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Submitted via email: cp21-07@fca.org.uk

28 May 2021

Dear Sir/Madam,

AIMA/ACC/MFA's response to Consultation Paper 21/07 – A new UK prudential regime for MiFID investment firms

The Alternative Investment Management Association Limited (AIMA)[1], the Alternative Credit Council (ACC)[2] and the Managed Funds Association (MFA)[3] appreciate the opportunity to submit their comments to the Financial Conduct Authority (FCA) in relation to its Consultation Paper 21/07 (the 'CP') on a new UK prudential regime for MiFID investment firms (the 'IFPR').

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[1] AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 1,900 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, www.aima.org.

[2] The ACC currently represents over 170 members that manage over $400bn of private credit assets. The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council. ACC members provide an important source of funding to the economy, providing finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure as well the trade and receivables business. The ACC's core objectives are to provide direction on policy and regulatory matters, support wider advocacy and educational efforts, and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits.

[3] MFA represents the global alternative investment industry and its investors by advocating for public policies that foster efficient, transparent, fair capital markets, and competitive tax and regulatory structures. MFA supports member business strategy and growth via proprietary access to subject matter experts, peer-to-peer networking, and best practices. MFA's more than 140 member firms collectively manage nearly $1.6 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has a global presence and is active in Washington, London, Brussels, and Asia, supporting a global policy environment that fosters growth in the alternative investment industry.

As we expressed in our responses to the FCA's Discussion Paper 20/2 (the 'DP') and the FCA's Consultation Paper 20/24 ('CP20/24'), we strongly support the introduction of a prudential framework for investment firms that is as user-friendly as possible and one that will allow a level of flexibility and proportionality while protecting clients and investors. The implementation of the IFPR could fundamentally affect the global competitiveness of the UK and its attractiveness to non-EU firms so it is crucial that the IFPR does not place the UK at a competitive disadvantage with other global investment jurisdictions and that it safeguards the UK's position as a leading financial hub that is able to attract and retain the best talent.

We welcome the clarifications made by the FCA in the CP following our comments to the DP and CP20/24, in particular around increasing the on-and-off balance sheet assets threshold from GBP 100 million to GBP 300 million and the omission of quantitative criteria to identify a firm's material risk taker ('MRT'). We also support the FCA's clarification on calculating the K-factors of relevance to our members. Overall, we regard the measures envisaged for the IFPR as pragmatic and welcome.

We have, however, significant concerns with respect to a number of proposals put forward in the consultation:

- **Imposing requirements stricter than those required by the corresponding IFR/IFD provisions**: While we recognise that the UK, as a result of Brexit, is no longer bound to adhere to EU rules and can choose to adopt a similar or different prudential framework for investment firms than the European Union's IFR/IFD, in our responses to the DP and CP20/24 we highlighted several instances where the FCA has opted to go further than the requirements under IFR/IFD. Previously we shared our concerns with regards to the FCA's decision to adopt a more stringent approach, compared to the IFR/IFD, concerning reporting requirements for SNIs, and its application of malus and clawback arrangements in cases of an investment firm's subdued financial performance. In a further divergence from the IFR/IFD, UK firms above the GBP 300 million on-and-off balance sheet threshold are required to establish a risk, remuneration, and nomination committee on an individual entity level and would need to apply for a waiver to establish these three committees on a group level. The FCA has also opted for a stricter approach by requiring SNIs to comply with the basic liquid assets requirement whereas under the IFR national competent authorities ('NCAs') are allowed to extend these requirements to SNIs. In general, we would urge the FCA to adopt a more proportionate approach by avoiding, in effect, 'gold plating' certain aspects of the IFR/IFD.

- **ICARA implementation flexibility**: While the requirement to undertake an ICARA will be a new exercise for those investment firms who have not previously been subject to an ICAAP, we understand that the FCA will require all investment firms (including current BIPRU, IFPRU and exempt-CAD firms) to have undertaken an ICARA by 1 January 2022, which will include the requirement to hold additional capital if this is indeed required. However, the FCA has previously stated that it is not expecting large increases in investment firms' own funds immediately due to the transitional provisions it suggested in CP20/24. The absence in this CP of any transitional provisions for ICARA will be particularly burdensome for those firms who have had no prior experience with ICAAP (i.e., exempt-CAD firms) so we would urge the FCA to introduce a transitional provision for the amounts under ICARA in line with the fixed overheads requirement transitional provision as proposed in CP20/24. For firms that have previously been undertaking the annual ICAAP exercise, we ask that the FCA consider permitting such firms to either: (i) perform their first ICARA by when their 2022 ICAAP would have been due, or

(ii) replace their annual ICAAP exercise for 2021 with the ICARA that must be completed by year end to avoid having to undertake two overlapping processes in close proximity to each other.

