

**Alpina Fund Management S.A.**  
**(the “Management Company”)**

**Remuneration Policy**  
**(the „Policy“)**

This Remuneration Policy adopted by the Management Company aims at promoting sound and effective risk management and shall encourage risk taking which is consistent with the risk profiles, rules or instruments of incorporation of any of the funds managed by the Company.

Munsbach, 25.05.2023

## 1 List of abbreviations

Insofar as the context does not require any other interpretation, means

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
BoD	Board of Directors
CSSF	Commission de Surveillance du Secteur Financier
ESG	Environmental, Social, Governance

## 2 Definitions

The following indicative definitions, which do not override equivalent definitions in national law, have been developed only for the purposes of this Policy.

Identified Staff	categories of staff, including senior management, risk takers, control functions and any employee receiving total remuneration that falls into the remuneration bracket of senior management and risk takers, whose professional activities have a material impact on the management company's risk profile or the risk profiles of the UCITS that it manages and categories of staff of the entity(ies) to which investment management activities have been delegated by the management company, whose professional activities have a material impact on the risk profiles of the UCITS that the management company manages
Remuneration, fixed	the basic monthly gross salary and benefits; it remunerates role, responsibility and expertise
Remuneration, variable	also referred to as "bonus"; remunerates personal and collective achievements; it can be paid to the employee, when and if the financial result of the Management Company and the work performance of the employee allow so

## 3 Applicable regulations and other relevant documents

Directive	Directive 2011/61/EU on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (known as "AIFMD"); and
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## Luxembourg Law

European Commission Delegated Regulation (EU) N° 231/2013 of December 19th, 2012, supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (the “Delegated Regulation”);

Directive 2014/91/EU, amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (known as “UCITS V”);

European Securities and Markets Authority’s Guidelines on sound remuneration policies under the UCITS Directive and AIFMD (“the ESMA Guidelines”);

MIFID II Directive 2014/65/EU on Markets in Financial Instruments (MiFID II Regulations);

Luxembourg law of 17 December 2010 on undertakings for collective investment (the “UCI Law”); and

Luxembourg law of 12 July 2013 on alternative investment fund managers (the “AIFM Law”).

Circular CSSF 10/437 related to the guidelines concerning the remuneration policies in the financial sector (the “CSSF Circular 10/437”);

CSSF Regulation N° 10-4 of December 20th, 2010, transposing Commission Directive 2010/43/EU of July 1st, 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council, as regards organizational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a Depositary and a Management Company (the “CSSF Regulation N° 10-4”);

CSSF Circular 18/698, regarding specific provisions on the fight against money laundering and terrorist financing applicable to investment fund managers and entities carrying out the activity of registrar agent (the “CSSF Circular 18/698”);

Circular CSSF 14/585 - Transposition of the European Securities Markets Authority’s (ESMA)

guidelines on remuneration policies and practices (MiFID).

Pursuant to article 5 of the EU Regulation n. 2019/2088, the Remuneration Policy contains appropriate information on how such policy is consistent with the integration of sustainability risks

## 4 Remuneration Rules

UCITS V is the latest iteration of Directives governing UCITS funds and management companies. European Economic Area (“EEA”) Member States were required to apply UCITS V on 18 March 2016.

UCITS V contains rules on the manner in which staff are remunerated, which are designed to promote sound and effective risk management. This Policy focuses on the remuneration rules in this Directive on asset managers. Remuneration rules were introduced for alternative fund managers in 2013 under the Alternative Investment Fund Managers Directive (“AIFMD”). AIFMD provides the “blueprint” for the rules in UCITS V for fund managers regulated under the UCITS Directive.

Alpina Fund Management S.A. operates as so called “Super-ManCo”, which is understood as a management company authorized to manage UCITS and alternative funds, both, the UCITS as well as the AIFMD remuneration rules are applicable. Nevertheless, the UCITS V remuneration rules are similar to the rules under the AIFMD, i.e., no substantial deviation was identified.

Alpina Fund Management S.A. take further into account Circular CSSF 10/437 related to the guidelines concerning the remuneration policies in the financial sector (the “CSSF Circular 10/437”);

**Taking into consideration the allocation of assets managed by Alpina Fund Management S.A. under UCITS or AIFMD, Alpina Fund Management S.A. has decided to follow the UCITS V remuneration rules.** However, the Management Company remains subject to both legislations, UCITS and AIFMD.

### 4.1 Remuneration rules under UCITS V

UCITS V introduced remuneration rules that are similar to the rules for AIFMs under the AIFMD, requiring UCITS management companies to put in place remuneration policies that are consistent with sound risk management.<sup>1</sup>

The following is a summary of the UCITS V remuneration principles<sup>2</sup>, requirements *italicized* may have been dis-applied by the Management Company (see section regarding proportionality principle):

- the manager must have a remuneration policy that is consistent with and promotes sound and effective risk management and does not encourage risk-taking that is inconsistent with the UCITS’ risk profiles or rules;

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<sup>1</sup> Articles 14a and 14b of Directive 2009/65/EU, as amended by UCITS V.

<sup>2</sup> Article 14b of Directive 2009/65/EU, as amended by UCITS V.

- the remuneration policy should be in line with the business strategy, objectives, values and interests of the UCITS, the manager and the investors in the UCITS, and include measures to avoid conflicts of interest;
- the management body of the manager should adopt the remuneration policy and perform at least an annual review (according to UCITS V, this can only be undertaken by members of the management body who do not perform any executive functions and who have expertise in risk management and remuneration);
- the compliance function should, at least annually, review implementation of the remuneration policy;
- staff in control functions (such as senior legal and compliance staff) should be compensated in accordance with their functions' objectives, independently of the performance of the business areas that they control;
- *a remuneration committee should oversee remuneration of senior officers in risk management and compliance;*
- performance-related remuneration must be based on a combination of the assessment of the performance of the individual and of the business unit or fund concerned and the overall results of the UCITS manager, taking into account financial and non-financial criteria;
- performance must be assessed in a multi-year framework (appropriate to investors' recommended holding period in the fund), so that the assessment is based on longer-term performance of the fund;
- guaranteed variable remuneration must only be paid in the first year following a new hire and even then only in exceptional circumstances;
- fixed and variable remuneration components must be balanced appropriately, and the manager must have the option of paying no variable remuneration;
- The Variable Remuneration has a maximum threshold, depending on working area and the role. As part of a prudent management, the variable remuneration may not exceed 100% of the Fixed Remuneration for each employee, except for the Control Functions employees, which are assigned a maximum limit of 30% of the Fixed Remuneration. Exemptions to upper limits are allowed only in exceptional cases, after a proposal to the Board of Directors of the Management Company which needs to take final decisions in this respect.
- payments for early termination reflect the performance achieved over time and are designed in a way that does not reward failure;
- *variable remuneration must be put in place with an adjustment mechanism that integrates all types of current and future risks;*
- *a substantial portion (at least 50%) of the variable remuneration component must be paid in non-cash instruments, such as units of the UCITS concerned, equivalent ownership instruments or other instruments with equally effective incentives. Where the management of UCITS funds accounts for less than 50% of the total portfolio managed by the manager, the 50% minimum does not apply, but the obligation to pay a substantial portion of variable remuneration in non-cash instruments remains. This requirement is subject to the fund's legal structure, its fund rules or instruments of incorporation. In practice, managers are likely to take a pragmatic approach to satisfy this requirement;*
- *pay-out of between 40% and 60% of variable remuneration must be deferred over a period of three to five years, subject to the requirements that the deferral period is (1) appropriate in the view of investors' holding period, and (2) correctly aligned with the nature of the risk of the fund in question;*
- variable remuneration (including the deferred portion) must only be paid if it is sustainable according to the manager's financial situation as a whole and the individual's and fund's performance, and provide for variable remuneration to be reduced where either the manager or the fund concerned performs badly, or where the individual performs a "bad act" (*including claw-back of remuneration already paid*);

- discretionary pension benefits must be held in non-cash instruments for five years if a staff member leaves before retirement. Following retirement, the manager must also pay discretionary benefits in the form of non-cash instruments which must be subject to a five-year retention period;
- staff may not use personal hedging strategies or insurance to undermine the risk alignment in the remuneration arrangements; and
- variable remuneration may not be paid through vehicles or methods that facilitate avoidance of the requirements in UCITS V.

