

Consultation Response

Draft regulatory technical standards on the criteria to define managerial responsibility and control functions, material business unit and significant impact on their risk profile, and other categories of staff whose professional activities have a material impact on the institution's risk profile

19 February 2020

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the **CONSULTATION PAPER ON DRAFT REGULATORY TECHNICAL STANDARDS ON THE CRITERIA TO DEFINE MANAGERIAL RESPONSIBILITY AND CONTROL FUNCTIONS, MATERIAL BUSINESS UNIT AND SIGNIFICANT IMPACT ON THEIR RISK PROFILE, AND OTHER CATEGORIES OF STAFF WHOSE PROFESSIONAL ACTIVITIES HAVE A MATERIAL IMPACT ON THE INSTITUTION'S RISK PROFILE**.

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

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

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

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

Executive Summary

We have made drafting suggestions or asked for clarification on the following aspects of the RTS:

- Readability – while we acknowledge that the structure of the RTS is to some extent driven by the mandate in CRD, we think the RTS could be made more readable, for example by defining material business unit before defining managerial responsibility for a material business unit

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- Scope and application – we have set out our understanding of the application of the RTS on an individual basis, with particular reference to Article 7(1)(b)
- Material business unit – we have asked for clarification of the rationale for including critical function in Article 4 – this seems to duplicate Article 6
- Control function – we have suggested simplifying the drafting to focus on the independent risk management function, compliance function and internal audit function; other functions can be covered via Article 6
- Managerial responsibility – we consider that the concept should be defined in relation to control functions and material business units, linking to the definition in Article 92(3)(b) CRD
- Significant impact – we consider that there should be more flexibility in the assessment, and have suggested some alternative drafting
- Qualitative criteria – we have suggested using ‘head of legal affairs’ etc to retain the current scope, noting that using the concept of managerial responsibility would bring in further levels of staff than currently
- Remuneration for a performance year – we propose some additional flexibility to allow firms to use the remuneration for a performance year
- Quantitative criteria – we have suggested that there should be some examples set out in updated guidelines, given the extra complexity with some criteria being in CRD and others in the RTS
- Proportionality – a starting point may be for smaller entities to identify staff by the criteria in Article 92(3) CRD
- Timing – we propose aligning the timing of implementation with the Investment Firm Directive, given the interaction between the two frameworks

Question 1: Are the Subject matter, scope and level of application within Article 1 appropriate and sufficiently clear?

Article 1(2) states that “The criterion under point (b) of paragraph 1 of Article 7 shall only be applied on an individual basis.”

We would like to clarify the scope of application of the criterion.

For the reasons set out below, our understanding is that the criterion only applies to entities which are themselves subject to Directive 2013/36/EU (“CRD”)

We would suggest that this point is clarified and confirmed in the updated guidelines.

We would also welcome confirmation that our reasoning below is correct.

Reasoning:

Article 1(1) states that “...this Regulation establishes regulatory technical standards setting out criteria to identify categories of staff whose professional activities have a material impact on an institution’s risk profile...”

Article 1(2) states that “The criteria shall be applied in accordance with Article 109 of [Directive 2013/36/EU] on a consolidated, sub-consolidated and individual basis.”

This is qualified by a later sentence in Article 1(2), which states that “The criterion under point (b) of paragraph 1 of Article 7 shall only be applied on an individual basis.”

Article 109(2) of Directive 2013/36/EU states that “Competent authorities shall require the parent undertakings and subsidiaries subject to this Directive to meet the obligations set out in Section II of this Chapter...”

Article 109(2) of Directive 2013/36/EU further states that “Subsidiary undertakings that are not themselves subject to this Directive shall comply with their sector-specific requirements on an individual basis”.

Recital 10 to Directive 2019/878 states that “subsidiaries which are not institutions, *and therefore not subject to Directive 2013/36/EU on an individual basis* [our emphasis added], might be subject to other remuneration requirements pursuant to the relevant sector-specific legal acts which should prevail. Therefore, as a rule, remuneration requirements set out in this Directive should not apply on a consolidated basis to such subsidiaries.