- **IFPR remuneration application to carried interest arrangements**: The proposed rules state that carried interest is remuneration. Some of our members, particularly in the private debt, equity and venture capital sectors, maintain carried interest arrangements. In fact, carried interest is not part of an individual's remuneration since an individual pays for the shares or units that entitle them to receive any carried interest. We are concerned that the application of the remuneration rules to these arrangements is both unnecessary and likely to cause several important issues in practice. It is unnecessary because carried interest schemes have features that, taken together, meet the intention of the IFPR remuneration rules, including a significant gap between award and cash pay-out and that "bad leavers" will typically forfeit their unvested carried interest rights. Such schemes are also an effective and well-established way to align the interests of staff and fund investors. Key issues that the application of the rules to carried interest arrangements would raise include (i) inconsistency with HMRC guidance, (ii) harm to UK competitiveness and (iii) the disproportionate amount of time that firms would have to spend in engaging with the rules to determine whether the form of their arrangements aligns with the letter of the new rules, notwithstanding the fact that, in substance, they often contain malus- and clawback-like features.

- **IFPR remuneration application to CPMIs**: The proposal to require CPMIs to apply the most stringent of the IFPR, AIFMD or UCITS Remuneration Codes will add considerable complexity and legal uncertainty, with little benefit. Subject to that, it appears likely that the MIFIDPRU Remuneration Code will often be the most stringent applicable remuneration code. Considering CPMIs frequently operate as a single firm rather than as “two firms” sitting within one legal entity, this code would apply (seemingly) to the whole of every senior individual’s remuneration. We consider this to be disproportionate since, in practice, CPMI MiFID top-up activities are generally secondary and complementary to the core business of AIFM management. A provision such as that which currently exists in SYSC 19C.1.1A would be appropriate and proportionate.

We stand ready to engage with the FCA in its final consultation on the details of the new UK prudential regime for MiFID investment firms.

We would be happy to elaborate further on any of the points raised in this letter or, indeed, join a call or provide further detail on any issue raised in our response, noting that aspects of the IFPR are highly technical. For further information please contact Jennifer Wood, Managing Director, Global Head of Asset Management Regulation & Sound Practices, at +44 (0) 20 7822 8380 or jwood@aima.org.

Yours faithfully,

/s/ Jiří Król

Jiří Król
Deputy CEO, Global Head of Government Affairs, AIMA
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/s/ Michael Pedroni

Michael Pedroni
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Annex I: Responses to CP questions

In addition to the points raised in the letter, we have responded below to some of the individual questions asked in the consultation paper. Questions on which we had no comments have been omitted, but the order and numbering of the remaining questions has been retained for clarity.

How these rules will apply (Chapter 3)

1. Do you agree that CPMIs should apply MIFIDPRU requirements to their MiFID business? If not, please provide details of an appropriate prudential regime for the MiFID business of a CPMI.

Please see our response to question 22 below.

Own funds requirements (Chapter 4)

2. Do you have any specific comments on our proposed approach to the calculation of the fixed overheads requirement (FOR) and the specific items of expenditure that may be deducted from total expenses? If yes, what items would you suggest are/are not deducted, and why?

Paragraph 4.7 of the CP provides an overview of the expenses that may be deducted in order to calculate the FOR. In particular, an investment firm may deduct "non-recurring expenses from non-ordinary activities". We suggest that in the interests of simplicity and consistency when determining the items that may be deducted to calculate the FOR, the FCA should seek to align the items that may be deducted with internationally adopted accounting standards and definitions. For example, we would recommend replacing the above quoted text with the following: "non-recurring expenses from non-recurring activities."

6. Do you agree with our proposals for calculating K-COH? Especially for measuring the value of cash trades, and for when certain transactions may be excluded from the measurement of COH? If not, please explain why and provide evidence to support any alternative suggested treatments.

We are supportive of the FCA's proposals for the exclusion of "transactions that are caught within the definition of reception and transmission of client orders only as a result of the situation described in recital 44 of MiFID" (i.e., transactions that result from a firm bringing together two or more investors and/or advising in the purely corporate finance/PE context) is helpful. We think that this would also be equally relevant to certain bespoke and highly negotiated credit deals too.

7. Are our proposals that cover the interaction between K-AUM and K-COH clear and prudent? If not, what specific suggestions do you have to improve this?

