2020

AQR Capital Management (Europe) LLP

PILLAR 3 DISCLOSURE

Pillar 3 Disclosure & Policy

AQR Capital Management (Europe) LLP Pillar 3 Disclosure and Policy
31 December 2020

1. Introduction

AQR Capital Management (Europe) LLP ("AQR Europe" or the "Firm") acts as a full-scope UK alternative investment fund manager ("AIFM") to an alternative investment fund ("AIF") in Luxembourg ("AQR Lux Funds"), as well as a key strategic sub-distributor of AQR's European fund ranges offered in the UK and internationally. These include AQR's two Luxembourg incorporated private funds and two Luxembourg domiciled UCITS umbrella funds, with a total of 26 sub-funds spread across the AIF and UCITS structures.

AQR Europe is regulated by the Financial Conduct Authority of the United Kingdom ("FCA") as an AIFM pursuant to the UK implementation of the European Alternative Investment Fund Managers Directive ("AIFMD"). AQR Europe's scope of permissions is limited to conducting regulated activities with professional clients and/or eligible counterparties only (as defined in the FCA's Handbook of Rules and Guidance (the "FCA Rules")).

This disclosure statement references the following AQR entities:

AQR Capital Management (Europe) LLP; a limited liability partnership established under the laws of England and having its principal place of business in the UK.

AQR Capital Management, LLC ("AQR US"); a limited liability company organised under the laws of the State of Delaware and having its principal place of business in the United States.

AQR Europe is an indirect subsidiary undertaking of AQR US. Together, with other AQR group entities, they are referred to in this disclosure statement as "AQR Group".

This Pillar 3 disclosure statement for AQR Europe is provided in accordance with the requirements of the FCA's "General Prudential Sourcebook" (GENPRU) and the "Prudential Sourcebook for Banks, Building Societies and Investment Firms" (BIPRU).

2. Scope and Application of the Requirements

As AQR Europe is authorised and regulated by the FCA, it is subject to minimum regulatory capital requirements. As a full-scope AIFM, AQR Europe's regulatory capital requirements are primarily set out in Chapter 11 of the Interim Prudential Sourcebook for Investment Businesses ("IPRU-INV"). Since AQR Europe (in addition to acting as the AIFM for AQR Lux Funds) also provides certain MiFID investment services pursuant to Article 6(4) of AIFMD, AQR Europe is also known for regulatory purposes as both a Collective Portfolio Management Investment Firm ("CPMI firm") and a "BIPRU firm". IPRU-INV 11.6.1G provides that, in addition to complying with the regulatory capital requirements for AIFMs (which derive from AIFMD), CPMI firms must also comply with other applicable requirements contained in the GENPRU and BIPRU sourcebooks of the FCA Rules. These sourcebooks derive from various legislation under the European Union's prudential regime for credit institutions and investment firms.

The BIPRU framework consists of three “Pillars”:

- Pillar 1 sets out the minimum capital amounts that a BIPRU firm is required to hold;
- Pillar 2 requires a BIPRU firm to assess whether its Pillar 1 capital is adequate to meet the risks to which its business is exposed (via the Internal Capital Adequacy Assessment Process (“ICAAP”)), an assessment which is subject to potential annual review by the FCA; and
- Pillar 3 requires a BIPRU firm to disclose publicly certain information about its underlying risk management controls and capital position.

The BIPRU Pillar 1 requirements only apply to CPMI firms such as AQR Europe in respect of their activities that constitute the provision of MiFID investment services whereas Pillar 2 and Pillar 3 requirements apply to the whole of AQR Europe’s business.

Chapter 11 of BIPRU implements the Pillar 3 requirements referred to above and requires AQR Europe to make certain public disclosures regarding its capital, risks, risk assessment process and remuneration policy. This Pillar 3 disclosure statement addresses these obligations. AQR Europe makes Pillar 3 disclosures at least annually. This disclosure statement has been prepared to coincide with AQR Europe’s financial year-end (31 December). The information contained in this disclosure statement has not been audited by AQR Europe’s external auditors and does not constitute any form of financial statement.

AQR Europe is an investment management firm and, as such, has no trading book exposures. It acts solely as investment manager and distributor. AQR Europe does not hold client money or client assets.

