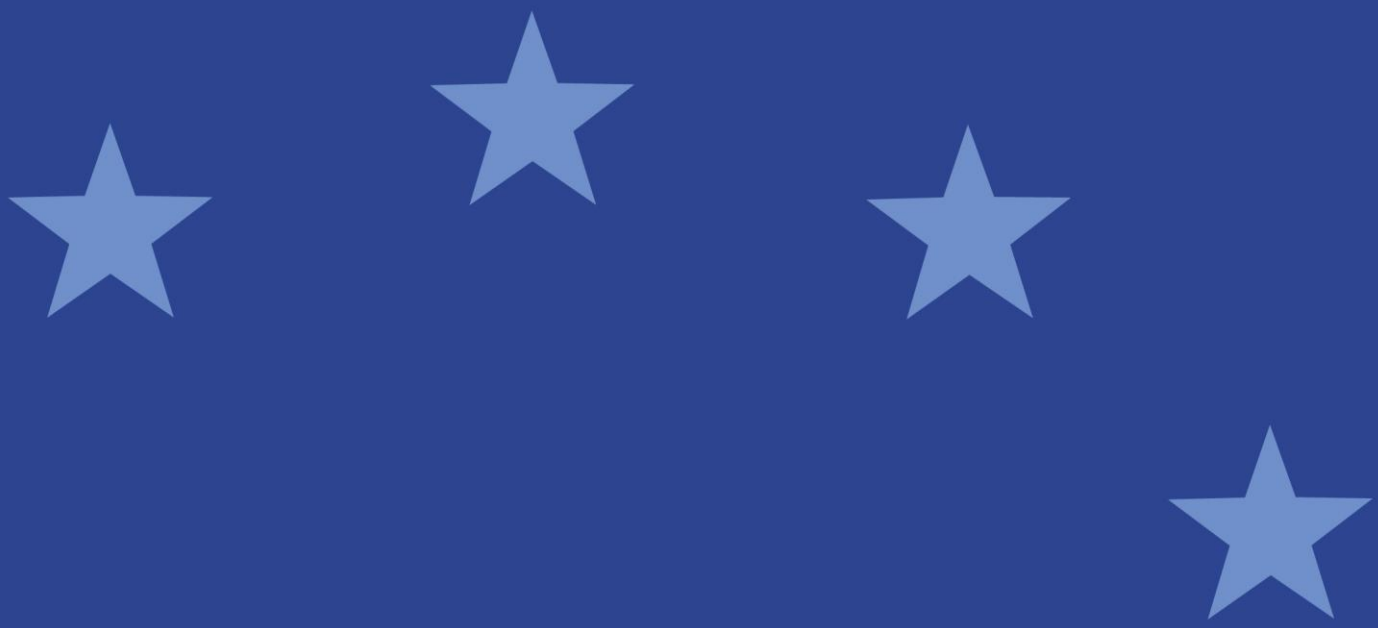
esma European Securities and Markets Authority

Final report

Guidelines on sound remuneration policies under the UCITS Directive and AIFMD



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1 Executive Summary

Reasons for publication

Article 14a(4) of Directive 2009/65/EC ("UCITS Directive"), as amended by Directive 2014/91/EU ("UCITS V Directive") provides that ESMA shall issue guidelines addressed to competent authorities or financial market participants concerning the application of the remuneration principles set out under Article 14b of the UCITS Directive ("UCITS Remuneration Guidelines"). This final report sets out the final text of the guidelines on remuneration policies required by the UCITS V Directive and also provides for a targeted revision of the Guidelines on sound remuneration policies under the AIFMD (ESMA/2013/232) ("AIFMD Remuneration Guidelines"), which were originally published on 3 July 2013.

Contents

Section 2 provides feedback on the consultation paper (2015/ESMA/1172) published by ESMA in July 2015.

Annex I includes the cost-benefit analysis for the guidelines. Annex II comprises the opinion of the Securities and Markets Stakeholder Group. Annex III provides the full text of the final UCITS Remuneration Guidelines, while Annex IV sets out the targeted amendment to the AIFMD Remuneration Guidelines.

Next Steps

The guidelines in Annexes III and IV will be translated into the official languages of the EU and the final texts published on the ESMA website. The deadline for compliance notifications will be two months after the publication of the translations. The UCITS Remuneration Guidelines will apply from 1 January 2017, subject to the transitional provisions stated therein. The amendment to the AIFMD Remuneration Guidelines will apply from 1 January 2017.

2 Feedback on the consultation

1. ESMA received 37 responses to the consultation paper (CP) on Guidelines on sound remuneration policies under the UCITS Directive and AIFMD. Responses were received from asset managers (and their associations), banking associations, representatives of the legal and accountancy sector, a representative of the insurance sector, the advisory body to a public authority and an individual.

I. General comments

2. Various respondents supported the approach followed in the ESMA consultation paper on proportionality.

3. An asset managers' association supported the alignment of the UCITS remuneration guidelines with the existing ones for AIFMs for the sake of consistent remuneration requirements for investment management companies holding both a UCITS and an AIFM management licence.

4. An asset manager made comments on the approach followed in the EBA's consultation on remuneration linked to the provision referring to asset management companies which are part of a banking group. According to this respondent, the fact that variable remuneration should be capped to 100% of the fixed remuneration for these companies would disrupt the level playing field between actors and introduce a major disadvantage for affiliates of banks.

5. The advisory body to a public authority mentioned that it would be advisable to explicitly recognize the possibility of voluntarily applying the policies of a single industry to a given group, provided that this achieves the goals of sound risk management and oversight of individual risk-taking behaviours, thereby simplifying compliance with these requirements on the part of large groups engaged in a variety of activities.

6. An asset managers' association recalled that as a result of the potentially overlapping requirements for portfolio management activities EU-wide between four competing regimes – i.e. UCITS, AIFMD, MiFID and CRD – an individual may become subject as "identified staff" to one or more of these, all while broadly performing the same underlying type of activity, i.e. contributing to professionally manage money on behalf of third-party clients for a chosen risk/return profile. This respondent stressed the need for a consolidated, as much as consistent, sectoral remuneration regime for all types of asset management activities.

7. An individual mentioned that the UCITS remuneration guidelines should be aligned to the CRD to ensure a level playing field across the financial sector.

8. A respondent mentioned that remuneration guidelines at European level should not be done without taking into account the social partners' absolute right to negotiate, conclude and enforce collective agreements. This respondent was of the view that any legal provisions regarding remuneration do not apply to remuneration policies and provisions agreed in a collective agreement.

Remuneration committee

9. One respondent argued that a reference to employee representatives in the remuneration committee is missing in the proposed guidelines.

ESMA response: Most of the comments mentioned above are addressed in the following sections which is hereby referred to. As for the lack of reference to employee representatives in the guidance on the remuneration committee, ESMA consider that no specific guidance is required, to the extent that Article 14b(4), last sub-paragraph of the UCITS Directive provides that "[i]*f employee representation on the management body is provided for by national law, the remuneration committee shall include one or more employee representatives*".

II. Proportionality

Q1: In this consultation paper ESMA proposes an approach on proportionality which is in line with the AIFMD Remuneration Guidelines and allows for the disapplication of certain requirements on an exceptional basis and taking into account specific facts. Notwithstanding this, ESMA is interested in assessing the impact from a general perspective and more precisely in terms of costs and administrative burden that a different approach would have on management companies. For this reason, management companies are invited to provide ESMA with information and data on the following aspects:

1) All management companies (i.e. those that hold a separate AIFMD licence and those that do not) are invited to provide details on the following:

a) compliance impacts and costs (one-off and ongoing costs, encompassing technological/ IT costs and human resources), and

b) any type of practical difficulties in applying in any circumstances the remuneration principles that could otherwise be disapplied according to the provisions under Section 7.1 of the draft UCITS Remuneration Guidelines (Annex IV to this consultation paper).

2) Management companies that also hold an AIFMD licence and benefit from the disapplication of certain of the remuneration rules under the AIFMD Remuneration Guidelines are asked to provide an estimate of the compliance costs in absolute and relative terms and to identify impediments resulting from their nature, including their legal form, if they were required to apply, for the variable remuneration of identified staff:

a) deferral arrangements (in particular, a minimum *deferral period* of three years);

b) retention;

c) the pay out in instruments; and

d) **malus (with respect to the deferred variable remuneration).**

Wherever possible, the estimated impact and costs of these changes should be quantified, supported by a short explanation of the methodology applied for their estimation and provided separately, if possible, for the four listed aspects.

10. The overwhelming majority of respondents supported the approach on proportionality set out in the consultation paper on UCITS Remuneration Guidelines, while criticising the approach followed by the EBA on proportionality in its consultation paper on guidelines on sound remuneration policies under the CRD IV.

11. Two asset managers mentioned that:

    a) A de-minimis threshold (absolute amount) ("*specific proportionality*") should be applied EU-wide at a reasonable level (as is the case currently in many jurisdictions), which would better protect both small/simple and large/complex firms, and would leverage on EU regulation's time-tested and approved principle of proportionality.

    b) However, *general proportionality* remains useful to avoid the cost of a remuneration committee where it can be avoided by a firm, based on its nature, internal organisation, scope, complexity of activity.

    c) As is, in practice, the case in the AIFMD, a blanket exemption of the remuneration requirements for firms with less than 100 million € of AuM should be provided for, for the sake of consistency, simplicity and competitiveness of the EU.

12. A representative of the insurance sector similarly asked to consider the size and relevance of the relevant firms in question and mentioned that proportionality should be a general rule and should not be applicable on an exceptional basis only. Another respondent mentioned that proportionality should depend on the characteristics of the firms in the investment management industry and should not necessarily be applied "exceptionally" to management companies.

13. Two respondents asked ESMA to consider the introduction of thresholds for triggering the application of certain principles, such as the principles having specific numerical criteria. They suggested applying one threshold throughout the whole of the EU/EEA, e.g. a threshold of 100,000 EUR, in order to ensure a level playing field between countries and business sectors. A banking association also supported the proposal of introducing a threshold of 100,000 EUR.

14. An individual was of the view that since inappropriate remuneration schemes have been one of the causes of the financial crisis, it would be appropriate not to make any changes in this area.

15. Specific feedback on the impact – from a general perspective and more precisely in terms of costs and administrative burden – that an approach on proportionality different

from the one set out in the consultation paper would have on management companies is set out below.

16. An asset managers' association provided the following estimated costs:

Estimates of costs linked to Pay-out Process

Pay out Process costs est.				
	in €000s	**One-off**	**Recurring**	**Total 1st year**
		medium vs. large firms	*medium vs. large firms*	*medium vs. large firms*
With specific* proportionality				
	Deferral	50-200	20-50	70-250
	Retention / Instruments	30-200	20-50	50-250
	Malus	30-60	20-30	50-90
	Total	**110-460**	**60-130**	**170-590**
Without specific* proportionality				
	Deferral	100-500	60-250	160-750
	Retention / Instruments	60-500	60-250	120-750
	Malus	40-150	40-100	80-250
	Total	**200-1150**	**160-600**	**360-1750**
** specific proportionality = de minimis threshold - see answer to question 1*				

NB: "medium" firms have some 50bn € AuM; "large" firms have some 500bn € AuM

Estimates of costs linked to Remuneration Committee

Remuneration Committee costs est.			
in €000s	**One-off**	**Recurring**	**Total 1st year**
	medium vs. large firms	*medium vs. large firms*	*medium vs. large firms*
With general* proportionality	0-150	0-250	0-400
Without general* proportionality	80-150	150-250	**230-400**
** see definition in answer to question 1*			

NB: "medium" firms have some 50bn € AuM; "large" firms have some 500bn € AuM

17. An asset manager mentioned some indirect detrimental effects which would be linked to a different approach on proportionality: un-level playing field with non EU competitors, or else deterioration of the coherency and social atmosphere within the company.

18. For this respondent, another main cost would result from applying AIFMD and UCITS rules without any de-minimis threshold which would be both disproportionate and very detrimental in terms of staff management. However, this respondent recognised that it would be neither possible nor relevant to introduce or impose the same threshold across Europe because levels of remuneration may be very different in various Member States.

19. An asset managers' association noted that increased costs would incur for those firms needing to adjust their firm-wide remuneration policies. In particular, this respondent

referred to those specific to defining “identified staff” and to the pay-out process, accompanied by those on the functioning of remuneration committees. A proxy for these costs would be the amount of work required to implement such changes by employing both internal and external project teams and resources. These would include the following:

- costs for external consultancy (employed to prepare the remuneration policy and advice the remuneration committee, for example, on mechanisms valuations and retrospective tests),

- costs for compliance and information technology (to implement the valuation mechanisms related to, for example, risks, liquidity and stress tests), as well as

- costs for executives occupying the remuneration committees.

20. Another asset managers’ association mentioned the following changes in the case of changing the interpretation of the principle of proportionality:

    - Adjusting the content of the remuneration policies (such as changing the scope of the remuneration policy with regard to the identified staff and the payout process);

    - Implementation of a payout process for parts of the bonus (such as deferral arrangements, pay out in instruments, application of malus) including software adaption for the payout process and adjust-ing the accounting systems (such as implementation of different payment methods and new employees’ accounts, monitoring of the deferral arrangements, initiation of subsequent payments);

    - In cases where a payout process is partially in place, changing the implemented processes for salary payments (such as changing the calculation process for the deferred part of the bonus and the timeline of the deferred period);

    - Adjusting the employment contracts of the identified staff, including conduct of negotiations with the employees;

    - Informing – where applicable - the workers council (“Betriebsrat”) and requiring the consent of the worker council (including complying with the requirements of the Equal Treatment Law); in practice, there are open questions what happens if the works council fails to give its approval under employment legislation or collective agreements (e.g. consent for malus agreements);

    - Clarification of legal issues by internal/external lawyers;

    - Hiring external service providers for the implementation of the new requirements.

21. A respondent noted that an approach to proportionality that is different to what ESMA has proposed would have a much wider and far-reaching impact on the UCITS industry than the one-off and on-going administrative costs associated with redesigning and implementing remuneration packages to technically fit the rules including:

- Sub-Optimal Alignment of Incentives: Imposing prescriptive remuneration principles that do not take into account proportionality in the context of the characteristics of the investment management industry risks interfering with the existing remuneration practices already in place when this is inappropriate in the context of the investment management industry. The outcome would be the application of remuneration policies which are not only costly to implement, but also result in remuneration packages that are actually less well suited to achieve the optimal alignment of investment managers' interests with those of the funds and client accounts that they manage.

- EU Funds Industry: Mandating prescriptive remuneration policies will make it difficult for the EU funds industry to attract, and access, the investment professional expertise necessary to manage a wide range of regional and global mandates because applying such remuneration principles prescriptively is often incompatible with the rules applicable, and the approach taken, in other jurisdictions and the firm wide approach to the overall remuneration package of an investment manager. This could severely limit the range of UCITS and other funds that are available to EU investors and would not be in the investors' best interests. This is particularly relevant in the context of delegation outside the EU where some non-EU delegates may simply resign from their EU UCITS management mandate preferring to focus on other mandates, or where the management fees that they charge may be increased to address the prescriptive principles.

22. The advisory body to a public authority was of the view that a change of approach on proportionality would result in severe distortions by requiring different remuneration principles to be applied to persons managing UCITS with respect to those managing AIF. That distortion would entail operational and legal costs (hiring of advisors to implement new guidelines due to differing application of the proportionality principle, maintenance of two separate remuneration schemes, etc.). Additionally, most operators that manage UCITS and AIF simultaneously do not have separate human and material resources for these two lines.

23. An asset managers' association provided the following feedback which considers two scenarios:

    - Full alignment with the AIFMD Guidelines: Generally, being the UCITS management industry considerably larger than the AIFM one, applying analogous types of remuneration requirements to the former implies an additional cost factor between two- to three-times that of complying with the AIFMD rules, given the UCITS industry's larger scale of EU domiciled funds. Increased costs would mainly be observed for those firms needing to adjust their firm-wide remuneration policies to take into account a larger number of individuals as "identified staff" and their related pay-out process, accompanied by the necessary requirements to set-up or adjust the functioning of remuneration committees where these firms are deemed to be "significant". An adequate proxy for these costs would be the amount of work required to implement such changes by employing both internal

and external project teams and resources, from human resources, legal, compliance and product specialists, to project managers, as a well as senior executives occupying the remuneration committees.

Alignment under this scenario would also call for the adaptation of employment contracts of the identified staff, including the uncertain granting of permission by workers' councils in certain jurisdictions with regard to collective agreements. Software adaptions and adjustments to be made to the accounting systems would complete this scenario.

