**Response to the EBA’s Consultation Paper on Draft Guidelines on Sound Remuneration Policies**

Dear Sirs

In response to the EBA’s Consultation Paper on the Draft Guidelines on sound remuneration policies under Article 74(3) and 75 of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013 (the “Draft Guidelines”), we set out below answers to those questions relating to matters of most significance to our clients. The comments reflect the views of this firm as legal advisors as well as those of a number of our clients.

Defined terms used in this letter have the same meaning as used in the Draft Guidelines, unless defined in this letter.

**Q 1: Are the definitions provided sufficiently clear; are additional definitions needed?**

We consider the definition of “retention bonus” contained in the Draft Guidelines is too wide. Arguably, many forms of variable remuneration structured as longer term incentive arrangements, including deferral arrangements, could fall within the scope of this definition on the basis that one of the vesting conditions is continued employment. We suggest omission of this definition in the EBA’s finalised guidelines.

**Q 4: Are the guidelines regarding remuneration policies and group context appropriate and sufficiently clear?**

Many clients consider the requirement for all significant institutions at individual, parent company and group level to have a remuneration committee to be inappropriate. This requirement would necessitate duplication of remuneration committees where any subsidiary entity is “significant” even where there is a group-wide remuneration committee. This does not reflect the governance structures at many of our clients, which operate on a global basis with a remuneration committee at parent company level. The proposed requirement would lead to increased bureaucracy and costs and will not contribute towards improved governance within firms. The commonly adopted structure of a single group remuneration committee overseeing group-wide remuneration policies and procedures is considered by our clients to be the most appropriate and effective arrangement for managing the risks associated with remuneration policies.

**Q 5: All respondents are welcome to provide their comments on the chapter on proportionality, with particular reference to the change of the approach on ‘neutralisations’ that was required following the interpretation of the wording of the CRD. In particular institutions that used ‘neutralisations’ under the previous guidelines for the whole institution or identified staff receiving only a low amount of variable remuneration are asked to provide an estimate of the implementation costs in absolute and relative terms and to point to impediments resulting from their nature, including their legal form, if they were required to apply, for the variable remuneration of identified staff: a) deferral arrangements, b) the pay out in instruments and, c) malus (with respect to the deferred variable remuneration). In addition those institutions are welcome to explain the anticipated changes to the remuneration policy which will need to be made to comply with all requirements. Wherever possible the estimated impact and costs should be quantified, supported by a short explanation of the methodology applied for their estimation and provided separately for the three listed aspects.**

Our clients strongly disagree with the approach taken in the Draft Guidelines in relation to proportionality. In particular, our clients do not agree with the resulting increased application of the “Pay-Out Process Rules” (i.e. those relating to (i) ratio (fixed versus variable) limits (the “Ratio Cap”), (ii) retained shares or other Instruments, (iii) deferral and (iv) performance adjustment). This has serious implications for firms that can currently neutralise the Pay-Out Process Rules (about 1,000 in the UK) and firms able to operate de minimis concessions in the UK and elsewhere.

We do not consider that the proposed interpretation of the remuneration rules in CRD is correct for the following reasons.

**Legal position**

Recital 66 of CRD makes clear that the remuneration provisions should be applied proportionately and that it would not be proportionate for certain types of investment firms to comply with all of the remuneration principles of CRD. So, it is clear that proportionality means that neutralisation is possible, in particular in relation to investment firms.

Article 92(2) of CRD provides that competent authorities must ensure that institutions apply total remuneration policies for material risk takers *to the extent that* it is appropriate to their size, internal organisation and the nature, scope and complexity of their activities. The words “to the extent that”, given Recital 66, must result in the ability to neutralise the Pay-Out Process Rules. Article 94 specifically applies proportionality to the Pay-Out Process Rules, which it states apply in addition to and *under the same conditions* as those set out in Article 92(2)).

As mentioned in the Consultation Paper, CEBS published its Guidelines, including in relation to the concept of proportionality in December 2010, well before CRD IV was negotiated between the European Parliament and the European Council. If the European co-legislators had intended to reverse the approach of CEBS in relation to proportionality, this should have been reflected in CRD IV itself by the removal or amendment of the relevant provisions (i.e. by not including the proportionality wording within the provisions of the pay-out process rules). Given that the European co-legislators did not take that approach, they must have considered the CEBS interpretation to be correct. If the EBA reverses the legal position relating to proportionality as set out in Recital 66 and Articles 92(2) and 94 of CRD, it would effectively be changing the legislative position, which is beyond the scope of the EBA’s powers. Any such change should be debated between the European Parliament and European Council and enacted (if at all) in the appropriate way.

