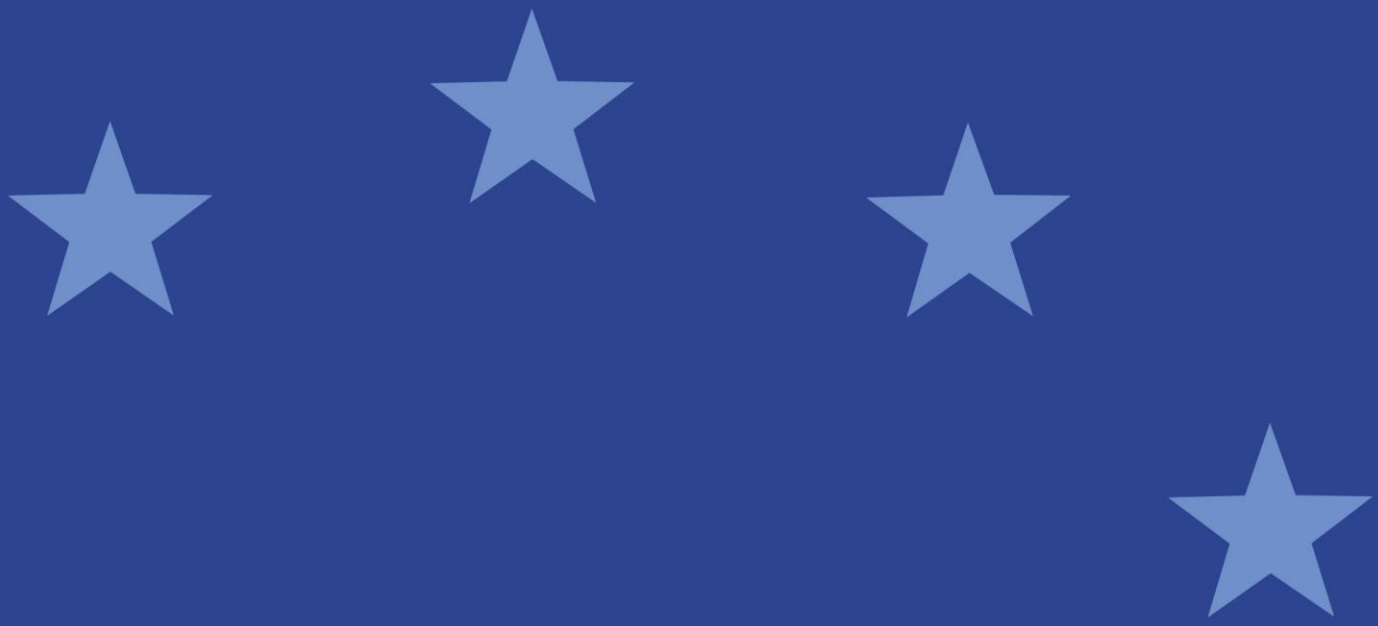
esma European Securities and Markets Authority

Final Report

Guidelines on certain aspects of the MiFID II remuneration requirements



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1 Executive Summary

Reasons for publication

The remuneration of staff involved in the provision of investment and ancillary services and activities or selling or advising on structured deposits to clients is a crucial investor protection issue.

On 19 July 2021, ESMA published a Consultation Paper (CP) with proposed draft guidelines on certain aspects of the MIFID II remuneration requirements.[1]

The consultation period closed on 19 October 2021. ESMA received 20 responses, 1 of which confidential. The responses received are available on ESMA's website unless respondents requested otherwise. In addition, ESMA also received the advice of the Securities and Markets Stakeholders Group (SMSG).

This paper summarises the responses to the CP and explains how the responses have been taken into account. ESMA recommends reading this report together with the CP published on 19 July 2021 to have a complete view of the rationale for the guidelines.

The purpose of these guidelines is to enhance clarity and foster convergence in the implementation of certain aspects of the new MiFID II remuneration requirements, replacing the existing ESMA guidelines on the same topic, issued in 2013.[2] These guidelines build on the text of the 2013 guidelines, which have been substantially confirmed (albeit clarified and refined where necessary). In addition, it takes into account new requirements under MiFID II and the results of supervisory activities conducted by national competent authorities (NCAs) on the topic. By pursuing the objective of ensuring a consistent and harmonised application of the remuneration requirements, the guidelines will make sure that the objectives of MiFID II can be efficiently achieved. ESMA believes that the implementation of these guidelines should strengthen investor protection – a key objective for ESMA.

Contents

Section 2 gives an overview of the Final Report.

Section 3 contains the Annexes: Annex I contains the cost-benefit analysis; Annex II summarises the opinion of the SMSG; Annex III contains the feedback statement; and Annex IV contains the full text of the final guidelines.

Next Steps

The Guidelines in Annex IV will be translated in the official EU languages and published on ESMA's website. The publication of the translations in all official languages of the EU will trigger a two-month period during which NCAs must notify ESMA whether they comply or intend to comply with the Guidelines.

2 Overview

Background

1. The remuneration of staff involved in the provision of investment services to clients is a crucial investor protection issue. While MiFID I did not contain specific requirements on remuneration, it set out the obligations on firms in respect of conflicts of interest[3] and conduct of business obligations when providing investment and/or ancillary services.[4]

2. In October 2013, ESMA published guidelines on remuneration policies and practices (MiFID) (hereafter the "2013 guidelines").[5] The purpose of the guidelines was to enhance clarity and foster convergence in relation to the existing MiFID I conflicts of interest and conduct of business requirements in the area of remuneration. The guidelines focus mainly on the governance and design (criteria) of the remuneration policies and practices as well as on the risks that they can create and how to control them.

3. The importance of the topic of remuneration is highlighted in MiFID II which now contains specific remuneration requirements that, notably, include some of the recommendations set out in the 2013 guidelines.

4. Firstly, Article 9(3)(c) of MiFID II introduces a new, explicit requirement on the management bodies of investment firms to define, approve and oversee a remuneration policy of persons involved in the provision of services to clients. Such remuneration policy shall be aimed at encouraging responsible business conduct, fair treatment of clients as well as avoiding conflicts of interest in the relationships with clients.

5. MiFID II also highlights the issues related to remuneration in the organisational requirements applicable to firms by requiring them to take all appropriate steps to identify and to prevent or manage conflicts of interest, including those caused by the firm's own remuneration and other incentive structures (Article 23(1) of MiFID II).

6. In addition to these broadly framed organisational requirements, MIFID II also tackles the topic of remuneration in its conduct of business rules: Article 24(10) of MiFID II provides that an investment firm shall ensure that it does not remunerate or assess the performance of its staff in a way that conflicts with its duty to act in the best interests of its clients and that, in particular, it should not make any arrangement by way of remuneration, sales targets or otherwise that could provide an incentive to its staff to recommend a particular financial instrument to a retail client when the investment firm could offer a different financial instrument which would better meet that client's needs.

[3] Articles 13(3) and 18 of MiFID I and Articles 21, 22 and 23 of the MiFID I Implementing Directive.
[4] Article 19 of MiFID I.
[5] ESMA/2013/606.

7. It is worth noting that, in addition to the MiFID II specific requirements relating to remuneration, the conflicts of interest and conduct of business obligations nonetheless continue to apply to firms' remuneration policies and practices.

8. In December 2014, ESMA provided technical advice to incorporate some of the content of the 2013 guidelines in the MIFID II delegated acts. Following the ESMA advice the topic of remuneration has been addressed in Articles 2(5), 27 (mostly) and 34 of the MiFID II Delegated Regulation.

9. The MiFID II remuneration framework is thus now mainly set out in Article 27 of the MiFID II Delegated Regulation as well as, on the one hand, regarding the conflicts of interest requirements, in Articles 16(3) and 23 of MiFID II and Article 34 of the MiFID II Delegated Regulation and, on the other hand, regarding the conduct of business rules, in Article 24 of MiFID II. In addition, the governance requirements applicable in the area of remuneration are set out in Article 9(3) of MIFID II.

10. The need to enhance clarity and to foster convergence on some of the above-mentioned aspects has triggered the review and update of the 2013 guidelines.

11. In addition, ESMA also aims to:

    - take into account the results of supervisory activities conducted by national competent authorities (NCAs) on the implementation of the remuneration requirements (including the implementation by firms of the 2013 guidelines); and

    - provide additional detail on some aspects that were already covered under the 2013 guidelines.

General approach followed for the review of the 2013 guidelines

12. MiFID II has highlighted the importance of the topic of remuneration by introducing in the MiFID II framework new and specific requirements relating to remuneration policies and practices. However, a large part of these new requirements comes directly from the 2013 guidelines. For this reason, ESMA has chosen to build upon the text of the 2013 guidelines, which have been substantially confirmed (albeit clarified, refined and supplemented where necessary).

13. ESMA notes that, in order to avoid any unnecessary repetitions, it has deleted from the 2013 guidelines the ones that have been incorporated directly in the MiFID II framework or that have become unnecessary (for instance, guideline 8 on competent authorities' supervision and enforcement of remuneration policies and practices). ESMA however notes that the remaining guidelines have been generally confirmed, as they still provide a valuable contribution in terms of practical examples and clarification on how the requirements should be applied in practice.

14. Taking into considerations all the above, the guidelines have been reorganised and divided in the following sections: I. Design of remuneration policies and practices II. Governance III. Controlling risks that remuneration policies and practices create.

15. In order to facilitate the reading of the document, a correlation table between the proposed guidelines and the 2013 guidelines has been set out in Annex IV.

Public consultation

16. On 19 July 2021, ESMA published a Consultation Paper (CP) on the draft guidelines on certain aspects of the MiFID II remuneration requirements in order to explain their rationale and gather input from stakeholders. The consultation period closed on 29 October 2021.

17. ESMA received 20 responses, 1 of which confidential. The answers received are available on ESMA's website unless respondents requested otherwise. In addition, ESMA also sought the advice of the Securities and Markets Stakeholders Group (SMSG).

Final report

18. This Final Report summarises and analyses the responses to the CP and explains how the responses, together with the SMSG advice, have been taken into account. ESMA recommends reading this report together with the CP published on 19 July 2021 to have a complete view of the rationale for the guidelines.

3 Annexes

Annex I - Summary of questions

Q1: Do you agree that career progression is likely to have an impact on fixed remuneration and that, consequently, firms should define appropriate criteria to align the interests of the relevant persons or the firms and that of the clients in respect of all types of remuneration (not just in respect of variable remuneration)? Please also state the reasons for your answer.

