European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken

CEBS
Committee of European Banking Supervisors

Brussels, 8 November 2010
VH/WSC/B2/10-193

CP42@c-ebs.org

CEBS' Consultation Paper on Guidelines on Remuneration Policies and Practices (CP42)

Dear Sir, Madam,

The European Association of Co-operative Banks (EACB) welcomes the opportunity to comment on CEBS' Consultation Paper on Guidelines on Remuneration Policies and Practices (CP42).

Please find our general and specific remarks to the questions on the following pages.

We remain at your disposal for any further questions or requests for information.

In particular, we would express our wish to maintain a dialogue with CEBS regarding share-based payment and co-operative banks and non-listed banks.

Yours sincerely,

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GENERAL REMARK

The EACB supports the aim of CEBS Guidelines to ensure that the remuneration policies and practices in financial institution are consistent with and promote sound and effective risk management. Nevertheless, we wish to remind that cooperative banks were not at the origin of the financial crisis and were resilient during the crisis.

In principle, CEBS guidelines on Remuneration Policies and Practices (CEBS GL) are welcomed, as they take the proportionality principle as enshrined in the CRD III into account and provide room for national implementation.

However, CEBS GL are in comparison to CRD III, more specific and detailed. CEBS interpretation of CRD III is very restrictive. More precisely, the focus of CEBS GL is too much on the day-to day practices and specific details than on the process of remuneration policies.

Furthermore, a clear structure of CEBS GL for practical application is lacking. There is no clear distinction between general requirements (to be applied on an institution-wide basis) and specific requirements (to be applied to individual remuneration packages of Identified Staff). The strict character and complex structure of CEBS GL could create considerable difficulties.

The required implementation of CEBS Guidelines by 1st January 2011 is not feasible. The CEBS guidelines appear in the present version, in principle, would be excessive, will present significant implementation difficulties and relatively high cost.

SPECIFIC REMARKS

1. *Scope of guidelines*

Existing contracts

We regret that the guidelines do not make any reference at all to possible problems due to the application of CRD III as well as these guidelines to existing contracts as stipulated in recital 22. The application of these provisions to existing contracts, even retro-actively and even outside the EEA may create serious legal problems in many jurisdictions.

The fact is that the terms and conditions for existing contracts cannot be changed easily without breaching national contract and labour law. Credit institutions will also have administrative and tax problems to apply these new rules on remuneration retroactively on existing contract of 2010.

In Recital 14 CRD III a reference is made that the provisions on remuneration should be without prejudice to general principles of national contract and labour law (...) and in accordance with national law and customs. Such problems will be even bigger where EU directives have no legal authority (non-EEA countries). We do not understand why there is no reference and/or comment to this recital in the draft guidelines.

By doing so, CEBS even increases uncertainty among banks, which may find themselves between court-cases with employees and subject to pressure from supervisors for a proper application of principles.

We therefore urge CEBS to address this problem in the guidelines and to indicate that national supervisors should clarify the legal situation for banks in every jurisdiction and develop clear guidance for appropriate behaviour. For non-EEA countries, the introduction of the new standards should be based on a “best-possible” basis.

2. *General Requirements*

Group Context

We consider that the interpretation of the draft guidelines of Annex V, Section 11, point 23 CRD III on the application of the remuneration policies and practices to a subsidiary of an EEA parent located off shore are too strict.

As indicated above, retro-active implementation may create significant legal problems in non-EEA countries. Moreover, if EU credit institutions need to apply CRD III to non-EEA branches, this will lead to competitive distortions. It will be difficult for credit institutions in non-EEA to maintain their staff or even to recruit their staff if other global competitors will not be subject to such strict remuneration policies but rather subject to the more lenient FSB principles. The implementation of CRD III and CEBS Guidelines on a global level will thus certainly not lead to an equal global level playing field. We consider it necessary for CEBS to provide appropriate guidelines in this respect which makes practical implications of the CRD III requirement feasible.

