

September 27, 2012

Mr. Steven Maijoor, Chair
European Securities and Markets Authority
103 Rue de Grenelle
75007 Paris
France

Re: ESMA's Consultation Paper on Guidelines on Sound Remuneration Policies under the AIFMD

Dear Mr. Maijoor,

The Investment Company Institute ("ICI")¹ and ICI Global² appreciate the opportunity to comment on the European Securities and Markets Authority's ("ESMA's") Consultation Paper on Guidelines on Sound Remuneration Policies under the AIFMD (the "Paper").³ Members of ICI and ICI Global are, in many instances, part of large financial services organizations operating in multiple jurisdictions around the globe, including Europe. We support the goal of ensuring that asset management firms have remuneration policies and practices that are consistent with and promote sound and effective risk management and do not encourage inappropriate risk-taking (*e.g.*, risk-taking that is inconsistent with the risk profiles or instruments of incorporation of the funds they manage). Policymakers must, however, take account of the fact that, unlike certain other financial institutions,

¹ ICI is the national association of U.S. registered investment companies, including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts. ICI encourages adherence to high ethical standards, promotes public understanding, and otherwise advances the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.3 trillion and serve over 90 million shareholders.

² ICI Global is the global association of regulated funds publicly offered to investors in leading jurisdictions worldwide. ICI Global seeks to advance the common interests and promote public understanding of global investment funds, their managers, and investors. Members of ICI Global manage total assets in excess of US \$1 trillion.

³ See ESMA/2012/406, Consultation Paper: Guidelines on sound remuneration policies under the AIFMD (June 2012), available at <http://www.esma.europa.eu/system/files/2012-406.pdf>.

asset managers are both agents and fiduciaries that are engaged specifically to take disclosed risks with their clients' assets, and in the case of regulated funds, only as permitted under fund laws (*e.g.*, limits on type of investments, leverage, diversification, concentration, etc.). This directed risk taking on behalf of clients is markedly different from taking risks with a financial services firm's own assets.

It is paramount that remuneration rules do not blunt the motivation or incentives for asset managers to carry out their responsibilities and take appropriate risks as directed by their clients. Further, given the global nature of investing and the asset management business, the Guidelines should afford firms adequate flexibility to appropriately tailor their remuneration policies in order to attract qualified and talented staff in local markets around the world.

Our comments focus on the following main issues:

- Fees and commissions received by intermediaries and service providers
- Scope of identified staff
- Proportionality
- Alternative investment fund managers ("AIFMs") being part of a group

Fees and Commissions Received by Intermediaries and Service Providers

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

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

We believe that ESMA has appropriately proposed not to apply the remuneration principles to payments received by intermediaries and outside service providers, including entities to which an activity has been delegated by the AIFM. We agree that ESMA's position is consistent with Section 1.5 of Recommendation 2009/384/EC (the "Recommendation"), which ESMA has been directed to take

into account when drafting these principles.⁴ Specifically, the Recommendation provides that fees and commissions received by intermediaries and external service providers in the case of outsourced activities should not be addressed, because the compensation practices relating to such fees and commissions are covered by other applicable regimes.⁵

Application of the remuneration principles to intermediaries and service providers is not contemplated by the Alternative Investment Fund Managers Directive (“AIFMD”). However, the AIFMD framework is such that the principles will inform an AIFM’s arrangements with, and oversight of, third parties. Ensuring appropriate delegation of tasks to third parties is a key element of the AIFMD and the AIFMD makes it very clear that, if an AIFM delegates to third parties the task of carrying out functions on its behalf, the AIFM remains ultimately responsible under the AIFMD. Specifically, Article 20(e) provides that “the delegation must not prevent the effectiveness of supervision of the AIFM, and, in particular, must not prevent the AIFM from acting, or the AIF from being managed, in the best interests of its investors.” Article 20(f) further provides that, if there is delegation, the AIFM must be able to demonstrate that “...the AIFM is in a position to monitor effectively at any time the delegated activity, to give at any time further instructions to the delegate and to withdraw the delegation with immediate effect when this is in the interest of investors.”⁶ In addition, as is noted in the Paper, 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.⁷ Together, these provisions adequately address any concerns arising from payments to third parties with respect to services provided to an alternative investment fund (“AIF”).