- The non-application of the proportionality principle in the application of UCITS remuneration requirements: the denial of the principle of proportionality applied to UCITS remuneration principles would lead to a considerable impact. This would consist in an increase in fixed operational costs for UCITS- (and/or AIFM-) licensed asset management companies as a result of a higher fixed component in the total remuneration package of identified staff. Such increase would be prompted by the need to retain management talent and expertise at several levels within a company. Inevitably, the staff's annual pay will become less sensitive to investment performance and thus detrimental to a proper incentive alignment. Furthermore, an asset management company will have greater difficulty in adjusting to a negative economic cycle, becoming obliged to reduce workforce numbers, rather than simply adjust their variable remuneration to reflect poorer investment performance.

ESMA response: ESMA carefully considered the feedback received from the consultation, in particular those contributions highlighting the impact that an approach on proportionality that differed from the one set out in the consultation paper would have on management companies. ESMA also took into account the EBA Guidelines on sound remuneration policies under the CRD IV, published on 21 December 2015 (EBA/GL/2015/22) which are silent on the possibility to disapply any of the CRD IV remuneration requirements. In this respect, ESMA had to balance the co-legislators' steer to ensure alignment with the AIFMD Remuneration Guidelines and the obligation to closely cooperate with the EBA "*in order to ensure consistency with requirements developed for other financial services sectors, in particular credit institutions and investment firms*" (Article 14a(4) of the UCITS Directive, as amended by the UCITS V Directive).

Against this background, and mindful of the information gathered from national competent authorities on different legal interpretations of the proportionality clause established in the sectoral asset management legislation, ESMA decided to follow the approach adopted by the EBA and did not include in its final UCITS Remuneration Guidelines any guidance on the possibility not to apply certain of the remuneration requirements set out in the UCITS Directive. Together with this final report ESMA has also issued a letter to the European institutions setting out ESMA's views on proportionality and calling for further clarity.

III. Management companies being part of a group

24. An asset managers' association mentioned that the sectoral AIFMD and UCITS discipline shall prevail over and above the CRD IV provisions. This should not only be true for those provisions which are deemed to be "in conflict" (e.g. payment of variable remuneration in instruments) but a fortiori for those cases where no specific requirement is foreseen in sectoral regimes: the intent of the legislation with more "proximity" to the sector should not be circumvented. This respondent recalled that the nature of professional (both collective and individual) portfolio management is fundamentally different, from a risk perspective, from the activity of a CRD-entity operating on its own account.

25. Similarly, another asset managers' association asked ESMA to delete paragraph 31 of the draft UCITS Remuneration Guidelines as well as paragraph 33 of the draft AIFMD Remuneration Guidelines and to maintain the current version of paragraph 33 of the AIFMD Remuneration Guidelines. This respondent argued that the proposed wording seems to suggest that it would be left to the discretion of the non-UCITS or non-AIF sectoral prudential supervisors of group entities' to decide which set of sectoral rules should prevail. This would lead to the consequence that competent authorities in the banking or insurance area are also required to supervisor management companies subject to the AIFMD or the UCITS Directive.

26. A third asset managers' association mentioned that the number of staff of asset managers who should be 'identified staff 'for the purpose of the CRD should be exceptionally limited.

ESMA response: ESMA considers that the guidance on management companies/AIFMs being part of a group merely takes note of the possible outreach of sectoral prudential rules applying to group entities which is not for ESMA to interpret. Therefore, ESMA left substantially unchanged the guidance provided on this topic. However, ESMA saw merit in adapting the relevant wording in order to address the concern emerged from the feedback to the consultation and not to give the impression that it should be to the discretion of the non-UCITS or non-AIF sectoral prudential supervisors of group entities' to decide which set of sectoral rules should prevail. Further specific guidance on the application of the CRD IV rules in a group context is provided in the EBA Guidelines on sound remuneration policies under CRD IV (EBA/GL/2015/22) (see Section 3 of the EBA Guidelines and, in particular, its paragraph 68).

IV. Specificities of the UCITS V remuneration rules

a) Definitions

Definition of 'performance fees'

Q2: Do you agree with the proposal to set out a definition of "performance fees" and with the proposed definition? If not, please explain the reasons why and provide an alternative definition supported by a justification.

27. The majority of respondents agreed with the proposed definition.

28. Two respondents mentioned that the language in the last paragraph of the definition should not encompass all payments, otherwise any variable remuneration paid to identified staff could potentially be considered performance fees. These respondents suggested clarifying that the definition relates to payments linked to the performance of the portfolio and made by the clients to the management company or the UCITS itself.

29. Four respondents objected to the inclusion of a definition of performance fees. Three respondents mentioned that these are paid by the UCITS to the management company, but they are never paid to individuals. An asset managers' association considered that the provisions of art. 14b(3) of the UCITS Directive should be sufficient in this respect.

30. Another asset managers' association suggested modifying the last sentence in the definition into "*Performance fees are charged to the UCITS by the management company*". Two other respondents mentioned that the current definition appears to inappropriately link performance fees and variable remuneration. Charges from the fund for its management are fees, and those linked to fund performance are performance fees. Variable payments to members of staff are variable remuneration, which in some cases may be based on the performance of a fund but may also take account of other factors according to the firm's policy. These definitions are not dependent on who is remunerating the individuals or to whom the fees are paid.

    ESMA response: Given the support received, ESMA left the definition broadly unchanged. However, it saw merit in clarifying that the definition relates to performance-related payments made by the clients to the management company or the UCITS itself.

    Definition of 'supervisory function'

    Q3: Do you see any overlap between the proposed definition of 'supervisory function' in the UCITS Remuneration Guidelines and the definition of 'management body' in the UCITS V Level 1 text? If yes, please provide details and suggest how the definition of 'supervisory function' should be amended in the UCITS Remuneration Guidelines.

31. The overwhelming majority of respondents saw no overlap between the proposed definition and the definition of 'management body' in the UCITS V Level 1 text.

32. A respondent noted that the definition of "management body" makes direct reference to an 'ultimate decision-making authority', while "supervisory function" refers to persons/a body/bodies 'responsible for the supervision of the management company's senior management'. Accordingly, this respondent considered that the two definitions allude to different groups of people within the company, i.e. the decision-makers themselves and the supervisors of the decision-makers.

33. Two asset managers' associations mentioned that a separate supervisory function is not a common standard used across EU Member States. It is a feature that can be found in the company law of certain Member States. Therefore, the ESMA Guidelines should take this into account, recognising the fact that such a function may not exist in some cases.

One of these two respondents also objected to the expectation embedded in the draft guidelines that the supervisory function comprises non-executives.

34. An individual mentioned that the definition of "supervisory" function could be amended to recognise the role and responsibilities of the Board of Directors, which management companies have in place.

ESMA response: Given the broad support received, ESMA left the definition substantially unchanged, while slightly amending the language in order to further acknowledge that a separate supervisory function does not exist in all the EU jurisdictions and that, in such circumstances, the supervisory function should be understood to be the management body.

b) Remuneration covered by the UCITS guidelines

35. An asset managers' association suggested modifying paragraph 10(ii) of the draft guidelines to change the reference to "*any amount paid by the UCITS itself, including performance fees*" as follows: "*any amount paid by the UCITS itself, including any portion of performance fees that are paid directly or indirectly for the benefit of identified staff*". This respondent explained that the manager may, at its discretion, pay a portion of the performance fee to employees as remuneration, but the performance fee itself would not ordinarily be "for the benefit of" staff or any individual.

ESMA response: ESMA saw merit in the suggested modification of paragraph 10(ii) of the draft guidelines and modified the language under paragraph 11(ii) of the final UCITS Remuneration Guidelines accordingly.

c) Application of different sectoral rules

Q4: Please explain how services subject to different sectoral remuneration principles are performed in practice. E.g. is there a common trading desk/an investment firm providing portfolio management services to UCITS, AIFs and/or individual portfolios of investments? Please provide details on how these services are operated.

36. Feedback from respondents generally evidenced that it is quite common for firms to have common trading desks providing services to a wide range of entities, including UCITS management companies and AIFMs.

37. Two respondents mentioned having a common trading platform for a number of group entities/products, i.e. UCITS, AIF and MiFID activities. An asset manager stated that at group level they have a common trading desk which is a subsidiary and applied CRD IV rules.

38. A couple of respondents mentioned that in a global firm portfolio managers tend to have an asset class and/or geographical and sectoral expertise. Accordingly, their investment management responsibilities are not tied to one particular investment management company, fund or client account. Instead, the assets that each portfolio manager is

responsible for will typically belong to a range of clients including UCITS funds, segregated accounts and other non-EU funds and accounts.

39. An asset manager mentioned that in this firm a UCITS manager / AIFM delegates portfolio management, typically to a CRD or MiFID-licenced entity within the group, or occasionally to a third-party asset manager. A portfolio manager within the relevant delegate might be responsible for both UCITS and AIFs, as well as segregated client mandates. The same dealing teams support trades for both UCITS, AIFs and segregated mandates, though all trades must be pre-allocated to a particular mandate at the point the trade is instructed by the portfolio manager. Within that dealing team, the same individuals would handle trades irrespective of whether the mandate to which that trade relates is a UCITS, or AIF or segregated mandate. The control functions provide the second-line of defence equally across UCITS, AIFs and other operations, and the same control function personnel are carrying out that work across those activities.

40. An asset managers' association and an asset manager mentioned that where asset management companies have both a UCITS and an AIMF licence, it will be quite frequent that investment management staff, control functions and senior management are identified staff under both licences.

41. A respondent provided the results of a survey conducted among its members. Respondents were approximately evenly split between those that work in firms using a common trading desk, and those that separate their service operations. This respondent provided the following additional information on its survey:

    - One of its members noted that the UCITS product is just one fund of a few different funds managed by the same traders/PMs. Another highlighted that "a common trading desk executes the trades instructed by almost all portfolio managers. Some portfolio managers execute their trades independently." One of the respondents noted that "there are different trading desks by asset class and region, but not by regulatory framework".

    - Some members highlighted that alternative investment funds were separated, "but the same dealing desk was active for both UCITS and individual mandates (institutional investors and high-net-worth individuals). The dealing desk was segmented between equities and fixed income. FX was dealt via the dealing desk of the group's bank". Other respondents noted that a separate sales desk is used for unlisted special funds and alternative funds.

42. An asset managers' association asked to clarify that the scope of the proposed ESMA guidelines only covers the application of different sectoral rules for services provided by management companies within the meaning of the UCITS Directive. To be clearly distinguished from these services are the questions to what extent remuneration requirements shall apply to investment firms providing direct MiFID services and whether and to which extent the parent institution in a banking group shall ensure that subsidiaries not subject to the CRD such as AIFMD or the UCITS management companies implement remuneration policies which are consistent with the CRD remuneration requirements.

43. Another asset managers' association asked for further clarifications on the application of sectoral regimes to personnel not materially performing activities falling under different sectoral rules. This respondent asked ESMA to clarify whether and, if so, how the application of different sectoral rules would apply in relation to executive and non-executive members of the management body of the UCITS management company (or AIFM), not comprised within the staff of the management company materially performing activities falling under different sectoral rules.

ESMA response: On the rules applicable in a group context, see the ESMA response above under the section "III. Management companies being part of a group".

As to the request to clarify how the remuneration rules should apply to members of the management body of the management company, ESMA did not provide any further guidance as it considers that the being a member of the management body equals to "performing services" subject to the remuneration principles, to the extent that members of the management body should be included in the "identified staff" based on the guidance already provided under paragraph 18 of the final UCITS Remuneration Guidelines.

Q5: Do you consider that the proposed 'pro rata' approach would raise any operational difficulties? If yes, please explain why and provide an alternative solution.

44. Respondents' views on the application of the 'pro rata' approach were overall split.

45. Several respondents supported the proposed approach, some of them specifying that it is feasible as long as it remains optional.

46. An asset managers' association mentioned that for cases of management of both UCITS and AIFMs, the application of the "pro rata approach" becomes less pertinent, as both the remuneration rules are deemed equivalent. This respondent encouraged ESMA to consider, as a third option, the criterion of "prevalence" and, on the basis of the (UCITS or AIFMD) activity performed, consider to apply the set of remuneration (UCITS or AIFMD) which refers to the prevalent type of activity.

47. A number of other respondents mentioned that the proposed approach is not practicable. One of these respondents was of the view that the optimal outcome is that each of the regimes are sufficiently similar and applied in a sufficiently similar manner. Another respondent mentioned that the 'pro rata' approach would raise several operational challenges. For example, research could be classified as benefitting both UCITS and AIFs. An asset manager and asset managers' association were of the view that the 'pro rata' approach would not be impossible to implement, but would be extremely complex.

48. Another asset managers' association mentioned that the proposed 'pro rata' approach is not practicable as managers do not assign the services provided under the AIFMD, UCITS Directive or MiFID to their staff members on a pro-rata basis.

49. **ESMA response**: Given that mixed views were expressed by respondents on the operational difficulties that the 'pro rata' approach may trigger and considering that such an approach is optional, ESMA decided to retain it in the final UCITS Remuneration Guidelines. Mindful of the comments made by several respondents on the operational difficulties of the 'pro rata' approach, ESMA decided to clarify in paragraph 30a) of the UCITS Remuneration Guidelines that this approach should be followed to the extent that it is possibility to single out an individual activity.

    ESMA did not see merit in the suggestion to introduce an alternative "prevalence" approach as paragraph 34 of the UCITS Remuneration Guidelines already recognises that for requirements applying firm-wide, it is sufficient to comply with one set of rules, being the UCITS Directive or the AIFMD.

Q6: Do you favour also the proposed alternative approach according to which management companies could decide to voluntarily opt for the sectoral remuneration rules which are deemed more effective in terms of avoiding excessive risk taking and ensuring risk alignment and apply them to all the staff performing services subject to different sectoral remuneration rules? Please explain the reasons behind your answer.

50. The large majority of respondents supported this approach. An individual respondent mentioned that a possibility would be to implement the most restrictive approach, i.e. the CRD IV requirements, although this could end up being unfair on investment firms with limited banking activities. An asset managers' association who supported this alternative approach mentioned that it is needed only in the case where management companies provide MiFID services in addition to management services under the AIFMD or the UCITS Directive.

51. An asset manager and an asset managers' association mentioned that thanks to the proposed approach, CRD IV or AIFMD/UCITS frameworks can be applied in a mutually exclusive manner, allowing for better consistency of – and more holistic implementation in – each framework. Another asset manager favoured the possibility of applying a single set of rules (UCITS or AIFMD) for the eligible staff involved in the core business.

52. An asset managers' association considered that there should not be a "conflict" between sectoral remuneration principles given that, for the most part, individuals falling in any of the categorised "identified staff" – as per Section 6 of the draft Guidelines – carry out specific functions each with a different material risk dimension within the same asset management company. More concretely, only individuals classified as "other risk takers" under Section 6 of the draft Guidelines should be remunerated differently, via varying combinations of cash and non-cash instruments for their relevant variable remuneration components, and above all, proportionately according to their distinct risk profiles.

53. Two respondents mentioned that the reference to 'excessive risk taking' is inappropriate in the UCITS framework, given the constraints in terms of portfolio diversification, counterparty exposure, limits on leverage, etc.

54. An asset manager mentioned that there is difficulty estimating the time spent by an individual on AIFMD and UCITS work and between different funds, given the lack of timesheet system and the costs / difficulties of implementing one.

ESMA response: Given the support received, ESMA left the relevant provisions substantially unchanged. However, ESMA saw merit in introducing the following amendments under paragraph 30b) of the UCITS Remuneration Guidelines:

i) deleting a reference to a conflict between the sectoral remuneration principles, and

ii) replacing the reference to 'excessive risk taking' with a reference to 'inappropriate risk taking', which better recognises the specificities of the UCITS framework.

Moreover, ESMA would like to provide clarification on the meaning of paragraph 30b) of the UCITS Remuneration Guidelines.

Some respondents to the consultation seem to have interpreted these provisions as allowing management companies simply to make a choice between the CRD IV, AIFMD and UCITS remuneration rules without giving them due consideration. The rationale behind paragraph 30b) is in fact to give firms the possibility to opt for the remuneration rules that are most effective for achieving the outcomes of discouraging inappropriate risk taking and aligning the interest of the relevant individuals with those of the investors in the funds or other portfolios they manage. The first decision to be made by a firm is whether to apply a 'pro rata' approach or to select the most effective set of remuneration principles. If the second option is chosen, the management company should consider carefully, taking into account its specific activities and circumstances, which remuneration principles would be most effective. For the avoidance of doubt, this could lead to circumstances in which the management company would apply the CRD IV rules in full, including the so called 'bonus cap', to all the staff performing services subject to different sectoral remuneration rules, without having to ensure a line-by-line compliance with the relevant corresponding principles under the AIFMD and/or the UCITS Directive. This is without prejudice to the fact that, where specific requirements of the CRD IV (such as those on the payment of variable remuneration in instruments) conflict with those under the AIFMD or the UCITS Directive, the specific sectoral legislation should prevail (e.g. for services subject to the AIFMD or the UCITS Directive the variable remuneration should be always paid in units or shares of the alternative investment fund concerned or units of the UCITS concerned (Annex II(1)(m) of Directive 2011/61/EU and Article 14(b)(m) of Directive 2009/65/EC, respectively)).

