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

EACB Position Paper on EBA Consultation Paper on Draft Guidelines on Sound Remuneration Policies under Art. 74 (3) and 75 (2) of Directive 2013/36/EU and Disclosures under Art. 450 of Regulation (EU) No 575/2013

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EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

Contact:

The EACB trusts that its comments will be taken into account.

For further information or questions on this paper, please contact:

- Mr. Volker Heegemann, Head of Department (volker.hegeemann@eacb.coop)
- Ms. Teodora Magdalincheva, Legal Adviser (teodora.magdalincheva@eacb.coop)

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 31 member institutions and of co-operative banks in general. Co-operative banks form decentralized networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4,200 locally operating banks and 68,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 205 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 78 million members and 860,000 employees and have a total average market share of about 20%.

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Introduction

The European Association of Co-operative Banks (EACB) welcomes the opportunity to participate in the public consultation of the EBA draft Guidelines on sound remuneration policies (EBA draft Guidelines). Generally, we support the EBA initiative to update the 2010 CEBS Guidelines in order to enable consistent, efficient and effective implementation of the requirements by the institutions and promote sound compensation practices for the entire financial sector.

At the same time, however, we note that the new EBA draft Guidelines significantly change remuneration and compensation rules applicable EU-wide. On a number of issues the EBA draft Guidelines overstep the CRD IV requirements and effectively amend them requiring wider and stricter application. In addition, the new draft Guidelines seem to target a larger scope of staff members and not only the material risk takers, as envisaged under the CRD IV. Finally, we express our concerns that the EBA draft rules might not be always in line with the national legal provisions, which have been recently amended to correspond to the CRD IV. In our view this may create unsound legal environment and lead to unnecessary administrative and practical burdens for regulators, supervisors and institutions.

Our comments below are meant to make a contribution to some fundamental aspects.

Proportionality

EACB members are very concerned about the EBA approach on proportionality, according to which smaller and non-complex institutions would be required to comply with remuneration provisions in a similar to systemically important institutions way. It would include without limitation the identification of material risk takers, compliance with the deferral periods and deferred portions of variable remuneration, observance of the requirements for payment in instruments, etc. EACB members do not support the above interpretation of proportionality for a number of reasons.

Firstly, it is our understanding that the CRD IV endorses the principle of proportionality, providing therefore a possibility for application of Art. 92 to 95 on a proportional basis.

Secondly, we note that EBA's interpretation is not consistent with the currently applicable national legal regimes which have already been properly and timely adjusted to the CRD IV provisions.

Finally, any "one-fits-all" application could place unjustified administrative burdens and adversely affect competition instead of ensuring sound remuneration policies of the institutions subject to the EBA draft Guidelines.

<u>CRD IV incorporates the principle of proportionality</u>

We remind that the 2010 CEBS Guidelines explicitly recognize that the application of proportionality may lead to the neutralization of some requirements if it is reconcilable with the risk profile, risk appetite and the strategy of the institution. The 2010 CEBS Guidelines also distinguish two dimensions of proportionality (and therefore the neutralization of certain requirements): (i) proportionality among institutions on the basis of the criteria such as size, internal organization, nature, scope and complexity of the activities and (ii) proportionality among categories of staff in accordance with their degree of seniority, size of obligations of the obligations into which a risk taker may enter on behalf of the institution, the size of the group of persons, who have only collectively a material impact on the risk profile of the institution, the size of the group of persons, who have a collectively a material impact on the risk profile of the institution, the business model of the line of business of the staff members, the ratio of variable and fixed payment and/or in combination with the total amount of remuneration[1].

We do not see any substantial changes of CRD IV compared to CRD III, which would justify ignoring of the above described principles in any new guidelines. EACB Members are of the opinion that the CRD IV equally incorporates the principle of proportionality which allows for proportionate ('neutralized') application of the remuneration-related provisions.

More specifically, recital 66 of the Directive 2013/36/EU envisages that the provisions on remuneration should "reflect differences between different types of institutions in a proportionate manner, taking into account their size, their internal organization and nature, scope and complexity of their activities." In this context it should be noted that recital 66 of the Directive also states that "it would not be proportionate to require certain types of investment firms to comply with all of those principles". In the same vein, recital 54 provides for the application of the principles and standards on the sound management of risk in a way that takes into account the "nature, scale and complexity of the institutions' activities."

Furthermore, Art. 75 (2) CRD legal basis for the EBA draft Guidelines, stipulates that the EBA guidelines on sound remuneration policies should comply with the principles set out in Art. 92-95 CRD. In this context, we note therefore, that pursuant to Art. 92 (2) the establishment and the application of the total remuneration policies should be done in a manner and to the extent that is appropriate to the institutions' size, their internal organization and nature, scope and complexity of their activities. To the extent the application of the principles under Art. 94 is subject to "the same conditions, as those set out in Art. 92 (2)", the reference to institutions' size and complexity is also envisaged in the provision of Art. 94 CRD. In a similar manner, the co-legislators have also acknowledged the principle of proportionality in Art. 450 (2) CRR.

