Response to the ESMA Consultation Paper on Guidelines on sound remuneration policies under the AIFMD[1]

1. Introduction

The HFSB welcomes the opportunity to respond to the European Securities and Markets Authority (ESMA) Consultation Paper on Guidelines on sound remuneration policies under the AIFMD.

The Hedge Fund Standards Board (HFSB) is the guardian of the Standards drawn up by international investors and hedge fund managers to create a framework of discipline for the hedge fund industry. The HFSB's mission is to promote the Standards through collaboration with managers, investors and the regulatory community.

The HFSB actively engages with the regulatory community and has responded to consultations on issues in relation to hedge fund regulation, including recent consultations from the European Commission, ESMA, IOSCO and others.

The HFSB is pleased to continue to inform the regulatory process and help ESMA address the specific questions arising in the context of the Annex II rules of the AIFMD on remuneration.

2. General observations

- The HFSB agrees that remuneration rules in the context of banking should address issues of excessive risk taking in banks and arising financial stability concerns. However, in asset management, issues of alignment of interest between investors and portfolio managers are relevant, therefore remuneration regulation in asset management conceptually relates to the regulatory objective of investor protection.
- The consultation paper seems to focus considerably on “alignment of interest” of staff with the AIFM (i.e. the owners of the AIFM), rather than the AIF (the investor). This is partly due to the fact that the consultation paper is based on the CEBS Guidelines on Remuneration Policies and Practices designed primarily for banks, and which focus on aligning bank staff with the owners of the bank. Therefore, the proposed approach needs to be better tailored to the asset management sector, with a clearer focus on alignment of interest with clients / investors.

[1] Consultation Paper: http://www.esma.europa.eu/consultation/Consultation-Guidelines-sound-remuneration-policies-under-AIFMD

- In particular, the nature of the framework is highly formalised and complex and suitable for large publicly listed institutions (banks) with existing extensive governance structures. However, activities in the asset management sector are often much more entrepreneurial (and "project style") by nature. In fact, most firms are midsized companies run by their owners, and this is why there is no need for an extra layer of governance to address conflicts of interests between the owners and the management/staff.[2] Also, many firms do not have large HR departments to administers highly complex incentive programs, including payment in shares and instruments. Regulators should take this into account when designing a suitable and proportionate approach.
- The very specific guidance might also create challenges where firms operate multiple types of funds – AIFs, UCITS and separate accounts, with staff potentially acting for different firms in the group. This requires a consistent approach, rather than multiple differing remuneration schemes subject to different Directives. <u>A broader more principle based approach might therefore be more suitable to cover the activities in the asset management sector</u>, which do indeed differ significantly in terms of nature, scale and breadth.
- Accordingly, exemptions and tailoring will play an important role to cater adequately for the alternative investment sector. The proportionality principle (VII. Guidelines on the proportionality principle, p. 81) provides for some tailoring in light of the characteristics of an AIFM. The CEBS Guidelines on Remuneration Policies and Practices for institutions allows for neutralisation of some requirements[3]. Consideration should be given to include this "neutralisation approach" into the remuneration guidelines to the extent permitted by the level 1 text.
- It should be noted that co-investment often proved to be the most effective mechanism to align managers fully with their investors, which is common practice in the hedge fund industry.

3. Specific comments

II. 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.

There is concern that the approach leads to an overly complex approach to remuneration:

Firms/individual employees might be subject to multiple sources of remuneration regulation (AIFMD, UCITS, MiFID), rather than having a single set of principles driving the overall remuneration framework.

---

[2] However, fund governing bodies, catering for the interests of investors are strongly recommended and constitute good practice, as delineated in the Hedge Fund Standards.

[3] See p. 18, CEBS Guidelines (http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Remuneration/Guidelines.pdf

As a further observation, the distinction between AIFM and AIF is often not very clear. This aspect is of great significance and should be taken into account when developing a balanced approach to compensation, which focuses on what matters most: alignment of interest with investors. Therefore, it would be useful to clarify this. The HFSB has made suggestions to improve the overall framework in this respect (Please see the answer to Q34).

IV. Scope of the 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.

Agreed.

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.

-

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

Yes.

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

No. The level 1 text clarifies that the guidelines apply to the remuneration of AIFM staff.

