



# THE NEW REGULATORY ENVIRONMENT FOR REMUNERATION POLICIES IN EU INVESTMENT FIRMS: LOOKING INTO 2021 AND BEYOND

## SUMMARY & ANALYSIS PAPER

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## Introduction

The new Investment Firms' Regulatory Prudential Package released by the EU consists of the **Directive 2019/2034** and the **Regulation 2019/2033** (henceforth "Investment Firms Directive" and "Investment Firms Regulation", or IFD/IFR), and discusses **comprehensive prudential and capital, reporting, disclosure and remuneration requirements for EU Investment Firms**, with ramifications into the overall Financial Services industry (banks, credit entities, asset and wealth managers, market operators, insurance companies, etc.).

From the **Remuneration** perspective, there are **significant implications for all in-scope EU investment firms** in terms of **what, how and when to pay** their Board members, Executives, and Employees at large, as well as **governance and administration aspects**.

Even if for the largest groups, or at the other extreme for the smallest companies, it might not be fully applicable, the package represents a **new prudential framework for all firms under MIFID 2** (EU Directive 2014/65), and changes MIFID 2 itself, CRD IV, AIFMD and others. Following mandates both in IFD and IFR, and also the new "CRD V" (Directive

2019/878), the European Banking Authority (EBA) has just outlined an **implementation roadmap**, and launched consultations on the **regulatory technical standards' set to be compulsory for investment firms** affected (“Regulatory and Implementation Technical Standards” – RTS / ITS). Commentaries will be accepted until Sept. 4<sup>th</sup>, 2020.

When developing these RTS and ITS, the EBA has considered the **proportionality principle** to allow specificities of the different classes of investment firms. After consultations and adoption by the countries, it is assumed that investment firms will have to comply both with the **Prudential Package and the final Technical standards** as pertain to **Remunerations awarded for the performance year 2021 and beyond**.

Both standalone investment firms and/or divisions within larger Financial Services entities will have to **determine applicability, analyse impact and possibly modify Remuneration** schemes, processes, documents, and tools to be compliant. Remuneration strategies and packages may need to be modified as well.

With an **aim to provide sound information for investment firms' decision making as regards Remuneration**, we hereinunder provide 1) an overview on Regulatory Antecedents, 2) a Summary of the new Regulatory Prudential Package, and 3) some Conclusions. In addition, we offer a structured New Regulatory Remuneration Provisions' Detailed Compilation Annexe for further convenient practitioner's reference.

## Regulatory antecedent

Vis-a-vis Remuneration and among some additional country-specific legal rules, the following is being currently applied overall to **EU credit entities**:

TYPE OF REGULATION	LEGAL RULE	Content
PRUDENTIAL	<ul style="list-style-type: none"> <li>✓ CRD IV (Directive 2013/36)</li> <li>✓ Regulation 2013/575</li> <li>✓ EBA Guidelines 2015/22 on “sound Remuneration”, and others (benchmarking, high earners, etc.)</li> </ul>	<ul style="list-style-type: none"> <li>✓ Remuneration conditions overall</li> <li>✓ Remuneration governance and disclosure</li> <li>✓ Adequate Remuneration policies</li> <li>✓ Deferrals and pay with instruments</li> <li>✓ Bonus caps and adjustments</li> <li>✓ Periodic independent review</li> </ul>
	<ul style="list-style-type: none"> <li>✓ Delegated Regulation 2014/604 (to be repealed by a new RTS as at end of 2020)</li> </ul>	<ul style="list-style-type: none"> <li>✓ “Identified staff” (material risk takers' definition)</li> </ul>

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TYPE OF REGULATION	LEGAL RULE	Content
<b>PRUDENTIAL (cont.)</b>	✓ Delegated Regulation 2014/527	✓ Instruments reflecting entity's credit quality; other Remuneration details
	✓ New CRD V - Directive 2019/878 (changes parts of CRD IV)	✓ Remuneration specifics – reintroduces proportionality of regulation and gender equality, modifies certain points (identified collective, bonus deferrals, etc.)
<b>CONDUCT</b>	✓ MIFID 2 (Directive 2014/65) ✓ Delegated Directive 2017/593 ✓ MIFIR - Delegated Regulation 2017/565	✓ Good financial product governance and financial product lifecycle ✓ Organizational requirements, internal processes ✓ Remuneration aspects and incentives
	✓ ESMA Guidelines 35-43-620 (2018)	✓ Specifics on Remuneration practices and policies
	✓ EBA Guidelines 2016/06	✓ Remuneration/incentives and commercial sale of products and services to customers

On their side, regarding “management companies of undertakings for collective investment in transferable securities” (**investment service companies** including credit entities’ divisions and securities’ fund managers), the Directive 2014/91 (“UCITS V”) and the ESMA Guidelines 2016/575 and 2016/411 have been applicable so far.

As regards **alternative investment managers**, the Directive 2011/61 (“AIFMD”) and the ESMA Guidelines 2013/232, 2016/579 and 2016/411 have had a similar role. **Insurance companies** are subject to Solvency II (Directive 2009/138) and **Occupational pension fund managers**, to the Directive 2016/2341, among other rules.

