

Paris, December 7 2012.

Response of the French Banking Federation (FBF) to the Consultation of ESMA on Guidelines on remuneration policies and practices

The Fédération Bancaire Française (the French Banking Federation, hereinafter FBF) is the professional organisation that represents the interests of the banking sector in France. It comprises all of the credit establishments registered as banks and doing business in France, i.e. more than 430 commercial and cooperative banks. FBF member banks have 400,000 employees, nearly 39,000 branches, 72 million current accounts and 16.4 billion payment transactions processed every year.

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Please note that our official response is the French version, this English translation is provided for your convenience and is non-binding.

General comments

The FBF welcomes the ESMA's consultation on its draft Guidelines on remuneration policies and practices.

As with any business, setting remuneration policy is a crucial and complex task for banks. It is crucial, because it is one of the key components of labour policy and it is complex because it must take into account a range of different and sometimes contradictory variables. Since the implementation of the MiFID, French banks have modified their policies in this area so that they best serve the interest of their customers.

In France, banks and customers build long-term relationships covering a wide array of needs. In the banking sector, as in other business sectors, French consumers prefer a single consumer representative who is able to provide solutions to a number of different needs under the same roof. Taking into account customers' concerns and interests is critical to the success of this long-term relationship. This can be seen in the high level of customer satisfaction with banks in France (81% have a favourable image) and their customer representative (73% are satisfied)¹.

We share the opinion that not all variable remuneration is a *de facto* source of conflict of interest, as can attest the best practices published by the ESMA. It is one of the factors that can help boost quality customer care in the daily relationship between the employees and the customers. As a result, variable remuneration can be an effective tool for ensuring quality customer service and putting customer satisfaction at the heart of retail banking management.

However, we would like to call your attention to the risks of skewing competition if the rules and practices on remuneration differ depending on whether the affected persons are investment service providers or not, even when their activities are similar. For a given client category, we are favourable to an indiscriminate application of the remuneration policy regardless of the type of employee (investment service provider or not) or type of transaction on a financial instrument.

¹ IFOP poll on the image of banks - 2012

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.

French banks have indeed changed their remuneration policies when the MiFID went into effect. In accordance with Article 13(2) of the MiFID, they set up policies that guarantee compliance with their obligations in terms of conflicts of interest management.

In retail banking, banking advisors' variable remuneration is awarded in addition to their fixed salary. The variable part is determined using a host of criteria set by their management. In addition to sales performance, qualitative aspects have been optimized (e.g. quality of advice and sales, compliance with internal rules and procedures, behavioural criteria regarding the customer relationship, etc.). The way in which variable pay is calculated has also changed (no direct relation between products sold and bonuses, lack of automatic indexing, etc.). The payment of variable remuneration may be deferred in order to ensure that the product that was sold does in fact meet the customer's needs and, where applicable, banks may not award variable 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.

We have a concern about the implied scope of the term "methods of distribution". Paragraph 44 contains an example with the nature of the service (advised or non-advised) and the channel used (face-to-face or through telecommunications). We believe that the nature of the service is a factor that should indeed be included in shaping remuneration policy; however, we feel that making the distinction between channels is irrelevant.

The scope of the AEMF guidelines needs to be specified, particularly:

- to whom do they actually apply? The relationship with the retail customer (which is not defined) can range from a customer representative in a branch to an investment banking manager;
- to what activities do they apply? We believe that these guidelines should only target employees who are in direct contact with customers;
- to what products do they apply? For example, some regulated products cannot cause a conflict of interest due to their inherent structure;
- regarding distribution channels, we do not really see why using one channel versus another could generate a conflict of interest.

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?

This principle has already been addressed for some employees by Directive 2010/76/EU dated 24 November 2010, also known as CRD III. To avoid having texts that contradict one another, we believe it is critical to clarify which employees are subject to the CRD (employees whose work has a significant influence on the company's risk profile) and which are subject to the MiFID.

