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Link'n Learn

Financial services remuneration

(CRD,MiFID, AIFMD, UCITS)

Leading Business Advisors

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Agenda

1. Key areas of focus for 2015
2. Regulatory developments:
   - EBA guidelines on CRD IV
   - AIFMD
   - UCITS V
   - MiFID
3. Key themes in asset management remuneration
4. Alignment of risk, reward and culture

Key areas of focus for 2015

Key areas of focus in 2015

Impact of draft EBA guidelines for CRD IV

AIFMD housekeeping and disclosures

Preparation for UCITS V

Alignment of risk, reward and culture

Focus on operation of malus and clawback

Focus on governance and processes

Regulatory Developments

Regulatory developments

CRD IV remuneration requirements

- **Linkage to business strategy, values and long-term interests**
- **Risk management and risk adjustment**
- **Governance – Remuneration Committee and control function input**
- **Material Risk Taker identification**
- **Performance assessment – firm, business unit and individual**
- **Funding and capital**
- **Joiners and leavers**
- **Balance of fixed and variable pay**
- **Remuneration structures**
  - Deferral
  - Payments in shares / instruments
  - Malus / clawback
  - Bonus cap

Regulatory developments

EBA guidelines on remuneration under CRD IV

- On 4 March 2015, the EBA released a consultation paper setting out proposed guidelines on sound remuneration policies under CRD IV.
- The EBA is aiming to issue final guidelines in Q4 2015, from which time national regulators across the EU will have two months to express their intention to comply or explain their intention not to.
- Firms are expected to apply the final guidelines for the 2016 performance year onwards.

Key issues:

Proportionality

- Removal of neutralisation
- *De minimis* rule

Changes in remuneration policy requirements

- Deferral and retention periods
- Instruments and dividends
- LTIP valuation
- Definitions of fixed and variable

Governance requirements

- Remuneration Committee at subsidiary level

Additional reporting requirements

- Qualitative reporting

Regulatory developments

EBA guidelines on remuneration – proportionality

Reduction of the benefit of proportionality

- Provisions cannot be neutralised
- Minimum rules on variable remuneration to be applied to smaller firms
  (40% deferral; 50% instruments; malus)
- Stricter rules (e.g. higher deferral) may apply to larger firms

Larger firms: low impact

- No direct impact
- Removal of *de minimis* rule will impact some individuals
- Large firms should consider setting more strict criteria (at least minimum criteria under CRD IV)

Smaller firms: high impact

- Provisions cannot be 'neutralised' altogether anymore.
- Minimum quantitative rules on deferral and variable remuneration portion awarded in instruments should apply.
- The cap on the ratio of fixed to variable pay should not be subject to proportionality at all.

Will also impact smaller subsidiaries of large firms

Regulatory developments

EBA guidelines on remuneration – fixed remuneration definition

"Remuneration is either fixed or variable; there is no third category of remuneration"

Fixed remuneration requirements

- Pre-determined
- Non-discretionary
- Transparent to employees
- Permanent
- Non-revocable
- Not able to be reduced/suspended/cancelled
- Not considered to provide incentives to take risks
- Not dependent on performance

Additional requirements for Role Based Allowances

- Must be tied to a role or organisational responsibility
- The role or responsibility is the only factor determining the amount
- Any other individual with the same role/responsibility in a comparable situation is entitled to the allowance

Firms will need to document why their role-based allowances are considered as fixed pay

Regulatory developments

EBA guidelines on remuneration – changes to the payout process

Deferral	• Deferral increased to at least five years for the Board and senior managers of a significant institution.
Instruments	• Firms should prioritise the use of shares or bail-in instruments rather than using share-linked instruments.
Dividend	• No dividends or interest allowed on deferred instruments (presumably this also includes dividend equivalents).
LTIP	• Performance-based LTIP awards will be included in the variable/fixed remuneration ratio calculation in the year the performance conditions are met.
Retention period	• Retention period increased to one year • Possible extension of the retention period for Board members and senior management (increasing the retention period for upfront awards to that of the combined deferral and retention periods or deferring a higher proportion of the variable remuneration paid in instruments)
Malus and clawback	• Malus and clawback should at least cover deferral and retention periods • Where national law prevents significant downward adjustment, firms should consider the following: longer deferral and retention periods, no pro-rata vesting where malus can be applied but clawback cannot, and higher portion of instruments.