**Reasons for applying proportionality to neutralise particular requirements**

As the text of CRD allows firms and competent authorities to neutralise particular requirements (as reflected in the CEBS guidance), the EBA should issue guidance which reflects the differing positions of different firms.

Currently, many firms do not apply the Pay-Out Process Rules on the basis of proportionality under CRD. The proposal to require such firms to apply the Pay-Out Process Rules would result in a significant change in terms of direct costs and, it is anticipated, staff turnover. Our clients express concern about the adverse impact on their businesses. This is of particular relevance for UK firms in proportionality level three, compromising organisations including investment managers, small and non-systemically important banks and broker/dealers which consider any requirement to apply the Pay-Out Process Rules to be unnecessary from a risk management perspective and disproportionality burdensome. Clients also express concern that the lack of consistency in the regulatory approach to this matter is damaging for businesses.

**Banking groups:** The proposal to apply Pay-Out Process Rules on a group-wide basis both to firms within the scope of CRD and to other group firms outside the scope of CRD (including firms subject to AIFMD and the UCITS Directive) is arbitrary and unfair given that other firms regulated by AIFMD and the UCITS Directive are not subject to the same rules. It should be noted that the European legislators specifically considered the application of the Ratio Cap in the context of UCITS V and did not accept it.

**Investment firms:** Article 66 of CRD clearly provides for investment firms to have the flexibility to structure remuneration by neutralising the Pay-Out Process Rules. To require such firms to apply the Pay-Out Process Rules puts them at a significant commercial disadvantage with respect to other asset managers that are not subject to CRD and creates an un-level playing field.

In addition, it is usual practice for investment firms to design remuneration structures and levels of variable remuneration to reflect client experience and fees (which normally reflect performance based on appropriate authority provided by specific client mandates). The Ratio Cap is inappropriate where firm capital is not put at risk and investment firms should be able to retain flexibility in relation to structuring remuneration to reflect performance. The application of the Ratio Cap would force investment firms to maintain higher levels of fixed remuneration, i.e. committing them to a higher cost base regardless of the firm’s actual profit performance and irrespective of the commercial arrangements agreed with clients. Increased proportions of fixed remuneration inhibit a firm’s ability to adapt remuneration to reflect changing financial circumstances and to reward staff appropriately. Our clients consider that the application of the Ratio Cap could ultimately lead to (i) higher fixed salaries in order to retain staff and (ii) potential reward for failure. In addition, it would lead to greater volatility during times of market instability by encouraging firms to reduce staff numbers, rather than simply allowing variable remuneration to reflect financial performance. For these reasons, the Ratio Cap, particularly in relation to investment firms is considered to be contrary to sound and effective risk management.

**Other firms which do not risk their own capital and whose profits are based on realised revenue:** the same analysis applies to other organisations whose revenues and profits are realised at the relevant time and may vary significantly from year to year (e.g. broker dealers). Again, it is appropriate, in particular, for these organisations to disapply the Pay-out Process rules (including the Ratio Cap) so as to align the interests of their shareholders and stakeholders with those of employees.

**Other smaller/less significant institutions:** other institutions are currently not required to comply with the detailed Pay-Out Process Rules on the basis of proportionality, the nature of their business and the absence of systemic risk. We consider this to be the correct application of the CRD text.

**De minimis:** In addition to the concerns expressed about proportionality generally and the inability for certain firms to neutralise particular principles, our clients believe that there should be a lower limit beyond which it is not necessary to apply the Pay-Out Process Rules in line with the rules operated by the PRA/FCA in the UK. For example, we understand that some of our clients have staff in control functions who are identified as Material Risk Takers only on the basis of a signing authority on behalf of the firm (and that the firm would not otherwise identify such individuals as Material Risk Takers). If a de minimis exemption cannot be used by virtue of the revised application of the proportionality principle, this would result in significant changes to the remuneration structure of such employees and our clients consider this to be a threat to staff retention (as employees in such functions may wish to seek employment in businesses which are not under structuring obligations in relation to variable remuneration). This would impact on the stability of the control function itself which would increase prudential risk for firms.

**Q 6: Are the guidelines on the identification of staff appropriate and sufficiently clear?**

Given that the Regulatory Technical Standards (RTS) were published so recently, our clients consider it inappropriate and unduly onerous to change the position on the identification of staff under the Draft Guidelines. As it takes time for institutions to comply with new regulatory requirements, our clients strongly request an appropriate opportunity to allow the current provisions to entrench in their businesses. If inadequacies are perceived after such an opportunity, change could be considered at that later stage, if appropriate. In any event, the obligation to identify Material Risk Takers under quantitative tests at non-CRD entities merely creates administrative burdens as such individuals will be excluded under Article 4 of the RTS in any event. Our clients consider the requirements in the Draft Guidelines to be too prescriptive and unnecessary and that the relevant provisions would place a disproportionate strain on resources required to manage the process of identification of staff. There would be no objection if it were made clear that the process was intended to be an example rather than formally required and it were made clear that different organisations will adopt different and/or less formal requirements. It should also be clear that the guidelines do not add additional obligations beyond a firm’s obligations to identify the appropriate persons under the RTS.

