POSITION PAPER

ESBG response to ESMA guidelines on certain aspects of the MiFID II remuneration requirements

ESBG (European Savings and Retail Banking Group)

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ESBG

General Comments

Employee remuneration in investment firms is rightly an important supervisory issue. In recent years, numerous regulations have been issued on this topic, aiming to ensure that consumer interests are not impaired by the design of remuneration systems. ESBG is of the opinion that there are sufficient regulatory and monitoring requirements for remuneration systems. Member States have implemented some of their own texts on remuneration, taking into account the ESMA guidelines. The concept of distribution specifications also include certain incentive and bonus systems, so that this set of rules also ensures that consumer interests are safeguarded in the design and implementation of remuneration principles.

Legal regulations for the definition and implementation of remuneration principles (and practices) can be found in Art. 27 MiFID II Delegated Act. According to this text, the remuneration must be structured in particular without affecting the interests of the consumer. An investment firm must ensure that it does not remunerate or evaluate the performance of its employees in a way that conflicts with its obligation to act in the best possible interests of the client. In particular, remuneration must not provide any incentives to recommend a product that does not meet the needs of the client.

We are not aware of any remuneration practices that conflict with these requirements or deficiencies. Corresponding information from the supervisory authorities or the auditors is also not available.

We agree that the incorporation of the MiFID II rules is necessary, but anything beyond that is excessive and does not make sense at this state. The ESMA Guidelines in 2013 were already more detailed than MiFID regulated at that time, and they have been introduced in most of the firms in recent years. From our point of view, there is no need to tighten the regulations beyond this, the introduced regulations can now also be tested for suitability and have so far proven to avoid conflicts of interest in the area of remuneration.

In our view, there is therefore no reason to set additional requirements beyond the adjustment of the applicable ESMA guidelines on remuneration to the MiFID II requirements. Constant changes in the regulations would mean that introduced systems cannot prove themselves, especially since there are no indications for changes due to a higher number of complaints, damage claims or findings from supervisory audits regarding this topic.

Questions

Q1: 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.

In principle, professional development can impact the fixed remuneration of a relevant person. However, with regard to the fixed remuneration, in our view there can be no collision with client interests (unlike point 19 of the consultation paper). If – unlike in the case of variable remuneration linked to distribution, for example – the employee always receives the same (agreed) salary, there is no incentive to act contrary to the interests of the client. In this respect, there is no need for regulation. This is because the ongoing fixed remuneration of an employee is not used to reward sales success, i. e. it is already not provided in connection with investment services or ancillary services. Nor is it suitable for this purpose, since it grants the employee a permanent entitlement which is intended to ensure his livelihood irrespective of performance (or success). This entitlement is not reduced even if the employee is assigned another activity outside the securities business by the employer within the scope of the right to issue instructions to which the employer is entitled or if the employee violates client's interests. Therefore, the investment firm cannot achieve performance management in line with the firms' objectives and business and risk strategies at all with fixed remuneration components. Variable remuneration components can be used for this purpose, which can also be used to react appropriately to changes in the employee's performance and conduct as well as to any violations of customer interests. In addition, especially in the case of long-term employment, there is an interest in looking after the clients' interests particularly well, because the customer will then also (hopefully) use services again and again.

There are also many other aspects, such as collective bargaining agreements or supply and demand on the labour market. The consumer satisfaction, mentioned as a possible criterion, is only suitable as a snapshot in the present case. This is very subjective, and often depends on the development of the product, which in turn is mainly influenced by external factors (and especially not by the employee) and mostly represents a snapshot that is not suitable to use as a criterion for measuring long-term fixed remuneration.

Q2: Do you agree with the suggested approach on career progression? Please also state the reasons for your answer.

