

FOCUS ON

REMUNERATION

The FSA's announcement of a consultation document covering the payment of bonuses has created concern in the hedge fund sector, particularly in the UK, as regulators now seem to regard the entire asset management sector, including hedge funds, as fair game. Adam Palmer, director at the European division of ACA Compliance Group, talks to *HFMWeek* about the FSA's proposed update to its Remuneration Code, which will include hedge funds and Ucits



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Q HFMWEEK (HFM): HOW WILL THE FSA'S READING OF CRD3 IMPACT MOST HEDGE FUNDS?

A ADAM PALMER (AP): The FSA's reading of the CRD takes account, to the fullest extent permitted by the CEBS guidance, of implementing the remuneration elements of CRD 3 on a proportionate basis. In doing so, the FSA has significantly diluted the impact of the extension of the remuneration code to UK hedge fund managers. The regulator's remuneration principles proportionality rule permits all regulated firms to take account of their size and complexity when establishing remuneration policies.

To assist, the FSA has established four proportionality tiers. The tier in which the firm is placed determines the strictness with which the firm applies the principles of the code. The majority of hedge fund managers fall within tier four where there is the most scope to dis-apply the detailed rules, although this assessment changes if the manager takes risk on their own balance sheet. While some of the more contentious remuneration structural issues such as deferral and retained shares can be disapplied by tier-four hedge fund managers, there is still work to be completed such as identifying code staff and establishing a remuneration policy statement (RPS).

Q HFM: HOW SHOULD FIRMS BEGIN TO PREPARE? WHAT STEPS SHOULD THEY BE TAKING NOW?

A AP: Compliance with the code must be achieved by 1 July and new hires should now be engaged on a basis that is code-consistent, and existing contracts should also be reviewed. A prudent starting point would be to commence drafting the RPS, which must be in place by 1 September; the FSA has provided some detailed guidance to assist firms through this process. Establishing those staff whose remuneration will be subject to the code (code staff) also requires careful analysis; it will include senior management and significant risk takers.

Q HFM: WHAT LEVEL OF DISCLOSURE WILL BE REQUIRED?

A AP: The Pillar 3 disclosure must be made by the end of 2011 and updated annually. For

those managers in tier four this will need to include information regarding the decision-making process for determining the remuneration policy, how pay is linked to performance and aggregated information on remuneration by business area. Remuneration details of specific individuals will not be required.

There will be an annual FSA data item to complete as well to enable baseline monitoring. It will include a self certification of compliance with the code and further aggregate information such as number of retention payments made or number of guaranteed bonuses – both of which can only be made in exceptional circumstances.

Q HFM: HOW WILL REPORTING REQUIREMENTS DIFFER ACROSS DIFFERENT SIZES OF FUNDS?

A AP: The proportionality tier in which the firm falls determines the level of detail that must be reported or disclosed rather than funds under management, although this may change under the terms of the AIFM Directive. The granularity is likely to be greater for firms in tiers one and two than for those in three and four.

Q HFM: HOW COULD IT IMPACT NON-EEA FUNDS WITH A UK PRESENCE?

A AP: Probably the area of greatest interest is that non-EEA firms who have a UK-regulated entity may need to classify individuals based overseas as code staff if they perform significant influence functions or have a material impact on the firm's risk profile. Once classified as code staff, that individual's entire remuneration will fall within the scope of the code.

Q HFM: WHAT OTHER REMUNERATION PRESSURES ARE FUNDS FACING FROM THE AIFM DIRECTIVE, PARTICULARLY IN RELATION TO BONUSES?

A AP: The remuneration constraints in the AIFM Directive, especially those in relation to bonuses, were originally politically driven and directed towards banks – indeed, remuneration did not appear in the early draft of the Directive.

However in the current version of the Directive, provisions such as the requirement for 50% of bonuses to be paid in the form of shares of the managed fund are prescriptive beyond the FSA's current code. The exact scope of AIFM Directive's remuneration provisions will not be known until the Directive's level-two discussions are complete, but it is possible that the proportionality tier structure – itself only FSA guidance that sits outside of the rulebook – will be amended or managers may move to higher tiers and therefore have to apply rules from which they can currently exempt themselves under the FSA's proportionality structure.

A hedge fund manager's remuneration policy will also be partly driven by the size of the alternative fund that it manages and the provisions of the AIFM Directive will extend to include the carried interest paid by the fund to the manager. The hope is that the European Securities and Markets Authority (ESMA) recognises, in the same way that the FSA has done, the significant differences that exist between the different business models of regulated firms. ■