



**Financial Services  
Commission**

# **Consultation Paper**

## **AIFM Remuneration Code**

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## Introduction

The Alternative Investment Fund Managers Directive (“AIFMD”) was transposed into Gibraltar law on 22 July 2013. One of the requirements under AIFMD is the requirement for firms within the scope of the Directive to comply with remuneration rules (Article 13). The purpose of this consultation paper is to set out a proposed Remuneration Code that will apply to in-scope Gibraltar AIFM’s and to offer guidance on the interpretation of subsequent guidelines issued by the European Securities and Markets Authority (“ESMA”) (“the Guidelines<sup>1</sup>”).

## Executive Summary

In respect of the remuneration aspects of AIFMD, the FSC has confirmed that it will comply with the ESMA Guidelines in order to ensure common, uniform and consistent application of the provisions on remuneration in Article 13, and Annex II of the AIFMD.

The Guidelines cover substantive areas such as the definitions of remuneration and identified staff, the concept of proportionality, the composition and role of remuneration committees, payments in units, shares or other instruments and disclosure.

The intention of the Remuneration Code is to provide a framework that will assist firms in interpreting the Guidelines. The general guidance on the Remuneration Code set out at Appendix A of this consultation is also intended to offer clarification with respect to certain elements of interpretation of those Guidelines in Gibraltar. It is ultimately the AIFM’s responsibility to assess appropriate application of the remuneration principles to its business and the FSC expects firms to be able to justify the rationale behind any application of the proportionality principle.

## Basis of consultation

The FSC considered the various options in relation to the adoption of the ESMA Guidelines. The FSC concluded that the ESMA Guidelines should be adopted in full whilst also applying the AIFMD principles of proportionality to the Guidelines. To this end, this consultation paper aims to gauge industry responses to various aspects which may require a revision of, for example figures, so that these are in line with Gibraltar’s business. This paper, therefore, only discusses the proportionality aspects being considered and not the full test of the ESMA Guidelines.

Following the end of the consultation period, the FSC will consider the responses. The Paper will then be submitted to the Minister with Responsibility for Financial Services for his consideration. Where comments are received during the consultation process with which the FSC does not concur, these will also be advised to the Minister together with the FSC’s reason for not accepting them.

All responses to the Consultation Paper will be made available for inspection, at Government’s disposal, or on the FCS’s website, unless there are particular reasons not to do so or confidential information that needs to be protected.

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<sup>1</sup> [http://www.esma.europa.eu/system/files/2013-232\\_aifmd\\_guidelines\\_on\\_remuneration\\_-\\_en.pdf](http://www.esma.europa.eu/system/files/2013-232_aifmd_guidelines_on_remuneration_-_en.pdf)



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To reach her by no later than close of business on 28/07/2014.

To view the FSC policy on public consultation, please see  
<http://www.fsc.gi/firms/consultation.htm>

# The Draft Remuneration Code

## 1 Introduction

The Remuneration Code is intended to reflect the rules that apply to firms that are within the scope of AIFMD, as well as the ESMA Guidelines that have been adopted by the FSC.

## 2 Timing

The general guidance offers direction on when firms should be compliant with the Remuneration Code. This is based on when firms become subject to AIFMD obligations under Gibraltar Law.

## 3 Proportionality

AIFMD specifically allows firms to comply with the remuneration requirements in a way and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities<sup>2</sup>. The general guidance (Part II) sets out a suggested size threshold for AIFMs based on the net amount of alternative investment fund assets under their management. The size of the AIFM creates a presumption as to whether or not certain remuneration requirements may be disapplied on the grounds of proportionality. The categorisation of the different types of AIFM's is based primarily of the types of AIFs that are being managed. This is a categorisation that is also used in the Directive to distinguish AIFMs.

## 4 Delegation

The Guidelines state that delegates of AIFMs performing portfolio or risk management should be subject to regulatory requirements on remuneration that are equally as effective as those under AIFMD<sup>3</sup>. The general guidance proposes that delegates that are subject to Capital Requirements Directive ("CRD") remuneration rules could generally be considered as subject to regulatory requirements on remuneration that are equally as effective as those under AIFMD. The determination of whether or not a regime is equally effective shall be determined on a case by case basis, and in accordance with the Guidance on the AIFM Remuneration Code.

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<sup>2</sup> Para. 23-31 ESMA Guidelines

<sup>3</sup> Para. 18 ESMA Guidelines

- Q1. Do you agree that a size threshold, based on an AIFM's net assets under management, provides a sound working presumption as to whether an AIFM may disapply certain remuneration requirements on the grounds of proportionality? Do you agree with the proposed thresholds in the attached, proposed paper?
- Q2. Do you agree with the proposed proportionality guidance? Are there other proportionality criteria on which we should also focus?
- Q3. In relation to the question of delegation of portfolio management, and the application of remuneration principles to such a delegate, are there other regulatory requirements or regimes that should be considered equally as effective?
- Q4. Do you believe that the FSC should follow this position<sup>4</sup>? If not, how do you think the FSC should deviate from this position, for example, in relation to the minimum retention period, variable remuneration provisions, insofar as this is possible,

This Guidance Note will apply to all firms licensed as In-Scope AIFMs by the Gibraltar Financial Services Commission under the Financial Services (Alternative Investment Fund Managers) Regulations 2013.

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<sup>4</sup> This refers to the position taken by the FSC in relation to the adoption of the ESMA Guidelines whilst also applying the AIFMD principles of proportionality to these Guidelines. As per the Basis of Consultation (P.3)



**Disclaimer:** Where any conflict arises between FSC issued guidance and the European Supervisory Authority guidance, the latter has precedence.

