

Response to the European Banking Authority's Consultations on the Investment Firms Directive's Remuneration Requirements

ICI Global¹ appreciates the opportunity to provide feedback on the European Banking Authority's (EBA's) consultation papers on the draft Regulatory Technical Standards for (1) instruments/ alternative arrangements that can be used for variable remuneration under the Investment Firms Directive (Instruments RTS)² and (2) the identification of material risk takers (MRTs) under the Investment Firms Directive (MRT RTS).³ Many of our member firms are part of regulated fund complexes with operations around the globe, which include UCITS that receive portfolio management services from MiFID-licensed firms subject to the Investment Firms Directive (IFD).

In the first section below we express our concerns with the assumption in the Instruments RTS regarding the timing of the IFD remuneration rules. We follow that, in the second section below, with our response to the appropriateness of the qualitative and quantitative criteria used to identify MRTs.

Timing of the IFD (Instruments RTS)

The consultation on the Instruments RTS assumes that “institutions will have to comply with the RTS with regard to the remuneration awarded for the performance year 2021.”⁴ We acknowledge that Article 67 of the IFD requires European Union Member States to have transposed the IFD into domestic law by June 26, 2021. However, we do not believe that this necessarily requires that investment firms comply with the IFD remuneration rules with respect to the performance year in effect as of the date of transposition. We also disagree that firms should be required to comply with the IFD remuneration rules from that date because the RTS will not likely be published until June/July 2021 at the earliest, and it would be impractical and difficult to introduce the rules in the middle of a performance year. Timing the application of the rules appropriately will help ensure that when they are applied, they are applied correctly and do not create unnecessary employment

¹ ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US\$33.9 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

² The consultation is available at https://eba.europa.eu/sites/default/documents/files/document_library/Publications/Consultations/2020/%20CP%20on%20RTS%20on%20instruments%20for%20IF%20remuneration/884630/EBA-CP-2020-08%20CP%20on%20RTS%20on%20instruments%20for%20IF%20remuneration.pdf.

³ The consultation is available at https://eba.europa.eu/sites/default/documents/files/document_library/Publications/Consultations/2020/CP%20on%20RTS%20on%20IS%20under%20IFD/884631/EBA-CP-2020-09%20CP%20on%20RTS%20on%20IS%20under%20IFD.pdf.

⁴ The assumption can be found on page 5, under “Next Steps.”

law risk. Firms need to have enough time to make the requisite changes to their policies, practices and procedures to ensure compliance in the long term.

To illustrate, if the rules were to take effect from June 26, 2021, firms with a calendar year performance year would be subjecting their employees to new rules in the middle of the year, when they had been working towards annual bonuses on a different basis for the first six months of the year. To limit employment law risk, such firms would in effect be forced to apply the IFD rules from January 1, 2021 – six months before they are required to do so (and before the RTS is finalized). Such early application would mean making changes to policies, practices and procedures in the next few months, prior to the adoption of the final RTS and the finalization of details of the IFD remuneration provisions. In particular, we understand that the EBA’s guidelines on sound remuneration policies under the IFD may not be published prior to January 1, 2021. We therefore urge the EBA to remind the European Commission of the timeline for the finalization of the guidelines and RTS and the necessity for the Commission to ensure that the “appropriate course of action” (as it was recognized to be by the EBA in its public hearing on June 30, 2020) is taken, which is to make the IFD remuneration provisions applicable to firms from the next full performance year after it has been transposed into local law.

If it is determined that, as we recommend, this is the correct course of action, a further matter needs to be addressed: what rules should soon-to-be IFD firms that fall within the scope of CRD V apply between December 28, 2020, when the CRD V regime becomes applicable, and when the IFD rules become applicable (a period we will refer to as the “timing gap”). In our view, the appropriate approach is not to apply CRD V, including the CRD V MRT RTS, to such soon-to-be IFD firms during the interim period. First, it would be disproportionately time consuming and expensive to update remuneration policies, practices and procedures to comply with CRD V when such rules would apply to an IFD firm only during the timing gap. Second, the CRD V rules will not officially apply to IFD firms at the point bonuses for the 2021 performance year are awarded and paid out. There is, therefore, no basis for applying the CRD V rules for any part of performance year 2021, given they will not be enforceable against the relevant firm by the end of that performance year.

In our view, the better option would be to apply transitional provisions to cover the timing gap for those firms that will become subject to IFD. Those provisions could provide that the existing remuneration rules to which such firms are currently subject continue to apply until the date upon which the IFD requirements become applicable to the firm. For many firms this will mean continuing to apply the CRD IV regime during the timing gap. Under this proposal, the IFD would then first apply to the 2022 performance year for calendar year firms.