The remuneration provisions apply to senior management, risk takers, control functions and any other staff member whose remuneration falls in the remuneration bracket of senior management, and other risk takers whose professional activities have a material impact on the risk profile of the Management Company or UCITS.<sup>3</sup>

The Management Company's remuneration principles consider the conduct of business and conflict of interest risks that may arise. The remuneration policy is in line with the business strategy, objectives, values and interests of the Management Company and the UCITS that it manages and of the shareholders and investors in such UCITS and includes measures to avoid conflict of interests.

## 4.2 Proportionality principle

In AIFMD and UCITS V, remuneration principles are subject to the proportionality principle, which is that the rules must be applied in a manner appropriate to the size of the firm and the types of activities which it undertakes. Article 14(b) (1) of the UCITS Directive (as amended by the UCITS V Directive) states that UCITS management companies must comply with the rules “in a way and to the extent that is appropriate to their size, internal organization and nature, scope and complexity of their activities”<sup>4</sup> - noting at the same time that UCITS management companies must “apply all the principles governing remuneration policies.”<sup>5</sup>

Therefore, a key element of the UCITS Remuneration Guidelines (as well as the other aforementioned guidelines) relates to proportionality and, in particular, whether proportionality can lead to a situation in which the specific requirements on the pay-out process (i.e. the requirements on variable remuneration in instruments, retention, deferral and ex-post incorporation of risk for variable remuneration)<sup>6</sup> set out in the Directives may not have to be applied.

Proportionality may lead “on an exceptional basis” to the dis-application of some requirements, if this fits with the risk profile, risk appetite and strategy of the management company and the UCITS.

### 4.2.1 The Management Company's approach to the Proportionality principle

Following the principle of proportionality, Alpina Fund Management S.A. has decided to explicitly not apply the following requirements:

- the requirements on the pay-out process, namely the requirements on
  - i. variable remuneration in instruments;
  - ii. retention;
  - iii. deferral and

<sup>3</sup> Article 14a (3) of Directive 2009/65/EU, as amended by UCITS V.

<sup>4</sup> 12Article 14b (1) of Directive 2009/65/EU, as amended by UCITS V.

<sup>5</sup> Recital 3 of UCITS V.

<sup>6</sup> Article 14b (1) (m), (n) and (o) of the UCITS Directive and Annex II, paragraph 1, letters (m), (n) and (o) of the AIFMD.

- iv. ex-post incorporation of risk for variable remuneration; and
- the requirement to establish a remuneration committee.

In applying the proportionality principle, the types of factors that the Management Company has taken into account include:

- the Management Company's total assets under management (AuM);
- the percentage of UCITS assets under management relative to other fund assets under management;
- the average ratio between its fixed and variable remuneration paid to staff; and
- the funds' strategies, the respective risk appetite and risk approach ("complexity of investment strategies").

**Alpina Fund Management S.A. is not significant in terms of its size or the size of the funds managed, its internal organization and nature, scope and complexity of its activities (i.e. UCITS and AIF).**

assets under management	approximately EUR 650m
number of employees on payroll	5
their cumulated total remuneration does not exceed	EUR 750,000 per year
average ratio between fixed and variable remuneration	less than 1 : 0.50
ratio of UCITS assets relative to other fund assets	> 100:1
<i>(as of 31st December 2021)</i>	

*Non-complexity of investment strategies:* The funds managed by the Management Company do not pursue complex investment strategies. These are securities funds and funds of funds. This also applies to the funds that does not fall under the UCITS regime. Some sub-funds use forward exchange contracts to hedge currency risks. No sub-fund uses derivatives for speculative purposes, so there is no high leverage, including through other potentially suitable instruments ("unleveraged assets"). Securities financing transactions, e.g. securities lending transactions and (reverse) repurchase agreements, are not carried out. Even if the risk of a total loss cannot be excluded, the risk appetite of the sub-funds is therefore limited. This is also reflected in the selection of the method for measuring global risk, all sub-funds apply the commitment approach. Upon request, investors can obtain additional information on the risk management process from the Management Company.

In any case, the Company ensures that the fixed and variable components of the total remuneration are appropriately balanced and the fixed component represents a sufficiently high proportion of the total remuneration, including the possibility to pay no variable remuneration component.

#### 4.3 Role of the Board of Directors and of the Senior Management

UCITS V requires a UCITS Manager's non-executive board members to:

- (i) adopt the remuneration policy;
- (ii) adopt and review at least annually the general principles of the remuneration policy; and
- (iii) take responsibility for and oversee their implementation.

The Board of Directors considers that its members have appropriate expertise in risk management and remuneration to fulfil its responsibility for the adoption of this remuneration Policy and practices that do not encourage risk taking that is inconsistent either with the risk profiles, rules or instruments of incorporation of the UCITS funds and AIFs that the Management Company manages or with the Management Companies' duty to act in the best interest of those funds. Where a periodic review reveals that the

remuneration system does not operate as intended or prescribed, the Board of Directors shall ensure that a timely remedial plan is put in place.

The Board of Directors recognizes the important role played by sound risk management in protecting its stakeholders. Moreover, the Board acknowledges that inappropriate remuneration structures could, in certain circumstances, result in situations whereby individuals assume more risk on the relevant entity's behalf than they would have done had they not been remunerated in this way.

Therefore, the Board of Directors will budget the corresponding expenses ("personnel costs") in a manner that is conducive to the effective implementation of this Policy.

Nevertheless, the Board may deviate from this Policy. However, in such a case, the relevant payments must comply with the relevant regulations and guidelines (to the extent applicable) and in addition, the Board of Directors shall approve any payments made.

The senior management will act within the aforementioned budget. Any additional personnel expenses are discussed with the Board of Directors, if necessary.

The Compliance department ensures that this Policy has been reviewed by the Board of Directors at least annually, and that all related principles and procedures have been implemented accordingly. The Compliance department oversees the fair and consistent application of this Policy within the Management Company.

#### **4.4 Determination of Identified Staff**

The list of Identified Staff is approved by the Board of Directors and is reviewed once a year. It is approved on the basis of criteria laid down in the ESMA Guidelines on sound remuneration policies under the UCITS Directive (ESMA/2016/575).

#### **4.5 Variable remuneration**

##### **4.5.1 Malus and clawback**

Malus means the adjustment of an award of variable remuneration, such as a performance-linked bonus or share award, before it has vested. Clawback means the recovery of variable remuneration which has already been paid.

From a practical point of view, it is easier for firms to apply malus since that involves an adjustment being made before any money or shares are paid over to the employee. Clawback is harder to apply in practice since it involves recouping money or shares that have already been paid or transferred to the employee.

The ESMA final guidelines on sound remuneration policies under UCITS V state that any variable remuneration award shall be subject to malus and clawback provisions.

