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Submitted electronically to: cp21-07@fca.org.uk

May 28, 2021

Re: FCA Consultation Paper 21/7: "A new UK prudential regime for MiFID investment firms"

Dear Mr. Rich and Ms. Neale,

ICI Global[1] appreciates the opportunity to provide feedback on the remuneration aspects of the Financial Conduct Authority's (FCA's) Consultation Paper 21/7 titled "A new UK prudential regime for MiFID investment firms" (CP21/7).[2] Many of our member firms are part of regulated fund complexes with operations around the globe and will be subject to the UK's investment firms prudential regime (IFPR), which is based on the EU Investment Firms Directive (IFD) and Regulation (IFR).

In this letter, we respond to certain of the FCA's questions on the remuneration provisions addressed in CP21/7.

Q16: Do you agree with our proposals to require certain non-SNI firms to have a risk committee, remuneration committee and nomination committee?

We do not agree with all of the FCA's proposals in this regard, as set out below.

Requirement to Establish an Entity Level Remuneration Committee

Paragraph 12.27 of CP21/7 proposes to require the largest non-SNI firms (those that are subject to the extended remuneration requirements) to establish a remuneration committee (as well as risk and nomination committees), and paragraph 8.12 proposes to require that such remuneration committee be established at entity level. In our view, requiring an entity level remuneration committee is an unduly burdensome means of achieving the regulatory objective of sufficient UK oversight of UK remuneration matters. The requirement also does not reflect that, in groups, it is often most appropriate for remuneration structures to be applied on a group basis, including to

[1] ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US$39.4 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Brussels, Hong Kong, and Washington, DC.

[2] CP21/7 is available at https://www.fca.org.uk/publication/consultation/cp21-7.pdf.

ensure consistency and alignment of the group's remuneration strategy. Moreover, the FCA's proposal goes beyond the position under the IFD, which allows a group remuneration committee to be used.

This is particularly a concern for larger investment firms, which may have several non-SNIs subject to the extended remuneration rules. These firms will, therefore, be required to establish multiple remuneration committees – one for each entity. This requirement creates an administrative and cost burdensome for such firms and also discourages uniformity of approach to remuneration management across the wider group.

Although we appreciate that the FCA is proposing to put in place a waiver process that will allow firms to seek consent to use a group remuneration committee, the process described in Chapter 8 for applying for such a waiver appears time-consuming and administratively burdensome. Given the importance of the role played by a firm's remuneration committee and the need to have the appropriate body set up with minimal disruption and delay, we recommend that instead the FCA revise this provision to require an investment firm to notify the FCA of its intent to establish a group remuneration committee and afford the FCA a set period of time in which to object.

Collective Portfolio Management Investment (CPMI) Firms

For CPMI firms, the FCA's position requiring an entity level remuneration committee is particularly difficult. The ESMA Guidelines on sound remuneration policies under the AIFMD, and the equivalent guidelines under the UCITS V Directive, allow for the use of a group level remuneration committee (see paragraphs 55 and 57 of those guidelines, respectively). However, if the same position is not adopted under the IFPR, CPMI firms will be required to establish a separate remuneration committee for the CPMI firm at an entity level. We believe this requirement unnecessarily goes beyond the requirements under those other regimes.

Furthermore, the threshold at which such remuneration committee must be established (broadly £300m by reference to balance sheet assets) is different than the threshold under the AIFMD/ UCITS V ESMA Guidelines (again at paragraphs 55 and 57 of those guidelines, respectively). Instead, under these regimes, firms may not need to establish a remuneration committee where the value of the portfolios managed does not exceed a threshold of (at the minimum) EUR 1.25 billion, subject to the assessment of the cumulative presence of qualitative and quantitative factors.

To allow for better alignment among the different regimes, we request that CPMI firms that are in compliance with the requirements regarding remuneration committees under either the AIFM Remuneration Code or the UCITS V Remuneration Code be deemed to be in compliance with those requirements under the MIFIDPRU Remuneration Code.

Q17: Do you agree with our proposal for firms to apply the new MIFIDPRU Remuneration Code from the start of their next performance year beginning on or after 1 January 2022.

Yes, we agree with this proposal.

Q20: Do you have any comments on our proposed approach to identifying material risk takers?

