EUROPEAN BANKING AUTHORITY

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EBA FINAL draft Regulatory Technical Standards

on classes of instruments that are appropriate to be used for the purposes of variable remuneration under Article 94(2) of Directive 2013/36/EU

Contents

1. Executive Summary **3**

2. Background and rationale **4**

3. EBA FINAL draft Regulatory Technical Standards on classes of instruments that are appropriate to be used for the purposes of variable remuneration under Article 94(2) of Directive 2013/36/EU **7**

4. Accompanying documents **18**

4.1 Cost- Benefit Analysis / Impact Assessment 18

4.2 Feedback on the public consultation and on the opinion of the BSG 27

1. Executive Summary

Directive 2013/36/EU (Capital Requirements Directive – CRD) sets out requirements concerning remuneration which apply from 1 January 2014, and mandates the EBA to prepare draft regulatory technical standards (RTS) specifying the classes of instruments within the meaning of Articles 52 or 63 of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR) or other instruments that can be fully converted to Common Equity Tier 1 (CET 1) instruments or can be written down, that in each case adequately reflect the credit quality of the institution as a going concern and that are appropriate to be used for the purposes of variable remuneration. At least 50% of the variable remuneration of staff whose professional activities have a material impact on the institution's risk profile must be awarded in non-cash instruments. In accordance with Article 94(1)(l) of the CRD, the instruments must consist of a balance of (i) shares, share-linked or equivalent non-cash instruments and, (ii) where possible, Additional Tier 1 (AT 1), Tier 2 or other instruments, subject to the conditions set out in the CRD and these draft RTS.

Main features of the draft RTS

The draft RTS specify the classes of instruments that can be used for variable remuneration under Article 94(1)(l)(ii) of the CRD. The draft RTS introduce requirements for AT 1, Tier 2 and Other Instruments, to ensure that they appropriately reflect the credit quality of the institution, and define for Tier 2 and Other Instruments the write-down, write-up and conversion mechanisms. For AT 1 instruments, these mechanisms are defined by the CRR. In a similar way to Article 94(1)(l)(i) of the CRD regarding the possibility of using shares, share-linked instruments or equivalent non-cash instruments, the classes of Other Instruments covered by these draft RTS include other non-cash instruments and instruments that are linked to AT 1 and Tier 2 instruments.

The requirements of the CRR for AT 1 instruments and Tier 2 instruments must also be complied with if these instruments are used for the purpose of variable remuneration. Specific requirements have been designed for Other Instruments that do not count as regulatory own funds under CRR provisions to ensure that these instruments are also suitable for the purposes of variable remuneration.

The draft RTS set out requirements to ensure that the credit quality of the institutions is reflected in the instruments and that these instruments are appropriate for the purposes of variable remuneration. The link to credit quality as a going concern is established by introducing uniform minimum trigger events for write-down and conversion of AT 1, Tier 2 and Other Instruments.

To ensure that different classes of instruments are appropriate for the purposes of variable remuneration, these instruments should provide appropriate incentives for staff to be prudent and long term oriented in their risk-taking. All instruments used for variable remuneration must have a sufficient maturity to cater for deferral and retention arrangements. In addition, dividends

or interest in any form should adequately reflect market rates for comparable instruments. Conversion, write-down and write-up mechanisms should not create undue advantages for staff, which could be understood as a circumvention of the requirements of the CRD regarding remuneration policies. Article 94(1)(q) of the CRD requires that 'variable remuneration is not paid through vehicles or methods that facilitate the non-compliance with this Directive or Regulation (EU) No 575/2013.'

To ensure that the instruments used for the purposes of variable remuneration are issued at market conditions, the draft RTS require that either a significant portion, at least 60%, of the instruments are issued to other investors or, if instruments are used for the sole purpose of variable remuneration, that they are issued at market rates for similar instruments under a cap on the distributions paid, which is calculated when the instrument is issued.

In accordance with its mandate, the EBA has submitted the draft RTS to the European Commission.

2. Background and rationale

The nature of RTS under EU law

These draft RTS are produced in accordance with Article 10 of Regulation (EU) No 1093/2010 of 24 November 2010 (the EBA Regulation) as amended by Regulation (EU) No 1022/2013. Paragraph 4 of that same Article provides that the RTS shall be adopted by means of an EU Regulation or Decision.

In accordance with EU law, EU regulations are binding in their entirety and directly applicable in all Member States. This means that, on the date of their entry into force, EU Regulations become part of the national law of the Member States and that their implementation into national law is not only unnecessary but also prohibited by EU law, except insofar as this is expressly required by the regulations.

Legal basis and background

Article 94(1)(l) of the CRD requires that 'a substantial portion, and in any event at least 50%, of any variable remuneration shall consist of a balance of the following: (i) shares or equivalent ownership interests ... or share–linked instruments or equivalent non-cash instruments, in the case of a non-listed institution; (ii) where possible, other instruments within the meaning of Article 52 or 63 of Regulation (EU) No 575/2013 or other instruments that can be fully converted to CET 1 instruments or written down, that in each case adequately reflect the credit quality of

the institution as a going concern and are appropriate to be used for the purposes of variable remuneration.'

Article 94(2) of the CRD mandates the EBA to develop 'draft regulatory technical standards with respect to specifying the classes of instruments that satisfy the conditions set out in point (l)(ii) of paragraph 1...'. The purpose of the draft RTS is to specify classes of instruments that are appropriate to be used for variable remuneration.

A similar requirement, but limited to AT 1 instruments, had already been put in place following CRD III. The EBA's predecessor, the Committee of European Banking Supervisors (CEBS), issued 'Guidelines on Remuneration Policies and Practices' in 2010, and the EBA published an implementation review in 2012. The EBA has taken these into account when developing the draft RTS.

The EBA has conducted an impact assessment of costs and benefits caused by the provisions contained in these draft RTS. The possibility of using Tier 2 and Other Instruments was introduced in the CRD during the legislative process, enabling institutions to use a broader scope of instruments in their remuneration framework. The EBA came to the conclusion that the additional costs caused by these draft RTS are very limited and mainly consist of one-off costs for the adjustment of remuneration policies, and minor adjustments in the terms of instruments and the prospectus, where institutions use such instruments for paying variable remuneration. The additional requirements are considered to have no impact on the ability of firms to issue capital instruments. The assessment does not cover costs that result from the CRD itself.

Regulatory approach within the RTS

The EBA took into account market practices for own funds instruments to ensure that such issuances can also be used for the purpose of variable remuneration. So far, trigger events have primarily been based on CET 1 capital figures. While AT 1 and Tier 2 instruments are regulatory own fund instruments, Other Instruments are not.

Variable remuneration awarded in instruments is intended to promote sound and effective risk management and should not encourage risk-taking that exceeds the level of tolerated risk within the institution. Instruments should provide incentives for staff to act in the long-term interest of the institution.

The price or value of instruments awarded as variable remuneration should reflect changes in the credit quality of the firm, in particular if it deteriorates, to ensure that instruments awarded to staff participate in potential losses that have an adverse effect on credit quality as a going concern. This link provides incentives for prudent and long term oriented risk-taking. Credit quality may be measured by different means, e.g. using a rating, spreads or capital ratios. To ensure that a reliable measure exists for all institutions without creating costs for additional rating processes, the CET 1 capital ratio was chosen as an indicator for the credit quality as a going concern. The capital ratio is a strong indicator for the credit quality and is audited, available and

easy to apply. The use of the CET 1 ratio is consistent with the requirements regarding the trigger event for the types of instrument specified in these draft RTS. While the EBA is aware that other indicators exist, the draft RTS were limited to the CET 1 ratio as this ratio can be applied by all institutions and leads to a harmonised approach.

The qualification that the instrument shall reflect the credit quality of the institution as a going concern makes it necessary to introduce measures that ensure that the value of instruments is not reduced only at the time where an institution is resolved or at the point of non-viability. Therefore, the trigger level at which write-off or conversion takes place is set above the regulatory minimum requirements.

Instruments must be appropriate for the purposes of variable remuneration. The CRD provisions for variable remuneration require deferral and retention periods and state, among other requirements, that variable remuneration is not paid through vehicles or methods that facilitate non-compliance with the requirements of either the CRD or CRR. Consequently, the conditions of instruments need to ensure a sufficiently long maturity to account for deferral and retention periods and to be at market rates to avoid situations in which overly high distributions jeopardise the ability of institutions to strengthen their capital bases or that would circumvent limits set for the variable components of remuneration. This is achieved by a cap on the distributions or through the requirement to issue significant parts of any issuance to other investors.

In line with comments received during the public consultation, the draft RTS contain uniform trigger events for all classes of instruments. The definition of the trigger event is based on CET 1 capital and is consistent with the definition of trigger events used in the CRR for AT 1 instruments, but sets the trigger event at a higher level of 7% CET 1 to ensure that the instruments are suitable for the purposes of variable remuneration. The EBA also took into account comments relating to the write-down, write-up and conversion of Tier 2 and Other Instruments. For these two classes of instruments, the EBA introduced processes that are closely aligned with the processes applicable for AT 1 instruments to avoid making the existing framework for capital instruments more complex.

3. EBA FINAL draft Regulatory Technical Standards on classes of instruments that are appropriate to be used for the purposes of variable remuneration under Article 94(2) of Directive 2013/36/EU

COMMISSION DELEGATED REGULATION (EU) No …/..

of XXX

supplementing Directive (EU) No 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the classes of instruments that adequately reflect the credit quality of an institution as a going concern and are appropriate to be used for the purposes of variable remuneration

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

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

Having regard to Directive (EU) No 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC[1], and in particular Article 94(2) thereof,

Whereas:

(1) Variable remuneration awarded in instruments should promote sound and effective risk management and should not encourage risk-taking that exceeds the level of tolerated risk of the institution. Therefore classes of instruments which can be used for the purposes of variable remuneration should align the interests of staff with the interests of shareholders, creditors and other stakeholders by providing incentives

[1] OJ L 176, 27.6.2013, p. 338.

for staff to act in the long-term interest of the institution and not to take excessive risks.

(2) To ensure that there is a strong link to the credit quality of an institution as a going concern, instruments used for the purposes of variable remuneration should contain appropriate trigger events which reduce the value of the instruments in situations where the credit quality of the institution as a going concern has deteriorated. The trigger events used for remuneration purposes should not change the level of subordination of the instruments and therefore should not lead to a disqualification of Additional Tier 1 or Tier 2 instruments as own funds instruments.

(3) While the conditions which apply to Additional Tier 1 and Tier 2 instruments are specified in Articles 52 and 63 of Regulation (EU) No 575/2013 of the European Parliament and of the Council[2], the other instruments referred to in point (l)(ii) of Article 94 of Directive 2013/36/EU which can be fully converted to Common Equity Tier 1 instruments or written down ('Other Instruments') are not subject to specific conditions pursuant to that Regulation as they are not classified as own funds instruments for prudential purposes. Specific requirements should therefore be set for different classes of instruments to ensure that they are appropriate to be used for the purposes of variable remuneration, taking account of the different nature of the instruments. The use of instruments for the purposes of variable remuneration should not in itself prevent instruments from qualifying as own funds of an institution as long as the conditions laid down in Regulation (EU) No 575/2013 are met. Nor should such use in itself be understood as providing an incentive to redeem the instrument, as after deferral and retention periods staff are in general able to receive liquid funds by other means than redemption.