**Alpina Fund Management S.A. is of the opinion that the Company does not pay any variable remunerations that may lead to excessive risk taking.**

When appropriate, the Management Company will adjust an award of variable remuneration, i.e. the Management Company will apply a malus.

Regarding clawbacks, it remains unclear how tax and national insurance contributions paid can be reimbursed, e.g. tax bills over a period of three years would need to be appealed



against. As clawbacks shall fall under the sole discretion of the Management Company, the Management Company may face compensation claims, litigation or other legal action.

**Taking into consideration these issues, the Management Company deems appropriate to apply a malus instead of a clawback, if possible.**

#### **4.5.2 Performance assessment**

When the remuneration of the employee is performance related, the remuneration is calculated in order to reflect the performance of the employee, the results of the business unit and the overall result of the Management Company.

The employee can be evaluated on the basis of financial and non-financial criteria (e.g., unethical or non-compliant behaviors). The appropriate mix of both criteria can vary depending on the tasks and responsibilities of the employee.

**The financial targets are subject to appropriate risk adjustment.**

For the infrastructure functions, the performance assessment is based on the achievement of cost and control targets. At the level of the individual, managers must fully appreciate both the absolute and relative risk-taking activities of individuals to ensure that variable remuneration allocations are balanced and risk-taking is not inappropriately incentivized.

The factors and metrics to be considered include, but are not limited to, applicable risk-adjusted financial and non-financial performance, culture and behavioral considerations, disciplinary sanctions, and individual performance.

Managers of Material Risk Takers must document the factors and risk metrics considered when making Individual variable compensation decisions, and demonstrate how these factors influenced the Individual variable compensation decision

For staff members engaged in control processes and who are independent from the business units they oversee, the assessment is performed in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control (i.e. risk management, audit, and compliance functions).

The remuneration of senior officers in the risk management and compliance functions is directly overseen by the Board of Directors.

#### **4.5.3 Award process**

The Management Company translates the performance assessment into the variable remuneration component for each employee. Risks are taken into account when the amount is determined by the Management Company.

In case subdued financial performance of the Management Company or of the funds occurs, the variable remuneration of the employees will be considerably contracted, if appropriate.

The specific measure may effect both current compensation and reductions in payouts of amounts previously earned, including through malus or clawback arrangements.

The Management Company will ensure that the variable remuneration will not be paid through vehicles or methods that facilitate the avoidance of the requirements.

#### 4.5.4 Conflict of Interest

The policy has been designed and implemented in a way to avoid any potential conflict of interest.

Employees of the Management Company, who are identified as risk-takers are not remunerated based on the performance of the funds under management.

Should nevertheless any potential arise, the implemented Conflict of Interest Policy of Management Company should apply and such potential conflict should be reported to Compliance function in order to be logged and properly addressed and mitigated as foreseen in the policy.

#### 4.5.5 ESG

Environmental, Social and Governance (ESG) factors are receiving considerable public attention. Integrating these aspects into compensation systems is an important step for credibly driving the sustainability agenda of the Management Company.

ESG criteria such as the reduction of carbon emissions or customer satisfaction cannot and should not be maximized per se and as a consequence should rather be integrated as boundary conditions that need to be fulfilled in order to receive any variable compensation (so-called “thresholds conditions”). In other words, non-achievement might lead to a downward adjustment of variable pay.

#### 4.6 Application of remuneration rules to delegates

Under AIFMD, ESMA required, in its remuneration guidelines, the application of the AIFMD remuneration rules to portfolio management delegates of an AIFM, including delegates established outside the EEA. Although UCITS V did not include this principle within its provisions, a recital to the Directive mentions the possibility of this being required, referring to remuneration rules applying to third parties that “take investment decisions that affect the risk profile of the UCITS”, with such rules applying “in a proportionate manner”.

In its guidelines, ESMA has taken the same approach on this point as it did under AIFMD, and requires the application of remuneration rules to portfolio management delegates of UCITS management companies, by either of the following means:

- satisfying the condition that the delegate is “subject to regulatory requirements on remuneration that are equally as effective as those applicable under these guidelines”; or
- the UCITS management company including a provision in the contract appointing the delegate, which states that the delegate must follow, to an appropriate degree, UCITS remuneration rules.

#### 4.7 Remuneration disclosures

UCITS V includes the following requirements for remuneration disclosure.

##### 4.7.1 Prospectus<sup>7</sup>

The prospectus must include:

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<sup>7</sup> Article 69(1).

- details of the remuneration policy, including a description of how remuneration and benefits are calculated, the persons responsible for awarding the remuneration and benefits, including the composition of any remuneration committee; and
- a statement that the details of the remuneration policy (outlined above) are available on a website and by a paper copy.

The key investor information document must also contain a statement that the details of the up-to-date remuneration policy is available on a website and on request.

#### 4.7.2 Annual report<sup>8</sup>

Although the Management Company has decided to follow the UCITS Directives with respect to this Policy, the Management Company will take into account relevant deviations from the AIFMD with respect to disclosure requirements, while involving the auditor of the relevant fund.

The fund's annual report must include:

- the total amount of remuneration during the fund's financial year, split into fixed and variable remuneration, paid by the management company to its staff, the number of beneficiaries, and any amount paid by the UCITS itself;
- the aggregate amount of remuneration broken down by categories of employees or other members of staff that are subject to the remuneration rules. This appears to require a break-down of remuneration by each category of staff, including senior management, other risk takers and control functions;
- a description of how the remuneration and benefits have been calculated;
- the outcome of the annual review of the remuneration policy; and
- details of any material changes to the policy.

Alpina Fund Management S.A. reports the total amount of remuneration during the fund's financial year, the ratio between fixed and variable remuneration, paid by the Management Company to its staff, the number of beneficiaries, and any amount paid by the UCITS itself.

**As the number of employees on the payroll is low and in order to protect the privacy rights of these persons, Alpina Fund Management S.A. will not break down the aggregate amount of remuneration by categories of employees or other members of staff that are subject to the remuneration rules. Alpina Fund Management S.A. is of the opinion that it is not appropriate to disclose the remuneration of individuals, being otherwise the consequence.**

Alpina Fund Management S.A. provides the investor with a description of how the remuneration and benefits have been calculated, the outcome of the annual review of the remuneration policy and details of any material changes to the policy.

The remuneration-related disclosure requirements under Article 69(3)(a) of the UCITS Directive also apply to the staff of the delegate of a management company to whom investment management functions (including risk management) have been delegated. The disclosure may be provided on an aggregate basis i.e. by means of a total amount for all the delegates of the Management Company in relation to the relevant UCITS.

**The Management Company will communicate to investors the names of the Delegates, their functions and the remuneration paid to these Delegates in the annual report and with the involvement of the auditor of the respective fund.**

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<sup>8</sup> Article 69(3).

## 4.8 Supplementary provisions

The Management Company will 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;
- guaranteed variable remuneration is exceptional, occurs only in the context of hiring new staff and is limited to the first year;
- staff is required to undertake not to use personal hedging strategies or remuneration- and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements;
- any retention bonus agreement, a form of variable remuneration, is appropriately designed, if such an agreement is agreed in individual cases.

## 5 Supplementary information

For the time being, the Management Company does not grant the following types of remuneration (*non-exhaustive enumeration*):

- employer-funded pension,
- company car,
- lunch pass (*chèque repas*),
- subsidization of contracts (e.g. public transport, gym membership).

However, the Management Company may pay employees parking fees at cost price.

