



June 4, 2015

Via Electronic Submission

European Banking Authority
One Canada Square (Floor 46)
Canary Wharf
London E14 5AA
United Kingdom

Dear Sir or Madam:

Re: Response to the Consultation Paper on Remuneration Guidelines under CRD IV

Managed Funds Association¹ (“**MFA**”) welcomes the opportunity to provide comments to the European Banking Authority (“**EBA**”) in response to its consultation paper and draft guidelines (the “**Consultation Paper**”)² on remuneration policies under Directive 2013/36/EU (“**CRD IV**”) dated 4 March 2015.

MFA supports a regulatory framework that will minimize systemic risk, promote internal governance and ensure a level playing field amongst institutions subject to such regulation. MFA therefore appreciates the EBA’s intention to ensure institutions have remuneration policies that reflect sound internal governance, aligned interests of staff, stakeholders and owners and appropriate risk-weighting of institutions’ profile and strategy. Our members are subject to extensive regulation and are long-time advocates of clear guidelines and strong enforcement.

MFA wishes to respond to Question 5 of the Consultation Paper. Question 5 reads:

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

¹ Managed Funds Association represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

² Available at: [https://www.eba.europa.eu/documents/10180/1002374/EBA-CP-2015-03+\(CP+on+GLs+on+Sound+Remuneration+Policies\).pdf](https://www.eba.europa.eu/documents/10180/1002374/EBA-CP-2015-03+(CP+on+GLs+on+Sound+Remuneration+Policies).pdf).

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 payout 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.

At page 11 of the Consultation Paper, the EBA expresses the view that:

“Although the former CEBS Guidelines on Remuneration Policies and Practices allowed for the so called ‘neutralisation’ of some provisions in small and less complex institutions. The terms of the CRD do not explicitly grant for such a right and therefore the preliminary assessment of the EBA is that a full waiver of the application of even a limited set of remuneration principles for smaller and non-complex institutions would not be in line with the CRD. (Emphasis added)

For the reasons discussed below, MFA respectfully disagrees with the view expressed above. Further, we believe that the ability of competent authorities to permit certain firms to neutralize individual principles is a key component of the proportionality principle. Requiring all firms to comply with all of the principles set out in the EBA guidelines, even when the policy concerns underlying particular principles are not relevant to an individual firm, would impose significant costs and burdens on firms without furthering the legislative goals of the principles. We believe this result is inconsistent with the policy rationale underlying the proportionality principle and is unnecessary to achieve the policy goals of the EBA guidelines.

Neutralization under CRD III

The concept of ‘neutralization’ was introduced in December 2010 by the Committee of European Banking Supervisors (“**CEBS**”) in their guidelines on sound remuneration policies³ (“**CEBS Guidelines**”). The CEBS Guidelines provided firms with the possibility to ‘neutralize’ certain requirements based on the principle of proportionality. The requirements that were allowed to be neutralized were those providing for the deferral of variable remuneration, the pay out in instruments and the application of *malus* and clawback (such rules to be referred to as, the “**Payout Process Requirements**”).

This ability to neutralize Payout Process Requirements under the CEBS Guidelines is clearly consistent with the wording of CRD III:

³ Available at: <https://www.eba.europa.eu/documents/10180/106961/Guidelines.pdf>.

Recital 4 CRD III

“The principles should recognise that credit institutions and investment firms may apply the provisions in different ways according to their size, internal organisation and the nature, scope and complexity of their activities and, in particular, that it **may not be proportionate for investment firms** referred to in Article 20(2) and (3) of Directive 2006/49/EC to **comply with all of the principles.**” (emphasis added)

Recital 9 CRD III

“A substantial portion of the variable remuneration component, such as 40 to 60 %, should be deferred over an appropriate period of time. That portion should increase significantly with the level of seniority or responsibility of the person remunerated. Moreover, a substantial portion of the variable remuneration component should consist of shares, share-linked instruments of the credit institution or investment firm, subject to the legal structure of the credit institution or investment firm concerned or, in the case of a non-listed credit institution or investment firm, other equivalent non-cash instruments and, where appropriate, other long-dated financial instruments that adequately reflect the credit quality of the credit institution or investment firm. In that context, the principle of proportionality is of great importance since **it may not always be appropriate to apply those requirements in the context of small credit institutions and investment firms.**” (emphasis added)

Annex I (amending Annex V, adding Section 11(23) to Directive 2006/48/EC) CRD III

“When establishing and applying the total remuneration policies... credit institutions **shall comply with the following principles in a way and to the extent that is appropriate** to their size, internal organisation and the nature, the scope and the complexity of their activities...” (emphasis added)

The Recitals above explicitly refer to certain types of investment firms not having to comply with **all** of those principles. It is thus clear that **some** of the principles listed in Annex I CRD III need not be complied with by certain types of investment firms.

In addition, Annex I of CRD III states institutions should comply with the remuneration principles “*to the extent that is appropriate*”. This indicates that there exists circumstances in relation to the characteristics listed (“*size, internal organisation and the nature, scope and complexity of their activities*”) where it would not be appropriate for institutions to comply. This means that there are some requirements that may not be appropriate for every firm subject to CRD III.

