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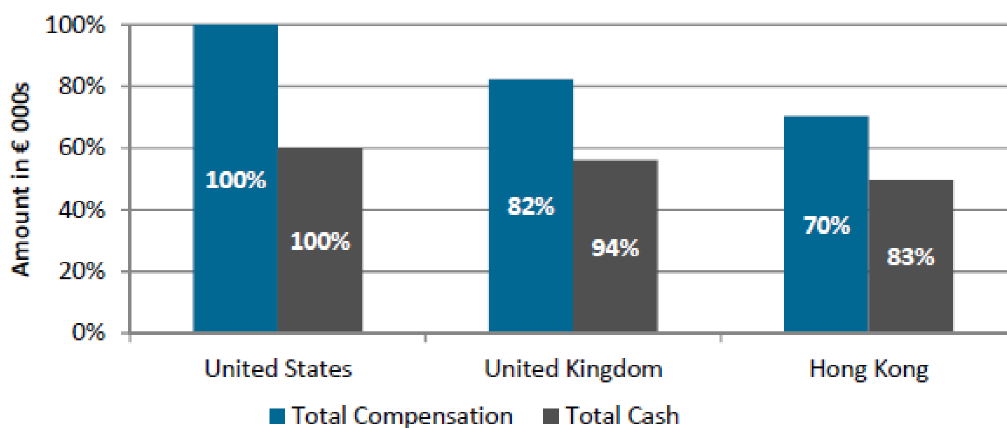
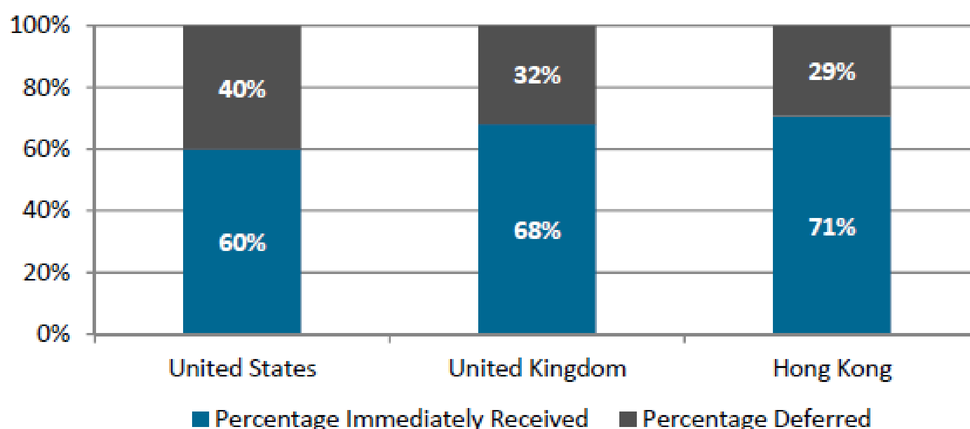
Consultation response

Appendix to AFME's Response to the EC Consultation on Impacts of Maximum Remuneration Ratio under CRD4 and Overall Efficiency of CRD 4 Remuneration Rules

Figure 1 – Comparison of pay levels and deferral across regions (Review of the Reward Environment in the Banking Industry, McLagan, January 2016)



Note: United States indexed to 100%



Scope: 18 AFME firms with combined Global BCM revenue of €148bn.

Figure 2- Competitive tensions created by the CRD 4 remuneration provisions (source AFME)

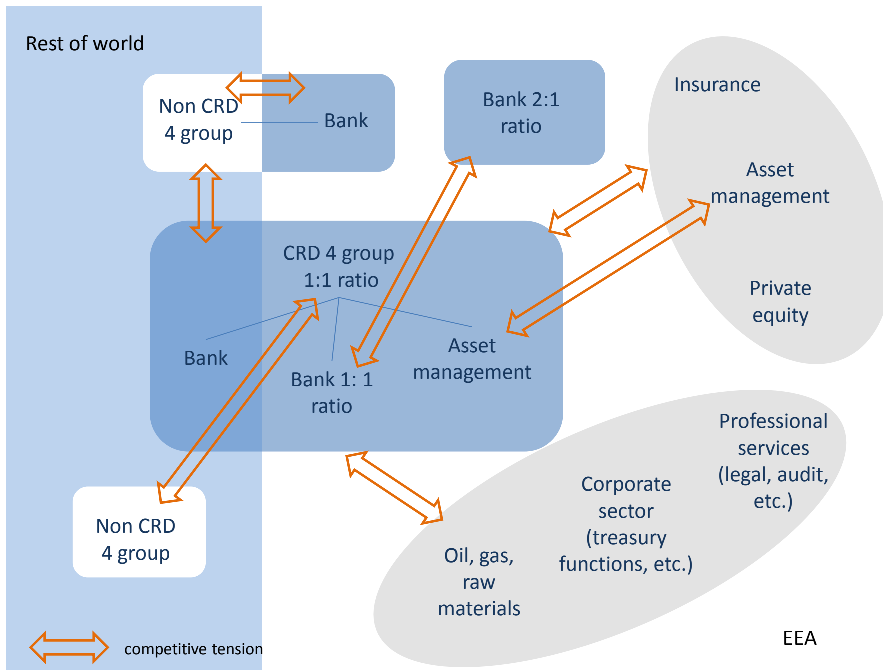
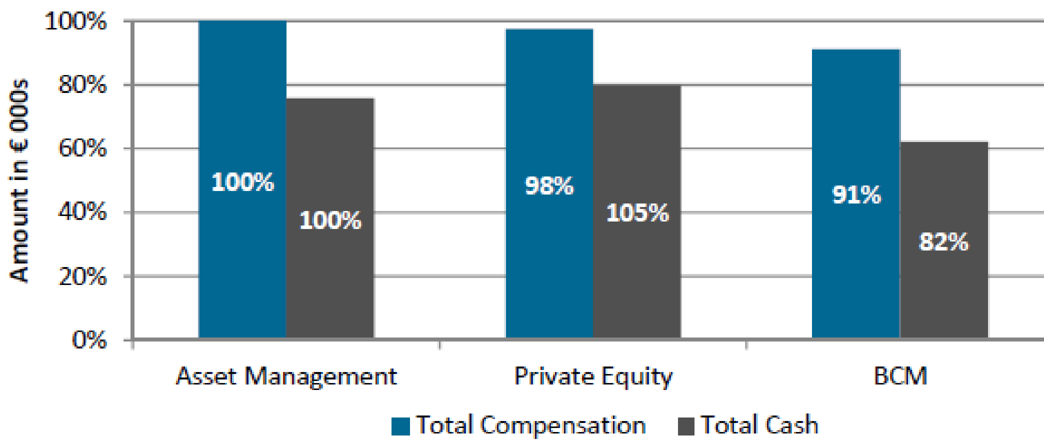