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## Regulatory objectives and principles of good regulation – checklist

<b>Which regulatory objectives are the proposals aimed to facilitate:?</b>	
(a) To promote market confidence;	Yes
(b) The reduction of systemic risk;	Yes
(c) To promote public awareness;	Not applicable
(d) The protection of the reputation of Gibraltar;	Yes
(e) The protection of consumers;	Yes
(f) The reduction of financial crime, including the funding of terrorism;	Not applicable
<b>Do the proposals accord with the following principles of good regulation?</b>	
1. The need to use our resources in the most efficient, effective and economic way;	Not applicable
2. The principle that the duty to manage a business falls upon the senior management of that business. The Directors of a licence holder, both executive and non-executive have ultimate responsibility for ensuring that the business is properly run and operates in accordance with regulatory requirements;	Yes, firms' remuneration policies and procedures will be the responsibility of the board as will the periodic review and the involvement of non-executive directors, particularly where remuneration committees are required.
3. The principle that a burden or restriction which is imposed upon authorised firms should be commensurate with the benefits expected to result from such action, so ensuring that the Authority is striking the right balance between achieving the statutory objectives and ensuring that the impact on those being regulated is not such as to be counterproductive;	Not applicable
4. The desirability of facilitating innovation in connection with regulated activities;	It is not expected that this document will hinder innovation given that remuneration is not being curtailed but necessary controls are being put in place to ensure the protection of fund subscribers.
5. The international character of financial services and markets and the desirability of maintaining the competitive position of Gibraltar; and	No impact should be felt in this respect as the ESMA Guidelines will be widely adopted.
6. The need to consider the adverse effects of regulation on competition and consumer choice.	Not applicable



7. Does this match UK supervisory practices	Yes, the UK has adopted the ESMA Guidelines.
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# Appendix A

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Financial Services  
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## Guidance Notes

### The Alternative Investment Fund Managers ("AIFM") Gibraltar Remuneration Code

Issued :

[TBC]

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## PART I

### Introduction

1. The AIFM Remuneration Code (“the Code”) applies to an in-scope<sup>5</sup> Gibraltar AIFM of:
  - a) a Gibraltar AIF;
  - b) an EEA AIF; and
  - c) a non-EEA AIF.

ESMA published Guidelines on sound remuneration policies under the AIFMD on 3 July 2013 which in-scope Gibraltar AIFMs should comply with in applying the rules which are set out below<sup>6</sup>.

The FSC has introduced the Code in order to reflect these ESMA Guidelines, and have also provided additional guidance, in Appendix 1, in relation to the application of the principles of proportionality to the remuneration policies of an AIFM. The Part II Guidance (“the Guidance”) also addresses several other aspects of the Code and the interpretation of principles set out in the ESMA Guidelines.

This document is comprised of higher principles (Part I) followed by further interpretation (Part II) and ending in the provision of examples (Appendix 1) and glossary (Appendix 2).

### Who does the code apply to?

2. In accordance with Regulation 19(1) of the Financial Services (Alternative Investment Fund Managers) Regulations 2013 (“the Regulations”), an AIFM must have remuneration policies and practices for categories of staff whose professional activities have a material impact on the risk profiles of the AIFMs or AIFs they manage (the “AIFM Code Affected Staff”). These policies and practices should be consistent with, and promote, sound and effective risk management and not encourage risk-taking which is inconsistent with the risk profile of the instrument constituting the AIFs it manages. It is expected that an AIFM will establish, implement and maintain such remuneration policies and practices.
3. AIFM Code Affected Staff will include senior management, risk takers, staff in control functions, and any employees receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers.
4.
  - a) When establishing and applying the total remuneration policies for AIFM Code Affected Staff (inclusive of salaries and discretionary pension benefits), an AIFM must comply with the AIFM remuneration principles in a way that is proportional and appropriate to its size, internal

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<sup>5</sup> Please see Appendix 2.

<sup>6</sup> [http://www.esma.europa.eu/system/files/2013-232\\_aifmd\\_guidelines\\_on\\_remuneration\\_-\\_en.pdf](http://www.esma.europa.eu/system/files/2013-232_aifmd_guidelines_on_remuneration_-_en.pdf)

organisation and the nature, scope and complexity of its activities in accordance with Annex II of the Regulations.

- b) Sub Paragraph (a) above does not apply to the requirement for significant AIFMs to have a remuneration committee under Section 9 below.
- c) The AIFM remuneration principles apply to remuneration of any type paid by the AIFM, to any amount paid directly by the AIF itself as set out under paragraph 2 of Annex II of the Regulations.

## AIFM Remuneration Principles

### Risk Management

- 5. In accordance with paragraph 1(a) of Annex II of the Regulations an AIFM must ensure that its 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 of the instrument constituting the AIFs it manages.

### Supporting business strategy, objectives, values and interests, and avoiding conflicts of interest

- 6. In accordance with paragraph 1(b) of Annex II of the Regulations, an AIFM must ensure that its remuneration policy is in line with the business strategy, objectives, values and interests of the AIFM and the AIFs it manages or the investors of such AIFs, and includes measures to avoid conflicts of interest.

