Consultation Response

Draft EBA Guidelines on Sound Remuneration Policies

29 January 2021

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the **DRAFT EBA GUIDELINES ON SOUND REMUNERATION POLICIES** ("the Guidelines"). AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

We summarise below our high-level response to the consultation, which is followed by answers to the individual questions raised.

Executive Summary

We welcome the opportunity to respond to the changes to these Guidelines and recognise the EBA's work in updating them to reflect the changes to CRD V[1] requirements. We have provided detailed comments below, but note a few key points:

- The Guidelines should apply to the first full performance year following their finalisation (which for most firms will be from 1 January 2022);
- There are provisions in the Guidelines which appear to conflate the responsibilities of the Remuneration Committee with the broader Human Resources function and we suggest that the latter should be separately documented;
- There are some instances in the revised drafting that appear to place inadvertent restrictions on remuneration practices, for example in relation to currency conversions; and
- There are areas of the Guidelines where interaction with existing national legislation could be clarified to avoid any risk of conflict or overlapping obligations.

[1] Directive (EU) 2019/878

Association for Financial Markets in Europe
London Office: 39th Floor, 25 Canada Square, London E14 5LQ, United Kingdom T: +44 (0)20 3828 2700
Brussels Office: Rue de la Loi 82, 1040 Brussels, Belgium T: +32 (0)2 788 3971
Frankfurt Office: Bürohaus an der Alten Oper, Neue Mainzer Straße 75, 60311 Frankfurt am Main, Germany
T: +49 (0)69 153 258 967
www.afme.eu

Company Registration No: 6996678 Registered Office: 39th Floor, 25 Canada Square, London E14 5LQ
AFME is registered on the EU Transparency Register, registration number 65110063986-76

Questions

Question 1: Are the amendments to the subject matter, scope and definitions appropriate and sufficiently clear?

First, we request confirmation that the new Guidelines will apply to the first full performance year following their finalisation (which for most firms will be from 1 January 2022). This will allow sufficient time for National Competent Authority (NCA) adoption and firms' implementation. For instance, we note that elements such as those required under the new paragraphs 26 and 27 will require significant work to complete. as Application from 2022 would also avoid the complexity of applying two sets of guidelines across a single performance year.

We note that the definition of 'Gender neutral remuneration policy' given in these Guidelines differs from that used in CRD V, which is given in Article 1(2)(a) as *"a remuneration policy based on equal pay for male and female workers for equal work or work of equal value"*. We suggest that a consistent definition is used.

The definition of "Gender pay gap' is given as "*means the difference between the average gross hourly earnings of men and women expressed as a percentage of the average gross hourly earnings of men"*. However, gross hourly earnings is not a concept that is used elsewhere in the Guidelines. For consistency, we suggest that this definition is amended to refer to gross annual remuneration calculated on a Full Time Equivalent (FTE) basis.

We would also like to raise the following points which are not covered by the remaining consultation questions:

We are concerned that, in the revised paragraph 101, the reference to the three-month threshold for identification of Material Risk Takers (MRTs) has been removed. Identification of an individual as an MRT when they have been in the role for less than three months of a performance year may disincentivise individuals from taking on such a role, for example towards the end of a performance year. Additionally, in practice, the first couple of months of a new role are often also a period of adjustment, in which individuals may not yet have taken on full decision-making responsibility within the role. Those leaving a MRT role might also be affected, for example where there are handover periods or gardening leave. We request that this language is reinstated. This would also remove the risk of divergent approaches between Member States.

Section 5.1 (paragraphs 106-109) has been renamed to remove the reference to notifications. Now that the section only covers prior approval of exclusions, it would be helpful to reconfirm that it only applies to individuals referred to in Article 7(2) of the EBA draft regulatory technical standards on criteria to define managerial responsibility and control functions, a material business unit and a significant impact on its risk profile, and categories of staff whose professional activities have a material impact on an institution's risk profile ("draft MRTS RTS").

The revised paragraph 258 states that *"For members of the management body and senior management institutions that do not benefit from the waiver within Article 94(3) of Directive 2013/36/EU should defer a significant higher portion than 50% of the variable remuneration paid in instruments"*. We understand that this actually relates to the percentage of variable remuneration that is paid in instruments, rather than the percentage of variable remuneration that is deferred. We therefore suggest the following drafting to make this clearer *"For members of the management body and senior management, institutions that do not benefit from the waiver within Article 94(3) of Directive 2013/36/EU should ensure that ~~defer~~ a significantly higher portion than 50% of the deferred variable remuneration is paid in instruments"*.

Similarly, the revised paragraph 259 appears to refer to a deferral period when it should refer to a proportion of remuneration. We suggest that it should be revised as follows *"Institutions should set an appropriate portion of remuneration that should be deferred for a category of identified staff or a single identified staff member at or above the minimum proportion of 40%. In case of particularly high amounts*

of variable remuneration the ~~deferral period~~ portion of remuneration that should be deferred for such staff members should be ~~of~~ at least 60%."

