

21 August 2013

Dear Sir/Madam

**EBA Consultation Paper 2013-11: Draft Regulatory Technical Standards on Qualitative and Quantitative Criteria for the Identification of Staff Who Have a Material Impact on Risk Profile**

ICAP is a leading markets operator and provider of post trade risk mitigation and information services. The company is headquartered in the UK, with operations in 32 countries and around 5000 employees worldwide.

ICAP welcomes the opportunity to provide comment on the EBA's consultation on proposed Regulatory Technical Standards (RTS) on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile under Article 90(2) of the proposed Capital Requirements Directive (CRD 4).

ICAP supports efforts to strengthen governance and better align remuneration with risk. We understand the intention of the proposed RTS is to harmonise certain risk management policies as they apply to credit institutions. We do not believe the intention is for the RTS to apply to all investment firms as this is not in line with the principle enshrined in the Level 1 Directive, namely that "The provisions of this Directive on remuneration should reflect differences between different types of institutions in a proportionate manner, taking into account their size, internal organisation and the nature, scope and complexity of their activities. *In particular it would not be proportionate to require certain types of investment firms to comply with all of those principles*"<sup>1</sup> [our emphasis].

This interpretation appears consistent with the EBA consultation, which includes no assessment of the potential costs or benefits that might arise for investment firms were the RTS to apply.

In our view, a blanket extension of the RTS to all investment firms is neither necessary nor proportionate. Many investment firms present significantly lower credit and market risk profiles than those institutions that provide credit, accept deposits and / or trade on their own account.

Certainly, given the nature of ICAP's business model and the levels of risks that the business incurs, we believe that a proportionate approach should be permitted. ICAP is not a bank, lender, custodian, clearer or proprietary trader. We do not engage in proprietary trading or manage other people's money; nor do we carry material market, credit, liquidity or operational risk relative to a credit institution in our activities, as is recognised in the limited FCA Permissions pertaining to our businesses. As such, the concept of "risk taking" staff must be interpreted very differently to the approach that might be appropriate for a bank.

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<sup>1</sup> Recital 66 of Directive 2013/36/EU. See also Recital 54 and Articles 74(2), 76(3), and 92(2).

We would have serious concerns should the proposed RTS be applied to investment firms, such as ICAP, that do not have a risk profile in any way similar to a credit institution. The broad scope of the qualitative and quantitative criteria that the EBA has proposed is not appropriate for our business model and would not contribute to risk reduction or safer governance. Instead, it would disadvantage us competitively and increase our costs in a disproportionate manner.

We would therefore encourage the EBA to clarify its proposal so that the RTS are explicitly qualified by Recital 66 of CRD 4; and that the application of the proposed criteria is limited to those firms that pose banking and trading book credit and market risks.

Furthermore, we do not believe that it is appropriate to assume that a particular level of remuneration is directly linked to an impact on risk profile. This approach has the potential to bring within scope many staff who do not have a material impact on an institution's risk profile and would not otherwise be identified under other criteria. We consider this to be a disproportionate approach that will not assist the identification of staff that are genuine risk takers.

Responses to the EBA consultation questions are attached at Annex A.

Yours faithfully

**Robert Standing**

**Chairman of the Remuneration Committee, ICAP plc**

## ANNEX A

### ***ICAP response to the EBA consultation on draft RTS on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile under Article 90(2) of the proposed Capital Requirements Directive***

#### **Q1: Is the list of specific functions listed appropriate or should additional functions be added?**

We have a number of concerns with the list of functions that have been proposed, namely:

- The functions listed should apply at group, not entity level. Groups maintain their legal structures for a variety of reasons (governance, legal, regulatory). The entities within a group will commonly operate within risk parameters that have been approved at group level. As such, it would be disproportionate to require the same identification to be carried out at each entity within a group.
- There may be a situation where a firm has a very small business line in a particular jurisdiction. In this case, a criterion based solely on geography or business line is not likely to be relevant.
- In relation to Article 3(1)(e), we consider these criteria too broad. It is not clear what functions are intended to be captured by “budgeting” and “economic analysis”; we would suggest these are part of a Finance function, which would also comprise “taxation”. The “business continuity planning” function should already be captured under Article 3(1)(c) as part of the risk control function.

