German Banking Industry Committee

Die Deutsche Kreditwirtschaft

National Association of German Cooperative Banks | Schellingstraße 4 |
10785 Berlin | Germany

ESMA
103 Rue de Grenelle
75007 Paris
France

Contact: Ruth Claßen
Telephone: +49 30 2021-2312
Fax: +49 30 2021-192300
E-mail: classen@bvr.de
Our ref: 413-ESMA-MIFID

Ref. DK: 413-ESMA-MIFID
Ref. BVR: 413-ESMA-MIFID

12-12-07

GBIC Comments on ESMA's Consultation Paper "Guidelines on remuneration policies and practices (MiFID)" of September 2012 – ESMA/2012/570

Enclosure:
Answer to ESMA's questions and specific comments

Dear Sir or Madam,

The German Banking Industry Committee (GBIC)[1] appreciates the opportunity to comment on the draft "Guidelines on remuneration policies and practices (MiFID)".

We agree that the remuneration of employees of investment firms is an important supervisory issue. Notwithstanding the foregoing, there needs to be a differentiation between the remuneration of executives who are already subject to comprehensive banking supervision requirements and the remuneration of non-executives such as employees working in the field of investment advice. Non-executives are generally paid on the basis of collective labour agreements. Beside the amount of agreed remuneration, also the maximum permissible amount of variable remuneration is fixed in the collective labour agreement. Under the current collective labour agreements applicable to private banks, savings banks and cooperative banks, at least 90 percent of the agreed remuneration paid to German bank employees are fixed remuneration.

Even as regards the timing of the payment of the variable remuneration, there needs to be a differentiation between executives and non-executives. This is due to the fact that, for non-executives, any delay in the payment of the agreed remuneration including the variable part would

[1] the **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry.These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,200 banks.

not be appropriate. Rather, non-executive employees have a contractual right to timely payment, unless there have been breaches against the bank's internal arrangements (see in detail our specific comments to paragraph 25, first example, **enclosure**).

I. General comments concerning supervision law

1. Variable remuneration as an economic necessity

The GBIC is aware of the fact that remuneration policies and practices may potentially trigger conflicts of interest. Depending on the design of the remuneration policies and practices, these conflicts of interest may be considerable, indeed. Furthermore, there is an obvious need to manage corresponding conflicts of interest.

However, in our view, the draft ESMA Guidelines don't take enough into account the economic necessity for variable remuneration (see, for instance, in Annex 5 in paragraph 33, first indent – example for poor practice). From the point of view of revenue, there is an indispensable need for a – at least partially – flexible design of employee remuneration. The remuneration of employees needs to be funded on the basis of the revenues generated by an investment firm. These revenue streams do not remain at a constant level. Hence, there is a need for an instrument that allows investment firms to link the remuneration to changes in the revenue situation. Variable remuneration constitutes such an instrument. Generally speaking, investment firms don't differ from other business enterprises. At this juncture, the ESMA proposals impose a taboo on quite legitimate economic interests i.e. the need for financially viable management. Furthermore, there is an exclusive focus on the clients' interests. This dilutes the boundary necessary between the work of business enterprises on the one hand (to which investment firms belong) and non-profit organisations/charities on the other hand.

The aspect of remunerating certain achievements is a legitimate concern. Investment firms can only spend the revenues available for the remuneration of their employees once. As a consequence, they need to have the right to remunerate employees on the basis of their contribution to the investment firm's revenue. It would be utterly inconsistent with the principles of a free market economy and the sense of fairness of motivated staff if all employees were to receive the same remuneration – regardless of their effort made and their value added for the investment firm. Business enterprises shall and must have the right to give their employees a share in their economic corporate success, who have contributed to this success on the basis of their skilful and customised investment (advisory) services. Anything else would inappropriately interfere into the established business (company and property rights).

The necessity of variable remuneration is confirmed by paragraph 4 of CEBS Guidelines on remuneration Policies and Practices (published on 10 December 2010) and the requirements of the CRD. Accordingly, remunerations serves also the purpose of risk management in investment firms. This purpose can only be reached by variable remuneration components, which have an adequate volume. Extensively fixed remunerations are inadequate for this purpose.

Whilst it will be necessary to achieve a balance of interests, it is worth noting that such a balance of interests equally needs to take account of investment firms' legitimate business interests.

2. Important organisational arrangements to protect the clients' interests are – unduly – left unconsidered

The draft ESMA Guidelines unduly left unconsidered important organisational arrangements that investment firms have implemented in order to protect clients' interests. For instance, we would like to mention the fact that employees must comply with the internal instructions and other internal organisational arrangements (that are legally binding under labour law) the investment firms have implemented in order to meet the MiFID-provisions and therefore to protect their clients' interests; furthermore the regular and *ad-hoc* monitoring and assessment of these organisational arrangements through the compliance function whether they are (still) adequate and effective (in order to protect the clients' interests); last but not least, the first and second controls through the business units and the compliance function whether the employees comply with the above mentioned internal organisation arrangements. The fact that none of these measures are taken into account by the Consultation Paper leads to an excessive focus on remuneration issues which is inappropriate.