Finally, we note that recital 62 and Art. 92 (2) provide for the application of the remuneration policies and principles not to all staff members, but to a specific category of staff members, namely those whose professional activities have material impact on the institutions' risk profile.

Against this legal background, we, therefore, consider that CRD IV does not stipulate a "one-fits-all" approach; right on the contrary it requires a diversified and sophisticated application of the relevant provisions to ensure a sound regulation on a proportionate basis. While one may note that there is no explicit waiver under the CRD, we are of the opinion that this is exactly because the European legislature has envisaged in a very flexible manner the application of the principle of proportionality. The proper application of proportionality would exclude the need for general waivers, but as an end result flexibility is allowed and non-compliance with specific rules based on institutions' size, complexity and overall significance is justified. This legal reading is also enshrined in recital 66 of CRD as it allows for certain institutions to waive certain remuneration principles. This demonstrates that

[1] See page 20 and 21 of the 2010 CEBS Guidelines

CRD IV already incorporates the concept of "neutralization" for certain institutions. Therefore, exceptions for small and non-complex institutions as well as for low amounts of variable remuneration can, in principle, be based on proportionality.

This reading is also backed by the historical genesis of the CRD IV that does not provide any differing indications. On the contrary, the wording of the CRD IV and its legislative predecessors (see only CRD III, recital 9) are all based on the understanding that proportionality implies a flexibility in the application of some requirements. The wording "*to the extent*" in Art. 94 (1) and 92 (2) gives some evidence to that and cannot mean anything else regarding the principle of proportionality than the opening for a neutralization (exemption) of certain requirements in the CRD IV.

In this context it has to be underlined that the business model of cooperative banks does not favour taking of excessive risks. First, cooperative banks are retail banks, which primarily take deposits and finance SMEs, housing and private households. This business is generally seen as rather stable with risks that are manageable but also with limited returns on investment. While also in retail banking things may go wrong, a business policy of "excessive risk taking" in retail banking, however, would require quite exceptional circumstances. Second, the business models of cooperative and mutual banks do not promote excessive risk taking at all. While regular surpluses are a key element of their business policy, the generation of maximum profits is out of the scope. The primary purpose of cooperative banks is the provision of services to members within their area of business, which implies an approach to the business that is focused on the long-term and on regular, but stable, profits. Such philosophy is mirrored also in remuneration policies which do not contain any elements or incentives to encourage excessive risk-taking. In this respect we also note that given the cooperative banks' values, variable payments may often not be based on formulae related to contribution of a unit and its staff to the general result. We have evidence that in a few jurisdictions the variable pay in a majority of co-perative banks is rather tuned according to the overall financial profit of the banks, the reserve allocation and the dividends to the shareholders. Thus cuts in the variable remuneration are often related to the bank's profit reduction.

In the light of this and giving due regard to the aforementioned provisions, EACB is of the view that the application of the principle of proportionality allows neutralization (to the extent of full non-application) of certain rules both on institution and individual level and that it is appropriate to apply it particularly in the case of cooperative banks.

While the EBA seems not to share our view regarding "implied" proportionality, it nevertheless sees a need for a proportionate approach to remuneration policies and therefore intends to develop such an approach *de lege ferenda*. From our perspective this approach is only the second best, but with regard to the consequences for our members, we confirm that EACB will provide any input or necessary support to the EBA to achieve results that solve the specified issues for our members. In this context, we further note that any approach *de lege ferenda* triggers the question of transition rules to which a solution has to be found.

<u>EBA draft Guidelines should consider threshold requirements as in the EU Member States</u>

EACB notes that the EBA understanding of proportionality is not in line with the current national legal provisions regarding remuneration and compensation policies. Those national provisions have been amended EU-wide in the past two years as a general rule to be compliant with the CRD IV. Their respective implementation has already required much efforts from national regulators, supervisors and institutions.

Despite the differences that exist in the various EU Member States (due to the different legal framework and practical situation), in a vast majority of them the regulators and/or supervisors have taken a pragmatic approach in line with the CRD IV and have specified thresholds below which remuneration rules would not apply or would apply to a substantial minimum. Depending on the specific regimes, such thresholds apply on institutional level and/or individual level. Irrespective of their particular design (and amount), they all aim to take into consideration fair competition, thus providing exceptions for certain institutions and staff members for which the application of some requirements would be disproportionate.

There are evident reasons for such “neutralization thresholds”. They compensate for the effect that the percentage of material risk takers in the smallest institutions is the highest and may easily go beyond 50% of staff so that those institutions are the ones that are hit the hardest by the remuneration rules. Furthermore, they ensure that insignificant amounts of variable remuneration do not have to be deferred and paid out in instruments. In fact, we believe that the regulator did not intend to affect variable remuneration below certain thresholds and that also the regulatory purpose is no more perceptible by the individual staff member below those thresholds.