No comment in relation to the specific interaction of K-AUM and K-COH, however, we note that the distinction between K-COH and K-DTF is not particularly clear in places. In particular, we recommend that draft guidance in MIFIDPRU 4.15.2G(1) be clarified to confirm expressly that K-DTF is only relevant for firms that deal on own account in line with MIFIDPRU 4.11.4R.

Basic liquid assets requirement (Chapter 6)

10. Do you agree with our proposals for a basic liquid asset requirement, to be met by holding core liquid assets? If not, please explain what alternative proposal you would suggest and why.

While not directly related to this question, we note that the CP proposes to apply the IFPR liquidity requirements to all firms, including SNIs, which represents a stricter approach than is strictly

required to be adopted by EU-based national competent authorities ('NCAs') under IFD. Article 24(1) of the IFD requires non-SNIs to adopt internal capital and liquidity assets requirements but Article 24(2) allows NCAs to choose whether or not to extend these requirements to SNIs.

We are uncertain as to why the FCA has opted for a stricter approach by also requiring SNIs to comply with the basic liquid assets requirement, especially when IFD gives NCAs flexibility not to do this. While we recognise that the FCA proposes grandfathering for certain types of investment firms (i.e., commodities and emissions allowance dealers), we would urge the FCA to exclude all SNIs from the basic liquid assets requirement.

We welcome the guidance in paragraph 16.131 of the CP confirming that where a firm benefits from transitional relief limiting their FOR, they will also have their basic liquid assets requirement correspondingly reduced during the transitional period (as the liquid assets requirement is determined by reference to FOR). We would welcome if this were more explicitly reflected in the MIFIDPRU rules.

Please also see our response to question 11 below in respect of the ICARA requirements.

<u>Risk management, ICARA and SREP (Chapter 7)</u>

11. Are our expectations of firms regarding the ICARA and meeting the OFAR sufficiently clear? If not, which areas would benefit from further clarification?

Under the proposed rules, all UK investment firms will have to undertake an ICARA, formerly known as "Pillar 2", to determine any additional own funds/liquid assets requirements and specify recovery and wind-down planning. The ICARA will replace the Internal Capital Adequacy Assessment Process ('ICAAP') which currently applies to BIPRU and IFPRU firms. The requirement to undertake an ICARA will be completely new for other investment firms, such as exempt-CAD firms. While all UK investment firms have already had to assess that they have adequate capital and liquid resources to cover potential harm, in paragraph 7.45 of the CP the FCA acknowledges that the concept of wind-down triggers "will be new to FCA investment firms, so it is important that they familiarise themselves with our proposals".

In paragraph 7.44 of the CP, the FCA introduces an 'own funds/liquid assets wind-down trigger' which is the higher of a firm's FOR (i.e., 1/4 of a firm's relevant expenditure), and any amount the FCA sets. The 'liquid assets wind-down trigger' is the higher of a firm's basic liquidity assets requirement and any amount the FCA decides to set. In CP 20/24, several capital requirement transitionals were introduced to help firms adjust to the new minimum capital requirements the FCA has proposed under the IFPR. We were very supportive of these transitional provisions as some firms would otherwise be facing material uplifts in their capital requirements. However, by introducing the own funds/liquid assets wind-down triggers, investment firms will still be required to hold additional capital and liquid assets once the IFPR has entered into force (i.e., 1 January 2022) which, as noted in our cover letter, effectively and inappropriately undermines the benefit of the own funds transitional provisions set out in CP 20/24.

Furthermore, as mentioned above, for some types of investment firms, the introduction of the ICARA will be a completely new requirement as they were not previously subject to the FCA's ICAAP requirements. While this has not been expressly confirmed in the CP, we understand that firms

previously excluded from an ICAAP or other similar requirements will be expected to comply with the ICARA requirement as per the IFPR's application date of 1 January 2022.

If that is correct, we believe that compliance with the ICARA requirements by 1 January 2022 will prove to be burdensome for these type of firms so we would ask the FCA to consider introducing a transitional provision to allow a certain degree of flexibility of complying. In particular, we suggest a one-year transitional, or informal grace, period for those firms not previously subject to an ICARA (or ICAAP) style risk management framework as well as current BIPRU and IFPRU firms in order to allow them to determine their additional own funds, liquid assets requirements and specific recovery and wind-down planning.