The MiFID does not require that investment firms must prevent conflicts of interest *ex ante*. Rather, the MiFID requires that adverse effects on clients' interests, caused by conflicts of interest, need to be prevented, primarily (cf. Article 13(3) MiFID ("… to prevent conflicts of interest … **from adversely affecting the interests of its clients**" (cf. also Recital 29 MiFID: "… It is therefore necessary to provide for rules that ensure **that such conflicts do not adversely affect the interests of their clients**."; emphasis added). In fact, the MiFID acknowledges that investment firms may be subject to conflicts of interest in their capacity as business enterprises (cf. Recital 29, Sentence 1 MiFID). The MiFID does not request giving up business activities or parts of business units in order to prevent conflicts of interest. Under the provisions of the MiFID, investment firms have to identify potential conflicts of interest which may have a detrimental effect on clients' interests and have to manage these conflicts of interest by effective organisational arrangements in order to avoid adverse effects on clients' interests (cf. Article 13(3) MiFID "3. An investment firm shall maintain and operate **effective organisational and administrative arrangements** with a view to taking all reasonable steps **designed to prevent conflicts of interest** as defined in Article 18 **from adversely affecting the interests of its clients**.").

That investment firms are not obliged to prevent conflicts of interest *ex ante* is also illustrated in a very clear manner by Article 18(2) MiFID. Under said provisions, even a disclosure of a conflict of interest *vis à vis* the client is sufficient if the organisational arrangements (for managing conflicts of interest) are not sufficient to ensure that risks of damage to client interests will be prevented. Finally, also the principle of proportionality under Article 22 MiFID Implementing Directive lends itself to the aforementioned understanding.

As a consequence, guidelines which tend to or even require that already the remuneration policies and practices must protect the clients' interests (cf. Annex V, particularly paragraphs 13, 14, 15, 27, 28, 34/35, furthermore, cf. the example for poor practices under paragraph 33, first indent), wouldn't be in line with the MiFID. Any supervisory practice to this effect would interfere in an inappropriate manner into the established business (company and property rights).

3. The examples for "good and poor practices" are inconsistent with the continental European regulatory and interpretation approach and fall short

The draft Guidelines provide examples of "good practices" and "poor practices". There is a description of one specific example which is accordingly deemed good or poor practice. We see this regulatory method

as a source for concern. This approach seems to be based on common law principles. The application of common law is based less on abstract legislation but rather on case law. In this context, a review is held whether a specific scenario can be subsumed under a legal precedent (case previously decided). In continental Europe, on the other hand, it is common practice to subsume a specific scenario under an abstract legal provision. Hence, also the competent supervisory authorities publish abstract interpretation guidelines which are not based on individual cases.

Therefore, the use of case law/examples will create considerable problems with respect of its implementation and enforcement not only in Germany but across the whole of continental Europe.

In the present case, this is further compounded by the fact that the examples only take account of single aspects which are relevant. However, the questions

- to which extent conflicts of interest may arise due to remuneration policies and practices and – provided this is the case –
- whether effective and appropriate organisational arrangements have been implemented in order to protect clients' interests

require a case-by-case assessment under due consideration of all aspects. Furthermore, such a comprehensive assessment on a case-by-case basis is necessary with respect of the principle of proportionality according to Article 22 MiFID Implementing Directive. Due to the fact that they leave important aspects (e.g. the principle of proportionality) unconsidered, the examples, on the other hand, fall short. Partly, these examples don't reflect the day-to-day-practice correctly (see in detail our specific comments concerning Annex V., paragraphs 25, 26, 32, 33, 34/35, 36, **enclosure**). This, too, argues for **"high level principles"** in this case.

Therefore, we are of the opinion that the **examples of concrete cases should be deleted**.

By way of analogy, the same applies if and when the Guidelines include so-called **program(matic) sentences/proposals** (cf. Annex V, paragraphs 21, 30) which do not allow deriving any specific requirements.

4. The Guidelines do not take account of the principle of proportionality

To date, the principle of proportionality (cf. Article 22(1) subparagraph (1) as well as (3) subparagraph (1) MiFID Implementing Directive) has not been taken into account in the draft Guidelines. Under II., paragraph 34, ESMA, however, refers quite rightly to this principle. We suggest incorporating the principle of proportionality into the Guidelines and also taking into account when finalising the Guidelines.

5. Convergence with the published ESMA Guidelines on the compliance function missing

At various points, it is worth noting that the draft Guidelines contain interpretations on which ESMA has already made specifications in its "Guidelines on certain aspects of the MiFID compliance function requirement" published in July 2012. Said specifications are also relevant with respect of the remuneration policies and practices (cf. Annex V, paragraphs 19, 21, 27, 29, 30, 31). In order to avoid duplicate guidelines or potential inconsistencies as far as content is concerned, we therefore hold the view that the envisaged Guidelines on remuneration should refrain from revisiting the aforementioned regulatory field.

Instead, an incorporation by reference to the already published Guidelines on the compliance function would be conceivable.