AQR Europe is not a member of a UK or EEA consolidation group and so is not required to prepare consolidated reporting for prudential purposes. There are no differences in the basis of consolidation for accounting and prudential purposes.

AQR Europe does not currently foresee any material practical or legal impediment to (1) the prompt transfer of capital resources to it by AQR US should the need arise; or (2) the prompt payment of liabilities owed to it by the AQR Group (as applicable).

3. Governance Framework

AQR Europe

AQR Europe has adopted a robust governance framework, which includes a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks to which it is or might be exposed, and internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements for information processing systems.

The governing body of AQR Europe is the European Executive Committee (the “EEC”) to whom the Firm has delegated its day to day business operations. The EEC has one sub-committee –The Product Governance Committee (the “PGC”) – which reports to the EEC and is responsible for the systems and controls AQR Europe has in place to design, approve, market and manage products throughout the products' lifecycle to ensure they meet legal and regulatory requirements..

As the governing body of AQR Europe, the EEC is responsible for the overall management and oversight of AQR Europe. It provides leadership and oversight of the organisation within a framework of prudent and effective controls that enable risk to be assessed and managed. It sets AQR Europe’s strategic aims and is responsible for overseeing the establishment and maintenance of appropriate systems and controls to ensure it operates within applicable laws, rules and guidance issued by the FCA and other competent regulatory authorities. The EEC also undertakes the monitoring and overview of AQR Europe's European-domiciled fund business in respect of the functions to which AQR US has been appointed.

The PGC is responsible for day-to-day decision making and oversight with respect to product structuring, governance and distribution, having due regard to the fund-specific identified target market of distributed funds. In addition, the PGC is responsible, on a regular basis, for post launch analysis, changes in investment objectives of AQR products and services and distribution oversight and monitoring.

Global Governance Arrangements

The AQR Group maintains a management structure and leadership designed to facilitate the strategic advancement and global oversight of the entire business of the AQR Group.

AQR Europe, as a key strategic subsidiary undertaking of AQR US, is an integral part of the AQR Group. As such, its strategy, activities, policies and procedures are aligned with those of AQR US (unless applicable law or regulation requires otherwise).

4. Risk Management Objectives and Policies

General Risk Framework

AQR Europe has effective processes in place to identify, manage, monitor and report the risks to which it is or might be exposed. The EEC must approve and periodically review the strategies and policies for managing the risks to which AQR Europe is or might be exposed, including those posed by the macroeconomic environment in which it operates.

Risk Appetite

AQR Europe has a low risk profile. It does not hold client money or client assets, operate a trading book, or deal directly with retail clients. It benefits from the financial support of its indirect parent, AQR US, and maintains capital levels significantly in excess of its regulatory capital requirement.

The stated risk appetite of the EEC is low.

Risk Management Function

AQR Europe maintains a permanent risk management function which has in place effective risk management policies and procedures in order to verify, manage and monitor all relevant risks on an ongoing basis.

The Risk Manager reports to the Chief Operating Officer who is responsible for the execution of all risk management obligations, for creating a stable and consistent framework for discussion and for the promotion of a culture of risk awareness in the firm.

The Chief Operating Officer is a Member and Deputy Chairman of the EEC.

Risk Management Governance

AQR Europe's risks are managed through a framework of policies and procedures having regard to relevant laws, standards, principles and rules (including the FCA Rules) with the aim to operate a defined and transparent risk management framework.

Policies and procedures are updated as required but are reviewed at least annually. The ICAAP is an integral part of AQR Europe's risk management framework. The ICAAP identifies the sources of risk to the Firm and then assesses the potential impact of each risk to the Firm's business, offsetting this against the systems and controls which have been put in place to mitigate against those risks. As part of this process, the EEC determines whether the amount of regulatory capital held is adequate. The Risk Manager undertakes an assessment, at least annually, of the ICAAP to ensure that the statement of risk appetite and the stress testing remain appropriate. The outcome of this review is reported to the EEC which is ultimately responsible for approval and adoption of the ICAAP. This review is also undertaken whenever there is a material change to the business. Furthermore, the EEC meets on a quarterly basis to discuss all key business issues including regulatory capital and risk management.