(4) Other Instruments are non-cash debt instruments or debt-linked instruments that do not qualify as own funds. Other Instruments are not limited to financial instruments as defined in point 50 of Article 4(1) of Regulation (EU) No 575/2013, but can also include further non-cash instruments, including contracts between institution and staff. To ensure that these instruments reflect the credit quality of an institution as a going concern, requirements should ensure that the circumstances in which such instruments are written down or converted extend beyond recovery or resolution situations.

(5) When instruments used for the purposes of variable remuneration are called, redeemed, repurchased or converted, in general such transactions should not increase the value of the remuneration awarded by paying out amounts that are higher than the value of the instrument or by converting into instruments which have a higher value than the instrument initially awarded. This is to ensure that remuneration is not paid through vehicles or methods that facilitate non-compliance with Article 94(1) of Directive 2013/36/EC.

(6) When awarding variable remuneration and when instruments used for variable remuneration are redeemed, called, repurchased or converted, those transactions should be based on values that have been established in accordance with the

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[2] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

applicable accounting standard. A valuation of the instruments should therefore be required in all these situations in order to ensure that the requirements of Directive 2013/36/EU regarding remuneration are not circumvented, in particular as regards the ratio between variable and fixed components of remuneration and the alignment with risk taking.

(7) Article 54 of Regulation (EU) No 575/2013 sets out the write-down and conversion mechanisms for Additional Tier 1 instruments. Additionally, point (l)(ii) of Article 94(1) of Directive 2013/36/EU requires that Other Instruments can be fully converted into Common Equity Tier 1 instruments or written down. As the economic outcome of a conversion or write-down of Other Instruments is the same as for Additional Tier 1 instruments, write-down or conversion mechanisms for Other Instruments should take into account the mechanisms that apply to Additional Tier 1 instruments, while also taking into account that Other Instruments do not qualify as own fund instruments from a prudential perspective. Tier 2 instruments are not subject to regulatory requirements regarding write-down and conversion under Regulation (EU) No 575/2013. To ensure that the value of all such instruments is reduced when the credit quality of the institution deteriorates, the situations in which a write-down or conversion of the instrument is necessary should be specified. The write down, write up and conversion mechanisms for Tier 2 and Other Instruments should be defined to ensure consistent application.

(8) Distributions arising from instruments may take various forms. They may be variable or fixed and may be paid periodically or at the final maturity of an instrument. In line with guidelines on remuneration policies and practices issued by the Committee of European Banking Supervisors, in order to promote sound and effective risk management no distributions should be paid to staff during deferral periods. Staff should only receive distributions in respect of periods which follow the vesting of the instrument. Therefore only instruments with distributions which are paid periodically to the owner of the instrument are appropriate for use as variable remuneration; zero coupon bonds or other instruments which retain earnings should not count towards the substantial portion of remuneration which must consist of a balance of the instruments referred to in point (l) of Article 94(1) of Directive 2013/36/EU. This is because staff would benefit during the deferral period from increasing values, which can be understood as equivalent to receiving distributions.

(9) Very high distributions can reduce the long-term incentive for prudent risk-taking as they effectively increase the variable part of the remuneration. In particular distributions should not be paid out at longer than annual intervals as this would lead to distributions effectively accumulating during deferral periods and being paid out once the variable remuneration vests. Accumulation of distributions would circumvent point (g) of Article 94(1) of Directive 2013/36/EU regarding the ratio between variable and fixed components of remuneration and the principle in point (m) of that Article that remuneration payable under deferral arrangements vests no faster than on a pro rata basis. Therefore distributions made after the instrument has vested should not exceed market rates. This should be ensured by requiring instruments used for variable remuneration, or the instruments to which they are linked, to be issued mainly to other investors, or by requiring such instruments to be subject to a cap on distributions.

(10) Deferral and retention requirements which apply to awards of variable remuneration pursuant to Article 94(1) of Directive 2013/36/EU have to be met at all relevant times, including when instruments used for variable remuneration are called, redeemed, repurchased or converted. In such situations instruments should therefore be exchanged with Additional Tier 1, Tier 2 and Other Instruments which reflect the credit quality of the institution as a going concern, have features equivalent to those of the instrument initially awarded, and are of the same value, taking into account any amounts which have been written down. Where instruments other than Additional Tier 1 instruments have a fixed maturity date minimum requirements should be set for the remaining maturity of such instruments when they are awarded in order to ensure that they are consistent with requirements regarding the deferral and retention periods for variable remuneration.

(11) Directive 2013/36/EU does not limit the classes of other instruments that can be used for variable remuneration to a specific class of financial instruments. It should be possible to use synthetic instruments or contracts between staff members and institutions which are linked to Additional Tier 1 and Tier 2 instruments which can be fully converted or written down. This allows for the introduction of specific conditions in the terms of such instruments which apply only to instruments awarded to staff, without the need to impose such conditions on other investors.

(12) In a group context issuances may be managed centrally within a parent undertaking. Institutions within such a group may not issue instruments which are appropriate to be used for the purpose of variable remuneration. Regulation (EU) No 575/2013 enables Additional Tier 1 and Tier 2 instruments issued through an entity within the scope of consolidation to form part of an institution's own funds subject to certain conditions. Therefore such instruments should also be usable for the purpose of variable remuneration, provided that there is a clear link between the credit quality of the institution using these instruments for the purpose of variable remuneration and the credit quality of the issuer of the instrument. Such a link can usually be assumed to be the case between a parent undertaking and a subsidiary. Instruments other than Additional Tier 1 and Tier 2 instruments which are not issued directly by an institution should also be capable of being used for variable remuneration, subject to equivalent conditions. Instruments which are linked to reference instruments issued by parent undertakings in third countries and which are equivalent to Additional Tier 1 or Tier 2 instruments should be eligible to be used for the purposes of variable remuneration if the trigger event refers to the institution using such a synthetic instrument.

(13) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the European Commission.

(14) EBA has conducted open public consultations on the draft regulatory technical standards, 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 of the European Parliament and of the Council[3],

HAS ADOPTED THIS REGULATION:

Article 1

Classes of instruments that adequately reflect the credit quality of an institution as a going concern and are appropriate to be used for the purposes of variable remuneration

1. The classes of instruments that satisfy the conditions laid down in point (l)(ii) of Article 94(1) of Directive 2013/36/EU are the following:

   (a) classes of Additional Tier 1 instruments where those classes fulfil the conditions in paragraph 2 and in Article 2, and comply with Article 5(9) and point (c) of Article 5(13);

   (b) classes of Tier 2 instruments where those classes fulfil the conditions in paragraph 2 and in Article 3, and comply with Article 5;

   (c) classes of instruments which can be fully converted to Common Equity Tier 1 instruments or written down and which are neither Additional Tier 1 instruments nor Tier 2 instruments (hereinafter referred to as "Other Instruments") in the cases referred to in Article 4 where those classes fulfil the conditions in paragraph 2 and comply with Article 5.

2. The classes of instruments referred to in points (a) to (c) of paragraph 1 shall fulfil the following conditions:

   (a) instruments shall not be secured or subject to a guarantee that enhances the seniority of the claims of the holder;

   (b) where the provisions governing an instrument (the "awarded instrument") allow conversion of that instrument, the awarded instrument shall only be used for the purposes of variable remuneration where the rate or range of conversion is set at a level that ensures that the value of the instrument received when the awarded instrument is converted is not higher than the value of the awarded instrument at the time it was awarded as variable remuneration;

   (c) the provisions governing instruments which are used for the sole purpose of variable remuneration (the "awarded instrument") shall ensure that the value of the instrument received when the awarded instrument is converted is not higher than the value of the awarded instrument at the time of conversion;

   (d) the provisions governing the instrument shall provide that any distributions are paid on at least an annual basis and are paid to the holder of the instrument;

   (e) instruments shall be priced at their value at the time the instrument is awarded, in accordance with the applicable accounting standard. The

[3] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

valuation shall take into account the credit quality of the institution and shall be subject to independent review;

(f) the provisions governing the instruments issued for the sole purpose of variable remuneration shall require a valuation to be carried out in accordance with the applicable accounting standard in the event that the instrument is redeemed, called, repurchased or converted.

Article 2

Conditions for classes of Additional Tier 1 instruments

Classes of Additional Tier 1 instruments shall comply with the following conditions:

(a) the provisions governing the instrument shall specify a trigger event for the purpose of point (n) of Article 52(1) of Regulation (EU) No 575/2013;

(b) the trigger event referred to in point (a) occurs when the Common Equity Tier 1 capital ratio of the institution issuing the instrument, as referred to in point (a) of Article 92(1) of Regulation (EU) No 575/2013, falls below either of the following:

(i) 7 %;

(ii) a level higher than 7 %, where determined by the institution and specified in the provisions governing the instrument;

(c) one of the following requirements is met:

(i) the instruments are issued for the sole purpose of being awarded as variable remuneration and the provisions governing the instrument ensure that any distributions are paid at a rate which is consistent with market rates for similar instruments issued by the institution or by institutions of comparable nature, scale, complexity and credit quality and which in any case is, at the time the remuneration is awarded, no higher than 8 percentage points above the annual average rate of change for the Union published by the Commission (Eurostat) in its Harmonised Indices of Consumer Prices published pursuant to Article 11 of Council Regulation (EC) No 2494/95[4]. Where the instruments are awarded to staff who perform the predominant part of their professional activities outside the Union and the instruments are denominated in a currency issued by a third country, institutions may use a similar independently-calculated index of consumer prices produced in respect of that third country;

(ii) at the time of the award of the instruments as variable remuneration, at least 60% of the instruments in issuance were issued other than as an award of variable remuneration and are not held by the following or by any undertaking that has close links with the following:

– the institution or its subsidiaries;

– the parent undertaking of the institution or its subsidiaries;

[4] Council Regulation (EC) No 2494/95 of 23 October 1995 concerning harmonized indices of consumer prices (OJ L 257, 27.10.1995, p. 1).

– the parent financial holding company or its subsidiaries;
– the mixed activity holding company or its subsidiaries;
– the mixed financial holding company and its subsidiaries.

Article 3
Conditions for classes of Tier 2 instruments

Classes of Tier 2 instruments shall comply with the following conditions:

(a) at the time of the award of the instruments as variable remuneration, the remaining period before maturity of the instruments shall be equal to or exceed the sum of the deferral periods and retention periods that apply to variable remuneration in respect of the award of those instruments;

(b) the provisions governing the instrument provide that, upon the occurrence of a trigger event the principal amount of the instruments shall be written down on a permanent or temporary basis or the instrument be converted to Common Equity Tier 1 instruments;

(c) the trigger event referred to in point (b) occurs when the Common Equity Tier 1 capital ratio of the institution issuing the instrument, as referred to in point (a) of Article 92(1) of Regulation (EU) No 575/2013, falls below either of the following:

(i) 7 %;

(ii) a level higher than 7 %, where determined by the institution and specified in the provisions governing the instrument;

(d) one of the requirements in point (c) of Article 2 is met.