The other control functions (cf. Annex V, paragraphs 27, 30) concern requirements in the field of banking supervision law. At least if and when banks are concerned, the interpretation of these rules falls under the mandate of EBA. Therefore, ESMA should refrain from issuing its own Guidelines in this regard.

6. Scope of application

Concerning their scope of application, the envisaged Guidelines are very extensive.

Article 2(3) MiFID Implementing Directive already contains a **definition of "relevant person".** This is also applicable to Article 21 and Article 22 MiFID Implementing Directive meaning that it simultaneously applies to the envisaged Guidelines. Therefore, a definition of "relevant person" by ESMA (cf. I. paragraphs 8 and 10) is redundant and should be deleted (see in detail our specific comments on paragraph 14, **enclosure**). However, we recommend exempting the "tied agents" from the Guidelines' scope of application. This is due to the fact that the envisaged Guidelines are incompatible with the nature of tied agents (*Handelsvertreter)* in Germany (see in detail our specific comments on paragraph 14, **enclosure**).

Last but not least, in terms of intents and purposes also the **definition of "remuneration"** has to be limited to monetary payments or non-cash benefits which employees receive from their investment firm and thus from their employer (see in detail our specific comments on paragraphs 7 ff, **enclosure**).

II. General comments concerning labour law

- **Interference with the freedom of contract is not possible by way of interpretation**

As far as the proposed Guidelines cover requirements concerning the remuneration agreements between the investment firm and its employees (cf. also our general comments under I.2 on this matter), this is at odds with the civil law "principle of private autonomy". The contractual relationship between an investment firm and its employees is based on the employment contract. The (German) labour law is the special law of private law. The principle of private autonomy is particularly expressed in the freedom of contract, which contains, *inter alia,* the freedom to determine the content of such contracts. Limits of this contractual freedom are, *inter alia,* the protection of third parties or statutory provisions especially in the field of labour law (involving a wide variety of rules aimed at protecting employees).

Therefore, a mandate of ESMA to stipulate legally binding specifications for remuneration terms and conditions is questionable. Both, the MiFID and the MiFID Implementing Directive fail to provide such a mandate (to ESMA). According to the MiFID-provisions, variable remuneration may – where applicable – constitute a conflict of interest. Which arrangements an investment firm implements in order to protect its clients' interests in the event of such a conflict of interest remains in the responsibility of the respective investment firm. **As a consequence, ESMA cannot use its mandate to publish guidelines (i.e. for interpreting the MiFID) as a mandate to stipulate individual remuneration terms and conditions.** In so far, we also cannot comprehend, why the regulatory approach of ESMA is wider than the of CEBS/EBA, whose Guidelines on Remuneration Policies and Practices are directly applicable only to the national authorities.

Apart from this, at least under German law, **any provisions limiting the contractual freedom have to comply with the principle of legal certainty as well as the principle of proportionality**. The proposed Guidelines fail to meet both of these requirements, too (cf. also our general comments under I.3).

Last but not least, we would like to point out that any **unilateral amendment of existing contracts would not necessarily be easy**. Such a unilateral amendment would only be possible if there was an explicit legal basis for this. What is more, this legal basis would also have to meet the aforementioned requirements. Any such legal basis, however, is absent (cf. our comments under I.2).

III. Conclusion

We subscribe to ESMA's opinion that the "remuneration policies and practices" is an important supervisory issue. We also share the view that, depending on their specific design, the "remuneration policies and practices" may become a source of – perhaps even considerable – conflict of interest.

However, we feel that ESMA's view that the "remuneration policies and practices" already must protect the clients' interests is extensive and not in line with the MiFID-provisions. Rather, all organisational arrangements implemented by an investment firm to protect its clients' interests must be taken into account when answering the question whether the clients' interests are sufficiently protected.

The examples (concrete cases) which are provided (good/poor practices) are inconsistent with the continental European regulatory and interpretation approach. Additionally, in the present case, these examples fall short, because important aspects are ignored (such as the principle of proportionality). Partly, these examples don't reflect the day-to-day practice correctly.

The principle of proportionality set out under Article 22 MiFID Implementing Directive should be incorporated into the Guidelines. Furthermore, the principle of proportionality would also suggest that the clients' interests do not have to be protected first and foremost by the remuneration policies and practices; besides, it also suggests deleting the use of examples at least in the present case.

Furthermore, the MiFID does not provide any mandate to stipulate individual remuneration terms and conditions.

Please find our answers to ESMA's questions and also our detailed comments on the draft Guidelines in the **enclosure**.

We trust that our comments will be taken into consideration adequately by ESMA when finalising the Guidelines. Should there be any need for further information or any questions on our comments, please feel free to contact us.

Yours faithfully,
on behalf of the German Banking Industry Committee
National Association of German Cooperative Banks


Gerhard Hofmann Ruth Claßen

Enclosure

Answers to ESMA's questions and specific comments

Unless expressly stated otherwise, our response to ESMA's questions and our specific comments refer to "Annex V: Draft Guidelines".