EACB members are convinced that this flexibility of neutralization, including to the extent of full non-application in some cases, should be ensured. Due to the diversified legal and structural frameworks in the various EU Members States, the local regulators may successfully adapt EU rules on remuneration only if they are given certain discretion by way of sustaining the principle of proportionality. The thresholds, both on institutional and on individual level, should be preserved in order to avoid unnecessary administrative burdens being placed on the institutions and to ensure legal certainty and sound business environment.

The thresholds may remain as designed on national level. National supervisory authorities and legislators have implemented the CRD IV provisions in consideration of national banking markets‘ structures; institutions have adapted their remuneration policies accordingly. A renewed change of guiding values is unacceptable for the institutions, taking into account the multifaceted demands of various regulatory acts in the context of remuneration. A coordinated approach on the institutional level is necessary. Due to many mixed functions in small and medium-sized institutions, the remuneration of one employee can often be subject to multiple regulatory provisions, which is almost impossible to convey. In addition, institutions also have to implement and cope with massive regulatory measures outside the field of remuneration.

Alternatively, common thresholds may be established EU-wide in order to ensure better harmonization. In this case the amounts should be set at levels that give regard to the various national practices already established and not discriminate against regimes that have adopted higher thresholds.

Administrative burden and competition concerns

The EBA interpretation of the principle of proportionality, excluding any possibility for neutralization (exemption) would eventually lead to disproportions, imposing equally unjustified burdens both on smaller and bigger institutions and staff members who would otherwise not fit into the concept of "high earners" and "material risk takers", because their variable remuneration is low.

The implementation of all provisions related to the variable remuneration to all staff by all institutions and by all of their respective subsidiaries would be very burdensome. It requires additional administrative capacity, new (or at least an upgraded) technical infrastructure to practically process all necessary calculations, involvement of more human resources in this area, etc. Extra IT costs will be necessary to adapt current remuneration tools in order to manage the remuneration policy in compliance with the complex new rules (functionalities for deferral and pay-out in instruments on variable part, tax team expertise to manage the withholding of social charges and income taxes on the employees' bank accounts for the parts of variable remuneration paid in instruments, costs linked to the opening of deposit accounts for all regulated staff) and the extended number of identified staff members. In the case of very small banks, it is hardly possible to create such capacities. Instead, an additional layer of tasks is imposed on directors. Implementation and communication of regulatory acts remain in the area of responsibility of the employer even if external help is being consulted. As a rule, only members of senior management would be in a position to achieve this. Associations, too, will not be able to fill this gap, since they are not in a position to interact with medium-sized employers as they are with a group of companies as regards staff organization and performance culture. Finally, medium-sized bank employers are not „standardized“ in a way that would allow them to translate all the regulatory demands, which aim at major European Banks, into their business model. Some of the provisions cannot even be sensibly applied by small and medium-sized cooperative banks with a low-risk business model, let alone be solved at reasonable costs.

It is our concern that especially in smaller institutions the required wide application would affect a big number of people with modest variable remuneration. Moreover, particularly in regional cooperative banks, the variable part of remuneration remains rather limited, (in most jurisdictions not exceeding two monthly salaries). Variable remuneration, in most cooperative banks, is kept in a range that does not exceed 6 % of the institution's overall HR-costs and is, on the individual level, within a range of 0.25 to 2 monthly salaries per year. The same applies for variable remuneration of highly qualified key performers that does not exceed the amount of 50,000 Euros per year.

In direct connection with proportionality and the removal of the minimum thresholds of remuneration are also the issues in respect of deferral. The removal will mean a significant number of additional employees are caught by deferral, many of which are on lower salaries and bonus potential, resulting in very small deferred amounts. The purpose of variable remuneration is two-fold - firstly, to incentivise and motivate and, secondly, to provide scope for reclaim, through malus and clawback, both by remuneration committees and regulators. The removal of proportionality and the application of deferral to smaller bonus levels, removes both purposes of variable pay, as not receiving it for a number of years removes any link between performance and reward and the pot being built to apply malus or clawback is insignificant.

A further burden is the implementation of a risk-based and performance-oriented remuneration policy. While variable remuneration normally is performance oriented, most smaller cooperative banks apply tools for its measurement that are not or only to a minimum extent based on commercial results or risk. With regard to the specific mission of cooperative banks, where customer/member satisfaction is the guiding principle, any approach that focuses too much on risk and commercial results would be unacceptable. Moreover, the implementation of a stringent risk-/commercial performance-related approach would also be one of the most demanding challenges for smaller institutions. A proportionate approach is therefore urgently needed in this context as well.

