Answers to sections 9 and 10 to the Joint EBA and ESMA call for advice on the investment firms' prudential framework (the "Call for Advice")

Executive Summary

- AFG notes the question 24 of the Call for Advice, on interactions with AIFMD and UCITSD and questions 27 to 30 of the Call for Advice, on governance and remuneration, which relate notably, to asset management ("**AM**") sectoral regulations (UCITSD & AIFMD);
- AFG welcomes the broad statement in §230, that "*the supervisory community does not have any practical evidence causing problems due to this legal differences with regard to the application of remuneration requirements in these firms*";
- Current remuneration framework in the EU's financial services is time-tested and has proven effective, striking a successful and competitive balance between consistency in principles and adaptation to financial sectors' strategic and risk dynamics;
- Given the increasing presence of regulation in many aspects of business, in particular in the EU, AFG notes the importance of avoiding the layering and/or duplicating of regulations, and of ensuring consistency between various horizons of regulations (for example, pay transparency directive vs. gender neutrality in financial services' remuneration);
- AFG would like to stress that remuneration is highly strategic and related regulations must retain its current "fit-for-purpose" design to allow EU AM players to continue to strive as successful competitors in international markets.

Introductory remarks

Introductory remarks on Section 9

AFG is of the opinion that the existing framework dedicated to investment firms through IFD and IFR is fit to take into account their specificities, in a more proportionate manner than was the case under CRD and CRR. And the regulatory framework for UCITS management companies and AIFMs has proven its effectiveness and robustness during the last decades. We therefore believe that revising such established frameworks would not contribute to an efficient Capital Market Union.

Introductory remarks on Section 10

Set out below, are the answers to the questions 27 to 30 of the Call For Advice, which have been prepared by AFG's Technical Committee on Remunerations. AFG is the leading trade association for asset managers in France.

As the Call For Advice entails a review of the remuneration provisions set out in the Investment Firms Directive and Regulation ("IFD/IFR") when compared to other sectoral remuneration provisions, including AIFMD/UCITS, AFG's Technical Committee on Remunerations wishes to express the following observations and answers to those questions 27 to 30, corresponding to "Section 10 Remuneration and its Governance" of the Call For Advice (please see for ease of reference, the corresponding extract of the Call For Advice, quoted in Appendix to this memo).

First, AFG welcomes the factual approach of the Call for Advice, and regarding the variations between IFD/IFR's and AIFMD/UCITS' remuneration provisions in particular, notes the broad statement in §230, that "*the supervisory community does not have any practical evidence causing problems due to this legal differences with regard to the application of remuneration requirements in these firms*".

Second, as an important element of context, AFG would like to stress that the remuneration framework which inspired both AIFMD/UCITS' and IFD/IFR's, as well as CRD's and even MICAR's, and Solvency II's, etc. is the framework defined by the G20 in September 2009 in Pittsburgh, shortly after the Great Financial Crisis, aka the "Implementation Standards of the Principles For Sound Compensation Practices" ("PSCPs"), which were subsequently rolled-out worldwide, as monitored from time to time by the FSB. This **consistency by design** ensured both a quality and robust level playing field across the financial sectors in all G20 jurisdictions.

In the EU, CRD 3 was first to include PSCPs (end 2009), then AIFMD (2011), then UCITS and CRD 4 (2013), etc.

We believe it is important to note two points:

- The range of financial players is extensive. **Remuneration is a very highly strategic dimension** for each of these entities. As activities, functions and sizes are very diverse, a full one size fits all approach is not possible. For example, banks bear risks on their balance sheet and not encouraging excessive (and short-term) risk taking via wrong incentives is of the essence; while asset managers are entrusted with the management of their clients' assets, which are not on asset managers' books, and incentives must be primarily geared towards the level of risk taking which has been promised to such clients and the protection of their interest. For example, too conservative remuneration practices in asset management could incentivize so-called "closet-tracking" (or "career risk-adverse") behaviors from portfolio managers, hence result in an unintended and client interests-adverse outcome**. Therefore, it was recognized early by the EU co-legislators** that although certain key principles should be universal (e.g. comprehensive inclusion of risks, qualitative and quantitative performance measurement, long term alignment, independence of control functions, robust governance, disclosure, etc.) **certain practices such as notably: modalities of risk alignment, compensation structure, regulated staff, proportionality would be differentiated in financial sectors' specific legislation.**
- G20/FSB's 2009 priority was to weed out systemic risk from the financial sector's remuneration practices. Hence in PSCPs' 5 pages, the word "risk" is mentioned 18 times, while the words "client" and "investor" are never mentioned. In the EU, a more comprehensive approach has been designed since the early 2010s: notably, mis-selling risk was specifically addressed by MIFID Remuneration Guidelines published in June 2013 (followed by a revision in 2023, notably to adapt to MIFID II). Also, in AIFMD/UCITS Remuneration Guidelines in particular, the avoidance of conflicts of interests in incentives were specifically flagged as a key remuneration policy objective. These Guidelines were published in 2013 (AIFMD) and updated (to cover also UCITS) in 2016.

