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European Association of Co-operative Banks comments on

Consultation Paper

Guidelines on remuneration policies and practices (MiFID)

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The voice of 4.000 local and retail banks, 51 million members, 181 million customers

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Introduction

The Members of the European Association of Co-operative Banks (EACB) are pleased to receive the opportunity to comment on ESMA's *Guidelines on remuneration policies and practices (MiFID)*.

EACB has focused its response mainly on the actual draft guidelines (Annex V) which will provide the basis for the recommendations to be implemented by the national supervisors and has incorporated ESMA's questions into these remarks.

General Remarks

Before providing ESMA with its specific remarks, the European co-operative banks would like to raise their deep concerns about the general tenor of this consultation which is – sometimes – at odds with the MiFID legislation itself as well as existing labour laws in the Member States.

Variable remuneration is an economic necessity

We are fully aware of the fact that remuneration policies and practices can give rise to conflicts of interest.

Nevertheless, in the view of the European co-operative banks, ESMA's draft guidelines do not take sufficient account of the fact that compensating employees in parts with variable remuneration is a basic economic necessity in successfully managing a company[1]. In particular, the possibility to flexibly design – at least a part of – the employee remuneration is essential from a business perspective to run a company in an economic sensible fashion. The basis of employees' wages and salaries have to be based on the investment firm's earnings which are never constant. It is necessary to design remuneration in a way that allows the investment firm to respond to these fluctuating earnings. The correct instrument to achieve this is the variable remuneration. Also from a management standpoint it must be possible for the investment firm to distribute the income generated by its employees in accordance to their respective performance. It does not make any sense to completely detach the employees' performances (which are the cause for a company's success or downfall) by providing them all with the same remuneration regardless of their efforts and performances which would not motivate to provide above-average performance and would, in turn, demotivate all employees. Of course, the payment of the variable remuneration should depend on the precondition that the employee complies with the internal organisational measures and procedures the investment firm has implemented in order to meet the MiFID requirements.

[1] See in Annex V, example for poor practice in paragraph 33, first indent

Last but certainly not least, the necessity of variable remuneration is also confirmed in the CEBS Guidelines on remuneration Policies and Practices[2] in response to the requirements of the CRD. Accordingly, remunerations serves also the purpose of risk management in investment firms[3]. This aim can only be achieved by introducing a variable remuneration component.

Organisational safeguards to manage conflicts of interest are disregarded

We are of the opinion that the ESMA draft guidelines are not taking appropriate account of the essential organisational and administrative arrangements that have already been put in place by investment firms "designed to prevent conflicts of interests […] from adversely affecting the interests of its clients"[4]. Such arrangement are either of internal nature or are – with respect to labour laws – binding instructions to employees to comply with the internal organisational measures and procedures the investment firm has implemented in order to meet the MiFID-provisions. Furthermore, these arrangements also include the monitoring and regular assessment by the compliance function whether these organisational measures and procedures are still adequate and effective[5]and controls whether employees comply with the above mentioned internal instructions.

The MiFID and the MiFID-Implementing Directive does not simply ignore the existence of conflicts of interest within investment firms by outlawing them, but – in contrast – even acknowledges the existence of conflicts of interest[6]. The legislation stipulates that the investment firm must manage these conflicts of interest in order to prevent them from adversely affecting the interests of its clients[7]. Out of these reasons do we believe that the ESMA draft guidelines – which show a tendency or even require that already the remuneration policies and practices themselves must keep the interests of the clients[8] - are not in line with the MiFID and the MiFID-Implementing Directive and would inappropriately interfere with the MiFID-compliant and already established business operations.

Important ESMA guidelines on compliance are ignored

We have noticed that several parts of the proposed guidelines are also not taking account of the already published ESMA "Guidelines on certain aspects of the MiFID compliance function requirement" [9]which have relevance to various parts of the proposed remuneration guidelines. In view of consistency throughout all ESMA

[2] Published on 10 December 2010; the link to the document can be found under the following link: http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Remuneration/Guidelines.pdf
[3] Cf. ibid. paragraph 4 of the CEBS Guidelines
[4] cf. Art. 13 (3) MiFID. A similar argument can be found in Art. 22 (2) (b) MiFID-Implementing Directive: „The conflicts of interest policy established in accordance with paragraph 1 shall include the following content: …(b) it must specify procedures to be followed and measures to be adopted in order to manage such conflicts."
[5] cf. Art. 6 (2)(a) MiFID-Implementing Directive
[6] cf. also Recital 29 MiFID
[7] see Art. 13 (3) MIFID and Art. 22 MiFID-Implementing Directive
[8] cf. Annex V especially paragraph 13, 14, 15, 27 28, 32, 33, 34/35
[9] cf. Annex V, paragraph 19, 21, 27, 29, 30, 31

recommendations and to avoid different guideline content of working, would we ask to refer to the compliance guidelines in the ESMA remuneration guidelines.