## Summary of the new regulation for Remuneration

Even if several provisions released within the new Prudential Package and draft Technical standards recently released have similarities with the legal rules above, **the new regulations are more specialized, detailed, and fitter to investment firms than before.**



CHANGES BY THE NEW REGULATION	Where (art.)	Explanation
<p><b>Large firms' exemptions</b> (proportionality)</p> <p><b>More precision in scope of the norms</b></p>	1 IFR	<ul style="list-style-type: none"> <li>✓ Overall application of rules to all MIFID 2 firms</li> <li>✓ Exemption, and related continuity into general CRD IV-V and Reg. 575/2013 (but not Del. Reg. 2014/604), for:               <ul style="list-style-type: none"> <li>○ Investment firms considered 'systemic'</li> <li>○ Firms of certain large size and activity type</li> <li>○ Some firms in credit entities/holdings' consolidation, with conditions and as allowed by competent authority</li> </ul> </li> </ul>
<p><b>"Small, non-inter-connected firms" – small firms' exemptions</b> (proportionality)</p>	25 IFD 12 IFR	<ul style="list-style-type: none"> <li>✓ Assets under Management &lt; EUR 1.2 billion</li> <li>✓ Client Orders Handled &lt; EUR 100 M. for cash trades/day, or EUR 1 billion/day in derivatives</li> <li>✓ On- and off-balance assets &lt; EUR 100 mill</li> <li>✓ Total annual gross revenue &lt; EUR 30 mill.</li> <li>✓ No realization of certain activities</li> </ul>
<p><b>Remuneration content modifications</b></p> <p>(gender equality caps, deferrals and retentions, more disclosure detail)</p>	30 and 32 IFD 51 IFR	<ul style="list-style-type: none"> <li>✓ Remuneration = gender-neutral</li> <li>✓ Annual central and independent internal review</li> <li>✓ Control functions with separate Remuneration themselves</li> <li>✓ Bonus % is public but <u>there is no 100%/200% cap</u></li> <li>✓ Performance for variable pay pools will consider risks, cost of capital and liquidity</li> <li>✓ Deferral 40%-60% 3-5 years + 'appropriate retention'</li> <li>✓ Discretionary pensions in form of instruments for 5 years</li> <li>✓ More detailed Remuneration package disclosure</li> </ul>
<p><b>Specific exclusions to Remuneration provisions</b> (proportionality)</p>	32 IFD	<ul style="list-style-type: none"> <li>✓ On and off-balance sheet assets &lt; EUR 100 million in the previous 4 years; OR</li> <li>✓ Individuals &lt; EUR 50,000 and does not represent more than ¼ of that individual's total remuneration</li> <li>✓ Member states can change these limits up- or downwards with certain conditions</li> </ul>
<p><b>"Material risk takers" / "identified staff"</b></p> <p>Concepts</p>	1 to 4 RTS 20/05	<ul style="list-style-type: none"> <li>✓ COMPULSORY APPLICATION OF DEFINITIONS EVEN TO LARGE ENTITIES - repeals/derogates Delegated Regulation 2014/604 (very similar contents, though)</li> <li>✓ Clarification of application at individual and consolidated levels, and of "managerial responsibility", "control function" and "material business unit" meaning</li> </ul>
<p><b>"Material risk takers" / "identified staff"</b></p> <p>Quali- and quantitative criteria</p>	5 to 7 RTS 20/05	<ul style="list-style-type: none"> <li>✓ They may be NOT enough to identify staff's material business unit risk impact – evaluation required</li> <li>✓ 'Qualitative' adds: money laundering and terrorist financing; remuneration policy; information tech AND security; managing outsourcing of critical functions</li> </ul>

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CHANGES BY THE NEW REGULATION	Where (art.)	Explanation
<b>Greater detail as regards types of instruments valid for Remuneration</b>	<b>1 to 5 RTS CP 20/08</b>	<ul style="list-style-type: none"> <li>✓ Classes and requirements (art. 1):               <ul style="list-style-type: none"> <li>○ AT 1, T 2, Other (high detail in arts. 2 to 4)</li> <li>○ No seniority enhancing, no undue value increase, fair accounting/valuation, distributions OK (art. 1.2)</li> </ul> </li> <li>✓ Conversions, write-up and down conditions – art. 5</li> </ul>
<b>Requirements for valid Remuneration “alternative arrangements”</b>	<b>6 RTS CP 20/08</b>	<ul style="list-style-type: none"> <li>✓ Compliance with several requirements – Remuneration composition, risk profiles, credit quality, deferrals, malus and clawback, etc.</li> <li>✓ Permission by competent authorities</li> </ul>

## Conclusions – looking into 2021 and beyond

The new Regulatory Prudential Package tries to capitalize on the extensive EU regulations’ last decade’s real-world experience concerning Financial Services Remuneration. Introduction of more proportionality to the norms as per company size and impact is welcome news, as well as concepts’ clarification and scope of applicability. However, firms will need to review such applicability, and perhaps Remuneration contents and processes. Looking into 2021 and beyond, whilst compliant, Remuneration will have to technically ensure that industry challenges are seriously addressed and embedded – technology, new competitors, post-Covid world, low interest rates, etc. –, plus the specific firm’s business and risk plans, and talent ‘attract/retain/engage’ needs.