Risk Identification

AQR Europe's most significant risks have been identified as:

- Operational Risk – AQR Europe is exposed to the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. An appropriate risk framework is in place to manage operational risk, designed to identify risk in processes and mitigate the probability and impact of any loss arising.
- Credit and Concentration Risk – AQR Europe is exposed to credit risk directly as a result of its transfer pricing agreement with AQR US and its investment advisory agreement with AQR Lux Funds. AQR Europe manages the credit risk with quarterly reviews of AQR US's financial position and the use of a custodian for safekeeping of fund assets.
- Legal Risk – AQR Europe is exposed to the risk that changes in the legislative environment in which it operates could adversely impact its ability to conduct current business activities, particularly on a cross-border basis. AQR Europe has a dedicated legal & compliance team tasked with the assessment and management of any such risk including, with respect to Brexit, appropriate contingency planning to allow the Firm to continue its regulated business activities.
- Regulatory Risk – AQR Europe is exposed to regulatory risk. AQR Europe's dedicated legal & compliance team is tasked with the assessment and management of any such risk. AQR Europe also utilises the services of professional advisers where necessary.
- Liquidity Risk – AQR Europe is exposed to liquidity risk resulting from its relationship with AQR US. If AQR US were to experience financial hardship and be unable to settle its obligation to AQR Europe, AQR Europe would likely experience difficulty in meeting its own obligations. AQR Europe manages this risk with quarterly reviews of AQR US's financial position.
- Business risk – AQR Europe is exposed to the risk of a substantial and sustained reduction in funds under management, caused by adverse market conditions or investor redemptions, resulting in a loss of management fee income. Stress testing is conducted in order to assess and evaluate the ongoing potential impact of the various stress events on the performance of AQR Europe's funds[1].
- Pandemic Risk – The COVID-19 pandemic has created and continues to pose economic and financial risk to the global economy. AQR Europe continues to operate within its Business Continuity Plan (BCP), which was successfully deployed in March 2020 in response to the pandemic, in order to prioritise the safety of its employees and to ensure the continued successful operation of its business. The policies and procedures in place continue to be reviewed in light of the evolving public health requirements and applicable legislation. The extent of to which further pandemic developments impact AQR Europe's business is highly uncertain and cannot be predicted. However, the BCP and the operating infrastructure have demonstrated suitable resilience to the challenges experienced to date.

[1] Note, however, that business risk is largely mitigated by the Firm's revenue share model comprising net allocation of management fees from AQR US, with a cost-plus floor, which underwrites future profitability and capital preservation.

In addition, the EEC has considered the following risks:

- Market Risk – Market risk exposure has been assessed by AQR Europe and is limited to its exposure to any cash amounts held by AQR Europe in any currency other than Sterling, the predominant currency of its liabilities.
- Cyber Risk – AQR Europe is exposed to the risk of a cyber-attack from an external actor materially impacting day-to-day operations or compromising the arrangements it has in place to maintain the confidentiality of client data. The AQR Group has various controls in place to enhance the Firm's cyber security. These controls are built around (a) preventing external intrusion/denial of service, and (b) protecting intellectual property from leaking outside the AQR Group.

AQR Europe considers the estimated costs of an orderly wind-down of its business as part of its ICAAP. AQR Europe believes that it maintains sufficient capital to meet its liabilities for the duration of an orderly wind-down process.

5. Regulatory Capital Requirements as at 31 December 2020

AQR Europe actively monitors its capital base to ensure that it has adequate capital to meet its liabilities. As an AIFM, AQR Europe's minimum capital requirement is calculated as the higher of:

- its fixed overhead requirement ("FOR") calculated as 13 weeks' fixed expenditure based on the most recent audited financial statements; and
- its funds under management requirement which is the base capital requirement of €125,000 plus 0.02 per cent of the amount by which the total value of funds under management exceeds €250 million (or equivalent), subject to a cap of €10 million (or equivalent).

plus, in accordance with IPRU-INV 11.3.11, AQR Europe must cover the professional liability risks set out in article 12 of the AIFMD level 2 regulation (professional liability risks) by either:

- maintaining additional own funds equivalent to 0.01 per cent of funds under management of the AIFs being managed by the AIFM; or
- holding professional indemnity insurance and maintaining an amount of own funds to meet the PII capital requirement under article 15 of the AIFMD level 2 regulation as laid out in IPRU-INV 11.3.15UK.

As a CPMI and BIPRU firm, AQR Europe's minimum capital requirement under Pillar 1 is calculated as the highest of:

- its base capital requirement of €50,000 (or approximately £45,000);
- the sum of its credit and market risk requirements; and
- its FOR.