In summary, therefore, our proposals are:

Current position	Our analysis	Proposed amendments
MRT RTS (and, by association, remuneration rules under the IFD generally) apply from June 26, 2021.	Likely to result in firms not having time to review, implement and apply the RTS adequately considering the RTS will not likely be published until June/July 2021.	Apply to first full performance year commencing on or after June 26, 2021.

Current position	Our analysis	Proposed amendments
Unclear what rules should apply during the timing gap to firms that will be subject to the IFD.	There is no basis for applying CRD V to soon-to-be IFD firms during the timing gap given it will not apply when bonuses are awarded/paid out.	Roll-out transitional provisions, most efficient of which will be to require firms to continue applying their existing regimes until the first full performance year commencing on or after June 26, 2021.

Appropriateness of the Qualitative and Quantitative Criteria Set Out in the MRT RTS

The purpose of the MRT RTS is, in accordance with Article 30(4) of the IFD, to “specify appropriate criteria to identify the categories of individuals whose professional activities have a material impact on the investment firm’s risk profile or that of the assets that it manages,” i.e. to identify those commonly referred to as “Material Risk Takers” or “MRTs.”⁵ It seeks to do this through the application of qualitative and quantitative criteria, as is the approach under CRD IV. In our view, these criteria have not been adequately adapted to suit investment firms for the reasons set out in this section.

CRD IV as Basis for MRT RTS

The MRT RTS is based on the criteria applied under CRD IV. Using the same criteria for investment firms that were designed for credit institutions ignores the differences between the two, which the EBA itself recognizes in the MRT RTS as being the reason for introducing a new prudential regime for investment firms.⁶ It stands to reason that unique quantitative and qualitative criteria, reflective of the heterogeneous characteristics of the investment management (of which asset management is a large part) industry and its business model, should be used to identify MRTs.

Not only is the CRD IV RTS used as a template for the MRT RTS, but it is also used in the cost-benefit analysis/impact assessment as the baseline to assess the impact of the proposed requirements. This ignores the reality that many investment firms will never have had to identify MRTs in this way before and that, as a result, the impact will be much greater than the baseline scenario suggests. Given its impact, it is important the MRT RTS applies criteria that will truly target those who have a material impact on the risk profile of the firm and managed funds and not others.

Quantitative Criteria

Quantitative thresholds. Under proposed Article 6(1), members of staff are deemed to have a material impact on an investment firm’s risk profile or assets it manages if one or more of the following criteria are met:

⁵ Page 7 MRT RTS.

⁶ Paragraph 4 of section 3.2 of the MRT RTS.

- (a) the staff member has been awarded total remuneration which is equal to or greater than EUR 500,000 and equal to or greater than the average of the remuneration of members of the management body and senior management in or for the preceding financial year;
- (b) the staff member has been awarded total remuneration which is equal to or greater than EUR 750,000 or more in or for the preceding financial year;
- (c) in case the investment firm has over 1,000 members of staff, the staff member is within 0.3% of staff, rounded to the next higher integral figure, who have been awarded the highest total remuneration in or for the preceding financial year;
- (d) the staff member was in or for the preceding financial year awarded total remuneration that is equal to or greater than the lowest total remuneration awarded in that financial year to a member of staff who meets one or more of the criteria in points 1, 3, 4, 7, 8 or 9 of Article 5 (which contain certain qualitative criteria).⁷

Except for that set out in Article 6(1)(d), none of the quantitative thresholds in the MRT RTS are stipulated in the IFD. Instead they are, as mentioned above, based on the CRD IV approach and include some requirements that are specific to CRD V. Not only does the CRD IV/ V premise result in a gold plating of the requirements of the IFD, it also fails to take account of the differences in the asset management sector. The scale of pay reflects the business models for these firms rather than the risk the individuals concerned pose to the firm and/or the assets under management. It is important that this fact is factored into any consideration of the application and appropriateness of quantitative thresholds. Unlike with credit institutions, for example, it is not always the case with investment firms and specifically asset managers that “the staff with a high level of total remuneration ha[ve] a higher impact on the risk profile or assets it manages compared to staff with significantly lower remuneration levels,” and we caution the EBA against relying too heavily on this presumption.⁸ Indeed, as explained below, MRTs in investment firms may fall within a broad range of remuneration levels at the firm, and remuneration is often not a “proxy for risk taking” in the asset management sector.

Although the MRT RTS goes some way to addressing this different pay model by allowing firms, at Article 6(2)-(6), to apply for individuals to be excluded as MRTs, the proposed process will be costly, both in terms of time and money. This is so much the case that even the EBA recognized the burden, stating that “[t]he cost of implementing the exclusion is significant, as the burden of proving to the competent authority that the staff member has no material impact on the investment firm’s risk profile or assets that it manages will be on the investment firm.”⁹ In our view a less expensive and more efficient solution needs to be found.

