FIA EPTA
EUROPEAN PRINCIPAL TRADERS ASSOCIATION

17 March 2021

FIA EPTA response to the EBA Consultation on Guidelines on remuneration policies for investment firms (EBA/CP/2020/26)

The FIA European Principal Traders Association (FIA EPTA) appreciates the opportunity to provide feedback to the European Banking Authority (EBA) Consultation on its Guidelines on remuneration policies for investment firms.

FIA EPTA represents 30 independent European Principal Trading Firms (PTFs) which deal on own account, using their own money for their own risk, to provide liquidity and immediate risk-transfer in exchange-traded and centrally-cleared markets for a wide range of financial instruments, including shares, options, futures, bonds and ETFs.

Our members are independent market makers and providers of liquidity and risk transfer on trading venues and end-investors across Europe. Market making and liquidity provision (also referred to as principal trading or dealing on own account) is a distinct activity that is undertaken by non-systemic investment firms rather than banks, in a highly dispersed and varied ecosystem of independent Principal Trading Firms. These firms operate in an innovative and competitive fashion leading to a vibrant, dynamic and diverse ecosystem which massively reduces interconnectedness and increases substitutability. This fundamentally reduces systemic risk whilst improving market quality and lowering costs for retail and institutional investors alike.

FIA EPTA members appreciate the EBAs consideration of our comments and suggested solutions and stand ready to provide any further input as required.

General remarks

FIA EPTA members note that the Draft EBA Guidelines on sound remuneration policies are very similar to the Guidelines EBA/GL/2015/22 dated 21 December[1] 2015 currently in effect and applicable to firms subject to CRD V and MiFID firms, with minimal changes.

Specifically, FIA EPTA members wish to point out that under the Guidelines EBA/GL/2015/22, some requirements are dependent on whether the firm is significant or not. In particular, a remuneration committee is not required for non-significant firms while a five-year deferral period is required for the management body of a significant firm.

[1] https://www.eba.europa.eu/sites/default/documents/files/documents/10180/1314839/5057ed7d-8bf1-41b4-ad74-70474d6c3158/EBA-GL-2015-22%20Guidelines%20on%20Sound%20Remuneration%20Policies_EN.pdf?retry=1

Significant under these Guidelines means (as per the definition in section 10) "*institutions referred to in Article 131 CRD (global systemically important credit institutions (G-SIIs) and other systemically important credit institutions (O-SIIs)), and, as appropriate, other credit institutions determined by the competent authority or national law, based on an assessment of the credit institutions' size and internal organisation, and the nature, scope and complexity of their activities*."As per the EBA's Final Report from 21 December 2015 (Section 5.3 paragraph 25 and 26), the notion of "significant", "*comprises the institutions with the highest balance sheet totals and with the highest impact on the financial markets, but leaves appropriate discretion to include other large and relevant institutions*".

FIA EPTA members, therefore, conclude that the concept of significant firms used in CRD and related Guidelines that include mostly systematically important or similar credit institutions **has been translated into Directive (EU) 2019/2034 ("IFD") as firms with a balance sheet above EUR 100 million**. **The definition of significant has been materially changed but provisions to a large extent are applied equally.**

For this reason, FIA EPTA members believe that the provisions required under CRD and related Guidelines (particularly provisions dependent on being significant) should not be automatically carried forward under IFD.

FIA EPTA members note that the Guidelines acknowledge that the Guidelines should be applied with due regard to the principle of proportionality (set out in point Title I under 4 of the Draft EBA Guidelines), which is helpful. However, we believe that the principle of proportionality is not reflected in several areas set out in the Guidelines and in some cases, the Guidelines go beyond of what is required by the Level 1 text.

As the purpose and intention of IFD is to put in place a prudential regulatory framework that is more appropriate and proportionate for investment firms, FIA EPTA members would urge the EBA to take a similar approach in considering the appropriate governance that should be required of investment firms, which we note are generally smaller and, on balance, as non-systemic Class 2 firms pose no risks to the stability of the financial system, compared to CRD V firms.

By way of final introductory comment, we would like to express our concern with the very limited scope of the impact assessment which was undertaken for the purpose of these new Guidelines. We note that it is stated on p.76 that "*The assessment is **limited to areas where the guidelines have changed** compared to the framework established as applicable on 28 December 2020 (CRD V). Areas that have not changed in substance and the changes introduced within the Directive (EU) 2019/2034 (IFD) and Regulation (EU) 2019/2033 **have not been assessed***."