### Governance

- 7. In accordance with paragraph 1(c) of Annex II of the Regulations, an AIFM must ensure that the governing body of the AIFM, in its supervisory function, adopts and periodically reviews the general principles of the remuneration policy and is responsible for its implementation.
- 8. In accordance with paragraph 1(d) of Annex II of the Regulations, an AIFM must ensure 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 governing body in its supervisory function.
- 9. An AIFM that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities must establish a remuneration committee in accordance with paragraph 3 of Annex II of the Regulations. For guidance on when an AIFM should be considered to be significant in accordance with these factors, please consult the Guidance at Annex I. When a remuneration committee is required to be constituted;
  - a) The remuneration committee must 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.
  - b) The chairman and the members of the remuneration committee must be members of the governing body who do not perform any executive function in the AIFM.
  - c) The remuneration committee must be responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk and risk

management of the AIFM or the AIF concerned and which are taken by the governing body in its supervisory function.

## Control functions

10. An AIFM must ensure that employees engaged in control functions are compensated according to the achievement of the objectives linked to their functions, independent of the performance of the business areas they control.
11. An AIFM must ensure the remuneration of the senior officers in the risk management and compliance functions is directly overseen by the remuneration committee, or, if such a committee has not been established, by the governing body in its supervisory function.

## Remuneration Structures

### Assessment of performance

12. An AIFM must ensure that, where remuneration is performance related, the total amount of remuneration is based on a combination of the assessment of the performance of the individual and of the business unit or AIF concerned and of the overall results of the AIFM. When assessing individual performance, financial and non-financial criteria are taken into account.
13. In accordance with paragraph 1(h) of Annex II of the Regulations, an AIFM must ensure that the assessment of performance is set in a multi-year framework appropriate to the life-cycle of the AIFs managed by the AIFM to ensure that:
  - a) the assessment process is based on longer term performance; and
  - b) the actual payment of performance-based components of remuneration is spread over a period which takes account of the redemption policy of the AIFs it manages and their investment risks.
14. Taking into account the proportionality principle set out under Section 4 of this Code, the FSC does not generally consider it necessary for a firm to apply the rules referred to in subsection (b) below, where, in relation to an individual who is a member of the AIFM Code Affected Staff, both of the following conditions are satisfied:
  - a)
    - (i) That the individual's variable remuneration is no more than 33% of the total remuneration; and
    - (ii) The individual's total remuneration is no more than £500,000.
  - b) The rules referred to in subsection (a) are those relating to:
    - (i) A guaranteed variable remuneration under Section 15 of this Code;
    - (ii) Retained units, shares or other instruments under Section 18 of this Code;
    - (iii) Deferral under Section 19 of this code; and
    - (iv) Performance adjustment under Section 20 of this Code.

## Guaranteed variable remuneration

15. As set out in paragraph 1(i) of Annex II of the Regulations, an AIFM must not award, pay or provide guaranteed variable remuneration unless it;
- (1) is exceptional;
  - (2) occurs only in the context of hiring new staff; and
  - (3) is limited to the first year of service.

## Ratios between fixed and variable components of total remuneration

16. An AIFM, according to paragraph 1(j) of the Regulations, must set appropriate ratios between the fixed and variable components of total remuneration and ensure that:
- a) fixed and variable components of total remuneration are appropriately balanced; and
  - b) 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 of not paying a variable remuneration component.

## Payments related to early termination

17. An AIFM must ensure that 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 in accordance with paragraph 1(k) of Annex II of the Regulations.

## Retained units, shares or other instruments

18. In accordance with paragraph 1(m) of Annex II of the Regulations:
- a) Subject to the legal structure of the AIF and the instrument constituting the fund, an AIFM must ensure that a substantial portion, and in any event at least 50% of any variable remuneration, consists of units or shares of the AIF concerned, or equivalent ownership interests, or share-linked instruments or equivalent non-cash instruments. However, if the management of AIFs accounts for less than 50% of the total portfolio managed by the AIFM, the minimum of 50% does not apply.
  - b) The instruments in (a) must be subject to an appropriate retention policy designed to align incentives with the long-term interests of the AIFM and the AIFs it manages and the investors of such AIFs.
  - c) This rule applies to the portion of the variable remuneration component deferred in line with Section 19 of this Code, and the portion not deferred.

## Deferral

19. In accordance with paragraph 1(n) of Annex II of the Regulations:
- a) An AIFM must not award, pay or provide a variable remuneration component unless a substantial portion, and in any event at least 40%, of the variable remuneration component, is deferred over a period which is appropriate in view of the life cycle and

redemption policy of the AIF concerned and is correctly aligned with the nature of the risks of the AIF in question

- b) The period referred to in (1) must be at least three to five years, unless the life cycle of the AIF concerned is shorter.
- c) Remuneration payable under (1) must vest no faster than on a pro-rata basis.
- d) In the case of a variable remuneration component of a particularly high amount, at least 60 % of the amount must be deferred.

A figure of £500,000 is a particularly high amount for the purpose of Section 19(d).

## Performance adjustment, etc.

- 20. An AIFM, according to paragraph 1(o) first sub-paragraph of Annex II of the Regulations, must ensure that any variable remuneration, including a deferred portion, is paid or vests only if it is sustainable according to the financial situation of the AIFM as a whole and justified according to the performance of the AIF, the business unit and the individual concerned.
- 21. In accordance with paragraph 1(o) second sub-paragraph of Annex II of the Regulations, the total variable remuneration should generally be considerably contracted where subdued or negative financial performance of the AIFM or of the AIF concerned occurs, taking into account both current compensation and reductions in payouts of amounts previously earned, including through malus or clawback arrangements.

## Measurement of performance

- 22. An AIFM must ensure 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, as stated in paragraph 1(l) of Annex II of the Regulations.