In the light of the above remarks and due to the very burdensome implications, we fear that the EBA approach will push the institutions to redesign their remuneration policies and completely withdraw from the use of variable remuneration. The unintended impact could be:

1. losing an important managerial instrument to incentivise good performance - even in institutions where the variable remuneration has a limited weight, a large number of staff receives this kind of compensation which is instrumental in aligning staff behaviour to the management guidelines;
2. increasing fixed costs - the bank cost structure would become less flexible and, simultaneously, the bank would lose the only suitable instrument to manage labour costs, taking into account the market scenarios (a concern of all times, but particularly relevant in times of stress);
3. possible staff reduction or less qualified staff - when faced with a choice of employment between financial sector with high regulation, personal accountability, deferred remuneration and another sector, with no such requirements, then a too severe approach in the financial sector will potentially drive talent away. This is particularly likely at this mid to senior management band, now being caught by the removal of proportionality, where salaries are not significant enough for bonuses not to feature in the individual's consideration of what they expect their annual remuneration to be.

Finally, the more stringent EBA draft rules further deviate from the FSB principles applicable worldwide, thus extending the regulatory gap between the EU–based institutions and the ones based in third countries, while placing the EU-based institutions in competitive disadvantage.

EACB Conclusion

Considering the aforementioned arguments, the EACB members are of the view that CRD IV already incorporates the principle of proportionality, leaving a room for a possible exemption (neutralization) of a number of the remuneration rules in line approach undertaken in 2010 CEBS Guidelines. This could be practically implemented in compliance with the conditions and the thresholds that are already endorsed by the national regulators and/or supervisors. Alternatively, in order to promote a more harmonized application of the remuneration rules among the Member States, on the basis of CRD IV EBA may define *de minimis* thresholds on both institutional and individual level that could be applicable consistently to the EU banking industry and below which requirements relating to deferral, payment in instruments, retention periods could be neutralized. There are a number of European models for setting such thresholds. In any case, specific calculations would be required. To illustrate its position, EACB notes that the single common threshold at institution level should not be set below EUR 10 billion of total assets. The common threshold at individual level may be set relatively, i.e. 50% of the fixed component of the remuneration of the respective staff member, or in absolute terms, in which case, balancing between the different levels existing at national level, we suggest that the common threshold at individual level should not go below a variable remuneration that equals to EUR 120 000.

Finally, should the regulators nevertheless decide that the CRD IV does not allow neutralization (exemption) of some remuneration rules, then as suggested by EBA it would be appropriate to initiate legislative amendments. In this respect, the EACB members note that some transitional period has to be considered during which the neutralization of some rules will be applied both on institutional and individual level. All of the arguments outlined above are applicable for the transitional period request.

Right of social partners to conclude and enforce collective agreements

We strongly regret that the EBA draft Guidelines, when eliminating possibilities of neutralization, do not make any reference to collective labour agreements. In fact, in some jurisdictions variable elements are part of such agreements and are paid either to all employees, or to certain categories of employees. Typically, when stipulated in such agreements, those elements of variable remuneration are not significant. Particularly in smaller regional institutions, which identify a high percentage of staff members as material risk takers, the rules on variable remuneration would have to be applied to a relevant number of staff members falling under collective agreements.

In a number of jurisdictions the collectively agreed rules (including remuneration rules) benefit from a high-rank legal protection. This is also enshrined under CRD IV, where recital 69 specifically stipulates that the "*provisions on remuneration should be without prejudice to the full exercise of fundamental rights under article 153 (5) …and the rights of social partners to conclude and enforce collective agreements, in accordance with national law and customs*." This recital properly reflects that the right of coalition is a fundamental right in the EU and the right to conclude collective agreements a fundamental right in several Member States.

Due to the deletion of any possibilities of exemption (neutralization), we see an urgent need for the EBA to provide explicit guidance on the relationship of the CRD IV, the future guidelines and the right of coalition and the right to conclude collective agreements, in particular, whether and how such agreements resulting from national labour law could be affected without questioning the hierarchy of norms and the separation of powers.

We nevertheless maintain our serious doubts that the CRD IV intends to affect any such agreements, as it would according to the EBA draft Guidelines. We challenge the legal argument brought forward in the hearing, that collective labour agreements would also be possible in the future, strikes the right note in this context. In fact it leaves recital 69 without any substance: EU interference in the freedom of coalition and collective agreements would be permitted as long as at least theoretically just some room for such agreements is left. Since there will be theoretically always some room left, even in the case of substantial interference, only a full negation of the rights in question would be in conflict with recital 69. This would imply that recital 69 is completely useless.

In the light of the aforementioned, EACB considers that Recital 69 of the CRD should be referred to directly within the draft Guidelines and that the payments agreed within collective agreements should be excluded from the scope of application the EBA rules regarding payment of variable remuneration.

