



September 27, 2012

Via *ESMA Website*

European Securities and Markets Authority
103 Rue de Grenelle
75007 Paris
France

**Re: GUIDELINES ON SOUND REMUNERATION POLICIES UNDER THE
AIFMD – RESPONSE TO PUBLIC CONSULTATION**

Dear Sir or Madam:

Managed Funds Association (“MFA”)¹ welcomes the opportunity to provide comments to ESMA in response to its public consultation (the “**Consultation Paper**”) on guidelines on sound remuneration policies under the Directive on Alternative Investment Fund Managers (the “**AIFMD**”).

Throughout the drafting process on the AIFMD, MFA engaged with EU policy makers in, what we believed was, a thoughtful and constructive manner on a number of important issues, including the remuneration provisions in Annex II of the AIFMD. We welcome the opportunity to work with ESMA further in this regard and set out our responses to the questions raised in the Consultation Paper in the Annex.

As discussed in further detail in our responses, MFA believes that ESMA should interpret the concept of proportionality embodied in Annex II to allow flexibility in the application of certain of the Annex II principles to owner-managed AIFMs. Owner-managed AIFMs should be distinguished from other AIFM structures. These types of AIFMs should have greater scope for discretion in setting remuneration for their owners and staff because of the long-term alignment of interests between such AIFMs and the AIFs (and investors in such AIFs) they manage, including effective safeguards against excessive risk-taking which are inherent features of owner-managed AIFM structures.

We believe that the considerations of proportionality are particularly relevant in the following circumstances:

¹ The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and all other regions where MFA members are market participants.

- only the remuneration paid to the most senior individuals in each relevant category of Identified Staff should be subject to the Guidelines. Individuals acting in more junior roles who do not have overall responsibility for the performance of the relevant function should not be considered as Identified Staff;
- many owner-managed AIFMs take the form of limited liability partnerships (or similar structures) with a high proportion of staff being members (or partners) of such AIFMs. The management of such AIFMs is typically delegated to the most senior partner or partners of the AIFM or a management committee with the more junior members/partners having no control over the management of the AIFM or its risk profile. In this context, it would not be appropriate to automatically consider all members/partners of such AIFM to fall within Identified Staff categories;
- owner-managed AIFMs should be given sufficient flexibility in deciding whether a RemCo is required and, if so, in determining its constitution, functions, responsibilities and reporting lines;
- the Guidelines should not require AIFMs to have a strict set of parameters for determining individual awards of variable remuneration and should instead give AIFMs sufficient room for discretion in making such awards;
- due to the considerations detailed in the Annex, it would not be appropriate to apply certain of the principles, including those on deferral of remuneration and pension policy to the owners of an AIFM; and
- there should be no requirement to disclose remuneration policies or amounts to the public.

We appreciate the opportunity afforded by ESMA at its hearing of 25 September 2012 (the “**Hearing**”) on the Guidelines to make representations on the above points. However, we would like to address an important issue which ESMA raised at the Hearing. ESMA indicated at the Hearing that, in its view, the AIFMD Level 1 text set out the minimum requirements, which ESMA was then free to add to in its Level 2 work. We respectfully disagree with that view. As with other directives or regulations, the Level 1 text was the result of negotiations among the European institutions (the Parliament, Council and Commission) and represents the final agreed positions of the institutions. We do not believe that ESMA should seek to impose requirements which go beyond those agreed to by the institutions.

We would be very happy to discuss our comments or any of the issues raised in the Consultation Paper with ESMA. If ESMA has any comments or questions, please do not hesitate to contact Stuart J. Kaswell (SKaswell@managedfunds.org) or the undersigned at +1 (202) 730-2600.

Respectfully submitted,

/s/ Richard H. Baker

Richard H. Baker
President and CEO

ANNEX

MANAGED FUNDS ASSOCIATION

**RESPONSES TO THE ESMA CONSULTATION ON SOUND REMUNERATION
POLICIES UNDER THE AIFMD**

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.