Regulatory developments

AIFMD

AIFMD

DISCLOSURE

Finalise approach for AIFMD disclosure requirements

REWARD STRUCTURES

Review remuneration structures to ensure fit for purpose - business strategy, culture and risk

IDENTIFIED STAFF

Overlap with CRD IV Material Risk Takers and incorporation of ESMA Q&As on portfolio managers

RISK ADJUSTMENT

Finalise the operational implementation of malus/clawback

Regulatory developments

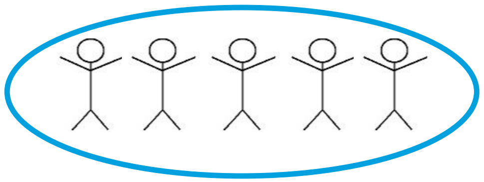
AIFMD – quantitative disclosures

1) Aggregate remuneration paid to all Identified Staff at the AIFM

	Fixed	Variable	Carried Interest
Senior Management	• xxx	• xxx	• xxx
Other Identified Staff	• xxx	• xxx	• xxx

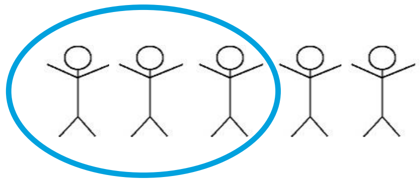
2) Total amount of remuneration for the financial year paid by the AIFM to its staff

Option 1



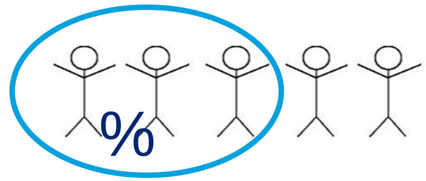
The total remuneration of the entire staff of the AIFM

Option 2



The total remuneration of those staff of the AIFM who are fully or partly involved in the activities of the AIF

Option 3



The portion of the total remuneration of the staff of the AIFM attributable to the AIF

Whichever option is chosen, the total remuneration for the financial year should be split into fixed and variable remuneration, indicate the number of beneficiaries the amount relates to, and mention any carried interest paid by the AIF.

Regulatory developments

AIFMD – qualitative disclosures

- AIFMD requires the disclosure of general information about the AIFM's remuneration policy and practices and link between pay and performance.
- Specifically requires details off:

Financial and non-financial performance criteria	Measures adopted to avoid or manage conflicts of interest

- Must give enough detail to enable investors to:

Assess the incentives created	Understand the impact on the risk profile of the AIF

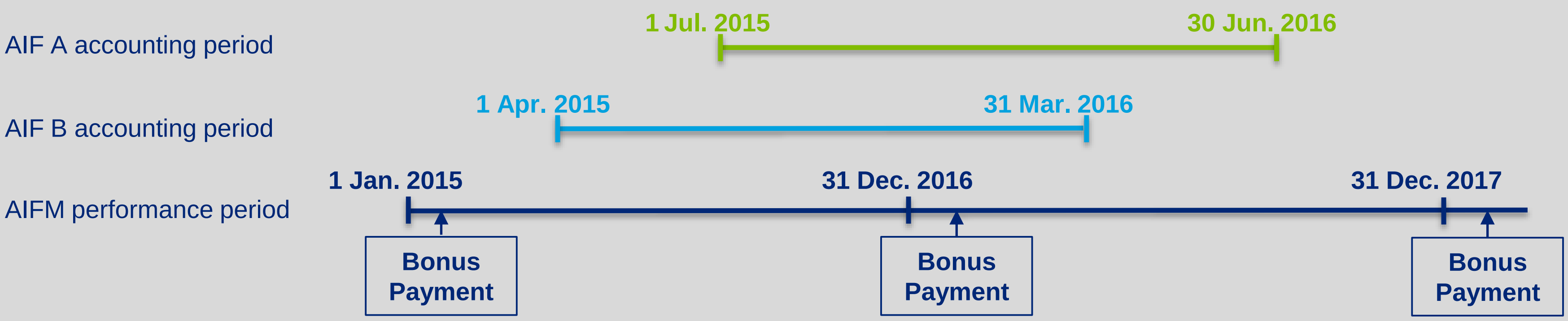
- Suggests an overview of the remuneration policy and a reference to where the full remuneration policy of the AIFM is available
- ESMA guidelines also refer to additional disclosures in Commission Recommendation from 2009