It should be stressed that **the PSCP model**, which assigns a clear autonomy and responsibility for the remuneration policy to the management body in its supervisory role, and ensures high professional standards and long term alignment by strong controls (notably, annual audit), significant disclosure and (generally) three year deferral of variable remuneration for the most

senior managers and risk takers, **has proven effective**, and remuneration scandals in the financial sector have become a rare occurrence today, whilst they were unfortunately rather frequent before 2010.

In conclusion, we believe the remuneration framework in the EU financial sector strikes an effective and well-structured balance between :

- **(i) consistency in principles, which ensures a robust level playing field across financial sectors, thanks to FSB's seminal PSCPs, and**
- **(ii) necessary differentiation to taylor each financial sector's specific risks and strategic dynamics.**

AFG's answers to questions 24 and 27 to 30 of the Call for Advice

Section 9

24. Do you have any views on the possible ways forward discussed above concerning the provision of MiFID ancillary services by UCITS management companies and AIFMs?

Firstly, AFG would like to stress the fact that the review of the IFD/IFR prudential framework, as provided for in the review clauses of IFD and IFR[1], does not contain any mandate for EBA and ESMA to also review capital requirements for UCITS management companies and AIFMs. Section 9 of the Call for advice only contemplates interactions of both aforementioned regulations with other regulations, in particular AIFM and UCITS Directives. AFG therefore believes that the two possible ways forward suggested in the Call for advice, such as imposing capital requirements on UCITS and FIAs management companies or introducing requirements limiting the amount of provided ancillary services by such management companies, exceed EBA's and ESMA's mandate within the framework of this review.

Policymakers are currently conducting extensive work to identify ways to improve the Capital Markets Union, in a context where European capital markets struggle to develop and face strong competition from non-EU actors. **One of the prerequisites for the development European investments markets is regulatory stability, especially for regulations such as UCITS and AIFMD that have proved efficient in achieving their purposes**. Indeed, UCITS Directive and AIFMD have been reviewed very recently, the amending Directive 2024/927 having been published in the Official Journal in March 2024. As such, it is **disproportionate to reopen every year such key regulations that have been functioning well**, especially given that the question of the computation methodology for AUMs has been analysed within the AIFMD in 2021 and the European Commission has deemed the current methodology adequate.

To be noted that firms that manage greater AUMs are <u>not</u> subject to higher operational risks (e.g. negligence, violation of conduct rules or investment policies), but evidence is actually contrary, as firms that manage larger AUM typically have more stringent compliance and risk management frameworks. As a reminder, assets are managed on behalf of third parties and are segregated.

Even more so, we strongly oppose the suggested alternative of limiting the volume of ancillary services provided by UCITS/AIFMD management companies, that would create unwarranted

[1] Article 66 of IFD n°2019/2034 and Article 66 of IFR n°2019/2033

organisational complexities such as: undue costs, notably related to the resulting obligation to create dedicated subsidiaries, impossibility to benefit from economies of scale.

Section 10

27. Is the different scope of application of remuneration requirements a concern for firms regarding the level playing field between different investment firms (class 1 minus and class 2), UCITS management companies and AIFMs, e.g., in terms of the application of the remuneration provisions, the ability to recruit and retain talent or with regard to the costs for the application of the requirements?

Given the introductory remarks above highlighting the consistency of remuneration principles, we concur with the broad observation made at § 230, that consider that the differences in certain practical requirements are not preventing a level playing field nor creating unfair or disproportionate costs to certain sectors. To the contrary, we welcome the time-proven balance between consistency inspired by the simple and powerful PSCP framework, and the wisdom developed over time by EU legislators when differentiating the framework per sector where needed (notably: risk alignment modalities, compensation structure, regulated staff, proportionality...), after due and thorough public consultations of stakeholders and the industry.

