6 November 2013

Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

By email: fca-cp13-09@fca.org.uk

Dear Sirs,

Re: BVCA Regulatory Committee response to Chapter 14 of the Financial Conduct Authority's Quarterly Consultation (No. 2) (CP 13/9) on 'AIFM Remuneration Code Guidance'

This response to Chapter 14 of the second quarterly consultation by the Financial Conduct Authority (the "**FCA**"), relating to *'AIFM Remuneration Code Guidance'* (the "**Consultation Paper**") is made by the Regulatory Committee of the British Private Equity and Venture Capital Association (the "**BVCA**").

The BVCA is the industry body for the UK private equity and venture capital ("**PE/VC**") industry. With a membership of over 500 firms, the BVCA represents the vast majority of all UK-based PE/VC firms and their advisers. Its members have invested £33 billion in over 4,500 UK companies over the last five years. Companies backed by UK-based PE/VC firms employ over half a million people and 90 per. cent of UK investments in 2012 were directed at small and medium-sized businesses.

We have structured our response so that our general observations on the proposed changes in the Consultation Paper precede our answers to the specific questions. In order to focus our response appropriately, we have not responded to every question in the Consultation Paper, but instead have set out answers to those questions which we believe raise issues which are particularly relevant to PE/VC firms.

British Private Equity & Venture Capital Association
1st Floor North, Brettenham House, Lancaster Place, London WC2E 7EN
T +44 (0)20 7420 1800 F +44 (0)20 7420 1801 bvca@bvca.co.uk www.bvca.co.uk

We would be happy to discuss any of the issues raised in our responses to the Consultation Paper in further detail with the FCA if this would be of assistance.

Yours sincerely,

Margaret Chamberlain
Chair - BVCA Regulatory Committee

FCA QUARTERLY CONSULTATION (NO. 2) CP 13/9 - CHAPTER 14: AIFM REMUNERATION CODE GUIDANCE

PART A: GENERAL COMMENTS AND CONCERNS

1. We would like to begin by expressing our general support for the approach adopted by the FCA in the Consultation Paper in respect of the application of the AIFM remuneration code (the "**Code**"). In our view, it is of central importance that firms are able to apply the AIFMD remuneration rules in a sensible and proportionate manner and that there is clear, practical guidance to assist firms in determining the extent of their obligations in this regard. We consider that in most cases, the Consultation Paper proposes useful starting presumptions and practical examples which also allow firms to take into account their specific factual circumstances when determining whether any requirements can be disapplied under the proportionality test.

2. Nonetheless, there are certain aspects of the guidance which we consider could be further clarified by the FCA in order to avoid confusion in relation to the application of the Code's provisions and we have identified these in our answers to the specific questions in Part B of this response.

3. AIFMs and AIFs may use a variety of legal forms, operational structures and investment strategies and a case-sensitive approach must therefore be adopted when considering whether it would be disproportionate to require compliance with all elements of the Code. As a general observation, we consider that it is important that starting presumptions remain flexible and can be rebutted in appropriate circumstances, rather than becoming rigid and acquiring the status of concrete rules. We interpret the FCA's proposed guidance as endorsing a flexible approach based on the specific circumstances of each firm, but we would observe that the ultimate test of whether the guidance is appropriate will depend upon how it is interpreted and applied by the FCA in the future. We would therefore like to express our hope that the FCA will continue to be sensitive to all of the relevant factors which apply to each particular firm when considering a firm's obligations under the Code.

PART B: RESPONSES TO CONSULTATION QUESTIONS

Question 14.1: Do you agree with our guidance on when firms should implement the AIFM remuneration code?

4. We agree with the FCA's guidance that firms should only be required to implement the Code for the first full performance period after the firm becomes authorised. We also agree with the FCA's guidance that the Code will not apply to any remuneration payments earned, allocated or otherwise awarded in performance periods prior to the firm's authorisation, including remuneration awarded in the form of instruments which have not yet vested at the time of the firm's authorisation.