As a preliminary matter, in considering the appropriate application of the Guidelines to AIFMs – and in particular hedge fund managers – we believe it is important to consider some fundamental differences between the structures of hedge fund managers and other types of AIFMs and other financial institutions. AIFMs are not deposit-taking entities and do not maintain accounts that have deposit protection or other forms of government insurance. AIFMs do not have significant amounts of assets themselves, but rather manage assets on behalf of client investment funds. Further, most hedge fund managers are privately-owned businesses and the funds they manage are sold through private placements only to institutional and other sophisticated investors. We believe that these features, as well as the structure, revenue model and remuneration model of hedge fund managers, each of which are discussed below, should be considered by ESMA as it determines how the AIFMD remuneration principles may or may not apply to hedge fund managers and, if they do apply, how to tailor those principles that are applied to hedge fund managers compared to AIFMs in general.

MFA agrees generally with the approach ESMA takes in the Consultation Paper in using the CEBS Guidelines as a starting point. However, as will be noted further below, MFA believes that certain of the AIFMD remuneration principles should not apply in full to owner-managed AIFMs, such as a typical hedge fund manager. These types of structures should be contrasted with AIFMs which are part of a banking or insurance group.

MFA appreciates that, unlike the 2010 amendments to the Capital Requirements Directive (“**CRD3**”), the AIFMD does not expressly provide for the complete neutralization of certain remuneration principles for certain firms. Nonetheless, we believe that ESMA has authority to make clear in the Guidelines that the concept of proportionality should mean that minimal application of certain of the principles is appropriate in certain contexts, most notably in respect of owner-managed AIFMs.

In owner-managed AIFMs, the “alignment of interest” to which ESMA refers at paragraph 12 of the Consultation Paper is already present. Principals who own the hedge fund manager are also typically senior management of the manager with primary responsibility for the portfolio management activities, risk management and oversight of other employees of the AIFM. Unlike financial institutions with public shareholders, therefore, management and ownership of hedge fund managers are integrated, not separated. This integration of ownership and management ensures a long-term alignment of interest, which provides strong incentives to structure the remuneration of senior managers and members of staff in a way that promotes prudent risk management and discourages excessive risk-taking. Further, we believe that payments tied to a person’s ownership stake in an AIFM should not be treated as remuneration and should be deemed outside of the scope of ESMA’s guidelines. Treatment of these types of payments as remuneration would unfairly subject the owners of one type of business structure to restrictions on their ownership interests.

We further believe that the concept of proportionality should allow for minimal application of the principles to third country AIFMs (at least AIFMs in FSB jurisdictions), to the extent the AIFM is subject to remuneration rules in its home jurisdiction.

As a separate matter, MFA notes that the Guidelines do not take into account the fact that, from late 2015, there may be non-EU AIFMs that become subject to the AIFMD in its entirety, including the remuneration provisions (*e.g.* as a result of managing EU-based AIFs). It is important for ESMA to make clear that nothing in the Guidelines requires a non-EU AIFM to put in place remuneration policies that conflict with the requirements of the non-EU AIFM's home jurisdiction or the AIF's home jurisdiction. In this regard, MFA would urge ESMA and the Commission to engage with non-EU regulators to ensure consistency in approach as remuneration increasingly is looked at in the major financial centers.

IV. SCOPE OF THE GUIDELINES

IV.I. Which remuneration?

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.

MFA generally agrees with the scope of the draft Guidelines; provided, that, as discussed in our response to Question 1 above, we believe that payments made in connection with a person's ownership interest in an AIFM should not be deemed remuneration under the Guidelines. Further, as noted in our response to Question 6 below, ESMA should make it clear that fees paid by the AIF to the AIFM (*e.g.* management/performance fees) are not "remuneration" subject to the Guidelines.

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.

Please refer to our response in Question 1 above. We believe that the same principles should apply to remuneration paid in the form of carried interest.

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

We agree that the AIFMD remuneration provisions should not apply to fees and commissions received by third parties. Please refer to our response to Question 5 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)?