We request that the addition to the new paragraph 260 which refers to *"ratio of the variable to fixed remuneration of that staff member"* is removed. Paragraph 260 should focus on the level of total remuneration in order to determine what would constitute a particularly high amount of variable remuneration; the ratio between the fixed and variable components is not relevant to this consideration.

The revised paragraph 293 states that *"Where malus can only be applied at the moment of vesting of the deferred payment, institutions may choose, where possible, to apply clawback after paying out or vesting of the variable remuneration. The application of malus may not be possible where the derogation under Article 94(3) of Directive 2013/36/EU applies as the requirement to defer variable remuneration is not applied; institutions should ensure that clawback can be applied"*. We note that the application of clawback varies between Member States, particularly in relation to the requirement that clawback should apply during a period that matches the deferral and retention period. In some applications, where the rules on instruments and deferral can be disapplied, the clawback period is effectively set at zero, as there is no regulatory deferral or retention period. We request that the wording of the revised paragraph 293 is amended to take this situation into account to avoid it inadvertently placing a new interpretation on the clawback rules.

Question 2: the amendments regarding gender neutral remuneration policies sufficiently clear?

AFME and its members strongly support efforts to promote gender-neutral remuneration policies and to reduce the gender pay gap.

However, we are concerned that, as drafted, this section includes requirements that differ from existing practice in some Member States. For example, some Member States have provisions regarding collective bargaining agreements and long-established practice about what positions are considered equal or of equal value. Depending on the Member State, these apply to the whole job market or are specific to the financial sector. We note CRD IV[2] recital 69 that *"Remuneration should be without prejudice to the full exercise of fundamental rights guaranteed by Article 153(5) TFEU, general principles of national contract and labour law… and the rights, where applicable, of the social partners to conclude and enforce collective agreements, in accordance with national law and customs."* We request that the EBA clarify that national practice or collective bargaining agreements based on the TFEU should take precedence over the Guidelines. For instance, if national practice concludes that the work is of equal value but the longer list of criteria introduced by the EBA concludes that the work is not of equal value, the former prevails.

This section also now includes aspects which would not fall within the remit of a firm's remuneration policy or Remuneration Committee. For instance in paragraph 23 *"career development and succession plans, access to training and ability to apply for internal vacancies"* or paragraph 26 that requires firms to *"document job descriptions for all their staff members and determine which positions are considered as equal or of equal value per unit of measurement or time rate, taking into account at least the type of activities, tasks and responsibilities assigned to the position or staff member"*. We believe that these are broader Human Resources (HR) requirements on gender equality, of which remuneration policies should be considered only as a subset. Any broader gender equality requirements should be separately consulted on and documented.

Furthermore, if the provisions which go beyond Remuneration Committee responsibilities are to be retained, we suggest that they are revised to ensure that they refer to well understood concepts without the requirement for overly granular details. For example paragraph 23 "*all related employment conditions that have an impact on the pay per unit of measurement or time rate*" is not precisely understood, beyond the examples then given. On the other hand, the example cited from paragraph 26 is extremely granular in nature. It should be sufficient to state that firms should be required to *"monitor that gender neutral*

[2] Directive 2013/36/EU

remuneration policies are applied" without mandating the exact methods of the monitoring. This would allow firms to focus on achieving the outcome in the most appropriate manner and using their existing internal audit procedures. The same paragraph also refers to "job descriptions", whereas we would suggest that "categories of job positions" would be more proportionate to further reduce unnecessary reporting burdens.

In relation to paragraph 25, we suggest that *"gross annual remuneration calculated on a Full Time Equivalent (FTE) basis"* would be a better measure than the reference to *"working time arrangements"*. This would also fit with our comments on the definition of 'gender pay gap' under Question 1 above.

In relation to the aspects to be considered in determining the value of work under paragraph 27, we suggest that *"the specific skills or competences of staff"* is added. We also suggest that the final aspect is expanded to include allowances for expatriates, as, while expatriate allowance policies should be gender neutral, the allowances may create distortions when making comparisons with local staff.

The addition made to paragraph 46c appears to be missing a word as follows *"how it is ensured that the remuneration policy is gender neutral and that equal opportunities for all genders exist"*. However, as noted above in relation to paragraphs 23-26, equal opportunity policy is a general HR responsibility beyond the remuneration remit and should not be included here.

We suggest that the requirements currently set out in the revised paragraph 63 should be split into two separate paragraphs, covering (i) independent internal review of remuneration policy and practices and (ii) the steps that should be taken if material differences between the average pay between male and female staff or male and female members of the management body are found. The latter should not be the responsibility of the internal audit function, which would be clearer if the two parts are separated.