We feel that the relationship between fixed and variable remuneration should not be such that it encourages decisions that are not in the best interest of the customer. However, it should be left to the banks discretion to set the appropriate fixed and variable components breakdown, given that these ratios may vary according to the job. In its guidelines published

in December 2010, the CEBS recognised this principle, in the following terms, “Because situations vary enormously, it is not possible to decree one optimal relationship between fixed and variable components of remuneration”.

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.

In response to the global financial crisis, international and European regulatory authorities took steps in 2009-2010 to control the remuneration of risk-taking employees who, because of their sizeable variable remuneration, could be encouraged to take, in some cases, inappropriate risks affecting the bank. Thus, in accordance with CRD III in the EEA, a significant part of this variable remuneration is deferred over a period of at least three years and contingent on achieving minimal performance criteria and penalty clauses, whereby the deferred variable remuneration is not paid under certain circumstances (e.g. when the bank views behaviour as being non-compliant). For these employees, the majority of whom are concentrated in investment banking, their variable remuneration as a percentage of their overall pay was significantly higher than the amounts considered in retail banking. We have observed that the breakdown of fixed and variable remuneration can, in some cases, lead to a substantial increase in fixed salary. We believe that remuneration is not the only tool that can be used to bring about behavioural changes.

Overbalancing the fixed part could strip banks of the flexibility they need to considerably reduce operating costs when they encounter financial difficulties. French regulations state (CRBF rule no. 97-02, article 31-3) that “*in order to control risk, companies must be able to reduce variable remuneration significantly during year(s) when losses occur*”.

French banks’ current remuneration structure, including the part of overall remuneration accounted for by variable pay, seems appropriate and allows banks to recognise and compensate employees who work in the best interest of customers.

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.

Employee evaluations are a comprehensive exercise that must include many objective criteria for analysing behaviour, particularly with regard to customer relations and also compliance with internal rules. We understand that the criteria cited in the question are not exhaustive examples. The company must remain free to set other criteria.

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.

The management body in its supervisory function must approve the principles behind remuneration policy in collaboration with, depending on the size of the company and its structure, appropriate functions within the company and the remuneration committee, if there is one.

These principles must be defined by the HR Department. The Compliance function should then provide their view on the principles. Thereafter, senior management presents them to the remuneration committee and to the management body that approves them before implementation.

Given the different structures involved, and in compliance with the proportionality principle, each establishment must be given the flexibility of deciding which body should approve its rules and procedures.

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.

The rules and procedures on remuneration are approved by the management body, while senior management is responsible for implementing them. The management body in its supervisory function and senior management are informed in the event of a significant anomaly. They might need to adjust these policies and/or the way they are implemented if they lead to excessive risk taking.

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.

The organisational measures adopted for the launch of new products should indeed comply with the remuneration policy and must not create a conflict of interest.

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.

Please refer to our answer to question 8.

Yes, the variable remuneration policy associated with a new product must be an integral part of the overall remuneration policy.

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.

Yes, the existing analysis systems, which analyse the quality of sales in particular, must identify practices that are contrary to the defined remuneration policy.

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.

Yes, Compliance must participate in the validation of the remuneration policy principles and can be consulted in the event of an anomaly. Each bank advisor's remuneration is individually monitored by the audit, internal control and/or the general inspection teams. As indicated in question 5, during employee evaluations, the quality of customer service is one of the employee performance evaluation criteria that is used to determine whether or not variable remuneration is paid. In addition, the audit and general inspection teams carry out checks regarding the way in which these activities are conducted, focusing specifically on evaluating compliance with internal regulations.

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.

Yes, we think it is quite natural for the Compliance Department to be involved in preparing a new remuneration policy or practice, in order to verify that a conflict of interest is not being generated.

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?

Paragraph 2a mentions the concept of product category. We believe that this idea of category, as long as it is correctly defined, meets the rules laid out in the MiFID. In fact, if the variable portion of remuneration is based on a product category that is correctly defined, the fact that variable remuneration is paid would not jeopardise the interest of the client. Each category must include products with characteristics that are sufficiently varied so as to meet all client needs and would be treated in the same way with regards to variable remuneration.

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.

See our answer to question 13.