

## Consultation on the EBA's draft Technical Standards for the definition of material risk takers for remuneration purposes (EBA/CP/2013/11)

### Submission from the Banking Stakeholder Group of the EBA

The EBA has issued a Consultation Paper on Draft Regulatory Technical Standards on the criteria to identify categories of staff in regulated institutions whose professional activities have a material impact on an institution's risk profile. These material risk takers will be subject to specific provisions of the Capital Requirements Directive (CRD) related, in particular, to the payment of variable remuneration. The objective is to ensure an appropriate harmonisation and level playing field across the EU while taking into account each institution's profile.

#### **GENERAL OBSERVATIONS**

In its in-depth analysis of the crisis in 2008, the de Larosière report highlighted as one of the risk-factors the remuneration and incentive schemes within financial institutions which contributed to excessive risk-taking by rewarding short-term expansion of the volume of (risky) trades rather than the long-term profitability of investments. Therefore, remuneration policies have received special attention by civil society and the European Parliament, and since the CRD 2.5, financial institutions have been requested to produce a report on remunerations, including the number of staff regulated by the Basel criteria

In April 2009, the predecessor of the EBA, the Committee of European Banking Supervisors (CEBS), published a first set of principles on remuneration policies and practices, followed by formal Guidelines to be implemented by the end of 2010. A survey on the implementation of the Guidelines on Remuneration Policies performed by the EBA in April 2012 showed serious inconsistencies and discrepancies between the definitions of "identified staff" (those staff who have a material impact on risk taking) that make effective comparisons between institutions difficult if not almost impossible. The EBA also stated that if "the potential variable remuneration is greater than the fixed one, this could incentivise staff to take too much risk in order to assure a certain minimum pay level."

The final text of the CRD4 was published on June 26th, 2013 in the Official Journal. The part related to remuneration includes several important changes concerning remuneration policies, notably the introduction of a ratio of 1:1 between fixed and

variable pay (with some flexibility to increase the ratio to 1:2 with shareholder approval).

Its stated objective is to ensure that institutions have a sound remuneration policy in place. In order to ensure that competent authorities are able to verify a consistent compliance across all banks, the EBA is requested, in Article 94.2.(ii) of CRD4, to develop adequate standards to specify criteria to identify categories of staff whose activities have a material impact on risk taking.

Achieving this objective is a formidable challenge because of the sensitivity of any criteria that are chosen. The risk to make uneven the playing field with the rest of the world and to be over-prescriptive is very significant. While the criteria are applicable both in EU and in subsidiaries established in third countries, banks outside the EU jurisdiction, and most likely their branches in the EU, would benefit from a distinctive competitive advantage. Playing in combination, the proposed criteria will capture an extensive perimeter which might to some degree go beyond the intent of the legislators and could significantly reduce the degrees of freedom left for internal remuneration policies.

The first point is known and recognized by the European political bodies. The second, driven by the lack of trust in the banking industry, may lead to regulation without adequate consideration to any specificities, a situation that globally might exacerbate the dangers of the first point and cause inefficiencies.

## **SPECIFIC ISSUES**

In this respect three specific observations are made:

1. The number of criteria proposed in the EBA draft is too high. Their combined role makes the system very complex to understand and to implement. Most of the time they will overrule firms' internal criteria.
2. Some of the criteria are overlapping and might capture staff members who are already considered by other criteria or who should not be covered by the regulation. This is clearly the drawback of the contagion principle (Article 3.3) which is defined too broadly and could hamper efficient and expert decision making.
3. The "500K €" absolute criterion needs to be made more flexible while acting as an efficient backstop. We would suggest to turn it into a "comply or explain" threshold in order to allow some necessary, yet controlled, adaptability.

Given the diversity of the European banking sector, great care is needed when formulating and writing this regulation in order to keep it proportionate and efficient for large as well as small financial institutions.

**David T Llewellyn,**

**Chair, Banking Stakeholder Group of the EBA on behalf of the BSG.**