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For more detailed information, please check the Annexe below. For more information on this paper and Zereon Associates’s Remuneration and overall advisory services:

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## **ANNEXE: New Regulatory Remuneration Provisions’ Detailed Compilation**

This Annexe compiles the new regulations as refer to Investment Firms’ Remuneration in more detail by discussing:

- Applicability of the new Directive (“IFD”), Regulation (“IFR”) and the proposed EBA Technical Standards.
- Definition of “small and non-interconnected” investment firms in the IFR (art. 12).
- Remuneration policies in the IFD - principles (art. 30).
- Variable Remuneration in the IFD - requirements (art. 32.1, 2. and 3.) and Remuneration exceptions (art. 32.4 to 32.7).
- Other IFD Remuneration provisions.
- Remuneration policies in the IFR - disclosure (art. 51).
- Proposed EBA Technical standards on Remuneration (“RTS/ITS”) - context, “identified staff” qualitative and quantitative criteria, allowed variable pay instruments and alternative arrangements.

### **Applicability of the new Directive (“IFD”), Regulation (“IFR”) and the proposed EBA Technical Standards (“RTS”)**

The new Investment Firms’ regulatory Package is **applicable to all MIFID 2-authorized investment firms, with some exemptions and exceptions**. Remuneration provisions within the IFD are in articles 25 and 26 (general scope and governance), and articles 30 to 34 included (provisions themselves). IFR Remuneration provisions are in its art. 51.

As regards **the regulatory Prudential Package scope of application**, including the RTS, it can be found manly in the IFR (art. 1, and Recitals / “Whereas” 2-12):

- **Most investment firms are subject to the new Package**, as the risks faced and posed by are different to the ones at credit institutions. A specific prudential regime is therefore required if they are not systemic.
- **However, systemic investment firms** by virtue of size and interconnectedness with other financial and economic actors **are excluded and thus will remain into the existing general prudential framework** under Regulation 575/2013 and Directives 2013/36 - 2019/878 (CRD IV-V), and related rules and EBA guidelines.
- **Other investment firms** which deal on own account, underwrite financial instruments or place them on a commitment basis, or which are clearing members in central counterparties, **can be excluded, and remain into the existing general prudential CRD IV-V framework, if so decided by competent national authorities** (ie local central banks and equivalents).

**A firm will also be excluded and remain into the existing general prudential CRD IV-V framework if** (art. 1.2 IFR), not being a commodity and emission allowance dealer, or a collective investment or insurance undertaking, **ANY of the following applies:**

- a) Total average last 12-months value of assets is  $\geq$  EUR 15 billion, excluding subsidiaries outside the EU; or
- b) Total value is  $\leq$  EUR 15 billion and the investment firm is part of a group in which the total consolidated value of all undertakings is  $\geq$  EUR 15 billion; or
- c) a competent authority so decides if, with assets  $\geq$  EUR 5 billion, there is systemic risk, firm is a clearing member, or size, nature, scale and complexity warrants it.

Likewise, **competent authorities may allow** an investment firm **to be excluded and remain into the existing general prudential CRD IV-V framework** (art. 1.5 IFR) where **ALL the following** conditions are fulfilled:

- a) the firm is a subsidiary included in the consolidated basis of a credit institution, financial holding company or mixed financial holding company; and
- b) the investment firm notifies the competent authority; and
- c) the application of the own funds requirements of Regulation (EU) No 575/2013 on an individual basis to the firm and on a consolidated basis to the group, is prudentially sound, does not result in a reduction of the own funds, and is not undertaken for the purposes of regulatory arbitrage.

Finally, article 25 of the IFD comments on **an additional specific exemption:** investment firms which are **“small and non-interconnected” will not need to fulfil the Remuneration requirements of the IFD and IFR** (again, application of the **“proportionality principle”**). The conditions of such qualification and other exceptions regarding Remuneration that exist can be found in the IFD and IFR Sections below.

## Definition of “small and non-interconnected” investment firm in the IFR (art. 12)

Investment firms shall be deemed “small and non-interconnected”, and thus **exempt** from IFD / IFR / RTS Remuneration requirements, if **meeting ALL of the following:**

INDICATOR			Art. IFR	Limit
a)	AUM	Assets under Management	17	< EUR 1,2 billion
b)	COH	Client Orders Handled	20	(i) < EUR 100 M./day for cash trades (ii) < EUR 1 bill./day for derivatives
c)	ASA	Assets Safeguarded and Administered	19	0

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INDICATOR			Art. IFR	Limit
d)	CMH	Client Money Held	18	0
e)	DTF	Daily Trading Flow	33	0
f)	NPR	Net Position Risk, OR	22	0
	CMG	Clearing Member Margin required	23	
g)	TCD	Trading Counterparties Default	26	0
h)	On- and off-balance assets		-	< EUR 100 million
i)	Total annual gross revenue from investment services and activities		-	< EUR 30 million, calculated as an average on the previous two years

End-of-day and intraday calculations, and some other time frame considerations apply. Conditions in points (a), (b), (h) and (i) shall apply on a combined basis for all investment firms that are part of a group. For point (i) double counting can be disregarded. The conditions set out in points (c) to (g) shall apply to each investment firm individually.

