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Remuneration policies under CRD IV – A new piece of the puzzle has been issued

Patience is a virtue. Via the law of 23 July 2015, the *Chambre des Députés,* 20 months after the deadline, has finally implemented Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (the so-called Capital Requirements Directive IV – hereinafter "CRD IV" or the "Directive")[1]. CRD IV has mainly been incorporated into the Luxembourg legal framework in the form of an amendment to the Law of 5 April 1993 relating to the financial sector as well as of CSSF regulations (hereinafter the "Law of 1993").

The transposition law notably introduces a new chapter 4bis entitled "Governance arrangements and remuneration policies" into the Law of 1993. The new article 38-6 set outs provisions relating to the variable component of remuneration for certain categories of staff, including the introduction for the first time of a bonus cap, *i.e.* a limit of 100% for the fixed component of the total remuneration (increased to 200% if approved by the shareholders, owners or members of the relevant institution).

The majority of the articles of the new law are applicable from 3 August 2015 to all parties concerned by them. The provisions of the previous directive, CRD III, implemented into Luxembourg law notably through CSSF circulars 10/496 and 10/497, have been repealed insofar as these provisions were not retained in CRD IV. In addition, the provisions which were not retained in CRD IV but introduced in the other document in the CRD package, namely the Capital Requirements Regulation[2], have been removed from the Law of 1993.

I. Key changes

Introduction of a cap on banker's bonuses

As mentioned above, to curb excessive risk-taking, the variable component must not exceed, as a general rule, 100% of the fixed component of the total remuneration.

However, the 1:1 bonus-to-salary ratio may be raised to a maximum of 200% of the fixed component of the total remuneration if approved by at least 66% of the shareholders representing at least half of the shares or by 75% of votes if there is no quorum.

[1] OJEU L 176, 27.6.2013, p. 338–436
[2] Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (CRR), OJEU L 176, 27.6.2013, p. 1–337

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In addition, the calculation of the maximum bonus is partly subject to a discount rate. Luxembourg belongs to a group of Member States which have chosen to allow institutions to apply the discount rate in the calculation of the ratio between the fixed and variable components of remuneration up to a maximum of 25% of total variable remuneration provided it is paid in instruments that are deferred for a period of no less than 5 years.

The Directive furthermore specifies that staff directly concerned by the higher maximum bonus levels is not permitted to exercise any voting rights they may have as shareholders of the company or owners or members of the institution. In this regard, the transposition law tacitly amends the provisions of the law of 10 August 1915 on commercial companies, according to which shareholders may approve only the remuneration of the members of the board of directors.[3]

Clearer distinction between fixed and variable remuneration

The CRD now requires the remuneration policies to make a clear distinction between the criteria used for setting fixed and variable remuneration.

The basic fixed remuneration is independent of any performance criteria and should primarily reflect adequate professional experience and organisational responsibility. By contrast, variable remuneration should reflect a sustainable and risk-adjusted performance as well as any performance in excess of that required to fulfill the employee's job description as part of the terms of employment. National criteria relating to the fixing of the salaries shall also be taken into account.

The Directive also confirms that the guaranteed variable remuneration will remain exceptional and introduces the additional condition that it may be permitted only where the institution has a sound and strong capital base.

II. Complementary documents to the CRD package

In addition to the CRD package, two Regulatory Technical Standards (RTS) were developed by the European Banking Authority (EBA) pursuant to the mandate given to it under Article 94(2) of the Capital Requirements Directive (CRD 4), and then endorsed by the European Commission. These RTSs specify criteria to determine the "identified staff" as well as the types of instruments that can be used for paying bonuses. For a more thorough discussion of the RTS we refer to one of our previous newsflashes.[4]

III. Final remark

To end, we would like to draw the attention of our readers to the fact that CEBS guidelines are currently being reviewed by the EBA.[5] This should be closely followed since one major aspect under review is the application of the proportionality principle used in the CRD.

In this regard, the draft Guidelines follow a legal reading of CRD IV supported by the European Commission according to which the requirements on deferral and payment in instruments must be applied to all institutions.

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[3] For further information regarding the CRD IV package, please refer to our article: "Remuneration policy in banks and investment firms. Adoption by the EU Parliament of CRD IV" in AGEFI Luxembourg no. 05/268.

[4] http://www.arendt.com/publications/documents/newsflash/rempol.pdf

[5] http://www.eba.europa.eu/regulation-and-policy/remuneration/guidelines-on-sound-remuneration-policies

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However, “the EBA is of the view that specific exemptions could be introduced for certain institutions that do not rely extensively on variable remuneration and, if confirmed by further analysis, also for identified staff that receive only a low amount of variable remuneration. To this regard, the Authority intends to send its advice to the European Commission suggesting legislative amendments that would allow for a broader application of the proportionality principle.”

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