Q7: Do you agree that the performance of ancillary services under Article 6(3) of the UCITS Directive or under Article 6(4) of the AIFMD by personnel of a management company or an AIFM should be subject to the remuneration principles under the UCITS Directive or AIFMD, as applicable? Or do you consider that that MiFID ancillary services do not represent portfolio/risk management types of activities (Annex I of the AIFMD) nor investment management activities (Annex II of the UCITS Directive) and should not be covered by the rules under Article 14b of the UCITS Directive and Annex II of the

AIFMD which specifically refer to the UCITS/AIFs that a UCITS/AIFM manages? Please explain the reasons of your response.

55. Several respondents agreed with the proposed approach. An asset managers' association agreed that these services are comparable to the management of a UCITS or an AIF; however, it stated that firms providing these ancillary services should be able to apply the most efficient regime and to align their remuneration policies with investor interest.

56. An asset manager and an asset managers' association mentioned that it was unclear what ancillary services the relevant question referred to and assumed that it did not include non-core services under Article 6(3) of the UCITS Directive and Article 6(4) of the AIFMD, and only related to the individual management of portfolios of investments on a discretionary basis.

57. A large number of respondents mentioned that when an employee performs non-UCITS/AIFMD activities (e.g. investment advice) these services should not be subject to the UCITS/AIFMD remuneration rules (or at least not mandatorily, according to some of these respondents). An asset manager and an asset managers' association added that for individual portfolio management services, asset managers should be able to choose to apply the UCITS/AIFMD rules instead of the MiFID rules as the former are more prescriptive. Three asset managers' associations were of the view that the payment of variable remuneration in instruments for personnel performing MiFID services would create distortion, as these instruments are unrelated to their activities and not tied with the performance of the individual mandate.

58. An asset managers' association mentioned an ambiguity arising from the provisions of paragraph 37 of the draft guidelines (now paragraph 35 of the final UCITS Remuneration Guidelines) read together with paragraph 33 (now paragraph 31). This respondent mentioned that according to the UCITS Directive and the AIFMD, the performance of MiFID services (i.e. ancillary services under Article 6(3) of the UCITS Directive or under Article 6(4) of the AIFMD) by personnel of a UCITS management company or an AIFM is carried out through a UCITS or AIFMD license, not by virtue of an authorization under the CRD IV. Accordingly, the personnel of a UCITS management company or an AIFM performing such activities should be by no means subject to CRD IV provisions on remuneration.

ESMA response: ESMA considered the feedback received and decided to keep its approach substantially unchanged and clarify that the remuneration rules under the UCITS Directive and the AIFMD have to be applied also in the context of providing the 'ancillary services'. This is for the following reasons:

- Article 14a of the UCITS Directive establishes the general principle as regards the application of remuneration policies and practices thereby setting out in its paragraph 3 that '*the remuneration policies and practices shall apply to those categories of staff, including senior management, risk takers, control functions and any employee receiving total remuneration that falls within the remuneration bracket of senior management and risk takers whose professional activities have a material impact on*

the risk profiles of the management companies or of the UCITS that they manage'. Furthermore paragraph 4 of this article specifies that *'those guidelines shall take into account (…) the size of the UCITS that they manage, their internal organisation, and the nature, scope and complexity of their activities*'.

- It should be clear from this provision that the application of the remuneration policies and practices is linked to the providing of business activities in general and is not restricted to the portfolio and/or risk management of the UCITS only. The legislature establishes an all-encompassing approach taking into consideration the different kinds of activities relevant in the course of the business of a management company generating possible risks (also) for the management company itself. Since the legislature does not contain an explicit exemption with respect to the application of the remuneration policies and practices those principles have to be applied to the 'ancillary services' as well.

- Article 14b of the UCITS Directive then sets out specific provisions and rules concretizing further the abovementioned general principle with respect to the application of the remuneration policies and practices taking into account the relevant circumstances such as the different structures or size of a management company.

Moreover, ESMA confirms the following:

i) The guidance provided under paragraph 35 of the UCITS Remuneration Guidelines relates to the performance of any of the specific MiFID services mentioned under Article 6(3) of the UCITS Directive and Article 6(4) of the AIFMD.

ii) The provision of ancillary services under Article 6(3) of the UCITS Directive or under Article 6(4) of the AIFMD is carried out through a UCITS or AIFMD license, not by virtue of an authorization under the CRD IV. Therefore, the provision of these services by the personnel of a UCITS management company or an AIFM should not in itself make the relevant personnel subject to the CRD IV remuneration rules.

d) <u>Application of the rules to delegates</u>

59. The following comments were made in relation to the provisions on delegating investment management according to Article 13 of the UCITS Directive (paragraph 15 of the draft guidelines):

- an asset managers' association asked to clarify that the reference to "investment management activities" under paragraph 15(a) referred to the first indent of Annex II of the UCITS Directive (which refers to "investment management") and does not include risk management or administration;

- another respondent mentioned that a proportionate approach should also be taken to delegation by management companies outside the EU, in line with recital 2 of the UCITS V Directive.

ESMA response: ESMA saw merit in modifying the language under paragraph 15 of the draft guidelines (now paragraph 16 of the final UCITS Remuneration Guidelines) to align it to the provisions of the UCITS Directive which refers to a delegation of "functions" under its Article 13. ESMA also clarified that investment management functions include risk management.

ESMA did not consider necessary to include a reference to a proportionate approach to delegation outside the EU to the extent that the rules applicable to delegates should mirror the ones applicable to management companies under the guidelines (i.e. the approach on proportionality should be the same). Moreover, proportionality is already explicitly mentioned under recital 2 of the UCITS V Directive which states that the requirements on remuneration policies and practices "*should apply, in a proportionate manner, to any third party which takes investment decisions that affect the risk profile of the UCITS because of functions which have been delegated in accordance with Article 13 of* [the UCITS Directive]".

e) Payment in instruments

Q8: Do you agree with the proposal to look at individual entities for the purpose of the payment in instruments of at least 50% of the variable remuneration or consider that it would risk favouring the asset managers with a bigger portfolio of UCITS assets under management? Should you disagree, please propose an alternative approach and provide an appropriate justification.

60. The majority of respondents agreed with the proposed approach. One respondent considered that the proposed approach would not risk favouring larger investment managers. Two other respondents suggested clarifying that the calculation should be made at sub-fund level.

61. A minority of respondents considered that the proposed approach would put at disadvantage small firms as they will have more often than large firms, UCITS representing more than half of their total assets. In order to solve this issue, some of these respondents proposed to introduce a threshold for the application of the rule. An asset manager considered this inconsistent with the approach under the AIFMD and mentioned that the proposed approach may benefit fund managers with more UCITS funds, as the more funds you have, the less likely it would be for any single UCITS fund to account for more than 50%of the UCITS portfolio. An individual stated that payment in instruments of at least 50% of the variable remuneration should consider the net asset value of combined entities to avoid circumvention of the rules through the creation of smaller UCITS.

62. Two asset managers' associations mentioned that current practices do not foresee that an individual is remunerated entirely for the variable part of his/her remuneration in shares/units of one single UCITS.

63. An asset manager asked for further clarity whether in a scenario where no single UCITS fund makes up more than 50% of the total UCITS funds managed, the instrument requirement is disapplied for all Identified Staff of the UCITS manager.

ESMA response: The original text of the UCITS V Directive included an error under Article 14(1)(m) which was recently amended through a corrigendum published in the Official Journal of the European Union L 52 of 27 February 2016 (page 37). According to the amended text, the Article 14(1)(m) shall read as follows: "*(m) subject to the legal structure of the UCITS and its fund rules or instruments of incorporation, a substantial portion, and in any event at least 50 %, of any variable remuneration component consists of units of the UCITS concerned, equivalent ownership interests, or share-linked instruments or equivalent non-cash instruments with equally effective incentives as any of the instruments referred to in this point, unless the management of UCITS accounts for less than 50 % of the total portfolio managed by the management company, in which case the minimum of 50 % does not apply*". This correction (i.e. the deletion of the word "the" from the part of the sentence referring to "management of the UCITS") does change the meaning of the relevant Article and shows that the intention is to impose the non-cash remuneration linked to the performance of funds managed by the manager, except for cases where the management of UCITS is not the major activity of the manager. Based on this development, ESMA changed the approach in paragraph 149 of the final UCITS Remuneration Guidelines accordingly.

Moreover, in response to the specific question on what happens if no single UCITS fund makes up more than 50% of the total UCITS funds managed, ESMA clarifies that in such a scenario, the rule on the payment in instruments still applies. However, in such a case "a substantial portion" of variable remuneration needs to be paid out in instruments and not at least 50% of it.

V. Date of application of the guidelines

Q9: Do you consider that there is any specific need to include some transitional provisions relating to the date of application of the UCITS Remuneration Guidelines? If yes, please provide details on which sections of the guidelines would deserve any transitional provisions and explain the reasons why, also highlighting the additional costs implied by the proposed date of application. Please be as precise as possible in your answer in order for ESMA to assess the merit of your needs.

64. Respondents generally expressed a need to introduce some transitional provisions for the date of application of the UCITS Remuneration Guidelines.

65. The following specific requests were made:

- 5 respondents asked for a transitional period of 1 year (some of them specified that this should mean 18 March 2017);
- 1 respondent proposed a transitional period of 18 months;
- 8 respondents favoured 1 January 2017 as a starting date of application in order to allow asset management companies to implement their remuneration policy over a full 12 months cycle;

- 2 respondents (an asset manager and an asset managers' association) mentioned that only variable remunerations paid from the first quarter of 2018 would be subject to the pay-out requirements;

- 6 respondents were of the view that the guidelines should start applying on the first full performance period following the UCITS V implementation (some of these respondents mentioned that this is based on the assumption that there will be broad alignment between the UCITS and AIFMD rules);

- 1 respondents (a law firm) asked for specific transitional provisions for the release of an updated KIID.

66. An asset managers' association asked for a specific transitional period for the guidance on the group context as the effort necessary to identify staff with a relevant impact of the group risk profile and to amend the remuneration agreements is not exactly foreseeable.

67. Two asset managers' associations asked ESMA to clarify whether the two-month period for competent authorities to notify ESMA whether they comply or intend to comply with the guidelines start from the date of publication in English or the date of publication of the translations of the guidelines.

ESMA response: In light of the feedback received, ESMA saw merit in setting the date of application of the UCITS Remuneration Guidelines and of the amendment to the AIFMD Remuneration Guidelines on 1 January 2017. Moreover, ESMA decided to start applying its guidance on the pay-out process for variable remuneration for the calculation of payments relating to new awards of variable remuneration to identified staff for the first full performance period after 1 January 2017. This is without prejudice to the application of the requirements stemming from the UCITS V Directive by 18 March 2016.

As for the request to provide guidance on the update of KIIDs following the UCITS V Directive, ESMA refers to the provisions under Question 1 (Directive 2014/91/EU (UCITS V) – update of documentation) of the Q&A on the application of the UCITS Directive (2016/ESMA/181).

ESMA did not include any specific transitional provisions in relation to the guidance for management companies/AIFMs being part of a group as such guidance is closely linked to the release of the EBA Guidelines on sound remuneration policies under CRD IV (EBA/GL/2015/22) which start applying as of 1 January 2017. Therefore, ESMA did not see any reason for including a different starting date of application of this part of the UCITS Remuneration Guidelines and for the amendment to the AIFMD Remuneration Guidelines.

Finally, ESMA confirms that the two-month period for the notification from competent authorities starts from the date of publication of the translations of the guidelines on the ESMA website.

VI. Cost-benefit analysis

Q10: Do you agree with the assessment of costs and benefits above for the proposal on proportionality? If not, please explain why and provide any available quantitative data on the one-off and ongoing costs that the proposal would imply.

68. Respondents who replied to this question supported option 2 in the draft cost-benefit analysis and generally agreed with the assessment of costs and benefits presented in the consultation paper.

69. An asset managers' association did not agree with ESMA's assessment that option 2 (consistency with the AIFMD approach), which allows for neutralization of certain remuneration rules, cannot ensure the same benefits in terms of investor protection as an approach which does not allow neutralization.

ESMA response: As no substantive objections were raised to the proposed assessment of costs and benefits, ESMA left its cost-benefit analysis substantially unchanged on this aspect (while updating its content to reflect the preferred option in this final report, i.e. the absence of provisions on the possibility to disapply any of the remuneration rules in the UCITS Remuneration Guidelines).

Q11: Do you agree with the assessment of costs and benefits above for the proposal on the application of different sectoral rules to staff? If not, please explain why and provide any available quantitative data on the one-off and ongoing costs that the proposal would imply.

70. Respondents who replied to this question supported option 2 in the draft cost-benefit analysis and generally agreed with the assessment of costs and benefits presented in the consultation paper.

71. An asset managers' association did not agree with the proposal on the application of different sectoral rules to staff.

72. One respondent agreed with the assessment for option 2, while disagreeing with the assessment for option 1.

ESMA response: As no substantive objections were raised to the proposed assessment of costs and benefits, ESMA left its cost-benefit analysis substantially unchanged on this aspect.

3 Annexes

3.1 Annex I

Cost-benefit analysis

1. Introduction

1. The UCITS Directive and its implementing measures set out a comprehensive framework for the regulation of UCITS within Europe. The UCITS Directive was amended most recently by the UCITS V Directive which introduced new rules on UCITS depositaries, remuneration and sanctions.

2. Following that amendment, Article 14a(4) of the UCITS Directive provides that ESMA shall issue guidelines addressed to competent authorities or financial market participants concerning the application of the remuneration principles set out under Article 14b of the UCITS Directive.

3. The remuneration principles set out under the UCITS Directive are broadly in line with those under the AIFMD on which ESMA already issued guidelines (AIFMD Remuneration Guidelines). Therefore, when developing the proposed draft guidelines under the UCITS Directive, ESMA started from the text of the AIFMD Remuneration Guidelines and adapted it to the specificities of the UCITS framework, also taking into account the differences between the AIFMD and UCITS V Level 1 texts.

4. This final report sets out the final guidelines required under the UCITS V Directive which relate to the remuneration principles set out under Article 14b of the UCITS Directive. These principles cover topics such as: (i) the governance of remuneration, (ii) requirements on risk alignment and (iii) disclosure of remuneration.

5. In preparing the consultation paper which preceded this final report, ESMA consulted with the Consultative Working Group (CWG) of ESMA's Investment Management Standing Committee (IMSC), in particular on the proportionate application of the remuneration rules. The input provided by the CWG was useful for the purpose of the draft cost-benefit analysis (CBA) included in the consultation paper as it allowed, inter alia, views to be gathered on the various approaches that may be envisaged when applying the relevant provisions of the UCITS Directive.

6. For the purposes of this CBA ESMA carried out a mapping exercise among national competent authorities (NCAs) to gather data on the approaches proposed on (i) proportionality and (ii) the application of different sectoral rules to staff (see sections 7 and 8 below).

7. This CBA is mostly qualitative in nature. Ad hoc questions were introduced in the draft CBA included in the consultation paper in order to elicit market participants' input on the quantitative impact of the proposals. However, limited amount of data was received through the consultation process. This was taken into account when

finalising the UCITS Remuneration Guidelines and included in the present CBA accompanying the final report.

2. Policy objective

8. The UCITS remuneration rules are intended to protect the interests of UCITS investors by ensuring that the remuneration of risk takers within management companies are subject to appropriate governance requirements and the interests of these risk takers are aligned with those of the management companies and the UCITS they manage. These rules should be applied consistently across Europe.

9. The UCITS Remuneration Guidelines aim to promote the objectives of the UCITS Directive and, by extension, those of the Commission Recommendation of 2009. They should contribute to the creation of a level playing field across Member States, which will help ensure that the risks tackled by the guidelines are done so in a harmonised way and there is reduced scope for regulatory arbitrage (e.g. a management company choosing to move its activities to a jurisdiction with a more flexible approach) which could hamper the key objectives of the UCITS Directive.

3. Baseline scenario

10. The baseline scenario for this CBA would be the application of the requirements in the Level 1 Directive (i.e. the provisions in Article 14b of the UCITS Directive) without any further guidance. This would in effect be more of a principles-based approach, leaving discretion to management companies to determine how best to apply the high-level requirements to their businesses. This could lead to a lack of harmonisation in the application of the provisions of the Level 1 Directive across the UCITS industry.

