

Comments

on draft Regulatory Technical Standards on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile

Register of Interest Representatives

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,000 banks.

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I. General remarks

The German Banking Industry Committee express their thanks and have pleasure in availing themselves of this opportunity to submit comments, to express their views on the proposal for RTS and to make further suggestions for amendments of the draft.

We welcome the decision of the EBA to define uniform criteria for identifying risk takers. It is to be expected that this will give the institutions a certain degree of legal security when deciding their risk takers.

However, the criteria proposed by the EBA are judged to go largely too far. In particular, the proposals far exceed the specifications of CRD IV. The principle of proportionality is disregarded. Moreover, under the categorisation proposed by the EBA the risk taker attribute is on principle irrefutably presumed if one of the criteria named by the EBA applies. In our view, the criteria named by the EBA should at best serve as indications for identification on an institution-by-institution basis. The fact that only few criteria are to be refutable meets with strong reservations in this context. Rather, all criteria should on principle be deemed refutable. Furthermore, the RTS submitted do not, contrary to the specifications of CRD IV, take the actual impact as the point of departure for identification as a risk taker but even the possibility of material impact on the risk profile. We also see as critical the fact that the institutions are to set up further internal criteria in excess of the large number of criteria already named. Therefore, the draft as a whole should be substantially revised. Specifically:

1. Compliance with the principle of proportionality

Recital 66 to CRD IV envisages that remuneration regulations should reflect the differences between the various types of institutions and should take their size and internal organisation as well as the nature, scope and complexity of their business into consideration in an appropriate way.

Pursuant to recital 92, this principle of proportionality applies to Regulatory Technical Standards as well. Proportionality in this sense means not only the proportionality at institutional level but also proportionality at employee level. However, the RTS draft in question does not make any use of this. Instead, the uniform criteria proposed by the EBA aim to define certain categories of members of staff in all institutions uniformly as risk takers without taking an institution-specific risk analysis into account and without considering the institution-specific organisational and business structures.

Admittedly Art. 2 (3) names the proportionality principle on which the internal criteria put in place by the individual institution are to be based; however, this is not taken into consideration particularly in the case of the qualitative and quantitative criteria. Instead, all institutions are to use the same criteria to define the risk takers. The approach adopted in the draft proposal, namely to define the risk takers solely on the basis of objective (qualitative and quantitative) criteria, contradicts the principle of proportionality as this procedure defines the risk takers independently of the risk profile of the institution and independently of the actual risk impact of the person in question. This means that many employees are classified as risk takers, who in practice are actually not to be seen as such.

The result of abstract criteria is that there are a certain number of risk takers in each institution without it being a question of the size of the institution or the type, scope and complexity of its business. In view of

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the regulations contained in Art. 3 (1) lit. f and Art. 3 (3) lit. a, this is likely to mean significantly more persons are categorised as risk takers in small institutions than would be the case in larger ones. Therefore, it should be decided that not all proposed criteria apply to all institutions and all categories of employees. In addition, the de minimis rules should be set for all quantitative criteria.

We also see the fact that one applicable category alone suffices to define the employee in question as a risk taker as being extremely critical. Differentiation according to real impact on the total risk profile of the institution is, however, indispensable.

Taking the institution-specific situation into account is necessary, particularly for smaller institutions as well as for those that have a low-risk business model and thus all in all a conservative total risk profile. In particular for small and medium-sized institutions with a simple and low-risk business model per se, it appears to be disproportionate, for example, to classify the heads of the legal, taxes or personnel departments generally as 'risk takers'. The position is similar for institutions whose operations are determined by set framework conditions and only permit a limited number of business operations with a low risk profile (e.g. promotional banks). The business operations and risk strategy of these institutions differ very substantially from those of the large commercial banks. Here it must be ensured that not only the interpretation of the criteria has to be restrictive but also the organisation specific to the individual institution and the risk structure as well as the powers the members of staff actually have must shape the identification of risk takers. Otherwise, the costs and time taken will be completely inappropriate and no longer justifiable in the case of these institutions, which is not in line with the purpose pursued by CRD IV and the underlying idea of proportionality.

