German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

on the ESMA consultation paper "Guidelines on certain aspects of the MiFID II remuneration requirements" of 19 July 2021 - ESMA35-36-2324

Register of Interest Representatives
Identification number in the register: 52646912360-95

Our ref
Ref. DK: 413-ESMA-MIFID
Ref. DSGV:4673, 7106/00

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Berlin, October 8, 2021

The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 1,700 banks.

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I. General remarks

The German Banking Industry Committee (GBIC) appreciates the opportunity to comment on the draft "Guidelines on certain aspects of the MiFID II remuneration requirements".

The remuneration of employees of investment firms is rightly an important supervisory topic. In recent years, numerous regulations have been published in this regard with the aim of ensuring that client interests are not adversely affected by the design of remuneration systems. In our view, there are sufficient regulatory requirements for remuneration systems and their monitoring. In Germany, the requirements for remuneration systems in connection with the provision of investment services and ancillary investment services are specified in BT 8 of Circular 4/2010 (WA) – MaComp of the German Federal Financial Supervisory Authority (BaFin), in particular the aspect of variable remuneration elements (bonus payments, performance bonuses, etc.). In BT 8 MaComp, BaFin has implemented the requirements of the ESMA guidelines on remuneration principles and procedures from 2013 in German administrative practice. In addition, there are dedicated guidelines in Germany on how to deal with sales targets (section 80 (1) no. 3 Wertpapierhandelsgesetz, WpHG), which must not infringe on client's interests. The concept of distribution targets also covers certain incentive and bonus systems, so that this set of regulations also ensures that the interests of the clients are protected when structuring and implementing remuneration principles.

Requirements on the definition and implementation of remuneration principles (and practices) can be found in Article 27 of the MiFID II Delegated Act. Accordingly, the remuneration must be structured in particular without impairing the client's interests. Section 63 (3) WpHG additionally regulates further aspects of the remuneration of investment services companies in implementation of Art. 24 (10) MiFID II Directive. Pursuant to section 63 (3) sentence 1 WpHG, an investment firm must ensure that it does not remunerate or assess the performance of its employees in a way that conflicts with its duty to act in the best interests of its clients. In particular, the remuneration must not create incentives to recommend a product that is less suited to the client's needs (section 63 (3) sentence 2 WpHG).

We are not aware of any remuneration policies or practices that conflict with these requirements or of any shortcomings/malpractices. There are also no corresponding indications from the supervisory authority or the auditors.

In our view, there is therefore no reason to impose additional requirements beyond adapting the current ESMA guidelines on remuneration to the MiFID II requirements.

II. On the individual 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)?

Insofar as the Guidelines suggest the regulation of fixed remuneration components, the concept of remuneration defined in Art. 2 No. 5 MiFID II Delegated Act must always be taken as a basis. According to this definition, remuneration covers any form of payment or service provided by firms "directly or indirectly [...] in the provision of investment or ancillary services to clients". Recital 40 of that Regulation refers to payments and services provided 'in the course of providing investment or ancillary services'.

Against this background, the inclusion of fixed remuneration in the sense of current salary in the subject matter to be regulated appears questionable. This is because, at any rate with regard to ongoing, fixed remuneration components, a link to additional regulatory criteria intended to avoid a conflict of interest with client interests is not justified. In principle, the employee's fixed salary is not based on variable (quantitative or qualitative) criteria.

Basically, professional development can have an impact on 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 firm's 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 client's interests particularly well, because the customer will then also (hopefully) use services again and again.

Furthermore, the client's satisfaction mentioned as a possible criterion is only conditionally suitable as a snapshot. This is very subjective, often depends on the development of the product, which in turn is also influenced to a large extent by external factors (and precisely not by the employee) and mostly represents a snapshot, which in any case is not suitable as a criterion for measuring the longer-term fixed remuneration.

The level of the fixed salary must take into account the objective qualifications and expectations required for the job, but also, if necessary, individual qualifications and expectations that go beyond this. The fixed remuneration is therefore not only determined by the specific requirements of a position, but also by social and market-related aspects. In doing so, the bank/savings bank takes into account a combination of aspects, e. g.

- the interest of the firm in retaining the individual employee in the bank/savings bank (individual suitability and development potential, replaceability from the firm's own personnel pool)
- the conditions on the regional and national personnel market for employees with a corresponding level of qualification (wage level in the sector-specific and cross-sector competition for qualified specialists)
- personal expectations of the qualified specialist from the point of view of employee retention.
- the appropriate determination of remuneration in so-called mixed functions, i. e. activities which include other advisory and/or other activities in addition to a task in the securities business.