Curtailing of contractual freedom through proposed ESMA's draft guidelines at odds with Member States' civil law

We also have noticed that several proposed guidelines in relation to the remuneration policy are incompatible with the civil law principle of contractual freedom in many Member States. In this context we are genuinely questioning whether ESMA has to power to introduce recommendations that will constitute the basis for all future fixed and variable remuneration policies. Neither MiFID nor its implementing directive contain limits or other restrictions with respect of variable remuneration. The MIFID and its implementing directive requires that the investment firms must identify any conflict of interest and leave it to the investment firms to establish effective measures in order prevent these conflicts of interest from adversely affecting the interests of their clients. This leads us to the conclusion that ESMA does not seem to have the authority to curtail this contractual freedom through their guidelines in such a way that only specific remuneration models are allowed in future[10]. Finally we would like to stress that investment firms can not amend their contractual obligations on its own. For such an amendment, an explicit legal basis would be necessary. Furthermore, such a basis must be sufficient specific and appropriate. But, as already explained above (see our general remarks to the MiFID-provisions), such a legal basis doesn't exist.

Answers to Questions and Remarks on Draft Guidelines (Annex V)

I. Scope

Paragraph 4: Implementing period

We would like to draw ESMA's attention to the fact that 60 calendar days will not be enough to implement the necessary changes as required by these guidelines. ESMA's own cost-benefit analysis (Annex III, para. 8 & 9) speaks of a certain time frame needed for existing personnel to familiarise themselves with the new guidelines and put the appropriate structures in place. Feedback from our banks suggest that this timeframe should be at least ½ year, in cases when an involvement of employees or employees' representation is necessary at least one year.

[10] cf. Annex V especially paragraph 13, 14, 15, 27 28, 32, 33, 34/35

III. Purpose

Paragraph 7: Definition of "remuneration policies and practices"

We believe that the definition of remuneration is cast too wide and should be limited in two ways: Firstly, remuneration should be limited solely to cash or cash-like benefits that are paid out by the investment firm (employer) to its employees. Monetary benefits by third parties can create conflicts or interest and should not be part of the discussion on internal remuneration policies of investment firms.

Secondly, ESMA's draft guidelines should only consider cash or cash-like benefits and exclude non-monetary benefits. The non-monetary benefits[11] mentioned (health insurance, discounts, or special allowances for car or mobile phone etc.) by ESMA are more cash-like benefits and/or do not impair the clients interests.

V. Guidelines on remuneration policies and practices (MiFID)

V.I. Governance and design of remuneration policies and practices in the context of the MiFID conduct of business and conflicts of interest requirements

Question 1

Do you agree that firm's remuneration policies and practices should be aligned with effective conflicts of interest management duties and conduct of business risk management obligations so as not to create incentives that may lead relevant persons to favour their own interest, or the firm's interests, to the potential detriment of clients? Please also state the reasons for your answer.

Please find our remarks to the question in the following paragraphs.

Paragraph 13: Direct relationship between impairment of client's interests and remuneration

In line with our general comments above, we are critical of the proposed guideline „that clients' interests are not impaired by the remuneration policies and practices adopted by the firm in the short, medium and long term". We are, of course, not against acting in the client's best interest, but MiFID and the MiFID Implementing Directive clearly consider a more holistic view of the conflicts of interest[12]. In case remuneration policies could create such conflicts, organisational requirements have to be put in place to manage these conflicts effectively and adequately. Some ESMA guidelines like paragraph 13, on the other hand, do not consider other measures and insinuate that remuneration policies are the only means that can prevent conflicts of interest from adversely affecting the interests of clients. It can clearly be seen that the suggested guidelines are therefore not in line with MiFID and the MiFID-Implementing Directive.