Q2: Do you agree with the suggested approach on career progression? Please also state the reasons for your answer.

Q3: Do you agree that, to align the interests of relevant persons or the firms with the interests of clients on a long-term basis, firms should consider the possibility to adjust remuneration previously awarded through the use of ex-post adjustment criteria in their remuneration policies and practices (such as clawbacks and malus)? Please also state the reasons for your answer.

Q4: Do you agree with the suggested approach on ex-post adjustment criteria? Please also state the reasons for your answer.

Q5: Do you agree with the added focus and suggested approach on the remuneration policies and practices for control functions and members of the management body or senior management? Please also state the reasons for your answer.

Q6: Do you believe that guideline 1 should be further amended and/or supplemented? Please also state the reasons for your answer.

Q7: Do you agree that the remuneration policy should not only be reviewed on a periodic basis but also upon the occurrence of certain ad hoc events as described in new general guideline 2? Please also state the reasons for your answer.

Q8: Do you agree that the persons involved in the design, monitoring and review of the remuneration policies and practices should have access to all relevant documents and information to understand the background to and decisions that led to such remuneration policies and procedures? Please also state the reasons for your answer.

Q9: Do you believe that guideline 2 should be further amended and/or supplemented? Please also state the reasons for your answer.

Q10: Do you agree with the amendments made to guideline 3? Please also state the reasons for your answer.

Q11: Do you believe that guideline 3 should be further amended and/or supplemented? Please also state the reasons for your answer.

Q12: Do you agree with the deletion of Section V.III. of the 2013 guidelines? Please also state the reasons for your answer.

Q13: Do you agree with the arguments set out in the cost-benefit analysis in Annex IV? Do you think that other items should be factored into the cost-benefit analysis and if so, for what reasons?

Annex II - Cost-benefit analysis

1. The remuneration of staff involved in the provision of investment services to clients is a crucial investor protection issue. While MiFID I did not contain specific requirements on remuneration, it set out the obligations on firms in respect of conflicts of interest[6] and conduct of business obligations of firms when providing investment and/or ancillary services.[7]

2. ESMA published the 2013 guidelines to enhance clarity and foster convergence in the implementation of the MiFID I conflicts of interests and conduct of business requirements with respect to firms' remuneration policies and practices.

3. MiFID II recognised further and highlighted the importance of the topic of remuneration. The MiFID II framework now contains specific remuneration requirements that, notably, include some of the recommendations set out in the 2013 guidelines.

4. The purpose of these draft guidelines is to enhance clarity by emphasising a number of important issues, and to foster convergence in the implementation of the MiFID II remuneration requirements. The aim is to help firms to improve their implementation of these requirements and thereby enhance existing standards.

5. For firms, effective remuneration policies and practices that take into account clients' interests and align the interests of the firm and of relevant persons with them leads to better investor outcome. Greater convergence leads to improved investor protection (consumer outcomes), which is a key ESMA objective.

The impact of the ESMA guidelines

6. In light of the main objectives of these Guidelines (extensively illustrated in the background), the following preliminary assessment aims at explaining the benefits and costs of the key policy choices that are presented for consultation.

7. It should be preliminary observed that since the remuneration requirements are provided under MiFID II and the MiFID II Delegated Regulation, the impact of the proposed guidelines should be considered having in mind those legal provisions that they support. While market participants will likely incur certain costs for implementing these guidelines, they will also benefit from the increased legal certainty and the harmonised application of the requirements across Member States. The proposed Guidelines should also facilitate competent authorities' efforts to improve the overall compliance with MiFID requirements increasing the investor confidence in the financial markets, which is considered necessary for the establishment of a genuine single capital market. Lastly, greater convergence leads to improved investor protection (consumer outcomes), which is a key ESMA objective.

[6] Articles 13(3) and 18 of MiFID I and Articles 21, 22 and 23 of the MiFID I Implementing Directive.
[7] Article 19 of MiFID I.

8. Finally, it is important to remind that those existing 2013 guidelines which are confirmed should not imply any additional impacts/costs for both firms and NCAs.

Benefits

9. It is possible to illustrate the main benefits linked to the proposed Guidelines as follows:

    a) better convergence and clarity and, consequently, the reduction of the compliance risk and its related financial and reputational consequences;

    b) stronger remuneration policies and practices taking into account clients' interests which lead to better client outcome and satisfaction;

    c) reduction of risks linked to regulatory or supervisory arbitrage due to an increased degree of harmonisation and more consistent supervisory convergence;

    d) positive effects from improved harmonisation and standardisation of the processes that firms have to put in place when implementing the MiFID II remuneration requirements;

    e) positive effects from improved harmonisation and standardisation for competent authorities on the costs and activities needed to implement the new supervisory processes related to the remuneration requirements;

    f) restoring investors' confidence in financial markets.

Costs

10. With reference to the costs, it should be firstly reminded that the importance of firms' remuneration policies and practices already stemmed from the MiFID I conflicts of interests and conduct of business requirements. The importance of firms' remuneration policies and practices in the pursuit of clients' best interests was also stressed in the 2013 guidelines.

11. In light of what has been said, it can be reasonably expected that those firms having already in place a complete set of arrangements to comply with the provisions, principles and good practices issued under the MiFID I conflict of interests and conduct of business requirements in the area of remuneration as well as the 2013 guidelines will presumably incur less overall costs when implementing the new framework and these guidelines.

12. ESMA considers that potential and incremental costs that firms will face when implementing the remuneration requirements under the MiFID II regime (including but not limited to these draft guidelines) might have both one-off and ongoing nature, arguably linked to: a) (direct) costs linked to the update/review of the existing procedures and practices as well as, potentially, the firms' organisational arrangements (e.g. the review and/or the update of the firm's arrangements to assess staff performance); and 17 b) (direct) initial and ongoing IT costs.

13. ESMA believes that the proposed options in this area provide the most cost-efficient solution to achieving the general objectives of these Guidelines.

Conclusions

14. In light of what has been illustrated above, ESMA believes that the overall (compliance) costs associated with the implementation of the new regime on the remuneration requirements (which includes the proposed guidelines) will be fully compensated by the benefits from the highlighted and clarified importance of the remuneration requirements and from the subsequent reduction of compliance risk and improved investor protection. These benefits will interest all the market participants contributing to the restoration of the fundamental trust in the financial markets.

15. ESMA also considers that the proposed guidelines are able to achieve an increased level of harmonisation in the interpretation and application of the remuneration requirements across Member States, minimising the potential adverse impact on firms linked to compliance costs. These benefits will outweigh all associated costs in respect of these Guidelines.

16. Finally, ESMA believes that the adoption of guidelines is the best tool to achieve the explained objectives since this topic is already covered by existing guidelines. Furthermore, the adoption of guidelines further reduces the risk of diverging interpretations that might lead to discrepancies in the application and supervision of the relevant regulation and requirements across Member States (determining a risk of regulatory arbitrage and circumvention of rules).

Annex III - Advice of the Securities and Markets Stakeholder Group

I. Executive summary

Overall, the SMSG is positive towards these guidelines. The SMSG has two general remarks, however. First, an overview of existing policies and practices would have been very useful. As there is no such overview, it is not clear to what extent these guidelines are a response to shortcomings encountered in existing policies and practices. This makes it difficult to assess the relevance of the guidelines. Second, the SMSG advises ESMA to ensure that there is adequate coherence and consistency between its proposed guidelines and the EBA guidelines on remuneration, published in July 2021.

Apart from this, the SMSG has a number of specific concerns.

First of all, some of the examples may have undesirable side effects. Is linking deferred variable remuneration of investment advice to the performance of the investment really an example of good practices? A side effect could be that the risk attitude of the advisor impacts on the suitability assessment. Also, there may be practical problems. For example: the investment horizon may be too long for deferred remuneration. Finally, advice in good faith does not mean that you can predict the future. In respect of the examples of bad practices, some of them are so bad that one wonders whether they still exist.

The SMSG also warns against intruding into labour legislation, which remains primarily a national competency under the Treaty on the Functioning of the European Union. Legal conflicts may arise in this respect for the financial institutions implementing the guidelines. For this reason, the SMSG suggests, amongst other things, to incorporate a general statement with wording identical to recital 69 of CRD IV into the guidelines.

The SMSG also cautions against unduly restricting the possibility for manufacturers to include independent advisors in their network. For this reason, it suggests additional clarifications on whether and to what extent independent advisors are in scope of these guidelines. Also, the SMSG warns not to consider multi-level distribution as a bad thing per se.

On the issues with regard to career progression, periodic reviews and event-based reviews, the SMSG is generally satisfied with the high-level, principle-based approach taken by ESMA. The proposals as they are, are sufficient. The SMSG warns against more micro-regulation.

I. General remarks

1. Before answering the different questions, the SMSG wants to make a general remark. We have a very fragmented picture when it comes to remuneration rules, with a large number of rules in financial and company laws as well as self-regulation/codes. The 2020 Common Supervisory Action on MIFID II suitability requirements does not refer to remuneration issues. Although the Consultation states that ESMA aims to “take into account the results of supervisory activities conducted by national competent authorities (NCAs) on the

implementation of the remuneration requirements", these findings are not described in the consulted proposals. This makes it difficult to assess them. It is not clear whether the new guidelines are proposed as a remedy for short-comings that were encountered, whether there are short-comings that are not addressed in these guidelines or whether certain guidelines are merely 'desk-based'. It would thus be important to get an overview of the results of the supervisory activities conducted by NCAs, and then find a way to "streamline" rules in this area.

2. We also note that the EBA published guidelines on remuneration in July 2021 and that the ESAs should ensure that there is adequate coherence and consistency between the two frameworks.

3. The SMSG agrees with the general structure of the guidelines, i.e. (i) design of remuneration policies and practices; (ii) governance; (iii) control. All three are important and reinforce one another. It is good that ESMA highlights all three of them.

4. While the SMSG is generally positive towards these guidelines, it warns against regulating in more detail in order to avoid micro-regulating. In this respect, regulation of competitors from outside the EU (UK) should also be taken into account. In this respect, it would be useful to have more information on the extent to which the guidelines are a response to shortcomings and deficiencies that were encountered, for example, in NCA assessments.

II. Question 1: Do you agree that career progression is likely to have an impact on fixed remuneration and that, consequently, firms should define appropriate criteria to align the interests of the relevant persons or the firms and that of the clients in respect of all types of remuneration (not just in respect of variable remuneration)? Please also state the reasons for your answer.

