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FINANCIAL SERVICES

AIFMD: Much ado about remuneration

AIFMs need to prepare for stringent new rules regarding remuneration

What is the AIFMD?

In the aftermath of the global financial crisis, the European Commission drafted one of the most ambitious and complex regulatory reform agendas ever introduced into the asset management industry in the form of the Alternative Investment Fund Managers Directive (AIFMD). The Directive will have profound, wide-reaching and long-term implications for in-scope alternative investment fund managers (AIFMs), who are required to comply by 22 July 2013.

Strict new rules around AIFM remuneration

Under the impending AIFMD regime, European AIFMs will be required to comply with a set of stringent, new rules covering remuneration. Managers are expected to ensure that sound and prudent remuneration practices are in place in their firms. While these provisions come into effect on 22 July 2013, those firms already marketing or managing alternative investment funds (AIFs) may have up to an additional year to apply for authorization and comply with the new rules, depending on the stance adopted by their local regulators with respect to transposition.

The new rules, which continue to generate much discussion and debate among industry players, are intended to help prevent risky behavior that would increase short-term compensation while increasing long-term risk. AIFMs outside the EU, but who are using passport agreements, will also be subject to these new rules around remuneration following a transitional period.

The guidelines, which will restrict the form and structure of remuneration that can be paid to AIFMs, also cast a dim view on avoidance mechanisms, saying such tactics are prohibited.

Who will the new remuneration rules impact?

The new rules cover all 'identified' staff members whose activities within the firm could potentially have a material impact on the fund's risk profile. This would include members of senior management, individuals in control or risk-taking functions, or employees whose level of remuneration would be comparable to that of the parties in those aforementioned roles.

The list of staff members subject to the new remuneration rules also includes employees of those companies to which risk management or portfolio management functions have been outsourced, as their activities could potentially have a material impact on the AIFM's funds.

Disapplication of remuneration provisions

On an exceptional basis and taking into account specific circumstances, AIFMs may be able to disapply some of the variable remuneration risk alignment requirements, subject to the proportionality framework developed by the national regulators. These exceptions stem from the principle of proportionality and require that such disapplications are in alignment with the risk profile of the AIFM and the funds it manages. There are specific rules around the disapplication of AIFMD remuneration requirements and AIFMs are expected to be able to provide regulators with detailed criteria explaining why certain requirements have been disapplied.

There is still a fair degree of uncertainty surrounding the precise manner in which this disapplication process will work in practice. Ultimately, it is advisable for AIFMs to engage in direct discussions with their regulatory authorities in order to clarify the manner in which the authority intends to interpret and enforce these rules.

Other issues and considerations

The subject of remuneration is among the more controversial elements under the impending Directive and there are a number of pressing issues that AIFMs will need to consider, including:

- **Timing:** Changing their remuneration policies and procedures partway through the year may prove disruptive to many AIFMs. As such, the process should be planned and implemented so as to minimize disruption.
- **Partnership profits:** Partnership profits are not expected to be impacted by the new rules unless those profits would represent a circumvention of remuneration guidelines.
- **Variable remuneration:** The main principles include the fact that between 40 percent and 60 percent of variable pay should be deferred and that at least 50 percent of variable pay should be in the form of equity instruments linked to the AIF in question. In addition, the minimum deferral period is 3 to 5 years, unless the AIFM can demonstrate the life cycle of the AIF is shorter. The AIFM is required to consider longer deferral periods for members of the management body.
- **Tax:** The new remuneration guidelines will present a number of challenges from a tax perspective and AIFMs are advised to plan accordingly.
- **Differing interpretations:** AIFMs doing business in multiple EU countries will need to be aware that each different regulators may have distinct interpretations of the same rule.
- **Interpretation of remuneration:** As currently written, the provisions would deem management fees, carried interest or any other transfer of AIF units/shares paid by the AIF to the AIFM for professional services as 'remuneration'. Likewise, partners in receipt of dividends as shareholders of the AIFMD may also be caught by the provisions. And in a controversial move, the provisions require non-EU regulated delegate entities with 'appropriate contractual arrangements' to apply the new rules to the pay of senior employees of the delegate.
- **Remuneration committees:** AIFMs will only need to have a Remuneration Committee if they have more than EUR1.25 billion in assets under management and over 50 employees.

These are just a few of the many remuneration-related issues that need to be considered by AIFMs in the lead-up to the AIFMD. Given the scope and potential impact of these new remuneration rules, it is important for AIFMs to begin planning at the earliest opportunity.

Next steps

The remuneration policy adopted by each AIFM should be aligned with its respective business strategy and the long-term objectives of the funds it manages on behalf of its investors. Those AIFMs impacted by these new remuneration guidelines should begin by compiling a list of impacted staff members, studying the impending changes, determining whether their current remuneration policies are in compliance and, in cases where they are not, implementing changes and formulating contingency plans as required.

How KPMG can help

KPMG's global network has extensive expertise helping some of the world's largest and most prominent AIFMs, fund administrators, depositaries and other service providers prepare for complex regulatory regime change. KPMG member firms help their clients understand their specific requirements under the new rules and provide expert guidance, advice and implementation support in the areas of gap analysis, implementation planning, data protection and migration, report design and much more. We also have the capabilities and expertise to provide ongoing assurance services once clients' systems and infrastructure are up and running.

KPMG's dedicated global team of AIFMD experts have the credentials, the knowledge and the track record that comes from helping clients identify and implement their requirements under the AIFMD and position themselves to achieve not only compliance, but long-term profitability under these new rules.

Common AIFMD-related acronyms

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AIFMD	Alternative Investment Fund Managers Directive
ESMA	European Securities and Markets Authority
EU	European Union
FATF	Financial Action Task Force
MiFID	Markets in Financial Instruments Directive
MS	Member State of the European Union
MSR	Member State of Reference for a non-EU AIFM
UCITS	Undertakings for Collective Investment in Transferable Securities

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