Regulatory developments

AIFMD – remuneration disclosures – key challenges

First disclosure / transitional rules	Scope of the disclosure	Qualitative disclosure	Quantitative disclosure		
National regulator guidance?	Inclusion of delegates?	Level of detail of remuneration policy to disclose?	Aggregate pay of the AIFM vs. breakdown by AIF?	Identified Staff performing a mix of AIFM and non-AIFM activities?	Misalignment of AIF financial year with AIFM performance period?

What to disclose in respect of each AIF?



Regulatory developments

UCITS V

UCITS V

Review remuneration structures and governance in preparation for UCITS V implementation in 2016
(ESMA consultation paper expected summer 2015)

Deferral

Payment in instruments

Malus and clawback

Governance / disclosure

Identified Staff analysis

Regulatory developments

MiFID – remuneration developments

MiFID II

- Explicit requirement for the management bodies of investment firms to **define, approve and oversee remuneration policies** aimed at encouraging **responsible business conduct** and the **fair treatment** of clients.

- Rules to ensure sales staff and advisers are not remunerated in a way that creates **incentives for staff to sell products inappropriately**. In particular, MiFID II requires that firms do not remunerate or assess the performance of their own staff in a way that **conflicts with their duty to act in the best interest of their client**, or provides an incentive for recommending or selling a particular financial instrument when another product may better meet the client's needs.

- Comes into force in **January 2017** and is expected to codify the expectations already set out in the existing ESMA guidelines on remuneration policies and practices for MiFID firms, published in June 2013. These guidelines apply to the following firms where they provide investment and ancillary services to retail and/or professional clients:

Investment firms | Credit institutions | UCITS managers | AIF managers

- The principles are intended to apply to all individuals who can have a **material impact** on the ability of a firm to comply with its overarching obligations to act **fairly, honestly and professionally** in line with the best interest of retail and professional clients.

Regulatory developments

MiFID II

- The focus of the guidelines is on:

Alignment of remuneration with risk management	Inclusion of non-financial as well as financial measures
Appropriate balance of fixed and variable pay	Documentation of remuneration policies
Simplicity of design	Governance and controls

- In March, the FCA released a discussion paper considering whether these remuneration principles should apply more broadly to sales staff in non-MIFID firms across the whole financial services market (e.g. to consumer credit firms).

Key themes in asset management remuneration

Key themes in asset management remuneration

Base salary increases generally low – may change depending on EBA consultation outcome

Increased deferral, usually over three years

Firms considering the use of fund units to satisfy AIFMD and UCITS V requirements