MFA is firmly of the view that the AIFMD remuneration principles should not apply to payments made by the AIFM or AIF to any delegate. The Level 1 text of the AIFMD is clear in that the remuneration principles apply only to payments to the senior management and staff of AIFMs. We note that nothing in CRD3 or the CEBS Guidelines would suggest that it is appropriate to consider such payments “in scope” in CRD3. Applying the remuneration principles to payments to delegates of the AIFM/AIF goes far beyond the requirements of the Level 1 text and exceeds the scope of ESMA’s mandate in preparing the Guidelines; the Guidelines would also be completely out of step with the CEBS Guidelines in circumstances where such deviation is unwarranted.

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)?

The Level 1 text is clear in that the AIFMD remuneration principles apply only to payments to the senior management and staff of AIFMs; we thus repeat the views we expressed in our response to Question 5 above. As such, payments made by an AIF to the AIFM in the form of fees (e.g. management fees or performance fees) do not fall under the scope of the AIFMD remuneration rules (and, therefore, of the Guidelines). These types of payments are made based on the contractual agreement between the AIFs (*i.e.* the investors) and the AIFM which is made at the time the AIF is established and/or when an AIFM is appointed under an investment management agreement. Such payments are made as remuneration for the services provided by the AIFM to the AIF and are not for the benefit of any specific member (or categories) of staff.

IV.II. 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.

We believe that the term “other risk taker” in the Guidelines should provide flexibility, taking into consideration the different types of business models and structures of AIFMs subject to the Guidelines. In this regard we support the emphasis on a risk taker having to have a “significant” and “material” impact on the AIFM’s results before being classed as Identified Staff. However, we are concerned that Member State regulators may simply take the approach that even junior traders should be included in the list of “other risk takers.”

In connection with “other risk takers,” the Guidelines refer to such persons who have a material influence on “the AIFM’s risk profile” and on “the AIFM’s results and/or balance sheet...” . Hedge fund managers do not generally trade on their own balance sheets. In this regard, a hedge fund manager’s risk profile is very different to, for example, the risk profile of a bank or own account dealer, from which this concept under the CEBS Guidelines originated. By contrast, a hedge fund manager’s risk profile is typically limited to its exposure to operational risk (*e.g.* staff, systems).

As a separate matter, MFA notes that the Guidelines refer to “partners” as being Identified Staff, on the basis that they are “members of the governing body of the AIFM.” However, it would be helpful for the Guidelines to acknowledge that not all partners perform a role which is necessarily relevant to the risk of the AIFM. For example, an individual could be a partner in a UK limited liability partnership (LLP) (a common UK hedge fund manager entity) but, due to the LLP structure, not have a significant role in governing the LLP. This is of particular relevance to AIFMs that are part of an affiliated group, for example, in which the management of the LLP is delegated to a managing member (or members) or a management committee (or other governing body) consisting of only senior partners of the firm.

Similarly, an individual could be a member of a US limited liability company (LLC) (a common US hedge fund manager entity) but, due to the LLC structure, not have a significant role in governing the LLC (*e.g.* if the management is delegated to one or more “managers”).

MFA is also concerned with the inclusion of persons in “control functions which include staff (other than senior management) responsible for risk management, compliance, internal audit and similar functions...” as Identified Staff. As drafted, it would potentially capture most staff in those functions (*e.g.* even junior compliance staff). We note that the CEBS Guidelines, in comparison, refer to “senior staff responsible for heading the compliance, [etc.]” functions. We would urge ESMA to be consistent with the CEBS Guidelines in this regard.

IV.III. Timing of entry into force of these Guidelines

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.

No comment.

V. PROPORTIONALITY PRINCIPLE

V.II. 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.

As a general matter, MFA agrees with the clarifications proposed by ESMA. However, although we recognize that complete neutralization of the remuneration principles is not expressly referred to in the Level 1 text, we are of the view that the concept of proportionality expressed in Annex II of the AIFMD allows for flexible application of certain principles in Annex II, particularly in the context of owner-managed AIFMs and non-EU AIFMs subject to remuneration rules in their home jurisdiction.

We believe that such a flexible approach does not equate to disregarding Annex II requirements. Conversely, we believe that such flexibility would allow AIFMs to tailor their remuneration policies to address the specific operational risks inherent in their structures, to attract and retain talent and to provide appropriate long-term incentives to their staff to act in the best interest of AIFs they manage.

