

## CONSULTATION PAPER ON RTS ON CRITERIA TO IDENTIFY MATERIAL RISK TAKERS

We welcome the opportunity to respond to the consultation on draft Regulatory Technical Standard (RTS) setting criteria (qualitative and quantitative) to identify categories of staff whose professional activities have a material impact on the institution's risk profile (hereafter "material risk takers" or "MRT") in the framework of CRD IV.

In order to improve the process of MRT identification and to reach a higher level of harmonization across the banking industry, we agree with the proposed approach based on a combination of internal criteria developed by institutions and other regulatory qualitative and quantitative criteria to ensure consistency across institutions.

However, we would like to take the opportunity of this consultation to draw your attention in particular to level playing field concerns and to the issues related to applying such criteria in a Group context. The underlying concern is that key principles set out in the level 1 text such as proportionality (i.e. consideration of size, internal organization, business model and the risk profile of institution) and the notion of effective material impact of the staff member will be lost under the proposed drafting.

We summarize hereafter our key requests for alternative regulatory choices, followed by detailed comments on specific Articles of the draft RTS.

### Key concerns regarding the proposed Material Risk Taker identification criteria:

The two major concerns developed hereafter can be summarized as follows:

- There is particular concern that the binding variable/fixed ratio of 1:1 (or up to 2:1 with shareholder approval) provided for in CRDIV will create difficulties for EU head-quartered institutions when competing for talent in key financial centers outside of the EU, in particular in the US and Asia. This competitive distortion will be further accentuated if the 500 K EUR Total Compensation criteria under Article 3 (2) c. remains "all inclusive", without the possibility to make an assessment/demonstration of the effective material risk influence of the staff member provided for under Article 4 and taking into account the levels of remuneration which are market practice in different jurisdictions. This "all inclusive" approach also seems in contradiction with the Level 1 text which indicates that the inclusion of those captured by virtue of their total remuneration level is contingent on them having an effective material risk impact<sup>1</sup> => **Request that Article 4 can be applied to all staff members identified solely as a result of any one of the remuneration related criteria under Article 3 (2) (i.e. without limiting this possibility to only points (a) and (b) of such Article).**
- In a consolidated Group context, the approach to identification of Material Risk Takers should take into the account the influence of Group level supervision on policies, procedures, business strategy, etc. and that subsidiaries often have hierarchical reporting lines to staff members in the parent institution => **Request that all the criteria in the RTS be assessed at the consolidated Group level and not on a subsidiary by subsidiary basis within the EEA, with the possible exception of subsidiaries that are significant in relation to their local market, as suggested below under paragraph 1.**

<sup>1</sup> Art. 88 of CRDIV: "...categories of staff including senior management, risk takers, ...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...."

## 1. Scope of application (Article 1)

The scope of application covers all institutions covered by CRD IV. Article 1 (2) and Recital (2) specify that the criteria should be applied at group, parent and subsidiary levels. Those firms who are not covered institutions themselves, but who are within the consolidated or sub-consolidated scope of a covered parent institution do not have to apply the criteria themselves, but should be included in the assessment done at group level. Therefore, it appears that CRDIV covered institutions would have a similar “core” population of Material Risk Takers (management body, senior management, heads of business units, staff responsible for internal risk control/compliance/internal audit, head of legal, tax, HR, IT, budgeting, economic analysis, business continuity planning, 0.3% of highest paid staff...) irrespective of their size, internal organization and the nature and scope and the complexity of their activities. This seems in contradiction with the proportionality principle specified in the Level 1 text<sup>2</sup>. For example, in a Group context, each separate legal entity within the Group will have the above mentioned functions in scope, but this does not take into account the fact that many of such staff are only responsible for implementing the Group policies and strategy (including, in particular, risk policies and procedures) rather than defining them, will often report to a superior in the parent company and therefore cannot take material decisions at their own level.