Article 4
Conditions for classes of Other Instruments

1. Under the conditions laid down in point (c) of Article 1(1), Other Instruments satisfy the conditions laid down in point (l)(ii) of Article 94(1) of Directive 2013/36/EU in each of the following cases:

(a) the Other Instruments fulfil the conditions in paragraph 2;

(b) the Other Instruments are linked to an Additional Tier 1 instrument or Tier 2 instrument and fulfil the conditions in paragraph 3;

(c) the Other Instruments are linked to an instrument which would be an Additional Tier 1 instrument or Tier 2 instrument but for the fact that it is issued by a parent undertaking of the institution which is outside the scope of consolidation pursuant to Chapter 2 of Title II of Part One of Regulation (EU) No 575/2013 and the Other Instruments fulfil the conditions in paragraph 4.

2. The conditions referred to in point (a) of paragraph 1 are the following:

(a) the Other Instruments shall be issued directly or through an entity included within the group consolidation pursuant to Chapter 2 of Title II of Part One

of Regulation (EU) No 575/2013, provided that a change to the credit quality of the issuer of the instrument can reasonably be expected to lead to a similar change to the credit quality of the institution using the Other Instruments for the purpose of variable remuneration;

(b) the provisions governing the Other Instruments do not give the holder the right to accelerate the scheduled payment of distributions or principal other than in the insolvency or liquidation of the institution;

(c) at the time of the award of the Other Instruments as variable remuneration the remaining period before maturity of the Other Instruments is equal to or exceeds the sum of the deferral periods and retention periods that apply in respect of the award of those instruments;

(d) the provisions governing the instrument provide that, upon the occurrence of a trigger event the principal amount of the instruments be written down on a permanent or temporary basis or the instrument be converted to Common Equity Tier 1 instruments;

(e) the trigger event referred to in point (d) occurs when the Common Equity Tier 1 capital ratio of the institution issuing the instrument referred to in point (a) of Article 92(1) of Regulation (EU) No 575/2013 falls below either of the following:

(i) 7 %

(ii) a level higher than 7 %, where determined by the institution and specified in the provisions governing the instrument;

(f) one of the requirements in point (c) of Article 2 is met.

3. The conditions referred to in point (b) of paragraph 1 are the following:

(a) the Other Instruments fulfil the conditions in points (a) to (e) of paragraph 2;

(b) the Other Instruments are linked to an Additional Tier 1 or Tier 2 instrument issued through an entity included within the group consolidation pursuant to Chapter 2 of Title II of Part One of Regulation (EU) No 575/2013 (hereinafter referred to as the 'reference instrument');

(c) the reference instrument fulfils at the time that the instrument is awarded as variable remuneration the requirements of points (c) and (f) of paragraph 2;

(d) the value of an Other Instrument is linked to the reference instrument such that it is at no time more than the value of the reference instrument;

(e) the value of any distributions paid after the Other Instrument has vested is linked to the reference instrument such that distributions paid are at no time more than the value of any distributions paid under the reference instrument;

(f) the provisions governing the Other Instruments provide that if the reference instrument is called, converted, repurchased or redeemed within the deferral or retention period the Other Instruments shall be linked to an equivalent

reference instrument which fulfils the conditions in this Article such that the total value of the Other Instruments does not increase.

4. The conditions referred to in point (c) of paragraph 1 are the following:

   (a) the competent authorities have determined for the purpose of Article 127 of Directive 2013/36/EU that the institution which issues the instrument to which the other instruments are linked is subject to consolidated supervision by a third-country supervisory authority which is equivalent to that governed by the principles set out in that Directive and the requirements of Chapter 2 of Title II of Part One of Regulation (EU) No 575/2013;

   (b) the Other Instruments fulfil the conditions in points (a) and (c) to (f) of paragraph 3.

Article 5

Write down, write up and conversion procedures

1. For the purpose of point (b) of Article 3 and point (d) of Article 4(2) the provisions governing Tier 2 instruments and Other Instruments shall comply with the procedures and timing laid down in paragraphs 2 to 14 for calculating the Common Equity Tier 1 capital ratio and the amounts to be written down, written up or converted. The provisions governing Additional Tier 1 instruments shall comply with the procedures laid down in paragraph 9 and point (c) of paragraph 13 in respect of amounts to be written down, written up or converted.

2. Where the provisions governing Tier 2 and Other Instruments require the instruments to be converted into Common Equity Tier 1 instruments upon the occurrence of a trigger event, those provisions shall specify either of the following:

   (a) the rate of that conversion and a limit on the permitted amount of conversion;

   (b) a range within which the instruments will convert into Common Equity Tier 1 instruments.

3. Where the provisions governing the instruments provide that their principal amount shall be written down upon the occurrence of a trigger event, the write-down shall permanently or temporarily reduce all the following:

   (a) the claim of the holder of the instrument in the insolvency or liquidation of the institution;

   (b) the amount to be paid in the event of the call or redemption of the instrument;

   (c) the distributions made on the instrument.

4. Any distributions payable after a write-down shall be based on the reduced amount of the principal.

5. Write-down or conversion of the instruments shall, under the applicable accounting framework, generate items that qualify as Common Equity Tier 1 items.

6. Where the institution has established that the Common Equity Tier 1 ratio has fallen below the level that activates conversion or write-down of the instrument the management body or any other relevant body of the institution shall be required to determine without delay that a trigger event has occurred and there shall be an irrevocable obligation to write-down or convert the instrument.

7. The aggregate amount of instruments that is required to be written down or converted upon the occurrence of a trigger event shall be no less than the lower of the following:

   (a) the amount required to fully restore the Common Equity Tier 1 ratio of the institution to the percentage set for the trigger event in the provisions governing the instrument;

   (b) the full principal amount of the instrument.

8. Where a trigger event occurs, institutions shall be required to do the following:

   (a) inform the staff who have been awarded the instruments as variable remuneration and the persons who continue to hold such instruments;

   (b) write down the principal amount of the instruments, or convert the instruments into Common Equity Tier 1 instruments as soon as possible and within a maximum period of one month in accordance with the requirements laid down in this Article.

9. Where Additional Tier 1 instruments, Tier 2 instruments and Other Instruments include an identical trigger level, the principal amount shall be written down or converted on a pro rata basis to all holders of such instruments which are used for the purposes of variable remuneration.

10. The amount of the instrument to be written down or converted shall be subject to independent review. That review shall be completed as soon as possible and shall not create impediments for the institution to write-down or convert the instrument.

11. An institution issuing instruments that convert to Common Equity Tier 1 on the occurrence of a trigger event shall be required to ensure that its authorised share capital is at all times sufficient to convert all such convertible instruments into shares if a trigger event occurs. The institution shall be required to maintain at all times the necessary prior authorisation to issue the Common Equity Tier 1 instruments into which such instruments would convert upon the occurrence of a trigger event.

12. An institution issuing instruments that convert to Common Equity Tier 1 on the occurrence of a trigger event shall be required to ensure that there are no procedural impediments to that conversion by virtue of its incorporation or statutes or contractual arrangements.

13. In order for the write-down of an instrument to be considered temporary, all of the following conditions shall be met:

   (a) write-ups shall be based on profits after the issuer of the instrument has taken a formal decision confirming the final profits;

   (b) any write-up of the instrument or payment of coupons on the reduced amount of the principal shall be operated at the full discretion of the

institution subject to the constraints arising from points (c) to (e) and there shall be no obligation for the institution to operate or accelerate a write-up under specific circumstances;

(c) a write-up shall be operated on a pro rata basis among Additional Tier 1 instruments, Tier 2 instruments and Other Instruments used for the purpose of variable remuneration that have been subject to a write-down;

(d) the maximum amount to be attributed to the sum of the write-up of Tier 2 and Other Instruments together with the payment of coupons on the reduced amount of the principal shall be equal to the profit of the institution multiplied by the amount obtained by dividing the amount determined in point (i) by the amount determined in point (ii):

   (i) the sum of the nominal amount of all Tier 2 instruments and other instruments of the institution before write-down that have been subject to a write-down;

   (ii) the sum of own funds and of the nominal amount of Other Instruments used for the purpose of variable remuneration of the institution;

(e) the sum of any write-up amounts and payments of coupons on the reduced amount of the principal shall be treated as a payment that results in a reduction of Common Equity Tier 1 and shall be subject, together with other distributions on Common Equity Tier 1 instruments, to the restrictions relating to the Maximum Distributable Amount as laid down in Article 141(2) of Directive 2013/36/EU.

14. For the purposes of point (d) of paragraph 13, the calculation shall be made at the moment when the write-up is operated.

Article 6

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
[…]

4. Accompanying documents

4.1 Cost- Benefit Analysis / Impact Assessment

Article 10(1) of the EBA Regulation provides that before any draft regulatory technical standards developed by the EBA are submitted to the Commission for adoption the EBA should analyse 'the potential related costs and benefits'. This analysis is to provide an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.

The analysis is presented herewith as an impact assessment (IA) of the draft RTS on classes of other instruments within the meaning of Articles 52 or 63 of the CRR, or Other Instruments that can be fully converted to CET 1 instruments or written down, that in each case adequately reflect the credit quality of the institution as a going concern and are appropriate to be used for the purposes of variable remuneration. The draft RTS have been developed under the requirement laid down in Article 94(2) of the CRD.

Problem definition

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

In the impact assessment accompanying its CRD III proposal, the Commission noted that in some cases institutions did not react appropriately to changing economic conditions, due to short-term oriented remuneration structures or herding behaviour. In many institutions, remuneration policies entailed *excessive rewards* on the upside and *insufficient penalties* on the downside; in particular, risk adjustments and deferral arrangements were missing.

To address the harmful effects of poorly designed remuneration structures, CRD III had included requirements for credit institutions and investment firms to establish and maintain, for those categories of staff whose professional activities have a material impact on the institution's risk profile, remuneration policies and practices that were consistent with effective risk management. These requirements were intended to create more incentives for staff members to behave prudently, by making short-term risk-taking less attractive and ensuring that their personal objectives were aligned with the long-term interests of the institution. The requirements were supplemented at a later stage by the CEBS 'Guidelines on Remuneration Policies and Practices'.

After the implementation of CRD III, most institutions paid variable remuneration partly in cash and partly either in shares, share-linked or equivalent instruments. So-called hybrid instruments were not used because of stringent regulatory requirements and the need to increase the CET 1 capital first. A survey published in 2012 by the EBA found that no AT 1 instruments had yet been

used to grant variable remuneration to persons who had a material impact on the institution's risk profile (identified staff).

To encourage the payment of variable remuneration in instruments, the CRD contains stricter rules regarding the structure of remuneration for identified staff. For instance, Article 94(1)(l) of the CRD requires that 'a substantial portion, and in any event at least 50%, of any variable remuneration shall consist of a balance of the following: (i) shares or equivalent ownership interests ... or share–linked instruments or equivalent non-cash instruments, in case of a non-listed institution; (ii) where possible, other instruments within the meaning of Articles 52 or 63 of Regulation (EU) No 575/2013 or other instruments that can be fully converted to Common Equity Tier 1 instruments or written down, that in each case adequately reflect the credit quality of the institution as a going concern and are appropriate to be used for the purposes of variable remuneration.'