## Remuneration policies in the IFD - principles (art. 30)

The Remuneration policies applied to “**material risk takers**” of applicable firms will need to comply with a series of principles. Those “material risk takers” are defined with greater detail in the proposed RTS 2020/05, but in the IFD they are basically mentioned as:

- Senior management, major risk takers, staff engaged in control functions.
- Any employees receiving overall remuneration equal to at least the lowest remuneration received by senior management or major risk takers, with activities materially impacting the risk profile of the firm or assets it manages.

Principles in Remuneration to comply with are the following:

- a) Clearly documented and proportionate to the firm;
- b) gender-neutral;
- c) promotes sound risk management;
- d) in line with business strategy and long term effects of the investments;
- e) seeks avoiding conflicts of interest, responsible conduct, prudent risk taking;
- f) management body in its supervisory function adopts and periodically reviews the policy and oversees implementation;

Other principles are:





- g) implementation subject to a **central and independent internal review** by control functions, at least annually;
- h) **control functions are independent, have authority**, and are remunerated according to their functions, regardless of the performance of areas they control;
- i) senior officers' remuneration in **risk management and compliance** is directly overseen by the **remuneration committee** or equivalent;
- j) the remuneration policy, with national wage rules, clearly differentiates between:
  - i. **basic fixed remuneration**, which primarily reflects relevant professional experience and organisational responsibility;
  - ii. **variable remuneration**, which reflects a sustainable and risk adjusted performance of the employee;
- k) the fixed component represents a high proportion of total remuneration to enable a **flexible variable**, including the **possibility of paying no variable**.

Member States shall ensure that investment firms set the **appropriate ratios** between the **variable and fixed components of total remuneration**, considering the business activities of the investment firm and associated risks. For the entities who had it before, now under the IFD / IFR, **the EU is effectively removing here the 100% variable pay cap (200% with shareholder approval), that was applicable with CRD IV.**

The Principles referred above shall apply in a manner appropriate to the **firm's size and internal organisation** and to the **nature, scope, and complexity of its activities**.

## Variable Remuneration in the IFD - requirements

(art. 32.1, 2. and 3.)

**Variable remuneration** awarded and paid for "**material risk takers**" will satisfy that:

- a) where **variable remuneration** is performance related, it is based on a combination of **individual performance, business unit and overall results**;
- b) when assessing the performance of the individual, both **financial and non-financial criteria** are included;
- c) the assessment of performance referred to in (a) is based on a **multi-year period**, considering business cycle and risks;
- d) the investment firm's ability to ensure a **sound capital base** is not affected;
- e) there is **no guaranteed variable remuneration, with very few exceptions** - only for the first year of new staff and with a strong capital base;
- f) **early termination of an employment contract reflect performance achieved** over time by the individual and shall not reward failure or misconduct;
- g) **buy out from contracts in previous employment are aligned with long-term** interests of the investment firm;

- h) **performance as basis to calculate pools of variable remuneration takes into account all current and future risks and cost of the capital and liquidity requirements in the new Regulation 2019/2033 (IFR);**
- i) allocation of variable remuneration considers all current and **future risks;**

Other demands for material risk takers variable remuneration are that:

- j) **at least 50 % of the variable remuneration consists of instruments** (much greater detail about those is specified in the proposed RTS 2020/08):
  - i. shares or equivalent ownership interests;
  - ii. share-linked or equivalent non-cash instruments;
  - iii. Tier 1 instruments, or Tier 2 instruments which can be fully converted to Common Equity Tier 1, or written down, and that adequately reflect the credit quality of the investment firm;
  - iv. non-cash instruments which reflect the portfolios managed;
- k) where an **investment firm does not issue any of the instruments referred above, competent authorities** (ie local central banks or equivalent) may approve the use of **alternative arrangements** (also discussed in the proposed RTS 2020/08).
- l) **at least 40 % of the variable remuneration is deferred over a three- to five-year period**, depending on the business and activities of the individual; in the case of variable remuneration of a particularly high amount deferral will be at least 60 %;
- m) **up to 100 % of the variable remuneration is “contracted” (ie can be subject to become zero)** where the financial performance is subdued or negative, including through **malus or clawback arrangements** subject to firm criteria which in particular cover situations where the individual:
  - i. participated in or was responsible for **conduct which resulted in significant losses;** or
  - ii. is **no longer considered fit and proper;**
- n) **discretionary pension benefits** are in line with the business strategy, objectives, values, and long-term interests of the firm.

**“Material risk takers” cannot use personal hedging strategies or insurances to undermine the remuneration requirements above, and receive variable pay through financial vehicles or methods that facilitate non-compliance with the IFD and IFR.**

The **deferral** of the variable remuneration **shall vest no faster than on a pro-rata basis.**

Instruments shall be subject to an **“appropriate retention policy” afterwards** designed to align the incentives of the individual with the longer-term interests of the investment firm, its creditors, and clients. Member States or their **competent authorities may place restrictions** on the **types and designs of the instruments** or even **prohibit them.**

Where an employee leaves the firm before retirement age, **discretionary pension benefits shall be held by the firm for a period of five years in the form of instruments.** Where an employee reaches retirement age and retires, pension benefits shall be paid to the employee in the form of instruments, equally subject to a five-year retention period.