It is unclear to us how a sufficient level of harmonization is to be obtained across the EEA if the criteria are identical, irrespective of the size and activity of the institution. If, subsequently, application of proportionality and the ability to neutralize the most stringent remuneration rules (deferral, retention, variable remuneration in instruments and ex post risk adjustment) is left to national supervisory authorities, who today apply proportionality rules very differently, it will lead to uneven application of the rules between EEA institutions and also between institutions within the same Group.

**Recommendation:** The RTS should provide that in a consolidated Group context, the criteria should be assessed at Group level and not at the level of each EEA subsidiary subject to CRDIV. Exceptions could be made to this rule for institutions that are significant subsidiaries of EU parent institution and those subsidiaries which are of material significance for their local market, who would apply the criteria on an individual or sub-consolidated basis. This would align the perimeter of identification of Material Risk Takers with the scope of disclosure requirements for remuneration under the CRR.

The notions of significant subsidiary / material significance in the local market should be clearly defined and aligned with other regulatory texts (i.e. the proposed European Parliament definition in Article 7. 1a of the draft Recovery and Resolution Directive).

In addition, the RTS should clarify that identification under such criteria as a Material Risk Taker, does not preclude a subsequent neutralization of the requirements on the pay-out-process for all or some categories of such staff, under the application of proportionality as provided under CEBS guidance of December 2010.

---

<sup>2</sup> Art. 88 of CRDIV: “.....institutions comply with the following principles in a way and to the extent that is appropriate to their size, internal organization and the nature, the scope and the complexity of their activities:”

## 2. Quantitative and Qualitative Criteria (Article 3)

### Criteria relating to role/function

The proposed specific functions are appropriate, subject to the ability to make the assessment in a group context of which functions have a material risk impact taking into account internal organization within the Group (see above). The reference to “budgeting” could possibly be more broadly defined as “finance”.

### Criteria relating to authorization to commit to credit risk or market risk exposure

Article 3 (1) g (market risk exposure) is appropriate, notwithstanding the two required specifications:

- Criterion g. ii. permits the institution to use an internal model based approach, however, the reference exposure at the 95<sup>th</sup> percentile is not in line with some institutions' internal model approaches (i.e. some banks internal models are based on VaR at the 99<sup>th</sup> percentile). The RTS should give the flexibility for institutions to base the market risk exposure assessment based on their existing internal models.
- The text refers to “collectively” and “authority to commit to transactions on the trading book which in the aggregate represent...” as well as the text in Recital (9) which specifies “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”. While the assertion that market risk exposure is generally managed at the desk level is correct, the definition of Material Risk Taker should target the individual staff member who is directly accountable for the limit of authority (i.e. generally the desk head) and not all traders on the desk, to the extent that this would encompass many junior traders who are simply executing instructions from their line management and are only authorized to take positions/commit to transactions subject to a significant level of internal supervision.

#### **Recommendation:**

- Article 3 (1) g. ii should read “.....the institution’s internal value-at-risk limit for trading book exposure at a 95<sup>th</sup> percentile *or such higher percentile used in the internal model as approved by the relevant supervisory body, ...*”
- Article 3 (1) g. and Recital (9) should specify “Where trading limits of authority are based on aggregate exposures at the trading desk level, this encompasses the staff member who is directly accountable for the limit/threshold and who supervises the group of staff who can enter into positions within such limit”.

Article 3 (1) h refers to a staff member who has responsibility for a group of staff members who have individual authorities....the sum of those authorities equals or exceeds a threshold set out in point (f) or in point (g). To the extent that it is not possible to “sum” risk exposures due to netting effects, this criterion is difficult to apply in practice. A more general condition that any staff member who has managerial responsibility for Material Risk Taker identified under Article 2 or Article 3 would be more feasible to implement.

#### **Recommendation:**

- Merge Articles 3 (1) h and i to read “the staff member has managerial responsibility for another 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 and the criteria (1) a. through g. in this Article 3.

