Guidelines

Guidelines on sound remuneration policies under the AIFMD

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Table of Contents

I. Scope

Who?

1. These guidelines apply to AIFMs and competent authorities.

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

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

What?

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

When?

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

II. Definitions

Unless otherwise specified, terms used in the Directive 2011/61/EC of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010[1] (AIFMD) and in the delegated acts adopted by the Commission according to the provisions of the AIFMD have the same meaning in these guidelines. In addition, the following definitions apply for the purposes of these guidelines:

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

Recommendation	Commission Recommendation 2009/384/EC of 30 April 2009 on remuneration policies in the financial services sector.[2]
identified staff	categories of staff, including senior management, risk takers, *control functions* and any employee receiving total remuneration that takes them into the same *remuneration bracket* as senior management and risk takers, whose professional activities have a material impact on the AIFM's risk profile or the risk profiles of the AIF that it manages and categories of staff of the entity(ies) to which portfolio management or risk management activities have been delegated by the AIFM, whose professional activities have a material impact on the risk profiles of the AIF that the AIFM manages.
control functions	staff (other than senior management) responsible for risk management, compliance, internal audit and similar functions within an AIFM (e.g. the CFO to the extent that he/she is responsible for the preparation of the financial statements).
remuneration bracket	the range of the total remuneration of each of the staff members in the senior manager and risk taker categories – from the highest paid to the lowest paid in these categories.
instruments	units or shares of the AIFs managed by the AIFM or equivalent ownership interests (including – for AIFs issuing only units – unit-linked instruments), subject to the legal structure of the AIFs concerned and their rules or instruments of incorporation, or share-linked instruments or equivalent non-cash instruments.
malus	arrangement that permits the AIFM to prevent vesting of all or part of the amount of a deferred remuneration award in relation to risk outcomes or performances of the AIFM as a whole, the business unit, the AIF and, where possible, the staff member. Malus is a form of ex-post risk adjustment.
clawback	contractual agreement in which the staff member agrees to return ownership of an amount of remuneration to the AIFM under certain circumstances. This can be applied to both upfront and deferred variable remuneration. When related to risk outcomes, clawback is a form of ex-post risk adjustment.
supervisory function	the relevant persons or body or bodies responsible for the supervision of the AIFM's senior management and for the assessment and periodical review of the adequacy and effectiveness of the risk management process and of the policies, arrangements and procedures put in place to comply with the obligations under the AIFMD. For those AIFMs that given their size, internal organisation and the nature, scope and complexity of their activities or their legal structure do not have a separate supervisory function, the supervisory function should be understood as the member or members of the *management body* responsible for these functions.
management body	the governing body of an AIFM.

[2] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:120:0022:0027:EN:PDF.

retention period	period of time during which variable remuneration that has been already vested and paid out in the form of *instruments* cannot be sold.
accrual period	period during which the performance of the staff member is assessed and measured for the purposes of determining its remuneration.
deferral period	the deferral period is the period during which variable remuneration is withheld following the end of the *accrual period*.
vesting point	an amount of remuneration vests when the staff member receives payment and becomes the legal owner of the remuneration. Once the remuneration vests, no explicit ex-post adjustments can occur apart from *clawback* clauses.

III. Purpose

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

IV. Compliance and reporting obligations

Status of the guidelines

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

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

Reporting requirements

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

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

V. Guidelines on which remuneration is covered by these guidelines

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

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

(i) all forms of payments or benefits paid by the AIFM,

(ii) any amount paid by the AIF itself, including carried interest, and

(iii) any transfer of units or shares of the AIF,

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

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

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

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

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

(i) the portion of the payment made by the AIF to the above mentioned categories of staff members which exceeds the pro-rata investment return for the investment made by the relevant staff members and represents carried interest, i.e. a share in the profits of the AIF accrued to the staff members as compensation for the management of the AIF (which is subject to the remuneration provisions of these guidelines) [4]; and

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

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

14. A "retention bonus" is a form of variable remuneration and can only be allowed to the extent that risk alignment provisions are properly applied.

15. AIFMs should ensure that variable remuneration is not paid through vehicles or that methods are employed which aim at artificially evading the provisions of the AIFMD and these guidelines. The governing body of each AIFM has the primary responsibility for ensuring that the ultimate goal of having sound and prudent remuneration policies and structures is not improperly circumvented. Circumstances and situations that may pose a greater risk under this perspective may be: the conversion of parts of the variable remuneration into benefits that normally pose no incentive effect in respect of risk positions; the outsourcing of professional services to firms that fall outside the scope of the AIFMD; the use of tied agents or other persons not considered “employees” from a legal point of view; transactions between the AIFMs and third parties in which the risk takers have material interests; the setting up of structures or methods through which remuneration is paid in the form of dividends or similar pay outs (e.g. improper use of performance fees) and non-monetary material benefits awarded as incentive mechanisms linked to the performance.

16. The so called ‘carried interest vehicles’ are typically limited partnerships (or other kinds of vehicle) being themselves limited partners in the AIF together with third party investors and are used by senior executives of an AIF either to regulate the executives’ entitlements to carried interest among themselves as a consequence of a modest capital contribution or to commit capital which is more than merely nominal – i.e. co-investments – in transactions along with the AIF. If payments made by the AIF to the relevant staff members through these carried interest vehicles fall under the definition of carried interest, they should be subject to the remuneration provisions of these guidelines, whereas if they represent a pro-rata return on any investment by the staff members (through the carried interest vehicle) into the AIF, they should not be subject to such provisions.

17. Consideration should also be given to the position of partnerships and similar structures. Dividends or similar distributions that partners receive as owners of an AIFM are not covered by these guidelines, unless the material outcome of the payment of such dividends results in a circumvention of the relevant remuneration rules, any intention to circumvent such rules being irrelevant for such purpose.

18. When delegating portfolio management or risk management activities according to Article 20 of the AIFMD and its implementing measures, AIFM should ensure that:

    a) the entities to which portfolio management or risk management activities have been delegated are subject to regulatory requirements on remuneration that are equally as effective as those applicable under these guidelines; or

    b) appropriate contractual arrangements are put in place with entities to which portfolio management or risk management activities have been delegated in order to ensure that there is no circumvention of the remuneration rules set out in the present guidelines; these contractual arrangements should cover any payments made to the delegates’ *identified staff* as compensation for the performance of portfolio or risk management activities on behalf of the AIFM.

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

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

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

- Executive and non-executive members of the governing body of the AIFM, depending on the local legal structure of the AIFM, such as: directors, the chief executive officer and executive and non-executive partners.

- Senior management

- *Control functions*

- Staff responsible for heading the portfolio management, administration, marketing, human resources

- Other risk takers such as: staff members, whose professional activities – either individually or collectively, as members of a group (e.g. a unit or part of a department) – can exert material influence on the AIFM's risk profile or on an AIF it manages, including persons capable of entering into contracts/positions and taking decisions that materially affect the risk positions of the AIFM or of an AIF it manages. Such staff can include, for instance, sales persons, individual traders and specific trading desks.

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

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

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

21. Additionally, if they have a material impact on the risk profile of the AIFM or of the AIFs it manages, other employees/persons, whose total remuneration takes them into the same *remuneration bracket* as senior managers and risk takers should be included as the *identified staff*, such as: high-earning staff members who are not already in the above categories and who have a material impact on the risk profile of the AIFM or of the AIFs it manages. It is likely that in some cases, those staff members whose remuneration is as high as or higher than senior executives and risk takers will be exerting material influence in some way on the risk profile of the AIFM or of the AIFs it manages. In other AIFMs, this may not be the case.