## Remuneration in the IFD – exceptions

(art. 32.4 to 32.7)

**Bonus payment with instruments, deferral, remuneration committee supervision, and retention of retirement benefits for 5 years, and related disclosure, will not apply to:**

- a) firms where on and off-balance sheet assets were  $\leq$  EUR 100 million in the previous 4 years; OR
- b) individuals whose annual variable pay does not exceed EUR 50,000 and does not represent more than  $\frac{1}{4}$  of that individual's total remuneration.

**Member States may increase the 100 million asset threshold referred to in a), provided that the investment firm meets ALL the following criteria:**

- a) the investment firm is not in the Member State one of the three largest investment firms in terms of total value of assets; and
- b) is not subject to special obligations of recovery and resolution planning; and
- c) the size of the trading-book business is equal to or less than EUR 150 million; and
- d) the size of the derivative business is equal to or less than EUR 100 million; and
- e) the threshold does not exceed EUR 300 million; and
- f) it is appropriate to increase the threshold, taking into account nature and scope of activities, internal organisation and characteristics of the parent group, if any.

**Member States may also lower the cited 100 million asset threshold** considering the same factors as f) above.

Finally, **Member States can decide to lower the EUR 50,000 /  $\frac{1}{4}$  of total remuneration thresholds**, because of national remuneration market specificities or nature of responsibilities / job profile of the firm's staff members.

## Other IFD Remuneration provisions

- **Governance – clear organization, risk management and controls and sound and gender-neutral Remuneration required** (Article 26). Investment firms will need to have “robust governance arrangements”, including all of the following: (a) a clear organisational structure with well-defined, transparent and consistent lines of responsibility; (b) effective processes to manage risks; (c) adequate internal controls including sound administration and accounting; (d) remuneration policies and



practices that are consistent and promote sound risk management. The remuneration policies and practices will have to be gender neutral.

- **Remuneration Committee** (Article 33). Unless exempt (criteria from art. 32.4 to 32.7), it will need to be established at firm or group level. It shall be gender balanced, composed by non-executives of the firm, and shall exercise independent judgment on remuneration and incentives created for managing risk, capital, and liquidity. It will prepare decisions regarding remuneration, with implications for the risk of the firm to be taken by the management body and shall consider the public interest and long-term interests of shareholders, investors, and other stakeholders.
- **Information for the authorities** (Article 34.4). Investment firms will provide competent authorities with detailed information on the number of natural persons remunerated with EUR 1 million or more per financial year, as well as (upon demand), the total remuneration figures for each member of the management body or senior management.
- **Investment firms that benefit from extraordinary public financial support** (Article 31). No variable pay allowed to members of the “management body” in these cases; limitations as % of net revenues for the rest of employees

## Remuneration policies in the IFR - disclosure (art. 51)

Investment firms shall **disclose every year** the following **information** for their **material risk takers** regarding Remuneration, including aspects related to gender neutrality:

- a) the most important **design characteristics** of the remuneration, including **level of variable remuneration and criteria** for awards, **payout in instruments policy, deferral policy** and **vesting**;
- b) the **ratios between fixed and variable pay**;
- c) aggregated **quantitative information** on remuneration, broken down **by senior management and members of staff with material risk profile**, indicating:
  - i. **amounts** of remuneration awarded, including a **description of the fixed components, and variable, and number of beneficiaries**;
  - ii. amounts and forms of awarded variable remuneration, split into **cash, shares, share-linked and other types separately for part paid upfront and deferred**;
  - iii. amounts of deferred remuneration awarded for **previous performance periods, split into amount due to vest in current year vs. subsequent years**;
  - iv. amount of **deferred remuneration due to vest that is paid out during the financial year, and that is reduced through performance adjustments**;
  - v. **guaranteed variable** remuneration awards during the financial year and the number of beneficiaries of those awards;
  - vi. **severance payments awarded** in previous periods, that have been **paid out during the financial year**;

- vii. amounts of **severance payments awarded during the financial year, split into paid upfront and deferred**, number of beneficiaries and highest payment awarded to a single person;
- d) **information** on whether the investment firm benefits from an **exemption in pay requirements** (“derogation”) laid down in Article 32.4) of the IFD.

For the purposes of point (d) above, **firms shall indicate whether that “derogation” was granted on the basis of point (a) or point (b) of Article 32.4 of the IFD, or both** - ie assets <= EUR 100 million, or individual variable pay < 50,000 and not more than ¼ of total remuneration.

Firms shall also indicate **for which of the remuneration principles they apply the derogation(s)**, the **number of staff members who benefit** and their total remuneration, **split into fixed and variable**.

All of this shall be without prejudice to the provisions of Regulation (EU) 2016/679 (EU Data Protection Directive, GDPR).