### Annex 1 - Remuneration rules under CRD IV

CRD IV remuneration rules apply to credit institutions (broadly, EU deposit-taking banks) and some types of EU investment firms.<sup>9</sup> Broadly, the types of investment firms that are subject to CRD IV are investment firms that have permission to engage in proprietary trading (encompassing broker-dealers) or certain corporate finance activities (such as “placing” or underwriting). In addition, there are a number of asset managers that have sought to be subject to CRD IV to qualify as a “sponsor” for securitization risk retention purposes.

CRD IV made a number of changes to the previous remuneration rules that applied to EEA firms that are subject to the CRD. In particular, CRD IV imposes the bonus cap, which imposes a ratio of fixed and variable remuneration of 1:1, or 1:2 with shareholder approval (with a quorum of 50% of shareholders, 66% of votes in favor would be required, and, if that quorum is not reached, 75% of votes must be in favor).<sup>10</sup> CRD IV also requires that all variable remuneration should be subject to “claw-back” arrangements (in light of subsequent poor performance by the individual).<sup>11</sup>

CRD IV includes the proportionality principle, which is that the rules must be applied in a manner appropriate to the size of the firm and the types of activities that it undertakes.<sup>12</sup> The European Banking Authority (“EBA”) is responsible for publishing guidelines on, amongst other things, the precise application of this principle. The EBA published a consultation

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<sup>9</sup> See definition of investment firm in Article 4 (2) of Regulation 575/2013.

<sup>10</sup> Article 94 (1) (g).

<sup>11</sup> Article 94 (1) (n).

<sup>12</sup> Recital 66.

paper and draft guidelines in March 2015, where it outlined its proposed approach in regard to proportionality. In this paper, the EBA expressed its view that proportionality cannot act to dis-apply individual requirements of CRD IV (such as the bonus cap and the requirement to pay a portion of the remuneration “in kind” in equity). In the EBA’s view, all remuneration requirements must be applied to at least the minimum thresholds set by CRD IV, and that proportionality means application of all the rules in a manner appropriate to the institution’s size, internal organization and nature, scope and complexity of its activities. The EBA has acknowledged that its interpretation has a significant impact on small and less risky firms. The European Commission’s announcement in October 2015 of two consultations on the impact of the CRD IV remuneration rules suggested that it will not release final remuneration guidelines until the results of these consultations, meaning that resolution of this issue may not take place quickly.

On 16 June 2017, the CSSF adopted CSSF Circular 17/658 in relation to the adoption of the EBA Guidelines on sound remuneration policies (EBA/GL/2015/22), which the CSSF intends to follow. The Circular repeals the existing CSSF Circular 10/496 and specifies that CSSF Circulars 10/497 and 11/505 will be amended. The main amendments introduced by the EBA Guidelines are described in the Circular and the following point is worth mentioning:

According to the EBA’s interpretation of the application of the principle of proportionality in respect of remuneration policies, the wording of Article 92 (2) of CRD IV would no longer permit the neutralization of requirements in terms of remuneration policy. Nevertheless, the CSSF maintains the application of CSSF Circular 11/505, so that all the requirements that could be neutralized until now may continue to be neutralized until the application of new European rules in the area.

#### **Position of asset managers that are part of a group**

Many alternative investment fund managers (“AIFMs”) and UCITS managers are part of a group (such as a banking group) that is subject to CRD IV. CRD IV requires a group-wide remuneration policy to apply to all staff at group, parent and subsidiary levels, and states that CRD IV’s requirements for the contents of remuneration policies should apply at least to those staff members whose professional activities have a material impact on the group’s risk profile.<sup>13</sup> According to the EBA’s draft guidelines:

- Staff within an AIFM or UCITS manager whose professional activities have a material impact on the group’s risk profile on a consolidated basis are subject to CRD IV remuneration rules, including the bonus cap. Firms will need to identify any such staff and determine whether, for instance, the activities of an individual portfolio manager within an AIFM or a UCITS manager can be said to have an impact on the group’s risk profile. It is likely that an individual in an AIFM or a UCITS manager would need to exercise significant influence either within the firm or at the group level to be subject to CRD IV, such as a board member of an AIFM or UCITS manager.
- Where specific CRD requirements conflict with the “sectoral” requirements (meaning the specific remuneration rules put forward under the AIFMD or the UCITS Directive), the remuneration policy should set out for the relevant individuals which requirements should apply within the entity on an individual basis. This means that, for instance, the requirement in the AIFMD or UCITS Directive to pay part of the variable remuneration in units in the fund would “trump” the equivalent requirement in CRD IV to pay part of the variable remuneration in equity in the firm.

Subject to these qualifications, staff within an AIFM or UCITS manager that is within a group that is subject to CRD IV are subject to the rules in the AIFMD and UCITS Directive (which are broadly similar, but not identical, to the rules in CRD IV).

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<sup>13</sup> Articles 92 (1) and 92 (2).

The European Securities and Markets Authority (“ESMA”), the pan-EEA regulator, published a consultation paper on guidelines on sound remuneration policies under the UCITS V Directive on 23 July 2015. According to ESMA’s draft guidelines (which form part of the consultation):

- There should be no exception to the application of the UCITS remuneration principles to any management company which is a subsidiary of a credit institution.
- Where staff of the UCITS management company or the AIFM are “identified staff” for the purpose of CRD IV rules, they should be remunerated either:
  - On activities carried out on a pro rata basis between CRD IV, UCITS and AIFMD (based on, for instance, time spent on each service); or
  - Where there is a conflict between CRD IV and UCITS (or AIFMD) remuneration principles, by applying “sectoral” remuneration principles which are deemed more effective for discouraging excessive risk taking. Where the firm determines that compliance with CRD IV is more effective, this should deem compliance with remuneration requirements under UCITS and AIFMD. However, where specific CRD IV requirements conflict with requirements under UCITS or AIFMD, the remuneration of the individual should follow the specific requirements under UCITS or AIFMD. This is in line with the EBA’s guidance.

Subsequent to ESMA’s draft guidelines, ESMA published its final report “Guidelines on sound remuneration policies under the UCITS Directive and AIFMD” on 31 March 2016 (ESMA/2016/411) which, in essence, confirms the draft guidelines regarding the above mentioned points.

Following the final report, ESMA published “Guidelines on sound remuneration policies under the UCITS Directive” (ESMA/2016/575) and “Guidelines on sound remuneration policies under the AIFMD” (ESMA/2016/579) on 14 October 2016.

## Annex 2 - ESMA’s Consultation Paper

### Introduction

The objective of this section is to provide high level advice on ESMA’s Consultation Paper (“CP”) titled “Guidelines on sound remuneration policies under the UCITS Directive”, launched July 23, 2015.

The Securities and Markets Stakeholder Group (“SMSG”), in line with its mandate to offer high level advice to ESMA, took opportunity to express its strong support for the approach taken by ESMA on the matter of proportionality. This approach, which is in line with that taken by ESMA on the AIFMD Remuneration Guidelines, allows for the dis-application of certain requirements of these draft Guidelines on an exceptional basis and taking into account specific facts.

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

The notion of proportionality is inherent in European Union law and lies at the heart of EU governance and policy-making. A key element of sound regulation, it allows disapplication and thus “neutralization”, on an exceptional basis and subject to a case-by-case assessment,



of certain requirements of the guide-lines, where what is intended to be achieved by the regulation can be sufficiently achieved through the workings of the business model in question. This is especially important where a piece of regulation encompasses many different sub-sets of funds and managers with quite different business models, risk-profiles and negotiated structures like those regulated under the UCITS and/or AIFM Directives.