Q6:Do you consider that payments made directly by the AIF to the AIFM as a whole (e.g. payment of a performance fee or carried interest) shall be considered as payments made to the benefit of the relevant categories of staff of the AIFM and, therefore, fall under the scope of the AIFMD remuneration rules (and, therefore, of these Guidelines)?

No, these are the contractual arrangements between the investor/fund and the managing entity. This would force the alteration of established terms between investors and managers, including high watermarks.

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.

ESMA rightly highlights in its introduction that the overall objective is alignment of interest between clients/investors and portfolio managers who make investment decisions.[4] In accordance with this, it would indeed be appropriate to focus specifically on risk taking in the context of the AIF, thus focussing on relevant activities which impact the investor directly.

Portfolio management and <u>senior staff</u>[5] in risk control functions should be included. Inclusion of junior staff in risk control functions is not necessary. Also, roles such as HR, marketing and administration should not automatically fall in scope. For these functions, a less detailed and prescriptive approach should be taken, and it should be left to the firms to determine whether such staff should be treated as "other risk takers".

The Guidelines also refer to partners in the firm, who should be specified as partners in a senior management role.

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.

-

V. Proportionality principle

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

In general, the HFSB agrees that the listed criteria play a role, and are by no means a comprehensive list of aspects to consider. Additional aspects to consider include whether the firm is owner managed (with implications for the type of governance arrangements), and should take account of a wide range of approaches in member-states, including legal and incorporation set-ups. While level 1 of the AIFMD does not explicitly mention neutralisation, it is possible to apply the guidelines to a minimal extent in instances where they are not appropriate ("to the extent that is appropriate to

---

[4] See page 10 [12.] in the ESMA Consultation Paper

[5] Consistent with CEBS Guidelines on Remuneration, which also refer to <u>senior staff</u> responsible for heading the compliance, risk management… (p. 16)

their size, internal organisation, …”). Explicit introduction of neutralisation in the guidelines would provide more certainty to local regulators.

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.

The listed criteria play a role in assessing proportionality.

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

-

VI. AIFMs being part of a group

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

We have already highlighted the complexities that may arise when multiple remuneration regulations are applied to firms. A way to address this could be a principles-based approach that allows one comprehensive remuneration policy applicable to the entire firm. A more flexible system will also cater for the diversity of firms in the alternative asset management space, and removes the need for overly detailed rules to cater for all types of exceptions.

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.

The AIFMD approach conflicts with the principles-based approach under CRD. A way to address this could be that firms falling under one directive (e.g. CRD), will be exempt from other requirements or deemed compliant with the principles.

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.

-

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

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

Generally yes, but it is important to highlight that AIFM are not banks, where regulatory focus on "preserving the soundness of the institution financial situation" is anchored in systemic concerns about bank failures. These systemic concerns do not exist in asset management. Also, it is important to highlight that capital requirements are addressed separately in 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.

-

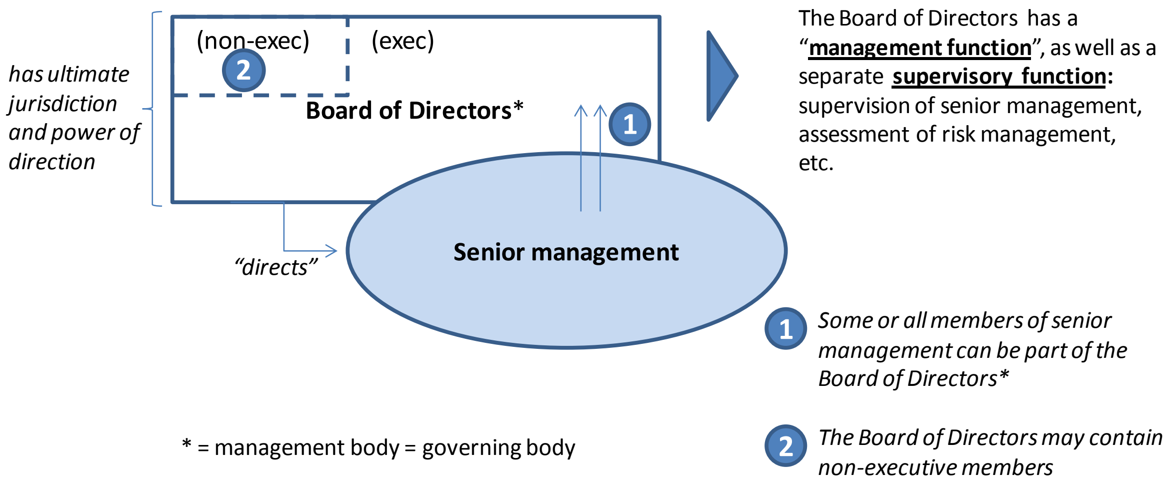
VIII. Governance of remuneration

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

The framework refers to a number of different managerial levels and functions, including the board of directors (=the management body=governing body) and the executive and non-executive members of the management body in its supervisory function, senior management, the relevant person or body responsible for the supervision of the AIFM, etc.