In addition, we believe that it would be unnecessary, duplicative and inefficient for investment firms that are currently subject to an ICAAP requirement to undertake both an ICARA and an ICAAP in close proximity. We note that if firms are expected to have completed their first ICARA by 1 January 2022, they will need to commence that exercise relatively soon, and certainly by the end of Q4 of 2021. Many investment firms choose to finalise their ICAAPs towards the end of the year, while others may operate different timelines. For those investment firms that are currently subject to an ICAAP requirement, and in line with our request above, we ask the FCA to grant a up to one-year transitional period for these firms to undertake an ICARA. We believe there is little justification, or logic, for the FCA to require these firms to undertake an ICARA before the IFPR takes effect, especially given they will have performed the ICAAP in 2021. We believe that firms that have previously had to do the ICAAP exercise should be permitted to either: (i) perform their first ICARA by when their 2022 ICAAP would have been due, or (ii) replace their annual ICAAP exercise for 2021 with the ICARA that must be completed by year end.

12. Is the rationale for and explanation of the own funds and liquid assets wind-down trigger sufficiently clear? If not, which areas would benefit from further clarification?

Please see our response to question 11 above.

13. Do you agree with our proposal to use an early warning indicator?

We think that the FCA's proposals ought to be clarified. In particular, our members read paragraph 7.79 of the CP as effectively requiring all firms to hold a minimum additional 10% of capital (i.e., if they did not they would need to make continuous notifications that they are at the minimum early warning indicator because their own funds resources fall to within a minimum of 110% of the threshold requirement). In our view, firms ought to be able to retain flexibility to set their early warning indicator at a level equal to their rules-based own funds requirement or at a percentage less than 110% where the facts and circumstances of their businesses support such a conclusion.

<u>Governance (Chapter 8)</u>

16. Do you agree with our proposals to require certain non-SNI firms to have a risk committee, remuneration committee and nomination committee?

We welcome the FCA's decision to not implement Article 33(2) of the IFD that would require firms that are in scope of the risk, remuneration and nomination committees' requirement to only appoint non-executive directors ('NEDs') as members of these committees. Due to the nature, size and complexities of many UK firms, their activities and the limited supply of suitably qualified NEDS, many of them do not appoint or make use of NEDs.

However, as we expressed in our response to the DP, we continue to believe that the IFPR should offer investment firms as much flexibility as is available under the existing CRD IV prudential regime. To that end, we suggest that the UK legislation should retain the possibility for the FCA to apply proportionality and retain the discretion to waive the application of certain requirements depending on the nature and complexity of the investment firm concerned and the risks that it poses to the broader financial system.

One particular area where the FCA has to date applied proportionality that should be retained in the IFPR relates to the availability to obtain waivers from the requirement for all non-SNI firms to create separate risk, nomination and remuneration committees. Requiring large non-SNI firms to create separate risk, nomination and remuneration committees would create an un-level playing field between large non-SNIs that are not significant under CRD IV, but may still be quite large, and non-SNI investment firms under IFR. We note that there are investment firms who may be classified as a large non-SNI under the IFPR's suggested quantitative thresholds but who, in fact, often have a relatively small board size. As a result, and in combination with the limited supply of suitably qualified NEDs, these investment firms often have NEDs that sit across the various committees. We believe that, in these circumstances, maintaining three separate committees is operationally burdensome with no real tangible benefit. Providing the flexibility to combine the nominations and remuneration committees, for example, would be helpful. While we fully support the importance of strong oversight of, for instance, investment firms' risk and remuneration systems, we note that these can be (and have to date been) effectively overseen by many investment firms' full boards, rather than specialist subcommittees.

In addition, we note that while under Article 33(1) of the IFD non-SNIs are allowed to establish a remuneration committee at group level, the FCA has decided to adopt a different approach. According to paragraphs 8.14-8.15 of the CP, to permit firms to apply to the FCA for a modification of the requirement to establish one or more of the committees at individual entity level, firms are required to submit an application that should set out, among others, why setting up a committee at individual entity level would be unduly burdensome. We do not understand why the FCA is, in effect, 'gold plating' the aforementioned IFD provisions, and we would encourage the FCA to allow firms to establish these committees at group level by right, rather than requiring them to submit a lengthy and costly application process.

<u>MIFIDPRU Remuneration Code: scope and application (Chapter 9)</u>

17. Do you agree with our proposal for firms to apply the new MIFIDPRU Remuneration Code from the start of their next performance year beginning on or after 1 January 2022?

We fully agree with the FCA's proposal to apply the MIFIDPRU Remuneration Code to remuneration earned after the start of the next performance year following implementation. We also welcome the transitional provisions that allow firms that are currently subject to either the IFPRU and/or BIPRU remuneration requirements to transition to the IFPR provisions and for remuneration awarded under one regime but paid out to relevant staff under the IFPR rules to be subject to the MIFIDPRU Remuneration Code.

