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COMMISSION STAFF WORKING DOCUMENT

Detailed assessment of the remuneration rules under Directive 2013/36/EU and Regulation (EU) No 575/2013

Accompanying the document

Report from the Commission to the European Parliament and the Council

Assessment of the remuneration rules under Directive 2013/36/EU and Regulation (EU) No 575/2013

{COM(2016) 510 final}
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1. INTRODUCTION

The Capital Requirements Directive [1] ("CRD" or "the Directive") and the Capital Requirements Regulation[2] ("CRR" or "the Regulation") contain requirements regarding the remuneration policies and practices of credit institutions and investment firms[3].

The Directive contains provisions regarding the principles and design of remuneration policies, together with a number of rules concerning the pay-out process and structure of the remuneration of staff whose professional activities have a material impact on the institutions' risk profile. The Regulation contains requirements for institutions to disclose elements related to the design of their remuneration systems and quantitative information for different components of remuneration packages.

The first set of rules on remuneration within the financial sector was put forward at EU level in the Commission Recommendation of 30 April 2009[4], followed by the introduction of binding rules on remuneration for credit institutions and investment firms in CRD III[5], adopted in 2010. Those rules, which had to be implemented by the Member States by January 2011, were further extended following the adoption of CRD IV in 2013 (with the new rules applicable as of 2014).

This Staff Working Document (SWD) accompanies the Commission Report COM(2016)510, which is submitted to the European Parliament and the Council in fulfilment of an obligation under Article 161(2) CRD. This Article requires the Commission, in close cooperation with the European Banking Authority (EBA), to report on the provisions on remuneration in CRD and CRR, and in particular to:

- Take into account international developments *(Section 2 SWD)*
- Review the implementation and enforcement of the provisions on remuneration *(Section 3 SWD)*
- Include the identification of any lacunae arising from the application of the principle of proportionality to the provisions on remuneration *(Section 4 SWD)*
- Review the efficiency of the provisions on remuneration *(Section 4 SWD)*
- Assess the impact of compliance with the Maximum Ratio Rule (Article 94(1)(g)) in respect of financial stability *(Section 5.1 SWD)*
- Assess the impact of compliance with the Maximum Ratio Rule (Article 94(1)(g)) in respect of competitiveness *(Section 5.2 SWD)*
- Assess the impact of compliance with the Maximum Ratio Rule (Article 94(1)(g)) in respect of any staff working effectively and physically in subsidiaries established outside the EEA of parent institutions established within the EEA, and consider whether the Maximum Ratio Rule should continue to apply to any such staff *(Section 5.3 SWD)*

In carrying out this review, the Commission engaged in several work streams. It has sought stakeholders' input through a public consultation[6], a fact-finding stakeholder event[7] and bilateral

[1] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0338:0436:En:PDF

[2] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013R0575

[3] Recitals 62-68 CRD

[4] Commission Recommendation 2009/384/EC on remuneration policies in the financial services sector, available at http://ec.europa.eu/internal_market/company/docs/directors-remun/financialsector_290409_en.pdf

[5] Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies

[6] Public consultation on impacts of maximum remuneration ratio under Capital Requirements Directive 2013/36/EU (CRD IV), and overall efficiency of CRD IV remuneration rules (22.10.2015 – 14.01.2016), available at http://ec.europa.eu/justice/newsroom/civil/opinion/151015_en.htm

[7] Stakeholders Meeting - Fact-finding on remuneration under CRD IV (16.12.2015), available at http://ec.europa.eu/justice/newsroom/civil/events/151116_en.htm

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meetings with industry representatives. Moreover, the Commission engaged with Member States' representatives and supervisory authorities in the context of the Commission's Expert Groups on Banking, Payments and Insurance, as well as on Company Law, and EBA's Standing Group on Governance and Remuneration, where the European Securities Markets Authority is also represented. The Commission studied available academic literature. An external study[8] on the effects of CRD and CRR remuneration rules has also been prepared for the Commission, the results of which were, however, affected by a relatively recent adoption of the CRD and CRR and subsequently limited data availability.

In accordance with the CRD mandate, EBA was closely associated with the review process and delivered valuable information and remuneration data, *inter alia* gathered and processed for the purpose of its Reports on Remuneration Benchmarking and High-Earners[9], and through its Opinions on the proportional application of the remuneration rules[10] and on role-based allowances[11].

Overall, the review exercise has been hampered to some extent, as some remuneration rules have entered into force relatively recently and were in practice not always applied to a full extent, often on the grounds of proportionality considerations. This created limitations in terms of data availability and regarding some of the aspects of the analysis affected the ability to formulate, at this point in time, conclusive findings. Another difficulty resulted from the very nature of the rules: they are meant to curb the possible wrong incentives given to individuals and thus to impact on individuals' behaviour. Concrete impact on individuals' behaviour is very complex to measure. Finally, it is important to recognise that the remuneration rules are just one element of the regulatory framework that was put in place with the purpose of fostering financial stability. It has for all these reasons not been possible to precisely quantify the impact on financial stability of the remuneration rules seen in isolation, and for certain aspects a more qualitative assessment has been carried out.

2. INTERNATIONAL CONTEXT

This section discusses relevant international developments, which according to Article 161(2) CRD shall be taken into account in the Commission review.

The introduction of the CRD rules on remuneration was inspired by the developments at the international level following the 2008 financial crisis. The G20 Leaders in their Declaration from the Washington, D.C. Summit on the Financial Markets and the World Economy of 15 November 2008[12] called for priority work on *"reviewing compensation practices as they relate to incentives for risk taking and innovation"*. The G20 London Summit Declaration of 2 April 2009 on Strengthening of the Financial System[13] and the Statement from the Pittsburgh Summit of 24-25 September 2009[14] both confirmed the agreement of the global leaders that "*reforming compensation policies and practices is*

[8] institut für finanzdienstleistungen e.V. (IFF, 2016), report available at http://ec.europa.eu/justice/civil/company-law/corporate-governance/index_en.htm

[9] EBA remuneration benchmarking reports: *"High earners 2010 and 2011 data"; "High earners 2012 data"; "Benchmarking of Remuneration practices at Union level 2012 data"; "Benchmarking of Remuneration practices at Union level and data on high earners 2013 data"; "Benchmarking of Remuneration practices at Union level and data on high earners data as of end 2014"; "Benchmarking of approved higher ratios 2014 data";* all publications available at https://www.eba.europa.eu/regulation-and-policy/remuneration/-/topic-documents/ckV8kFRsjau9/more

[10] Opinion of the European Banking Authority on the application of the principle of proportionality to the remuneration provisions in Directive 2013/36/EU (21.12.2015), available at https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-25+Opinion+on+the+Application+of+Proportionality.pdf

[11] Opinion of the European Banking Authority on the application of Directive 2013/36/EU (Capital Requirements Directive) regarding the principles on remuneration policies of credit institutions and investment firms and the use of allowances (15.10.2014), available at https://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-10+Opinion+on+remuneration+and+allowances.pdf; EBA follow up report on the actions taken by competent authorities following the publication of the 15.10.02014 Opinion (12.11.2015), available at https://www.eba.europa.eu/documents/10180/950548/Report+on+the+Use+of+Allowances.pdf

[12] Available at http://www.un.org/ga/president/63/commission/declarationG20.pdf

[13] Available at https://www.imf.org/external/np/sec/pr/2009/pdf/g20_040209.pdf

[14] Available at http://www.g20.utoronto.ca/2009/2009communique0925.html

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an essential part of our effort to increase financial stability", and sealed their commitment to endorse and implement the *Principles and standards on sound compensation practices* adopted by the Financial Stability Board (FSB)[15].

CRD aims to implement in the EU those internationally agreed principles. One of the main differences between the EU rules and those principles and standards is the maximum ratio between variable and fixed remuneration, which only exists in the EU. The FSB's fourth progress report[16] shows that *"almost all FSB jurisdictions have fully implemented the P&S for banks"* and that remuneration is embedded in bank supervisory frameworks in most FSB jurisdictions. However, the FSB reports that a number of implementation gaps still remain.

Globally, there have been a number of relevant developments with respect to remuneration. These include, for example, the introduction in the US of new mandatory disclosure requirements for public companies on the ratio between the median of the annual total compensation of all employees to that of the chief executive officer and the recent release by US regulators of proposed new rules containing stricter pay rules for bankers, including longer deferral periods and clawback; the introduction in the UK of tougher requirements for deferral and clawback; or the 2013 Swiss referendum on executive remuneration, whereby the use of certain types of remuneration, such as severance payments, has been restricted, and where a maximum ratio between executive pay and the company's lowest wage was rejected.

In Europe, the Single Supervisory Mechanism/European Central Bank took over supervision of the significant banks within the Banking Union, and gained competences to carry out tasks for prudential supervisory purposes also in the area of remuneration policies and practices[17].