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

VII.Guidelines on proportionality

VII.I. Proportionality in general

23. According to the *Recommendation*, when taking measures to implement remuneration principles Member States should take account of the size nature and scope of financial undertakings' activities. In taking measures to comply with the remuneration principles AIFMs should comply in a way and to the extent that is appropriate to their size, internal organisation and the nature scope and complexity of their activities. In this way the Annex II to the AIFMD and the *Recommendation* envisage that provisions should operate in a way to enable an AIFM to take a proportionate approach to compliance with a remuneration principle.

24. Not all AIFMs should have to give substance to the remuneration requirements in the same way and to the same extent. Proportionality should operate both ways: some AIFMs will need to apply more sophisticated policies or practices in fulfilling the requirements; other AIFMs can meet the requirements of the AIFMD in a simpler or less burdensome way.

25. Although the remuneration principles in Annex II of the AIFMD are applicable to all AIFMs, proportionality may lead, on an exceptional basis and taking into account specific facts, to the disapplication of some requirements if this is reconcilable with the risk profile, risk appetite and the strategy of the AIFM and the AIFs it manages and within the limits set by the present guidelines. If AIFMs deem a disapplication for these requirements appropriate for their type of AIFM or *identified staff*, they should be able to explain to competent authorities, if requested, the rationale for every single requirement that is disapplied. Disapplication should never be automatically triggered on the basis of these guidelines alone: AIFMs should perform an assessment for each of the remuneration requirements that may be disapplied according to the following paragraph and determine whether proportionality allows them not to apply each individual requirement; if AIFMs come to the conclusion that no disapplication is possible for any of the disapplicable requirements, there should be no variation to the general application of such requirements to them.

26. The following are the only requirements that may be disapplied and then only if it is proportionate to do so:

- the requirements on the pay-out process for which guidelines are given below under Section XII.IV (Payout process). This means that some AIFMs, either for the total of their *identified staff* or for some categories within their *identified staff*, may decide not to apply the requirements on:
  - variable remuneration in *instruments*;
  - retention;
  - deferral;
  - ex post incorporation of risk for variable remuneration;

- the requirement to establish a remuneration committee for which guidelines are given below in Section X.II (Remuneration committee).

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

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

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

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

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

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

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

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

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

- the type of authorized activity (investment management functions listed in point 1 of Annex I of the AIFMD only or also the additional functions listed in point 2 of Annex I of the AIFMD and/or the additional services listed in Article 6(4) of the AIFMD);

- the type of investment policies and strategies of the AIFs the AIFM manages;

- the national or cross-border nature of the business activities (AIFM managing and/or marketing AIFs in one or more EU or non-EU jurisdictions); and

- the additional management of UCITS.

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

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

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

- The size of the obligations into which a risk taker may enter on behalf of the AIFM;

- The size of the group of persons, who have only collectively a material impact on the risk profile of the AIFM;

- The structure of the remuneration of the staff members (e.g. fixed salary with a variable remuneration vs. profit sharing arrangements), in particular, the following elements:

  - the amount of variable remuneration perceived;

  - the percentage of variable remuneration over the fixed remuneration.

VIII. Guidelines for AIFMs being part of a group

32. These guidelines apply in any case to any AIFM. In particular, there should be no exception to the application to any of the AIFMs which are subsidiaries of a credit institution of the sector-specific remuneration principles set out in the AIFMD and in the present guidelines.

33. Compliance with these sectoral remuneration principles by AIFMs which belong to banking, insurance, investment groups or financial conglomerates should be considered as ensuring the respect by such a group of the remuneration principles applicable to the group with specific regard to the AIFM.

IX. Guidelines on the financial situation of the AIFM

34. In order to guarantee ongoing compliance with the requirements of Article 9(1) to (3), 9(5) and 9(7) of the AIFMD, AIFMs should ensure that they maintain a prudent balance between sound financial situation and the award, pay out or vesting of variable remuneration.

35. The AIFM should ensure that its financial situation will not be adversely affected by:

1) the overall pool of variable remuneration that will be awarded for that year; and

2) the amount of variable remuneration that will be paid or vested in that year.

36. The fact that an AIFM is or risks becoming unable to maintain a sound financial situation, should be a trigger for, inter alia: a) reducing the variable remuneration pool for that year and b) the application of performance adjustment measures (i.e. *malus* or *clawback*) in that financial year[5]. Instead of awarding, paying out the variable remuneration or allowing it to vest, the net profit of the AIFM for that year and potentially for subsequent years should be used to strengthen its financial situation. The AIFM should not compensate for this at a later date by awarding, paying out or vesting a greater amount of variable remuneration than it otherwise would have done, unless it becomes evident in subsequent years that the AIFM's financial results justify such actions.

X. Guidelines on governance of remuneration

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

X.I. Management body

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

38. An AIFM's remuneration policy should encourage the alignment of the risks taken by its staff with those of the AIFs it manages, the investors of such AIFs and the AIFM itself; in particular, the remuneration policy should duly take into consideration the need to align risks in terms of risk management and exposure to risk.

39. The *supervisory function* should be responsible for approving and maintaining the remuneration policy of the AIFM, and overseeing its implementation. The remuneration policy should not primarily be controlled by executive members of the *supervisory function*. The *supervisory function* should also approve any subsequent material exemptions or changes to the remuneration policy and carefully consider and monitor their effects. Procedures to determine remuneration should be clear, well-documented and internally transparent. For example, proper documentation should be provided on the decision-making process, the determination of the *identified staff*, the measures used to avoid conflicts of interest, the risk-adjustment mechanisms used etc.

[5] See also Section XII (Guidelines on the specific requirements on risk alignment).

40. In the design and oversight of the AIFM's remuneration policies, the *supervisory function* should take into account the inputs provided by all competent corporate functions (i.e. risk management, compliance, human resources, strategic planning, etc.). As a result, those functions should be properly involved in the design of the remuneration policy of the AIFM.

41. Ultimately, the *supervisory function* should ensure that an AIFM's remuneration policy is consistent with and promotes sound and effective risk management. The remuneration policy should:

- be in line with the business strategy, objectives, values and interests of the AIFM,
- not encourage excessive risk taking as compared to the investment policy of the AIFs the AIFM manages, and
- enable the AIFM to align the interests of the AIFs and their investors with those of the *identified staff* that manages such AIFs, and to achieve and maintain a sound financial situation.

42. The *supervisory function* should ensure that the AIFM's overall corporate governance principles and structures, as well as their interactions with the remuneration system are considered within the design and implementation of an AIFM's remuneration policies and practices. The *supervisory function* should ensure that the following elements are taken into account: the clear distinction between operating and *control functions*, the skills and independence requirements of members of the *management body*, the role performed by internal committees, including the remuneration committee, the safeguards for preventing conflicts of interests and the internal reporting system and the related parties' transactions rules.

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

43. The remuneration of the members of the *management body* should be consistent with their powers, tasks, expertise and responsibilities.

44. Where appropriate considering the size of the AIFM, its internal organisation and the nature, scope and complexity of its activities, the *management body* should not determine its own remuneration. The *supervisory function* should determine and oversee the remuneration of the members of the *management body*. To the extent compatible with national law, the *supervisory function* should also specifically approve and oversee the remuneration of senior executives and staff members who receive the highest amounts of total remuneration within the AIFM.