EBA questions for consultation: selected issues

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

The EBA draft Guidelines would be applicable to all EU competent authorities and institutions on a solo and consolidated basis, including all subsidiaries which are not subject to the CRD IV framework (para 2 and 4) and to all or to a specific staff of the institutions (para 5). In this respect, the definition of "staff" is particularly important. According to para 6g "staff" includes not only all employees and management bodies of the institutions and all its subsidiaries (including not subject to CRD), but also "any other person acting on behalf of the institution and its subsidiaries". The latter element is so broad that it may even allow capturing subcontractors (such as IT and health specialist) and even persons acting on the basis of a power of attorney on behalf of a respective institution (or even its subsidiary which would not qualify as institution), irrespective of the peculiarities of the specific civil, labour, corporate or commercial law provisions that may vary from one Member State to the other.
Furthermore, in order to ensure consistency between EBA draft Guidelines and other guidelines on remuneration, such as the AIFMD Guidelines[2], the definition of staff should be limited only to persons acting on behalf of an employment agreement and the members of the managements bodies.

Q 2: Are the guidelines in chapter 5 appropriate and sufficiently clear?

We appreciate that the EBA draft Guidelines explain in para 8 the differentiation between all staff and identified staff. However, the Guidelines should possibly elaborate more on this differentiation and clearly indicate in one place which rules apply to all staff and which apply to identified staff only. As a minimum, it should be clearly explained that rules on instrument payment, deferral, retention and clawback only apply to identified staff.

Q 3: Are the guidelines regarding the shareholders' involvement in setting higher ratios for variable remuneration sufficiently clear?

The EBA draft Guidelines go into much more details regarding the involvement of the shareholders in the governance of the remuneration process, envisaging powers which are not provided for under the CRD IV in favour of the general meeting. More specifically, CRD requires that the general principles of remuneration policy are approved by the "management body in its supervisory function" (Art. 92(2)(c) CRD), while EBA leaves a possibility for the approval of the institution's remuneration policy by the shareholders (para 32). This inconsistency is also obvious with regard to the decisions on remuneration of the members of the management board (or other identified staff). Art. 92(2)(f) CRD stipulates that "management board in its supervisory function", and not the shareholders, as envisaged by the EBA, will oversee the remuneration to some senior officers (para 32). In this context, we note that in some national jurisdictions the remuneration issues are not within the competences of the shareholders. Therefore, the stipulated additional powers granted to the shareholders' meeting create a confusion and are not justified. They miss a sound legal base in the CRD IV and might conflict with national legal provisions.

2 See ESMA Guidelines on sound remuneration policies under the AIFMD, 2013, p. 5

Furthermore, we note that the EBA draft Guidelines provide for very detailed rules on the shareholders' rights to increase the variable and fixed component ratio up to 200%. While EACB members acknowledge that such powers are generally CRD-based, we are of the view that the EBA highly detailed rules are quite complicated and not flexible to possible market changes and/or specific situations that might require timely increase on prudent basis of some payments in order to ensure professionalism.

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

Design and oversight of remuneration policy

EACB is of the view that the detailed draft provisions of the Guidelines interfere with the general allocation of competence as envisaged under the respective national legal acts, which is also not in line with the CRD IV. The full transfer of remuneration policy competences to the management board (not only of the general principles of the remuneration policy) is not in compliance with CRD IV and with the national legal provisions.

Pursuant to CRD IV, the management board in its supervisory function is competent to "**adopt and periodically review the general principles of the remuneration policy**", as well as to oversee its implementation (Art. 92(2)(c) CRD IV). EBA reflected this provision in the draft Guidelines slightly differently, stipulating that the "supervisory function should be responsible for **adopting and maintaining remuneration policy of the institution**, and overseeing its implementation…" (para 17). In addition, according to the EBA the supervisory function would have to approve any changes to the remuneration policy, as well as material exemptions for single staff members (para 17) and would be responsible for directly overseeing the remuneration of senior officers in independent control function (para 25).

The interpretation of the EBA goes beyond the legally provided competences of the supervisory function under the CRD IV, entrusting it with the adoption and review of the remuneration policy of the institution in its entirety, not only of the general principles that govern this remuneration policy. The EBA approach is not consistent with a majority of national legal regimes and is therefore not compatible with the hierarchy of norms. It is not common for the supervisory board to be entrusted with specific tasks with every-day implications.

Moreover, considering the rather detailed responsibilities and tasks of the remuneration committee, we have the impression that the "management board in its supervisory function" is converted into an operational unit, with all its implications on e.g. knowledge and expertise of members, time commitment, remuneration, liability, etc. This conversion may be a source of governance problems – namely, how would the supervisory function, which is increasingly mandated with tasks beyond supervision, be controlled. This problem may become particularly evident in two-tier systems. We therefore ask the EBA to reconsider and to come to a distribution of powers in remuneration between executive and supervisory function that does not hamper the basic principles and design.

Finally, we note that the EBA interpretation might be seen as not fully in line with the approach of ESMA either. More specifically, pursuant to para 21 of the ESMA Guidelines on remuneration policies and practices (MiFID) "the design of remuneration policies and practices should be approved by senior management" or only where appropriate by the supervisory function. This allows some flexibility in the implementation of the respective requirement in a way that best suits the different legal frameworks and business structures. In this context, we note that general regulatory consistency in accordance with the CRD IV requirements should be ensured.