5. We note that the FCA's website currently states that firms may request a deferral of determination beyond the normal three month statutory time limit and may request an authorisation date as late as 21 July 2014, provided that sufficient reasons are given supporting the request. We appreciate that the FCA has a difficult task in processing a large number of applications for authorisation prior to 22 July 2014. However, in the context of such requests for deferral of authorisation, we think it is important that the FCA reviews the application as quickly as possible and contacts the relevant firm to indicate whether the proposed deferral date will be acceptable, as this will clearly have a consequential impact on a firm's arrangements for implementation of the Code.

Question 14.2: Do you agree that a size threshold based on an AIFM's net assets under management provides a sound working presumption as to whether an AIFM may disapply certain remuneration requirements on the grounds of proportionality? If so, what are the appropriate thresholds for AIF net assets under management for the two categories of AIFMs?

6. We agree that a starting presumption based on net assets under management is helpful when considering whether certain requirements can be disapplied on the grounds of proportionality, but we think it is important that in practice it is not treated as determinative on its own. The size of the AIFs being managed does not, taken in isolation, necessarily indicate that the AIFM has a complex business model or internal structure or is otherwise engaged in practices which carry greater inherent risk than those of a smaller AIFM. We interpret the FCA's proposed guidance as acknowledging that the presumption established by the AIFM's net assets under management figure may be rebutted in appropriate cases depending on the presence or absence of other relevant factors (of which Table 3 of Part C of Appendix 14B is a non-exhaustive list), and we support this fact-sensitive approach. Nonetheless, we consider that the final guidance in Appendix 14B

could be more explicit in recognising that the other qualitative factors may be used to rebut the initial size presumption.

7. We consider that it would be appropriate for AIFs with a limited life or which are in run-off within the meaning of Articles 74 or 75 of the Alternative Investment Fund Managers Regulations 2013 (SI 2013/1773) to be excluded from the calculation of net assets under management for the purposes of the starting presumption, given that such AIFs are excluded from the scope of most of the AIFMD requirements under the transitional provisions. In our opinion, the FCA should add explicit wording to paragraph 1(b) of Part C of Appendix 14B to make this position clear.

8. We note that the presumptions outlined in the Consultation Paper cover AIFMs who manage leveraged AIFs and AIFMs who manage unleveraged closed-ended AIFs, but do not indicate the starting position that should be adopted in relation to AIFMs managing unleveraged open-ended AIFs. We therefore think that it is important for the FCA to clarify the relevant approach in relation to such AIFs in order to reduce potential confusion.

9. We would suggest that in addition to the assets under management figure providing an initial working presumption, a separate initial working presumption should also be based on a firm's FCA-allocated conduct and prudential supervision categories. For these purposes, we consider that firms falling within categories C3 or C4 and P3 or P4 should be considered as low risk and therefore subject to a presumption that they are able to disapply the Pay-out Process Rules. The FCA will already have undertaken considerable work in devising these classifications and applying to them to individual firms in a risk sensitive manner. It would appear unnecessarily duplicative to require firms to undertake a separate analysis for the purpose of the AIFM remuneration rules, as well as inconsistent to categorise firms that are low risk by reference to the supervision categories as potentially high risk by reference to the assets under management thresholds. In our view, firms should be able to rely on the FCA's judgement, expressed through their allocated supervision categories, when determining the initial working presumption to which they are subject.

Question 14.4: Do you agree with the proposed proportionality guidance?

10. We note that in paragraph 1(c) of Part C of Appendix 14B, the FCA states that it "*would encourage comparisons to a firm's peers and competitors in the UK or EEA market where relevant*" when considering other proportionality elements. We are concerned that in many situations, a firm may not have access to information on key aspects of its

competitors such as their internal organisation or risk management procedures and parameters, which in the context of PE/VC firms would typically be confidential information. Accordingly, we would question whether it is realistic to expect firms to undertake such an analysis in order to justify the disapplication of the Pay-out Process Rules. We consider that a more practicable approach would be to allow the firm to consider the other elements of proportionality in the context of its own business and to use reasonable conclusions drawn from that analysis to justify its application of the rules. In our opinion, a review of the approaches adopted by competitors can only be relevant where peer data is both readily available and reasonably reliable. To the extent that the FCA's guidance is intended to indicate that peer analysis is always a necessary element of considering the other elements of proportionality after the initial size presumption has been established, it is our view that such an approach is likely to be unworkable in practice.