45. For AIFMs which have a separate *supervisory function*, in order to properly address conflicts of interests, it may be more appropriate for members of the *supervisory function* to be compensated only with fixed remuneration. When incentive-based mechanisms are in place, they should be strictly tailored to the assigned monitoring and control tasks, reflecting the individual's capabilities and the achieved results. If *instruments* are granted, appropriate measures should be taken, such as *retention periods* until the end of the mandate, in order to preserve the independence of judgment of those members of the *management body*. For those AIFMs that given their size, internal organisation and the nature, scope and complexity of their activities do not have a separate *supervisory function*, the principle according to which members of the *supervisory function* may more appropriately be compensated only with fixed remuneration should apply only to the non-executive members of the *management body* that perform the tasks of the *supervisory function*.

X.I.III Shareholders' involvement

46. The approval of an AIFM's remuneration policy and decisions relating to the remuneration of members of the *management body*, may be assigned to the meeting of the shareholders of the AIFM, depending on the AIFM's characteristics or on the national rules in the jurisdiction in which the AIFM is established. The shareholders' vote may be either consultative or binding. To this end, shareholders should be provided with adequate information in order that they can make informed decisions.

47. The *supervisory function* remains responsible for the proposals submitted to the meeting of the shareholders of the AIFM, as well as for the actual implementation and oversight of any changes to the remuneration policies and practices.

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

48. The *supervisory function* should ensure that the implementation of the remuneration policy of the AIFM will be reviewed on an annual basis at a minimum. Such central and independent reviews should assess whether the overall remuneration system:

    - operates as intended (in particular, that all agreed plans/programs are being covered; that the remuneration payouts are appropriate, and that the risk profile, long-term objectives and goals of the AIFM are adequately reflected); and

    - is compliant with national and international regulations, principles and standards.

49. The relevant internal *control functions* (i.e. internal audit, risk management, compliance functions, etc.) as well as other key *supervisory function* committees (i.e. audit, risk, and nominations committees) should be closely involved in reviewing the remuneration system of the AIFM.

50. Where periodic reviews reveal that the remuneration system does not operate as intended or prescribed, the *supervisory function* should ensure that a timely remedial plan is put in place.

51. The periodic review of the implementation of the remuneration policies and practices may be, partially or totally, externally commissioned when appropriate according to proportionality. Larger and more complex AIFMs should have sufficient resources to conduct the review internally, though external consultants may complement and support the AIFM in carrying out such tasks where appropriate. In line with proportionality, smaller and less complex AIFMs may decide to outsource the entire review, by performing the review less frequently than annually or carrying out at least annually an internal assessment not amounting to a full independent review. In all cases, the *supervisory function* should remain responsible for the review of remuneration policies and practices and for ensuring that the results of the review are followed up; moreover, the relevant *control functions* should be closely involved.

X.II. Remuneration committee

X.II.I Setting up a remuneration committee

52. The setting up of a remuneration committee should be considered, as a matter of good practice, even by those AIFMs that are not obliged to set up such a committee under paragraph (3) of Annex II to the AIFMD.

53. In order to identify whether a remuneration committee is expected to be set up, the factors mentioned in Section VII (Guidelines on proportionality) need to be considered. When assessing whether or not an AIFM is significant, an AIFM should consider the cumulative presence of all the three factors (i.e. its size or the size of the AIFs it manages, its internal organisation and the nature, scope and complexity of its activities). An AIFM which is significant only with respect to one or two of the three above factors should not be required to set up a remuneration committee.

54. Without prejudice to the previous paragraph, specific (non-exhaustive) elements to be taken into account when determining whether or not to establish a remuneration committee are:

- whether the AIFM is listed or not;
- the legal structure of the AIFM;
- the number of employees of the AIFM;
- the AIFM's assets under management;
- whether the AIFM is also a UCITS management company;
- the provision of the services mentioned under Article 6(4) of the AIFMD.

55. Taking into account the above principles and having regard to all circumstances, the following are examples of AIFMs which may not need to establish a remuneration committee:

- AIFMs for which the value of the portfolios of AIFs that they manage does not exceed EUR 1.25 billion and not having more than 50 employees, including those dedicated to the management of UCITS and the provision of the services mentioned under Article 6(4) of the AIFMD;
- AIFMs which are part of banking, insurance, investment groups or financial conglomerates within which an entity is obliged to set up a remuneration committee which performs its tasks and duties for the whole group, provided that the rules governing such remuneration committee's composition, role and competences are equivalent to the ones set out in these guidelines and the existing remuneration committee takes responsibility for checking the compliance of the AIFM with the rules set out in these guidelines.

56. It should also be understood as mentioned above under paragraph 52 that AIFMs falling within the examples set out above may choose to set up a remuneration committee at their own initiative as a matter of good practice.

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

X.II.II Composition of the remuneration committee

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

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

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

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

X.II.III Role of the remuneration committee

62. The remuneration committee should:

- be responsible for the preparation of recommendations to the *supervisory function*, regarding the remuneration of the members of the *management body* as well as of the highest paid staff members in the AIFM;

- provide its support and advice to the *supervisory function* on the design of the AIFM's overall remuneration policy;

- have access to advice, internal and external, that is independent of advice provided by or to senior management;

- review the appointment of external remuneration consultants that the *supervisory function*, may decide to engage for advice or support;

- support the *supervisory function* in overseeing the remuneration system's design and operation on behalf of the *supervisory function*;

- devote specific attention to the assessment of the mechanisms adopted to ensure that:

  – the remuneration system properly takes into account all types of risks and liquidity and assets under management levels, and

  – the overall remuneration policy is consistent with the business strategy, objectives, values and interests of the AIFM and the AIFs it manages and the investors of such AIFs; and

- formally review a number of possible scenarios to test how the remuneration system will react to future external and internal events, and back test it as well.

63. The remuneration committee itself may be in charge of overseeing the central and independent review of the implementation of the remuneration policies and practices.

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

64. The remuneration committee should:

- have unfettered access to all data and information concerning the decision-making process of the *supervisory function*, on the remuneration system's design and implementation;

- have unfettered access to all information and data from risk management and *control functions*. Such access should not hinder the AIFM's ordinary activities;

- ensure the proper involvement of the internal control and other competent functions (e.g. human resources and strategic planning). The remuneration committee should collaborate with other board committees whose activities may have an impact on the design and proper functioning of remuneration policy and practices (e.g. risk audit, and nomination committees); and

- provide adequate information to the *supervisory function*, and, where appropriate, to the AIFM's shareholders' meeting about the activities performed.

X.III. Control functions

X.III.I Roles of control functions

65. AIFMs should ensure that *control functions* have an active role in the design, ongoing oversight and review of the remuneration policies for other business areas.

66. Working closely with the remuneration committee and the *supervisory function* and *management body*, the *control functions* should assist in determining the overall remuneration strategy applicable to the AIFM, having regard to the promotion of effective risk management.

67. The risk management function should assess how the variable remuneration structure affects the risk profile of the AIFM. It is good practice for the risk management function to validate and assess risk adjustment data, and to attend a meeting of the remuneration committee for this purpose.

68. The compliance function should analyse how the remuneration structure affects the AIFM's compliance with legislation, regulations and internal policies.

69. The internal audit function should periodically carry out an independent audit of the design, implementation and effects of the AIFM's remuneration policies.

X.III.II Remuneration of control functions

70. The remuneration level of staff in the *control functions* should allow the AIFM to employ qualified and experienced personnel in these functions.

71. If staff in *control functions* receives variable remuneration, it should be based on function-specific objectives and should not be determined solely by the AIFM-wide performance criteria.

72. The remuneration structure of *control functions* personnel should not compromise their independence or create conflicts of interest in their advisory role to the remuneration committee, *supervisory func-*

tion and/or *management body*. If remuneration of the *control functions* includes a component based on AIFM-wide performance criteria, the risk of conflicts of interest increases and, therefore, should be properly addressed.

