ICI Global

Q 4: Are the guidelines regarding remuneration policies and group context appropriate and sufficiently clear?

ICI Global believes that the guidelines regarding remuneration policies and group context are not appropriate because: (i) they are built on an overly-expansive reading of CRD IV Article 92(1); (ii) they undermine the political agreements found between co-legislators at Level 1 in respect of other legislative pieces (i.e., UCITS V and AIFMD); and (iii) they would create an un-level playing field for UCITS managers and AIF managers.

The International arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US$19.4 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment undrs, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.

Overly-Expansive Reading of CRD IV With Respect to Subsidiaries

In the consultation, the EBA takes the position that: “In accordance with Articles 92(1) and 109 of CRD the consolidating institution must ensure that subsidiaries within the group which are not themselves subject to the CRD, apply the group wide remuneration policies to all staff and the requirements of Article 92(2), 93 and 94 of CRD at least to those staff members whose professional impact on the group’s risk profile […]” The EBA envisages applying the full CRD IV remuneration framework to all subsidiaries, even to subsidiaries which are already subject to the same principles limiting excessive risk-taking through tailored sectoral regulation (i.e., UCITS V and AIFMD). [1]

In our view, this is an overly-expansive reading of the Level 1 text. We believe that Article 92(1) should be read as imposing the CRD IV remuneration framework to […] institutions at group, parent company and subsidiary levels, […] only when these affiliates are not already subject to sectoral regulation applying the same principles (i.e., UCITS V and AIFMD). We understand that the EBA is seeking to have a consistent application of its remuneration framework for a group and its subsidiaries. However, because AIFM and UCITS managers are already subject to specific remuneration requirements it is not necessary for these entities to be captured under the CRD IV remuneration requirements.

EBA Approach Undermines the Political Agreement at Level 1

Applying the CRD IV remuneration requirements to AIFMs and UCITS managers already covered by sectoral legislation undermines the political agreements reached in respect of these Directives. If co-legislators (European Parliament and Council of Ministers) and the European Commission had wanted to impose the CRD IV remuneration regime to all UCITS managers and AIFM, it would have been done more directly (e.g., by drafting CRD IV so that it was clear it was applicable to fund (UCITS and AIF) managers or by cross-referencing CRD IV in AIFMD and UCITS V Level 1 texts). Instead, there have been extensive discussions on each text between the co-legislators agreeing to specific provisions for the respective Directive. For instance, the question of imposing a cap on bonuses paid to UCIS managers was specifically debated within the Parliament when reading the UCITS V Level 1 proposal and the Parliament voted clearly against such a cap. It would therefore be wholly inappropriate to indirectly impose such a cap on UCIS managers through Level 3 guidelines elaborated by EBA in the context of CRD IV.

Regarding remuneration of UCITS managers and AIFMs, the co-legislators' intent was to impose similar principles as those adopted under CRD IV, but, importantly, adjusted for each sector. As a whole, the remuneration frameworks under the AIFMD and UCITS V, on the one hand, and CRD IV, on the other hand, are not fundamentally different; they do, however, address different segments of the financial sector in the manner appropriate for that financial sector.

Distortions in Competition

Lastly, indirectly imposing the CRD IV remuneration requirements to UCITS and/or AIF managers that are subsidiaries of a banking group would create distortions in competition (e.g., an un-level playing field), and would not work towards improving financial stability.

The EBA's interpretation would create a dual regime between bank-owned UCITS and/or AIF managers that would be forced to apply the CRD IV and EBA remuneration guidelines, including a cap on bonuses and a questionable reading of proportionality, and "non-bank-owned" UCITS and/or AIF managers that would be subject to the requirements in UCITS V and/or AIFMD. See our response to Question 5 below regarding EBA's interpretation of proportionality and our concerns with a dual regime.

As stated above, imposing the CRD IV remuneration framework on bank-owned UCITS and/or AIF managers is not necessary. AIFMs and UCITS managers are each subject to
specific sectoral legislation that contains substantive remuneration requirements that have been developed and agreed to among the co-legislators in order to mitigate the risks associated with remuneration policies that encourage excessive risk taking, keeping in mind the very specific nature of fund management (acting as agent on behalf of investors). Importantly, these Directives have been specifically designed for this type of entity and should adequately address bank regulators' concerns regarding risks that such entities may pose to the parent or group. Risks that may arise from UCITS or AIF managers are, without a doubt, better addressed by sectoral legislation that recognizes the fundamental distinction between the agency nature of the fund management business and the principal nature of banking.

