To **European Banking Authority**

Introduction
Towers Watson has an industry group focus to our consulting practices. We bring a depth of financial industry experience to the range of assignments with a significant emphasis on pay reward, but also on the broader issues of performance, culture, talent, and technology. Our core clients include leading global financial institutions including Universal Banks, Asset Managers, Wealth and Insurance. We thank you for the opportunity to respond to the consultation paper EBA-CP-2013-11 and would be pleased to talk to you about any of our responses below.

Question 1: Is the list of specific functions listed appropriate or should additional functions be added?
We agree with the principle of paragraph (a) of Article 3(1).

In respect of Article 3(1)(b), we are concerned that there is no recognisable definition to “senior management”. This is a generic term that can be interpreted narrowly or widely, without it being linked to job titles, functions or reporting lines. Our recommendation is that paragraphs (a) and (b) are amalgamated to refer to members of the management board or executive committee that has responsibility for implementing the strategy and decisions made by the full board of directors to whom it reports.

Our concern with Article 3(1)(c) is that it is aimed at second-in-commands and is not reflective of typical reporting lines. We think that the better approach for paragraph (c) would be for it to capture the individuals who have primary responsibility for these functions but are not members of the management board or executive committee.

In respect of Article 3(1)(d), we are concerned about the width of the definition of a business unit by reference to geographic location. For example, many banks may have a country head who is responsible for a relatively small operation and who reports into a geographical regional head who is the more appropriate role for you to capture within paragraph (d). Similar to above, we think the better approach is to look at reporting lines and define the individuals by reference to their position and responsibility within the internal organisation framework.

In respect of Article 3(1)(e), we would welcome your clarification that this list refers to group function roles only. We note that the paragraph does not include a reference to “business units” so we are assuming that you are not seeking to cover all these functions in each branch or subsidiary if those individuals report to a group function head or a person who falls within paragraphs (a) to (d) of Article 3(1). The only other function which you may wish to consider for paragraph (e) is Group Reward, because often this is a distinct operation within the wider human resources department and the Group Reward Director may in practice report directly to the management body and/or the remuneration committee.

Questions 2 and 3: Can the above criteria be easily applied and are the levels of staff identified and the provided threshold appropriate?
These criteria are specifically focused on credit risk exposure. There are a range of other risk exposures that may be important to consider and might impact the size and magnitude of the credit exposure, such as market, liquidity, operational and conduct risk.

Question 4 a): Is this criterion appropriate to identify risk takers?
We are of the view that quantum in pay is not an appropriate mechanism to identify those that are material risk takers. While it may be correlated, the reality is people are generally paid on an economic basis of supply and demand for skills sets and experience. As a result, pay quantum and structure are economic terms that are not appropriate to identify risk takers.

We attended the public consultation at the EBA and heard your comments that this criterion is viewed as necessary because you are of the view that the identification of material risk takers under CRD III was too narrow in practice. We can understand why an approach based on variable pay proportion could have assisted in implementing CRD III; however, we question whether it’s required under CRD IV, which does provide a binding variable to fixed pay cap.

Questions 4 b): Are the thresholds set in the criterion appropriate?
We have three concerns with the thresholds:

Firstly, most organisations have not historically operated with a bonus maxima approach. Conceptually pay may be viewed as uncapped for most roles, while in practice it is not. As such, it will be challenging to identify staff with a variable pay opportunity of greater than 75% of salary and higher than €75,000. We think that the better approach is the one which you have adopted in paragraph (b) whereby the organisation reviews actual pay in the two proceeding financial years.

Secondly, we think that the reference to €75,000 does not reflect the pay differentials across local markets in the EU. If the focus is to identify an appropriate percentage of risk takers, the local market nuances between major financial markets such as London and Frankfurt will lead to different results than in other locations such as Poland. As such the criterion causes an uneven playing field across geographical markets in the EU. Thirdly, there is a risk that this criterion will influence pay policy and practice away from performance-related deferrals and longer term incentives. Instead, it encourages the greater use of upfront cash bonuses with more immediate payment terms. This is contrary to the whole drive to manage risk through longer term pay. Our suggestion to address this would be to define the €75,000 as the immediate cash payable bonus. This will then encourage high amounts to be paid in instruments, to be deferred and to be subject to further vesting performance conditions or a claw-back under which would be positive risk management, subject to the CRD IV cap.

Question 4 c): What would be the number of staff members identified in addition to all other criteria within the RTS?

Our analysis of Towers Watson data collected from European based banks is shown below. Our analysis indicates that (a) this criterion will be the one that captures the most employees under Article 3(2); and (b) that very broadly it captures about twice the number of employees compared to the CRD III criteria for the median bank in our survey.

Median analysis of quantitative criteria based on Study Sample					
In top 0.3% of highest paid staff	Total remuneration exceeds EUR 500,000	Variable remuneration exceeds EUR 75,000 and 75% of fixed pay	Median Study Headcount	CRD III baseline	EBA quantitative median coverage
33+	480	945	10,708	514	988

The link to our public statement on this topic is:
http://www.towerswatson.com/en/Insights/Newsletters/Europe/executive-compensation-market-watch/2013/05/Update-on-CRD-IV

Question 4 d): What would be the additional cost of implementation for the above criterion if an institution applies Article 4 to exclude staff from the group of identified staff?

As can be shown from our survey data above, it is not a question of "if" an institution seeks to apply Article 4; in our view all of the major banks will be required to apply an Article 4 review. As can be seen for the median institution, this could be a review of up to 1,000 members of staff and, as such, there would be additional costs of implementation. These would be material and on-going on the basis that this Article 4 review should be repeated regularly.

Question 5 a): Can the above criterion be easily applied?

We welcome the reference to actual remuneration paid rather than potentially awarded remuneration, in light of our response to question 4(b). However, we envisage that the comparison of this pay to the threshold of the lowest total remuneration of a staff member who meets the other specified criteria will cause extremely difficult situations for our clients. If Article 3(1)(e) is interpreted as covering branch/subsidiary functions then the threshold figure will be low. There are many more practical problems. For example, what if a senior manager who is clearly within one of the criterion in Article 3(1) works part-time, is on long-term sick leave or is a poor performer who is not paid a bonus, which in all cases may mean that they have a very low remuneration in that year? Again, this sets a very low threshold. Our recommendation would be to limit this criterion to the remuneration paid to a staff member who is a member of the management body, i.e., one who falls within Article 3(1)(a) rather than the subsequent paragraphs.

Question 5 b): Would it be more appropriate to use remuneration which potentially could be awarded as a basis for this criterion?

As explained above we do not endorse this approach because most banks do not have bonus maxima; it is better to focus on actual pay levels.

Question 6: Can the above criterion be easily applied and are the threshold and levels of staff identified appropriate?

We are of the view that this criterion can easily be applied, is appropriate and, further, for many institutions would be a similar approach to that adopted under CRD III.

Question 7: Can the above criteria be easily applied and are the levels of staff identified appropriate?

We are of the view these criteria can be easily applied. However, the impact of the 0.3% figure very much depends on the size of the institution which may be linked to business profile, but in most cases this is not going to be an important criterion because staff may have already been caught by criteria in paragraphs (a) to (c). However, for example, this may ensure that large retail banks include an appropriate portion of the management team.

Question 8: Are there additional criteria which should be used to identify staff having a material impact on the institutions' risk profile?

We do not have any additional criteria to propose to you.

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Thanks you again for giving us the opportunity to participate in this consultation.

Yours sincerely,

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