2. Refutability of the criteria

As we understand it, the qualitative and quantitative criteria can – as far as applicable in due consideration of the principle of proportionality - only be brought in as refutable indications for the institution-specific identification process. We consider linking the qualitative and quantitative criteria with an institution specific risk analysis to be essential. The institutions must be given the possibility of applying the relevant criteria on the basis of their own business and risk structures.

Therefore, we do not consider the exception provided for in Art. 4 to be sufficient; on the one hand, it is only usable for the parameters 'variable remuneration' and 'remuneration spread', on the other hand, it would have to be established for each individual member of staff whether he or she is to be classified as a risk taker and, if not, why not. In our view, Art. 4 is to be formulated in such a way that the institutions have the right to refute all qualitative and quantitative criteria. Failing this, this right should at least exist in the case of the quantitative criteria. At all events, it must remain possible not to categorise groups of employees whose remuneration is variable to a large proportion, but only generate risks to a small extent (e.g. real estate agents) as risk takers for formal reasons.

3. Definition of the risk takers

Recital 62 as well as Art. 92 (2) and Art. 94 (2) of CRD IV define risk takers as such persons who effectively have a material impact on the risk profile of the institution. The draft submitted departs from this. Rather, all persons are categorised as risk takers if they have the possibility to have a material

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impact. This would increase the number of risk takers significantly. Therefore, we call for taking actual impact as a basis in line with the requirements proposed by parliament.

In addition, the relevant 'risk profile' should be defined in line with the regulatory criteria and be based on the market price, counterparty and operating risks that have already been quantified internally anyway. Here lower limits are to be set with a view to proportionality.

4. Document duty

Pursuant to Art. 2 (1), the institutions are to document the annual review. In order to keep administrative costs and work low, it makes sense for institutions to be given the possibility as part of the annual review to establish that in comparison with last year there have been no new risk takers. In this case, the further activities (renewed documentation of the review) could be dispensed with. It should be sufficient to document that there had been no changes.

5. Internal criteria

Given the background of qualitative and quantitative criteria drawing up additional internal identification criteria (Art. (2)) is neither necessary nor appropriate. The relevant risk takers have already been covered by the above criteria categories. This additional criterion is a completely indefinite opening which leaves each user of norms on his own. The resulting time and work involved, more precisely the process of developing and documenting criteria is entirely disproportionate.

The draft also states that the internal criteria are also to follow a completely unspecific definition of the term 'risk profile'. This means that the operating risk initially covers the risk for which the member of staff is accountable in the course of carrying out his or her function in the due and proper manner, but in addition requires considering the risks that can occur when a task is not performed in the due and proper manner. Giving such consideration to a group of employees that is initially not definable would involve an unreasonable cost and amount of time for operations in practice. Purely theoretically, far-reaching possibilities are to be taken into consideration for a large number of employees at a credit institution. This and the elusive reputation risk lead to uncertainties that foil what is being attempted by the orientation guidelines using the qualitative and quantitative criteria. It is likely to be barely possible to develop internal criteria that correspond to the other groups of criteria in their perceived value, but at the same time cover all conceivable risks at the institution. In view of the above remarks, the additional benefit of internal criteria is not recognisable.

Therefore it should be left up to the institutions themselves whether they define internal criteria of their own as part of their assessment in addition to the qualitative and quantitative criteria. A simple presentation of results in the documentation should be possible for this. In particular non 'important' institutions should be exempted from such an obligation.

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6. Qualitative and quantitative criteria

It does not seem appropriate to define each head of a business unit as a risk taker as Art.3. (1) lit. d envisages. This would mean that institutions would, for example, have to identify every branch office manager (also one-man offices). This clearly goes too far. As a rule, they have no powers in the risk-taking lending business. It should suffice to define such heads of the business units that actually have wide-ranging credit and other powers to assume risks.

As stated above, an acceptable result can only be obtained for identification of risk takers, if the qualitative and quantitative criteria only act as indicators that are reviewed using an institution-specific risk analysis. At any rate, the institutions must be given the possibility to refute categorisation as a risk taker in the case of those employees whose professional activities do not significantly affect the risk profile of the institution.

II. On the individual questions of the EBA

Q1: Is the list of specific functions listed appropriate or should additional functions be added?

