



## ADVICE TO ESMA

### **SMSG advice to ESMA on its Consultation Paper on Guidelines on sound remuneration policies under the UCITS Directive and AIFMD**

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#### **I. Executive summary**

The objective of this paper is to provide high level advice to ESMA on its Consultation Paper titled “Guidelines on sound remuneration policies under the UCITS Directive”, launched July 23, 2015 and as per ESMA’s request to the SMSG dated August 11 2015.

The SMSG very much appreciates the opportunity to comment on this consultation paper. While the areas specifically addressed by the consultation paper as well as the approach followed and reasoning applied by ESMA in the development of the Guidelines are largely uncontroversial to the SMSG, the SMSG would still, and in line with its mandate to offer high level advice to ESMA, like to take this opportunity to express its strong support for the approach taken by ESMA on the matter of proportionality. This approach, which is in line with that taken by ESMA on the AIFMD Remuneration Guidelines, allows for the disapplication of certain requirements of these draft Guidelines on an exceptional basis and taking into account specific facts.

The SMSG believes it to be critical to ensure, that where sub-segments of industries as diverse as the UCITS or AIFM already have in place proven arrangements which have been negotiated and agreed with investors and/or which achieve the alignment of interest between investors and managers and their identified staff, which is the purpose of these guidelines, such fund managers should not be deprived of the possibility to disapply, on a case by case basis, certain of the requirements.

The notion of proportionality is inherent in European Union law and lies at the heart of EU governance and policy-making. A key element of sound regulation, it allows disapplication and thus “neutralization”, on an exceptional basis and subject to a case-by-case assessment, of certain requirements of the guidelines, where what is intended to be achieved by the regulation can be sufficiently achieved through the workings of the business model in question. This is especially important where a piece of regulation encompasses many different sub-sets of funds and managers with quite different business models, risk-profiles and negotiated structures like those regulated under the UCITS and/or AIFM Directives.

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#### **II. Background**

1. Article 14a(4) of the UCITS Directive provides that ESMA shall issue guidelines addressed to competent authorities or financial market participants concerning the application of the Remuneration principles set out under Article 14b of the UCITS Directive (“UCITS V Remuneration Guidelines”).

2. Article 14a(4) of the UCITS V Directive sets out the following requirements:

- ESMA shall take into account the principles of sound remuneration policies set out in Recommendation 2009/384/EC (“Recommendation”);
- ESMA shall take into account proportionality “*the size of the management company and the size of the UCITS that [the relevant persons] manage, their internal organization, and the nature, scope and complexity of their activities*”); and
- ESMA shall co-operate closely with EBA.

### III. ESMA’s working method

3. Both the above mentioned requirements and the UCITS V remuneration principles themselves (i.e the principles under Article 14b of the UCITS Directive) broadly reflect the provisions on remuneration under the AIFMD. For this reason ESMA decided to take the Guidelines on sound remuneration policies under the AIFMD (“AIFMD Remuneration Guidelines”) as a starting point for developing the UCITS V Remuneration Guidelines and depart from them only if and when strictly necessary.
4. This is in line with and justified by the approach envisaged by the co-legislators according to the Level 1 text. Indeed, recital 9 of the UCITS V Directive states that “*ESMA’s guidelines on remuneration policies and practices should where appropriate, be aligned, to the extent possible, with those funds regulated under Directive 2011/61/EU of the European Parliament and of the Council*”.
5. Therefore, when developing the proposed draft guidelines, ESMA started from the text of the AIFMD Remuneration Guidelines and adapted it to the specificities of the UCITS framework, also taking into account the differences between the AIFMD and UCITS V Level 1 texts. ESMA has further also described the main areas of difference in its CP.
6. Given that the provisions of the UCITS V Directive require close co-operation with EBA as regards the UCITS Remuneration Guidelines, in developing the present consultation paper, ESMA also considered the provisions of the EBA consultation paper published on 4 March 2015 (EBA/CP/2015/03) (“EBA CP”).

### IV. Matter of Proportionality (Question 1 of ESMA CP)

7. As stated above, recital 9 of the UCITS Directive states that ESMA’s UCITS Remuneration Guidelines should, where appropriate, be aligned, to the extent possible, with the AIFMD Remuneration Guidelines. With respect to proportionality, the AIFMD Remuneration Guidelines permit the disapplication or “neutralization” of certain specific remuneration requirements under specific circumstances and conditions. In the interest of ensuing consistency between the UCITS Remuneration Guidelines and the AIFMD Remuneration Guidelines, ESMA therefore considers it appropriate to make provisions for a similar approach to disapplication in the draft guidelines.
8. In reaching this conclusion, ESMA, also took into account the reading of the CRD IV provisions recently followed by EBA. While the EBA CP does not foresee the possibility to disapply any of the

remuneration principles under the CRD IV, ESMA concludes that the reading followed by EBA in the context of CRD relates to a different sector of the financial services industry and that the diverse nature of the UCITS sector could justify a different approach to proportionality.

9. The SMSG strongly supports this view taken by ESMA, which is in line with the approach taken on the AIFMD Remuneration Guidelines and which allows for disapplication of certain requirements on an exceptional basis and taking account specific facts. The SMSG believes this to be the right approach.
10. The notion of proportionality is inherent in European Union law (Article 5 of the Treaty on European Union). The need for proportionality and the possible neutralisation or disapplication of certain principles has consistently also been put forward in the European financial regulation (UCITS and AIFM Directives).
11. Where the intended effect of the legislation – alignment of interest between investors, managers and their identified staff – is already achieved via established and proven business models, an alternative that seeks to impose “one size fits all” type of arrangements (for e.g. deferral, payment in units and risk adjustments which were designed for other industries or sub-segments thereof), is neither necessary, nor effective, nor proportionate to attain the legislation’s intended purpose.
12. The latter approach – as descending from the EBA’s preliminary views around proportionality as expressed in the EBA CP – would not only lead to significant additional costs, but more importantly it would introduce inconsistency and instability in the European area, as all regulation proposed and implemented over the last five years within the EU and its Member States has been done in compliance with the proportionality principle as we all know it. It would further run the risk of breaking proven models and distorting competition for EU-based managers fund raising on global markets, like for example private equity and venture capital managers. Especially the smaller ones would be negatively affected (e.g. in terms of employment and competitiveness) and this at a time when, under e.g. the Capital Markets Union discussions, emphasis is made on the financing of SMEs.
13. Further, the neutralization envisaged by ESMA in its AIFMD remuneration guidelines does not amount to a general waiver from the remuneration requirements and neutralization is never automatically triggered on the basis of these guidelines alone. AIFMs are always required to perform an assessment for each of the different remuneration requirements that may be disappplied and determine whether proportionality allows them to dis-apply in part or in whole any or all of these individual requirements.
14. While it could possibly be argued that as the banking services industry is a more homogeneous one than either of the UCITS or AIFM industries, and that the EBA approach therefore could be seen as justified in that light, the SMSG would still like to reiterate that proportionality is inherent in all EU law and that sound regulatory approaches help to ensure diversity and efficiency of markets and thus also global competitiveness. While proportionality is of outmost importance for the global competitiveness of heterogeneous industries like the UCITS and AIFM, also the European banking services industry has had a long regulatory tradition building on the proportionality principle, i.e. subject to size of regulated entity as well as any fund being managed, the internal organization and the nature, scope and complexity of the activities undertaken.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

Adopted on 30 October 2015

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Chair  
Securities and Markets Stakeholder Group