Based on Article 109(2) and Recital 10 to Directive 2019/878, our understanding is that if a parent undertaking or a subsidiary undertaking is itself subject to Directive 2013/36/EU, then the criteria generally apply on a consolidated, sub-consolidated and individual basis (unless there is a specific exception, for example as in Article 7(1)(b)).

Whereas if a subsidiary undertaking is not itself subject to the Directive (“the Exempted Entity”), the criteria would not apply on a consolidated or sub-consolidated basis (unless the relevant Member State has used the derogation in Article 109(6)) and would also not apply on an individual basis. However to prevent possible circumvention, the requirements laid down in Articles 92, 94 and 95 of the amended CRD IV apply on an individual basis to their members of staff acting on behalf of an asset manager or providing services listed in points 2, 3, 4, 6 and 7 of Section 1 of Annex I to Directive 2014/65/EU and who have been mandated to perform professional activities that have a direct material impact on the risk profile or the business of the institutions within the group. More precisely, members of staff performing services like asset management, portfolio management or execution of orders, from an Exempted Entity, are not subject on an individual basis to the application of RTS and remuneration requirements, unless they are mandated via delegation or outsourcing arrangements concluded (explicitly or not) between the Exempted Entity employing them and another not-Exempted Entity belonging to the group.

Question 2: Are the definitions within Articles 2, 3 and 4 appropriate and sufficiently clear?

We consider that the definitions could be clarified, and that the organisation of the text could be changed to improve the readability.

We set out below our suggestions and the rationale.

Definition of managerial responsibility for a control function or material business unit

Article 92(3) CRD states that

“...categories of staff whose professional activities have a material impact on an institution’s risk profile shall, at least, include:

...(b) staff members with managerial responsibility over the institution's control functions or material business units..."

Article 94(2) CRD states that

"...EBA shall develop draft RTS setting out the criteria to define the following:

- (a) managerial responsibility and control functions;
- (b) material business unit and significant impact on the relevant business unit's risk profile..."

Article 2 of the draft RTS states that

"Managerial responsibility" shall be defined as a situation in which either of the following criteria applies:

- a. the staff member heads a business unit or a control function and is directly accountable to the management body as a whole or to a member of the management body or to the senior management;
- b. the staff member heads a subordinated unit or subordinated control function and reports to a staff member referred to in point (a).

We think it is important to note that Article 92(3) CRD refers to "staff members with managerial responsibility over the institution's control functions or material business units". It follows from this wording that the concept of managerial responsibility is only relevant when it relates to the control functions or material business units. The mandate in Article 94(2) to define managerial responsibility should be read in that context. Part a of Article 2 of the draft RTS should therefore refer to material business unit, not just to business unit.

Part b of Article 2 is unclear (for example there is no definition of subordinated unit or subordinated control function). We suggest that part b should be amended by limiting it to staff who have been given delegated authority to make decisions which may have a material impact on the institution's risk profile.

The wording would also be easier to read if it started with "A staff member has managerial responsibility for a material business unit if..."

We therefore suggest the following amended wording:

"A staff member has managerial responsibility for a material business unit or control function if either of the following criteria applies:

- a. the staff member heads the material business unit or a control function and is directly accountable to the management body as a whole or to a member of the management body or to the senior management;
- b. the staff member reports directly to a staff member referred to in point (a) and has been given delegated authority to make decisions which may have a material impact on the institution's risk profile."

Definition of control function

Article 3 of the draft RTS states that

" "Control function" shall be defined as a function independent from the business units that it controls, which has a responsibility to provide objective assessment of risks, reporting or

assurance. This includes, but is not limited to the risk management function, the compliance function and the internal audit function.”

We consider that this definition could be clarified.

The first point relates to the draft wording “is not limited to”.

Article 3(4) of the current RTS states the criterion that “the staff member is responsible and accountable to the management body for the activities of the independent risk management function, the compliance function and the internal audit function.”

There is no stated rationale for extending the concept as defined in Article 3 of the draft RTS by using the words “is not limited to”. On the contrary, to ensure greater consistency of application, it would be better to exclude those words.

Furthermore, in the current RTS, Article 3(9) states the criterion that “the staff member heads a function responsible for legal affairs, finance including taxation and budgeting, human resources, remuneration policy, information technology or economic analysis.”

A similar approach is taken in Article 6 of the draft RTS, which lists a number of functions.