FIA EPTA members would like to remind the EBA that many firms now subject to IFD would have been exempt from the remuneration rules under CRD on the principle of proportionality and non-significance. Indeed, these investment firms have a very different profile compared to the credit institutions subject to CRD.

In consequence, the previous impact assessment is in our view not fit for purpose for non-systemic investment firms and we consider that it is not possible or appropriate to draw definite policy conclusions from this previous impact assessment for the remuneration requirements for such investment firms. E.g., most of these firms have a lean structure with directors assuming executive and supervisory functions, they do not have a remuneration committee, they do not issue shares other than to their

founders or holding company. This is in stark contrast to the credit institutions for which the previous guidelines were development. We would strongly recommend, therefore, that a full cost benefit analysis for these guidelines under IFD be done even for those sections that have been carried forward from CRD. In the interim, we would urge the EBA to adjust, as part of the current consultation, those requirements which are being flagged by stakeholder feedback as clearly disproportionate, including as per our comments below.

Question 3: Are the sections of the remuneration committee sufficiently clear?

1. With regard to section 2.3.1 (Composition of the Remuneration Committee), FIA EPTA members note that this appears to be a copy from the existing Guidelines EBA/GL/2015/22 and so replicates the requirement that remuneration committees be independent. FIA EPTA members note that this requirement is not supported by the Level 1 text, which only requires that members of the remuneration committee be compromised of "*members of the management body who do not perform any executive function in the investment firm concerned*".

2. In respect of the requirement to have a gender-balanced committee, FIA EPTA members welcome clarification that, when it is not practicable to do so, this should mean that an investment firm should ensure appropriate representation rather than prescribing equal representation.

3. More generally, the draft EBA Guidelines apply the exact same requirements as currently apply to the largest, riskiest banks, to a broad range of small investment firms, which pose far less risk to the financial system. FIA EPTA members would urge the EBA to reconsider whether, notwithstanding the application of the general principle of proportionality, it is appropriate to require investment firms to adhere to the same extensive requirements as the largest, most systemically significant banking institutions.

Question 4: Are the Guidelines on the application of the requirements in a group context sufficiently clear?

In paragraph 73, the Draft EBA Guidelines state that seconded staff should be subject to the remuneration provisions provided they would fall into the scope of identified staff if they were permanent employees of an EU investment firm or branch.

It goes on to say, "*For the purposes of short-term secondments, for example where a person is only residing in a for a few weeks to carry out project work, that person should be subject to such provisions only if the person would be identifiable under the RTS on identified staff, taking into account the remuneration awarded for the relevant time period and the role and responsibilities during the secondment.*"

FIA EPTA members believe the standard for when seconded (identified) staff become subject to European remuneration provisions must be clear and measurable in order to be able to be administered by investment firms. Note that applying European remuneration provisions to seconded staff is not just conceptual – this must be implemented in practice. It would be clearly disproportionate to expect an overseas entity not currently subject to the remuneration provisions of Directive (EU) 2019/2034 to set up and administer a "European remuneration program" solely for only a limited number of individual employees who may periodically be carrying out short, ad-hoc projects for an affiliate company in the EU for a few weeks.

The practical way for investment firms to administer this guideline would be for the European entity to take responsibility for said employee's remuneration administration – i.e., placing the seconded employee on European payroll, which then clearly delineates the portion of compensation that may be subject to European rules.

However, "a few weeks" is not a clear standard for firms to work with; moreover, including an employee on a European payroll for less than a full month period would by definition mean dual (international) payroll administration. The cost of that most clearly outweighs the benefit. Also, given this guideline has the potential severely to complicate employees' international tax and social security situations, FIA EPTA members believe the threshold for application of European remuneration rules to seconded staff must include a **de minimis threshold**.

To prevent unnecessary complexity and preserve proportionality, we suggest the Guidelines on this point align with existing rules which define the concept of cross-border worker for the purpose of determining in which Member State they are considered to be tax-resident, which is generally in the country where an employee spends more than 6 months a year.[2]

Therefore, to minimize complexity and preserve proportionality in the application of the Guidelines, we recommend a de minimis threshold of 6 months.

Question 7: Are the provisions on performance criteria sufficiently clear, which other performance indicators, e.g. regarding the performance of business units or portfolios, are used to determine the variable remuneration of identified staff?

In paragraph 28, the draft EBA Guidelines equate the management body of financial institutions with its supervisory function. The Guidelines note that different management body structures can be observed in EU Member States and that in some Member States a unitary structure is common, i.e. **supervisory and management functions of the board are exercised by only one body**. In other Member States a dual structure is common, with two independent bodies being established, one for the management function and the other for the supervision of the management function. The Draft EBA Guidelines refer thereafter to the '**supervisory function' as a proxy for 'management body**.'

