

Consultation Paper

Draft Regulatory Technical Standards

On criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile under Article 90(2) of the proposed Capital Requirements Directive



Consultation Paper 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 under Article 90(2) of the proposed Capital Requirements Directive

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1. Responding to this Consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions within the consultation paper.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Please send your comments to the EBA by email to EBA-CP-2013-11@eba.europa.eu by 21.08.2013, indicating the reference 'EBA/CP/2013/11' on the subject field. Please note that comments submitted after the deadline, or sent to another e-mail address will not be processed.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please indicate clearly and prominently in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an e-mail message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.eba.europa.eu under the heading 'Legal Notice'.

2. Executive Summary

The proposed Capital Requirements Directive (CRD) sets out requirements concerning remuneration, which are expected to apply from 1 January 2014, and mandates the EBA to prepare draft regulatory technical standards (RTS) in this area.

The EBA has developed these RTS proposals on the basis of the legislative texts for the CRD agreed by the European Parliament and the Council in April 2013.¹ These texts will be subject to legal-linguistic review before being adopted formally and the final text being published in the Official Journal of the European Union. The EBA will review the RTS proposals to ensure that they take account of any changes made in the final text of the CRD, and any changes arising out of the consultation process.

The draft RTS set out an identification process and criteria for the identification of categories of staff who have a material impact on the institution's risk profile ('Identified Staff') in accordance with the requirements of Article 88 (2) of the proposed Capital Requirements Directive (CRD).

The objective is to harmonise the identification of staff to whom the recently agreed regulatory requirements for the payment of variable remuneration will apply. The proposed Capital Requirements Directive (CRD) includes new requirements regarding variable remuneration to ensure that the remuneration awarded to identified staff provides appropriate incentives for long-term and sustainable risk-taking.

The identification process proposed is based on a combination of internal criteria developed by the institution itself and other regulatory qualitative and quantitative criteria:

Internal criteria: The use of internally developed criteria based on the institution's individual risk profile aim at ensuring that an institution is identifying staff comprehensively and in line with its business and risk strategy.

Qualitative criteria: The qualitative criteria identify staff within the management body, senior management and other staff with key functions or managerial responsibilities over other risk takers within institutions. In addition, the draft RTS contains criteria based on the authority of staff to commit to credit risk exposures and market risk transactions above certain thresholds calculated as a percentage of the Common Equity Tier 1 capital.

Quantitative criteria: The proposed quantitative criteria are different in nature: (i) one is based on total remuneration in absolute terms (staff earning more than EUR 500 000); (ii) one is defined in relative terms (0.3 % of staff with the highest remuneration); (iii) one is based on the remuneration bracket of senior management and other risk takers and, (iv) one is based on variable remuneration (variable remuneration exceeds 75 % of the fixed component of remuneration and EUR 75 000).

While the use of regulatory, qualitative and quantitative criteria aims at ensuring harmonisation and a level playing field regarding the employment conditions of staff, the internal criteria will help to take the risk profile of individual institutions into account.

¹ The CRD text as agreed by the Council can be found at <http://register.consilium.europa.eu/pdf/en/13/st07/st07746.en13.pdf>

Under this proposal, a staff member will be characterised as ‘Identified Staff’ if at least one of the criteria (internal risk analysis criteria or regulatory qualitative/quantitative criteria) is met. However, if staff are identified under the criteria based on the payment bracket or variable remuneration only, institutions would be able to exclude staff from the group of identified staff if they can demonstrate that the staff member has in fact no material impact on the institutions’ risk profile. The proposed criteria together will ensure that all material risk takers within different types of institutions are identified.

In accordance with its mandate, the EBA will finalise the draft RTS at the beginning of 2014, taking into account the responses to the public consultation and the opinion of the Banking Stakeholders Group. When the draft RTS are finally adopted by the European Commission, the EBA will update the Guidelines on Remuneration Policies and Practices.

3. Background and rationale

Inappropriate incentives for management and employees within institutions' remuneration frameworks are considered to have been a contributory factor that led institutions to implement short-term oriented and excessively risky strategies, by granting disproportionate rewards on the upside and insufficient penalties on the downside. The remuneration policies did not take into account sufficiently the long-term risk profile, but focused on the short-term profitability of the institution. Directive 2010/76/EC (CRD III) has already introduced requirements on the payment of remuneration to identified staff.

Article 88(2) of the proposed new Capital Requirements Directive (CRD IV) provides that 'Competent authorities shall ensure that, when establishing and applying the total remuneration policies, inclusive of salaries and discretionary pension benefits, for categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on their risk profile, institutions comply with the following principles in a way and to the extent that is appropriate to their size, internal organisation and the nature, the scope and the complexity of their activities.'