19. Do you agree that only certain non-SNI firms should be required to apply the remuneration rules on deferral, pay-out in instruments and discretionary pension benefits? Do you have any comments on the thresholds we propose?

We strongly agree that, in order to arrive at a final regime which is proportionate in its application to the wide range of investment firms, only certain non-SNI firms should be required to apply the remuneration rules on deferral, pay-out in instruments and discretionary pension benefits. In keeping with the principle of proportionality, we do not think that the relevant thresholds should be set any lower than those currently proposed by the FCA.

20. Do you have any comments on our proposed approach to identifying material risk takers?

The remuneration requirements proposed in the IFPR will apply not only to senior management and staff with managerial responsibilities for control functions but also to categories of staff whose professional activities are otherwise deemed to have a material impact on the risk profile of the investment firm or of the assets it manages. Draft SYSC 19G.5.3R provides a list of categories of staff that the FCA considers to be MRTs. We are concerned about the fact that this list includes a category of staff not included in existing definitions of MRTs under existing remuneration rules, namely, in firms that have permission for carrying on certain prescribed types of regulated activity, staff members "responsible for managing … information technology, information security and/or outsourcing of critical or important functions" (the "IT and outsourcing function").

Whilst we understand the logic of applying remuneration rules in relation to those with meaningful responsibility for material operational risk, we think the way the IT and outsourcing function is framed is problematic, for two reasons:

Firstly, we think it will have a disproportionate (and possibly unintended) impact on smaller firms, particularly asset managers, which often have relatively flat management structures with a large number of staff with a direct reporting line to senior management, including relatively junior staff. For example, "responsibility" for IT (including trading software) of a small asset management firm might lie with a relatively junior member of staff who, in reality, has a relatively insignificant role in the asset manager due to the small size of the function but, as a result of the wording of the IFPR, would be identified as an MRT.

Secondly, in smaller firms, whilst formal responsibility may often be assigned to more junior members of staff, in practice relevant staff members will report to the board or management committee of the firm. The reality will therefore often be that the operational risks sought to be addressed by the IT and outsourcing function lie with senior individuals who will already be directly caught as MRTs. Therefore, not only is it disproportionate to require the holders of the IT and outsourcing function to be MRTs, it is also unnecessary.

To that end, we would invite the FCA to amend the wording in SYSC 19G.5.3R from “For the purposes of SYSC 19G.5.1R, a staff member is deemed to have a material impact on a firm’s risk profile or the assets the firm manages if one or more of the following criteria are met” to instead read “For the purposes of SYSC 19G.5.1R, the following criteria are indicative of a staff member that have a material impact on a firm’s risk profile or the assets the firm manages”. We believe that by amending SYSC 19G.5.3R as suggested, the identification of MRTs by non-SNIs firms will be more proportionate and capture fewer staff who, for the reasons outlined above, should not be considered MRTs due to the low impact of their work on the firm’s risk profile or on the assets it manages.

21. Do you agree with our proposals for exempting certain individuals from the rules on deferral, pay-out in instruments and discretionary pension benefits? Do you have any evidence that may assist us in defining the scope of the exemption?

While we welcome and support the IFPR's de minimis MRT carve-out as suggested in paragraph 9.73 of the CP, we note that paragraph 9.76 states that the FCA may "revisit the finalised criteria at a later date in light of new evidence or subsequent developments that may change our view of this, including those regarding **EU market access** (emphasis added)". As such, it seems the FCA may consider reverting to alignment with the EU rules if this were the gateway to an equivalence decision.

The possibility of an equivalence decision should not forestall the FCA from making divergences from EU law where it makes sense to do so (albeit avoiding imposing more restrictive requirements than those under IFR/D), including with respect to the omission of the aforementioned quantitative criteria. We respectfully ask the FCA to not introduce these criteria in future years because, and as the FCA has recognised in paragraph 9.59 of the CP, remuneration alone is not a reliable indicator of the level of risk.

22. Do you have any other comments on the proposed scope and application of the remuneration rules?

The IFPR will extend the remuneration requirements to non-SNI CPMI firms. As we have conveyed in our response to the DP, the remuneration provisions under the IFD are more exacting than those under the AIFMD and the UCITS Directive in certain crucial ways as they impose prescriptive requirements on deferral, non-cash remuneration and malus/clawback, among others. However, it is not clear from the text of IFD that it applies to CPMI firms and we understand that the approach to be taken by EU Member States to this issue remains unclear, and will likely vary as between them. The extension of the IFPR remuneration requirements to non-SNI CPMI firms is therefore an instance of UK choosing to impose a more restrictive requirement than IFR/D – and, for the following reasons, one which we think is inappropriate and so ought to be reversed or, if it is to be preserved, implemented differently.