We therefore propose the following amendments:

#### *Article 3 – Qualitative and Quantitative Criteria*

(1) Staff shall be identified as having a material impact on an institution's risk profile if they meet one or more of the following criteria:

- a. The staff member is a member of the group executive management body
- b. The staff member is a member of the group senior management
- c. The staff member is responsible and accountable to the group executive management body for the activities of the internal risk control function, the compliance function or the internal audit function
- d. The staff member heads a business unit (for which purpose “business unit” means any separate organisational or legal entities, ~~business lines, geographical locations~~)
- e. The staff member heads a group function responsible for legal affairs, ~~taxation~~, human resources, finance or risk management ~~information technology, budgeting, economic analysis or business continuity planning~~

**Q2: Can the above criteria be easily applied and are the levels of staff identified and the provided threshold appropriate?**

We do not believe that these criteria could be easily applied for the following reasons:

- The criteria referred to are banking terms and as such are not appropriate for many investment firms. We would encourage the EBA to clarify its proposal so that the RTS are explicitly qualified by Recital 66 of CRD 4; and that the application of the proposed criteria is limited to credit institutions and those investment firms that pose banking and trading book credit and market risks.
- It is unclear precisely who this provision is seeking to capture. As drafted, it could be read as applying to front office staff who undertake a trade and commit to an exposure. If this is not the intention, and the criteria are intended to apply to senior managers who are in a position to authorise the taking of risk, the provision will need to be amended. (In this respect, the drafting of Article 3(1)(h) perhaps more accurately reflects the allocating and decision making powers within firms).
- The phrase “individually or collectively” is very broad and could lead to difficulties in its application.
- The draft RTS include a criterion that would capture any member of staff who has the authority to commit credit risk exposures per transaction which represents 0.25% of CET1. This is relevant for credit institutions (although we would question whether a blanket 0.25% threshold is appropriate in all cases). However, it is not relevant for investment firms, such as ICAP, that do not hold regulatory permissions to take credit and market risk in the same way as credit institutions.

**Q3: Can the above criteria be easily applied and are the levels of staff identified and the provided thresholds appropriate?**

We have a number of concerns with the criteria that have been proposed and do not consider they would be easily applied. For example:

- The criteria in **Article 3(1)(g)** are not appropriate for investment firms. These refer to the use of internal models and trading books, which are not relevant for investment firms, such as ICAP, that do not undertake proprietary trading. We would therefore encourage the EBA to clarify that the RTS are to be applied to credit institutions and those investment firms that pose banking and trading book credit and market risks.
- **Article 3(1)(j)** is drafted in very broad terms and has the potential to bring within scope many staff who pose no material risk to a firm. We recommend that this provision is deleted because

the decision makers that this provision is seeking to bring within scope should already be identified under Article 3(1)(a) and (b).

- Similarly, we would expect the managerial staff referred to in **Article 3(1)(i)** to have already been identified through the internal risk identification process referred to in Article 2. As such, this provision appears somewhat redundant.
- Finally, in relation to **Article 3(1)(h)**, we would note that these criteria appear to better reflect the allocation of authority and decision making powers within firms than is proposed under Article 3(1)(f).

**Q4a: Is this criterion appropriate to identify risk takers?**

**Q4b: Are the thresholds set in the criterion appropriate?**

**Q4c: What would be the number of staff members identified in addition to all other criteria within the RTS?**

**Q4d: What would be the additional costs of implementation for the above criterion if an institution applies Article 4 in order to exclude staff from the group of identified staff?**

We do not believe that it is appropriate to assume a particular level of remuneration is directly linked to an impact on risk profile. This approach has the potential to bring within scope many staff who do not have a material impact on an institution's risk profile and would not otherwise be identified under other criteria.

We firmly believe that this criterion should be deleted. It is disproportionate and will not in any way assist the identification of staff that are genuine risk takers.

Given that staff identified under the provision may subsequently be excluded under Article 4, this appears a burdensome exercise for no real risk benefit. As such, the provision should be deleted.

**Q5a: Can the above criterion be easily applied?**

**Q5b: Would it more appropriate to use remuneration which potentially could be awarded as a basis for this criterion?**

**Q5c: What would be the difference in implementation costs if the potentially awarded remuneration would be used as a basis?**

We do not believe this criterion is either appropriate or easily applied.

- It will result in the population of Identified Staff varying year to year simply on the basis of the overall levels of gross remuneration, rather than on the basis of their impact on the risk profile of the institution.
- For a global business, there will be fluctuations in exchange rates that could affect the population of Identified Staff.