Pursuant to IPRU-INV 11.6.3G, AQR Europe's capital requirements under AIFMD and BIPRU apply in parallel to each other. This means that AQR Europe is permitted to use the same capital resources to satisfy these capital requirements (AQR Europe must have capital resources that exceed the higher of the two amounts – not the sum of the two amounts).

AQR Europe's capital resources and capital resources requirements as at 31 December 2019 are set out below:

Regulatory Capital

	£'000
Core tier one capital	23,312
Deductions	(2,024)
Total regulatory capital	**21,288**

Regulatory Capital Requirement under BIPRU

Under BIPRU, the higher of the following:

	£'000
1. Base capital resources requirement	45
2. Credit and market risk	1,635
3. Fixed overheads requirement	3,247
Capital requirement (highest of 1, 2 or 3)	3,247
Excess over requirement	**18,041**

Regulatory Capital Requirement under AIFMD

	£'000
1. Funds under management requirement	2,962
2. Fixed overheads requirement	3,247
Capital requirement (higher of 1 or 2)	3,247
Plus professional liability risk own funds requirement	1,447
Total capital requirement	4,694
Excess over requirement	**16,594**

The EEC is committed to reviewing capital adequacy on a regular basis and maintaining a comfortable surplus of regulatory capital over the Firm's regulatory capital requirements.

6. Remuneration

AQR Europe has implemented and maintains a remuneration policy and practices that are consistent with, and promote, sound and effective risk management and do not encourage risk-taking which is inconsistent with the risk profile of the AIFs it manages.

AQR Europe is subject to the AIFM Remuneration Code in its capacity as a full-scope AIFM. AQR Europe is additionally subject to the BIPRU Remuneration Code through its performance of certain other investment services. However, FCA guidance provides that compliance with the AIFM Remuneration Code is deemed to constitute compliance with the BIPRU Remuneration Code and so AQR Europe's remuneration policy is based upon the AIFM Remuneration Code.

AQR Europe's remuneration policy is reviewed periodically, and at least annually, by the EEC and the AQR Finance Committee. Owing to the nature, scale and complexity of AQR Europe's business, the Firm has decided not to establish a remuneration committee nor does it apply any of the pay-out process rules.

When reviewing remuneration, including any variable remuneration, AQR Europe considers the overall contribution made by individual staff, which includes financial and non-financial criteria. Relevant factors include (but are not limited to):

- Overall firm performance during the relevant year;
- Individual performance based on the three core elements of (1) effort; (2) attitude; and (3) results (as against key accomplishments, progress against goals, objectives or initiatives);
- Competitive benchmarking criteria; and
- Other facts as decided by the AQR Group in its discretion from time to time.

The assessment of performance for awarding variable remuneration is not individually tied to the profits or performance of any fund, group affiliate or any client. All variable remuneration awards are calculated after allowing for the capital and liquidity requirements of the Firm.

AQR Europe only has one "business area", namely its asset management and distribution business. All AQR Europe's Code Staff (as that term is interpreted in accordance with the FCA's AIFM Remuneration Code and associated proportionality guidance) fall into the "senior management" category of Code Staff. The total "remuneration" awarded to AQR Europe's Code Staff (again, in line with the AIFM Remuneration Code and associated FCA proportionality guidance) during the calendar year ending on 31 December 2020 was £5,377,827.

7. Items Omitted from the Pillar 3 Disclosures

AQR Europe's minimum capital requirement under Pillar 1 is driven by its FOR and not the sum of its credit risk and market risk requirements. AQR Europe has, accordingly, concluded that the detailed disclosure requirements in relation to credit risk and market risk set out in BIPRU 11.5.4R(2)-(4), BIPRU 11.5.5-11.5.13R, and BIPRU 11.5.15R-11.5.16R may be excluded from the Pillar 3 Disclosures on the grounds that they are immaterial (in accordance with BIPRU 11.3.5R).

AQR Europe does not engage in securitisation activity and the securitisation disclosures in BIPRU 11.5.17R are not applicable. AQR Europe has therefore concluded that it is permitted to exclude such disclosures from the Pillar 3 Disclosures on the grounds that they are immaterial (in accordance with BIPRU 11.3.5R).