18 October 2021

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

Key points:

MIFID covers a very large population but not all employees have high levels of variable remuneration or important levels of responsibilities. Other regulations (CRD, AIFM, UCITS? Solvency) require putting in place complex mechanisms on variable remuneration, but to targeted populations, based on their levels of responsibility or particularly high levels of remuneration. These guidelines should not make it too complex to manage remuneration structures for all employees covered by MIF especially on:

- Career management
- Deferral
- Ex-post adjustments

Moreover, remuneration policies only concern staff members not third-party distributors. They are concerned by inducements which are already covered by specific guidelines. Inducements and remuneration are very distinct, inducements and reference to third party distributors should therefore not be mentioned in these guidelines.

In addition, compliance function should be able to review all collective documentation regarding remuneration policy and practices but is it not adequate for them to have access to individual remuneration data due to confidentiality reasons and protection of personal data.

EBF position:

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.

Career progression indeed has an impact on fixed remuneration, but no commercial objectives enter into consideration in career progression. Fixed remuneration is based on

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experience, market practice, level of responsibility and the risk regarding conflicts of interest with clients is very limited - it has nothing to do with what is sold to clients and how the products are sold. Indeed, in compliance with Capital Requirements Directive (CRD), fixed remuneration is:

- based on predetermined criteria;
- non-discretionary reflecting the level of professional experience and seniority of staff;
- transparent with respect to the individual amount awarded to the individual staff member;
- permanent, i.e. maintained over a period tied to the specific role and organisational responsibilities;
- are non-revocable; the permanent amount is only changed via collective bargaining or following renegotiation in line with national criteria on wage setting;
- cannot be reduced, suspended or cancelled by the institution;
- does not provide incentives for risk assumption; and
- does not depend on performance.

Moreover, the first sentence in paragraph 25 is non-contentious. However, the example given in second sentence extends beyond the requirements in Delegated Regulation (EU) 2017/565 ("Regulation"). The Regulation requires the absence of a conflict: "*not to create a conflict of interest or incentive that may lead relevant persons to favour their own interests or the firm's interests to the potential detriment of any client*"[1]. The wording in paragraph 25 refers to "*remuneration that may create conflicts of interests that may encourage such relevant persons to act against the interests of their firms' clients*". '*May* create a conflict that *may* encourage' is broader and more indirect than Article 27(1). ESMA Guidelines should adhere to the scope of the Regulation. Extending the scope might make it difficult to set compliant criteria due to the presence of the two 'mays' which creates undue uncertainty and can lead to unproductive speculation. The proposed amendment to the wording is shown below in red:

> "*For instance, firms' career progression management systems should not be used to reintroduce quantitative commercial criteria upon which may depend relevant persons' career advancement and having an impact on their (fixed and/or variable) remuneration that ~~may~~ create conflicts of interests that may encourage such relevant persons to act against the interests of their firms' clients."* to match Article 27(1) of MiFID II Delegated Regulation: "*Remuneration policies and practices shall be designed in such a way so as not to create a conflict of interest or incentive that may lead relevant persons to favour their own interests or the firm's interests to the potential detriment of any client."*

It should also be noted that there is a difference between setting "*appropriate criteria to align the interests*" as formulated in the question and avoiding criteria which creates conflicts, which is required in paragraph 25. The difference is significant since there are plenty of positions held by relevant persons where criteria for career progression which increases fixed remuneration is neutral re client interests or not linked to client interests. This is the case for instance for certain support functions where a requirement to align

[1] Article 27(1)

with client interests would narrow the scope of criteria available and in some cases make the criteria unfit or inadequate to judge increases in fixed compensation.

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

We are afraid that too complex information might be requested to justify how career progression is planned. Career progression depends on a variety of factors which are not linked to sales volume, but rather on the capacity to manage people, to invest into transversal activities, to take overall responsibility for subjects.

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.

The ability to use malus and particularly clawback are severely restricted by national laws of member states. For that reason, paragraph 26 should start by "Without prejudice to the general principles of national contract or labour law and/or collective bargaining agreements.". Moreover, words such as 'misconduct' are preferred to "negative staff performance" since the latter can refer to underperformance against set targets and is not comparable to the seriousness of misconduct.

Given the differences between member states on the ability to use malus and clawback, and the absence in the Regulation and in the MiFID II Directive (Directive 2014/65/EU) of any requirement to adopt such mechanisms, the requirement for firms to "consider including ex-post adjustment criteria" strikes the right tone. This way, firms can assess and set such criteria at the appropriate level for their jurisdiction.

