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Publication of two Regulatory Technical Standards (RTS) specifying criteria to determine the "identified staff" as well as the types of instruments that can be used for paying bonuses

A little more than two months after their adoption by the European Commission, these two RTS were published in the Official Journal of the European Union on 20 May and 6 June 2014[1] respectively. Taking the form of two Commission delegated regulations, they shall enter into force on the twentieth day following that of their publication, namely since 9 June 2014 with regard to the classes of instruments[2] and as from 26 June 2014 as regards the criteria to identify staff[3]. From these dates, their provisions shall be directly applicable, *i.e.* they shall be legally binding in all Member States without having to be implemented into national law.

This contribution aims at describing briefly the key points of the above-mentioned texts.

I. Qualitative and quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile

The above-mentioned 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. They set out a methodology for identifying material risk takers at group, parent company and subsidiary levels, including institutions established in offshore financial centers, based on a combination of qualitative and quantitative criteria that will have to be applied by all the institutions subject to CRD 4.

The stated objective of these standards is to achieve a higher level of harmonisation across Europe. A survey on national implementation and the practical application of the CEBS guidelines showed notably that significant discrepancies remained in the approaches taken by different institutions and Member States to identify material risk takers. However, the above-mentioned RTS will above all result in a considerable extension of the scope of the "Identified Staff" and, therefore, in an extended application of the remuneration rules by every institution subject to CRD 4.

Under these RTS, a staff member will indeed be characterised as "Identified Staff" if at least one of the qualitative or quantitative criteria is met. Nevertheless, where staff members would be identified only under the quantitative criteria but do not, in fact, have a material impact, it would be possible to exclude such staff members under additional conditions (see section II. below).

15 qualitative criteria

The RTS lay down a list of 15 criteria under the form of categories of staff members that shall be deemed to have a material impact on an institution's risk profile. The list provided in the CEBS Guidelines is supplemented by, *inter alia*, the following categories of staff qualifying as material risk takers:

- any staff member having the overall responsibility for risk management within a material business unit[4], or heading a material business unit, or else, having a managerial responsibility in such a business unit and reporting directly to the staff member who heads that unit;

[1] OJ L148, 20.5.2014, p. 21 and OJ L167, 6 June 2014, p. 30.
[2] Commission delegated regulation (EU) N°527/2014 of 12 March 2014.
[3] Commission delegated regulation (EU) N°604/2014 of 4 March 2014.
[4] As defined in Article 3(5) of Commission delegated regulation (EU) N°604/2014.

- any staff member who has managerial responsibility in a control function (risk, internal audit, compliance) or in a material business unit but who reports directly to the staff member responsible for a control function or having the overall responsibility for risk management in a material business unit;
- any staff heading a function responsible for legal affairs, finance including taxation and budgeting, human resources, remuneration policy, IT, or economic analysis;
- any staff member responsible for, or member of, a committee responsible for the management of one of the risk categories provided for in Articles 79 to 87 of CRD 4, except credit risk and market risk; and
- staff members having authority to take, approve or veto a decision with respect of significant credit risk exposures, or decisions to approve or veto the introduction of new products as well as transactions on the trading book within an institution to which the derogation for small trading book business does not apply.

To sum things up, the main part of an institution's managerial lines as well as decision takers will fall within the scope of application of the CRD remuneration rules.

In contrast to quantitative criteria, the fulfilment of one of the qualitative criteria constitutes an irrebuttable presumption that the concerned staff member has a material impact on the institution's risk profile.

Quantitative criteria

Additional elements are provided in the above-mentioned RTS in comparison with the CEBS guidelines, according to which a staff member shall be deemed to have a material impact on an institution's risk profile.

Indeed, the following staff shall also be included in the scope of the "Identified Staff" : any staff member who (i) has been awarded total remuneration of EUR 500,000 or more in the preceding financial year; or (ii) is within the 0.3 % of the number of staff who have been awarded the highest total remuneration in the preceding financial year; or else (iii) who was in the preceding financial year awarded total remuneration that is equal to or greater than the lowest total remuneration awarded in that financial year to staff members meeting certain of the above-mentioned qualitative criteria. For the purpose of qualification under (ii) and (iii), the remuneration awarded may be considered separately for each Member State and third country where the institution has an establishment and staff shall be assigned to the country where they carry on the predominant part of their activities.

