity and venture capital asset managers' association mentioned that it is not yet practicable to estimate the costs of the proposed rules.

Governance of remuneration

73. A respondent mentioned that the rules in this section are very difficult to apply for small AIFMs since this section places too much emphasis on the distinction between the governing body and senior management who, in a partnership environment, may be the same people, and it assumes that the governing body "in its supervisory function" will include non-executive members, which is not typical in certain jurisdictions and for certain structures. This respondent suggested revisiting Section VIII of the CP to substantially simplify it and clearly indicate that AIFMs have flexibility in applying these principles in line with the proportionality principle.

Management body (Annex II, paragraph (1)(b), (c) and (d) of the AIFMD)

A. Design, approval and oversight of the remuneration policy

B. Remuneration of members of the management and supervisory function

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.

74. Two asset managers' associations agreed with the proposed split of competences between the members of the management function and those of the supervisory function.
75. Two other asset managers' associations made the following comments:

- i) 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; and
- ii) the guidelines on governance of the remuneration policy must have sufficient flexibility to address different legal structures such as partnerships, where senior managers and long term shareholders are the same people.

Paragraph 55

76. A hedge funds asset managers' association was of the opinion that in an owner-managed business the supervisory function is unnecessary and the management function can appropriately be responsible for these matters since the senior managers are the owners of the business. This respondent added that some firms may not have a distinct supervisory and management function or non-executive directors and in a partnership structure this is simply not possible; therefore, it asked ESMA to take into account proportionality when considering the appropriate governance structure of the AIFM and suggested structuring the AIFMD Guidelines in the following manner: minimum requirements that would apply to all AIFMs and additional requirements that will be applicable to publicly-traded AIFMs.

77. Another respondent similarly asked for confirmation that proportionality applies to the requirement for non-executives both where there is, and where there is not, a separate supervisory function. Indeed, this respondent argued that owner-managed businesses (even in large AIFMs) do not, as a rule, have non-executive directors and, where non-executives do exist, it would be inappropriate for them to be responsible for protecting the interests of investors in the AIFs, as this would create a conflict with their fiduciary obligations to shareholders.

78. Furthermore, the same respondent asked ESMA to apply proportionality also to the requirement in paragraph 55 of the CP according to which non-executive members should collectively have sufficient knowledge of remuneration policies.

Paragraph 63

79. A private equity and venture capital asset managers' association welcomed the application of proportionality with regard to the fixed remuneration of the supervisory function and noted that the relevant requirement is likely to be applicable to the largest firms which already have non-executive members.

ESMA's response: ESMA did not consider it appropriate to change the approach taken in the CP as a consequence of the feedback received. In particular, on the point that some firms may not have a distinct supervisory and management function, ESMA considered that it was not necessary to introduce any amendment to the extent that this is already recognised in the definition of "supervisory function".

C. Shareholders' involvement

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

80. Several respondents agreed with the proposed guidelines on shareholders' involvement.

81. A private equity and venture capital asset managers' association agreed with the proposal provided that proportionality applies and the shareholders' involvement is not obligatory.

82. Two respondents disagreed with the proposal for the following reasons:

- i) in an owner-managed business this requirement is unnecessary as the shareholders are the owners of the business making the decisions;
- ii) shareholder involvement may vary significantly depending on the legal form of the AIFM and is not really compatible with limited liability companies; guidelines on this are part of company law or corporate governance best practice and not financial regulation;
- iii) the AIFMD does not confer any specific role on the shareholders in the remuneration of members of the management body.

ESMA's response: ESMA did not change the approach followed in the CP to the extent that this already implies a certain flexibility, since the shareholders' involvement is dependent on the AIFM's characteristics or national rules in the AIFM's jurisdiction.

Remuneration Committee (Annex II, paragraph (3) of the AIFMD)

A. Setting up a remuneration committee

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.

83. Some respondents agreed with the proposed criteria to determine whether or not a remuneration committee (RemCo) has to be set up. Some of them asked ESMA to clarify that not only AIFMs which are direct subsidiaries of a credit institution may rely on the RemCo at group level, but also AIFMs which are part of banking groups, insurance groups or other financial groups. Moreover, these respondents mentioned that existing national legislation in Member States regarding the governance structures must be taken into account.
84. A private equity and venture capital asset managers' association suggested adding the fact that an AIFM is owner-managed, a partnership or a limited liability partnership among the examples of factors that might indicate that an AIFM does not need to establish a RemCo.
85. An asset managers' association asked ESMA to clarify who, in the absence of a RemCo, should perform the tasks that in other AIFMs are performed by the RemCo.
86. A few respondents asked that the examples of AIFMs which need not establish a RemCo be removed (in particular, one asked for the removal of the EUR 250 million threshold since it was in their view arbitrary and inconsistent with the approach taken in paragraph 24 of the cost benefit analysis). These respondents argued that a decision on whether or not a RemCo should be established should be subject to sensible application by the national competent authorities and firms.
87. Some respondents considered the proposed threshold of EUR 250 million too low. A private equity and venture capital asset managers' association suggested that no numerical threshold be included; failing this, it suggested that it reflect the proportion in Article 3(2) of the AIFMD and, thus, provide for a threshold of EUR 250 million for other AIFMs and a threshold of EUR 1.25 billion plus a minimum of more than 20 employees for private equity/venture capital AIFMs. Another respondent asked ESMA to raise the threshold to at least EUR 500 million and to make it cumulative with other conditions, for instance a minimum of employees (e.g. 50 persons).

ESMA's response: Considering the feedback received, ESMA saw merit in increasing the threshold on the value of the managed portfolios in the example of AIFMs that may not need to establish a remuneration committee and making this criteria cumulative with a maximum number of employees. ESMA decided to add further guidance on the assessments to be made by those AIFMs which do not fall under the aforementioned thresholds.

ESMA also considered it appropriate to clarify that not only AIFMs which are direct subsidiaries of a credit institution, but also AIFMs which are part of banking groups, insurance groups, investment groups or financial conglomerates may rely on the RemCo at group level.

ESM did not see any justification for providing that the fact that an AIFM is owner-managed, a partnership or a limited liability partnership might indicate that an AIFM does not need to establish a RemCo.

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.

88. Two respondents agreed that the above factors should be taken into consideration when assessing the significance of an AIFM for the purposes of this test. A third respondent agreed on the fact that the criteria should be cumulative.

ESMA's response: Given the support received, ESMA decided to follow the approach set out in the CP.

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.

89. A hedge funds managers' association estimated the costs of a RemCo to be as follows:

- i) annual costs: between EUR 99,600 and EUR 204,600;
- ii) one-off fee in year one: between EUR 22,200 and EUR 44,400;
- iii) additional costs for external advisers and consultants (not quantified).

90. Another hedge funds managers' association mentioned that to have separate RemCos for companies carrying out activities for multiple legal entities within the group (including MiFID firms, AIFMs and UCITS management companies) would be extremely costly and would not add any benefit to that which a group RemCo would bring.

91. A private equity and venture capital asset managers' association provided details on the costs and benefits of assessing (against the proposed criteria) whether a RemCo is required and not of the costs and benefits of the RemCo existence itself. On the costs, this respondent mentioned that the more specific the criteria are, the lower the costs would be, whereas if the criteria remain vague this would have higher costs since input from external consultants would be required. On the benefits, the same respondent mentioned that these are represented by the independence the RemCo may bring to the setting and review of remuneration policy and the RemCo's contribution to protecting investors.

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.

92. There were mixed views on whether there was merit in adding further examples. Of those respondents who did favour such additions, one suggested clarifying that AIFMs with a portfolio with a value greater than EUR 250 million, but which do not have a separate supervisory function, should not be required to set up a RemCo.

ESMA's response: Given the answers received, ESMA decided not to add further examples of AIFMs which should not be required to set up a RemCo.

B. Composition

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.

93. Two asset managers' associations considered the proposed principles too strict, in particular the one requiring sufficient expertise and professional experience concerning risk management and control activities. A third asset managers' association suggested that only one member of the RemCo should have sufficient expertise and professional experience concerning risk management and control activities.

94. Similarly, some other respondents mentioned that the requirements on the composition of the RemCo need to be able to be applied in a proportionate manner. An asset managers' association was of the opinion that executive members should be permitted to serve on the RemCo, subject to the management of any conflicts of interest. Two other respondents also mentioned that proportionality implies that asset managers which do not have non-executive directors in their group should not be required to appoint non-executive directors solely to meet RemCo requirements, provided that the RemCo meets the spirit of the requirements. Another respondent considered that the requirement that the RemCo should comprise members of the supervisory function who do not perform executive functions, at least the majority of whom qualify as independent, went outside the scope of Level 1.

95. A private equity and venture capital asset managers' association agreed with the principles for the composition of the RemCo where a separate supervisory function already exists and contains sufficient independent members, whereas where such a separate supervisory function does not exist, or does not contain sufficient non-executives and/or independent members, this respondent assumed that a RemCo would not be required, although recommended.

96. On the costs and benefits implied by the proposal, the same respondent mentioned that the costs would depend to a large extent on the fees paid to the independent non-executives and whether they already sat on the supervisory function, whereas the benefit is the independence this may bring to the setting and review of remuneration policy. Another respondent mentioned that the proposed organisation is rather complex and burdensome both in terms of time that will need to be allocated and in terms of costs.

ESMA's response: Notwithstanding the feedback received, ESMA decided not to amend the provisions on the sufficient expertise and professional experience concerning risk management and control activities of an appropriate number of members of the RemCo. Indeed, ESMA considered that these provisions were necessary in order to enable the RemCo to perform its tasks appropriately. ESMA did

not take into account the requests that the provisions on the composition of the RemCo be applied in a proportionate manner since proportionality should only apply in order to assess whether a RemCo has to be set up for a specific AIFM; once such a determination has been made, the RemCo should be composed as indicated in the AIFMD and the guidance provided in the AIFMD Guidelines.

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

97. Several respondents mentioned that they did not see any need for setting out additional rules.
98. A respondent asked further guidance on the criteria for determining whether a member of the RemCo would be considered to be independent.

ESMA's response: Given the answers to the respondents to the consultation, ESMA decided not to introduce any additional guidance on the composition of the RemCo.

C. Role

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

99. Several respondents agreed with the proposed role for the RemCo.
100. A private equity and venture capital asset managers' association made the following comments:
- i) it asked ESMA to clarify whether the reference to the "highest paid staff members" referred to a set number of employees (e.g. the top five highest paid) or those paid above a certain threshold (e.g. with total remuneration exceeding EUR 1 million); and
 - ii) it disagreed with the requirement for the RemCo to formally review a number of possible scenarios and to test the remuneration system on the basis that this would be an onerous task.

ESMA's response: Having regard to the answers received, ESMA decided not to modify the proposed guidance on the role of the RemCo. As for the request to provide additional guidance on the notion of "highest paid staff members", ESMA preferred not to do so in order to leave flexibility in the application of the relevant provision based on the factual circumstances of each specific case.

D. Process and reporting lines

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.

101. Several respondents agreed with the proposed principles. One asked ESMA to clarify that for AIFMs being part of a group, the process and reporting lines should also reflect the communication and coordination with group level.
102. A hedge funds asset managers' association was of the opinion that these principles can only be applied subject to applicable data protection and privacy regulations and in a way designed to manage conflicts of interest and maintain confidentiality.

ESMA's response: Having regard to the answers received, ESMA decided not to modify the proposed guidance on process and reporting lines to be followed by the RemCo.

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.

103. Several respondents disagreed that the information about the RemCo's activities should be provided to the AIFs' shareholder meetings. They put forward the following arguments:

- i) disclosure requirements are set out in Article 22 of the AIFMD and there is no reference to disclosure of information of the RemCo at a shareholder meeting;
- ii) there is a danger of misleading shareholders of an AIF since, when providing information about the entire AIFM, it will be difficult for them to identify which part of the activities concern the specific AIF and which relate to the entire AIFM;
- iii) for a corporate body of the AIFM to report to the shareholders' meeting of a different legal entity would conflict with corporate law principles and potentially create conflicts of interest; and
- iv) when an investor is considering an investment in an AIF, the investor considers the fully disclosed amount of the management and performance fee payable by the AIF and, if the investor is not happy with that rate, the investor will not invest or, if subsequently unhappy with the rate, the investor will redeem: the basis of the contract is a fee at the disclosed rate to be paid to the AIFM for the AIFM (and not individual members of the AIFM staff) to provide services.

104. On the information to be provided to the AIFM's shareholders' meeting, a private equity and venture capital asset managers' association agreed to the extent that an AIFM already has a requirement for such a meeting, but not if there is no requirement for such a meeting.

ESMA's response: Taking into consideration the feedback received, ESMA decided not to add any guidance on the provision of adequate information about the activities performed to the AIFs' shareholders' meetings.

Control functions (Annex II, paragraph (1)(e) and (f) of the AIFMD)

A. Roles of control functions

B. Remuneration of control functions

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

105. Several respondents agreed with the proposed criteria. Some asset managers' associations considered that remuneration of the control functions must be designed to minimise conflicts and avoid compromising their independence.

106. A couple of respondents disagreed with the concept that the individual financial performance of the business area that staff in control functions monitor should not be considered in connection with the award of variable remuneration. They pointed out the following:

- i) this requirement would be particularly difficult in small firms where senior staff perform multiple functions; as such, paragraph 63 of the draft guidelines in the CP should be amended as follows: *“If staff in control functions receive variable remuneration, it should be based at least in part on function-specific objectives and should not be based solely on AIFM-wide performance or the performance of any particular business area”*;
- ii) there appears to be a tension between paragraphs 63 and 64 of the draft guidelines in the CP since the latter refers to a component of remuneration of staff in control functions that may be based on AIFM-wide performance criteria; and
- iii) the requirement should be replaced with one to design remuneration in a way that manages any conflicts of interest.

107. A private equity and venture capital asset managers’ association also suggested modifying paragraph 68 of the draft guidelines in the CP as follows (new text underlined): *“Control function personnel should not be placed in a position where, for example, approving a transaction, making decisions or giving advice on risk and financial control matters could be directly linked to an increase or decrease in their performance based remuneration, where the control function personnel member could reasonably be expected to be incentivised to take a decision adverse to the interests of the AIF or its investors”*.

ESMA’s response: ESMA took into consideration the feedback received and decided not to introduce any substantial amendments in the relevant guidelines, but considered it appropriate to clarify the wording of the final guidance in order to address the tension between paragraphs 63 and 64 of the draft guidelines in the CP mentioned by some respondents. Therefore, the final guidelines provide that control functions may receive a variable remuneration determined also by AIFMD-wide performance criteria, but that such a variable remuneration should not be exclusively based on this element.

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.

108. A private equity and venture capital asset managers’ association mentioned that it is not yet practicable to estimate the costs of the proposed rules.

General requirements on risk alignment

The basic principle of risk alignment (Annex II, paragraph (1)(a), (b) and (p) of the AIFMD)

A. The general remuneration policy, including the pension policy

109. In relation with paragraph 98 of the CP, a hedge funds asset managers’ association noted that where AIF investors have chosen to invest in an AIF bearing a performance fee, failing to pay bonuses to staff may encourage insufficient risk-taking: for this reason in these circumstances there should be a pre-

sumption that risk-taking within the limitations disclosed to investors is desired by those AIF investors.

ESMA's response: ESMA did not consider it appropriate to amend the relevant provisions to the extent that they relate to a requirement set out in Annex II, paragraph 1(a) of the AIFMD.

B. Discretionary pension benefits

Q30: Do you agree with the principles related to the treatment of discretionary pension benefits? If not, please provide explanations.

110. Several respondents agreed with the proposed principles. As for the payment in AIFs' interests referred to in paragraph 102 of the CP, an asset managers' association pointed out that in certain jurisdictions personnel of AIFMs may not hold parts of AIFs they manage and AIFMs may manage AIFs which are not open to the public but reserved for certain investors.
111. A respondent mentioned that the principles related to the treatment of discretionary pension benefits should be part of the specific requirements on risk alignment, otherwise they would also apply to those categories of staff whose activities have no connection with the risk profile of the AIFM or the AIF.
112. An asset managers' association asked that collective pension schemes be exempted from the remuneration requirements under the AIFMD.