Figure 3- Banking and Capital Markets (BCM) pay compared to other financial sectors (source: McLagan, January 2016)



Note: Asset Management indexed to 100%

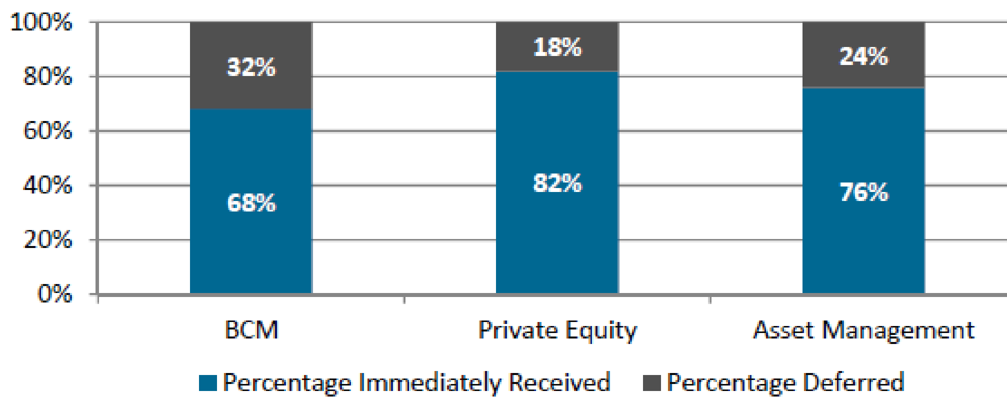


Figure 4 – Evolution of total compensation (source: McLagan, January 2016)

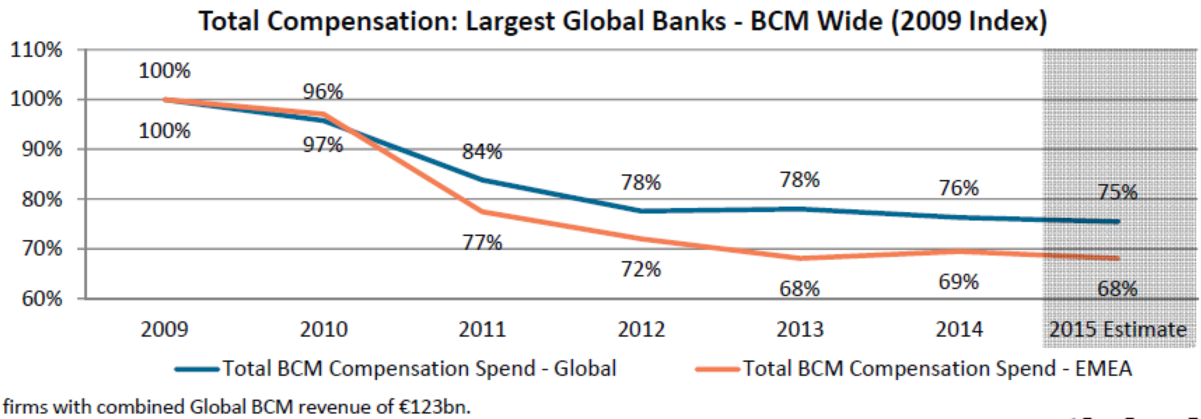


Figure 5- Evolution of fixed vs variable pay (source: McLagan, January 2016)