Subsequently, in paragraph 178 the Draft EBA Guidelines state: "*In order to properly address conflicts of interest and without prejudice to paragraphs 178 and 179, **members of the supervisory function should be compensated only with fixed remuneration**. Incentive-based mechanisms based on the performance of the investment firm should be excluded*."

We note that for investment firms with unitary board structures – often smaller to medium-sized investment firms – the management body fulfils multiple functions – a supervisory function as well as an executive management function responsible and accountable for the day-to-day management of the undertaking.

[2] https://europa.eu/youreurope/citizens/work/taxes/income-taxes-abroad/index_en.htm

Management board members who determine the policy of an enterprise either solely or jointly must be fit and proper for the performance of their tasks. This assessment by competent authorities includes among other things a so-called fitness or suitability matrix. Per the EBA's template for the Assessment of Collective Suitability, "*The responsibility of the management body in its supervisory function as well as in its management function is* ***collective***."[3]

Further it goes on to say that, "*Institutions usually have, depending on the national regulation, one-tier or two-tier structures. In both structures, the members who fulfil the management function and the members who fulfil the supervisory function need to be collectively suitable.* ***Each area of knowledge or expertise needs to be covered collectively by the member(s) of the management body in its management function and – although the type and level of experience may be different – collectively by the member(s) of the management body in its supervisory function****."*[4]

In other words, the role of the management body in a unitary board structure cannot be separated from its role as a collective supervisory function.

In this context FIA EPTA members read the Draft EBA Guideline in paragraph 178 as effectively saying thatfor the many investment firms throughout the EU with unitary board structures, the management body in its entirety would be prohibited from receiving variable compensation.

Further, this prohibition internally contradicts the Guideline paragraph 249, which suggests a five-year deferral period [of variable compensation] for members of the management body.

FIA EPTA members believe a prohibition on receiving variable compensation goes beyond what is required in the Level 1 text. With due regard for proportionality, FIA EPTA members believe this should be revised for unitary board structures in the same manner that EBA sets out for control functions in paragraph 183: "The methods used for determining the variable remuneration of the [control] *supervisory* function *within unitary board structures* should not compromise [staff's] *the management body's* objectivity and independence."

Question 8: Is the section on the pay out in instruments sufficiently clear?

1) *Deferral of variable remuneration*

Investment firms exceeding the threshold set out in Article 32 (4) (a) IFD have to apply the deferral rules set out in point (l) of paragraph 1. As the threshold is set at a relatively low level, a substantial part of the Class 2 investment firms will have to comply with the abovementioned requirements. The principle of proportionality, therefore, bears significant importance in this area.

To the contrary, paragraph 249 of draft EBA Guidelines sets out two prescriptive elements to the deferral period:

[3] https://www.eba.europa.eu/regulation-and-policy/internal-governance/joint-esma-and-eba-guidelines-on-the-assessment-of-the-suitability-of-members-of-the-management-body

[4] Idem.

1) The minimum requirement of a **three-year deferral period applies "in any case**," leaving no room to apply the principle of proportionality; and
2) A **five-year deferral period for members of the management body**, where an investment firm has more than EUR 100 million of on and off-balance sheet assets over the four-year period immediately preceding the given financial year.

On these points we note the following:

- The Draft EBA Guideline go **beyond** what is required in the Level 1 text; no minimum deferral period is set for the management body in the Level 1 text;
- FIA EPTA members read the Draft EBA Guideline as effectively saying that the **minimum threshold** for firms having to apply any deferral requirement at all **automatically triggers the maximum deferral period for members of the management body**; and
- The draft EBA Guidelines create an **unlevel playing field** between firms subject to CRD V and firms subject to IFD and **between class 1 and class 2 investment firms**. Seeing that the current Guidelines on sound remuneration policies in effect for CRD V firms **only require significant institutions** to apply a five-year deferral period for a members of the management body. Further, **Class 1 firms** which are under the scope of CRD V, but which are not considered significant (but still with balance sheet assets well above EUR 100 million), **would be subject to less stringent deferral** rules than (small)Cclass 2 firms (with EUR 100 million of balance sheet assets)

Consequently, FIA EPTA members believe this draft guideline does not pay due regard to the principle of proportionality and should be amended to be more appropriately tailored to investment firms, particularly in light of their relatively smaller size, compared to CRD firms.