We recognize that the EBA may be concerned about potential circumvention of the CRD IV remuneration requirements by firms and its subsidiaries, including UCITS and AIF managers. We stress, however, that the EBA does not need to apply the remuneration guidelines in the manner contemplated because, to the extent a relevant Member State banking regulator believes a significant risk exists in a particular circumstance, the banking regulator would have ample authority to step in to protect the banking entity from such perceived risk.

[1] This also applies to specific requirements of CRD, which have not been included in other sectoral legislation (e.g. staff within entities that fall within the scope of the AIFMD and UCITS Directive and are part of a group have to comply with the limitation of the variable components of remuneration to 100% [if applicable, up to 200% with shareholders’ approval] of the fixed components of remuneration if their professional activities have a material impact on the group’s risk profile on a consolidated basis).

Q6: All respondents are welcome to provide their comments on the chapter on proportionality, with particular reference to the change of the approach on ‘neutrality’ that was required following the interpretation of the wording of the CRD. In particular institutions that used ‘neutralizations’ under the previous guidelines for the whole institution or identified staff receiving only a low amount of variable remuneration are asked to provide an estimate of the implementation costs in absolute and relative terms and to point to impediments resulting from their nature, including their legal form, if they were required to apply, for the variable remuneration of identified staff: a) deferral arrangements, b) the pay out in Instruments and, c) malus (with respect to the deferral variable remuneration). In addition those institutions are welcome to explain the anticipated changes to the remuneration policy which will need to be made to comply with all requirements. Whenever possible the estimated impact and costs should be quantified, supported by a short explanation of the methodology applied for their estimation and provided separately for the three listed aspects.

The EBA states that, based on its preliminary legal analysis – supported by the European Commission – the approach to the application of the principle of proportionality has been changed compared to the 2010 CEBS Guidelines with respect to the possibility to “neutralize” some of the principles such as the deferral of variable remuneration, the pay out in Instruments and the application of malus and clawback. We fundamentally disagree with the EBA’s legal analysis regarding proportionality and neutralisation. We further believe that the EBA’s proposed approach is inappropriate from a policy perspective, particularly because of the expected impact on UCITS, AIFs, and their managers.

Legal Analysis

CRD IV Level 1 Text

The CRD IV Level 1 text, together with the previous interpretation under CRD III, does not support the proposed EBA interpretation of proportionality. The operative provisions in article 92(2) and 94(1) of CRD IV state that “institutions must comply with the following principles in a manner and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities” [emphasis added]. The specified principles with which firms need to comply include general principles such as establishing a remuneration policy that is consistent with and promotes sound and effective risk management as well as specific principles such as setting appropriate ratios between the fixed and the variable component of the total remuneration whereby the variable component shall not exceed 100% of the fixed component of the total remuneration for each individual.

The phrase “to the extent” refers to the limit or scope of application of a principle. The natural reading of the phrase “comply with the...principles...to the extent...appropriate” is that in certain circumstances it may not be appropriate to comply with all of them. Synonyms for “to the extent” are “to the degree” or “so far as.” [1] Compliance with a principle “to so far as appropriate” or to the degree appropriate” does not require full compliance with every detail of every provision and permits neutralisation or dissipation of a particular principle when deemed appropriate. Disapplication or less than full compliance are manners by which the principles as a whole may be applied proportionately.

Recital 66 of CRD IV also supports this interpretation: “The provisions of this Directive on remuneration should reflect differences between different types of institutions in a proportionate manner, taking into account their size, internal organisation and the nature, scope and complexity of their activities. In particular it would not be proportionate to require certain types of investment firms to comply with all of those principles.” [emphasis added] If all institutions were required to apply the principles to the full extent and were unable to apply a lesser threshold or to neutralize, then they would be obliged to comply with all of the principles, contrary to this provision.

It is also important to note that an equivalent recital in CRD III expressly provided that “it may not be proportionate for investment firms referred to in Article 20(2) and (3) of Directive 2006/49/EC [e.g. MiFID investment managers] to comply with all of the principles” (Recital 4, Directive 2019/76/EU). Through its equivalent guidelines under CRD III, CEBS permitted certain firms to treat certain principles as having been neutralized on the basis of proportionality. We submit that position taken by CEBS is in correct interpretation.