III. Question 2: Do you agree with the suggested approach on career progression? Please also state the reasons for your answer?

5. The SMSG agrees that career progression is likely to have a positive effect on remuneration. It also agrees that higher fixed remuneration should not be used to circumvent guidelines on variable remuneration (for example: people being promoted merely because of high sales volumes, when insufficient care was given to suitability). Nevertheless, the SMSG also has some questions. Is this guideline a response to malpractices or a desk-based proposal?

6. is the SMSG also has a proportionality concern. Is this guideline merely established as a general principle that should be controlled sample-wise, for example by internal audit? Or does it mean that all promotions should be properly motivated and archived, for example for possible control by the NCA? In this respect, the SMSG refers to its above advise not to go too far in regulating and to avoid micro-regulation.

IV. Question 3: Do you agree that, to align the interests of relevant persons or the firms with the interests of clients on a long-term basis, firms should consider the possibility to adjust remuneration previously awarded through the use of ex-post adjustment

criteria in their remuneration policies and practices (such as clawbacks and malus)? Please also state the reasons for your answer.

V. Question 4: Do you agree with the suggested approach on ex-post adjustment criteria? Please also state the reasons for your answer.

7. In general terms, the SMSG believes in the usefulness of claw-backs, deferred payments and ex post adjustments. For this reason, it agrees that these are no longer cited as examples of good practices but as guidelines. Nevertheless, it also expresses three concerns:

   a) The proposals, as they are formulated right now, extend the principle of claw-backs, deferred payments and ex post adjustment well beyond key identified staff and senior management, towards all layers of employees. This risks bringing the guidelines into conflict with national labour legislation. Also, this requires introducing deferral of variable remuneration to a broad range of staff, to make sure that there is something to claw back on. The alternative would be clawing back on money already spent or on savings of a lower income category. Notwithstanding its remarks, the SMSG believes that is important that breaches are not condoned and that companies should do what is necessary to prevent this, irrespective of the category of staff.

   b) Remuneration issues are often covered by labour legislation which remains in many respects a competency of the member-states. CRD IV anticipates potential conflicts through recital 69: “The provisions on remuneration should be without prejudice to the full exercise of fundamental rights guaranteed by Article 153(5) TFEU, general principles of national contract and labour law, Union and national law regarding shareholders' rights and involvement and the general responsibilities of the management bodies of the institution concerned, and the rights, where applicable, of the social partners to conclude and enforce collective agreements, in accordance with national law and customs”. The SMSG suggests that identical wording be included in the guidelines.

   c) The guidelines include examples of good and bad practices. While the examples of bad practices are useful and clearly indicate the concerns of ESMA, the SMSG is concerned about side-effects of one of the ‘good’ examples. Guideline 1, point 37 c and d suggest to link deferred variable remuneration to the return of the products that were sold over an appropriate time-frame. Two problems arise here:

   i. There is a disturbing potential side-effect. Imagine an investment advisor who is risk-averse and wants to avoid potential risks for his/her variable remuneration. In such a case, the advisor has an incentive to advice low-risk, low-volatility products, even if the investor has a preference for higher risk products. The reverse can also occur. A self-confident advisor wants to earn some extra income and steers the investor towards riskier investments. In other words, there is a risk that suitability for the advisor, not suitability for the investor determines the advice;

ii. There could be a practical problem as well. Some investment products have recommended holding periods that go well beyond the time span over which deferred payments are practically feasible. Recommended holding periods of equity funds would typically be longer than 5 years; and so would often be the time to maturity for structured funds. However, to what extent does deference of payments remain possible and effective over time spans longer than 5 years?

iii. the sales person's responsibility is to provide appropriate advice adapted to a client's profile at a given point in time, not to accurately forecast future developments. To draw a parallel: an honest umbrella salesman sells a good quality product at a fair price, based on the clients expressed needs. He is not responsible or account-able for future rainfall.

iv. For sales personnel who don't provide continuous advice (in open architecture, or where the establishment doesn't host the client account), the appreciation of the product's performance in the investment portfolio can be very challenging;

VI. Question 5: Do you agree with the added focus and suggested approach on the remuneration policies and practices for control functions and members of the management body or senior management? Please also state the reasons for your answer.

8. The SMSG is of the opinion that sound governance is very important for control functions and in particular that remuneration of the control functions should be independent of quantitative commercial performance of those they are to control;

VII. Question 6: Do you believe that guideline 1 should be further amended and/or supplemented? Please also state the reasons for your answer.

9. The SMSG's views are covered by the remarks made above.

VIII. Question 7: Do you agree that the remuneration policy should not only be reviewed on a periodic basis but also upon the occurrence of certain ad hoc events as described in new general guideline 2? Please also state the reasons for your answer.

10. Whether or not the remuneration policy should be reviewed after the occurrence of specific events, is linked to the frequency of the periodic reviews. In case of frequent periodic reviews, these events could be covered in the scheduled reviews. However, the SMSG does not believe in the usefulness of a too high periodicity of review. An annual review for example would be too often. In order for the remuneration policy to be effective, stability is also needed. As such, a lower periodicity of review could be compensated by a review after the occurrence of specific events. For example: if an internal audit, or a check by the NCA, concludes that there are deficiencies in the remuneration policies, it would be good that these are remedied;

11. Guideline 2, point 27, mentions some examples (changes to the business activities or structure of the firm, if the remuneration policy does not operate as intended or if there is

a residual risk of detriment to the firm's clients), the occurrence of which should trigger a review. The SMSG considers this high-level overview to be useful and sufficient.

12. It is likely that not only financial institutions, but also national supervisory authorities are on a learning curve. For this reason, the SMSG proposes that the implementation of this legislation should be high on the agenda for regulatory convergence. Also, it suggests that questions by financial institutions should be primarily answered through ESMA Q&A, rather than bilaterally with national competent authorities.

IX. Question 8: Do you agree that the persons involved in the design, monitoring and review of the remuneration policies and practices should have access to all relevant documents and information to understand the background to and decisions that led to such remuneration policies and procedures? Please also state the reasons for your answer.

X. Question 9: Do you believe that guideline 2 should be further amended and/or supplemented? Please also state the reasons for your answer.

13. The SMSG considers it to be a necessity that persons involved in design, monitoring and review of the remuneration policies and practices have access to all relevant documents and information but wonders whether this is not already so. In this respect, the SMSG repeats its remark above: it would be good to know whether these guidelines are a response to shortcomings and deficiencies that were encountered in practice.

14. No other remarks with regard to guideline 2.

XI. Question 10: Do you agree with the amendments made to guideline 3? Please also state the reasons for your answer.

XII. Question 11: Do you believe that guideline 3 should be further amended and/or supplemented? Please also state the reasons for your answer.

XIII. Question 12: Do you agree with the deletion of Section V.III. of the 2013 guidelines? Please also state the reasons for your answer.

15. The guidelines should not be misinterpreted as establishing disproportional controlling responsibilities of manufacturers on independent distributors or as unduly restricting the possibility of these manufacturers to include these distributors in their distribution networks, because if so, that would discourage the use of independent distributors. Generally speaking, point 49 of guideline 3, is formulated in a well-balanced way (including the sentence: "Where a firm is seeking to use another firm for the provision of services it should check that the other firm's remuneration policies and practices follow an approach consistent with these guidelines."). Nevertheless, the SMSG would like to voice a concern here: independent advisors that work on their own, work outside the context of a financial institution. As such, there would not be a compliance department, with controlling responsibilities or a board that sets remuneration practices. It cannot be the purpose of these guidelines to increase the overhead on these independent distributors by forcing

them into a structure that is needed to comply with these guidelines to allow manufacturers who use their services to comply at their turn with the guidelines. For this reason, the SMSG suggests that ESMA clarifies if and to what extent these guidelines apply to independent advisors.

16. The SMSG recognizes that certain examples of multi-level sales networks can be problematic, as high-lighted in point 52.d. However, the SMSG cautions that the guidelines should not also presuppose that the constitution of a multi-level sales network is per se a poor practice. Such networks, in parallel to the in-house distribution, which they complement, can reach those retail clients which prefer to rely on individual investment advisors for their product selection. The SMSG, therefore, recommends that ESMA should develop further best practices with respect to the setting-up of such distribution schemes, the prior vetting of the network participants by the regulated entities that create and or operate them (with KYC/KYD questionnaires and an extended due diligence applied to distributors and sub-distributors) and the signing of distribution agreements setting the respective responsibilities of each participant.

17. No specific comment on question 12.

XIV. Question 13: Do you agree with the arguments set out in the cost-benefit analysis in Annex IV? Do you think that other items should be factored into the cost-benefit analysis and if so, for what reasons?

18. The SMSG's assessment of costs and benefits are in line with the remarks made above:

    a) while the benefits that are mentioned seem obvious, the SMSG notes that it would have been useful to get more information on whether these guidelines are a response to short-comings and deficiencies that were encountered in regulatory assessments (and if so, which ones) or merely a theoretical exercise. The benefits are higher to the extent that they are a response to actual shortcomings and/or deficiencies.

    b) With regard to the costs, the SMSG agrees that the cost would be lower for companies that already have in place a complete set of arrangements to comply with the MIFID principles. Nonetheless, the SMSG has some remarks with regard to the overview of costs. The focus is primarily on the initial costs for setting up and reviewing the remuneration policies (12a) as well as on the IT costs (12b). A third section should be added (12c): overhead for monitoring and controlling.

    c) Still with regard to costs, the SMSG would like to reiterate the concerns raised above. The guidelines should avoid the side-effect of increasing the overhead on independent distributors. Also, they should avoid creating potential conflicts with national labour legislation.

    d) Finally, with regard to costs, the SMSG warns for possible unintended side-effects. Some of the examples of bad practices seem to be trivial and conflicting with MIFID II provisions (art 24, 10). As such, merely citing them as example of bad practices

could create the impression that they could even be considered and inspire market participants acting in bad faith. In this respect, it would have been useful to know to what extent these guidelines are a response to shortcomings and deficiencies that have been encountered.

Annex IV - Feedback on the consultation paper

General feedback

1. Whilst most respondents welcomed ESMA's initiative to review the guidelines, especially to take into account the changes brought by the MiFID II framework, a significant number also highlighted that, in their view, the review should be limited to taking into account the changes brought by MiFID II since no major shortcomings or malpractices were identified in the area of the MiFID II remuneration rules. In addition, some respondents also expressed their concern over the guidelines imposing additional requirements compared to the ones provided by the Level 1 and Level 2 provisions.