Remuneration continues to be a high priority on the international policy agenda, and the debate on remuneration is now focusing on the links with misconduct. In its report on misconduct risk in the banking sector[18], the European Systemic Risk Board found that the number and scale of misconduct cases recently observed, as well as the related penalties and redress costs, mean that misconduct issues may have the potential to create systemic risks. The FSB decided to examine the case for further strengthening disincentives to misconduct also through remuneration-related tools.

3. IMPLEMENTATION AND ENFORCEMENT

As required by Article 161(2) CRD, this section discusses the implementation and enforcement of the CRD and CRR remuneration provisions.

Following the adoption in June 2013, Member States had to transpose CRD IV into national law by 31 December 2013, with the new rules applying as of 1 January 2014. The transposition checks are ongoing.

[15] The FSB *Principles for Sound Compensation Practices and their Implementation Standards*, available at http://www.fsb.org/what-we-do/policy-development/building-resilience-of-financial-institutions/compensation/

[16] Financial Stability Board, "Implementing the FSB Principles for Sound Compensation Practices and their Implementation Standards - Fourth progress report" (10.11. 2015), available at http://www.fsb.org/wp-content/uploads/FSB-Fourth-progress-report-on-compensation-practices.pdf

[17] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013R1024

[18] European Systemic Risk Board "Report on misconduct risk in the banking sector" (2015), available at https://www.esrb.europa.eu/pub/pdf/other/150625_report_misconduct_risk.en.pdf

However, several trends have been already identified concerning the national transposition by Member States, or concerning their national supervisory practices[19].
The first issue concerns the Member States' interpretation of what is “fixed” and what is “variable” remuneration, and how so-called “role-based allowances” should be classified. Some institutions introduced such “role-based allowances” as a form of “fixed” remuneration to be able to continue to pay higher "variable" remuneration and remain compliant with the limitations imposed on the ratio between the "fixed" and "variable" remuneration components. Upon the Commission's request, EBA assessed the use by institutions of such allowances. This led to the EBA Opinion of 15 October 2014[20], in which it was found that these “role-based allowances” were often wrongly classified as “fixed” remuneration while they were in fact “variable” remuneration. Meanwhile, all Member States reported that they have taken measures to ensure correct mapping of allowances. On 21 December 2015 EBA adopted guidelines on sound remuneration practices[21]. This will contribute to further harmonising remuneration practices in the EU.

The second issue concerns the interpretation by Member States of the principle of proportionality that underlies the CRD remuneration rules in accordance with Article 92(2) CRD. Proportionality considerations have led a great majority of Member States to waive the application of certain remuneration rules to small and non-complex institutions or to staff with low amounts of variable remuneration. This concerns in particular the rules on deferral and pay-out in instruments, set out in points (l) and (m) of Article 94(1) CRD. The rules on deferral and pay-out in instruments are evaluated in detail in the Staff Working Document SWD(2016)266, where it is found that there may be a case for allowing some degree of exemptions from the application of those rules and it is suggested that, following a comprehensive impact assessment, a legislative amendment for the requirements on deferral and pay-out in instruments be considered.

4. ASSESSMENT OF REMUNERATION PROVISIONS

Article 161(2) CRD mandates the Commission to assess the efficiency of the remuneration rules of CRD and CRR. The first part of this section (4.1) analyses the appropriateness of the scope of application of the remuneration rules, in terms of the types of entities and individuals covered. In the second part (4.2), analysis of individual remuneration requirements is provided.

4. 1. ASSESSMENT OF THE SCOPE OF APPLICATION

4.1.1. Application of the remuneration rules to investment firms

In accordance with Article 2 and 3(3) CRD, the remuneration rules apply not only to credit institutions but also to "CRR investment firms". The definition of a CRR investment firm covers a subset of firms subject to the MiFID[22] definition.

[19] CRD contains a large number of national discretions and options concerning remuneration rules, which may be applied on the basis of national circumstances. An overview of the use by Member States of these discretions and options is available at http://www.eba.europa.eu/supervisory-convergence/supervisory-disclosure/options-and-national-discretions

[20] Opinion of the European Banking Authority on the application of Directive 2013/36/EU (Capital Requirements Directive) regarding the principles on remuneration policies of credit institutions and investment firms and the use of allowances (15.10.2014), available at https://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-10+Opinion+on+remuneration+and+allowances.pdf

[21] EBA Guidelines on sound remuneration policies (21.12.2015), available at https://www.eba.europa.eu/documents/10180/1314839/EBA-GL-2015-22+Guidelines+on+Sound+Remuneration+Policies.pdf/1b0f3f99-f913-461a-b3e9-fa0064b1946b

[22] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the

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Investment firms have been linked to the prudential requirements for credit institutions since 1993[23]. The reason for this was to ensure a level-playing field for credit institutions and investment firms that were seen to compete in the field of investment services. In CRD IV/CRR the remuneration rules apply to all "CRR investment firms", although for other prudential requirements in this package, such as those relating to own funds or initial capital, some types of investment firms receive a different treatment.

An argument often made by the "CRR investment firms" is that the CRD IV remuneration rules are made for credit institutions and are unsuited for their own business model, said to be significantly different from that of banks. They consider therefore that they should be exempted from the application of some of the remuneration rules.

There is a very wide diversity of CRR investment firms and the different types of investment firms have their own concerns with respect to the remuneration rules. Some firms, where risks are said to be short-lived, argue that the multi-year performance assessment is not suitable for them. In the same way, some investment firms claim that the deferral periods required by CRD are not aligned with the time horizon of their risks and investments[24].

Investment firms overall consider that the Maximum Ratio Rule is not fit for their business model. They argue that it is important that they can keep a remuneration model based predominantly on variable remuneration, which is not paid out if no profit is generated. In their view, increased fixed costs, resulting from a higher portion of remuneration being "fixed", would affect their profitability and own funds requirements, in some investment firms based on the fixed overheads. Many investment firms claim that remuneration is their single highest cost, and argue that revenues, often generated by commissions and fees, are highly volatile. In such case, an increased fixed pay could impact on investment firms' ability to successfully face times of reduced revenues. Smaller investment firms claim that a high variable remuneration structure is a key factor to remain competitive vis-à-vis larger competitors. Those firms operating in global markets also argue that the Maximum Ratio Rule may limit their appetite to operate in or from the EU markets. There is currently no empirical evidence to confirm or refute those concerns, largely because of the limited application of the Maximum Ratio Rule by CRR investment firms.

Under CRR[25], the Commission is examining and will report on an appropriate regime for the prudential supervision of investment firms (the "investment firms' review"). EBA has in this context called for a more proportionate and risk-based prudential regime for investment firms, including with respect to the remuneration rules[26]. The work is however still in the early stages and the information currently available is not sufficient to fully determine whether and to what extent the differences in business models and risk profiles would also justify a change of the remuneration rules for investment firms.

4.1.2. Application of the remuneration rules in a group context

In accordance with Articles 92(1) and 109 CRD, consolidating institutions must ensure that subsidiaries that fall within the scope of prudential consolidation have remuneration policies that are consistent with the group-wide remuneration policy for all staff and comply with the specific CRD remuneration rules applicable to staff whose activities have a material impact on their risk profile.

Council and repealing Council Directive 93/22/EEC, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1398325978410&uri=CELEX:02004L0039-20110104

[23] See the Recitals of the Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investments firms and credit institutions, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31993L0006:EN:HTML

[24] For the analysis of the rules on performance assessment and deferral in the case of credit institutions, please refer to Sections 4.2.1 and 4.2.5.

[25] Art 508, 493(2) and 498(2) CRR

[26] EBA Report on investment firms (EBA/Op/2015/20), available at https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-20+Report+on+investment+firms.pdf

Therefore, entities that are not themselves subject to the CRD rules could indirectly be covered as a result of them being part of a CRD group.

This will be, for example, the case for managers of undertakings for collective investment in transferable securities (UCITS) or of Alternative Investment Funds (AIF) that are part of a CRD group. In line with the objective of the Directive, staff members of such entities will be identified and subject to the CRD remuneration rules if it is determined that their professional activities pose a material risk to the CRD regulated group[27].

This has led to some concerns from the UCITS and AIF managers, who are subsidiaries of CRD-regulated groups. Such fund managers are already subject to remuneration rules similar to those provided in CRD under their own sectorial legislation[28] (with the most significant difference being the fact that the Maximum Ratio Rule is unique to CRD). EBA Guidelines[29] clarify how the two sets of rules should interact, which rules would take precedence and under which conditions. For example, they specify that staff of UCITS or AIF manager subsidiaries that have an impact on the risk of the group should be paid in the instruments of the fund.

Some concerns were also expressed that the application of CRD rules to such subsidiaries may create a un-level-playing field between similar entities in and outside of a CRD-group. As this relates mostly to the Maximum Ratio Rule, this is further discussed in Section 5.2 on impacts of the Maximum Ratio Rule on competitiveness.