## Proposed EBA Technical standards on Remuneration (“RTS”) - context

Taking over the IFD and IFR mandates to develop the corresponding topics, the EBA proposed RTS / ITS cover the following:

- **Prudential requirements** (1st consultation paper):
  - o 3 draft RTS on the reclassification of certain investment firms to credit institutions (there is an effective partial amendment to the definition of ‘credit institution’ within Regulation 575/2013).
  - o 5 draft RTS on capital requirements for investment firms at the ‘solo’ level.
  - o 1 draft RTS on the scope and methods of prudential consolidation for investment firms at group level.
- **Reporting requirements and disclosures** (2nd consultation paper):
  - o 1 draft Implementing Technical Standards (ITS) on the levels of capital, concentration risk, liquidity, and level of activities as well as disclosure of own funds.
  - o 1 draft RTS specifying the information that investment firms must provide to enable the monitoring of thresholds that determine whether an investment firm must apply for authorisation as credit institution.

Then, one additional proposed Standard (final draft submitted to the EU Commission) and one Consultation Paper on **Remuneration** deal with the following, respectively:



- **RTS 2020/05 - Criteria to identify all categories of staff whose professional activities have a material impact on the firm's risk profile or assets it manages** ("material risk takers", also commonly known as "identified staff" or "identified collective"). This changes the criteria of the broader scope Regulation 2014/604.
- **RTS CP 2020/08 - Specification of 1) classes of instruments** that adequately reflect the **credit quality** of the investment firm, and **2) possible alternative arrangements** appropriate for material risk takers' variable remuneration.

## Proposed EBA Technical Standards on Remuneration (RTS 2020/05) – “identified staff” and qualitative criteria

This Regulatory Technical Standard is designed to **identify categories of staff** whose activities have a **material impact** on an investment firm or managed assets **risk profile**, in more detail than the IFD / IFR, and leveraging on the new CRD V. **Criteria have some differences from the prudential Delegated Regulation 2014/604 so far applicable.**

As long as any individual fulfils **one or more of the conditions** (qualitative or quantitative), she or he will be considered “identified staff” or “material risk taker”.

Art. 1. RTS clarifies application of criteria at the individual, sub-consolidated and consolidated levels. Arts. 2, 3, 4 specify the meaning of:

- **Managerial responsibility.** a) heading a BU / control function and reporting to Board / CEO/ C-Suite; b) heading other function (see qualitative criteria); c) for large firms (Regulation 575/2013), heading a subordinated area reporting to a).
- **Control function.** Basically, but not only, Risk, Compliance, and Internal Audit.
- **Material business unit.** Business unit as per art. 142.1.3 of Regulation 575/2013, that a) has allocated internal capital  $\geq 2\%$  of the institution or is otherwise seen to have a material impact on it, or b) is a core business line by Directive 2014/59.

**As the RTS is defined in a way applicable to all firms, it may not identify all effective material risk takers.** Therefore, investment firms may have to apply **additional internal criteria to meet the IFD / IFR requirements.** In this light (art. 5), institutions shall set **objective criteria to identify staff's material business unit risk impact**, considering:

- a) the risk profile of the material business unit and distribution of internal capital to cover the risks as set out in Article 73 of the CRD IV;
- b) the risk limits of the material business unit;
- c) the relevant risk and performance indicators used (art. 74 CRD IV);
- d) the relevant performance criteria set (art. 94.1 CRD IV);
- e) the duties and authorities of staff members or categories of staff.

Members of staff shall be deemed to have **a material impact** on a firm's risk profile or assets it manages if one or more of the following **qualitative criteria** are met (art. 6 RTS):

QUALITATIVE CRITERION / CONDITION	Detail (if applicable)
<p>Initial reference to art. 92.3.a) and b) CRD IV (amended by CRD V):  <b>(a)</b> all members of the <b>management body and senior management</b>; AND  <b>(b)</b> staff members with managerial responsibility over the institution's <b>control functions or material business units</b>; <b>PLUS</b></p>	
<p><b>(1)</b> managerial responsibility (ie heading) for the following <b>functions</b> :</p>	<p><b>a)</b> legal affairs;  <b>b)</b> soundness of accounting policies and procedures;  <b>c)</b> finance, including taxation and budgeting;  <b>d)</b> performing economic analysis;  <b>e)</b> prevention of money laundering and terrorist financing;  <b>f)</b> human resources;  <b>g)</b> prevention of money laundering and terrorist financing;  <b>h)</b> information technology; <b>i)</b> information security;  <b>j)</b> managing outsourcing arrangements of critical or important functions (Delegated Regulation 2917/565)</p>
<p><b>(2)</b> managerial responsibilities for a <b>risk category set out in CRD IV-V</b> or is a voting member of a committee responsible for the management of such a risk category</p>	
<p><b>(3)</b> with regard to <b>credit risk exposures</b> of a nominal amount per transaction representing <b>0.5% of the CET 1 capital AND at least EUR 5 million...</b></p>	<p><b>a)</b> the staff member has the <b>authority to take, approve or veto decisions</b> on such credit risk exposures; OR  <b>b)</b> the staff member is a <b>voting member of a committee</b> which has the authority</p>
<p><b>(4)</b> in relation to an institution to which the derogation for small <b>trading book</b> in Regulation 575/2013 does NOT apply...</p>	<p><b>a)</b> the staff member has the <b>authority to take, approve or veto decisions</b> on transactions with the following thresholds:  <b>a) i).</b> where the standardised approach is used, an own funds requirement that represents <b>0.5% or more of the CET 1 capital</b>;  <b>a) ii).</b> where an internal model-based approach is approved for regulatory purposes, <b>5% or more of the institution's internal value-at-risk limit</b> for trading book exposures at a 99th percentile (one-tailed confidence interval level); OR  <b>b)</b> the staff member is a <b>voting member of a committee</b> that has the authority</p>

(cont.)