2. In this respect, and as explained in the consultation paper, a large part of the new MiFID II remuneration requirements comes directly from the 2013 guidelines. ESMA therefore chose to build upon the text of the 2013 guidelines, which have been substantially confirmed (albeit clarified, refined and supplemented where necessary). In addition, ESMA took into account the results of supervisory activities conducted by national competent authorities (NCAs) on the implementation of the remuneration requirements (including the implementation by firms of the 2013 guidelines) and provided additional details on some aspects that were already covered under the 2013 guidelines. However, it was not ESMA's objective to introduce a completely new and different regime and/or to go beyond Level 1 and Level 2 measures. Instead, when the 2013 guidelines have been supplemented, it is to provide a clarification of the relevant MiFID II remuneration requirements, aiming to ensure a convergent approach in the supervision and application of those requirements.

3. In addition, a number of respondents objected to the proliferation of remuneration rules, citing the UCITS Directive[8], AIFMD[9], CRD[10]/CRR[11] and IFD/[12]IFR[13] as examples of legislative frameworks including remuneration requirements in addition to the MiFID II rules, with sometimes overlapping scopes. Such respondents were concerned by ESMA adding further complexity with the guidelines. Whilst ESMA acknowledges that the above-referenced legislative frameworks also contain remuneration requirements, it must remind respondents that it is not within its power to issue and/or amend Level 1 texts and that the MIFID II remuneration requirements thus remain applicable alongside any other remuneration requirements provided by the UCITS Directive, AIFMD, CRD/CRR and IRD/IFR. Therefore, the need to enhance clarity and to foster convergence on some aspects of the MiFID II remuneration requirements remain relevant and rightly triggered

[8] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).
[9] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/ 2010.
[10] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.
[11] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.
[12] Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU.
[13] Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014.

the review and update of the 2013 guidelines. However, when reviewing the guidelines, ESMA made sure that, although solely providing clarity on the Level 1 requirements relating to remuneration under MiFID II, the guidelines did not contradict remuneration requirements that may otherwise be applicable under the above-referenced legislative texts (or related Level 3 guidance such as the EBA Guidelines on sound remuneration policies under Directive 2013/36/EU)[14].

4. In the same vein, some respondents regretted that the guidelines were not always aligned with remuneration requirements applicable under other legislative frameworks or that they did not refer to such other frameworks. As already stated above, the guidelines only clarify the remuneration requirements under MiFID II and cannot go beyond the Level 1 and Level 2 MIFID II requirements, which is why i) the guidelines do not refer to other legislative texts when providing clarification on the MiFID II remuneration requirement and ii) it is not always possible to be aligned with the requirements applicable under other legislative frameworks as the MiFID II texts do not provide for the same requirements.[15] However, as also already explained above, when reviewing the guidelines, ESMA made sure that did not contradict remuneration requirements that may otherwise be applicable under the above-referenced legislative texts.

5. Furthermore, a number of respondents also argued that the scope of the guidelines was too large in terms of entities and staff covered. Indeed, a minority of respondents expressed the view that the MiFID II remuneration requirements should not apply to firms otherwise subject to other remuneration requirements, citing the UCITS Directive and the AIFMD as well as the IFD.

6. In respect of the concurrent application of the MIFID II and UCITS/AIFMD requirements, ESMA would like to restate that the MIFID II requirements listed in Articles 6(3) and 6(4) of, respectively, the UCITS Directive and the AIFMD apply to UCITS asset management companies and AIFM providing MiFID investment services and activities under Articles 6(3) and 6(4) of the UCITS Directive and the AIFMD (respectively). The MiFID II requirements applicable include the remuneration requirements provided by Articles 23(1) and 24(10) of MiFID II and Articles 2(5), 27 (mostly) and 34 of the MiFID II Delegated Regulation. Therefore, such entities would be subject to the remuneration requirements under the UCITS Directive and the AIFMD when they provide collective portfolio management services but would also be subject to the MiFID II remuneration requirements when providing MiFID II investment services.

7. In respect of the concurrent application of the MIFID II and IFD/IFR remuneration requirements, ESMA notes that the IFD/IFR remuneration requirements do not apply to

[14] EBA/GL/2021/04.
[15] For instance, some respondents asked for the guidelines to suggest that the ex-post adjustments mechanisms referred to in paragraphs 26 to 29 only apply above a certain threshold of variable remuneration, similarly to the possibility left to Member States by the CRD. As such threshold is not expressly provided in the MiFID II Level 1 and Level 2 texts, ESMA may not be so specific in the guidelines. However, the guidelines leave a large amount of flexibility to market participants as to how they apply this part of the guidelines.

small and non-interconnected firms[16] but the MiFID II remuneration requirements would.[17] In addition, although for other types of investment firms the MiFID II and IFD/IFR remuneration requirements would both apply, it is worth stating that the MiFID II and IFD/IFR rules are not incompatible as well as follow different logics and purposes. The MiFID II remuneration requirements stem from the obligations on firms in respect of conflicts of interest[18] and conduct of business obligations when providing investment and/or ancillary services whilst the IFD/IFR remuneration requirements, similarly to the CRD/CRR requirements, primarily respond to a risk management logic and purpose. These different goals are reflected in the requirements as well as in the staff covered. Therefore, both set of rules should be applied.

8. Another general comment received from several respondents is that the scope of the guidelines is too large in terms of staff covered. Some respondents noted that other legislations including remuneration requirements cover a more targeted population. In this respect, ESMA is bound to follow the scope defined by the MiFID II Level 1 and Level 2 texts which provide that the remuneration requirements apply to "relevant persons", as defined in Article 2(1) of the MiFID II Delegated Regulation. The guidelines therefore follow the scope as set up in Articles 2(1) and (5) of the MiFID II Regulation. More specifically, a few respondents argued that the guidelines were exceeding what should be their scope because they should only cover staff members (i.e. employees) of firms. As set out previously, ESMA is bound by the scope provided for in the Level 1 and 2 texts, especially Article 2(1) and (5) of the MiFID II Delegated Regulation. In accordance with such articles, the MiFID II remuneration requirements apply to, inter alia, "*an employee of the firm or of a tied agent of the firm"* as well as "*any other natural person whose services are placed at the disposal and under the control of the firm or a tied agent of the firm and who is involved in the provision by the firm of investment services and activities*" and "*a natural person who is directly involved in the provision of services to the investment firm or to its tied agent under an outsourcing arrangement for the purpose of the provision by the firm of investment services and activities*". In the guidelines, ESMA is thus always applying the scope as set out in the MiFID II Level 1 and 2 texts.

9. Finally, several respondents asked for ESMA to introduce more proportionality in the guidelines, especially in relation to the ex-post adjustment mechanisms. With respect to the ex-post adjustment mechanisms, ESMA responded below when addressing the answers received to Q3 and 4. More generally, when appropriate, the guidelines include references to a proportionate application (for instance, the guidelines relating to the remuneration policies and practices applicable to the personnel of internal control functions).

Q1: Do you agree that career progression is likely to have an impact on fixed remuneration and that, consequently, firms should define appropriate criteria to align

[16] See Article 12 of the IFR.
[17] As rightly noted by Recital 23 of the IFD: "Small and non-interconnected investment firms should, however, be exempt from those rules because the provisions on remuneration and corporate governance laid down in Directive 2014/65/EU are sufficiently comprehensive for those types of investment firms.".
[18] Articles 13(3) and 18 of MiFID I and Articles 21, 22 and 23 of the MiFID I Implementing Directive.

the interests of the relevant persons or the firms and that of the clients in respect of all types of remuneration (not just in respect of variable remuneration)? Please also state the reasons for your answer.

Q2: Do you agree with the suggested approach on career progression? Please also state the reasons for your answer.

10. Most respondents agreed that career progression is likely to have an impact on the fixed remuneration of relevant persons. However, most respondents disagreed that a firm should define appropriate criteria to align the interests of the relevant persons or firm with that of the clients with respect to all types of remuneration, including fixed remuneration. The main reason given is that career progression also depends on various other factors such as collective bargaining agreements, supply and demand on the labour market, experience, responsibilities, etc.

11. ESMA acknowledges that career progression depends on many factors that are not always within the full control of the firm (for instance, collective bargaining agreements) or that may not always permit the firm to align the interests of the relevant persons or the firm with that of the clients. It may thus be difficult for firms to define appropriate criteria to align the interests of the relevant persons or firm with that of the clients with respect to career progression. Paragraph 16 of the guidelines has been amended accordingly to make this clear.

12. Nonetheless, ESMA is of the view that firms can and should nonetheless, when designing remuneration policies and practices in accordance with the requirements under Article 27 of the MiFID II Delegated Regulation, ensure that the criteria used for career progression do not create conflicts of interests that may encourage such relevant persons to act against the interests of their firms' clients, as set out in paragraph 25 of the guidelines.

Q3: Do you agree that, to align the interests of relevant persons or the firms with the interests of clients on a long-term basis, firms should consider the possibility to adjust remuneration previously awarded through the use of ex-post adjustment criteria in their remuneration policies and practices (such as clawbacks and malus)? Please also state the reasons for your answer.

Q4: Do you agree with the suggested approach on ex-post adjustment criteria? Please also state the reasons for your answer.

13. The majority of respondents welcomed the addition of the reference to ex-post adjustment mechanisms to the guidelines. Some respondents, however, asked for a more explicit reference to the proportionality principle or, for some of them, to even introduce in the

guidelines a minimum threshold under which ex-post adjustments mechanisms would not apply (similarly to the minimum threshold provided by Article 32(1)(j) of the IFD)[19].

14. Other respondents as well as the SMSG asked for the guidelines to specify that the introduction of ex-post adjustments mechanisms is subject to national law, especially national labour law as well as collective bargaining agreements since they may, in certain jurisdictions, prevent firms from introducing the ex-post adjustments mechanisms described in the guidelines in their remuneration policies and practices.

15. A few respondents also remarked that the scope foreseen in the draft guidelines for the ex-post adjustments mechanisms was too broad in two respects: i) they cover "negative staff performance" but should instead cover only cases of misconduct and ii) they apply to "*the relevant persons whose responsibilities and roles include the areas where the relevant events crystallised, provided that such relevant persons have an impact, directly or indirectly, on the investment and ancillary services provided or on the corporate behaviour of the firm. As such, adjustment mechanisms may, depending on the relevant event, be applied collectively, to a particular business unit or department or at individual level*" whilst, they should, in their view, apply only to the person(s) responsible for the misconduct.

