

Verena Ross
Executive Director
European Securities and Markets Authority
European Securities and Markets Authority
1030 Rue de Grenelle
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7th December 2012

Dear Verena

*Consultation paper - Guidelines on remuneration policies and practices (MiFID) –
ESMA / 2012 / 581¹*

The British Bankers' Association ("BBA") is the leading association for UK banking and financial services representing members on the full range of UK and international banking issues. It has more than 200 banking members that are active in the UK, which are headquartered in 50 countries and have operations in 180 countries worldwide. All the major banking groups in the UK are members of our association as are large international EU banks, US and Canadian banks operating in the UK and a range of other banks from the Middle East, Africa, South America and Asia, including China. In the integrated nature of banking means that our members are engaged in activities ranging widely across the financial spectrum from deposit taking and other more conventional forms of retail and commercial banking to products and services as diverse as trade and project finance, primary and secondary securities trading, insurance, investment banking and wealth management.

The BBA is pleased to respond to the consultation.

Key messages

The BBA supports the issue of guidance and alignment of remuneration policies and practices with other frameworks.

As we noted in our response to the recent ESMA consultation on sound remuneration practices under AIFMD the original intention of the Financial Stability Board (FSB) Principles on Sound Compensation Practices was to ensure an internationally coherent response to reforming remuneration in the Financial Services Sector. We supported this, and still do, as it is essential that these principles should be coordinated centrally and implemented consistently to ensure a global level playing field to allow firms to compete fairly in the global market place.

It is important that ESMA's guidelines on both AIFMD and for investment firms do not contradict CRD III requirements will not contradict each other and ESMA's guidelines do not go beyond the scope or duplicate requirements under of CRD III. For example whilst helpful, the inclusion of

¹ <http://www.esma.europa.eu/consultation/Consultation-Guidelines-remuneration-policies-and-practices-MiFID>

examples of good and bad practice goes beyond the scope of CRD III and indeed the requirements of MiFID I.

The ESMA guidelines, which in our view exceed regulatory requirements in other international markets, would be applicable globally to all EEA headquartered organisations. This means that non-EEA organisations may enjoy a competitive advantage in jurisdictions where they are not bound by such wide-ranging rules on remuneration policy. The BBA is keen to understand how ESMA intends to address this issue and would urge ESMA to be flexible in the way that the rules are applied to subsidiaries outside the EU to mitigate the potentially severe competitive impacts on European firms. A more explicit statement of proportionality, as proposed in the AIFMD guidelines, would help with this and allow recognition of remuneration requirements already applied on a group-wide basis under other financial sector legislation, such as CRD III.

Firms operating on the UK have already aligned their practices so that their remuneration policies are consistent with and promote sound and effective risk management and to avoid prudentially relevant conflicts of interest. They have also complied with the principles established by the Financial Stability Board through the requirements of the 2009 FSA Remuneration Code. As part of this code, the FSA signed off on the remuneration policy statements of UK credit institutions and investment firms in 2010 and 2011. And of course under the soon to be implemented results of the Retail Distribution Review financial advisers will no longer be able to receive commissions from product providers for recommending retail investment products to customers. Instead, they will have to charge their customers for advice.

The industry recognises that effective measures on remuneration are important. However, if these are not progressed in a practical and proportionate manner there is a risk that key personnel will either seek to relocate outside the EU, or be reluctant to move to the EU. Over time this would have an increasingly significant impact on the amount of financial services jobs, activities and revenues located in the EU. Other regions, notably North America and Asia-Pacific, would stand to gain.

Furthermore, depending on how prescriptively and conservatively the rules and guidance are implemented, the impact is likely to be felt most intensely in only a small number of larger international markets (i.e. London, Paris and Frankfurt).

Given the heavy concentration of global markets activity in these three EU Member States, the key focus of new rules should be about ensuring a level playing across the EU. High quality standards should have the flexibility to support the EU's ability to compete for global talent while ensuring that it supports effective risk management. We would urge ESMA to take the lead to ensure that this happens.

Some of our members, both British and continental-headquartered, have reported difficulties in recruiting and/or retaining employees in third countries in the past few years. Not only do the new rules make it more difficult for EU firms to execute their strategy, they make it more difficult for these banks to support their clients appropriately in key, often emerging, markets.

The fact that some third countries scope banks into their rules, which are derived from the FSB's principles, but not other financial institutions, adds to the uneven playing field.

Internal vs. external application

The draft guidelines suggest that, as with conflicts of interest policies, remuneration requirements should apply to tied agents and outsourced entities. We consider that an investment firm can only set the kinds of remuneration policies described in the guidelines for its employees. Agreements with third parties subject to commercial contractual agreements should be explicitly out of scope.

