

ESMA'S CONSULTATION PAPER
**Guidelines on remuneration policies
and practices (MiFID)**
-
AMAFI's Comments

1. Association française des marchés financiers (AMAFI) has more than 120 members representing over 10,000 professionals who operate in the cash and derivatives markets for equities, fixed-income products and commodities. Nearly one-third of members are subsidiaries or branches of non-French institutions.

2. The Association welcomes the opportunity to comment on the Consultation paper (hereafter referred to as the CP) on the "Guidelines on remuneration policies and practices (MiFID)" (hereafter referred to as the Guidelines) issued by the European Securities and Market Authority (ESMA).

Before answering the questions of the CP (B.), preliminary comments are set out regarding the scope of the guidelines (A.).

A. Preliminary Comments

1. The definition of relevant persons

3. Paragraph 8 of the CP sets the scope of the Guidelines as regards the persons whose remuneration is concerned but it does so in such a general manner that it is of no practical use for the implementation of the Guidelines by firms and extends it with a lack of proportionality. The scope indeed includes not only persons "who can have a material impact on the service provided and on the conduct of business risk profile (...)" but also "all persons involved in the provision of investment and/or ancillary services".

As far as conflicts of interest and conduct of business risks are concerned, and considering the target of the Guidelines, which is sales activities with retail clients, the persons whose remuneration should be in scope of these Guidelines are only the ones who can have a material impact on the risk profile of firms in these two respects. These are client facing staff.

It may be tempting to take a larger view of conduct of business and conflicts of interest risks, since not only client facing staff is concerned with complying with the related regulations: the firm's organisation to manage those risks obviously involves a larger population such as compliance staff, marketing, audit and even sometimes back-offices. But the risk generated by these functions' activities do not by nature fulfil the criterion of materiality: such risks inherently lie with client facing staff whose activities may lead to

breaches to conduct of business rules and conflicts of interest in-between clients or between firms and clients.

The variable remuneration of support staff is not comparable to client-facing staff's in terms of volume and proportion of the total remuneration, hence not producing the same potential incentives for improper conduct.

As a reminder, the focus of CRD3 with regard to remuneration (Directive 2010/76/EU, 24 November 2010) is not on all staff but on the ones whose activities may have a significant impact of the firm's risk profile, hence taking a proportionate approach. ESMA's mandate with respect to remuneration was set within this context (Directive 2010/76/EU, Recital (19) and Article 1.4). It should therefore be governed by the same philosophy.

2. The remuneration of outsourced entity or person or tied agent

4. The remuneration provided by firms to an outsourced entity or person or tied agent is regarded as remuneration for the purpose of the Guidelines, which would be justified provided that it is made clear that the outsourced entities or tied agents concerned are those including relevant persons as per the definition provided in § 8 (i.e. persons involved in the provision of investment and/or ancillary services for the account of the firm).

5. Secondly, the consequence of this remuneration falling within the scope of the Guidelines is that firms "*should ensure that the tied agents and outsourced entities have remuneration policies and practices that are equally as effective as the firms' own arrangements (...)*". Such requirement is problematic on several counts :

- It places responsibility for the effectiveness¹ of the outsourced entity's own remuneration arrangements on investment firms, which is contrary to the basic principles of corporate responsibility and calls for firms' intrusion into the management of outsourced entities contrary to labour laws;
- It ignores the fact that entities must be licensed to provide investment services (and therefore participate in the provision of firms' investment services) and are hence subject to the same requirements as investment firms².

In actual fact, the key element that is within the control of firms is how they set the remuneration of the services that the outsourced entity provides to them. Only this remuneration should be within the scope of the Guidelines to ensure that it does not entice an outsourced entity to act contrary to client's interests.

6. Paragraph 10 should therefore be amended as follows (the proposed amendments are evidenced as follows: additions are in bold and underlined and suppressions are in bold and crossed out):

"Furthermore, where entities or persons **are involved in the provision of investment and/or ancillary services for the account of** ~~provide services to~~ firms on the basis of an outsourcing arrangement or as tied agents, the remuneration provided by firms to the outsourced entity or person or tied agent is also regarded as remuneration for the purposes of these guidelines. **~~In such cases, firms should also ensure that the tied agents and outsourced entities have remuneration policies~~**

¹ A mere mention in the outsourcing agreement that the outsourced entity must have proper remuneration arrangements does not supposedly meet the criterion of effectiveness.

² The fact that some Member States may allow some entities to provide some investment services without a license is an issue to consider per se by these Member States, in particular with regard to how they ensure that these entities act in accordance with the basic principles of honesty and integrity – this issue should not be transferred onto private sector's firms.

~~and practices that are equally as effective as the firms' own arrangements in addressing and mitigating the potential conduct of business and conflict of interest risks.~~"

Questions

Q1- 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.

7. Yes, AMAFI agrees: proper remuneration policies and practices are just one of the aspects of compliance with the overarching principles of integrity and honesty and the rules on conflicts of interests. There is no need for an additional regulation on this issue, only for an explanation ensuring that these principles are applied in the same way everywhere in Europe.

Q2 - 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.

8. The role of persons is to be taken into account to define the perimeter of relevant persons, who will then be subject to specific remuneration policies and practices. So this factor is to be used beforehand, not so much on the design of remuneration policies but on the definition of the scope of relevant persons.