- It would require a comparison of an individual’s remuneration against all Identified Staff. However, a comparison of pay levels between staff across different functions is unlikely to be relevant in this context.
- It is not clear how “potentially” awarded remuneration could be used as the basis for the calculation. It would be administratively burdensome to apply and most, if not all, staff identified under such a process would be subsequently excluded under Article 4.

In our view, a better metric is proposed at Article 3(2)(d), although we recommend this should be applied at group, rather than entity, level.

**Q6: Can the above criterion be easily applied and are the threshold and the levels of staff identified appropriate?**

We do not believe that it is appropriate to assume a particular level of remuneration is directly linked to an impact on risk profile.

Article 3(2)(c) proposes a minimum gross remuneration threshold above which a member of staff would automatically be identified as having a material impact on an institution’s risk profile. The threshold that has been proposed is that the staff member has been awarded total gross remuneration of EUR 500,000 or more in one of the two preceding financial years.

This approach has the potential to bring within scope staff that do not have a material impact on an institution’s risk profile and would not otherwise be identified.

In our view, a minimum remuneration threshold is not an effective proxy for identification of staff who could have a material impact on an institution’s risk profile. We believe this provision should either be deleted or subordinated to Article 4 so that any staff identified with total remuneration at this level can be excluded if it is demonstrated that they do not pose a material risk to the firm.

Finally, we would query whether the threshold has been calculated on a broad enough data set. In our reading, the remuneration threshold that has been proposed under Article 3(2)(c) is based on data drawn from only 23 institutions (see paragraph 26 of the consultation paper). If this is correct, we would urge the EBA to broaden its sample size. Should the intention be to apply the RTS to investment firms, we would urge the EBA to ensure it reviews its assessment so that any remuneration threshold is tailored appropriately and not based solely on data from credit institutions.

**Q7: Can the above criteria be easily applied and are the levels of staff identified appropriate?**

As stated in response to Questions 4 and 6, we do not believe that it is appropriate to assume a particular level of remuneration is directly linked to an impact on risk profile. However, if the EBA’s policy intention is to ensure that staff are identified solely on the basis of their remuneration, then we believe Article 3(2)(d) is preferable as it is a more targeted measure than a minimum gross

remuneration threshold. We would recommend, though, that the provision be clarified so that it refers to the 0.3% of highest paid staff at the group level. This is because it would not, in our view, be appropriate to apply the criterion at the entity level.

We therefore propose the following amendment:

- d. the staff member is within the 0.3% of group staff who received the highest total gross remuneration in either the most recent financial year or in the preceding financial year.

**Q8: Are there additional criteria which should be used to identify staff having a material impact on the institution's risk profile?**

The criteria proposed under Article 3(3) are very broad and could bring within scope staff that do not have a material impact on an institution's risk profile and would not otherwise be identified. For example:

- A member of staff who provides advice to a committee may in fact have a relatively junior role and in no way pose a material impact to the risk profile of the firm.
- As noted in our response to Question 2, the phrase "individually or collectively" is very broad and could lead to difficulties in its application.

Unless the drafting of this provision is tightened, we believe it should be deleted because the individuals it is seeking to identify would already be captured by the criteria in Article 3(1) or through an institution's internal identification process (Article 2). However, as a minimum we would propose the following amendments:

(3) In paragraph (1), a reference to staff members having, ~~individually or collectively with other staff members,~~ authority to commit to transactions or exposures or to take, approve or veto a decision includes ~~both the following categories of staff:~~

- ~~a. Staff who are responsible for advising on or initiating such commitments or decisions;~~
- b. Staff who are members of a committee which has authority to make such commitment or take such decisions.

**Q9: Could you indicate whether all the main drivers of direct costs from the RTS have been identified in the table above? Are there any other costs or benefits missing? If yes, could you specify which ones?**

In our view, the impact assessment does not identify all the main cost drivers arising from the RTS and we have a number of concerns, as follows:

- The impact assessment has been drawn from a small data set that may not be representative. The EBA acknowledges this on page 23 when it states it is extrapolating from a "limited sample".

- The impact assessment focuses on credit institutions only. For example, in relation to the costs identified in the table at page 23, we note that this specifies the “party concerned” as credit institutions and national supervisory institutions. No reference is made to the direct costs to investment firms.