ESMA's response: ESMA did not consider it necessary to amend the proposal to the extent that the requirement to pay discretionary pension benefits in the form of instruments is already subject to the relevant pension legislation.

General prohibitions

A. Severance pay (Annex II, paragraph (1)(k), of the AIFMD)

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.

113. Several respondents did not consider it necessary to add further guidance on the payments related to the early termination of a contract.
114. A private equity and venture capital asset managers' association mentioned that when a staff member leaves the AIFM before retirement, the discretionary pension benefit vested to the staff member should not always be subject to a five-year retention period since this requirement might contradict existing national labour law.

ESMA's response: Considering the feedback received, ESMA decided not to add any further guidance on the payments related to the early termination of a contract.

B. Personal hedging (Annex II, paragraph (1)(q), of the AIFMD)

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.

115. Several respondents considered the proposed guidance sufficiently broad. An asset managers' association mentioned that it is important to retain the clause which states that "each case should be judged on its merits".
116. A respondent mentioned that the compliance with the requirement foreseen in paragraph 115 of the CP could be ensured by a self-certification of the employees concerned that they will not seek to hedge awards they are granted.

ESMA's response: Considering the answers to the consultation, ESMA decided not to modify the guidance on the hedging strategies.

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.

117. A private equity and venture capital asset managers' association mentioned that it is not yet practicable to estimate the costs of the proposed rules.

Specific requirements on risk alignment

118. Notwithstanding the application of the proportionality principle to this section, a respondent suggested to qualify the section so that it applies "*so far as relevant to a particular element of remuneration*" or to clarify that carried interest is capable of satisfying the requirements in this section. Another respondent suggested taking a risk-focused and principles-based approach into consideration, in particular for the implementation of the specific requirements on risk alignment.

ESMA's response: see below ESMA's response under Section III (Structure of the Guidelines).

Fully flexible policy on variable remuneration (Annex II, paragraph 1(j) of the AIFMD)

Risk alignment of variable remuneration

A. Risk alignment process (Annex II, paragraph 1(g), (h) and (l) of the AIFMD)

- 1. Performance and risk measurement process**
- 2. Award process**
- 3. Payout process**

119. Some respondents disagreed that ex-post adjustments should take errors in the performance into account since a direct linkage of errors to variable remuneration might encourage non-reporting of errors. Two respondents suggested requiring this only where there has been gross negligence or recklessness on the part of the relevant person.

ESMA's response: Having considered the comments received, ESMA decided not to modify the guidance on the payout process.

B. Common requirements for the risk alignment process

- a. Time horizon
- b. Levels of risk and performance measurement
- c. Quantitative and qualitative measures
- d. Judgemental measures

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

120. A respondent agreed with the proposed requirements subject to a proportionate approach in assessing compliance.

121. A hedge funds asset managers' association made the following comments on the proposed risk alignment process:

i) Share-based awards:

- awarding staff equity or equity-linked instruments raises complex issues in the context of AIFMs being small privately owned businesses, structured either as LLPs or (less frequently) as private unlisted companies since these entities usually do not issue publicly tradable equities or equity-like instruments for which there is a secondary market: for these entities it is unclear what could constitute “equivalent non-cash instruments”; phantom share schemes are not an appropriate solution for small privately-owned businesses such as AIFMs (mainly for the risks arising from the need to be able to redeem the phantom shares at their revaluation price and for the costs linked to their valuation);
- payment in shares will also be problematic to the extent that AIFs are separate legal entities from the AIFM: a position in the AIF would not be entirely representative of the risk inherent in the firm (in particular, where the AIFM manages several funds); this respondent mentioned a series of other issues such as, inter alia, the fact that the fund may be closed to new investment while unlisted funds are restricted from allowing investments below a minimum size and from certain types of investor.

ii) Deferral and clawback: a deferral of at least 40% (and, in some cases, up to 60%) over three to five years bears no obvious relevance to the ‘life cycle’ of the fund and even the minimum one year deferral period may bear no obvious relevance to that life-cycle. The deferral of some part of the AIFM’s staff variable remuneration would have no impact on the investor since performance fees tend to be payable on a quarterly or annual basis and investors may, at specified times (also typically quarterly or annually) choose to redeem their interest and leave the fund at that time.

ESMA’s response: ESMA decided not to modify its guidance to the extent that the concerns related to the payments in instruments and the deferral provisions were linked to requirements coming from the Level 1 text.

C. Risk measurement

Q35: Do you agree with the proposed criteria on risk measurement? If not, please provide explanations and alternative criteria.

122. A respondent pointed out that the principle of proportionality is specifically mentioned in relation with the risk management calculations in paragraph 101 of the draft guidelines in the CP; however, proportionality should be taken into account with respect to all of the provisions of the AIFMD Guidelines and not only this specific paragraph.

ESMA's response: ESMA considered that the specific reference to proportionality in the aforementioned section of the CP was without prejudice to the general approach on proportionality as set out in Section VII (Guidelines on proportionality) of the final guidelines.

Q36: Do you agree that in order to take into account all material risks AIFMs should also take into account the risks arising from the additional management of UCITS and from the services provided under Article 6(4) of the AIFMD?

123. Two asset managers' associations agreed that the risks arising from the additional management of UCITS and from services provided under Article 6(4) of the AIFMD should be taken into account.

ESMA's response: Given the feedback received, ESMA did not modify its approach.

D. Performance measurement (Annex II, paragraph 1(g) of the AIFMD)

a. Qualitative/Quantitative measures

Q37: Do you agree with the proposed guidance for the financial and non-financial criteria to be taken into account when assessing individual performance? If not, please provide explanations and alternative guidance.

124. No objections were raised in relation to the proposed guidance.

ESMA's response: Given the feedback received, ESMA did not modify its approach.

b. Relative/absolute and internal/external measures

Q38: Do you agree with the proposal to distinguish between absolute and relative performance measures on one side and between internal and external performance measures on the other? If not, please provide explanations.

125. No objections were raised in relation to the proposed guidance.

ESMA's response: Given the feedback received, ESMA did not modify its approach.

Award process

A. Setting and allocation of pools

Q39: Do you agree with the requirement set out above to document the policy for the award process and ensure that records of the determination of the overall varia-

ble remuneration pool are maintained? If not, please provide explanations and an alternative procedure.

126. Two respondents agreed with the relevant requirement.

ESMA's response: Given the feedback received, ESMA did not modify its approach.

B. The risk adjustment in the award process (Annex II, paragraph 1(l) and(o) of the AIFMD)

a. Quantitative ex-ante risk adjustment

b. Qualitative measures for ex-ante risk adjustment

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.

127. The following comments were made in relation to ex-ante risk adjustment:

- i) ex-ante risk adjustment has to be considered in the context of an asset management firm where fees paid are based upon realised performance and investors who redeem their shares will receive that realised return; and
- ii) the requirement to apply ex-ante risk adjustment at an individual entity level could have unintended consequences for AIFMs who belong to a group where bonus pools are typically created at a group level, and not at entity level (given many staff members are providing shared services for multiple firms within the group); furthermore, at the individual level, quantitative measures may not be appropriate for many in support roles.

ESMA's response: ESMA did not modify its approach since it considered that an ex-ante risk adjustment at an individual level is appropriate in the context of the qualitative risk adjustment foreseen in the guidance.

Pay-out process

A. Non-deferred and deferred remuneration (Annex II, paragraph 1(h) and (n) of the AIFMD)

a. Time horizon and vesting

b. Vesting point

c. Proportion to be deferred

d. Time span between end of accrual and vesting of deferred amount

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.

128. Two asset managers' associations agreed with the different components set out in paragraph 154 of the CP/paragraph 118 of the draft guidelines in the CP. However, one of them suggested that two additional components be taken into consideration:

- i) the length of the accrual period: where the staff member's entitlement is assessed over a multi-year *accrual period*, this of itself contributes to the long-term alignment of interests of the AIFM's staff members with those of the AIFM and the AIFs it manages; and
- ii) the life-cycle or redemption policy of the AIF: leveraging on the provisions of paragraph 1(h) of Annex II of the AIFMD, this respondent argued that where an investor has redeemed its interest in the AIF, any variable remuneration which was derived from that investor's investment in the AIF can cease to be subject to any further vesting, deferral, malus or clawback arrangements. For these reasons, this respondent disagreed with the requirements suggesting minimum deferral and vesting periods in all circumstances (namely, in paragraphs 119 and 123 of the draft guidelines in the CP).

129. Since paragraph 37 of the CP expressly provides that the deferral principle may be tailored and paragraph 154 of the CP indicates that AIFMs can vary the five components indicated herein, an asset managers' association asked ESMA to clarify the extent to which an AIFM can tailor (i) the minimum deferral period of 3 to 5 years, (ii) the minimum portion of 40% to 60% of variable remuneration to be deferred and (iii) the minimum portion of 50% of variable remuneration to be paid in instruments.

ESMA's response: ESMA did not modify its approach since it considered that the provisions of paragraph 1(h) of Annex II of the AIFMD may not be used to switch off the other requirements in Annex II of the AIFMD.

ESMA clarified in the final guidelines that the specific numerical criteria set out in Annex II of the AIFMD – the minimum deferral period of three to five years, the minimum portion of 40 to 60% of variable remuneration that should be deferred (Annex II, paragraph 1(n) of the AIFMD) and the minimum portion of 50% of variable remuneration that should be paid in instruments (Annex II, paragraph 1(m) of the AIFMD) – if disapplied, may only be disapplied in their entirety. It should not be possible to apply, within an AIFM, lower thresholds based on proportionality.

B. Cash vs. instruments (Annex II, paragraph 1(m) of the AIFMD)

a. Types of instruments

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

130. Some respondents underlined certain difficulties linked to the payment in instruments:

- i) in certain jurisdictions personnel of AIFMs may not hold parts of AIFs they manage and AIFMs may manage AIFs which are not open to the public but reserved for certain investors; and
- ii) the objective of the alignment of interest may not be achieved through the payment in instruments since such remuneration creates new conflicts of interest which need to be carefully managed (e.g. managers may manage segregated mandates of UCITS and AIFs and such remuneration incentives could cause managers to give preference to AIFs over other products).

131. An asset managers' association expressed scepticism on the feasibility of payments in fund shares when a fund manager manages several funds and suggested studying the idea of profit-sharing plans to ensure that AIFM staff is rewarded over the long term. Another asset managers' association mentioned that it is not certain that the use of alternative instruments (as mentioned under paragraph 165 of the CP) will legally be feasible; this respondent argued that AIFMs do not have the legal authority to create new instruments such as certificates which reflect the AIF's value and have the same intended effect as share-linked instruments.
132. A respondent asked ESMA to provide some practical examples of "alternative instruments" that reflect the AIF's value and have the same intended effect as share-linked instruments.
133. A bank mentioned that the AIFMD Guidelines should explicitly recognise that group shares are an appropriate instrument.
134. A hedge funds asset managers' association mentioned that the requirements in paragraph 125 of the draft guidelines in the CP might not be easily applied to some categories of Identified Staff, such as those in marketing or human resources, or in the case of firms where all of the employees carry out tasks for all of the clients. Another respondent mentioned that (i) there is no basis in Level 1 for the prohibition on Identified Staff receiving instruments related to AIFs other than those in respect of which they provide services and (ii) in the case of closed-ended funds with a life of several years, it may not always be practicable to give exposure to "alternative instruments" which relate to the performance of a closed fund.
135. A respondent suggested that it should be clarified that Identified Staff already subject to CRD rules on the use of deferred awards and instruments would also be in compliance with the AIFMD Guidelines.
136. A hedge funds asset managers' association asked ESMA to clarify the following:
- i) what happens when the management of AIFs accounts for less than 50% of the total portfolio managed by the AIFM (i.e. whether there is no need to pay in instruments in such a case);
 - ii) how to measure the 50% threshold: i.e. whether or not that should be based on net asset value or trading level (which includes notional funds); and
 - iii) assets of an AIF for which the investment firm only acts as a sub-advisor and does not act as the AIFM are not to be included in determining the percentage of AIF business of an AIFM.
137. A private equity and venture capital asset managers' association asked for the inclusion of a reference to "synthetic carried interest scheme" in paragraph 127 of the draft guidelines in the CP: these are long-term cash bonus schemes which are the most likely arrangements in private equity/venture capital context.

ESMA's response: Considering that the provisions of Level 1 already provide that the payment in instruments is subject to the legal structure of the AIF and its rules or instruments of incorporation, in order to address the comments received ESMA saw merit in including the following amendment only. ESMA clarified that for the purposes of the requirement to pay at least 50% of variable remuneration in instruments unless the management of AIFs accounts for less than 50% of the total portfolio managed by the AIFM, the 50% threshold should be based on the net asset value of the AIFs.

As for the situation when the management of AIFs accounts for less than 50% of the total portfolio managed by the AIFM, ESMA considered that in this case, as established in Annex II, paragraph 1(m), it is only the minimum of 50% of variable remuneration in instruments which does not apply.

Q43: Do you consider that additional safeguards should be introduced in these Guidelines in order to ensure that the payment of the Identified Staff with instruments does not entail/facilitate any excessive risk-taking by the relevant staff in order to make short-term gains via the instruments received? If yes, please provide details.

138. Several respondents did not consider any additional safeguards to be necessary. One of them argued that the proposed retention policy should be sufficient and the absence of any need of additional safeguards is reinforced by the statement in paragraph 20 of the CP.

ESMA's response: Given the feedback received, ESMA decided not to add any further safeguards.

b. Retention policy

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.

139. Several respondents agreed with the proposed guidance. However, one mentioned that:

- i) where the Identified Staff already holds a substantial investment in the AIF the retention policy should be capable of being disapplied where that Identified Staff member will continue to hold a substantial investment; and
- ii) the retention period should end for remuneration paid with respect to an investor when the investor has redeemed (or otherwise exited) its interest in the AIF as there is no longer any need for, or possibility of, alignment of interests with respect to that investor.

ESMA's response: ESMA did not change its approach considering that the retention requirement is set by the Level 1 provisions.

c. Minimum portion of instruments and their distribution over time

C. Ex post incorporation of risk for variable remuneration (Annex II, paragraph 1(o) of the AIFMD)

a. Explicit ex-post risk adjustments

b. Implicit adjustments

c. Possibility of upward revisions

Q45: Do you agree with the proposed guidance for the ex-post risk adjustments to be followed by AIFMs? If not, please provide explanations and alternative guidance.

140. A respondent mentioned that, notwithstanding the wording of paragraph 1(o) of Annex II of the AIFMD, the draft guidelines (in particular, paragraphs 140 and 146 of the draft guidelines in the CP) significantly downplay the importance of the subsequent performance of the AIF in relation to ex-post adjustment, whereas ultimately investors will judge an AIFM on the performance of the AIFs it manages.
141. Another respondent asked for a proportionate interpretation of the guidance so that agency businesses where there is no/minimal ex-post risk are not required to go through time-consuming processes to explain why no ex-post adjustment was required.

ESMA's response: ESMA considered that the feedback received did not merit an amendment of the relevant provisions.

Compliance of certain remuneration structures with the requirements on risk alignment of variable remuneration, award and pay-out process

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

142. A private equity and venture capital asset managers' association made the following comments in relation to paragraph 150 of the draft guidelines in the CP:
- i) The description of carried interest is unduly restrictive and other formulations of the carried interest waterfall may be required by, or negotiated with, investors which meet the same policy objectives as the ones described in the CP. In the typical PE/VC carried interest structure there are generally measures in place (for example, escrow, interim claw-back and end of life true-ups) to protect investors, such that by the end of the life of the AIF, investors will have received back all the money they have paid into the AIF, and the AIFM will only have received its agreed share of the net profits generated.
 - ii) The references to those sections under the headings "Risk alignment of variable remuneration", "Award process" and "Pay-out process" are unduly narrow since carried interest models may also be relevant to the satisfaction of other requirements, including those under the headings "Financial situation of the AIFM", "Governance of remuneration" and "Fully flexible policy on variable remuneration".
 - iii) Commonly, part of any carried interest due may be advanced to the relevant holders to enable them to pay taxes triggered in such jurisdictions as the carried interest accrues (i.e. after award but prior to vesting).
 - iv) Holders of carried interest will also receive salary, and some may receive annual cash bonuses or other elements of variable incentive from the AIFM.
 - v) Sub-paragraphs a) and b) of paragraph 150 should not be conjunctive and the "and" should be replaced with an "or".

