Reply form for the
Guidelines on sound remuneration policies under the UCITS
Directive and AIFMD
Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the Consultation Paper “Guidelines on sound remuneration policies under the UCITS Directive and AIFMD”, published on the ESMA website.

Instructions

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

- use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
- do not remove the tags of type <ESMA_QUESTION_UCITS_V_AIMFD REM_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

- if they respond to the question stated;
- contain a clear rationale, including on any related costs and benefits; and
- describe any alternatives that ESMA should consider

Naming protocol

In order to facilitate the handling of stakeholders responses please save your document using the following format:

ESMA_UCITS V_AIMFD REM_NAMEOFCOMPANY_NAMEOFDOCUMENT.

E.g. if the respondent were XXXX, the name of the reply form would be:

ESMA_UCITS V_AIMFD REM XXXX_REPLYFORM or

ESMA_UCITS V_AIMFD REM XXXX ANNEX1

To help you navigate this document more easily, bookmarks are available in “Navigation Pane” for Word 2010 and in “Document Map” for Word 2007.

Deadline

Responses must reach us by 23 October 2015.

All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input/Consultations’.
Publication of responses

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the headings ‘Legal notice’ and ‘Data protection’.
General information about respondent

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Introduction

Please make your introductory comments below, if any:

ICI Global appreciates the opportunity to provide feedback on this important consultation. The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US$19 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC. Many of our member firms have extensive experience managing UCITS and several member firms have a significant presence “on the ground” in Europe.

We believe that it is of paramount importance that European policymakers adopt remuneration guidelines for UCITS that encourage effective risk management, while taking into consideration the unique nature of the fund management business. In June we submitted a response to the European Banking Authority’s (“EBA”) consultation on remuneration under Directive 2013/36/EU (“CRD IV”) expressing our significant concerns with the approach taken by the EBA with respect to proportionality and application of CRD IV’s remuneration provisions in the group context.¹

Consequently, we generally support the European Securities and Markets Authority’s (“ESMA’s”) approach to the UCITS remuneration guidelines. We believe that ESMA has correctly started from the text of the AIFMD Remuneration Guidelines and adapted it to the specificities of the UCITS framework as needed. This approach correctly builds up a consistent framework for investment fund managers in Europe by distinguishing them from the banking sector players. Many of our member firms manage both UCITS and AIFs. In our view, European policymakers have adopted a framework for remuneration for the European financial services industry that is comprehensive, sufficiently strict to curb excessive risk-taking, and appropriately differentiated to reflect differences among varying types of financial services entities. We caution both ESMA and the EBA to remain fully cognizant of these factors as they finalize the sector-specific remuneration guidelines.

Our responses to certain questions raised in the consultation are provided below.

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. 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 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.

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We strongly support ESMA’s proposed interpretation of proportionality in which, on an exceptional basis and taking into account specific facts, some remuneration requirements may be applied in a proportionate manner and, if appropriate, disapplied. We believe that this approach correctly interprets the text of the UCITS Directive and is supported from a policy perspective.

Legal Analysis

UCITS Article 14a states that: “management companies shall comply with the following principles in a way and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities” [emphasis added].
The phrase “to the extent” refers to the limit or scope of application of a principle. The natural reading of the phrase “comply with the...principles...to the extent...appropriate” is that in certain circumstances it may not be appropriate to comply with all of them. Synonyms for “to the extent” are “to the degree” or “so far as.” Compliance with a principle “so far as appropriate” or “to the degree appropriate” does not require full compliance with every detail of every provision and permits neutralisation or disapplication of a particular principle when deemed appropriate. Disapplication or less than full compliance are manners by which the principles as a whole may be applied proportionately. As we stated in our response to the EBA Consultation, we fundamentally disagree with the Commission Legal Service interpretation of proportionality used by the EBA, which does not foresee the possibility of disapplying any of the remuneration principles under CRD IV.