## Pension policy

- 23. An AIFM must ensure that, in accordance with paragraph 1(p) of Annex II of the Regulations:
  - a) its pension policy is in line with its business strategy, objectives, values and long-term interests of the AIFs it manages;
  - b) when an employee leaves the firm before retirement, any discretionary pension benefits are held by the firm for a period of five years in the form of instruments in Section 18 of this Code; and
  - c) in the case of an employee reaching retirement, discretionary pension benefits are paid to the employee in the form of instruments referred to in Section 18 of this Code and subject to a five-year retention period.

## Personal investment strategies

- 24. An AIFM must ensure that its employees undertake not to use personal hedging strategies or remuneration and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements as stated in paragraph 1(q) of Annex II of the Regulations.



## Avoidance of the remuneration code

25. An AIFM, as set out in paragraph 1(r) of Annex II of the Regulations, must ensure that variable remuneration is not paid through vehicles or methods that facilitate the avoidance of the requirements of the AIFM Remuneration Code.

## PART II

### Guidance on the AIFM Remuneration Code

#### Part A - Introduction and interpretation

##### Status of Guidance

1. This general guidance is provided under Section 57A of the Financial Services (Investment and Fiduciary Services) Act and relates to the AIFM Remuneration Code and the ESMA Guidelines (defined in Appendix II below).
2. This guidance represents FSC guidance in a field where new remuneration requirements for asset managers are being implemented within the EEA. The FSC intend to keep the guidance set out here under review, and may revise it once we have received more data on the number, size, organisation and activities of in-scope Gibraltar AIFMs.

##### Arrangement of Guidance Statement

3. This guidance is divided into six parts and an appendix:
  - This part, *Part A*: Introduction and interpretation.
  - *Part B*: Guidance to firms as to when the AIFM Remuneration Code takes effect, to which remuneration payments the AIFM Remuneration Code will first apply, and the scope of the AIFM Remuneration Code in relation to small Gibraltar AIFMs<sup>7</sup>.
  - *Part C*: Guidance to firms about applying proportionality to AIFMs, delegates of the AIFM, AIFM Code Affected Staff performing permitted business not involving the management of AIFs, and remuneration committees.
  - *Part D*: Guidance on remuneration in the form of units, shares or other instruments.
  - *Part E*: Guidance on minimum retention periods.
  - *Appendix 1* – supplemental guidance on applying proportionality (examples) and glossary of terms.

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<sup>7</sup> Please see Appendix 2.

## Part B – When does the AIFM Remuneration Code Take Effect

***When does the AIFM Remuneration Code take effect, to which remuneration payments the AIFM Remuneration Code apply and what is the scope of the AIFM Remuneration Code in relation to small Gibraltar AIFMs?***

- a) This guidance statement has effect from [date to be confirmed] for those firms authorised as in-scope Gibraltar AIFMs.
- b) Once a firm becomes authorised as an in-scope Gibraltar AIFM, whether the AIFM is a small AIFM that has opted-in or an in-scope AIFM, it becomes subject to the AIFM Remuneration Code and the ESMA Guidelines. The FSC 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. So the AIFMD remuneration regime will apply only to full performance periods and will first apply to the first full performance period after the firm becomes authorised. The AIFM Remuneration Code will not apply to any remuneration payments earned, allocated or otherwise awarded in performance periods prior to the firm's authorisation, including any remuneration previously awarded in the form of instruments that have not yet vested at the time of the firm's authorisation or which vest in subsequent performance periods.

The ESMA Guidelines contain some references to Small AIFMs, and state that the Commission Recommendation 2009/384/EC of 30 April 2009 (on remuneration policies in the financial services sector) should be considered by Small AIFMs. However, Gibraltar's AIFM Remuneration Code does not apply to Small AIFMs (provided that they have not opted in to become in-scope AIFM's), non-EEA AIFMs or small non-EEA AIFMs. Although any of these firms may choose to implement some or all of these remuneration rules, they are not required to comply with the AIFM Remuneration Code nor the ESMA Guidelines.

## Part C - Applying Proportionality

***Applying proportionality to AIFMs, delegates of the AIFM, AIFM Code Affected Staff at an AIFM performing permitted business not involving the management of AIFs and remuneration committees.***

- a) The AIFM Remuneration Code requires, among other things, a firm to apply requirements in the Remuneration Code to AIFM Code Affected Staff. The AIFM remuneration proportionality rule requires a firm, when establishing and applying the total remuneration policies for AIFM Code Affected Staff, to comply with the Remuneration Code in a way and to the extent that is appropriate to its size, internal organisation and the nature, scope and complexity of its activities. Further guidance on proportionality is provided below (P.12).
- b) This guidance provides the FSC's view on when it may be appropriate for firms to be able to apply the AIFM remuneration proportionality rule. This process by which firms determine whether the AIFM remuneration proportionality rule applies is provided below (P.12). This process is also used as the basis for the separate proportionality test which applies in relation to remuneration committees (P.16).
- c) We also consider proportionality applicable to the payment of remuneration in shares, units or other instruments (P.16).

- d) Although this guidance gives the FSC's view of how certain provisions in the AIFM Remuneration Code could be applied in light of the principle of proportionality, it is the primary responsibility of the AIFM to assess its own characteristics and to develop and implement remuneration policies and practices which appropriately align the risks faced and provide adequate and effective incentives to its staff. AIFMs should, if requested, be able to explain to the FSC the rationale for how they apply the AIFM remuneration proportionality rule, particularly where they have concluded that it is appropriate for certain rules to be disapplied.

