

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

11 November 2016

**Securities & Markets
Supervision Unit**

To: Alternative Investment Fund Managers

Unit Tel: (+356) 21441155
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Attn: The Directors and Compliance Officer

Dear Sir/Madam,

Re: Thematic Review focusing on Compliance with the Remuneration provisions in terms of the AIFM Directive

The AIFM Directive provides that each AIFM must have remuneration policies and practices for prescribed categories of staff that are consistent with and promote sound and effective risk management and do not encourage risk-taking which is inconsistent with the risk profiles, rules or instruments of incorporation of the AIFs they manage. The AIFM must determine the remuneration policies and practices in accordance with a detailed list of principles set out in Annex II to the AIFM Directive.

Further to the ESMA Guidelines on sound remuneration policies under the AIFMD (“the Guidelines”), the MFSA has issued Guidance notes on the application of the proportionality principle providing guidance to the industry on the applicability of the said Guidelines to Maltese AIFMs, particularly with regards to the application of the principle of proportionality tackled in Section VII of the Guidelines. In terms of the Guidance notes and subject to the adherence to the proportionality principle, local AIFMs may request a derogation from the requirements of the pay-out process and the need to establish a remuneration committee.

During 2016, the Securities and Markets Supervision Unit conducted thematic reviews on compliance of the remuneration provisions in terms of the AIFM Directive through thematic visits at the offices of a number of self-managed collective investment schemes and Fund Managers. A range of licence holders varying in size, type and business model were selected in order to obtain a representative picture of the whole sector. The sample chosen included AIFMs which delegate their day to day portfolio management to overseas based EU and non-EU based entities.

The visits were designed to verify the extent to which the selected licence holders are in adherence with the remuneration requirements in terms of the AIFM Directive including how these are being complied with and applied in practice. MFSA Officials assessed various documents related to the remuneration obligations applicable to the different types of fund managers, such as the remuneration policy and board minutes where remuneration related matters and decisions are discussed.



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Furthermore, checks also covered the relevant monitoring arrangements that AIFMs have in place with regards to their delegates, including also on the applicable remuneration provisions at the delegate level.

The purpose of this letter is to inform the industry about the common findings of these onsite visits in order to encourage licence holders to take corrective action and avoid the common pitfalls in relation to lack of observance of regulatory and compliance standards. In this regard, you are encouraged to consider carefully the key findings set out below and undertake an assessment of your company's compliance levels vis-à-vis these findings, making sure that any remedial action is taken in a timely manner. The main findings noted are as follows:-

1.0 Remuneration Disclosure Requirements

During the visits, MFSA Officials noted that Annual Reports and Audited Financial Statements of AIFMs generally provide brief details of "Staff Costs" and "Directors Remuneration", or else, in certain instances, applicable remuneration details are being provided at the level of the financial statements of the AIF.

Whilst the location of remuneration disclosures as required by AIFM Directive may vary, AIFMs (which are subject to Art. 22 of the AIFM Directive) are directed to liaise with external auditors and ensure that proper and adequate disclosure in relation to remuneration is undertaken to fully comply with the disclosure requirements as set out in Section 12 of Appendix 12 of Part B of the Investment Services Rules for Investment Services Providers ('the Rules')/ Art. 22 of the AIFM Directive and Art. 103 – 107 of the Commission Delegated Regulation (EU) 231/2013.

2.0 Minutes relating to Remuneration discussions and decisions

MFSA Officials noted that whilst the fixed/ variable remuneration paid to each member of the identified staff are ordinarily discussed during ad hoc meetings/ periodic board meetings, the proceedings of meetings concerning remuneration related matters are, however, not always adequately recorded, or not minuted at all. AIFMs are required to ensure to document accordingly the discussions held and decisions taken relating to the remuneration setting and payments.

3.0 Remuneration Structure - Fixed and Variable components of total remuneration

MFSA Officials noted instances where the fixed and variable components of the total remuneration of identified staff may not have been appropriately balanced.



AIFMs should ensure that fixed and variable components of total remuneration of identified staff are appropriately balanced and the fixed component of the remuneration should represent 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. AIFMs should also aim to ensure in this regard to have in place an appropriate ratio between fixed and variable components of total remuneration.