11. We are unclear on what precisely is meant by the reference to "*a low level of risk taken by the AIFM*" when discussing the level of risk in the context of the nature, scope and complexity of an AIFM's activities in Table 3 of Part C of Appendix 14B, particularly in the context of PE/VC firms. We assume that a firm could undertake an objectively justifiable assessment of risk by reference to the risk factors contained in the AIFMD Commission Delegated Regulation (No. 231/2013) – i.e. by considering market risks; credit risks; liquidity risks; counterparty risks and operational risks. We also note that the guidance states that firms may use their FCA-allocated conduct and prudential supervision categories to measure their risk profiles, but does not indicate which of these categories might be considered by the FCA to be low risk in this context. If our point in paragraph 9 above in relation to the FCA's categorisation of firms establishing a second working presumption is not accepted, we would suggest that firms falling in categories C3 or C4 and P3 or P4 should be considered low risk for these purposes. Given that the interpretation of this element of proportionality is likely to be central to many firms' analyses of whether the initial size presumption should be disapplied, we consider that it would be useful for the FCA to provide additional guidance on this issue.

12. We note that the guidance in paragraph 4(a) of Part C of Appendix 14B states that "*only significant AIFMs should be required to establish a remuneration committee*". A number of AIFMs may already have a remuneration committee as part of their pre-existing governance arrangements, but may not be "significant" in this context. It is important that the mere existence of a remuneration committee does not lead to the relevant AIFM being classified as a significant AIFM and that AIFMs which are not significant but which nonetheless have a remuneration committee should not be required to restructure that

committee so as to comply with ESMA's guidelines. We would welcome the addition of guidance which confirms this position.

13. We also consider that the existence of a remuneration committee is another relevant factor which should be taken into account when considering elements of proportionality which might rebut the AuM presumption. Where a firm has a well-structured remuneration committee and discloses significant information to investors about its remuneration policies and how compensation arrangements are used to manage risk-taking, we consider that this is another element of internal organisation which enables better investor due diligence and reduces overall risk.

14. Paragraph 2 of Part E of Appendix 14B states that where a firm decides to disapply the rule requiring that 50% of any variable remuneration consists of units of shares of the AIF concerned, the FCA recommends that firms elect to pay staff in shares, interests or instruments linked to the AIFM or its parent company. We note that it may not always be possible for an AIFM to pay staff in such instruments, particularly where the AIFM or its parent company is a private entity. We assume that this recommendation would not apply in such a situation, but we consider that it would be useful for the FCA to add additional guidance to this effect.

Question 14.6: Do you agree with the suggested approaches to allocation of payments?

15. Although the FCA has provided guidance on how to determine the proportion of a partner's income which should be considered to be remuneration and the proportion which should be considered to be a return on equity, we nonetheless consider that it is still unclear in certain circumstances how deferral of a partner's remuneration is intended to operate in practice. Where profits are allocated automatically to partners under the terms of the partnership, it appears that deferral of cash remuneration may simply have the effect of increasing each partner's profits on equity in the relevant year instead (by removing that expenditure for the current year). This would negate the effect of such a deferral, even if it creates a future contingent liability. We presume that this is not intended and consider that this is a fundamental issue which must be addressed clearly by the FCA before the Code can be applied in the context of AIFMs structured as partnerships.

Question 14.7: Do you have any concerns about how the regulatory regime will interact with the taxation of partnerships or LLPs in the UK?

16. We consider that the interaction between the regulatory rules relating to AIFM remuneration and the taxation of partnerships or LLPs in the UK is an important issue

which requires further detailed consideration. We are engaging with HMRC separately in relation to this issue in order to clarify the position and would be happy to discuss this in further detail with the FCA in the near future.