## Proportionality with respect to the different characteristics of AIFMs - Process

### i. Overview

This section provides guidance as to how proportionality should be taken into account by an in-scope Gibraltar AIFM in determining the firm's remuneration policy. Considerations of proportionality may result in the disapplication of the following rules:

- Retained units, shares or other instruments (Section 18 of the Remuneration Code);
- Deferral (Section 19 of the Remuneration Code); and
- Performance adjustment (Section 20 and 21 of the Remuneration Code).

For convenience, these rules are together referred to in this guidance as the Pay-out Process Rules.

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. The ESMA Guidelines provide some detail on the proportionality elements that must be considered: size, internal organisation and the nature, scope and complexity of the firm's activities. We provide further guidance on each of these elements and suggest additional elements where appropriate.

### ii. Size – AuM Thresholds

Size includes factors such as capitalisation and assets under management. As a first step, we would expect an AIFM to calculate the value of its AuM in the AIFs that it manages. The AIFM should calculate its AuM by reference to the value of the portfolios of AIFs (i.e. net asset value of AIFs) that it manages on the most recent valuation date for the AIFs. However, portfolios of AIFs that the AIFM is managing under delegation should be excluded from the calculation.

The value of AuM should be taken as a useful working presumption (to be confirmed or disconfirmed by considering other factors) as to how considerations of proportionality are likely to be reflected in the AIFM's remuneration policy. For these purposes we think it is reasonable to use the AuM thresholds specified in the table below. If an AIFM's AuM is above the relevant AuM threshold, we would expect it to review the other criteria to determine whether there are other characteristics of the firm or its AIFs that, notwithstanding its size, merit disapplication of all or some of the Pay-out Process Rules on the grounds of proportionality. Similarly, if an AIFM's AuM is below the relevant AuM threshold, we would presume that it may disapply the Pay-out Process Rules on the grounds of proportionality. However, we would still expect it to review the other criteria

to determine whether there are other characteristics of the firm or its AIFs that merit full application of all or some of the Pay-out Process Rules.

The following table shows the AuM thresholds for the two types of in-scope UK AIFMs. We would expect a firm corresponding to the description given in the first and second columns to commence its analysis of its remuneration policy by using the working presumption listed in the third column.

Table 2: Proportionality – AuM thresholds<sup>8</sup>

AIFMs which manage portfolios of AIFs including assets acquired through use of leverage	Less than £500 million – 1.5 billion	it is appropriate to disapply Pay-out Process Rules
	Greater than £500 million – 1.5 billion	it is not appropriate to disapply Pay-out Process Rules
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	Less than £4 - 6 billion	it is appropriate to disapply Pay-out Process Rules
	Greater than £4 - 6 billion	it is not appropriate to disapply Pay-out Process Rules

### ***Other proportionality elements***

Based on the presumption derived from the AuM threshold, we would expect firms then to consider other proportionality elements against the characteristics of the firm and its business. We note in the table below additional non-exhaustive factors that firms should take into account when confirming or disconfirming the presumption created by the AuM threshold. We have illustrated this process in a number of examples in the Appendix.

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<sup>8</sup> This consultation document seeks to determine the threshold at which there should be a proportional working presumption that it should be appropriate for smaller In Scope AIFM's to disapply certain rules or for larger In Scope AIFMS to apply all of the remuneration principles.



Table 3: Proportionality – other elements

Proportionality element	Specific factor	Comments
Size	Number of the AIFM's partners, members, employees and consultants performing services for the AIFM	This factor may be taken into account considering the type of staff performing services, i.e. the number of AIFM Code Affected Staff.
Internal Organisation	Whether the AIFM is listed and traded on a regulated market	This factor favours application of the Pay-out Process Rules because compliance is likely to align the interests of the AIFM with the external investors in the AIFM's equity.
	Ownership structure - whether a significant portion of the firm's equity or such other appropriate legal and/or economic interests is held by investors not working in the business	To the extent that the senior management of the firm own a majority stake in the firm, this could be an indicator favouring the disapplication of some or all of the Pay-out Process Rules on the grounds of proportionality in respect of the senior management.
Nature, scope and complexity of activities	Number of investment strategies / styles and number of AIFs	To the extent a firm manages a large number of AIFs which implement a wide range of strategies, this is likely to indicate increasing complexity.
	Risk management and monitoring	Where the discretion of the AIFM or its delegated portfolio manager (and thus its risk-taking) is strictly controlled within certain pre-defined narrow parameters and/or investment decisions are rules-based (such as where there is a mandate to track an index), this may justify disapplications of the deferral and retention requirements.

	Level of risk	<p>Alternatively, firms should use their own indicators of risk, such as a VaR measure (where applicable) or other appropriate methods, to determine the level of risk linked to their AIFs' activities. A low level of risk taken by the AIFM is likely to be reconcilable with the disapplication of the Pay-out Process Rules.</p> <p>Firms may also wish to use the risk profile communicated to them by the FSC during the</p>
	The nature of any delegation arrangement between the AIFM and its delegate	This factor should be taken into account when an AIFM delegates portfolio or risk management to a third-party delegate. See below and example 5 in the Appendix 1.
	The nature of certain fee structures such as performance fees or carried interest	This factor may be considered where fee structures satisfy the objectives of alignment of interest with investors and avoid incentives for inappropriate risk-taking, but perhaps do not meet the requirements of the ESMA Guidelines.

### Proportionality – delegation of portfolio or risk management

Where an AIFM is delegating portfolio or risk management, the ESMA Guidelines say that either:

- the delegate is subject to regulatory requirements on remuneration that are equally as effective as those applicable under the ESMA Guidelines; or
- appropriate contractual arrangements are put in place with the delegate in order to ensure that there is no circumvention of the remuneration rules set out in the ESMA Guidelines.