Paragraph 4 - Implementation deadline

Under "Annex III Cost-benefit analysis", paragraphs 8 and 9, ESMA itself assumes that an implementation of the Guidelines will require a certain amount of time (cf. paragraph 8 "… from the time needed for existing personnel to familiarise themselves with the guidelines and to put the necessary structures in place."; furthermore, paragraph 9 "Firms may also be required to change employment contracts and bonuses may need to be renegotiated if not in line with the guidelines. …"; critical on this issue our general comments, see the cover letter). Based on the foregoing, the envisaged implementation deadline of 60 calendar days after the reporting requirement date referred to in paragraph 11 is clearly too short. In our view, the minimum implementation deadline of at least half a year is necessary. In cases where the involvement of employees or employee representatives is required, this deadline should even amount to one year.

Paragraphs 7 ff – Definition of remuneration

In our view, the definition of remuneration provided under I. Overview, paragraph 11 is very extensive. In terms of its intents and purposes, two restrictions need to be made:

1. Under the ESMA Guidelines only such monetary payments or non-cash benefits should be deemed as a remuneration which the **investment firm grants in its capacity as an employer** to its employees ("on behalf of the investment firm (employer)"; ambiguous in this respect I., paragraph 10, because it only contains the generic language "by firms"). Potentially, monetary payments or non-cash benefits received by an employee from third parties may give rise to conflicts of interest and the investment firm must implement organisational arrangements in order to prevent such conflicts of interest from adversely affecting the interests of its clients. However, such payments or benefits can hardly be subsumed under the term "remuneration". Also, the envisaged Guidelines on remuneration don't suit to this type of conflict of interest.

2. Furthermore, the term remuneration within the meaning of the ESMA Guidelines should only cover **monetary payments or non-cash benefits** (ambiguous in this respect paragraph 11, which mentioned monetary payments and benefits and also non-monetary benefits). This term should not include "non-monetary benefits". *De facto* the existence of "non-monetary benefits" is highly unlikely. Rather, the examples mentioned under paragraph 11 (health insurance, discounts, or special allowances for car or mobile phone etc.) will rather qualify as non-cash benefits and/or be irrelevant with a view to the potential conflicts of interest when providing investment and/or ancillary services (cf. health insurance, at least to the extent that it refers to statutory health insurance; allowances for car or mobile phone, at least to the extent that these allowances are not part of the remuneration but are merely necessary for the purposes of the employee's job).

The rationale behind listing "cancellations of loans to relevant persons at dismissal" as an example for remuneration is not immediately obvious to us. Under labour law, cancelling an employer loan when an employee is dismissed is an entirely usual practice. In our view, there is no relation to the issue of conflicts of interest.

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.

Answer to Q1 together with comments on the subsequent paragraphs.

Paragraph 13

First, we would like challenge the assumption that there are any policies which "deliberately" impair clients' interests.

Also the requirement, **"that clients' interests are not impaired by the remuneration policies and practices adopted by the firm in the short, medium and long term"** is problematic (emphasis added). In our view, important organisational arrangements to protect the clients' interests which are also relevant with regard to the "remuneration policies and practices" are unduly left unconsidered.

Whilst not limited to, such arrangements include the instructions to employees. Under labour law, these instructions are legally binding for employees. These instructions were issued as part of the implementation of MiFID-provisions in order to protect the clients' interests; furthermore, we would like to mention the regular and *ad-hoc* monitoring and assessment through the compliance function of each and any arrangement the investment firm has implemented in order to meet the MiFID-provisions wether they are (still) adequate and effective (to protect the clients' interests); last but not least, the first and second control through the business units and the compliance function wether the employees comply with the above mentioned instructions and other binding organisational arrangements on a case by case basis. In our view, also Q14 points into the same direction. Q14 alludes to the fact that also "specific requirements (i.e. stronger controls etc)" have to be taken into account.

In our view, this is the only interpretation which is consistent with the MiFID. The MiFID does not require preventing conflicts of interest. Instead, the MiFID acknowledges the fact that conflicts of interest may exist. The MiFID requires that adverse effects on clients' interests need to be prevented by conflicts of interest, primarily. Contrary to paragraph 13 of the draft Guidelines it is not the "remuneration policies and practices" themselves that should inherently protect the clients' interests. Instead, such protection should result in combination with other organisational arrangements (see in detail our general comments contained in the cover letter under I.2).

Paragraph 14

By way of analogy, our comments under paragraph 13 apply accordingly. In our view, "remuneration policies and practices" can – where applicable – be a conflict of interest. However, "remuneration policies and practices" themselves must not ensure (at least not single-handedly) to protect the clients' interests.

"Relevant persons" are defined in Article 2(3) of the MiFID Implementing Directive. This definition is also relevant in terms of Articles 21 and 22 MiFID Implementing Directive. Hence, this definition is also applicable to the envisaged ESMA Guidelines on remuneration policies and practices. As a consequence, ESMA should refrain from an independent definition (such as the one envisaged under I. Overview paragraphs 8 and 10). What is more, some parts of this proposed definition would also be very extensive. This is due to the fact that, for instance, it also seeks to cover employees "indirectly involved in the provision of investment services". The MiFID, on the other hand, only refers to the provision of "investment services" (cf. also Article 2(3) MiFID Implementing Directive). Under the provisions of the MiFID, there exists no "indirect provision of investment services". For the same reasons, also an inclusion of "relevant persons involved in complaints handling, claims processing, client retention and product design and development" would be too extensive (cf. paragraph 8 above, last sentence). Also Recital 25 of the MiFID implementing Directive emphasises that "[c]onflicts of interest should be regulated **only** where an investment service or ancillary service is provided by an investment firm." (emphasis added).

