

MEMO# 33093

February 5, 2021

European Banking Authority Issues Consultation on Remuneration Guidelines Under the Investment Firms Directive

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February 5, 2021 TO: ICI Global Members SUBJECTS: MiFID, EMIR, AIFMD, UCITS V RE: European Banking Authority Issues Consultation on Remuneration Guidelines Under the Investment Firms Directive

On December 17, the European Banking Authority (EBA) issued a consultation on guidelines on sound remuneration policies under the Investment Firms Directive (Guidelines).^[1] Responses are due by March 17. The final Guidelines are expected to be published before the end of June 2021, and Member States will need to notify the EBA regarding whether they will comply with the Guidelines or explain their non-compliance.

The key points of the proposed Guidelines are described below. Overall, they draw heavily from the remuneration guidelines that have been issued under the CRD IV/V regime.

We will be preparing a response to the consultation. If this consultation is of particular interest to your firm please reach out to me at emykolenko@ici.org.

Date of Application

The Guidelines will apply beginning on June 26, 2021, and investment firms will be required to make any adjustments to their remuneration policies by December 31, 2021 (where shareholder approval is required, approvals should be requested by June 30, 2022). The EBA states that the remuneration policy should be applied in line with the Guidelines for the performance year beginning after December 31, 2021; however, it is not fully clear whether this means that firms can delay applying the whole of the Investment Firms Directive (IFD) until the performance years starting after December 31, 2021.

The UK Financial Conduct Authority has specified that it is intending to apply its investment firms prudential regime (IFPR) beginning on January 1, 2022.

Remuneration Committee

The Guidelines provide that investment firms with on and off balance sheet assets that exceed EUR100 million must establish a remuneration committee (the EBA does not appear

to interpret the IFD as permitting the threshold to be increased to EUR300 million if certain conditions are met). The Guidelines specify that the Chair and a majority of the members of the remuneration committee must qualify as independent, and further provide that where there are not a sufficient number of independent members, firms should implement other measures to limit conflicts of interest. This is the same as the expectations under the CRD IV guidelines.

The Guidelines also state, in line with the IFD, that the remuneration committee can be established at group level and clarify that this includes the level of a CRD parent.

Remuneration Policies and Group Context

The EBA makes clear that the IFD remuneration requirements including those in the Guidelines apply on an individual and consolidated basis. The Guidelines state that specific remuneration requirements of subsidiaries should be taken into account, but that this does not override application at the regulatory consolidation group level. They also provide that when applying the requirements on a consolidated basis, the remuneration requirements applicable in the Member State where the parent undertaking is located apply, even if they are stricter. Therefore, staff working for a UCITS management company within an IFD regulatory consolidation group who are identified as material risk takers under the IFD quantitative criteria can be subject to the IFD pay-out process rules (including those on malus and clawback), without regard to the remuneration rules that apply to UCITS management company on a solo basis.

Proportionality

Under the IFD, proportionality applies if the four-year average of a firm's on and off balance sheet assets does not exceed EUR100 million, with Member States being able to increase the threshold to EUR300 million under certain conditions. The Guidelines confirm that proportionality applies on a solo and consolidated basis (including the higher EUR300 million threshold).

The Guidelines provide that, when applying the requirements in a proportionate manner, investment firms and competent authorities should consider the nature, scale, and complexity and the risks inherent in the business model and the activities of the investment firm. They then also specify that, for these purposes, investment firms and competent authorities should take into account – at a minimum – a long list of additional criteria, including assets under management, business strategy, funding structure of the firm, types of clients, and volume of daily trading flow.

Identification of Material Risk Takers

The EBA's Regulatory Technical Standards specify how material risk takers are to be identified. The Guidelines specify that all investment firms should conduct annually a self-assessment in order to identify material risk takers. The self-assessment should be based on the qualitative and quantitative criteria set out in the RTS on identified staff and where needed, to ensure the complete identification of all staff whose professional activities have a material impact on the investment firm's risk profile or of the assets that it manages, additional criteria set forth by the investment firm that reflect the levels of risk of different activities within the investment firm and the impact of staff members on the risk profile.

The Guidelines contain similar guidance to that under CRD IV/V regarding documenting the material risk taken identification process, governance of the process, and exclusions.

Payout Process Rules

The Guidelines specify that the remuneration policy should set an appropriate ratio between the variable and the fixed components of the total remuneration (but it does not prescribe an upper bound on this ratio), and further states that the fixed remuneration components should be set at a level that would allow a fully flexible policy on variable remuneration for all staff. The EBA has retained much of the guidance from the CRD IV/V regime on allocating pay to the fixed or variable component, the characteristics of allowances, and calculating the ratio.

Notably, the Guidelines state that “the maximum ratios allowable should include levels of pay-outs that would cover ‘above target’ or exceptional performance,” and that the effective ratio between variable remuneration awarded and fixed remuneration should increase with the performance achieved.

The Guidelines indicate that there is flexibility in applying the requirement for 50% of a material risk taker’s pay to be in non-cash instruments by suggesting that firms have the choice to apply the requirement only to the deferred component or equally to both components of variable pay. The IFD Level 1 text is silent on this, whereas the CRD IV/V Level 1 text is clear that this requirement applies equally to both the deferred and non-deferred components of variable pay.

Gender Neutral Remuneration Policy and ESG

The IFD requires that the remuneration policy be gender neutral. The EBA has adopted the same interpretation of what this means as it did for CRD V, specifying that this means “equal pay for male, female and diverse workers for equal work or work of equal value” and also that “there should also be a gender neutral approach to pay increases and career progression” and gender neutrality includes “career development and succession plans, access to training and ability to apply for internal vacancies.” The Guidelines also contain documentation and process requirements associated with the requirement for the remuneration policy to be gender neutral.

In line with the overall regulatory focus on sustainable finance, the Guidelines provide that the remuneration should have “regard to environmental, social and governance (ESG) risk factors.”

EBA Consultation Questions

The EBA has asked for feedback on the following questions.

1. Are the subject matter, scope and definitions appropriate and sufficiently clear?
2. Is the section on gender neutral remuneration policies sufficiently clear?
3. Are the sections on the remuneration committee sufficiently clear?
4. Are the guidelines on the application of the requirements in a group context sufficiently clear?
5. Are the guidelines regarding the application of waivers within section 4 sufficiently clear?
6. Is section 9 on severance payments sufficiently clear?
7. Are the provisions on performance criteria sufficiently clear, which other performance indicators, e.g. regarding the performance of business units or portfolios, are used to determine the variable remuneration of identified staff?
8. Is the section on the pay out in instruments sufficiently clear?

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endnotes

[1] The consultation is *available at* https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Consultations/2021/Consultation%20on%20Guidelines%20on%20remuneration%20policies%20for%20investment%20firms/961607/CP%20on%20GL%20on%20remuneration%20policies%20under%20IFD.pdf.

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