16. The respondents who expressed their opposition to the introduction of the reference to ex-post adjustments mechanisms did so on the basis that: i) it may conflict with national law, especially labour law, as well as collective bargaining agreements; ii) ex-post adjustments mechanisms are already addressed in other sector-specific legislation such as CRD/CRR; iii) other mechanisms are already in place to deal with misconduct; and iv) risks of misconduct should be dealt with beforehand.

17. ESMA acknowledges that other mechanisms may already be in place to address cases of misconduct. However, ESMA also believes that firms introducing ex-post adjustment mechanisms in their remuneration policies and practices would better align the interests of relevant persons or the firms with the interests of clients on a long-term basis (as required by Article 27(1) of the MiFID II Delegated Regulation) and, therefore, would further avoid incentives for misconduct thereby also preventing cases of misconduct. In addition, although other sector-specific legislation may indeed provide for ex-post adjustment mechanisms, given their different scopes of application, ESMA is of the view that it is still worth specifying that firms subject to the MiFID II remuneration requirements should consider implementing them in their remuneration policies and practices. Finally, ESMA would also like to point out that the wording used in paragraphs 24 to 29 of the guidelines already gives firms a great amount of flexibility and thus already allows them to take into account any possible conflicts with national legislation - such as labour law - or collective bargaining agreements. This flexibility will also allow firms to avoid any conflict with other sector-specific legislation.

[19] Under Article 32(1)(j) of the IFD, investment firms must pay out at least 50% of the variable remuneration of identified staff in instruments and defer the pay-out for a part of the variable remuneration. However, Member States have the possibility to waive the application of such requirements for firms that have total assets under a certain threshold set within national law and for staff with a variable remuneration of EUR 50,000 or below, when it does not represent more than one quarter of the staff member's total annual remuneration.

18. Regarding the introduction of a minimum threshold, ESMA believes that firms should make their own assessment, depending on the nature, scale and complexity of their activities, when they consider whether and how they should apply ex-post adjustment mechanisms, given that the MiFID II framework does not give any indication of such threshold (unlike the IFD).

19. Lastly, in respect of the concerns raised by some respondents in relation to the scope set out in the guidelines for ex-post adjustment mechanisms, ESMA acknowledges that the scope set out in the draft guidelines may be, in certain circumstances, too broad. ESMA thus amended paragraphs 26 and 27 in order to give more flexibility to firms when applying ex-post adjustment mechanisms and let them determine the scope of application of such mechanisms in terms of persons to whom it should apply and types of behaviour that should trigger them.

Q5: Do you agree with the added focus and suggested approach on the remuneration policies and practices for control functions and members of the management body or senior management? Please also state the reasons for your answer.

20. The majority of respondents agreed with the added focus on remuneration policies and practices for control functions and senior management. Some respondents however objected on that basis that the personnel of control functions are not "*relevant persons*".

21. On this point, ESMA acknowledges that the staff of control functions would, in most cases, not fall within the definition of "relevant persons" as set out in the MiFID II Delegated Regulation.[20] However, ESMA is of the view that the guidelines are nonetheless supported by the obligations on firms in respect of conflicts of interest and conduct of business obligations when providing investment and/or ancillary services. In addition, ESMA would also like to point out Article 22(3)(e) of the MiFID II Delegated Regulation that provides the following: "*the method of determining the remuneration of the relevant persons involved in the compliance function does not compromise their objectivity and is not likely to do so*".

22. Other respondents objected on the basis that smaller firms may combine their control function with operational functions, as permitted by Article 22(4) of the MiFID II Delegated Regulation. In such case, Article 22(4) allows for the non-application of Article 22(3)(e) provided that "*it is able to demonstrate that in view of the nature, scale and complexity of its business, and the nature and range of investment services and activities, the requirements under point (d) or (e) are not proportionate and that its compliance function continues to be effective*".

23. In this respect, ESMA is of the view that, although smaller firms may combine control functions with operational functions under certain limited circumstances, they remain subject to their MiFID II obligations in respect of conflicts of interests and conduct of business obligations.

[20] They may however be relevant persons where the compliance function is combined with operational functions.

24. In addition, Article 22(4) of the MiFID II Delegated Regulation provides that even though Article 22(3)(e) may be disapplied, the compliance function must continue to remain effective. This principle should also apply to the remuneration policies and practices that should allow the compliance function to remain effective. In addition, Article 22(4) further provides that "*the investment firm shall assess whether the effectiveness of the compliance function is compromised. The assessment shall be reviewed on a regular basis*". Indeed, the circumstance that permitted the combination of the control function with operational functions may cease to exist and firms should thus review regularly whether such combination is still justified and permitted. ESMA is of the view that an annual review is advisable.

25. For other internal control functions (where established), the same should apply: due to firms' MiFID II obligations in respect of conflicts of interests and conduct of business obligations and in order to avoid conflicts of interests with respect to their role in the design and/or overseeing of the remuneration policies and practices of the firm, the design of the remuneration policies and practices should not compromise their objectivity and independence. ESMA amended the draft guidelines in order to provide some clarifications in this respect.

26. Lastly, a few respondents were of the opinion that the guidelines should not focus on the remuneration policies and practices for control functions and members of the management body or senior management because such topic was otherwise addressed in other sector-specific legislation. However, given their different scopes of application, ESMA is of the view that the added focus in the MiFID II remuneration guidelines on control functions, members of the management body and senior management is nonetheless required.

Q6: Do you believe that guideline 1 should be further amended and/or supplemented? Please also state the reasons for your answer.

27. Several respondents raised concerns with the practicality of linking variable remuneration with the return on investments (paragraphs 19 and 37(c) of the draft guidelines) while others were concerned that this may actually incentivize relevant persons to take too much risk and therefore have potential undesirable side-effects (such as the SMSG).

28. As already specified in the draft guidelines, this is an example of a criterion that could be used by firms in their remuneration policies and practices. In order not to create conflicts of interests or incentives that may lead relevant persons to favour their own interests or their firm's interests to the potential detriment of any client, it should be used with the relevant pondering factors such as the clients' investment horizon, investment objective and risk profile, in order to mitigate any risk of excessive risk taking. This may, however, not be appropriate for all services and in all circumstances.

29. A few respondents also argued that the deferral of variable remuneration according to the investment term (see paragraph 37(c) of the draft guidelines) may be impossible or impracticable i) for some investment products with an investment horizon that is too long and ii) where staff sell different products with different investment horizons.

30. ESMA is of the view that, although such practices may not be appropriate for all types of investment services and in all circumstances, it may nonetheless be a good practice for certain services where there is an ongoing relationship between the firm and the client and the client has a set investment horizon and objective (for instance, for portfolio management services). However, ESMA acknowledges that this may be difficult to implement appropriately in practice and took into account the points raised by the SMSG and respondents about potential conflicts of interests. In order to give more flexibility to firms in determining appropriate quantitative criteria for their activities and business model, ESMA amended paragraph 19 of the guidelines and deleted good practices (c) and (d) of paragraph 53 as both referred to linking variable remuneration with the return of the product.

31. Lastly, although this was not raised by the respondents to the consultation paper, ESMA sees merit in clarifying the remuneration related obligations of firms providing copy-trading services. ESMA already issued some guidance on the subject[21] and made clear that copy-trading services may fall under the scope of MiFID II when provided in relation to financial instruments. ESMA recalls that in the context of copy trading, firms offer their clients the possibility to automate their trading by copying the trades of other traders. The client then chooses the trader that he/she wants to copy and the firm is in charge of replicating the trades automatically (without further intervention from the client). ESMA understands that the trader who is being copied will be remunerated by the firm who is advertising its trades through the firm's platform. This remuneration generally depends on number of clients and total copy assets (Assets under Management) the copy trader in question has. ESMA would like to remind market participants that the MiFID II remuneration requirements do not apply solely to employees of the firm. Article 27(1) of the MiFID II Delegated Regulation provides that the MiFID II remuneration requirements apply also to relevant persons including the following: *"an employee of the firm or of a tied agent of the firm, as well as any other natural person whose services are placed at the disposal and under the control of the firm or a tied agent of the firm and who is involved in the provision by the firm of investment services and activities*" and "*a natural person who is directly involved in the provision of services to the investment firm or to its tied agent under an outsourcing arrangement for the purpose of the provision by the firm of investment services and activities*". When offering copy trading services such as described above, the persons whose trades are copied are likely to meet the definition of "*relevant person*" under Article 2(1) of the MiFID II Delegated Regulation. In the cases described above, ESMA is thus of the view that the remuneration of traders whose trades are being copied should also comply with the MiFID II remuneration requirements. Clarification of the scope of the MiFID II remuneration requirements relating to third parties to the firm has been included in paragraph 38 of the guidelines to that effect.

32. Where no automatic order execution occurs because client action is required prior to each transaction being executed, depending on the interaction with the client, an investment service or activity may still be provided[22] and, as such, firms should carefully consider

[21] ESMA/2021/382, Q9, p. 15.
[22] As above.

whether the traders whose trades are copied also fall within the definition of relevant persons and, thus, whether their remuneration should comply with the MiFID II remuneration requirements.

Q7: Do you agree that the remuneration policy should not only be reviewed on a periodic basis but also upon the occurrence of certain ad hoc events as described in new general guideline 2? Please also state the reasons for your answer.

33. Responses to this question were mixed. The respondents that objected most often did so on the basis that an annual review was sufficient and already a widespread practice. Some respondents further asked to clarify that the events leading to an ad hoc review be systemic, significant and structural.

34. ESMA is of the view that ad hoc reviews may be useful as not all firms have implemented annual reviews of their remuneration policies and practices. In addition, *ad hoc* events requiring the review by a firm of its remuneration policies and practices may occur between two annual reviews and may need to be taken into account on an interim basis before the next annual review in order to amend in a timely and efficient manner the relevant policies and practices that do not operate as intended or that include a residual risk of detriment to the firm's clients.

35. ESMA, however, amended paragraph 41 to specify that the events that should lead to an *ad hoc* review of the remuneration policies and policies need to be significant.

Q8: Do you agree that the persons involved in the design, monitoring and review of the remuneration policies and practices should have access to all relevant documents and information to understand the background to and decisions that led to such remuneration policies and procedures? Please also state the reasons for your answer.