Issues addressed and objectives

Until now, the use of AT 1 instruments and the setting of specific requirements were left at the discretion of national competent authorities, based on the CEBS 'Guidelines on Remuneration Policies and Practices' and the provisions contained in CRD III. CRD IV has broadened the set of eligible instruments, which now also encompasses Tier 2 and Other Instruments that can be fully converted into CET 1 instruments or can be written down. Once it is adopted by the Commission, the proposed draft RTS will supplement, at a technical level, the provisions of the CRD.

Following the mandate provided in Article 94(2) of the CRD, classes of eligible instruments will now be defined within this regulatory technical standard to ensure the harmonised application of the relevant level 1 requirements within the European Union. In accordance with the mandate, the EBA must propose requirements that are to:

- ensure that instruments awarded as variable remuneration adequately reflect the credit quality of the institution as a going concern;
- ensure that instruments are appropriate for the purpose of variable remuneration by providing incentives for prudent and long term oriented risk-taking; and
- specify additional requirements for 'other' instruments, including the situations in which they would be converted or written down, because the CRR does not contain specific requirements for Other Instruments as it does for AT 1 and Tier 2 instruments.

Instruments must appropriately reflect the credit quality of the institution as a going concern. Changes in the credit quality should lead to changes in the value of the instrument. A strong link to the credit quality also ensures that the remuneration paid in such instruments is aligned to risks, and staff members receiving such instruments have an incentive to act in the long-term interest of the institution. For this reason, instruments must be compatible with deferral and retention requirements. Instruments should not provide for any mechanisms that may circumvent

the remuneration requirements set out in the CRD and, in particular, the cap on the ratio between variable and fixed components of total remuneration.

In an earlier Consultation Paper (CP on draft RTS on own funds) the EBA proposed additional technical requirements for AT 1 and Tier 2 instruments. All AT 1 and Tier 2 instruments used for paying variable remuneration to identified staff need to be compliant with the provisions in the CRR and CRD, as well as those of these RTS.

Technical options proposed

This section explains the rationale behind some of the decisions that the EBA made when designing the RTS proposals. In these draft RTS, the EBA has defined the additional requirements that AT 1, Tier 2 and Other Instruments should meet in order to be eligible for variable remuneration. For Other Instruments, no specific regulatory definition exists. Thus, the proposed draft RTS set out the minimum requirements for such debt instruments, including the conversion and write-down features required for these instruments.

Common requirements for all three types of instruments

To ensure that instruments are issued at market conditions reflecting the credit quality of the issuer, the following requirements were specified.

Issuance: two options were considered to ensure that the instruments are issued on arm's length conditions and the distributions are paid out so as not to lead to a circumvention of remuneration requirements.

Option 1: requiring that a significant portion (60%) of the issuance of instruments is placed with investors or that alternatively instruments are issued at market rates for similar instruments issued by peer institutions and an absolute cap for distributions is applied;

Option 2: requiring that instruments are issued at market conditions.

- When an instrument is privately or publicly placed, institutions will need to monitor the amount of instruments to ensure that a portion of 60% of the instruments used for paying variable remuneration is held by other investors and was not awarded as variable remuneration. The amounts held by the institution or within the group should not account for the 60% that should be placed with other investors. The amounts used for variable remuneration will need to be accounted for. When the larger part of an issue is placed with other investors, it can be assumed that this is done at market conditions and that there will also not be any material conflicts of interest at a later stage when instruments are called, converted, redeemed or repurchased. In addition, the valuation of such instruments should be easier as market rates would be available for most of these issuances.

If instruments are used for the sole purpose of variable remuneration, they should be issued at the market rates that would apply for the institution issuing the instrument. A cap should ensure that the distribution of these issuances does not circumvent regulatory requirements. If a cap is placed on distributions, the cap should be set on the basis of the average annual inflation rate within the European Union plus a spread of 800 basis points, considering market rates observed for contingent capital issuances. Taking into account the fact that issuances can be used within the scope of consolidation, it is appropriate to use an annual EU inflation rate as a basis. Inflation rates are measured by Eurostat, the statistical office of the EU, and provide an objective basis for the calculation of a cap. This also takes into account concerns about the objectivity of market rates that could otherwise be used. The cap should only be applied when the instruments are awarded to avoid subsequent changes of contracts. In some cases it may be appropriate to use inflation rates applicable for third countries, e.g. when staff are remunerated in a currency issued by a third country. The cap simplifies the supervision of the remuneration framework as otherwise an analysis of the appropriateness of conditions set would be needed under supervisory scrutiny. Option 1 was retained.

- The second option of requiring the issuance of instruments only at market conditions was considered insufficiently effective and also difficult to supervise. Issuances used for the sole purpose of variable remuneration would need to be scrutinised by competent authorities if a cap for distributions paid did not exist. Market conditions differ between institutions and the burden of assessing appropriateness would lead to additional costs for institutions and competent authorities.

Issuance in a group — In a group context, not all institutions issue instruments that are appropriate to be used for the purpose of variable remuneration. Additional Tier 1 and Tier 2 instruments count as own funds pursuant to Article 52(1)(p) of the CRR where the instrument is issued through an entity within the scope of consolidation pursuant to Chapter 2 of Title II of Part One of the CRR and the proceeds are immediately available to the institution without limitation and in a form that satisfies the conditions of Articles 53 or 63 of the CRR. Therefore, such instruments should also be appropriate for variable remuneration provided that there is a clear link between the credit quality of the institution using these instruments for the purpose of variable remuneration and the credit quality of the issuer of the instruments. For 'Other Instruments' this should apply analogously. The link to the credit quality of the institution would be stronger if that institution were required to use for the purposes of variable remuneration only those instruments issued by itself. However, if each institution using instruments for the purposes of variable remuneration had to issue such instruments, the costs, including the costs of the prospectus, would be significant. In addition, the issuances would probably have a smaller nominal amount, which could impede their placement with institutional investors.

Issuance by third-country institutions — Issuances by parent institutions domiciled in third countries are not covered in the aforementioned scope of consolidation. However, instruments used by institutions for the purposes of variable remuneration could be linked to instruments issued by the parent institution in a third country if those instruments are equivalent to AT 1 and

Tier 2 instruments except for the fact that they are issued by the parent institution in a third country and if the trigger event defined refers to the institution within the EU that issues that 'Other Instrument'. These instruments were added to the RTS, because some groups manage issuances of capital instruments centrally at the level of the parent institution. This, combined with the trigger event set at the EU institution level, ensures that issuances within the group can be used, while the link to the credit quality of the institution awarding variable remuneration in such instruments is maintained. Allowing the use of instruments linked to Other Instruments that are not equivalent to AT 1 and Tier 2 instruments was considered, but not included in the draft RTS, as subsidiaries of non-EU parent institutions can create Other Instruments for the sole purpose of variable remuneration themselves. As such instruments would not be issued publicly, the EBA considered that the additional burden of issuing such instruments, compared with the costs for the creation of another instrument at the parent institution and the creation of a linked instrument at the subsidiary would be minimal, if any.

Maturity — While AT 1 instruments are perpetual, Tier 2 and Other Instruments can have a fixed maturity. To be suitable for the purposes of variable remuneration, the remaining maturity needs to allow for deferral and retention periods. Deferral periods are required within the CRD to increase the risk alignment of remuneration. The maturity of instruments should be sufficiently long to avoid the necessity of instruments being replaced during such periods. This could create conflicts of interest when decisions on capital measures (e.g. to call such an instrument) are taken.

Triggers — The objective of these RTS is to ensure that the value of the instruments awarded as variable remuneration is effectively aligned with the risk profile of the institutions. The draft RTS introduce a specific minimum trigger event for the write-down or conversion of AT 1 and other instruments and requires a write-down mechanism for Tier 2 instruments. The EBA set the trigger events above the minimum capital requirements to ensure that they reflect the credit quality as a going concern. A uniform trigger of 7% of CET 1 capital was introduced, as a trigger event of this nature is easier to monitor and in line with the CRR requirements for AT 1 instruments.

Conversion, redemption, call and repurchase of instruments — The value of instruments changes over time and instruments could be converted, redeemed, called or repurchased. To ensure that such transactions in instruments that have been awarded as variable remuneration are done at fair values, a valuation of instruments in such situations is required. This also ensures that there cannot be undue gains for staff that could lead to a circumvention of the remuneration requirements. A valuation is also needed when instruments are awarded to ensure that they equal the value of the awarded remuneration.

Guarantees — To ensure that instruments reflect the credit quality of the institution, the EBA proposes that the instruments should not be subject to any guarantees or other measures that enhance the seniority of the claim, as this would weaken the link to credit quality as a going concern. This requirement is stricter than the requirements set out in Articles 52 and 63 of the CRR regarding AT 1 and Tier 2 instruments. For the purposes of own funds, instruments that are guaranteed by parties outside the scope of connected entities are allowed. However, as explained

above, stricter requirements must be complied with if such instruments are also used for variable remuneration. This should not hinder the issuance of such instruments, as institutions can, and regularly do, issue instruments where no guarantees are provided, and only instruments used for the purposes of variable remuneration need to fulfil this additional requirement.

Requirements for Other Instruments

Some flexibility has been granted to institutions with regard to paying variable remuneration using other types of instruments. This was to allow institutions to use instruments that are linked to the risk profile of the institutions while Other Instruments do not need to comply with the additional requirements for AT 1 and Tier 2 instruments and do not directly affect the level of own funds of that institution. To that end, institutions are allowed to use debt instruments or synthetic instruments linked to AT 1 or Tier 2 instruments. The use of synthetic instruments will ensure that institutions can add additional specific clauses for staff regarding deferral and retention arrangements or call options included in the provisions governing the instrument to which such instruments are linked without violating the requirements of the prospectus directive, which ensure that all investors are treated in the same way. This will also ensure that measures to increase own funds are not hindered by requirements for variable remuneration.

***Payment and distribution* —** Instruments should not give the holder the right to accelerate the future scheduled payment of distributions or principal other than in the event of insolvency or liquidation of the institution. This is to ensure that deferral and retention arrangements are respected. This requirement is already part of the regulatory requirements for AT 1 and Tier 2 instruments and, therefore, needed to be included only for Other Instruments.

The CEBS ‘Guidelines on Remuneration Policies and Practices’ specify that no distributions should be paid during deferral periods. Therefore, instruments should have at least annual distributions. This ensures that during deferral periods no distributions would be paid, whereas staff would be able to receive distributions for retention periods. If zero coupon bonds were allowed for paying variable remuneration, the value would increase over time, which is equivalent to receiving distributions. Therefore, institutions are required to use instruments that pay out distributions at least annually; staff should receive those payments only for periods after the instruments have vested. This also ensures that the requirements regarding the ratio between variable and fixed remuneration cannot be circumvented.

***Write-down and conversion* —** In line with the CRD requirement that instruments can be fully converted or written down and to ensure that instruments reflect the credit quality of the institution, the RTS introduce a permanent or temporary write-down, write-up and conversion mechanism for Tier 2 and Other Instruments under requirements that are closely linked to the applicable mechanisms for AT 1 instruments. This is to avoid institutions having to develop separate processes.

Proportionality

Under Article 94(1)(l)(ii) of the CRD, institutions should use, where possible, AT 1, Tier 2 or Other Instruments for the purposes of variable remuneration that meet the requirements of these draft RTS. Smaller institutions are less likely to issue AT 1 and Tier 2 instruments, and therefore, for those institutions (which include many cooperative banks and savings banks), the EBA has tried to facilitate the use of Other Instruments.