73. For AIFMs which are required to have a remuneration committee, the remuneration of the senior staff responsible for heading the *control functions* should not be solely left to the *supervisory function*, but should be directly overseen by the remuneration committee. The remuneration of those staff members in compliance and risk management functions must be designed in a way that avoids conflict of interests related to the business unit they are overseeing and, therefore, should be appraised and determined independently. The remuneration committee should make recommendations to the *management body* on the remuneration to be paid to the senior officers in the risk management and compliance functions.

74. For AIFMs which are not required to have a remuneration committee, the remuneration of the senior staff responsible for heading the *control functions* should be overseen by the *supervisory function*.

75. Conflicts of interest which might arise if other business areas had undue influence over the remuneration of staff within *control functions* should be adequately managed. The need to avoid undue influence is particularly important where staff members from the *control functions* are embedded in other business areas. However, the views of other business areas should be sought as an appropriate part of the assessment process.

76. *Control functions* should not be placed in a position where, for example, approving a transaction, making decisions or giving advice on risk and financial control matters could be directly linked to an increase or decrease in their performance-based remuneration.

XI. Guidelines on the general requirements on risk alignment

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

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

78. The long-term strategy of the AIFM should include the overall business strategy and quantified risk tolerance levels with a multi-year horizon, as well as other corporate values such as compliance culture, ethics, behaviour towards investors of the AIFs it manages, measures to mitigate conflicts of interest etc. The design of the remuneration systems should be consistent with the risk profiles, rules or instruments of incorporation of the AIFs the AIFM manages and with the objectives set out in the strategies of the AIFM and the AIFs it manages and changes that could be decided in the strategies must be taken into account. AIFMs should, therefore, ensure that their remuneration systems are well designed and implemented. This includes, in particular, a proper balance of variable to fixed remuneration, the measurement of performance as well as the structure and, where appropriate, the risk-adjustment of the variable remuneration. Even a smaller or less sophisticated AIFM should ensure it makes the best possible attempt to align its remuneration policy with its interests and the interests of the AIFs it manages and their investors.

79. When developing their remuneration policy, AIFMs should give due consideration to how remuneration contributes to the prevention of excessive risk-taking, the efficiency of the AIFM and the AIFs it manages and the consistency of the remuneration policy with effective risk management.

80. Managers should consider conservative valuation policies and should not ignore concentration risks and risk factors, such as liquidity risk and concentration risk that could place the AIFs that the AIFM manages under stress at some point in the future. There are strong incentives not to follow such obligations if the variable part of the remuneration consists predominantly of *instruments* that are paid out immediately, without any deferral or ex post risk adjustment mechanisms (*malus* or *clawback*), and/or are based on a formula that links variable remuneration to current year revenues rather than risk-adjusted profit.

81. In order to counterbalance the dangers mentioned, risk management elements should be connected to the remuneration policy. When properly structured and implemented, variable remuneration can be an efficient tool to align the staff's interests with the interests of the AIFs that the AIFM manages. Having regard to the nature, scale and complexity of an AIFM, alternative approaches exist for connecting risk management elements to a remuneration policy.

XI.II. Discretionary pension benefits

82. Remuneration policy should cover all aspects of remuneration including fixed components, variable components, pension terms and other similar specific benefits. The pension policy (the fixed as well as the variable pension payments) should be aligned with the long term interests of the AIFM and the AIFs it manages.

83. In case of discretionary pension benefits, as part of the variable remuneration, a staff member should not retire or leave the AIFM with such benefits vested, with no consideration of the economic situation of the AIFs that the AIFM manages or risks that have been taken by the staff member in the long term.

84. In order to align this specific kind of pension benefits with the economic situation of the AIFs that the AIFM manages, discretionary pension benefits, where legally possible according to the relevant pension legislation, should be paid in the form of *instruments*.

85. In the context of a retirement, the discretionary pension benefits vested to the staff member should be subject to a five years *retention period*.

86. Where a staff member leaves the AIFM before retirement, the discretionary pension benefits should not be vested before a period of five years and should be subject to performance assessment and ex post risk adjustment before pay out.

XI.III. Severance pay

87. "Golden parachute" arrangements for staff members who are leaving the AIFM and which generate large payouts without any performance and risk adjustment should be considered inconsistent with the principle in Annex II, paragraph (1)(k) of the AIFMD. Any such payments should be related to performance achieved over time and designed in a way that does not reward failure. This should not preclude termination payments in situations such as early termination of the contract due to changes in the strategy of the AIFM or of the AIFs it manages, or in merger and/or takeover situations.

88. AIFMs should set up a framework in which severance pay is determined and approved, in line with the AIFM's general governance structures for employment. The framework should ensure that there is no reward for failure.

89. AIFMs should be able to explain to competent authorities the criteria they use to determine the amount of severance pay. It is good practice to defer any outstanding variable payments or long-term incentive plans and for these to mirror the original deferral schemes.

XI.IV. Personal hedging

90. Staff could be considered to have hedged away the risk of a downward adjustment in remuneration if the staff member enters into a contract with a third party which requires the third party to make payments directly or indirectly to the staff member that are linked to or commensurate with the amounts by which the staff member's variable remuneration has been reduced. The contract could for instance take the form of an option or any other derivative contract or other form of contract which provides any type of hedging for the staff member's variable remuneration.

91. In order to ensure the effectiveness of risk alignment, staff members should not buy an insurance contract which compensates them in the event of a downward adjustment in remuneration. As a general rule, however, this would not prohibit insurance designed to cover personal payments such as healthcare and mortgage instalments (provided that the mortgage coverage concerns health-related circumstances that would render the staff member unable to work in an equivalent position), although each case should be judged on its merits.

92. The requirement not to use personal hedging strategies or insurance to undermine the risk alignment effects embedded in their remuneration arrangements should apply to deferred and retained variable remuneration. AIFMs should maintain effective arrangements to ensure that the staff member complies with this requirement.

XII. Guidelines on the specific requirements on risk alignment

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

XII.I. Fully flexible policy on variable remuneration

94. Having a fully-flexible policy on variable remuneration implies not only that variable remuneration should decrease as a result of negative performance but also, that it can go down to zero in some cases. For its practical implementation, it also implies that the fixed remuneration should be sufficiently high to remunerate the professional services rendered, in line with the level of education, the degree of seniority, the level of expertise and skills required, the constraints and job experience, the relevant business sector and region. Individual levels of fixed remuneration should be indirectly impacted by the basic principle on risk alignment.

XII.II. Risk alignment of variable remuneration

XII.II.I Risk alignment process

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

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

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

XII.II.I.II Award process

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

XII.II.I.III Payout process

98. In order to align the actual payment of remuneration to the life-cycle and redemption policy of the AIFs managed by the AIFM and their investment risks, the variable remuneration should partly be paid upfront (short-term) and partly deferred (long-term). The short-term component should be paid directly after the award and rewards staff for performance delivered in the *accrual period*. The long-term component should be awarded to staff during and after the *deferral period*. It should reward staff for the sustainability of the performance in the long term, which is the result of decisions taken in the past. Before paying out the deferred part, a reassessment of the performance and, if necessary, a risk adjustment should be required in order to align variable remuneration to risks and errors in the performance and risk assessments that have appeared since the staff members were awarded their variable remuneration component. This so-called ex post risk adjustment should always be necessary, because at the time remuneration is awarded, the ultimate performance cannot be assessed with certainty.