143. The same respondent suggested that paragraph 150 be redrafted as follows:

"While it is necessary to have regard to all the relevant circumstances case-by-case, certain guidelines may be satisfied in relation to the whole of an AIFM's variable incentive arrange-

ments (i) where the most important element of variable incentive is intended to be carried interest, (ii) where the arrangements are contractually agreed to by investors, and (iii) where:

- (a) such carried interest accrues only after the AIFM first returns to the investors of the AIF all capital contributed by those investors to the AIF and an amount of profits at a previously agreed preferred rate of return (if any); or
- (b) to the extent all or any portion of such carried interest is paid prior to the end of the life of the relevant AIF, it is subject to appropriate arrangements (such as claw-back or escrow arrangements) to protect investors, or is paid only to fund related tax obligations.”

The guidelines that may be satisfied in this manner include but are not limited to the guidelines under the headings “Risk alignment of variable remuneration”, “Award process” and “Pay-out process” and aspects of the guidelines under the headings “Design, approval and oversight of the remuneration policy” and “Remuneration of control functions”.

144. A hedge funds asset managers’ association requested that paragraph 150 of the draft guidelines in the CP make clear that the method set therein is not the sole allowable method for ensuring the risk alignment requirements in relation to variable remuneration are met; other structures should be considered to comply with the criteria: the most obvious being one where the investor has redeemed its interest in the AIF.

ESMA’s response: ESMA considered that the relevant section provided an appropriate recognition of the specificities of certain remuneration structures and saw merit in introducing a limited amendment only aimed at clarifying that the compensation that is subject to certain specific conditions under this section is the variable compensation only.

Q47: Do you consider that there is a need for submitting to an equivalent/similar treatment any other form of remuneration? If yes, please provide details of the remuneration structure(s) and of the specific treatment that you consider appropriate.

145. Two respondents did not consider that there are any other forms of remuneration that need to be submitted to equivalent or similar treatment.

146. A private equity and venture capital asset managers’ association mentioned that few private equity/venture capital groups have publicly-listed AIFs or parent companies, and stock options or similar instruments may form part of the incentives of AIFM staff: it asked ESMA to address the treatment of such incentives combined with carried interest.

ESMA’s response: Given the feedback received, ESMA considered that there was no need to apply an equivalent/similar treatment to any other form of remuneration.

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.

147. A private equity and venture capital asset managers’ association mentioned that it is not yet practicable to estimate the costs of the proposed rules.

Disclosure

148. A respondent claimed that it should be sufficient for investors to know that the remuneration rules are applied correctly and there should be no necessity to disclose remuneration figures; furthermore, disclosure of remuneration concerns sensitive information, especially where it concerns a small group of directors or senior management.
149. Another respondent suggested clarifying that disclosure requirements would be met when they already apply on a group-wide basis under the CRD; in particular, it should be specified that disclosure for each AIF is not necessary where it is part of a group-wide annual remuneration report.

External disclosure

A. Specific and general requirements on disclosure

150. A large number of respondents disagreed with the public disclosure of remuneration information and mentioned that this should be limited to investors and competent authorities.
151. Two respondents mentioned that there is no basis in Level 1 to require public disclosure and no sound policy justification for it (contrary to banks, AIFMs deal exclusively as agents). A private equity and venture capital asset managers' association recalled that according to the second sub-paragraph of Article 22(1) of the AIFMD it is only if the AIFM opts to use the annual financial report that a public disclosure is to be made.
152. An asset managers' association argued that there is no mention in the AIFMD that the disclosure requirements under Section III of the Commission Recommendation of 2009 shall also apply to AIFMs and they should therefore be deleted from the AIFMD Guidelines, which should stick to the external disclosure required under Article 22(e) and (f) of the AIFMD.
153. A stakeholder mentioned that individual amounts of remuneration should not be made public and, at least, amounts have to be aggregated for public disclosure. Another respondent argued that for small AIFMs the disclosure of the aggregate amount of remuneration could make the individual remuneration easily identifiable if the number of staff of the AIFM is available.
154. Two respondents asked ESMA to clarify that the annual reporting requirements under Article 22 of the AIFMD come into effect for the first full financial year after the AIFM is granted authorisation under the AIFMD.

ESMA's response: Given the feedback received, ESMA considered it appropriate to provide that the disclosure should not necessarily be public. ESMA also saw merit in clarifying that the disclosure made in accordance with this Section should be without prejudice to the disclosure obligations vis-à-vis prospective investors under Article 23 of the AIFMD.

B. Policy and practices

Internal disclosure

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.

155. A hedge funds asset managers' association considered that remuneration figures are a private matter between the employee and his employer and that not all staff needs to have knowledge of that. Furthermore, this respondent mentioned that internal disclosure of remuneration is not a Level 1 requirement. Similarly, another respondent did not consider it appropriate to require the same level of internal disclosure as is made in disclosures to investors and regulators since many of the remuneration principles for which an external disclosure is contemplated do not directly concern most individuals (e.g. it is not relevant to most staff to explain remuneration governance).

156. An asset managers' association mentioned that this guidance should not be necessary since employees will be able to see the external guidance should they wish to as it is publicly available.

ESMA's response: Notwithstanding the feedback received, ESMA considered it appropriate to keep the provisions on the internal disclosure unchanged.

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

157. A private equity and venture capital asset managers' association mentioned that it is not yet practicable to estimate the costs of the proposed rules.



Annex I

Cost-benefit analysis

ESMA considered that no update to the cost-benefit analysis included in the consultation paper (ESMA/2012/406) was to be introduced in the present final report as a consequence of the consultation.

Therefore, stakeholders are invited to refer to the cost-benefit analysis in Annex VI of the consultation paper (ESMA/2012/406).



Annex II

Opinion of the Securities and Markets Stakeholder Group

I. Executive summary

The Securities and Markets Stakeholder Group has reviewed ESMA’s Consultation paper regarding Guidelines on sound remuneration policies under the AIFMD. In our analysis of the draft ESMA guidelines, we have focused on how they contribute to achieving the main purposes of the AIFM Directive: anticipate and control systemic risk and provide the appropriate level of investor protection. The Stakeholder Group has considered if these objectives are achieved in a fit for purpose manner, while also allowing the right level of tailoring and proportionality for the fundamental diversity and divergence in nature, scale and complexity of the different product offerings to the investors concerned.

In this perspective, the Securities and Markets Stakeholder Group acknowledges the highly valuable work of ESMA. The Group supports the overall approach of these Guidelines – to align managers’ and their relevant staff’s interests with those of their investors through promoting sound remuneration policies under the AIFMD. However the Securities and Markets Stakeholder Group also calls for a consideration of a number of specific elements in the draft ESMA Guidelines. Consideration by ESMA of these elements should lead to a better balance between market stability and investor protections on the one hand and the tailoring of the remuneration and alignment of interest policies when applied to the wide range of managers with different business models on the other hand. The Securities and Markets Stakeholder Group has chosen to focus its advice around the following four high level elements: (i) need for consistency, (ii) need for proportionality, (iii) use of neutralization and (iv) how existing remuneration and incentive practices that align the interests of the investors and managers can be assessed in context of compliance with the Guidelines.

II. INTRODUCTION

The Securities and Markets Stakeholder Group (“SMSG”) welcomes this opportunity to comment on ESMA’s Consultation paper Guidelines on sound remuneration policies under the AIFMD published on 28 June 2012 (ESMA/2011/209) (“the Guidelines”).

It is important that ESMA’s final Guidelines provide a balance between serving as guidance to industry participants and competent authorities which is as concrete and practical as possible, while staying within the perimeters of the Level 1 text.

In its analysis of the ESMA draft Guidelines, the Stakeholder Group has taken the perspective that its advice to ESMA should focus on the balance between market stability and investor protections on the one hand and the tailoring of the remuneration and alignment of interest policies when applied to the wide range of managers with different business models on the other hand, rather than focussing on more technical responses to the draft Guidelines which can be expected to be provided by the different respondents to the Consultation. Four elements have been identified by the SMSG which could potentially impact this balance:

(i) Need for consistency – while recognizing diversity

A large number of traditional investment management firms in Europe are currently and in the future likely to have activities falling under the AIFMD, the UCITS Directive and/or MiFID. Furthermore a number of these traditional investment management firms are also part of financial institutions like banks and insurance companies and therefore the CRD articles applicable to these financial institutions will also impact some of their activities, including remuneration.

Within many of these investment management firms, the same personnel is on a daily basis conducting activities and working on different product lines which fall under the different directives. Compliance officers will for example be responsible for the compliance in the entire firm and not only compliance related to the activity under the one or the other of the directives.

These more traditional investment managers need to manage investments for investors regardless of the directive by which these investments are regulated. The staff employed by these managers has one remuneration package despite perhaps working for different types of investors, covered under different regulatory regimes. It will therefore in practice be very difficult, if not impossible, to distinguish between which parts of the remuneration that would be falling under which rule.

Therefore, the SMSG proposes that, in these cases, ESMA should provide high-level guidance to avoid the creation of a patch-work of remuneration principles across a single company falling into that category. At the same time ESMA should continue to reflect in the Guidelines the differences between the non-bank asset management sector and the banking sector, as reflected in the texts of AIFMD and CRD III.

(ii) Need for proportionality

The SMSG echoes the statement made by ESMA that it is primarily the responsibility of the AIFM to assess its own characteristics and to develop and implement remuneration policies and practices which appropriately align the risks faced and provide adequate and effective incentives to staff.

While the SMSG also acknowledges that the proportionality principle does not imply that AIFM can disregard any of the guidelines, sufficient flexibility must be provided to allow for tailoring when applied to individual sectors and individual firms. The very different business models of financial institutions like banks and insurance companies, different types of investment firms and asset managers must be sufficiently taken into account. Proportionality is therefore a key concern.

Managers covered by the AIFMD should be able to apply the guiding principles in different ways according to their size and strategy pursued as well as, where relevant, the size of the funds they manage, their internal organization and the nature, scope and complexity of their activities and their products.

As the universe of managers and their funds covered by the AIFMD is very broad it is critical to include the following differentiating factors into the proportionality assessment:

- whether funds are closed-ended or open-ended (noting also the different redemption policies applied by the latter)
- whether fees are fixed or can be influenced through trading activity
- whether incentives and incomes are based upon actual cash returns or valuations



- whether investment decisions are taken by committees or “autonomous traders”
- whether management companies are partner owned, parts of larger groups and/or listed; and
- whether or not there is consistent sharing of investment risk between managers and investors.

(iii) Use of neutralization

Given the very wide variety in size, internal organization and the nature, scope and complexity of activities of different fund managers, the SMSG recommends that the remuneration guidelines include an express recognition that the application of the proportionality principle may lead to neutralization of some requirements, if this is reconcilable with the risk profile, risk appetite and strategy of the relevant AIFMs and of the AIFs they manage. Furthermore, neutralization is also crucial to allow for consistency with other regulatory frameworks applicable to the asset managers.

The CEBS remuneration guidelines specifically provide for ‘neutralisation’ of certain requirements if this is reconcilable with the risk profile, risk appetite and the strategy of the firm. This ability was specifically extended to firms which fall under Article 20(2) of Directive 2006/49/EC. This should equally be reflected under the guidelines issued by ESMA for MiFID firms, AIFM and UCITS Management Companies, especially as the scope for neutralization provided at Level 1 does not seem to differ.

(iv) Assessment of existing risk-sharing models for compliance with the Guidelines

Within the alternative investment management sector there exist different incentive models - negotiated and agreed between investors and managers –which are based on a sharing of the investment risk and which – to a certain or larger extent – integrate the risk adjustment, deferral and retention requirements, as stated in Annex 2 of the AIFMD

The SMSG recommends that the option should be considered to neutralize the relevant articles of the Guidelines where the variable component of such risk sharing remuneration and incentive models only vests after the fund first returns to the investors all the capital contributed by such investors or – in case any portion of such remuneration or return is paid out prior to final payments to investors – where such pay-outs are subject to appropriate claw-back or escrow arrangements, protecting the investors. As such risk sharing remuneration and incentive models protecting the investors also imply a high degree of conditionality and irregularity in the actual payment of the variable component of the remuneration, the SMSG further recommends to consider the option to take into consideration the payments made over the whole life of the relevant fund - rather than on an annual basis – when assessing the relevance of such structures in the total variable remuneration arrangements of these managers.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA’s website.

Adopted on 27 September 2012

Guillaume Prache
Chair
Securities and Markets Stakeholder Group

Annex III

Guidelines on sound remuneration policies under the AIFMD

I. Scope

Who?

1. These guidelines apply to AIFMs and competent authorities.

As long as the national regimes referred to in Article 42 of the AIFMD will continue to be in force, non-EU AIFMs which market to professional investors units or shares of AIFs in Member States without a passport will only be subject to Section XIII (Guidelines on disclosure) of these guidelines. These non-EU AIFMs will be subject to the full set of remuneration provisions in these guidelines as from the date when the national regimes referred to in Article 42 of the AIFMD will be terminated and the passport regime provided for in Articles 37 to 41 of the AIFMD will become the sole and mandatory regime applicable in all Member States, as determined by the Commission's delegated act referred to in Article 68(6) of the AIFMD.

2. In accordance with Article 5 of the AIFMD, for the purposes of these guidelines, the AIFMs to which the remuneration principles apply shall be either an external manager or, where the legal form of the AIF permits internal management and where the AIF's governing body chooses not to appoint an external AIFM, the AIF itself. AIFs which are not internally managed and have appointed an external AIFM are not subject to the remuneration principles established in the AIFMD as well as these guidelines. However, the remuneration principles set out in the *Recommendation* are relevant to those AIFs, as well as the AIFMs which can benefit from the exclusions and exemptions foreseen in Articles 2 or 3 of the AIFMD, to the extent that they fall within the definition of 'financial undertaking' provided in paragraph 2.1 of the *Recommendation*. Annex I of these guidelines provides for a correlation table highlighting those principles of the *Recommendation* which are reflected in the AIFMD.

What?

3. These guidelines apply in relation to the remuneration policies and practices for AIFMs and their *identified staff*. Annex II of these guidelines provides details on which guidelines apply to AIFMs as a whole and which apply to their *identified staff* only.

When?

4. These guidelines apply from 22 July 2013, subject to the transitional provisions of the AIFMD.

II. Definitions

Unless otherwise specified, terms used in the Directive 2011/61/EC of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010³ (AIFMD) and in the delegated acts adopted by the Commission according to the provisions of the AIFMD have the

³ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:174:0001:0073:EN:PDF>.

same meaning in these guidelines. In addition, the following definitions apply for the purposes of these guidelines:

| | |
|-----------------------------|---|
| <i>Recommendation</i> | Commission Recommendation 2009/384/EC of 30 April 2009 on remuneration policies in the financial services sector. ⁴ |
| <i>identified staff</i> | categories of staff, including senior management, risk takers, <i>control functions</i> and any employee receiving total remuneration that takes them into the same <i>remuneration bracket</i> as senior management and risk takers, whose professional activities have a material impact on the AIFM's risk profile or the risk profiles of the AIF that it manages and categories of staff of the entity(ies) to which portfolio management or risk management activities have been delegated by the AIFM, whose professional activities have a material impact on the risk profiles of the AIF that the AIFM manages. |
| <i>control functions</i> | staff (other than senior management) responsible for risk management, compliance, internal audit and similar functions within an AIFM (e.g. the CFO to the extent that he/she is responsible for the preparation of the financial statements). |
| <i>remuneration bracket</i> | the range of the total remuneration of each of the staff members in the senior manager and risk taker categories – from the highest paid to the lowest paid in these categories. |
| <i>instruments</i> | units or shares of the AIFs managed by the AIFM or equivalent ownership interests (including – for AIFs issuing only units – unit-linked instruments), subject to the legal structure of the AIFs concerned and their rules or instruments of incorporation, or share-linked instruments or equivalent non-cash instruments. |
| <i>malus</i> | arrangement that permits the AIFM to prevent vesting of all or part of the amount of a deferred remuneration award in relation to risk outcomes or performances of the AIFM as a whole, the business unit, the AIF and, where possible, the staff member. Malus is a form of ex-post risk adjustment. |
| <i>clawback</i> | contractual agreement in which the staff member agrees to return ownership of an amount of remuneration to the AIFM under certain circumstances. This can be applied to both upfront and deferred variable remuneration. When related to risk outcomes, clawback is a form of ex-post risk adjustment. |
| <i>supervisory function</i> | the relevant persons or body or bodies responsible for the supervision of the AIFM's senior management and for the assessment and periodical review of the adequacy and effectiveness of the risk management process and of the policies, arrangements and procedures put in place to comply with the obligations under the AIFMD. For those AIFMs that given their size, internal organisation and the nature, scope and complexity of their activities or their legal structure do not have a separate supervisory function, the supervisory function should be understood as the member or members of the <i>management body</i> responsible for these |

⁴ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:120:0022:0027:EN:PDF>.

functions.

management body the governing body of an AIFM.

retention period period of time during which variable remuneration that has been already vested and paid out in the form of *instruments* cannot be sold.

accrual period period during which the performance of the staff member is assessed and measured for the purposes of determining its remuneration.

deferral period the deferral period is the period during which variable remuneration is withheld following the end of the *accrual period*.

vesting point an amount of remuneration vests when the staff member receives payment and becomes the legal owner of the remuneration. Once the remuneration vests, no explicit ex-post adjustments can occur apart from *clawback* clauses.

