



ADVICE TO ESMA

Consultation Paper on Guidelines on certain aspects of the MiFID II remuneration requirements.

I. Executive summary

Overall, the SMSG is positive towards these guidelines. The SMSG has two general remarks, however. First, an overview of existing policies and practices would have been very useful. As there is no such overview, it is not clear to what extent these guidelines are a response to shortcomings encountered in existing policies and practices. This makes it difficult to assess the relevance of the guidelines. Second, the SMSG advises ESMA to ensure that there is adequate coherence and consistency between its proposed guidelines and the EBA guidelines on remuneration, published in July 2021.

Apart from this, the SMSG has a number of specific concerns.

First of all, some of the examples may have undesirable side effects. Is linking deferred variable remuneration of investment advice to the performance of the investment really an example of good practices? A side effect could be that the risk attitude of the advisor impacts on the suitability assessment. Also, there may be practical problems. For example: the investment horizon may be too long for deferred remuneration. Finally, advice in good faith does not mean that you can predict the future. In respect of the examples of bad practices, some of them are so bad that one wonders whether they still exist.

The SMSG also warns against intruding into labour legislation, which remains primarily a national competency under the Treaty on the Functioning of the European Union. Legal conflicts may arise in this respect for the financial institutions implementing the guidelines. For this reason, the SMSG suggests, amongst other things, to incorporate a general statement with wording identical to recital 69 of CRD IV into the guidelines.

The SMSG also cautions against unduly restricting the possibility for manufacturers to include independent advisors in their network. For this reason, it suggests additional clarifications on whether and to what extent independent advisors are in scope of these guidelines. Also, the SMSG warns not to consider multi-level distribution as a bad thing per se.

On the issues with regard to career progression, periodic reviews and event-based reviews, the SMSG is generally satisfied with the high-level, principle-based approach taken by ESMA. The proposals as they are, are sufficient. The SMSG warns against more micro-regulation.

I. General remarks

1. Before answering the different questions, the SMSG wants to make a general remark. We have a very fragmented picture when it comes to remuneration rules, with a large number of rules in financial and company laws as well as self-regulation/codes. The 2020 Common Supervisory Action on MIFID II suitability requirements does not refer to remuneration issues. Although the Consultation states that ESMA aims to “take into account the results of supervisory activities conducted by national competent authorities (NCAs) on the implementation of the remuneration requirements”, these findings are not described in the consulted proposals. This makes it difficult to assess them. It is not clear whether the new guidelines are proposed as a remedy for short-comings that were encountered, whether there are short-comings that are not addressed in these guidelines or whether certain guidelines are merely ‘desk-based’. It would thus be important to get an overview of the results of the supervisory activities conducted by NCAs, and then find a way to “streamline” rules in this area.
2. We also note that the EBA published guidelines on remuneration in July 2021 and that the ESAs should ensure that there is adequate coherence and consistency between the two frameworks.
3. The SMSG agrees with the general structure of the guidelines, i.e. (i) design of remuneration policies and practices; (ii) governance; (iii) control. All three are important and reinforce one another. It is good that ESMA highlights all three of them.
4. While the SMSG is generally positive towards these guidelines, it warns against regulating in more detail in order to avoid micro-regulating. In this respect, regulation of competitors from outside the EU (UK) should also be taken into account. In this respect, it would be useful to have more information on the extent to which the guidelines are a response to shortcomings and deficiencies that were encountered, for example, in NCA assessments.

II. Question 1: Do you agree that career progression is likely to have an impact on fixed remuneration and that, consequently, firms should define appropriate criteria to align the interests of the relevant persons or the firms and that of the clients in respect of all types of remuneration (not just in respect of variable remuneration)? Please also state the reasons for your answer.

III. Question 2: Do you agree with the suggested approach on career progression? Please also state the reasons for your answer?

5. The SMSG agrees that career progression is likely to have a positive effect on remuneration. It also agrees that higher fixed remuneration should not be used to circumvent guidelines on variable remuneration (for example: people being promoted merely because of high sales volumes, when insufficient care was given to suitability). Nevertheless, the SMSG also has some questions. Is this guideline a response to malpractices or a desk-based proposal?
6. Is the SMSG also has a proportionality concern. Is this guideline merely established as a general principle that should be controlled sample-wise, for example by internal audit? Or does it mean that all promotions should be properly motivated and archived, for example for possible control by the NCA? In this respect, the SMSG refers to its above advice not to go too far in regulating and to avoid micro-regulation.

IV. Question 3: Do you agree that, to align the interests of relevant persons or the firms with the interests of clients on a long-term basis, firms should consider the possibility to adjust remuneration previously awarded through the use of ex-post adjustment criteria in their remuneration policies and practices (such as clawbacks and malus)? Please also state the reasons for your answer.