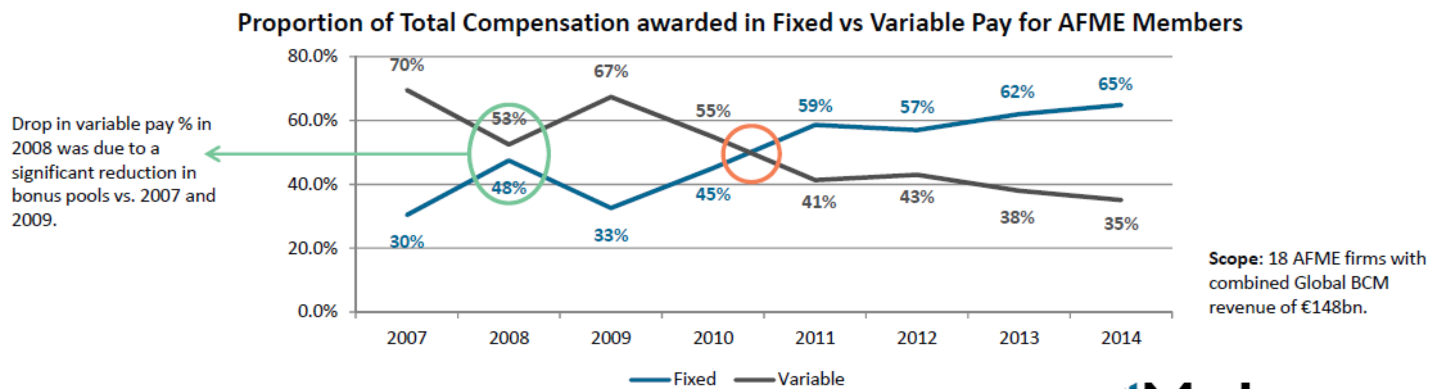


Figure 6 - Fixed versus variable remuneration as a proportion of total remuneration for the MRTS in major UK banks (source: Bank of England, Quarterly Bulletin Q4 2015)

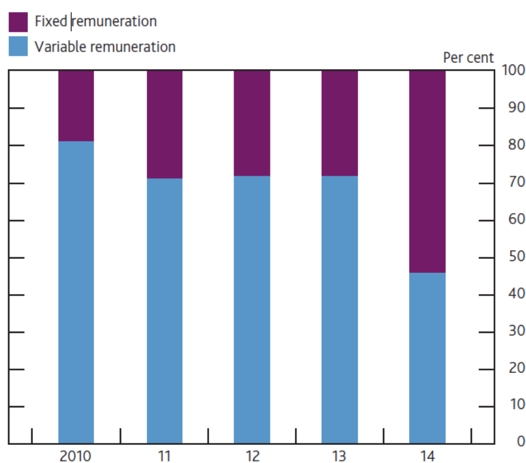


Figure 7 -Total malus adjustments applied across the MRT population within the major UK banks (source: Bank of England, Quarterly Bulletin Q4 2015)

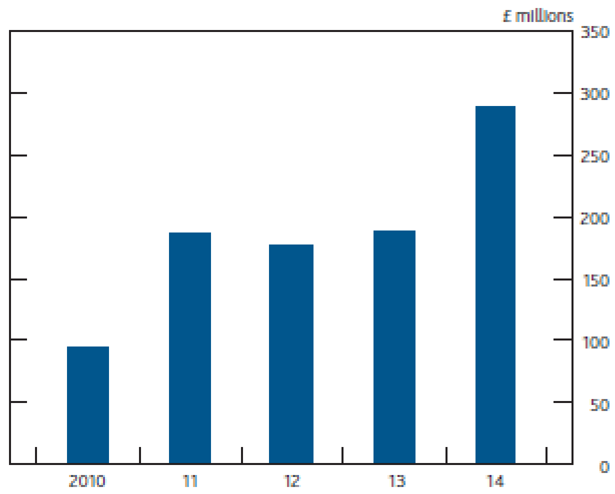
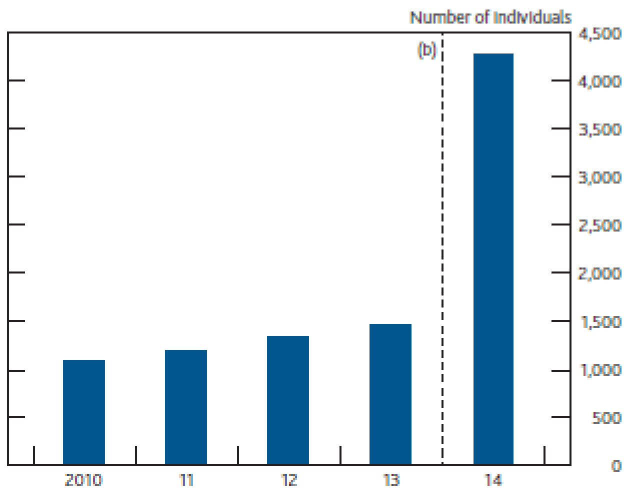


Figure 8 - Population of MRTS in the major UK banks (source: Bank of England, Quarterly Bulletin Q4 2015)



Sources: Annual accounts and Pillar 3 remuneration disclosures.

(a) Defined as the top five UK-headquartered banks by market capitalisation.
(b) Introduction of the EBA's regulatory technical standard on the identification of material risk-takers.

Example 1- Obstacles and costs involved in the use of physical shares and instruments for granting variable pay

The use of physical shares (and indeed other instruments such as bail-in bonds) is not possible in all countries, or is only possible at significant cost to deal with local legal and regulatory requirements, implying a differentiated treatment of employees depending on their location. The following are examples of cases where securities law requirements create difficulties for firms to make share awards:

- *In Russia, only Russian listed firms can offer share awards (apart from a limited exemption).*
- *In the US, a maximum 5 Million $ can be awarded in shares to employees in the US where the parent company is not listed on a US stock exchange. This cap, which includes all types of remuneration in shares (profit-sharing; company savings plan; employee share ownership; free shares; variable remuneration), can be quickly exceeded.*
- *In the EU, if a non-EU firm does not have securities listed on an EU exchange it will have to file an EU prospectus at significant extra cost to make share awards available to EU based employees*
- *In Australia, there are complex securities laws which companies must comply with to make shares available to employees*
- *In Israel there are complex securities laws and tax requirements to make share awards available and most firms who make share awards available need to set up a specific Israel based trust.*
- *In the Philippines application must be made to the local SEC to make share awards*
- *In Saudi Arabia, share awards can only be made if application and consent is given by the Capital Markets Authority*

Indeed, even within the EU, there are the costs for non-EU firms who do not have securities listed on an EU exchange who will have to file an EU prospectus to make share awards available to EU employees.