If there is a function that the EBA wishes to include, it could do so by explicitly including it in the list in Article 6.

The second point relates to the wording “which has a responsibility to provide objective assessment of risks, reporting or assurance”.

This wording does not seem to be necessary or clear.

We would suggest that the definition of control function should be amended, as follows:

“ “Control function” shall be defined as a function independent from the business units that it controls, which has responsibility for risk management, compliance or internal audit.”

Definition of material business unit

The definition of material business unit is broader than the definition in the current RTS:

Point a of Article 4 includes “or is otherwise considered by the institution as having a material impact on the internal capital requirements of the institution”.

Point b of Article 4 is new “it provides a critical function or a core business line as defined in points (35) and (36) of paragraph 1 and paragraph 2 of Article 2 of Directive 2014/59/EU”.

Our understanding is that point a of Article 4 reflects the way that some institutions are already applying the current RTS.

However we are not sure of the rationale for point b. This seems to duplicate part of Article 6. For example, one function which may meet the definition of a critical function could be IT security, but this is already covered in Article 6.

We would like to ask for clarification as to what is intended to be covered under the critical function part of point b that is not already covered in Article 6.

The new wording of Article 4 is also more complex than under the current RTS. We ask for confirmation that firms that allocate regulatory capital to their divisions can continue to apply the test defined in limb (a) “2% of the internal capital of the institution” as a standalone test for identifying material business units, and that likewise, limb (b) “provides a critical function or a core business line” can be applied by firms that do not allocate regulatory capital to their

divisions, again on a standalone basis. It would be helpful if this understanding could also be clarified in the definition.

Significant impact on the material business unit's risk profile

Article 5(1) states that “...institutions shall set out within their remuneration policy qualitative or quantitative metrics to determine whether the professional activities of staff or categories of staff have a significant impact on the material business unit's risk profile...”

We consider that the requirement for firms to create a new set of qualitative or quantitative metrics “to determine whether the professional activities of staff or categories of staff have a significant impact on the material business unit's risk profile” appears to create circularity or inconsistency by asking firms to create a second qualitative framework for MRT identification. Article 92 paragraph 3 (c) (ii) of Directive 2013/36/EU is intended to ensure that only staff members receiving significant remuneration whose activities have a significant impact on the business unit's risk profile should be categorised as material risk takers. This therefore simply requires the careful application of the qualitative criteria in the regulatory technical standards to those staff. We do not think it requires the creation of new qualitative and quantitative criteria to supplement the regulatory technical standards, which presents circularity and may result in inconsistencies with the regulatory technical standards themselves.

We would suggest alternative drafting as follows:

“For the purpose of applying point (c) (ii) of paragraph 3 of Article 92 of Directive 2013/36/EU, institutions shall set out ~~within their remuneration policy qualitative or quantitative metrics~~ **objective criteria** to determine whether the professional activities of staff or categories of staff have a significant impact on the material business unit's risk profile, taking into account the following ~~criteria~~ factors:

- a) the risk profile of the **material** business unit as defined by Article 73 of Directive 2013/36/EU;
- b) the institutions' overall risk strategy and risk appetite;
- c) the risk limits of the **material** business unit;
- d) the relevant risk and performance indicators used by the institution to identify, manage and monitor risks of the **material** business unit in accordance with Article 74 of Directive 2013/36/EU;
- e) the relevant performance criteria set by the institution under points (a) and (b) of paragraph 1 of Article 94 of Directive 2013/36/EU;
- f) ~~the professional activities, including~~ the duties and authorities of staff members or categories of staff.”

Readability

Article 5(2) is helpful in providing a reminder that institutions should consider staff expressly referred to in Article 92 CRD, and those referred to under Article 94(2)(c) CRD, and categories of staff under Article 6 (qualitative criteria) and Article 7 (quantitative criteria).

We suggest that this could usefully be moved so that it is at the end of Article 1. (Article 5 would then just have one paragraph, defining significant impact. We suggest that the heading of Article 5 should be amended to “Significant impact on the material business unit’s risk profile”).

We suggest also that it would be helpful to institutions to clarify within the RTS that the RTS criteria apply in addition to the criteria in CRD, given that the regulators will require both the criteria in the RTS, and the criteria in the CRD (as transposed by the relevant Member State) to be applied.

