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Consultation Paper: draft guidelines on sound remuneration policies under Article 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013

A response from the Wealth Management Association[1]

The Wealth Management Association welcomes the opportunity to respond to the European Banking Authority's consultation paper regarding draft guidelines on sound remuneration policies under Directive 2013/36/EU and disclosures under Regulation (EU) No 575/2013 (together, "CRD IV"). Although we have not responded to the specific questions posed therein, we wish to raise some general points for the EBA's consideration.

The WMA represents 186 wealth management firms and associate members that deal in stocks, shares and other financial instruments for the retail sector, comprising individuals, trusts and charities, under formal contracted relationships. They offer a range of services across a spectrum from execution only through to full discretionary management on behalf of 4m UK customers. Our members can employ as few as a handful of employees, are sometimes structured as limited liability partnerships (LLPs), and their business models result in them posing no systemic risk to the stability of financial markets. They are not bailed out by national governments on failure; instead books of business may be transferred to another firm, and/or eligible clients may apply for compensation from the Financial Services Compensation Scheme, fully funded by the industry itself. WMA member firms typically fall into the lowest proportionality tiers in the FCA's implementation of CRD III's remuneration guidelines. This means that our members can disapply some of those guidelines, including those requiring deferral of remuneration or the setting of limits on the ratio of fixed to variable remuneration. As such, our member firms will be particularly impacted by EBA's proposals.

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1 The Wealth Management Association (WMA) is a trade association representing 186 Wealth Management firms and Associate Members. With formal contracted client relationships our firms deal in stocks and shares and other financial instruments for individuals, trusts and charities and offer a range of services across a spectrum spanning execution only through to full discretionary services.

Our member firms act for over 4 million private investors and carry out around 20 million transactions a year in the marketplace. Our members also manage in excess of £670 billion of wealth in the UK, Ireland, Channel Islands and Isle of Man, operate across more than 580 sites and employ approximately 32 000 staff.

Our aim is to ensure that any changes including operational, regulatory, tax and other business matters across Europe and the rest of the world are appropriate and proportionate for our wealth management community and, most importantly, their clients.

Our predominant concern lies with EBA's reasoning for extending the full range of CRD IV's remuneration provisions to all investment firms within the scope of CRD IV, regardless of their size or the risks they run. We note that the EBA believes that this reflects the policy intent of the European Commission and the European Parliament, but has not provided sufficient evidence that this is in fact the case. Firstly, the Consultation Paper ignores Recital 66 of CRD IV, which provides a very clear statement that the Commission's legislative intention was that some of the remuneration provisions might not need to be applied by some firms. Any change to this intention requires the Commission to undertake a full impact analysis, and for agreement to be sought from the European Parliament and Council through the usual channels. Secondly, the Consultation Paper quotes the European Parliament resolution of 3 July 2013 on reforming the structure of the European banking sector in support of their approach. But this is clearly targeted at banks – and not at the small investment firms that will be most impacted by the EBA's proposals. The EBA must not treat all financial services firms as if they were large, systemic banks, but instead must develop a more nuanced and differentiated approach taking into account the business models operated, and risked posed, by different financial services firms. There are a number of commentaries on the proposals that provide detailed legal arguments as to why the EBA's approach is misguided[2], so we will not repeat all the arguments here.

The EBA's proposals will also create an uneven playing field between investment firms within scope of CRD IV and those out of scope of CRD IV. As such, CRD III investment firms will be able to continue to disapply those remuneration provisions to which CRD IV firms will now become subject, but this is not based on a clear understanding of the risks posed to financial stability by different investment firms' business models that should underlie different approaches to remuneration. This raises competition concerns that the EBA does not seem to have considered.

We note, too, that the business models of small and medium investment firms are based on maintaining long-term relationships with clients rather than on selling products to investors, and placing orders on regulated exchanges with defined default rules on an agency basis means that those dealing are not taking principal risks with assets on the firm's balance sheet. Would the EBA be able to clarify what it considers as 'risk-taking' in this business model? Indeed, it is not senior managers that carry out these activities; rather, it is more likely to be client facing staff that undertake such activities.

We are also concerned that the EBA has not considered how the Guidelines will apply to small businesses that are not structured as large, listed banks. Many of our members are structured as LLPs or as private companies with modest balance sheets: how does the EBA envisage the guidelines on variable remuneration will apply in these cases? Would such firms be obliged to issue equivalent non-cash instruments to meet these Guidelines, which would lead to significant legal and accountancy costs for these firms? Has the EBA considered the tax consequences on individual partners in LLPs of deferring remuneration? And has the EBA factored in the costs of such firms developing these schemes from scratch? We note that in small and medium investment firms, many of those individuals caught by the remuneration guidelines will already have a substantial part of their wealth invested in the firm, so that application of the Guidelines in such cases simply increases firms' costs without mitigating any risks.

Given that the EBA has no investment firm representation on its steering groups – meaning that investment firms have not been able to raise their concerns with these proposals before the consultation paper was issued – we hope that the EBA will take note of our views at this stage. Rather than implement costly changes with unproven benefits to financial stability or investor protection, we recommend that the EBA undertakes a proper review of the impacts of their proposals as part of the upcoming Commission review of the prudential regime for

2 See for example, http://sites.herbertsmithfreehills.vuturevx.com/42/9168/landing-pages/remuneration-and-incentives-briefing---26-march-2015-d2.pdf.

such firms. The review can fully consider the risks associated with investment firms and apply a proportionate response to managing these risks both in terms of the capital investment firms must hold and the remuneration practices they implement.

The WMA would be pleased to discuss our views in more detail as required.

Wealth Management Association

28 May 2015