V. Question 4: Do you agree with the suggested approach on ex-post adjustment criteria? Please also state the reasons for your answer.

7. In general terms, the SMSG believes in the usefulness of claw-backs, deferred payments and ex post adjustments. For this reason, it agrees that these are no longer cited as examples of good practices but as guidelines. Nevertheless, it also expresses three concerns:

- a. The proposals, as they are formulated right now, extend the principle of claw-backs, deferred payments and ex post adjustment well beyond key identified staff and senior management, towards all layers of employees. This risks bringing the guidelines into conflict with national labour legislation. Also, this requires introducing deferral of variable remuneration to a broad range of staff, to make sure that there is something to claw back on. The alternative would be clawing back on money already spent or on savings of a lower income category. Notwithstanding its remarks, the SMSG believes that it is important that breaches are not condoned and that companies should do what is necessary to prevent this, irrespective of the category of staff.
- b. Remuneration issues are often covered by labour legislation which remains in many respects a competency of the member-states. CRD IV anticipates potential conflicts through recital 69: "The provisions on remuneration should be without prejudice to the full exercise of fundamental rights guaranteed by Article 153(5) TFEU, general principles of national contract and labour law, Union and national law regarding shareholders' rights and involvement and the general responsibilities of the management bodies of the institution concerned, and the rights, where applicable, of the social partners to conclude and enforce collective agreements, in accordance with national law and customs". The SMSG suggests that identical wording be included in the guidelines.
- c. The guidelines include examples of good and bad practices. While the examples of bad practices are useful and clearly indicate the concerns of ESMA, the SMSG is concerned about side-effects of one of the 'good' examples. Guideline 1, point 37 c and d suggest to link deferred variable remuneration to the return of the products that were sold over an appropriate time-frame. Two problems arise here:
 - i. There is a disturbing potential side-effect. Imagine an investment advisor who is risk-averse and wants to avoid potential risks for his/her variable remuneration. In such a case, the advisor has an incentive to advise low-risk, low-volatility products, even if the investor has a preference for higher risk products. The reverse can also occur. A self-confident advisor wants to earn some extra income and steers the investor towards riskier investments. In other words, there is a risk that suitability for the advisor, not suitability for the investor determines the advice;
 - ii. There could be a practical problem as well. Some investment products have recommended holding periods that go well beyond the time span over which deferred payments are practically feasible. Recommended holding periods of equity funds would typically be longer than 5 years; and so would often be the time to maturity for structured funds. However, to what extent does deference of payments remain possible and effective over time spans longer than 5 years?
 - iii. the sales person's responsibility is to provide appropriate advice adapted to a client's profile at a given point in time, not to accurately forecast future developments. To draw a parallel: an honest umbrella salesman sells a good quality product at a fair price, based on the clients expressed needs. He is not responsible or accountable for future rainfall.

- iv. For sales personnel who don't provide continuous advice (in open architecture, or where the establishment doesn't host the client account), the appreciation of the product's performance in the investment portfolio can be very challenging;

VI. Question 5: Do you agree with the added focus and suggested approach on the remuneration policies and practices for control functions and members of the management body or senior management? Please also state the reasons for your answer.

- 8. The SMSG is of the opinion that sound governance is very important for control functions and in particular that remuneration of the control functions should be independent of quantitative commercial performance of those they are to control;

VII. Question 6: Do you believe that guideline 1 should be further amended and/or supplemented? Please also state the reasons for your answer.

- 9. The SMSG's views are covered by the remarks made above.

VIII. Question 7: Do you agree that the remuneration policy should not only be reviewed on a periodic basis but also upon the occurrence of certain ad hoc events as described in new general guideline 2? Please also state the reasons for your answer.

- 10. Whether or not the remuneration policy should be reviewed after the occurrence of specific events, is linked to the frequency of the periodic reviews. In case of frequent periodic reviews, these events could be covered in the scheduled reviews. However, the SMSG does not believe in the usefulness of a too high periodicity of review. An annual review for example would be too often. In order for the remuneration policy to be effective, stability is also needed. As such, a lower periodicity of review could be compensated by a review after the occurrence of specific events. For example: if an internal audit, or a check by the NCA, concludes that there are deficiencies in the remuneration policies, it would be good that these are remedied;

- 11. Guideline 2, point 27, mentions some examples (changes to the business activities or structure of the firm, if the remuneration policy does not operate as intended or if there is a residual risk of detriment to the firm's clients), the occurrence of which should trigger a review. The SMSG considers this high-level overview to be useful and sufficient.