Article 3 (3) refers to staff who are responsible for advising on or initiating material commitments or decisions. In order to avoid capturing larger numbers of more junior staff such as credit analysts and other control or operational risk functions who may involved in advising on a specific

transaction or decision, the wording should be more specific in order to capture only significant influence functions whose position could considerably weigh on the ultimate decision.

**Recommendation:**

- Either delete sub-paragraph (3) a. of Article 3 or clarify through re-wording "...staff in a significant influence function who are responsible for advising on or initiating such material commitments or decisions".

**Criteria relating to remuneration level**

As a general comment, the remuneration criteria are too numerous and would therefore create a significant administrative burden for institutions. The remuneration related criteria should represent backstop criterion in order to verify whether all Material Risk Takers have indeed been identified through the other criteria, but should not represent the principle criteria. The number of individuals identified "ex ante" (i.e. due to function/role, ability to commit to market/credit risk exposure, etc.) should constitute the vast majority of material risk takers and the number identified "ex post" (i.e. due to their remuneration level) should be minimal. This is both in the interest of institutions, for whom it is difficult to manage remuneration regulations over time from a HR standpoint for a very volatile perimeter of staff, but also for supervisors and stakeholders (i.e. shareholders, etc.) who use publicly disclosed data to make year-on-year comparisons of the remuneration pool allotted to such staff.

**Article 3 (2) a.**

More particularly, Article 3 (2) a. (i.e. more than EUR 75 000 and 75% of fixed remuneration) is particularly difficult to implement since the criteria is conditional, "could be awarded under the remuneration policy". If the institution's remuneration policy does not fix formal caps for variable remuneration awards, it would be particularly difficult to identify the population concerned as it could potentially mean all staff in the institution, even if in reality such variable levels are not awarded. With regards to remuneration market practices in some countries (i.e. in particular, the US, the UK, certain Asian markets) the caps proposed are too low and would capture a significant number of staff ex post: the process of demonstrating to supervisors that each staff member concerned does not in fact have the capacity to take material risk would be lengthy, costly and burdensome. Finally, this criteria does not appear to be in line with the remuneration criterion included in the level one text which is "...any employee receiving total remuneration that takes them into the same remuneration bracket...", not "...any employee who could receive total remuneration...".

**Article 3 (2) b.**

Article 3 (2) b. is the criteria which is most closely aligned with the level 1 text ("...any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers"). However, if in practice the remuneration bracket is very wide, this could lead to a significant administrative burden and costs of identifying a large circle of staff and reviewing their risk profile. If "entity" encompasses all branches, in different geographical locations, forming part of an institution, the remuneration bracket will be very wide.

It would be helpful to have a relatively stable reference remuneration bracket in order to reduce the administrative burden of reviewing the risk profile of all staff receiving remuneration in this bracket. This could be achieved by:

- Making the analysis at the level of each entity (i.e. subsidiary or branch) in a given location;
- Excluding control function and infrastructure staff from the reference remuneration bracket. This seems to be the spirit of the Level 1 text;
- Making reference to the lowest gross remuneration that could potentially be awarded to senior management and risk takers (i.e. taking into account the institutions maximum

variable/fixed remuneration ratio). This would reduce the volatility of the lower bracket which would occur when even just one member of the senior management/risk taker categories received no variable remuneration due to poor performance.