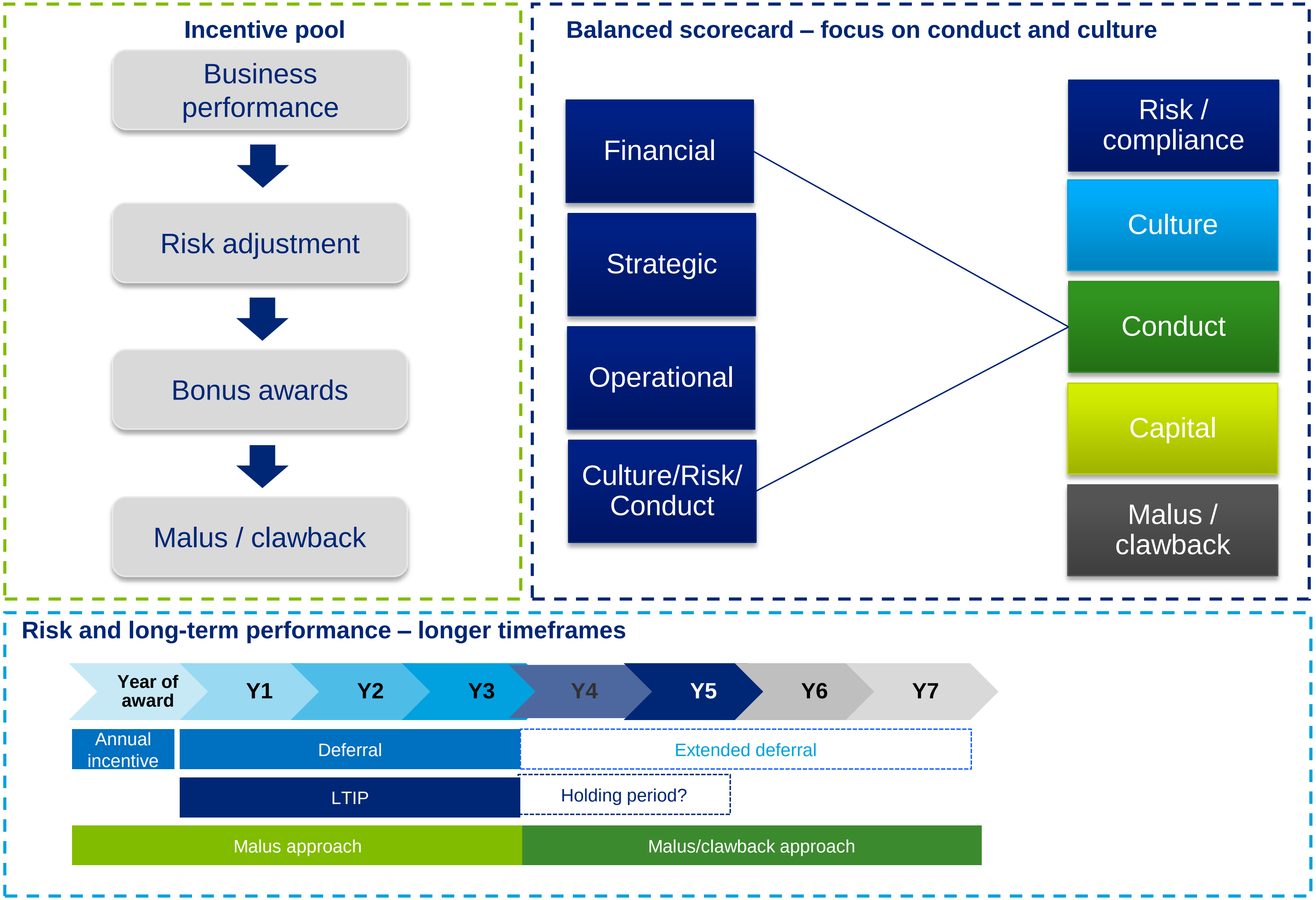
Increased focus on risk and conduct – focusing on the “how” as well as the “what”