III. Purpose

5. The purpose of these guidelines is to ensure common, uniform and consistent application of the provisions on remuneration in Articles 13 and 22(2)(e) and (f) of, and Annex II to, the AIFMD.

IV. Compliance and reporting obligations

Status of the guidelines

6. This document contains guidelines issued under Article 16 of the ESMA Regulation⁵. In accordance with Article 16(3) of the ESMA Regulation competent authorities and financial market participants must make every effort to comply with guidelines and recommendations.

7. Competent authorities to whom the guidelines apply should comply by incorporating them into their supervisory practices, including where particular guidelines within the document are directed primarily at financial market participants.

Reporting requirements

8. Competent authorities to which these guidelines apply must notify ESMA whether they comply or intend to comply with the guidelines, with reasons for non-compliance, within two months of the date of publication of the translations by ESMA. In the absence of a response by this deadline, competent authorities will be considered as non-compliant. A template for notifications is available from the ESMA website.

9. AIFMs are not required to report whether they comply with these guidelines.

⁵ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC.

V. Guidelines on which remuneration is covered by these guidelines

10. Solely for the purposes of the guidelines and Annex II to the AIFMD, remuneration consists of

- (i) all forms of payments or benefits paid by the AIFM,
- (ii) any amount paid by the AIF itself, including carried interest, and
- (iii) any transfer of units or shares of the AIF,

in exchange for professional services rendered by the AIFM *identified staff*.

For the purpose of item (ii) of this paragraph, whenever payments, excluding reimbursements of costs and expenses, are made directly by the AIF to the AIFM for the benefit of the relevant categories of staff of the AIFM for professional services rendered, which may otherwise result in a circumvention of the relevant remuneration rules, they should be considered remuneration for the purpose of the guidelines and Annex II to the AIFMD.

11. All remuneration can be divided into either fixed remuneration (payments or benefits without consideration of any performance criteria) or variable remuneration (additional payments or benefits depending on performance or, in certain cases, other contractual criteria). Both components of remuneration (fixed and variable) may include monetary payments or benefits (such as cash, shares, options, cancellation of loans to staff members at dismissal, pension contributions, remuneration by AIFs e.g. through carried interest models) or non (directly) monetary benefits (such as, discounts, fringe benefits or special allowances for car, mobile phone, etc.). Ancillary payments or benefits that are part of a general, non-discretionary, AIFM-wide policy and pose no incentive effects in terms of risk assumption can be excluded from this definition of remuneration for the purposes of the AIFMD specific risk alignment remuneration requirements.

12. Any payment made directly by the AIF to the benefit of those categories of staff mentioned under Annex II, paragraph (2) of the AIFMD which consists of a pro-rata return on any investment made by those staff members into the AIF should not be subject to any of the remuneration provisions set out in these guidelines. In order for a return on an investment made by the staff member into the AIF to be considered as exempted from the remuneration provisions, the investment needs to consist in an actual disbursement made by the staff member (i.e. loans granted by the AIFM to the staff member in order to allow a co-investment into the AIF should not be considered as an investment for the purposes of the exemption if the loan has not been reimbursed by the staff member by the time the return is paid).

13. AIFMs should be able to clearly identify and make the relevant distinctions in the treatment of:

- (i) the portion of the payment made by the AIF to the above mentioned categories of staff members which exceeds the pro-rata investment return for the investment made by the relevant staff members and represents carried interest, i.e. a share in the profits of the AIF accrued to the staff members as compensation for the management of the AIF (which is subject to the remuneration provisions of these guidelines)⁶; and

⁶ See however Section XII.V (Compliance of certain remuneration structures with the requirements on risk alignment of variable remuneration, award and pay-out process) for some specific provisions which may apply to certain remuneration structures.

(ii) the portion of the payment made by the AIF to the same categories of staff members which represents a share in the profits of the AIF accrued to the staff members as a pro-rata return on any investment by the staff members into the AIF (which is not subject to the remuneration provisions of these guidelines).

14. A "retention bonus" is a form of variable remuneration and can only be allowed to the extent that risk alignment provisions are properly applied.
15. AIFMs should ensure that variable remuneration is not paid through vehicles or that methods are employed which aim at artificially evading the provisions of the AIFMD and these guidelines. The governing body of each AIFM has the primary responsibility for ensuring that the ultimate goal of having sound and prudent remuneration policies and structures is not improperly circumvented. Circumstances and situations that may pose a greater risk under this perspective may be: the conversion of parts of the variable remuneration into benefits that normally pose no incentive effect in respect of risk positions; the outsourcing of professional services to firms that fall outside the scope of the AIFMD; the use of tied agents or other persons not considered "employees" from a legal point of view; transactions between the AIFMs and third parties in which the risk takers have material interests; the setting up of structures or methods through which remuneration is paid in the form of dividends or similar pay outs (e.g. improper use of performance fees) and non-monetary material benefits awarded as incentive mechanisms linked to the performance.
16. The so called 'carried interest vehicles' are typically limited partnerships (or other kinds of vehicle) being themselves limited partners in the AIF together with third party investors and are used by senior executives of an AIF either to regulate the executives' entitlements to carried interest among themselves as a consequence of a modest capital contribution or to commit capital which is more than merely nominal – i.e. co-investments – in transactions along with the AIF. If payments made by the AIF to the relevant staff members through these carried interest vehicles fall under the definition of carried interest, they should be subject to the remuneration provisions of these guidelines, whereas if they represent a pro-rata return on any investment by the staff members (through the carried interest vehicle) into the AIF, they should not be subject to such provisions.
17. Consideration should also be given to the position of partnerships and similar structures. Dividends or similar distributions that partners receive as owners of an AIFM are not covered by these guidelines, unless the material outcome of the payment of such dividends results in a circumvention of the relevant remuneration rules, any intention to circumvent such rules being irrelevant for such purpose.
18. When delegating portfolio management or risk management activities according to Article 20 of the AIFMD and its implementing measures, AIFM should ensure that:
 - a) the entities to which portfolio management or risk management activities have been delegated are subject to regulatory requirements on remuneration that are equally as effective as those applicable under these guidelines; or
 - b) appropriate contractual arrangements are put in place with entities to which portfolio management or risk management activities have been delegated in order to ensure that there is no circumvention of the remuneration rules set out in the present guidelines; these contractual arrangements should cover any payments made to the delegates' *identified staff* as compensation for the performance of portfolio or risk management activities on behalf of the AIFM.

VI. Guidelines on how to identify the categories of staff covered by these guidelines

19. AIFMs should identify the *identified staff*, according to these guidelines and any other guidance or criteria provided by competent authorities. AIFMs should be able to demonstrate to competent authorities how they have assessed and selected *identified staff*.

20. The following categories of staff, unless it is demonstrated that they have no material impact on the AIFM's risk profile or on an AIF it manages, should be included as the *identified staff*:

- Executive and non-executive members of the governing body of the AIFM, depending on the local legal structure of the AIFM, such as: directors, the chief executive officer and executive and non-executive partners.
- Senior management
- Control functions
- Staff responsible for heading the portfolio management, administration, marketing, human resources
- Other risk takers such as: staff members, whose professional activities – either individually or collectively, as members of a group (e.g. a unit or part of a department) – can exert material influence on the AIFM's risk profile or on an AIF it manages, including persons capable of entering into contracts/positions and taking decisions that materially affect the risk positions of the AIFM or of an AIF it manages. Such staff can include, for instance, sales persons, individual traders and specific trading desks.

When assessing the materiality of influence on an AIFM's risk profile or on an AIF it manages, AIFMs should define what constitutes materiality within the context of their AIFMs and the AIFs they manage. Criteria that AIFMs may follow to check whether they are capturing the correct staff members include an assessment of staff members or a group, whose activities could potentially have a significant impact on the AIFM's results and/or balance sheet and/or on the performance of the AIFs they manage.

An analysis of job functions and responsibilities at the AIFM should be undertaken for a proper assessment of those roles that could materially affect the risk profile of the AIFM or of the AIFs it manages. There could be cases where a staff member does not earn a high amount of total remuneration but could have a material impact on the risk profile of the AIFM or of the AIFs it manages given the individual's particular job function or responsibilities.

Staff members such as administrative or logistical support staff that, given the nature of their job functions, clearly do not have any connection with the risk profile of the AIFM or the AIF, should not be considered risk takers. However, such exclusion only applies to support staff whereas, as mentioned in the fourth bullet point in the present paragraph, staff heading the administration should be included as the *identified staff*.

21. Additionally, if they have a material impact on the risk profile of the AIFM or of the AIFs it manages, other employees/persons, whose total remuneration takes them into the same *remuneration bracket* as senior managers and risk takers should be included as the *identified staff*, such as: high-earning staff

members who are not already in the above categories and who have a material impact on the risk profile of the AIFM or of the AIFs it manages. It is likely that in some cases, those staff members whose remuneration is as high as or higher than senior executives and risk takers will be exerting material influence in some way on the risk profile of the AIFM or of the AIFs it manages. In other AIFMs, this may not be the case.

22. The examples mentioned in paragraphs 20 and 21 above are not definitive. The greater the assumption that there may be risk-takers in certain business units, the more in-depth the risk analysis must be to assess whether a person is to be considered a material risk-taker or not.

VII. Guidelines on proportionality

VII.I. Proportionality in general

23. According to the *Recommendation*, when taking measures to implement remuneration principles Member States should take account of the size nature and scope of financial undertakings' activities. In taking measures to comply with the remuneration principles AIFMs should comply in a way and to the extent that is appropriate to their size, internal organisation and the nature scope and complexity of their activities. In this way the Annex II to the AIFMD and the *Recommendation* envisage that provisions should operate in a way to enable an AIFM to take a proportionate approach to compliance with a remuneration principle.
24. Not all AIFMs should have to give substance to the remuneration requirements in the same way and to the same extent. Proportionality should operate both ways: some AIFMs will need to apply more sophisticated policies or practices in fulfilling the requirements; other AIFMs can meet the requirements of the AIFMD in a simpler or less burdensome way.
25. Although the remuneration principles in Annex II of the AIFMD are applicable to all AIFMs, proportionality may lead, on an exceptional basis and taking into account specific facts, to the disapplication of some requirements if this is reconcilable with the risk profile, risk appetite and the strategy of the AIFM and the AIFs it manages and within the limits set by the present guidelines. If AIFMs deem a disapplication for these requirements appropriate for their type of AIFM or *identified staff*, they should be able to explain to competent authorities, if requested, the rationale for every single requirement that is disappplied. Disapplication should never be automatically triggered on the basis of these guidelines alone: AIFMs should perform an assessment for each of the remuneration requirements that may be disappplied according to the following paragraph and determine whether proportionality allows them not to apply each individual requirement; if AIFMs come to the conclusion that no disapplication is possible for any of the disapplicable requirements, there should be no variation to the general application of such requirements to them.
26. The following are the only requirements that may be disappplied and then only if it is proportionate to do so:
- the requirements on the pay-out process for which guidelines are given below under Section XII.IV (Payout process). This means that some AIFMs, either for the total of their *identified staff* or for some categories within their *identified staff*, may decide not to apply the requirements on:

- variable remuneration in *instruments*;

- retention;
 - deferral;
 - ex post incorporation of risk for variable remuneration;
- the requirement to establish a remuneration committee for which guidelines are given below in Section X.II (Remuneration committee).

27. The specific numerical criteria set out in Annex II of the AIFMD – the minimum *deferral period* of three to five years, the minimum portion of 40 to 60% of variable remuneration that should be deferred (Annex II, paragraph 1(n) of the AIFMD) and the minimum portion of 50% of variable remuneration that should be paid in *instruments* (Annex II, paragraph 1(m) of the AIFMD) – if disappplied, may only be disappplied in their entirety. It should not be possible to apply, within an AIFM, lower thresholds based on proportionality. For instance, when justified by its size, internal organisation and nature, scope and complexity of its activities, an AIFM may decide not to defer any of the variable remuneration component, but may not decide to apply a 20% deferral of variable remuneration i.e. if the AIFM does not pass the proportionality test for the disapplication of the requirement, it has to apply at least a 40% deferral, or a 60% deferral in the case of a variable remuneration component of a particularly high amount.

28. It is primarily the responsibility of the AIFM to assess its own characteristics and to develop and implement remuneration policies and practices which appropriately align the risks faced and provide adequate and effective incentives to its staff. Competent authorities should review the ways AIFMs actually implement proportionality, taking into account the achievement of regulatory objectives and the need to preserve a level playing field among different AIFMs and jurisdictions.

VII.II. Proportionality with respect to the different characteristics of AIFMs

29. The different risk profiles and characteristics among AIFMs justify a proportionate implementation of the remuneration principles. Criteria relevant to the application of proportionality are the size of the AIFM and of the AIFs it manages, its internal organization and the nature, scope and complexity of its activities.

- a) Size: the size criterion can relate to the value of the AIFM capital and to the value of the assets under management (including any assets acquired through the use of leverage) of the AIFs that the AIFM manages; liabilities or risks exposure of the AIFM and of the AIFs that it manages; as well as the number of staff, branches or subsidiaries of an AIFM. The size of an AIFM and of the AIFs it manages should not be considered in isolation when applying proportionality. An AIFM might be considered “small” in terms of number of staff or subsidiaries, but be engaged in a high level of risk taking. An AIFM should adhere strictly to the remuneration principles where the aggregate set of AIFs that it manages - each of them considered “small” - becomes a potentially systemically important (e.g. in terms of total assets under management) or leads to complex investment management activities.

The general obligation to have sound remuneration policies and practices applies to all AIFMs, regardless of their size or systemic importance.

- b) Internal organization: this can relate to the legal structure of the AIFM or the AIFs it manages, the complexity of the internal governance structure of the AIFM, the listing on regulated markets of the AIFM or the AIFs it manages.

This criterion should be assessed having regard to the entire organisation of the AIFM including all the AIFs it manages, meaning that for instance the listing of one AIF should not by itself be sufficient for considering the AIFM as having a complex internal organisation.

- c) Nature, scope and complexity of the activities: in considering this criterion, the underlying risk profiles of the business activities that are carried out, should be taken into account. Relevant elements can be:

- the type of authorized activity (investment management functions listed in point 1 of Annex I of the AIFMD only or also the additional functions listed in point 2 of Annex I of the AIFMD and/or the additional services listed in Article 6(4) of the AIFMD);
- the type of investment policies and strategies of the AIFs the AIFM manages;
- the national or cross-border nature of the business activities (AIFM managing and/or marketing AIFs in one or more EU or non-EU jurisdictions); and
- the additional management of UCITS.