36. Most respondents agreed with ESMA's view that the persons involved in the design, monitoring and review of the remuneration policies and practices should have access to all relevant documents and information to understand the background to and decisions that led to such remuneration policies and procedures. However, a significant number of respondents expressed their concern that this may translate into the requirement that firms must also share with such personnel (involved in the design, monitoring and review of the remuneration policies and practices) individual remuneration data which, in their opinion, is not in scope of the compliance function responsibility.

It was not ESMA's intention to specify whether or not the compliance function should have access to individual remuneration data. Therefore, ESMA amended paragraph 43 of the Guidelines to clarify that, in accordance with Article 22(3)(a) of the MiFID II Delegated Regulation, the compliance function should have access to all relevant documents and information enabling it to discharge its responsibilities regarding the remuneration policies and practices relating to relevant persons, including senior managers and board members, in a proper and independent manner.

Q9: Do you believe that guideline 2 should be further amended and/or supplemented? Please also state the reasons for your answer.

37. The great majority of respondents replied that no further amendments should be made to Guideline 2. The few points that were raised in response to this question have otherwise been addressed elsewhere in this feedback section and, as the case may be, in the guidelines.

Q10: Do you agree with the amendments made to guideline 3? Please also state the reasons for your answer.

38. Many respondents expressed their concern about the addition made to paragraph 49 of the draft guidelines as well as the new example of poor practice added as paragraph 52(d) which both relate to outsourcing or distribution structures.

39. Two types of concerns were raised in this respect. Some respondents were concerned that the amendments made to guideline 3 were casting multi-level sales network as a bad practice *per se*. In addition, a few respondents argued that such practices were not in scope of the MiFID II remuneration requirements as such practices did not relate to staff of investment firms.

40. Regarding the scope, ESMA relies in Article 27(1) of the MiFID II Delegated Regulation that also includes "any other natural person whose services are placed at the disposal and under the control of the firm or a tied agent of the firm and who is involved in the provision by the firm of investment services and activities" and "a natural person who is directly involved in the provision of services to the investment firm or to its tied agent under an outsourcing arrangement for the purpose of the provision by the firm of investment services and activities". As the MiFID II remuneration requirements thus do not only apply to employees of the firm, ESMA did not amend the scope of paragraphs 49 and 52(d) of the draft guidelines.

41. However, ESMA amended guideline 3 to make clear that multi-level sales network should not be regarded as poor practices *per se* but that the remuneration policies and practices applicable may require further scrutiny from firms as well as NCAs.

Q11: Do you believe that guideline 3 should be further amended and/or supplemented? Please also state the reasons for your answer.

42. Most respondents answered that no further amendments should be made to guideline 3. Points raised by some in their answers to this question have been addressed elsewhere in this section (for instance, the addition in the draft guidelines referring to multi-level sales networks).

Q12: Do you agree with the deletion of Section V.III. of the 2013 guidelines? Please also state the reasons for your answer.

43. All respondents agreed with the deletion of Section V.III. of the 2013 guidelines.

Q13: Do you agree with the arguments set out in the cost-benefit analysis in Annex IV? Do you think that other items should be factored into the cost-benefit analysis and if so, for what reasons?

44. Of the respondents who responded to this question, most highlighted that any additional requirements or change in the MiFID II remuneration requirements would lead to significant implementation costs ultimately being born by the end clients.

45. On this point, ESMA would like to clarify that the guidelines mostly focus on aligning with the MiFID II requirements. Thus, the parts of the 2013 guidelines that were redundant with the MiFID II requirements were taken out but the rest of the 2013 guidelines was substantially confirmed. In addition, the guidelines take into account new requirements under MiFID II, the results of supervisory activities conducted by national competent authorities (NCAs) on the topic and provides more details where useful and/or necessary to strengthen investor protection.

46. Therefore, also the guidelines provide additional detail on some aspects that were already covered under the 2013 guidelines, they do not include new requirements for firms. Market participants should likely incur limited costs for implementing these guidelines and will also benefit from the increased legal certainty and the harmonised application of the requirements across Member States, therefore improving supervisory convergence.

Annex V - Guidelines

Guidelines on certain aspects of the MIFID II remuneration requirements

I. Scope

Who?

1. These guidelines apply to competent authorities and firms.

What?

2. These guidelines apply in relation to the remuneration requirements set out in Article 27 of the MiFID II Delegated Regulation as well as, on the one hand, the conflicts of interest requirements set out in Articles 16(3) and 23 of MiFID II and Article 34 of the MiFID II Delegated Regulation in the area of remuneration; and on the other hand, the conduct of business rules set out in Article 24(1) and (10) of MiFID II. In addition, these guidelines clarify the application of the governance requirements in the area of remuneration under Article 9(3) of MIFID II.

When?

3. These guidelines apply from six months of the date of publication of the guidelines on ESMA's website in all EU official languages.

4. The Guidelines on remuneration policies and practices (MiFID)[23] issued under MiFID I will cease to apply on the same date.

II. Legislative references, abbreviations and definitions

Legislative references

AIFMD	Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/ 2010[24]
CRR	Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012[25]

[23] ESMA/2023/606.
[24] OJ L 174, 01.07.2011, p.1-73.
[25] OJ L 176, 27.6.2013, p. 1-337.

ESMA Regulation	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC[26]
MiFID II	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU[27]
MiFID II Delegated Regulation	Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive
UCITS Directive	Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

Abbreviations

ESMA	European Securities and Markets Authority
EU	European Union

Definitions

5. Unless otherwise specified, terms used in MiFID II and the MiFID II Delegated Regulation have the same meaning in these guidelines.

6. In addition, for the purposes of these guidelines, the following definitions apply:

firms	investment firms (as defined in Article 4(1)(1) of MiFID II), credit institutions (as defined in Article 4(1)(1) of the CRR) when providing investment services and activities within the meaning of Article 4(1)(2) of MiFID II, investment firms and credit institutions when selling or advising clients on structured deposits, UCITS management companies and external Alternative Investment Fund Managers (AIFMs) (as defined in

[26] OJ L 331, 15.12.2010, p. 84.
[27] OJ L 173, 12.06.2014, p. 349.

	Article 5(1)(a) of the AIFMD) when providing the investment services or non-core services listed in Article 6(3) of the UCITS Directive and Article 6(4) of the AIFMD
quantitative criteria	primarily numeric or financial data that is used to determine the remuneration of a relevant person (e.g. value of instruments sold, sales volumes, establishment of targets for sales or new clients, etc.)
qualitative criteria	primarily criteria other than quantitative criteria. It can also refer to numeric or financial data used to assess the quality of the relevant person's performance and/or service to the client e.g. return on the client's investment, very low number of complaints over a large timescale, etc

III. Purpose

7. These guidelines are based on Article 16(1) of the ESMA Regulation. The purpose of these guidelines is to ensure the common, uniform and consistent application of the MiFID II remuneration requirements set out in Article 27 of the MiFID II Delegated Regulation as well as, on the one hand, the conflicts of interest requirements set out in Articles 16(3) and 23 of MiFID II and Article 34 of the MiFID II Delegated Regulation in the area of remuneration; and on the other hand, the conduct of business rules set out in Article 24(1) and (10) of MiFID II. In addition, these guidelines clarify the application of the governance requirements in the area of remuneration under Article 9(3) of MIFID II.

8. ESMA expects these guidelines to promote greater convergence in the interpretation of, and supervisory approaches to, the MiFID II remuneration requirements as well as the MiFID II conflicts of interest and conduct of business requirements in the area of remuneration by emphasising a number of important issues, and thereby enhancing the value of existing standards. By helping to ensure that firms comply with regulatory standards, ESMA anticipates a corresponding strengthening of investor protection.

9. Guidelines do not reflect absolute obligations. For this reason, the word 'should' is often used. However, the words 'shall', 'must' or 'required to' are used when describing a MiFID II or MiFID II Delegated Regulation requirement.

IV. Compliance and reporting obligations

Status of the guidelines

10. In accordance with Article 16(3) of the ESMA Regulation, competent authorities and financial market participants must make every effort to comply with these guidelines.

11. Competent authorities to which these guidelines apply should comply by incorporating them into their national legal and/or supervisory frameworks as appropriate, including where particular guidelines are directed primarily at financial market participants. In this case, competent authorities should ensure through their supervision that financial market participants comply with the guidelines.

Reporting requirements

12. Within two months of the date of publication of the guidelines on ESMA's website in all EU official languages, competent authorities to which these guidelines apply must notify ESMA whether they (i) comply, (ii) do not comply, but intend to comply, or (iii) do not comply and do not intend to comply with the guidelines.

13. In case of non-compliance, competent authorities must also notify ESMA within two months of the date of publication of the guidelines on ESMA's website in all EU official languages of their reasons for not complying with the guidelines.

14. A template for notifications is available on ESMA's website. Once the template has been filled in, it shall be transmitted to ESMA.

15. Financial market participants are not required to report whether they comply with these guidelines.

V. Guidelines on certain aspects of the MiFID II remuneration requirements

V.I. DESIGN OF REMUNERATION POLICIES AND PRACTICES

Relevant legislation: Articles 16(3), 23 and 24(10) of MiFID II as well as Articles 27 and 34 of the MiFID II Delegated Regulation

Guideline 1

16. When designing remuneration policies and practices in accordance with the requirements under Article 27 of the MiFID II Delegated Regulation and, especially, where remuneration comprises variable components, firms should define appropriate criteria to align the interests of the relevant persons and of the firms with that of the clients. Such criteria aligning the interests of the relevant persons and of the firms with that of the clients should allow the firms to assess the performance of relevant persons.

17. In order to do so and in accordance with Article 27(4) of the MiFID II Delegated Regulation, firms shall consider qualitative criteria that encourage the relevant persons to act in the best interests of the client. Examples of appropriate qualitative criteria include compliance with regulatory requirements such as conduct of business rules (in particular, the review of the suitability of instruments sold by relevant persons to clients, if relevant) and internal procedures, fair treatment of clients and client satisfaction.

18. Qualitative criteria used by firms in their remuneration policies and practices should be sufficiently and clearly defined and documented to ensure that they are not being used to indirectly reintroduce quantitative commercial criteria that may create conflicts of interests or incentives that may lead relevant persons to favour their own interests or their firm's interests to the potential detriment of any client. For instance, if a firm uses client satisfaction as a qualitative criterion in the determination of the variable remuneration of relevant persons, it should be clear from the remuneration policy how the firm will be measuring staff performance in this respect with the remuneration policy indicating what data will be used, any thresholds applicable, etc. so as to avoid creating a vague criterion that may be used by the firm to, instead, reward sales or pressure sales staff to sell certain products (although the remuneration policy would not be indicating such quantitative commercial criteria as performance indicators).