We generally agree with the FCA's proposed approach to identifying material risk takers (MRTs) as set out in CP21/7. In particular, we support the FCA's determination not to identify MRTs by reference to quantitative (pay-based) thresholds.

We believe, however, that the proposed list of staff members that must be identified as an MRT set out at paragraph 9.56 of CP21/7 (and in draft rule SYSC 19G.5.3R) is overly broad because it assumes that individuals in all of the roles identified have a material impact on the firm's risk profile or the assets the firm manages when, in certain circumstances, that may not be the case. For example, a staff member who has managerial responsibility for a business unit *"advising on investments, except P2P investments"* will be caught under the FCA's proposal even if such individual may in fact be fairly junior and, despite having managerial responsibility for other staff members, does not have final approval authority on matters that may affect the risk profile of the firm or investments under management. The list of roles identified by the FCA does not take into account internal approval processes and, as a consequence, a staff member may need to be identified even if he or she does not have formal approval authority – such as where decisions are subject to the approval of a relevant committee.

To prevent such individuals (in particular the roles at SYSC 19G.5.3(4)) from being designated as MRTs when they do not have a material impact on the firm's risk profile or the assets the firm manages, we suggest that the criteria set out in draft rule SYSC 19G.5.3R be provided as guidelines, i.e. the firm is required to evaluate whether such individuals are MRTs rather than designate them as such based on the job title/description alone. Whether such individuals are then identified would be subject to an overarching evaluation, such that they are identified if the individual in fact has a material impact on the firm's risk profile or the assets it manages. In the alternative, we suggest that the rules be revised such that individuals who meet the criteria listed are deemed to be MRTs, but with the option for firms to apply to the FCA for a waiver/exemption where they think the individual concerned should, in fact, not be identified as such.

We recognize that our proposed approach may diverge from the manner in which the qualitative MRT criteria are applied under the CRD V regime. In our view, a different approach is justified due to the much broader range and type of firms that will be subject to the IFPR.

Q22: Do you have any other comments on the proposed scope and application of the remuneration rules?

We generally agree with the proposed scope and application of the remuneration rules. However, more could be done to clarify and focus the application of the rules with respect to: (a) MRTs who are subject to more than one remuneration code; and (b) MRTs working for group undertakings in third countries who oversee or are responsible for business activities that take place in the UK.

<u>MRTs Subject to More Than One Remuneration Code</u>

CP21/7 states at paragraph 9.51 that *"where an MRT of a CPMI has responsibilities for just MiFID or just non-MiFID business, the firm should apply the relevant remuneration code. Where an MRT has responsibilities for both MiFID and non-MiFID business, we propose that the firm must apply the stricter of the requirements (for example any longer deferral periods) to the individual."* This proposal is then reflected in draft rule SYSC 19G.1.14 (3), which states that where individuals are MRTs under the MIFIPRU Remuneration Code and either the AIFM Remuneration Code and/or the UCITS V Remuneration Code, the most stringent of the applicable remuneration requirements should be applied to them.

We recommend that this provision be revised to instead provide flexibility to CPMI firms to apply the remuneration code that would be most appropriate for that individual under the particular facts and circumstances. In applying the remuneration code determined to be most appropriate for that

individual, the firm should then be deemed to have complied with the requirements of all of the remuneration codes applicable to the relevant individual. Our reasons for recommending this approach are as follows:

i. Where an individual does the vast majority of his or her work for the MiFID side of the business or the non-MiFID side of the business, it may be most appropriate and most equitable for the relevant code that would ordinarily be applicable to that portion of their work to be applied with respect to all of their variable pay.

ii. It may not be clear what firms should identify as the most "stringent rules" in any one case, as this will may depend on the circumstances. For example, a firm may have enhanced one set of requirements under its own policies, so that requirements that would usually be less onerous are in fact the most onerous in terms of how the firm applies them.

Alternatively, we suggest that where individuals are caught by more than one of these three remuneration codes, firms be given the option to apportion the individual's pay so that the relevant rules apply to each portion. For example, an individual that spends 50% of their time working for the MiFID business, and 50% of their time working for the non-MIFID UCITS business, would have the MIFIDPRU Remuneration Code apply to 50% of their salary and the UCITS V Remuneration Code apply the rest. This approach makes clear to firms which rules should apply to an individual and is, in our view, more likely to result in fair and consistent application of the remuneration requirements.