Trend towards balanced scorecard approach, away from solely financial metrics

Use of malus more common, but clawback still unusual

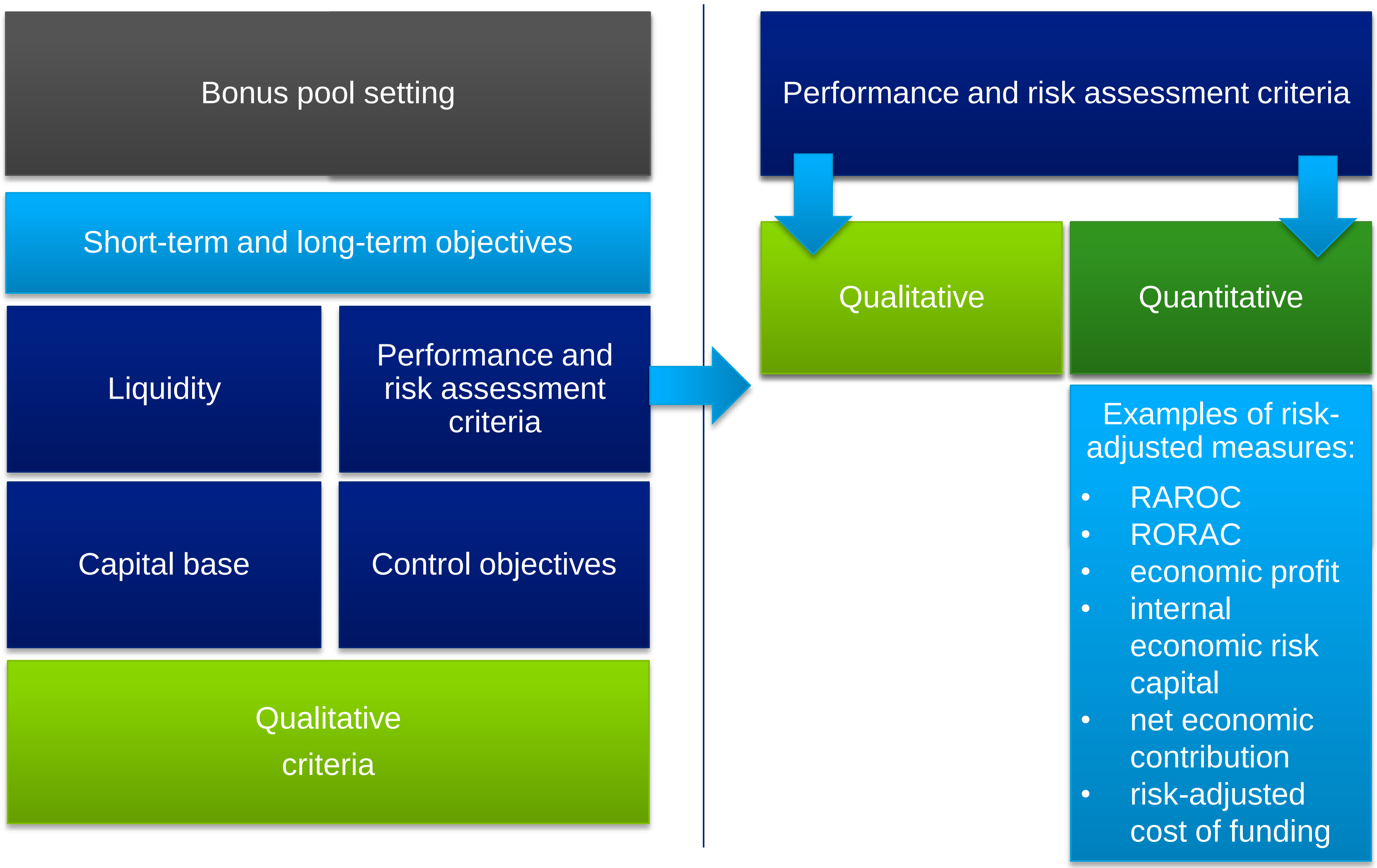
Alignment of risk, reward and culture

Alignment of risk, reward and culture