We see no need to add additional functions. The functions proposed already go too far. Criterion (d) is especially unreasonable since it would cover any staff member who heads a separate legal entity within the group. For organisational or operational reasons, it is often necessary to have several (small) legal entities in a group to perform non-financial operations (i.e. back-office, call centre, housing. etc.). Heads of such legal entities generally have no material impact on the institution's risk profile and should therefore not be included in the category of identified staff. We would suggest excluding such functions or at least enabling staff members to be excluded from the category of identified staff if they meet this criterion only and have no material impact on the institution's overall risk profile.

To enable the proposed criteria to be applied, the following terms, in particular, need to be defined more precisely.

'Management body' in criterion (a): does this term only cover the Board of Managing Directors or also (parts of) the management level below? It should be made clear that the supervisory bodies in a 'two tier board system' do not count here.

Is criterion (e) ("heads a function responsible for...") restricted to a certain management level or could that also cover, for example, a team head two, three or four levels below the Board of Managing Directors? In our view, criteria (a) - (e) should all be restricted to the hierarchy levels 1 and 2 steps below the Board of Managing Directors.

Under Art. 3 (1) lit. e, the management levels below the Board of Management are automatically to be classified as risk takers. Even in larger institutions this blanket procedure would give rise to inappropriate burdens. And this applies all the more to small and medium-sized institutions, which as a rule are only accountable for a low level of risk. This is due to the fact that their inclusion would not reflect the actual distribution of risk takers in the bank. In many cases, managers subordinate to the Board of Management do not always have a relieving function in qualitative terms. In many cases, all important decisions,

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including those involving risk, are prepared and taken at the Board of Management level exclusively in small and medium sized institutions. By involving division heads in key functions, even in larger institutions members of staff are often included, who are only accountable for implementing the decisions of the Board of Management properly, but not for the underlying decision. In these cases categorisation as a risk taker is inappropriate on its merits. Therefore Art. 3 (1) lit. e should be deleted. Whether the persons named there are actually risk takers should be based on quantitative criteria entirely.

The relevant risk taker is only the person who ultimately decides whether a risk is taken or not. The voting that precedes it is irrelevant. Something else can only apply if the decision-maker is unable to assess the risk himself due to lack of understanding of the subject matter or the right methods (e.g. hedging instruments). In this case, the risk taker is to be seen as the member of staff at the immediately lower level in the hierarchy who voted for the decision and has the necessary knowledge of the matter in question.

Here, too, a minimum salary level or a lower limit for the variable pay is to be set.

Q2: Can the above criteria be easily applied and are the levels of staff identified and the provided threshold appropriate?

The proposed threshold of 0.25% would lead to a significant increase in the number of risk takers compared to the status quo.

The inclusion of members of staff who are authorised to take credit risks exceeding a certain percentage of the tier 1 capital requirement will lead to a disproportionately high number of staff members to be identified in the case of small institutions in particular. The RTS does not only cover the cases of individual authority but also those of overall authority. In other words, if the credit decision is signed by a number of members of staff as holders of decision-making power and the limit set is exceeded, all signatories will become risk takers directly. Thus the point of departure should only be the individual power to actually enter into a credit risk. A particular point to be criticised is that the relatively small size (0.25%) in banks with a small business volume very small credit exposures, which in terms of risk are of no relevance, are also covered. This, too, leads to a completely inappropriate enlargement of this group of persons and the concept of the 'risk taker'. To avoid this consequence, it is, in our view, strongly advisable to introduce a minimum amount as of which credit risk becomes relevant as a criterion for a risk taker. A threshold of 5 million euro would appear appropriate.

The proposed low threshold of 0.25 % ultimately means that in small institutions every corporate account manager would have to be identified as a risk taker. Therefore, the figure ought to be clearly increased. Setting differing threshold values for individual powers and joint powers is also conceivable (e.g. 0.5 % for individual powers and 1.0 % for joint powers). This could mean that not every corporate account manager in small institutions is categorised as a risk taker but only the members of management in corporate account and credit management or in trading.

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Q3: Can the criteria be easily applied and are the levels of staff identified and the provided thresholds appropriate?

The criterion in Article 3(1) lit. g (ii) should not be restricted to trading book exposures as banks' internal VaR methodologies usually cover both trading and banking book market risk in a combined approach. Applying the criteria only to the trading book would require significant additional investments in IT infrastructure. For this reason, the proposed threshold of 5 % should be reduced to 2.5 % but then cover both trading and banking book exposures.