## Background

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

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

- ESMA shall take into account the principles of sound remuneration policies set out in Recommendation 2009/384/EC (“Recommendation”);
- ESMA shall take into account proportionality “the size of the management company and the size of the UCITS that [the relevant persons] manage, their internal organization, and the nature, scope and complexity of their activities”; and
- ESMA shall co-operate closely with EBA.

## ESMA’s working method

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

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

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

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

## Matter of Proportionality

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

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

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

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

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

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

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

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



### Annex 3 - Comparison table UCITS V vs. AIFMD texts on remuneration and assessment of distinctions

Art. 14b(1)(a) UCITS Directive  
vs. Par. (1)(a) Annex II AIFMD

the remuneration policy is consistent with and promotes sound and effective risk management and does not encourage risk-taking which is inconsistent with the risk profiles, rules or instruments of incorporation of the UCITS that the management company manages;

Art. 14b(1)(b) UCITS Directive  
vs. Par. (1)(b) Annex II AIFMD

the remuneration policy is in line with the business strategy, objectives, values and interests of the management company and the UCITS that it manages ~~or~~ and of the investors in such UCITS, and includes measures to avoid conflicts of interest;

Art. 14b(1)(c) UCITS Directive  
vs. Par. (1)(c) Annex II AIFMD

the remuneration policy is adopted by the management body of the management company, in its supervisory function, and that body adopts, and reviews at least annually, the general principles of the remuneration policy and is responsible for, and oversees, their implementation; the tasks referred to in this point shall be undertaken only by members of the management body who do not perform any executive functions in the management company concerned and who have expertise in risk management and remuneration;

Art. 14b(1)(d) UCITS Directive  
vs. Par. (1)(d) Annex II AIFMD

the implementation of the remuneration policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for remuneration adopted by the management body in its supervisory function;

Art. 14b(1)(e) UCITS Directive  
vs. Par. (1)(e) Annex II AIFMD

staff engaged in control functions are compensated in accordance with the achievement of the objectives linked to their functions, independently of the performance of the business areas that they control;

Art. 14b(1)(f) UCITS Directive  
vs. Par. (1)(f) Annex II AIFMD

the remuneration of the senior officers in the risk management and compliance functions is directly overseen by the remuneration committee, where such a committee exists;

Art. 14b(1)(g) UCITS Directive  
vs. Par. (1)(g) Annex II AIFMD

where remuneration is performance related, the total amount of remuneration

	<p>is based on a combination of the assessment as to the performance of the individual and of the business unit or UCITS concerned and of as to their risks and of the overall results of the AIFM management company, when assessing individual performance, taking into account financial as well as and non-financial criteria;</p>
Art. 14b(1)(h) UCITS Directive vs. Par. (1)(h) Annex II AIFMD	<p>holding period recommended to the investors of the UCITS managed by the management company in order to ensure that the assessment process is based on the longer-term performance of the UCITS and its investment risks and that the actual payment of performance-based components of remuneration is spread over the same period;</p>
Art. 14b(1)(i) UCITS Directive vs. Par. (1)(i) Annex II AIFMD	<p>guaranteed variable remuneration is exceptional, occurs only in the context of hiring new staff and is limited to the first year of engagement;</p>
Art. 14b(1)(j) UCITS Directive vs. Par. (1)(j) Annex II AIFMD	<p>fixed and variable components of total remuneration are appropriately balanced and the fixed component represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy, on variable remuneration components, including the possibility to pay no variable remuneration component;</p>
Art. 14b(1)(k) UCITS Directive vs. Par. (1)(k) Annex II AIFMD	<p>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;</p>
Art. 14b(1)(l) UCITS Directive vs. Par. (1)(l) Annex II AIFMD	<p>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;</p>
Art. 14b(1)(m) UCITS Directive vs. Par. (1)(m) Annex II AIFMD	<p>subject to the legal structure of the UCITS and its fund rules or instruments of incorporation, a substantial portion, and in any event at least 50 %, of any variable remuneration component consists of units of the UCITS AIF concerned, equivalent ownership interests, or share-linked instruments or equivalent non-cash instruments with equally effective incentives as any of the instruments</p>

referred to in this point, unless the management of the UCITS AIFs accounts for less than 50 % of the total portfolio managed by the management company, in which case the minimum of 50 % does not apply.

The instruments referred to in this point shall be subject to an appropriate retention policy designed to align incentives with the interests of the management company and the UCITS that it manages and the investors of such UCITS. Member States or their competent authorities may place restrictions on the types and designs of those instruments or ban certain instruments as appropriate. This point shall be applied to both the portion of the variable remuneration component deferred in line with point (n) and the portion of the variable remuneration component not deferred;

Art. 14b(1)(n) UCITS Directive  
vs. Par. (1)(n) Annex II AIFMD

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 holding period recommended to the investors of the UCITS AIF concerned and is correctly aligned with the nature of the risks of the UCITS in question.

The period referred to in this point shall be at least three years; remuneration payable under deferral arrangements vests no faster than on a pro-rata basis; in the case of a variable remuneration component of a particularly high amount, at least 60 % of the amount is shall be deferred;

Art. 14b(1)(o) UCITS Directive  
vs. Par. (1)(o) Annex II AIFMD

the variable remuneration, including the deferred portion, is paid or vests only if it is sustainable according to the financial situation of the management company as a whole, and justified according to the performance of the business unit, the UCITS and the individual concerned.

The total variable remuneration shall generally be considerably contracted where subdued or negative financial performance of the management company or of the UCITS concerned occurs, taking into account both current compensation and reductions in payouts of amounts previously earned, including through malus or clawback arrangements;

Art. 14b(1)(p) UCITS Directive  
vs. Par. (1)(p) Annex II AIFMD

the pension policy is in line with the business strategy, objectives, values and long-term interests of the AIFM management company and the UCITS AIFs that it manages.

If the employee leaves the management company before retirement, discretionary pension benefits shall be held by the management company for a period of 5 five years in the form of instruments defined in point (m). In the case of an employee reaching retirement, discretionary pension benefits shall be paid to the employee in the form of instruments defined in point (m), subject to a 5 five-year retention period;

Art. 14b(1)(q) UCITS Directive  
vs. Par. (1)(q) Annex II AIFMD

staff are required to undertake not to use personal hedging strategies or remuneration- and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements;

Art. 14b(1)(r) UCITS Directive  
vs. Par. (1)(r) Annex II AIFMD

variable remuneration is not paid through vehicles or methods that facilitate the avoidance of the requirements laid down in this Directive.

Art. 14b(2) UCITS Directive  
(no correspondent under the AIFMD)

In accordance with Article 35 of Regulation (EU) No 1095/2010, ESMA may request information from competent authorities on the remuneration policies and practices referred to in Article 14a of this Directive.

ESMA shall, in close cooperation with EBA, include in its guidelines on remuneration policies provisions on how different sectoral remuneration principles, such as those set out in Directive 2011/61/EU of the European Parliament and of the Council and in Directive 2013/36/EU of the European Parliament and of the Council, are to be applied where employees or other categories of personnel perform services subject to different sectoral remuneration principles.

Art. 14b(3) UCITS Directive  
vs. Par. (2) Annex II AIFMD

The principles set out in paragraph 1 shall apply to any benefit of any type paid by the management company, to any amount paid directly by the UCITS AIF itself, including performance fees, and to any transfer of units or shares of the UCITS, made for the benefits of those categories

Art. 14b(4) UCITS Directive  
vs. Par. (3) Annex II AIFMD

of staff, including senior management, risk takers, control functions and any employee receiving total remuneration that falls into the remuneration bracket of senior management and risk takers, whose professional activities have a material impact on their risk profile or the risk profiles of the UCITS that they manage.