Further, it is highly relevant that Article 92 and recital 66 were not substantively amended from the text in CRD III. The provisions relating to proportionality were lifted from the CRD III measures and if it was ever the intention of the Parliament, Council or Commission to change the interpretation of the CRD III measures (given also that the CEBS Guidance was in force and publicly available during the triilogue process), there was sufficient opportunity for the legislature to have changed the operative provisions in CRD IV. That they did not indicates that the interpretation of proportionality was settled under CRD III and the CEBS Guidance.

Proportionality Generally

This interpretation of the CRD text, as described above, is also consistent with the proportionality principle under EU law. As specified in the Treaty on European Union (“TEU”), all EU law must be proportionate. [2] The Parliament, Council and Commission are bound by the principle of proportionality and, consistent with the Meroni doctrine [3], so too is
EBA when exercising its powers under CRD IV and the Founding Regulation (1093/2010).

The EBA's guidelines addressed to institutions and competent authorities must therefore be necessary to achieve a legitimate aim and there must not be a less onerous way of achieving the aim. The guidelines must also be reasonable, taking into account the competing interests of different groups. [4]

If the EBA and the Commission were to interpret the pay-out process rules as setting the lowest common standards which all institutions must apply, "proportionality" would mean that certain institutions (e.g. those that are more complex, large or trade in complex products) would only be free to set more onerous standards. This form of "upward" proportionality would be contrary to the wider principle of subsidiarity/proportionality established by case law and the TEU.

Legitimate Expectation and Legal Certainty

Regulatory stability and predictability are central to the fundamental EU law principles of legal certainty and the protection of economic participants' legitimate expectations. The European Court of Justice has repeatedly stated that rules should be clear and precise, and their application predictable.

As explained above, the interpretation of proportionality under CRD 4 proposed by the EBA is fundamentally and qualitatively different from the approaches of certain Member State authorities as well as financial institutions' understanding of proportionality under very similar rules in CRD III and the textual interpretation of the CRD IV Level 1 text. There is a degree of instability and unpredictability in departing from the existing interpretation of proportionality in the manner which the EBA has proposed. Should the EBA's interpretation of proportionality be taken forward into new EBA Guidance, this would represent a clear departure from what financial institutions have up to now legitimately implemented and expected of the law and would unfortunately lessen legal uncertainty.

Policy Considerations

In addition to being contrary and inconsistent with EU law, the EBA's proposed interpretation of the Directive is also inappropriate and undesirable from a policy perspective. We are, in particular, concerned about the impact the EBA's interpretation would have on UCITS, AIFs, and their managers.

Under the EBA's proposed interpretation of proportionality, the UCITS and AIF managers to which the CRD IV remuneration framework would apply would need to apply all of the CRD IV remuneration rules fully (with no ability to neutralize). In contrast, UCITS and AIF managers outside the scope of the CRD IV requirements would only be subject to their respective sectoral regulation. This interpretation would lead to a significant difference in the particular remuneration requirements applicable to AIFM and UCITS managers, depending on the applicability of the CRD IV requirements to the manager, resulting in a dual regime and an un-level playing field.

For UCITS and AIF managers to which the CRD IV remuneration framework would apply, there may be a significant negative impact both with respect to the firm's financial operations and the quality of talent that the fund manager can retain. First, in order to pay its staff a globally competitive level of remuneration, the fund manager would, in reality, need to pay a contractually higher level of fixed remuneration in order to be competitive. This would limit the firm's ability to manage its expenses in unfavorable market conditions, which could decrease the firm's flexibility and would negatively impact overall financial stability. Second, the inability of such a fund manager to compensate certain staff in the same manner, and perhaps at the same total level, as a fund manager that is not subject to the CRD IV requirements could dissuade talented and skilled individuals from seeking or accepting employment at such a firm.

A one-size fits all approach for all CRD IV firms, including their subsidiaries, does not make sense and is not appropriate. In particular, a UCITS or AIF manager generally does not engage in deposit taking or proprietary trading; a bonus cap placed on the manager's employees for such purposes will not, therefore, reduce the risk of systemic events.