30. In assessing what is proportionate, the focus should be on the combination of all the mentioned criteria (size, internal organization and the nature, scope and complexity of the activities) and, as this is not an exhaustive list, of any other relevant criteria. For instance, an AIFM's business may well be small-scale but could still include complex risk-profiles because of the nature of its activities or the complexity of the managed AIFs.

VII.III. Proportionality with respect of the different categories of staff

31. Proportionality should also operate within an AIFM for some of the specific requirements. The categories of staff whose professional activities have a material impact on their risk profile should comply with specific requirements which aim to manage the risks their activities entail. The same criteria of size, internal organisation and the nature, scope and complexity of the activities should apply. In addition, the following non-exhaustive elements should be taken into account, where relevant:

- The size of the obligations into which a risk taker may enter on behalf of the AIFM;
- The size of the group of persons, who have only collectively a material impact on the risk profile of the AIFM;
- The structure of the remuneration of the staff members (e.g. fixed salary with a variable remuneration vs. profit sharing arrangements), in particular, the following elements:
 - the amount of variable remuneration perceived;
 - the percentage of variable remuneration over the fixed remuneration.

VIII. Guidelines for AIFMs being part of a group

32. These guidelines apply in any case to any AIFM. In particular, there should be no exception to the application to any of the AIFMs which are subsidiaries of a credit institution of the sector-specific remuneration principles set out in the AIFMD and in the present guidelines.
33. Compliance with these sectoral remuneration principles by AIFMs which belong to banking, insurance, investment groups or financial conglomerates should be considered as ensuring the respect by such a group of the remuneration principles applicable to the group with specific regard to the AIFM.

IX. Guidelines on the financial situation of the AIFM

34. In order to guarantee ongoing compliance with the requirements of Article 9(1) to (3), 9(5) and 9(7) of the AIFMD, AIFMs should ensure that they maintain a prudent balance between sound financial situation and the award, pay out or vesting of variable remuneration.
35. The AIFM should ensure that its financial situation will not be adversely affected by:
 - 1) the overall pool of variable remuneration that will be awarded for that year; and
 - 2) the amount of variable remuneration that will be paid or vested in that year.
36. The fact that an AIFM is or risks becoming unable to maintain a sound financial situation, should be a trigger for, inter alia: a) reducing the variable remuneration pool for that year and b) the application of performance adjustment measures (i.e. *malus* or *clawback*) in that financial year⁷. Instead of awarding, paying out the variable remuneration or allowing it to vest, the net profit of the AIFM for that year and potentially for subsequent years should be used to strengthen its financial situation. The AIFM should not compensate for this at a later date by awarding, paying out or vesting a greater amount of variable remuneration than it otherwise would have done, unless it becomes evident in subsequent years that the AIFM's financial results justify such actions.

X. Guidelines on governance of remuneration

37. The general requirements on governance of remuneration should apply to the AIFM as a whole.

X.I. Management body

X.I.I Design, approval and oversight of the remuneration policy

38. An AIFM's remuneration policy should encourage the alignment of the risks taken by its staff with those of the AIFs it manages, the investors of such AIFs and the AIFM itself; in particular, the remuneration policy should duly take into consideration the need to align risks in terms of risk management and exposure to risk.
39. The *supervisory function* should be responsible for approving and maintaining the remuneration policy of the AIFM, and overseeing its implementation. The remuneration policy should not primarily be controlled by executive members of the *supervisory function*. The *supervisory function* should also

⁷ See also Section XII (Guidelines on the specific requirements on risk alignment).

approve any subsequent material exemptions or changes to the remuneration policy and carefully consider and monitor their effects. Procedures to determine remuneration should be clear, well-documented and internally transparent. For example, proper documentation should be provided on the decision-making process, the determination of the *identified staff*, the measures used to avoid conflicts of interest, the risk-adjustment mechanisms used etc.

40. In the design and oversight of the AIFM's remuneration policies, the *supervisory function* should take into account the inputs provided by all competent corporate functions (i.e. risk management, compliance, human resources, strategic planning, etc.). As a result, those functions should be properly involved in the design of the remuneration policy of the AIFM.
41. Ultimately, the *supervisory function* should ensure that an AIFM's remuneration policy is consistent with and promotes sound and effective risk management. The remuneration policy should:
 - be in line with the business strategy, objectives, values and interests of the AIFM,
 - not encourage excessive risk taking as compared to the investment policy of the AIFs the AIFM manages, and
 - enable the AIFM to align the interests of the AIFs and their investors with those of the *identified staff* that manages such AIFs, and to achieve and maintain a sound financial situation.
42. The *supervisory function* should ensure that the AIFM's overall corporate governance principles and structures, as well as their interactions with the remuneration system are considered within the design and implementation of an AIFM's remuneration policies and practices. The *supervisory function* should ensure that the following elements are taken into account: the clear distinction between operating and *control functions*, the skills and independence requirements of members of the *management body*, the role performed by internal committees, including the remuneration committee, the safeguards for preventing conflicts of interests and the internal reporting system and the related parties' transactions rules.

X.I.II Remuneration of members of the management body and supervisory function

43. The remuneration of the members of the *management body* should be consistent with their powers, tasks, expertise and responsibilities.
44. Where appropriate considering the size of the AIFM, its internal organisation and the nature, scope and complexity of its activities, the *management body* should not determine its own remuneration. The *supervisory function* should determine and oversee the remuneration of the members of the *management body*. To the extent compatible with national law, the *supervisory function* should also specifically approve and oversee the remuneration of senior executives and staff members who receive the highest amounts of total remuneration within the AIFM.
45. For AIFMs which have a separate *supervisory function*, in order to properly address conflicts of interests, it may be more appropriate for members of the *supervisory function* to be compensated only with fixed remuneration. When incentive-based mechanisms are in place, they should be strictly tailored to the assigned monitoring and control tasks, reflecting the individual's capabilities and the achieved results. If *instruments* are granted, appropriate measures should be taken, such as *retention*

periods until the end of the mandate, in order to preserve the independence of judgment of those members of the *management body*. For those AIFMs that given their size, internal organisation and the nature, scope and complexity of their activities do not have a separate *supervisory function*, the principle according to which members of the *supervisory function* may more appropriately be compensated only with fixed remuneration should apply only to the non-executive members of the *management body* that perform the tasks of the *supervisory function*.

X.I.III Shareholders' involvement

46. The approval of an AIFM's remuneration policy and decisions relating to the remuneration of members of the *management body*, may be assigned to the meeting of the shareholders of the AIFM, depending on the AIFM's characteristics or on the national rules in the jurisdiction in which the AIFM is established. The shareholders' vote may be either consultative or binding. To this end, shareholders should be provided with adequate information in order that they can make informed decisions.
47. The *supervisory function* remains responsible for the proposals submitted to the meeting of the shareholders of the AIFM, as well as for the actual implementation and oversight of any changes to the remuneration policies and practices.

X.I.IV Review of the implementation of the remuneration policy

48. The *supervisory function* should ensure that the implementation of the remuneration policy of the AIFM will be reviewed on an annual basis at a minimum. Such central and independent reviews should assess whether the overall remuneration system:
 - operates as intended (in particular, that all agreed plans/programs are being covered; that the remuneration payouts are appropriate, and that the risk profile, long-term objectives and goals of the AIFM are adequately reflected); and
 - is compliant with national and international regulations, principles and standards.
49. The relevant internal *control functions* (i.e. internal audit, risk management, compliance functions, etc.) as well as other key *supervisory function* committees (i.e. audit, risk, and nominations committees) should be closely involved in reviewing the remuneration system of the AIFM.
50. Where periodic reviews reveal that the remuneration system does not operate as intended or prescribed, the *supervisory function* should ensure that a timely remedial plan is put in place.
51. The periodic review of the implementation of the remuneration policies and practices may be, partially or totally, externally commissioned when appropriate according to proportionality. Larger and more complex AIFMs should have sufficient resources to conduct the review internally, though external consultants may complement and support the AIFM in carrying out such tasks where appropriate. In line with proportionality, smaller and less complex AIFMs may decide to outsource the entire review, by performing the review less frequently than annually or carrying out at least annually an internal assessment not amounting to a full independent review. In all cases, the *supervisory function* should remain responsible for the review of remuneration policies and practices and for ensuring that the results of the review are followed up; moreover, the relevant *control functions* should be closely involved.

X.II. Remuneration committee

X.II.I Setting up a remuneration committee

52. The setting up of a remuneration committee should be considered, as a matter of good practice, even by those AIFMs that are not obliged to set up such a committee under paragraph (3) of Annex II to the AIFMD.
53. In order to identify whether a remuneration committee is expected to be set up, the factors mentioned in Section VII (Guidelines on proportionality) need to be considered. When assessing whether or not an AIFM is significant, an AIFM should consider the cumulative presence of all the three factors (i.e. its size or the size of the AIFs it manages, its internal organisation and the nature, scope and complexity of its activities). An AIFM which is significant only with respect to one or two of the three above factors should not be required to set up a remuneration committee.
54. Without prejudice to the previous paragraph, specific (non-exhaustive) elements to be taken into account when determining whether or not to establish a remuneration committee are:
- whether the AIFM is listed or not;
 - the legal structure of the AIFM;
 - the number of employees of the AIFM;
 - the AIFM's assets under management;
 - whether the AIFM is also a UCITS management company;
 - the provision of the services mentioned under Article 6(4) of the AIFMD.
55. Taking into account the above principles and having regard to all circumstances, the following are examples of AIFMs which may not need to establish a remuneration committee:
- AIFMs for which the value of the portfolios of AIFs that they manage does not exceed EUR 1.25 billion and not having more than 50 employees, including those dedicated to the management of UCITS and the provision of the services mentioned under Article 6(4) of the AIFMD;
 - AIFMs which are part of banking, insurance, investment groups or financial conglomerates within which an entity is obliged to set up a remuneration committee which performs its tasks and duties for the whole group, provided that the rules governing such remuneration committee's composition, role and competences are equivalent to the ones set out in these guidelines and the existing remuneration committee takes responsibility for checking the compliance of the AIFM with the rules set out in these guidelines.
56. It should also be understood as mentioned above under paragraph 52 that AIFMs falling within the examples set out above may choose to set up a remuneration committee at their own initiative as a matter of good practice.

57. AIFMs that fall outside the above examples should not be automatically required to set up a remuneration committee. For this purpose, AIFMs that are above the thresholds set out in paragraph 55 should be considered significant in terms of their size or the size of the AIFs they manage; in order to decide whether or not they need to set up a remuneration committee, however, such AIFMs should still assess whether or not they are significant in terms of their internal organisation and the nature, the scope and the complexity of their activities.

X.II.II Composition of the remuneration committee

58. In order to operate independently from senior executives, the remuneration committee should comprise members of the *supervisory function* who do not perform executive functions, at least the majority of whom qualify as independent.

59. The chairperson of the remuneration committee should be an independent, non-executive member.

60. An appropriate number of the members of the remuneration committee should have sufficient expertise and professional experience concerning risk management and control activities, namely with regard to the mechanism for aligning the remuneration structure to AIFMs' risk and capital profiles.

61. The remuneration committee should be encouraged to seek expert advice internally (e.g. from risk management) and externally. The chief executive officer should not take part in the remuneration committee meetings which discuss and decide on his/her remuneration.

X.II.III Role of the remuneration committee

62. The remuneration committee should:

- be responsible for the preparation of recommendations to the *supervisory function*, regarding the remuneration of the members of the *management body* as well as of the highest paid staff members in the AIFM;
- provide its support and advice to the *supervisory function* on the design of the AIFM's overall remuneration policy;
- have access to advice, internal and external, that is independent of advice provided by or to senior management;
- review the appointment of external remuneration consultants that the *supervisory function*, may decide to engage for advice or support;
- support the *supervisory function* in overseeing the remuneration system's design and operation on behalf of the *supervisory function*;
- devote specific attention to the assessment of the mechanisms adopted to ensure that:
 - the remuneration system properly takes into account all types of risks and liquidity and assets under management levels, and

- the overall remuneration policy is consistent with the business strategy, objectives, values and interests of the AIFM and the AIFs it manages and the investors of such AIFs; and
 - formally review a number of possible scenarios to test how the remuneration system will react to future external and internal events, and back test it as well.
63. The remuneration committee itself may be in charge of overseeing the central and independent review of the implementation of the remuneration policies and practices.

X.II.IV Process and reporting lines of the remuneration committee

64. The remuneration committee should:

- have unfettered access to all data and information concerning the decision-making process of the *supervisory function*, on the remuneration system's design and implementation;
- have unfettered access to all information and data from risk management and *control functions*. Such access should not hinder the AIFM's ordinary activities;
- ensure the proper involvement of the internal control and other competent functions (e.g. human resources and strategic planning). The remuneration committee should collaborate with other board committees whose activities may have an impact on the design and proper functioning of remuneration policy and practices (e.g. risk audit, and nomination committees); and
- provide adequate information to the *supervisory function*, and, where appropriate, to the AIFM's shareholders' meeting about the activities performed.

X.III. Control functions

X.III.I Roles of control functions

65. AIFMs should ensure that *control functions* have an active role in the design, ongoing oversight and review of the remuneration policies for other business areas.
66. Working closely with the remuneration committee and the *supervisory function* and *management body*, the *control functions* should assist in determining the overall remuneration strategy applicable to the AIFM, having regard to the promotion of effective risk management.
67. The risk management function should assess how the variable remuneration structure affects the risk profile of the AIFM. It is good practice for the risk management function to validate and assess risk adjustment data, and to attend a meeting of the remuneration committee for this purpose.
68. The compliance function should analyse how the remuneration structure affects the AIFM's compliance with legislation, regulations and internal policies.
69. The internal audit function should periodically carry out an independent audit of the design, implementation and effects of the AIFM's remuneration policies.

X.III.II Remuneration of control functions

70. The remuneration level of staff in the *control functions* should allow the AIFM to employ qualified and experienced personnel in these functions.
71. If staff in *control functions* receives variable remuneration, it should be based on function-specific objectives and should not be determined solely by the AIFM-wide performance criteria.
72. The remuneration structure of *control functions* personnel should not compromise their independence or create conflicts of interest in their advisory role to the remuneration committee, *supervisory function* and/or *management body*. If remuneration of the *control functions* includes a component based on AIFM-wide performance criteria, the risk of conflicts of interest increases and, therefore, should be properly addressed.
73. For AIFMs which are required to have a remuneration committee, the remuneration of the senior staff responsible for heading the *control functions* should not be solely left to the *supervisory function*, but should be directly overseen by the remuneration committee. The remuneration of those staff members in compliance and risk management functions must be designed in a way that avoids conflict of interests related to the business unit they are overseeing and, therefore, should be appraised and determined independently. The remuneration committee should make recommendations to the *management body* on the remuneration to be paid to the senior officers in the risk management and compliance functions.
74. For AIFMs which are not required to have a remuneration committee, the remuneration of the senior staff responsible for heading the *control functions* should be overseen by the *supervisory function*.
75. Conflicts of interest which might arise if other business areas had undue influence over the remuneration of staff within *control functions* should be adequately managed. The need to avoid undue influence is particularly important where staff members from the *control functions* are embedded in other business areas. However, the views of other business areas should be sought as an appropriate part of the assessment process.
76. *Control functions* should not be placed in a position where, for example, approving a transaction, making decisions or giving advice on risk and financial control matters could be directly linked to an increase or decrease in their performance-based remuneration.

XI. Guidelines on the general requirements on risk alignment

77. The general requirements on risk alignment should be applied by AIFMs only to the individual remuneration packages of the *identified staff*, but a voluntary AIFM-wide application is strongly recommended as indicated in Annex II. AIFMs should make an assessment on whether these requirements should be applied to the AIFM as a whole and, if required, be able to demonstrate to competent authorities why they have applied these requirements to the *identified staff* only.