4.1.3. Application of the rules in terms of staff covered

CRD requires institutions to have appropriate remuneration policies applicable to all staff and contains additional specific rules concerning the pay-out process and structure of the remuneration of staff whose professional activities have a material impact on the institutions' risk profile ("identified staff"). The correct identification of these staff members is an important step in ensuring the effectiveness of the remuneration rules. Institutions need to carry out the identification on a solo basis and where relevant also on a consolidated and sub-consolidated basis.

By setting out clear, harmonised identification criteria, the Commission Delegated Regulation (EU) No 527/2014[30] aims to put an end to the serious discrepancies in the approaches followed by supervisors and institutions in the past. There are criteria of a qualitative and of a quantitative nature. The qualitative criteria are based on an assumption that staff in certain positions or with certain responsibilities has the capacity to take material risks for the institution. The quantitative criteria are

[27] Commission Delegated Regulation (EU) No 604/2014 of 4 March 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ%3AJOL_2014_167_R_0003

[28] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32011L0061; Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0091

[29] EBA Guidelines on sound remuneration policies (21.12.2015), available at https://www.eba.europa.eu/documents/10180/1314839/EBA-GL-2015-22+Guidelines+on+Sound+Remuneration+Policies.pdf

[30] Commission Delegated Regulation (EU) No 604/2014 of 4 March 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ%3AJOL_2014_167_R_0003

based on the assumption that high overall pay levels may suggest a risk taking authority of the individual.

The objective of having a harmonization of the criteria at EU level is overall well received by stakeholders. Institutions expressed the hope that this will result in a better level playing field and they find the criteria useful for setting their internal remuneration policies.

Concerns were nevertheless raised over the material increase in the number of identified staff as a result of the new rules. However, despite this increase, identified staff on average still represent only a relatively small part of total staff (2.34% on average in 2014[31]).

Concerns were also raised that the identification criteria may in practice lead to the identification of staff that in reality does not have a material impact on the institution's risk profile. While some requests have been made to simplify the qualitative criteria, the main concerns related to the quantitative criteria. It was argued that it cannot be automatically assumed that persons earning high remuneration have the ability to materially impact the institution's risk profile. It appears that, from the different quantitative criteria, the requirement according to which all staff receiving remuneration at the same level as risk takers should be considered as identified staff is the one that has the highest impact on the increase in number of identified staff.

Conversely, it is important to note that the qualification under the quantitative criteria is rebuttable: it is indeed presumed that an earner of a certain level of remuneration is identified staff, but there is a possibility for an institution to exclude that person from identification if the staff member in reality does not have a material impact on the risk profile of the institution[32].

Some concerns were also raised that the procedure to secure such exclusions would be lengthy and cumbersome. In particular, the requirement of "exceptional circumstances", which must be met in case of exclusions of staff earning more than EUR 1 million, was said to be insufficiently clear. It was also argued that the presumption of being identified staff on the basis of the quantitative criteria would force institutions to engage in massive exclusion procedures. According to the information available from the supervisory authorities, this has so far not materialised with regard to exclusions that have to be notified to them or that require their approval. However, it should be recognised that because of the recent entry into force of the Delegated Regulation (and also because of the existing national practices waiving certain remuneration requirements), the experience with the exclusion procedure is still limited.

EBA's annual benchmarking reports provide very useful information on trends with respect to the identification of staff, based on data collected by competent authorities from credit institutions and investment firms. This, together with further concrete experience to be gained by Competent Authorities and institutions, will be a good basis for a continued evaluation of the criteria.

4.1.4. Conclusions on the scope of application

Overall, in terms of the scope of application, the biggest concerns have been raised by investment firms who consider that they should not be subject to the same remuneration rules as banks. Full conclusions cannot be drawn in isolation from the ongoing "investment firms' review". As for the staff of fund managers who are subsidiaries of a CRD-regulated group, it is necessary to apply CRD remuneration rules in the event that it is determined that they pose material risks to the group. For staff identification, the introduction of harmonized criteria is expected to bring benefits in terms of clarity

[31] EBA *"Benchmarking of Remuneration practices at Union level and data on high earners data as of end 2014"*, available at https://www.eba.europa.eu/documents/10180/950548/Report+on+Benchmarking+of+Remuneration+and+on+High+Earners+2013.pdf . The share of identified staff in total staff increased from 1.17 % in 2013 to 2.34 % in 2014.

[32] This could for example be the case for staff in a UCITS or AIF manager subsidiary, which may receive high remuneration but may have no material impact on the group's risk profile.

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and the level-playing-field. Detailed, practical aspects of the application of the identification criteria can be further looked into when more experience with those criteria is gained.

4.2. ASSESSMENT OF INDIVIDUAL REMUNERATION PROVISIONS

4.2.1. Rules on performance assessment

Points (a) and (b) of Article 94(1) CRD require that variable remuneration be based on a combination of the assessment of the individual, business unit and institution performance. Performance assessment needs to take into account financial and non-financial criteria, and is to be performed in a multi-year framework, taking into account the underlying business cycle of the institution and its business risks.

In general, stakeholders assess these requirements positively[33] and see the merit of combining individual with collective performance assessment, as well as financial with non-financial criteria. A recent survey[34] showed that for both senior managers and other identified staff, compliance and conduct ranked first among the performance criteria used by institutions in 2014, which constitutes a good indication that non-financial criteria are indeed used alongside financial ones in assessing performance.

Article 94(1)(j) CRD requires that the assessment of performance for the purposes of determining variable remuneration include an adjustment for all types of current and future risks and take into account the cost of the capital and the liquidity required. The fact that the minimum equity-capital ratio is used as a relatively frequent performance criterion suggests an appropriate link between variable remuneration and regulatory capital requirements.

In the view of surveyed supervisory authorities, there has been progress in the use of risk-adjusted performance criteria. However, there is still an overreliance on return on equity and other earning-based metrics for measuring performance to the detriment of other criteria, which might represent better indicators of the risk profile of the institution. In this context, it is noteworthy that the one supervisory authority has recently announced that earnings-based metrics are to be used as performance criteria only alongside properly weighted non-profit based measures. In general, more transparency into the sometimes complex performance assessment models used by institutions would facilitate effective supervision.

All in all, the CRD IV rules on performance assessment are positively evaluated at this stage, with the caveat that there is room for an improved consideration of risks in the performance criteria used by institutions.

4.2.2. Corporate governance

The remuneration-related corporate governance provisions of CRD (Articles 74, 76(4), 92(2) and 95) concern mainly the overall responsibility and oversight by the management body in its supervisory function of the general principles of the remuneration policy, the involvement of the risk committee in the establishment of sound remuneration policies and the requirement for “significant” institutions to set up a remuneration committee.

Main industry concerns relate to the requirement to set up a remuneration committee: while there is general agreement with the requirement for “significant” institutions to set up a remuneration committee, in the case of groups there is some resistance towards establishing a remuneration committee at the level of “significant” subsidiaries in addition to the level of the parent institution.

[33] This finding may not apply to (some) investment firms. As mentioned in Section 4.1.1, some investment firms where risks are said to be short-lived argue that the multi-year performance assessment is not suitable for them.
[34] IFF, 2016

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This requirement seems nevertheless justified, for instance as it might be difficult for the single remuneration committee at parent level to fulfil its functions across the entire group, especially if it contains a number of "significant" institutions, or to take account of possible local specificities.

With regard to the effectiveness of governance provisions touching upon risk management, a recent survey[35] revealed a number of positive assessments concerning the link between risk management and remuneration design. Enhancements to risk management and its linkage with remuneration processes were considered a significant factor in improving financial stability. In addition, strong internal governance arrangements tend to be associated with reduced risk-taking[36].

All in all, the corporate governance provisions of CRD touching upon remuneration issues are assessed positively and provide a valuable supplement for the CRD provisions focusing strictly on the remuneration structure, award and pay-out.

4.2.3. Disclosure and reporting

The objective of the disclosure requirements (Articles 450 CRR and Article 96 CRD) is to allow stakeholders to assess whether institutions have adopted remuneration policies consistent with sound risk management, and supervisors to effectively review these remuneration policies.

These provisions are in general positively assessed by industry and supervisors alike, as they provide a basis for gathering granular and comparable information about the institutions' remuneration policies and practices. By promoting increased transparency and accountability, disclosure requirements can be considered a contributing factor to a better alignment of remuneration with institutions' performance and risk profile. They also allow observing trends in remuneration practices.

Some concerns have been expressed regarding confidentiality when publishing the number of high-earners per remuneration brackets: it is alleged that in exceptional cases, where those brackets contain very few individuals or only one, identification of those individuals might be possible. However, considering that high earners normally have an important role to play in directing the business of institutions and in their long-term performance, transparency on their remuneration brackets serves the legitimate objective of general interest of contributing to sound remuneration policies, which are in turn important for the soundness and stability of financial institutions.