Neutralization under CRD IV

The approach taken in relation to the remuneration requirements and proportionality in CRD IV is materially the same as the approach taken in CRD III and the CEBS Guidelines. The relevant provisions of CRD IV are set out below:

Recital 66

“The provisions of this Directive on remuneration should reflect differences between different types of institutions in a proportionate manner, taking into account their size, internal organisation and the nature, scope and complexity of their activities. **In particular it would not be proportionate to require certain types of investment firms to comply with all of those principles.**” (emphasis added)

Article 92(2)

“Competent authorities shall ensure that, when establishing and applying the total remuneration policies... institutions **comply with the following principles in a manner and to the extent that is appropriate** to their size, internal organisation and the nature, scope and complexity of their activities...” (emphasis added)

Article 94(1)

“For variable elements of remuneration, the following principles shall apply in addition to, and under the same conditions as, those set out in Article 92(2)...”

In comparing the legislative provisions in CRD III and CRD IV, MFA notes that Annex I CRD III and Article 92(2) CRD IV contain materially identical wording in relation to the principle of proportionality: that institutions comply with the remuneration principles set out in the relevant legislation “*in a [way [CRD III] / manner [CRD IV]] and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities*”.

In fact, Recital 66 of CRD IV goes further than Recital 4 of CRD III. While Recital 4 of CRD III provides that it “**may not**” be proportionate for certain investment firms to comply with all of the principles, Recital 66 of CRD IV states that it “**would not**” be proportionate for certain investment firms to comply with all of the principles. The European Parliament and the Council clearly meant to emphasise that proportionality means that not all of the remuneration principles need to be complied with in certain circumstances.

Finally, Article 92(2) CRD IV states institutions should comply with the remuneration principles “*to the extent that is appropriate*”. That language is identical to that of Annex I CRD III; our observations above regarding Annex I CRD III apply equally here.

Proportionality expressed as a minimum standard

Paragraph 73 of the draft EBA Guidelines state that, where CRD IV specifies specific requirements with numerical criteria (such as the Payout Process Requirements), “proportionality” means that, for significant institutions, “more strict criteria should be set.”

MFA respectfully disagrees with that interpretation of the CRD IV remuneration provisions. In our view, Articles 92 and 94 (and the related Recitals) CRD IV do not suggest that proportionality should be interpreted to mean that stricter criteria should be set for significant institutions.

If the Council and Parliament had intended for such stricter criteria to apply to significant institutions, they would have provided as such in the CRD IV text. There are several examples of such provisions. For example, Article 76(3), which deals with the treatment of risks by an institution, provides that: “Member States shall ensure that institutions that are significant in terms of their size, internal organisation and the nature, scope and complexity of their activities establish a risk committee composed of members of the management body who do not perform any executive function in the institution concerned.”

Similarly, Article 88(2), on governance arrangements, provides that: “Member States shall ensure that institutions which are significant in terms of their size, internal organisation and the nature, scope and complexity of their activities establish a nomination committee composed of members of the management body who do not perform any executive function in the institution concerned.”

Other examples include Article 77(1) (on internal approaches for calculating own funds requirements), 91(3) (on the management body of an institution) and 95(1) (on remuneration committees).

If the Payout Process Requirements were to be imposed as a bare minimum of compliance, such requirements would become unduly burdensome for certain investment firms which fall within the scope of CRD IV.

The EBA’s change in approach compared to CEBS

MFA notes that, since the CEBS Guidelines were published in December 2010 and entered into force from January 2011:

- the Commission proposal for CRD IV was published in July 2011;
- the EBA published its *Survey on the implementation of the Guidelines on remuneration policies and practices* (the “**Implementation Survey**”)⁴ in April 2012; and
- the final text of CRD IV was published in the Official Journal on 27 June 2013.

None of these documents indicated any reservations to the approach to proportionality taken in the CEBS Guidelines or suggested any change to the approach. In particular, so far as MFA is aware, no particular concerns or reservations on the interpretation of the proportionality principle by CEBS under CRD III were raised by the Commission, Council or Parliament throughout the legislative process leading to the final CRD IV text.

In fact, the EBA’s Implementation Survey highlighted the appeal of taking a flexible approach to neutralizations by stating: “Given the differences in the size and complexity of individual markets, a **flexible approach to neutralization is desirable** although this should be balanced against the possible scope, albeit modest, for regulatory arbitrage” (emphasis added). The EBA clearly endorsed the approach taken by CEBS on proportionality.

⁴ Available at: <https://www.eba.europa.eu/documents/10180/106961/Implementation-survey-on-CEBS--Guidelines-on-Remuneration--final-.pdf>.

Conclusion

MFA is of the view that the EBA's proposed approach to the principle of proportionality, as set out in its Consultation Paper and draft guidelines, is inconsistent with the legislative drafting of CRD III and CRD IV. MFA respectfully submits that the approach to proportionality in the CEBS Guidelines, allowing for the neutralization of certain remuneration requirements, should be retained and included in the EBA's final guidelines on sound remuneration policies.

MFA thanks the EBA for the opportunity to provide comments on the Consultation Paper. We would welcome the opportunity to discuss our views in greater detail. Please do not hesitate to contact Benjamin Allensworth or the undersigned at (202) 730-2600 with any questions the EBA or its staff might have regarding this letter.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President, Managing Director &
General Counsel