4. Technical options

11. The following options were identified and analysed by ESMA to address the policy objectives referred to above and provide guidance on the application of the rules under Article 14b of the UCITS Directive.

12. In identifying the options set out below and choosing the preferred ones, ESMA was guided by the relevant UCITS Directive rules.

13. To the extent that, in line with the steer given to ESMA by the co-legislators under recital 9 of the UCITS V Directive[1], the UCITS Remuneration Guidelines should broadly reflect the content of the AIFMD Remuneration Guidelines, this section focuses on the options that were available on the two major issues on which ESMA either had to provide additional guidance as compared to the AIFMD Remuneration Guidelines (Guidelines on the application of different sectoral rules – Section 9 of the

[1] Recital 9 of the UCITS V Directive states that "*ESMA's guidelines on remuneration policies and practices should, where appropriate, be aligned, to the extent possible, with those for funds regulated under Directive 2011/61/EU of the European Parliament and of the Council*".

UCITS Remuneration Guidelines) or considered a possible departure from the content of the AIFMD Remuneration Guidelines (Guidelines on proportionality – Section 7 of the UCITS Remuneration Guidelines).

4.1. Proportionality

Policy Objective	According to Article 14b of the UCITS Directive, the remuneration principles are to be applied taking into account the size, internal organisation and the nature, scope and complexity of the management companies' activities.
Baseline scenario	No further guidance would be provided through the guidelines on how to apply the proportionality principle spelled out under the "Policy Objective" above.
Option 1	The UCITS Remuneration Guidelines would provide that remuneration principles are applicable to all management companies and proportionality may not lead to any disapplication of any of the requirements. This means that the specific minima set out in Article 14b of the UCITS Directive (e.g. the minimum deferral of 40 to 60% of variable remuneration) should never be disapplied. Management companies should in any case apply at least the minima criteria set out therein and, where appropriate, apply more strict criteria. The AIFMD Remuneration Guidelines – which currently provide for the possibility to disapply certain of the AIFMD remuneration principles under the specific conditions – would be amended in order to align them with the UCITS Remuneration Guidelines and provide that proportionality may not lead to any disapplication of any of the remuneration requirements.
Option 2	The UCITS Remuneration Guidelines would provide that – in line with the approach followed under the AIFMD Remuneration Guidelines – proportionality may lead, on an exceptional basis and taking into account specific facts, to the disapplication of some requirements under certain specific conditions and limits.
Option 3	The UCITS Remuneration Guidelines would provide that remuneration principles are applicable to all management companies and proportionality may not lead to any disapplication of any of the requirements. This means that the specific minima set out in Article 14b of the UCITS Directive (e.g. the minimum deferral of 40 to 60% of variable remuneration) should never be disapplied. Management companies should in any case apply at least the minima criteria set out therein and, where appropriate, apply more strict criteria.

	Disapplication of certain of the AIFMD remuneration principles would continue to be allowed under the specific conditions spelled out under the AIFMD Remuneration Guidelines.
Preferred Option	ESMA decided to change the approach on which it consulted (i.e. option 2) and to follow the baseline scenario. This decision took into account the approach followed by the EBA in its Guidelines on sound remuneration policies under the CRD IV, published on 21 December 2015 (EBA/GL/2015/22) which are silent on the possibility to disapply any of the CRD IV remuneration requirements. In this respect, ESMA had to balance the co-legislators' steer to ensure alignment with the AIFMD Remuneration Guidelines and the obligation to closely cooperate with the EBA "*in order to ensure consistency with requirements developed for other financial services sectors, in particular credit institutions and investment firms*" (Article 14a(4) of the UCITS Directive, as amended by the UCITS V Directive). ESMA is aware that the baseline scenario provides limited guidance on how to apply proportionality in relation to the remuneration principles. However, the aforementioned recent work and legal analysis have called into question the existing understanding that proportionality may lead to a result where the rules on the pay-out process for variable remuneration are not applied. Therefore, ESMA decided to follow the approach adopted by the EBA and did not include in its final UCITS Remuneration Guidelines any guidance on the possibility not to apply any of the remuneration requirements set out in the UCITS Directive. Together with this final report ESMA also issued a letter to the European institutions setting out ESMA's views on proportionality and calling for further clarity on this issue.

4.2. Application of different sectoral rules

Policy Objective	The UCITS Directive requests that ESMA include in its guidelines on remuneration policies guidance on how different sectoral remuneration principles are to be applied where staff performs services subject to different sectoral remuneration principles.
Baseline scenario	No further guidance would be provided through the guidelines on how different sectoral remuneration principles are to be applied where staff performs services subject to different sectoral remuneration principles.
Option 1	The sectoral remuneration principles (CRD IV, AIFMD and UCITS

	Directive) would have to be applied to staff on a pro rata basis based on objective criteria.
Option 2	The pro rata criterion described under option 1 would be accompanied by an alternative option under which it would be allowed to apply to staff performing services subject to different sectoral principles those principles which are deemed more effective for achieving the outcomes of discouraging inappropriate risk taking and aligning the interest of the relevant individuals with those of the investors in the funds or other portfolios they manage.
Preferred Option	ESMA retained option 2 and discarded option 1. The baseline scenario was also discarded as it would not have complied with the explicit mandate granted to ESMA under the Level 1 provisions on the topics to be covered in the UCITS Remuneration Guidelines. Moreover, this would have led to inconsistent approaches across Europe in relation to staff performing services subject to different sectoral remuneration principles. ESMA preferred option 2 as it provides some flexibility by setting out two alternative approaches, while at the same time ensuring an appropriate level of investor protection to the extent that the approach which is additional in option 2 (as compared to option 1) requires that the rules which are more effective in discouraging inappropriate risk taking are applied[2]. Option 1 would have been less cost effective as it would have set a fixed rule, while the alternative approach set out under option 2 may save implementation costs for those firms that already voluntarily follow this approach in practice. In elaborating the two options, ESMA informed its views also by taking into account the outcome of the mapping of the data available at national level on staff subject to different sectoral rules (see section 7 of this draft CBA).

5. Assessment of the impact of the various options

5.1. Proportionality

[2] ESMA saw merit in replacing the reference to 'excessive risk taking' with a reference to 'inappropriate risk taking', which better recognises the specificities of the UCITS framework.

Option 1	Qualitative description
Benefits	Clarifications that proportionality cannot lead to the disapplication of any of the rules on remuneration under the UCITS Directive or the AIFMD would set appropriate standards in terms of investor protection (including retail investors as regards UCITS). Indeed, the application of the minimum standards set out under the UCITS Directive and the AIFMD would ensure a better alignment of the interests of risk takers with those of the managers for which they act and, ultimately, with those of the investors in the relevant funds that they manage. This option would ensure an alignment between the provisions under the AIFMD Remuneration Guidelines and the UCITS Remuneration Guidelines.
Costs to regulator and compliance costs	While no detailed data are available at this stage[3], one-off and ongoing costs to certain competent authorities and asset managers are expected to arise from the prohibition to disapply any of the remuneration requirements under both the UCITS Directive and the AIFMD. This is particularly the case for those UCITS management companies (and their supervisors) also holding a separate AIFMD licence which are allowed to disapply certain of these rules in line with the provisions of the AIFMD Remuneration Guidelines.[4] Moreover, these costs may be more relevant to those AIFMs currently disapplying all of the requirements that may be disapplied according to the AIFMD Remuneration Guidelines.[5] For some quantitative data gathered on this point through the consultation, see the summary of the responses received on Question 1 of the consultation paper under Section 2 of the final report. The costs under this option are expected to be substantially higher than those under options 2 and 3.

Option 2	Qualitative description
Benefits	The benefits in terms of investor protection highlighted above under option 1 are not expected from this option. This option would ensure an alignment between the provisions

[3] See tables 5 and 6 under section 7 below.
[4] See table 2 under section 7 below.
[5] See table 4 under section 7 below.

	under the AIFMD Remuneration Guidelines and the UCITS Remuneration Guidelines and help foster a harmonised approach throughout Europe.
Costs to regulator and compliance costs	To the extent that this option would mirror the approach followed under the AIFMD Remuneration Guidelines, no one-off and ongoing compliance costs to both competent authorities and asset managers are expected to arise from it.

Option 3	Qualitative description
Benefits	Clarifications that proportionality cannot lead to the disapplication of any of the rules on remuneration under the UCITS Directive would set appropriate standards in terms of protection of retail investors. However, contrary to option 1, the same outcome would not be achieved for investors investing into funds falling under the AIFMD. Moreover, contrary to options 1 and 2, this option would introduce a misalignment between the provisions under the AIFMD Remuneration Guidelines and the UCITS Remuneration Guidelines.
Costs to regulator and compliance costs	To the extent that this option would not change the approach followed under the AIFMD Remuneration Guidelines, no one-off and ongoing costs to both competent authorities and AIFMs are expected to arise from it. However, certain one-off and ongoing costs to certain competent authorities and UCITS management companies are expected to arise from the prohibition to disapply any of the remuneration requirements under the UCITS Directive. Such costs are expected to be higher than costs under option 2, but lower than costs under option 1, even if the misalignment between the requirements under the UCITS Remuneration Guidelines and the AIFMD Remuneration Guidelines might in itself create additional compliance costs.

5.2. Application of different sectoral rules

Option 1	Qualitative description

Benefits	The pro rata criterion has the advantage of being based on simple and objective elements such as the time spent on the performance of the different services to which different rules apply. By applying the different rules based on the activities performed, the relevant level of investor protection targeted under each piece of applicable legislation would be ensured.
Costs to regulator and compliance costs	Limited one-off and ongoing compliance costs are expected to arise from the application of the pro rata criterion. Indeed, even in the absence of such a provision being clearly spelled out, firms are expected to apply remuneration rules based on the activities performed by each relevant staff member. Therefore, they should already be in a position to determine which activities are performed under each sectoral rules. Additional one-off and ongoing monitoring costs are more likely to arise for supervisors who are not necessarily supervising this element for the time being in the context of their supervision of asset managers, credit institutions and investment firms.

Option 2	Qualitative description
Benefits	The same benefits highlighted above for option 1 are expected from this option. Moreover, the possibility under this option to adopt a criterion which is alternative to the 'pro rata' one should introduce more flexibility while at the same time ensuring an equivalent level of investor protection.
Costs to regulator and compliance costs	One-off and ongoing costs are expected to be less relevant than under option 1 for both supervisors and supervised entities. This is linked to the fact that supervised entities could voluntarily decide to apply – for instance – CRD IV rules to staff performing activities subject to different sectoral legislation, thus reducing compliance costs within entities such as those that are part of a group.

6. Mapping of data available at national level in relation to the possible approaches on proportionality

14. In order to inform its decision on the approach to take on proportionality under the UCITS and AIFMD Remuneration Guidelines, ESMA submitted a number of questions to NCAs in order to gather data available at national level.

15. The relevant questions are set out in the tables below which include the data received from the relevant NCA for each Member State. Unless stated otherwise, the data reflect the situation as at 30 March 2015.

Table 1

Question 1	***How many UCITS management companies out of those authorised in your jurisdiction also hold a separate AIFMD licence?***	
	Authorised UCITS management companies	*Holding a separate AIFMD licence*
Estonia	5*	None[6]
Sweden	43*	18
Spain	79	55[7]
Croatia	18	11
Greece	16*	2
Portugal	21*	11
Denmark	13*	10
Latvia	12*	4
Luxembourg[8]	206	111
Germany	52*	32
Belgium	7	5
Austria	25*	19
Ireland	78	24
Czech Republic	8*	8

[6] 1 was in the process of authorization for an additional AIFM licence.
[7] 55 management companies also manage non-UCITS funds. AIFMD was transposed into Spanish law on November 2014. An additional provision states that AIFM were required to provide a declaration of compliance with the Spanish law to the national authority (CNMV) within 3 months. Declarations have to get approved in order to grant the license to AIFM and include them into the national register. As of the closing date of the mapping exercise (30 March 2015) declarations received were being reviewed and no licenses were granted yet. Therefore, figures included in the table above for Spain were obtained based on the distinction between 'UCITS' and 'non-UCITS' funds.
[8] Data as of 31/12/2014.

United Kingdom	159*	Circa 90
France	316*	142
Malta	14*	5[9]
TOTAL:	**1,072**	**547**

*Source: data available as at 5 June 2015 in the UCITS management companies register available at the ESMA website.

Table 2

Question 2	***Among the UCITS management companies also holding an AIFMD licence, how many of them avail themselves of the possibility to disapply (some of) the remuneration requirements as foreseen under the AIFMD Guidelines?***
Estonia	N/A
Sweden	None[10]
Spain	N/A[11]
Croatia	All of them (11)
Greece	None
Portugal	N/A
Denmark	No data available
Latvia	None
Luxembourg	N/A – no data available
Germany	None
Belgium	4[12]

[9] Data as at 1 June 2015.
[10] 2 applications were under process as of 30 March 2015.
[11] Information not available as at 30 March 2015 (see footnote 21).
[12] These management companies avail themselves of the exemption from the obligation to set up a remuneration committee whenever such a committee is set up at group level pursuant to the Guidelines on sound remuneration policies under the AIFMD.

Austria	11
Ireland	No data available
Czech Republic	7
United Kingdom	No data available[13]
France	73
Malta	All of them (5)
TOTAL:	**111**

Table 3

Question 3	***If in your jurisdiction the possibility to disapply any of the remuneration requirements under the AIFMD Guidelines is based on quantitative thresholds, please provide details.***
Estonia	No quantitative thresholds
Sweden	N/A
Spain	No quantitative thresholds
Croatia	No quantitative thresholds[14]
Greece	N/A
Portugal	No quantitative thresholds
Denmark	The Danish remuneration regulation applicable to AIFMD-companies contains a de minimis threshold of up to DKK 100.000. According to this quantitative threshold smaller amounts of variable remuneration (of up to DKK 100.000) which does not encourage employees to excessive risk taking can be exempted from instrument, retention and deferral requirements if the management function in its supervisory function or the senior management asses that exemption is appropriate. The threshold is absolute and cannot be exceeded. If an

[13] This NCA issued specific guidance on the application of the AIFMD remuneration rules. This guidance covers the circumstances under which AIFMs might be able to apply proportionality to the remuneration provisions and it sets out certain quantitative thresholds.

[14] All the Croatian AIFMs are below the threshold stipulated in the AIFMD Remuneration Guidelines for the purpose of the establishment of a remuneration committee – their AuM is below EUR 1.25 billion and they have less than 50 employees, including those dedicated to the management of UCITS and providing investment services under Article 6(4) of the AIFMD

	employee is remunerated more than DKK 100.000 in variable remuneration during the financial year all the remuneration requirements of the AIFMD have to be applied to the total variable remuneration. The Danish AIFMD remuneration regulation does not contain other possibilities to disapply remuneration requirements. On request, the companies should be able to demonstrate to the relevant NCA that the exempted smaller amounts of remuneration does not encourage the employees to excessive risk taking and that disapplication of instrument, retention and deferral requirements are appropriate.
Latvia	The use of instruments is required only in cases where the variable part of the remuneration is significant (i.e. >60% of the total annual remuneration).
Luxembourg	No quantitative thresholds
Germany	No quantitative thresholds
Belgium	The relevant NCA could apply – by analogy – the quantitative thresholds that exist pursuant to article 62, § 2ter of the Belgian law on the legal status and supervision of investment firms.[15] Pursuant to this article, a "small" investment firm (due to its internal organisation or due to the nature, the scope and the complexity of its activities) is exempted from setting up a remuneration committee if at least two of the three following criteria are satisfied: - the average number of employees lower than 250 people over the full year concerned; - the balance sheet total equal or lower than 43.000.000 euros; - the net annual turnover equal or lower than 50.000.000 euros.
Austria	Quantitative thresholds are either based on the size of the company (AIF assets under management, number of AIF managed, number of employees, number of delegations etc versus the respective industry median numbers) and/or the size of the bonus itself: EUR 30.000 or 25% of fixed remuneration serve as materiality threshold and are considered as too small for application of the pay-out requirements under section XII.IV of the AIFMD Remuneration Guidelines.
Ireland	No quantitative thresholds

[15] As at 30 March 2015 these provisions were not applied to any specific case.