### Interpretation of remuneration requirements that are 'equally as effective'

An AIFM's assessment of which remuneration regulatory requirements are equally as effective as the requirements of the AIFMD should include a comparison of the objectives of those regulatory requirements, and should not require equivalence between regimes. As a result, the FSC will generally consider regimes where the AIFMD objectives are likely to be achieved, as being equally as effective.

## Other proportionality considerations

The requirements on AIFMs when delegating portfolio or risk management may be subject to proportionality. As noted above, the nature of delegation arrangement should be considered for example, the contractual terms and conditions, including the requirements of the investment mandate, agreed between the AIFM and delegate. We have illustrated some cases in example 5 in the Appendix, where a delegate is subject to a group remuneration policy equivalent to CRD or where the delegate performing portfolio management has limited investment discretion.

## Appropriate contractual arrangements with delegate

Where it would be appropriate for the AIFM to put in place contractual arrangements with the delegate, we expect the AIFM to tailor these arrangements so that it applies the AIFM Remuneration Code to the remuneration of the delegate's relevant staff resulting from the delegation. For example, the AIFM need only put arrangements in place with respect to those staff of the delegate who have a material impact on the risk profiles of the relevant AIFs, and in respect of remuneration that is connected with the delegated activities.

## Proportionality – Staff at an AIFM performing permitted business not involving the management of AIFs

The AIFM Remuneration Code applies to all staff whose professional activities have a material impact on the risk profiles of the AIFM or of the AIFs the AIFM manages (AIFM Code Affected Staff). AIFMs are permitted to manage other funds, and are permitted to carry out certain MiFID investment activities. To the extent that AIFM Code Affected Staff are not involved in the management of AIFs, this can be considered in any proportionality analysis of such staff, and may justify disapplication of the Pay-out Process Rules in respect of those staff. We would also expect that some staff performing non-AIFMD business (e.g. providing services relating to MiFID business only) would not be considered AIFM Code Affected Staff because of their limited impact on the risk profiles of the AIFM or of the AIFs it manages.

For a member of staff whose work is a mixture of AIFMD and non-AIFMD business, a firm could apportion his or her remuneration according to the type of business performed, and treat such portions under the relevant remuneration regime after taking into consideration the need to align risks in terms of risk management and exposure to risk. A firm may apportion an individual's remuneration based on time, funds under management or another benchmark taking into account any risks created in each case.

Because of additional regulatory changes, remuneration received by an individual in respect of non-AIFMD activities may fall in the near future within the scope of other Directives and be subject to their respective proportionality frameworks, if applicable.

## Remuneration committees

### i. General

Section 9 of the Remuneration Code provides that a firm that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities must establish a remuneration committee. Although at least some of the same factors are considered as for general proportionality, the ESMA Guidelines explain that only significant AIFMs should be required to establish a remuneration committee. That means

an analysis of each of the proportionality elements should show that the relevant firm is significant.

ii. Proportionality elements

The guidance provided in tables 2 and 3 above should also be used when analysing the proportionality elements. Without prejudice to the criteria outlined in paragraph 55 of the ESMA Guidelines, we would also have regard to the AuM thresholds specified above and, if a firm is above the relevant AuM threshold, that would provide a working presumption of significance in terms of size.

## Part D – Remuneration in the form of units, shares or other instruments

- a) The AIFM Remuneration Code requires that 50% of any variable remuneration consists of units or shares of the AIF concerned or equivalent ownership interests or share-linked instruments or equivalent non-cash instruments. However, this rule is subject to:
- the legal structure of the AIF
  - the instrument constituting the fund
  - whether the management of AIFs accounts for less than 50% of the total portfolio managed by the AIFM

### Legal structure of the AIF and the instrument constituting the AIF

We interpret this condition to be where the legal structure or instrument of the AIF makes the rule's application impracticable considering the objectives of the AIFM Remuneration Code. Some non-exhaustive considerations for judging impracticability in this context would be where:

- an AIF is closed-ended and there are no units available to acquire;
- the AIF's constituting instrument or rules prohibit investments by AIFM Code Affected Staff or prescribe a large minimum investment amount that will not be met by staff investments.
- the AIF may not be marketed to some or all AIFM Code Affected Staff due to laws or regulations preventing distribution to investors for whom units in the AIF are not suitable, or
- legislation or regulation limits or prohibits the AIFM or an individual from holding units in an AIF or AIFs, or
- an investment by AIFM Code Affected Staff in an AIF could result in adverse tax consequences for any third party investors in the AIF, or
- because of the AIF's structure, the creation of equivalent ownership interests, share-linked instruments or equivalent non-cash instruments is unduly costly when weighed against any benefits gained from aligning interests between relevant staff and investors.

Where the firm decides to disapply this rule, there is no requirement in the AIFM Remuneration Code for payment in units linked to other entities. Nevertheless, in order to align the incentives of relevant staff with those of the relevant AIFs, the investors of

such AIFs and the AIFM itself, we would recommend that firms elect to pay staff in shares, interests, or instruments linked to the AIFM or its parent company where reasonable, or in shares or instruments linked to the performance of AIF's or other portfolios managed by the AIFM or its affiliates.

### Proportionality considerations for payment in shares, units or other instruments

We recognise that for some AIFMs the effect of Section 18 of the Remuneration Code may be disproportionate, due to the number of AIFs that it manages or for certain types of AIFM Code Affected Staff such as senior management or compliance and audit functions. In such cases, firms may alternatively pay staff in:

- shares, interests, or instruments linked to the AIFM, or its parent company; or
- shares or instruments linked to the performance of a weighted average of the AIFs managed by the AIFM.

