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FCA Guidance
on the AIFMD
Remuneration
Code



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Introduction

The FCA has published its final guidance on the AIFM Remuneration Code (FG14/2), which is contained in SYSC 19B of the FCA Handbook. The FCA proposed draft guidance on the AIFM Remuneration Code as well as ESMA's 'Guidelines on sound remuneration policies under the AIFMD' in a consultation paper issued in September 2013 (CP13/9).

The FCA's guidance on the AIFM Remuneration Code and ESMA's Guidelines is directed at firms authorised as full-scope UK AIFMs under the AIFMD. The FCA expects firms to implement the AIFMD remuneration regime for new awards of variable remuneration to relevant staff for performance periods following that in which the firm becomes authorised. The FCA has confirmed that the guidance will apply only to full performance periods and will therefore not apply to any remuneration periods prior to the first full performance period after authorisation.

The Remuneration Code will not apply to small AIFMs, although firms may elect to implement some or all of these remuneration rules.

Summary of the FCA guidance

Among other things, the guidance covers:

1. applying proportionality to AIFMs, delegates of the AIFM, AIFM remuneration code staff at an AIFM performing permitted business not involving the management of AIFs, and remuneration committees;
2. how to treat payments to partners or members of an AIFM;
3. remuneration in the form of units, shares and other instruments; and
4. minimum retention periods.

(i) Applying proportionality

The AIFM remuneration proportionality rule requires a firm to comply with SYSC19B.1 in a way and to the extent that is appropriate to its size, internal organisation and the nature, scope and complexity of its activities. In its guidance statement, the FCA provides its view on when it may be appropriate for firms to be able to apply this rule. The FCA warns, however, that it is ultimately the responsibility of the AIFM to assess its own characteristics and to develop and implement remuneration policies and practices which are appropriate to it.

The FCA provides guidance as to how proportionality should be taken into account in determining the AIFM's remuneration policy and indicates that, where appropriate, certain rules of SYSC 19B.1 can be disapplied, namely:

1. retained units, shares or other instruments, as set out in SYSC 19B.1.17R;
2. deferral, as set out in SYSC 19B.1.18R; and
3. performance adjustment, as set out in SYSC 19B.1.19R and SYSC 19B.1.20G,

the 'Pay-out Process Rules'.

The proportionality elements that must be considered when assessing whether to disapply the Pay-out Process Rules include: size, internal organisation and the nature, scope and complexity of its activities. The guidance covers each of these elements and suggests additional elements where appropriate.

If an AIFM is able to completely disapply the Pay-out Process Rules, it may in its discretion apply all or part of the Pay-out Process Rules to the remuneration of its staff. Where an AIFM is not able to disapply the Pay-out Process Rules in their entirety, the specific numerical criteria in the Pay-out Process Rules need to be adhered to.



The FCA suggests that firms consider the elements as follows:

1. *Size* – this includes factors such as capitalisation and assets under management. The guidance provides a table setting out applicable AUM thresholds to be used as a working presumption (to be confirmed or disconfirmed by considering other factors) as to whether to apply or disapply the Pay-out Process Rules. The table is divided into leveraged and unleveraged AIFs;
2. *Characteristics of the firm and its business* - the guidance provides a further table setting out other elements to be used as a working presumption, such as number of personnel, whether listed or non-listed, ownership structure, number of investment strategies and AIFs, risk management and monitoring, level of risk, delegation arrangements and nature of fee structures;
3. *Delegation arrangements* – matters to take into account here include whether the delegate is subject to regulatory requirements on remuneration which are equally effective as those applicable under the FCA guidance (such as CRD and MiFID) and whether appropriate contractual arrangements are in place; and
4. *Staff not involved in managing AIFs* – to the extent staff are not involved, this could justify the disapplication of the Pay-out Process Rules or, where a mixture of work is carried out, apportion such member's remuneration according to the type of business performed.

The annex to the guidance contains examples of how to apply proportionality.

The FCA also confirms that only significant AIFMs should be required to establish a remuneration committee and that an analysis of the same proportionality elements should show whether the relevant firm is significant or not. Again, it points out that a firm may establish a remuneration committee even if it is not significant, in which case it will not need to be compliant with the Remuneration Code

requirements in this respect, but that it should take account of general principles.

(ii) How to treat payments to partners or members of an AIFM

The FCA provides guidance on how remuneration should be calculated for partners or members of a full-scope AIFM and, where applicable, how deferral of the variable remuneration component can be operated.

The ESMA Guidelines allow payments to members and partners as owners of an AIFM, such as dividend and distributions, to be excluded from the scope of the remuneration requirements. Many AIFMs in the UK are currently structured as partnerships or limited liability partnerships. Currently, payments from the AIFM to partners or members working in the business are classified as a profit share or distribution primarily for tax purposes and no part is classified as a fixed remuneration or a variable remuneration. The requirements of the AIFM Remuneration Code primarily fall on the portion of a staff member's remuneration that is considered variable remuneration.

The FCA provides guidance on the process to determine the portion of the payments to partners or members that is considered remuneration within AIFMD scope and the portion that is a return on equity in the relevant firm.

The guidance states that the process of determining fixed and variable remuneration should depend on the circumstances of the relevant partner or member and their relationship to the firm and provides a mixture of approaches, as follows:

1. *Approach based on existing payments to partners* – e.g. an amount paid as additional profit share to a senior partner or member is likely to be a profit distribution falling outside the scope of the Code, whereas a discretionary profit share distributed to all partners or members may be considered



variable remuneration, while drawings taken in advance may be considered fixed;

2. *Approach based on benchmarking* – e.g. the remuneration structures of others performing similar tasks; and
3. *General considerations* – e.g. whether a partner works full-time or less than full-time and the need to take SYSC 19B.1.5R into account (fixed and variable components to be appropriately balanced).

(iii) Remuneration in the form of units, shares and other instruments

The Remuneration Code requires that 50% of any variable remuneration consists of units or shares of the AIF concerned. However, this rule is subject to: (i) the legal structure of the AIF and the instrument constituting the AIF; and (ii) whether the management of AIFs accounts for less than 50% of the total portfolio managed by the AIFM.

The guidance interprets (i) as taking into account circumstances which make the rule's application impracticable; it then lists some non-exhaustive considerations for judging impracticability and, where the firm decides to disapply the rule on the grounds of impracticability, this means that there is no requirement for payment in shares linked to other entities, although a firm has the option to use shares linked to the AIFM or shares linked to the performance of AIFs or other portfolios managed by the firm.

(iv) Minimum retention periods

This part of the guidance relates to all shares forming part of a variable remuneration award and the FCA states that it considers a retention period of 6 months to be sufficient, provided that other risk management techniques within the firm are operating to secure sound and effective risk management.

The guidance also states that the rule on retention may be applied on a 'net of tax' basis, whether deducted at source via PAYE or paid on a self-assessment basis. This means that the tax owed may be deducted at source to facilitate the tax owed, but that the remainder of the shares forming part of the variable remuneration should be subject to the minimum retention period. The guidance adds that it will not be acceptable for firms to sell shares that are subject to retention to meet tax liabilities on the cash amount.

Next Steps

The FCA guidance on the AIFMD Remuneration Code took effect from 31 January 2014.

If you have any questions at all on the above or any aspect of the AIFMD and would like to discuss further, please contact Claire Cummings at: claire.cummings@cummingslaw.com or on 020 7585 1406.

**This document is for general guidance only. It does not constitute advice.
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