In addition to securities law issues, firms will also need to consider:

- *Foreign Exchange consent in countries like China where a SAFE consent is essential and takes considerable time and cost to implement*
- *Appointing a local financial intermediary in some countries like Italy*
- *Dealing with extensive data privacy obligations like in Russia where there is a requirement to store all data related to share awards on a local server*
- *Reporting foreign asset holdings in countries like Argentina, Austria, Canada, India and Japan*

From an operational perspective, the distribution of shares (or other instruments) is also complicated and costly as it involves, as a matter of routine:

- *Obtaining shareholder approval (who may not give their approval to dilution for this purpose).*
- *Managing the various requirements vis-à-vis market authorities and the public*
- *Communicating towards identified staff*
- *Putting in place service contracts with the administrators and brokers in charge of managing the distribution of shares*
- *Management of the withholding of social charges and income taxes on the employee's bank accounts for the parts of variable remuneration paid in instruments. The complexity of this is increased significantly for firms having to deal with mobile workers when they need to track and pay tax on share awards globally.*
- *Re-invoicing expenses (with possible tax implications) to the entities of a group granting the ward*
- *Putting dedicated IT tools in place, where such systems are normally outside the usual HR/payroll arrangements because of the complexities of operating share plans.*

Awards over shares and other instruments are generally more complex to administer and communicate than linked awards. All firms that have share awards will have staff who specialise and understand the complexities involved in operating such plans properly (including compliance with listing and other governance requirements such as dealing codes or internal governance. Moreover, when employees are awarded shares or other instruments, it is important that they understand how their tax will be paid (in some countries it will not be by the employer withholding as it would otherwise be with cash) and how they can sell their instruments when they are released.

Firms that currently use instruments will already be bearing these costs; however the costs may become disproportionate if the firm has to extend share plans around the world and to more individuals as a result of the removal of proportionate application from the remuneration rules.

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Consultation response

Impacts of Maximum Remuneration Ratio under CRD4 and Overall Efficiency of CRD 4 Remuneration Rules

14 January 2016

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the **EUROPEAN COMMISSION'S PUBLIC CONSULTATION ON IMPACTS OF MAXIMUM REMUNERATION RATIO UNDER CRD4 AND OVERALL EFFICIENCY OF CRD 4 REMUNERATION RULES** (hereafter "the consultation"). 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 listed on the EU Register of Interest Representatives, registration number 65110063986-76.

Answers to consultation questions

2.1.1 The Maximum Ratio Rule applies to credit institutions and investment firms as defined in CRD in the EEA, as well as (indirectly) to their subsidiaries within the scope of prudential consolidation (including subsidiaries outside the EEA and asset management subsidiaries). Please indicate for which of the aforementioned type(s) of undertaking(s) your answer to the below question applies.

My answer below applies to (multiple answers possible):

Credit institutions established in the EEA (directly subject to the Maximum Ratio Rule) YES, including the subsidiaries of 3rd country firms

Investment firms as defined in Art 4(1)(2) CRR established in the EEA (directly subject to the Maximum Ratio Rule) NO

Non-EEA subsidiaries of EEA parent covered by CRD (indirectly subject to the Maximum Ratio Rule through the application at group level) YES

EEA subsidiaries of EEA parent covered by CRD (indirectly subject to the Maximum Ratio Rule through the application at group level), such as asset management companies or other types of financial institutions YES

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2.1.2 What impact, if any, of compliance with the Maximum Ratio Rule have you observed on the COMPETITIVENESS of the undertakings concerned? Please provide as much as possible factual, concrete and verifiable elements that support your answer. If you ticked more than one box above, please make sure to distinguish as relevant.

Introductory Comments

Our members recognise the importance of sound remuneration practices that promote prudent risk taking and appropriately align incentives, long term performance and pay. However, our members believe that certain aspects of the remuneration requirements under the EU Capital Requirements Directive ("CRD IV"), and subsequent rules and guidelines by the European Banking Authority (EBA), have had a negative impact on financial stability and competitiveness. Our response highlights where this has arisen, and notes aspects where implementation has been problematic and could be improved.

We note in particular, that the financial stability and competitive implications associated with the Maximum Ratio Rule could be reduced, while preserving the positive incentives associated with variable remuneration. This could be done for instance by retaining a proportionate application of the remuneration provisions reflective of a firm's size and complexity of activities and an individual's role and responsibilities and applying the Maximum Ratio Rule to cash, introducing an appropriate valuation mechanism or providing a meaningful discount factor for deferred equity. There are clear benefits to paying variable remuneration in deferred equity vis-à-vis cash in terms of prudential risk management and incentivising appropriate employee behavior. Whilst a discount factor currently exists under CRD IV, it is rarely used by firms because it only applies to equity deferred for longer than 5 years, and the discount is so low that, in practice firms are reluctant to implement it.

We refer to charts and examples in the response (in brackets) which will be provided to the Commission separately.