Q4a: Is this criterion appropriate to identify risk takers?

In our view, this criterion is not appropriate to identify risk takers as it solely focuses on the remuneration of an employee. We would prefer criteria which instead take account of the function, authority and responsibilities of the employee as well as of different locations, market peculiarities, etc.

The German banking industry therefore rejects a fixed threshold for the variable remuneration. There are by all means employees who have a high variable proportion of their income without this making them risk takers for the institution (e.g. estate agents and other members of staff working on a fee basis). They are definitely not risk takers. Apart from this, taking variable remuneration for the definition of risk takers is not logical if as a result of establishing risk takers the variable remuneration is to be limited.

If the sole focus nevertheless remains on remuneration, there has to be a possibility to exclude staff members from the category of identified staff if they are identified by this criterion only and have no material impact on the institution's overall risk profile.

Q4b: Are the thresholds set in the criterion appropriate?

It is not clear why variable compensation exceeding EUR 75,000 should indicate that an employee has a material impact on the institution's risk profile. Furthermore, we would like to point out that an absolute threshold of this kind is not appropriate for companies with global activities in several markets. Additionally, this criterion is not consistent with, and even contradicts, the CRD IV approach, under which employees whose total remuneration exceeds EUR 500,000 are considered risk takers. There would be a massive impact on fixed salaries. We anticipate that the combination mentioned above (100,000 EUR / 75,000 EUR) would lead to a massive shift from variable to fixed pay.

At any rate, the basis should not be the remuneration that can be achieved but remuneration actually achieved.

Q4c: What would be the number of staff members identified in addition to all other criteria within the RTS?

It is not possible to say how many additional staff would be identified on the basis of the criteria in Article 3(2). But assuming that a risk taker is identified even if just one criterion is met (e.g. solely one in Article 3(2)), our rough estimate is that the number of identified risk takers would increase threefold.

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An analysis of effects on the number of persons affected should be carried out before the regulatory standards come into force. This combined with the option to infer the adjustments shown to be necessary by the conclusions of the survey. However, this may not mean that adjustments go on being made until a defined minimum number of risk takers are prescribed in each bank.

Q4d: What would be the additional costs of implementation for the above criterion if an institution applies Article 4 in order to exclude staff from the group of identified staff?

Additional IT capacity would be needed. The corresponding costs would depend on the extent of all risk-taker relevant criteria and the necessary changes these would entail. The scale of additional costs therefore cannot be foreseen as things stand.

Q5a: Can the above criterion be easily applied?

On the subject of this criterion, it can be generally said that it does not seem appropriate. The criterion is supposed to have been met when members of staff are identified whose remuneration is comparable with the lowest remuneration level of another risk taker. This is not compatible with the aims of CRD IV, which takes the incentives of variable remuneration as a point of departure for the definition of risk takers.

By including members of staff below the Board of Management level (in particular through Art. 3 (1) lit. e), persons with annual income well below 100,000.00 EUR would be seen as risk takers in smaller institutions. If other members of staff are linked with these risk takers, the number of persons concerned rises exorbitantly. Admittedly, the institution is as an exception to have the possibility to prove that the members of staff who are comparable from the remuneration point of view do not have any significant impact on the risk profile of the institution. However, this requires a great deal of time and effort on the part of the institution and, given the wide definition of the concept 'risk profile', is hardly likely to be realisable. After all, in addition to the credit, market, interest rate and liquidity risks, the risk profile is also to cover the operating risk and the risk of damage to reputation. If an institution does not want to treat a member of staff identified as a risk taker, it must show that the person in question cannot have a material impact to the risk profile of the institution described in this way. This proof is likely to be hard to provide particularly regarding the operating risk and the risk of damage to reputation. Here, too, recourse is to be made to the risks quantified anyway.

In our view, this criterion is not suitable for the definition of a risk taker due to its volatility either. The classification of members of staff as risk takers since their remuneration is as high as that of another person defined as a risk taker leads to implementation problems in practice. It is not clear what the consequences will be if the remuneration of the reference person increases and as a result this criterion is no longer met. From the logical point of view the person assessed under Art. 3 (2) (b) would no longer qualify for categorisation as a risk taker. In this connection, the question also arises as to how this volatility in categorisation is to be resolved in terms of labour law. Moreover, it is to be borne in mind that Art. 92 (2) CRD IV only uses the criterion of the income level as a standard for the relevant members of staff categories with reference to the income level of senior management.