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

XII.II.II.I Time horizon

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

100. The right balance between accrual and payout periods should depend on the type of AIFs managed by the AIFM and on the type of business and activity developed by the staff member. However, the use of multi-year *accrual periods* is more prudent since the assessment of the performance can take into account with certainty more risks that have materialized since the beginning of the *accrual period*.

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

101. Performance-related remuneration should include parameters linked to the risks and performance of the AIF concerned and of the business unit of the AIFM in addition to the risks and performance of the individual activities. Thus, the amount of variable remuneration a staff member is eligible for should be determined by his/her individual performance, the performance of his/her business line or the AIF concerned and the performance of the AIFM. The relative importance of each level of the performance criteria should be determined beforehand and adequately balanced to take into account the position or responsibilities held by the staff member.

102. To have the greatest impact on staff behaviour, the variables used to measure risk and performance should be linked as closely as possible to the level of the decisions made by the staff member that is subject to the risk adjustment. Performance criteria should include achievable objectives and measures on which the staff member has some direct influence. For example, for senior executives, AIFMs may design the remuneration policies to include financial measures based on the performance of all the AIFs managed by the AIFM or the entire AIFM, or for performance and risks of units, or decisions that were determined by senior executive strategy. In contrast, variables for the manager of a business unit ideally would be for performance and risk of that unit.

XII.II.II.III Quantitative and qualitative measures

103. The risk alignment process should use a mix of quantitative and qualitative approaches (e.g. measurement of performance or risk; setting of the pool and adjustment to risks).

104. Quantitative measures may have some advantages in terms of transparency if they are pre-defined. They can, therefore, influence the behaviour of staff more directly. However, quantitative measures or criteria are not sufficient to measure all risk or performance or to risk adjust remuneration. To complete the measurement and adjustment of risk or performance, AIFMs should also rely on qualitative approaches.

XII.II.II.IV Judgemental measures

105. Whenever judgement is used for a risk and performance measurement or risk adjustment, there should be:

- a clearly written policy outlining parameters and key considerations on which the judgement will be based;

- clear and complete documentation of the final decision regarding risk and performance measurement or risk adjustment;

- involvement of relevant *control functions* experts;

- appropriate levels of approval obtained, e.g. of the *management body* or *supervisory function*, or of the remuneration committee; and

- consideration of the personal incentives of the manager making the judgement, e.g. by using scorecards.

106. For both quantitative and qualitative measures, AIFMs should be prepared to disclose and reproduce any judgmental elements incorporated into their risk alignment process. AIFMs should also provide detailed information to the competent authority if the final outcome after applying judgmental measures is significantly different from the initial outcome using pre-defined measures.

XII.II.III Risk measurement

107. AIFMs should take into account all risks, whether on or off balance sheet, differentiating amongst risks affecting the AIFM, the AIFs it manages, business units and individuals. Risk identification and quantification at the AIF level can be found in the risk management policy that the AIFM is required to establish, implement and maintain and which identifies all the relevant risks to which the AIFs they manage are or might be exposed to. AIFMs should also determine whether measures they are using for risk adjustment include 'difficult-to-measure' risks, such as reputational and operational risk.

108. In order to take into account all material risks, AIFMs should use the same risk measurement methods as used in the risk management policy established for the AIFs managed by the AIFM. Furthermore, AIFMs should also take into account (i) the risks arising from the additional management of UCITS and from the services provided under Article 6(4) of the AIFMD and (ii) the potential professional liability risks that AIFMs have to cover through either additional own funds or professional indemnity insurance according to Article 9(7) of the AIFMD.

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

XII.II.IV Performance measurement

XII.II.IV.I Qualitative/Quantitative measures

110. AIFMs should use both quantitative (financial) as well as qualitative (non-financial) criteria for assessing individual performance.

111. The appropriate mix of quantitative and qualitative criteria should depend on the tasks and responsibilities of the staff member. In all cases, the quantitative and qualitative criteria and the balance between them should be specified and clearly documented for each level and category of staff.

112. Quantitative measures should cover a period which is long enough to properly capture the risk of the staff member's actions. Examples of quantitative performance measures used in the asset management sector which fulfil the abovementioned provisions are the internal rate of return (IRR), earnings before interest, taxes, depreciation and amortization (EBITDA), Alpha Ratio, absolute and relative returns, Sharpe Ratio and assets raised.

113. In addition to quantitative performance measures, variable remuneration awards should also be sensitive to the staff's performance with respect to qualitative (non-financial) measures. Examples are the achievement of strategic targets, investor satisfaction, adherence to risk management policy, compliance with internal and external rules, leadership, management, team work, creativity, motivation and cooperation with others business units and with *control functions*. Such determined qualitative criteria could rely on compliance with risk control measures such as limits and audit results. Negative non-financial performance, in particular unethical or non-compliant behaviour, should override any good financial performance generated by a staff member and should diminish the staff member's variable remuneration.

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

114. Absolute performance measures are measures set by the AIFM on the basis of its own strategy, which includes the risk profile and risk appetite of the AIFM and of the AIFs it manages, as further developed down through the chain of business levels. Such measures help to minimize the risk that remuneration is awarded that is not justifiable by the AIFM's or AIFs' performance. They also tend to create long term incentives. However, it may be difficult to calibrate absolute performance measures, especially for new entrants or for new kinds of financial activities (with difficult-to-measure risks) linked to the management of AIFs.

115. Relative performance measures are measures that compare performance with peers, either 'internal' peers (i.e. within the organization) or 'external' (similar AIFMs). Relative performance measures are easier to set because the benchmark is readily available. However, such measures pose the risk that variable remuneration that is not supported by long-term success of the business unit or the AIFM or the AIFs it manages will be paid out anyway. In a period of sector wide positive financial performances, it could lead to 'raising the bid' and/or 'herd' mentality, providing incentives to take on excessive risk. In a downturn economic cycle where most AIFMs and AIFs may perform poorly, relative measures may nonetheless lead to positive outcomes (and thus to an insufficient contraction of the AIFM's total variable remuneration) even if absolute performance has deteriorated compared to previous periods.

116. Internal (e.g. profits) and external (e.g. share price) variables come with both advantages and disadvantages that should be balanced carefully. Internal performance measures are able to generate more involvement of the staff members if they can influence the outcome by their own behaviour. This is especially true if the performance measures are fixed at the level of the business unit (rather than on the AIFM-wide level). Furthermore, it is easier to introduce risk adjustment features for internal

measures, because the link with in-house risk management techniques is more readily available. On the other hand, such measures can be manipulated and can create distorted outcomes on a short-term basis. External performance measures are less subject to this danger of manipulation, although attempts to artificially increase the stock price (probably only relevant for top executives) may still occur.

XII.III. Award process

XII.III.I Setting and allocation of pools

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

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

118. In determining remuneration pools or individual awards, AIFMs should consider the full range of current and potential (unexpected) risks associated with the activities undertaken. Performance measures used in setting the remuneration pool may not fully or adequately capture risks undertaken, thus, ex-ante adjustments should be applied to ensure that the variable remuneration is fully aligned with the risks undertaken. AIFMs should establish whether the risk adjustment criteria they are using take into consideration severe risks or stressed conditions.

119. AIFMs should determine to what level they are able to risk adjust their variable remuneration calculations quantitatively – whether to the business unit level or further down the line such as to a trading desk level, if any, or even to an individual level. AIFMs should determine the level of granularity that is suitable for each level.

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

120. In order to have a sound and effective remuneration scheme, AIFMs should use a number of different quantitative measures for their risk adjustment process. Normally, these measures should be based on an overarching risk adjustment framework.