Management companies that are significant in terms of their size or of the size of the UCITS they manage, their internal organisation and the nature, scope and complexity of their activities shall establish a remuneration committee. The remuneration committee shall be constituted in a way that enables it to exercise competent and independent judgment on remuneration policies and practices and the incentives created for managing risk.

The remuneration committee that is, where appropriate, set up in accordance with the ESMA guidelines referred to in Article 14a(4)<sup>14</sup> shall be responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk and risk management of the management company or the UCITS concerned and which are to be taken by the management body in its supervisory function. The remuneration committee shall be chaired by a member of the management body who does not perform any executive functions in the management company concerned. The members of the remuneration committee shall be members of the management body who do not perform any executive functions in the AIFM management company concerned.

If employee representation on the management body is provided for by national law, the remuneration committee shall include one or more employee representatives. When preparing its

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<sup>14</sup> In accordance with Article 16 of Regulation (EU) No 1095/2010, ESMA shall issue guidelines addressed to competent authorities or to financial market participants concerning the persons referred to in paragraph 3 of this Article and the application of the principles referred to in Article 14b. Those guidelines shall take into account the principles on sound remuneration policies set out in Commission Recommendation 2009/384/EC (\*), the size of the management company and the size of the UCITS that they manage, their internal organisation, and the nature, scope and complexity of their activities. In the process of the development of those guidelines, ESMA shall cooperate closely with the European Supervisory Authority (European Banking Authority) ('EBA'), established by Regulation (EU) No 1093/2010 of the European Parliament and of the Council (\*\*), in order to ensure consistency with requirements developed for other financial services sectors, in particular credit institutions and investment firms.

<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0091>

decisions, the remuneration committee shall take into account the long-term interest of investors and other stakeholders and the public interest.

## Annex 4 - ESMA's stance on proportionality (ESMA/2016/412)

Both the AIFMD and UCITS Directive prescribe that proportionality shall apply to the full set of remuneration principles set out under these Directives. This is made clear by the language in both Directives stating that management companies and AIFMs “shall comply with the [remuneration] principles in a way and to the extent that is appropriate to their size, internal organization and the nature, scope and complexity of their activities”. ESMA considers, therefore, that proportionality applies to the full set of requirements under Article 14b (1)(a) to (r) of the UCITS Directive and letters (a) to (r) of paragraph 1 of Annex II of the AIFMD. Proportionality is also a key element that had to be taken into account by ESMA when elaborating guidelines under both the AIFMD and UCITS Directive<sup>15</sup>.

Recent work and legal analysis have called into question the existing understanding that the aforementioned proportionality provisions as set out under the UCITS Directive and AIFMD may lead to a result:

- a) where - under specific circumstances - the requirements on the pay-out process (i.e. the requirements on variable remuneration in instruments, retention, deferral and ex post incorporation of risk for variable remuneration) are not applied; or
- b) where it is possible to apply lower thresholds whenever minimum quantitative thresholds are set for the pay-out requirements (e.g. the requirement to defer at least 40% of variable remuneration).

ESMA considers that the scenarios under a) and b) should remain possible in certain situations and further legal clarity on this possibility could be beneficial to all the interested parties (market participants, investors and regulators).

This is true, in particular, in light of the specificities of the fund management sector. Fund managers operate according to an agency model and do not accept deposits nor deal on their own account. As a consequence, Fund managers, unlike credit institutions, do not issue liabilities to fund investors. Fund investors have a claim on the investment portfolio which is ring-fenced from the fund manager. Fund managers manage a portfolio of securities on behalf of a fund, in the interest of the investors in such fund, under an investment mandate. Their discretion on how to dispose of the assets in the relevant portfolio is constrained by the investment objectives and specific limits and restrictions set out in the investment management mandate and in specific product regulation (e.g. UCITS concentration limits). ESMA recalls that remuneration rules under the UCITS Directive and AIFMD are aimed to align the interests of, including the risks taken by, the fund managers with those of the investors of the funds that they manage.

Given the nature of activities of fund managers, and the variety of funds they manage and strategies they implement for those funds, it is appropriate to recognize the possibility to tailor the rules on the pay-out process of variable remuneration when these do not, in the specific circumstances, achieve the goal of aligning the interests of the fund manager's staff with those of the investors in the funds. For example:

Small and non-complex fund managers and small amounts of variable remuneration: small and non-complex fund managers have a relatively high number of identified staff, compared to larger fund managers, to whom the remuneration requirements could apply (even though this number is low in absolute terms). For these fund managers, the application of the pay-out process rules needs to be proportionate so as not result in significant one-off and on-going administrative and

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<sup>15</sup> Both Article 14a (4) of the UCITS Directive and Article 13(2) of the AIFMD state that ESMA shall issue guidelines on the remuneration principles taking into account “*the size of the [AIFMs/management company] and the size of [AIFs/the UCITS that] they manage, their internal organization and the nature, the scope and the complexity of their activities*”.

systems costs which could put them at a competitive disadvantage against larger fund managers.<sup>16</sup>

Similarly, certain staff only receives small amounts of variable remuneration. The pay-out process rules are only effective in aligning long-term interests when the amount of variable remuneration is meaningful enough to be spread over a multi-year horizon.

Application of the deferral rules: Article 14b (1)(n) of the UCITS Directive requires a substantial portion, and in any case at least 40%, of the variable remuneration component to be deferred over a period which is appropriate in view of the holding period recommended to the investors of the UCITS and is correctly aligned with the nature of the risks of the UCITS in question. The same article then goes on to clarify that the deferral period should be at least three years.

Certain types of funds may have an investor's holding period which is significantly shorter than three years. Because of this, it can be argued that the application of the deferral rules is unlikely to align the interests of the management company's staff with those of the investors in the UCITS and the risks of the UCITS in question.

Application of the payments in instruments rules: Article 14b(1)(m) requires that a substantial portion of any variable remuneration component consists of units of the UCITS concerned, equivalent ownership interests, or share-linked instruments or equivalent non-cash instruments.

The payment of variable remuneration in shares or UCITS or equivalent non-cash instruments might not achieve an effective alignment of interests for certain staff of the management company who have no direct involvement in the management of UCITS, for example the head of the compliance or internal audit function. In such cases, it could be desirable to include other types of instruments in the remuneration packages of those staff such as, for example, shares in the management company.

Application of payout process rules to delegates: the UCITS remuneration guidelines, as well as the AIFMD remuneration guidelines clarify that the remuneration requirements apply to delegates of the management company. This is the case even when the delegate's contract with the management company sets out strict investment guidelines or it only covers a small portion of the UCITS portfolio. As a consequence, the delegate would have little or no discretion to affect the risk profile of the UCITS. In light of the above, there might be cases where the application of the payout process rules to the staff of the delegate would not be proportionate and would not achieve the outcome of aligning the delegates' staff interests with those of the investors in the UCITS. There is also a risk that the unwillingness of delegates outside of the EEA to be subject to some requirements they consider disproportionate, could prevent access of EU management companies to certain investment strategies.

Application of pay-out process rules to portfolio managers who do not manage only portfolios of UCITS: certain portfolio managers employed by the management company do not manage the UCITS as a whole. For example, they may have responsibilities for managing an asset class / strategy in which they have a very specific expertise. These portfolio managers would apply this expertise across the various products managed by the management company, which could be UCITS, alternative investment funds or segregated mandates, but they might only affect the risk of a small proportion of the relevant portfolio.

