MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

December 7, 2012

Via *ESMA Website*

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

Re: GUIDELINES ON REMUNERATION POLICIES AND PRACTICES UNDER MiFID – 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 remuneration policies and practices under the Markets in Financial Instruments Directive ("**MiFID**"). MFA and its members strongly support the primary principle underlying the Guidelines that remuneration policies must incorporate robust measures to mitigate conflicts of interests and ensure that the interests of the clients are protected. Indeed, we believe that this principle underlies the governance structure and the revenue and remuneration models utilized by hedge fund managers.

We note that many hedge fund managers operating in the EU will soon be subject to the remuneration principles of the Alternative Investment Fund Managers Directive ("**AIFMD**"), and we have separately provided responses to ESMA's draft Guidelines on Sound Remuneration Policies Under the AIFMD.[2] This letter relates to those hedge fund managers who– for example, EU sub-advisors/sub-managers of non-EU AIFMs – would be MiFID firms and so subject to the matters discussed in the Consultation Paper.

As noted in the Consultation Paper, investment firms that provide services under MiFID are subject to the remuneration provisions in the most recent amendments to the Capital Requirements Directive and the related guidelines issued by the Committee of European Banking Supervisors

[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.

[2] MFA's comment letter to ESMA on remuneration guidelines under the AIFMD is available at the following link -- MFA comment to ESMA on AIFMD guidelines.

("**CEBS**") and relevant Member State supervisors. MFA generally supported those efforts[3] and we generally support the additional guidelines in the Consultation Paper, which seek to ensure that investment firms consider investor protection and conflicts of interest issues in designing and implementing remuneration policies. MFA also strongly agrees with the statement in the Consultation Paper that guidelines regarding organizational structure should be interpreted in connection with the principle of proportionality, to ensure that firms have appropriate flexibility in implementing their remuneration policies. We believe; however, that the principle of proportionality should apply to all of the provisions in the Guidelines, similar to the approach taken in the CEBS guidelines, and we encourage ESMA to amend its Guidelines accordingly. We further encourage ESMA to state that, consistent with the CEBS guidelines, provisions in ESMA's Guidelines may be subject to neutralization with respect to certain investment firms.

In considering the proportional application of the Guidelines to hedge fund managers, we believe that ESMA should consider the following areas. The scope of relevant staff subject to the Guidelines should be limited to senior individuals in each relevant category. We encourage ESMA to delete the examples of good and poor practices set out in the Guidelines because we believe they do not account for firm specific factors that may lead to a different conclusion than the examples given and, therefore, may be misleading for particular firms. We also encourage ESMA to consider revising the Guidelines to make clear that investment firms are not required to have a strict set of parameters for determining individual awards of variable remuneration. Finally, we encourage ESMA to refine the intended scope and goals of an investment firm's remuneration policies.

Structure of Hedge Fund Managers

As a preliminary matter, in considering the appropriate application of the Guidelines to hedge fund managers that are MiFID investment firms, we believe it is important to consider some fundamental differences between the structures of hedge fund managers and other types of financial institutions. Hedge fund managers 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 remuneration guidelines 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 other types of MiFID investment firms and other financial institutions.

In most hedge fund managers, the alignment of remuneration policies with effective management of conflicts of interest 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 manager. 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

[3] *See*, MFA's comment letter to CEBS on its remuneration guidelines, available at the following link -- MFA comment letter on CEBS guidelines and MFA's comment letter to the UK Financial Services Authority on its guidelines on remuneration, available at the following link -- MFA comment letter on FSA guidelines.

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 a hedge fund manager 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.

Further, because the principals of the hedge fund manager typically have significant amounts of their own capital invested in the funds they advise, and because the performance fees earned by the manager typically are subject to high-water marks, the fee structure for manager is designed to align the manager's interests with fund investors by encouraging long-term risk-adjusted returns and discouraging excessive short-term risk taking. The variable remuneration earned by senior employees of the manager is, in turn, based on the manager's ability to earn those performance fees, further aligning the interests of the manager's employees and fund investors. It is important to note that this fee structure is agreed upon by sophisticated investors prior to investing in the fund who can and do exercise their redemption rights if they believe the fee structure no longer aligns their interests with the interests of the manager.