The category of Other Instruments has been interpreted in a broad sense. The draft RTS allow the use of linked or synthetic instruments that can be linked to AT 1 and Tier 2 instruments issued by the institution if the requirements set out in the draft RTS are met. Under the category 'Other Instruments', the issuance could be in the form of contracts between institution and staff. This would not require a prospectus, which reduces compliance costs. This should also allow smaller and less complex banks to create linked, synthetic instruments or individual issuances under the class of Other Instruments.

Impact of the proposals

Costs

The implementation of these draft RTS will lead to incremental compliance costs for firms. There will be two main drivers of costs:

- Institutions need to ensure that the provisions governing the instruments to be used for the purposes of variable remuneration meet the requirements. This may increase the costs for issuing instruments that are to be used for paying variable remuneration.

- Institutions need to ensure that the required write-off or conversion is applied where necessary and they must valuate the instruments when awarded, called, redeemed, converted or repurchased. This may perhaps increase the administrative costs for variable remuneration awarded in such instruments. However, similar procedures have to be applied if remuneration is awarded in shares or other equity instruments.

These draft RTS only specify the classes of instruments within the meaning of Articles 52 or 63 of the CRR and Other Instruments that adequately reflect the credit quality of the institution and are appropriate to be used for the purposes of variable remuneration. Beyond this specific aspect, they do not set additional requirements for the variable part of remuneration. The requirements are set out in the CRD; the draft RTS complement these by adding the necessary technical standards. Therefore, the impact assessment is limited to this specific aspect. The requirement to use such instruments if possible, appears in the CRD and is therefore also not assessed here. Consequently, the incremental costs directly related to these draft RTS should be limited.

To date, competent authorities have not seen AT 1 instruments being used for variable remuneration. Therefore, the draft RTS will only have an impact on costs when institutions start to use AT 1, Tier 2 or Other Instruments as part of their remuneration policies as required by the

CRD. No grandfathering arrangements need to be considered for instruments that have already been awarded and no additional costs for the transformation of already used instruments are triggered by the draft RTS.

Table 1 – Summary of the costs of the RTS for institutions

Costs	One-off	On-going
Changing the way remuneration policies are set; systems and controls	a. Cost of additional staff time to review and align remuneration policies in addition to the review caused by other regulatory changes. This is likely to be low, as it affects only a limited number of aspects within the remuneration policy and is relevant only when institutions start to use such instruments for paying variable remuneration as required by the CRD (low)	b. None
Adjusting instruments used to pay variable remuneration	c1. Cost of ensuring that instruments comply with these RTS in addition to requirements set by the CRD or the RTS on own funds. This is likely to be low as the RTS allows for a broad range of instruments and the requirements are mainly based on concepts already introduced by the CRR for AT 1 instruments (negligible) c2. Costs for the prospectus and introduction of instruments. Most instruments would be introduced to trading on the market anyway; additional costs should therefore be negligible. In addition, instruments that do not need to be introduced to a regulated market can be created (negligible)	d. Increase of interest cost if institutions decide to place new issuances on the market with higher trigger events (medium)
Monitoring of the 60% condition	e. Implementation of reports to collect the necessary information before remuneration is awarded. This cost is likely to be negligible, as the underlying information is available in the accounting and reporting systems (negligible)	f. Annual calculation of the amounts held by other persons when the instrument is used for awarding variable remuneration. This cost is likely to be negligible, as the calculation will require information that should be readily available (negligible)
Prudent valuation of instruments	g. Valuation methodologies should be in place, hence no additional costs should be incurred.	h. Valuation of instruments would potentially need to be done more frequently (annually for instruments that are awarded and when call options etc. are exercised), but, as this is a standardised procedure, the costs would be low (low)

The implementation of these RTS may also have additional resource implications for national supervisory authorities. However, they should be somewhat limited, as the own funds of institutions are subject to regular supervisory review and the scope of the additional review needed is limited to the scope of these draft RTS. The impact of costs is expected to be ***low.***

Benefits

By specifying harmonised classes of eligible AT 1, Tier 2 and 'Other Instruments' to be used for the purposes of variable remuneration, the RTS will ensure that institutions in different Member States use the same practices thus meeting the CRD requirement of better aligning remuneration to risk. This will increase the legal certainty of institutions in developing such instruments and may in turn also reduce the costs for institutions that use such instruments in a group context in different Member States. Overall, the benefits from the implementation of the draft RTS are expected to have a ***low to medium*** impact, mainly being indirect benefits in terms of contribution to the stability of the financial system.

Net Impact

The net impact from the implementation of the RTS is expected to be ***low to medium***.

4.2 Feedback on the public consultation and on the opinion of the BSG

The EBA publicly consulted on the draft proposal contained in this paper.

The consultation period lasted for three months and ended on 29 October 2013; 13 responses were received, of which 9 were published on the EBA website. The Banking Stakeholder Group (BSG) did not submit an opinion on the draft RTS.

This section presents a summary of the key points and other comments arising from the consultation, the analysis and discussion triggered by these comments and the actions taken to address them if deemed necessary.

In many cases, several industry bodies made similar comments or the same body repeated its comments in the response to different questions. In such cases, the comments and EBA analysis are included in the section of this paper where EBA considers them most appropriate.

Changes to the draft RTS have been made as a result of the responses received during the public consultation.

Summary of key issues and the EBA's response

Many respondents commented that institutions should not be required to use debt instruments as part of their remuneration policies and they referred also to the principle of proportionality, suggesting that under this principle, the situations in which such instruments should be used are limited. These aspects were introduced in the CRD and are not part of the draft RTS, which is limited to setting out the classes of instruments under Article 94(1)(l)(ii) of the CRD that can be used for the purposes of variable remuneration.

With regard to the RTS, respondents stated that they would prefer trigger events to be set based on the CET 1 definition and commented that the draft RTS should not require higher trigger events to be set than those that have already been introduced in Regulation (EU) No 575/2013. Respondents also suggested aligning the provisions with the Banking Recovery and Resolution Directive (BRRD) with regard to the write-down of Tier 2 and Other Instruments at the point of non-viability.

As instruments should reflect the credit quality as a going concern, it is appropriate to require higher levels of trigger events for instruments used for the purposes of variable remuneration so that remuneration provides incentives for prudent and long term oriented risk-taking and that a write-down takes place before the point of non-viability or the trigger event set for AT 1 instruments in the CRR. To date, the point of non viability has not been defined in quantitative terms in the draft Banking and Recovery Resolution Directive (BRRD), which has not yet been adopted. However, in line with comments received during the public consultation, the draft RTS have been amended and now contain uniform trigger events for all classes of instruments. The definition of the trigger event is based on CET 1 capital and is consistent with the definition of

trigger events used in the CRR for AT 1 instruments, but sets the trigger event as a higher level of 7% CET 1 to ensure that the instruments are suitable for the purposes of variable remuneration. The EBA also took into account comments regarding write-down, write-up and conversion of Tier 2 and Other Instruments and for these two classes of instruments introduced processes that are closely aligned with the processes applicable for AT 1 instruments to avoid making the existing framework for capital instruments more complex.

For a complete overview of the main comments received and EBA's view, please refer to the feedback table below.

EBA EUROPEAN BANKING AUTHORITY

Summary of responses to the consultation and the EBA's analysis

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
General comments			
Proportionality	A few respondents underlined the fact that the draft RTS should be applied in a proportionate way and in particular it should be considered that investment firms have a different risk profile to credit institutions. The CRR states that such instruments should only be used 'where possible.' While the mandate of the RTS is limited, institutions need clarification on whether and to what extent they need to use such instruments. Possibly should be interpreted as the ability to use those instruments without incurring inappropriate costs and in line with the objectives of variable remuneration paid in instruments. Investment firms would be regulated on a going concern basis. With regard to limited licence firms the Regulation provides sufficient safeguards against failure and therefore a bail in of instruments awarded as remuneration is not necessary. The current CEBS Guidelines remove several requirements for such firms, and respondents suggested that this approach should be retained. The variable remuneration cap should not be applied for these firms as this is not part of Markets in Financial Instruments Directive (MiFID),	In accordance with the EBA's mandate, the draft RTS set out the classes of instruments that can be used for the purposes of variable remuneration in accordance with Article 94 (1)(l)(ii) of the CRD. The draft RTS do not cover the situations in which such instruments must be used. The scope of application is set by the CRD. Some investment firms do not fall within the scope of the definition of an institution as set out in Article 4(2) of the CRR. The CRD requires the use of such instruments 'if possible'; institutions must comply with that requirement in a manner and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities. The CRD requires competent authorities to ensure that institutions comply with that requirement. EBA will issue guidelines on remuneration practices as soon as possible; these guidelines will replace the CEBS 'Guidelines on Remuneration Policies and Practices'.	No change

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	Alternative Investment Fund Managers Directive (AIFME) or Undertakings for Collective Investments in Transferable Securities (UCITS) legislation. Limited licence firms should not be forced to apply the proposed RTS. One respondent suggested that institutions that are not active on the capital market should not be required to use other instruments to limit the risk of such issuances. Institutions should not be forced to issue instruments on the capital markets.		
Scope of RTS	One respondent explicitly agrees that the term 'instruments' should be understood in a broad sense and suggested stating that 'phantom share plans' would also fall under the definition.	In accordance with Article 94 (1)(l)(i) of the CRD, institutions may use shares or share-linked instruments or equivalent instruments. This includes 'phantom shares'. In accordance with the EBA's mandate, the draft RTS only cover the instruments under Article 94(1)(l)(ii) of the CRD. Phantom shares are not subject to the additional requirements of the draft RTS.	No change
Balance of instruments to be used and link to the BRRD	In general, many respondents agreed with the proposal that leads to the possibility of using a wider set of instruments for the purposes of variable remuneration. However, the draft RTS should be more compatible with the requirements of the BRRD. However, respondents do not see much added value in such additional instruments compared to instruments already used for remuneration purposes. Shares and share-linked	The draft RTS set out the classes of other instruments that, if possible, must be used for variable remuneration. This is a requirement of Article 94 of the CRD and cannot be changed via RTS. The draft RTS aim to ensure that the instruments are suitable for the purposes of variable remuneration. If the instruments were	No change

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	instruments are directly linked to the institution's development. The use of a diverse set of instruments may lead to a very complex remuneration packet that is difficult to understand and may therefore not succeed in providing appropriate incentives for prudent risk-taking biased towards the long term. Therefore, respondents asked for flexibility for institutions to use only shares or share-linked instruments as well. Shares in particular would reflect the economic development of a firm and would encourage greater stewardship by employees. In contrast, one respondent stated that the use of shares and equivalent ownership rights creates significant operational costs that are higher than the costs for other instruments, but also agrees that such instruments should be in line with CRR and BRRD requirements.	only written down in a situation where there is urgent need to re-establish a sound capital basis, the instruments would not provide sufficient incentives for prudent and long term oriented risk-taking. Hence the trigger events for instruments used for the purposes of variable remuneration should be set above the level defined within the CRR. The BRRD has not yet been adopted. The draft BRRD does not contain any quantitative definition regarding the point of non-viability. A quantification of trigger events is needed to ensure a sufficient harmonisation of instruments used for the purposes of variable remuneration.	
Proportionality in the application of the remuneration requirements	One respondent pointed out the importance of equivalent ownership rights and instruments linked to them. As ownership rights are not subject to the draft RTS, it should be specifically confirmed that the CEBS Guidelines regarding this matter remain valid. The respondent suggested adding further clarification regarding such instruments in future guidelines.	In accordance with the EBA's mandate, the draft RTS set out instruments that can be used for the purposes of variable remuneration in accordance with Article 94(1)(l)(ii) of the CRD. The draft RTS do not apply to instruments under Article 94(1)(l)(i) of the CRD. The EBA will update the CEBS Guidelines and issue EBA Guidelines on Remuneration Practices as soon as possible.	No change

Comments	Summary of responses received	EBA analysis	Amendments to the proposals

Responses to questions in Consultation Paper EBA/CP/2013/32

For consistency and clarity, the answers to the Consultation Paper have been grouped into several blocks. Responses to questions related to specific articles have sometimes been merged with other comments those articles. Also, articles of Directive 2013/26/EU (CRD) are referenced with the phrase 'Article xx of the CRD' whereas articles referring to articles of the draft RTS are referenced only with the phrase 'Article xx'.