Indeed, we note that in CRD, subsidiaries part of a banking group have the possibility to apply their sector specific provisions on remuneration. This is notably the case for investment firms covered by CRD, where Art. 109(4)(a) CRR allows subsidiaries to apply different remuneration policies if they are subject to sector-specific EU legislation (e.g. IFD/AIFMD/UCITSD). As pointed out in § 231 of the Call for Advice, this is not the case for the provisions of IFD and therefore we would suggest to adjust Art. 25 IFD so that subsidiaries part of an investment firm Group may apply as well their sectoral remuneration legislations.

28. Are the different provisions on remuneration policies, related to governance requirements and the different approach to identify the staff to whom they apply a concern for firms regarding the level playing field between different investment firms (class 1 minus under CRD or class 2 under IFD), UCITS management companies and AIFMs, e.g. in terms of the application of the remuneration provisions, the ability to recruit and retain talent or with regard to the costs for the application of the requirements?

Given the introductory remarks above highlighting the consistency of remuneration principles, we concur with the broad observation made at § 230, that consider that the differences in certain practical requirements are not preventing a level playing field nor creating unfair or disproportionate costs to certain sectors. To the contrary, we welcome the time-proven balance between consistency inspired by the simple and powerful PSCP framework, and the wisdom developed over time by EU legislators when differentiating the framework per sector where needed (notably: risk alignment modalities, compensation structure, regulated staff, proportionality...), after due and thorough public consultations of stakeholders and the industry.

In addition, regarding § 234 and its considerations on gender neutrality (and also, §244), we note that the Pay Transparency Directive must be transposed EU-wide before June 2026, and thus that this issue will be dealt with comprehensively beyond the sole financial sector, thereby further

strengthening a level playing field between financial sectors and also with other sectors of the economy. We believe it is important to avoid layering the regulations and would respectfully encourage the EU legislators to implement subsidiarity, ensuring the financial sector has no “gold plating” vs. the rest of the economy, in terms of equal pay, including in respect of gender difference.

29. Are the different provisions, criteria and thresholds regarding the application of derogations to the provisions on variable remuneration, and that they apply to all investment firms equally without consideration of their specific business model, a concern to firms regarding the level playing field between different investment firms (class 1 minus under CRD and class 2 under IFD), UCITS management companies and AIFMs, e.g., in terms of the application of the remuneration provisions, the ability to recruit and retain talent or with regard to the costs for applying the deferral and pay out in instruments requirements? Please provide a reasoning for your position and if possible, quantify the impact on costs and numbers of identified staff to whom remuneration provisions regarding deferral and pay out in instruments need to be applied.

Given the introductory remarks above highlighting the consistency of remuneration principles, we concur with the broad observation made at § 230, that consider that the differences in certain practical requirements are not preventing a level playing field nor creating unfair or disproportionate costs to certain sectors. To the contrary, we welcome the time-proven balance between consistency inspired by the simple and powerful PSCP framework, and the wisdom developed over time by EU legislators when differentiating the framework per sector where needed (notably: risk alignment modalities, compensation structure, regulated staff, proportionality...), after due and thorough public consultations of stakeholders and the industry.

Regarding § 239 in particular, notably for the reasons mentioned in the introductory remarks above, we believe UCITS and AIFMD should not be “aligned” on the mentioned aspects with CRD and IFD. Also, we note that CRD contains provisions, notably in article 109 of CRR, which specifically provide for the banning of circumvention in the field of remuneration, which ensures regulatory robustness.

30. Are the different provisions regarding the oversight on remuneration policies, disclosure and transparency a concern for firms regarding the level playing field between different investment firm, UCITS management companies and AIFMs, e.g., with regard to the costs for the application of the requirements or the need to align these underlying provisions? Please provide a reasoning for your position.

Given the introductory remarks above highlighting the consistency of remuneration principles, we concur with the broad observation made at § 230, that consider that the differences in certain practical requirements are not preventing a level playing field nor creating unfair or disproportionate costs to certain sectors. To the contrary, we welcome the time-proven balance between consistency inspired by the simple and powerful PSCP framework, and the wisdom developed over time by EU legislators when differentiating the framework per sector where needed (notably: risk alignment modalities, compensation structure, regulated staff, proportionality...), after due and thorough public consultations of stakeholders and the industry.

Regarding § 243 in particular, on the granularity of disclosure, it seems to us that the granularity may be too detailed in IFD and to a certain extent, in CRD, and if a greater convergence were to be

achieved, we would respectfully suggest that a prior survey be implemented, to verify if the detailed disclosures of IFD (and CRD) are:

(i) useful to stakeholders to whom these disclosures are intended
(ii) not weakening the competitiveness of EU financial institutions vs. non-EU players, who are subject to lighter requirements and better able to protect their competitive positions.