MiFID II

Remuneration requirements

Dechert LLP

MiFID II planning and implementation is a top priority for asset managers affected by European regulations and brings with it both challenges and opportunities.

What is the focus of the remuneration rules?

MiFID II introduces new remuneration rules which aim to reduce the risk that a firm's remuneration and incentive practices may give rise to conflicts of interest with its clients, and from having remuneration, sales targets or other arrangements that could provide an incentive to its staff to recommend a particular financial instrument when that firm could otherwise offer another financial instrument more appropriate to a client's needs.

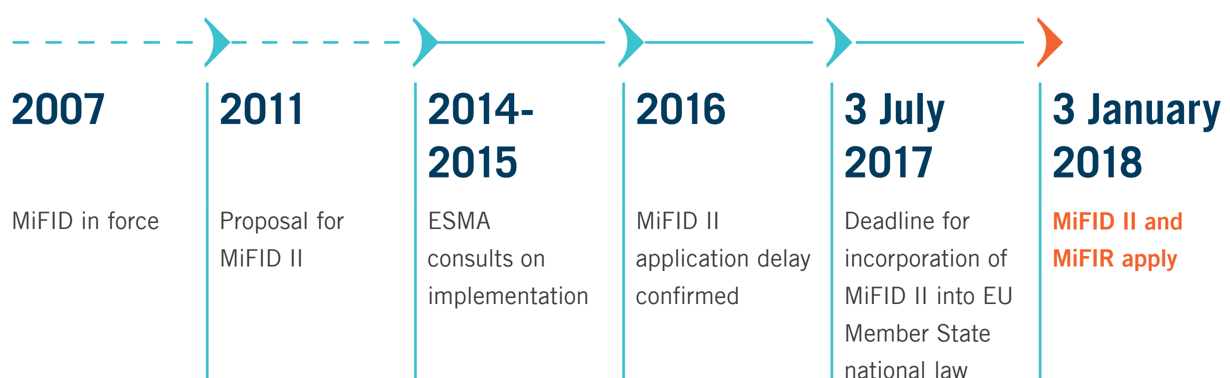
What's new under MiFID II?

The MiFID II requirements are broadly similar to ESMA's existing remuneration guidelines under MiFID I, but now give them legislative status. Notably, the requirement on management bodies to define, approve and oversee the remuneration policy is new and highlights the importance given to these issues in MiFID II.

Investment firms subject to MiFID II will already be subject to remuneration requirements under CRD III, CRD IV and/or UCITS V and AIFMD. Such firms are already under an obligation to have in place remuneration policies which are implemented and overseen by management bodies, incorporate measures to avoid conflicts of interest and require an appropriate balance between fixed and variable remuneration. However, these are prudential rules, intended to control the impact of remuneration policies on financial stability and are accordingly targeted at firms' principal risk takers and senior management. MiFID II focuses more on staff who might have a material impact on "services" provided to clients and conflicts of interest rather than their risk impact. In addition, the criteria that should be applied to determining the balance between fixed and variable remuneration focuses on compliance with applicable regulations and fair treatment of clients, rather than the relevant individual's or overall firm performance.

To which staff do the remuneration rules apply?

The remuneration rules apply to all "relevant persons" who could have an impact, directly or indirectly, on the investment or ancillary services provided by an investment firm or its corporate behaviour, regardless of client type, to the extent that such persons' remuneration could lead to a conflict of interest with any of the firm's clients. "Relevant persons" is defined widely and includes individuals involved in the provision of investment services and activities to the investment



firm under an outsourcing agreement. The Delegated Regulation identifies front-office staff, sales force staff, persons overseeing the sales force, financial analysts (whose material may be used by sales staff marketing to clients), persons involved in complaints-handling or in product design and development, tied agents and other staff indirectly involved in the provision of investment or ancillary services as being in scope.

The FCA has indicated that it does not intend to carry across the new rules to firms regulated under other EU directives. As a result, in the UK the FCA only proposes to apply MIFID II's remuneration standards for sales staff and advisers to:

- Common platform firms (including MiFID investment firms and dormant account fund operators, but excluding collective portfolio management investment firms).
- Article 3 firms (MiFID exempt firms).
- Branches of third-country firms (only where activities are carried on from an establishment in the UK).

What are the remuneration rules?

Under MiFID II, remuneration is defined broadly as "all forms of payments or financial or non-financial benefits provided directly or indirectly by a firm to relevant persons in the provision of investment or ancillary services to clients," and includes cash, shares, loans, carried interest and pension contributions. Remuneration may be non-financial and includes employee benefits (such as health insurance and seminars in "exotic" destinations) and career progression.

The management body of an investment firm is responsible for defining, approving (after taking advice from the firm's compliance function) and overseeing a remuneration policy for relevant staff. The purpose of such policy should be to "encourage responsible business conduct, fair treatment of clients as well as avoiding conflicts of interest". The policy should be designed to avoid any conflict of interest or incentive that may lead to relevant persons favouring their own or the firm's interests to the potential detriment of a client. In respect of retail clients, MiFID II strictly prohibits any remuneration, sales targets or other arrangements which could provide an incentive to staff to recommend a particular financial instrument when another product would better suit that client's needs.

The remuneration policy should provide for a balance between fixed and variable remuneration and remuneration or other incentives should be established on the basis of both quantitative and qualitative criteria reflecting applicable regulations, fair treatment of clients and the quality of client services.

The firm's remuneration policy should also ensure that persons involved in the compliance function are remunerated in a manner that does not (or is not likely to) compromise their objectivity.

Next steps for investment firms

Investment firms should verify that their existing remuneration policies (and those of their tied agents) are consistent with the remuneration requirements set out in MiFID II and appoint members of the management body to oversee the remuneration policy and compliance with the MiFID II remuneration rules. To the extent that firms were already complying with ESMA's existing guidance, changes and implementation costs should not be material.

Contact us

Christopher D. Christian
Partner, Boston
+1 617 728 7173
christopher.christian@dechert.com

Richard L. Heffner, Jr.
Partner, London
+44 20 7184 7665
richard.heffner@dechert.com

Dick Frase
Partner, London
+44 20 7184 7692
richard.frase@dechert.com

Matthew Duxbury
Associate, London
+44 20 7184 7301
matthew.duxbury@dechert.com

Monica Gogna
Partner, London
+44 20 7184 7554
monica.gogna@dechert.com

Mikhaelle Schiappacasse
Associate, London
+44 20 7184 7845
mikhaelle.schiappacasse@dechert.com

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