EACB position paper
on EBA consultation on draft Regulatory Technical Standards on criteria to identify categories of staff whose professional activities have a material impact on an institution's profile under Article 90(2) of the proposed Capital Requirements Directive

20 August 2013

The EACB is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks" business model. With 4.200 locally operating banks and 63.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 160 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 50 million members and 750.000 employees and have a total average market share of about 20%.
For further details, please visit http://www.eurocoopbanks.coop/

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

Key messages:

- The EACB members would **recommend that the RTS focus on persons who actually have material impact on the risk profile of the credit institution**. Upon analysing the EBA's draft RTS, the co-operative banks have doubts whether the proposed formulation leads to the identification of the risk takers that have an *actual material* impact, or whether it is so extensive that it would cover all persons who could *potentially* have influence. We would like to recall that Art 90.2 CRD IV gives the EBA a mandate to propose criteria to identify staff whose professional activities have a material impact on the institution's risk profile.
- Likewise, **what is relevant is whether or not a person actually receives variable remuneration**. Thus, the EBA's excessive focus on the level of total remuneration of the individual is not in our view justified by the purpose of identifying such staff, and it should be replaced by whether or not such person's remuneration contains a variable component.
- Finally, the **degree of variable remuneration** also plays an important role.

EACB proposal:

Based on the above, and going forward, the **EACB would like to make the following proposal** for identifying the MRTs:

I. Since the underlying reason for identifying the MRT is to use this definition in applying the policies on (variable) remuneration, the point of departure should be to take into account only staff actually receiving variable remuneration, and excluding from the annual assessment staff receiving only fixed remuneration.

II. Given the fact that in some credit institution all or vast majority of staff, including staff without any influence on the institution's risk profile, receives a variable component of remuneration, as a second step it should be ensured that certain *de minimis* rules apply. For example, thresholds on variable remuneration could be proposed, to exclude from the annual assessment staff receiving insignificant variable component, e.g. employed under the common labour agreement (such thresholds could be the lower of the two: variable remuneration equal or more than 10% of the fixed component, or variable remuneration equal or more than EUR 25k).

III. For the remaining staff, the focus should be on:

➔ First, their **actual decision making powers**, more or less in line with Art 2.1, however with certain important modifications:
  - only staff who have actual decision powers should be considered as MRT. Thus staff who is only advising or initiating commitments to credit risk exposures should not be defined as a MRT. As a consequence, Art 3.3 should be deleted;
  - concerning the authority to commit to credit risk exposures of 0,25% of the institution's CET1, we would suggest a proportionate approach. E.g., staff responsible for processing applications for consumer credits in small banks should not be classified as MRT. Therefore, the proposed criterion should be further calibrated, according to size of the institution (e.g. higher threshold for smaller institutions, and lower for the bigger ones)

➔ Secondly, **only staff members identified as potential MRT under qualitative criteria, should be assessed in accordance with the quantitative criteria**. This 2-step approach would also allow for disregarding staff which could be identified as MRT under the absolute quantitative criteria but which have no material impact on the institution's risk profile. This would allow for deletion of Art 4 which in its current form would be difficult to apply.

GENERAL REMARKS

- The application of the qualitative and quantitative criteria would lead to identifying significant numbers of staff, who have no actual impact on the risk profile.

- This seems, to a large part, be due to the fact that EBA extend the notion of material risk takers and includes in the definition *"persons, (…) whose activities **could have** a material impact on the institution's risk profile".* This is not in line, however, with Art 92(2) and Art 94(2), as well as recital 62, which refer to *"staff, whose activities **have** a material impact on the institution's risk profile".* In our opinion, the EBA should respect the limits imposed by the legislator.

- Moreover, we do not see how recital 66 of the CRD has been taken into consideration: *"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".* The standard does not propose any criteria for differentiation, which could be the basis for the development of general criteria for proportionality.

- The proposed qualitative and quantitative criteria listed in Art 3 are extremely detailed and extensive, leaving no room for flexibility or proportional application. If no flexibility is afforded already at the stage of the design of the qualitative and quantitative criteria, the development of additional internal identification criteria would be redundant and superfluous. We seriously wonder which additional criteria banks should develop for their assessment of MRTs, since the range of criteria imposed by the standard is so large that any additional criteria would rather duplicate the EBA standard.

- The standard also seems disproportionate both in terms of the capacities of smaller credit institutions, but also all other institutions in general.

- Moreover, we believe that the standard should provide a kind of "standardized approach" for smaller banks, which does not require the development of "own criteria".

- The EACB members are also concerned about the onerous process of annual assessment of staff. The objective of identifying MRTs is to ensure that the remuneration policy concerning this category of staff meets certain standards, and in particular that appropriate rules on variable remuneration apply to those persons. Therefore, we do not see any practical use of complex annual assessment processes for the identification of MRTs, looking also at staff without any variable remuneration, as long as the principles of remuneration are in line with the standards imposed by Article 92 CRD.