No. In addition to our answer to question 1, a remuneration system must be designed in such a way that consumer interests are not impaired. Relevant persons are informed clearly and in writing about the remuneration system in advance, in particular on criteria for the level of remuneration as well as the levels and schedule of their performance assessment. Some Member States have understood "remuneration" to mean any form of direct or indirect payment or services to relevant persons who are involved in the provision of investment services for consumers. The remuneration can be financial and non-financial. The term "remuneration" generally does not include remuneration that is agreed through or on the basis of a collective bargaining agreement, within the scope of a collective bargaining agreement by agreement between the parties to the employment contract on the application of the collective bargaining agreement, or based on a collective bargaining agreement in a company or service agreement. Promotions (career progression) also fall under the term of (non-financial) remuneration. The relevant internal regulations must therefore already take client interests into account.

Q3: 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.

We speak out clearly against regulations in the guidelines on so-called clawbacks or *malus* regulations or the introduction of *ex-post* adjustment criteria for variable remuneration.

Clawbacks or *malus* regulations are to be viewed extremely critically with regard to the existing protection of employee confidence. Work and wages are in a reciprocal relationship to which any reclaims based on a "catalog of criteria" do not systematically match. Against the background of the applicable collective bargaining autonomy, there are considerable doubts as to whether the relevant requirements would be enforceable at all. Rather, the existing possibilities for action under labour law appear (admonition, warning, [extraordinary] termination and, if necessary, assertion of claims within the framework of so-called employee liability), the existing supervisory powers to intervene (up to a temporary employment ban as a last resort) and, in extreme cases, criminal sanctions are completely sufficient.

In addition, there is also the question of ESMA's authority to set legally binding requirements for corresponding salary conditions. This does not result from MiFID II and the MiFID Implementing Regulations. According to MiFID II, variable remuneration could represent a conflict of interest. It is the responsibility of the investment services company to determine which measures it takes to safeguard client interests in the event of such a conflict of interest. As a result, ESMA cannot derive any competence to stipulate individual salary conditions from its authority to publish guidelines and thus to interpret MiFID II. Apart from that, the regulations restricting freedom of contract would have to meet the requirement of certainty and be proportionate (according to some Member State law). In our opinion, these two requirements do not meet the proposed regulations in Guideline 1, Item 26.

Finally, we would like to point out that existing contracts cannot easily be changed unilaterally. Instead, it requires an important reason or explicit legal basis that also meets the above requirements. The latter is missing (see above). The former should not be the case on a regular basis in some Member States due to their collective bargaining regulations on variable remuneration.

Q4: Do you agree with the suggested approach on ex-post adjustment criteria? Please also state the reasons for your answer.

On the planned *ex-post* judgment criteria in Guideline 1 Numbers 27 to 29, we would like to point out that the remuneration system must already be checked regularly today. It must also be ensured that cases in which relevant persons are not acting in the interest of the client can be effectively identified and countermeasures can be initiated. ESBG members believe that these requirements are sufficient to effectively counter any conflicts of interest.

But it is important to stress that if rules about *ex-post* criteria are implemented, they necessarily have to be linked to any misconduct of the employee as the client's profit always depends on the development of a product influenced by external factors, no matter how good the advice is in advance.

Referring to **paragraph 29 of the draft GL** we would like to state that linking *ex-post* adjustment mechanisms and the deferral of remuneration to the interest of clients should not mean that the employee has to take responsibility for a negative product development, even though he cannot be accused of any misconduct. Many products have a medium or longer

maturity and the question arises as to how many years a deferral can be maintained and managed in a firm.

Q5: 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.

In Guideline 1, Item 35, ESMA proposes that remuneration of the control units is to be based on "function-specific objectives" and that the variable remuneration component must not be linked to the quantitative performance of the relevant persons who are monitored by it.

We believe that there is no further need for regulation in this regard.