V.III. Proportionality with respect to 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.

We believe that, as with proportionality with respect to different characteristics of AIFMs above, certain of the remuneration principles should apply only in a minimal manner to certain categories of staff (*e.g.* less senior staff or staff in certain support functions, to the extent such staff are Identified Staff, as defined in the Guidelines).

Separately, the Guidelines focus on proportionality as between risk takers. As noted above, MFA believes that proportionality should also apply in relation to members of the AIFM who are not on the "governing body" of the AIFM (for example, individuals who may be partners/members of the AIFM may not automatically have a significant influence on the management and risk profile of the AIFM).

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

No comment.

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 note that ESMA's focus in this part of the Guidelines is on the situation where an AIFM is part of an EU banking or insurance group. ESMA should also consider that AIFMs may, in many cases, be part of fund management groups which are not subject to the CRD, for example, because the AIFM's affiliates are located outside the EU.

ESMA should clarify that staff of such non-EU affiliates should not be considered to be Identified Staff, even if they may carry out some work for the EU based AIFM. One example would be the in-house counsel or chief compliance officer of the non-EU parent of an EU AIFM. This individual may have an overall oversight responsibility of legal or compliance issues within the group, but should not be considered to be performing "control functions" for purposes of the definition of "Identified Staff."

Even if such non-EU based individual were to be considered Identified Staff of the EU-based AIFM, it would only be appropriate for the relevant part of that individual's remuneration related to the EU-based AIFM's activities to be subject to the Guidelines.

Q13: Do you agree that the proposed alignment of the CRD and AIFMD remuneration provisions will reduce the existence of any conflicting remuneration requirements at group level for AIFMs whose parent companies are credit institutions subject to the

CRD? If not, please state the reasons for your answer and provide quantitative details on any additional costs implied by the proposed approach.

No comment.

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.

No comment.

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.

MFA respectfully does not agree with the proposed principle. An AIFM's minimum capital requirement (and other matters relating to authorisation of AIFMs) are dealt with separately in the AIFMD and is an independent requirement. In this regard, the AIFM should already have systems and controls (in the same way as MiFID investment firms do) to ensure that the minimum capital requirement is met. For example, it is common in UK limited liability partnership agreements (an LLP is a typical structure for UK AIFMs) to contain provisions limiting distributions in circumstances where the LLP's minimum capital requirement would be breached.

MFA does not believe that there is a need for the Guidelines to address issues relating to minimum capital requirements.

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.

No comment.

VIII. GOVERNANCE OF REMUNERATION

VIII.I.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.

As a practical matter, the vast majority of hedge fund managers would be too small to make a distinction between the "management body" (being the governing body) and the "senior management." Many hedge fund managers are also too small to have non-executive directors or persons in a similar "supervisory function" as defined in the Guidelines. In this regard, we urge ESMA to provide that owner-managed AIFMs should apply these requirements on the basis of proportionality.

VIII.I.C. Shareholders' involvement

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

As a general matter, MFA supports the approach taken by ESMA that shareholder involvement *may* be appropriate in setting an AIFM's remuneration policy rather than making shareholder involvement a *requirement*.

Given that most hedge fund managers are owner-managed and have no true external shareholders, this question is not directly relevant to most MFA members.

VIII.I.D. Review of the implementation of the remuneration policy

MFA General Comment

Although ESMA has not posed any questions in relation to this section, we would like to raise an issue of concern to our members. We are of the view that ESMA should delete the requirement expressed in Paragraph 67 of the Consultation Paper for the AIFM to assess, on an annual basis, whether the remuneration policy "is compliant with national and international regulations, principles and standards."

The obligation of the AIFM is to comply with the AIFMD and any other law that it may be subject to. However, it is not the responsibility of the AIFM to determine whether its remuneration policy, which it has designed in accordance with the Guidelines, is compliant with international standards. It is for ESMA or the Commission, as the case may be, to determine whether the AIFMD remuneration principles are compliant with international standards. We would thus urge ESMA to delete that bullet point in paragraph 67 of the Consultation Paper and correspondingly in the Guidelines.