Some stakeholders (in particular small institutions or certain types of investment firms) point to the administrative burden entailed in recent years by increasing EU and national-level disclosure requirements. Moreover, certain differences persist among institutions or Member States with regard to the format and/or level of granularity of remuneration disclosures. In this respect, the EBA Guidelines on sound remuneration policies issued in December 2015 are expected to contribute to a further harmonisation of the way in which remuneration disclosures are made.

In conclusion, the requirements on remuneration disclosure increase transparency with regard to institutions' remuneration practices, which is crucial for their oversight and for observing trends that could inform the assessment of the impacts of the remuneration provisions.

4.2.4. Guaranteed variable remuneration and severance pay

According to Article 94(1)(d) and (e) CRD, guaranteed variable remuneration is exceptional, occurs only when hiring new staff and where the institution has a sound and strong capital base, and it is limited to the first year of employment. Regarding severance payments, Article 94(1)(h) stipulates that payments relating to the early termination of a contract reflect performance achieved over time and do not reward failure or misconduct.

[35] IFF, 2016

[36] See for instance the finding of the IMF "Global Financial Stability Report" (2014) that the existence of a board risk committee is related to less risk-taking in banks.

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The recent EBA benchmarking of remuneration practices[37] reveals that the use of both sign-on bonuses and severance payments decreased considerably in 2014 compared to previous years in terms of the number of identified staff benefitting from such incentives. In 2014, only 281 identified staff (0,4% of all identified staff) received sign-on bonuses, compared to around 2 274 in 2011, and only 467 identified staff (0,7% of all identified staff) received severance payments, compared to 1 011 in 2011.

Based on these latest trends, conclusion could be drawn that the use of sign-on bonuses and severance pay goes in the direction of the CRD rationale of better framing the use of these forms of remuneration.

4.2.5. Deferral

Largely in line with the *Implementation Standards of the FSB Principles for Sound Compensation Practices* and as already provided in CRD III, Article 94(1)(m) CRD IV requires that in the case of identified staff, institutions defer at least 40% of variable remuneration (or 60% in the case of a particularly high amount) over a period that is no less than three to five years and is correctly aligned with the nature of the business, its risks and the activities of the staff member in question.

Deferral is a key mechanism to align variable remuneration with the long-term risks and performance of an institution by enabling the application of *malus.* In addition, deferral prolongs the period during which variable remuneration reflects the changes in the market prices of the awarded instruments. By aligning the interests of identified staff with the long-term interests of shareholders, deferral prevents short-termism in business decisions. Some studies suggest that deferral also contributes to aligning the interests of identified staff with those of creditors, in that deferred remuneration has debt-like characteristics: it is an unsecured future claim, vulnerable if the institution underperforms or goes bankrupt[38].

Deferral is generally positively assessed by stakeholders in terms of ensuring the alignment of remuneration with the long-term performance of the institution and of deterring excessive risk-taking.

Concerns were nevertheless expressed in relation to the impact of the application of the deferral requirements to mid-level staff, which became identified staff as a result of the recent harmonised rules on identification. This concerns mainly staff in internal control functions, whose skills are relatively easily transferable to other non-CRD-regulated sectors or jurisdictions. It is argued that this may result in difficulties in retaining such staff, who may be interested in moving into sectors where their pay would not be deferred. Thus, CRD entities may feel compelled to increase the remuneration of such staff to remain competitive. It is worth noting however that, in accordance with the EBA Guidelines, remuneration of staff in independent control functions should be predominantly fixed and, as such, a relatively small part of their total pay would be subject to deferral.

Significant reservations also exist regarding the appropriateness of applying deferral by small and non-complex institutions and in the case of low amounts of individual variable remuneration (see Staff Working Document SWD(2016)266 for details).

Concerning the percentage of variable remuneration to be deferred, stakeholders tend to support the prescribed percentage, including a higher deferred portion (i.e. 60%) for senior managers and the highest paid identified staff. The average ratio of deferred to total variable remuneration of identified staff has increased quite significantly between 2010 and 2013[39] (i.e. from 55.22% to 62.99%), and it went slightly down in 2014 (to 62.50%)[40]. The fact that already in 2010 the average ratio of deferred

[37] EBA *"Benchmarking of Remuneration practices at Union level and data on high earners data as of end 2014*

[38] See Lin Peng and Ailsa Roell *"Managerial Incentives and Stock Price Manipulation"* (2009); Uhde, André *"Risk-taking incentives through excess variable Compensation Evidence from European banks"* (2015). However, it is recognised that remuneration is usually paid out to staff before the claims of institution's creditors are satisfied.

[39] EBA remuneration benchmarking data

[40] This evolution from 2013 to 2014 can most likely be attributed to the changes in the staff identification process, which in 2014 led to the identification of staff previously not captured, traditionally earning lower amounts of variable remuneration

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to total variable remuneration of identified staff as captured in the EBA data was above the minimum deferral ratio prescribed by CRD seems to point to an earlier recognition of deferral by large institutions as an effective risk-alignment mechanism.

Regarding the length of the deferral period, the three to five years period has generally been positively assessed. Nonetheless, views exist according to which in certain cases a longer deferral period, better aligned with the length of financial cycles, would be desirable. This would be fully in line with the Directive, which prescribes only the lower end of the applicable deferral period (at least three to five years) and also stipulates that the deferral period needs to be correctly aligned with the institution's nature and risks and with the staff member's activities, therefore permitting – and even requiring – the introduction of longer deferral periods when deemed appropriate[41]. In conclusion, deferral is a successful tool in aligning the interests of staff with the long-term interests and performance of institutions, especially for larger and more complex institutions and in cases of a material portion of remuneration being variable. The minimum deferral amounts seem appropriate and the minimum prescribed deferral period is in general positively assessed, although there are views that in certain cases a longer deferral period might be appropriate[42].

4.2.6. Malus and clawback

Article 94(1)(n) CRD requires that up to 100% of the total variable remuneration of identified staff be subject to *malus* or clawback arrangements. The application of *malus* and clawback can be triggered by the financial performance of the institution or its business unit, or by individual conduct. It could also be triggered by potential subsequent corrections to the level of the performance and risks assessed when the remuneration was awarded.

A recent survey[43] revealed that a majority of industry and supervisors respondents agree that introducing ex-post risk adjustments through *malus* and clawback reduces risk-taking incentives. Clawback, however, appears to be rarely used due to implementation difficulties stemming from certain national labour and contract law specificities (which may create an un-level playing field), taxation uncertainties or potential legal costs. When used, it is mainly to address misconduct.

These findings closely reflect feedback from the Commission's stakeholder event and public consultation, where most respondents considered ex-post adjustments a good tool to limit excessive risk-taking, to reduce the incidence of misconduct and to link remuneration with performance, but highlighted practical difficulties in the application of clawback, and to a lesser extent of *malus*: a few respondents argued that it can be complicated to determine to which instalment *malus* should be applied and in which specific instances, and that the reduction or cancellation of variable remuneration in the current period is easier. It has to be noted nonetheless that by not applying ex-post adjustments to the correct performance period, the link between remuneration and performance may be eroded.

Literature[44] suggests that *malus* and clawback tend to be most beneficial in large, systemically-important institutions, as they help mitigate the "too-big-to-fail" distortion by ensuring that risk-takers are subject to financial losses in case of failure regardless of the existence of deposit insurance or government guarantees.

Despite the generally positive assessment of ex-post adjustments tools, the practical use of *malus* and especially clawback appears to remain low. This is confirmed by the latest EBA Remuneration Benchmarking report, which found that in 2014 only 0.49% of the outstanding deferred remuneration

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and in many jurisdictions previously exempted from the deferral requirement on the basis of proportionality (this affected downwards the 2014 average deferral ratio of the Identified Staff population).

[41] In this respect we note the UK authorities' initiative to tailor the deferral regime by imposing a 7-year deferral period for senior managers.

[42] This conclusion may not apply to (some) investment firms. As mentioned in Section 4.1.1, some investment firms would favour a shorter deferral period.

[43] IFF, 2016

[44] J. Thanassoulis, M. Tanaka *"Bankers' pay and excessive risk"* (2015), available at http://www.bankofengland.co.uk/research/Documents/workingpapers/2015/swp558.pdf

was subject to ex-post risk-adjustments (compared to 0.40% in 2013 and 2.17% in 2012). This suggests that the use of ex-post adjustments remains low.

From a conduct angle the perspective is similar: as the latest FSB Compensation report[45] notes, while there seems to be agreement that the tools to ensure the alignment of remuneration with conduct (essentially deferral, *malus* and clawback) are in place, there is scarce information on the actual use of *malus* and clawback available at the moment.

In conclusion, *malus* and clawback are generally positively assessed as useful mechanisms in terms of limiting excessive risk-taking and misconduct, and linking remuneration with performance. Admittedly, the practical use of these ex-post mechanisms to date remains low.

It is also noteworthy that, although ex-post adjustments are essentially applied as a reactive tool once the excessive risk-taking or misbehaviour has materialised, the mere existence of an ex-post adjustment frame properly communicated to staff promotes accountability and functions to a certain extent as a deterrent of excessive risk-taking and misconduct[46].