Any such alternative should be justified by showing that it aligns the risks taken by staff with those of the relevant AIFs, the investors in such AIFs and the AIFM itself, or, when staff (such as those in compliance and audit functions) are not risk-takers, that it does not represent a conflict of interest with their duty to perform their functions independently.

### Part E – Minimum Retention Periods

- a) This guidance relates to the appropriate retention policy under Section 18 of the Remuneration Code. We would normally consider 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 (including, in particular, those on performance adjustment and measurement of performance set out in Sections 19 to 21 of the Remuneration Code). The retention period should apply to all units forming part of a variable remuneration award, beginning from the date at which the units vest. Longer retention periods may also be appropriate in certain cases.

## Appendix 1

### Supplemental guidance on applying proportionality (examples)

The following non-exhaustive examples illustrate the operation of this guidance. It should be borne in mind that individual guidance could vary the outcome provided by the operation of this general guidance.

#### Example 1 - Proportionality does not apply:

Firm A is an in-scope Gibraltar AIFM that manages many AIFs which implement a number of investment strategies, including equity, fixed income and alternatives. The AIFs that it manages are both open-ended and closed-ended, and several are leveraged. Its AuM is approximately £10 billion. Taking into account this guidance, Firm A assesses that it must comply with the full AIFM Remuneration Code. It considers its size and other relevant factors including that several of its AIFs are listed on a regulated market.

We would expect Firm A to conclude that it is appropriate for it to comply in full with the AIFM Remuneration Code because on assessment of the proportionality elements, there is little evidence to demonstrate that Firm A should be considered less complex or small-scale.

#### Example 2 - Proportionality does apply:

Firm B is an in-scope Gibraltar AIFM that manages three AIFs investing in commercial and residential property in Europe. The AIFs are closed-ended and unleveraged, and the firm's AuM is approximately £750 million. Taking into account this guidance, Firm B presumes that it may disapply certain Pay-out Process Rules. The Firm considers its size, and other relevant factors. Regarding its internal organisation, its internal governance structure is non-complex. Neither it nor its AIFs are listed. It is owned by three of its partners, each of whom works full-time in the business. With respect to its activities, it only provides services to these three AIFs. Its investment strategies are not considered complex.

Firm B could reasonably conclude that it is appropriate for it to disapply the Pay-out Process Rules, assessed on a case-by-case basis, because on assessment of the proportionality elements, there is sufficient evidence to demonstrate that Firm B should be considered less complex or small-scale.

#### Example 3 - Small size presumption displaced by consideration of other proportionality factors:

Firm C is an in-scope Gibraltar AIFM that manages three AIFs investing in global macro strategies. The AIFs are open-ended and highly leveraged, and the firm's AuM is approximately £800 million. Taking this guidance into account, Firm C presumes that it may disapply certain Pay-out Process Rules. The Firm considers its size, and other relevant factors. Its internal organisation involves external shareholders. With respect to its activities, it carries out the additional service of individual portfolio management and provides fund administration to a handful of small AIFs. Its global macro strategies are complex and use

significant human capital, such as experienced analysts and computer programmers. It uses considerable leverage at most times in its management of its AIFs. The AIFs are intended for investors with a high risk appetite. The AIFs are passported widely in the EEA, and Firm C has passported its services to a number of countries on a branch basis.

We would expect Firm C to apply the Pay-out Process Rules despite the size presumption, because Firm C carries out complex activities, namely managing highly-leveraged, volatile AIFs on a cross-border basis and it is part of a listed asset management group which makes its internal organisation more complex.

#### Example 4 - Large size presumption rebutted, proportionality does apply:

Firm D is an in-scope Gibraltar AIFM that manages several AIFs investing in equities, including open-ended structures. Its AuM is £2 billion. Taking this guidance into account, Firm D presumes that it must apply the Pay-out Process Rules because it manages some open-ended AIFs. The Firm considers its size, and other relevant factors. Its internal organisation is straightforward as most of the owners work in the business, with only a few external shareholders who together comprise a minority. Firm D is not listed. In terms of its activities, it uses limited leverage for bridging purposes in its AIFs, not more than 1.5 times their net asset values. The portfolios are characterised by strict investment restrictions requiring considerable diversification, and the firm strives to limit the volatility of its portfolios. Its AIFs do not pay performance fees to the firm. However, the AIFs are marketed under the Prospectus Directive or passported under AIFMD in a number of markets in Europe. Firm D also manages several UCITS with aggregate net assets of approximately £250 million that implement conservative equity strategies. Refer to Article 8 of the Commission Delegated Regulation (EU) No 231/2013 for the method for calculating the exposure of an AIF.

Firm D could reasonably conclude that it is appropriate to disapply some or all of the Pay-out Process Rules, despite the size presumption, because Firm D carries out non-complex activities, namely conservative, low volatility strategies; it is not listed; and it does not have significant external ownership with respect to internal organisation.

#### Example 5 - Proportionality applies to delegate when it has limited investment discretion:

Firm F is an in-scope Gibraltar AIFM managing EEA AIFs. It has delegated portfolio management to a non-EU manager, Firm Z, under a contract with strict investment guidelines leaving limited investment discretion to Firm Z. In addition, Firm Z is required by the contract to implement the ESMA Guidelines, except the Pay-out Process Rules. Due to the limited discretion given to Firm Z, there is little scope for it to take excessive risks.