Under Article 90(2) of CRD IV the EBA is mandated to 'develop draft regulatory technical standards with [...] respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on the institution's risk profile as referred to in Article 88(2).'

In developing its proposals the EBA took into account the Guidelines on Remuneration Policies and Practices issued by the Committee of European Banking Supervisors. Those contained general criteria for the assessment of the materiality of the influence of staff on the institution's risk profile. The appropriate identification of risk takers is necessary to ensure an effective application of remuneration requirements contained within the CRD IV. The application of the remuneration framework is subject to existing Guidelines on Remuneration Policies and Practices^[1] which will be revised.

EBA conducted a survey on the national implementation and the practical application of the CEBS Guidelines. The 'Survey on the implementation of the CEBS Guidelines on Remuneration Policies and Practices' was published on 12 April 2012^[2]. The analysis showed that the range of practices was inappropriately broad and found that the percentage of staff being identified still differs significantly between Member States and institutions. The criteria for the identification of risk takers developed by institutions so far did not always consider sufficiently the impact on the institutions' risk profile and therefore sometimes failed to identify appropriately staff members for which the regulatory requirements regarding the payment of remuneration should be applied. The present level of regulation provided in Directive 2006/48/EC and the CEBS Guidelines has not been sufficient to establish consistent practices throughout the European Union.

The draft RTS in this consultation paper sets out qualitative and quantitative criteria for the identification of categories of staff who have a material impact on the institution's risk profile in accordance with the requirements of Article 88 (2) [CRD].

The identification process proposed is based on a combination of internal criteria developed by the institution itself and other regulatory qualitative and quantitative criteria. The combination of all the criteria put forward in this draft RTS will ensure that each institution's individual risk profile is taken into

^[1] Guidelines issued by CEBS, available on the EBA website

^[2] The survey can be found on the EBA website published together with the Guidelines on Remuneration Policies and Practices.

account appropriately while common qualitative and quantitative criteria will ensure a consistent identification of risk takers between institutions.

Institutions will have to develop internal criteria based on the results of their internal risk assessment processes. The use of internally developed criteria based on the institution's individual risk profile aims at ensuring that an institution is identifying staff comprehensively in line with its business and risk strategy.

The qualitative criteria aim at identifying staff in key areas and functions where the EBA considers that the impact on the risk profile is always material, and staff with the authority to take material risks. In particular, all members of the management body or senior management shall be identified. The draft RTS also elaborates on other functions which are relevant for the institution's risk profile. Other criteria are based on the authority of staff to commit to credit risk exposures and market risk transactions above certain thresholds calculated as a percentage of the Common Equity Tier 1 capital.

In addition, the levels of remuneration are used as quantitative criteria. The total remuneration awarded depends mainly on the responsibilities, duties, abilities and skills of staff and the performance of staff and the institution. Where individuals could potentially be awarded a very high remuneration, this is usually linked to the potential impact of their activities on the risk profile. This draft RTS puts forward quantitative criteria of different natures: (i) criteria based on total remuneration in absolute terms with predefined quantitative thresholds or in relative terms compared to the remuneration bracket of senior management and risk takers within the institution and (ii) criteria based on variable remuneration.

The quantitative criteria based on the remuneration bracket or variable remuneration may in some cases lead to the identification of staff members who have in fact no material impact on the institution's risk profile. Institutions, therefore, have the possibility, subject to additional assessment and documentation requirements, to demonstrate that staff members identified solely by these two criteria, and who have not been identified by any of the regulatory qualitative or internal criteria, have in fact no material impact on the institution's risk profile and exclude those staff members from the group of identified staff. For staff receiving a particularly high remuneration it can be assumed that they always have a material impact on the institution's risk profile.

4. Draft regulatory technical standards on criteria to identify categories of staff whose professional activities have a material impact on the institution's risk profile under Article 90(2) of CRD IV

In between the text of the draft RTS/ITS/Guidelines/advice that follows, further explanations on specific aspects of the proposed text are occasionally provided, which either offer examples or provide the rationale behind a provision, or set out specific questions for the consultation process. Where this is the case, this explanatory text appears in a framed text box.