Furthermore, we would appreciate a delay in applying these remuneration requirements to tied agents. Arrangements between banks and tied agents are already subject to MiFID I requirements to address conflicts of interest and other organisational requirements and our member banks' will have contracts in place which ensure conflicts of interest requirements are met. Remuneration of tied agents, however, generally relies on commission depending on the products they distribute and applying the same remuneration requirements as those for employees would be a significant shift in current practice. As with inducements, remuneration and conflicts of interest including for tied agents is an area where MiFID II is expected to introduce major changes. We therefore consider that, like inducements, remuneration of tied agents should be outside the scope until MiFID II is finalised, on the basis that these guidelines as drafted would require a significant overhaul in a short space of time which may need to be changed again in short order to align with MiFID II.

Proportionality

Recognition through proportionality clauses of the huge variety of size and business model in firms that will be covered by the Guidelines would be helpful. We also support a flexible approach that allows firms to balance a variety of risk-adjustment techniques to achieve a remuneration model that best matches their business requirements and risk frameworks. We also welcome an approach in which local supervisors are free to respond to breaches of remuneration requirements in a way which best suits the nature of the breach and the company involved without necessarily resorting to automatic, punitive quantitative measures.

Alignment

For global firms it is likely that several sets of remuneration regulations, home and host, EU and third country, will apply. We would welcome further guidance from ESMA on how this would work in practice. Therefore, we urge ESMA to ensure a practicable solution, for example by way of colleges of supervisors as per the college of supervisors that operate under the auspices of the European Banking Authority. We would also welcome co-operation between international regulators to reduce the need to demonstrate compliance separately to each regulator in every country in which a banking group operates. Our members would also welcome the opportunity of only dealing with one, lead, regulator in the EU whichever structure is adopted.

We would also like to draw ESMA's attention to overlaps between the proposals made by the Capital Requirements Directive (CRD), Alternative Investment Fund Managers Directive (AIFMD) and Solvency II. We urge ESMA to liaise with the EBA and EIOPA to ensure that no contradictions arise.

A group approach

Many of our members will develop remuneration policies centrally and apply them on group-wide basis. So there should be no requirement to establish a Remuneration Committee at subsidiary level if there is already one at group level, although we recognise that the supervisor should always be able to discuss with local management their approach to remuneration in order to avoid creating conflicts of interest at any time.

A detailed and thorough identification process across the whole group will identify all remuneration practices to ensure they prevent conflicts of interest. This will aid the competent authority to satisfy itself with the methodology and outcomes on a group-wide basis.

Conclusion

Firms should have the autonomy to decide on the most appropriate mix of remuneration provided it supports sound risk management. Remuneration policy and practice should be consistent with risk management and the avoidance of excessive risk.

The financial services industry operates in a global and competitive environment so a global solution is needed. The failure to align practice between the EU and the rest of the world may lead to arbitrage and the loss of business as firms locate operations outside the EU, and to less regulated and/or more tax-advantageous jurisdictions.

Many firms operating in the EU have global remuneration policies that are set outside the EU. Without a co-ordinated global approach, further reform will be difficult to implement consistently and have only partial effect.

Annex 1 to our letter contains our formal response to the consultation, and further specific observations and questions arising from the proposals.

We hope that you will find our comment useful. Please contact me by way of e-mail (simon.hills@bba.org.uk) or telephone on (00 44) 20 7216 8861 should you require further information.

Yours sincerely

A handwritten signature in black ink that reads "Simon Hills". The signature is written in a cursive style with a long horizontal line underneath the name.

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Executive Director

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Annex 1

List of consultation questions

- 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 inter-ests, to the potential detriment of clients? Please also state the reasons for your answer.

We agree with this alignment. Please note that under CRD III, which was preceded by the FSA's Remuneration Code and in-house standards, non-financial metrics, which include conduct of business rules, are used to assess remuneration.

- 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.

Firms may well differentiate, but they are unlikely to stray far from a group approach as multiple rules increase costs.

- 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?

We agree that there should be a balance, but firms should retain the flexibility to design something appropriate for their business model.

- 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.

As stated above, firms should set up arrangements that are appropriate for their business models. This should be with regard to various stakeholders, including clients.

- 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.

We agree with the inclusion of non-financial metrics. Their use in the UK goes back to the 1990s.

- 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.

We agree. This aligns with practice in banking.

- 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.

We agree. This aligns with practice in banking.

- 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.

Do we agree?

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Do we agree?

- 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.

We agree.

- 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.

We agree.

- 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.

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We agree.

- 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.

One such control is the “client fact find”, whereby relationship managers ask clients about their circumstances, plans and risk appetite, and, in reply, provides details of investments that may be suitable. These are available for checks by control functions.

The British Bankers' Association ("BBA") is the leading trade association for the UK banking and financial services sector. We represent over 230 banking members, which are headquartered in 60 countries and have operations in 180 countries worldwide. These member banks collectively provide the full range of banking and financial services, and make up the world's largest international banking centre.