However, we recommend exempting the "**tied agents"** from the Guidelines' scope of application. Whilst the legal conception of "tied agents" varies from Member State to Member State, such agents are always located outside of the investment firm organisations. Hence, for instance in Germany, "tied agents" are regulated as "*Handelsvertreter"* under Article 84 of the Commercial Code (HGB). One characteristic feature of the German "tied agent" within the meaning of the German Commercial Code is their independence. In the case of absence of such independence, Article 84(2) HGB sets out that the *Handelsvertreter* shall be regarded as an employee. One feature of such independence by a *Handelsvertreter* is the fact that he bears the entrepreneurial risk. This is regularly the case, if the *Handelsvertreter* merely receives a commission for his or her services instead of a fixed remuneration. It is also necessary part of the self-employed nature of a *Handelsvertreter* that they are free to choose whether they will work for the firm or not. Hence, any fixed remuneration or remuneration component for tied agents would be incompatible with the defining characteristics of *Handelsvertreter*. The payment of a fixed remuneration or remuneration component could furthermore lead to a situation where the *Handelsvertreter* would have to be regarded as a bank employee. We feel that a potential application of the Guidelines on remuneration to tied agents would jeopardise the survival of this sales model.

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.

Answer to Q2 together with comments on paragraph 15

We would like to refer to our comments on paragraph 13. "Remuneration policies and practices" may – where applicable – be conflicts of interest. However, "remuneration policies and practices" themselves must not ensure (at least not single-handedly) to protect the clients' interests. The extent of variable remuneration and further design of the remuneration policies and practices primarily depends upon legitimate business aspects (cf. our general comments under I.1 in the cover letter). Whether the remunera-

tion policies and practices can lead to a conflict of interest and if this were to be the case, the resulting risk level for a potential detriment of clients' interests depends again on the specific design of the remuneration policies and practices.

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?

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.

Answer to Q3 and Q4 together with comments on paragraphs 16 and 17

The ratio between fixed and variable remuneration is **one aspect** to be covered by the bank's necessary internal review whether the design of the remuneration policies and practices may potentially constitute a conflict of interest. However, it is **not an absolute or, moreover, stand-alone criterion**. For instance, further aspects that are relevant are the assessment basis of the variable remuneration as well as supporting measures (e.g. the rule that the payment of the bonuses will be subject to the condition that employees have complied with the banks' internal instructions and arrangements, the investment firm has implemented in order to meet the MiFID-provisions and thus to protect their clients' interests). Last but not least, there will be a need for a **case-by-case assessment under due consideration of all aspects** before the following questions can be answered:

- If and to which extent the remuneration policies and practices give rise to a conflict of interest and – provided this is the case –
- whether effective and appropriate organisational arrangements have been implemented in order to protect the clients' interests.

Regarding the subject, that the draft Guidelines don't comply with the principle of legal certainty (see e.g. "appropriately balanced") cf. our general comments in the cover letter under II.

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.

Answer to Q5 together with comments on the subsequent paragraphs

Paragraph 18

We see the final sentence as a source for concern: Already under labour law, employees are obligated to comply with the bank's internal instructions and other binding arrangements, the investment firm has implemented in order to ensure MiFID compliance. Hence, employees will always have the duty to comply with these internal arrangements. On the other hand, under labour law, employees will exclusively have to comply with their employer's internal arrangements. The responsibility for the appropriateness and effectiveness of the banks' internal arrangements as regards MiFID compliance and the protection of clients' interests is exclusively incumbent upon the investment firms. As a consequence, the payment of the

variable part of the remuneration can be made exclusively subject to compliance with banks' internal arrangements.

The further criteria mentioned above and beyond this (e.g. fair treatment of clients) are very difficult to implement. This is due to the fact that – in objective terms – they are extremely difficult to quantify (for instance in the form of customer surveys).

Paragraph 19

Concerning the detection of possible non-compliance with banks' internal instructions or arrangements, we should like to refer to the general principles which apply here, too (cf. ESMA Guidelines on certain aspects of the MiFID compliance function requirements (ESMA/2012/388)). On the other hand, paragraph 19 requests that non-compliance can be detected "**promptly**". However, at any rate, this would require 100 percent monitoring. Such an approach would be inconsistent with the risk-based monitoring approach set out in the aforementioned ESMA Guidelines. Hence, in order to avoid potential inconsistencies, any renewed presentations covering this regulatory area should be deleted from the envisaged ESMA Guidelines on remuneration. Instead, there should be a reference to the ESMA Guidelines concerning the compliance function which have already been published. At this point, we assume that the ESMA does not intend to use the Guidelines on remuneration for an amendment of the interpretation of the requirements with regard to the compliance function.