Czech Republic	No quantitative thresholds
United Kingdom	The relevant NCA has provided some guidance to AIFMs on how to interpret the application of the principle of proportionality. This guidance includes the following quantitative thresholds which provide a working presumption, to be confirmed or disconfirmed by considering other factors, as to how considerations of proportionality should be reflected in the AIFM's remuneration policy: – AIFMs which manage portfolios of AIFs that are unleveraged and have no redemption rights exercisable during a period of 5 years following the date of initial investment in each AIF: it is appropriate to disapply 'Pay-out Process Rules' if their assets under management (AuM) are less than £5 billion; – AIFMs which manage portfolios of AIFs in other cases, including any assets acquired through the use of leverage: it is appropriate to disapply 'Pay-out Process Rules' if their assets under management (AuM) are less than £1 billion.[16] The proportionality guidance provided by the NCA states that *"disapplication of the pay-out process rules is never automatic; AIFMs should perform an assessment for each of the rules that may be disapplied based on the application of the principle of proportionality"*. As a consequence: • AIFMs must apply all the pay-out process rules, unless they believe they can justify to the NCA that it would be disproportionate to do so; and • the AuM threshold is an initial test which indicates that a firm may be eligible for disapplication. The firm must then perform the relevant analysis to demonstrate that disapplication of a particular provision is warranted; passing the AuM test is not, in of itself, reason enough for disapplication.
France	The possibility to disapply some of the rules is based on an overall case-by-case analysis, which is based on the following criteria: – size (e.g. less than 500 million EUR AuM), – internal organization (e.g. 2/3 of the salary is fixed and

[16] The relevant guidance is available at the following address (see p. 5 ff.): https://www.fca.org.uk/static/documents/finalised-guidance/fg14-02.pdf.

<table>
<tr><td></td><td>maximum 1/3 of the salary is variable) and

– the nature, scope (e.g. less than 10% of AuM are AIFs) and

– complexity of their activities (e.g. applied investment strategies: index management, formula management, management linked to employee saving plans).</td></tr>
<tr><td>Malta</td><td>The relevant NCA has established different thresholds for AIFMs whose portfolio of AIFs includes assets acquired through use of leverage and AIFMs whose portfolio of AIFs does not include leveraged assets. These thresholds are as follows:

– Leveraged assets

<table>
<tr><th>Value of Portfolio of AIFs</th><th>Pay-Out Process Rules</th><th>Remuneration Committee</th></tr>
<tr><td>Less than €100 million</td><td>Disapplied</td><td>Disapplied</td></tr>
<tr><td>Between €100 million and €1.25 billion</td><td>Disapplication could be considered on the grounds of proportionality</td><td>Disapplication could be considered on the grounds of proportionality</td></tr>
<tr><td>Over €1.25 billion</td><td>Full application of the ESMA Guidelines</td><td>Full application of the ESMA Guidelines</td></tr>
</table>

– Unleveraged assets

<table>
<tr><th>Value of Portfolio of AIFs</th><th>Pay-Out Process Rules</th><th>Remuneration Committee</th></tr>
<tr><td>Less than €500 million</td><td>Disapplied</td><td>Disapplied</td></tr>
<tr><td>Between €500 million and €6 billion</td><td>Disapplication could be considered on the grounds of proportionality</td><td>Disapplication could be considered on the grounds of proportionality</td></tr>
<tr><td>Over €6 billion</td><td>Full application of the ESMA Guidelines</td><td>Full application of the ESMA Guidelines</td></tr>
</table>
</td></tr>
</table>

Table 4

Question 4	***Among the UCITS management companies referred to under Q2, please provide:*** ***(i) the number of those disapplying all the remuneration requirements that may be disapplied according to the AIFMD Guidelines (i.e. those under Section XII.IV of the Guidelines [variable remuneration in instruments, retention, deferral, ex post incorporation of risk for variable remuneration]), and* […]**
Estonia	None
Sweden	None
Spain	N/A
Croatia	All of them (11)
Greece	N/A
Portugal	N/A
Denmark	No data available
Latvia	N/A
Luxembourg	N/A
Germany	None
Belgium	None
Austria	Most of the management companies either apply all requirements of Section XII.IV of the AIFMD Remuneration Guidelines or none. Currently 8 out of the 19 AIFM/UCITS management companies fully apply all requirements.
Ireland	N/A
Czech Republic	7
United Kingdom	No data available
France	Five requirements can be disapplied (four are linked to the pay-out process and one concerns the establishment of a remuneration

	committee). The 72 management companies mentioned in the response to question 2 disapply all these five requirements.[17]
Malta	All of them (5)
	Among the UCITS management companies referred to under Q2, please provide: **[…]** **(ii)** ***the number of those disapplying only some of these requirements***
Estonia	None
Sweden	None
Spain	N/A
Croatia	None
Greece	N/A
Portugal	N/A
Denmark	No data available
Latvia	N/A
Luxembourg	N/A
Germany	None
Belgium	None
Austria	Some companies - even though they would have qualified as small and non-complex - apply the deferral requirement on a voluntary basis.
Ireland	N/A
Czech Republic	None
United Kingdom	No data available

[17] Beyond that, and only as far as individuals are not identified as risk takers, a partial disapplication can be granted on an individual basis (an additional evaluation needs to be undertaken).

France	N/A
Malta	None

Table 5

Question 5	***Based on the data provided in your answer to Q2, please provide an estimate of the direct costs to your competent authority arising from the prohibition to disapply any of the remuneration rules under the UCITS Directive. Please provide details on their one-off or ongoing component.***
Estonia	N/A
Sweden	Approximately 600 EUR for a one-off assessment, the ongoing costs may vary considerably depending on the number of applications.
Spain	No data available
Croatia	N/A
Greece	No data available
Portugal	N/A
Denmark	No data available
Latvia	N/A
Luxembourg	N/A
Germany	N/A
Belgium	None
Austria	N/A
Ireland	N/A
Czech Republic	The prohibition to disapply any of the remuneration rules under the UCITS Directive would generate extra costs for the relevant NCA (as a result of additional staff requirements). One-off costs would be related to necessary legislative changes (an amendment of the Act No. 240/2013 on Investment Companies and Investment Funds and relating decrees) whereas ongoing costs would have to be allocated on introduction of new internal rules, on-site and off-site supervision and

	enforcement.
United Kingdom	No data available
France	If a prohibition of disapplication called into question the hundreds of AIFM authorisation granted, a team of the relevant NCA consisting of approximately 40 persons would need to work at least 15 days per person for the review of the authorisation process. Additional costs would also appear due to the revision and disclosure of material recently issued in relation to the AIFMD Remuneration Guidelines.
Malta	The main cost to the relevant NCA arising from the prohibition to disapply any of the remuneration rules would be the additional human resources and man hours required to examine the setups and ensure that these remain compliant at all times. It is not envisaged that one off and ongoing supervisory costs would be significant, although one has to bear in mind that this would be an additional task for supervisory resources.

Table 6

Question 6	***Based on the AIFMD experience (i.e. data gathered in that context, if any), which is the estimated implementation cost (one-off and ongoing) by an investment manager to implement the remuneration rules under the UCITS Directive? To what extent can these costs be reduced by applying the principle of proportionality?***
Estonia	No data available. The relevant NCA does not expect these costs to be unreasonable or significant for the management company.
Sweden	No data available
Spain	No data available
Croatia	N/A
Greece	No data available
Portugal	N/A
Denmark	N/A
Latvia	N/A

<table>
<tr><td>Luxembourg</td><td>N/A</td></tr>
<tr><td>Germany</td><td>No data available</td></tr>
<tr><td>Belgium</td><td>No data available</td></tr>
<tr><td>Austria</td><td>No data available. The relevant NCA would expect both costs and efforts to be disproportionately high for the majority of the UCITS management companies because of their small size and small bonuses (on average).</td></tr>
<tr><td>Ireland</td><td>No data available</td></tr>
<tr><td>Czech Republic</td><td>Currently, every UCITS management company in the Czech Republic holds also an AIFMD licence (there is no management company holding UCITS license only). As a consequence all UCITS management companies apply the same remuneration rules as those required under the AIFMD and, therefore, a joint system of remuneration is applied to all relevant employees within one management company (no matter under which Directive (UCITS or AIFMD)). Excluding UCITS management companies from the possibility to apply the proportionality approach (and thus to adopt different remuneration systems within one company) would cause in particular implementation costs.</td></tr>
<tr><td>United Kingdom</td><td>The below estimates of costs for AIFMs from applying the AIFMD remuneration rules were prepared by the relevant NCA when consulting on the implementation of AIFMD:

Table 10: Costs for investment managers from applying the Remuneration Code
<table><tr><th rowspan="2">Costs</th><th colspan="2">Incremental costs</th></tr><tr><th>One-off</th><th>Ongoing (annual)</th></tr><tr><td>For changing:
• the way remuneration policies are set;
• systems and controls;
• additional data collection;
• reporting; and
• record keeping requirements.</td><td>£0 – £300,000</td><td>£0 – £50,000</td></tr><tr><td>Issuing an annual remuneration statement</td><td>£0 – £100,000</td><td>£0 – £30,000</td></tr><tr><td>Senior management board or committee time</td><td>NA</td><td>£0 – £24,000</td></tr><tr><td>Enhanced risk management function</td><td>NA</td><td>£0 – £31,000</td></tr><tr><td>Adjusting remuneration structures</td><td>£0 – £47,000</td><td>£0 – £50,000</td></tr><tr><td>Average of total costs</td><td>£7,000</td><td>£4,000</td></tr><tr><td>Median</td><td>Minimal costs</td><td>Minimal costs</td></tr></table></td></tr>
</table>

France	If the UCITS Remuneration Guidelines remain close to the AIFMD Remuneration Guidelines, then implementation costs should be acceptable for all players. If the UCITS Remuneration Guidelines deviate strongly from the AIFMD Remuneration Guidelines, important costs will appear for all players (those applying the guidelines totally and those disapplying the allowed number of requirements). The costs are mainly linked to IT implementation/ transformation costs.
Malta	Currently all the licensed AIFMs have satisfied the proportionality principles and have qualified to be exempt from the relevant requirements (e.g. on remuneration committee and payout process). Maltese UCITS management companies tend to be modest/ small in size. It is difficult for the relevant NCA to estimate the one-off implementation costs although it was mentioned that not distinguishing on the basis of scale, size and complexity would be deleterious on UCITS management companies and UCITS and in a worst case scenario they may tilt the scales to make them uneconomic/ non-viable.

7. Mapping of data available at national level in relation to the possible approaches on the application of different sectoral rules to staff

16. In order to inform its decision on the approach to take on the application of different sectoral rules to staff under the UCITS and AIFMD Remuneration Guidelines, ESMA submitted a number of questions to NCAs in order to gather data available at national level.

17. The relevant questions are set out in the tables below which include the data received from the relevant NCA for each Member State. Unless stated otherwise, the data reflect the situation as at 30 March 2015.

Table 7

Question 7	***How many asset managers out of those authorised in your jurisdiction are subsidiaries of an entity subject to the CRD? Please distinguish between*** ***(i) UCITS management companies***
Estonia	5
Sweden	2
Spain	6 (out of 24 UCITS management companies)
Croatia	6

Greece	8[18]
Portugal	3
Denmark	4
Latvia	9
Luxembourg[19]	34
Germany	None
Belgium	2
Austria	23
Ireland	No data available
Czech Republic	None
United Kingdom	Circa 70 (including AIFMs)[20]
France	56
Malta	1
TOTAL:	**159**[21]
	How many asset managers out of those authorised in your jurisdiction are subsidiaries of an entity subject to the CRD? Please distinguish between* […]** ***(ii) AIFMs
Estonia	None
Sweden	None
Spain	2 (out of 10 non-UCITS managers)
Croatia	None

[18] 2 of them were under liquidation as at 30 March 2015.
[19] Data as at 31/12/2014.
[20] There are circa 70 AIFMs or UCITS management companies which are part of a group with at least an entity subject to CRD IV requirements within it.
[21] Please note that the total does not include the United Kingdom as figures for this jurisdiction were provided in aggregate taking into account AIFMs and UCITS management companies.

Greece	None
Portugal	4
Denmark	None
Latvia	1
Luxembourg[22]	9
Germany	27
Belgium	None
Austria	24
Ireland	No data available
Czech Republic	None
United Kingdom	Circa 70 (including UCITS management companies)
France	94
Malta	None
TOTAL:	**161**[23]
	How many asset managers out of those authorised in your jurisdiction are subsidiaries of an entity subject to the CRD? Please distinguish between* […]** ***(iii) entities authorised under both the UCITS Directive and AIFMD
Estonia	None
Sweden	6
Spain	41 (out of 55 management companies also managing non-UCITS funds)[24]
Croatia	None

[22] Data as at 31/12/2014.
[23] See comment under footnote 35 above.
[24] See footnote 27 above for an explanation on the reference to 'non-UCITS funds'.

Greece	1
Portugal	9
Denmark	4
Latvia	1
Luxembourg[25]	44
Germany	10
Belgium	3
Austria	19
Ireland	No data available
Czech Republic	5
United Kingdom	Circa 70 (including AIFMs or UCITS management companies)
France	53
Malta	None
TOTAL:	**196**[26]

Table 8

Question 8	***How many asset managers have employees or other categories of personnel performing services subject to different sectoral remuneration principles (UCITS and/or AIFMD and/or CRD)? Please distinguish between*** ***(i) UCITS management companies […]***
Estonia	7
Sweden	26
Spain	No data available

[25] Data as at 31/12/2014.
[26] See comment under footnote 35 above.

Croatia	11
Greece	No data available
Portugal	12
Denmark	4
Latvia	No data available
Luxembourg	No data available
Germany	No data available
Belgium	None
Austria	No data available
Ireland	No data available
Czech Republic	8
United Kingdom	No data available[27]
France	No data available
Malta	No data available
TOTAL:	**68**
	How many asset managers have employees or other categories of personnel performing services subject to different sectoral remuneration principles (UCITS and/or AIFMD and/or CRD)? Please distinguish between* […]** ***(ii) AIFMs
Estonia	None
Sweden	18
Spain	Not available
Croatia	11

[27] While the requested information was not available, the relevant NCA mentioned that there are 320 firms carrying out ancillary services under either AIFMD or UCITS Directive.

Greece	None
Portugal	4
Denmark	None
Latvia	No data available
Luxembourg	No data available
Germany	No data available
Belgium	No data available
Austria	No data available
Ireland	No data available
Czech Republic	8
United Kingdom	No data available[28]
France	No data available
Malta	No data available
TOTAL:	**41**

Table 9

Question 9	***How many entities perform investment management activities under delegation from a UCITS according to Article 13 of the UCITS Directive? Please distinguish between*** ***(i) AIFMs […]***
Estonia	None
Sweden	4
Spain	1[29]

[28] See footnote 41 above.
[29] See footnote 21 above.

Croatia	None[30]
Greece	No data available
Portugal	8
Denmark	None
Latvia	N/A
Luxembourg	No data available
Germany	No data available
Belgium	No data available
Austria	None[31]
Ireland	No data available
Czech Republic	None
United Kingdom	No data available
France	No data available
Malta	No data available
TOTAL:	**13**
	How many entities perform investment management activities under delegation from a UCITS according to Article 13 of the UCITS Directive? Please distinguish between* […]** ***(ii) entities subject to the CRD
Estonia	2
Sweden	11
Spain	5

[30] 6 UCITS management companies have delegated the function of internal audit on credit institutions. In all cases, credit institutions that perform the function of internal audit under delegation are within the same group as UCITS management companies.

[31] There are a few management delegations of UCITS to AIFMs, but only to those AIFM with an additional UCITS authorisation, so this should rather be seen as a delegation to a UCITS management company.

Croatia	None
Greece	4
Portugal	8
Denmark	None
Latvia	N/A
Luxembourg	No data available
Germany	No data available
Belgium	No data available
Austria	16[32]
Ireland	No data available
Czech Republic	2
United Kingdom	No data available
France	No data available
Malta	No data available
TOTAL:	**48**

[32] This figure covers Austrian CRD entities only. The total amount of delegations is higher because there are some delegations to foreign CRD entities.

3.2 Annex II

Opinion of the Securities and Markets Stakeholder Group

ADVICE TO ESMA

SMSG advice to ESMA on its Consultation Paper on Guidelines on sound remuneration policies under the UCITS Directive and AIFMD

Executive summary

The objective of this paper is to provide high level advice to ESMA on its Consultation Paper titled “Guidelines on sound remuneration policies under the UCITS Directive”, launched July 23, 2015 and as per ESMAs request to the SMSG dated August 11 2015.

The SMSG very much appreciates the opportunity to comment on this consultation paper. While the areas specifically addressed by the consultation paper as well as the approach followed and reasoning applied by ESMA in the development of the Guidelines are largely uncontroversial to the SMSG, the SMSG would still, and in line with its mandate to offer high level advice to ESMA, like to take this opportunity to express its strong support for the approach taken by ESMA on the matter of proportionality. This approach, which is in line with that taken by ESMA on the AIFMD Remuneration Guidelines, allows for the disapplication of certain requirements of these draft Guidelines on an exceptional basis and taking into account specific facts.

