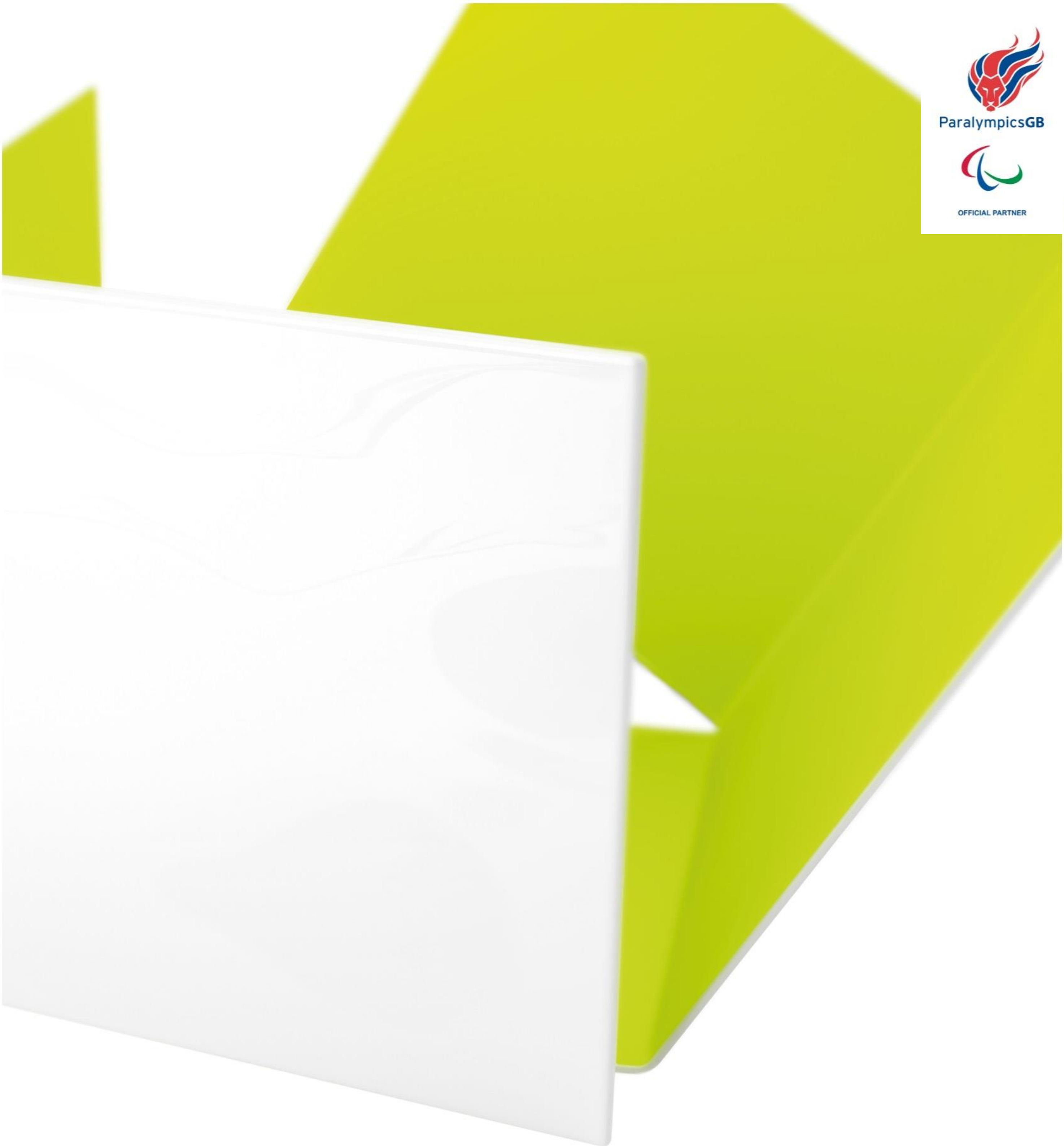

# MiFID II

**Remuneration**

December 2016

## Key Points

- Firms will be required to issue a remuneration policy that has been approved and overseen by senior management.
- Firms must identify and prevent or manage conflicts of interest that may arise due to the firms' remuneration structures.
- Firms must ensure that the remuneration of compliance staff does not compromise the objectivity of such staff.

## Remuneration in the MiFID II Directive

Remuneration issues are not specifically mentioned in MiFID I and its implementing measures.

The MiFID II Directive imposes specific requirements on firms in relation to remuneration. In particular, the Directive requires:

- management bodies of investment firms to define, approve and oversee a remuneration policy for persons involved in the provision of services to clients;[1]
- firms to take appropriate steps to identify and to prevent or manage conflicts of interest, including conflicts arising from the firms' remuneration structures;[2] and
- firms to ensure that their remuneration, sales targets or other incentives do not lead staff to recommend instruments to clients when other instruments would better meet their clients' needs.[3]

## ESMA proposals for remuneration

ESMA issued guidelines on remuneration in 2013.[4] ESMA has proposed that these guidelines should be used as the basis for its advice in the implementing measures for MiFID II.

In its Technical Advice to the European Commission, ESMA proposed that:

- the management body should seek advice from the compliance function before approving a remuneration policy;
- senior management are responsible for the day-to-day implementation of the remuneration policy and the monitoring of compliance risks related to the policy;
- remuneration policies should be designed in a way that does not create incentives that may lead staff to favour their own or the firm's interests to the potential detriment of clients; and
- an appropriate balance between fixed and variable components of remuneration should be maintained at all times.[5]

## Detailed requirements set out in the Delegated Regulation

The European Commission adopted the MiFID II Delegated Regulation based on ESMA's Technical Advice which contains more detailed rules on remuneration.[6] There are three main sets of requirements set out in the MiFID II Delegated Regulation, which also includes a new definition of remuneration.