The extension of ex-post adjustment to those who were not directly engaged in misconduct is excessive. It would require firms to apply malus to or even clawback remuneration to individuals who were not responsible for any wrongdoing. The wording only requires that the person worked in the area where events crystallised "*Ex-post adjustment mechanisms… should also be applied to the relevant persons whose responsibilities and roles include the areas where the relevant events crystallised*" and that the person has "*an impact, directly or indirectly, on the investment and ancillary services provided or on the corporate behaviour of the firm*". This wording requires no nexus between the person and the wrongdoing and no responsibility on the part of the person for the wrongdoing. Such a link and a degree of responsibility are prerequisites for any consideration of ex post adjustment.

With respect to deferring variable remuneration under paragraph 29, a reference to proportionality is a must. Other regulations which target specific populations based on their level of responsibility require to put in place deferral mechanisms which are already in place in institutions. As already indicated, MIF regulation covers a very large population with different levels of responsibility and various pay levels. Although the paragraph requires firms to "consider paying the variable remuneration partly upfront and partly deferred" and does not require that variable remuneration must be deferred, firms should only be expected to consider deferring remuneration when the amounts in question are

significant and the level of responsibility important. This matters for two reasons. First of all, there are significant costs and resources associated in running deferral systems. The costs outweigh the benefits if the requirement is extended to all remuneration, even small amounts and it would not make sense for populations which have limited responsibility level. Additionally, the incentives offered by remuneration will be diluted, from the employee's perspective, if even small amounts are deferred. Similar proportionality consideration was introduced under CRD V where deferrals are required only if the variable remuneration amount is of a certain size (larger than EUR 50k or 1/3 of total remuneration). As for the definition of "small amount", we suggest leaving the assessment to each firm, which, in this way, could take into account, inter alia, the average remuneration in the relevant sector, the average remuneration in the firm, and other relevant factors such as the level of responsibility.

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

The criteria detailed for ex-post adjustment are similar to the ones which are already in place in most institutions. Misconduct already triggers ex-post adjustments. With reference to deferral of variable remuneration, please consider our remarks under Q3.

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.

This is quite in line with what already exists within institutions and in line with requirements under CRD or other regulations.

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

Specific paragraphs to be reviewed:

Paragraph 18
The level of detail that is suggested to be included in a management body level document i.e. the remuneration policy is excessive. Including details on how, for instance, a client satisfaction criterion is measured, specifying the data and thresholds used would mean that all criteria used in the firm would need to be approved by the management body. The objective of the paragraph "*to ensure that [qualitative criteria] are not being used to indirectly reintroduce quantitative commercial criteria that may create conflicts*" can be achieved by requiring firms to document the measurement of such criteria without having this description included in the remuneration policy.

Paragraph 19
"the investment return on clients' portfolios/investments, taking into account the clients' investment horizon (short, middle or long term) and risk profile (to mitigate any risk of excessive risk taking)"

This sentence should be suppressed as it is impossible to align remuneration with the effective return for clients. These returns on investment depend on a variety of external

factors (economical, market, environmental factors) and staff members who sell these products do not have direct input on these factors and therefore on the effective return for clients. Moreover, some staff members can sell different types of investment products which can have very different returns on investments, and which will be adapted to the clients' needs.

Paragraph 29
In order for ex-post adjustment mechanisms to be meaningful, firms should consider paying the variable remuneration partly upfront and partly deferred, in an appropriate balance between the part paid upfront and the one deferred, and according to an appropriate deferral schedule allowing for the interests of the relevant persons and of the firms to be aligned with the interests of clients.

MIFID population is very large and some staff members who sell products in the retail banking have very small variable remunerations. Deferral can only make sense for higher variable remunerations and cannot cover all MIFID population. Firms already identify populations which have subject to deferral and payment in instruments, based on their level of responsibility or their level of remuneration.

Paragraph 31
The requirements on weights are new and unduly restrict how firms assess performance. The wording in the paragraph would exclude firms from grouping criteria and assigning weights to each group or performing holistic assessments of criteria. The weight per criterion and consequences per criterion can, as a result of their inflexibility and formulaicness, lead to outcomes which do not reflect an individual's performance as a whole.

