

EFAMA Response to ESMA's Consultation Paper on Guidelines on remuneration policies and practices (MiFID)

EFAMA¹ welcomes the opportunity to provide comments to the ESMA Consultation paper on Guidelines on remuneration policies and practices (MiFID) (the “**Consultation Paper**”).

EFAMA would like to submit a few general comments (please see I. General Comments below) before providing answers to the specific questions raised in the ESMA Consultation Paper (please refer to II. Answers to questions raised in the Consultation Paper below).

I. General Comments

1. Consistency with other remuneration guidelines

EFAMA would like to stress once again the need for consistency between the proposed guidelines on remuneration policies and practices (MiFID) (the “**Guidelines**”) and other remuneration guidelines. All EFAMA Members will in the future be falling under the scope of several directives, as they will be holding licences as AIFM, as UCITS Management Companies and possibly as MiFID firms. They will act as management companies of investment funds and also perform investment services of individual portfolio management or non-core services. Many of them are also part of financial groups, thus falling as group companies under the CRD requirements or relevant requirements for insurance groups or pension groups.

These EFAMA members will have to apply at least four sets of remuneration guidelines, namely the guidelines to be issued by ESMA under AIFMD, guidelines to be issued by ESMA under MiFID, guidelines to be issued by ESMA under UCITS V and the existing CEBS Guidelines (to be modified by EBA). Given this background, ESMA explicitly states that the Guidelines shall not be applicable only to investment firms (as defined in Article 4(1) (1) of MiFID) but also to UCITS management companies and external AIFMs when they are providing the investment services of individual portfolio management or non-core services². These sets of remuneration guidelines will also have to be implemented at different times, increasing the complexity.

¹ EFAMA is the representative association for the European investment management industry. EFAMA represents through its 27 member associations and 59 corporate members about EUR 14 trillion in assets under management of which EUR 8.4 trillion managed by 54,000 investment funds at end June 2012. Just under 36,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds. For more information about EFAMA, please visit www.efama.org.

² ESMA Consultation Paper, Footnotes 1 and 20.

EFAMA fully agrees with ESMA's statement that "firms should avoid creating unnecessarily complex policies and practices (such as combinations of different policies and practices,...)"³. EFAMA also agrees that "this may potentially lead to inconsistent approaches and hamper proper knowledge or control of the policies by the compliance function"⁴. Therefore, it is crucial that consistency be ensured by legislators between the four different sets of guidelines mentioned above while leaving enough room to take into account the specificities of the different business models. The guidelines should be consistent but not identical.

EFAMA therefore favours the application of a broader principles-based approach to ensure the measures can be adapted to fit the circumstances of the firm or funds and the wider group context in which many such firms will be operating. EFAMA welcomes the statement by ESMA regarding group structures, which clarifies that "a balance between the requirements of the parent undertaking to have the group remuneration policy applied coherently and the requirement of subsidiaries to take into account local responsibilities, based on local risk provide and regulatory environment, should be achieved."⁵

2. Need for Proportionality

EFAMA notes that, given the broad range of firms and the wide spectrum of activities and products covered by the Guidelines, proportionality in the application of the Guidelines will be of outmost importance.

EFAMA therefore particularly appreciates the statement that the Guidelines should be read together with the proportionality principle as set out in Article 22 of the MiFID Implementing Directive and that this will give firms the necessary flexibility to comply with the Guidelines according to the nature, scale and complexity of their business⁶. EFAMA also welcomes that ESMA holds that, in the design of remuneration policies and practices, firms shall consider all relevant factors such as the role performed by relevant persons, the type of products offered and the methods of distribution⁷.

3. Scope of the Guidelines

EFAMA would appreciate further clarification regarding the scope of the Guidelines. While ESMA seeks to outline the scope of the Guidelines throughout the document, the delimitations still leave room for or even lead to a number of questions:

³ ESMA Consultation Paper, N. 52.

⁴ ESMA Consultation Paper, N. 52.

⁵ ESMA Consultation Paper, N. 12.