1. General comments on the RTS

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Going concern	Some respondents disagreed with the need to set additional trigger events to ensure that the instruments are written down or converted under going concern conditions and referred to the requirements of the BRRD. For AT 1 instruments, the CRR already sets a trigger event. Respondents stated that both AT 1 and Tier 2 instruments are relevant instruments under the proposed BRRD. This enables regulatory intervention at the point of non-viability, which respondents consider to be still under going concern conditions. The BRRD already defines a hierarchy of within the capital structure, which should be used.	The CRD requires the EBA to develop draft RTS to ensure that instruments are appropriate to be used for the purposes of variable remuneration, that they can be fully converted or written down and in each case adequately reflect the credit quality of the institution as a going concern. Variable remuneration should set incentives for prudent and long term oriented risk-taking. If a write-down or conversion only took place at the trigger points set in the CRR to ensure there is a capital basis that is slightly above the minimum requirements, this would not provide appropriate incentives to avoid such situations. The BRRD has not yet been adopted. The draft BRRD does not contain any quantitative definition of the point of non-viability. A quantification of trigger events is needed to ensure there is a sufficient harmonisation of instruments used for the purposes of variable	Trigger event definition amended

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		remuneration. To date, there is no fixed definition of the point of non-viability. Therefore, it is appropriate and necessary to set specific trigger events. The EBA has reviewed the trigger level and defined a uniform trigger event for all classes of instruments at 7% of the CET 1 ratio.	
Use of existing instruments	A few respondents disagreed with EBA's view expressed in the Consultation Paper that under the RTS it would be possible to use instruments that exist already. Instruments should be consistent with own funds instruments used. The requirements in the draft RTS should not lead to a situation in which AT 1 or Tier 2 instruments do not count as own funds any longer.	It may be that in many institutions such instruments do not yet exist; nonetheless, the EBA has seen instruments that would meet the relevant requirements. The draft RTS set out requirements to ensure that the instruments are suitable for the purposes of variable remuneration; they do not aim to establish a higher capital ratio within banks or to impose higher trigger events for capital instruments in general. AT 1 and Tier 2 instruments must meet all requirements applicable to such instruments; this includes the requirements of the CRR, other RTS and the RTS on instruments after it is adopted and has come into force. The additional requirements set out in the draft RTS do not interfere with the qualification of such instruments as own funds instruments. However, if instruments are e.g. held by the institution, they do not count as own funds	No change

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		according to the requirements set out in the CRR.	
Hierarchy of capital instruments	One respondent asked the EBA to analyse whether the write-down and conversion mechanisms are compatible with the CRR requirements regarding the hierarchy of instruments, as otherwise those instruments would no longer count as own funds.	The CRR requirement applicable for AT 1 and Tier 2 instruments refers to the insolvency of the institution. The draft RTS do not change the hierarchy of instruments in this situation. Write-down and conversion under the draft RTS take place under going concern conditions.	No change
Level of trigger events	High trigger events will reduce the possibility of placing instruments on the market or would increase the costs for such placements significantly; also, the monitoring of such instruments would be difficult. This contradicts the requirement that instruments that are also issued to other investors should be used. Material risk takers would also be treated less favourably than other investors. Many respondents stated that triggers should be set at the level defined by the CRR (AT 1 5.125% of CET 1). Uniform trigger events would be preferred. Providing different thresholds for full and 50% write-down is problematic as there is no clear link between the trigger and the credit quality. One respondent commented that CET 1 is also fluctuating for other reasons than the credit quality	The EBA has reviewed the trigger events and changed the draft RTS. All trigger events in the revised draft RTS refer to CET 1. Uniform trigger events simplify the monitoring of the trigger event. As capital requirements must be complied with on an on-going basis, the EBA does not see a major cost in monitoring a uniform trigger event. The level of the trigger event was set to 7% of CET 1. Identified staff would be treated in an identical manner to any other investor in the same product when the instrument has vested. One needs to consider that the situation of identified staff differs from the situation of other investors. For identified staff, the variable remuneration awarded, including parts awarded in such instruments, should set	Definition of trigger events amended

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	and therefore may not always be appropriate to be used as a trigger event. A few respondents stated that other aspects are also relevant for the credit quality and are not taken into account, but did not provide detailed suggestions on how alternative trigger events should be defined.	incentives for prudent and long term oriented risk-taking. Identified staff are also not free to decide which instruments they wish to receive; instruments need to be appropriate for variable remuneration and must not lead to the circumvention of the requirements in the CRD. There is no contradiction in the requirements set out in the draft RTS, even if the interest rates of instruments with a higher trigger event are higher compared to otherwise identical instruments with lower trigger events. Instruments with higher trigger events can be observed in the market. The cap on the distributions was increased. It should be remembered that the cap only applies to instruments used for the sole purpose of variable remuneration. The provisions regarding write-down have been amended to require a full write-down; the option of an intermediate step for a partial write-down was not retained. Defining additional measures to monitor the credit quality (e.g. rating, spreads etc.) would lead to less objective and not fully harmonised rules, therefore a simple definition of the trigger events based on the existing capital (CET 1) definition has been retained.	

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		Moreover, the monitoring of additional conditions would add costs for the implementation of required systems.	
Eligible instruments	A few respondents suggested that all own funds instruments and relevant instruments under the BRRD should be eligible to be used for variable remuneration. For Other Instruments, the same requirements as under the BRRD should be applied. Alternatively, another respondent suggested that national requirements should be set to align the requirements with Pillar II considerations.	The CRD requires technical conditions to be set out under which Other Instruments are considered suitable for the purposes of variable remuneration. Variable remuneration should set incentives for prudent and long term oriented risk-taking. If a write-down or conversion only took place at the trigger points set out in the CRR to ensure a capital basis that is slightly above the minimum requirements, this would not provide incentives to avoid such situations. The BRRD has not yet been adopted. The draft BRRD does not contain any quantitative definition of the point of non-viability. A quantification of trigger events is needed to ensure a sufficient harmonisation of instruments used for the purposes of variable remuneration. Therefore, it is appropriate and necessary to set specific trigger events. Setting a trigger on the basis of Pillar II capital requirements would not lead to a sufficient harmonisation and would lead to a situation in which employment conditions between institutions differ.	No change

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Arm's length conditions	Some respondents suggested that either instruments that are issued to other investors or instruments with similar conditions should be eligible. Market instruments are usually issued with a spread compared to a market rate and not to an inflation rate; ratings, exchange rate, spreads applicable to the issuer and the different nature of instruments would need to be taken into account. A cap of 6% above was considered to be too low, as the inflation in some member states could be higher compared to others. The cap should instead be linked to existing instruments.	The draft RTS were amended; instruments should be issued at market rates for similar issuances of comparable issuers. The cap was retained as an additional safeguard to ensure that requirements do not lead to a circumvention of CRD requirements, but the cap was increased. The cap should be complied with when the remuneration is awarded, regardless of the way the interest is set for the instrument. E.g. if a cap of 8% + inflation is applied, the actual yield of the instrument must not be higher when it is awarded; the interest may be defined in a different way.	Article 2 amended
Deferral and retention	Some respondents suggested that these requirements should ideally be linked to the contract rather than to the instruments. The minimum maturity requirement for Tier 2 instruments already ensures that they sufficiently cover such periods.	The required minimum maturity of Tier 2 instruments must be met when instruments are issued. For instruments already issued in the past and subsequently used for remuneration purposes, the remaining maturity may not be sufficient to cover deferral and retention periods. Therefore, the draft RTS introduce the requirement that the remaining maturity is sufficiently long. Replacing the instrument during the period may be difficult and would require at least a valuation of the instrument and the existence of other eligible instruments. The monitoring of	No change

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		compliance with the requirements would become more difficult	
Write-down	One respondent suggested that it is not necessary to attach additional malus and clawback mechanisms to the instruments as these are already required under the remuneration requirements set out in the CRD. A few respondents stated that a permanent write-down for Other Instruments would not be appropriate as a temporary write-down would provide for incentives to contribute to the recovery of the firm. This would be a more strict treatment than for AT 1 and Tier 2 instruments. Such Other Instruments would not be marketable.	It is not a necessary condition that instruments are marketable. Institutions can develop other means to enable staff to cash in the instruments after the retention period or can align the maturity of instruments with the deferral and retention arrangements. This should be easy to apply where synthetic instruments are used. A write-up of Other Instruments would reduce the capital base of the institution, while a write-up of AT 1 and Tier 2 instruments would only lead to a different capital structure. However, write-down, write-up and conversion has been introduced for both Tier 2 and Other Instruments under the same conditions.	Article 5 amended
Prospectus Directive	One respondent suggested seeking an opinion from ESMA with regard to the fact that there are two different types of investors, namely staff and external investors.	The EBA has consulted ESMA already with regard to the Prospectus Directive to discuss whether it would be possible to differentiate between the treatment of staff and external investors for one instrument. ESMA advised that both classes of owners of one instrument need to be treated in the same way. Hence conditions applicable to staff need to be applicable to all investors as they would apply	No change

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		to the instrument.	
Equal treatment of investors	One respondent stated that staff and other investors should be treated equally; clawback or malus should not be applied to a specific instrument.	Clawback and malus are part of the remuneration framework and can, if exercised, be applied to variable remuneration paid to staff independent of the instruments used.	No change
Ability to cash in instruments	Many respondents agree that instruments should be designed in a way that they are issued at arm's length. However, staff must also be able to cash in the variable remuneration after deferral and retention periods. This requires the liquidity of instruments to be guaranteed and the instruments to be in line with market standards. If staff wishes to sell those instruments afterwards, it could have an adverse effect on the price of such instruments. Staff needs to be treated in the same way as other investors as otherwise institutions would face legal risks.	Arm's length conditions are crucial to prevent a circumvention of remuneration requirements. In addition to the existence of secondary markets, institutions can ensure by other means that staff are able to cash in instruments after deferral and vesting periods, e.g. by aligning the maturity of the instrument with such arrangements. For AT 1 and Tier 2 instruments, institutions should be aware that providing an indication that the instruments would be called or paid back early would lead to a situation where such instruments would no longer fulfil the requirements for AT 1 or Tier 2 instruments as set out in the CRR. The draft RTS do not mean that staff holding an instrument are treated in a different way than other investors. It should be remembered that during deferral periods, staff are not yet the holders or owners of the instrument.	No change