Further, to reiterate a point we raise at the beginning of this set of responses, ESMA should clearly state that an AIFM is not required to apply the AIFMD remuneration principles where that would result in the non-EU AIFM breaching remuneration or other rules applicable to the AIFM or its AIFs in their respective home jurisdiction(s).

VIII.II.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.

Although many hedge fund managers will have remuneration committees in some form, they may not take the form contemplated by the Guidelines. In that respect, MFA supports ESMA's proposal (which is consistent with Level 1 text) that RemCos are only required for AIFMs that are significant in size, scope and/or AIFs managed.

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

We generally support the criteria that ESMA has suggested, subject to the following comments.

We are of the view that the examples given by ESMA at paragraph 74 are very unhelpful. For example, in the hedge fund context, an AUM of EUR 250 million is a very small amount. In light of the fact that AIFMs with less than EUR 100 million in AUM generally are exempt from the AIFMD, ESMA's proposed threshold would effectively deem the vast majority of AIFMs to be of significant size. The AIFM industry is vastly different across EU Member States; for example, EUR 250 million might be "significant" say in Latvia or Slovenia, but is an extremely small amount in the UK context. We would thus propose that any amount to be specified be left to Member State competent authorities, should they wish to specify a threshold.

At the same time, we believe that setting a numerical AUM threshold does not take into consideration the different types of strategies AIFMs may pursue. As such, we would urge ESMA to assign more significance to the types of assets under management, the range and complexity of investment strategies employed, and the number of staff and internal organization of the AIFM.

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.

No comment.

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.

As noted above, greater emphasis should be placed on (i) the number of staff and internal organization of the AIFM, and (ii) the complexity and the range of investment strategies employed by the AIFM. In addition, we urge ESMA to specify that RemCos need not be a mandatory feature in owner-managed AIFMs.

VIII.II.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.

Please refer to our comments to Questions 17, 19 and 22 above.

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

We do not believe that specific rules on the composition of RemCos would be appropriate given the wide range of the types of AIFM operations that are subject to the AIFMD remuneration rules.

VIII.II.C. Role

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

We generally agree with the role as described in the Guidelines. However, we urge ESMA to allow a flexible application of these criteria given the wide range of AIFMs that are subject to the AIFMD remuneration rules. We believe that it is important to give AIFMs flexibility in their approach to specifying the functions and responsibilities of a RemCo.

VIII.II.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.

Generally, yes, although we reiterate our points made earlier that there would typically not be a separate supervisory function nor external shareholders in the hedge fund manager context. In addition, RemCos of AIFMs that are a part of a group may be established at group level. In this regard, it is important to allow AIFMs sufficient flexibility in structuring their RemCos.

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.

MFA does not agree with such a requirement. Setting aside the point made above about AIFMs generally not having external shareholders, the AIFM is already required under the AIFMD to provide disclosures of its remuneration policy and related information to the AIF. Hedge funds also do not typically hold shareholders' meetings, so it is difficult to see how this could be complied with by hedge funds.

VIII.III.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.

As noted in our responses in Questions 7 and 10 above, only the senior managers responsible for the control function (*e.g.* head of the team) should be included within the scope of the Guidelines.

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.

No comment.

IX. GENERAL REQUIREMENTS ON RISK ALIGNMENT

IX.I.B. Discretionary pension benefits

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

It would be helpful to define in some consistent manner what is intended to be covered by the term “discretionary pension benefits.” We assume that the term is only intended to cover pension payments that are part of the relevant employee's variable remuneration package, but excluding accrued benefits granted to an employee under the terms of his company pension scheme.

IX.II.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.

No comment.

IX.II.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.

No comment.

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.

No comment.

X. SPECIFIC REQUIREMENTS ON RISK ALIGNMENT

X.II.B. Common requirements for the risk alignment process

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

No comment.