⁶ ESMA Consultation Paper, N. 34.

⁷ ESMA Consultation Paper, N. 44.

3.1. Activities and clients

Regarding activities and types of clients covered by the scope of the Guidelines, ESMA states that the Guidelines shall mainly target sales activities with retail clients but shall also be considered applicable, to the extent they are relevant, when services are provided to any types of client⁸.

EFAMA welcomes the statement that the Guidelines shall mainly be applicable to sales activities with retail clients and not to the relationship management of a contract with professional clients. Professional clients investigate and negotiate with product providers before investing and have the ability and skill to understand the product's risk and advantages. Regularly, specific products are designed at the request and following the instructions of professional clients. A limitation of the Guidelines to sales activities to retail clients takes these differences between retail and professional clients into account.

While EFAMA welcomes the clarification that the Guidelines shall be applicable mainly to sales activities to retail clients, the subsequent remark and a number of statements throughout the Guidelines explicitly hold that they shall also be applicable to other services (including investment and/or ancillary services)⁹ provided to any type of client¹⁰. These indications open the scope of application in a way that it becomes unclear.

EFAMA would appreciate a more explicit clarification of the scope to limit the scope to sales activities to retail clients and to avoid an application to any service rendered to any type of client.

3.2. Persons in scope and "relevant persons"

In view of the persons covered by the Guidelines, ESMA defines the scope of application in an extremely broad manner and in several parts of the Guidelines, which must be read together to allow a clearer picture of the persons covered. Due to this dispersed approach to definition, the scope of the Guidelines remains unclear and seems too broad, and questions arise whether it goes beyond the Level 1 of MiFID.

EFAMA understands that the Guidelines shall cover a large number of persons, including all persons involved in the provision of investment and/or ancillary services, and not only to "Relevant Persons"¹¹ (apparently a sub-category of this larger addressee group). Throughout the Guidelines, clarification would be appreciated as to which rules shall apply to all persons and which rules are targeted only at the "Relevant Persons".

ESMA states that the Guidelines shall not be limited to the "Relevant Persons" but also address any entity or person providing services to firms on the basis of outsourcing arrangements or as tied

⁸ ESMA Consultation Paper, N. 9.

⁹ ESMA Consultation Paper N. 10.

¹⁰ ESMA Consultation Paper N. 9.

¹¹ ESMA Consultation Paper, N. 8.

agents. EFAMA questions whether such a broad scope is still covered by Level 1 of the Directive. In any case, EFAMA would appreciate clarification that not all persons performing any service on the basis of outsourcing arrangements are covered by the Guidelines. For example, outsourced maintenance services, IT services, bookkeeping and accounting and similar services should not be covered by the Guidelines.

Furthermore, ESMA imposes the enforcement of these rules on firms, which shall ensure that tied agents and outsourced entities have remuneration policies and practices that are equally as effective as the firm's own arrangements in addressing and mitigating the potential conduct of business and conflict of interest¹². EFAMA questions whether such a concept is covered by Level 1 and would be workable in practice.

3.3. Distinction between remuneration and fee

ESMA defines remuneration as all forms of payment or benefits provided directly or indirectly by firms to relevant persons in the provision of investment and/or ancillary services. ESMA then extends this definition to payments made by firms to tied agents or other persons on the basis of an outsourcing arrangement¹³.

In this context, EFAMA would appreciate a clearer distinction between the terms "remuneration" (as payments within a firm¹⁴) and "fee" which are payments between two independent entities for services rendered. The fees paid by a firm to an independent service provider should not be considered as salary paid to an individual staff member of the service provider.

3.4. Distinction between remuneration and inducements

On the one hand, ESMA indicates that the Guidelines shall mainly target remuneration in relation to sales activities with retail clients.¹⁵ ESMA explicitly states that the Guidelines shall not be applicable to inducements under Article 26 of the MiFID Implementing Directive¹⁶ but emphasises the regulatory framework of remuneration practices by focussing on payments within a firm¹⁷. In this context, ESMA defines inducements as payments between firms¹⁸. Remuneration is defined as payments within a firm¹⁹.