4.2.7. Pay-out in instruments

Broadly in line with the Implementation Standards of the FSB Principles for Sound Compensation Practices and as already provided for in CRD III in a similar way, Article 94(1)(l) CRD IV requires institutions to pay at least 50% of any variable remuneration in financial instruments. Two types of instruments are eligible for this purpose: (i) shares or equivalent ownership instruments, subject to the legal structure of the institution concerned, or share-linked instruments or equivalent non-cash instruments, in the case of non-listed institutions; (ii) bail-in-able instruments adequately reflecting the credit quality of an institution as a going concern in the meaning of Commission Delegated Regulation (EU) No 527/2014.

According to EBA data, there has been an upward trend in the average use of pay-out in instruments in the years following the entry into force of CRD III: on average 55.69% of the variable remuneration of identified staff was paid out in instruments in 2014, compared to 48.50% in 2010. Evidence shows that institutions predominantly use the first category of instruments for the purposes of paying-out variable remuneration, with bail-in-able instruments being used by relatively few institutions.

Pay-out in shares or equity-based instruments is effective in aligning the interests of identified staff with those of the institution's owners. Coupled with deferral and additional retention periods during which the staff member cannot access or sell of the awarded instruments, pay-out in equity instruments helps to counter potential short-termism in identified staff's actions and ensures the alignment of their remuneration with the long-term risks and performance of the institution. In light of these considerations the effectiveness of pay-out in instruments is generally positively assessed, with the notable exception of staff with non-material levels of variable remuneration and of small and non-complex institutions, for which it can be costly and cumbersome to set up and valuate instruments appropriate for the purposes of variable remuneration (see Staff Working Document SWD(2016)266 for details).

Moreover, arguments were made that pay-out in equity instruments does not ensure alignment with the broader interests of society as a whole, focusing too much on the interests of shareholders. It is worth noting however that this effect is mitigated through *malus* and clawback, which align remuneration with taxpayers' interests by ensuring that Identified staff's variable remuneration is adjusted in case of failure, regardless of the existence of deposit insurance or government guarantees. Moreover, the use of bail-in-able debt instruments helps to ensure alignment with the interests of creditors.

Another aspect often raised by listed institutions is the fact that they are not allowed to use share-linked instruments as an alternative to shares for the purposes of meeting the requirement of Article

[45] Financial Stability Board, "Implementing the FSB Principles for Sound Compensation Practices and their Implementation Standards - Fourth progress report" (10.11. 2015), available at http://www.fsb.org/wp-content/uploads/FSB-Fourth-progress-report-on-compensation-practices.pdf

[46] IFF, 2016

94(1)(l)CRD. They are concerned about being limited to awarding remuneration in shares, which can be subject to restrictions in certain jurisdictions, can lead to dilution of voting rights of the existing shareholders when new shares are issued, or can be related to operational difficulties associated with repeatedly paying-out in shares (e.g. it may invite speculation, when market players are aware that the institution would have to acquire a certain amount of shares to award remuneration to its staff). Moreover, share-linked instruments, when they track the value of shares, achieve the same prudential objective of risk-alignment as shares (see Staff Working Document SWD(2016)266 for details). This argumentation is in line with the EBA Opinion, which recommends that CRD be amended so as to allow listed institutions to use share-linked instruments for the purposes of their variable remuneration.

Subject to this adjustment and to a proportional application of the rule and, as required by CRD, implemented in conjunction with deferral, retention and ex-post adjustments, the requirement to pay-out in instruments will continue to represent an effective mechanism to link remuneration with the long-term performance of the institution.

4.2.8. The Maximum Ratio Rule

Background

Since CRD III, credit institutions and investment firms are required to ensure that there is an appropriate balance between the fixed and variable components of the total remuneration of identified staff[47]. Fixed remuneration should reflect the relevant professional experience and organisational responsibility of staff, and variable a sustainable and risk adjusted performance, as well as performance in excess of that required under the terms of employment. Fixed pay must represent a proportion that is sufficiently high to allow the possibility of paying no variable remuneration at all. Under CRDIII, the decision on the optimal level of the ratio was left to individual institutions and the scrutiny of supervisors. CRD IV[48] upheld the requirements, but in addition it set the maximum ratio of variable to fixed remuneration at 100% (the ' Maximum Ratio Rule '). Member States have discretion to allow increasing the ratio to up to 200%[49] with shareholders' approval[50]; to allow a discount of maximum 25% of the variable component to encourage the long-term deferral of instruments[51]; or to impose stricter ratios below 100%[52].

It is very early to appropriately assess in full the impact of the Maximum Ratio Rule. The feasibility of appropriately assessing the impact of the Maximum Ratio Rule is strongly affected by the fairly recent entry into force of the rule and its still limited application. While, according to the Directive, the Maximum Ratio Rule had to be applied to remuneration awarded for services provided or performance from the year 2014 onwards, this has not always been the case due to delays in transposition. Moreover, some Member States, referring to the principle of proportionality, excluded from the application of the Maximum Ratio Rule certain institutions or certain types of subsidiaries, such as UCITS and AIF managers. Moreover, many institutions used so-called “role-based allowances”, often incorrectly mapped as fixed pay instead of variable pay[53], thereby distorting the calculation of the ratio. The analysis is also affected by the fact that harmonized rules on staff identification entered into force in 2014. As a result, statistics about actual remuneration ratios from before and after the entry into force of the Maximum Ratio Rule concern a somewhat different population. To date, granular EBA remuneration benchmarking data are available only for 2014.

[47] Paragraph 23(1) of Annex V of Directive 2010/76/EU
[48] Article 94(1)(g), 94(1)(f), Rec. 64 and 65 CRD
[49] Implemented by all Member States, except BE, SI, SE and RO
[50] At EU level, more than half of institutions (53%) in terms of the balance sheet total, and 3% of institutions in terms of the number of institutions have secured an approval of a higher ratio
[51] 8 Member States did not avail of this option
[52] 3 Member States
[53] Following the EBA Opinion all Member States have taken measures to ensure that remuneration components are correctly mapped as fixed or variable, but these measures will in many cases be effective only from performance year 2015.

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It is important to keep in mind that the below represents the findings *to date*, based on limited data available given the short period of time that the rule is in force, and the limited experience with its application.

The Maximum Ratio Rule does not impact directly on the level of pay[54], and the scope of staff affected by the rule is limited. Identified staff represent on average 2.34% of all staff, and among those, many traditionally do not receive variable pay above the CRD maximum. In 2013, before the rule was introduced, out of 140 analysed banks 17 reported average variable pay of their staff in excess of 200%, and 22 institutions had a higher ratio in at least one business line[55].

Furthermore, the impact of the Maximum Ratio Rule will be felt by institutions to a different degree. It will depend on the jurisdiction they operate in (some jurisdictions traditionally have a "bonus" culture with high levels of variable remuneration, in others variable remuneration is much less common or important), as well as on their business model (some "conservative" credit institutions may use predominantly fixed remuneration while certain other institutions may rely heavily on variable remuneration).

Trends on levels of remuneration and its components

According to the EBA remuneration benchmarking data, the *average absolute amount of variable remuneration* per identified staff has decreased over the last years. It dropped from EUR 269 286 in 2010 to EUR 121 589 in 2014. The most significant drops of the average absolute amount of variable remuneration took place in 2011 and 2014 (28% and 31% respectively).

The *average absolute amount of fixed remuneration* per identified staff has increased over the last years (with the exception of a slight decrease of around 1% in 2013). It increased from EUR 131 514 in 2010 to EUR 185 692 in 2014. The most significant increases of the average absolute amount of fixed pay took place in 2011 and 2012 (15% and 14 % respectively) and to a lesser extent in 2014 (9%).

The *increase in fixed remuneration* was on average less important than the *decrease of variable remuneration*. The average absolute variable remuneration of an identified staff in 2014 was EUR 174 697 lower than in 2010, while the average fixed remuneration in 2014 was EUR 54 178 higher than in 2010. Between 2013 and 2014, there was a 31% decrease of the variable pay and a 9% increase of the fixed pay per identified staff.

Also, the *importance of variable remuneration compared to fixed remuneration* decreased. While variable remuneration on average exceeded twice the fixed salary in 2010, in 2014 it represented on average 65% of fixed remuneration (although in single cases it could even reach 3 058%, owing to the application of waivers under national law).

The *average absolute levels of total remuneration* showed a consistent, downward tendency, with the biggest drops in 2011 and 2014 (14% and 12% respectively).