No generalisable criteria can be established for this purpose; rather, these aspects must be examined and assessed on a case-by-case basis against the backdrop of the bank's performance and the necessity. This

initial personnel policy situation, which is reflected in the individual contractual salary agreement, is also recognised and accepted by the law and case law.

Against this background, a direct supervisory impact on fixed remuneration components must be rejected. In point 25, the half sentence "*and having an impact on their (fixed and/or variable) remuneration*" should be deleted in order to avoid any misunderstandings to this effect.

Q2: Do you agree with the suggested approach on career progression?

No. In addition to our answer to question 1, a remuneration policy must be designed in such a way that client`s interests are not impaired. Relevant persons are informed in advance in an unambiguous manner and in writing about the remuneration system, in particular about the criteria for the amount of remuneration as well as the stages and timing of their performance assessment. BaFin understands "remuneration" to mean any form of direct or indirect payment or benefit to relevant persons involved in the provision of investment services to clients. Remuneration may be financial or non-financial in nature. Generally excluded from the definition of remuneration are those remunerations which are agreed by or on the basis of a collective bargaining agreement, in the scope of application of a collective bargaining agreement by agreement of the parties to the employment contract on the application of the provisions of the collective bargaining agreement (Tarif contract) or on the basis of a collective bargaining agreement in a works or service agreement (BT 8.1 para. 3 MaComp). Accordingly, promotions (career progression) also fall under the concept of (non-financial) remuneration. The relevant internal regulations of the firm must therefore already take into account the interests of the client. For this reason alone, it is necessary to clarify in point 25 that the requirements for career progression do not apply to firms that are bound by or apply collective agreements, since in these cases promotion above collective agreement groups results directly from the fulfilment of the classification criteria laid down in the collective agreement (e. g. qualification, responsibility). Adding supervisory requirements to the criteria relevant for career advancement would therefore constitute an unjustified encroachment on the autonomy of collective bargaining protected by the Grundgesetz.

In the case of activities paid above the pay scale, advancement takes place taking into account the works council's mandatory right of co-determination in accordance with the firm's remuneration regulation. As a rule, a higher fixed remuneration in these cases also results from more demanding tasks that have to be fulfilled and which consequently have to be remunerated at a higher level. Here, too, the employer cannot deny its employees such an advancement if a corresponding activity is performed. It is also not apparent how such a career advancement could promote a violation of client`s interests at all, since it is based on concrete objective criteria that are not related to sales/sales targets.

The question as to which employees in the investment firm should be considered for career advancement is linked to the personal suitability of an employee, e. i. e. g. his or her nature, ambitions and interests, i. e. to an overall view of his or her "development potential". What matters here is the match between the respective (even temporary) needs of a firm and the individual suitability of internal and external applicants. These developments are not subject to standardised determination and are also not in conflict with customer interests.

Furthermore, conditioning career advancement at the firm would also result in different treatment of existing employees and new hires. Whereas the firm can hire an external applicant with a certain fixed remuneration, the same fixed remuneration could only be awarded to an existing employee moving up the career ladder if further criteria were checked. However, since career advancement is about concrete

objective framework conditions (decision-making authority, qualification), this distinction is not comprehensible.

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 are 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 the employee's legitimate expectations. Work and wages are reciprocal, and any clawbacks based on a "catalogue of criteria" are systematically inappropriate. Against the background of the existing autonomy of collective bargaining agreements, there are considerable doubts as to whether such requirements would be enforceable at all. Instead, the existing possibilities for action under labour law (admonition, warning, extraordinary termination and, if necessary, assertion of claims within the framework of so-called employee liability), the existing powers of intervention under supervisory law (up to and including a temporary ban on employment as ultima ratio) and, in extreme cases, the possibilities for sanctions under criminal law appear to be entirely sufficient. In addition, the question also arises as to ESMA's authority to set legally binding requirements for appropriate salary conditions. This does not arise from MiFID II or the MiFID Delegated Acts. Under MiFID II, variable remuneration may constitute a conflict of interest where appropriate. The measures taken by the investment firm to safeguard the client's interests in the event of such a conflict of interest are the responsibility of the investment firm. Consequently, ESMA cannot derive any competence to prescribe individual salary conditions from its power to publish guidelines and thus to interpret MiFID II. Apart from that, regulations restricting contractual freedom would have to comply with the requirement of certainty and be proportionate, at least under German law. In our view, the proposed rules in Guideline 1 point 26 do not meet these two requirements.