19. Regarding quantitative criteria, firms should ensure to take into account criteria that do not create conflicts of interests or incentives that may lead relevant persons to favour their own interests or their firm's interests to the potential detriment of any client. For example, firms may assign sales objectives to staff provided that such commercial objectives do not create an incentive for sales staff to recommend only certain products to the detriment of clients' best interest (for instance, group products or those that are more lucrative to the firm or group) and that any remaining conflicts of interests are properly mitigated through the use of other equally weighted criteria such as staff's performance regarding suitability requirements or clients' satisfaction.

20. The weights attributed to the criteria used to determine the remuneration should not be such that they render some of the criteria, especially qualitative ones, insignificant or that they give others, especially quantitative commercial ones, too much significance.

21. When designing remuneration policies and practices in accordance with the requirements under Article 27 of the MiFID II Delegated Regulation, firms should consider all relevant factors such as, but not limited to, the role performed by relevant persons, the type of products offered, and the methods of distribution (e.g. advised or non-advised, face-to-face or through telecommunications/electronic communications) in order to prevent potential conduct of business and conflict of interest risks from adversely affecting the interests of their clients and to ensure that the firm adequately manages any related residual risk.

22. Without prejudice to the requirement in the second subparagraph of Article 27(4) of the MiFID II Delegated Regulation, the remuneration policies and practices in place should allow the operation of a flexible policy on variable remuneration, including, where relevant, the possibility to pay no variable remuneration at all.[28]

23. Regarding variable remuneration, firms should avoid setting performance targets that may incentivise the relevant persons to adopt behaviours focused on short-term gains to meet the relevant thresholds such as "all or nothing targets" when those might create a conflict of interest or impair clients' interests. Firms should favour remuneration policies and

[28] When determining the remuneration for tied agents, firms may take the tied agents' special status (usually as self-employed commercial agents) and the respective national specificities into consideration.

practices in which the variable part of the remuneration paid out is calculated and awarded on a linear basis or where the variable part depends on several performance targets set at different levels and giving rights to different amounts or, preferably, different rates of variable remuneration.

24. When designing and implementing their remuneration policies, firms should take into account possible conflicts of interests or risks of impairing clients' interests stemming from cross-selling objectives imposed on relevant persons. For instance, specific attention should be paid to situations where relevant persons would be encouraged to make the grant of better conditions under a mortgage loan to a client dependent on the condition that this client buys a specific financial instrument which is part of the relevant persons' sales objectives.

25. In light of the broad definition of remuneration provided in the MiFID II Delegated Regulation, firms' remuneration policies and practices should also ensure that the criteria used to assess wage increases and promotions comply with the MiFID II remuneration requirements. For instance, firms' career progression management systems should not be used to reintroduce quantitative commercial criteria upon which may depend relevant persons' career advancement and having an impact on their (fixed and/or variable) remuneration if this may create conflicts of interests that may encourage such relevant persons to act against the interests of their firms' clients.

26. Without prejudice to the general principles of national contract or labour law, firms should consider including ex-post adjustment criteria of the variable remuneration in their remuneration policies and practices in order to further discourage relevant persons to disregard client's interests or favour their own interests (for instance, by investing in products with higher short term returns but presenting more risks in the long term or not suitable to the client's investment horizon) in order to attain short-term performance objectives. Ex-post adjustment criteria should allow firms to further align the interests of the firm and of relevant persons with that of clients by adjusting variable remuneration if a case of misconduct appears after the remuneration has been awarded or paid-out. For such criteria to be effective, firms should consider, depending on the nature, scale and complexity of their activities, including in their remuneration policies and practices appropriate ex-post adjustment mechanisms such as the application of malus (i.e. the reduction of value of all or part of deferred variable remuneration based on ex-post risk adjustments before it has vested) and clawbacks (i.e. the return of ownership of an amount of variable remuneration paid in the past or which has already vested to the institution under certain conditions).

27. Ex-post adjustment mechanisms referred to in the previous paragraph should be triggered by relevant events impacting the firm's or relevant persons' compliance with the applicable provisions under MiFID II and its delegated acts aiming at the fair treatment of clients and the quality of services provided to clients. Relevant events impacting the firm's and relevant persons' compliance with applicable regulations should not be limited to those giving rise to supervisory action, fines or sanctions but should take into account confirmed failings or breaches. Ex-post adjustment mechanisms should be applied to the relevant persons who engaged directly in misconduct but firms should also consider whether it would be

appropriate to also apply them to a larger group such as to the relevant persons whose responsibilities include the areas where the relevant events crystallised.

28. The application of ex-post adjustment mechanisms should take into account the seriousness of any failings or misconduct impairing clients' interests.

29. In order for ex-post adjustment mechanisms to be meaningful, firms should consider paying the variable remuneration partly upfront and partly deferred, in an appropriate balance between the part paid upfront and the one deferred, and according to an appropriate deferral schedule allowing for the interests of the relevant persons and of the firms to be aligned with the interests of clients.

30. Furthermore, firms should adopt and maintain measures enabling them to effectively identify where the relevant person fails to act in the best interests of the client and to take remedial action.

31. Relevant persons should be clearly informed, at the outset, of the criteria that will be used to determine the amount of their remuneration, the weight attributed to each, the consequences of not meeting one or the other and the steps and timing of their performance reviews. The criteria used by firms to assess the performance of relevant persons should be accessible, understandable and recorded.

32. Firms should avoid creating unnecessarily complex policies and practices (such as combinations of different policies and practices, or multi-faceted or multi-layered schemes, which increase the risk that relevant persons' behaviour will not be driven to act in the best interests of clients, and that any controls in place will not be as effective to identify the risk of detriment to the client). This may potentially lead to inconsistent approaches and hamper proper knowledge or control of the policies by the compliance function. The Annex to these guidelines sets out illustrative examples of remuneration policies and practices that create risks that may be difficult to manage due to their complexity, and that give strong incentives to sell specific products.

33. Firms should ensure that the organisational measures they adopt regarding the launch of new products or services appropriately take into account their remuneration policies and practices and the risks that these products or services may pose. In particular, before launching a new product, firms should assess whether the remuneration features related to the distribution of that product comply with the firm's remuneration policies and practices and therefore do not pose conduct of business and conflicts of interest risks. This process should be appropriately documented by firms.

34. In order to avoid conflicts of interests with respect to their role in the design and/or overseeing of the remuneration policies and practices of the firm, the design of the remuneration policies and practices applicable to control functions (risk management and

internal audit functions, where established)[29], management body and senior management of the firm should not compromise their objectivity and independence.

35. As such, the remuneration of control functions' staff should be based on function-specific objectives. In addition, the variable part of the remuneration of staff in control functions, if any, should not be linked to quantitative commercial performance of relevant persons whose remuneration they are in charge of designing and/or controlling. Where the remuneration of the control functions' staff includes a component based on the firm's commercial performance (e.g. sales volume), the risk of conflicts of interest may increase and should be properly addressed through the use of appropriate qualitative performance or adjustment criteria.

36. Where firms are permitted to combine internal control functions with operational functions, they nonetheless remain subject to their MiFID II conflicts of interests and conduct of business obligations. As such, the remuneration policies and practices applicable to them should nonetheless permit such internal control functions to remain effective (as provided by Article 22(4) of the MiFID II Delegated Regulation for the compliance function).

37. Firms should also ensure that the structure of the remuneration of members of the management body and of the senior management of the firm, as well as the criteria used to assess performance, should not create conflicts of interest or incentives that may lead members of the management body or senior management of the firm or relevant persons in the firm to favour their own interests or the firm's interests to the potential detriment of any client.

38. The remuneration policies and practices applicable to relevant persons (including copy-traders, where applicable) who are not employees of the firm but nonetheless fall within the scope of the MiFID II remuneration requirements because they are:

    i) a natural person whose services are placed at the disposal and under the control of the firm or a tied agent of the firm and who is involved in the provision by the firm of investment services and activities[30]; or

    ii) a natural person who is directly involved in the provision of services to the firm or to its tied agent under an outsourcing arrangement for the purpose of the provision by the firm of investment services and activities[31],

    should also comply with the MiFID II remuneration requirements and these guidelines.

39. Examples of good practice:

    a. References used in the calculation of variable remuneration of relevant persons are common across products sold.

[29] Article 22(3)(e) of the MiFID II Delegated Regulation applies in respect of the compliance function.
[30] Article 2(1)(c) of the MiFID II Delegated Regulation.
[31] Article 2(1)(d) of the MiFID II Delegated Regulation.

In the case of an open-ended investment with no investment term, the remuneration is deferred for a set number of years or until the encashment of the product.

40. Examples of poor practice:

a. A firm has started offering advisers specific additional remuneration to encourage clients to apply for new fund products in which the firm has a specific interest. This often involves the relevant person having to suggest that their clients sell products that they would otherwise recommend they retain so they can invest in these new products.

b. Managers and employees receive a large bonus linked to a specific product. As a result, the firm's advisors recommend this specific product irrespective of the suitability of this product for the clients addressed.[32] Warnings from the risk manager are ignored because the investment products generate high returns for the firm. When the risks that had been identified occur, the products have already been sold and the bonuses have already been paid out.

c. The variable component of the total remuneration is based only on volumes sold, and increases the relevant person's focus on short-term gains rather than the client's best interest.

d. Relevant persons engage in frequent buying and selling of financial instruments in a client's portfolio in order to earn additional remuneration without considering the suitability of this activity for the client. Likewise, rather than considering the suitability of a product for a client, relevant persons focus on the sale of products that have a short investment term in order to earn remuneration from re-investing the product after the short term.

e. Regulatory breaches under MiFID II and its delegated acts that impair clients' interests are identified by the competent authority supervising the firm but no financial sanctions are imposed on the firm as non-compliance has since been remedied. The firm decides to allocate the maximum fixed and variable remuneration for the year to its board members on the basis that the other criteria were met, thereby not drawing the consequences of the firm's non-compliance with its regulatory obligations and its board members' role in it.

V.II. GOVERNANCE

Relevant legislation: Article 9(3) of MiFID II and Article 27(3) of the MiFID II Delegated Regulation

Guideline 2

[32] In that case, the firm would also breach applicable suitability requirements.

41. In addition to the periodic review of their written remuneration policy[33], firms should also review it upon any relevant and significant amendment to their business activities or structure. Where the review reveals that the remuneration policy does not operate as intended or that there is a residual risk of detriment to the firm's clients stemming from it (crystallised or not), the remuneration policy should be amended in a timely and efficient manner.