Response to question 2.1.2

EEA institutions need to be able to maintain compensation at competitive levels so as to compete and attract talent from a global pool of mobile workers. As a result of the Maximum Ratio Rule, EEA banks have to compete based on fixed pay, increasing fixed costs. Firms that do not increase fixed pay beyond what is prudent will lose talent to other markets, with a consequent impact on Europe's financial services industry, and its ability to attract highly skilled workers. The Maximum Ratio Rule has also reduced banks' ability to respond to spikes in demand for certain skill sets where firms in different jurisdictions and sectors, to whom the CRD IV requirements do not apply, have more flexibility to offer competitive pay packages.

International comparisons of pay levels across the MD level for the banking and capital markets (BCM) industry in 2014 shows that US MD BCM compensation levels are 18% above those of the UK which in turn are 15% above Hong Kong (see Figure 1). The levels of pay in Hong Kong are however significantly influenced by the very different rates of income tax compared to Europe. For instance, the highest rate of income tax in Hong Kong is 17% compared to the 45% in the UK. As such net levels of pay are lower in the UK than in Hong Kong. In an industry seeking to attract global talent, the Maximum Ratio Rule further diminishes the competitiveness of EEA banks.

The sources of competition for human resources for EEA banks subject to the Maximum Ratio Rule are multiple (see Figure 2). Not only do they have a competitive disadvantage in comparison to direct competitors from other jurisdictions, within the EEA the banking industry is the only industry required to limit variable pay in this manner. This means that they face competition from staff in other areas of the financial services sector and beyond the many other industries and areas where skill sets are comparable.

The competitive landscape for talent is further complicated by the fact that within the EEA there is a disparity between firms that have obtained approval for a 2:1 Maximum Ratio Rule whereas others have not. Tensions can also arrive within a group where some individuals are subject to the Maximum Ratio Rule and others are not (e.g. EU employees of a non-EU firm).

When looking to other areas of the financial services industry (see Figure 3), UK MD BCM total compensation is lower than Private Equity (-7%) and Asset Management (-9%). These gaps increase when looking at total cash payments due to the longer deferrals requirements for the banking industry compared to practice in other financial service sectors.

We continue to think that asset management subsidiaries part of a banking group should only be captured by the Maximum Ratio Rule on a solo basis if the entity and the individuals pose material risk to the banking group. While it is not clear whether this requires a change to the CRD IV, we invite the Commission to consider this in view of ensuring that the competitiveness of asset management arms of banking groups subject to CRD IV are not significantly impacted vis-à-vis standalone asset managers when it comes to attracting talent.

2.2.2 What impact, if any, of compliance with the Maximum Ratio Rule have you observed on FINANCIAL STABILITY? Please provide as much as possible factual, concrete and verifiable elements that support your answer. If you ticked more than one box above, please make sure to distinguish as relevant.

Total compensation levels have fallen steadily since the crisis, with data showing a decrease of 31% in the total pay of the Banking and Capital Market (BCM) activities of banks in the EMEA region, between 2009 and 2014 (Figure 4). The reasons for this change are cyclical and structural, as banks respond to challenging market conditions, a new regulatory environment, and make changes to their business models.

While overall pay is declining, the portion of fixed pay is increasing. Figure 5 shows that fixed pay has increased from 30% in 2007 to 65% of total compensation for the BCM activities of AFME members in 2014. This trend is further supported by data published by the Bank of England (in its Q4 quarterly bulletin) on fixed versus variable remuneration as a proportion of total remuneration in the major UK banks. The data shows that the portion of fixed pay has risen from less than 20% in 2010 to over 50% in 2014 (Figure 6).

The Maximum Ratio Rule has clearly meant that firms have had to adapt their remuneration structures to remain competitive and this has resultied in a substantial increase in fixed remuneration.

The rise in fixed costs reduces firm’s flexibility to conserve capital in a stress situation and slows down their ability to rebuild capital thereafter.

The larger the locked in fixed component of compensation expenses, the less flexibility firms have to adapt pay levels in times of stress (without reducing headcount). In other words, in a year where a firm is not able to pay variable remuneration, the scope it would otherwise have to reduce pay is limited by the fact that it is already faced with higher levels of fixed pay.

Although the rules should only apply to "true" MRTs, it is these individuals who have experienced the most important adjustments in the fixed/variable composition of pay, the amounts involved can be significant when compared to total compensation expense. We will provide the Commission with numerical examples of this.

Moreover, as the mix of fixed and variable pay has changed, we have also seen an acceleration of firms' compensation expenses as an increasingly greater portion of total compensation can no longer be deferred or cancelled through malus. This is clearly not in the interests of firms themselves as their ability to recover awards in cases of material events coming to light has also been reduced. As highlighted by the ESRB's June 2015 "Report on Misconduct Risk in the Banking Sector":

> *"Making management staff liable for their misconduct and ensuring sufficient variable remuneration which can be clawed back in some way would help to align incentives with the interests of the bank and society, and to encourage a sound risk culture within the banking sector.*
>
> *The relative increase in fixed pay at the expense of variable pay may thus be a negative factor, limiting the extent to which incentives can be aligned through the use of measures such as malus and clawback provisions. In this respect, the completion of the implementation of the FSB's Principles for Sound Compensation Practices is welcomed, as is its more recent attention to the use of malus and clawback clauses to address misconduct"*

Taken together, these effects may very well represent a drag on financial stability and, rather than encouraging less excessive risk taking behaviour, the results could potentially run counter to the objectives of the remuneration rules introduced in the CRD IV as part of the post crisis reform agenda.

To mitigate the broader prudential concerns associated with the Maximum Ratio Rule, it should be possible in some circumstances to adjust downwards or forfeit certain categories of fixed remuneration. Otherwise, firms have to pay out fixed remuneration permanently, even when, for example, there is an instance of misconduct, a significant deterioration in the performance of the firm, a failure of risk management or when capital requirements are breached.

