MEMO# 33084

February 3, 2021

European Banking Authority Issues Final Reports with Draft RTS on Remuneration Under the Investment Firms Directive

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February 3, 2021 TO: ICI Global Members SUBJECTS: MiFID, EMIR, AIFMD, UCITS V RE: European Banking Authority Issues Final Reports with Draft RTS on Remuneration Under the Investment Firms Directive

On January 21, the European Banking Authority (EBA) published two sets of draft Regulatory Technical Standards (RTS) under the Investment Firms Directive (IFD) on: (1) criteria to identify staff whose professional activities have a material impact on an investment firm's profile or assets it manages (risk takers RTS)[1] and (2) classes of instruments that adequately reflect the credit quality of the investment firm as a going concern and possible alternative arrangements (payment in instruments RTS).[2] ICI Global submitted a comment letter on the risk takers RTS in early September raising concerns with the potential timing of the effectiveness of the IFD remuneration rules and the appropriateness of the qualitative and quantitative criteria used to identify material risk takers (MRTs).[3]

Once adopted by the European Commission, the two sets of RTS will go through a three-month scrutiny period before being published in the Official Journal of the European Union, which is expected in Q2/Q3 2021. The IFD goes into effect on June 26, 2021.

The RTS will only be directly applicable to investment firms (or investment firm groups) regulated in the EU. However, they will also be important to firms in the United Kingdom because they are likely to influence the UK Financial Conduct Authority's approach in implementing the remuneration provisions of the UK Investment Firms Prudential Regime (IFPR).

Draft RTS on Material Risk Takers

The IFD requires investment firms to identify all staff whose professional activities have a material impact on the investment firm's risk profile or assets under management. The RTS lay out a common set of criteria that must be applied to identify such staff (referred to as "identified staff" or "material risk takers"). Modeled after the prescriptive approach for identifying material risk takers applied under the CRD IV RTS and the CRD V RTS, investment firm staff can qualify as material risk takers by meeting either quantitative or qualitative thresholds.

Qualitative Criteria

The qualitative criteria aim to identify staff in key areas and functions whose impact on the firm's risk profile, in EBA's view, will always be material. Specifically, all members of the management body or senior management must be identified. In addition, staff with managerial responsibility for certain functions, including money laundering and terrorist financing, economic analysis, outsourcing, and IT/information (where that role relates to the safeguarding of assets or client money, or the execution of client orders or trading activities) are within scope. The EBA specifies that the qualitative criteria are not exhaustive and that firms will need to continue to consider whether other categories of staff, not caught by the qualitative criteria, may nevertheless have a material impact on the firm's risk profile and therefore need to be identified as material risk takers. The EBA did not make significant changes to the draft RTS based on the feedback it received.[4]

Quantitative Criteria

Levels of remuneration are used for identifying staff based on quantitative criteria. The EBA notes that, where individuals are awarded very high total remuneration, this is usually linked to the impact of their professional activities on the investment firm's risk profile or the assets it manages. The quantitative criteria proposed in the draft RTS are set at the same level as those that will apply to banks under the new CRD V proposal, which the EBA proposes for cross-sectoral consistency. The quantitative criteria include, (1) staff earning more than €500,000, (2) for firms of 1,000 staff or more, staff that are in the top 0.3% of earners, and (3) staff whose remuneration is equal to or greater than the lowest total remuneration of certain staff included under the qualitative criteria. The quantitative criteria do not apply where the investment firm determines that the staff member has no material impact on the risk profile of the investment firm or the assets that it manages.

The draft RTS have been revised to clarify the conditions for excluding a staff member based on quantitative criteria, and now provide that staff earning €750,000 or more and staff pulled into scope based on the 0.3% of earners provision may be excluded only with the prior approval of the investment firm's competent authority. Exclusions for staff earning more than €1,000,000 requires approval from the competent authority, which will be given only in "exceptional circumstances," and the competent authority must inform the EBA before giving its approval.

In our letter, we had urged the EBA to remove the quantitative thresholds that were derived from CRD IV/V and had no legal basis under the IFD. We also proposed other alternatives, such as using the quantitative thresholds as indicators only, and not requiring regulatory approval for exclusion. In its response to the feedback it received, the EBA maintains that its approach is appropriate and underscores that the quantitative criteria are legally binding and not indicative.

Application of the Criteria

For investment firms that are part of a group, the criteria generally need to be applied at both the individual and group consolidated basis. The draft RTS have been revised to clarify how the provisions apply on an individual and consolidated basis.

Draft RTS on Payment in Instruments

The IFD requires that 50% of the variable pay of material risk takers be made in "instruments."[5] National competent authorities may approve the use of "alternative arrangements fulfilling the same objectives" if an investment firm does not issue any of the specified instruments. The draft RTS define the (1) Additional Tier 1 and Tier 2 instruments that may be used and (2) categories of instruments that may be used as "alternative arrangements fulfilling the same objectives." They are defined very similarly to how they are defined under the current CRD IV regime. The EBA explains that the provisions in the RTS are aligned with the current framework and with similar RTS under CRD, to ensure that groups of credit institutions and investment firms are able to use a common set of instruments for remuneration purposes.

Timing of the IFD

In our September comment letter, we urged the EBA to remind the European Commission of the timeline for the finalization of the guidelines and RTS (expected to be after the June 26, 2021, effective date), and the need for the Commission to make the IFD remuneration provisions applicable to firms from the next full performance year after it has been transposed into national law. The payments in instruments RTS provides that the provisions of the IFD should apply from June 26, 2021, and also states that the entry into force of the RTS will depend on the date of their publication in the Official Journal.

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endnotes

[1] The risk taker RTS are *available at* https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Draft%20Technical%20Standards/2021/962224/Final%20draft%20RTS%20on%20identified%20staff%20under%20IFD.pdf.

[2] The payment in instruments RTS are *available at* https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Draft%20Technical%20Standards/2021/962223/Final%20draft%20RTS%20on%20instruments%20for%20variable%20remuneration%20under%20IFD.pdf.

[3] *See* ICI Memorandum No. 32744, issued September 8, 2020, *available at* https://www.iciglobal.org/iciglobal/pubs/memos/memo32744.

[4] The EBA did revise the qualitative criteria to remove staff with managerial responsibility for a business unit that contributes 10/20% of the investment firm's own funds requirement, and replaced this with different criteria applicable to firms with a balance sheet over €100 million, pulling into scope staff with managerial responsibility for certain authorized business units.

[5] "Instruments" are defined in the IFD as: (1) shares or equivalent ownership interests, subject to the legal structure of the investment firm concerned; (2) share-linked instruments or equivalent non-cash instruments, subject to the legal structure of the

investment firm concerned; (3) Additional Tier 1 or Tier 2 instruments or Other Instruments which can be fully converted to Common Equity Tier 1 instruments or written down and that adequately reflect the credit quality of the investment firm as a going concern; and (4) non-cash instruments which reflect the instruments of the portfolios managed.