The SMSG believes it to be critical to ensure, that where sub-segments of industries as diverse as the UCITS or AIFM already have in place proven arrangements which have been negotiated and agreed with investors and/or which achieve the alignment of interest between investors and managers and their identified staff, which is the purpose of these guidelines, such fund managers should not be deprived of the possibility to disapply, on a case by case basis, certain of the requirements.

The notion of proportionality is inherent in European Union law and lies at the heart of EU governance and policy-making. A key element of sound regulation, it allows disapplication and thus “neutralization”, on an exceptional basis and subject to a case-by-case assessment, of certain requirements of the guidelines, where what is intended to be achieved by the regulation can be sufficiently achieved through the workings of the business model in question. This is especially important where a piece of regulation encompasses many different sub-sets of funds and managers with quite different business models, risk-profiles and negotiated structures like those regulated under the UCITS and/or AIFM Directives.

Background

1) Article 14a(4) of the UCITS Directive provides that ESMA shall issue guidelines addressed to competent authorities or financial market participants concerning the application of the Remuneration principles set out under Article 14b of the UCITS Directive ("UCITS V Remuneration Guidelines").

2) Article 14a(4) of the UCITS V Directive sets out the following requirements:

I. ESMA shall take into account the principles of sound remuneration policies set out in Recommendation 2009/384/EC ("Recommendation");

II. ESMA shall take into account proportionality *"the size of the management company and the size of the UCITS that* [the relevant persons] *manage, their internal organization, and the nature, scope and complexity of their activities")*; and

III. ESMA shall co-operate closely with EBA.

ESMA's working method

1) Both the above mentioned requirements and the UCITS V remuneration principles themselves (i.e the principles under Article 14b of the UCITS Directive) broadly reflect the provisions on remuneration under the AIFMD. For this reason ESMA decided to take the Guidelines on sound remuneration policies under the AIFMD ("AIFMD Remuneration Guidelines") as a starting point for developing the UCITS V Remuneration Guidelines and depart from them only if and when strictly necessary.

2) This is in line with and justified by the approach envisaged by the co-legislators according to the Level 1 text. Indeed, recital 9 of the UCITS V Directive states that "*ESMA's guidelines on remuneration policies and practices should where appropriate, be aligned, to the extent possible, with those funds regulated under Directive 2011/61/EU of the European Parliament and of the Council".*

3) Therefore, when developing the proposed draft guidelines, ESMA started from the text of the AIFMD Remuneration Guidelines and adapted it to the specificities of the UCITS framework, also taking into account the differences between the AIFMD and UCITS V Level 1 texts. ESMA has further also described the main areas of difference in its CP.

4) Given that the provisions of the UCITS V Directive require close co-operation with EBA as regards the UCITS Remuneration Guidelines, in developing the present consultation paper, ESMA also considered the provisions of the EBA consultation paper published on 4 March 2015 (EBA/CP/2015/03) ("EBA CP").

Matter of Proportionality (Question 1 of ESMA CP)

As stated above, recital 9 of the UCITS Directive states that ESMA's UCITS Remuneration Guidelines should, where appropriate, be aligned, to the extent possible, with the AIFMD Remuneration Guidelines. With respect to proportionality, the AIFMD Remuneration Guidelines permit the disapplication or "neutralization" of certain specific remuneration

requirements under specific circumstances and conditions. In the interest of ensuing consistency between the UCITS Remuneration Guidelines and the AIFMD Remuneration Guidelines, ESMA therefore considers it appropriate to make provisions for a similar approach to disapplication in the draft guidelines.

In reaching this conclusion, ESMA, also took into account the reading of the CRD IV provisions recently followed by EBA. While the EBA CP does not foresee the possibility to disapply any of the remuneration principles under the CRD IV, ESMA concludes that the reading followed by EBA in the context of CRD relates to a different sector of the financial services industry and that the diverse nature of the UCITS sector could justify a different approach to proportionality.

The SMSG strongly supports this view taken by ESMA, which is in line with the approach taken on the AIFMD Remuneration Guidelines and which allows for disapplication of certain requirements on an exceptional basis and taking account specific facts. The SMSG believes this to be the right approach.

The notion of proportionality is inherent in European Union law (Article 5 of the Treaty on European Union). The need for proportionality and the possible neutralisation or disapplication of certain principles has consistently also been put forward in the European financial regulation (UCITS and AIFM Directives).

Where the intended effect of the legislation – alignment of interest between investors, managers and their identified staff - is already achieved via established and proven business models, an alternative that seeks to impose “one size fits all” type of arrangements (for e.g. deferral, payment in units and risk adjustments which were designed for other industries or sub-segments thereof), is neither necessary, nor effective, nor proportionate to attain the legislation’s intended purpose.

The latter approach – as descending from the EBA’s preliminary views around proportionality as expressed in the EBA CP – would not only lead to significant additional costs, but more importantly it would introduce inconsistency and instability in the European area, as all regulation proposed and implemented over the last five years within the EU and its Member States has been done in compliance with the proportionality principle as we all know it. It would further run the risk of breaking proven models and distorting competition for EU-based managers fund raising on global markets, like for example private equity and venture capital managers. Especially the smaller ones would negatively affected (e.g.in terms of employment and competitiveness) and this at a time when, under e.g. the Capital Markets Union discussions, emphasis is made on the financing of SMEs.

Further, the neutralization envisaged by ESMA in its AIFMD remuneration guidelines does not amount to a general waiver from the remuneration requirements and neutralization is never automatically triggered on the basis of these guidelines alone. AIFMs are always required to perform an assessment for each of the different remuneration requirements that may be disapplied and determine whether proportionality allows them to dis-apply in part or in whole any or all of these individual requirements.

While it could possibly be argued that as the banking services industry is a more homogeneous one than either of the UCITS or AIFM industries, and that the EBA approach therefore could be seen as justified in that light, the SMSG would still like to reiterate that proportionality is inherent in all EU law and that sound regulatory approaches help to ensure diversity and efficiency of markets and thus also global competitiveness. While proportionality is of outmost importance for the global competitiveness of heterogeneous industries like the UCITS and AIFM, also the European banking services industry has had a long regulatory tradition building on the proportionality principle, i.e. subject to size of regulated entity as well as any fund being managed, the internal organization and the nature, scope and complexity of the activities undertaken.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

Adopted on 30 October 2015

Jesper Lau Hansen

Chair

Securities and Markets Stakeholder Group

3.3 Annex III

UCITS Remuneration Guidelines

1 Scope

Who?

1. These guidelines apply to management companies as defined under Article 2(1)(b) of the UCITS Directive and competent authorities. They also apply to investment companies that have not designated a management company authorised pursuant to the UCITS Directive.[33]

2. UCITS having designated a management company authorised pursuant to the UCITS Directive are not subject to the remuneration principles established in the UCITS Directive, nor to these guidelines. However, the remuneration principles set out in the *Recommendation* are relevant to those UCITS, 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 UCITS Directive.

What?

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

When?

4. These guidelines apply from 1 January 2017.

5. Without prejudice to the application of Directive 2014/91/EU by 18 March 2016, the guidance on the rules on variable remuneration provided under Sections 12 (Guidelines on the general requirements on risk alignment) and 13 (Guidelines on the specific requirements on risk alignment) of these guidelines, should first apply for the calculation of payments relating to new awards of variable remuneration to *identified staff* for the first full performance period after 1 January 2017. For example, a management company whose accounting period ends on 31 December should apply the guidance on the rules on variable remuneration provided in these guidelines to the calculation of payments relating to the 2017 accounting period.

[33] The remuneration principles in Article 14a and 14b of the UCITS Directive apply *mutatis mutandis* to these investment companies, based on the provisions of Article 30 of the UCITS Directive.

2 Definitions

Unless otherwise specified, terms used in the Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) have the same meaning in these guidelines. In addition, the following definitions apply for the purposes of these guidelines:

Recommendation	Commission Recommendation 2009/384/EC of 30 April 2009 on remuneration policies in the financial services sector.[34]
performance fees	a variable fee linked to the "performance of the UCITS". The "performance of the UCITS" includes capital appreciation as well as any income linked to the UCITS's assets (e.g. dividends). It may be assessed with reference to a target 'performance'. A performance fee can be based on elements such as a share of the capital gains or the capital appreciation of the UCITS' net asset value or any portion of the UCITS' net asset value as compared to an appropriate index of securities or other measure of investment performance. *Performance fees* are performance-related payments made directly by the management company or the UCITS itself for the benefit of *identified staff*.
identified staff	categories of staff, including senior management, risk takers, *control functions* and any employee receiving total remuneration that falls into the *remuneration bracket* of senior management and risk takers, whose professional activities have a material impact on the management company's risk profile or the risk profiles of the UCITS that it manages and categories of staff of the entity(ies) to which investment management activities have been delegated by the management company, whose professional activities have a material impact on the risk profiles of the UCITS that the management company manages.
control functions	staff (other than senior management) responsible for risk management, compliance, internal audit and similar functions within a management company (e.g. the CFO to the extent that he/she is responsible for the preparation of the financial statements).
remuneration	the range of the total remuneration of each of the staff members in the

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

bracket	senior manager and risk taker categories – from the highest paid to the lowest paid in these categories.
instruments	units or shares of the UCITS managed by the management company, equivalent ownership interests (including – for UCITS issuing only units – unit-linked instruments), subject to the legal structure of the UCITS concerned and its fund rules or instruments of incorporation, or share-linked instruments or equivalent non-cash instruments with equally effective incentives as any of the instruments referred to in this definition.
malus	arrangement that permits the management company to prevent the vesting of all or part of the amount of a deferred remuneration award in relation to risk outcomes or performances of the management company as a whole, the business unit, the UCITS 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 management company 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 management company'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 UCITS Directive. For those management companies 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 to be the members of the management body.
retention period	period of time during which variable remuneration that has 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 his or her 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.

3 Purpose

6. The purpose of these guidelines is to ensure common, uniform and consistent application of the provisions on remuneration in Articles 14a and 14b of the UCITS Directive.

4 Compliance and reporting obligations

4.1 Status of the guidelines

7. This document contains guidelines issued under Article 16 of the ESMA Regulation. 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.

8. 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.

4.2 Reporting requirements

9. 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 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.

10. Management companies are not required to report to ESMA whether they comply with these guidelines.

5 Guidelines on which remuneration is covered by these guidelines

11. Solely for the purposes of the guidelines and Article 14b of the UCITS Directive, remuneration consists of one or more of the following:

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

    (ii) any amount paid by the UCITS itself, including any portion of *performance fees* that are paid directly or indirectly for the benefit of *identified staff*, or

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

in exchange for professional services rendered by the management company's *identified staff*.

Whenever payments, excluding reimbursements of costs and expenses, are made directly by the UCITS to the management company for the benefit of the relevant categories of staff of the management company, or directly by the UCITS to the relevant categories of staff of the management company, 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 Article 14b of the UCITS Directive.

12. 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) 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, management company-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 risk alignment remuneration requirements that are specific to the UCITS Directive.

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

14. Management companies should ensure that variable remuneration is not paid through vehicles or that methods are employed which aim at artificially evading the provisions of the UCITS Directive and these guidelines. The management body of each management company 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 UCITS Directive (unless these firms are subject to regulatory requirements on remuneration that are equally as effective as those applicable under these guidelines, according to the provisions of paragraph 16); the use of tied agents or other persons not considered "employees" from a legal point of view; transactions between the management companies 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 and non-monetary material benefits awarded as incentive mechanisms linked to the performance.

15. Consideration should also be given to the position of partnerships and similar structures. Dividends or similar distributions that partners receive as owners of a management company 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.

16. When delegating investment management functions (including risk management) according to Article 13 of the UCITS Directive, where the remuneration rules would otherwise be circumvented, management companies should ensure that:

    a) the entities to which investment 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 investment 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 investment management activities on behalf of the management company.

17. For the purpose of letter a) under the previous paragraph, an entity can be considered subject to regulatory requirements on remuneration that are equally as effective as those applicable under these guidelines, inter alia, where the following conditions are met:

    i) the entity with whom the delegation arrangement is concluded is subject to the remuneration rules under either Directive 2013/36/EU (CRD IV) or Directive 2011/61/EU (AIFMD), and

    ii) the staff of the entity who are *identified staff* for the purpose of these guidelines are subject to the CRD IV or AIFMD rules.

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

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

19. The following categories of staff, unless it is demonstrated that they have no material impact on the management company's risk profile or on a UCITS it manages, should be included as the identified staff:

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

    - Senior management

    - *Control functions*

- Staff responsible for heading the investment 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 management company's risk profile or on a UCITS it manages, including persons capable of entering into contracts/positions and taking decisions that materially affect the risk positions of the management company or of a UCITS it manages. Such staff can include, for instance, sales persons, individual traders and specific trading desks.

  When assessing the materiality of influence on a management company's risk profile or on a UCITS it manages, management companies should define what constitutes materiality within the context of their management companies and the UCITS they manage. Criteria that management companies 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 management company's results and/or balance sheet and/or on the performance of the UCITS they manage.

  An analysis of job functions and responsibilities at the management company should be undertaken for a proper assessment of those roles that could materially affect the risk profile of the management company or of the UCITS 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 management company or of the UCITS 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 management company or the UCITS, 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*.

20. Additionally, if they have a material impact on the risk profile of the management company or of the UCITS it manages, other employees/persons, whose total remuneration falls into the remuneration bracket of 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 management company or of the UCITS 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 management company or of the UCITS it manages. In other management companies, this may not be the case.

21. The examples mentioned in paragraphs 19 and 20 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.

7 Guidelines on proportionality

7.1 Proportionality in general

22. 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 management companies 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 Article 14b of the UCITS Directive and the Recommendation envisage that provisions should operate in a way to enable a management company to take a proportionate approach to compliance with a remuneration principle.

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

24. It is primarily the responsibility of the management company 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 management companies actually implement proportionality, taking into account the achievement of regulatory objectives and the need to preserve a level playing field among different management companies and jurisdictions.

7.2 Proportionality with respect to the different characteristics of management companies

25. The different risk profiles and characteristics among management companies justify a proportionate implementation of the remuneration principles. Criteria relevant to the application of proportionality are the size of the management company and of the UCITS 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 management company capital and to the value of the assets under management (including any assets acquired through the use of leverage) of the UCITS that the management company manages; liabilities or risks exposure of the management company and of the UCITS that it manages; as well as the number of staff, branches or subsidiaries of a management company. The size of a management company and of the UCITS it manages should not be considered in isolation when applying proportionality. A management company might be considered "small" in terms of number of staff or subsidiaries, but be

engaged in a high level of risk taking. A management company should adhere strictly to the remuneration principles where the aggregate set of UCITS that it manages - each of them considered "small" - becomes 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 management companies, regardless of their size or systemic importance.

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

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

c) Nature, scope and complexity of the activities: 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 (collective portfolio management of UCITS only or also the additional services listed in Article 6(3) of the UCITS Directive);
- the type of investment policies and strategies of the UCITS the management company manages;
- the national or cross-border nature of the business activities (management company managing and/or marketing UCITS in one or more EU or non-EU jurisdictions); and
- the additional management of AIFs.

26. 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, a management company'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 UCITS.

7.3 Proportionality with respect of the different categories of staff

27. Proportionality should also operate within a management company 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 management company;
- The size of the group of persons, who have only collectively a material impact on the risk profile of the management company;
- 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;
  - the percentage of variable remuneration over the fixed remuneration.

8 Guidelines for management companies being part of a group

28. These guidelines apply in any case to any management company. In particular, there should be no exception to the application to any of the management companies which are subsidiaries of a credit institution of the sector-specific remuneration principles set out in the UCITS Directive and in the present guidelines.

29. It may be the case that in a group context, non-UCITS sectoral prudential rules applying to group entities may lead certain staff of the UCITS management company which is part of that group to be 'identified staff' for the purpose of those sectoral remuneration rules.

9 Guidelines on the application of different sectoral rules

9.1 General guidelines

30. Without prejudice to the guidance in paragraphs 28 and 29 of these guidelines, where some employees or other categories of personnel of management companies perform services subject to different sectoral remuneration principles, they should be remunerated either:

    a) based on the activities carried out and on a pro rata basis, to the extent that it is possible to single out an individual activity; or

    b) by applying the sectoral remuneration principles which are deemed more effective for achieving the outcomes of discouraging inappropriate risk taking and aligning the interest of the relevant individuals with those of the investors in the funds or other portfolios they manage.

31. The approach under item a) of paragraph 30 means that, for instance, the remuneration of an individual which performs services subject to the UCITS Directive and services subject to CRD IV and/or the AIFMD, should be determined applying the remuneration principles under the UCITS Directive, CRD IV and AIFMD on a pro rata basis based on objective criteria such as the time spent on each service or the assets under management for each service.