As a first step, we are seeking to clarify terminology in the following illustration.

Illustration: Governance structure



The proposed approach seems to originate from a listed corporate/bank environment, and adaptations will be needed to make it work in a more entrepreneurial, owner-led environment as commonly found in the alternative investment sector, and corresponding legal structures such as partnership structures. In particular, the split between the management function and the supervisory function is not always easy to establish in owner-led firms. Therefore, this framework should be tailored to cater for the diversity of set-ups.

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

The delineated approach is suitable for listed institutions, where principal agency conflicts arise. However, it is useful to highlight that most alternative asset managers are not listed, and are often owner-led.

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.

The criteria listed are helpful in assessing whether an AIFM needs to set up a RemCo. The "size" of the manager provided in one of the examples appears very low (i.e. firms with € 250MM in AUM rarely have more than 20-40 employees and are usually owner led), and the proposed formalised RemCo approach appears over-engineered in this context with too much focus on addressing principle agent conflicts (which are least relevant in this context), rather than a straight forward focus on investor alignment. Therefore, more flexibility is required to accommodate the diverse nature of firms, including their legal and ownership structures. As for determining the criteria, this should be left to local regulators who can tailor them based on specific characteristics of their local market.

The guidelines should also cater for firms wishing to establish a single RemCo within their own group structures.

The box below provides the rationale for RemCos in (quoted) banks, and the type of issues addressed which are different from those in asset management.

- *RemCos are often set up at board level to provide a formal process for setting remuneration of senior executives to ensure that remuneration supports the strategic aims of the business and <u>minimise the cost of separation of ownership from control</u>.*
- *RemCos are common at quoted companies, <u>where principle agent conflicts arise</u> (due to the separation of beneficial ownership and executive decision making).*
- *The Committee of European Banking Supervisors (CEBS) Guidelines on Remuneration Policies and Practices published on 10 December 2010, extended the scope of RemCos to include all staff that have a material impact on the institution's risk profile, including risk takers which do not form part of the senior management or are executive members of the institution's corporate bodies.*
- *The rationale for broadening the scope of RemCos is that <u>excessive remuneration had fuelled a risk appetite within banks (not only at senior level) that was disproportionate to the capacity of these banks to absorb losses</u>, to the detriment of bank shareholders (and taxpayers).*

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.

Agree.

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.

-

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.

-

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.

Where owners are in charge, there might be limited rationale for NEDs.

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

No.

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

Yes (in instances where a RemCo is necessary).

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.

Notwithstanding the general concerns raised, we agree.

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.

AIF investors should be informed via the existing reporting mechanisms about alignment of interest of the relevant staff. However, in 152. (p.102), reference is made to public disclosure of detailed information regarding remuneration policies and practices. There is no reference to public disclosure in level 1 (annual report to be provided to investors upon request [Art 22]), unless a firm is required to make its annual report public. Therefore, the reference to public disclosure should be deleted.

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

Remuneration should be designed to minimise conflicts.

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.

-

IX. General requirements on risk alignment

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

This aspect has been taken from the CEBS Guidelines on Remuneration Policies and Practices[6] published on 10 December 2010, including the 5 year retention period, but modified to the extent that payment in the form of "shares or equity linked instruments" has been replaced with "shares in the AIF concerned". While the approach is relevant for executive compensation in banks, where management decisions have a far reaching impact beyond the actual employment term of the executive, it might not be applicable in asset management and raises a number of questions:

- In situations where the relevant staff members' actions have no impact whatsoever on the performance of the AIF in the 5 years subsequent to retirement, the five year retention period appears excessive. This is the case where the underlying funds are actually liquid, when investors are able to redeem, for example, daily, weekly, monthly or quarterly basis.
- In situations where funds are very specialised by nature to cater for specific diversification requirements of investors (e.g. a short fund), which will form a small part of the investors' overall portfolio, it might be inappropriate to have an employee's discretionary pension payment tied up in this singular fund or instrument. In all areas of finance, investors (and regulators) seek to achieve better risk diversification and risk management, and it would not be a good practice to mandate such potentially concentrated long term positions, particularly in instances when they have no meaningful impact on alignment.
- Restrictions for retail investment in professional funds should also be considered in this context.