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Synthetic instruments	A few respondents commented that under the draft RTS, it would be most likely that synthetic instruments would be used instead of AT 1 or Tier 2 instruments. To ensure that AT 1 and Tier 2 instruments would be used, the draft RTS should specify that such instruments do not need to be deducted from the own funds if they are held by the institution even if they have not vested yet.	The EBA considers the use of synthetic instruments or Other Instruments for variable remuneration as appropriate. The conditions under which deductions from the own funds for AT 1 and Tier 2 instruments held by the institution must be made are defined within the CRR and cannot be altered by the draft RTS. The EBA's mandate is to specify classes of instruments.	No change
Group context	One respondent commented that the standard is not sufficiently clear regarding the relation between issuer, user and reference point for the trigger event. For AT 1 and Tier 2, the RTS does not provide any information on to whom the trigger event should refer. Recital 11 postulates a link between the credit quality of parent institution and subsidiary, while Article 4(1) potentially requires further evidence to establish such a link. For linked instruments, respondents suggest that the requirement that the trigger refers to the institution should only be applied if instruments issued by non-EU parent institutions are used. It was suggested that instruments issued in the group context with a trigger linked to the issuer should always be allowed unless the issuer is located outside the EU, in which case the trigger should be linked to the institution using the instrument. In some situations,	In general, the trigger event of the instrument refers to the issuer of the instrument. The EBA amended the provisions regarding third-country issuances. If contracts are used that establish a link to the value of an AT 1 or Tier 2 instrument issued by a parent institution in a third country, the trigger refers to the EU institution issuing the Other Instrument. The CRD requirements refer to the credit quality of the institution. An unconditional possibility to use instruments issued within the group context would not be appropriate as the credit quality between different group entities can differ. A link usually exists between the credit quality of the parent institution and a subsidiary. It can be expected that instruments are either issued by the institution or by the parent	Article 4 amended

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	instruments may be issued in a group context by institutions that are not subject to the consolidation (minority interest). The draft RTS are not clear about such issuances. One respondent suggests amending the requirements in a way that one remuneration policy for the whole group can be used. In particular, issuances from parents in third countries would, in practice, not comply with the requirements of the draft RTS as they are not tied to the credit quality of the EU firms and therefore specific issuances would need to be created that would not have a liquid secondary market.	institution. The issue of no liquid secondary markets can be overcome in particular via linked instruments as the instrument can be a contract (synthetic instrument) between the institution and staff that makes reference to the value of an AT 1 or Tier 2 or equivalent instrument. The contract must meet the requirements of the CRD and the draft RTS.	
Contract clauses	One respondent suggested providing standard clauses that could be used to ensure that Other Instruments comply with the RTS instead of solely setting out requirements.	The EBA has a mandate to provide the Commission with draft RTS on classes of instruments. The EBA is not mandated to develop contractual language. Institutions need to develop their own instruments or may use appropriate valid contractual clauses developed by professional bodies.	No change
2. Additional Tier 1 instruments			
Q 1	Some respondents argued that the requirement for write-down or conversion in Article 52ff of the CRR already reflects credit quality as going concern. Recent market practice is for AT 1 to have a lower trigger level (in the CRR it is 5.125%) so it may be	EBA has reviewed the draft RTS. A write-down only at 5.125 % was considered to not be sufficient to set incentives for staff to be prudent and long term oriented in their risk-taking. To ensure that the trigger events can be	Definition of trigger events amended

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	difficult to place instruments with a higher trigger level with external investors. Respondents suggest keeping the trigger level at 5.125% and leaving room for discretion for setting higher levels as long as this is consistent with the overall capital structure. A higher trigger level would also mean a higher coupon, which may not be possible under the Prospectus Directive. A trigger level of 7% was perceived as too high and may have an inconsistent outcome (if the ratio drops <7%, the bank may still pay dividends but the staff variable pay would suffer). 7% could be understood to mean that the EBA believes that anything lower will jeopardise going concern conditions. The minimum trigger level should be 5.125%. Respondents supported harmonisation but note that the CRR sets a trigger level of 5.125% and recommend keeping the trigger level for employees at that harmonised level, with discretion for firms to set a higher trigger level if required. Respondents argue that the rationale for a trigger level of 7% is weak; only a few market instruments exist with a trigger level of this nature. A trigger level of 7% would create another tier of AT 1, adding complexity and early signalling effects that could potentially lead to a destabilising of the institution. This respondent expects the market to	monitored without additional burden, EBA introduced a common trigger event based on CET 1 capital of 7%. The BRRD has not yet been adopted. The draft BRRD does not contain any quantitative definition of the point of non-viability. A quantification of trigger events is needed to ensure a sufficient harmonisation of instruments used for the purposes of variable remuneration. This higher trigger event is only required if instruments are used for the purposes of variable remuneration. Institutions can create specific issuances for the purposes of variable remuneration. This would also help to avoid early signalling effects. However, some institutions already issue instruments with trigger events at the required level. The conditions for one instrument must apply to all owners of the instrument according to the Prospectus Directive. In light of the EBA's mandate, it is obvious that the legislator expected additional requirements to be put in place to ensure the suitability of instruments for the purposes of variable remuneration; otherwise the CRD could have set down that all AT 1 and Tier 2 instruments	

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	converge to CRR levels and recommends that the EBA should not deviate from that framework. One respondent suggested that the trigger level should be set after discussion with firms and their regulators, perhaps within the capital planning process, and should depend on business model.	could be used without further qualifications. The draft RTS are intended to specify clearly the classes of instruments that can be used for the purposes of variable remuneration; this includes the definition of trigger events.	
Q 2	Some respondents stated that the use of different trigger events would be overly complicated and would increase the cost of monitoring such trigger events. This would also make it more difficult for staff to understand the incentives set by variable remuneration. The RTS should be based on trigger events already defined in the CRR or BRRD. Multiple trigger events would also reduce transparency for other investors, and could have an impact on the capital structure. Other respondents suggested that competent authorities should be able to exercise discretion regarding the trigger events.	See comments above under Q 1.	Definition of trigger events amended
Q 3	Some respondents stated that a single trigger level (5.125%) for all instruments would be more appropriate, with the option to go higher. For instruments that do not qualify as own funds, capacity for write-down or conversion as per the BRRD should be included.	See also comments above under Q 1. The CRR neither requires nor forbids trigger events for Tier 2 instruments. A Tier 2 instrument must comply with all relevant requirements of the CRR.	Definition of trigger events amended

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	One respondent stated that trigger events for Tier 2 instruments are not mentioned in legislation. Such trigger events would create a new type of instrument.		
Q 4	Some respondents agree that distributions should be set at arm's length but at current Harmonised Index of Consumer Prices (HICP) the cap would be lower than market levels. It should either be possible for competent authorities to review the coupon levels, or the draft RTS should set criteria that include recent market levels over 6-12 months. If instruments are issued in other currencies, a few respondents state that this cap is not suitable. A few respondents suggest that appropriate levels can be derived from secondary levels of instruments with similar risk profile or getting at least three independent quotes. One respondent stated that the proposed level is too low, does not take account of conditions for smaller banks.	The EBA has reviewed the draft RTS. It is necessary to set a hard cap to avoid circumvention of the remuneration requirements. However, instruments should also not pay out higher interest than comparable instruments that can be observed on the market. Both aspects were combined in one criterion and the cap was increased. The cap only needs to be observed when the instruments are awarded. The interest rate of the instrument can be defined in a way that differs from the definition of the cap. The CRD is directed at institutions located in the Union, hence using a cap based on the inflation rate of the Union is appropriate. In some defined cases, the inflation rate of a third country can be used. The EBA is aware that inflation rates are not used as a benchmark for interest rates. The specific requirement must be met when remuneration is awarded. This does not require the interest rate of the instrument to be based on the inflation rate, but commonly used	Article 2 amended

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		market rates can be used as long as the instrument is issued at market conditions but the interest is not above the cap set. Setting an absolute cap reduces the costs of competent authorities supervising remuneration practices.	
Q 5	Some respondents suggest that market practice for such instruments should be considered. Or there could be a waiver if the firm can show that the coupon is in line with market practice. The cap should be reviewed periodically; one fixed cap would not be suitable for all banks and instruments. The pricing needs to reflect risk profiles. One respondent stated that the EBA has already considered market-related measures in the RTS on own funds under 'broad market indices' and could do so here too.	See comments on Q 4 above.	Article 2 amended
Q 6	Some respondents state that issuance costs will be higher because instruments with a higher trigger level are unfamiliar to investors, are not consistent with the overall capital structure and are challenging for smaller, lower-rated banks. The administrative burden to issue different AT 1 instruments with different trigger levels would be significant. The difference in the interest rate could be up to 200–300 bps.	See also comments above to Q 1. The EBA is aware that such instruments may be more costly than instruments with a lower trigger event. However, institutions have the option to create instruments for the sole purpose of variable remuneration or to link instruments to AT 1 or Tier 2 instruments. As distributions should not be paid to staff during deferral periods, higher trigger events	Article 2 amended

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	One respondent states that it would be difficult to monitor the 60% threshold; it is not clear how to maintain data on holdings and how the threshold should be checked. It should be sufficient if 60% is met at the time of issuance. One respondent states that the threshold may not be suitable for privately owned firms or firms that are non-listed or listed overseas.	would not cause additional costs if instruments are used for the sole purpose of variable remuneration. Institutions can also use linked instruments that do not carry an interest themselves. The EBA has not identified any inconsistency with other European legislation. Institutions need to know which part of an issuance is held within the scope of consolidation, and which part is held for market making purposes and was used for remuneration. All information is therefore available to calculate which amount is held outside of the above scope. However, the provision has been clarified; amounts held by staff which have not been part of remuneration packages is difficult to monitor; the calculation of the threshold was amended for this reason.	
3. Tier 2 instruments			
Article 2	Respondents pointed out that the minimum maturity required for Tier 2 instruments is five years, hence it would not be necessary to set additional conditions if such instruments were used for the purposes of variable remuneration.	The required minimum maturity might not be sufficient for longer deferral periods and differs from the initial maturity. Replacing the instrument during the period would require at least a valuation of the instrument and the existence of other eligible instruments. Monitoring compliance with the requirements	No change

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		would become more difficult and costly.	
Article 2	Respondents asked for clarification on whether subordinated debt could qualify as Tier 2 instruments as described in Article 2.	Tier 2 instruments are instruments that comply with the requirements of Article 63 of the CRD and the applicable RTS on own funds. These draft RTS set out classes of instruments that are suitable for the purposes of variable remuneration.	No change
Q 7	A few respondents have serious reservations about adding contractual trigger events to Tier 2 instruments as this goes beyond the CRR and probably the BRRD. A minimum retention and deferral period should be sufficient. To avoid complications, trigger events should be defined on the basis of CET 1 and set at 5.125% in line with CRR requirements for AT 1 instruments. One respondent stated that two trigger events are not needed.	The EBA has reviewed the draft RTS and has introduced a common trigger event of 7% of CET 1 capital. For Tier 2 and Other Instruments, an intermediate trigger event leading to a 50% write-down was not retained. See also further comments above under Q 1.	Article 2,3 and 4 amended accordingly
Q 8	A few respondents suggest that if an AT 1 trigger event was used, it should be aligned with CET 1 5.125%, +1.5% = 6.625%, but note that a 50% intermediate write-down is not market practice and suggest either requiring a progressive write-down until the minimum CET 1 is re-established, or a full write-down. One respondent stated that the first write-down is	See also further comments above under Q 1 and Q 7.	See above