We recommend that the quantitative thresholds at Article 6(1) be removed, except for the one set out at Article 6(1)(d), which alone is true to the requirement in the IFD to identify “any employee receiving overall remuneration equal to at least the lowest remuneration received by *senior management or risk takers*, and whose professional activities have a material impact on the risk profile of the investment firm or of the assets that it manages” (emphasis added). We see no legal basis for including the other quantitative thresholds, as they are not explicitly contained within the IFD. Instead, they exceed the requirements in the IFD and incorporate CRD IV and V

⁷ Article 6(2)-(6) specify the conditions for excluding staff that is within scope of these criteria.

⁸ Page 4 MRT RTS.

⁹ Page 28 MRT RTS.

requirements. Credit institutions are not subject to criteria that are IFD-specific, and it is not, in our view, appropriate for IFD firms to be subject to a threshold intended specifically for credit institutions under a different prudential regime.

Should the EBA not agree with our proposal to remove the quantitative thresholds as described above, we urge the EBA to revise Article 6 so that the quantitative thresholds are only indicators that firms must consider but may rebut if they consider the individuals within scope do not have a material impact on the firm or the assets it manages, without having to seek prior approval from regulators for exclusions as envisaged in Article 6(3). Instead, we propose that firms could be required to record their reasoning for excluding such individuals as MRTs and provide that documented reasoning to the relevant authority on request. As noted above, because the proposed process for seeking approval for an exclusion will be burdensome and costly, both in terms of time and money, we urge a more efficient approach.

If the EBA declines to implement either of our prior recommendations, we at a minimum request that the conditions specified in Article 6(5) with respect to excluding a staff member earning EUR 1 million or more be revised. We recommend that, to obtain regulatory approval for exclusion, firms only be required to be able to demonstrate that such staff member has no material impact on the risk profile of the investment firm or the assets it manages, and that the requirement to demonstrate “exceptional circumstances” be eliminated. So long as it is demonstrated that the staff member has no material impact as described above, and provided that the competent authority will, as proposed in Article 6(5), inform the EBA prior to its approval of such staff members, there is no justification for imposing the additional requirement to demonstrate “exceptional circumstances,” along with the associated increased burden of making such demonstration.

Remuneration Bracket – Article 6(1)(d). Article 6(1)(d) of the MRT RTS requires identification of those who, for the preceding financial year, were awarded total remuneration that is equal to or greater than the lowest total remuneration awarded in that financial year to a member of staff who meets one or more of the qualitative criteria set out in 1, 3, 4, 7, 8 or 9 of Article 5. Articles 5(7) and (9) include not only the staff member that meets the specified criteria, but also any individual who is a voting member of a committee responsible for such activity or decisions.¹⁰ The EBA should recognize that some individuals may be caught by those qualitative criteria by virtue of being a member of the respective committee, which could include more junior and/or lower remunerated individuals within the firm. These individuals may be part of such a committee because they have a more technical, analytical and/or advisory role.

As a result, Article 6(1)(d), which looks to the lowest total remuneration of that group, could result in a large number of employees of an investment firm initially being considered as MRTs even if they are subsequently excluded as MRTs by virtue of Article 6(2). This process would impose a significant administrative burden for firms with little or no prudential justification. We therefore recommend that Article 6(1)(d) be amended by carving out those only caught because they are voting members of committees referred to in Articles 5(7) and 5(9).

In summary, therefore, our proposal is:

¹⁰ Article 5(7) broadly captures those responsible for managing, monitoring and mitigating a material risk to which the investment firm is exposed and Article 5(9) broadly captures those which have authority to take decisions for approving or vetoing the introduction of new products.

Current position	Our analysis	Proposed amendments
Quantitative thresholds replicate CRD IV/V thresholds.	Not appropriate for investment firms and will result in many individuals being inappropriately identified as MRTs.	<p>Remove CRD IV/V quantitative thresholds that have no legal basis under the IFD.</p> <p>If the first recommendation is not taken, use quantitative thresholds as indicators only and do not require regulatory approval for exclusion.</p> <p>If the prior recommendations are declined, eliminate the requirement to demonstrate “exceptional circumstances” for staff members earning EUR 1 million or more as long as they have no material impact on the risk profile of the investment firm or the assets it manages.</p>
Article 6(1)(d) pulls into scope those earning the same or more as staff meeting specified qualitative criteria.	Because the threshold is based on lowest total remuneration of that group and the group can include some more junior qualitative staff, may result in many individuals being wrongly considered as MRTs.	Carve out from the group those only caught because they are voting members of committees referred to in Articles 5(7) and 5(9).