(cont.)

QUALITATIVE CRITERION / CONDITION	Detail (if applicable)
(5) the staff member <b>heads a group of staff members who have individual authorities</b> to commit the institution to the transactions above, AND...	<p><b>a)</b> the sum of those authorities equals or exceeds the threshold set out in points 3 (a) or point 4 (a) (i) ; OR</p> <p><b>b)</b> where an internal model-based approach is used, those authorities amount to 5% or more of the internal value-at-risk limit for trading book exposures at a 99th percentile; where the institution does not calculate at the level of that staff member, values of staff supervised shall be added up</p>
(6) with regard to approving or vetoing introduction of <b>new products</b> :	<p><b>(a) authority to take such decisions</b>; OR</p> <p><b>b) voting member of a committee</b> with the authority.</p>

## Proposed EBA Technical Standards on Remuneration (RTS 2020/05) – “identified staff” and quantitative criteria

Staff members shall be deemed to have material impact under the following (art. 7.1 RTS):

QUANTITATIVE CRITERION / CONDITION
Initial reference to art. 92.3.c) CRD IV (amended by CRD V): staff members entitled to significant remuneration in the preceding financial year, provided that the following is met:
(i) the <b>total remuneration is &gt;= EUR 500 000 AND &gt;= average remuneration awarded to the management body and senior management</b> ; AND
(ii) <b>professional activity within a material business unit</b> and has a <b>significant impact on the relevant unit risk profile</b> ; PLUS
(b) awarded <b>total remuneration &gt;= EUR 750 000</b> the previous year;
(c) if firm has <b>over 1,000 members of staff</b> , the staff member is <b>within the 0.3% of staff who have been awarded the highest total remuneration</b> the previous year;
EXCEPTION: However, these criteria shall be <b>waived</b> if the staff member (art. 7.2.) <b>a)</b> only carries out activity and has authority in a <b>non-material business unit</b> (art. 4); OR <b>b)</b> the professional activities have <b>no significant impact on risk profile</b> of a <b>material business unit</b> (art. 5).





For exceptions, **firms need to submit own assessment to the competent authorities.** Staff receiving **EUR 1,000,000 or more** (high earners), will only **be approved in justified, exceedingly rare circumstances** - very infrequent or far beyond usual in magnitude or degree and directly related to the staff member concerned. **Competent authorities will inform the EBA** about any such exclusions before approval.

## Proposed EBA Technical Standards on Remuneration (RTS Consultation Paper 2020/08) – applicable instruments

The Regulatory Technical Standard gives **clarity on classes of instruments** that adequately reflect the **credit quality of the investment firm as a going concern**, and **possible alternative arrangements** for variable Remuneration.

The RTS aims to provide appropriate incentives to be **prudent and long term oriented in risk-taking**. The **link to credit quality** by the draft RTS is established by introducing **uniform minimum trigger events for write-down and conversion of Additional Tier 1, Tier 2 and Other Instruments**, with the intention to **protect the capital base** of the firm and **proper applicability of instruments as variable remuneration**. Art. 5 RTS establishes a detailed number of rules under different scenarios, including write-up possibilities as well.

The classes of variable pay permitted instruments shall fulfil the following (art. 1.2 RTS):

- a) instruments shall **not subject to a guarantee that enhances the seniority** of the claims of the holder;
- b) where an instrument allow for its conversion, that instrument shall only be used for awarding variable remuneration where the conversion is at a level that ensures that the value into which it is converted is **not higher than the value of the instrument initially awarded at the time it was awarded**;
- c) convertible instruments used for the **sole purpose of variable remuneration** shall ensure that the **conversion** value of the new instrument is **not higher than the value of the instrument initially awarded at the time it was converted**;
- d) any **distributions are paid on at least an annual basis** and are paid to the holder of the instrument;
- e) instruments **priced in accordance with accounting standard at the time the instrument is awarded**, AND **valuation shall be subject to independent review**;
- f) instruments issued for the **sole purpose of variable remuneration** shall require a **valuation** to be carried out in accordance with the applicable accounting standard **if the instrument is redeemed, called, repurchased, or converted**.

