Stricter rules on pay for asset managers – are you ready?

The new remuneration rules in the Investment Firms Directive (IFD) may apply from as early as 1 January 2021.

They’ll have a material impact for any Class 2 investment firm (which includes any asset manager with AUM of at least €1.2bn), so it’s crucial to start preparing now.

See this briefing from our Financial Regulatory Group for details on how investment firms will be classified.

**Main IFD requirements**

<table>
<thead>
<tr>
<th>IFD rule</th>
<th>Impact on how you structure pay</th>
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<tbody>
<tr>
<td>Fixed / variable pay ratio</td>
<td>The CRD “hard” bonus cap of 1x (or 2x) fixed pay won’t apply under the IFD outside of banking groups*, but you will have to continue to set an “appropriate” ratio of fixed to variable pay.</td>
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<tr>
<td>Malus and clawback</td>
<td>All Class 2 firms will have to comply with the full IFD rules on malus and clawback, a big change for many investment firms. You’ll need to set appropriate criteria, revise documents, and ensure you can enforce the rules.</td>
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<tr>
<td>Pay out process: deferral, non-cash instruments and retention</td>
<td>Many Class 2 firms will become subject to the full IFD pay-out process rules, because it will be harder to use proportionality to disapply them. You’ll need to deliver at least 50% of variable pay in non-cash instruments (these can now include instruments linked to the value of funds under management), and defer 40% – 60% of variable pay over three to five years.</td>
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<tr>
<td>Disapplying the pay-out process rules: asset test</td>
<td>It will be much harder to use proportionality to disapply these rules. You should be able to disapply if you’ve got on- and off- balance sheet assets of €100m or less. The UK may increase this limit to €300m, but there are some conditions.</td>
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<tr>
<td>Disapplying the pay-out process rules: de minimis</td>
<td>This exemption, allowing some staff to be outside the pay-out process rules, is restricted. It will only apply to individuals who receive variable pay of less than €50,000, if this is less than 1/4 of their total pay.</td>
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<tr>
<td>Remuneration committee</td>
<td>If you’ve got on- and off- balance sheet assets of over €100m you will need to operate a remuneration committee complying with the full IFD requirements. This includes being gender balanced.</td>
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<tr>
<td>Public / regulatory disclosures</td>
<td>You will need to disclose more information on pay than you currently do, both publicly and to the regulators. This will include information on so-called “high earners” in your organisation.</td>
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What this means for you

Class 2 firms will have to navigate around complex pay rules. If you are currently using “proportionality” to disapply some onerous pay requirements, this may not be possible under the IFD. So the IFD rules may look familiar to some of the current regimes, but their impact may be significantly greater in practice.

Groups which include AIFMs and UCITS ManCos will need to analyse the interaction of these regimes with the IFD. International groups and investment firms within CRD banking groups should consider carefully how the IFD rules will affect them.
Key “tricky areas”

- Structuring appropriate deferral arrangements and delivering the non-cash portion of variable pay.
- Implementing best practice pay governance procedures and demonstrating compliance to the regulator.
- When (and how) to apply performance adjustment (ie malus and clawback) and ensuring enforceability.
- Identifying / structuring pay for your MRTs, and agreeing changes with them.
- Preparing public / regulatory disclosures.
- Working out if you can disapply the pay-out process rules, and for whom.
- Scoping your regulatory consolidation group and which pay rules apply.

These are issues that larger banking institutions already face and on which we regularly advise. We have the depth of experience to draw on for firms which will have to apply these rules in full for the first time.

Benefit from our expertise

Expertise in this area is scarce – but we can help you to minimise the impact of IFD on your pay arrangements.

We advise half of the top 20 asset managers (plus 14 of the top 20 global banks and their asset manager subsidiaries) on pay and compliance with the different regulatory regimes.

So you’ll get the most current, best practice on pay in the market, plus how to avoid getting caught out by the more complex aspects of the rules. If you’ve got cross-border roles, you’ll get clear, relevant and targeted advice identifying the key differences between national regimes that you’ll need to consider, including due to Brexit.

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