COMMISSION DELEGATED REGULATION (EU) No .../..

of XXX

[...]

supplementing Directive 2013/xx/EU [CRD IV] of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2013/xx/EU [CRD IV] of the European Parliament and of the Council of dd/mm/yyyy on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate², and in particular Article 90(2) thereof,

Whereas:

- (1) The Committee of European Banking Supervisors issued Guidelines on Remuneration Policies and Practices (the CEBS Guidelines) which contained general criteria for the assessment of the materiality of the influence of staff on the institution's risk profile, which have been implemented by institutions and competent authorities. The European Supervisory Authority (European Banking Authority) (EBA) subsequently conducted a survey on the national implementation and the practical application of the CEBS Guidelines which showed that the range of remuneration practices remained inappropriately broad and that the criteria used did not always consider sufficiently the impact of staff on the institution's risk profile. These technical standards should therefore build on the experience of the CEBS Guidelines and aim to achieve a higher level of harmonisation.
- (2) To ensure a sufficient level of harmonisation, the regulatory technical standards should provide a set of common criteria. Those criteria should be applied by the institution to ensure that staff having a material impact on the institution's risk profile is identified. The criteria should also be applied for institutions at group, parent institution and subsidiary level, including the branches and subsidiaries established in third countries. For this purpose the criteria should be based on the respective consolidated, subconsolidated and individual institutions' figures to ensure that the risk profile at all those different levels are consistently taken into account. When applying the criteria at consolidated and subconsolidated level, this can also encompass firms which are not institutions themselves. Those firms do not have to apply the criteria themselves, but

² OJ.....

should be included in the assessment to identify staff which is done at group and parent company level.

- (3) Risk assessment processes within institutions and groups are tailored to their activities and internal organisation. Therefore internal criteria should be used to assess the materiality of the influence of the professional activities of staff on the risk profile which also take into account the potential impact of staff on the institution's risk profile based on their authorities and responsibilities. Those criteria should therefore fully reflect all risks to which the institution or group is or may be exposed. The use of internal identification processes also enables institutions to set proper incentives within the remuneration policy to ensure the prudent behaviour of staff. These internal criteria should ensure that the identification of staff reflects the level of risk of different activities within the institution.
- (4) To ensure that the internal criteria do not have an adverse influence on the conditions of competition, institutions should have comparable processes and policies with respect to the application of the criteria. Hence the regulatory technical standards should set the framework for the application of the criteria within the internal identification process, while the more general framework for remuneration policies set out in [CRDIV] should be supplemented by guidelines issued by the EBA.
- (5) Members of the management body have the ultimate responsibility for the institution, its strategy and activities and therefore are always able to have a material impact on the institution's risk profile. This applies to the members of the management body in its management function who take decisions as well as to the members of the supervisory function who oversee the decision making process and challenge decisions made.
- (6) The senior management, heads of business unit and staff responsible for control functions within an institution are responsible for the day-to-day management of the business or the control functions. This encompasses the responsibility for making strategic or other fundamental decisions on the business's activities or the control framework applied. The risks taken by the business and the way they are controlled are the most important factors for the institution's risk profile.
- (7) Other functions can also be relevant for the institution's risk profile. This is not limited to functions responsible for creating additional business, but also extends to functions responsible for providing infrastructure and internal support which are crucial to the operation of the business.
- (8) As credit risk and market risk are typically entered into in order to generate business, the impact on risk profile can be assessed using criteria based on limits of authority which are calculated on the basis of capital figures and taking into account the risks inherent in positions. Credit exposures should also be taken into account where they are not related to lending activities to ensure that staff taking material credit risks are identified.
- (9) For some institutions the requirements for the trading book can be waived and the way limits are set differs between institutions using different approaches for the calculation of the capital requirements. The aforementioned aspects should be taken into account in defining the criteria for identifying staff. Within the trading area, limits are often set on a trading desk level, which is responsible for trading certain types of instruments. Trading desks often comprise a number of staff members. Limits of authority in the trading area should therefore be based on the aggregated exposures taken by a trading desk, encompassing all staff who have the authority to enter into such positions.

- (10) Staff in a managerial position are responsible for the business activities in the area under their management. Therefore, these regulatory technical standards should ensure that staff are identified as having a material impact where they are responsible for groups of staff whose activities could have a material impact, including where the activities of individual staff members under their management do not individually have a material impact on risk profile but the overall scale of their activities could have such an impact.
- (11) Decision-making involves the evaluation of risks. Significant decisions in institutions are regularly made on the basis of a four eyes principle requiring the approval of more than one staff member. The outcome of decisions is also often influenced by the staff advising on or initiating the decision while the formal decision making power is with more senior staff or committees. Therefore the criteria should take into account such collective decision-making processes.
- (12) The total remuneration awarded consists of a fixed and a variable component and depends principally on the responsibilities, duties, abilities and skills of staff and the performance of staff and the institution. In particular when an individual could potentially be awarded very high total or variable remuneration this is usually linked to the potential impact of their activities on the risk profile. The technical standards should therefore include criteria based on the total remuneration of staff and the ratio of variable to fixed remuneration for the identification of other risk takers. The thresholds used take into account the experience of competent authorities and data collected by the EBA and competent authorities.
- (13) However, levels of potential variable remuneration and being in the same remuneration bracket as staff whose activities have a material impact on risk profile are only proxies for the impact that a staff member has on an institution's risk profile. To ensure that the criteria within these regulatory technical standards only identify staff who actually have a material impact on risk profile, institutions should have the possibility of demonstrating that the professional activities of staff members who have been identified only under this criteria in fact have no material impact on the institution's risk profile. To ensure consistent application the regulatory technical standard should set out criteria for this purpose and documentation requirements to enable competent authorities to review the identification as appropriate. Such a process is, however, not necessary in relation to other criteria which more closely reflect the risk entailed in carrying out the activities concerned.
- (14) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) to the Commission.
- (15) The European Supervisory Authority (European Banking Authority) has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010.