### **Article 3 (2) c.**

Article 3 (2) c. provides that any staff member that has been awarded total gross remuneration of EUR 500 000 or more in one of the two preceding years is automatically identified to be a Material Risk Taker, irrespective of their job function/activity. The problem of having an all inclusive total remuneration criteria is the issue already raised above of having too many staff identified ex post and therefore a very variable year-on-year population of Material Risk Takers. In addition, individuals could fall in or out of this category simply due to a small fluctuation in exchange rates. Finally, due to very different cost-of-living levels across different countries, this level would capture a disproportionate level of staff in some locations (i.e. New York, London, Hong Kong), some of whom have no material impact on the risk profile of the institution or group and on the contrary would be irrelevant in many EEA countries. The concern that EEA-headquartered institutions are subject to competitive distortion when having to apply CRDIV remuneration provisions outside of the EEA will be even more acute if such institutions have to encompass all staff remunerated above a fixed threshold, irrespective of their material risk impact. To the extent that remuneration levels vary significantly across jurisdictions, the review of risk profile and “levels of remuneration which can be awarded in different jurisdictions” provided under Article 4 should apply to those staff members identified under Article 3 (2) c. If it is deemed absolutely necessary to have an “all inclusive” remuneration criteria in order to capture in all cases the highest earning staff in the major financial centers, at the very least the threshold should be higher in line with remuneration practices and taking into account the cost of living in such locations.

### **Article 3 (2) d.**

The proposed 0.3% of highest paid staff is a useful reference for large institutions, but does not take into account proportionality and therefore could create unnecessary rules for small non complex institutions. As mentioned above, in line with CEBS guidance of December 2010, proportionality should allow neutralization of the pay-out-process rules for small, non-complex institutions (see recommendations under “scope of application”).

Proportionality should apply both with respect to the size of the institution, but also the nature of the activities performed within the institution. While the 0.3% is a relatively low threshold, it may still lead to a disproportionate number of risk takers being identified within a large retail bank taking into account the risk profile of the institution.

As such, the possibility to apply Article 4 to those staff members identified under Article 3 (2) d. should be given in order to take into account the different risk profiles between institutions.

### **Recommendation:**

- Article 4 should apply to those staff identified under Article 3 (2) c and Article 3 (2) d. At the very least proportionality rules should apply and if deemed absolutely necessary to have an “all inclusive” remuneration threshold under 3 (2) c to capture high earners, this threshold should be increased to take into account market remuneration practices in the major financial centers.
- Delete Article 3 (2) a. which is inoperable in many institutions due to its conditional nature and which is disconnected from the remuneration levels of senior management and risk taker functions in an international context.
- Article 3 (2) b. should read “the staff member has been awarded gross remuneration in one of the two preceding financial years which is equal to or greater than the lowest total remuneration that could, in accordance with the institution’s remuneration policy, have been 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 a risk taker. For purposes of this assessment the senior management and risk taker categories include

those staff identified in paragraph (1) or under Article 2, with the exception of control function and infrastructure staff. "Entity" is understood to be a parent, subsidiary or branch in a given location.

#### **Staff with no material impact on the risk profile (Article 4)**

Given the very large number of staff who could be subject to review after having been identified under the remuneration based criteria, it should be possible to exempt categories of staff (i.e. by activity and/or function) rather than on a individual case by case basis which would be very time consuming and burdensome.

#### **Recommendation:**

- Add to the end of Article 4 "In the situation where a significant number of staff are subject to review under this Article, the assessment can be made for each category of staff (i.e. with the same activity and/or function) rather than on an individual basis.

#### **Entry into force (Article 5)**

According to the calendar set by the CRDIV, the publication of the RTS could take place as late as mid-2014 (i.e. submission to the Commission by end March 2014 and subsequent validation by the Commission prior to publication). However, since the remuneration provisions (i.e. in particular the variable/fixed maximum ratio) apply to remuneration awarded for the 2014 performance year, Institutions really need to have a clear picture of the final criteria by end 2013 for operational implementation of the new rules (i.e. adjustment of processes and information systems to take into account the identification criteria, communication to employees, modification of any contractual arrangements, immediate implementation of the maximum ratio in January 2014 for any staff whose variable remuneration is paid on a monthly basis, preparation of the Annual General Shareholders Meeting, etc.) .

#### **Recommendation:**

- Request for the publication of the final RTS on identification criteria for Material Risk Takers by end 2013.