An approach to determine the retention period could incorporate the redemption policy of investors in the relevant fund or the life cycle of the fund.

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.

-

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.

[6] Http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Remuneration/Guidelines.pdf

-

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.

-

X. Specific requirements on risk alignment

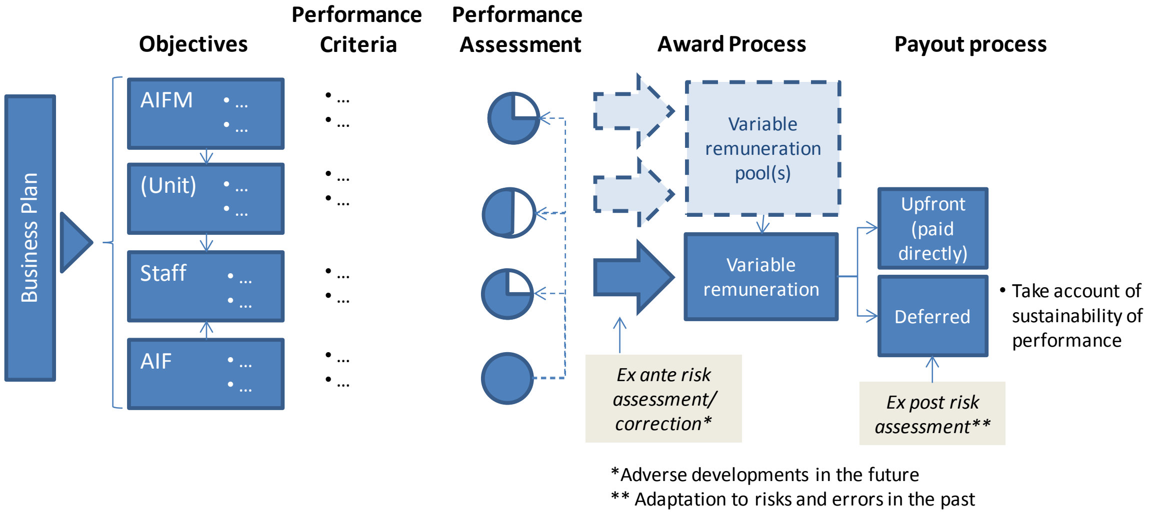
Q34: Do you consider these common requirements for the risk alignment process appropriate? If not, please provide explanations and alternative requirements.

General observations:

The HFSB agrees that the assessment is set in a multi-period/year framework appropriate to the life cycle of the AIFs, taking into account the redemption policy of the AIFs it manages and their investment risks. However, the CP uses terminology identical to the one adopted in the CEBS Guidelines on Remuneration Policies and Practices (p. 48, [86.]: "To limit excessive risk taking…"), which are aimed at banks, where indeed excessive risk taking on behalf of the bank should be prevented. **In asset management, the risk management (and risk alignment of remuneration) focuses on ensuring that the risk profile remains within the stated risk profile/appetite of the AIF.** It would be helpful to rephrase this paragraph to address issues that are relevant specifically to asset management.

In order to assess the proposed process for performance and risk measurement, we have included a schematic illustration of the process proposed by ESMA.

Illustration of the performance and risk measurement process



While the overall logic of the approach might appear intuitive, again it seems to be taken from the CEBS Guidelines on Remuneration Policies and Practices without sufficiently accounting for the specificities of asset management.

Two key concerns arise in this context:

(a.) the frameworks seem to be designed for large integrated financial institutions such as banks

(b.) it introduces a bias against risk taking (suitable in banking, but not asset management).

(a.) Large organisations and in particular systemically relevant banks often face many conflicting objectives at multiple layers in the organisation, across divisions, etc. This includes:

- maximising overall shareholder value while maintaining adequate capital ratios,
- managing capital trade-offs in risk taking across divisions and "books",
- serving as counterparties to clients, and potentially having regard to client interests at the same time.