We would consider this factor to indicate to Firm F that it would be proportionate to disapply the Pay-out Process Rules in relation to Firm Z.

If Firm Z is not required under the terms of the delegation to implement the ESMA Guidelines at all, it would need to be shown that the delegate was subject to regulatory requirement on remuneration that were equally as

effective as those applicable under the ESMA Guidelines. As set out in the Guidance, this does not necessarily require direct equivalence between regimes. Delegation to a firm that is subject to a group remuneration policy equivalent to CRD will also generally be deemed to be equally as effective.

### Example 6 – Flexibility to disapply strict variable remuneration requirements under certain circumstances

Firm G is an in-scope Gibraltar AIFM managing sizeable EEA AIFs but the minimum subscription is larger than the retained unit allocation. What should Firm G do in these circumstances?

The AIFM Remuneration Code requires that 50% of any variable remuneration consists of units or shares of the AIF concerned, or equivalent ownership interests, or share-linked instruments or equivalent non-cash instruments. However, the variable remuneration allocation is below the minimum subscription amount permitted for the units of the AIFs in question. As such, the circumstances make the rule's application impracticable for Firm G. In considering the objectives of the AIFM Remuneration Code, Firm G can decide to disapply this rule.

Although the firm may decide to disapply this rule, and although there is no requirement in the AIFM Remuneration Code for payment in units linked to other entities, in order to align the incentives of relevant staff with those of the relevant AIFs, the investors of such AIFs and the AIFM itself, a firm has the option to use the following forms of payment:

- a. shares, interests, or instruments linked to the AIFM or its parent company where reasonable such as, e.g. if either is a listed entity or where the performance of the AIFM business is relevant to the parent company's valuation; or
- b. shares or instruments linked to the performance of a weighted average of the AIFs managed by the AIFM (or a particular AIF where appropriate), or other portfolios managed by the AIFM or its affiliates.

## Appendix 2

### Glossary of Terms Defined in this Guidance Statement

Defined Expression	Definition
AIFM remuneration proportionality rule	The rules under Section 4 of the AIFM Remuneration Code
AIFM Remuneration Code, or Remuneration Code	The Alternative Investment Fund Managers (AIFM) Gibraltar Remuneration Code
AuM	Net assets under management in AIFs managed by the relevant AIFM
ESMA Guidelines	ESMA guidelines on sound remuneration policies under the AIFMD (ESMA/2013/232) (available at <a href="http://www.esma.europa.eu/system/files/2013-201.pdf">http://www.esma.europa.eu/system/files/2013-201.pdf</a> )
Pay-out Process Rules	The following rules:  Retained units, shares or other instruments (Section 18 of the Remuneration Code)  i. Deferral (Section 19 of the Remuneration Code), and  ii. Performance adjustment (Sections 20 and 21 of the Remuneration Code).
In-scope AIFM	An AIFM with AuM above the “ <i>de minimis thresholds</i> ” (please see Article 3 of Directive 2011/61/EU) or a small AIFM (one that falls below the “ <i>de minimis thresholds</i> ”) that has opted-in to become an in-scope AIFM.
Small AIFM	Small AIFMs are those with AuM <b>below</b> the “ <i>de minimis thresholds</i> ” (please see Article 3 of Directive 2011/61/EU) that have <b>not</b> opted-in to become an in-scope AIFM.



### **Legal Notice**

The advice or interpretation given in this paper only represents the views of the FSC as to its expectations of how the requirements of the relevant legislation in question are to be complied with. It is not intended as a definitive interpretation of the legislation as this is a matter for the courts to determine. You are, therefore, strongly advised to seek appropriate legal advice before any action or decision is taken.

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Regulatory objectives and principles of good regulation – checklist

<b>Which regulatory objectives are the proposals aimed to facilitate:?</b>	
(a) To promote market confidence;	Yes
(b) The reduction of systemic risk;	Yes
(c) To promote public awareness;	No
(d) The protection of the reputation of Gibraltar;	Yes
(e) The protection of consumers;	Yes
(f) The reduction of financial crime, including the funding of terrorism;	Not applicable
<b>Do the proposals accord with the following principles of good regulation?</b>	
8. The need to use our resources in the most efficient, effective and economic way;	Not applicable
9. The principle that the duty to manage a business falls upon the senior management of that business. The Directors of a licence holder, both executive and non-executive have ultimate responsibility for ensuring that the business is properly run and operates in accordance with regulatory requirements;	Yes, firms’ remuneration policies and procedures will be the responsibility of the board as will the periodic review and the involvement of non-executive directors, particularly where remuneration committees are required.
10. The principle that a burden or restriction which is imposed upon authorised firms should be commensurate with the benefits expected to result from such action, so ensuring that the Authority is striking the right balance between achieving the statutory objectives and ensuring that the impact on those being regulated is not such as to be counterproductive;	Not applicable



<p>11. The desirability of facilitating innovation in connection with regulated activities;</p>	<p>It is not expected that this document will hinder innovation given that remuneration is not being curtailed but necessary controls are being put in place to ensure the protection of fund subscribers.</p>
<p>12. The international character of financial services and markets and the desirability of maintaining the competitive position of Gibraltar; and</p>	<p>No impact should be felt in this respect as the ESMA Guidelines will be widely adopted.</p>
<p>13. The need to consider the adverse effects of regulation on competition and consumer choice.</p>	<p>Not applicable.</p>
<p>14. Does this match UK supervisory practices</p>	<p>Yes, the UK has adopted the ESMA Guidelines.</p>