32. The approach under item b) of paragraph 30 means that, for instance, where the remuneration of an individual which performs services for various entities (including management companies and/or AIFMs) that are subsidiaries of a parent company that is subject to the CRD IV, is determined – on a voluntary basis – in compliance with all the remuneration principles under the CRD IV for all the services performed by such an individual, this should be deemed to also satisfy the requirements on remuneration under the UCITS Directive and AIFMD. However, where specific CRD requirements – such as those relating to the payment of variable remuneration in *instruments* – conflict with the requirements under the AIFMD or UCITS Directive, the remuneration of the individual concerned should in any event follow the relevant specific sectoral legislation conflicting with the CRD requirements. This means that, for instance, for individuals performing services subject to the AIFMD or UCITS Directive the variable remuneration should always be paid in the AIF *instruments* or UCITS *instruments* (Annex II (1) (m) of AIFMD and Article 14(b)(m) of UCITS V).

33. For the avoidance of doubt, the guidance under paragraphs 30 to 32 above applies to employees or other categories of personnel of management companies (including, for instance, secondees from parent undertakings subject to different sectoral remuneration rules such as CRD IV). Whenever employees or other categories of personnel of other entities perform investment management activities under delegation according to Article 13 of the UCITS Directive, the guidance under paragraphs 16 and 17 above should apply.

34. For management companies engaging in activities covered by the AIFMD (subject to authorisation under the AIFMD), compliance with the sectoral remuneration principles applying firm-wide – based on the relevant sectoral guidelines issued under the AIFMD and UCITS Directive – should be sufficient to consider that at individual level each of the sectoral remuneration principles are complied with. For example, compliance with the requirement under Article 14b(1)(e) of the UCITS Directive – which applies firm-wide – should at the same time satisfy the equivalent requirement under paragraph 1(e) of Annex II of the AIFMD for management companies engaging in activities covered by the AIFMD.

9.2 Specific guidelines on ancillary services

35. For the performance of ancillary services under Article 6(3) of the UCITS Directive or under Article 6(4) of the AIFMD, personnel of a management company or an AIFM should be subject to (i) the remuneration rules under the UCITS Directive or AIFMD, as applicable and (ii) the relevant MiFID rules, including the ESMA Guidelines on remuneration policies and practices (MiFID) (ESMA/2013/606).

10 Guidelines on the financial situation of the management company

36. In order to guarantee ongoing compliance with the requirements of Article 7(1) of the UCITS Directive, management companies should ensure that they maintain a prudent balance between sound financial situation and the award, pay out or vesting of variable remuneration.

37. The management company 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.

38. The fact that a management company 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[35]. Instead of awarding, paying out the variable remuneration or allowing it to vest, the net profit of the management company for that year and potentially for subsequent years should be used to strengthen its financial situation. The management company 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 management company's financial results justify such actions.

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

11 Guidelines on governance of remuneration

39. The general requirements on governance of remuneration should apply to the management company as a whole.

11.1 Management body

11.1.1 Design, approval and oversight of the remuneration policy

40. A management company's remuneration policy should encourage the alignment of the risks taken by its staff with those of the UCITS it manages, the investors of such UCITS and the management company 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.

41. The *supervisory function* should be responsible for approving and maintaining the remuneration policy of the management company, and overseeing its implementation. The remuneration policy should not be controlled by any 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.

42. In the design and oversight of the management company'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 management company.

43. Ultimately, the *supervisory function* should ensure that a management company'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 management company,

    - not encourage excessive risk taking as compared to the investment policy of the UCITS the management company manages, and

    - enable the management company to align the interests of the UCITS and their investors with those of the *identified staff* that manages such UCITS, and to achieve and maintain a sound financial situation.

44. The *supervisory function* should ensure that the management company's overall corporate governance principles and structures, as well as their interactions with the

remuneration system are considered within the design and implementation of a management company'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.

11.1.2 Remuneration of members of the management body and supervisory function

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

46. Where appropriate considering the size of the management company, 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 management company.

47. For management companies 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 management companies 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*.

11.1.3 Shareholders' involvement

48. The approval of a management company'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 management company, depending on the management company's characteristics or on the national rules in the jurisdiction in which the management company 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.

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

11.1.4 Review of the remuneration policy and its implementation

50. The *supervisory function* should ensure that the remuneration policy of the management company and its implementation 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 management company are adequately reflected); and

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

51. 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 management company.

52. 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.

53. 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 management companies should have sufficient resources to conduct the review internally, though external consultants may complement and support the management company in carrying out such tasks where appropriate. In line with proportionality, smaller and less complex management companies may decide to outsource the entire 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.

11.2 Remuneration committee

11.2.1 Setting up a remuneration committee

54. The setting up of a remuneration committee should be considered, as a matter of good practice, even by those management companies that are not obliged to set up such a committee under Article 14b(4) of the UCITS Directive.

55. In order to identify whether a remuneration committee is expected to be set up, the factors mentioned in Section 7 (Guidelines on proportionality) need to be considered. When assessing whether or not a management company is significant, a management company should consider the cumulative presence of all the three factors (i.e. its size or the size of the UCITS it manages, its internal organisation and the nature, scope and complexity of its activities). A management company 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.

56. 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 management company is listed or not;
- the legal structure of the management company;
- the number of employees of the management company;
- the management company's assets under management;
- whether the management company is also an AIFM;
- the provision of the services mentioned under Article 6(3) of the UCITS Directive.

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

- management companies for which the value of the portfolios of UCITS that they manage does not exceed EUR 1.25 billion and not having more than 50 employees, including those dedicated to the management of AIFs and the provision of the services mentioned under Article 6(3) of the UCITS Directive;
- management companies 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 management company with the rules set out in these guidelines.

58. It should also be understood, as mentioned above under paragraph 54, that management companies 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.

59. Management companies that fall outside the above examples should not be automatically required to set up a remuneration committee. For this purpose, management companies that are above the thresholds set out in paragraph 57 should be considered significant in terms of their size or the size of the UCITS they manage; in order to decide whether or not they need to set up a remuneration committee, however, such management companies 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.

11.2.2 Composition of the remuneration committee

60. 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.

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

62. 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 management companies' risk and capital profiles.

63. 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.

11.2.3 Role of the remuneration committee

64. 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 management company;
- provide its support and advice to the *supervisory function* on the design of the management company'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 management company and the UCITS it manages and the investors of such UCITS; 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.

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

11.2.4 Process and reporting lines of the remuneration committee

66. 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 management company'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 management company's shareholders' meeting about the activities performed.

11.3 Control functions

11.3.1 Roles of control functions

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

68. 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 management company, having regard to the promotion of effective risk management.

69. The risk management function should assess how the variable remuneration structure affects the risk profile of the management company. 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.

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

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

11.3.2 Remuneration of control functions

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

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

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

75. For management companies 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.

76. For management companies 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*.

77. 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.

78. *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.

12 Guidelines on the general requirements on risk alignment

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

12.1 The general remuneration policy, including the pension policy

80. The long-term strategy of the management company 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 UCITS 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 UCITS the management company manages and with the objectives set out in the strategies of the management company and the UCITS it manages and changes that could be decided in the strategies must be taken into account. Management companies 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 management company should ensure it makes the best possible attempt to align its remuneration policy with its interests and the interests of the UCITS it manages and their investors.

81. When developing their remuneration policy, management companies should give due consideration to how remuneration contributes to the prevention of excessive risk-taking, the efficiency of the management company and the UCITS it manages and the consistency of the remuneration policy with effective risk management.

82. 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 UCITS that the management company 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.

83. 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 UCITS that the management company manages. Having regard to the nature, scale and complexity of a management company, alternative approaches exist for connecting risk management elements to a remuneration policy.

12.2 Discretionary pension benefits

84. 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 management company and the UCITS it manages.

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

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

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

88. Where a staff member leaves the management company 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.

12.3 Severance pay

89. “Golden parachute” arrangements for staff members who are leaving the management company and which generate large payouts without any performance and risk adjustment should be considered inconsistent with the principle in Article 14b(1)(k) of the UCITS Directive. 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 management company or of the UCITS it manages, or in merger and/or takeover situations.

90. Management companies should set up a framework in which severance pay is determined and approved, in line with the management company’s general governance structures for employment. The framework should ensure that there is no reward for failure.

91. Management companies 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.

12.4 Personal hedging

92. 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.

93. 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.

94. 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. Management companies should maintain effective arrangements to ensure that the staff member complies with this requirement.

13 Guidelines on the specific requirements on risk alignment

95. The specific requirements on risk alignment should be applied by management companies only to the individual remuneration packages of the *identified staff*, but management companies may always consider an management company-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 management company-wide application is strongly recommended.

13.1 Fully flexible policy on variable remuneration

96. 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.

13.2 Risk alignment of variable remuneration

13.2.1 Risk alignment process

97. To limit excessive risk taking, variable remuneration should be performance-based and risk adjusted. To achieve this aim, an management company 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 management company.

13.2.1.1 Performance and risk measurement process

98. Setting up a remuneration system should start by defining the objectives of the management company, the unit, as well the staff and the investment strategy of the UCITS concerned. These objectives should be derived from the business plan of the management company, if any, and should be in line with the risk appetite of the management company and the investment strategy of the UCITS 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 UCITS concerned and the business plan, if any, or the objectives of the management company. 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 UCITS concerned.

13.2.1.2 Award process

99. After the *accrual period*, the management company 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 management company, the business unit and the staff member, the management company 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.

13.2.1.3 Payout process

100. In order to align the actual payment of remuneration to the holding period recommended to the investors of the UCITS managed by the management company 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.

13.2.2 Common requirements for the risk alignment process

13.2.2.1 Time horizon

101. Management companies, 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 UCITS concerned or the management company as a whole. For this exercise, management companies should examine what the impact of the staff member's activities could be on the UCITS they manage and management company's short and long term success. To be able to do so, the management company should align the horizon of risk and performance measurement with the holding period recommended to the investors of the UCITS managed by the management company and their investment risks. The requirement of a management company to assess the performance of its staff in a multi-year framework appropriate to the holding period recommended to the investors of the UCITS managed by the management company implies the *accrual period* and the payout period for short-term and long-term remuneration covering an appropriate period in total.

102. The right balance between accrual and payout periods should depend on the type of UCITS managed by the management company 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*.

13.2.2.2 Levels of risk and performance measurement

103. Performance-related remuneration should include parameters linked to the risks and performance of the UCITS concerned and of the business unit of the management company 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 UCITS

concerned and the performance of the management company. 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.

104. 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, management companies may design the remuneration policies to include financial measures based on the performance of all the UCITS managed by the management company or the entire management company, 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.

13.2.2.3 Quantitative and qualitative measures

105. 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).

106. 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, management companies should also rely on qualitative approaches.

13.2.2.4 Judgemental measures

107. 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.

108. For both quantitative and qualitative measures, management companies should be prepared to disclose and reproduce any judgmental elements incorporated into their risk alignment process. Management companies 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.

13.2.3 Risk measurement

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

110. In order to take into account all material risks, management companies should use the same risk measurement methods as used in the risk management policy established for the UCITS managed by the management company. Furthermore, management companies should also take into account the risks arising from the additional management of AIFs and from the services provided under Article 6(3) of the UCITS Directive.

111. Taking proportionality into account, the risk management calculations should be transparent and the management companies should be able to demonstrate how the risk calculations can be broken down by UCITS and related to the management company'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 a management company should implement a more sophisticated variable remuneration policy based on performance measurements.

13.2.4 Performance measurement

13.2.4.1 Qualitative/Quantitative measures

112. Management companies should use both quantitative (financial) as well as qualitative (non-financial) criteria for assessing individual performance.

113. 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.

114. 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.

115. 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.

13.2.4.2 Relative/absolute and internal/external measures

116. Absolute performance measures are measures set by the management company on the basis of its own strategy, which includes the risk profile and risk appetite of the management company and of the UCITS 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 management company's or UCITS' 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 UCITS.

117. Relative performance measures are measures that compare performance with peers, either 'internal' peers (i.e. within the organization) or 'external' (similar management companies). 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 management company or the UCITS 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 management companies and UCITS may perform poorly, relative measures may nonetheless lead to positive outcomes (and thus to an insufficient contraction of the management company's total variable remuneration) even if absolute performance has deteriorated compared to previous periods.

118. 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 management company-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.

13.3 Award process

13.3.1 Setting and allocation of pools

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

13.3.2 The risk adjustment in the award process

120. In determining remuneration pools or individual awards, management companies 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. Management companies should establish whether the risk adjustment criteria they are using take into consideration severe risks or stressed conditions.

121. Management companies 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. Management companies should determine the level of granularity that is suitable for each level.

13.3.2.1 Quantitative ex ante risk adjustment

122. In order to have a sound and effective remuneration scheme, management companies 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.

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

124. The quantitative ex-ante risk adjustments made by management companies should largely rely on existing measures within the management companies, 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.

13.3.2.2 Qualitative measures for ex-ante risk adjustment

125. Qualitative risk elements should be considered by management companies. Qualitative ex-ante adjustments could take place while setting management company-wide and business unit remuneration pools or when determining or allocating 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.

126. Management companies 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).

13.4 Pay-out process

13.4.1 Non-deferred and deferred remuneration

127. 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.

128. 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. Management companies 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 a management company combines these components should lead to a meaningful deferral schedule, in which the long-term risk alignment incentives are clear.

13.4.1.1 Time horizon and vesting

129. 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 years. Management companies should set the *deferral period* which should be calculated on the basis of the holding period recommended to the investors of the UCITS and depending on the potential impact of the staff on the risk profile of the UCITS. 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 UCITS, which in many cases will imply longer time horizons.

The management company should consider longer *deferral period*s for at least members of the *management body*.

13.4.1.2 Vesting point

130. 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).

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

13.4.1.3 Proportion to be deferred

132. 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 UCITS managed by the management company and the responsibilities and tasks performed, and depending on the amount of variable remuneration. If management companies 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 management companies should respect the 40 to 60 % threshold.

13.4.1.4 Time span between end of accrual and vesting of deferred amount

133. 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.

13.4.2 Cash vs. instruments

13.4.2.1 Types of instruments

134. 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 UCITS. A misalignment of interests might arise in relation to *identified staff* that are not directly involved in investment management. Rewarding those individuals with *instruments* of UCITS might represent a conflict of interest with their duty to perform independently their functions relating to those UCITS.

135. For management companies managing several UCITS, in order to align the interests of the *identified staff* with those of the relevant UCITS, when possible according to the organisation of the management company and the legal structure of the managed UCITS, the *identified staff* should receive *instruments* related mainly to the UCITS 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 a management company which manages three UCITS (x, y and z) performs his/her activities for UCITS x only, in principle that member of the staff should receive *instruments* related mainly to UCITS x; however, should the application of such principle lead to a situation where the *identified staff* has too strong an interest in the UCITS for which they perform their activities, the management company 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 UCITS.

136. The availability of *instruments* is dependent on the legal structure of the UCITS concerned and their fund rules or instruments of incorporation. For UCITS in the legal form of a corporate fund, shares or share-linked instruments should be able to align the interests of the investors 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. Without prejudice to the guidance in paragraphs 135 and 136, where it is appropriate to ensure a better alignment of interest with investors, it may be possible to remunerate the *identified staff* with non-cash instruments whose performance is correlated with the performance of the portfolios they manage, provided that these instruments feature equally effective incentives as any of the instruments referred to in Article 14b(1)(m) of the UCITS Directive.

137. For UCITS which are common funds, *instruments* should consist of units of the UCITS concerned, or equivalent ownership interests; for many of these UCITS, share-linked instruments are not an option due to their legal form.

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

13.4.2.2 Retention policy

139. A retention policy should be determined by the management company in the remuneration policy. The management company 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*.

140. *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 years, 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.

141. 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 management company and the UCITS it manages and the investors of such UCITS.

142. 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 management company are sufficient and appropriate.

143. The minimum *retention period* should be sufficient to align incentives with the longer term interests of the management company, of the UCITS 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 management company and the UCITS it manages.

144. 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 management companies should consider the use of a *retention period* for upfront paid *instruments* that goes beyond the *deferral period* for the deferred *instruments*.

145. *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*.

146. 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).

13.4.2.3 Minimum portion of instruments and their distribution over time

147. The requirement in Article 14b(1)(m) of the UCITS Directive to apply the minimum of 50% (where applicable) to both the portion of the variable remuneration component that is deferred and the portion 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, management companies 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*, a management company 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*, a management company 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*, a management company were to establish a 50 *instruments* / 50 cash ratio for the variable remuneration, combined with a 40 % deferral scheme, the management company 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*, a management company were to establish a 70 *instruments* / 30 cash ratio for the variable remuneration, combined with a 50% deferral scheme, the management company 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.