The complexity of banks creates significant challenges, which require adequate managerial, governance and compensation frameworks at all levels in the organisation in order to ensure adequate alignment of interest throughout the organisation.

The framework proposed by ESMA seems to cater for this very complex nature of banks., as it puts significant focus on "the objectives of the AIFM, the unit, as well as the staff…" (p.35 (1.)), thus neglecting the most important element: alignment of interests with investors/AIF. This is not to say that objectives of the AIFM should be neglected, but the primary purpose of the performance and risk measurement process is not to address concerns related to conflicts of interest arising between the staff of the AIFM and the owners of the AIFM (often the managing partners running the firm), but alignment of interest with investors. It is worthwhile mentioning that non-alignment of AIFM staff with the AIFM (which the proposed framework seems to extensively address) has not been identified as a concern in the broader regulatory debate.

Therefore, the HFSB believes that this difference in nature between banks and asset managers should be reflected better in the ESMA proposal. Otherwise, there is a risk of developing a complex approach, prioritising the least relevant issues, while neglecting the actual client interests.

(b) Many characteristics of banks such as retail deposit taking, high levels of leverage and systemic relevance highlight the importance of preventing excessive risk taking to minimise negative externalities that can arise from banking. Therefore, adequate design of the incentives in banks is of particular relevance, including a strong bias against risk taking, as highlighted in the ex ante and ex post risk assessment/adjustment approach in the CEPS Guidelines on Remuneration Practices. Also, there should be significant focus on addressing conflicts between the staff and the owners of banks, and the public at large (facing potentially damaging externalities from failing banks).

However, in asset management, issues related to alignment and the performance measurement process are a lot simpler:

- there are no systemic concerns justifying a strong bias against risk taking, unlike in banking;
- the focus lies on alignment with clients (the AIF) [7], unlike in banking, where client interests are not a primary concern (staff in banks are meant to act as "owners" of the bank according to the CEBS Guidelines)[8],
- risk taking is within the AIF, not on the "balance sheet" of the AIFM,
- outcomes for customers are easily measureable (performance of the underlying investments/AIF over the relevant performance measurement periods).

For this reason, the framework developed in the CEBS Guidelines (addressing bank specific concerns) should not be adopted 1:1 in the asset management context.

We have provided below an illustration which puts more weight on customers/investors, rather than owners of AIFM, which ESMA could use as a blueprint for its approach to asset management. Key characteristics include:

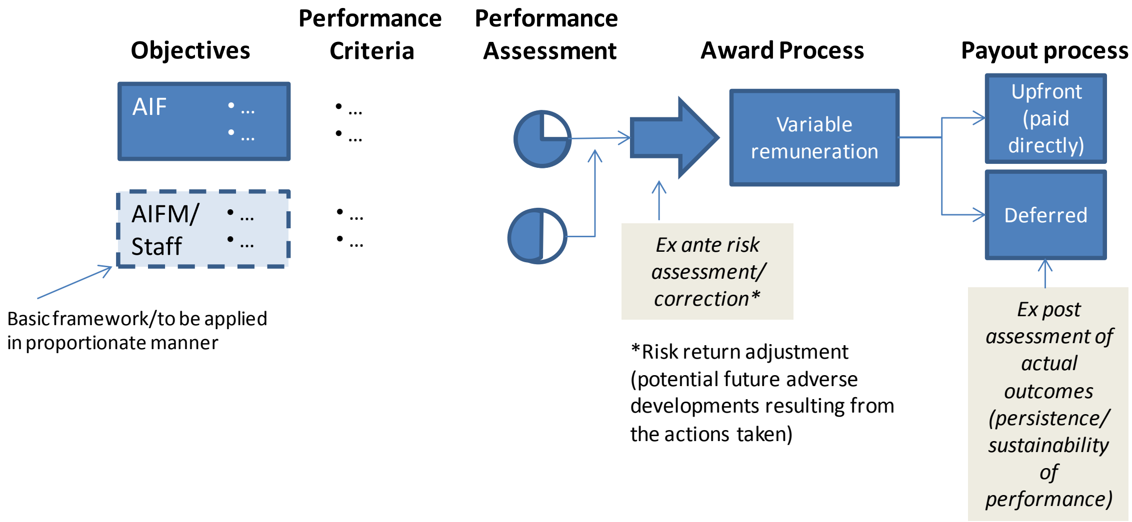
- Less complexity by focussing on the relevant issue: alignment with investors
- Stronger focus on longer term realised performance, rather than a second layer of "ex post risk assessment"
  - The upfront bonus component for performance achieved during a given period
  - The deferred element takes into account a longer term performance assessment period and accounts for the sustainability of performance, in line with the redemption policies / investment horizon of the AIF

The framework also accounts for the smaller scale entrepreneurial nature of alternative asset management (which is a "Mittelstand" style industry, opposed to banking, where the largest institutions have over 100,000 employees).