In addition, ESMA’s proposal to adopt an approach on proportionality which is in line with the AIFMD Remuneration Guidelines follows the direction given to ESMA in recital 9 of the Level 1 text, which provides 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.” ESMA’s approach correctly builds up a consistent framework for investment fund managers in Europe and distinguishes them from the banking sector players in the absence of reasons indicating why UCITS and AIFMD should not be aligned on this matter.

The interpretation of proportionality proposed by ESMA and supported by ICI Global is also consistent with the proportionality principle fundamental to EU law. As specified in the Treaty on European Union (“TEU”), all EU law must be proportionate. The Parliament, Council and Commission are bound by the principle of proportionality and, consistent with the Meroni doctrine, so too are the European Supervisory Authorities, including ESMA, when exercising their powers. ESMA’s guidelines addressed to institutions and competent authorities must therefore be necessary to achieve a legitimate aim and there must not be a less onerous way of achieving the aim. The guidelines must also be reasonable, taking into account the competing interests of different groups.

If ESMA were to interpret the pay-out process rules as setting the lowest common standards which all UCITS managers must apply, “proportionality” would mean that certain institutions (e.g. those that are more complex, large or trade in complex products) would only be free to set more onerous standards. This form of “upward” proportionality would be contrary to the wider principle of subsidiarity/proportionality established by case law and the TEU.

Our interpretation of the English version of the text is supported equally by the French language version, among others. In the French language version, the concept is expressed as “les sociétés de gestion respectent les principes suivants d’une manière et dans une mesure qui soient adaptées à leur taille et à leur organisation interne, ainsi qu’à la nature, à la portée et à la complexité de leurs activités”[emphasis added] which may be translated as “so far as” or “insofar as.”

3 Treaty on European Union, Article 5(4).
4 Meroni v. High Authority of the European Coal and Steel Community (Case 10/56) [1958].
5 Internationale Handelgesellschaft (Case 11/70) [1970].
Policy Arguments

The approach proposed by ESMA is also appropriate from a policy perspective. As recognized by ESMA in the UCITS Consultation, CRD IV relates to a different sector of the financial services industry. The different nature of UCITS compared to credit institutions supports ESMA’s view that it should not be restricted in making its own determination – as it is anyway bound to do – regarding how proportionality should be interpreted under the UCITS Directive. In contrast to employees of a credit institution who may engage in activities for the credit institution as a principal, a UCITS manager, and its employees, act as agent on behalf of the UCITS. Acting as agent on behalf of the UCITS, the UCITS managers and its employees must comply with the UCITS Directive, which imposes substantive restrictions on a fund’s investments that strictly limit risk-taking, as well as with any additional parameters or restrictions that are part of the investment strategy of the UCITS. In this context, a UCITS manager should be permitted to take into consideration, inter alia, its risk profile, risk appetite, and the strategy of the UCITS it manages to determine whether it can meet the Directive’s requirements in a less burdensome way.6

We therefore believe that alignment of the interpretation of proportionality under UCITS with the approach taken under the AIFMD is not only directed by the Level 1 recitals but also desirable from a policy perspective. As indicated by the results of ESMA’s mapping exercise, there are a significant number of firms in the asset management sector which hold both an AIFM license as well as a UCITS license, and many firms have relied on the ability to disapply certain rules under the AIFMD. Indeed, some of our members operate “super” management companies that serve both UCITS and AIFs, and certain of such firms’ portfolio managers are responsible for management of both UCITS and AIFs. We agree with ESMA that introducing a misalignment between the AIFMD Remuneration Guidelines and those under UCITS would create a potentially significant impact on these firms, as well as the supervisory authorities, particularly because they could otherwise leverage the experience that they have gained under the AIFMD framework on the application of proportionality. In addition, implementing different interpretations of proportionality would be operationally burdensome and costly and would lead to divergent business models within the asset management industry.

We further note that a determination to interpret proportionality in manner that permits only an application of more onerous requirements may lead to unintended consequences for UCITS managers, including restructuring of activities, operations and personnel. We also stress that, at a time when the EU is seeking to solidify and increase its position as a global financial centre, proportionality serves a wider and significant purpose in supporting this position. Appropriate application of proportionality, both “upward” and “downward,” affords firms the flexibility to address issues such as remuneration on a global level in a tailored, reasonable manner.