X.II.C. Risk measurement

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

We agree that risk measurement is an important part of determining the appropriate remuneration for Identified Staff. We do not believe, however, that the risk measurement methods

used for the AIFs should necessarily be the same for measuring Identified Staff. AIFMs should not necessarily measure risk under a one-size fits all approach. Risk measurements for Identified Staff making investment decisions may be different from risk measurements for other Identified Staff. Moreover, risk measurements for an Identified Staff person making investment decisions on an aspect of an AIF's portfolio may be different from risk measurements for Identified Staff on another aspect of an AIF's portfolio, each of which may be different than the methods to measure the AIF's overall risk profile. As such, we believe AIFMs need to retain flexibility in determining the appropriate methods by which to measure risk for Identified Staff and to be able to tailor those measurements, as appropriate, among different Identified Staff.

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?

MFA would be concerned by the situation in which such an AIFM may be caught by the provisions of the UCITS Directive or MiFID, as the case may be, as well as the AIFMD. We note that the relationship between the AIFMD and MiFID/UCITS was discussed in ESMA's Discussion Paper "Key concepts of the Alternative Investment Fund Managers Directive and types of AIFM" (February 2012). Until that relationship is clear we would urge ESMA not to finalize the Guidelines in that regard.

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

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.

AIFMs should be allowed maximum discretion in assessing the performance of their staff in order to tailor these requirements to the nature of the relevant function, the scale and complexity of the AIFMs operations and the incentives required to attract and retain talent in the AIFM's business. As part of this discretion, AIFMs should have the ability to reward good performance by an individual, even if the AIFM did not perform well overall.

We note, for example, quantitative measures have no real bearing on the performance of staff in certain control functions, such as legal and audit. We do not believe that any guidelines from ESMA are needed on this issue and would ask for their deletion from the Guidelines.

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.

As noted above, an AIFM should have discretion to assess the performance and contributions of its staff. Given this section of the Guidelines notes that there are advantages and disadvantages in relative/absolute and internal/external measures, the purpose of this section of the Guidelines is not entirely clear.

X.III. Award process

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

MFA generally agrees that a policy for the award process and related records should be maintained. However, it is important to allow AIFMs sufficient flexibility to include a discretionary component in determining variable remuneration awards.

As a practical matter, it is often impossible to assess an individual's performance against a strict set of parameters. In this respect, although AIFMs should maintain a set of indicative measures of performance in relation to allocation of variable remuneration, any awards of variable remuneration should be based on a discretionary determination by the RemCo (or senior managers responsible for determining individual awards in the absence of a RemCo).

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

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.

No comment.

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

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.

MFA does not believe that the considerations set out in Part X.IV (Pay-out process) of the Consultation Paper are relevant in the context of hedge fund managers.

The performance fees earned by AIFMs that manage hedge funds are determined on the basis of the gains earned by the AIFs. These fees are realized by the AIFM once they have been earned and generally are not subject to claw-back or other future adjustments. Hedge fund managers typically earn their fees on an annual basis, and the structure of the funds they manage is based on this model. It is important to note that this fee structure is agreed upon by professional investors prior to investing in the fund. Investors can, and do, exercise their redemption rights if they believe the fee structure no longer aligns their interests with the interests of the manager. Further, it is important for AIFMs to be able to structure the compensation of their employees in a manner that is consistent with the interests of the investors in the fund.

In light of the fee structure of hedge fund managers, we believe they generally should not be subject to a deferred remuneration requirement, particularly a requirement with a specified percentage. Taking into account the proportionality concept within Annex II of the AIFMD (as recognized by the Guidelines), MFA is strongly of the view that the requirement to defer 40%-60% of variable remuneration over a period of three to five years should be disappplied, at least in relation to the owners of owner-managed AIFMs. At a minimum, AIFMs should be permitted to tailor any deferral requirement in light of the payment terms of the fund, in order to better align the interests of AIFM employees and AIF investors.

We also believe that deferral requirements could have significant adverse tax implications for many senior employees of hedge fund managers. If the deferral requirements were applied to hedge fund managers, it could result in senior staff having tax liabilities in excess of the amount of cash they are permitted to earn under the Guidelines in a given year.

If, notwithstanding our views above, owner-managed firms would be required to comply with the full scope of the deferral measures, we would emphasize the importance of making clear that any deferral requirement can be met on the basis that it excludes any amounts distributed to such owners for purposes of meeting their tax obligations.