Given the direction in the Recommendation and the responsibilities of the AIFM regarding the use and oversight of service providers, we believe the AIFMD remuneration requirements should not apply to fees and commissions received by intermediaries and services providers, as well as entities to whom an activity has been delegated by the AIFM.

⁴ See Article 13(2) of the AIFMD. The Recommendation sets out general principles applicable to remuneration policy in the financial services sector and applies to all financial undertakings operating in the financial services industry.

⁵ In particular, the Recommendation notes Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments and Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation. See paragraph (9) of the Recommendation.

⁶ As an additional safeguard, where there is delegation of portfolio management or risk management to a third-country entity, Article 20(e) of the AIFMD requires cooperation between competent authorities of the home Member State of the AIFM and the third-country supervisory authority (*e.g.*, co-operation agreements).

⁷ See Paper Section IV, paragraph 23.

Scope of Identified Staff

Q7: Do you agree with the categories of staff identified above which should be subject to the remuneration principles set out in the Guidelines? If not, please state the reasons for your answer and also suggest an alternative approach.

The organizational structure of an AIFM, and the responsibilities allocated to various staff within an organization and, in turn, such staff's ability to impact the risk profile of the AIFM or the AIF it manages, varies greatly among organizations. The Guidelines should reflect these differences and maintain sufficient flexibility for firms when implementing the requirements.

ESMA explicitly states in the proposed Guidelines that identifying the members of staff to whom the specific requirements of the Guidelines will apply is the responsibility of an AIFM and that an AIFM should be able to demonstrate to competent authorities how it assessed and selected the Identified Staff.⁸ The proposed Guidelines further provide that an AIFM must define what constitutes materiality within the context of its organization and the AIFs it manages when it assesses the materiality of influence on the AIFM's risk profile or on an AIF it manages.⁹ We believe that these guiding principles, along with guidance on categories of staff that may typically fall under Identified Staff, would be sufficient in the Guidelines.

We disagree with ESMA's proposed approach of requiring an AIFM to include certain categories of staff as the Identified Staff unless it is demonstrated that they have no material impact on the AIFM's risk profile. ESMA should, instead, include these categories of employees only as examples of staff that would normally be expected to be included as Identified Staff, without a presumption of inclusion. These examples would indicate to AIFMs the types of staff that ESMA anticipates would be Identified Staff, but considering the wide range of types of AIFMs and AIF, and the vast differences in organization and structure of these entities, would leave firms sufficient flexibility to make the determination of who is Identified Staff as contemplated under the AIFMD.

Proportionality

Q9: Do you agree with the clarifications proposed above for the application of the proportionality principles in relation to the different criteria (i.e. size, internal organization and nature, scope and

⁸ See Paper Section IV, paragraph 30.

⁹ See Paper Section IV, paragraph 31.

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complexity of activities)? If not, please state the reasons for your answer and also suggest an alternative approach.

The principle of proportionality has rightfully been incorporated by European regulators into the development of remuneration guidelines and codes for various types of entities in the financial services industry, such as the CEBS Guidelines and the U.K. FSA's Remuneration Code. This principle has allowed firms to implement such codes and guidelines in a way that is appropriate for the size and internal organization of the firm, and the nature and scope of the firm's activities.

The Commission has recognized the importance of affording firms the flexibility to apply the remuneration provisions of the AIFMD in a manner that accommodates differences among firms, by explicitly stating that "AIFM shall comply with [the principles in Annex II] in a way and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities."¹⁰ This language, in our view, affords sufficient flexibility to allow certain AIFM, in consideration of their organization and activities, to disregard strict application of certain requirements specified in Annex II.