We suggest that the order of Articles 2, 3 and 4 should be changed, so that:

Material business unit is defined first;

Control function is defined second;

Managerial responsibility for a material business unit or control function is defined third (ie referring back to previously defined terms);

Question 3: Are the qualitative criteria within Article 6 appropriate and sufficiently clear? Having in mind that the qualitative criteria are comparable to the ones included in the RTS currently in force, respondents are asked to focus on the amended criteria within points 1 and 6.

The qualitative criteria, and the linkage to the level of decision-making

Article 6 of the draft RTS states that

“...members of staff shall be deemed to have a material impact on an institution’s risk profile if one or more of the following criteria are met:

- (1) the staff member has managerial responsibilities for [list of functions including legal, tax, etc]”

We consider that Article 6 should be clarified.

The first point is that there are consequences of choosing to use the concept of managerial responsibility in this Article.

When combined with the definition of managerial responsibility in Article 2 of the draft RTS, Article 6 would bring into scope not only the head of legal affairs, head of finance, etc, but also their direct reports. This would be a significant extension of Article 3(9) of the current RTS, and it is not clear why this is considered necessary.

The simplest option to retain the current scope would be to revert to the wording “heads a function responsible for” instead of “has managerial responsibilities for”. This would avoid getting the qualitative criteria in Article 6 mixed up with the new definition of managerial responsibility. It should be noted that the mandate in the CRD to define managerial responsibility does not itself require the EBA to use the term in the new Article 6. Another option, if the EBA considers that it is in fact necessary to go down to the level of the direct reports in some circumstances, would be to have a reference to staff with delegated responsibility to make decisions (though that would still be an extension of the current criteria).

The second point is about the descriptions in the list of functions. For example, the expression “dealing with human resources” is less clear than simply “human resources”. We would suggest

that all similar descriptions should be clarified. In addition, we understand that “information technology or security” is intended to mean “information technology or information technology security”.

The third point is that the meaning of “critical or important functions” is not clear. We understand that there is no definition of “important function” in CRD, and that from a legal point of view it is not permitted to use the definition of “critical and important functions” from the EBA guidelines on outsourcing, because that definition is in a lower level text. We also note that managing outsourcing arrangements of critical or important functions does not represent an existing function within the organisation but is directly managed through the strategy of the businesses. In this context, we consider that this criteria and function should be deleted.

Based on the above, we propose amending Article 6 as follows:

In Article 6(1):

“...members of staff shall be deemed to have a material impact on an institution’s risk profile if one or more of the following qualitative criteria are met:

The staff member is the head of:

- (a) legal affairs
- (b) finance
- (c) tax
- (d) economic analysis
- (e) prevention of money laundering and terrorist financing
- (f) human resources
- (g) remuneration policy
- (h) information technology or information technology security
- ~~(i) outsourcing arrangements of critical or important functions”~~

In Article 6(2):

“the staff member is head of a risk category...”

In Article 6(5):

"the staff member is head of a group of staff members..."

Question 5: Are the quantitative criteria within Article 7 appropriate and sufficiently clear? [AFME note: there is no Question 4 in the consultation response form]

The quantitative criteria in Article 7 are clear, though there is now greater complexity as a result of having some quantitative criteria in Article 92(3)(c) CRD.

Our understanding of the interaction of the various quantitative criteria is set out below.

We would appreciate confirmation that our understanding is correct, and we would suggest including examples in the guidelines when they are updated.

The conditions in Article 92(3)c) are as follows:

Condition (i) – first part

- the staff member's remuneration is equal to or greater than EUR 500 000

Condition (i) – second part

- the staff member's remuneration is equal to or greater than the average remuneration awarded to members of the institution's management body and senior management...

Condition (ii)

- the staff member performs the professional activity within a material business unit and the activity is of a kind that has a significant impact on the relevant business unit's risk profile;

For a staff member to fall within the definition in Article 92(3)(c), it is necessary to meet ALL these conditions.