On the other hand, ESMA extends the scope to all forms of payments or benefits provided directly or indirectly to persons/firms, even on the basis of outsourcing arrangements or as tied agents.

¹² ESMA Consultation Paper, N. 10.

¹³ ESMA Consultation Paper, N. 10.

¹⁴ ESMA Consultation Paper, N. 30.

¹⁵ ESMA Consultation Paper, N. 9.

¹⁶ ESMA Consultation Paper, N. 29.

¹⁷ ESMA Consultation Paper, N. 30.

¹⁸ ESMA Consultation Paper, N. 30.

¹⁹ ESMA Consultation Paper, N. 30.

Based on these statements, the distinction between remuneration of personnel and inducements paid to external distributors/tied agents, for example in form of a distribution fee or retrocession, becomes blurred.

EFAMA would very much appreciate clarification that the Guidelines shall be applicable only to remuneration and not to inducements. Such clarification could be brought by ESMA through a reformulation of its statements regarding the application of the Guidelines to payments to tied agents or for outsourced activities.

4. Level Playing Field

EFAMA understands that the ESMA Guidelines aim at avoiding mis-selling of financial products and services and at remunerations or practices that could be potentially to the detriment of clients. To ensure a level playing field, guidelines such as the ESMA Guidelines should apply not only to MiFID firms selling saving products. Relevant guidelines should also be published in the context of PRIPs and thus be applicable to the sale of any substitute financial product to retail clients.

II. Answers to questions raised in the Consultation Paper

Q1: Do you agree that firm's remuneration policies and practices should be aligned with effective conflicts of interest management duties and conduct of business risk management obligations so as not to create incentives that may lead relevant persons to favour their own interest, or the firm's interests, to the potential detriment of clients? Please also state the reasons for your answer.

EFAMA agrees that a firm's remuneration policies and practices should be aligned with effective conflict of interest management duties and conduct of business risk management obligations.

EFAMA understands that the ESMA Guidelines aim at avoiding mis-selling and remunerations or practices which could be potentially to the detriment of clients. EFAMA therefore agrees with ESMA's initial statement that the Guidelines are targeted mainly at sales activities with retail clients.²⁰ EFAMA also welcomes in this context ESMA's definition of Relevant Persons as persons being part of the sales force or complaints handling departments²¹. EFAMA would welcome a clarification that the Guidelines should apply only to firms providing investment services to the final client when selling a financial product.

²⁰ ESMA Consultation Paper, N. 9.

²¹ ESMA Consultation Paper, N. 8.

Q2: Do you agree that, when designing remuneration policies and practices, firms should take into account factors such as the role performed by relevant persons, the type of products offered, and the methods of distribution? Please also state the reasons for your answer.

EFAMA agrees that when designing remuneration policies and practices, firms should take into account factors such as the role performed by relevant persons, the type of products offered, and the methods of distribution. EFAMA welcomes this as an application of the proportionality principle.

Q3: Do you agree that when designing remuneration policies and practices firms should ensure that the fixed and variable components of the total remuneration are appropriately balanced?

EFAMA agrees that firms should ensure an appropriate balance between fixed and variable components of the total remuneration. For each firm, this should be possible as the remuneration policies and principles will be designed by each firm in application of the proportionality principle according to the nature, scale and complexity of their business and taking into account factors such as the role performed by the relevant persons, the type of products offered and the methods of distribution.

Q4: Do you agree that the ratio between the fixed and variable components of remuneration should therefore be appropriate in order to take into account the interests of the clients of the firm? Please also state the reasons for your answer.

EFAMA agrees that the ratio between fixed and variable components of remuneration should be set by each firm in its Guidelines in an appropriate manner to take into account the interests of the clients of the firm.

Q5: Do you agree that the performance of relevant persons should take account of non-financial (such as compliance with regulation and internal rules, market conduct standards, fair treatment of clients etc.), as well as financial, criteria? Please also state the reasons for your answer.