As indicated above, institutions may determine that either (a) the professional activities of a particular staff member do not have a material impact on the institution's risk profile because the staff member, or the category to which he/she belongs, does not carry out professional activities and has not authority in a material business unit or (b) has no material impact on the risk profile of a material business unit through the activities carried out.

The assessment of hypothesis (b) above shall however be based on objective criteria taking into account all relevant risk and performance indicators used by the institution for the purposes of identification, management and monitoring of risks. The institution shall also take into consideration the duties and authorities of the staff member or category of staff and make a comparison between their impact on the institution's risk profile and the impact of the professional activities of a staff member identified pursuant to the application of qualitative criteria.

If need be, an institution could make an exception and exclude a staff member from the list under additional conditions and subject to supervisory review. Institutions shall in this regard notify to the competent authority the exclusion of a staff member with an awarded total remuneration of EUR 500,000 or more. For staff with a total awarded remuneration of EUR 750,000 or for staff included in the 0.3 % of the highest earners, a prior approval of exclusions shall even be required. Finally, as regards staff with a total awarded remuneration of EUR 1,000,000 or more, competent authorities will have to inform the EBA about such intended exclusions before the decision is made.

In this respect, institutions shall furthermore demonstrate that those staff who are excluded on the basis of the business unit they are working in as well as of their duties and activities have indeed no material impact on the institution's risk profile.

Finally, according to recital (14) of the Commission delegated regulation, a record of the assessment made and of the list of "identified staff" to enable the competent authority and auditors to review the assessment shall be maintained by the institutions. This documentation shall also include staff members who have been identified under criteria based on their remuneration but for whom the professional activities are assessed as not having a material impact on the institution's risk profile.

II. Classes of instruments that adequately reflect the credit quality of an institution as a going concern and are appropriate to be used for the purposes of variable remuneration

The above-mentioned RTS were adopted by the European Commission along with eight other ones on 12 March 2014 to implement the Single Rulebook aimed at enhancing regulatory harmonisation in the banking sector in the European Union. They were developed by the European Banking Authority pursuant to the mandate given to it under Article 94(2) of the CRD 4 and followed a stakeholder consultation.

According to Article 94(1)(l) of the CRD 4, to the extent that the proportionality principle cannot be applied so that this requirement may be neutralised, a substantial portion, and in any event at least 50 % of any variable remuneration, shall consist of a balance of (i) shares, share-linked or equivalent non-cash instruments and (ii) where possible, additional Tier 1, Tier 2 or other instruments, under certain conditions. The above-mentioned Regulatory Technical Standards precisely introduce such specific requirements for additional Tier 1, Tier 2 and other instruments and thus, supplement the ones already laid down by the directive. They also define the write-down, write-up and conversion mechanisms for Tier 2 and other instruments.

The aim is notably to align the interests of staff with the interests of shareholders, creditors and other stakeholders by providing incentives for staff to act in the long-term interest of the institution and not to take excessive risks. Another objective is to try to prevent any circumvention of the rules laid down in CRD 4, in particular as regards the ratio between variable and fixed components of remuneration as well as the alignment with risk taking. This could for example be the case with very high distributions arising from instruments, which could increase the variable part of the remuneration. Similarly, calls, redemptions, repurchases or conversions of instruments used for the purposes of variable remuneration should not increase the value of the remuneration awarded by paying out amounts that are higher than the value of the instrument or by proceeding with conversions into instruments which have a higher value than the instrument initially awarded.

For further information, please refer to our articles: “Remuneration policy - recent developments for banks and AIFMs: CRD 4 and the ESMA Guidelines on sound remuneration policies” in AGEFI Luxembourg no 03/266 and “Remuneration policy in banks and investment firms. Adoption by the EU Parliament of CRD 4” in AGEFI Luxembourg no 05/268.

As at today, the bill of law transposing CRD 4 is still under scrutiny by the *Commission des Finances et du Bugdet* of the *Chambre des Députés*. It is also foreseen that the EBA will issue new guidelines on sound remuneration policies which comply with the principles set out in CRD 4, as requested by Article 75(2) of the directive. The thick pile of rules regarding remuneration will therefore continue to grow in the future.

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