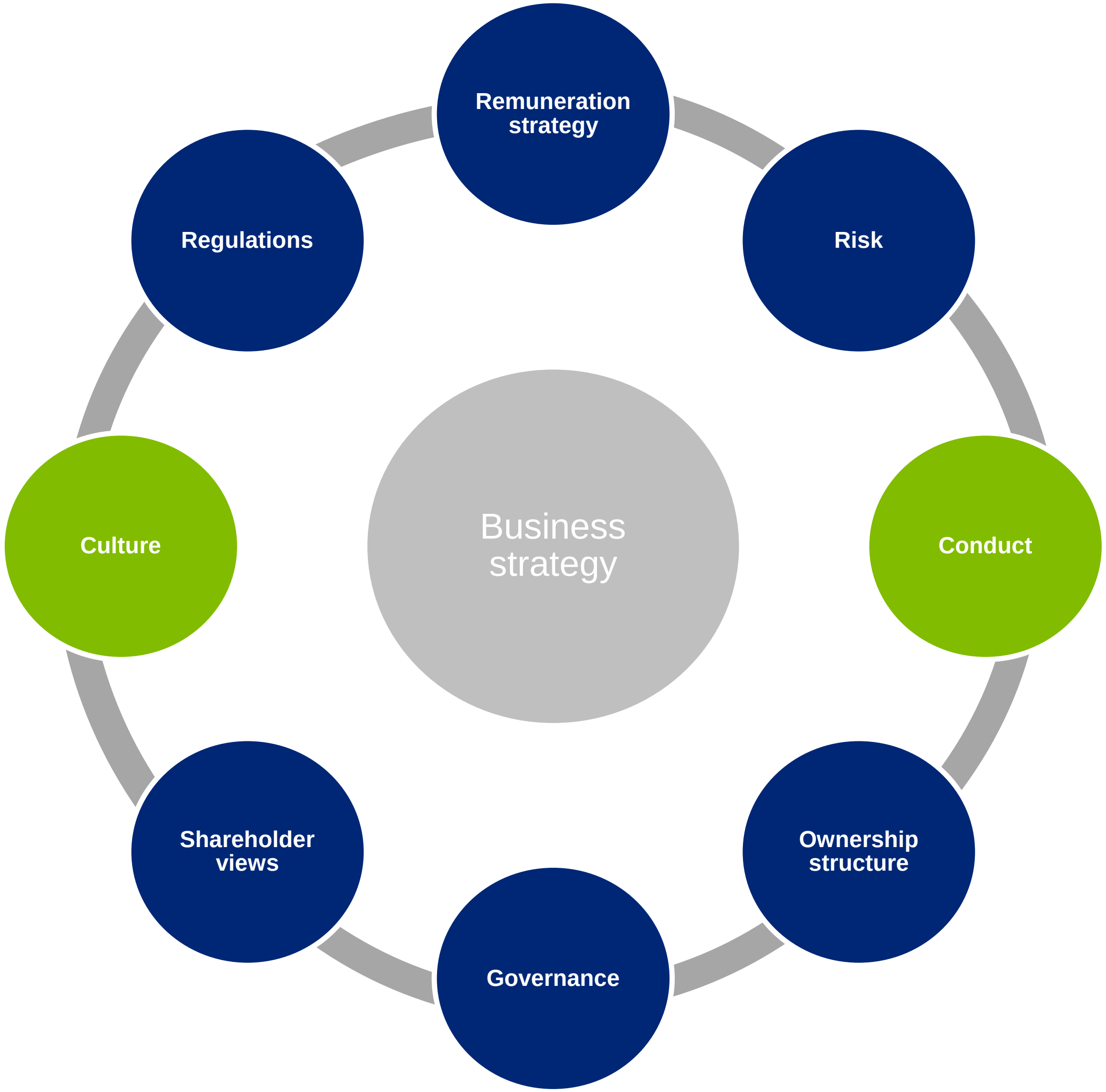
Alignment of risk, reward and culture

EBA guidelines – proposed changes in the risk alignment process



Alignment of risk, reward and culture

Remuneration - future proofing your strategy



Q&A

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