In our view, it is therefore necessary only to identify members of staff quantitatively if their pay exceeds a certain annual remuneration threshold. Gross annual remuneration of 150,000.00 EUR also seems

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appropriate against the background of the amounts for the other criteria. This means there would still be enough scope of application for the criterion in relation to the threshold of 500,000.00 EUR set out in Art. 3 (2) lit. c.

Q5b: Would it be more appropriate to use remuneration which potentially could be awarded as a basis for this criterion?

Past variable remuneration is much easier to apply and therefore more appropriate.

Potential remuneration is a theoretical figure and in addition it involves too much uncertainty in calculating the arithmetic value.

Q5c: What would be the difference in implementation costs if the potentially awarded remuneration would be used as a basis?

We anticipate no significant difference.

Q6: Can the above criterion be easily applied and are the threshold and the levels of staff identified appropriate?

With additional IT capacity, the criterion could be applied. The corresponding costs would depend on the extent of all risk-taker relevant criteria and the changes these entailed. It is therefore not possible at present to anticipate the level of the costs or classify them as being appropriate. In our view, this criterion is not suitable for identifying risk takers as it solely focuses on the remuneration of an employee. We would prefer criteria which instead take account of the employee's function, authority and responsibilities, as well as of different locations, market peculiarities, etc. However, if the sole focus remains on remuneration, there has to be a possibility to exclude such staff members from the category of identified staff if they are identified by this criterion only and have no material impact on the institution's overall risk profile. It should not be overlooked that individual contract modifications would be necessary.

Q7: Can the above criteria be easily applied and are the levels of staff identified appropriate?

The criteria can be applied with additional IT capacity.

Here it is, however, not a question of an objectively appropriate criterion. This criterion entirely serves the purpose of qualifying a certain percentage of persons as risk takers in each institution without it mattering whether the activities of these members of staff have a material impact on the risk profile of the institution or not. Instead, without taking an institution-specific view into consideration, it is assumed that the members of staff with the largest overall remuneration are risk takers automatically. Due to their special personnel and remuneration structures (very large proportion of part-time employees and nearly 100 % of employees paid under a collective agreement), results would be expected for certain small institutions that in part were not comprehensible. Thus defining the risk takers using this dubious quorum should be avoided.

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In addition, it is unclear whether the remuneration of members of the Board of Management should be included in the data base. Will the Board of Management itself be taken into consideration when establishing the (minimum) number of risk takers or are only the 'members of staff' to be included? This criterion is also dispensable as the qualitative criteria formulated already targets the Board of Management and the head of department's managers. Should, purely theoretically, other members of staff be on the list of the 0.3 % top earners apart from the management level, it is to be established in the individual case whether the person in question is a risk taker or not.

However, there should be a possibility to exclude staff members from the category of identified staff if they are identified by this criterion only and have no material impact on the institution's overall risk profile.

Q8: Are there additional criteria which should be used to identify staff having a material impact on the institutions risk profile?

No additional criteria should be added.

Q9: Could you indicate whether all the main drivers of direct costs from the RTS have been identified in the table above? Are there any other costs or benefits missing? If yes, could you specify which ones?

Yes, all the main drivers have been identified. No additional costs are missing.

Q10: For institutions, could you indicate which type of costs (a, b, c, d) are you more likely to incur? Could you explain what exactly drives these costs and give us an indication of their expected scale?

Drivers a and b are the most likely to occur. Costs will be significant in size and impact, especially when it comes to implementing the criteria in Article 3(1) lit. f and g.

Q11: Do you agree with our analysis of the impact of the proposals in this CP? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals?

As outlined in our replies to questions 1 to 10, there are certain points which are not appropriate in our view. In particular, the cumulative effect of using all the above-mentioned criteria would lead to a very large number of identified staff of which, in a second step (under Article 4), the majority would probably have to be excluded since they have no material impact on the institution's risk profile. Furthermore, the overall cost and time required for IT changes is not appropriate, in our opinion, and would make the process of identifying risk takers disproportionately time-consuming and expensive. By mainly focusing on quantitative criteria, moreover, there is a risk of ignoring "real" aspects of risk-taking functions.