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6 We remind ESMA that the substantive regulations that govern the management of UCITS impose restrictions that are even more prescriptive and risk-limiting than those imposed under the AIFMD.
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.

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 UCTS V Level 1 text? If yes, please provide details and suggest how the definition of ‘supervisory function’ should be amended in the UCITS V Guidelines.

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.

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.

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.

We support ESMA’s determination to afford UCITS managers two options for complying with the application of different sectoral rules to employees. This approach gives firms the flexibility to assess the implications, costs, and benefits of applying both of the approaches and determine which approach best addresses the circumstances unique to the firm and its employees. While providing flexibility to firms, ESMA’s approach also ensures an appropriate level of investor protection, because the second option (allowing firms to opt in to the same requirements for all staff) requires firms to implement the rules that are more effective in discouraging excessive risk taking and preventing misalignment of interests. In
either case, the manager’s choice – and its implementation thereof, including any use of proportionality – remains always subject to review by its Member State regulator and, ultimately, ESMA.

We additionally request that ESMA consider our remarks below regarding management companies being part of a group (relating to paragraphs 30-31 of the draft guidelines).

The proposed UCITS Guidelines provide that the guidelines apply in any case to any UCITS management company, even if it is a subsidiary of a credit institution. However, the proposed UCITS Guidelines in paragraph 31 grant non-UCITS sectoral prudential supervisors of group entities the ability to deem certain staff of the UCITS management company which is part of that group to be “identified staff” for the purpose of their sectoral remuneration rules. A similar change is also proposed for paragraph 33 of the AIFMD Remuneration Guidelines. These provisions, according to ESMA, are proposed in light of CRD IV provisions that state that the application of the remuneration rules shall be ensured by competent authorities for institutions at group, parent company, and subsidiary levels.

We support the provision providing that a UCITS management company is subject to the UCITS guidelines in any case. We understand this provision as indicating that the staff of a UCITS management company that is a subsidiary to a credit institution or investment firm covered by CRD IV would not by default fall under the CRD IV remuneration requirements, but would instead remain subject to the UCITS remuneration requirements unless and until the non-UCITS sectoral prudential supervisors of the parent company deemed certain staff of the UCITS management company to be “identified staff” for purposes of its sectoral rules.

We are concerned, however, that, as drafted, the UCITS and AIFMD guidelines would provide a carte blanche to a prudential regulator to deem, within its discretion, any staff of a UCITS management company or AIFM to be “identified staff” of the CRD IV institution without either input from ESMA or the firm itself. Given that UCITS and AIF managers are already subject to sectoral remuneration regulation and are subject to a robust regulatory framework, we believe that, in practice, the number of staff that meet this standard would likely be exceptionally limited and there will be instances when no staff member meets this standard. ESMA should therefore consider including in the guidelines language reflecting this point and otherwise provide a mechanism for firms to request reconsideration and review of any such determinations.

In line with our concern about the potential over-identification of UCITS and AIFM staff as material risk takers of a CRD IV institution is the concern that the EBA proposes to include those employees of subsidiaries that fall within the definition by virtue of the quantitative criteria. Employees of a UCITS management company or AIFM whose remuneration exceeds the quantitative threshold do not, by virtue of the size of their compensation alone, have a material impact on the CRD IV institution’s risk profile on a consolidated level. We encourage ESMA to recognize this point. This action is important to ESMA’s role in the European regulatory framework for UCITS managers.

The application of CRD IV remuneration requirements to certain UCITS and AIFM staff must be carefully considered because imposing these requirements on staff of UCITS and/or AIF managers that
are subsidiaries of a banking group would create a dual regime between bank-owned managers that would be forced to apply the CRD IV and EBA remuneration guidelines and “non-bank-owned” managers that would be subject to the requirements in UCITS V and/or AIFMD. This would result in distortions in competition (e.g., an unlevel playing field), and would not improve financial stability.

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.

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.

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.

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.
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.

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