**Q 8: Are the requirements regarding categories of remuneration appropriate and sufficiently clear?**

Our clients consider that the provisions relating to long term incentive plans (“LTIPs”) makes those vehicles unworkable in the context of the Ratio Cap. If the value of LTIP awards is taken into account in the performance year when the remuneration is awarded (i.e. on vesting), firms would be unable to manage and regulate the Ratio Cap. Therefore, from a practical perspective, LTIPs which are structured as conditional awards of shares (the vesting of which is subject to performance over a future vesting period), cannot continue to be used in the form currently adopted by many clients, meaning that a widely used and valuable tool for the alignment of the interests of senior staff with those of other stakeholders would be lost. We do not believe that the EBA’s intention involves the extinction of LTIPs. Instead, LTIPs should be valued at the date of grant according to appropriate accounting principles.

**Q 9: Are the requirements regarding allowances appropriate and sufficiently clear?**

Clarity in relation to the regulators’ expectations is of course helpful but our clients consider that the provisions of the Draft Guidelines relating to allowances go beyond the language of the primary legislation. In addition, our clients consider the provisions to be overly prescriptive and based on assumptions regarding employment relationships that are not applicable in all EU member states. The elements of allowances that allow firms to manage effectively prudential risk should be allowed under the finalised guidelines.

The distinctions between fixed remuneration and variable remuneration are set out in Article 92 of CRD. The proposed Draft Guidelines extend the meaning of fixed remuneration to such an extent that it is questionable whether the EBA is acting within its authority in providing guidelines or rewriting the provisions of the Directive. In particular, the following requirements in respect of fixed remuneration should be reconsidered:

* *any other staff member fulfilling the same role or having the same organisational responsibility and who is in a comparable situation would be entitled to a comparable allowance*. This is contrary to employment relationships in many EU member states. In the financial services sector generally, salaries reflect a multitude of factors including (but not limited to) role, seniority, market value, performance and desire to retain/risk of departure. It is entirely appropriate for institutions to set salary and other fixed remuneration in a way which reflects their business objectives;
* *allowances are non-revocable; the permanent amount is only changed via collective bargaining or following renegotiation in line with national criteria on wage setting*. In many countries in the EU, salaries are not standardised and/or varied by collective bargaining or national criteria - in most cases variations are agreed individually. There is no basis for the EBA to suggest that salary needs to be standardised for roles and/or that changes can only be agreed collectively when that is contrary to national requirements. From a UK perspective (and that of many other EU member states), most individuals negotiate their terms of employment on their own account and a normal annual salary review could result in increased (or even, depending on the circumstances, decreased salary); and
* *transparency*. It is not clear whether transparency (included in paragraph 117 and as it relates to allowances under paragraph 124) means (i) as between an individual employee and employer, in which case the reference is acceptable or (ii) as between an individual employee and the wider employee population, in which case the reference to transparency would not be appropriate.

Specific characteristics should form no more than an evidential indicator of the nature of a payment and national regulators should be given more discretion to determine what is appropriate in the context of normal business and employment law practice in their jurisdiction and to require compliance in an appropriate way.

**Q 10: Are the requirements on the retention bonus appropriate and sufficiently clear?**

Please see answer to Question 1. The definition of retention bonus has been drafted too widely for the provisions under section 12.2 to be workable in practice and we suggest the definition is omitted in the finalised guidelines and/or that is made clear that the EBA is not suggesting that all deferred variable remuneration in within the definition.

**Q 11: Are the provisions regarding severance payments appropriate and sufficiently clear?**

Our clients consider the provisions of section 13 of the Draft Guidelines in relation to severance payments to be inappropriate.

Where an employee makes a claim against his or her employer, the surrounding circumstances which result in an employer and employee entering into a settlement agreement in respect of the claim are many and varied. It is not possible to limit the criteria which should be taken into account and we do not think it is helpful to introduce further regulatory overlay in this regard.

**Paragraph 13 – Exceptional remuneration elements and prohibitions**

Our clients are concerned about the provisions contained in paragraphs 137 and 138 of the Draft Guidelines and consider that it is difficult to understand why guarantees would be treated differently to other payments of variable remuneration under the Draft Guidelines. Clients also consider that the provisions of paragraph 13 could encourage employee turnover.

**Simmons & Simmons LLP**

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