I. **Remuneration of compliance staff:**[7] The MiFID II Delegated Regulation sets out several conditions a firm must comply with to ensure that its compliance function can perform its obligations properly and independently. One of these is that the method of determining the remuneration of staff in its compliance function does not compromise their objectivity and is not likely to do so. However, a firm is not obliged to comply with this condition if it can show that:

- given the size, nature and complexity of its business (and the investment services it provides), the condition is not proportionate; and
- its compliance function would be effective in any case.

1 Article 9(3)(c), MiFID II Directive.
2 Article 23(1), MiFID II Directive.
3 Article 24(10), MiFID II Directive.
4 ESMA, Final report: Guidelines on remuneration policies and practices (MiFID), 11 June 2013 (ESMA/2013/606).

5 ESMA, Final Report: Technical Advice to the Commission on MiFID II and MiFIR, 19 December 2014 (ESMA/2014/1569). See also ESMA, Consultation Paper, 22 May 2014, Chapter 2.11.
6 Delegated Regulation of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (the "**MiFID II Delegated Regulation**").
7 Article 22(3), MiFID II Delegated Regulation.

II. **Remuneration policies:**[8] Firms are required to implement remuneration policies and internal practices/procedures to ensure that clients are treated fairly and not impaired by remuneration practices of the firm in the short, medium or long term. There are more detailed rules in relation to these policies and practices.

- These policies and practices should be designed to avoid conflicts of interests or the creation of incentives that may lead the relevant persons to favour their own interests or the firm's interests to the potential detriment of any client.
- These policies and practices should apply to all relevant persons with a direct or indirect impact on the investment services/ancillary services provided by the firm or on its corporate behaviour to the extent that the remuneration of such persons could create a conflict of interest or create incentives encouraging such persons to act against the interests of any of the firm's clients. Relevant persons for this purpose will include front-office staff, sales force staff and tied agents.[9]
- The policy must be approved by the management body, taking advice from the compliance function. Senior management will be responsible for the day to day implementation of the remuneration policy and the monitoring of related compliance risks.
- Remuneration and similar incentives must not be solely/predominantly based on quantitative commercial criteria. They must take into account appropriate qualitative criteria reflecting compliance with the applicable regulations, the fair treatment of clients and the quality of services provided to clients.
- A balance between fixed and variable components of remuneration must be maintained at all times, so that the remuneration structure does not favour the interests of the firm or relevant persons over any client.

III. **Conflicts of Interest Procedures:**[10] When designing conflicts of interest procedures, firms must provide for the removal of any direct link between:

- the remuneration of persons principally undertaking one activity; and
- the remuneration of, or revenues generated by, persons principally engaged in a different activity,

in a situation where this link results in a conflict of interest.

## Timescales for implementation

The MiFID II Directive and MiFIR came into force on 3 July 2014, and most of their provisions will come into effect in member states from 3 January 2018. Member states have until July 2017 to transpose the MiFID II Directive into national law.[11]

The MiFID II Delegated Regulation will become effective from 3 January 2018. The MiFID II Delegated Regulation will have direct effect and the member states will not need to implement these changes into national law.

[8] Article 27, MiFID II Delegated Regulation.
[9] Recital 41, MiFID II Delegated Regulation.
[10] Article 34, MiFID II Delegated Regulation.
[11] See Directive (EU) 2016/1034 of the European Parliament and of the Council of 23 June 2016 amending Directive 2014/65/EU on markets in financial instruments.

**Alicante**
**Amsterdam**
**Baltimore**
**Beijing**
**Brussels**
Budapest
**Caracas**
**Colorado Springs**
**Denver**
**Dubai**
**Dusseldorf**
**Frankfurt**
**Hamburg**
**Hanoi**
**Ho Chi Minh City**
**Hong Kong**
**Houston**
Jakarta
**Johannesburg**
**London**
**Los Angeles**
**Louisville**
**Luxembourg**
**Madrid**
**Mexico City**
**Miami**
**Milan**
**Minneapolis**
**Monterrey**
**Moscow**
**Munich**
**New York**
**Northern Virginia**
**Paris**
**Perth**
**Philadelphia**
**Rio de Janeiro**
**Rome**
**San Francisco**
**São Paulo**
**Shanghai**
Shanghai FTZ
**Silicon Valley**
**Singapore**
**Sydney**
**Tokyo**
**Ulaanbaatar**
**Warsaw**
**Washington, D.C.**
Zagreb

**Our offices**
Associated offices

5460791

# www.hoganlovells.com

**"Hogan Lovells" or the "firm" is an international legal practice that includes Hogan Lovells International LLP, Hogan Lovells US LLP and their affiliated businesses.**

**The word "partner" is used to describe a partner or member of Hogan Lovells International LLP, Hogan Lovells US LLP or any of their affiliated entities or any employee or consultant with equivalent standing. Certain individuals, who are designated as partners, but who are not members of Hogan Lovells International LLP, do not hold qualifications equivalent to members.**

**For more information about Hogan Lovells, the partners and their qualifications, see www.hoganlovells.com.**

**Where case studies are included, results achieved do not guarantee similar outcomes for other clients. Attorney advertising. Images of people may feature current or former lawyers and employees at Hogan Lovells or models not connected with the firm.**