HAS ADOPTED THIS REGULATION:

Article 1- Subject matter and scope

- (1) This Regulation establishes regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional

activities have a material impact on an institution's risk profile as referred to in Article 88(2) of Directive 2013/X/EU [CRDIV].

- (2) This Regulation applies, in accordance with Article 88 of Directive 2013/X/EU [CRDIV], for institutions at group, parent company and subsidiary levels, including those established in offshore financial centres, in addition to applying to institutions themselves.

Article 2 – Internal identification process

- (1) Institutions shall conduct an annual assessment to identify the staff whose professional activities have or could have a material impact on the institution's risk profile. Institutions shall identify and evaluate all information relevant to the assessment.
- (2) In conducting the annual assessment, institutions shall apply the criteria in Article 3. Institutions shall develop and apply additional internal qualitative and quantitative criteria which fully reflect the institution's risk profile in relation to all risks to which the institution is or may be exposed, including credit risk, market risk, interest rate risk, operational risk, reputational risk and liquidity risk.
- (3) When developing the internal criteria institutions shall take into account each of the following factors:
 - a. the size and internal organisation of the institution;
 - b. the nature, scope and the complexity of the institution's activities;
 - c. the extent to which the professional activities of staff could have a material impact on the institution's annual financial results or balance sheet;
 - d. the need for criteria to apply at different levels of application in accordance with Article 88(1) of Directive 2013/X/EU [CRDIV].
- (4) Institutions shall maintain a policy on the annual assessment process which includes each of the following elements:
 - a. the internal criteria and their underlying rationales;
 - b. a description of the information needed to carry out the assessment;
 - c. the roles and responsibilities of staff and functions, including control functions and committees, involved in designing, carrying out and reviewing the assessment process and its results.
- (5) Institutions shall maintain a record of the results of the assessments made, of the staff whose professional activities have been identified as having a material impact on the institution's risk profile, and of the staff whose professional activities have, in accordance with Article 4, been treated as not having such an impact.

Article 3 – Qualitative and quantitative criteria

- (1) Staff shall be identified as having a material impact on an institution's risk profile if they meet one or more of the following criteria:

- a. the staff member is a member of the management body;
- b. the staff member is a member of the senior management;
- c. the staff member is responsible and accountable to the management body for the activities of the internal risk control function, the compliance function or the internal audit function;
- d. the staff member heads a business unit (within the meaning of Article 137(1)(3) of Regulation (EU) No xxxx/2013 [CRR]);

Article 137 (1) (3) reads: 'business unit' means any separate organisational or legal entities, business lines, geographical locations;

- e. the staff member heads a function responsible for legal affairs, taxation, human resources, information technology, budgeting, economic analysis, or business continuity planning;

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

- f. the staff member has, individually or collectively with other staff members, authority to commit to credit risk exposures of a nominal amount per transaction which represents 0.25% of the institution's Common Equity Tier 1 capital;

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

- g. in relation to an institution to which the derogation for small trading book business under Article 89(1) of Regulation (EU) No xxxx/2013 [CRR] does not apply, the staff member has, individually or collectively with other staff members, authority to commit to transactions on the trading book which in aggregate represent one of the following:
 - i. where the standardised approach is used, an own funds requirement for market risks of 0.25% or more of the institution's Common Equity Tier 1 capital;
 - ii. where an internal model based approach is used, 5% or more of the institution's internal value-at-risk limit for trading book exposures at a 95th percentile, one-tailed confidence interval level;

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

- h. the staff member has managerial responsibility for a group of staff members who have individual authorities to commit the institution to transactions, and the sum of those authorities equals or exceeds a threshold set out in point (f) or in point (g);

- i. the staff member has managerial responsibility for a staff member whose professional activities have or may have a material impact on the institution's risk profile according to the internal risk identification process in Article 2;
- j. the staff member has, individually or collectively with other staff members, the authority to take, approve or veto decisions on the introduction of new products, material processes, or material systems.