Paragraph 63 also requires firms to review the gender-neutrality of their remuneration policies on a country-by-country basis, according to specific criteria. We note that, in many Member States, firms are already subject to national requirements on gender-neutral pay reporting, such as the German "General Act on Equal Treatment ("Allgemeines Gleichbehandlungsgesetz")[3] and the "Transparency in Wage Structures Act" ("Entgelttransparenzgesetz") [4]. While we understand that the EBA considers that such existing rules should have been taken into account by lawmakers at the Level 1 stage, we note that the EBA's mandate under Article 74 of CRD V *to "issue guidelines, in accordance with Article 16 of Regulation (EU) No 1093/2010, on gender neutral remuneration policies for institutions"* does not preclude the EBA from taking into account national requirements on gender-neutral remuneration policies when issuing guidelines on this topic. It would not be proportionate to require duplication of requirements and we therefore request that, where such reporting is already required by national law, this may be considered sufficient for compliance with this provision.

If the EBA maintains this additional reporting, we request that a proportionality threshold is set in relation to the number of employees an entity should have to be within the scope. For example 1000 employees (this is already the minimum number of staff used for the calculation of the 0.3% ratio at the individual level in the draft MRT RTS) and a minimum number of men and women per same category of work (e.g. 10 men and 10 women minimum for each category) in order to be able to make a relevant analysis on potential gender bias. We also note that the understanding of *"material differences"* will naturally vary between firms.

We also suggest, as with paragraph 46c above, equal opportunity policy is a general HR responsibility beyond the remuneration remit and should not be included here.

[3] https://www.gesetze-im-internet.de/englisch_agg/

[4] Entgelttransparenzgesetz" http://www.gesetze-im-internet.de/englisch_entgtranspg/

Question 3: Are the guidelines on the application of the requirements in a group context sufficiently clear?

AFME has no comments in response to this question, but we note our comment on paragraph 8c under Question 1 above.

Question 4: Are the guidelines regarding the application of waivers within section 4 sufficiently clear?

As an overall comment on section 4, we suggest that it would be clearer to split out institutional from individual proportionality. This would make it easier to identify the provisions applicable to proportionality at an individual level.

The new paragraph 94 states that *"Where the remuneration is paid in a currency other than EUR, the amounts should be converted in EUR, using the exchange rate published by the Commission for financial programming and the budget for the last month of the institutions financial year"*. We believe that the specification of a single rate unnecessarily restricts firms, as currently they do not generally use the Commission's rate for this purpose. In order to provide continuity with existing practice and with the rates used by firms for other remuneration calculations, as well as to avoid unnecessary confusion in communicating the remuneration policy to employees, we suggest that the provision should instead mirror the optionality given in the revised paragraph 100 *"When applying quantitative criteria that are defined in EUR, institutions which award remuneration in a currency other than the euro should convert the applicable thresholds using either the internal exchange rate used for the consolidation of the accounts or the exchange rate used by the Commission for financial programming and the budget for the month where the remuneration was awarded. or the exchange rate for the last month of the institutions financial year. The institution should document the applicable method to determine the exchange rate in their remuneration policy"*.

Furthermore, paragraph 94 makes reference to *"remuneration awarded for the preceding performance year"*. However, to align with current practice in many Member States, and with the de minimis thresholds used to apply deferrals to the variable remuneration of MRTs, we suggest that this paragraph should give firms the option to reference the relevant performance year instead. An individual's remuneration may vary significantly from one year to the next, so, unless there is an existing national requirement to notify an individual of their MRT status at the start of a performance year, only reference to the current performance year will ensure that the calculation is made correctly. For example, when determining de minimis for the current performance year (2021), the remuneration awarded in respect of 2021 should be taken into account, not the remuneration awarded in respect of 2020.

Question 5: Is the section 8.4 on retention bonuses sufficiently clear?

The new paragraph 145 states that *"No pro rata awards should be made during the retention period"*. However, there are situations in which the individual is responsible for a project of significant size or importance, where phased retention bonus awards tied to intermediate milestones (with the proportional awards set out clearly at the start of the retention period) would be more appropriate than a single award at the end of the retention period. We request that the EBA considers whether there could be some flexibility on this point.

Question 6: Is the amended section 9 on severance payments sufficiently clear?

We suggest an amendment to paragraph 165b as follows: *"remuneration awarded for a limited time period that is agreed to introduce a cooling-off period after the contractual notice period and subject to a non-competition clause ~~in the contract~~"*. Non-competition clauses may be negotiated as part of an employment contract or at the point of termination and we request that this flexibility is not restricted.

We are concerned that the amended paragraph 165e now only covers *"settlement in case of an actual labour dispute that could potentially lead to a court ruling",* rather than also potential labour disputes.