We note that there is no requirement in CRD that would prevent firms from using such adjustments or forfeiture provisions for fixed pay. However, the EBA guidelines on sound remuneration practices go further, and introduce new restrictions by stating that such provisions alter the character of fixed remuneration which should therefore be re-characterised as variable pay. In our mind, employees should also be accountable for risks that they have taken using fixed remuneration as a tool, particularly as less variable remuneration is being paid out.

2.3 What impact, if any, of compliance with the Maximum Ratio Rule have you observed on staff working effectively and physically in subsidiaries established outside the EEA of parent institutions established within the EEA?

EU headquartered firms have generally noticed an increase in turnover rates, particularly in their North American and Asian operations where the effect of the bonus cap on firms' ability to compete for staff is the most acute. While it is difficult to disentangle whether these departures are due specifically to regulatory constraints on remuneration, there is anecdotal evidence that that turnover rates have increased in particular from 2013 (pre-bonus cap) to 2014 (post-bonus cap implementation).

For instance, one international EU headquartered bank has experienced the following turnover rates[1]:

- Americas: approx 11% in 2014 vs. 8% in 2013
- Asia: approx 14% in 2014 vs. 12% in 2013

Interestingly, this firm has also observed a more marked increased in turnover rates for compliance and legal functions in Asia (21% for legal function and 16% for internal audit functions in 2014).

Member firms have encountered issues when having to apply the ratio for non-EEA subsidiaries based in countries that do not have similar requirements. In particular, some countries *impose a minimum* variable amount. Russia for instance requires that variable remuneration must not be lower than 40% of total pay. When combined with the CRD IV rule, this creates a situation where EU firms have virtually no flexibility in setting the proportions of fixed versus variable pay making it difficult to compete with other firms not subject to the EU rules their competitors who are not subject to such rules do benefit from this flexibility.

3.1 Against this background, how would you assess the efficiency of the following remuneration rules of CRD IV and CRR? Please always back up your views with specific evidence:

3.1.1 The requirement set out in Article 94(1)(a) CRD that the assessment of performance is based on a combination of the individual's performance (taking into account financial and non-financial criteria), the performance of the business unit concerned and of the overall results of the institution; the requirement set out in Article 94(1)(b) CRD that the assessment of the performance is set in a multi-year framework

The requirement that the assessment of performance be based on a range of factors and in the context of a multiyear framework corresponds to industry practices to ensure an appropriate link between risk and reward, discouraging excessive risk taking and short-termism.

We view this provision as being efficient as it allows firms the flexibility to implement the most appropriate solution for their business so long as the overall objective is met.

[1] Calculated on the basis of total staff working in investment banking division

** 3.1.2 The requirement set out in Article 94(1)(m) CRD to defer at least 40% of the variable remuneration.*

Variable pay is important because, unlike fixed pay, it is subject to deferral and clawback. A ratio that only applies to variable pay in the form of cash, or that provides a discount for deferred equity, would ensure that these prudential and risk conscious aspects of variable pay are preserved for a greater proportion of total pay.

We support the principle of deferral as it promotes the alignment of employees' incentives with a firm's performance. This is particularly true when the deferral period is adapted to a firm's risk horizon. Deferral is also extremely useful to retain employees and enables firms to vary remuneration according to performance, effectively aligning compensation with risk.

Whether the 40% requirement is efficient must be seen in the context of the ratio and the need to apply minimum requirements proportionately.

While deferral (i.e. the percentage of total variable pay deferred over a number of years) is useful in incentivising behaviour, there is a tipping point beyond which individuals begin to discount the value of the award. This is evidenced in "The Psychology of Incentives", by PwC and the London School of Economics and Political Science. As bonuses become smaller, the tipping point gets closer. When variable levels become too low and deferral percentages/periods too high, variable pay no longer creates the intended incentives.

The proportionate application of the CRD IV rules has helped mitigate this effect to some extent for those MRTs whose functions within the firm (e.g. compliance/risk/HR, etc.) and/or total compensation levels do not justify treatment beyond the CRD minimum deferral requirements. If proportionate application is removed, it is these types of important functions that will be at risk of leaving to join other firms not subject to these rules. The cost for firms to manage multiple, small instalments in cash and instruments is also likely to become disproportionate.

We therefore strongly support the EBA recommendation to have derogations for staff with low levels of variable. We also support the EBA having a mandate to specify the criteria for such cases. We disagree however with the EBA proposal to not extend derogations to the subs of larger firms as this creates an unlevel playing field re independent firms or subsidiaries of smaller groups. The latter can be of the same nature as subs of larger firms yet their staff would receive all variable immediately in cash and without the possibility of malus, whereas staff in the same activity and responsibility but in subs of significant firms would be subject to the full rules. This will further hamper the capacity of these firms to attract talent and retain staff on already volatile labour markets and will increase their operational constraints and costs.

We support a risk based approach so that the remuneration requirements can be disapplied to entities of a group that are not significant in terms of size and complexity of their activities.