Paragraph 20

In this context, we would like to refer to our comments under paragraph 18. Furthermore, we see no qualitative difference between paragraphs 18 and 20. Hence, this begs the question whether paragraph 20 is necessary.

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.

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.

Answer to Q6 and Q7 together with comments on paragraph 21

Here, too, we have difficulties in comprehending why – at least in terms of securities supervision law – with respect of the remuneration policies and practices other provisions (e.g. guidelines) should apply as in general (cf. also our earlier comments on paragraph 19). So far, investment firms have the organisational freedom concerning the person who takes internal decisions within the bank and how they implement them. Accordingly, the focus of the ESMA Guidelines on the compliance function is quite rightly exclusively on senior management's responsibility for the correct and proper business organisation. However, said Guidelines refrain from any specific requirements concerning the way in which this should be implemented in the individual case (cf., for instance, ibid. paragraph 12). More specifically, said Guidelines contain no requirements concerning the need for decisions or, moreover, approvals on the part of senior management. At least in terms of securities supervision law, the principle of organisational freedom

should be upheld also with respect of the remuneration practices and policies. By way of analogy, this also applies to the supervisory function. Additionally, guidelines with respect of the organisation of the supervisory function would be incompatible with company law.

Furthermore, contrary to the codified law common in continental Europe, the first and second sentences are partly modelled on the Anglo-American legal model (sentence no. 1: "… to promote effective corporate governance."; sentence no. 2: "… effective oversight in place within the firm to approve …"). These sentences do not allow deriving any specific organisational obligations and thus no specific implementing measures. Hence, such program(matic) sentences/proposals should be generally deleted.

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.

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.

Answer to Q8 and Q9 together with comments on the subsequent paragraphs.

There is no immediately obvious link between questions 8 and 9 and the draft Guidelines in Annex V. of ESMA's Consultation Paper. Apparently, these questions refer to the explanations under III. paragraphs 56 f – however, said explanations are not part of the draft Guidelines.

Concerning III. paragraph 56, we should like to point out that linking the remuneration to the sale of specific financial instruments constitutes a considerable conflict of interest. Also the link to a specific category of financial instruments may present a conflict of interest. However, the general conclusion under III., paragraph 56, that "it is unlikely that such firms could in this situation, demonstrate compliance with MiFID" is incorrect. Again, this claim fails to acknowledge that further aspects have to be taken into account when answering the question whether the clients' interests are adversely affected. Whilst not limited to, these further aspects especially include the organisational arrangements implemented by the investment firm in order to protect its clients' interests (see in detail our comments on paragraph 13). Also, Article 18(2) MiFID remains unconsidered.

The intention behind III. paragraph 57 is unclear. What is the link between "the risks that these products or services may pose" and "remuneration policies and practices"? The risk of a financial instrument or of a service is exclusively relevant with respect of compliance with the conduct of business obligations. On the other hand, for the purposes of evaluating a conflict of interest resulting from the remuneration policies and practices it is irrelevant which risk may be associated with the respective financial instruments or services. Given the fact that we are unclear about the intention behind III. paragraph 57, we are incapable of answering question 9.

Paragraph 23

This paragraph is hardly comprehensible and there its implementation is utterly unfeasible. Should paragraph 23 seek to impose specific requirements on the individual remuneration terms and conditions, then

it is worth bearing in mind that the MiFID does not contain any legal mandate for such an interference in the freedom of contract, especially not by way of interpretation (at this point, cf. also our general comments contained in the cover letter under II.).

Concerning the examples for "high risk remuneration policies and practices" listed under Annex I, we refer to our general comments in the cover letter under I.3 as well as our detailed comments on paragraph 35.

Paragraph 25

Concerning the examples listed for good practice, first, cf. our general comments set out in the cover letter under I.3.

Additionally, we would like to share the following comments on the individual examples:

The **first example** is in favour of paying out the variable part of the remuneration in several tranches over an appropriate period of time. In our view, it would be equally conceivable to make the payment of the variable remuneration subject to compliance with the banks' internal instructions and other binding arrangements. This would – where applicable – facilitate a direct payment. At the same time, however, it would also provide an opportunity for clawbacks, should it subsequently turn out that an employee has not complied with the bank's internal arrangements.

It is unclear what is meant by "long term results". The variable remuneration is in general based on the investment firm's forecast for the entire **business year** and the targets contained therein (which may have to be updated during the business year in order to accommodate, for instance, negative market trends). Already on business considerations, it makes sense to use the period of the business year (in general one year) as a mean of orientation, because investment firms will not be able to pay their employees more than they have actually earned over a given period of time. Furthermore, employees have a contractual right to timely payment of the remuneration agreed. This right also extends to the variable part of their remuneration, except non-compliance with the bank's internal arrangements were identified. Here, too, the situation of e.g. an investment advisor cannot be compared to that of a member of the board or other executives. Therefore, it would be inappropriate to transfer the banking supervision requirements applicable to the remuneration of such executives to all employees.

Concerning the **second example**, please see our comments on paragraphs 16 and 17.

Concerning the third example, please see our comments on paragraph 18. The question whether an employee may keep the variable part of their remuneration can only be answered on the basis of **legitimate** customer complaints etc.