(2) Staff shall be identified as having a material impact on an institution's risk profile if they meet one or more of the following criteria, subject to Article (4):

- a. the staff member could, in accordance with the institution's remuneration policy, be awarded variable remuneration that exceeds both of the following amounts:
 - i. 75% of the fixed component of remuneration;
 - ii. EUR 75 000;

Q4 a) Is this criterion appropriate to identify risk takers?
 Q4 b) Are the thresholds set in the criterion appropriate?
 Q4 c) What would be the number of staff members identified in addition to all other criteria within the RTS?
 Q4 d) 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?

- b. the staff member has been awarded total gross remuneration in one of the two preceding financial years which is equal to or greater than the lowest total remuneration that was awarded in that year to a member of staff who performs professional activities for the same entity and who either is a member of senior management or meets one of the criteria in paragraph (1) or one of the internal criteria referred to in Article 2;

Q5 a) Can the above criterion be easily applied?
 Q5 b) Would it be more appropriate to use remuneration which potentially could be awarded as a basis for this criterion?
 Q5 c) What would be the difference in implementation costs if the potentially awarded remuneration would be used as a basis?

- c. the staff member has been awarded total gross remuneration of EUR 500 000 or more in one of the two preceding financial years.

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

- d. the staff member is within the 0.3% of staff who received the highest total gross remuneration in either the most recent financial year or in the preceding financial year.

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

- (3) In paragraph (1), a reference to staff members having, individually or collectively with other staff members, authority to commit to transactions or exposures or to take, approve or veto a decision includes both of the following categories of staff:
- a. staff who are responsible for advising on or initiating such commitments or decisions;
 - b. staff who are members of a committee which has authority to make such commitments or to take such decisions.

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

- (4) For the purposes of this Article remuneration which has been awarded but is not yet paid shall be valued as at the date of the award without taking into account application of the discount rate referred to in Article 90(1)(f) of Directive 2013/xx/EU [CRD] or reductions in payouts, whether through clawback, malus, or otherwise. All amounts shall be calculated as at the end of the institution's financial year and on a full-time equivalent basis.

Article 4 - Staff with no material impact on the risk profile

Where a member of staff is identified as having a material impact on an institution's risk profile only as result of either or both of the criteria in points (a) and (b) of Article 3(2) the institution may treat the professional activities of that staff member as not having a material impact on the institution's risk profile if each of the following conditions is met:

- a. the professional activities of the staff member are not considered to have a material impact on the institution's risk profile pursuant to the institution's internal identification process carried out in accordance with Article 2 (other than as a result of the application of the criteria in points (a) and (b) of Article 3(2));
- b. the staff member in fact does not have a material impact on the institution's risk profile, taking into account in particular the absolute amount of variable remuneration which could be awarded, the staff member's authorities and duties and differences between the levels of remuneration which can be awarded in different jurisdictions where the institution undertakes business.

Article 5- Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission
The President*

*[For the Commission
On behalf of the President*

[Position]

5. Accompanying documents

5.1 Impact Assessment

Introduction

1. As per Article 10 (1) of the EBA regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council), any draft implementing technical standards/regulatory technical standards developed by the EBA – when submitted to the EU Commission for adoption – shall be accompanied by an Impact Assessment (IA) which analyses ‘the potential related costs and benefits’. Such Impact Assessment shall provide the reader with an overview of the findings as regards the problem identification, the options identified to remove the problem and their potential impacts.
2. This note outlines the Impact Assessment (IA) on the criteria defined to identify staff whose professional activities have a material impact on an institution's risk profile. The development of draft RTS covering criteria for the identification of categories of staff who have a material impact on the institution's risk profile stems from the requirement presented in Article 90 (2) of the Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (CRD IV).

Problem definition

Issues addressed by the European Commission (EC) regarding staff whose professional activities have a material impact on the institution's risk profile

3. In its impact assessment of the CRDIV framework, the European Commission noted that the existence of wrong incentives for management and employees, in particular within remuneration policies, might have been a contributory factor that led institutions to implement short-term, excessively risky strategies. The Commission stated that “*remuneration policies in financial institutions had an enhancing pro-cyclical effect where they entailed disproportionate rewards on the upside and insufficient penalties on the downside, e.g., bonuses based on short-term profits that are paid immediately, with no risk adjustment or deferred payment to take account of future performance of the business unit or institution as a whole.*”³
4. In order to address the harmful effects of poorly designed remuneration structures, the European Parliament and Council adopted in CRD III in 2010 provisions requiring credit institutions and investment firms to establish and maintain, for those categories of staff whose professional

³ [Impact Assessment accompanying the document Regulation of the European Parliament and the Council on prudential requirements for the credit institutions and investment firms](#), p81

activities have a material impact on their risk profile, remuneration policies and practices that are consistent with effective risk management. These requirements aimed to create more incentives for staff members to behave prudently, by making short-term risk taking less attractive and ensuring that their personal objective are aligned with the long-term interest of the credit institution. They were clarified and completed later by CEBS Guidelines, which provided some additional guidance on the selection of Identified Staff.