XI.I. The general remuneration policy, including the pension policy

78. The long-term strategy of the AIFM should include the overall business strategy and quantified risk tolerance levels with a multi-year horizon, as well as other corporate values such as compliance culture, ethics, behaviour towards investors of the AIFs it manages, measures to mitigate conflicts of in-

terest etc. The design of the remuneration systems should be consistent with the risk profiles, rules or instruments of incorporation of the AIFs the AIFM manages and with the objectives set out in the strategies of the AIFM and the AIFs it manages and changes that could be decided in the strategies must be taken into account. AIFMs should, therefore, ensure that their remuneration systems are well designed and implemented. This includes, in particular, a proper balance of variable to fixed remuneration, the measurement of performance as well as the structure and, where appropriate, the risk-adjustment of the variable remuneration. Even a smaller or less sophisticated AIFM should ensure it makes the best possible attempt to align its remuneration policy with its interests and the interests of the AIFs it manages and their investors.

79. When developing their remuneration policy, AIFMs should give due consideration to how remuneration contributes to the prevention of excessive risk-taking, the efficiency of the AIFM and the AIFs it manages and the consistency of the remuneration policy with effective risk management.
80. Managers should consider conservative valuation policies and should not ignore concentration risks and risk factors, such as liquidity risk and concentration risk that could place the AIFs that the AIFM manages under stress at some point in the future. There are strong incentives not to follow such obligations if the variable part of the remuneration consists predominantly of *instruments* that are paid out immediately, without any deferral or ex post risk adjustment mechanisms (*malus* or *clawback*), and/or are based on a formula that links variable remuneration to current year revenues rather than risk-adjusted profit.
81. In order to counterbalance the dangers mentioned, risk management elements should be connected to the remuneration policy. When properly structured and implemented, variable remuneration can be an efficient tool to align the staff's interests with the interests of the AIFs that the AIFM manages. Having regard to the nature, scale and complexity of an AIFM, alternative approaches exist for connecting risk management elements to a remuneration policy.

XI.II. Discretionary pension benefits

82. Remuneration policy should cover all aspects of remuneration including fixed components, variable components, pension terms and other similar specific benefits. The pension policy (the fixed as well as the variable pension payments) should be aligned with the long term interests of the AIFM and the AIFs it manages.
83. In case of discretionary pension benefits, as part of the variable remuneration, a staff member should not retire or leave the AIFM with such benefits vested, with no consideration of the economic situation of the AIFs that the AIFM manages or risks that have been taken by the staff member in the long term.
84. In order to align this specific kind of pension benefits with the economic situation of the AIFs that the AIFM manages, discretionary pension benefits, where legally possible according to the relevant pension legislation, should be paid in the form of *instruments*.
85. In the context of a retirement, the discretionary pension benefits vested to the staff member should be subject to a five years *retention period*.
86. Where a staff member leaves the AIFM before retirement, the discretionary pension benefits should not be vested before a period of five years and should be subject to performance assessment and ex post risk adjustment before pay out.

XI.III. Severance pay

87. “Golden parachute” arrangements for staff members who are leaving the AIFM and which generate large payouts without any performance and risk adjustment should be considered inconsistent with the principle in Annex II, paragraph (1)(k) of the AIFMD. Any such payments should be related to performance achieved over time and designed in a way that does not reward failure. This should not preclude termination payments in situations such as early termination of the contract due to changes in the strategy of the AIFM or of the AIFs it manages, or in merger and/or takeover situations.
88. AIFMs should set up a framework in which severance pay is determined and approved, in line with the AIFM’s general governance structures for employment. The framework should ensure that there is no reward for failure.
89. AIFMs should be able to explain to competent authorities the criteria they use to determine the amount of severance pay. It is good practice to defer any outstanding variable payments or long-term incentive plans and for these to mirror the original deferral schemes.

XI.IV. Personal hedging

90. Staff could be considered to have hedged away the risk of a downward adjustment in remuneration if the staff member enters into a contract with a third party which requires the third party to make payments directly or indirectly to the staff member that are linked to or commensurate with the amounts by which the staff member’s variable remuneration has been reduced. The contract could for instance take the form of an option or any other derivative contract or other form of contract which provides any type of hedging for the staff member’s variable remuneration.
91. In order to ensure the effectiveness of risk alignment, staff members should not buy an insurance contract which compensates them in the event of a downward adjustment in remuneration. As a general rule, however, this would not prohibit insurance designed to cover personal payments such as healthcare and mortgage instalments (provided that the mortgage coverage concerns health-related circumstances that would render the staff member unable to work in an equivalent position), although each case should be judged on its merits.
92. The requirement not to use personal hedging strategies or insurance to undermine the risk alignment effects embedded in their remuneration arrangements should apply to deferred and retained variable remuneration. AIFMs should maintain effective arrangements to ensure that the staff member complies with this requirement.

XII. Guidelines on the specific requirements on risk alignment

93. The specific requirements on risk alignment should be applied by AIFMs only to the individual remuneration packages of the *identified staff*, but AIFMs may always consider an AIFM-wide application (or, at least, a “broader than strictly necessary” application) of all or some of the specific requirements. Annex II indicates the specific requirements for which this voluntary AIFM-wide application is strongly recommended.

XII.I. Fully flexible policy on variable remuneration

94. Having a fully-flexible policy on variable remuneration implies not only that variable remuneration should decrease as a result of negative performance but also, that it can go down to zero in some cases.

For its practical implementation, it also implies that the fixed remuneration should be sufficiently high to remunerate the professional services rendered, in line with the level of education, the degree of seniority, the level of expertise and skills required, the constraints and job experience, the relevant business sector and region. Individual levels of fixed remuneration should be indirectly impacted by the basic principle on risk alignment.

XII.II. Risk alignment of variable remuneration

XII.II.I Risk alignment process

95. To limit excessive risk taking, variable remuneration should be performance-based and risk adjusted. To achieve this aim, an AIFM should ensure that incentives to take risks are constrained by incentives to manage risk. A remuneration system should be consistent with effective risk management and governance processes within the AIFM.

XII.II.I.I Performance and risk measurement process

96. Setting up a remuneration system should start by defining the objectives of the AIFM, the unit, as well as the staff and the investment strategy of the AIFs concerned. These objectives should be derived from the business plan of the AIFM, if any, and should be in line with the risk appetite of the AIFM and the investment strategy of the AIFs concerned. The performance criteria, which should be used to assess the staff member's achievement of his/her objectives during the *accrual period*, can be directly derived from these objectives. The right to receive the variable remuneration is earned ("awarded") at the end of the *accrual period* or during the *accrual period*, which should be at least one year, but it may be longer. In some cases different *accrual periods* may overlap. If properly designed, the performance assessment links the remuneration with the achievement of the investment strategy of the AIFs concerned and the business plan, if any, or the objectives of the AIFM. On the contrary, performance criteria which are badly designed can be an incentive for taking too much risk. When assessing performance, only the effective results should be taken into account. Risk alignment during performance measurement can be achieved by using risk adjusted performance criteria or by adjusting performance measures for risk afterwards. The risk adjustment may differ according to the activity of the staff member and the business line or AIF concerned.

XII.II.I.II Award process

97. After the *accrual period*, the AIFM should use a specified award process in order to translate performance assessment into the variable remuneration component for each staff member. This should usually be carried out through so-called "pools" of variable remuneration that are first determined and later on allocated. As not all performance and risk measures are suitable to be applied at the level of the AIFM, the business unit and the staff member, the AIFM should identify the risks at each level and ensure that a risk correction adequately captures the magnitude and the duration of the risk at each level. This so-called "ex-ante risk adjustment" should adjust remuneration for potential adverse developments in the future.

XII.II.I.III Payout process

98. In order to align the actual payment of remuneration to the life-cycle and redemption policy of the AIFs managed by the AIFM and their investment risks, the variable remuneration should partly be paid upfront (short-term) and partly deferred (long-term). The short-term component should be paid directly after the award and rewards staff for performance delivered in the *accrual period*. The long-

term component should be awarded to staff during and after the *deferral period*. It should reward staff for the sustainability of the performance in the long term, which is the result of decisions taken in the past. Before paying out the deferred part, a reassessment of the performance and, if necessary, a risk adjustment should be required in order to align variable remuneration to risks and errors in the performance and risk assessments that have appeared since the staff members were awarded their variable remuneration component. This so-called ex post risk adjustment should always be necessary, because at the time remuneration is awarded, the ultimate performance cannot be assessed with certainty.

XII.II.II Common requirements for the risk alignment process

XII.II.II.I Time horizon

99. AIFMs, when assessing risk and performance, should take into account both current and future risks that are taken by the staff member, the business unit, the AIF concerned or the AIFM as a whole. For this exercise, AIFMs should examine what the impact of the staff member's activities could be on the AIFs they manage and AIFM's short and long term success. To be able to do so, the AIFM should align the horizon of risk and performance measurement with the life-cycle and redemption policy of the AIFs managed by the AIFM and their investment risks. The requirement of an AIFM to assess the performance of its staff in a multi-year framework appropriate to the life-cycle of the AIFs managed by the AIFM implies the *accrual period* and the payout period for short-term and long-term remuneration covering an appropriate period in total.
100. The right balance between accrual and payout periods should depend on the type of AIFs managed by the AIFM and on the type of business and activity developed by the staff member. However, the use of multi-year *accrual periods* is more prudent since the assessment of the performance can take into account with certainty more risks that have materialized since the beginning of the *accrual period*.

XII.II.II.II Levels of risk and performance measurement

101. Performance-related remuneration should include parameters linked to the risks and performance of the AIF concerned and of the business unit of the AIFM in addition to the risks and performance of the individual activities. Thus, the amount of variable remuneration a staff member is eligible for should be determined by his/her individual performance, the performance of his/her business line or the AIF concerned and the performance of the AIFM. The relative importance of each level of the performance criteria should be determined beforehand and adequately balanced to take into account the position or responsibilities held by the staff member.
102. To have the greatest impact on staff behaviour, the variables used to measure risk and performance should be linked as closely as possible to the level of the decisions made by the staff member that is subject to the risk adjustment. Performance criteria should include achievable objectives and measures on which the staff member has some direct influence. For example, for senior executives, AIFMs may design the remuneration policies to include financial measures based on the performance of all the AIFs managed by the AIFM or the entire AIFM, or for performance and risks of units, or decisions that were determined by senior executive strategy. In contrast, variables for the manager of a business unit ideally would be for performance and risk of that unit.

XII.II.II.III Quantitative and qualitative measures

103. The risk alignment process should use a mix of quantitative and qualitative approaches (e.g. measurement of performance or risk; setting of the pool and adjustment to risks).
104. Quantitative measures may have some advantages in terms of transparency if they are pre-defined. They can, therefore, influence the behaviour of staff more directly. However, quantitative measures or criteria are not sufficient to measure all risk or performance or to risk adjust remuneration. To complete the measurement and adjustment of risk or performance, AIFMs should also rely on qualitative approaches.

XII.II.II.IV Judgemental measures

105. Whenever judgement is used for a risk and performance measurement or risk adjustment, there should be:
- a clearly written policy outlining parameters and key considerations on which the judgement will be based;
 - clear and complete documentation of the final decision regarding risk and performance measurement or risk adjustment;
 - involvement of relevant *control functions* experts;
 - appropriate levels of approval obtained, e.g. of the *management body* or *supervisory function*, or of the remuneration committee; and
 - consideration of the personal incentives of the manager making the judgement, e.g. by using scorecards.
106. For both quantitative and qualitative measures, AIFMs should be prepared to disclose and reproduce any judgmental elements incorporated into their risk alignment process. AIFMs should also provide detailed information to the competent authority if the final outcome after applying judgmental measures is significantly different from the initial outcome using pre-defined measures.

XII.II.III Risk measurement

107. AIFMs should take into account all risks, whether on or off balance sheet, differentiating amongst risks affecting the AIFM, the AIFs it manages, business units and individuals. Risk identification and quantification at the AIF level can be found in the risk management policy that the AIFM is required to establish, implement and maintain and which identifies all the relevant risks to which the AIFs they manage are or might be exposed to. AIFMs should also determine whether measures they are using for risk adjustment include ‘difficult-to-measure’ risks, such as reputational and operational risk.
108. In order to take into account all material risks, AIFMs should use the same risk measurement methods as used in the risk management policy established for the AIFs managed by the AIFM. Furthermore, AIFMs should also take into account (i) the risks arising from the additional management of UCITS and from the services provided under Article 6(4) of the AIFMD and (ii) the potential professional liability risks that AIFMs have to cover through either additional own funds or professional indemnity insurance according to Article 9(7) of the AIFMD.

109. Taking proportionality into account, the risk management calculations should be transparent and the AIFMs should be able to demonstrate how the risk calculations can be broken down by AIFs and related to the AIFM's business units and different types of risk positions throughout the organisation. The quality of methods and models used should influence the extent to which an AIFM should implement a more sophisticated variable remuneration policy based on performance measurements.

XII.II.IV Performance measurement

XII.II.IV.I Qualitative/Quantitative measures

110. AIFMs should use both quantitative (financial) as well as qualitative (non-financial) criteria for assessing individual performance.
111. The appropriate mix of quantitative and qualitative criteria should depend on the tasks and responsibilities of the staff member. In all cases, the quantitative and qualitative criteria and the balance between them should be specified and clearly documented for each level and category of staff.
112. Quantitative measures should cover a period which is long enough to properly capture the risk of the staff member's actions. Examples of quantitative performance measures used in the asset management sector which fulfil the abovementioned provisions are the internal rate of return (IRR), earnings before interest, taxes, depreciation and amortization (EBITDA), Alpha Ratio, absolute and relative returns, Sharpe Ratio and assets raised.
113. In addition to quantitative performance measures, variable remuneration awards should also be sensitive to the staff's performance with respect to qualitative (non-financial) measures. Examples are the achievement of strategic targets, investor satisfaction, adherence to risk management policy, compliance with internal and external rules, leadership, management, team work, creativity, motivation and cooperation with others business units and with *control functions*. Such determined qualitative criteria could rely on compliance with risk control measures such as limits and audit results. Negative non-financial performance, in particular unethical or non-compliant behaviour, should override any good financial performance generated by a staff member and should diminish the staff member's variable remuneration.

XII.II.IV.II Relative/absolute and internal/external measures

114. Absolute performance measures are measures set by the AIFM on the basis of its own strategy, which includes the risk profile and risk appetite of the AIFM and of the AIFs it manages, as further developed down through the chain of business levels. Such measures help to minimize the risk that remuneration is awarded that is not justifiable by the AIFM's or AIFs' performance. They also tend to create long term incentives. However, it may be difficult to calibrate absolute performance measures, especially for new entrants or for new kinds of financial activities (with difficult-to-measure risks) linked to the management of AIFs.
115. Relative performance measures are measures that compare performance with peers, either 'internal' peers (i.e. within the organization) or 'external' (similar AIFMs). Relative performance measures are easier to set because the benchmark is readily available. However, such measures pose the risk that variable remuneration that is not supported by long-term success of the business unit or the AIFM or the AIFs it manages will be paid out anyway. In a period of sector wide positive financial performances, it could lead to 'raising the bid' and/or 'herd' mentality, providing incentives to take on excessive risk. In a downturn economic cycle where most AIFMs and AIFs may perform poorly, relative

measures may nonetheless lead to positive outcomes (and thus to an insufficient contraction of the AIFM's total variable remuneration) even if absolute performance has deteriorated compared to previous periods.

116. Internal (e.g. profits) and external (e.g. share price) variables come with both advantages and disadvantages that should be balanced carefully. Internal performance measures are able to generate more involvement of the staff members if they can influence the outcome by their own behaviour. This is especially true if the performance measures are fixed at the level of the business unit (rather than on the AIFM-wide level). Furthermore, it is easier to introduce risk adjustment features for internal measures, because the link with in-house risk management techniques is more readily available. On the other hand, such measures can be manipulated and can create distorted outcomes on a short-term basis. External performance measures are less subject to this danger of manipulation, although attempts to artificially increase the stock price (probably only relevant for top executives) may still occur.

XII.III. Award process

XII.III.I Setting and allocation of pools

117. AIFMs should adopt a documented policy for the award process and ensure that records of the determination of the overall variable remuneration pool are maintained.

XII.III.II The risk adjustment in the award process

118. In determining remuneration pools or individual awards, AIFMs should consider the full range of current and potential (unexpected) risks associated with the activities undertaken. Performance measures used in setting the remuneration pool may not fully or adequately capture risks undertaken, thus, ex-ante adjustments should be applied to ensure that the variable remuneration is fully aligned with the risks undertaken. AIFMs should establish whether the risk adjustment criteria they are using take into consideration severe risks or stressed conditions.
119. AIFMs should determine to what level they are able to risk adjust their variable remuneration calculations quantitatively – whether to the business unit level or further down the line such as to a trading desk level, if any, or even to an individual level. AIFMs should determine the level of granularity that is suitable for each level.