Remuneration Committee (Rem Co)

EACB also notes that the detailed and mandatory requirements regarding the Rem Co could be quite problematic.

More specifically, the independence requirements seem to go beyond the CRD IV. Art. 95 (1) CRD does not require that a "majority" of the Rem Co members should be independent, rather it emphasizes that the Rem Co should be constituted in a way that enables it to "exercise competent and independent judgement on remuneration policies and practices". Likewise, the Guidelines on Internal Governance to which EBA cross refers, also leave it up to the respective institution to decide on the appropriate number of the independent members. Thus, we don't see any reason for the EBA to require that a majority of the Rem Co members should be independent (para 42).

The detailed rules on the composition and tasks of the Rem Co (supervisory function) could indirectly influence internal governance rules of the institutions. This might be an issue when, for instance, there is interdependence between the composition of the Rem Co and other bodies of the institutions, required under the national law. Such new burden seems disproportionate and would impose additional material costs and efforts for cancelling the membership of individuals not fulfilling the requirements and recruiting new members in compliance with this regulation.

In addition, the reference to independence as defined under the Guidelines on Internal Governance (independence from subsidiary, group and controlling shareholder) is also quite problematic from our perspective, since it does not give regard to the cooperative banks' models. In cooperative groups/networks the board members (respectively the committee members) are actually clients and holders of capital instruments of the cooperatives. Therefore, the concept of "independent directors" as determined under the Guidelines on Internal Governance is not suitable in the context of most cooperative banking groups.

We appreciate that the EBA draft Guidelines provide for the possibility to ensure independence via "other measures" (para 42). At the same time, however, the EBA draft Guidelines are not precise what those "other measures" might be. If the idea behind this provision is, as already stated by EBA during the public hearing, that the directors should not decide on their own remuneration, it should be more clearly stated to avoid any misinterpretation. Therefore, EACB suggests that the draft Guidelines include an explicit language to recognize the cooperative structure regarding the independence of the Rem Co (supervisory board) members.

We consider that non-executive directors are independent by nature in a cooperative bank for specific reasons such as *inter alia* the following:

- their democratic election process by the general meeting (the cooperative rule "one man, one vote" fully applies and the voting rights are not proportional with the shareholdings),
- the absence of common interest between each director and a specific shareholder or a group of shareholders (no conflict of interest) unlike other joint stock companies, listed or not, in which the directors represent a determined shareholder or a specific group of shareholders.

Finally, EACB members are also concerned about the highly detailed rules on the collaboration between the Rem Co and the other internal committees. It is our understanding that this collaboration should be encouraged as a "good practice", while not requiring mandatory participation in the various internal committees.

Remuneration policies in group context

Generally, the EBA draft Guidelines seem to ensure the use of the derogation provided under CRR for the application of the remuneration policies on individual level (para 60). EACB supports this approach and notes its legal compliance and practical meaning. In order to avoid any misinterpretation and burdensome consequences, however, this possibility for exemption from application on a solo basis for subsidiaries included in the supervision on a consolidated basis should be more clearly outlined. Thus, for instance, EACB notes the mandatory wording under para 63, according to which "...the consolidating institution **must** ensure that subsidiaries within the group which are not themselves subject to the CRD, apply the group-wide remuneration policies to all staff....". In the same vein para 74 explicitly stipulates that for subsidiaries of significant institutions all requirements should be applied as they apply on consolidated level.

It's been EBA's understanding that "the subsidiaries which are not subject to the CRD on an individual basis do not need to apply the CRD and consequently the RTS on a solo level, but are included in a consolidated group level assessment" (see page 39, EBA final draft RTS on Identified Staff). This understanding has been reiterated by the wording of para 100 of the EBA draft Guidelines. Additionally, para 105 explicitly requires that the subsidiaries, including the ones outside the scope of the CRD, should provide necessary information only for the staff "with material impact on the institutions risk profile on the consolidated level". Therefore, it seems that in subsidiaries which are not themselves subject to CRD only identified staff of material business units from group perspective (based on consolidated assessment) have to be assessed and not (all) staff of all subsidiaries as provided for under section 7 of the EBA draft Guidelines.

In a Group context, applying CRD IV provisions on a solo basis to each subsidiary irrespective of its size, significance and organization would constitute an administrative burden and a source of great complexity (in terms of identification process, implementation of CRD rules on the variable remuneration of the identified staff, public disclosures and reporting). Furthermore, this would create an uneven playing field between in-scope and out-of-scope institutions. EEA would have major competitive concerns in particular to maintain the same level playing field and retain their best performers applying these rules in all their subsidiaries located outside EEA. Similarly, subsidiaries located in EEA countries would be confronted to a distortion of competition with their peers which are not part of a Group.