3. Provisions for Identified Staff

Identification Process

We suggest that the guidelines should elaborate much more on the on the process for the assessment process in banks for the identification of ‘material risk takers’. The aim should be to have a general process for determining material risk takers on the basis of relevant indicators that leads to a meaningful outcome with clear results. Such process should provide appropriate evidence and consistent results with regard to the size and the business profile of the bank.

Therefore, we suggest that CEBS should develop more general criteria and indicators that can be used in the assessment process.

Moreover, we would like to invite CEBS to elaborate on the extent to which a strict governance structure, with clear mandates and (internal) supervision has influence on the fact whether certain staff members are considered to be risk taker. In our opinion, some employees can potentially be a risk taker (by the nature of their work), but in practice the risk of their behaviour is fully mitigated by a tight governance structure, in which the amount of risk they can engage is exactly regulated (and supervised).

Other criteria should be the amount of the variable remuneration, the ratio of variable to fixed remuneration, the job functions and responsibilities of staff and their cumulative effect in relation to the business model, size, nature, scope and complexity of the credit institution, to determine whether a staff member can exert considerable influence on the risk profile. Such criteria could be far more useful for a meaningful assessment process than putting a large variety of different staff in one category based on a single factor e.g. being in a position to directly report to the board or having same remuneration as senior managers. In fact, the defined categories of identified staff having material impact on the risk profile are too specific and overly prescriptive.

Moreover, as regards relevant staff the guidelines go beyond the Directive (gold-plating). Also in general it seems that the guidelines are much more strict than CRD III. The broad scope of structures of the institutions and their individual systems of internal functions and competences necessitates flexibility by identifying staff, which has in reality material risk influence; e.g.: only the fact, that individuals directly report to corporate bodies is not an obligatory reason, to expect almost stringently, that they have the relevant impact on institutions risk profile. Regarding CRD III it is not stipulated, to demonstrate, that in this cases is no material impact. Rather contrary the institutions have to prove individually, if there are circumstances, which suggests respective the individual situation of the institution effective a material risk influence; a “register” of categories, which (in general) “must” be included do not fulfil the differentiated and more flexible approach of the CRD. We do not see any reason why the GL are so restrictive and rather tend to put as much staff as possible. This leads an extension of “identified staff” beyond material risk-takers.

Proportionality and neutralisation of Identified Staff

The aforementioned extension of “material risk-takers” also makes the provisions on neutralisation and proportionality difficult to understand. The possibility to have complete neutralisation as described in Annex II point (o), for ‘Identified staff with less impact’ seems to be contradicting. Its practical implementation seems difficult: In a first step, the identification process requires that wide categories of staff are considered as material risk takers according to the different categories. Then, with this neutralisation clause, in a second step “identified staff with less impact” is neutralized. A meaningful assessment process will be difficult.

Thus this over-extension of the notion of material risk taker has the consequence that the specific requirements apply to all, while some are taken out and neutralised. This unnecessarily complicates matters. For a better understanding and practical implementation we therefore propose primarily highlighting the obvious cases in identification-process and ask for further clarifications in order to have a better understanding of the notion of “material risk-takers with less impact”. Only for other staff an identification process, if they are material risk takers, should be relevant. This allows for an appropriate application of Annex II (o) in comparison with para. 16 on page 16.

In priority, we suggest that CEBS could elaborate more on neutralization regarding smaller and less complex institutions as well as those mostly oriented on retail activity. We would demand a further widening neutralisation for requirements of Annex V, Item 11 especially for these institutions. In this term we suggest to define a minimum threshold (e.g. a certain amount of balance sheet sum), up to which a local bank in no case has to fulfil the requirements.

Furthermore within the context of the proportionality principle, we would think it would be a good idea to distinguish between the retail banking activities (which have recurring results and seen their cost of risk remain low) from market activities. Indeed, the major risk taking comes from market operators and not from the retail banking activities who have been able to keep risks at a low level. Thus, the retail banking activities should be excluded from the scope of application of the CEBS guidelines.