This is acceptable if the RTS are to be applied only to credit institutions. However, if the intention is to extend these RTS to investment firms it is essential that the EBA conduct a more rigorous cost-benefit analysis. This will need to take account of the diverse business models of investment firms and include a sufficiently broad geographical sample as to be representative. It will also need to apply the proportionality that is enshrined in the Directive as, for example, in Recital 66 and Article 92(2).

- The impact assessment fails to attempt any quantification of the costs (direct and indirect) or the purported benefits.
- The impact assessment omits a number of costs which could have a material impact. These include:
  - The direct one-off costs for those firms that are obliged to renegotiate (and potentially breach) existing staff contracts in order to comply with the RTS and the accompanying remuneration requirements under CRD IV.
  - The direct ongoing costs for firms whose fixed cost base will increase as a result of ensuring that total remuneration is broadly consistent with existing staff contracts and / or that the remuneration package remains competitive, in particular for staff operating outside the EU where local competitors are domiciled outside the EEA.

An increase in the fixed cost base will result in an increase in the regulatory capital demanded by the business thereby potentially making EU-domiciled institutions less competitive than their peers incorporated outside the EU. For those firms that do not take proprietary risk, this will impact profitability as a result of having to raise new capital which will only earn an interest return.

- The direct ongoing costs for EU-domiciled credit institutions and investment firms that will be put at a competitive disadvantage vis-à-vis their non-EEA competitors. This can be measured quantitatively as loss of market share and associated revenue as a result of EU-headquartered firms having difficulty in recruiting or retaining staff (where their non-EEA competitors are not subject to the same remuneration restrictions).



**Q10: For institutions, could you indicate which type of costs (a, b, c, d) are you more likely to incur? Could you explain what exactly drives these costs and give us an indication of their expected scale?**

We do not believe that the costs a - d as identified in the impact assessment are the most material or most likely to be incurred by our business. In our view, the most likely costs that will be incurred are those set out in our response to Question 9.

For example, the RTS would in many cases necessitate renegotiation of staff contracts, potentially across multiple jurisdictions with different employment laws, and an increase in fixed costs in order to ensure that the total compensation package remained competitive. This would be the case with brokers who are paid commissions, not bonuses. These commissions are fixed percentages of the revenues for which the individual brokers (or sometimes their desks) are responsible for generating. They are contractual obligations of the firm over the life of the relevant broker's employment contract which typically will be two to three years and in some cases as long as five years.

Legally it is not possible under these contracts to change the basis on which commissions are calculated or paid, defer cash payments, pay commissions in shares rather than cash or performance adjust payments already made (other than for obvious non-financial reasons such as breaches of regulations, internal policies or other disciplinary matters). Each contract is specific to the individual broker and therefore renegotiation of the terms of these contracts would require individual discussions with employees across many jurisdictions.

**Q11: Do you agree with our analysis of the impact of the proposals in this CP? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals?**

We do not agree with the analysis of the potential impact so far as the consultation paper may be intended to apply to investment firms. This is because there is no evidence in the paper that the impact on investment firms has been considered.

We do not believe the intention can be to apply the RTS to all investment firms as this is not in line with the principle enshrined in Recital 66 of the Directive, namely that "The provisions of this Directive on remuneration should reflect differences between different types of institutions in a proportionate manner, taking into account their size, internal organisation and the nature, scope and complexity of their activities. In particular it would not be proportionate to require certain types of investment firms to comply with all of those principles".

In our view, a blanket extension of the RTS to all investment firms is neither necessary nor proportionate. We would have significant concerns should the EBA intend to apply the proposed RTS to all investment firms, when many of them do not have a risk profile in any way similar to a credit institution. If this is the intent, it is essential that the EBA assesses the impact on investment firms as a matter of urgency and explains how it intends to apply the proportionality principle.

We note that in the context of the quantitative criteria that have been proposed the gross remuneration threshold of EUR 500,000 appears to have been based on a very limited sample, specifically:

- i) data gathered from only 23 institutions (presumably credit institutions) of which only five would have had to identify additional staff if the threshold was set at 750,000 EUR.
- ii) benchmarking data received for 110 institutions from which average total remuneration of risk takers in 2011 was 508,000 EUR.

In neither case is it clear how broad a geographical sample these institutions represent. Nor is it clear that this data in any way reflects the situation in investment firms.