While we understand that there may be a concern about the broad interpretation of 'potential', in practice, situations arise in which there is intention on the part of the employee to raise a labour dispute, but this is resolved before litigation. Severance pay in such circumstances would now have to be treated as part of variable remuneration, which would be a disincentive for early resolution. The removal of 'potential' would also further limit the application of paragraph 170 (which would exacerbate our concerns about the limitations of the new drafting of 170 as set out below). We therefore request that the reference to *"potential"* labour disputes is reinstated.

Under the revised paragraph 170, the restrictions on the situations in which severance pay may be considered as separate from variable remuneration raise concerns as (i) this may result in a cap on the amount of the severance pay, which is detrimental to the indemnity of prejudice which must be sufficient in order to secure such agreements, and (ii) it may result in introducing a fluctuation in the value of the indemnity according to the evolution of the share price, which is likely to contradict to labour laws in some Member States. The prejudice is usually assessed by taking into account factors such as the economic and family situation of the employee, the circumstances of the early termination, the likelihood of the employee finding another job. In this, we request that the wording of the previous Article 154 is maintained, otherwise it may not be possible to apply transactional agreements to regulated staff, which would remove the possibility of avoiding a court case via this means.

We are concerned about the combination of the option for competent authorities to impose a notification requirement under paragraph 171 with the assessment power given to competent authorities under paragraph 173(a) which would be counter to general focus on conciliation and early resolution of disputes in Member States.

- First, we note that the assessment power would essentially impose an approval process, which would have the potential to significantly delay the agreement of the severance pay which would negatively impact party relations, increase the number of court claims to preserve rights and increase settlement/negotiation expense for the firm.
- Second, if the competent authority exercises its power under paragraph 173(a) and the severance pay is taken into account in the bonus cap calculation, this can result in the severance pay being reduced by the 100/200% cap. If an individual had received annual variable up to the maximum cap and the competent authority were to challenge the severance pay, the result would be that the institution could not pay any severance pay. This would have a direct negative impact on the employee, which would restrict a firm's ability to negotiate fair and reasonable settlement. This would significantly increase future risk of negative party relations and therefore higher likelihood of litigation and settlement cost, even though the competent authority's criticism is towards the institution on the basis of its pre-defined generic formula (para 170(b)). It must be noted that severance pay is to meet a statutory obligations, compensate for loss of office or to settle a dispute and is not related to performance, in consideration of the labour law requirements of each Member State to fairly dismiss.
- Finally, there is a possibility that the individual could then successfully challenge the decision through the courts, on the basis that the individual is being affected for a competent authority's judgement on the policies of the institution. It would therefore be more appropriate for competent authorities to focus their supervisory work on reviewing the internal policies of institutions on severance pay and addressing any deficiencies directly with the institution.

In addition, what constitutes a 'material' payment under paragraph 171 is likely to cause challenges. Competent authorities may supervise institutions with subsidiaries and branches in several locations across the world. How severance pay is determined is based on a range of factors such as national employment law, established practice and collective bargaining agreements. It is likely that these authorities will not have the necessary expertise to determine what constitutes a material severance pay in all applicable jurisdictions. On the other hand, this also means that a centrally-set materiality threshold

would also be inappropriate. We therefore request that the EBA reconsiders this option for competent authorities to require notification.

In paragraph 172, the EBA provides that *"where national legislation limit the length of non-competition clauses, any payment made beyond those time limits cannot be considered as a 'settlement made for a non-competition clause and therefore cannot be excluded from the ratio of variable to fixed"*. We would like to request clarity on the rationale for adding this sentence: if national legislation prohibits non-competition clauses exceeding a specific period of time, firms are not able to exceed that period.

Finally, for clarity it would be helpful if the discussion in paragraph 172 of the treatment of amounts paid in respect of non-competition clauses could be linked back to paragraph 170(b)(ii) specifically. We suggest this could be achieved as follows: *"Only those amounts of the settlement specifically identified in the contract as a compensation for the non-competition clause would comply with paragraph 170(b)(ii). Where national legislation limit the length of non-competition clauses, any payment made beyond those time limits cannot be considered as a "settlement made for a non-competition clause" and therefore cannot be excluded from the ratio of variable to fixed pursuant to paragraph 170(b)(ii)."*

Next steps

AFME welcomes the opportunity to submit comments, and would be pleased to engage further as the regulatory process continues.

AFME Governance

We confirm that AFME has put in place internal arrangements to manage our work in compliance with the conditions set by the EBA on Adam Farkas' appointment as CEO of AFME. As part of these arrangements, Adam Farkas has not been involved in the preparation of this consultation response.

AFME contacts

Richard Middleton, richard.middleton@afme.eu +44 (0)20 3828 2709

Fiona Willis, fiona.willis@afme.eu +44 (0)20 3828 2739