

Consultation on draft Technical Standards for the definition of material risk takers for remuneration purposes¹

a response from the British Bankers' Association

Introduction

The British Bankers' Association ("BBA") is the leading association for UK banking and financial services, representing members on the full range of UK and international banking issues. It has almost 200 banking members that are active in the UK, which are headquartered in 50 countries and have operations in 180 countries worldwide. All the major banking groups in the UK are members of our association as are large international EU banks, US and Canadian banks operating in the UK and a range of other banks from the Middle East, Africa, South America and Asia, including China. The integrated nature of banking means that our members are engaged in a wide range of activities, ranging widely across the financial spectrum from deposit taking and other more conventional forms of retail and commercial banking activities to products and services as diverse as trade and project finance, primary and secondary securities trading, insurance, investment banking and wealth management.

We are pleased to be able to respond to the European Banking Authority's draft regulatory technical standards on the identification of material risk takers as it will affect the vast majority of our members, many of whom are very concerned about the proposals therein.

We emphasise that all of our members recognise the importance of ensuring that members of staff that are able to incur material risks on behalf of their institution should be rewarded appropriately with the right mix of fixed and variable remuneration. Within the mix of variable remuneration a significant proportion should be paid in instruments that bind the recipient into the long term success of the institution.

In addition we support the clawing back of variable remuneration that has been awarded but not yet invested in circumstances where it can be demonstrated that the individual's performance over an extended period are not in the best interests of the institution. We recognise too that a harmonised approach is necessary. This should be based on a combination of qualitative and quantitative criteria but with much less emphasis than is envisaged in the current draft, on quantitative measures.

Total compensation is not indicative of material risk taking

We believe pay level does not equate to risk taking authority. Our members have identified a number of role-holder titles where the incumbent may earn in excess of €500,000 but who are not, in their view a material risk taker, including:

¹ <http://www.eba.europa.eu/documents/10180/206140/EBA-CP-2013-11---Draft-RTS-on-criteria-for-Identified-Staff.pdf>

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We believe that the intention of the CRDIV text was to identify those individuals who are '*material risk takers*' therefore it is to those individuals which the ratios should then apply. Applying the €500,000 quantitative limit is a blunt backstop that will unnecessarily and disproportionately include significant numbers of individuals who are not material risk takers within the scope of the requirements. We recommend the removal of this quantitative limit entirely, or at the very least an upward revision in the threshold to ensure that fewer individuals (unless they really are material risk takers) are within scope. This should be accompanied by a simplification of the myriad of qualitative tests which the technical standard proposes to apply.

The quantum of Common equity Tier 1 capital should be fixed

In a number of places the draft technical standards require banks to test parameters – for instance the ability to commit to risk exposures – against common equity tier 1 (CET1). This varies continually and whilst banks are able to assess this in order to compute their capital ratios at any point in time we suggest that for the purposes of remuneration calculations the level of the institution's CET1 as in published accounts at previous year-end should be the test benchmark.

The EBA's proposals further exacerbate the move to fixed pay and will have a global effect

A behavioural response of banks to the EBA proposal will be for institutions to increase the level of an individual's fixed pay. This has already happened.

The more widely the net is drawn the greater the number of people likely to benefit from an increase in base pay and consequently the greater will be the incremental fixed cost of the institution. We fear that this will have wider salary inflationary impacts, not just in the EU, because of the extraterritorial nature of the CRDIV remuneration requirements. As EU banks pay a higher proportion of total compensation by way of fixed remuneration so their competitor banks in third countries will be forced to do the same in order to attract world class talent that is highly mobile. This would be a poor outcome.

A secondary effect of increased fixed pay will be the reduced flexibility of banks which will no longer be able to reduce variable pay to conserve costs and reinforce their capital in the event of a future downturn.

The requirement should come into effect in respect of the 2015 bonus year

As we understand it, it is unlikely that the technical standards will be finalised until the first quarter of 2014, by which time individuals will be well into that calendar year for performance assessment purposes. As variable remuneration levels and the targets against which they are measured are invariably enshrined in an individual's contract it will thus be impossible to make the required changes to implement the requirements in time. We therefore recommend that the requirements should come into effect in respect of the 2015 bonus year, so that institutions have sufficient time to design and finalise the necessary contractual amendments.

The remainder of our response addresses the question posed in the consultation paper.

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

The functions listed in 1 a) to d) are clearly identifiable and it is proper that such individuals are classified as material risk takers, but this analysis should only be undertaken at group level, in order that, for instance, the *group* head of tax, or the *group* HR Director are within the scope of the requirements. It is our view that only those individuals that can take material decisions should be within scope of these requirements and we expect that such people would be at or very close to the top of a bank's group organogram. Such an approach would therefore exempt for instance the individuals responsible for HR or tax in a small local subsidiary.