Scope of Relevant Persons

We believe that the term 'relevant persons' in the Guidelines should provide flexibility, taking into consideration the different types of business models and structures of investment firms subject to the Guidelines. In this regard, we support the emphasis on relevant persons having to have a "material" impact on a hedge fund manager's business or corporate behavior before being classified as relevant staff. In determining the appropriate scope of hedge fund manager employees, it is important to consider that hedge fund investors are sophisticated, not retail, investors and that most hedge fund managers do not distribute a wide range of financial products from different sponsors; to the extent they are involved in distribution, it is typically only for their own funds. As such, we believe that the primary concerns expressed by ESMA are not particularly relevant for hedge fund managers. We are concerned, however, that, as drafted, the Guidelines could be interpreted to potentially capture most staff in client-facing functions (*e.g.,* even junior sales or investor relation staff). We note, for example, that the CEBS Guidelines, with respect to control functions, refers to "senior staff responsible for heading" the relevant functions. We would urge ESMA to be consistent with the CEBS Guidelines in this regard.

Examples of Good and Poor Practices

We note that, in describing the examples in Annex I, ESMA specifically states that the examples are for illustrative purposes and do not create additional requirements. Nonetheless, we are concerned that the examples may be interpreted as establishing requirements for investment firms to demonstrate compliance. We also are concerned that the examples included in paragraphs 25, 26, 32, and 33 of the Guidelines may be misleading with respect to certain firms because the examples do not account for differences in business models and firm specific factors. The determination of whether a firm's remuneration policies comply with MiFID and the Guidelines is necessarily fact specific and will vary based on the business model and other firm specific factors. Accordingly, we are concerned that the examples in the Guidelines and in Annex I may be misleading with respect to many firms and we encourage ESMA to delete them from the Guidelines.

Further, in explanatory paragraph 56 of the Consultation Paper, ESMA suggests that remuneration policies linked to the sale of specific financial instruments or a specific category of financial instruments are unlikely to be compliant with MiFID. To the extent a hedge fund manager is involved with distribution, it is often only in connection with the distribution of that manager's hedge funds. In this context, the suggestion in paragraph 56 of the Consultation Paper seems overly broad and misleading with respect to many hedge fund managers.

Factors in Determining Remuneration

With respect to the discussion in paragraph 18 of the Guidelines, hedge fund managers 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 manager's operations and the incentives required to attract and retain talent in the manager's business. As part of this discretion, hedge fund managers should have the ability to reward good performance by an individual, even if the manager did not perform well overall.

We note, for example, quantitative measures have no real bearing on the performance of staff in certain control functions of the manager. We do not believe that any guidelines from ESMA are needed on this issue and would ask that this provision be subject to neutralization.

With respect to paragraph 22 of the Guidelines, MFA generally agrees that a policy for the award process and related records should be maintained. However, it is important to allow hedge fund managers 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 hedge fund managers 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 appropriate senior management.

Scope of Remuneration Policies

We agree with the general principle expressed in the Guidelines, that remuneration policies should be designed to promote alignment of interests with investors and mitigate conflicts of interest that can arise from the manner in which relevant persons are compensated. We are concerned; however, that specific provisions in the Consultation Paper go beyond this principle and, as drafted, would create standards would be difficult or impossible to achieve, depending on the circumstances. For example, Paragraph 19 of the Guidelines states, "Furthermore, where a firm's policy provides for variable remuneration, the firm should adopt and maintain measures enabling it to promptly identify where the relevant person fails to act in the best interests of the client and to take remedial action." While we agree that firms should have policies to identify failures to act in the best interest of clients, we believe these policies are beyond the scope of remuneration policies and are more appropriately included as part of a firm's broader compliance program. As such, we encourage ESMA to delete this paragraph from the Guidelines.

Similarly, paragraph 15 of the Guidelines provides that remuneration policies should be designed to prevent potential conduct of business and conflict of interest risks. Not all conduct of

business and conflict of interest risks; however, arise as a result of the manner in which employees are compensated. We encourage ESMA to narrow the scope of this paragraph to clarify that remuneration policies and procedures should be reasonably designed to prevent those conflict of interest and conduct of business risks that are relevant to or associated with remuneration of employees.

Further, paragraph 21 of the Guidelines suggests that senior management of an investment firm is responsible for preventing any risks that remuneration policies and practices can create. While we agree that senior management has an important role in designing policies to identify and mitigate risks, it is not possible to prevent all risks. We encourage ESMA to revise this paragraph to provide that senior management should take reasonable steps to mitigate risks that may result from a firm's remuneration policies and procedures.

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