9. The types of products offered is definitely a factor to consider, as are the investment services provided. The "methods of distribution" quoted by the Guidelines is improper if it is used to designate such concepts as "advised or non advised" because these are not methods of distribution but rather relate to investment services (investment advice, portfolio management or other investment services).

Finally, the methods of distribution (meaning face-to-face or through telecommunications) have no relation to remuneration incentives and seem quite irrelevant in the design of remunerations policies and practices. If ESMA was to keep them in its final guidelines, further explanations should be provided.

Q3 - 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?

10. Yes, with the caveat that such requirement be not interpreted in the same manner as set in the CRD3 (and the future CRD4) for persons who do not fall within the CRD3's definition of relevant persons (see § 3 above). The scope of ESMA's Guidelines is larger than the one of CRD3, even if it were limited to client facing staff, because the concept of materiality is interpreted by ESMA with respect to two types of risk profiles (business of conduct and conflicts of interest) and not the entire risk profile of the whole firm, resulting in a population of relevant persons different to the population of relevant persons under CRD3.

The balance between variable and fixed remunerations should therefore be set freely by firms, the crux being the potential consequences of this determination on conduct of business and management of conflicts of interest.

Q4 - 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.

11. Yes, with the same caveat as in Q3: this ratio should not be identical to the one applying to risk takers as per CRD3.

Q5 - 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.

12. Non financial criteria related to compliance with rules of conduct should always be taken into account. Incidentally, if the definition of relevant persons is not limited to client facing staff, financial criteria may not be applicable to all relevant persons (hence, the need to define them more precisely).

13. Paragraph 48 of the CP states that “*where a firm’s policy provides for variable remuneration*”, the firm should identify when a relevant person fails to act in the best interests of the client and should take remedial action. This statement is very general and no example of remedial action is given.

As, it is already compulsory for a firm that detects breaches to regulatory requirements to take remedial action (as part of its compliance duties), the insertion of this statement in relation specifically to cases where variable remuneration is part of a firm’s policy raises questions. What is the intention? If the objective is to make sure that the firm has the ability to reduce accordingly the variable pay of the relevant person, it is not arguable. But it should then be added. Else, one could infer from this general statement that the firm should be able to take back some of the variable pay already paid, which obviously is a totally different issue conflicting with labour law (at least in France), which cannot be provided for in a level 3 text (such provisions in CRD3 have given rise to major difficulties and are currently applicable to a population of relevant persons that is not identical to the one defined in this CP).

Q6 - 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.

14. In France, the supervisory body approves the remuneration policy (with the help of the remuneration Committee when it exists) as it is responsible for ensuring that it is in line with the firm’s risk profile. The management body implements the policy, adapting it to the various business lines if need be (see AMAFI’s Standard on remuneration, AMAFI / 11-20a, §§ 12 and 28, http://www.amafi.fr/index.php?option=com_content&view=article&id=2468%3Aamafi-11-20-remuneration-des-professionnels-des-marches-financiers&catid=154%3Acode-professionnel&Itemid=69&lang=fr)

Taking advice from the compliance function is indeed necessary to verify compliance of the policy with applicable regulations and help set the non-financial parameters related to compliance that will be used to assess the relevant persons’ performance.

Q7- 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.

15. If senior management means management body, yes, it is responsible for the implementation of the remuneration policies and the management of related issues (*see Q6*). Significant issues are escalated to the supervisory body, which is also provided an annual report on remuneration policies and practices by the management body.

The management body is assisted by other functions (notably HR, internal control functions, risks) in the management of the remuneration policies and practices.

Q8 - 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.

Q9 - 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.

16. Yes. However, the example given in § 54 of the CP that a good practice is to increase fixed remuneration compared to variable one is incomplete in our view. If such practice may be seen as positive from a client perspective, it can also lead to situations where the increase is not commensurate with the firm's ability to absorb losses in a downturn (in this respect CRD3 makes it mandatory for firms to maintain their capability to reinforce their capital base). It may also result in higher staff turnover due to the inability to sustain the payment of high fixed salaries. Such practice labelled as a good one should therefore be strongly qualified.

Q10 - 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.

Q11 - 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.

17. Firms should indeed have controls in place and an escalation process as regards the implementation of their remuneration policies and their potential impacts on conflicts of interest and conduct of business.

In setting up their control structure in this respect, firms should make sure responsibilities are clearly set. The compliance function has a role to play in the design step of the remuneration policies. It also has a role in verifying that the policies are properly applied (including via its involvement in new products approval) and in reporting on its controls and the potential inefficiencies or inadequacies detected. However, the assessment of the adequacy of the levels of remuneration paid to relevant staff is the responsibility of the management body assisted by HR. The compliance function must verify that the

structure and systems are in place to comply with applicable requirements relative to remuneration but should not be involved in judging the levels of remuneration, otherwise endangering its independence. The Guidelines should not give rise to such interpretation by targeting uniquely and specifically the compliance function as having a role in controlling risks that remuneration policies and practices create.

Q12 - 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.

18. Yes (see Q6 and Q11).

Q13 - 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?

Q14 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.

19. AMAFI has no comment on these two questions.