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

149. For the purposes of the requirement to pay at least 50% of variable remuneration in *instruments* unless the management of UCITS accounts for less than 50% of the total portfolio managed by the management company, the 50% threshold should be based on the total net asset value of all the UCITS managed by the management company. For the purposes of the same requirement, the total portfolio managed by the management company should be the portfolios collectively and individually managed by the management company under its authorisation under the UCITS Directive and its authorisation under the AIFMD, if any.

13.4.3 Ex post incorporation of risk for variable remuneration

13.4.3.1 Explicit ex-post risk adjustments

150. 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 management company 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.

151. An ex-post risk adjustment is an explicit risk alignment mechanism through which the management company 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 management company to perform an analysis (similar to back testing) as to whether its initial ex-ante risk adjustment was correct. Management companies 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.

152. 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.

153. Management companies 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 UCITS and/or the management company and/or the business unit subsequently suffers a significant downturn in its financial performance (specific indicators should be used);

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

d. significant changes in the management company's overall financial situation.

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

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

156. 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 management company 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.

13.4.3.2 Implicit adjustments

157. 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 management company, 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 UCITS or, for listed UCITS, 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 management company. For non-senior staff in particular, there may be no direct relation between their decisions and the value of the UCITS.

158. 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*.

13.4.3.3 Possibility of upward revisions

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

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

14 Guidelines on disclosure

14.1 External disclosure

14.1.1 Specific and general requirements on disclosure

161. Management companies 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. Management companies 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 management company should ensure that the disclosure is clear and easily understandable and accessible.

162. Without prejudice to confidentiality and applicable data protection legislation, management companies 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 UCITS the management company manages.

163. 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 management companies/UCITS should only be expected to provide some qualitative information and very basic quantitative information where appropriate. In practice, this could mean that such management companies/UCITS are not expected to provide all the information under paragraph (8) of the *Recommendation*. Management companies should disclose how they have applied proportionality.

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

14.1.2 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. Management companies 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 management company'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 management company, top-level business lines, and for individuals (i.e. scorecards). Management companies 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 management company 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 management company takes into account current and future risks to which they are exposed when implementing remuneration

methodologies and what these risks are. Also, management companies should describe the measures used to take account of these risks and the ways in which these measures affect remuneration. In addition, management companies should disclose the ways in which they seek to adjust remuneration to take account of longer-term performance - as in the management company's policy on deferral, vesting and performance adjustment.

168. The quantitative (financial) as well as qualitative (non-financial) criteria used by management companies for assessing individual performance which are relevant for determining the remuneration policies and practices and are described under Section 13.2.4.1 (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.

14.2 Internal disclosure

170. The remuneration policy of a management company should be accessible to all staff members of that management company. Management companies 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 management company, 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/UCITS Directive

	Recommendation	UCITS Directive
1.	Section II, par. 3.1.	Art. 14b(1)(a)
2.	Section II, par. 3.2. and 6.1.	Art. 14b(1)(b)
3.	Section II, par. 6.2.	Art. 14b(1)(c)
4.	Section II, par. 6.5.	Art. 14b(1)(d)
5.	Section II, par. 6.6.	Art. 14b(1)(e)
6.	Section II, par. 5.1. and 5.4.	Art. 14b(1)(g)
7.	Section II, par. 5.2.	Art. 14b(1)(h)
8.	Section II, par. 4.1. and 4.2.	Art. 14b(1)(j)
9.	Section II, par. 4.5.	Art. 14b(1)(k)
10.	Section II, par. 5.3.	Art. 14b(1)(l)
11.	Section II, par. 4.4.	Art. 14b(1)(m)
12.	Section II, par. 4.3.	Art. 14b(1)(n)
13.	Section II, par. 6.4.	Art. 14b(4)

Annex II

Mapping of the remuneration principles included in the UCITS Directive

UCITS Directive requirements - Article 14b		**Paragraphs of these Guidelines relating to the relevant requirement**	**Scope**
Art. 14b(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 UCITS that the management company manages;	80 – 83	Only to the *identified staff*, but management company-wide strongly recommended and management companies, if required, should be able to demonstrate why the applied the requirement to the *identified staff* only
Art. 14b(1)(b)	the remuneration policy is in line with the business strategy, objectives, values and interests of the management company and the UCITS that it manages and of the investors in such UCITS, and includes measures to avoid conflicts of interest;	80 – 83 40 – 53	Paragraphs 80 – 83 → Only to the *identified staff*, but management company-wide strongly recommended and management companies, if required, should be able to demonstrate why the applied the requirement to the *identified staff* only Paragraphs 40 – 53 → management company-wide obligatory
Art. 14b(1)(c)	the remuneration policy is adopted by the management body of the management company in its supervisory function, and that body adopts, and reviews at least annually, the general principles of the remuneration policy and is responsible for, and oversees, their implementation; the tasks referred to in this point shall be undertaken only by members of the management body who do not perform any	40 – 53	Management company-wide obligatory

	executive functions in the management company concerned and who have expertise in risk management and remuneration;		
Art. 14b(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;	50 – 53	Management company-wide obligatory
Art. 14b(1)(e)	staff engaged in control functions are compensated in accordance with the achievement of the objectives linked to their functions, independently of the performance of the business areas that they control;	72 – 78	Management company-wide obligatory
Art. 14b(1)(f)	the remuneration of the senior officers in the risk management and compliance functions is directly overseen by the remuneration committee, where such a committee exists;	72 – 78	Management company-wide obligatory
Art. 14b(1)(g)	where remuneration is performance-related, the total amount of remuneration is based on a combination of the assessment as to the performance of the individual and of the business unit or UCITS concerned and as to their risks and of the overall results of the management company when assessing individual performance, taking into account financial and non-financial criteria;	103 – 108 112 – 115	Only to the *identified staff*, but management company-wide strongly recommended
Art. 14b(1)(h)	the assessment of performance is set in a multi-year framework appropriate to the holding period recommended to the investors of the UCITS managed by the	101 – 103 129 – 133	Only to the *identified staff*, but voluntary management company-wide application is always possible

	management company in order to ensure that the assessment process is based on the longer-term performance of the UCITS and its investment risks and that the actual payment of performance-based components of remuneration is spread over the same period ;		
Art. 14b(1)(i)	guaranteed variable remuneration is exceptional, occurs only in the context of hiring new staff and is limited to the first year of engagement;	None	Management company-wide obligatory
Art. 14b(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;	96	Only to the *identified staff*, but management company-wide strongly recommended
Art. 14b(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;	89 – 91	Only to the *identified staff*, but management company-wide strongly recommended and management companies, if required, should be able to demonstrate why the applied the requirement to the *identified staff* only
Art. 14b(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 current and future risks;	109 – 111 119 – 126	Only to the *identified staff*, but management company-wide strongly recommended
Art.	subject to the legal structure of the UCITS and its fund rules or	134 – 149	Only to the *identified staff*, but voluntary management

14b(1)(m)	instruments of incorporation, a substantial portion, and in any event at least 50 %, of any variable remuneration component consists of units of the UCITS concerned, equivalent ownership interests, or share-linked instruments or equivalent non-cash instruments with equally effective incentives as any of the instruments referred to in this point, unless the management of the UCITS accounts for less than 50 % of the total portfolio managed by the management company, 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 management company and the UCITS that it manages and the investors of such UCITS. 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;		company-wide application is always possible
Art. 14b(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 holding period recommended to the investors of the UCITS concerned and is correctly aligned with the nature of the risks of the UCITS in	127 – 133	Only to the *identified staff*, but voluntary management company-wide application is always possible

	question. The period referred to in this point shall be at least three years; 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 shall be deferred;		
Art. 14b(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 management company as a whole, and justified according to the performance of the business unit, the UCITS and the individual concerned. The total variable remuneration shall generally be considerably contracted where subdued or negative financial performance of the management company or of the UCITS concerned occurs, taking into account both current compensation and reductions in payouts of amounts previously earned, including through malus or clawback arrangements;	36 – 38 119 – 126 150 – 160	Only to the *identified staff*, but voluntary management company-wide application is always possible
Art. 14b(1)(p)	the pension policy is in line with the business strategy, objectives, values and long-term interests of the management company and the UCITS that it manages. If the employee leaves the management company before retirement, discretionary pension benefits shall be held by the management company for a period of five years in the form of	80 – 88	Only to the *identified staff*, but management company-wide strongly recommended and management companies, if required, should be able to demonstrate why the applied the requirement to the *identified staff* only

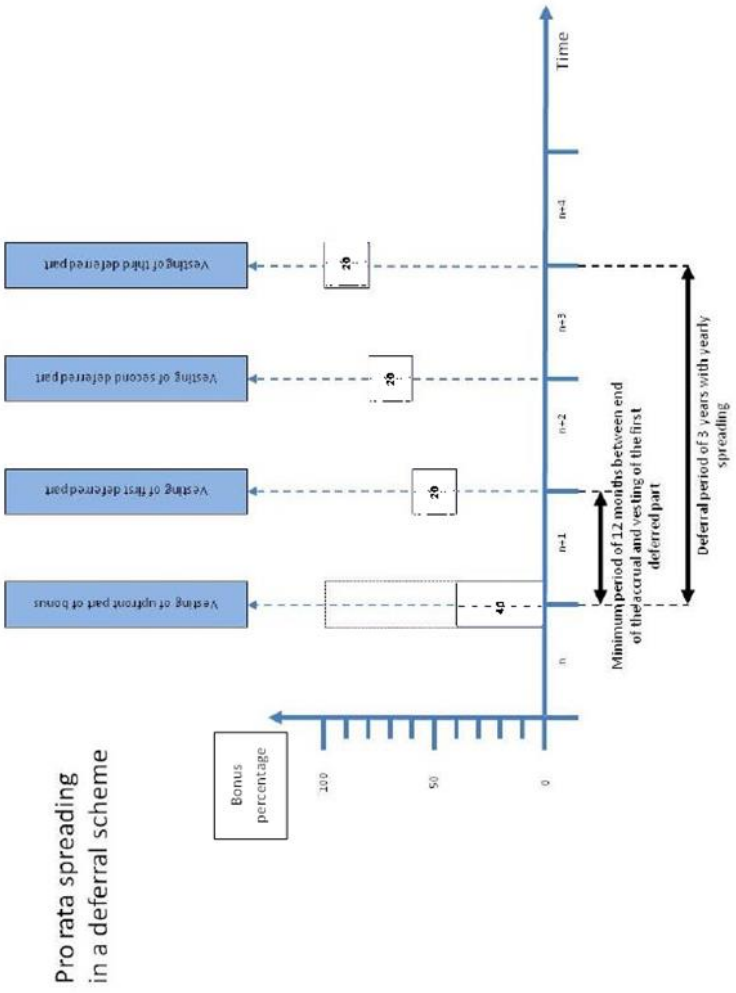
	instruments defined in point (m). In the case of an employee reaching retirement, discretionary pension benefits shall be paid to the employee in the form of instruments defined in point (m), subject to a five-year retention period;		
Art. 14b(1)(q)	staff are required to undertake not to use personal hedging strategies or remuneration- and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements;	92 – 94	Only to the *identified staff*, but management company-wide strongly recommended and management companies, if required, should be able to demonstrate why the applied the requirement to the *identified staff* only
Art. 14b (1)(r)	variable remuneration is not paid through vehicles or methods that facilitate the avoidance of the requirements laid down in this Directive.	14 – 17	Management company-wide obligatory
Art. 14b(2)	In accordance with Article 35 of Regulation (EU) No 1095/2010, ESMA may request information from competent authorities on the remuneration policies and practices referred to in Article 14a of this Directive. ESMA shall, in close cooperation with EBA, include in its guidelines on remuneration policies provisions on how different sectoral remuneration principles, such as those set out in Directive 2011/61/EU of the European Parliament and of the Council and in Directive 2013/36/EU of the European Parliament and of the Council, are to be applied where employees or other categories of personnel perform services subject to different sectoral remuneration	30 – 35	

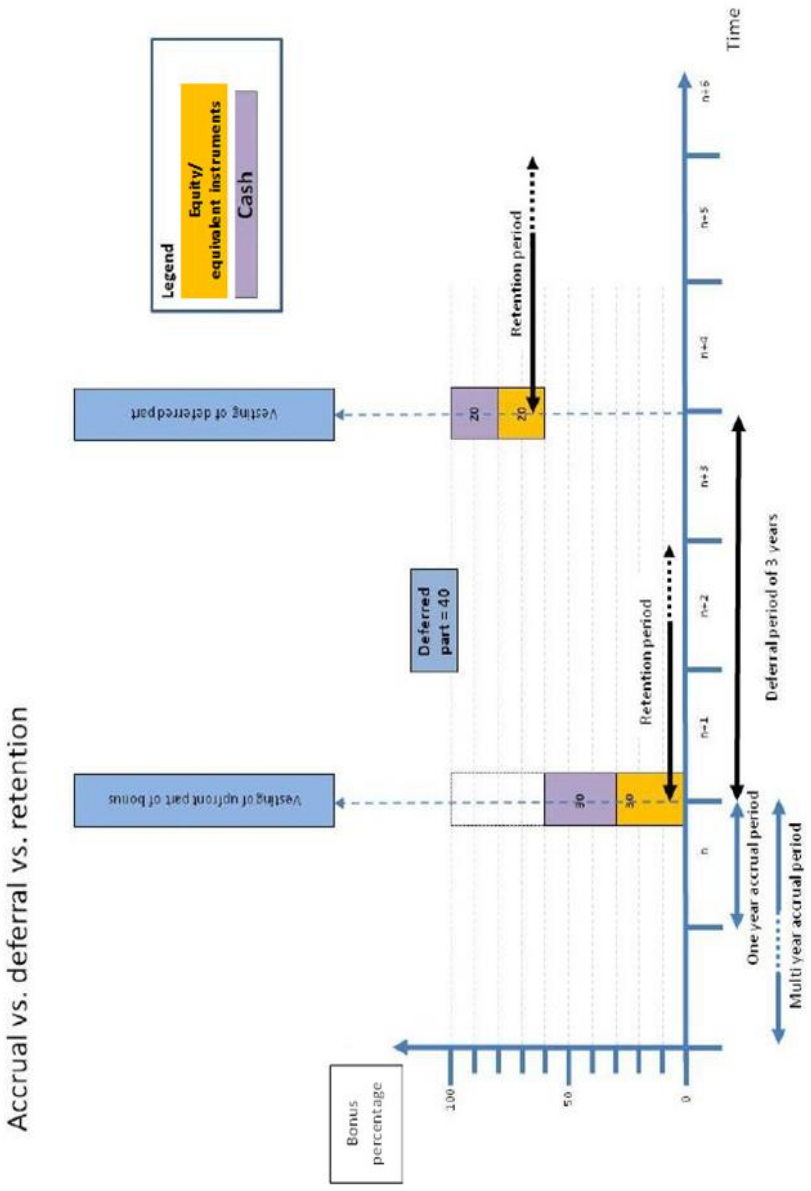
	principles.		
Art. 14b(3)	The principles set out in paragraph 1 shall apply to any benefit of any type paid by the management company, to any amount paid directly by the UCITS itself, including performance fees, and to any transfer of units or shares of the UCITS, made for the benefit of those categories of staff, including senior management, risk takers, control functions and any employee receiving total remuneration that falls into the remuneration bracket of senior management and risk takers, whose professional activities have a material impact on their risk profile or the risk profiles of the UCITS that they manage.	11 – 21	Management company-wide obligatory
Art. 14b(4)	Management companies that are significant in terms of their size or of the size of the UCITS they manage, their internal organisation and the nature, scope and complexity of their activities shall 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 that is, where appropriate, set up in accordance with the ESMA guidelines referred to in Article 14a(4) shall be responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk and risk management of the management company or the	54 – 66	Management company-wide obligatory

	UCITS 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 management company concerned. The members of the remuneration committee shall be members of the management body who do not perform any executive functions in the management company concerned. If employee representation on the management body is provided for by national law, the remuneration committee shall include one or more employee representatives. When preparing its decisions, the remuneration committee shall take into account the long-term interest of investors and other stakeholders and the public interest.		

Annex III

Schematic overview of some deferral mechanisms




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

3.4 Annex IV

AIFMD Remuneration Guidelines

1 Scope

Who?
What?

1. These guidelines amend the Guidelines on sound remuneration policies under the AIFMD (ESMA/2013/232) ('AIFMD Remuneration Guidelines') and have the same scope of application.

When?

2. These guidelines apply from 1 January 2017.

2 Guidelines for AIFMs being part of a group

3. Paragraph 33 of the AIFMD Remuneration Guidelines is amended so that Section VIII of such guidelines reads as follows:

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. It may be the case that in a group context, non-AIFM sectoral prudential rules applying to group entities may lead certain staff of the AIFM which is part of that group to be 'identified staff' for the purpose of those sectoral remuneration rules.