We caution the EBA to consider that a lack of ability to apply the CRD IV remuneration requirements in a proportionate manner that includes both upward and downward adjustment may lead to unintended consequences, including restructuring of activities, operations and personnel. We also urge the EBA to consider that, at a time when the EU is seeking to solidarity and increase its position as a global financial center, proportionality serves a wider and significant purpose in supporting this position. Appropriate application of proportionality, both "upward" and "downward," affords firms the flexibility to address issues such as remuneration on a global level in a tailored, reasonable manner.

[1] Our interpretation of the English version of the text is supported equally by the French and German language versions, among others. In the French language version, the concept is expressed as "les établissements respectent les principes suivants d'une manière et dans une mesure qui soient adaptées à leur taille et à leur organisation interne ainsi qu'à la nature, à l'échelle et à la complexité de leurs activités," [emphasis added] which may be translated as "so far as" or "insofar as." Similarly, in the German version it is expressed as, "die nachstehenden Grundsätze in einer Art und einem Ausmass anwenden, die ihrer Groisse, ihrer internen Organisation und der Art, dem Umfang und der Komplexität ihrer Geschäfte angemessen sind" [emphasis added], which may be translated as "to the extent" or "to the degree."


Contact name

Eva Mykolenko
Interpretation of the proportionality principle as set out in Article 92(2) of the Capital Requirements Directive – Remuneration policies

Dear Ms Michou,

Articles 74(3) and 75(2) of the Capital Requirements Directive 2013/36/EU (CRD IV) mandate the EBA to develop guidelines on sound remuneration policies which comply with the principles set out in Articles 92 to 95 of CRD IV. According to Article 92(2) of CRD IV, ‘Competent authorities shall ensure that, when establishing and applying the total remuneration policies […], institutions comply with the following principles in a manner and to the extent that is appropriate to their internal size, internal organisation, and the nature, scope and complexity of their services’. On this point, recital (66) of CRD IV states that ‘The provisions of this Directive on remuneration should reflect differences between different types of institutions in a proportionate manner, taking into account their size, internal organisation and the nature, scope and complexity of their activities. In particular it would not be proportionate to require certain types of investment firms to comply with all of those principles.’

At the last meeting of the EBA’s Board of Supervisors held on 10 and 11 December 2014, different interpretations on the application of the proportionality principle as set out in the abovementioned Article 92(2) of the CRD IV were discussed. In line with current national regulatory and supervisory practices since the application of the CRD III remuneration provisions in 2011\(^1\), a strong majority of the members of the Board interpreted the wording of this provision, in light of the abovementioned recital, in a way that allows small and non-complex institutions to partially or fully waive certain CRD IV remuneration provisions. These members are of the view that the terms ‘in a manner and to the extent that is appropriate’ could be relied on as a ground for not applying certain requirements for small and non-complex institutions. Those are the provisions in points (l), (m) and (n) of Article 94 (1) of the CRD, namely the deferral of variable remuneration, its pay-out in instruments and implicitly the application of malus, which can only be applied if remuneration is deferred. For those, minimum quantitative thresholds are set within the CRD.

\(^1\) In fact, the 2010 CEBS guidelines on remuneration policies allowed a ‘neutralisation’ of a limited set of requirements in small and less complex firms.
The EBA’s legal view, however, is that given that the CRD IV remuneration principles themselves must be considered proportionate\(^2\), in the absence of any clear provision in the enacting terms of the directive, a waiver of the application of even a limited set of remuneration principles for smaller and non-complex institutions, when their risk profile allows, would not be in line with the CRD IV. The ‘manner and extent’ wording would enable institutions to take different approaches to implement the principles and to vary the intensity with which they apply them, but subject always to achieving the requirements in the principles. Where principles are more specific, such as in relation to the deferral of the payment or vesting of a portion of the variable remuneration (Article 94(1)(m) CRD IV), the ‘extent’ of compliance cannot fall below the figures set out in the principle (i.e. 40% deferral over 3 years) but more complex, larger institutions need to comply to a greater extent (e.g. by deferring more than 40% over 5 years or more).

However, from a policy perspective a waiver would appear justified for small and non-complex institutions, where only low amounts of variable remuneration are paid, even when the CRD IV contains a specific minimum threshold (i.e. on deferral, payment in instruments and retention, malus). Indeed, in these cases incentives to take excessive risks are practically non-existent; the level of risk which can be assumed by single risk takers is in most cases relatively low and cannot justify the application of ex-post risk adjustments to the variable remuneration, given also the low absolute levels of bonuses. If the EBA Guidelines had to adopt a strict legal interpretation, the proportionality principle established in the CRD IV would be severely constrained in its application and a substantial number of small and non-complex institutions, with very limited recourse to variable pay, would need to face significant implementation costs. In addition, in case waivers were to be explicitly allowed within the upcoming review of the remuneration provisions provided for in Article 161 of the CRD for mid-2016, institutions would be forced to change their remuneration policies unnecessarily.