Illustration of a performance assessment framework for asset managers

[7] See p.10, [12.] in the ESMA Consultation Paper

[8] See CEBS Guidelines on Remuneration Policies and Practices p. 62 [123]
http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Remuneration/Guidelines.pdf



Such a framework could be established with a limited number of Standards / Guidelines focussing on the desired outcomes of alignment, while avoiding the type of rigidity and complexity arising in a more specific framework, which will have to cater for all types of exceptions and circumstances.

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

The section on risk measurement has again adopted the wording from the CEBS Guidelines on Remuneration Policies and Practices (but replacing "institution" with "AIFM" [131.]), but is otherwise strongly tailored to banking style issues ("off balance sheet risks", "risks affecting the institutions/AIFM", "risk calculations broken down by business units ("AIFs") and related to the AIFM's business units…"). The break down into an ex ante and ex post approach makes sense for a deal making environment where risks are entered and carried on the institution's balance sheet, and the ultimate profitability might not be entirely measurable at the time of deal making. In asset management, performance crystallises at the point of measurement and investors usually have the option to redeem their assets.

Therefore, it might be more suitable to have an ex ante risk assessment (e.g. looking at adherence of the portfolio manager to the risk policy of the relevant AIF), and an ex post assessment of actual outcomes (persistency/sustainability of performance). This is in line with the wording used in level 1 (1.(o)). Accordingly, this second stage is not called ex post risk assessment, but just ex post assessment (since it is actual outcomes that are being assessed, but not again "risks").

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?

The question highlights the need of a single firm wide remuneration framework, rather than multiple frameworks driven by different Directives. A more principles-based approach delineating desired outcomes and key features of remuneration frameworks (rather than the specific mechanism) would enhance the practicality of the overall approach and allow firms to operate remuneration frameworks suitable for their specific circumstances.

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.

The section again mixes together issues of alignment of interest with clients (AIF) and the owners of the AIFM (thus applying the framework applicable to banks (where client interests are not catered for) to asset management).

Again, it would be useful to tailor the performance measurement section to asset management by focussing primarily on achieved (crystallised) performance (e.g. returns, risk adjusted returns, adherence to investment objective) for clients and by incorporating additional qualitative factors such as compliance track record, etc. This can also be complemented by managerial aspects such as leadership, team work (as listed in 138.), but the details of this can be left to individual asset managers to determine as individual circumstances and requirements.

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.

It is appropriate to distinguish between absolute and relative performance. Usually the relevant performance / risk benchmarks are specified in the offering/investor documents and these should be used for performance measurement in order to ensure alignment with investors. Again, it is important to be clear on the distinction between the AIF and the AIFM.

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

Agree.

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.

It is appropriate to include both quantitative and qualitative measures for the ex-ante risk adjustment.

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.

-

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

The HFSB would recommend sufficient flexibility in relation to the types of instruments. It is also important to observe suitability aspects (not all private investors might be eligible for institutional products), new conflicts that might be introduced (where managers are in charge of multiple segregated mandates pursuing the same strategy), appropriate levels of staff alignment in very specialised products (e.g. a "short fund", funds focussing on exotic niche markets), complexities arising where individuals manage multiple AIFs, and finally the fact that most firms are small compared to banks, with limited scale to administer overly complex incentive schemes.

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.

-

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.

-

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.

The term "ex post risk adjustment" seems misleading, because it is not the risks that are assessed ex post but actual outcomes: For example, has an AIF delivered the returns for investors during the relevant observation period / investment horizon? In asset management, this is a clearly measurable outcome. Some potential risks (that might have been identified in the ex ante risk adjustment) might have materialised impacting the longer term performance of the fund, while other risks have not materialised or have been mitigated by the portfolio manager. Therefore, it appears to be more suitable to call this second iteration "ex post assessment of actual outcomes" (as illustrated in the proposed framework under Q34).

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

-

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.

-

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.

-

XI. 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.

-

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

-