Why it is inappropriate to apply IFPR remuneration rules to CPMI firms.

First, it may be challenging for CPMIs to split remuneration applicable to their MiFID activities from remuneration applicable to the services they perform in their capacity as an AIFM or UCITS management company since, in practice, relevant staff are likely to have roles that indistinguishably serve both activities and senior management will inevitably sit across the organisation, especially where the relevant products use substantially similar investment strategies.

Second, seeking to comply with two remuneration codes in parallel is likely to be a complex exercise and may place CPMIs at a disadvantage when compared to collective portfolio management firms, with no obvious improved outcomes. In Annex II we have included a table that compares the treatment of CPMIs under the IFPR's suggested remuneration requirements, divided by a CPMI's balance sheet number or its AUM level, and the SYSC 19B requirements and related guidance. The table demonstrates the considerable complexity – verging on legal uncertainty – that the application of two remuneration codes and their requirements will introduce for CPMIs who will either need to apply certain remuneration requirements under the IFPR or under the AIFMD, or indeed both. For example, a non-SNI firm with total assets under GBP 300m but with AUM of over GBP 1.2 billion, or in some cases GBP 5 billion, may have to apply the deferral, retention, payment in shares and the establishment of a remuneration committee requirements under the AIFMD (subject to an assessment of other relevant factors), but will need to apply the malus/clawback requirements as determined under both the AIFMD and the IFPR.

Third, in our view, where a firm complies with the legislation tailored to its sector, such as the AIFMD/UCITS Directive requirements, then it should not, in addition, be required to apply the FCA's proposed remuneration provisions to its MiFID activities. The MiFID activities of CPMI firms are, by virtue of Article 6(4) of AIFMD and its UCITS equivalent, very limited in scope, such that the primary objectives of both sets of remuneration rules will be met by compliance with the AIFMD/UCITS regime. Instead, firms should therefore be able to apply the AIFMD/UCITS requirements on a firm-wide basis. We note the existing deeming provision in SYSC 19C.1.1A whereby BIPRU CPMIs which are full-scope UK AIFMs that comply with SYSC 19B are deemed to be in compliance with SYSC 19C. We would encourage the FCA to adopt a similar deeming provision and to continue to permit CPMIs to apply the remuneration rules derived from the core AIFMD/UCITS regimes.

Why, if IFPR remuneration rules are to be applied to CPMI firms, they should be applied differently.

The FCA proposes that where an MRT has responsibilities for both MiFID and non-MiFID business, a CPMI must apply the stricter of the requirements to that individual. But this goes further than the FCA's logic that "the potential for harm to customers and markets is the same for [MiFID] investment services regardless of what type of firm is carrying them out" requires. That logic would only entail applying the IFPR requirements to remuneration received in relation to MiFID business. Instead, on the FCA's proposed approach, an MRT who, for instance, spent 10% of his or her time on MiFID business and 90% on CPM business would suffer a disproportionate burden incommensurate with the potential harm to customers or markets he or she has the potential to cause.

If the FCA disagrees with our suggestion (above) to insert a deeming provision modelled on SYSC 19C.1.1A and insists on applying its IFPR remuneration rules to the remuneration of 'dual-hatted' CPMI staff, then it ought to require CPMI firms only to apply the IFPR rules to that proportion of an MRT's remuneration connected with time spent on MiFID business. Whilst, as noted above, it may not always be straightforward for firms to split remuneration between CPM and MiFID business, the FCA's own logic dictates that they ought to be given the opportunity to do so.

Finally, MIFIDPRU 19G.6.3 R dictates that non-SNI firms must ensure that variable remuneration is performance related and that the total amount of this remuneration is based on a combination of the assessment of the performance of the individual, the business unit concerned, and the overall results of the firm. It further notes that this assessment should be based "on a multi-year period, taking into account the business cycle of the firm and its business risks." We note that many of our members operate variable remuneration processes that are focused primarily on employee performance and behaviour during the relevant performance year. These firms' 'business cycles' are heavily influenced by annual considerations (e.g., a substantial portion of revenue is tied to annual performance measures). For those firms that choose or are required to operate a deferral programme, we ask the FCA to amend and clarify the MIFIDPRU rules to explicitly acknowledge that such a deferral programme will be viewed to have helped the firm to establish that its variable remuneration processes appropriately addressed the 'multi-year period' requirements.

<u>MIFIDPRU Remuneration Code: standard remuneration requirements (Chapter 11)</u>

24. Do you have any comments on the specific remuneration rules we are proposing to apply to all non-SNI firms ('standard remuneration rules')?