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	too draconian and suggested that a 40% write-down would be sufficient.		
Q 9	One respondent stated that the draft RTS does not allow for Tier 2 instruments with equity conversion. A few respondents stated that it is not yet clear whether Pillar 2 or the BRRD will allow contingent capital but that if they do, then such instruments should be allowed.	The EBA has reviewed the draft RTS and decided to allow for the conversion of Tier 2 instruments. See also comment on Q 1.	Article 3 and 5 amended
Q 10	A few respondents suggest that a write-down mechanism in line with market practice would be more appropriate and suggest either a progressive write-down or full write-down (see also Q 8). Using a Tier 1 trigger event adds complexity and reduces transparency. A few respondents stated that the temporary write down mechanism is unclear and suggest that the option of conversion into CET 1, along with write-down, should also be allowed for Tier 2 instruments.	See comments on Q 7 and Q 9.	See above
4. Other Instruments			
General	One respondent commented that such instruments are not own funds instruments and therefore the requirements should be less complex, and recommends aligning the write-down e.g. with the	The requirements are consistent with the write-down mechanisms for own funds instruments. In general, uniform processes should be easier to apply as different processes. A write-down at the point of non-viability does not provide for	No change

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	requirements of the BRRD.	sufficient incentives. Regardless of the qualification as own funds, all instruments must provide for appropriate incentives for prudent and long term oriented risk-taking.	
General	One respondent suggested that Other Instruments should not be limited to debt instruments. They should not only be linked to credit quality, but also to business performance and have a write-down mechanism.	The CRD requires that instruments should appropriately reflect the credit quality of the institution. The business performance is not a criterion to be considered according to the CRD. The business performance should be considered when remuneration is awarded. As already stated, 'instruments' should be interpreted in a broad sense and could e.g. also cover contractual arrangements between an institution and its staff.	No change
Deferred cash instruments	A few respondents suggested that it should be possible to use deferred cash payments rather than Other Instruments as deferred cash payments would create similar incentives and would be easier to manage.	The draft RTS were amended to make it clear that deferred cash is not considered an instrument under Article 94 (1)(l)(ii) of the CRD. The CRD in fact requires institutions to use instruments other than cash for the award of at least 50 % of the variable remuneration. Deferred instruments that are similar to deferred cash would have a downside risk in the event of a trigger event being hit.	Recitals clarified

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Article 4	One respondent points out that the wording may need to be clarified as on the one hand the draft RTS state that Other Instruments would be issued, while on the other hand it states that it should be possible to use contracts that are not 'issued'.	The wording within the draft RTS covers both contracts and instruments.	No change
Article 6	One respondent stated that it is not clear when the trigger event should be calculated and suggested taking into account an average over a longer period.	The trigger event needs to be monitored on an on-going basis. A trigger event takes place once the trigger is reached. This does not take into account longer periods or averages in line with the requirements for trigger events for AT 1 instruments under the CRR.	No change
Q 11	Some respondents welcomed the flexibility in this proposal, in particular because such instruments can be used at subsidiary level where instruments issued by the parent may not be recognised by local regulators. A few respondents understood that the instruments linked to AT 1 or Tier 2 instruments will have an AT 1 or Tier 2 host that complies with CRR but at the same time includes additional provisions relating to retention and deferral or clawback. Based on this idea, the additional trigger in Article 4(1)(e) would not be justified as it would add complexity. One respondent was not in favour of allowing such instruments.	The EBA has reviewed the draft RTS and introduced a common trigger event of 7% of CET 1 Capital.	The definition of trigger events was amended

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Q 12	A few respondents felt that the requirements are appropriate. One respondent stated that the valuation could be complex as triggers based on total capital ratios and intermediate write-down are not common market practice. One respondent suggested that a temporary write-down should be allowed for Other Instruments; otherwise the reasoning for why this should not be allowed should be clearly set out.	The EBA has reviewed the draft RTS and introduced a common trigger event of 7% of CET 1 capital. For Tier 2 and Other Instruments, an intermediate trigger event leading to a 50% write down was not retained. The possibility of a temporary write-down for Other Instruments and conversion of Tier 2 instruments was introduced.	Article 3, 4 and 5 amended
Q 13	Many respondents agreed that it is appropriate to allow for conversion of Other Instruments. A few respondents agreed that, in principle, conversion into CET 1 instruments is appropriate, but commented that this would be difficult to manage as this is not provided for in regulations or market practice. The instruments should instead be subject to capital write-down under Article 51ff of the BRRD to ensure that they are part of the general recovery and resolution mechanisms.	The CRD requires instruments to be fully written down or converted. Institutions can choose either option. See comments on Q 1.	No change
Q 14	In general, respondents found it appropriate to have a permanent write-down as this is provided for in regulatory texts (and is comparable to malus	The possibility of a temporary write-down for Other Instruments was introduced.	Articles 3, 4 and 5 amended

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	arrangements). However, a few respondents commented that this would lead to a situation in which staff would be treated less favourably than shareholders if the institution recovers. A few respondents would prefer instruments that are subject to Article 51ff BRRD. If this cannot be implemented, a write-up should be allowed for Other Instruments with no restrictions, and respondents commented that this would not necessarily lead to a reduction of CET 1 capital. A few respondents argued that a temporary write-down should be allowed in line with the requirements for AT 1 and Tier 2 instruments.	Staff and other investors will be treated in the same way if they hold the same instrument. See also comments on Q 1 and Q 12.	
Q 15	Many respondents would prefer trigger events based on CET 1 as this is easier to apply and more transparent, in line with market practices. In accordance with Article 4(2), the subsidiary can use instruments linked to parent's A T1 and Tier 2 instruments, provided that the trigger event is linked to the capital ratio of the subsidiary. This seems to be envisaged for subsidiaries of non-EEA firms. However, this would mean that an EEA headquartered bank would have to differentiate between trigger events for employees in different subsidiaries, which is costly and complex.	The EBA has reviewed the draft RTS and introduced a common trigger event at 7% of CET 1 capital. The instrument should reflect the credit quality of the institution as a going concern. This may not be the case if instruments issued in the group context could be used without any other conditionality. However, it can be assumed that a link between the credit quality of the EU parent company and the subsidiary exists. When linked instruments are used, the EU institutions must comply with CRR and CRD	Definition of trigger events amended

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	One respondent commented that the draft RTS were aimed at larger firms but that smaller firms may not be able to issue sufficient amounts of AT 1 or Tier 2 instruments. The RTS should allow firms below a certain size to use other methods.	requirements; hence it should be possible to monitor the capital ratios without inappropriate costs being incurred. The draft RTS enable institutions to use a broad set of instruments. Under 'Other Instruments' institutions can use simple contracts or synthetic instruments between staff and institution that contain a trigger event for write-down or conversion. It is not necessary to create a bond, AT 1 or Tier 2 instrument and to issue it on the market.	
Q 16	Many respondents commented that they would prefer harmonised CET 1 trigger events that are consistent with CRR and BRRD requirements.	See comments on Q 1 above.	See above
Q 17	The same comments as those for Other Instruments generally also apply to linked instruments. One respondent suggested that banks should have the flexibility to set out the write-down mechanism and that it would be important to have the option of using instruments issued by parent or holding companies. For EEA headquartered firms, the draft RTS should allow trigger events based on the group consolidated CET 1 ratio, rather than the trigger event set by each subsidiary (see also Q 15 above).	See comment on Q 15 above.	See above

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Q 18	Respondents felt that the provisions are sufficiently clear, but stated that it would be important to include the possibility of a temporary write-down, subject to the same restrictions as for A T1 and Tier 2 instruments.	See comment to Q 12 above.	See above
5. Conditions for all classes of instruments			
Article 7	One respondent recommends allowing an increase of the value of the instrument to avoid an asymmetric approach between risk and performance.	The provision only deals with the situation in which an instrument needs to be exchanged into another instrument and aims to prevent the circumvention of remuneration requirements. However, the current market value of the instrument is considered. If the instrument were to be exchanged above the market value, this would represent a circumvention of the remuneration requirements if the instrument was being used for the sole purpose of variable remuneration. Such situations can occur if the instrument is also held by other investors and these situations cannot be avoided because different treatment of staff and investors is not possible under the Prospectus Directive. The remuneration should be awarded in a way that provides appropriate incentives for prudent and long term oriented risk-taking.	No change

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Article 7	One respondent suggested that the independent review of the valuation could be performed by the relevant control authority, which would be in a position to seek external advice.	Independent review can always be performed by either an independent internal office (usually by an internal audit team) or by external auditors.	No change
Q 19	A few respondents stated that the provisions on valuation of instruments seem appropriate. One respondent stated that under Article 7, all instruments should be callable after the applicable deferral or retention periods have lapsed (subject to any CRR requirements). It should be possible to call and replace instruments with similar instruments. This would help employees to liquidate their deferred compensation after the vesting period.	In addition to the existence of a secondary market, institutions can establish other means to enable staff to cash in the instruments, e.g. institutions can align the maturity of Other Instruments with the deferral and retention period.	No change
6. Impact assessment			
Impact assessment	Costs for monitoring trigger events would be higher if different trigger events had to be monitored.	The impact assessment was updated to take into account additional considerations after the public consultation. The option of using different trigger events has not been retained.	Impact assessment updated
Q 20	A few respondents broadly agree with the impact assessment, but commented that the impact assessment fails to take account of other aspects such as reduced investor demand due to higher trigger levels and different debt characteristics,	The comments have been taken into account in the review of the impact assessment insofar as they relate to the draft RTS. However, the impact assessment considers only the costs and benefits from the draft RTS and	Impact assessment updated

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	administration costs and increased costs from a lack of flexibility to call and replace instruments. Many of these costs can be reduced if trigger events were aligned with CET 1 at 5.125%. Some respondents did not fully agree with the impact assessment and suggested that the draft RTS would lead to higher costs. A few respondents stated that institutions should be able to use only shares or share-linked instruments, and said it should be possible to use a uniform remuneration policy. One respondent commented that a focus on the capital ratios could lead bank management to cut core lending.	does not evaluate the costs and benefits from the actual CRD requirements.	
Q 21	A few respondents stated that if the features of the instruments used for remuneration are not aligned with other capital instruments, institutions are unlikely to use this option as it will be difficult to issue. One respondent commented that identified staff may be considered as retail clients, so there may be MiFID considerations to take into account.	Institutions are obliged to use such instruments where possible in accordance with Article 94 of the CRD. Institutions must comply with all EU legislation regarding this issue. The draft RTS do not contradict MiFID requirements.	No change
Q 22	See responses to Q 20 and Q 21.	No further comments	See Q 20 and Q 21 above