- The use of absolute amounts of total remuneration seem inappropriate, especially when taking into account the differences in compensation levels between the Member States and also countries outside the EU.

- When it comes to the applicability of remuneration principles, amounts actually paid, rather then remuneration awarded, should be taken into account. Otherwise, employees in reality receiving remuneration below fixed thresholds (based on the institution's performance), could still be exposed unduly to restrictions, such as, for example, deferrals).

- We also suggest that when it comes to any qualitative criteria, banks should always have the opportunity to prove in an individual case that a member of staff is **not** a risk-taker.

- In addition, many of the proposed qualitative and quantitative criteria, such as the 0,3% criteria to identify the staff with the highest gross remuneration (Art 3.2.d), as well as the EUR 500k used as threshold for total gross remuneration (Art 3.2.c), and the EUR 75k + 75% criteria for the variable remuneration (Art 3.2.a), seem arbitrary and it is not clear how certain figures and thresholds were identified.

- Not all of the proposed criteria could be applied to all types of credit institutions and all categories of staff, and real possibilities for flexibility and more proportionality should be ensured for credit institutions. The CRD IV, in Art 88.2, requires that credit institutions comply with the principles on remuneration policies *"in a way and to the extent that is appropriate to their size, internal organization and the nature, the scope and the complexity of their activities"*. This should be suitably reflected in the EBA RTS on MRT, and it is not sufficient or indeed useful to require the institutions to apply the RTS requirements in a proportionate manner, if the requirements themselves are rigid and leave no real room for manoeuvre. We fear that the standard could hamper the competitiveness of smaller institutions: the possibility of any staff member to be identified as MRT is much higher than in a smaller institution (due to quantitative criteria such as in Art. 3(1)(f) or qualitative criteria such as Art 3(3)(a)), so that even staff members subject to Common Labour Agreements might be subject to the highly restrictive rule on variable pay. This will create disincentives for working in smaller institutions.

Responses to Questions

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

The list should not be further extended, however, certain precisions are in our view necessary.

Point (a) includes all members of the management body, and by consequence also the members of supervisory boards in a two tier board system. It has to be underlined that many cooperative banks dispose of supervisory boards at local, regional or group level. Treating these people as "staff" is not appropriate, as supervisory board members are no employees. Moreover, they may often not receive remuneration at all. If they do, they either do not receive variable remuneration, or they are paid in attendance fees of symbolic value, or their salary is indexed. Even when remunerated, they often earn significantly less than employees at the lower salary range. Thus, being a member of the supervisory board should not *per se* lead to being classified as a MRT.

The EACB is also concerned about the criteria proposed in Art 3.1.d (heads of business unit within the meaning of Art 137.1.3 CRR), which should be somehow substantiated by the relevance of different activities of such units.

As regards groups, it should be clarified that only staff employed by credit institutions is concerned.

The used terms are not always clear, for example the concept of 'key function' (Art 3.1) is rather abstract and therefore in practice not suitable to identify the MRT. Also the term *"economic analysis"* in point (e) is somewhat ambiguous.

Finally, it would be necessary to provide for a minimum level (based on the size of the organization) or proportionality with reference to a group exposure. Otherwise business heads within group entities would be included.

Q2 & Q3: Can the above criteria be easily applied and are the levels of staff identified and the provided threshold appropriate?

Although technically it would be possible to apply those criteria, the process would lead to identification of a high number of roles which actually have no material impact on the risk. The proposal, as it stands, would generate additional administration and cost.

Instead of including the executing roles (that are already tightly instructed and have their internal risk limits), the RTS should include staff taking the decisions on risk limits (and these roles are already included).

As a minimum, the threshold of 0.25% ECT1 should be calibrated differently, depending on the size of the credit institution. This criterion is particularly relevant when very small banks are concerned. By consequence, the rule would lead to the identification of staff members with rather limited income, which neither seems justified In addition, the threshold seems relatively strict in the case of a layered approval structure existing in some credit institutions, where the higher the amount of the credit application is, the more senior the level of decision making and approval is required. In case of a committee structure, it should be clarified that only sitting members, and not deputising members, are concerned.

Finally, the scope seems to be extended by virtue of Art 3.3, to include supporting and advisory functions as well. It is questionable whether these functions are MRT given their limited direct responsibility.

Q4:
a) Is this criterion appropriate to identify risk takers?
b) Are the thresholds set in the criterion appropriate?
c) What would be the number of staff members identified in addition to all other criteria within the RTS?
d) 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?