- 12. It is likely that not only financial institutions, but also national supervisory authorities are on a learning curve. For this reason, the SMSG proposes that the implementation of this legislation should be high on the agenda for regulatory convergence. Also, it suggests that questions by financial institutions should be primarily answered through ESMA Q&A, rather than bilaterally with national competent authorities.

IX. Question 8: Do you agree that the persons involved in the design, monitoring and review of the remuneration policies and practices should have access to all relevant documents and information to understand the background to and decisions that led to such remuneration policies and procedures? Please also state the reasons for your answer.

X. Question 9: Do you believe that guideline 2 should be further amended and/or supplemented? Please also state the reasons for your answer.

- 13. The SMSG considers it to be a necessity that persons involved in design, monitoring and review of the remuneration policies and practices have access to all relevant documents and information but wonders whether this is not already so. In this respect, the SMSG repeats its remark above: it would be good to know whether these guidelines are a response to shortcomings and deficiencies that were encountered in practice.

14.No other remarks with regard to guideline 2.

- XI. Question 10: Do you agree with the amendments made to guideline 3? Please also state the reasons for your answer?**
- XII. Question 11: Do you believe that guideline 3 should be further amended and/or supplemented? Please also state the reasons for your answer?**
- XIII. Question 12: Do you agree with the deletion of Section V.III. of the 2013 guidelines? Please also state the reasons for your answer?**

15.The guidelines should not be misinterpreted as establishing disproportional controlling responsibilities of manufacturers on independent distributors or as unduly restricting the possibility of these manufacturers to include these distributors in their distribution networks, because if so, that would discourage the use of independent distributors. Generally speaking, point 49 of guideline 3, is formulated in a well-balanced way (including the sentence: “Where a firm is seeking to use another firm for the provision of services it should check that the other firm’s remuneration policies and practices follow an approach consistent with these guidelines.”). Nevertheless, the SMSG would like to voice a concern here: independent advisors that work on their own, work outside the context of a financial institution. As such, there would not be a compliance department, with controlling responsibilities or a board that sets remuneration practices. It cannot be the purpose of these guidelines to increase the overhead on these independent distributors by forcing them into a structure that is needed to comply with these guidelines to allow manufacturers who use their services to comply at their turn with the guidelines. For this reason, the SMSG suggests that ESMA clarifies if and to what extent these guidelines apply to independent advisors.

16.The SMSG recognizes that certain examples of multi-level sales networks can be problematic, as highlighted in point 52.d. However, the SMSG cautions that the guidelines should not also presuppose that the constitution of a multi-level sales network is per se a poor practice. Such networks, in parallel to the in-house distribution, which they complement, can reach those retail clients which prefer to rely on individual investment advisors for their product selection. The SMSG, therefore, recommends that ESMA should develop further best practices with respect to the setting-up of such distribution schemes, the prior vetting of the network participants by the regulated entities that create and or operate them (with KYC/KYD questionnaires and an extended due diligence applied to distributors and sub-distributors) and the signing of distribution agreements setting the respective responsibilities of each participant.

17.No specific comment on question 12.

- XIV. Question 13: Do you agree with the arguments set out in the cost-benefit analysis in Annex IV? Do you think that other items should be factored into the cost-benefit analysis and if so, for what reasons?**

18.The SMSG’s assessment of costs and benefits are in line with the remarks made above:

- a. while the benefits that are mentioned seem obvious, the SMSG notes that it would have been useful to get more information on whether these guidelines are a response to shortcomings and deficiencies that were encountered in regulatory assessments (and if so, which ones) or merely a theoretical exercise. The benefits are higher to the extent that they are a response to actual shortcomings and/or deficiencies.
- b. With regard to the costs, the SMSG agrees that the cost would be lower for companies that already have in place a complete set of arrangements to comply with the MIFID principles. Nonetheless, the SMSG has some remarks with regard to the overview of costs. The focus is primarily on the initial costs for setting up and reviewing the remuneration policies (12a) as well as on the IT costs (12b). A third section should be added (12c): overhead for monitoring and controlling.

- c. Still with regard to costs, the SMSG would like to reiterate the concerns raised above. The guidelines should avoid the side-effect of increasing the overhead on independent distributors. Also, they should avoid creating potential conflicts with national labour legislation.
- d. Finally, with regard to costs, the SMSG warns for possible unintended side-effects. Some of the examples of bad practices seem to be trivial and conflicting with MIFID II provisions (art 24, 10). As such, merely citing them as example of bad practices could create the impression that they could even be considered and inspire market participants acting in bad faith. In this respect, it would have been useful to know to what extent these guidelines are a response to shortcomings and deficiencies that have been encountered.

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

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[signed]

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