37. Examples of good practice:
"b. In the case of an open-ended investment with no investment term, the remuneration is deferred for a set number of years or until the encashment of the product."

To be deleted, not feasible as employees do not sell only one investment product, it is not possible to align deferral length with each investment product. For specific populations or high variable remunerations, remuneration policies fix clear deferral lengths which enable to align variable remuneration with risks, but it is essential to have some clarity and visibility for concerned employees and deferral lengths cannot be adapted too frequently. Institutions do not have systems that can manage payment of remuneration on each product maturity/encashment nor split payments on many different schemes/maturities. This would be impossible to manage in terms of administration.

"c. Payment of variable remuneration may be aligned with the investment term or deferred in order to ensure that the product sold does in fact take into consideration the final return of the product for the client and, where applicable, an adjusted award of variable remuneration is made."

It is not relevant to take the final return of investments as it is very complicated to measure final return of the product and to align remuneration with this return. Besides such approach would encourage employees to sell the products based only on the potential highest level of return for the client, which may not be the appropriate product for the risk profile of the client. This would be contradictory to suitability objective.

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.

We agree that adequate ad-hoc events should trigger the review of remuneration policy, but only for structural and significant events.

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.

We agree that these persons should have access to all documentation on a general basis (remuneration policy, remuneration practices) and take part in the decision process to ensure compliance with regulations, but not to individual remuneration data. Access to personal data as remuneration is restricted and it is not compliance's role to overview individual remunerations. This role and skill stand within the HR function. At the level of management body and senior management, it is the role of the Board of Directors to oversee individual remuneration with some elements even validated by the General Shareholders Meeting for the management body.

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

Paragraph to be reviewed:

"41. In order to fulfil its advisory role regarding the firm's remuneration policy as per Article 27(3) of the MiFID II Delegated Regulation, the compliance function should have access to all relevant documents and information regarding the remuneration policy of relevant persons, including regarding the remuneration policy of members of the management body and senior management."

Compliance function can have access to all documentation regarding the remuneration policy and be involved in the definition of remuneration policies and practices in particular for defining how conduct and compliance criteria are taken into account in the evaluation of performance and the determination of remuneration.

But it is not their role to review individual remunerations – there is a confidentiality issue in reviewing personal data. At the level of management body and senior management, it is the role of the Board of Directors to oversee individual remuneration with some elements even validated by the General Shareholders Meeting for the management body.

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

The reference to third party distributors should be suppressed from these guidelines on remuneration policy as they are already covered via the inducement regulation and the relevant ESMA Q&A.

Third-party distributors are not staff members and are therefore not covered by the internal remuneration policies. These distributors might receive inducements, but these are subject to specific guidelines. Inducements and remuneration of staff members are two different things which should not be mixed together in these guidelines.

Moreover, we underline that also the reference to multi-level sales network consisting solely of personnel should be differently focused as there are some national experiences that cannot be considered as a poor practice being already deeply regulated by national supervisory authorities in order to ensure proper remuneration policies and a strengthened protection for investors. This is the case of the Italian legislation where it is provided a special regulation of the distribution model adopted by Italian investment firms and those of other European Union countries that make use in Italy of financial advisors authorized to make door-to-door selling: i) these financial consultants are necessarily natural persons (individually subject to the public control of a Supervisory Body) and the investment firm, even when it makes use of hundreds or thousands of financial advisors qualified for door-to-door selling, always selects them all individually and submits them directly to his own instructions and internal control systems; ii) the investment firms is specifically regulated with regard to this aspect by the supervisory provisions of the Bank of Italy on the remuneration and incentives of agents, Consob's regulatory provisions and administrative practice, the interventions of the Body of Financial Advisors directly on the financial advisors qualified for door-to-door selling.

Paragraph to be reviewed

"52. d. To distribute its products, a firm relies on a multi-level sales network (consisting solely of personnel or third-party distributors which are remunerated according to the volume of transactions of the clients captured directly by themselves, and their ranking in the sales structure of the firm. The sales structure of the firm is organized by multi-level groups of individuals coordinated by another individual called "supervisor" or "manager" and who is in charge of the support, training, coordination and supervision of the structure. These supervisors or managers are also tasked with the recruiting of other individuals. Where such sales structures have many levels of agents, this may make it difficult for the firm to monitor the compliance risks with these guidelines for each level (especially the most remote) and the whole structure."

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

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

Ok

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?

About EBF

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