A consequence of Article 92(3)(c) CRD is that staff who fail to meet condition (ii) will automatically fail to meet the MRT definition in that Article, irrespective of how much they earn. We understand that this is the reason why the EBA has introduced Article 7(1)(a) in the RTS, which states that

“Without prejudice to point (c) of paragraph (3) of Article 92...members of staff shall be deemed to have a material impact on an institution's risk profile, where...the staff member...has been awarded in the preceding financial year a total remuneration which is equal to or greater than EUR 750 000;”

This is to ensure that (subject to the limited exceptions set out in the rest of Article 7), staff whose remuneration is equal to or greater than EUR 750 000 will be identified as material risk takers.

Article 7(1)(b) (“the staff member is within the 0.3% of staff...who have been awarded the highest total remuneration”) now applies to the institution on an individual basis. We understand that the reason for this is that if there is a group which has operations in several countries with different pay levels, the current criterion (which applies at group level) may not identify the highest paid staff in a country with a lower pay level.

As a consequence, staff members not falling under Article 92(3)(c) and with a remuneration lower than 750 000€ may still be identified at the level of the subsidiary (based on the application of Article 7(1)(b)) if their remuneration is within the 0.3% of staff... (which may be lower than 750 000€).

Question 6: Are the provisions within Article 8 appropriate and sufficiently clear?

We suggest that Recital 14 (and therefore Article 8) should be clarified to state that there should be flexibility for remuneration to be calculated ‘for’ a performance year (in other words, firms should have the flexibility either to calculate ‘for’ a performance year or ‘in’ a performance year). Although we understand the EBA's concern that there is usually a delay between the end of a

performance year and the award of variable remuneration and therefore relevant MRTs are not identified until after the award of variable remuneration for the performance year, the concept of remuneration for a performance year is well understood by firms and staff and we consider that it would be more natural to use this concept, rather than constructing a different measure by taking the salary from one year and the bonus related to a different year. When a firm performs an MRT identification, that determination is considered for the full year, regardless of how long after the prior performance year the variable remuneration was actually awarded (and therefore when the quantitative criteria are calculated). The EBA Guidelines on Sound Remuneration Policies paragraph 85 should also be updated to reflect this greater flexibility. We note that cases of joiners and leavers during the year can also be accommodated with this more flexible approach.

Article 8(2) refers to “a full time equivalent basis”. We would like to ask for clarity as to what this means for Non-Executive Directors.

Question 7: Considering that the RTS will apply to all credit institutions, are there specific provisions within the RTS that would not be appropriate to be applied to small and non-complex institutions and should be replaced by different provisions?

Where this is the case, respondents are provided to make concrete examples of issues created and alternative approaches that would ensure that all staff whose professional activities have a material impact on the risk profile of the institution are identified.

Acknowledging that this is a requirement of the RTS currently in force, it would be helpful to apply a degree of proportionality specifically for application on an individual basis.

The current EBA Guidelines on Sound Remuneration Policies (paragraph 79) require that Material Risk Taker (“MRT”) identification be performed before the remuneration requirements are then applied in a proportionate manner. However, many of the institutions in scope of the CRR and CRD requirements are groups with a large number of legal entities and this can lead to duplication due to divisions and functions cutting across multiple entities (e.g. where one individual meets the same MRT criteria for multiple entities).

Some degree of proportionality may be appropriate for smaller subsidiaries. We would suggest exploring whether a starting point could be to identify MRTs in accordance with the criteria in Article 92(3) CRD. When interpreting “material business unit” in Article 92(3)(c), the assessment of whether it meets the criterion in point b of Article 4 should be determined by asking whether the business unit is a core business line at group level.

Question 8: Do respondents with the findings of the impact assessments? Where respondents have comments on the additional cost and benefits created by the consulted RTS, comments are most helpful if they detail the costs and the responsible drivers as well as the challenges when applying the criteria set out within the RTS. Where respondents find that the criteria lead to an identification of staff that does not have a material impact on the institutions risk profile, comments are most helpful if they detail the numbers of staff identified under the criteria and the main reasons why those staff members would systematically not have a material impact on the institutions risk profile.

We understand that the question of the application date is not a decision for the EBA. We would suggest however that it would make sense from a cost-benefit point of view for the application date to be aligned with that of the Investment Firm Directive, given the interaction with CRD.

Next steps

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

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

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