5. However, it seems that these principles were too general and not sufficiently precise and left a too wide margin of appreciation that led to a wide range of practices being used⁴. To address this issue, Art 90 (2) CRD IV requires that EBA should develop draft RTS to further specify the criteria to identify staff having a material impact on an institution's risk profile. Those staff would be subject to the stricter requirements regarding the structure of their remuneration⁵.
6. The directive contains also disclosure requirements on the remuneration of identified staff to increase market discipline on remuneration policies. Increased harmonisation of disclosure on remuneration is also expected to reduce information costs to investors and allow comparison of remuneration practices across Europe.

Issues addressed by the RTS and objectives

7. The proposed draft RTS will supplement at a technical level the provisions of the CRD IV, with the aim of contributing to the realisation of the objectives of the level 1 text described in the previous section, in accordance with the mandate received within the CRD.
8. The application of appropriate criteria to identify staff is the essential starting point for the application of the requirements in CRD for staff who has a material impact on the institution's risk profile. To this end, this draft RTS defines criteria ensuring a harmonised identification in the EU of such staff members. The criteria within the RTS should help to identify not only a very limited number of staff in the highest hierarchic level, but also other risk takers and take into account qualitative and quantitative aspects.
9. The criteria should also ensure that the requirements in CRDIV regarding the remuneration of identified staff and the disclosure of remuneration practices effectively contribute to align the remuneration practice with the institutions risk and improve risk management practices.

Technical options considered

⁴ A recent survey conducted by the EBA on the implementation of the guidelines in the EU concluded that "*varying practices lead to differences in the criteria used to identify staff and in the number of Identified Staff within jurisdictions and internationally. Those differences could lead to regulatory arbitrage and competitive disadvantages. The result is that institutions have tended to select low numbers of Identified Staff, which is contrary to the objective of managing effectively risks resulting from remuneration policies and practices*".

⁵ The remuneration can consist of fixed and variable components, but the variable part is subject to conditions, a part shall be deferred (40-60%) for 3-5 years with the possibility to apply ex post risk adjustment in the next years.

10. The scope of application of this RTS is defined by the level 1 text, i.e. all institutions covered by CRDIV. Because this scope covers institutions with very different business models, activities and size, the EBA has tried to find criteria that are general enough to fit all type of institutions, take into account the typical risks of banking and investment business and avoid burdening institutions as much as possible.

Data Survey

11. The EBA has conducted a data survey in which some institutions were asked to provide information about the level of identified staff and to give feedback on criteria that the EBA considered when developing the consultation paper. The EBA received answers from 30 institutions ranging from large to small and including universal, retail and investment banks. In addition EBA received two analyses from competent authorities based on their own data analysis. This information covers 18 member states.

12. The EBA is grateful for the institutions and authorities contributing to the survey as they added value to the policy making process and provided valuable feedback on the criteria considered. Furthermore, given the short timeframe, the ESA's thank the institutions participating in this survey for their efforts in submitting the data quickly.

13. The EBA has considered many different types of possible criteria before choosing the final set of criteria that is presented in this draft RTS. For the sake of concision, the section below presents only for a few of them (in particular those taken into closer consideration); the rationale and justifications for retaining or discarding them.

A. Criteria based on the function, responsibility or seniority of the staff.

14. These criteria have been considered on the basis that the level of seniority or the type of activity and responsibilities of these staff members are in general good proxies for the influence that a staff members has on the risk profile of the institution. The EBA has chosen to retain these criteria because it believes that they successfully identify a large portion of the staff having an impact of the risk profile of the institution while being easy to apply.