We therefore recommend the following re-draft:

- a. the staff member is a member of the group management body;
- b. the staff member is a member of the group's senior management;
- c. the staff member is responsible and accountable to the group 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]);

We do not however believe that individuals responsible for group business continuity planning should be within scope. Furthermore those heading the group tax, budgeting and economic analysis functions will typically report to the group Finance Director, who will undoubtedly be a member of the management body, and who should bear ultimate responsibility for these functions.

We therefore suggest that Article 3 (e) be re-drafted as follows:

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

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

It will be easy enough to identify the 0.25% of the institution's Common Equity Tier 1 capital threshold (providing that amount is fixed based on the amount as published in the previous year end's accounts) although it is not clear to us how this level has been set at what is an almost insignificant amount. The Basel Committee Large Exposure proposals define a large exposure as being above 5% of an institution's CET1. It is also important to ensure that activity involving netting/hedging effects in relation to counterparty exposures, does not lead to the identification of staff that entering into a transaction to offset or manage other risks in an institution. In many situations taking on an additional exposure can reduce the capital at risk to a particular counterparty and such hedging activity should not be discouraged.

It is important, we believe, to assess the capital on a consolidated basis so that group capital - rather than a solo institution's capital base - is the relevant test. Systems and controls, as well as HR and remuneration policies are typically set at the group level and then cascaded down. The EBA technical standards in this area should follow the consolidated/group home/host supervision approach, which we fully support.

The phrase 'individually and collectively' is also very broad, and could capture junior members of a trading team who are not responsible for the risk. It is really those responsible for 'authorising' the risk that ought to be caught and not whole desks. Using the phrase 'authorises the taking of Credit risk' rather than 'authority to commit' will also ensure that institutions identify the traders, who take the risk, rather than junior professionals in the Credit departments who are asked to sign off the counterparty risk before entering into a transaction.

A further practical consideration arises in that, within banks, limits are set by counterparty and not in relation to capital levels.

We therefore suggest that Article 3 (f) be redrafted as follows:

f. the staff member has, individually or collectively with other staff members, authorises the taking of authority to commit credit risk exposures to a counterparty for which the net counterparty exposure limit is set in excess of 0.25 5% of the institution's Common Equity Tier 1 capital;

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

Again we think that the capital test is set too tightly for banks on the standardised approach to the trading book and would recommend that the hurdle be set at 5% of the bank's Common Equity Tier 1 capital as outlined above. Our comments above regarding the rule being set too broadly also apply.

With respect to the VaR rule in subparagraph (ii), this is consistent with current practice amongst some of our member banks. However some might use a different percentile such as 99th percentile for their VaR calculations, or favour a Stress VaR (SVaR) approach. It is inappropriate for regulation of remuneration to drive institutions to change or create duplicate calculation methodologies simply for this purpose. We suggest allowing flexibility in approach or allowing competent authorities to exercise discretion in allowing institutions to vary the approach. We therefore suggest that Article 3 g be redrafted as follows:

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, authorise the taking of transactions on to 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~~ 5% 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;

Q4 a) Is this criterion appropriate to identify risk takers?

Q4 b) Are the thresholds set out 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?

We do not believe that this criterion is appropriate in identifying material risk takers. Particularly earlier in their career wholesale markets sales and trading staff, who may have a relatively small amount of fixed remuneration, can be rewarded on a performance/sales commission basis with

amounts that could exceed both the 75% and €75,000 thresholds. Such individuals always work within tightly defined limits, which if properly policed ensure that their activities do not expose the bank to material risks. A large number of junior staff will thus be identified and then excluded under the provisions of Article 4 adding to bureaucracy without identifying many more identified staff.

The inclusion of the word 'could' further complicates implementation and conflicts with the CRDIV text which requires that a person should actually be in receipt of a remuneration package.

We therefore recommend the deletion of Article 3 (2) (a).

It is almost impossible to quantify the additional costs of implementation in relation to the Article 4 exclusion. In some banks many hundreds of staff may be identified with records kept and updated on each one, including those that have been excluded.

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?

It is not clear to us that a criterion based on relative pay levels is a helpful in identifying material risk takers. We would prefer the deletion of this Article 3(2)(b) in its entirety. Furthermore this criterion will be difficult to apply as the pay scales for the same role in the same entity in different parts of the world are geographically specific, taking account of conditions in the local markets, the demand and supply of talented individuals. The comparative nature of this test, based on relative pays levels, will also result in the identified population varying year by year.