[54] Case C-507/13, available at http://curia.europa.eu/juris/documents.jsf?pro=&lgrec=en&nat=or&oqp=&lg=&dates=&language=en&jur=C&cit=none%252CC%252CCJ%252CR%252C2008E%252C%252C%252C%252C%252C%252C%252C%252C%252Ctrue%252Cfalse%252Cfalse&num=C-507%252F13&td=%3BALL&pcs=Oor&avg=&page=1&mat=or&jge=&for=&cid=521127

[55] EBA benchmarking data

The details are presented in the table below (numbers in brackets indicate an increase or decrease compared with a previous year):

	No of identified staff	Ratio variable to fixed for identified staff	Average level of absolute fixed per identified staff	Average level of absolute variable per identified staff	Average level of absolute total pay per identified staff	Sum of fixed pay for all identified staff	Sum of variable pay for all identified staff	Sum of total pay for all identified staff
2010	28 221	204,76%	131 514	269 286	400 800	3 711 454 537	7 599 510 462	11 310 964 999
2011	32 648	127,99%	151 409 *(+15%)*	193 785 *(-28%)*	345 194 *(-14%)*	4 943 187 088	6 326 699 323	11 269 886 411
2012	35 996	108,74%	172 379 *(+14%)*	187 441 *(-3%)*	359 820 *(+4%)*	6 204 956 466	6 747 141 336	12 952 097 801
2013	34 060	104,27%	170 164 *(-1%)*	177 431 *(-5%)*	347 595 *(-3%)*	5 795 794 360	6 043 294 697	11 839 089 057
2014	62 787	65,48%	185 692 *(+9%)*	121 589 (-31%)	307 281 *(-12%)*	11 659 016 123	7 634 227 752	19 293 243 875

Source: EBA remuneration benchmarking report 2014 (figure 22); EBA remuneration benchmarking report 2013 (Figure 21)

Those are general trends, calculated as averages for all jurisdictions, different types of institutions and identified staff covered by the Maximum Ratio Rule. Therefore, some deviations must be accounted for, depending on the jurisdiction, the sample of institutions (e.g. large, small, internationally active) or business area.

Despite the decrease of the *average absolute amount of variable remuneration per identified staff* when calculated on average for all business areas, in investment banking variable pay saw a +62% increase between 2011 and 2013, to then go down in 2014 and reach a level comparable to that of 2011 (+2%). Investment banking is also the only business area which noted an increase in *absolute amount of fixed remuneration per identified staff* already between 2012 and 2013 (+46%), and which noted an increase in total pay between 2011 and 2014 (despite a -13% drop between 2013 and 2014, it is still 40% higher than in 2011).

Despite the general increase between 2013 and 2014 of the *average absolute amount of fixed remuneration per identified staff*, when calculated for all business areas, in retail banking it went down (-14%).

Asset management was the only business area, where between 2013 and 2014 the *average absolute amount of variable remuneration per identified staff*, as well as the *average absolute amount of total*

remuneration per identified staff actually went up (+3% and +7% respectively), although they are both lower than in 2011 (-16% and -4% respectively)[56].

The details are presented in the table below (arrows indicate an increase or decrease compared with a previous year or within the years indicated):

	Absolute Fixed per identified staff					**Absolute Variable per identified staff**					**Absolute Total per identified staff**				
Investment ban-king	2011	2012	2013	2014	2011 - 2014	2011	2012	2013	2014	2011 - 2014	2011	2012	2013	2014	2011-2014
	175 095 na	185 668 ↗	271 383 ↗	365 975 ↗	↗	318 625 na	333 225 ↗	518 794 ↗	325 318 ↘	↗	493 720 na	518 893 ↗	790 177 ↗	691 293 ↘	↗
Retail banking	2011	2012	2013	2014	2011 - 2014	2011	2012	2013	2014	2011 - 2014	2011	2012	2013	2014	2011-2014
	998 24 na	134 445 ↗	117 726 ↘	100 854 ↘	↗	42 076 na	47 119 ↗	30 917 ↘	30 554 ↘	↘	141 900 na	181 564 ↗	148 634 ↘	131 408 ↘	↘
Asset management	2011	2012	2013	2014	2011 - 2014	2011	2012	2013	2014	2011 - 2014	2011	2012	2013	2014	2011-2014
	170 845 na	192 710 ↗	172 952 ↘	191 617 ↗	↗	229 457 na	248 328 ↗	186 920 ↘	191 974 ↗	↘	400 302 na	441 038 ↗	359 872 ↘	383 591 ↗	↘
All business areas[57]	2011	2012	2013	2014	2011 - 2014	2011	2012	2013	2014	2011 - 2014	2011	2012	2013	2014	2011-2014
	151 409 na	172 379 ↗	170 164 ↘	185 692 ↗	↗	193 785 na	187 441 ↘	177 431 ↘	121 589 ↘	↘	345 194 na	359 820 ↗	347 595 ↘	307 281 ↘	↘

Source: EBA remuneration benchmarking report 2014 (figure 51) and EBA remuneration benchmarking report (figure 34)

When reading those trends, it is worth noting that the increase of the average absolute levels of fixed pay may have been exacerbated by the fact that after the introduction of harmonised rules on staff identification, more persons with traditionally higher portion of fixed pay have been included in the sample. On the other hand, the decrease of average absolute levels of variable pay could be also attributed to a decrease of bonus pools that could result, for example, from lower levels of profits and trading revenue of institutions[58]. Also, an increase in the fixed portion of remuneration is not specific

[56] See also New Financial *"Feeling the squeeze? What's happening with pay at investment banks and asset managers"* (2015): Over the past decade, pay in asset management companies, which in 2004 was just over half of that in investment banks, has now almost caught up, and may soon overtake it.

[57] Including other than retail banking, investment banking and asset management

[58] McLagan *""Review of the Reward environment in the Banking industry"* (2015): Bonus pool per capita in respect of the 2014 performance year has declined by 40% since 2009; IFF, 2016: Roughly 75% of respondents confirmed that the bonus pool is smaller than it used to be; New Financial "*Taking stock on pay: 10 things we know (and don't know) about pay at*

to the EU, and has been observed in several non-EU jurisdictions in 2014 compared to 2011[59] (see also Section 5.2).

In conclusion, it is acknowledged that the ratio of variable to total remuneration has decreased and the ratio of fixed to total remuneration has increased. However, these evolutions have already begun several years before the introduction of the Maximum Ratio Rule. There are elements other than the Maximum Ratio Rule that would impact on the levels and proportions of remuneration components (for example financial performance, profitability, general prudential requirements). Nonetheless, it is likely that in certain individual cases the maximum ratio has indeed led to a shift from variable to fixed remuneration.

The impacts of the Maximum Ratio Rule on individual incentives for excessive risk-taking behaviour, conduct and fixed costs of institutions are discussed in Section 5.1 on financial stability. The impacts of the Maximum Ratio Rule on competitiveness and staff working in subsidiaries established outside the EEA of parent institutions established within the EEA are discussed in Sections 5.2 and 5.3 respectively.

5. IMPACTS OF THE MAXIMUM RATIO RULE ON FINANCIAL STABILITY, COMPETITIVENESS AND STAFF WORKING EFFECTIVELY AND PHYSICALLY IN SUBSIDIARIES ESTABLISHED OUTSIDE THE EEA OF PARENT INSTITUTIONS ESTABLISHED WITHIN THE EEA

Article 161(2) CRD requires that the review of the provisions on remuneration analyses the impact of the Maximum Ratio Rule on financial stability. It also requires the assessment of the efficiency of all remuneration rules. As the effects of the Maximum Ratio Rule on individual incentives for taking excessive risk or engaging in misconduct are closely related to the overall objectives of financial stability, this is discussed together with the impacts of the rule on the cost flexibility and profitability of institutions in Section 5.1.

5.1. IMPACT ON FINANCIAL STABILITY

5.1.1. Impact on incentives for excessive risk-taking behaviour and conduct

The Maximum Ratio Rule was introduced as a form of a behavioural safeguard, aimed to curb the excessive risk-taking incentives[60], which were seen to be induced by a high proportion of variable remuneration. Under CRD III, supervisors had a difficult task [61] of screening out undesirable remuneration policies and the approaches of institutions to an “appropriate balance” between variable and fixed remuneration varied. Some academics and regulators recommended a clear regulatory maximum ratio[62]. This was expected to substantially ease the task of the supervisors and harmonise practices. Some also expected that the rule could even help attract talented staff, for example to risk management functions, by reducing the pay wedge between business and risk management staff.

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investment banks and asset managers" (2016): Based on a sample of six banks, bonus pools shrank by 31% between 2010 and 2014.