B. Criterion based on the capacity of the staff to grant credit up to a certain percentage of common equity tier 1 capital (CET1) or to enter into other positions containing a material exposure to credit risk

15. These criteria aim to capture staff members taking credit risk, in particular when granting credit and also staff which has the authority to enter into positions which contain other credit risk exposures (e.g. bonds). The EBA considered that CET1 would be a more appropriate metric for the definition of a ratio than risk weighted exposure amounts or a ratio defined on the basis of overall own funds for the following reasons:

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16. Institutions usually set limits for lending activities in nominal values per transaction or per counterparty, mostly without considering the applicable risk weights. To take in account the risk of an exposure, the EBA considered the use of risk-weighted exposures as metrics. This option was not retained as institutions use different approaches for the calculation of the capital requirements, and using risk-weighted exposure would not have given consistent results across the industry.
17. The EBA has also considered using total own funds for the definition of thresholds, as it would have the advantage that the composition of the capital would have no impact on the thresholds. CET1 is relatively stable compared to Tier 2 capital which has a limited maturity. In addition larger institutions hold often a higher amount of additional tier 1 or tier 2 capital than smaller firms whose capital mainly consists of CET1 instruments. Due to the application of the regulatory requirements on Tier 2 capital, the overall own funds can be subject to fluctuations. In addition stakeholders may expect higher levels of capital in larger or systemic relevant firms. If the total own funds would be used as a basis, this would lead to lower numbers of identified staff within those institutions and to fluctuations. Therefore, CET1 capital seems to be more suitable to ensure that criteria provide a stable basis for the identification of staff and to avoid any disadvantages for smaller institutions.

C. Criterion based on the market risk limits at the trading desk

18. This criterion aims to capture staff members that have a material influence on the market risk of an institution. As market risk limits are generally set for traders or desks, this criterion should be reasonably straightforward to apply. To facilitate the application of this criterion for all institutions, the EBA proposed two different thresholds, whether the institution uses the standard or advanced approach for measuring market risk. As the application of the trading book rules are waived for small institutions, the criteria should only be applied if the institution has to comply with the trading book requirements.

D. Criterion based on the capacity of the staff to commit the institution up to a certain percentage of operating income and commissions/fees payable set out in the institution's most recent annual accounts

19. This criterion was considered on the basis that it may be a good proxy for risks influenced by staff which are not involved in the area of credit business or trading activities (e.g. credit risk within sovereign bonds) and to cover all other decisions which may lead to financial obligations (e.g. by entering into outsourcing contracts). However, from the feedback received, it seems that this criterion would be difficult to apply as one uniform threshold within an institution cannot be set which appropriately reflects the different risks in other areas. Credit risks should be covered specifically. Other material decisions would be made in particular by senior management which is already identified. Also operating income can be very volatile, this threshold and the number of identify staff would be likely to vary also a lot depending on the economic situation.. For these reasons, the EBA has decided not to retain criteria based on such metrics.

E. Criteria based on managerial responsibility:

20. The EBA has considered criteria based on managerial responsibility for:

- Identified staff and;
- units consisting of staff members who have individual authorities to commit the institution to transactions and the sum of those authorities equals or exceeds some of the thresholds proposed in this RTS.

21. Such criteria aim to ensure that individuals which are not identified themselves, but who have some influence on identified staff members (or group of staff member with a cumulative impact that exceeds some of the thresholds proposed in this RTS) and hence on their influence on the risk profile, are also identified. The EBA retained these criteria, as the potential impact of that staff resulting from the sum of their responsibilities and influence on other identified staff constitutes a material impact on the risk profile of an institution. Most of these individuals are likely to be already identified through other criteria (for instance those based on the function, responsibility or seniority of the staff), therefore only a few additional staff members should be identified because of these two criteria. However, these criteria are important to ensure that staff members with such responsibilities, but who are not senior management or heads of business units are being identified.

F. Criteria based on the amount of remuneration:

22. The EBA has considered criteria based on the amount of variable, fixed and total remuneration. The amount and type of remuneration awarded depends principally on the responsibilities, duties, abilities and skills of staff and the performance of staff and the institution. High level of remuneration, for which the variable share represents very often a major bulk of the total remuneration, are generally awarded to individuals conducting activities that have a direct impact on the risk profile of the institution.

23. The EBA has considered whether combining a relative and an absolute thresholds based on the level of variable remuneration could be used for the identification (for instance, if all individuals having a ratio of variable remuneration over total remuneration higher than 75 % and an absolute amount of variable remuneration higher than EUR 75.000 would be automatically identified).

24. Payment structures and levels between Member States differ significantly. Setting a relatively low threshold would create the risk that the staff identified would have in fact no material impact on the institution's risk profile. For this option, the option of granting exemptions was considered to allow institutions to exclude staff from the category of identified staff, if only identified under this criterion. To ensure a comprehensive identification of staff who has a material impact on the institutions risk profile this criterion and the possibility to exclude staff members who are only identified by this criterion has been retained.