XII.III.II.I Quantitative ex ante risk adjustment

120. In order to have a sound and effective remuneration scheme, AIFMs should use a number of different quantitative measures for their risk adjustment process. Normally, these measures should be based on an overarching risk adjustment framework.
121. When measuring the profitability of the AIFM and its business units as well as the AIFs it manages, the measurement should be based on net revenue where all direct and indirect costs related to the activity are included. AIFMs should not exclude IT costs, research costs, legal fees, marketing costs, and costs for outsourced activities. AIFMs should make sure that remuneration pools are not being “back-fitted” to meet remuneration demands.
122. The quantitative ex-ante risk adjustments made by AIFMs should largely rely on existing measures within the AIFMs, generally used for other risk management purposes. As a result, the limitations and

potential issues related to these measures should also be relevant for the remuneration process. The risk adjustments used should benefit from the experience gained when dealing with these risks in other contexts and should be challenged like any other component of the risk management process.

XII.III.II.II Qualitative measures for ex-ante risk adjustment

123. Qualitative risk elements should be considered by AIFMs. Qualitative ex-ante adjustments could take place while setting AIFM-wide and business unit remuneration pools or when determining or allocating individuals' remuneration. Qualitative ex-ante risk adjustments are common at pool and individual levels, contrary to quantitative adjustments which tend to be mostly observed only at the pool level.
124. AIFMs make qualitative risk adjustments when allocating/determining individuals' remuneration through assessments that may explicitly include risk and control considerations such as compliance breaches, risk limit breaches and internal control breakdowns (e.g. based on internal audit results).

XII.IV. Pay-out process

XII.IV.I Non-deferred and deferred remuneration

125. Although remuneration is aligned through ex-ante risk adjustments, due to uncertainty, ex-post risk adjustments should be put in place to keep incentives fully aligned. This can only be done if part of the remuneration has been deferred.
126. A deferral schedule is defined by different components: (a) the time horizon of the deferral, (b) the proportion of the variable remuneration that is being deferred, (c) the speed at which the deferred remuneration vests (*vesting point*), (d) the time span from accrual until the payment of the first deferred amount and (e) the form of the deferred variable remuneration. AIFMs can differentiate their deferral schedules by varying these five components. A stricter than necessary application for one component may influence the supervisory scrutiny for another component. In any case, the way in which an AIFM combines these components should lead to a meaningful deferral schedule, in which the long-term risk alignment incentives are clear.

XII.IV.I.I Time horizon and vesting

127. The *deferral period* always starts at the moment the upfront part of the variable remuneration is paid out and can be coupled either to cash variable remuneration or variable remuneration in *instruments*. It ends when the last variable remuneration has vested. The minimum *deferral period* is three to five years, unless the AIFM can demonstrate that the life cycle of the AIF concerned is shorter; this means that if the life cycle of the AIF concerned is, for instance, one year, the minimum *deferral period* may be one year. AIFMs should set the *deferral period* which should be calculated on the basis of the life cycle and redemption policy of the AIF concerned and depending on the potential impact of the staff on the risk profile of the AIF. The actual *deferral period* should be further tailored to the responsibilities and tasks performed by the staff and expected fluctuations in the value of the assets of the AIF, which in many cases will imply longer time horizons. The AIFM should consider longer *deferral periods* for at least members of the *management body*.

XII.IV.I.II Vesting point

128. Pro rata vesting (or payment) means that for a *deferral period* of, for example, three years one-third of the deferred remuneration vests at the end of each of the years $n+1$, $n+2$ and $n+3$, , where 'n' is the

moment at which performance is measured to determine the variable remuneration. Annex III includes a diagram showing an example of a pro rata spreading for a deferral scheme in which 60% of the variable remuneration is deferred (first diagram).

129. In any case, vesting should not take place more frequently than on a yearly basis (e.g. not every six months).

XII.IV.I.III Proportion to be deferred

130. The proportion of the variable remuneration that should be deferred ranges from 40 to 60 %, depending on the impact the staff member (or category of staff) can have on the risk profile of the AIFs managed by the AIFM and the responsibilities and tasks performed, and depending on the amount of variable remuneration. If AIFMs decide to determine the proportion that is being deferred by a cascade of absolute amounts (rather than percentages of the total variable remuneration - e.g. part between 0 and 100: 100% upfront, part between 100 and 200: 50% upfront and rest is deferred, part above 200: 25% upfront and rest is deferred ...), on an average weighted basis, such AIFMs should respect the 40 to 60 % threshold.

XII.IV.I.IV Time span between end of accrual and vesting of deferred amount

131. In order to ensure a proper assessment of the performance outcome and, thus, to undertake a proper ex-post risk adjustment, the first deferred portion should not be paid out too soon after the *accrual period*. For the deferral to be really effective with regard to the staff's incentives, the first amount should not vest sooner than 12 months after the accrual.

XII.IV.II Cash vs. instruments

XII.IV.II.I Types of instruments

132. Staff should only be remunerated using *instruments* if it does not trigger interest misalignment or encourage risk-taking which is inconsistent with the risk profiles, rules or instruments of incorporation of the relevant AIF(s). A misalignment of interests might arise in relation to *identified staff* that are not directly involved in portfolio management. Rewarding those individuals with *instruments* of AIFs might represent a conflict of interest with their duty to perform independently their functions relating to those AIFs.
133. For AIFMs managing several AIFs, in order to align the interests of the *identified staff* with those of the relevant AIF(s), when possible according to the organisation of the AIFM and the legal structure of the managed AIF(s), the *identified staff* should receive *instruments* related mainly to the AIF(s) in relation to which they perform their activities, provided that no excessive concentration in the holding of the *instruments* – facilitating an excessive risk-taking by the *identified staff* – is created. E.g. if one member of the staff of an AIFM which manages three AIFs (x, y and z) performs his/her activities for AIF x only, in principle that member of the staff should receive *instruments* related mainly to AIF x; however, should the application of such principle lead to a situation where the *identified staff* has too strong an interest in the AIF for which they perform their activities, the AIFM should consider enlarging the spectrum of *instruments* paid in order to prevent an excessive risk-taking from the *identified staff* in relation to the relevant AIF(s).

134. The availability of *instruments* is dependent on the legal structure of the AIFs concerned and their rules or instruments of incorporation. For AIFs in the legal form of a corporate fund, shares or share-linked instruments should be able to align the interests of the shareholders and staff. Share-linked instruments are those whose value is based on a market value appreciation of the stock and that have the share price as a reference point, e.g. stock appreciation rights, types of synthetic shares.
135. For AIFs which are common funds, *instruments* should consist of units of the AIF concerned, or equivalent ownership interests; for many of these AIFs, share-linked instruments are not an option due to their legal form. Even for unlisted corporate funds it may be difficult to determine a share price that represents the AIF's net asset value between two (at least annual) net asset value calculations. In these cases alternative instruments, may be used that reflect the AIF's value and have the same intended effect as share-linked instruments.
136. Neither dividends nor interest should be paid on *instruments* before vesting.

XII.IV.II.II Retention policy

137. A retention policy should be determined by the AIFM in the remuneration policy. The AIFM should be able to explain how the retention policy relates to other risk alignment measures in the total remuneration policy and should explain whether and how they differentiate between *instruments* paid upfront and deferred *instruments*.
138. *Retention periods*, as the most important element of the retention policy, should be coupled with the vesting of *instruments*. The *retention period* is independent from the *deferral period*. This means that, in order to meet the requirement of a minimum *deferral period* of three to five years (where applicable), the *retention period* counts for nothing. The *retention period* can last for a shorter or longer period than the *deferral period* applied to the *instruments* that are not paid up front.
139. In the case of upfront *instruments*, *retention periods* are the only mechanism available to emphasize the difference between cash paid upfront and *instruments* awarded upfront in order to align incentives with the longer-term interests of the AIFM and the AIFs it manages and the investors of such AIFs.
140. In the case of deferred *instruments*, the *retention periods* come after every vested portion (the second diagram in Annex III illustrates these concepts). Competent authorities may determine whether the *retention periods* proposed by the AIFM are sufficient and appropriate.
141. The minimum *retention period* should be sufficient to align incentives with the longer term interests of the AIFM, of the AIFs it manages and of their investors. Different factors may tend to suggest that this period could be longer or shorter. Longer *retention periods* should be applied for staff with the most material impact on the risk profile of the AIFM and the AIFs it manages.
142. It is possible that a *retention period* lasts for a shorter period than the *deferral period* applied to the *instruments* that are not paid up front. However, as an example of proportionality, for their most senior staff, large and complex AIFMs should consider the use of a *retention period* for upfront paid *instruments* that goes beyond the *deferral period* for the deferred *instruments*.
143. *Instruments* should be valued on the date of the award (at the end of the *accrual period*) of these *instruments*. This value is the basis for the determination of the initial number of *instruments* and for later ex-post adjustments to the number of *instruments*.

144. The upfront payment of *instruments*, even with a minimum *retention period* of, for example, three years, is not equivalent to deferred *instruments*. Deferred *instruments* are subject to an ex-post risk adjustment due to the back-testing of the underlying performance, possibly leading to a reduction in the number of *instruments* that will eventually be paid out (second diagram in Annex III).

XII.IV.II.III Minimum portion of instruments and their distribution over time

145. The requirement in paragraph (1)(m) of Annex II to the AIFMD to apply the minimum of 50% (where applicable) to both the portion of the variable remuneration component that is deferred and the portion of the variable remuneration component not deferred means that the 50% minimum threshold for *instruments* should be applied equally to the non-deferred and the deferred part; in other words, AIFMs should apply the same chosen ratio between *instruments* and cash for their total variable remuneration to both the upfront and deferred part.

Examples:

- Good practice: For a certain category within its *identified staff*, an AIFM establishes a 50 *instruments* / 50 cash ratio for the variable remuneration, combined with a 60% deferral schedule (that is, 40% is non-deferred variable remuneration). This results in an upfront payment in *instruments* of 20 (i.e. 50% of 40) and 20 in cash. The deferred part consists of 30 in *instruments* and 30 in cash.
- Good practice: For a certain category within its *identified staff*, an AIFM establishes a 70 *instruments* / 30 cash ratio for the variable remuneration, combined with a 40% deferral schedule (that is, 60% is non-deferred variable remuneration). This results in an upfront payment in *instruments* of 42 (i.e. 70% of 60) and 18 in cash. The deferred part consists of 28 in *instruments* and 12 in cash.
- Poor practice: If for a certain category within its *identified staff*, an AIFM were to establish a 50 *instruments* / 50 cash ratio for the variable remuneration, combined with a 40 % deferral scheme, the AIFM cannot decide to pay 50 in cash up front and 10 in *instruments*, leading to a deferred pay out of 40 in *instruments*.
- Poor practice: If for a certain category within its *identified staff*, an AIFM were to establish a 70 *instruments* / 30 cash ratio for the variable remuneration, combined with a 50% deferral scheme, the AIFM cannot decide to pay 50 upfront in *instruments* and 0 in cash, leading to a deferred pay out of 20 in *instruments* and 30 in cash.

146. The second diagram in Annex III provides an example of this equal distribution of *instruments* over the non-deferred and deferred parts of remuneration.

147. For the purposes of the requirement to pay at least 50% of variable remuneration in *instruments* unless the management of AIFs accounts for less than 50% of the total portfolio managed by the AIFM, the 50% threshold should be based on the net asset value of the AIFs.

XII.IV.III Ex post incorporation of risk for variable remuneration

XII.IV.III.I Explicit ex-post risk adjustments

148. An “ex-post risk adjustment” should imply that once an initial variable remuneration component has been awarded to the staff member, and an upfront part has already been paid, the AIFM is still able to adjust, by way of a reduction, the variable remuneration as time goes by and the outcomes of the staff member’s actions materialize.
149. An ex-post risk adjustment is an explicit risk alignment mechanism through which the AIFM itself adjusts remuneration of the staff member by means of *malus* or *clawback* clauses (e.g. by lowering cash remuneration or by awarding a lower number of *instruments*). Ex-post risk adjustment should always be performance-related: techniques that are, for example, based on the amount of dividends or the evolution of the share price are not sufficient because the link to the performance of a staff member is not sufficiently direct. Therefore, ex-post risk adjustments are frequently also called “performance adjustments” because they are a response to the actual risk outcomes of the staff member’s actions. Performance measures taken at this stage should allow the AIFM to perform an analysis (similar to back testing) as to whether its initial ex-ante risk adjustment was correct. AIFMs should ensure there is a link between the initial performance measurement and the back-testing. Thus, the extent to which an ex-post risk adjustment is needed depends on the quality (accuracy) of the ex-ante risk adjustment.
150. The effect of *maluses* should not be inflated by paying out artificially high interest (above market rates) on the cash deferred parts to the staff member. *Maluses* operate by affecting the *vesting point* and cannot operate after the end of the *deferral period*. Furthermore, *clawback* can be a method for achieving an ex-post risk adjustment on variable remuneration.
151. AIFMs may utilize specific criteria whereby *malus* (to both the cash portion and the *instruments* portion of deferred remuneration) and *clawbacks* would apply. Such criteria should, for example, include:
- a. evidence of misbehaviour or serious error by the staff member (e.g. breach of code of conduct, if any, and other internal rules, especially concerning risks);
 - b. whether the AIF and/or the AIFM and/or the business unit subsequently suffers a significant downturn in its financial performance (specific indicators should be used);
 - c. whether the AIF and/or the AIFM and/or the business unit in which the staff member works suffers a significant failure of risk management;
 - d. significant changes in the AIFM’s overall financial situation.
152. A *clawback* should typically operate in the case of established fraud or misleading information. Where applicable, AIFMs should include *clawback* clauses in addition to these cases e.g. for remuneration received in breach of the AIFMD and/or these guidelines.
153. Ex-post risk adjustment could be based on both quantitative measures and informed judgment.
154. To have the greatest impact on staff’s incentives, the variables should measure outcomes as close as possible to the level of the decisions made by the staff member that is subject to the ex-post explicit adjustment. For example, variables for senior executives probably should be for outcomes for the AIFM as a whole, or for outcomes of units or decisions that were determined by senior executive strategy. In contrast, variables for the head responsible for a business unit ideally would reflect outcomes of that unit.

XII.IV.III.II

Implicit adjustments

155. When the variable remuneration takes the form of *instruments*, the final payout to the staff member will depend partly on market prices due to fluctuations during the *deferral* or *retention period*. This implicit adjustment of remuneration is not related to any explicit decision of the AIFM, but is inherent to the form that is used for paying out. Under no circumstances should the evolution of the net asset value of the AIF or, for listed AIF, the evolution of the share price be considered sufficient as a form of ex-post risk adjustment. There should always be a form of explicit risk adjustment on the initiative of the AIFM. For non-senior staff in particular, there may be no direct relation between their decisions and the value of the AIF.
156. A *retention period* on its own can never be sufficient to design an ex-post risk adjustment for *instruments* and should not be a substitute for a longer *deferral period*.

XII.IV.III.III

Possibility of upward revisions

157. The market price of *instruments* can go up, so implicitly they are subject to movements in their value in both directions.
158. Under no circumstances should the explicit ex- post risk adjustment (both for cash and *instruments*) lead to an increase of the deferred part.

XII.V. Compliance of certain remuneration structures with the requirements on risk alignment of variable remuneration, award and pay-out process

159. While it is necessary to have regard to all the relevant circumstances case-by-case, the guidelines under Sections XII.II (Risk alignment of variable remuneration), XII.III (Award process) and XII.IV (Pay-out process) may be met where :
- a) an AIFM must first return all capital contributed by the investors of the AIF it manages and an amount of profits at a previously agreed hurdle rate (if any) to the investors of the AIF, before the *identified staff* of the AIFM may receive any variable compensation for the management of the relevant AIF; and
 - b) the compensation received by the *identified staff* of the AIFM is subject to *clawbacks* until the liquidation of the relevant AIF.