Apart from that, ESMA's concern seems to us to be difficult, if not impossible, to reconcile with principles of labour law. Existing contracts may not be changed unilaterally without further ado. Rather, this requires an important reason or an explicit legal basis that also meets the above requirements. On the one hand, a bank/savings bank cannot, in addition to the provisions of the collective bargaining agreement, stipulate any criteria that might alter the salary earned by the employee as a result of his or her classification (which regularly increases by the sheer duration of the job and the sheer existence of the employee). Irrespective of this, it will probably not be possible to intervene in (existing) employment relationships by (subsequently) unilaterally stipulating criteria that could change the salary (which the employee is adjusting to). In the case of new contracts, it will also not be possible - beyond the collective agreements - to introduce criteria which could subsequently change the salary. Otherwise, there would be a considerable risk of upsetting the entire salary structure in a company.

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

With regard to the planned ex-post judgement criteria in Guideline 1 point 27 to 29, we would like to point out that the remuneration system must already be reviewed regularly. It must also be ensured that cases in which relevant persons do not act in the interest of the client can be effectively identified and

countermeasures initiated. In our view, these requirements are sufficient to effectively counter any conflicts of interest.

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.

ESMA proposes in Guideline 1 point 35 to align the remuneration of control functions with "function-specific objectives". Furthermore, the variable remuneration component should not be linked to the quantitative performance of the relevant persons supervised by them.

In our view, there is no need for further regulation in this respect. Insofar as ESMA understands control functions to mean, for example, internal audit, risk or conflict of interest management or the compliance function, it is already regulated that these always perform their (supervisory) tasks independently of the other business areas of the investment firm and independently of the management. It would also have to be examined on a case-by-case basis whether they are relevant persons at all. The compliance function is also consulted before the remuneration policy is applied. It also monitors the establishment, design and implementation of remuneration systems. No separate regulations are required to avoid potential conflicts of interest for these employees/control functions only. The existing remuneration systems already do not create incentives to put the interests of the firm above the interests of the clients to their detriment. Moreover, in the case of the good and bad practices listed in points 37 and 38, we cannot see any reference to the variable remuneration of the control functions – as proposed in point 35.

In view of the principles for variable compensation of the Executive Board and senior management set out in point 36, 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 above reasons, we do not believe that there is a 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 must already be reviewed regularly today. It must also be ensured that cases in which relevant persons do not act in the interest of the client can be effectively identified and countermeasures initiated. Furthermore, an ad-hoc review of the remuneration policy on an ad hoc basis (possibly resulting in adjustments) cannot/should not lead to the undermining of collective bargaining agreements. Here, too, the primacy of labor law / collective bargaining autonomy must be taken into account.

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.

In our view, there is no need for regulation in this regard. The establishment of the remuneration system must already be carried out in coordination with the conflict of interest and risk management. The compliance function has to be consulted for advice before the remuneration system is applied. This

means, at the same time, that these units must also receive the necessary background information and documents for evaluating the remuneration systems, which, to our knowledge, is also in line with practice. The compliance function monitors the design, approval process and implementation of remuneration systems in accordance with the general principles on the monitoring tasks of the compliance function, drawing on a wide range of information. Furthermore, the results of previous (compliance) reviews as well as justified customer complaints are used in the compliance review of the remuneration system. We are not aware of any shortcomings or deficiencies in this regard.

Q9: Do you believe that guideline 2 should be further amended and/or supplemented?

We do not consider any further changes to 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 in point 48, 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. Please 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 on supervision and enforcement of remuneration policies and procedures by competent authorities". The planned deletion is logical as the supervision of the rules on remuneration principles is based on the existing Level I and Level II rules 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?

In the context of the cost-benefit analysis, it should be borne in mind that remuneration systems should not be overly complex. Due to the existing legal and regulatory provisions on remuneration principles, conduct of business rules, conflicts of interest and organisational requirements, there is a very high level of investor protection. Before adapting the new guidelines, the possible implementation effort and need for adaptation in the institutions must be weighed against the possible benefit of the new regulations. Even if ESMA correctly states that the adaptation of the existing internal remuneration principles means a lower effort compared to the initial implementation, it is important to note that any effort means an additional effort that is added to the existing requirements. In the interest of proportionality, we therefore request that ESMA focuses on such adjustments only resulting from MiFID II in the context of the revision of the guidelines. Apart from that, the guidelines should avoid creating potential conflicts with national labour legislation.