Pay out Process: Pay-Out in Instruments

For the members of the EACB, which unites cooperative banks, as well as many non-listed central banks of co-operative banking groups any pay-out in instruments would create major problems:

Co-operative Banks

As stated in the Statute for a European Cooperative Society (SCE), "*co-operatives are legal entities with particular operating principles that are different from those of other economic agents* (Recital 7)"[1]. Co-operative banks are to promote members' interest by providing services to them. They have to be profitable, but they do not have the aim to generate maximum profit. Co-operative banks serve their members on a long-term and intergenerational basis. As co-operative banks do not prioritize the maximization of profits, they do not attract large investors, but individuals who invest a limited amount of money. Moreover, co-operative banks are democratically controlled by their members, and typically each member has one vote regardless of the amount of capital he holds.

Due to these particularities, Common Equity Instruments of co-operative banks dispose of many features that make them inappropriate for a share-based payments. Today, pay out in capital instruments does not exist in a cooperative bank.

- In many cooperative banks the number of shares that a member can buy is limited. But even where such limits do not formally exist, staff members would be major shareholders, which does not seem desirable at all.
- In most cases, co-operative shares are not transferable, but redeemed by the co-operative bank. Where co-operative shares are transferable, there is often no market for them and they can only be transferred at nominal value.
- In many jurisdictions the issue of co-operative shares is only possible against cash payment or under conditions against contribution in kind. This could create problems regarding payment of the variable remuneration. Moreover, cooperatives may redeem shares, but are often prevented by law from subscribing their own shares, purchasing or accepting them as security (see Art. 4 of the SCE Statute).
- Co-operative mutual principles imply in most cases that members buy the shares at nominal value when entering the co-operative and that they are redeemed at nominal value when they give up membership. Of course, if there are no retained earnings and losses occur, capital could be written down and the redeemed amount would correspond to a (written-down) book value.
- In some co-operative banks there is even a cap on dividends.
- In some co-operative banks, in particular those that prepare their accounts on the basis of IFRS, the co-operative bank has the unconditional right to refuse the redemption of shares

By conclusion, share-based payments would create problems regarding the governance of most co-operative banks. Creating such instruments would be modifying the structure, the identity as well as being in complete opposition of the cooperative bank model while cooperative banks have shown very good resilience in the face of the financial crisis. Moreover, we doubt that it would lead to satisfactory results from a prudential perspective: Since co-operative shares are redeemed at nominal value, a share-based

[1] Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE).

payment would not create the incentives that the legislator has in mind, but only imply deferred pay-out periods.

Non-listed Banks

As indicated above, many central banks of co-operative banks are non listed joint stock or private limited companies. For non-listed companies the purchase or sale of shares is difficult as there is no relevant market for these shares. The sale of limited quantities of shares by staff members would create difficulties. Moreover, it may not be desirable to have staff as shareholders: In many co-operative banking groups the central bank is typically owned by local co-operative banks. They also define the business policy of that central bank, which is typically focussed on serving the needs of local banks.

Other Instruments

Due to the arguments mentioned above, co-operatives are not able to issue any hybrid instruments that can be converted into Equity. As for non-listed institutions the situations is also similar.

Moreover, we think that there is no reason to create “other instruments” with extraordinary expenses, when it is possible to achieve the same deferral-, retention- and sustained- effect by using e.g. Cash-Bonus-Bank-Models. The benefit.-cost relation is not appropriate.

Our Proposal

We therefore see an urgent need that that para. 122 ss. of CP 42 are much more specific on this points and effectively provide guidance for our member banks.

We would like to read the following.

123a: Non-listed companies and co-operative and mutual banks may apply cash-payout plans, which

- *are aligned regarding the pay-outs to the required retention and deferral periods and*
- *which are subject (indexed) to a weighting factor, which at the choice of the institutions*
    - i. *reflects the creditworthiness of the institution during the relevant deferral and retention period, or*
    - ii. *reflects the development of the company value or the development of the results of the company (for co-operatives) over these periods.*

Any such plan are subject to approval by regulators

We suggest that CEBS should explicitly stipulate these principles. Further details should be left to be an arrangement between the credit institutions and the national supervisors.