<u>MRTs Working for Group Undertakings in Third Countries</u>

At paragraph 9.41 of CP21/7, the FCA proposes *"to apply the remuneration rules only to MRTs of group entities in third countries who oversee or are responsible for business activities that take place in the UK."* We welcome this approach. However, many, if not most, MRTs who meet these criteria will only have a portion of their role focused on such UK-based business activities. We believe it would be both fair and reasonable in such circumstances to only subject a portion of such individual's remuneration to the MIFIDPRU Remuneration Code, where that portion reflects the portion of their role spent overseeing or taking responsibility for business activities taking place in the United Kingdom. This approach would, in our view, come at no prudential cost because such apportionment would not increase the prudential or conduct risks in relation to the consolidation group or its UK business activities.

Q24: Do you have any comments on the specific remuneration rules we are proposing to apply to all non-SNI firms ('standard remuneration rules')?

<u>Buy-Out Awards</u>

We generally consider the "standard remuneration rules" to be appropriate for non-SNI firms. However, we disagree with the provision requiring buy-out awards to be subject to the same malus and/or clawback terms as those applied by the previous employer, set out at paragraph 11.35 of CP21/7 and in draft rule SYSC 19G.6.12R(2).

If enforced, this requirement could result in: (i) divergence in the terms attached to new hires' buy-out awards given that they will be dependent on the firm that previously employed the relevant individual (e.g., if the firm was a dual-regulated bank, the buy-out could be subject to up to 10 years clawback with broad triggers, whereas if the previous firm was an AIFM, the buy-out may not be

subject to any clawback terms); and (ii) a misalignment in interests as the malus and clawback triggers would, in part, be tied to the previous firm's performance, rather than the new firm's performance.

We therefore believe that, in line with the approach taken at SYSC 19D 3.45R with CRD V firms, the FCA should require firms to apply deferral and performance adjustment (i.e., malus/clawback) arrangements to buy-out awards, which align with the long term interests of the new firm and not the previous one. In addition, although we agree that it may not generally be appropriate for buy-out awards to vest sooner than they would have done under the employer that granted the original awards that were bought out, we do not agree with the statement at SYSC 19G.6.12R(2) that firms should follow *"the same deferral and vesting schedule"* of that previous employer. Instead, we believe a firm should have flexibility to align the schedule with its own vesting dates.

Voluntary Over-Compliance

In Annex C of CP21/7, *"Amendments to the Prudential sourcebook for MiFID Investment Firms (MIFIDPRU),"* the FCA proposes at 1.1.8R that no provision in MIFIDPRU should be deemed to prevent a firm from voluntarily complying with measures that are stricter than those required by MIFIDPRU. We welcome this flexibility and recommend that the FCA further clarify that voluntarily over-complying with certain aspects of the regime will not result in firms being required to over-comply with other aspects.

For example, as described at paragraph 11.18 of CP21/7 and draft rule 19G.6.30R, the clawback period is required to span at least the combined length of the deferral and retention periods (where they exist). If a firm is not required to defer awards but chooses to do so, absent the clarity we request, it is unclear whether the clawback period the firm must then apply is equal to the deferral plus retention period, or whether the firm would have flexibility to set whatever clawback period it considered most appropriate.

We therefore recommend that the FCA clarify that voluntarily over-complying with certain aspects of the remuneration regime will not result in firms being required to over-comply with other aspects (e.g., no additional regulatory remuneration or other rules apply to firms in respect of any voluntary over-compliance).

Q28: Do you have any feedback on our reporting proposals? Please particularly provide details of any areas where you consider additional guidance on how to complete them is needed.

We would like to take this opportunity to request that the FCA does not implement any requirement to publicly disclose any ratios of fixed to variable remuneration set by firms. There are important concerns related to the commercially sensitive nature of such information, as well as MRTs' right to privacy, and we do not see any benefits to the public disclosure of such information. Public disclosure could be counterproductive and, in practice, lead to an increase in the ratio of fixed to variable remuneration for both between groups of staff within a firm and across the industry.

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We appreciate your consideration of our views and concerns on CP 21/7. Please contact Jennifer Choi, Chief Counsel, at +1 (202) 326-5876 or jennifer.choi@ici.org; or Eva Mykolenko, Associate Chief Counsel, ICI Global, at +1 (202) 326-5837 or emykolenko@ici.org with any questions.

Yours sincerely,

/s/ Jennifer S. Choi

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