Paragraph 26

Concerning the examples for poor practice, first, cf. our general comments in the cover letter under I.

In the **second example**, the malpractice already consists in the fact that the client has been sold a financial instrument which is unsuitable *per se*. However, this does not allow drawing any negative conclusions concerning the remuneration policies and practices.

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.

Answer to Q10

Question 10, too, seems to be divorced from the draft Guidelines in Annex V. of the ESMA Consultation Paper. Apparently, the question refers to IV., paragraph 64 (Overview), which, however, is not part of the draft Guidelines.

In our view, no specific features apply to remuneration policies and practices. There is neither a difference with regard to the mandatory risk-based monitoring whether the banks' internal arrangements were complied (first and second control) nor with regard to the question, in which cases the senior management or even the supervisory board will have to be informed of shortcomings that have been identified, nor with regard to the obligation of an timely adjustment of the organisational arrangements when shortcomings have been identified, nor with regard to the obligation of the compliance function to timely monitor and assess whether this adjustment is appropriate and effective in order to meet the MiFID-provisions (in the future). At any rate, the fact that individual investment firms fail to comply with their requirements under the MiFID should not give rise to ESMA Guidelines. Hence, we welcome the renunciation to a corresponding guideline.

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.

Answer to Q11 together with comments on paragraph 27

In our view, this paragraph has already been adequately reflected in the published ESMA Guidelines on the compliance function (ibid., for instance, paragraphs 21, 23). Hence, there are no specific features with regard to remuneration policies and practices that have to be taken into account. Therefore, ESMA should refrain from a further specification in the envisaged ESMA Guidelines on remuneration.

Should the envisaged specifications refer to other control functions than the compliance function, we would like to point out that (with the exception of securities compliance) all other control functions concern banking supervision requirements. The interpretation of these requirements falls under the mandate of the EBA (see also footnote 41 regarding paragraph 30), at least if and when these requirements are

addressed at banks. Hence, in order to avoid any inconsistencies, ESMA should refrain from issuing its own Guidelines at this regulatory area.

Additionally, we would like to point out that there is no **independent requirement** to **assess the quality of the services provided**. The task of the compliance function consists in monitoring and assessing whether the organisational arrangements implemented by the investment firm in order to comply with the MiFID requirements are (still) effective and appropriate (cf. Article 13(2) MiFID as well as Article 6 MiFID Implementing Directive). This constitutes qualitative monitoring and assessment which is also the case if and when such monitoring concerns the question whether the employees have complied with the organisational arrangements in a specific case (e.g. in the case of investment advice, whether a client has been recommended a suitable financial instrument on the basis of the information provided by him). Furthermore, already the MiFID requirements are aimed at ensuring the quality of the services. As a consequence, the wording under paragraph 27 "Such controls **should include assessing the quality of the service provided to the client"** (emphasis added) may potentially give rise to misunderstandings.

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.

Answer to Q12 together with comments on the subsequent paragraphs

Paragraph 28

In this paragraph, too, the fact is ignored that the remuneration policies and practices have to ensure the protection of clients' interests "merely" in combination with the investment firm's other organisational arrangements. Please see our corresponding comments under paragraph 13.

Concerning the fact that ESMA or the competent national supervisory authorities are not authorised to use the interpretation as a means for forcing investment firms into an adjustment of their remuneration terms and conditions agreed with their employees please cf. our general comments in the cover letter.

Paragraph 29

The involvement of the compliance function into the development of "relevant policies and procedures within the investment firm in the area of investment services, activities and ancillary services" as well as in the case of material adjustments of these policies and procedures are already covered in the ESMA Guidelines on the compliance function (cf. ibid. paragraph 40, sentence 1 and paragraph 41, sentence 1). Consequently, paragraph 29 is redundant. Instead, in order to ensure a consistent, harmonised approach, at this point there should be a reference to said Guidelines on the compliance function.

Paragraph 30

As regards the involvement of the compliance function we would like to refer to our comments on paragraph 29.

The support of the compliance function by senior management set out in sentence 2 is already completely covered by the ESMA Guidelines on the compliance function (cf. ibid. paragraph 41, last sentence and

paragraph 49, S. 1). Consequently, sentence 2 is redundant. At this point, too, there should exclusively be a reference to the Guidelines on the compliance function.

In effect, the same applies to sentence 3. If and when specifications on other control functions (other than the securities compliance) are intended, please see our respective comments on this under paragraph 27.

Paragraph 31

At this point, too, we would like to refer to the ESMA Guidelines on the compliance function (cf. ibid. paragraphs 18 f and 48). Hence, there is no need for a renewed specification in the envisaged ESMA Guidelines on remuneration policies and practices.

Paragraph 32

First, please cf. our general comments in the cover letter under I.3 concerning the examples for good practice.

Additionally, we would like to share the following comments on the individual examples:

"Customer satisfaction surveys" shortly after the completion of a sale (**cf. second example**) are just one possible approach. However, they shall and must not be "mandatory". Given the subjective assessment of clients who are unaware of the necessary legal requirements that will have to be complied with, such an approach only delivers a very limited amount of meaningful data. Hence, it is not appropriate as a general standard. What is more, depending on the point in time when such customer satisfaction surveys are undertaken, the results may feature major variations; on the whole, it is doubtful whether such an approach can be operationalised.