It is unclear whether the test would be applied on a 'siloes' basis – for instance comparing those in the internal risk control function only with others in that specific function or across all the Article 3 categories. The former interpretation would be the more logical approach as there are different rates of pay, say for internal auditors and in-house legal counsel.

Although our preference is for deletion; an alternative could be the revision of this clause as follows:

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~~ of the same entity and who either is:

- a member of senior management ~~or meets one of the criteria in paragraph (1) or~~
- who performs one of the same professional activity as the staff member
- professional activity means one of the activities referred to in Article 3 (1) a to e ~~the internal criteria referred to in Article 2;~~

We do not support the use of 'potentially awarded' remuneration as an alternative test, which is too subjective and would be difficult to evidence.

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

The €500,000 threshold will be easy to identify, aside from the inevitable complications that will arise because of changes in relative exchange rates. However setting a threshold purely based on levels of total compensation deviates very significantly from the requirement in CRD Article 91 2 that the remuneration polices apply *to material risk takers* and so we cannot support the text as written.

Significant number of individuals who are not material risk takers will fall within the scope of this restriction making it disproportionate.

Extending the scoping out individuals who do not take material risks as is permitted Article 4 to the €75,000/75% criterion would however overcome this strong objection. This would give supervisors comfort in that there would be a rebuttable presumption that any individual earning in excess of such a figure would fall within the regime unless the institution could demonstrate to their supervisor's satisfaction that they were not a material risk taker.

We therefore suggest that this Article 3 (2) c be amended as follows:

c. the staff member has been awarded total gross remuneration of EUR xxx,xxx or more, or its equivalent in a foreign currency based on the year end exchange rate, in one of the two preceding financial years and whose professional duties have a material impact on the institution's risk profile.

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

Yes the criteria and levels of staff identified are appropriate.

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

These criteria taken with the institution's internal identification process outlined in Article 2 are more than sufficient to identify material risk takers.

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?

The table identifies the first order one-off and on-going costs of preparing for the sort of regime that has been proposed in the draft Regulatory Technical Standard. But it completely ignores the likely second order effect which will be an increase in fixed remuneration. We believe that fixed remuneration will increase not only in the EU but, because of the global application of the proposed requirement, more widely for both EU banks operating in third countries. Furthermore because of the knock-on effect there will be general fixed remuneration inflation for third country banks too operating outside the EU. This would not be a prudentially sensible outcome.

In addition, too many staff are identified by the quantitative methods only to be excluded by the qualitative assessment. While we strongly support EBA's stated contention at the Public Hearing that qualitative methods are more important, the quantitative methods need to be more prudent in order not to identify significant numbers of staff members who we know take no material risk.

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?

Category (d) costs in relation to the demonstration that staff are not material risk takers (cf Article 4) are likely to be the most significant on-going costs for our member banks.

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?

Ten member banks, employing almost 300,000 people in the European Union have provided us with information about the number of employees that would become within scope of the 'material risk takers' definition at different levels of total remuneration. As might be expected these show that most 'material risk takers' based on the remuneration criterion work in the UK, but that the extra-territoriality of the CRD approach will also capture a significant number of employees outside the EU.

Remuneration Criteria <i>data from ten BBA member banks</i>	Number of Staff			Total Number of Staff across all Sectors
	UK	EU	RoW	
Total remuneration exceeds:				
€500,000+	2994	357	1621	4972
€750,000+	1524	171	695	2390
€1,000,000+	964	109	402	1475
In top 0.3% of staff with highest remuneration	972	94	779	1845
total remuneration exceeds that of the lowest member of senior management or other employees having a material impact on the institution's risk profile as defined in Article 3 (1)	22412	2579	6486	31477
Variable remuneration exceeds 75% of fixed salary and €75,000	4811	734	4233	9828
Current Code Staff	1120	116	248	1529
Staff in at least one criterion	23450	2835	8777	35117
Total Staff in all Banks	265286	43847	330843	639976

To summarise there are currently 1,529 'code but application of the material risk takers RTS would increase this number to 35,117 – a more than twenty fold increase which is a much more significant number than the doubling assumed in the cost benefit analysis.

Alternatively examining the quantitative criterion only, there would be a six fold increase if the comparison is made against all those earning over €500,000 to the current number of staff earning in excess of €500,000.

Further Comments where EBA has not asked a question

In Article 4(b) the draft RTS again refers to '...variable remuneration which could be awarded...' Based on our comments in relation to questions 4 and 5, we suggest deleting the words 'which could', as theoretical remuneration is neither easy nor appropriate to determine.

Similarly in Article 3(1)(i) the words '...professional activities have or may have a material impact...'. We would suggest that organisations will know who has a material impact and the words 'or may have' is confusing and they should be deleted.

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