[59] FSB *"Implementing the FSB Principles for Sound Compensation Practices and their Implementation Standards. Fourth Progress Report"* (2015), available at http://www.fsb.org/wp-content/uploads/FSB-Fourth-progress-report-on-compensation-practices.pdf

[60] Rec 65CRD

[61] Johnston in *"Preventing the next financial crisis? Regulating Bankers' pay in Europe"* (2014) calls it even an "impossible task"

[62] Final Report of the High-level Expert Group on reforming the structure of the EU banking sector Chaired by Erkki Liikanen (2012), available at http://ec.europa.eu/finance/bank/docs/high-level_expert_group/report_en.pdf; EBA and ESMA presentations at the Workshop on Banks’ Remuneration Rules (CRDIII) "Are they implemented and do they work in practice?" (2012), available at http://www.europarl.europa.eu/RegData/etudes/workshop/join/2012/464465/IPOL-ECON_AT(2012)464465_EN.pdf

The Maximum Ratio Rule is subject to criticism by part of industry, some Member States and some academics[63], who claim that increased reliance on fixed pay, not determined on the basis of risk-adjusted performance, may adversely affect the alignment of staff's incentives with the interests of the firm and society, dis-incentivise individual effort, discourage staff to take "good" risks, or even create incentives to take more "bad" risks. Other industry stakeholders and academics suggest, however, that the Maximum Ratio Rule may help influence conduct of staff and curb excessive, bonus-driven risk-taking behaviour.

According to certain estimates, the Maximum Ratio Rule could reduce the average bank's risk level by 16-48%[64]. IMF[65] analysis suggests that the Maximum Ratio Rule can in some cases eliminate the incentive for risk shifting by reducing the manager's expected payoff and therefore ensuring that the risky project is not undertaken. But, it suggests that those effects may be undone if banks respond by increasing their base pay. In a recent survey[66], the views of institutions in the sample were divided. Suggestions were made that it may also depend on the cultural background. Staff itself does not seem to consider that more fixed than variable pay has an impact on their motivation or risk-taking (neither to take more, nor to take less risk)[67].

Arguments have also been advanced that the Maximum Ratio Rule will limit the proportion of the remuneration, to which other remuneration tools such as deferral, pay-out in instruments, *malus* and clawback can be applied. Those remuneration tools are aimed at aligning remuneration with the long term risks of an institution, and at countering and penalising misbehaviour. Two observations need to be made in this respect. Firstly, available data on the use of those tools suggests that the variable remuneration that can be awarded within the limits imposed by the Maximum Ratio Rule can accommodate a much higher use of those remuneration tools (see Section 4.2.6). This is especially the case for *malus* and clawback, which remain largely untested in the EU and globally[68]. Secondly, it is worth noting that ex-post adjustments do not suffice as a sole tool to mitigate adverse risk incentives or misconduct. While their mere existence might function to some extent as a deterrent, they are essentially applied as a reactive tool, once the damage resulting from the excessive risk or misbehaviour has already materialised.

Given the recent introduction of the Maximum Ratio Rule and the limited experience with its application, it is very early to draw clear conclusions on the impact of the Maximum Ratio Rule on curbing incentives for excessive risk-taking behaviour. This has been indeed recognised by some supervisors. It also cannot be concluded that the Maximum Ratio Rule has a negative effect on the effectiveness of other remuneration rules in tackling misconduct.

5.1.2. Impact on fixed costs and profitability

Concerns have been expressed that a relative raise in fixed pay, which is believed to follow from the Maximum Ratio Rule, increases institutions' fixed costs and thus limits their cost flexibility. This would increase their vulnerability to business cycles, may have a negative impact on their regulatory capital ratios and profitability, and thus may have an adverse effect on financial stability.

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[63] Murphy *"Regulating banking bonuses in the European Union: a case study in unintended consequences"*(2013); Ferrarini *"CRDIV and the Mandatory Structure of Bankers' Pay"* (2015); Dittrich, Statter *"Regulating bankers pay: Incentive contracts and non-binding salary caps"* (2015), available at http://www.sole-jole.org/2015Staedter.pdf; Randall, Lu *"Capping of bankers' bonuses? Case C-507/13 UK v. Parliament and Council"*(2015), available at https://www.kluwerlawonline.com/document.php?id=LEIE2015023&PHPSESSID=qhe5ndb9kek4nr8gtimpkj7a97

[64] Jokivuolle, Keppo, Yuan *"Bonus caps, deferrals and bankers' risk-taking"* (2015), available at http://www.suomenpankki.fi/en/julkaisut/tutkimukset/keskustelualoitteet/Documents/BoF_DP_1505.pdf

[65] IMF *"Global financial stability report"* (2014), available at https://www.imf.org/external/pubs/ft/gfsr/2014/02/pdf/c3.pdf

[66] IFF, 2016

[67] IFF, 2016

[68] FSB *"Implementing the FSB Principles for Sound Compensation Practices and their Implementation Standards. Fourth Progress Report"* (2015), available at http://www.fsb.org/wp-content/uploads/FSB-Fourth-progress-report-on-compensation-practices.pdf

As a preliminary point, it is noted that the implementation of the Maximum Ratio Rule by institutions is uncomplicated, easy and does not create additional administrative costs[69].
When assessing the impact of the maximum ratio on institutions' cost flexibility, it is first worth noting that the remuneration of identified staff – i.e. staff whose remuneration structure risks being affected by the Maximum Ratio – represents only a small percentage of the total administrative costs of institutions. According to estimates by EBA, in most of the institutions examined the total variable remuneration of identified staff was in 2014 between 1% and 2% and the total fixed remuneration was below 5% of their total administrative costs[70].

In a recent survey[71], surveyed institutions expressed mixed views as to whether the Maximum Ratio Rule would actually affect their fixed costs. EBA found that for most of the institutions examined the increase in fixed costs from 2013 to 2014 (i.e. the first year that the Maximum Ratio Rule was in force) was very small[72]. Other sources have suggested in a similar way that the impact of the variable-to-fixed shift, allegedly resulting from the Maximum Ratio Rule, on the fixed cost base of sampled institutions, would not be material[73].

It is worth noting that the extent to which institutions can reduce their total cost base by reducing the variable remuneration should not be overstated: such a reduction would only have a limited effect on the total remuneration costs and an even more limited effect on their total administrative costs. As shown by EBA's analysis, in most of the institutions examined the total amount of variable remuneration of identified staff accounts for only 1% to 10% of the total remuneration costs in 2014and between 1% and 2% of their total administrative costs. The extent to which institutions can reduce their total cost base by reducing the variable remuneration of identified staff was even more limited before 2014 (and the entry into force of the RTS on identified staff)[74].

As mentioned in Section 5.1.1, arguments are advanced that the Maximum Ratio Rule limits the portion of remuneration to which *malus* and clawback can be applied, as means of adapting institutions' costs in case of a downturn event. However, available data indicate that the current levels of variable remuneration can easily accommodate a much higher use of those mechanisms. Moreover, at global institution level, total variable remuneration of identified staff to which *malus* and clawback can be applied has actually gone up following the increase of the number of identified staff. Therefore globally the basis for institutions to exercise flexibility has actually increased.

Fears have been expressed that higher fixed remuneration does not allow firms to align remuneration with the firm's cycle, and thus they may be forced to lay off staff in difficult times. As explained above, there is no evidence that the Maximum Ratio Rule would lead to a material loss of cost flexibility. Also, if necessary, even legally fixed components can be subject to renegotiation.

[69] IFF, 2016; Opinion of the European Banking Authority on the application of the principle of proportionality to the remuneration provisions in Directive 2013/36/EU (21.12.2015), paragraph 26, available at https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-25+Opinion+on+the+Application+of+Proportionality.pdf

[70] EBA *"Benchmarking of Remuneration practices at Union level and data on high earners data as of end 2014"*.

[71] IFF, 2016

[72] EBA "*Benchmarking of Remuneration practices at Union level and data on high earners data as of end 2014*".

[73] Autonomous (Stalmann, Costello) *"Bonus cap versus bowler hat"* (2013) estimates that in investment banking a shift of variable remuneration expenses to fixed remuneration expenses could lead to 4% of the institution's total cost base becoming less flexible (in case of the 200% Maximum Ratio), or 9% (in case of the 100% Maximum Ratio); New Financial "*Feeling the squeeze?"* (2015), available at http://newfinancial.eu/wp-content/uploads/2015/02/Feeling-the-squeeze-July-2015-updated.pdf: estimates that raising fixed remuneration could lead to an increase of bank's fixed costs by 1%.

[74] EBA *"Benchmarking of Remuneration practices at Union level and data on high earners data as of end 2014"*.

With respect to the impact of the maximum ratio on institutions' profitability**,** it is worth noting that between 2013 and 2014, all in all, the profitability of institutions remained stable besides a few institutions that showed material changes[75].

In the same way as fixed remuneration, variable pay also reduces the institution's net profit that could be otherwise retained or distributed as dividends. Variable remuneration nevertheless has the advantage that it is linked with performance and can be adapted accordingly. However, in practice there are still cases where despite a decrease of profits or even material losses, bonuses were awarded, or else bonuses were awarded above the amounts of dividends (or even they were awarded where no dividends were paid)[76].