If ESMA understands control functions to mean internal auditing, risk or conflict of interest management or the compliance function, it has already been regulated that they always carry out their (monitoring) tasks independently of the other business areas of the investment services company and independently of the management. It should also be checked in individual cases whether they are relevant people at all. The compliance function is also called in to provide advice before the remuneration system is applied. It also monitors the establishment, design and implementation of remuneration systems. No separate regulations are required to avoid possible conflicts of interest only for these employees or control functions. The existing remuneration systems do not provide any incentives to put the interests of the seller/company to the detriment of the consumers above their interests. In the case of the good and bad practices listed in Annex III of the consultation paper, Guideline 1 Sections 37 and 38, we cannot identify any reference to the variable remuneration of the control functions - as suggested in Section 35.

In view of the principles set out in Section 36 of the same paper, for the variable remuneration of senior management, we do not see any additional practical need for action.

Q6: Do you believe that guideline 1 should be further amended and/or supplemented? Please also state the reasons for your answer.

For the reasons mentioned above, from our point of view there is no need for further additions to the guidelines.

Q7: 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.

The remuneration system has to be checked regularly. It must also be ensured that cases in which relevant persons are not acting in the interests of the client can be effectively identified and countermeasures can be initiated. Furthermore, an *ad-hoc*, event-related obligation to review the remuneration principles (possibly with the result of adjustments) cannot and must not lead to the nullification of collective bargaining agreements. Here, too, the priority of collective bargaining autonomy must be taken into account. From our point of view there is no need for further regulation.

Q8: 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.

From our point of view, there is no need for further regulation in this regard. The remuneration system must already be set up whilst taking into account the potential conflict of interest and risk management. The compliance function is called in for advice before the remuneration system is applied. At the same time, this means that these roles must also receive the necessary background information and documents for evaluating the remuneration systems, which, to our knowledge, also corresponds to practice.

The compliance function monitors the conception, the approval process and the implementation of remuneration systems in accordance with the general principles for the monitoring tasks of the compliance function, drawing on a wide range of information. The results of previous (compliance) reviews and legitimate consumer complaints are also used in the compliance review of the remuneration system.

Q9: Do you believe that guideline 2 should be further amended and/or supplemented? Please also state the reasons for your answer.

We do not consider any further changes in Guideline 2 to be necessary.

Q10: Do you agree with the amendments made to guideline 3? Please also state the reasons for your answer.

The additions are generally understandable. However, it should be clarified that, in particular with regard to the control measures and the information obligations vis-à-vis the management, new precautions do not necessarily have to be taken, but that already established procedures can also be used (in particular monitoring by the compliance function together with corresponding reporting).

Q11: Do you believe that guideline 3 should be further amended and/or supplemented? Please also state the reasons for your answer.

No. We refer to our answer to question 10.

Q12: Do you agree with the deletion of Section V.III. of the 2013 guidelines? Please also state the reasons for your answer.

Section V.III of the 2013 Guidelines concerns the "Guidelines for the Oversight and Enforcement of Remuneration Policies and Procedures by Competent Authorities". The planned deletion is logical, as the supervision of the regulations on remuneration principles is largely based on the existing Level I and Level II regulations of MiFID II.

Q13: 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?

As part of the cost-benefit analysis, remuneration systems or principles must not be overly complex.

In ESBG's opinion, due to the existing legal and supervisory regulations on remuneration principles, rules of conduct, conflicts of interest and organisational requirements, there is a very high level of investor protection. Before adapting the guidelines, the possible implementation effort and need for adaptation in the company must be weighed against the possible benefits of the new regulations. Even if ESMA correctly states that the adjustment of the existing internal remuneration principles means less effort compared to the initial implementation, it is essential to note that any changes mean additional effort in addition to the existing requirements. In the interests of proportionality, we therefore ask that

ESMA concentrates on the adjustments that result from MiFID II as part of the revision of the guidelines.

About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping savings and retail banks in 21 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 900 banks, which together employ more than 650,000 people driven to innovate at roughly 50,000 outlets. ESBG members have total assets of €5.3 trillion, provide €1 trillion in corporate loans (including to SMEs), and serve 150 million Europeans seeking retail banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking. Our transparency ID is 8765978796-80.

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