The EBA is planning to finalise and publish a consultation paper at the end of February – following the meeting of the Board of Supervisors scheduled for 23 and 24 February 2015. The purpose of this letter is ask for the support of the Commission services to establish legal certainty regarding the scope and extent of application of the aforementioned proportionality principle as set out in Article 92(2) of CRD IV. In light of our tight deadlines, I would greatly appreciate if you could provide us with a response to this letter by 6 February 2015.

Thanking you in advance for your consideration.

Yours sincerely

Andrea Enria

CC: Jeroen Hooijer, Head of Unit A3 (Company Law)

\(^2\) In this regard, it is worth noting that the UK has withdrawn its challenge to Article 94(1)(g) (the so-called ‘bonus cap’ provision) on, *inter alia*, proportionality grounds.
EUROPEAN COMMISSION
DIRECTORATE-GENERAL JUSTICE and CONSUMERS

Acting Director General

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Subject: Interpretation of Article 92(2) of the Capital Requirements Directive
- remuneration policies

Dear Mr Enria,

Thank you for your letter of 8 January 2015, whereby you ask for our opinion about the application of Article 94(1) of the Capital Requirements Directive (CRD IV), in light of Article 92(2) of the Directive, to which it refers back.

The issue you raise in your letter is very important because it is essential that CRD IV is fully and correctly implemented across the EU in a way, which ensures financial stability within the EU and improves the functioning of the Single Market for financial institutions. It was thus essential for us to dedicate careful consideration to the issues raised in your letter.

The remuneration provisions in CRD IV contribute to its overall aim by ensuring that institutions have in place total remuneration policies, which are consistent with and promote sound and effective risk management, and which are suitable and appropriate in relation to the risk profile of the institution concerned. To this end, CRD IV lists several principles, which the total remuneration policies of the institutions covered by CRD IV need to comply with.

Articles 92 and 94 apply to all institutions, without any distinction. Article 92(2) clarifies in this context that competent authorities shall ensure that institutions comply with these principles in a manner and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities.

This means that each of the relevant provisions has to be applied to each institution, while any discretion those provisions may leave to Member States and competent authorities has to be exercised notably in compliance with the principle of proportionality. This is what Article 92(2) means when it stipulates that the "principles"
referred to must be applied "in a manner and to the extent that is appropriate …", as accurately highlighted in your letter.

By contrast, general principles as implicitly referred to in the introductory part of Article 92(2) can in no way justify the non-application of one or the other rule contained in that provision, or indeed in Article 94(1).

The above applies in particular to the provisions identified in your letter, namely points (l), (m) and (n) of Article 94 (1), which regulate deferral of variable remuneration, payout in instruments and the application of malus. Such provisions lay down clear rules and leave no room for exceptions or exemptions.

You highlight in your letter the significant implementation costs that accompany the requirements on deferral and payment in instruments, and you refer to the fact that in some small and non-complex institutions, where only low amounts of variable remuneration are paid, incentives to take excessive risks are practically non-existent.

However, it is neither for national competent authorities, nor indeed for EBA, acting in the context of Article 16 of Regulation No 1093/2010, to decide that certain rules adopted by the co-legislators shall not apply. It is exclusively for the co-legislators to amend the existing rules, notably with a view to make further distinctions. As you highlight in your letter, not applying certain provisions would be a decision taken "from a policy perspective", as opposed to the "legal view" that ought to govern EBA’s action in this matter.

The EBA guidelines are a very important tool in assisting the Member States and the institutions when implementing CRD IV, and therefore contribute to the consistent application of CRD IV across the EU. This purpose can only be fulfilled if they comply with the very terms of CRD IV, but not if they lead national authorities to the adoption of policies incompatible with those terms.

Naturally, guidelines should contribute to the consistent use of the margin of discretion co-legislators have left to national authorities, within the various individual rules. In this area, guidelines can provide a very valuable contribution, notably in light of the high degree of supervisory expertise available within the ESAs.

Yours sincerely,

Paraskevi Michou