Concerning the **third example**, we would like to point out that the compliance function's risk-based monitoring approach is already laid down in the ESMA Guidelines on compliance function. The same holds true for the consideration of **legitimate** customer complaints and of transactions cancelled for reasons **other than exclusively goodwill** through the compliance function during its monitoring and assessment (cf. ibid. paragraphs 14 ff, 18 ff, 26, 56). The decision on any potential need for a review of the remuneration policies and practices is incumbent upon the investment firm (cf. also our earlier, general comments in the cover letter under I.).

Paragraph 33

Concerning the example for poor practice, first of all, we would like to refer to our general comments in the cover letter under I.3.

In our view, the example under paragraph 33 entirely fails to acknowledge that the variable part of the remuneration is due to the investment firms' legitimate business interests. Furthermore, it must be possible to pay employees depending on the revenues generated respectively by them for the investment firm. If all employees were to receive the same remuneration (regardless of the effort they make and of the value added created by them for the investment firm), this would be inconsistent not only with the principles of a free market economy but also with the sense of fairness of motivated staff. Provided the investment firm consistently ensures investor protection by other means (for instance through binding instruc-

tions, controls and labour law practices like informal warninge or formal warning) a focus on business targets does not necessarily create conflicts of interest.

For instance, using the investment firm's forecast for the entire **business year** and the targets therein is not an issue *per se*. In other words, such an approach does not always lead to conflicts of interest (for instance if employees are given an overall target but if it is left to their own discretion how to achieve this target). But even if the variable part of the remuneration were deemed to be a conflict of interest, this is not synonymous with short-term thinking (see in detail our earlier comments on paragraph 25, first example). Last but not least, the "remuneration policies and practices" have to interact with the other organisational arrangements made by investment firms. Together with the latter, they have to jointly ensure the protection of clients' interests (cf. also our comments under paragraph 13 for a more detailed discussion of this aspect).

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?

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.

Answer to Q13 and Q14 together with comments on the subsequent paragraphs.

Paragraph 34

Regarding the examples listed under Annex I for "high risk remuneration policies and practices" we would like to refer to our general comments contained in the cover letter under I. as well as our detailed comments under paragraph 35. In terms of the question whether already the remuneration policies and practices have to ensure that the clients' interests are protected cf. furthermore our comments on paragraph 13.

Paragraph 35

In terms of its content, this paragraph is identical with paragraph 34. Hence, one of the two paragraphs is redundant and can be deleted.

Paragraph 36, example (e)/(a)

Example (e)/(a), sentence 2 is based on the assumption that investment firms earn the same for all their products. This assumption is divorced from reality. Consequently, the differences are also reflected in the variable parts of the remuneration which are calculated on the basis of earnings. However, this does not automatically lead to a high risk that employees will recommend products which are not suitable for the client. Whether a risk exists and – provided this is the case – whether the risk is considerable, depends on further terms and conditions of the remuneration agreement, especially on the specific design of the assessment basis of the variable remuneration. Hence, for instance, the risk is virtually non-existent if the basis for calculating the variable remuneration component exclusively consists in the bank's overall business result. Another example where there may be a risk but where this risk is not a considerable one would be if employees were given a (realistic) annual overall target (which potentially would have to be

adjusted throughout the year in order to reflect adverse market trends) but where the specific achievement of this target is left to the employees' own discretion.

example a1: The fact that individual product sales (targets) contain a high potential for conflicts of interest is correct. However, this should not be confused with the issue that investment firms don't earn always the same for each product and that these differences may also be reflected in the variable part of the remuneration (cf. our comments regarding example (e)/(a)).

In our view, the rationale behind example a3 is not comprehensible. The example assumes that all products are equally suitable for clients (i.e. also under due consideration of the costs incurred by such products for the clients). Provided this is the case then it is not comprehensible why it should be a problem if the employee provides the client with a recommendation of a product which generates a higher earning for the employer.

Paragraph 36, example (f)/(b)

The assumption that a payment of variable remuneration which depends on the achievement of a "minimum sales levels" is *per se* problematic is incorrect. Also at this point, the assessment will depend on further aspects. For instance, when an employee's level of fixed remuneration is already high, i.e. the variable part of their remuneration will only be paid "on top" this should lead – where applicable – in connection with further aspects (for instance the specific design of the assessment basis of the variable part of the remuneration) to the assumption that the "minimum sales levels" will not constitute a conflict of interest.

Because the variable part of the remuneration will always depend on certain conditions, but not every variable remuneration will automatically lead to a conflict of interest (cf. also our comments on example (e)/(a)), the second sentence is incorrect ("Conditions which must be met before an incentive will be paid may influence relevant persons to sell inappropriately.").

We should like to concede that examples b1 and b2 are only justified in specific cases. One of these cases may, for instance, exist if there was a specific assessment of clients' needs and potentials.

Paragraph 36, example (g)/(c)

By way of analogy, our comments on b1 and b2 apply accordingly to example c1.