** 3.1.3 The requirement set out in Article 94(1)(l) CRD to pay out at least 50% of variable remuneration in instruments, whereby there will be a balance of shares or equivalent ownership interests, subject to the legal structure of the institution concerned or share-linked instruments or equivalent non-cash instruments, in the case of a non-listed institution, and where possible other instruments adequately reflecting credit quality of the institution as a going concern.*

As noted in question 2.1.2, the current discount factor in CRD IV is rarely used by firms so has had a limited impact. We believe that the valuation of equity awards should be revisited with a view to reflecting the benefits of deferred equity. This could be done by using an IFRS valuation mechanism, by applying a discount factor to all deferred equity (not just that which is deferred for longer than 5 years) or introducing a more meaningful discount. A more widely used accounting valuation mechanism or discount factor would have the positive outcome of a greater proportion of total pay being risk and performance adjusted and deferred.

We do not see any economic justification for disallowing the use of share-linked instruments for listed firms. We therefore strongly support the EBA's recommendation to the EC that share-linked instruments be available to listed institutions.

The use of physical shares (and other instruments such as bail-in bonds) is not possible in all countries, or is only possible at significant cost to deal with local requirements, implying a different treatment of employees depending on their location. The distribution of shares or other instruments is more complex to administer than linked awards. We provide examples of these obstacles and costs (see example 1) which may be exacerbated if proporationate application is removed.

Granting variable pay in cash indexed on the change of a share price is more efficient to put in place, whereas it contributes in the same way to the alignment of the employee with the performance and risks of the group. It should therefore be explicitly allowed under the CRD for use by listed firms and we strongly recommend the EC adopt the EBA's recommendation, which should also be extended to allow the use of synthetic or indexed instruments for the granting of awards in bail-in bonds other similar instruments (when this is feasible).

The retention requirement on variable pay paid up front in instruments is not efficient. It acts as a further deferral element, again diminishing the perceived value of awards. It also creates costs to put the necessary deferral mechanisms in place whereby a firm has either to enter into arrangements where employees commit to retain the shares and then track that they do, or appoint an administrator to receive and hold the shares on behalf of the employees. Particularly as the structure of remuneration has evolved with the implementation of the CRD IV provisions, we question the efficiency of maintaining this requirement.

The right to dividends and other income on underlying securities have previously been allowed to accrue and this is an important part of alignment with investors. The EBA's position to prohibit the accrual of income during the vesting period undermines the use of instruments from alignment with investors. We recommend the Commission review this position.

** 3.1.4 The requirement set out in Article 94(1)(n) CRD that up to 100% of the variable remuneration is subject to malus and claw back.*

On condition that amounts subject to malus are meaningful (i.e. sufficiently important) and that it is used in a proportionate manner, we see malus as being an effective tool to incentivise individuals' behaviour. From the point of view of firms, malus also allows for the efficient recovery of awards should any circumstances that warrant ex-post adjustments come to light. Malus has been used increasingly by banks in relation to risk management failings that have come to light since 2010, as shown by data published by the Bank of England relating to UK banks (see Figure 7).

As the Commission is aware, clawback is a more difficult tool to put into practice, particularly in some countries where the legal framework does not permit clawback or makes it impossible to exercise in practice (e.g. France, Italy, Germany, Spain, Japan, India, etc.).

Given the legal uncertainty surrounding this practice, the likelihood that the enforcement of clawback will be contested by the individual in question is high, regardless of the jurisdiction in which it takes place. The potentially lengthy and costly court battles that could very well ensure imply that there is a good deal of uncertainty as to whether firms will be able to recover any significant amounts (individuals may no longer have funds to reimburse the firm or may question the reimbursement of gross award amounts). Consequently, in our view, the application of clawback in our view does not meet a cost/benefit test. This is particularly true given that malus already exists as a more practical and efficient alternative.

It would be helpful if the Commission could clarify that clawback should only relate to the net (after tax) amount of any paid out award.

** 3.1.5 The requirements set out in Articles 94(1)(f) and 94(1)(g) that fixed and variable components of remuneration are appropriately balanced; that the fixed component should represent a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy on variable remuneration components, including the possibility to pay no variable remuneration component; and that the variable remuneration cannot exceed 100% (or 200% with shareholders' approval) of the fixed remuneration.*

Minimum ratio

As explained in our response to questions 2.2.1, 2.2.2 and 2.3, we do not think these requirements are efficient.

Placing too great restrictions on variable pay not only reduces its value to incentivise appropriate behaviour because employees have "less skin in the game", it also limits firms' flexibility to reduce pay in times of stress and has the unintended consequence of driving up fixed pay.

With an increase in the fixed cost base being undesirable from a financial stability and incentivisation perspective, the FSB is investigating what would constitute a sufficient amount of variable remuneration.

Mark Carney, the Vice-Chair of the ESRB, recently told the European Parliament's ECON Committee[2],

"… the ESRB has also proposed tackling misconduct at source by increasing individual accountability. This can be done by reforming remuneration - using variable pay, combined with Malus and Clawback, to hard-wire stronger incentives for good behaviour within firms. The UK is committed to this approach with the toughest remuneration regime in the EU, including the longest deferrals and claw backs. However, the effectiveness of such measures across the EU is being tempered by the bonus cap. For example, in 2013, the ratio between fixed and variable for material risk takers at major UK banks was around 1:3 – meaning three quarters of remuneration was at risk from individual misconduct. The next year, when firms first had to apply the bonus cap, that ratio had fallen to around 1:1, with the overall level of remuneration unaffected. Prompted by the ESRB, the FSB is now examining the impact of various compensation tools on misconduct, and if appropriate, it will recommend improvements to next year's G20 summit."

Shareholder approval

The CRD IV shareholder approval requirements are unnecessary in the case of fully owned subsidiaries. Where a fully-owned subsidiary of an EU parent institution exists and is not itself listed on the open-market, authorisations received from shareholders of the EU parent institution should apply. To require the approval of intermediate shareholder levels in such cases creates unnecessary administrative burdens in groups with complex organisational structures with no additional benefit. It should therefore be clarified that shareholder decisions can be taken at the group level and cascaded down in these cases.