It is the Authority's view that with reference to control function related roles, the ratio of the respective variable to the fixed component of remuneration to be lower than employees involved in other business areas of the company.

4.0 Remuneration Policy

MFSA Officials conducted non-exhaustive checks of Remuneration Policy documents of AIFMs. Whilst the documents generally contained provisions in terms of the AIFM Directive and the Guidelines, certain policy documents lacked basic disclosure. It is recommended that AIFMs ensure that Remuneration Policy documents contain the necessary detail including, *inter alia* reference to the following matters:

- the identification of the identified staff of the AIFM and how these are selected;
- the types of remuneration (both fixed and variable) that the AIFM offers and the structure of fixed and variable remuneration;
- the criteria for determining: a) the variable remuneration allocation; b) how balance between variable and fixed remuneration is achieved; and c) how risk taking can be mitigated;
- the body responsible for the approval and maintenance of the Remuneration Policy and the oversight of its implementation;
- the frequency of review of the Remuneration Policy;
- the manner in which the Remuneration Policy is disseminated internally and how it is disclosed externally; and
- the remuneration (including the applicable criteria considered for the determination of such remuneration) of control functions and their involvement with respect to the remuneration function.

5.0 Remuneration Derogations – Pay-out Process and Remuneration Committee

In certain cases, the Authority has issued derogations from the pay-out process and remuneration committee requirements on an open-ended basis. In this regard, a number of licence holders visited by the Authority were requested to re-submit a proportionality assessment explaining how the disapplication of such requirements still applies for the company.



The Authority considers it appropriate that following two years after such derogations are granted, AIFMs re-undertake a proportionality assessment. This assessment needs to be documented accordingly and submitted for the Authority's consideration, indicating how such derogations are still appropriate or otherwise for the AIFM. It is also the licence holder's responsibility to carry out an ongoing assessment on the applicability of the respective derogations granted by the Authority.

6.0 Other Remuneration related matters

Other findings noted by MFSA Officials include the following:-

- Certain AIFMs did not have in place a formal staff appraisal process which documented in a transparent manner the criteria used in determining the staff's variable remuneration, as required in terms of SLC 12.02.3 of Appendix 12 to Part BIII of the Rules;
- MFSA Officials noted that few AIFMs did not involve control functions in the design, ongoing oversight and review of the remuneration policies for other business areas of the company. AIFMs are required to involve the person responsible for risk management in the assessment of how the variable remuneration structure affects the risk profile of the company. As prescribed in the Guidelines, it is also considered as good practice for the risk management function to validate and assess risk adjustment data. Furthermore, the compliance function should analyse how the remuneration structure affects the AIFM's compliance with legislation, regulations and internal policies. It is important that such involvement is documented accordingly by the AIFM.

7.0 Monitoring of delegate

Another area covered during the onsite inspections was the delegation/ outsourcing obligations (in relation to the investment management function), including also certain checks relating remuneration provisions related matters at the delegate level. MFSA Officials conducted a non-exhaustive check of the delegation/ outsourcing agreements, as well documentation related to the monitoring performed on the delegated functions. Certain AIFMs did not document any monitoring procedures and arrangements as well findings which are being carried out on the delegate.

The Authority considers that the monitoring of any outsourced function (which should also include including aspects such as the BCP/ DRP of the delegate) is to be carried out on a regular basis. Such monitoring should be adequately documented and any findings which are identified, are to be presented to the Board of Directors of the AIFM.



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Conclusion

We trust that the guiding principles outlined in this letter will help AIFMs, which have not yet been visited, to identify common pitfalls that we have seen in recent visits and to take the appropriate actions in a timely manner.

We remain committed to continue helping you in accomplishing your plans for adherence to compliance and regulatory standards.

Should you have any queries regarding the above, please do not hesitate to contact: Mr Joseph J. Agius [jagius@mfsa.com.mt]; Ms Clare Farrugia [cfarrugia@mfsa.com.mt], Ms Jeanelle Newell [jnewell@mfsa.com.mt]; or the undersigned.

Sincerely,



Dr Christopher P. Buttigieg
Director