Paragraph 14: Definition of "relevant person"

We would like to draw attention to the fact that the MiFID-Implementing Directive already includes a definition of "relevant person" in Art. 2(3). This is of importance as

[11] Overview, para. 11, p. 7
[12] cf. Art. 13 (3) and Art. 18 (MiFID), Art. 21 to 23 MiFID-Implementing Directive

ESMA's draft guidelines are proposing a much wider scope that includes "staff *indirectly* involved in the provision of investment services"[13]. We therefore would ask for alignment with the existing legislation which clearly does not include concept of "indirect provision of investment services". Therefore the inclusion of "relevant persons involved in complaints handling, claims processing, client retention and product design and development" should be deleted.

With respect to tied agents, the ESMA-Guidelines on remuneration should leave these group of people outside the scope because in some Member States tied agents are self-employed. The main characteristics of this self-employment is that these people can decide on their working hours and goals to be achieved. Consequently, self-employed tied agents only receive variable remuneration according to their activities.

Question 2

Do you agree that, when designing remuneration policies and practices, firms should take into account factors such as the role performed by relevant persons, the type of products offered, and the methods of distribution? Please also state the reasons for your answer.

Please find our remarks to the question in the following paragraph.

Paragraph 15: Design of the remuneration policies and practices

See our general comments and our detailed comments to paragraph 13, which are also relevant with respect to paragraph 15.

Question 3

Do you agree that when designing remuneration policies and practices firms should ensure that the fixed and variable components of the total remuneration are appropriately balanced?

Question 4

Do you agree that the ratio between the fixed and variable components of remuneration should therefore be appropriate in order to take into account the interests of the clients of the firm? Please also state the reasons for your answer.

Please find our remarks to the questions in the following paragraphs.

Paragraph 16 and 17: Basis of fix/variable remuneration

When designing remuneration policies we believe that the balance between fix and variable remuneration cannot be the only deciding factor. On the basis of the individual remuneration policies and practices, it has to be assessed whether this could lead to a conflict of interest. For example, also the basis for assessment of the variable remuneration is a relevant factor. Same applies to additional measures like a contractual clause that makes the payment of the variable remuneration dependent on the condition that the employee has followed all internal instructions (the investment firm has implemented to ensure MiFID compliance).

[13] See I. Overview; para. 8 on page 6

Ultimately, it has to be considered on a case-by-case basis taking into account all aspects

- whether a conflict of interest exists because of the remuneration structure and – this is the case
- the investment firm has implemented effective and adequate measures to prevent these conflicts of interests from adversely affecting the interests of its clients.

Question 5

Do you agree that the performance of relevant persons should take account of non-financial (such as compliance with regulation and internal rules, market conduct standards, fair treatment of clients etc.), as well as financial, criteria? Please also state the reasons for your answer.

Please find our remarks to the question in the following paragraphs.

Paragraph 18: Qualitative criteria as the basis of variable remuneration

We would like to raise our grave concerns to the last sentence of the paragraph, as employees are already bound to follow any (MiFID-related) internal instructions or other internal binding arrangements. That those arrangements are in line with MiFID and in the interest of the client is the sole responsibility of the investment firm. This means that investment firms can simple make the variable remuneration dependent on the condition that the employee has followed these instructions/arrangements.

While we – of course – agree with the "fair treatment of clients", do we see serious practical difficulties on translating soft data (such as customer surveys) into meaningful and comparable data that can be impartially applied to all employees.

Paragraph 19: Prompt identification of failure to act in best interest of the client

We believe that the requirement to "adopt and maintain measures enabling it to promptly identify where the relevant person fails to act in the best interests of the client and to take remedial action" is too far reaching and in contradiction with ESMA's recent MiFID guidelines on compliance[14].

Furthermore, to require "prompt" identification measures would entail an almost constant monitoring of activities which is against ESMA's stipulated risk-based approach (see ESMA guidelines on the compliance function). As we do not assume immediate changes to the just released compliance guidelines, would we suggest proper alignment.

Paragraph 20

We consider the meaning of paragraph 20 identical to paragraph 18. Our suggestion would be to delete the former. Please therefore regard our comments to paragraph 18.

Question 6

[14] ESMA/2012/388

Do you agree that the design of remuneration policies and practices should be approved by senior management or, where appropriate, the supervisory function after taking advice from the compliance function? Please also state the reasons for your answer.

