European Banking Authority

Public hearing on draft RTS on instruments for variable remuneration

3 October 2013 | London

CP on draft RTS on instruments for variable remuneration

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Next steps:

1) Comments can be sent to the EBA via the EBA website by **29 October 2013.**

2) EBA will finalise the draft RTS taking into account comments received and publish the draft RTS including a feedback statement.

3) Draft RTS will be submitted by **31 March 2014** to EU COM for adoption.

Outline of the presentation

Legal basis and mandate to EBA

Consultation Paper on draft RTS on classes of instruments which can be used for the purposes of variable remuneration

> background and rationale of the draft RTS
> classes of instruments
> main requirements of the draft RTS

Legal basis and EBA's mandate

Article 94 (1) (l) of Directive 2013/36/EU [CRD] requires that 'a substantial portion, and in any event at least 50 %, of any variable remuneration shall consist of **a balance of the following**:

(i) shares or equivalent ownership interests ... or share–linked instruments or equivalent non-cash instruments, in case of a non-listed company;

(ii) **where possible**, other instruments within the meaning of **Article [52 (AT1) or 63 (Tier2)]** of Regulation 2013/575/EU or **other instruments** which can be fully converted to Common Equity Tier 1 instruments or written down, that in each case **adequately reflect the credit quality** of the institution as a **going concern** and are **appropriate to be used for the purposes of variable remuneration.**

Art 94 (2) of the [CRD] mandates EBA to develop 'draft regulatory technical standards with respect to **specifying the classes of instruments that satisfy the conditions laid down in point (l)(ii)** of paragraph 1 ...'and submit it to the EU COM by **31 March 2014.**

Background and rationale of the draft RTS

- Classes of instruments should be used in remuneration policies to align the interests of staff with those of shareholders, creditors and other stakeholders over the long-term and without encouraging excessive risk taking.
- Under CRD III nearly all institutions rely solely on shares and share linked instruments (or equivalent instruments)
- Additional Tier 1 instruments so far not used
- The legislator broadened the scope of instruments (AT1, Tier 2 and other instruments)
- EBA's mandate refers to requirements for AT1, Tier 2 and other instruments
- Institutions should use such instruments if possible

Background and Rationale of the draft RTS

The draft RTS sets the requirements to ensure that instruments

- reflect the credit quality of the institution
- are fully written down or converted if trigger events occur
- are suitable for variable remuneration
- do not lead to a circumvention of remuneration requirements

The use or creation of instruments should not be too burdensome

- use of existing instruments
- consistence with provisions for own funds instruments

Classes of instruments

Additional Tier 1 instruments and Tier 2 instruments

> Need to fulfil all the existing CRR provisions regarding AT1/Tier 2 instruments

> Instruments can be issued in a group context

> Additional conditions apply only if instrument is used for variable remuneration

Other instruments

> Not defined within the CRD

> Interpretation in a broad sense – financial instruments, including synthetic instruments

> Instruments can be issued in a group context if there is a reasonable link between the credit quality of the issuer and the user of the instrument

> Synthetic instruments linked to AT 1 or Tier 2 instruments or equivalent instruments issued by a third country parent institution can be used for remuneration purposes – advantage: no need of new issuances, but trigger must refer to the institution using the instrument

Main requirements of the draft RTS

Trigger events at going concern conditions

- >AT1 instruments:
  - 7% CET 1 → write down or conversion according to CRR
- >Tier 2 instruments:
  - 8.5% of Tier1 capital → 50 % write down;
  - 8 % of Tier1 capital → full write down
- >Other instruments:
  - 10.5% of Total Capital → 50 % write down or conversion (rate or range of conversion to be defined ex ante);
  - 10% of Total Capital → full write down if not already converted
- >Should a common threshold be considered (e.g. 7% CET1)?
- >RTS sets out write down and write up mechanism (Tier 2) and write down and conversion mechanism (Other instruments) in line with the mechanisms for AT 1 instruments (RTS on own funds)

Main requirements of the draft RTS

Instruments should be issued at market conditions

- either private or public issuances – 60 % placed with other investors
- or cap on distributions – 6 percentage points above average EU inflation rate

Instruments should accommodate deferral and retention periods

- have a sufficient long maturity if not permanent
- provisions to ensure that deferral arrangements are respected if deferred instruments are called, redeemed, repurchased or converted

Main requirements of the draft RTS

- >Instruments should not be subject to any guarantee which enhances the seniority of the claim
- >Instruments should not facilitate a faster pay out of deferred remuneration
- >Conversion should not lead to an increase of the remuneration awarded
- >Distributions must be paid out at least annually (for deferred instruments no distribution should be paid before the instruments vest)
- >Instrument should be valued according to the applicable accounting standard when awarded / converted