The application of remuneration requirements to all subsidiaries would necessarily create a distortion of competition in favour of any subsidiary controlled by non-banking institutions and to the detriment of any subsidiary controlled by a banking institution if the latter is not in a position to offer any flexibility on the variable remuneration to its identified staff.

Considering the aforesaid concerns, EACB members are of the view that further clarifications are needed in the draft Guidelines to ensure the common understanding that the relevant provisions of the CRD (especially Art 92(1)) only refer to subsidiaries on a prudential consolidation basis. In this respect we would appreciate a clarification in the draft Guidelines that the insurance undertakings (not being financial institutions in the sense of CRR) would not be considered as subsidiaries in the context of the articles of the CRD on remuneration. In addition, we are of the opinion that the companies in a Group that are subject to specific rules (AIFMs and UCITs asset management) do not have to apply rules on remuneration on a consolidated (or sub-consolidated) basis, except for some individuals who have specific functions at the Group level.

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

EACB notes that CRD IV targets only those staff members whose activities materially impact the risk profile of the institutions. Art. 92 (1) CRD explicitly states that compliance with the principles envisaged therein would be required on the basis of the institutions' complexity and size and only for "risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same bracket as senior management" or material risk takers. Art. 94 CRD cross refers to Art 92 (2) CRD and is applicable under the same conditions as Art. 92 (2) CRD. Therefore, the EBA requirement under para 10 of the draft Guidelines that "all institutions should comply with regard to the remuneration policy for all staff with the principles set out in Art. 92 CRD" seems to overstep the provisions of the level 1 act.

Having outlined this understanding, we note that proper identification of the different categories of staff members requires both clear distinction between the various business areas of an institution and due consideration of the internal organizational workflows and responsibilities of the concerned staff. Decisive should also be how the business model of the business unit of the staff member is organized in detail. Employees who due to internal rules of procedure and organization only have limited powers or do not work in risk-entailing business divisions of the credit institution have no material impact on the risk profile within the meaning of the EBA draft Guidelines. Thus they should not be covered by the Art 92 – 95 CRD.

Finally, we further reiterate our position that there should be thresholds on individual level below which these draft Guidelines would not be applicable. The low amounts normally could not incentivize risk behaviour, while at the same time they do not endanger the financial stability and soundness of the bank. Thus, the restrictions under the CRD IV and the EBA draft Guidelines should not be applied to them.

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

Retention bonuses are used under extraordinary circumstances, such as restructuring, wind down or in change of control situations. In such cases, it is of utmost importance to motivate and retain the key staff members. To do so, it is a common market practice to grant retention bonuses in order to retain the key employees and ensure the successful implementation of the appropriate measures. The application of the very strict limitations relating to variable remuneration in these very special situations seems disproportionate and counter-productive, as the employees expect unconditional and immediate rewards. In particular the application of the strict bonus cap limits the possibility to grant market adequate retention bonuses in due time.

Furthermore, we note that it is unclear how the ex-post risk assessment shall be applied to deferred retention bonuses, when typically the retention bonuses are linked to the fact that the staff member is still employed by the institution for a pre-defined time period. Therefore, if there is a legitimate interest in awarding retention bonuses, the latter should be exempted from the application of the CRD IV rules relating to variable remuneration.

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

We note that the framework on severance payment has been significantly expanded. The increased specification under the EBA draft Guidelines might go far beyond the CRD IV, which only requires that "payments relating to early termination of a contract reflect performance achieved over time and do not reward failure or misconduct". Thus, there is no explicit requirement to apply all other CRD IV remuneration rules to voluntary severance payments.

Para 152 states that certain severance payments (*payments mandatory under national labour law, mandatory following a decision of court; settlements made for the loss of office where they are subject to a non-competition clause; severance payments under para 146*) should not be taken into account for the purpose of the calculation of the ratio between the variable and fixed components of the remuneration. With specific reference to severance payments mandatory under national law, we are of the view that they should be excluded from all the restrictions established for variable remuneration (see para 118).

Moreover, the increased specification risks the very flexibility of severance pay as an instrument. In this respect, we note that the required prior determination of a maximum amount that can be awarded as a severance pay to the categories of identified staff (para 140) places further administrative burdens on the institutions. In addition, the Guidelines should take into account that the severance payment is not always a performance-related payment. Thus, for instance, where it is a part of a settlement for potential or actual labour dispute, it would normally qualify as liability for damage, rather than remuneration. Besides, settlements could often be a material money-saving instruments for the banks.

EACB Members are of the view that the provisions on severance pay under the EBA draft Guidelines should be without prejudice to the national labour and contract law stipulations. It need to be more clearly stated in the draft Guidelines, as it is in para 266 with regard to malus and clawback arrangements.

Q 12: Are the provisions on personal hedging and circumvention appropriate and sufficiently clear?