EFAMA agrees that the performance of relevant persons should take account of non-financial as well as financial criteria. Some EFAMA Members question the practicability of the ESMA principle that a firm should adopt and maintain measures enabling it promptly to identify where the relevant person fails to act in the best interests of the client and to take remedial action²².

²² ESMA Consultation, N. 48.

Q6: Do you agree that the design of remuneration policies and practices should be approved by senior management or, where appropriate, the supervisory function after taking advice from the compliance function? Please also state the reasons for your answer.

EFAMA agrees that the design of remuneration policies and practices should be approved by the supervisory body. The approval of the remuneration policies and practices is in most cases, depending on national law, the responsibility of a remuneration committee which is usually a committee of the supervisory body. EFAMA agrees that the compliance function should be involved and provide advice.

Q7: Do you agree that senior management should be responsible for the implementation of remuneration policies and practices, and for preventing and dealing with any the risks that remuneration policies and practices can create? Please also state the reasons for your answer.

EFAMA agrees that the senior management should be responsible for the implementation of remuneration policies and practices.

Q8: Do you agree that the organisational measures adopted for the launch of new products or services should take into account the remuneration policies and practices and the risks that the new products or services may pose? Please also state the reasons for your answer.

EFAMA agrees that in the framework of the launch of new products or services, firms should assess whether the remuneration features related to the distribution of that product comply with the firm's remuneration policies and practices and therefore do not pose conduct of business and conflict of interest risks. Organisational measures and procedures adopted for the launch of new products or services should therefore take into account, among other factors, the compliance with the firm's remuneration policy.

Q9: Do you agree that the process for assessing whether the remuneration features related to the distribution of new products or services comply with the firm's remuneration policies and practices should be appropriately documented by firms? Please also state the reasons for your answer.

EFAMA agrees that each firm should assess whether the remuneration features related to the distribution of new products or services by the firm itself comply with the firm's remuneration policies and practices. This process should be appropriately documented.

This being said, EFAMA considers that firms cannot be responsible for assessing the remuneration features in any entity or person providing services to firms on the basis of outsourcing arrangements

or as tied agents. EFAMA would appreciate clarification by ESMA that such assessment is not required under the Guidelines and should not be documented by firms.

Furthermore, EFAMA considers the way of presenting good and poor practices extremely difficult as it entails the danger of stigmatizing certain products. For example, certain financial instruments such as new fund products are described as examples of poor practices²³ - a generalisation which should be avoided. EFAMA would appreciate if ESMA could clarify that the good or poor practices are examples applicable to any type of financial product.

Q10: Do you agree that firms should make use of management information to identify where potential conduct of business and conflict of interest risks might be occurring as a result of specific features in the remuneration policies and practices, and take corrective action as appropriate? Please also state the reasons for your answer.

EFAMA agrees that in the framework of the periodic review of remuneration policies, identification of conduct of business or conflict of interest incidents could be used to improve policies.

Q11: Do you agree that firms should set up controls on the implementation of their remuneration policies and practices to ensure compliance with the MiFID conflicts of interest and conduct of business requirements, and that these controls should include assessing the quality of the service provided to the client? Please also state the reasons for your answer.

EFAMA agrees that firms should control the implementation of their remuneration policies and practices.

Q12: Do you agree that the compliance function should be involved in the design process of remuneration policies and practices before they are applied to relevant staff? Please also state the reasons for your answer.

EFAMA agrees that the compliance function should be involved to provide advice to the chairman of the remuneration committee and the chairman of the supervisory function on the remuneration policies and practices (please refer to answer to Question 6 above).

Q13: Do you agree that it is difficult for a firm, in the situations illustrated above in Annex I, to demonstrate compliance with the relevant MiFID rules?

EFAMA agrees that it is difficult for a firm to demonstrate compliance with the relevant MiFID rules.

²³ ESMA Consultation, N. 26.

Q14: If you think some of these features may be compatible with MiFID rules, please describe for each of (a), (b), (c) and (d) in Annex I above which specific requirements (i.e. stronger controls, etc.) they should be subject to.

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