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<sup>16</sup> This is particularly the case for UCITS management companies. This is because in the UCITS Directive there is no equivalent provision to Article 3 of the AIFMD exempting asset managers with lower amounts of assets under management from the scope of the AIFMD.



As a consequence, the application of the pay-out process rules, for example the payment of a portion of variable remuneration in shares of the UCITS, could be disproportionate and may impose an excessive burden on certain portfolio managers which may ultimately reduce the level of diversification and choice available to the funds' investors.

It is also important to note that the fund manager's decision not to apply certain remuneration requirements should never be automatic. In applying proportionality, it is the responsibility of the fund manager to review how each remuneration principle should apply to it in a way that it aligns the interests of its staff with those of the underlying investors and having taken into account its size, internal organization and the nature, scope and complexity of its activities. Fund managers must document this process and be able to demonstrate at any time, with the support of objective evidence, to their national competent authorities the way in which they have applied the relevant remuneration principles.

Given, inter alia, these specificities, it would be inappropriate to impose the payout requirements where their implementation would not achieve the intended policy outcome. Moreover, to achieve an effective alignment of interests between the fund managers' staff and the investors, ESMA believes that it would be inappropriate for the following fund managers to be subject in all circumstances to the requirements on the pay-out process:

- i) smaller fund managers (in terms of balance sheet or size of assets under management),
- ii) fund managers with simpler internal organization or nature of activities, or
- iii) fund managers whose scope and complexity of activities is more limited.

ESMA also considers that it would be disproportionate to apply the requirements to relatively small amounts of variable remuneration and to apply certain requirements to certain staff when this would not result in an effective alignment of interests between the staff and the investors in the funds.

ESMA is of the view that legislative changes in the relevant asset management legislation could be one way to further clarify the applicable regulatory framework and ensure consistent application of the remuneration requirements in the asset management sector. These could further clarify the requirements in order to allow for the scenarios outlined in (a) and (b) above.

## Annex 5 - Application of remuneration rules to delegates

A delegate that is already governed by EU remuneration rules (such as a manager governed by AIFMD or CRD IV) will likely comply with whatever requirement is imposed on it by virtue of UCITS. There are questions as to the degree to which a delegate of a UCITS management company will be subject to the new rules. In particular:

- Under AIFMD, ESMA clarified that a delegate, in applying AIFMD remuneration rules, need only have regard to those staff who have a material impact on the fund's risk profile and only in respect of the portion of the remuneration they receive for the delegated mandate. ESMA provides the same guidance under UCITS. The remuneration of an individual which performs services subject to the UCITS Directive and services subject to CRD IV and/or the AIFMD, should be determined applying the remuneration principles under the UCITS Directive, CRD IV and AIFMD on a pro rata basis based on objective criteria such as the time spent on each service or the assets under management for each service.
- It seems sensible to apply the proportionality principle to the application of the remuneration rules to delegates. The UK Financial Conduct Authority's ("FCA") guidance under AIFMD allowed managers to dis-apply the "pay-out process rules"<sup>17</sup> to delegates where the delegate acts with limited investment discretion, and subject to the risk management of the appointing manager. It is unknown whether the FCA or ESMA will adopt a similar approach for UCITS remuneration rules. The FCA has stated that it will consider publishing further guidance once ESMA's guidelines are finalized.

The final Guidelines (unlike the draft version) do not include guidance on the dis-application of certain requirements on the pay-out process.

ESMA did not include such guidance in the final report due to "recent work and legal analysis ... which have called into question the existing understanding of the proportionality provisions" under the UCITS and AIFM Directives. As a result, ESMA has written to the European Commission and suggested that further clarity on the proportionality principle and cross-sectoral alignment is required. In this letter, ESMA explained that it had to balance the co-legislators' steer to ensure alignment with the AIFMD Remuneration Guidelines and the obligation to closely cooperate with the EBA "in order to ensure consistency with requirements developed for other financial services sectors, in particular credit institutions and investment firms".

However, ESMA also made it clear in its letter that it should be possible in certain situations to:

- dis-apply the requirements on the pay-out process (i.e. the requirements on variable remuneration in instruments, retention, deferral and ex post incorporation of risk for variable remuneration); or
- to apply lower thresholds whenever minimum quantitative thresholds are set for the pay-out requirements (e.g. the requirement to defer at least 40% of variable remuneration).

ESMA has concluded that it is appropriate to recognize the possibility to tailor the rules on the pay-out process of variable remuneration when these do not, in the specific circumstances, achieve the goal of aligning the interests of the fund manager's staff with those of the investors. For example:

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<sup>17</sup> The "pay-out process rules" comprise the rules on payment in kind in fund units, deferral of payment and adjustment of awards based on subsequent performance.

- Application of pay-out process rules to delegates: the UCITS remuneration guidelines, as well as the AIFMD remuneration guidelines clarify that the remuneration requirements apply to delegates of the management company. This is the case even when the delegate's contract with the management company sets out strict investment guidelines or it only covers a small portion of the UCITS portfolio. As a consequence, the delegate would have little or no discretion to affect the risk profile of the UCITS.

Consequently, there might be cases where the application of the pay-out process rules to the staff of the delegate would not be proportionate and would not achieve the outcome of aligning the delegate's staff interests with those of the investors in the UCITS. There is also a risk that the unwillingness of delegates outside of the EEA to be subject to some requirements that they consider disproportionate, could prevent access of EU management companies to certain investment strategies.

In practice, managers should consider the following possible approaches to address the requirement to apply remuneration rules to its delegates:

- It may be possible to argue that, in view of the strict regulatory risk controls to which a UCITS management company and its delegate are subject to, none of the delegate's staff have a material impact on the fund's risk profile.
- It may be possible to limit the identified staff within the delegate to a sub-set of the staff involved in the delegation, excluding for instance individual portfolio managers with limited investment discretion.
- It may be possible to argue that rules should be applied in a proportionate manner, because the UCITS mandate only represents a small portion of the delegate's activities.
- It may be open to managers to take the FCA's approach under AIFMD, which allows managers to dis-apply the "pay-out process rules" to delegates where the delegate acts with limited investment discretion, and is subject to the risk management of the appointing manager.

In the absence of any regulatory guidance, it is likely that the precise application of remuneration rules to delegates will be a matter for the principal and the delegate to discuss and tailor according to their interpretation of the rules and the risks that the principal perceives.

## Annex 5.1 - Application of remuneration rules to delegates Sprott Asset Management, Toronto, Canada

Under AIFMD, ESMA required, in its remuneration guidelines, the application of the AIFMD remuneration rules to portfolio management delegates (i.e., sub-advisors) of an AIFM, including delegates established outside the EEA. Although UCITS V did not include this principle within its provisions, a recital to the Directive mentions the possibility of this being required, referring to remuneration rules applying to third parties that “take investment decisions that affect the risk profile of the UCITS”, with such rules applying “in a proportionate manner”.

Is the delegate already governed by EU remuneration rules (such as a manager governed by AIFMD or CRD IV)?

*We have not received information that leads us to believe that the delegate is already governed by EU remuneration rules.*

Is the delegate “subject to regulatory requirements on remuneration that are equally as effective as those applicable under these guidelines”?

*We believe that the compensation package for US/ Canada based fund managers of funds that must meet the requirements of UCITS V will be far less attractive than for their US/Canadian peers.*

*It is more likely in the case of a non-EU manager that the relevant categories of staff will employ a particular investment strategy in a variety of structures, for example, in the case of a US investment manager, UCITS, US 1940 Act mutual funds, Cayman funds and segregated mandates. Therefore, it is more likely that the UCITS mandate only represents a small portion of the delegate’s activities.*

Is there a provision included in the contract appointing the delegate, which states that the delegate must follow, to an appropriate degree, UCITS remuneration rules?