2) *Variable remuneration of a particularly high amount*

In paragraph 250, the draft EBA Guidelines state investment firms should define what level of variable remuneration constitutes a "particularly high amount," and for such staff, EBA suggests the deferral period should be at least 60%. In determining what constitutes a "particularly high amount," investment firms are to take into account:

- the average remuneration paid within the investment firm,
- the ratio of the variable to fixed remuneration of that staff member,
- when available the EBA remuneration benchmarking report on investment firms and,
- where available, national and other remuneration benchmarking results and
- the thresholds set by competent authorities.

FIA EPTA members are concerned that thresholds set by competent authorities and/or remuneration benchmarking reports covering all investment firms will necessarily span a broad range of the financial services industry – from asset management and client-facing businesses on one end of the spectrum, to owner-operated principal trading firms without external clients on the other – and will not sufficiently distinguish among investment firm types, resulting in a disproportionate outcome.

Remuneration models among investment firms in Europe, depending on the type of activity, will necessarily vary widely: for example, it is well known that the principal trading industry has long operated remuneration models that depend heavily on a variable component linked to performance because this

creates a positive effect on risk-sharing and incentivising prudent risk-taking behaviour in line with the trading firm's risk appetite.

Therefore, any benchmarking report that does not distinguish among types of investment firms would in essence be comparing apples to oranges.

If investment firms are required to consider benchmarking reports, it is important that such benchmarking exercises be sufficiently granular to delineate among types of investment firms, for example, by breaking them down according to what MiFID II services and activities the investment firm performs (e.g. investment firms that only perform deals on own account vs. firms not authorised to perform deals on own account and/or underwriting/placing with firm commitment but holding client funds/securities vs. firm that only provide reception/transmission and/or investment advice).

3) ***Payment instruments***

Both the Level 1 and 2 texts (EBA-RTS-2021-01)[5] allow firms that do not issue eligible instruments, to use alternative arrangements provided that the objectives of article 32(1)(j) IFD and the specific criteria set out in Article 6 of the EBA RTS are met, subject to approval of the competent authority.

In paragraph 260, the draft EBA Guidelines state that where an investment firm does not issue any eligible instruments but does not benefit from a waiver under Article 32(4) of Directive (EU) 2019/2034, it should apply for the use of an alternative arrangement, demonstrating that it does not issue such instruments.

Paragraph 261 goes on to list considerations competent authorities should make when deciding on applications to use alternative arrangements, the first of which (a) is: "that for investment firms which are stock corporations (both listed and non-listed), **shares or share-linked instruments are issued."**

Subparagraph (a) reads as a declaratory statement, whereas FIA EPTA members believe the EBA intends it as a query: that for investment firms which are stock corporations (both listed and non-listed), ****whether**** shares or share-linked instruments are issued."

If subparagraph (a) were to be understood as a declaratory statement, this would deviate from the Level 1 text and of the considerations set out in the EBA RTS. A very great majority of investment firms are non-listed stock corporations. Many of these firms do not issue shares, other than to the founders of the firm (which could be individuals or a corporation when the investment firm is held by a holding company). If these firms would be required to issue new shares to a high number of individuals, this would substantially increase the **regulatory burden and costs** for those firms. Whereas the RTS specifically considers that the possibility for certain investment firms to use alternative arrangements is aimed at **reducing the regulatory burden for those firms**, and the setting up of alternative arrangements will only

[5] https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Draft%20Technical%20Standards/2021/962223/Final%20draft%20RTS%20on%20instruments%20for%20variable%20remuneration%20under%20IFD.pdf

trigger one-off costs that are very limited as they do not require the issuance of any financial instruments.

Moreover, FIA EPTA members believe that the requirements of Article 6 of the EBA RTS, allow such firms to establish deferral schedules, subject to retention, malus and clawback arrangements, that meet the same objectives as financial instruments. Such should not be unduly restricted or **prevented by the mere fact that a firm issued shares to its founders.** If restricted, this could lead to a situation where investment firms may have to change their remuneration policy to pay out exclusively fixed remuneration (due to the administrative burden and to the fact that these shares would be illiquid so not attractive). This would significantly increase the risk to these firms as they would be unable to reduce their cost base in a period of business downturn.

Finally, FIA EPTA members question whether subparagraph (a) adds any value, given the premise that firms applying for use of alternative arrangements by definition do not issue any eligible instruments (other than to the founding member); therefore, it seems the answer to such query will always be no. FIA EPTA members, therefore, would request that subparagraph a) be deleted.