It is unclear whether this article should be interpreted as referring to employees who could possibly receive variable income exceeding 75% of the fixed component of their remuneration, or employees for whom the variable income has a target level of 75%. In any case, this criterion would be difficult to apply in a situation in which a bonus pool is used, because in that case one cannot define *a priori* how high the variable income can possibly become. It would require analysis of what the theoretical maximum of the bonus pool would be, which seems unrealistic. Given those variables, it is not possible to say exactly what would be the number of staff members identified, in addition to all other criteria within the RTS, however, it seems clear that it could be a rather large and inappropriate group of employees. Most importantly, it could lead to the inclusion of many staff with no impact on the institution's risk profile.

The exoneration possibilities provided for in Art 4 would be extremely difficult and onerous to exercise, because providing an appropriate justification for each staff member would be challenging to say the least. As such, this gateway solution would be in fact impractical.

The cost impact would be rather high also because technical development in current human resources management systems would be required.

Finally, it is not clear how the figures of 75% and EUR 75k have been developed.

Q5:
a) Can the above criterion be easily applied?
b) Would it be more appropriate to use remuneration which potentially could be awarded as a basis for this criterion?
c) What would be the difference in implementation costs if the potentially awarded remuneration would be used as a basis?

The criteria proposed in Art 3.2.b, which provide that employees are identified as MRT if their total gross remuneration levels is equal or grater than the lowest total remuneration awarded to an employee identified as MRT under the qualitative or internal criteria, seem inappropriate. It is not in line with the CRD IV objectives to target the incentives created by variable remuneration to get involved in risk taking behaviour.

Concerning the credit institution's possibility to declare that those persons do not have material impact on risks, it must be re-emphasized that this exoneration would be difficult to exercise. This would be the case, inter alia, because the term of 'risk profile' is extremely difficult to define.

If this criterion was to be maintained, instead of *'the lowest total remuneration'* institutions should do their analysis based on the *median* remuneration of the pay bracket. Otherwise, institutions will have the incentive of increasing the remuneration of one outlier, just to decrease the amount of identified staff.

It would be easier if the definition of *'potentially awarded remuneration'* was used. In that case, the variable income percentages as mentioned in the institution's policy could be used. It would reduce the amount of administrative work and would be easier to explain to employees, if the selection of identified staff would remain rather stable from year to year.

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

Although technically possible to apply, this criterion uses total income as a definition, while the CRD IV underlying rules are aimed at variable income. Therefore, it would make more sense to use a criterion based on the amount of variable, instead of total, remuneration.

In addition, the figure of EUR 500k seems to be chosen at random.

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

Again, the article uses a definition based on total income. Based on the explanations in points 26 and 27 of the annexed impact assessment, the only aim of this article seems to be to identify higher paid employees (which is not in line with the objectives of CRD IV). A criterion based on variable income would seem more appropriate.

Again, the figure of 0,3% seems to be chosen at random.

Our estimate is that the population falling within this category would have been identified according to other criteria anyway.

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

Please refer to our proposal made on page 2 of this paper.

We believe that criterion Art 3(3)(f) is going beyond the limits of article 92(2) of the CRD, since even the (remote) possibility of influencing the risk profile of a bank is sufficient.

This criterion could become particularly relevant when very small banks are concerned. Staff with no impact on the risk profile of the institution, such as for example front office staff responsible for processing applications for consumer credits, could be affected, which would lead to a clearly disproportionate results. In particular, since this criterion is to be applied without any quantitative limitation (e.g. 3(1)(f)) it may lead to arbitrary results.

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?

The main cost drivers are identified.

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?

The main costs would result from the necessary IT changes. The registration tools for the remuneration of Identified Staff would require adjustments. More Identified Staff would lead to an increase in time and costs to process, analyse and communicate all the relevant data relating to the variable income of Identified Staff. However, it is difficult to estimate how large these costs would be.

The costs of changing the current relevant internal processes for identifying staff and additional costs for monitoring and identifying potential additional staff would be also important.

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?

The RTS mention as one of their goals ensuring a level playing field among all member states relating to the identification of MRT. However, because of both the internal analysis and the rigid qualitative and quantitative criteria, the level playing field still seems highly dependent on the interpretation by the national regulators.

ADDITIONAL COMMENT

Concerning the qualitative and quantitative criteria in Art 3.1.j, such employees do not have the responsibility, authorization or remuneration which would justify their classification as MRT. The terms used to describe the relevant staff, such as "material processes" and "material systems", are ambiguous and difficult to apply.

Contact:
Volker Heegemann, Head of Legal Department
+32 (0)2 286 98 48, v.heegemann@eurocoopbanks.coop

Katarzyna Kobylinska-Hilliard, Deputy Head of Department
+32 (0)2 289 68 55, k.kobylinska-hilliard@eurocoopbanks.coop