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

MFA General Comment

We are concerned about a requirement that AIFMs set maximum ratios between fixed and variable remuneration. This requirement would require most managers to pay their employees a higher percentage of fixed remuneration and increase fixed overheads along with other associated costs, such as benefits based on salary.

Contractually committing more capital to salary payments would have the unintended consequence of restricting the AIFM's ability to limit total remuneration in difficult times, such as in 2008 when many hedge fund managers severely reduced bonuses that were paid out. This would also limit managers' flexibility to maintain profitability (or potentially break even) in periods of underperformance, a result that seems inconsistent with the purported goals of the Guidelines. Higher fixed remuneration also disrupts the alignment of interests among the manager, the manager's employees and the manager's clients that results from the current revenue and remuneration structures of hedge fund managers. As such, we encourage ESMA to recognize that there should be flexibility in setting the fixed/variable ratio.

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.

We believe that remuneration by instruments in the AIFM would not appropriate for privately-owned AIFMs and so we support the definition of "instrument" in the Guidelines, which does not include interests in the AIFM.

To avoid potential conflicts of law, ESMA should make clear that remuneration by instruments in the AIF may be disappplied when other applicable rules (such as private placement

rules) would otherwise restrict the Identified Staff from investing in the AIF. This clarification is necessary with respect to instruments in the AIF as well as linked instruments, which may be subject to similar restrictions.

We respectfully disagree with the proposed guidance that AIFM employees should receive instruments only in the AIF(s) in relation to which they perform their duties. Many AIFMs limit the trading activities of their employees, particularly key employees involved in the investment decisions for the AIFs, in order to avoid potential conflicts of interest. Moreover, limiting these employees to investing only in the AIF in which they are involved would be overly restrictive and would create an unlevel playing field for AIFMs compared to other types of financial entities. Finally, it is difficult to see how such a proposal would apply to senior “control” staff, who generally do not provide services (compliance, audit) in respect of a specific fund but rather all aspects of the AIFM’s business. As such, we encourage ESMA to delete these guidelines to permit AIFMs to compensate employees through ownership of any AIF managed by the AIFM.

In addition, employees that receive those interests would be extremely limited in their ability to dispose of them at a future date. Whilst we appreciate ESMA’s recognition in paragraph 165 of the Consultation Paper that “alternative instruments” that “reflect the AIF’s value and have the same intended effect as share-linked instruments,” it is not clear to us how those would operate in practice, because such alternative instruments would be subject to the same problems in valuation and disposal.

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.

No comment.

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.

No comment.

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

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 fees generated by hedge fund managers generally are not subject to claw-back or risk of future loss; the performance fee is paid by the hedge fund after the NAV of the fund has been calculated unlike, say, bonuses paid in an investment bank. There does not appear to be a policy rationale for requiring hedge fund managers to have an *ex-post* adjustment component to the variable remuneration awarded to employees.

We believe that it is important for hedge fund managers to be able to compensate certain individuals who performed well and made a positive contribution to the manager appropriately, even if the overall performance of the manager was negative during that period. We encourage ESMA to provide additional guidance to clarify that an AIFM may pay appropriate variable remuneration to certain employees based on the individual's performance, even if the AIFM's (or the AIF's) overall performance was subdued or negative during that period, provided that such remuneration does not threaten the AIFMs' capital requirements or overall financial stability.

X.V. 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.

We do not believe that the analysis set out in paragraphs 192 and 193 would be appropriate in the context of hedge funds, as well as other open-ended AIF structures. Investors in hedge funds would not want their capital to be returned on a regular basis (just so that the AIFM staff can be paid), as this would be extremely inefficient for the investors from a tax perspective. Further, some investors may be restricted from receiving in-kind returns of capital, which could force the AIFM to sell AIF assets at times that are disadvantageous to investors.

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.

No. Please refer to our comments above.

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.

No comment.

XI. DISCLOSURE

MFA General Comment

MFA notes that, while non-EU AIFMs are using only the national private placement regime for marketing, they do not receive the benefit of the EU passport and, accordingly, are not required to comply with the operative provisions of the AIFMD other than Articles 26 to 30 (disclosure and transparency). As and when the passport regime is either opted into by the non-EU AIFM, or possibly imposed by the AIFMD, non-EU AIFMs will have to comply with all of the other Articles of the AIFMD.

