



Association of British Insurers

Guidelines on remuneration policies and procedures (MiFID)

ABI response to ESMA's consultation on guidelines on aspects of the MiFID remuneration requirements

Introduction

The ABI is the voice of the UK's insurance, investment and long-term savings industry. It has over 300 members, which together account for around 90% of premiums in the UK domestic market. The UK insurance industry is the third largest in the world and the largest in Europe. Employing more than 300,000 people in the UK alone, it is an important contributor to the UK economy and manages investments of £1.5 trillion, over 20% of the UK's total net worth.

General Comments

ABI welcomes the opportunity to respond to ESMA's consultation on guidelines on aspects of the remuneration policies and procedures in MiFID. It is worth noting that MiFID (as well as the Insurance Mediation Directive) is currently under review and the rules may change.

We support ESMA's vision to address conflicts of interest, while also agreeing that not all incentive schemes are inherently wrong or a cause of mis-selling.

All firms in all markets, not just financial services markets, need to be able to market and distribute their products and use fair means to encourage consumers to buy them. This includes the ability to remunerate their employees for their role in this process, including setting fixed and variable remunerations. Different firms operate a variety of incentive schemes and these schemes should remain acceptable, provided that the risks are effectively managed. The good practice examples given in the guidance will help firms to demonstrate compliance to the rules.

However, the guidelines seem to presuppose that firms in scope of the rules would tend to be large firms with numerous departments (such as sales function; a compliance function; senior management) and a clear and definitive separation of responsibility between these different departments. In reality however, many financial services are small or medium sized firms (in some cases run by one self-employed individual) and the guidelines need to allow proportionality for these firms.

In the UK, conflicts of interest in relation to MiFID products will be managed by a ban on commission payments for advised sales. This is one of the rules following the Retail Distribution Review (RDR) and will come into effect on 31st December 2012. It is important that both MiFID and the Insurance Mediation Directive (IMD) allow for national regulators to have flexibility so that they do not cut across existing member state initiatives of this type.

In addition, the FSA has already investigated the risks to consumers from financial incentives and steps have been taken by UK firms to mitigate the risk of mis-selling due to financial incentives. A number of ABI member insurance firms have made/are making alterations to their incentive schemes to address the risk of poor consumer outcomes.

For example, one ABI member firm removed an incentive scheme entirely upon review and in light of the FSA guidance. It was felt that the scheme could potentially result in poor consumer outcomes, and although a monitoring process was in place, it was discontinued.

The guidance proposes that the same remuneration basis/calculations be offered for all products. Differences between products should be acknowledged when designing and assessing remuneration policies. Variable remuneration calculations will sometimes reflect these differences and not be identical as this may lead to poor consumer outcomes. However, variable remuneration for sales of substitutable products should usually be calculated in the same manner.

The transitional period is quite short given the changes that some member states and firms may need.

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.

We agree. This is a key issue and firms need to identify and manage the risks of conflicts of interest associated with financial incentive schemes. We believe that financial incentive schemes can be acceptable, provided that the risks are effectively managed and there are controls in place to identify high risk areas and that these risks are mitigated. However, many financial services firms are small and medium sized enterprises, particularly customer-facing firms, which are primarily involved in the sale of financial products, and these guidelines must not lead to an onerous regulatory burden for small firms.

In our view, national regulators are best placed to assess proportionality, since they will already be closely monitoring the risk management approach in the firms they supervise. They will also be better placed to take account of the extensive variation in legal forms and incorporation structures and, importantly, in corporate governance regimes and practices.

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 agree. In the UK, the FSA has many rules and high level principles already in place which are designed to mitigate the risk of poor consumer outcomes by managing conflicts of interest. The Systems and Controls (SYSC) rulebook is clear and gives strong indications to senior management about their responsibilities in this area. The introduction of the RDR from 31st December 2012 will see a ban on commission for advised sales of retail investment products. In addition, there are a number of existing rules around suitability of advice, for delivery of non-advised sales and also guiding high level principles governing behaviour of senior management.

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 the approach to ensuring that the fixed and variable components of the total remuneration should be appropriately balanced and flexible. Firms need to be able to use their judgement to determine a balanced approach that fits their business models and target markets.

Again, national regulators are best placed to monitor the risk management approach in the firms they supervise and (as mentioned above) have substantial rules already in place to address this risk.

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.

We agree, although we believe that this would be covered under MiFID's best interest rule (article 21) - *When providing investment services to professional clients and retail clients, a firm must act honestly, fairly and professionally in accordance with the best interests of its client.* This is a high level principle and this should govern decisions in relation to a firm's fixed and variable remuneration and be reflected in a firm's controls and governance. We also believe that the approach to remuneration should be flexible.

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.

This is a sensible suggestion. ABI member firms already incorporate adherence to compliance as a criteria to earn incentives. For example, one firm includes weighted (to compliance) scores where a compliance failure results in complete clawback of incentive already paid and random monitoring by non-incentivised team managers. In addition this can include 'Qualitative measures' rather than purely compliance. This adds to the TCF / good customer service rather than purely rules-based compliance.

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 broadly agree, however it is worth noting that small businesses may not have separate supervisory/senior management functions which are separate from the compliance function and this should to be reflected in the guidelines. These businesses are usually customer-facing firms, which are primarily involved in the sale of financial services products.

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.

Most UK insurers have a remuneration committee (usually including senior HR and Finance management) in their firms, to design and review the schemes and take them to the Board and/or management to review and approve. However, this should be proportionate to the size of the firm.

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.

We are broadly supportive of this proposal, in that firms should take responsibility for assessing and managing the risks associated with their products. This should be supervised by national regulators, as they will be already closely monitoring the risk management approach in the firms they supervise.

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.

Remuneration practices and policies should always be well documented and we agree with this proposal.

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 and this is already practised in the UK. Firms in the UK are obliged to review appropriate management information to identify any areas where customer are potentially being treated unfairly. This may relate to activity or customer contact before, during or after the point of sale; service experiences; staff; trends and predictions etc. Management Information is not just numbers. Quantitative data is valuable to any business, but commentary and analysis MI are also important to provide a comprehensive and balanced view to decision makers within a firm. All information relevant to a firm, from whatever source, can be described as MI. Many of the guidelines outlined in this consultation are already embedded in the UK through the FSA's Treating Customers Fairly (TCF) initiative.

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.

While we agree that effective systems and controls should be in place to ensure compliance with the conflicts of interest and conduct of business requirements, it needs to be noted that not all financial services firms are large, corporate entities as set out in the paper and the proposals should ensure that the rules are implemented proportionally. In our view, national regulators are best placed to assess proportionality, since they will be already closely monitoring the risk management approach in the firms they supervise. They will also be better placed to take account of the extensive variation in legal forms and incorporation structures of firms and, importantly, in corporate governance regimes 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.

Again, proportionality is a key issue here. In many small firms, there may not be a separate compliance function and the compliance will be overseen by a director who is responsible for this area. The guidance should be clear that it relates to all financial services firms, not just large firms with separate departments for different functions.

ABI
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