We have a number of concerns about the proposed application of the malus and clawback requirements to the carried interest and co-investment arrangements which many of our members have in place:

1. Carried interest

Carried interest is an effective and well-established way to align the interests of staff and fund investors. It has been used for this purpose by the global private equity and venture capital industry, in particular, for many years. To the extent that carried interest arrangements are subject to FCA IFPR remuneration rules, the FCA should apply those rules in a way that is consistent with this practice, as the FCA has done with the AIFM Remuneration Code.

Many of these schemes operate at a global level within an alternative asset management group. If the UK rules effectively recognise the alignment effect of these schemes, that will be neutral for the UK industry. If, on the other hand, the UK requires specific changes to these schemes impacting only UK firms, we believe this will act as a disincentive (i) to invest in the UK as a financial services centre, and (ii) for investment professionals to work for UK firms that are subject to these rules, which would create a significant risk of loss of talent for the UK alternative asset management industry.

It is difficult to make carried interest fit exactly with the IFPR remuneration rules, especially the malus and clawback requirements. In particular, we disagree with the FCA's statement in CP 21/7 that carried interest "is" remuneration. We note that it will nevertheless be "treated as" remuneration for the purposes of the FCA's rules.

To comply with HMRC guidance, carried interest schemes are generally designed so that distributions are linked to the performance of the relevant fund rather than an individual's job performance, to make it clear that carried interest should not be treated as remuneration for tax purposes. Introducing a performance-related element would effectively result in all carried interest schemes to be in breach of the long-standing memorandum of understanding issued by HMRC on this point.

Nonetheless, carried interest schemes have features that, taken together, meet the intention of the IFPR remuneration rules on malus and clawback (i.e., to avoid creating a negative link between the risks taken by staff and the rewards they receive):

- Carried interest is a long-term fixed proprietary interest, and entitlements in carried interest schemes generally take many years to vest. Carried interest schemes therefore have an in-built element of deferral similar to the requirement imposed under the IFPR extended remuneration requirements.

- Carried interest schemes typically contain "bad leaver" provisions, which can operate to cancel an individual's distribution entitlements in certain circumstances. Usually, such provisions can be triggered if a member of staff leaves a firm to go to a competitor but in some cases they can also be triggered by egregious conduct issues, e.g., if the individual commits a serious breach such as fraud, bad faith, serious misconduct or gross negligence. It is possible that it could become common practice for firms to design or amend their carried interest schemes so that such conduct-related triggers are included in the bad leaver provisions.

In our view, taken as a whole the considerations described above, combined with the ability to claw back an individual's cash bonus (if applicable) would in spirit meet the IFPR requirement to apply malus and clawback to 100% of variable remuneration, even if they do not meet all of the detailed requirements of the rules.

2. Co-investment

We note the draft guidance at SYSC 19G.4.3G(1) that the FCA would treat staff co-investment as remuneration where the co-investment is funded by a loan from the firm. We disagree with this characterisation and would argue that co-investment fundamentally provides staff with a return on their investment, and is entirely distinct from their remuneration arrangements. In any event, we do not agree that the FCA should go further than the current ESMA AIFMD remuneration guidance on this point, which notes that a co-investment funded by the firm should only be treated as remuneration where the staff member has not reimbursed the loan by the time the return on the co-investment is paid.

Regulatory reporting (Chapter 13)

28. Do you have any feedback on our reporting proposals? Please particularly provide details of any areas where you consider additional guidance on how to complete them is needed.

We strongly support the FCA's approach to make regulatory reporting simpler and more straightforward, in particular for those firms who will no longer be subject to the reporting obligations under the Capital Requirements Directive IV. We also support the FCA's decision to not adopt the templates as drafted by the European Banking Authority in its Implementing Technical Standards (ITS) on reporting disclosure requirements under the IFR[4] which we believe are unclear and not user friendly.

However, as we expressed in our response to the DP, for many firms (especially current BIPRU and exempt-CAD firms), the new reporting templates, and collecting the data required in order to complete them, will require significant changes to those firms' systems and processes. It would be helpful if the reporting templates, when scheduled in the FCA's reporting system, could filter out reports that are not relevant for a firm's licence type (e.g., certain K-factor reports for firms that do not have permission to deal on own account). To aid firms' transition to the new reporting regime, we ask the FCA to permit firms to take a reasonable efforts approach to some aspects of the reports (at least in the early years of the new IFPR regime).