For assessing the possible impact of the maximum ratio rule on institutions' profitability, it is also relevant to compare the level of fixed remuneration with institutions' net profits. According to EBA, in 2014 the total fixed remuneration cost of identified staff was only a fraction of the net profits of institutions on an aggregate basis. EBA estimates show in this respect that for the analysed sample of institutions looked at on an aggregate basis, total fixed remuneration costs of identified staff would be EUR 10.6 billion, compared to EUR 53.2 billion net profits[77]. A similar finding comes from other estimates, which suggest that even if institutions were to double the fixed pay for their identified staff, this could create a risk for a profit-operating firm to start operating loss only in very rare and extreme scenarios. Even in those scenarios, the institution can entirely prevent this risk from materialising if it pays out no variable remuneration[78].

With respect to the impact of the maximum ratio on institutions' own funds, EBA's investigation suggests that there is no reason to assume that increased fixed pay could significantly contribute to a reduction of own funds, even in an adverse scenario, since for most of the examined institutions fixed remuneration of identified staff accounts for only 1% of their own funds[79].

The above taken on balance, considering the recent introduction of the maximum ratio and the limited experience with its application, it can be carefully considered that the assertions over the detrimental impacts of the Maximum Ratio Rule on cost flexibility and profitability of credit institutions are not substantiated.

5.2. IMPACT ON COMPETITIVENESS

Article 161(2) CRD calls for a review of the potential impacts of the Maximum Ratio Rule on competitiveness.

Criticism has been voiced that the Maximum Ratio Rule would reduce institutions' ability to attract and retain talented staff against competitors in non-EEA jurisdictions, or non-CRD-regulated business areas where skills are fairly transferable (e.g. standalone hedge funds, private equity firms or UCITs, fin-tech companies).

Concerns about the impacts of Maximum Ratio Rule are fuelled by the common perception that employees in the financial services sector are remarkably mobile[80]. Although it is too early to produce objective data on staff turnover levels following the introduction of the Maximum Ratio Rule, it should be recognised that many elements will factor into a staff member's decision to move, such as

[75] EBA *"Benchmarking of Remuneration practices at Union level and data on high earners data as of end 2014"*
[76] New Financial "*Feeling the squeeze?"* (2015), available at http://newfinancial.eu/wp-content/uploads/2015/02/Feeling-the-squeeze-July-2015-updated.pdf; EBA remuneration benchmarking data, available at https://www.eba.europa.eu/regulation-and-policy/remuneration/-/topic-documents/ckV8kFRsjau9/more
[77] EBA *"Benchmarking of Remuneration practices at Union level and data on high earners data as of end 2014"*
[78] IFF, 2016
[79] EBA *"Benchmarking of Remuneration practices at Union level and data on high earners data as of end 2014"*
[80] Murphy *"Regulating banking bonuses in the European Union: a case study in unintended consequences"*(2013)

job security, promotion prospects, reputation enjoyed by the sector, taxation, family, language or living conditions. There is also no strong evidence on which type of remuneration (more secure fixed or variable with more potential for upside gain) is preferred by staff. Fixed pay seems to represent a higher net present value for an individual, and in the opinion of employee representatives remuneration should consist primarily of a fixed component, but this may essentially be down to personal or cultural preferences.

If the Maximum Ratio Rule impacts on attracting and retaining staff of EEA institutions, it is yet to be seen whether this would be in a positive or a negative way. Indeed, it has been suggested that firms from non-EEA jurisdictions, including top global financial centres such as US, Hong Kong or Singapore, have increased their fixed portion of remuneration to match that of EEA banks operating in their markets[81]. This might suggest that a higher reliance on fixed remuneration is not hampering institution's attractiveness for staff. There are today no data available that would show difficulties in attracting and retaining staff[82]. To the contrary, a survey conducted in April 2016[83] has revealed that the majority of the surveyed credit institutions and investment/asset management firms considered that more fixed compensation had hardly any or no impact on their ability to attract and retain talent, or to motivate performance. In banking, approximately a quarter of respondents saw some or substantial positive impact.

Warnings were also expressed about the risk of brain drain from the EU financial centres and of a decline in their competitiveness. However, financial services professionals continue to rank EU global financial centres high in terms of competitiveness[84]. Publically reported cases of EEA-headquartered firms considering relocating elsewhere seem to have been motivated by considerations other than those of wanting to escape the CRD remuneration rules.

UCITS and AIF managers, argue that the Maximum Ratio Rule may create an un-level playing field between those of them that are subsidiaries of CRD-institutions, and those who operate independently. So far, this cannot be confirmed on the basis of empirical evidence, largely because of the limited application of the Maximum Ratio Rule by such entities. However, it is worth noting that being part of a group carries with it also competitive advantages, and these considerations must be part of the strategic choices to be made. At the same time, there is a good reason for applying the CRD IV rules on remuneration to all subsidiaries within the CRR prudential scope of consolidation. They all can have an impact on the risk profile of the group, and UCITS and AIF managers are no exception. In any case, the actual impact of the Maximum Ratio Rule on UCITS and AIF managers within CRD-groups may not be significant, given that the Maximum Ratio Rule would apply only to staff members who have a material impact on the risk profile of the entire group. Thus, the number of staff affected is not expected to be high.

In conclusion, competitiveness of institutions depends on a combination of many factors, going well beyond remuneration rules. So far, besides general and often rather theoretical claims made by the industry, there is no concrete evidence suggesting that the competitiveness of entities subject to the Maximum Ratio Rule is affected, but this may merit further assessment when more experience with the rule is gained.

5.3. STAFF WORKING EFFECTIVELY AND PHYSICALLY IN SUBSIDIARIES ESTABLISHED OUTSIDE THE EEA OF PARENT INSTITUTIONS ESTABLISHED

[81] Financial Stability Board, *"Implementing the FSB Principles for Sound Compensation Practices and their Implementation Standards - Fourth progress report"* (10.11.2015), available at http://www.fsb.org/wp-content/uploads/FSB-Fourth-progress-report-on-compensation-practices.pdf: for example Brazil, Canada, Hong Kong, Mexico, Singapore, US

[82] IFF, 2016

[83] Mercer Global Financial Services Executive Compensation Snapshot Survey (2016), a survey conducted on the sample of 68 financial services organizations in 20 countries

[84] QFC's Global Financial Centres Index 18 (2015), available at http://www.finance-montreal.com/sites/default/files/publications/gfci18_23sep2015.pdf

WITHIN THE EEA

Article 161(2) CRD calls for a review of the potential impacts of the Maximum Ratio Rule on staff working in subsidiaries established outside the EEA of parent institutions established within the EEA. The Commission is mandated to consider whether the Maximum Ratio Rule should continue to apply to any such staff.

The Maximum Ratio Rule applies to subsidiaries within the prudential scope of consolidation of EEA institutions but their staff (including staff working effectively and physically in subsidiaries established outside the EEA) will be identified only if it is found that they have a material impact on the whole group's risk profile. The number of staff affected should generally thus be rather limited.

There have not been many arguments raised against applying Maximum Ratio Rule to third country staff other than related to competitiveness aspects. Some internationally active EEA-headquartered institutions suggested that it is difficult to compete for talent with local firms, and that staff turnover in non-EEA locations has increased, but they could not quantify or attribute this to Maximum Ratio Rule or remuneration in general.

It has also been suggested that differences in the rules across countries may have hampered internationally active banks in setting consistent firm-wide compensation strategies. Some internationally active groups raised concerns about compatibility issues with local remuneration regimes. However, it must be noted that if it can be demonstrated that the application of the Maximum Ratio Rule is unlawful under the laws of the third country where the subsidiary is established, then the Maximum Ratio Rule shall not apply[85]. The assessment of impacts of the Maximum Ratio Rule on staff in non-EEA locations is for the time being affected by the relatively limited experience with the rule. Based on the available information, there is no compelling evidence to suggest at this stage that Maximum Ratio Rule should not continue to apply to such staff.

6. CONCLUSIONS

The review of the CRD and CRR remuneration provisions revealed overall a positive assessment of the rules on the governance of remuneration processes, performance assessment, disclosure and pay-out of the variable remuneration of identified staff, introduced already by CRD III. These rules were found to contribute to the overall objectives of curbing excessive risk-taking and better aligning remuneration with performance, thereby contributing to enhanced financial stability.

The review also revealed that the deferral and pay-out in instruments requirements are not efficient in the case of small and non-complex institutions and of staff earning low levels of variable remuneration, and that the use of share-linked instruments by listed institutions in fulfilment of the CRD pay-out in instruments requirement could be more efficient than the use of shares.

With regard to the maximum ratio between variable and fixed remuneration introduced by CRD IV, the review found that for the time being there is not enough evidence to draw final conclusions on the impact of the rule on competitiveness, on financial stability and on staff working for non-EEA subsidiaries. The results of the assessment are at the moment mitigated and it seems appropriate to revisit these issues once more implementation experience is gained.

Finally, under CRR[86] the Commission must provide a separate report to the European Parliament and to the Council on an appropriate regime for the prudential supervision of investment firms (the "investment firms' review"), which may reveal information relevant for the assessment of the application of the CRD remuneration rules to investment firms.

[85] Article 109(3) CRD
[86] Art 508, 493(2) and 498(2) CRR

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