121. When measuring the profitability of the AIFM and its business units as well as the AIFs it manages, the measurement should be based on net revenue where all direct and indirect costs related to the activity are included. AIFMs should not exclude IT costs, research costs, legal fees, marketing costs, and costs for outsourced activities. AIFMs should make sure that remuneration pools are not being "back-fitted" to meet remuneration demands.

122. The quantitative ex-ante risk adjustments made by AIFMs should largely rely on existing measures within the AIFMs, generally used for other risk management purposes. As a result, the limitations and potential issues related to these measures should also be relevant for the remuneration process. The risk adjustments used should benefit from the experience gained when dealing with these risks in other contexts and should be challenged like any other component of the risk management process.

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

123. Qualitative risk elements should be considered by AIFMs. Qualitative ex-ante adjustments could take place while setting AIFM-wide and business unit remuneration pools or when determining or allocat-

ing individuals' remuneration. Qualitative ex-ante risk adjustments are common at pool and individual levels, contrary to quantitative adjustments which tend to be mostly observed only at the pool level.

124. AIFMs make qualitative risk adjustments when allocating/determining individuals' remuneration through assessments that may explicitly include risk and control considerations such as compliance breaches, risk limit breaches and internal control breakdowns (e.g. based on internal audit results).

XII.IV. Pay-out process

XII.IV.I Non-deferred and deferred remuneration

125. Although remuneration is aligned through ex-ante risk adjustments, due to uncertainty, ex-post risk adjustments should be put in place to keep incentives fully aligned. This can only be done if part of the remuneration has been deferred.

126. A deferral schedule is defined by different components: (a) the time horizon of the deferral, (b) the proportion of the variable remuneration that is being deferred, (c) the speed at which the deferred remuneration vests (*vesting point*), (d) the time span from accrual until the payment of the first deferred amount and (e) the form of the deferred variable remuneration. AIFMs can differentiate their deferral schedules by varying these five components. A stricter than necessary application for one component may influence the supervisory scrutiny for another component. In any case, the way in which an AIFM combines these components should lead to a meaningful deferral schedule, in which the long-term risk alignment incentives are clear.

XII.IV.I.I Time horizon and vesting

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

XII.IV.I.II Vesting point

128. Pro rata vesting (or payment) means that for a *deferral period* of, for example, three years one-third of the deferred remuneration vests at the end of each of the years n+1, n+2 and n+3, , where 'n' is the moment at which performance is measured to determine the variable remuneration. Annex III includes a diagram showing an example of a pro rata spreading for a deferral scheme in which 60% of the variable remuneration is deferred (first diagram).

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

XII.IV.I.III Proportion to be deferred

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

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

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

XII.IV.II Cash vs. instruments

XII.IV.II.I Types of instruments

132. Staff should only be remunerated using *instruments* if it does not trigger interest misalignment or encourage risk-taking which is inconsistent with the risk profiles, rules or instruments of incorporation of the relevant AIF(s). A misalignment of interests might arise in relation to *identified staff* that are not directly involved in portfolio management. Rewarding those individuals with *instruments* of AIFs might represent a conflict of interest with their duty to perform independently their functions relating to those AIFs.

133. For AIFMs managing several AIFs, in order to align the interests of the *identified staff* with those of the relevant AIF(s), when possible according to the organisation of the AIFM and the legal structure of the managed AIF(s), the *identified staff* should receive *instruments* related mainly to the AIF(s) in relation to which they perform their activities, provided that no excessive concentration in the holding of the *instruments* – facilitating an excessive risk-taking by the *identified staff* – is created. E.g. if one member of the staff of an AIFM which manages three AIFs (x, y and z) performs his/her activities for AIF x only, in principle that member of the staff should receive *instruments* related mainly to AIF x; however, should the application of such principle lead to a situation where the *identified staff* has too strong an interest in the AIF for which they perform their activities, the AIFM should consider enlarging the spectrum of *instruments* paid in order to prevent an excessive risk-taking from the *identified staff* in relation to the relevant AIF(s).

134. The availability of *instruments* is dependent on the legal structure of the AIFs concerned and their rules or instruments of incorporation. For AIFs in the legal form of a corporate fund, shares or share-linked instruments should be able to align the interests of the shareholders and staff. Share-linked instruments are those whose value is based on a market value appreciation of the stock and that have the share price as a reference point, e.g. stock appreciation rights, types of synthetic shares.

135. For AIFs which are common funds, *instruments* should consist of units of the AIF concerned, or equivalent ownership interests; for many of these AIFs, share-linked instruments are not an option due to their legal form. Even for unlisted corporate funds it may be difficult to determine a share price that represents the AIF's net asset value between two (at least annual) net asset value calculations. In

these cases alternative instruments, may be used that reflect the AIF's value and have the same intended effect as share-linked instruments.

136. Neither dividends nor interest should be paid on *instruments* before vesting.

XII.IV.II.II Retention policy

137. A retention policy should be determined by the AIFM in the remuneration policy. The AIFM should be able to explain how the retention policy relates to other risk alignment measures in the total remuneration policy and should explain whether and how they differentiate between *instruments* paid upfront and deferred *instruments*.

138. *Retention periods*, as the most important element of the retention policy, should be coupled with the vesting of *instruments*. The *retention period* is independent from the *deferral period*. This means that, in order to meet the requirement of a minimum *deferral period* of three to five years (where applicable), the *retention period* counts for nothing. The *retention period* can last for a shorter or longer period than the *deferral period* applied to the *instruments* that are not paid up front.

139. In the case of upfront *instruments*, *retention periods* are the only mechanism available to emphasize the difference between cash paid upfront and *instruments* awarded upfront in order to align incentives with the longer-term interests of the AIFM and the AIFs it manages and the investors of such AIFs.

140. In the case of deferred *instruments*, the *retention periods* come after every vested portion (the second diagram in Annex III illustrates these concepts). Competent authorities may determine whether the *retention periods* proposed by the AIFM are sufficient and appropriate.

141. The minimum *retention period* should be sufficient to align incentives with the longer term interests of the AIFM, of the AIFs it manages and of their investors. Different factors may tend to suggest that this period could be longer or shorter. Longer *retention periods* should be applied for staff with the most material impact on the risk profile of the AIFM and the AIFs it manages.

142. It is possible that a *retention period* lasts for a shorter period than the *deferral period* applied to the *instruments* that are not paid up front. However, as an example of proportionality, for their most senior staff, large and complex AIFMs should consider the use of a *retention period* for upfront paid *instruments* that goes beyond the *deferral period* for the deferred *instruments*.

143. *Instruments* should be valued on the date of the award (at the end of the *accrual period*) of these *instruments*. This value is the basis for the determination of the initial number of *instruments* and for later ex-post adjustments to the number of *instruments*.

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

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

145. The requirement in paragraph (1)(m) of Annex II to the AIFMD to apply the minimum of 50% (where applicable) to both the portion of the variable remuneration component that is deferred and the por-

tion of the variable remuneration component not deferred means that the 50% minimum threshold for *instruments* should be applied equally to the non-deferred and the deferred part; in other words, AIFMs should apply the same chosen ratio between *instruments* and cash for their total variable remuneration to both the upfront and deferred part.

Examples:

- Good practice: For a certain category within its *identified staff*, an AIFM establishes a 50 *instruments* / 50 cash ratio for the variable remuneration, combined with a 60% deferral schedule (that is, 40% is non-deferred variable remuneration). This results in an upfront payment in *instruments* of 20 (i.e. 50% of 40) and 20 in cash. The deferred part consists of 30 in *instruments* and 30 in cash.