In addition, while not directly related to this question, we continue to have strong concerns with the IFPR's concept of 'connected undertaking', in particular in relation to the issue of consolidated reporting. The FCA's elaboration of the concept of unified management and the significant influence test (and the related gloss the FCA places on each) materially extend the scope of concepts that are already established and well understood in company law and used in other contexts. The additional glosses are likely to create uncertainty and could possibly lead to firms who would be in scope of prudential consolidation, to instead, may choose to restructure themselves so as to avoid being caught by the prudential consolidation requirements as this could lead to additional compliance costs, administrative burdens and unnecessary complexity. As

[4] EBA/ITS/2021/02, Implementing Technical Standards on reporting requirements for investment firms under Article 54(3) and on disclosures requirements under Article 49(2) of Regulation (EU) 2019/2033.

recommended in our responses to the DP and CP20/24, we believe that the FCA should consider (i) taking a robust position and decline to follow the EBA's policy[5] in this area; (ii) incorporate a territorial scope so that only UK connected undertakings are caught; and (iii) only require prudential consolidation where the FCA has assessed that the significant influence or managed on a unified basis tests have been met and a requirement has been imposed on the relevant firm's permissions to that effect (i.e., preserve the status quo - the FCA's current approach to these matters is both measured and proportionate); or (i) expressly acknowledge that each "connected undertaking" trigger can be rebutted based on an individual firms' facts and circumstances and (ii) one or more of the hallmarks are not determinative.

[5] EBA/RTS/2021/11, Regulatory Technical Standards on prudential consolidation of investment firms groups (Article 7(5) of the IFR).

Annex II: CPMI Firms: High-Level Summary of Applicable Remuneration Requirements

UK IFPR Traits[6]				AIFM Traits[7]		Differences in Treatment Based on Traits[8]				
						Which regime requires application under the named circumstances?				Regime requiring a remuneration committee[12]
(See key)	On- and Off-Balance Sheet Total	AUM[9]	MRT bonus <£167 k[10]	AUM[11]	Status under SYSC 19B guidance	Deferral	Retention	Payment in Shares	Malus/ Clawback	
SNI	<£100 m	<£1.2 b	N/A	<£1 / 5 b	Disapplying	Neither	Neither	Neither	Neither	Neither
Small non-SNI	>£100 m but <£300 m	<£1.2 b	N/A	<£1 / 5 b	Disapplying	Neither	Neither	Neither	IFPR	Neither
	<£300 m	>£1.2 b	N/A	>£1.2 b but <£1 / 5 b	Disapplying	Neither	Neither	Neither	IFPR	Neither
	<£300 m	>£1.2 b	N/A	>£1 / 5 b	Not disapplying	AIFMD	AIFMD	AIFMD	Both	AIFMD
Large non-SNI	>£300 m	<£1.2 b	Yes	<£1 / 5 b	Disapplying	Neither	Neither	Neither	IFPR	IFPR
			No			IFPR	IFPR	IFPR	IFPR	IFPR
	>£300 m	>£1.2 b	Yes	>£1.2 b but <£1 / 5 b	Disapplying	Neither	Neither	Neither	IFPR	IFPR
			No			IFPR	IFPR	IFPR	IFPR	IFPR
	>£300 m	>£1.2 b	Yes	>£1 / 5 b	Not disapplying	AIFMD	AIFMD	AIFMD	Both	Both
			No			Both	Both	Both	Both	Both

[6] The proportionality provisions under both the draft IFPR rules and the AIFMD Remuneration Code and related guidance are detailed and nuanced. This table reflects key provisions, but others need to be checked on a case-by-case basis (e.g., the SNI test under the draft IFPR rules also requires total annual gross revenue from investment services and activities to be under £30 m, while the AIFMD guidance contains a number of non-financial criteria).

[7] See footnote **Error! Bookmark not defined.**.

[8] Green indicates that neither the draft IFPR rules nor the AIFM rules require the application of the relevant requirement. Orange indicates that one of the two sets of rules requires the application, while red indicates that both do.

[9] On the basis that presumed AUM position is not rebutted based on additional proportionality factors. If the other factors rebut the AUM presumption, the AIFMD outcomes would be the opposite.

[10] And variable remuneration makes up one-third or less of total remuneration.

[11] The applicable threshold is £5 b if the AIFs managed are unleveraged and have no redemption rights exercisable during a period of 5 years following the date of initial investment in each AIF. In any other case it is £1 b.

[12] FCA AIFMD guidance states that, "without prejudice to" ESMA guidelines on sound remuneration policies under AIFMD, which contain a financial threshold of EUR 1.25 b in relation to the establishment of a remuneration committee, the FCA "would have regard to the [£1 / 5 b] AuM thresholds" it prescribes in relation to the pay-out process rules.