42. Proper documentation on the remuneration policy as well as the decision-making process and procedures that lead to its approval or amendment should be maintained in a clear and transparent manner and made available to the management body and senior management as well as other control functions involved in the design, monitoring and/or review of the remuneration policy and procedures.

43. Firms should ensure that the compliance function has access to all relevant documents and information enabling it to discharge its responsibilities in accordance with Article 22(3)(a) regarding the remuneration policies and practices relating to relevant persons, including members of the management body and senior management, in a proper and independent manner.

44. Firms should also ensure that their management body, after taking advice from the compliance function, approves any significant amendment made to the remuneration policy of the firm.

45. Depending on the size of the firm and complexity of its business model and of the investment services and activities provided, the review of the remuneration policy may also require the involvement of other control functions (such as the risk management and/or internal audit functions) to ensure that appropriate performance and risk adjustment criteria are used.

46. Senior management is responsible and should retain the ultimate responsibility for the day-to-day implementation of the remuneration policy and the monitoring of compliance risks related to the policy.

47. Firms should ensure that they have appropriate and transparent reporting lines in place across the firm or group to assist in escalating issues involving risks of non-compliance with the MiFID II remuneration, conflicts of interest and conduct of business requirements.

[33] In accordance with Article 9(3) of MiFID II and Article 27(3) of the MiFID II Delegated Regulation.

V.III. CONTROLLING RISKS RELATED TO REMUNERATION POLICIES AND PRACTICES

Relevant legislation: Articles 9(3) of MiFID II and Article 27(3) of the MiFID II Delegated Regulation

Guideline 3

48. Firms should set up adequate controls to assess compliance with their remuneration policies and practices and to ensure that these deliver the intended outcomes. The controls should be implemented throughout the firm and be subject to periodic review. Such controls should include assessing the quality of the service provided to the client - for example, monitoring calls for telephone sales, sampling of advice and client portfolios provided to check suitability or going through other client documentation on a periodic basis.

49. To carry out such controls in an effective and risk-based manner, firms should use a wide range of information on business quality monitoring and sales patterns, including trend and root-cause analysis, to identify areas of increased risk and to support a risk-based approach to sales monitoring, with particular focus on high performing relevant persons (regarding sales for instance).

50. Firms should ensure that the results of such analyses and controls are clearly documented and reported to senior management together with proposals for corrective action, if necessary. The compliance function should also assist senior management in monitoring effectively the compliance risks related to the remuneration policy of the firm (based also on the ex-post controls conducted in line with this guideline). Where potential or actual client detriment might arise as a result of specific features in remuneration policies and practices, firms should take appropriate steps to manage potential conduct of business and conflict of interest risks by reviewing and/or amending these specific features, and set up appropriate controls and reporting mechanisms for taking appropriate action to mitigate potential conduct of business and conflict of interest risks.

51. When outsourcing the provision of investment services, firms should have in mind the best interests of the client. Where a firm is seeking to use another firm for the provision of services it should check that the other firm's remuneration policies and practices follow an approach consistent with these guidelines. In addition, firms should avoid setting overly complicated outsourcing or distribution structures (including through the use of tied agents) where the remuneration policies or practices applicable to such structures make it difficult for the firm to monitor the compliance risks with these guidelines and with the conflicts of interest and conduct of business policies and procedures in the area of remuneration or increase the risk of detriment to clients' interests.

52. Firms should make sure to assess, on a regular basis, whether the information management tools they use adequately capture the qualitative data required to determine the variable remuneration they pay to relevant persons.

53. Examples of good practice:

a. In order to assess whether its incentive schemes are appropriate, a firm undertakes a programme of contacting a sample of clients shortly after the completion of a sale involving a face-to-face sales process where it is not able to monitor recorded telephone sales conversations, so as to test if the salesperson has acted honestly, fairly and professionally in accordance with the best interests of the client.

b. Top earners and performers are recognised as being potentially higher risk and, as a result, additional scrutiny is given to them; and information such as previous compliance results, complaints or cancellation data is used to direct compliance checking. The outputs have an impact on the design/review of the remuneration policy and practices.

54. Example of poor practice:

55. A firm mainly relies on quantitative commercial data as the criteria for assessing variable remuneration.

56. Senior management has set various strategic goals for the firm to be reached in a certain year. All goals seem to focus solely on financial or commercial aspects without taking into account the potential detriment to the firm's clients. The remuneration policy will be in line with these strategic goals and will therefore have a strong short-term financial and commercial focus.

57. Despite the care taken in designing and assessing remuneration policies and practices, some policies and practices still lead to client detriment, creating risks that need to be identified and mitigated.

58. To distribute its products, a firm relies on a multi-level sales network consisting solely of personnel or third-party distributors which are remunerated according to the volume of transactions of the clients captured directly by themselves, and their ranking in the sales structure of the firm, with a leverage effect depending on the number of distribution levels below and the number of distributors in each level.[34] Such sales structures, combined with the remuneration policies and practices described in the foregoing, may make it difficult for the firm to monitor the compliance risks with these guidelines for each level (especially the most remote) and the whole structure.

59. The Annex to these guidelines includes illustrative examples of remuneration policies and practices that would create strong incentives to sell specific products and for which firms would therefore have difficulties demonstrating compliance with the MiFID requirements. The conduct of business and conflict of interest risks related to such examples should be

[34] In such sales structures, multi-level groups of individuals are coordinated by another individual called "supervisor" or "manager" who is in charge of the support, training, coordination and supervision of the structure. These supervisors or managers are also tasked with the recruiting of other individuals.

taken into account by firms when designing and implementing their remuneration policies and practices.

VI. Annex

Illustrative examples of remuneration policies and practices that create conflicts that may be difficult to manage

1. Certain remuneration features (for example, the basis of pay, running performance-based competitions for relevant persons) involve higher risk of potential damage to clients than others (specifically those that include features which may have been designed to affect the behaviour of relevant persons, especially the sales force). Examples of high-risk remuneration policies and practices that will generally be difficult to manage, and where it would be difficult for a firm to demonstrate compliance with MiFID II, include:

2. Incentives that might influence relevant persons to sell, or 'push', one product or category of product rather than another or to make unnecessary/unsuitable acquisitions or sales for the investor: especially situations where a firm launches a new product or pushes a specific product (e.g. the product of the month or "in-house products") and incentivises relevant persons to sell that specific product. Where the incentive is different for different types of products, there is a high risk that relevant persons will favour selling the product that results in higher remuneration instead of another product without appropriate regard to what is in the client's best interests.

    a. Example: A firm has remuneration policies and practices linked to individual product sales where the relevant person receives different levels of incentives depending on the specific product or category of products they sell.

    b. Example: A firm has remuneration policies and practices linked to individual product sales, where the relevant person receives the same level of incentive across a range of products. However, at certain limited times, to coincide with promotional or marketing activity, the firm increases the incentive paid on the sales of certain products.

    c. Example: Incentives that might influence relevant persons (who may be remunerated solely by commission, for example) to sell unit trusts rather than investment trusts – where both products may be equally suitable for clients - because sales of unit trusts pay substantially higher commissions.

3. Inappropriate requirements that affect whether incentives are paid: remuneration policies and practices which include, say, a requirement to achieve a quota of minimum sales levels across a range of products in order to earn any bonus at all is likely to be incompatible with the duty to act in the best interests of the client. Conditions which must be met before an incentive will be paid may influence relevant persons to sell inappropriately. For example, where no bonus can be earned on sales unless a minimum target is met for each of several different product types, this may impact on whether suitable products are recommended. Another example is where a reduction is made to a bonus or incentive payments earned because a secondary target or threshold has not been met.

    a. Example: A firm has relevant persons who sell a range of products that meet different client needs, and the product range is split into three 'buckets' based on the type of

client need. Relevant persons can accrue incentive payments for each product sold, however at the end of each monthly period no incentive payment is made if they have not reached at least 50% of the sales target set for each 'bucket'.

b. Example: A firm sells products with a range of optional 'add-on' features. The relevant person receives incentive payments for all sales, with an additional payment if the client purchases an add-on feature. However, at the end of each monthly period no incentive payment is made if they have not achieved a penetration rate of at least 50% of products sold with an add-on feature.

4. Variable salaries where the arrangements vary base pay (up or down) for relevant persons based on performance against sales targets: in such cases, the relevant person's entire salary can become – in effect – variable remuneration.

   a. Example: A firm will reduce a relevant person's basic salary substantially if he or she does not meet specific sales targets. There is therefore a risk that he or she will make inappropriate sales to avoid this outcome. Equally, relevant persons may be strongly motivated to sell by the prospect of increasing basic salary and associated benefits.

5. Remuneration policies and practices which create a disproportionate return for marginal sales: where relevant persons need to achieve a minimum level of sales before incentive payments can be earned, or incentives are increased, the risk is increased. Another example would be schemes that include 'accelerators' where crossing a threshold increases the proportion of bonus earned. In some cases, incentives are payable retrospectively based on all sales rather than just those above a threshold, potentially creating significant incentives for relevant persons to sell particular products in particular circumstances.

   a. Example: A firm makes accelerated incentive payments to relevant persons for each product sold during a quarterly period as follows:

   - 0-80% of target no payments
   - 80-90% of target 50€ per sale
   - 91-100% of target 75€ per sale
   - 101-120% of target 100€ per sale
   - >120% of target 125€ per sale

   This example can also apply where the relevant person receives an increasing share of commission or income generated.

   b. Example: A firm has the same accelerated scale as the firm in the foregoing example, but the increase in payments per sale is applied retrospectively to all sales in the quarter, e.g. on passing 91% of target the incentive payments accrued to date at the

rate of €50 per sale are increased to €75 per sale. This creates a series of ‘cliff edge’ points, where one additional sale required to reach a higher target band causes a disproportionate increase in the incentive payment.

Annex IV - Correlation table between the 'new' draft guidelines and the 2013 guidelines

New Guidelines	2013 guidelines
Design of remuneration policies and practices Guideline 1	**V.I Governance and design of remuneration policies and practices in the context of the MiFID conduct of business and conflicts of interest requirements**
Governance Guideline 2	
Controlling risks that remuneration policies and practices create Guideline 3	**V.II. Controlling risks that remuneration policies and practices create**
n/a	**V.III. Guideline on competent authorities' supervision and enforcement of remuneration policies and practices**