Question 7

Do you agree that senior management should be responsible for the implementation of remuneration policies and practices, and for preventing and dealing with any the risks that remuneration policies and practices can create? Please also state the reasons for your answer.

Please find our remarks to the questions in the following paragraph.

Paragraph 21: Approval of remuneration policy

We are surprised that paragraph 21 clearly defines how remuneration policies have to be approved within an investment firm, as the current MiFID legislation sets out the requirements but not how they have to beaccomplished. This is especially striking in the light of the recent ESMA compliance guidelines, which take a contradictory approach that stresses that senior management is responsible but not how the compliance guidelines are implemented.

We also would like to underline the fact that paragraph 21 is not compatible with some Member States' company laws. Especially in Austria & Germany the supervisory board (in German: Aufsichtsrat) is not responsible for day-to-day business and would therefore not able to decide on the remuneration policies and practices of employees (with the exception of the remuneration of the board of directors).

Question 8

Do you agree that the organisational measures adopted for the launch of new products or services should take into account the remuneration policies and practices and the risks that the new products or services may pose? Please also state the reasons for your answer.

Question 9

Do you agree that the process for assessing whether the remuneration features related to the distribution of new products or services comply with the firm's remuneration policies and practices should be appropriately documented by firms? Please also state the reasons for your answer.

We refrain from answering these questions, as they have no relation to the draft guidelines. Please find our further remarks to the draft guidelines below.

Paragraph 23: Avoidance of complex remuneration structures

We believe that there is no legal basis under the current MiFID legislation that disallows certain remuneration schemes (as explained in our general remarks). Furthermore, the guideline itself is not comprehensible and therefore impossible to implement.

Paragraph 25: Examples of good practice

Instead of a pay-out of the variable remuneration in several tranches, it would also be equally possible to pay the remuneration at once (in accordance with the contractual right of the employee), but include a claw-back clause that would allow the investment firm to claim back any paid variable remuneration, if it comes to light that the employee has not complied with the binding internal instructions the investment firm has implemented to meet the MiFID-provisions.

Secondly, the meaning of "long term results" is unclear. Economic reasoning and good management make it viable to cap variable payments in relation to the investment firm's yearly earnings, as a firm simply cannot (in the long run) spend more than it earns. Nonetheless, we believe that if employees have complied with the binding instructions, they should be allowed to receive their variable remuneration within the contractually agreed timeframe. It is important to note that so far the situation of employees, like advisers, is differentiated from the situation of the senior management (and CRD/CRR).

Thirdly, we would like clarification that only legitimate complaints should count towards reasons that could put into question an employee's variable remuneration.

V.II. Controlling risks that remuneration policies and practices create

Question 10

Do you agree that firms should make use of management information to identify where potential conduct of business and conflict of interest risks might be occurring as a result of specific features in the remuneration policies and practices, and take corrective action as appropriate? Please also state the reasons for your answer.

We refrain from answering this questions, as we cannot find any relation to the draft guidelines under discussion. Furthermore, please be aware that the definition of "management information" has neither been part of previous MiFID information neither been explained in the consultation paper.

Question 11

Do you agree that firms should set up controls on the implementation of their remuneration policies and practices to ensure compliance with the MiFID conflicts of interest and conduct of business requirements, and that these controls should include assessing the quality of the service provided to the client? Please also state the reasons for your answer.

Please find our remarks to the question in the following paragraph.

Paragraph 27: Adequate compliance controls

We believe that the content of paragraph 27 has already been covered in the ESMA guidelines on the compliance function and therefore should be deleted from the remuneration guidelines, as the topic of remuneration does not create any need for special treatment from the compliance guidelines.

Furthermore, we would like to stress that the wording „such controls should include assessing the quality of the service provided to the client" is misleading as very the compliance controls/monitoring and their assessments are in themselves the required quality controls. Therefore, an additional requirement ("such controls should include") of assessing the quality of the service provided to the client does not exist.

Question 12

Do you agree that the compliance function should be involved in the design process of remuneration policies and practices before they are applied to relevant staff? Please also state the reasons for your answer.

Please find our remarks to the question in the following paragraphs.

Paragraph 28: ESMA's compliance guidelines

Please refer to our general comments and our detailed comments on paragraph 13 with regards to ESMA's view that the remuneration policy is the only tool to manage possible conflicts of interest and that only specific remuneration models are allowed in future.