We recommend that the EC adapt the Level 1 text to alleviate this unnecessary burden for firms.

** 3.1.6 The requirement for significant institutions to establish a remuneration committee (Article 95 CRD) as well as a risk committee (Article 76 CRD) which shall assist in the establishment of sound remuneration policies and practices.*

We have significant reservations with respect to the efficiency of the requirement relating to remuneration committees, particularly in terms of achieving effective group wide remuneration policies, which is one of the objectives of the CRD IV remuneration provisions.

Remuneration is typically the responsibility of a global remuneration committee that sets the firm's policies and approach to remuneration across the firm on a global business line/divisional basis but not by individual legal entity. Requiring multiple remuneration committees raises governance issues as to how the subsidiary committees should interact with consolidated parent remuneration committees under group-wide remuneration governance hierarchy, with the risk subsidiary remuneration committees end up asserting their autonomy over remuneration policy and jeopardising the CRD IV requirement to implement a group-wide remuneration policy.

Requiring individual structures risks creating a fragmented approach to remuneration policies within a firm and will make remuneration governance extremely complicated and

[2] http://www.bankofengland.co.uk/publications/Documents/speeches/2015/speech869.pdf

unnecessarily costly. The types of costs involved include finding and appointing suitably experienced individuals who would be willing to sit on the board of the subsidiary and its remuneration committee.

In our view, instead of forcing the establishment of remuneration committees at every level of a group (when an entity is deemed to qualify as significant), it would be more efficient to allow the group remuneration committee to carry out that function on behalf of the subsidiary.

We agree with the requirements with respect to risk committees. Risk committees at granular levels within a group ensure that there is good insight into local risk management practices. They contribute to the overall risk management performance assessment for the purposes of the bonus adjustment process, as well as the assessment of performance of franchise/function heads in relation to personal risk and control objectives.

3.1.7 The requirements set out in Article 96 CRD and Article 450 CRR on the public disclosure concerning remuneration policy and practices.

The disclosure requirements are largely efficient. The one area where firms encounter difficulties is when disclosures contradict data protection requirements. For instance, firms should be allowed to aggregate a band or bands to avoid the reasonable possibility of identifying that individual and his/her remuneration level.

** 3.2 How would you assess the overall efficiency of the remuneration rules of CRD IV and CRR collectively? Also, please indicate whether you have identified any lacunae in the existing rules. Please back up your views with specific evidence*

The remuneration requirements for MRTs must be assessed in their entirety, taking into account individuals' functions, compensation levels, the effect of the bonus cap, deferral requirements (% of variable and number of years of deferral) allowing for malus, the use of instruments for at least 50% of variable pay and associated retention requirements (which the EBA proposes to increase beyond current practice) as well as clawback provisions.

We note that the EBA has set out "quantitative" thresholds to determine those individuals to whose professional activities could have a "material impact" on the risk profile of the firm, and to whom the CRD IV remuneration requirements apply. These quantitative thresholds are based on the assumption (in our view, incorrect) that remuneration is a proxy for risk taking. Their prescriptive nature has no regard to the substance of an employee's role or to the nuances in pay between different functions as the thresholds are not limited to individuals in similar functions. The result of this is that, employees are identified as MRTs and subject to the CRD IV remuneration rules, regardless of their ability to expose the firm to "material" risk. In addition, by introducing remuneration thresholds, the number of individuals to whom the remuneration requirements apply has significantly increased, exacerbating the impact of the Maximum Ratio Rule and the application of clawback and deferral to a small proportion of total pay.

This is reflected in Bank of England data on the population of MRTs in the major risk takers before and after the introduction of the EBA's rules to identify MRTs (see Figure 8).

A further issue with these remuneration thresholds is that they are euro-denominated, and many of the banks headquartered outside the Eurozone set pay in local currencies. Exchange rate movements against the euro can have a material impact on the quantitative thresholds and highlight the arbitrary nature of the thresholds by capturing different employees each year regardless of any change in role. By way of example, since early 2014, the euro has depreciated by around 20% against the dollar, which means that the remuneration thresholds in US dollars have effectively been reduced by 20%.

While the EBA's remuneration guidelines helpfully set out how the conversion required in the RTS on identified staff should be applied, and while we recognise that this would require change to the RTS in question, we think that overall, the qualitative criteria should take precedence over the quantitative criteria. This is because the qualitative criteria are better aligned with the overarching prudential aim of the CRD Level 1 legislation whereas the quantitative criteria create undue burdens for firms subject to the effects of currency fluctuations. While the RTS provides for certain exclusion cases from the MRT definition which may help alleviate this issue, we do not see the benefit of requiring firms to undertake this simply administrative exercise in these marginal cases. Moreover, the Commission should be aware that some competent authorities are faced with severe resources constraints whereby the examination of exclusion notifications and approvals are either being severely delayed or are not taking place at all.

In conclusion, we think that the CRD IV remuneration provisions may have resulted in too great an emphasis being placed on remuneration as a means to change culture within organisations. While remuneration is a very useful tool to influence behavior, the CRD IV remuneration provisions will not on their own solve conduct issues or reduce misconduct risk. We would therefore invite the Commission to consider whether the CRD IV remuneration provisions are indeed effective in achieving their goal, particularly in light of ongoing work at international level by the FSB, and at European level, to address misconduct risk.