Accordingly, while a non-EU AIFM markets AIFs in the EU under the national private placement regime (*i.e.* not under the passport), the requirements of Article 13 and Annex II of the AIFMD to have remuneration policies do not apply to such non-EU AIFMs (and would not apply

unless/until the non-EU AIFM utilized the passport regime). That being the case, the corresponding requirement under Article 22(2)(e) and (f) for an AIFM to report the amount of remuneration should not apply to such a non-EU AIFM prior to the application of the passport.

If, notwithstanding the above, such reporting of total remuneration is required, then MFA would note that there should be no requirement for non-EU AIFMs to provide information relating to their remuneration *policies*. That is, even if information about total remuneration paid is disclosed, non-EU AIFMs marketing under the national private placement regime are not subject to any requirement which relates to remuneration *policies*, because the requirement in Article 13/Annex II of the AIFMD to have remuneration policies do not apply to such non-EU AIFMs. We would urge ESMA to consider the above points and reflect them in its Guidelines, as appropriate.

XI.I. External disclosure

MFA General Comment

We disagree with the statement in paragraph 196 of the Consultation Paper that “AIFMs should publicly 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.” Notwithstanding the acknowledgement that such disclosure is without prejudice to confidentiality and applicable data protection legislation, we would emphasize that the AIFMD Level 1 text does not mandate public disclosure of such information. Article 22 of the AIFMD refers to disclosure of such information in the annual report, which “shall be provided to investors on request.”

MFA supports disclosure of information to regulators (with appropriate confidentiality protections for sensitive and confidential information); however, we do not believe there is a public policy rationale for public disclosure of the detailed remuneration policies or quantitative information about privately-owned hedge fund managers. Further, such public disclosure may lead to a range of undesired consequences, particularly in smaller firms, where it may be simply to determine, by the process of elimination, the specific remuneration paid to the Identified Staff. This can result in a difficult working environment for AIFM staff, as well as increase the risk of to the AIFM of losing talent to competitors by making this information easily available to executive search agencies.

At the ESMA hearing on the Guidelines held on 25 September 2012, ESMA explained that in its view the AIFMD Level 1 text supported public disclosure; ESMA’s view was that the AIFM’s remuneration would be in the annual report which, along with the financial statements, would in any event be publicly available. We would respectfully disagree with that interpretation. Article 22(1) is clear in that where the AIF is required by the Transparency Directive (Directive 2004/109/EC) to make public an annual financial report, other information (in Article 22(2), including remuneration) “needs to be provided to investors on request, either separately or as an additional part of the annual financial report.” (Emphasis added). That is, there is no obligation to include the Article 22(2) information (which includes remuneration) in the publicly available annual financial report.

At the ESMA Hearing, ESMA also mentioned that it was seeking simply to incorporate paragraphs 7 and 8 of Section III (*Disclosure*) of Recommendation 2009/384/EC (the “**Recommendation**”). We believe that there is an important distinction between the

Recommendation and the Guidelines in this context. Paragraph 7 of the Recommendation refers to disclosing remuneration information to “stakeholders.” In that context, it is perhaps possible to argue that “stakeholders” means, in effect, the public, since the Recommendations deal with credit institutions, in particular, which have public shareholders. The CRD3 framework aims to align the interests of staff with shareholders of the institution. In the AIFMD context, however, “stakeholders” clearly means AIF investors, since the Guidelines take the approach that the interests of AIFM Identified Staff should be aligned with those of AIF investors. We thus believe that it is inappropriate to incorporate paragraphs 7 and 8 of the Recommendation without an adjustment as to who the relevant “stakeholders” are.

XI.II. 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.

While MFA supports giving AIFM Identified Staff a copy of the remuneration policy, we believe that AIFMs should have discretion to determine what other information should be provided, and would ask ESMA not to be prescriptive in this area. In particular, we do not believe that the parameters for determining individual variable remuneration awards should be disclosed (although a general disclosure of the factors which may be considered in the award process might be appropriate).

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

No comment.