Paragraph 29: ESMA's compliance guidelines

We would suggest the deletion of paragraph 29, as its content is already covered in ESMA compliance guidelines[15].

Paragraph 30 & 31: ESMA's compliance guidelines

We would like to again raise the already existing requirements in ESMA's compliance guidelines[16].

Paragraph 32: Assessment of incentive schemes through contacting sample of customers

Our first comments refer to the second example of the "good practices" in which it is required "to assess whether its incentive schemes are appropriate, a firm undertakes a programme of contacting a sample of customers shortly after the completion of a sale". Here we would like to underline that this practice could only be considered as an option and not a requirement. Even though customer satisfaction is as important for financial firms and services as any other companies, we doubt whether these subjective assessments would provide validity to draw hard conclusions to prove or disprove whether the investment firms complies with the correct implementation of the MiFID-provisions.

With regards to example three, we would again like to point out the existing risk-based monitoring approach by ESMA (as stipulated in the compliance guidelines). We believe that this example should be restricted to legitimate customer complaints and exclude any cancellation of orders that were offered on a goodwill-basis towards the client. With regards to our comments on the missing authority of ESMA to curtail the contractual freedom, please see our general remarks.

[15] ESMA compliance guidelines, paragraph 40, sentence 1 and paragraph 41, sentence 1
[16] ESMA compliance guidelines, paragraphs 18f, 41 & 48f

Paragraph 33

Firstly, please consider our general remarks.

Secondly, we have very strong objections against this example, as it completely ignores the economic reality that variable remuneration is a legitimate means to remunerate employees. It has to be possible to remunerate employees on the basis of the investment firm's earnings. It would also stand against any value of fairness, if harder working employees would not receive more remuneration for the additional value they create for the company. As stated various times in our response we believe that the focus on commercial aspects does not in any case lead to conflicts or interest, rather that an impairment of the client's interest can be prevented by other organisational measures (such as binding instructions to the employees, related labour law practices such as issuing of informal warning or formal warning). For further comments, please see our general comments.

Furthermore, we disagree strongly with the assumption that setting strategic annual goals per se impairs the client's interests. Even if variable remuneration could lead to a conflict of interest, it could still be prevented through other organisational measures and cannot be automatically equated with short-term thinking.

V.III Annex I: Illustrative examples of remuneration policies and practices that create conflicts that may be difficult to manage

Question 13

Do you agree that it is difficult for a firm, in the situations illustrated above in Annex I, to demonstrate compliance with the relevant MiFID rules?

Question 14

If you think some of these features may be compatible with MiFID rules, please describe for each of (a), (b), (c) and (d) in Annex I above which specific requirements (i.e. stronger controls, etc.) they should be subject to.

Please find our remarks to the questions in the following paragraphs.

Paragraph 35

Paragraph 35 is identical to paragraph 34 and should therefore be deleted.

Paragraph 36 – examples of high risk remuneration policies and practices

Lit. (e)/(a):
We are surprised by ESMA's assumption that an investment firm's earnings are equal, regardless which types of products it sells. This is against the economic reality. There will naturally be differences in earnings for different types of products. This nevertheless does not equate to an automatic high risk for the client. Whether a conflict of interest is possible and – if yes – whether there are considerable risks depends on further aspects of the remuneration policies and practices. For example, if the basis for the variable remuneration is solely based on the overall earnings of the whole bank, a conflict of interest should not exist. A considerable risk can for example be refuted, if employees

are given a realistic yearly goal to achieve (that will be adjusted in case of negative market developments) and the employees are given free rein on how to achieve this goal.

Example a3: If two products are equally suited for a client with regards to his investment goals and risk profile and the overall costs of the product, there should be no obligation to automatically recommend one product over another.

Lit. (f)/(b):
Here we do not believe that a "quota of minimum sales" is in any case problematic in real life. All circumstances have to be considered. If an employee already receives a high fixed remuneration, then a minimum sales quota that would only relate into a comparatively small variable bonus, should not create any conflicts of interest.

The second sentence[17] should be deleted, because each variable remuneration depends on special conditions which must be fulfilled. Furthermore, we believe that variable remuneration is not automatically linked to a conflict of interest. Our extensive arguments can be found above.

Contact

The EACB trusts that its comments will be taken into consideration. Should there be any need for further information or any questions on this paper, please contact:

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[17] Conditions which must be met before an incentive will be paid may influence relevant persons to sell inappropriately.