*We believe that as US/Canadian citizens may not be able to collect their variable compensation such provision in the contract would be disproportionate.*

Does the delegate has material impact on the fund’s risk profile?

*None of the delegate’s staff is member of the Board of Directors, neither the BoD of the Management Company nor the BoD of the SICAV. None of the delegate’s staff is member of the senior management of the Management Company. The delegate is appointed to act within strict investment guidelines. Therefore, we believe that the delegate does not have a material impact on the fund’s risk profile.*

Does the delegate act with limited investment discretion?

*We believe that the delegate is required to adhere to strict investment guidelines and therefore acts with limited investment discretion.*

Is the delegate subject to the risk management of the appointing manager?

*Yes, the delegate and the fund respectively are subject to the risk management of Alpina Fund Management S.A.*

Would the application of the payout process rules to the staff of the delegate not be proportionate and would it not achieve the outcome of aligning the delegates’ staff interests with those of the investors in the fund?

*As stated above, we believe that US/Canadian citizens may not be able to collect their variable compensation, i.e. purchase any shares of UCITS funds, due to securities laws or market-abuse laws.*

Is there a risk that unwillingness of the delegate outside of the EEA to be subject to some requirements the delegate considers disproportionate, could prevent access of the EU Management Company to certain investment strategies?

*Sprott is a global asset manager providing investors with access to highly-differentiated precious metals strategies. Sprott's specialized investment products include innovative physical bullion trusts, managed equities, mining ETFs, as well as private equity and debt strategies. They also partner with natural resource companies to help meet their capital needs through brokerage and resource lending activities. Sprott is based in Toronto and has offices in New York, San Diego and Vancouver. Sprott's common shares are listed on the New York Stock Exchange and the Toronto Stock Exchange under the symbol "SII".*

*We believe that disproportionate implementation would prevent access to the specific expertise regarding gold equity.*

## Annex 5.2 - Application of remuneration rules to delegates Alpina Capital Ltd., Zug, Switzerland (Alpina)

Under AIFMD, ESMA required, in its remuneration guidelines, the application of the AIFMD remuneration rules to portfolio management delegates (i.e., sub-advisors) of an AIFM, including delegates established outside the EEA. Although UCITS V did not include this principle within its provisions, a recital to the Directive mentions the possibility of this being required, referring to remuneration rules applying to third parties that “take investment decisions that affect the risk profile of the UCITS”, with such rules applying “in a proportionate manner”.

Is the delegate already governed by EU remuneration rules (such as a manager governed by AIFMD or CRD IV)?

*We have not received information that leads us to believe that the delegate is already governed by EU remuneration rules.*

Is the delegate “subject to regulatory requirements on remuneration that are equally as effective as those applicable under these guidelines”?

*Switzerland has rules in place that provide equivalence (cf. SFAMA Code of Conduct, margin no. 43 which refers to FINMA Circular 2010/1 Minimum standards for remuneration schemes of financial institutions).*

Is there a provision included in the contract appointing the delegate, which states that the delegate must follow, to an appropriate degree, UCITS remuneration rules?

*As the delegate is subject to regulatory requirements on remuneration that are equally as effective as those applicable under these guidelines a provision does not need to be included in the contract.*

Does the delegate has material impact on the fund’s risk profile?

*The CEO of Alpina is a member both the BoD of the Management Company and the BoD of the SICAVs. Therefore, the delegate’s staff is member of the senior management of the Management Company. Nevertheless, the delegate, i.e. the operating units of Alpina, is appointed to act within strict investment guidelines. Furthermore, it is important to mention that the delegates receive a fixed remuneration beyond the remuneration as employee of Alpina, paid by the Management Company.*

Does the delegate act with limited investment discretion?

*We believe that the delegate is required to adhere to strict investment guidelines and therefore acts with limited investment discretion.*

Is the delegate subject to the risk management of the appointing manager?

*Yes, the delegate and the fund respectively are subject to the risk management of Alpina Fund Management S.A.*

Would the application of the payout process rules to the staff of the delegate not be proportionate and would it not achieve the outcome of aligning the delegates’ staff interests with those of the investors in the fund?

*Switzerland has rules in place that provide equivalence (cf. SFAMA Code of Conduct, margin no. 43 which refers to FINMA Circular 2010/1 Minimum standards for*

*remuneration schemes of financial institutions). We have not received information that leads us to believe that the delegate has not implemented payout process rules.*

Is there a risk that unwillingness of the delegate outside of the EEA to be subject to some requirements the delegate considers disproportionate, could prevent access of the EU Management Company to certain investment strategies?

*Alpina Capital is a Swiss asset manager licensed by FINMA.*

### Annex 5.3 - Application of remuneration rules to delegates Bank J. Safra Sarasin, Switzerland (BJSS)

Under AIFMD, ESMA required, in its remuneration guidelines, the application of the AIFMD remuneration rules to portfolio management delegates (i.e., sub-advisors) of an AIFM, including delegates established outside the EEA. Although UCITS V did not include this principle within its provisions, a recital to the Directive mentions the possibility of this being required, referring to remuneration rules applying to third parties that “take investment decisions that affect the risk profile of the UCITS”, with such rules applying “in a proportionate manner”.

Is the delegate already governed by EU remuneration rules (such as a manager governed by AIFMD or CRD IV)?

*We have not received information that leads us to believe that the delegate is already governed by EU remuneration rules.*

Is the delegate “subject to regulatory requirements on remuneration that are equally as effective as those applicable under these guidelines”?

*Switzerland has rules in place that provide equivalence (cf. SFAMA Code of Conduct, margin no. 43 which refers to FINMA Circular 2010/1 Minimum standards for remuneration schemes of financial institutions).*

Is there a provision included in the contract appointing the delegate, which states that the delegate must follow, to an appropriate degree, UCITS remuneration rules?

*As the delegate is subject to regulatory requirements on remuneration that are equally as effective as those applicable under these guidelines a provision does not need to be included in the contract.*

Does the delegate has material impact on the fund’s risk profile?

*None of the delegate’s staff is member of the Board of Directors, neither the BoD of the Management Company nor the BoD of the SICAV. None of the delegate’s staff is member of the senior management of the Management Company. The delegate is appointed to act within strict investment guidelines. Therefore, we believe that the delegate does not have a material impact on the fund’s risk profile.*

Does the delegate act with limited investment discretion?

*We believe that the delegate is required to adhere to strict investment guidelines and therefore acts with limited investment discretion.*

Is the delegate subject to the risk management of the appointing manager?

*Yes, the delegate and the fund respectively are subject to the risk management of Alpina Fund Management S.A.*

Would the application of the payout process rules to the staff of the delegate not be proportionate and would it not achieve the outcome of aligning the delegates’ staff interests with those of the investors in the fund?

*Switzerland has rules in place that provide equivalence (cf. SFAMA Code of Conduct, margin no. 43 which refers to FINMA Circular 2010/1 Minimum standards for remuneration schemes of financial institutions). We have not received information that leads us to believe that the delegate has not implemented payout process rules.*



Is there a risk that unwillingness of the delegate outside of the EEA to be subject to some requirements the delegate considers disproportionate, could prevent access of the EU Management Company to certain investment strategies?

*BJSS is a Swiss asset manager licensed by FINMA.*