The discussion of proportionality in paragraph 36 of the Paper and the difference in this text from the parallel text in the CEBS Guidelines, however, has raised a concern that ESMA envisions AIFM having the flexibility to proportionately tailor application of a particular requirement only in a manner that results in a more stringent requirement or threshold. ESMA states that "These Guidelines set the limits on which requirements can potentially be applied in a tailored manner insofar as such tailoring should not be understood as allowing an AIFM to disregard any of the requirements of Annex II of the AIFMD." In contrast, the CEBS Guidelines allow certain requirements to be "neutralized," which has been interpreted to mean that a firm may determine that a less stringent application is appropriate for that firm.

We believe that altogether prohibiting an AIFM from "neutralizing" certain remuneration requirements is not consistent with the intent in Annex II of the AIFMD. Further, a varying approach to proportionality for different types of financial services entities (*e.g.*, AIFM versus MiFID firms) will pose serious challenges and complexity for implementing coherent remuneration policies at a group level. As a result, we urge ESMA to clarify that the proportionality principle allows an AIFM to make a determination to disregard a particular requirement or apply the requirement less stringently, if the AIFM determines that this is appropriate for its organization.

¹⁰ See Annex II of the AIFMD.

AIFMs Being Part of a Group

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

Q13: Do you agree that the proposed alignment of the CRD and AIFMD remuneration provisions will reduce the existence of any conflicting remuneration requirements at group level for AIFMs whose parent companies are credit institutions subject to the CRD? If not, please state the reasons for your answer and provide quantitative details on any additional costs implied by the proposed approach.

We agree with ESMA that there is a need for consistency in the potential application of different requirements for AIFMs subject to other remuneration requirements. Many firms that are subject to the AIFMD requirements are part of groups that currently comply with the remuneration provisions under CRD III, and will in the future need to comply with the UCITS and MiFID remuneration regimes.¹¹ It is paramount that regulators develop a consistent approach for asset managers across all of these guidelines. We are concerned, however, that the existing patchwork approach of regulation will not result in a consistent approach.

The proposed alignment of the CRD and AIFMD remuneration provisions would reduce conflicting requirements at the group level for AIFMs whose parent companies are credit institutions subject to the CRD. Therefore, the overarching principle in drafting the AIFMD remuneration guidelines should be the rational alignment of these principles with the CRD remuneration principles. Any alignment should, however, take into consideration the different businesses within a group (*e.g.*, asset management, banking, insurance), and the fact that some of these businesses manage proprietary assets versus client assets. Further, such alignment should not impose incompatible or inconsistent requirements on an AIFM.

In addition, when drafting and applying sector-specific principles, it is paramount that ESMA and other regulators recognize the different functions and often-regulated activities that entities perform within a group and their different risk profiles, and tailor the principles accordingly. For example, the activities of regulated funds such as UCITS or investment companies registered under the Investment Company Act of 1940 (“U.S. RICs”) are circumscribed by fund laws that place limits on the type of permitted investments, leverage, diversification, concentration, etc. Therefore, the remuneration principles that are appropriate for an AIFM may not be appropriate in their totality to managers of regulated funds such as UCITS or U.S. RICs since these types of funds operate under

¹¹ Asset management firms that are not banks are also covered by CRD III in certain instances.

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robust and detailed regulatory regimes that limit the risk profile of the fund and its manager. Further, such funds operate under significant regulatory oversight.

In order to address the serious issues raised by inconsistent or conflicting remuneration guidelines, we recommend that the ESMA Guidelines provide that, if a group has already implemented a group-wide policy under CRD, this should be deemed compliant with the AIFMD requirements.¹²

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We appreciate the opportunity to provide comments on the Paper. If you have any questions about our comments or would like additional information, please contact the undersigned.

Sincerely,

/s/ Karrie McMillan

/s/ Dan Waters

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¹² How a group-wide code applies to a particular entity within the group, such as an asset manager, may differ based on that entity's size, nature of activities and risk profile.