**The classes of instruments and requirements** that adequately reflect the **credit quality** of an institution and are **appropriate to be used for variable Remuneration** can be found in the art. 1.1 RTS; development and requirements are stated in the next articles:



INSTRUMENTS	Requirements
<b>Additional Tier 1 instruments</b> (art. 2 RTS)	<p>(a) the <b>provisions governing the instrument shall specify a trigger event</b> for the purpose of own funds composition (ref. art. 9.2 e) iii. IFR); AND</p> <p>(b) the trigger event occurs when the <b>Common Equity Tier 1 capital ratio falls below</b> either of the following:</p> <ul style="list-style-type: none"><li>(i) <b>7 % of the product of 12.5 multiplied by the own funds requirements</b> calculated under the IFR; OR</li><li>(ii) <b>a level higher than (i) where determined by the institution</b> and specified in the provisions governing the instrument; AND</li></ul> <p>(c) ONE of the following requirements is met:</p> <ul style="list-style-type: none"><li>(i) instruments are issued for the <b>sole purpose of variable remuneration AND any distributions are paid at a rate 1) consistent with market and 2) which in any case is, at award time, &lt;= 8% above the annual Eurostat average rate of change</b> for the EU Harmonised Consumer Prices. If activities are outside the EU and the instruments are in a third country currency, similar index of consumer prices can be used; OR</li><li>(ii) at the time of the award as variable remuneration, <b>&gt;= 60 % of the instruments were issued other than as variable remuneration AND are not held by the institution or any undertaking that has close links</b> with the firm.</li></ul>
<b>Tier 2 instruments</b> (art. 3 RTS)	<p>(a) at the time of the award of the instruments as variable remuneration, the <b>remaining period before maturity of the instruments &gt;= sum of the variable remuneration deferral and retention periods</b> that apply to in respect of those instruments;</p> <p>(b) the provisions governing the instrument provide that, upon the occurrence of a <b>trigger event</b>, the <b>principal amount shall be written down on a permanent or temporary basis or the instrument shall be converted to Common Equity Tier 1 instruments</b>;</p> <p>(c) and (d) are the same as Additional Tier 1 (b) and (c) above.</p>

(cont.)



(cont.)

INSTRUMENTS	Requirements
<p><b>Other Instruments</b> (art. 4 RTS)</p> <p>Not AT 1 or T 2 that can be fully converted to CET 1 instruments or written down</p> <p>3 cases (art. 4.1):</p> <p>Other Instruments in general</p> <p>Linked to AT 1 or T 2 with issuer in the EU</p> <p>Linked to AT 1 or T 2 with an issuer outside EU consolidation (as per Regulation 575/2013)</p>	<p><b>Other Instruments in general (art. 4.2)</b></p> <p>(a) Issued directly or through institution included in consolidation of the Regulation 575/2013 or the IFR – AND if a change to the credit quality of the issuer leads to similar change in credit quality of the firm;</p> <p>(b) holder does not have right to accelerate payment of distributions or principal other than in the case of the firm insolvency or liquidation;</p> <p>(c) and (d) are the same as Tier 2 (a) and (b) above.</p> <p>(e) and (f) are the same as Additional Tier 1 (b) and (c) above; (b) is extended to in the case of an institution issuing the instrument (requirement 7% of the CET 1 capital ratio of the issuer).</p> <p><b>Linked to AT 1 or T 2 with EU issuer (art. 4.3) – same as above, plus...</b></p> <p>(b) Linked to an AT 1 / T 2 instrument issued through institution included in consolidation of the Regulation 575/2013 or the IFR;</p> <p>(c) application of (c) and (f) above is at variable pay award time.</p> <p>(d) the value it is linked to the reference instrument such that it is never more than the value of the reference instrument;</p> <p>(e) the value of distributions paid after vesting is linked to the reference instrument such that distributions are never more than the value of distributions paid under the reference instrument;</p> <p>(f) if the reference instrument is called, converted, repurchased, or redeemed within the deferral or retention period, another reference instrument will apply such that total value does not increase</p> <p><b>Linked to AT 1 or T 2 with issuer outside EU (art. 4.4)</b> Same as above; it must be allowed by the competent authorities.</p>

## Proposed EBA Technical standards on Remuneration (RTS Consultation Paper 2020/08) – alternative arrangements

Alternative arrangements for variable pay under the IFD are possible, subject to **approval of the competent authority**, and will need to comply with ALL the following (art. 6):

- a) variable remuneration **alignment with the risk profile** of the investment firm;
- b) allows application of **deferral and retention** of variable remuneration received;

- c) the **amount received and conditions**, including deferral and retention, are **well documented and transparent** to the staff member;
- d) for amounts received under deferral and retention, **staff cannot access, transfer or redeem the deferred part** of variable remuneration;
- e) subject to **at least 6-month retention policy**, designed to align with the **longer-term interests** of the firm, its **creditors** and **clients**;
- f) alternative arrangement **does not foresee the increase of the variable remuneration received during deferral periods by interest payments or similar, other than by fulfilling conditions under point g)** below;
- g) where the alternative arrangement allows **changes of variable pay during deferral and retention**, the following conditions shall be met:
  - i. the change is based on **predefined performance indicators** considering **institution’s credit quality and the managed assets’ performance**;
  - ii. changes **at least calculated annually AND at the end of the retention**;
  - iii. the **rate of changes should equally be based on the level of positive or negative credit quality changes or performance** measured;
  - iv. where the value change is based on the performance of assets managed, the **percentage of value change should be limited to the percentage of value change of the managed assets**;
  - v. where the value change is based on the credit quality of the firm, the **percentage of value change should be limited to the percentage of net revenue in relation to the investment firms total own funds**;
- h) art. 32.1.m) of the IFD is not hindered: **“malus”, “clawbacks” and similar measures** for negative financial performance, conduct / “fit and proper” disqualification, etc.

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