- Good practice: For a certain category within its *identified staff*, an AIFM establishes a 70 *instruments* / 30 cash ratio for the variable remuneration, combined with a 40% deferral schedule (that is, 60% is non-deferred variable remuneration). This results in an upfront payment in *instruments* of 42 (i.e. 70% of 60) and 18 in cash. The deferred part consists of 28 in *instruments* and 12 in cash.

- Poor practice: If for a certain category within its *identified staff*, an AIFM were to establish a 50 *instruments* / 50 cash ratio for the variable remuneration, combined with a 40 % deferral scheme, the AIFM cannot decide to pay 50 in cash up front and 10 in *instruments*, leading to a deferred pay out of 40 in *instruments*.

- Poor practice: If for a certain category within its *identified staff*, an AIFM were to establish a 70 *instruments* / 30 cash ratio for the variable remuneration, combined with a 50% deferral scheme, the AIFM cannot decide to pay 50 upfront in *instruments* and 0 in cash, leading to a deferred pay out of 20 in *instruments* and 30 in cash.

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

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

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

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

148. An “ex-post risk adjustment” should imply that once an initial variable remuneration component has been awarded to the staff member, and an upfront part has already been paid, the AIFM is still able to adjust, by way of a reduction, the variable remuneration as time goes by and the outcomes of the staff member’s actions materialize.

149. An ex-post risk adjustment is an explicit risk alignment mechanism through which the AIFM itself adjusts remuneration of the staff member by means of *malus* or *clawback* clauses (e.g. by lowering cash remuneration or by awarding a lower number of *instruments*). Ex-post risk adjustment should always be performance-related: techniques that are, for example, based on the amount of dividends or

the evolution of the share price are not sufficient because the link to the performance of a staff member is not sufficiently direct. Therefore, ex-post risk adjustments are frequently also called "performance adjustments" because they are a response to the actual risk outcomes of the staff member's actions. Performance measures taken at this stage should allow the AIFM to perform an analysis (similar to back testing) as to whether its initial ex-ante risk adjustment was correct. AIFMs should ensure there is a link between the initial performance measurement and the back-testing. Thus, the extent to which an ex-post risk adjustment is needed depends on the quality (accuracy) of the ex-ante risk adjustment.

150. The effect of *maluses* should not be inflated by paying out artificially high interest (above market rates) on the cash deferred parts to the staff member. *Maluses* operate by affecting the *vesting point* and cannot operate after the end of the *deferral period*. Furthermore, *clawback* can be a method for achieving an ex-post risk adjustment on variable remuneration.

151. AIFMs may utilize specific criteria whereby *malus* (to both the cash portion and the *instruments* portion of deferred remuneration) and *clawbacks* would apply. Such criteria should, for example, include:

a. evidence of misbehaviour or serious error by the staff member (e.g. breach of code of conduct, if any, and other internal rules, especially concerning risks);

b. whether the AIF and/or the AIFM and/or the business unit subsequently suffers a significant downturn in its financial performance (specific indicators should be used);

c. whether the AIF and/or the AIFM and/or the business unit in which the staff member works suffers a significant failure of risk management;

d. significant changes in the AIFM's overall financial situation.

152. A *clawback* should typically operate in the case of established fraud or misleading information. Where applicable, AIFMs should include *clawback* clauses in addition to these cases e.g. for remuneration received in breach of the AIFMD and/or these guidelines.

153. Ex-post risk adjustment could be based on both quantitative measures and informed judgment.

154. To have the greatest impact on staff's incentives, the variables should measure outcomes as close as possible to the level of the decisions made by the staff member that is subject to the ex-post explicit adjustment. For example, variables for senior executives probably should be for outcomes for the AIFM as a whole, or for outcomes of units or decisions that were determined by senior executive strategy. In contrast, variables for the head responsible for a business unit ideally would reflect outcomes of that unit.

XII.IV.III.II Implicit adjustments

155. When the variable remuneration takes the form of *instruments*, the final payout to the staff member will depend partly on market prices due to fluctuations during the *deferral* or *retention period*. This implicit adjustment of remuneration is not related to any explicit decision of the AIFM, but is inherent to the form that is used for paying out. Under no circumstances should the evolution of the net asset value of the AIF or, for listed AIF, the evolution of the share price be considered sufficient as a form of ex-post risk adjustment. There should always be a form of explicit risk adjustment on the initiative of

the AIFM. For non-senior staff in particular, there may be no direct relation between their decisions and the value of the AIF.

156. A *retention period* on its own can never be sufficient to design an ex-post risk adjustment for *instruments* and should not be a substitute for a longer *deferral period*.

XII.IV.III.III Possibility of upward revisions

157. The market price of *instruments* can go up, so implicitly they are subject to movements in their value in both directions.

158. Under no circumstances should the explicit ex- post risk adjustment (both for cash and *instruments*) lead to an increase of the deferred part.

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

159. While it is necessary to have regard to all the relevant circumstances case-by-case, the guidelines under Sections XII.II (Risk alignment of variable remuneration), XII.III (Award process) and XII.IV (Pay-out process) may be met where :

a) an AIFM must first return all capital contributed by the investors of the AIF it manages and an amount of profits at a previously agreed hurdle rate (if any) to the investors of the AIF, before the *identified staff* of the AIFM may receive any variable compensation for the management of the relevant AIF; and

b) the compensation received by the *identified staff* of the AIFM is subject to *clawbacks* until the liquidation of the relevant AIF.

XIII. Guidelines on disclosure

XIII.I. External disclosure

XIII.I.I Specific and general requirements on disclosure

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

161. Without prejudice to confidentiality and applicable data protection legislation, AIFMs should disclose detailed information regarding their remuneration policies and practices for members of staff whose professional activities have a material impact on the risk profile of the AIFs the AIFM manages. AIFMs should also provide general information about the basic characteristics of their AIFM-wide remuneration policies and practices.

162. The *Recommendation*'s remuneration disclosures may be made on a proportionate basis and the overall remuneration proportionality principle will apply to the type and amount of information disclosed. Small or non-complex AIFMs/AIFs should only be expected to provide some qualitative information and very basic quantitative information where appropriate. In practice, this could mean that such AIFMs/AIFs are not expected to provide all the information under paragraph (8) of the *Recommendation*. AIFMs should disclose how they have applied proportionality.

163. The disclosure should be published on at least an annual basis and as soon as practicable after the information becomes available.

164. The disclosure made in accordance with this Section should be without prejudice to the disclosure obligations vis-à-vis prospective investors under Article 23 of the AIFMD.

XIII.I.II Policy and practices

165. The disclosure report should set out the decision-making process used to determine the remuneration policy for the individuals to which it applies. This may include the governance procedure relating to the development of the remuneration policy and should include information about the bodies (including their composition and mandate), such as the remuneration committee or external consultants, which played a significant role in the development of the remuneration policy. AIFMs should outline the role of all relevant stakeholders involved in the determination of the remuneration policy. Additionally, the disclosure should include a description of the regional scope of the AIFM's remuneration policy, the types of staff considered as material risk takers and the criteria used to determine such staff.

166. The report should include information on how pay and performance are linked. Such information should include a description of the main performance metrics used for: the AIFM, top-level business lines, and for individuals (i.e. scorecards). AIFMs should disclose information relating to the design and structure of remuneration processes, such as the key features and objectives of the remuneration policy and how the AIFM ensures that staff members in *control functions* are remunerated independently of the businesses they oversee. The report should also include a description of the different forms of variable remuneration used (i.e. cash, equity, options, other capital instruments, and long-term incentive plans) and should include the rationale for using these different forms and for allocating them to different categories of staff. Additionally, the report should include a discussion of the parameters used to allocate deferred and non-deferred remuneration for different staff categories.