XIII. Guidelines on disclosure

XIII.I.

External disclosure

XIII.I.I

Specific and general requirements on disclosure

160. AIFMs should consider the additional disclosure on remuneration required under paragraph (8) of the *Recommendation*, to the extent that the latter may also be relevant to them. AIFMs should have the flexibility to disclose the information mentioned in the *Recommendation* through an independent remuneration policy statement, a periodic disclosure in the annual report or any other form. In all cases, however, the AIFM should ensure that the disclosure is clear and easily understandable and accessible.

161. Without prejudice to confidentiality and applicable data protection legislation, AIFMs should disclose detailed information regarding their remuneration policies and practices for members of staff whose professional activities have a material impact on the risk profile of the AIFs the AIFM manages. AIFMs should also provide general information about the basic characteristics of their AIFM-wide remuneration policies and practices.
162. The *Recommendation*'s remuneration disclosures may be made on a proportionate basis and the overall remuneration proportionality principle will apply to the type and amount of information disclosed. Small or non-complex AIFMs/AIFs should only be expected to provide some qualitative information and very basic quantitative information where appropriate. In practice, this could mean that such AIFMs/AIFs are not expected to provide all the information under paragraph (8) of the *Recommendation*. AIFMs should disclose how they have applied proportionality.
163. The disclosure should be published on at least an annual basis and as soon as practicable after the information becomes available.
164. The disclosure made in accordance with this Section should be without prejudice to the disclosure obligations vis-à-vis prospective investors under Article 23 of the AIFMD.

XIII.I.II Policy and practices

165. The disclosure report should set out the decision-making process used to determine the remuneration policy for the individuals to which it applies. This may include the governance procedure relating to the development of the remuneration policy and should include information about the bodies (including their composition and mandate), such as the remuneration committee or external consultants, which played a significant role in the development of the remuneration policy. AIFMs should outline the role of all relevant stakeholders involved in the determination of the remuneration policy. Additionally, the disclosure should include a description of the regional scope of the AIFM's remuneration policy, the types of staff considered as material risk takers and the criteria used to determine such staff.
166. The report should include information on how pay and performance are linked. Such information should include a description of the main performance metrics used for: the AIFM, top-level business lines, and for individuals (i.e. scorecards). AIFMs should disclose information relating to the design and structure of remuneration processes, such as the key features and objectives of the remuneration policy and how the AIFM ensures that staff members in *control functions* are remunerated independently of the businesses they oversee. The report should also include a description of the different forms of variable remuneration used (i.e. cash, equity, options, other capital instruments, and long-term incentive plans) and should include the rationale for using these different forms and for allocating them to different categories of staff. Additionally, the report should include a discussion of the parameters used to allocate deferred and non-deferred remuneration for different staff categories.
167. Disclosure reports should describe how the AIFM takes into account current and future risks to which they are exposed when implementing remuneration methodologies and what these risks are. Also, AIFMs should describe the measures used to take account of these risks and the ways in which these measures affect remuneration. In addition, AIFMs should disclose the ways in which they seek to adjust remuneration to take account of longer-term performance - as in the AIFM's policy on deferral, vesting and performance adjustment.

168. The quantitative (financial) as well as qualitative (non-financial) criteria used by AIFMs for assessing individual performance which are relevant for determining the remuneration policies and practices and are described under Section XII.II.IV.I (Qualitative/Quantitative measures) should also be disclosed in the disclosure reports.
169. The disclosure should be produced and owned by the *management body* that has the ultimate sign-off on remuneration decisions.

XIII.II. Internal disclosure

170. The remuneration policy of an AIFM should be accessible to all staff members of that AIFM. AIFMs should ensure that the information regarding the remuneration policy disclosed internally reveals at least the details which are disclosed externally. Therefore, according to the size, internal organisation and the nature, scope and complexity of the activities of the AIFM, the information provided to staff members might contain some of the elements listed in Section III (Disclosure) of the *Recommendation*. The staff members should know in advance the criteria that will be used to determine their remuneration. The appraisal process should be properly documented and should be transparent to the member of staff concerned. Confidential quantitative aspects of the remuneration of staff members should not be subject to internal disclosure.

Annex I to the Guidelines

Correlation table Recommendation/AIFMD

| | Recommendation | AIFMD |
|-----|--------------------------------|---------------------|
| 1. | Section II, par. 3.1. | Annex II, par. 1(a) |
| 2. | Section II, par. 3.2. and 6.1. | Annex II, par. 1(b) |
| 3. | Section II, par. 6.2. | Annex II, par. 1(c) |
| 4. | Section II, par. 6.5. | Annex II, par. 1(d) |
| 5. | Section II, par. 6.6. | Annex II, par. 1(e) |
| 6. | Section II, par. 5.1. and 5.4. | Annex II, par. 1(g) |
| 7. | Section II, par. 5.2. | Annex II, par. 1(h) |
| 8. | Section II, par. 4.1. and 4.2. | Annex II, par. 1(j) |
| 9. | Section II, par. 4.5. | Annex II, par. 1(k) |
| 10. | Section II, par. 5.3. | Annex II, par. 1(l) |
| 11. | Section II, par. 4.4. | Annex II, par. 1(m) |
| 12. | Section II, par. 4.3. | Annex II, par. 1(n) |
| 13. | Section II, par. 6.4. | Annex II, par. 3 |

Annex II to the Guidelines

Mapping of the remuneration principles included in the AIFMD

| AIFMD requirements - Annex II | | Paragraphs of these Guidelines relating to the relevant requirement | Scope | Possible dis-application of the requirement based on proportionality |
|-------------------------------|---|---|---|--|
| Par. 1 (a) | the remuneration policy is consistent with and promotes sound and effective risk management and does not encourage risk-taking which is inconsistent with the risk profiles, rules or instruments of incorporation of the AIFs they manage; | 78 – 81 | Only to the <i>identified staff</i> , but AIFM-wide strongly recommended and AIFMs, if required, should be able to demonstrate why the applied the requirement to the <i>identified staff</i> only | No |
| Par. 1 (b) | the remuneration policy is in line with the business strategy, objectives, values and interests of the AIFM and the AIFs it manages or the investors of such AIFs, and includes measures to avoid conflicts of interest; | 78 – 81 38 – 51 | Paragraphs 78 – 81 → Only to the <i>identified staff</i> , but AIFM-wide strongly recommended and AIFMs, if required, should be able to demonstrate why the applied the requirement to the <i>identified staff</i> only Paragraphs 38 51 → AIFM-wide | No |

| | | | | |
|---------------|---|------------------------|--|----|
| | | | obligatory | |
| Par. 1 (c) | the management body of the AIFM, in its supervisory function, adopts and periodically reviews the general principles of the remuneration policy and is responsible for its implementation; | 38 – 51 | AIFM-wide obligatory | No |
| Par. 1 (d) | the implementation of the remuneration policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for remuneration adopted by the management body in its supervisory function; | 48 – 51 | AIFM-wide obligatory | No |
| Par. 1 (e) | staff engaged in control functions are compensated in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control; | 70 – 76 | AIFM-wide obligatory | No |
| Par. 1 (f) | the remuneration of the senior officers in the risk management and compliance functions is directly overseen by the remuneration committee; | 70 – 76 | AIFM-wide obligatory | No |
| Par. 1 (g) | where remuneration is performance related, the total amount of remuneration is based on a combination of the assessment of the performance of the individual and of the business unit or AIF concerned and of the overall results of the AIFM, and when assessing individual performance, financial as well as non-financial criteria are taken into account; | 101 – 106 110 – 113 | Only to the <i>identified staff</i> , but AIFM-wide strongly recommended | No |
| Par. 1 (h) | the assessment of performance is set in a multi-year framework appropriate to the life-cycle of the AIFs managed by the AIFM in order to ensure that | 99 – 100 127 – 131 | Only to the <i>identified staff</i> , but voluntary AIFM-wide | No |

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| | the assessment process is based on longer term performance and that the actual payment of performance-based components of remuneration is spread over a period which takes account of the redemption policy of the AIFs it manages and their investment risks; | | application is always possible | |
| Par. 1 (i) | guaranteed variable remuneration is exceptional, occurs only in the context of hiring new staff and is limited to the first year; | None | AIFM-wide obligatory | No |
| Par. 1 (j) | fixed and variable components of total remuneration are appropriately balanced and the fixed component represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy, on variable remuneration components, including the possibility to pay no variable remuneration component; | 94 | Only to the <i>identified staff</i> , but AIFM-wide strongly recommended | No |
| Par. 1 (k) | payments related to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward failure; | 87 – 89 | Only to the <i>identified staff</i> , but AIFM-wide strongly recommended and AIFMs, if required, should be able to demonstrate why the applied the requirement to the <i>identified staff</i> only | No |
| Par. 1 (l) | the measurement of performance used to calculate variable remuneration components or pools of variable remuneration components includes a comprehensive adjustment mechanism to integrate all relevant types of | 107 – 109 117 – 124 | Only to the <i>identified staff</i> , but AIFM-wide strongly recommended | No |

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| | current and future risks; | | | |
| Par. 1 (m) | <p>subject to the legal structure of the AIF and its rules or instruments of incorporation, a substantial portion, and in any event at least 50 % of any variable remuneration consists of units or shares of the AIF concerned, or equivalent ownership interests, or share-linked instruments or equivalent non-cash instruments, unless the management of AIFs accounts for less than 50 % of the total portfolio managed by the AIFM, in which case the minimum of 50 % does not apply.</p> <p>The instruments referred to in this point shall be subject to an appropriate retention policy designed to align incentives with the interests of the AIFM and the AIFs it manages and the investors of such AIFs. Member States or their competent authorities may place restrictions on the types and designs of those instruments or ban certain instruments as appropriate. This point shall be applied to both the portion of the variable remuneration component deferred in line with point (n) and the portion of the variable remuneration component not deferred;</p> | 132 – 147 | Only to the <i>identified staff</i> , but voluntary AIFM-wide application is always possible | Yes |
| Par. 1 (n) | <p>a substantial portion, and in any event at least 40 %, of the variable remuneration component, is deferred over a period which is appropriate in view of the life cycle and redemption policy of the AIF concerned and is correctly aligned with the nature of the risks of the AIF in question.</p> <p>The period referred to in this point</p> | 125 – 131 | Only to the <i>identified staff</i> , but voluntary AIFM-wide application is always possible | Yes |

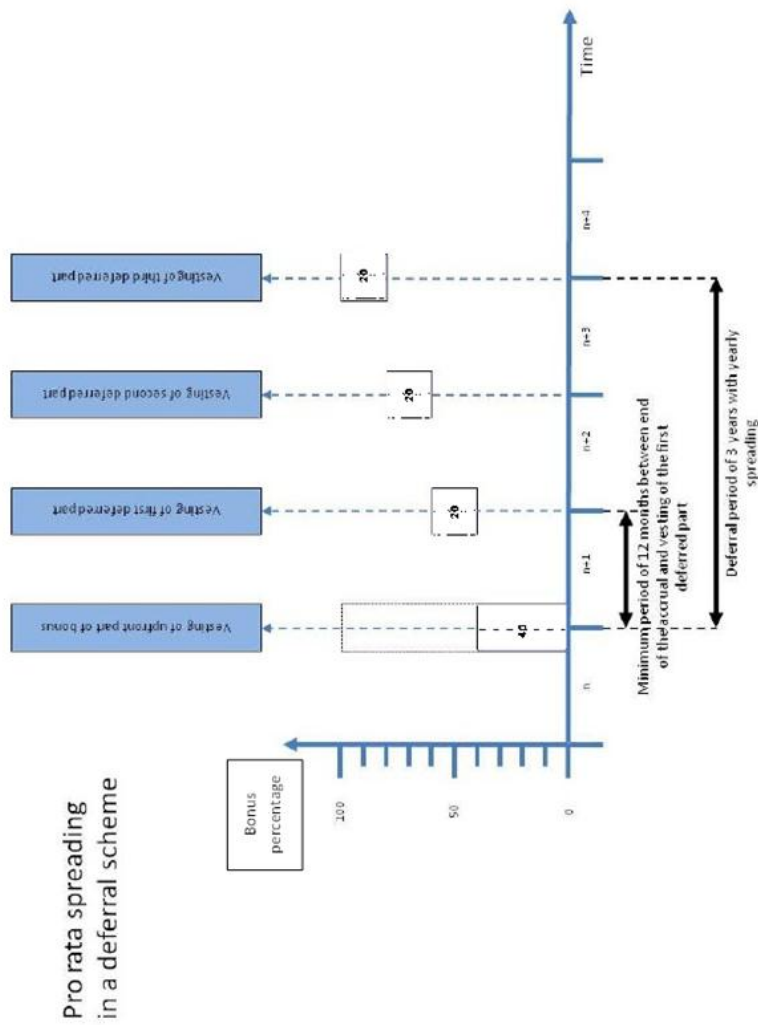
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| | shall be at least three to 5 years unless the life cycle of the AIF concerned is shorter; remuneration payable under deferral arrangements vests no faster than on a pro-rata basis; in the case of a variable remuneration component of a particularly high amount, at least 60 % of the amount is deferred; | | | |
| Par. 1 (o) | <p>the variable remuneration, including the deferred portion, is paid or vests only if it is sustainable according to the financial situation of the AIFM as a whole, and justified according to the performance of the business unit, the AIF and the individual concerned.</p> <p>The total variable remuneration shall generally be considerably contracted where subdued or negative financial performance of the AIFM or of the AIF concerned occurs, taking into account both current compensation and reductions in payouts of amounts previously earned, including through malus or clawback arrangements;</p> | <p>34 – 36</p> <p>117 – 124</p> <p>148 – 158</p> | <p>Only to the <i>identified staff</i>, but voluntary AIFM-wide application is always possible</p> | Yes |
| Par. 1 (p) | <p>the pension policy is in line with the business strategy, objectives, values and long-term interests of the AIFM and the AIFs it manages.</p> <p>If the employee leaves the AIFM before retirement, discretionary pension benefits shall be held by the AIFM for a period of 5 years in the form of instruments defined in point (m). In the case of an employee reaching retirement, discretionary pension benefits shall be paid to the employee in the form of instruments defined in point (m), subject to a 5 year retention</p> | 78 – 86 | <p>Only to the <i>identified staff</i>, but AIFM-wide strongly recommended and AIFMs, if required, should be able to demonstrate why the applied the requirement to the <i>identified staff</i> only</p> | No |

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| | period; | | | |
| Par. 1 (q) | staff are required to undertake not to use personal hedging strategies or remuneration- and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements; | 90 – 92 | Only to the <i>identified staff</i> , but AIFM-wide strongly recommended and AIFMs, if required, should be able to demonstrate why the applied the requirement to the <i>identified staff</i> only | No |
| Par. 1 (r) | variable remuneration is not paid through vehicles or methods that facilitate the avoidance of the requirements of this Directive. | 15 – 18 | AIFM-wide obligatory | No |
| Par. 2 | The principles set out in paragraph 1 shall apply to remuneration of any type paid by the AIFM, to any amount paid directly by the AIF itself, including carried interest, and to any transfer of units or shares of the AIF, made to the benefits of those categories of staff, including senior management, risk takers, control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on their risk profile or the risk profiles of the AIF that they manage. | 10 – 22 | AIFM-wide obligatory | No |
| Par. 3 | AIFMs that are significant in terms of their size or the size of the AIFs they manage, their internal organisation and the nature, the scope and the complexity of their activities shall | 52 – 64 | AIFM-wide obligatory | Yes |

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| | <p>establish a remuneration committee. The remuneration committee shall be constituted in a way that enables it to exercise competent and independent judgment on remuneration policies and practices and the incentives created for managing risk.</p> <p>The remuneration committee shall be responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk and risk management of the AIFM or the AIF concerned and which are to be taken by the management body in its supervisory function. The remuneration committee shall be chaired by a member of the management body who does not perform any executive functions in the AIFM concerned. The members of the remuneration committee shall be members of the management body who do not perform any executive functions in the AIFM concerned.</p> | | | |
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Annex III to the Guidelines

Schematic overview of some deferral mechanisms



Accrual vs. deferral vs. retention