25. The EBA has decided to set two criteria independently, one aiming to identify staff receiving a particular high salary within the institution and one set in absolute terms. A relative measure has

the advantage that the top earners within an institution are identified. Those staff members have high responsibilities and authority and therefore are considered to have a significant influence on the institutions risk profile. For small institutions this will not lead to the identification of additional staff, as a relatively high percentage of staff will be identified by other criteria.

26. The absolute threshold set takes account of the experience gathered within competent authorities and data collected. 23 institutions throughout the EU handed in specific data regarding the levels of staff which would be identified as risk takers, if staff receiving total remuneration above a certain threshold would be identified. A threshold of 750 000 Euro would only lead to an identification of additional staff members in five institutions, a threshold of 500 000 in eleven institutions and a threshold of 250 000 in 14 institutions. This translates to the following absolute figures with regard to staff which would be identified compared to staff already identified under the current arrangements:

	Number of staff being identified	Staff already identified
>250 000	13751	2702
>500 000	4796	1792
>750 000	2430	1468
>1 000 000	1490	1110

27. Considering the percentage of identified staff within the single institutions, thresholds of 500 000 Euro and 0.3 percent of staff with the highest income seemed to be appropriate to ensure the identification of staff who have a material impact on the risk profile. According to benchmarking data received for 110 institutions the average total remuneration of risk takers in 2011 was 508 000 Euro.

Impact of the proposals

28. The impact of this RTS will vary greatly between institutions and will depend mainly on the size of the institutions the activities it conducts and the composition of its staff.

- ▶ *Direct compliance costs* – They cover all the incremental costs that meeting the new requirements of this RTS will generate for institutions and national authorities.

Table 1 – Summary of the direct compliance costs of the proposal

Party concerned	Costs
Credit Institutions	<p>One-Off Costs</p> <ul style="list-style-type: none"> a. Costs of IT changes to the current information systems to identify staff b. Costs of changing the current relevant internal processes for identifying staff c. Costs of training or hiring staff members in charge of identifying staff <p>Ongoing Costs</p> <ul style="list-style-type: none"> d. Additional costs (compared to the current requirements), for monitoring and identifying potential additional staff members (new hires, changes in the institutions structure, etc.) with more complex criteria.
National Supervisory Institutions	<p>Ongoing Costs</p> <ul style="list-style-type: none"> e. Incremental costs (compared to the current requirements), of supervising compliance with new requirements for identifying staff.

29. Almost all the firms in the survey that provided answers on costs confirmed that the main drivers of costs of the RTS had been appropriately listed in the table above. From this limited sample, it appears that for most institutions, independently of their number of employees, changes to IT systems will be one of the main drivers of costs. Changing processes is another important driver of costs, but tends to affect larger institutions. As expected, smaller institutions cited rather hiring/training new staff as an important driver of costs. Most of the institutions in the sample were not able to provide any estimate of the scale of these changes.

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?

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?

- ▶ *Indirect Compliance Costs* – By defining the scope of the staff identified as having a material impact on the institution’s risk profile, the RTS will also affect the size of the costs driven by the requirements of the directive; for instance, the costs associated with changing individual contracts for identified staff that are not compliant with the CRR or due to the disclosure requirements.

Benefits – By establishing harmonised criteria to identify staff members who have a material impact on the institutions risk profile, the RTS will ensure that institutions in different member states use the same practices to indentify staff, reducing the burden to comply with different regulatory frameworks. These criteria will identify in some member states more staff as having a material impact on the institution’s risk profile compared to the current national framework. By doing so, they contribute to realise the benefits sought by the CRD IV requirements *which is beside others to ensure* that the remuneration of identified staff reflects more accurately the risks they generate and is more aligned with the longer term interests of the institution.

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?

5.2 Views of the Banking Stakeholder Group (BSG)

The EBA presented on 29 November 2012 *initial views on* criteria to identify staff who have a material impact on the institution's risk profile and informed the BSG about the EBA's internal planning.

Regarding whether staff within the whole institution or only within material risk areas should be assessed, two options were presented. Either there could be a limitation to material risk areas which would require setting out requirements on the risk assessment, or the identification of risk takers in the whole institution. The latter has so far been preferred by the EBA to ensure that all risk takers are identified and to avoid additional costs for the identification of material risk areas.

BSG members raised the question whether only executive directors would be covered. The draft RTS may include both, the members of the management body in its management and supervisory function.

A view was raised by one member whether risk takers is the relevant concept and that the aim should be to change certain behaviours. The EBA has to follow the mandate provided within the CRD, which includes the concept of risk takers.

The Banking Stakeholder Group will be notified about the publication of the consultation paper and will be invited to provide an opinion by the end of the consultation period.