167. Disclosure reports should describe how the AIFM takes into account current and future risks to which they are exposed when implementing remuneration methodologies and what these risks are. Also, AIFMs should describe the measures used to take account of these risks and the ways in which these measures affect remuneration. In addition, AIFMs should disclose the ways in which they seek to adjust remuneration to take account of longer-term performance - as in the AIFM's policy on deferral, vesting and performance adjustment.

168. The quantitative (financial) as well as qualitative (non-financial) criteria used by AIFMs for assessing individual performance which are relevant for determining the remuneration policies and practices and are described under Section XII.II.IV.I (Qualitative/Quantitative measures) should also be disclosed in the disclosure reports.

169. The disclosure should be produced and owned by the *management body* that has the ultimate sign-off on remuneration decisions.

XIII.II. Internal disclosure

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

Annex I

Correlation table Recommendation/AIFMD

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

Annex II

Mapping of the remuneration principles included in the AIFMD

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

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

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

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

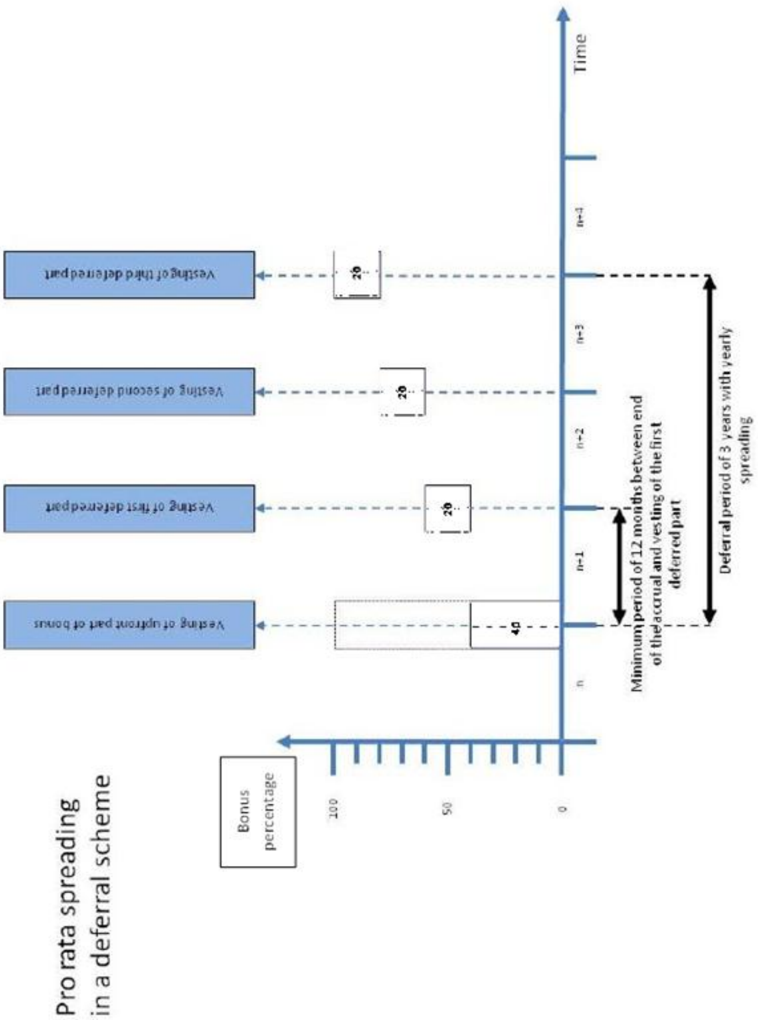
	shall be at least three to 5 years unless the life cycle of the AIF concerned is shorter; remuneration payable under deferral arrangements vests no faster than on a pro-rata basis; in the case of a variable remuneration component of a particularly high amount, at least 60 % of the amount is deferred;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

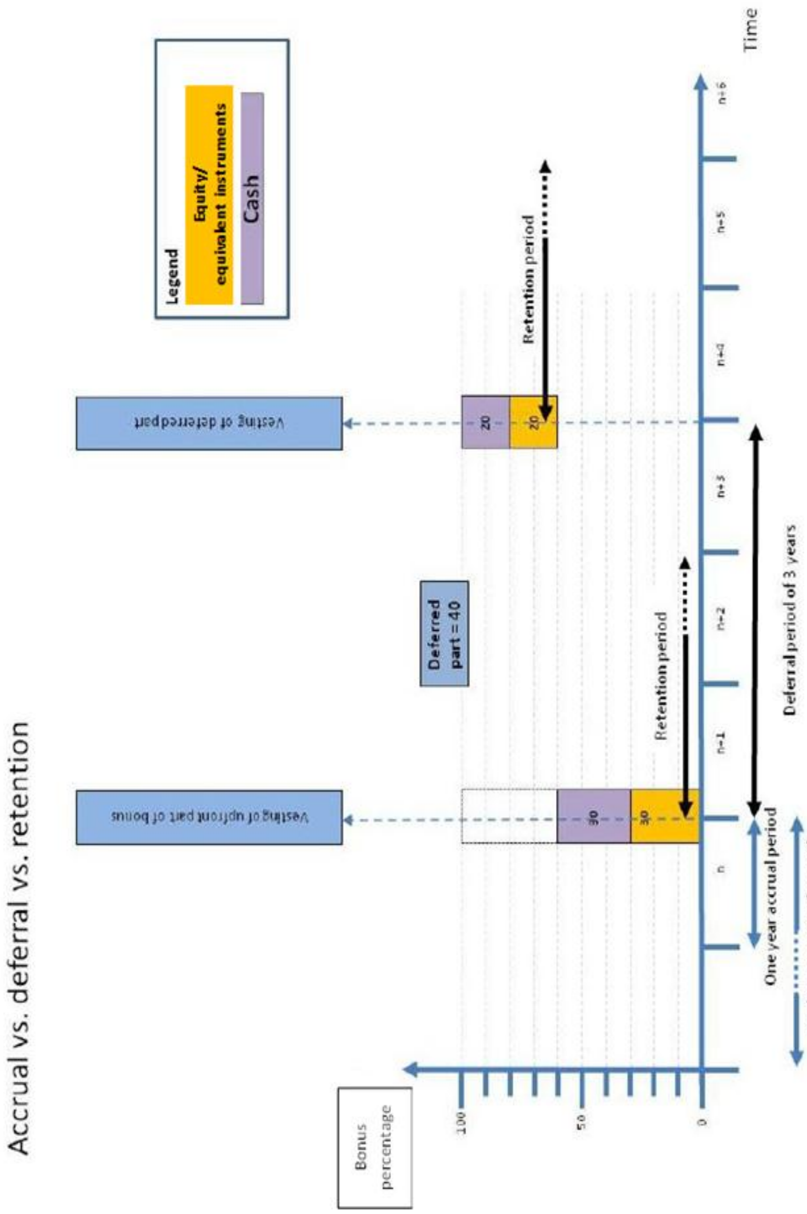
	period;			
Par. 1 (q)	staff are required to undertake not to use personal hedging strategies or remuneration- and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements;	90 – 92	Only to the *identified staff*, but AIFM-wide strongly recommended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

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

Annex III

Schematic overview of some deferral mechanisms




Accrual vs. deferral vs. retention
Bonus percentage
100
50
0
Vesting of upfront part of bonus
Vesting of deferred part
Deferred part = 40
30
30
20
20
Retention period
Retention period
Legend
Equity/ equivalent instruments
Cash
Time
n
n+1
n+2
n+3
n+4
n+5
n+6
One year accrual period
Multi year accrual period
Deferral period of 3 years