The required spot-checking inspections made by human resources or internal control functions for compliance with the hedging prohibition would be another administrative challenge to the institutions. They would require additional human and time resources. Moreover, such inspections would also imply privacy and data security problems concerns.

Q 13: Are the requirements on remuneration policies in section 15 appropriate and sufficiently clear?

We are of the view that the non-performing loan ratio is not an effective criterion to assess the performance and risks of the control functions. In fact, there would be a lack of objectivity (consequently a possible conflict of interest) because control functions could be induced to not control properly on non – performing loans.

Q 15: Are the provisions on deferral appropriate and sufficiently clear?
Q 17: Are the requirements regarding the retention policy appropriate and sufficiently clear?

The mechanism of paying out of the variable remuneration is very complicated. EBA requires that the institutions pay the variable portion partly upfront and partly deferred and in an appropriate balance between equity, equity-linked and other eligible instruments and cash. On the top of it before paying out the deferred part of cash or the vesting of deferred instruments, they should reassess the performance and, if necessary, apply risk adjustment to align variable remuneration to additional risks that have been identified or materialized after the award. The minimum deferral periods are set at 3 to 5 years (or even higher) and the minimum deferred portion of the variable remuneration component is set at 40% to 60% and could go even above for particular high amounts. In a similar way, setting of retention periods is quite complicated and requires due consideration of the impact of the staff members and the applied deferral period.

We note that the proper implementation of this complex system would require setting-up (or at least upgrading) of technical infrastructure and involve additional human resources. The cost of the implementation and administration of the entire process is relatively similar in all institutions, regardless of the number of employees affected. Thus, smaller institutions could be excessively burdened. To be more specific, the average estimations we have from one jurisdiction suggest that the introduction of deferral framework in a single institution would require approx. 1.5 qualified staff members per year, while the post administration of a deferral system would take the efforts of approx. 0.5 qualified staff members per year. This would result in initial costs in amount of approx. EUR 90 mil. (or approx. 3.5% of the net profit of the sector after tax) and annual costs in amount of approx. EUR 30 mil. (or approx. 1.1 % of the net profit of the sector after tax) for the cooperative sector in this respective jurisdiction.

In this context, we would like to indicate that the above thresholds (for deferral and retention) do not take into consideration business models of the different institutions. For banks with limited speculative activities , where the assumed risk is significantly restricted, those thresholds would be quite burdensome, implying excessive costs. Finally, we note that applying deferral to relatively junior staff on modest salaries in institutions with risk-averse business models would undermine the rationale for variable remuneration and erode the link between performance and reward. It will be counterproductive for smaller amounts and might easily lead to removal of skills from the sector.

Q 16: Are the provisions on the award of variable remuneration in instruments appropriate and sufficiently clear? Listed institutions are asked to provide an estimate of the impact and costs that would be created due to the requirement that under Article 94(1)(l)(i) CRD only shares (and no share linked instruments) should be used in parallel, where possible, to instruments as set out in the RTS on instruments. Wherever possible the estimated impact and costs should be quantified and supported by a short explanation of the methodology applied for their estimation.

One of the further complexities of the pay out of variable remuneration is the fact that 50 % of both the upfront and the deferred payment has to paid out in instruments, where the "instrument part" has to balance between two kinds of instruments – shares and similar instruments and "other instruments" (which can be fully converted to CET1 instruments or written down and which adequately reflect the credit quality of the institution as a going concern and are appropriate to be used for the purposes of variable remuneration). While EACB members acknowledge that CRD IV provides for pay out in instruments, we see some of the rules envisaged under the draft Guidelines as not strictly in line with the mandate given by the EU legislature. The draft provisions on pay out in instruments create a very complex and burdensome mechanism. This is especially relevant if those provisions are intended to be applied to all staff members within the group that receive variable remuneration, irrespective of its amount. A number of specific concerns shall be outlined.

It has to be underlined that the obligation to create shares or share-linked instruments for remuneration purposes only, implies a burden and extraordinary costs (e.g. yearly external valuation) that would be disproportionate in the case of smaller institutions. In such institutions, the establishment of the plan its application and monitoring would be imposed on the directors, since the banks cannot simply hire additional staff. Also for this reason, the application of the rules to smaller institutions as well as on low variable remuneration has to be avoided.

Moreover, it has to be underlined that due to the specificities of the cooperative form of enterprise, a pay-out in shares would create various legal and factual problems (limitation of shares per member, limited voting rights, no transferability, redemption only to the cooperative) and severely conflict with the governance of cooperative banks. In particular, since the cooperative shares can only be redeemed to the coop, which has the unconditional right to refuse redemption, these instruments are unsuitable for remuneration purposes. Thus, the payment in shares is no option at all. Since cooperative banks are not listed, Art. 94(1)(l)(i) does not even require them do so. Equally, there are no "equivalent ownership rights". The most realistic and appropriate solution for cooperative banks would be creation of an alternative mechanism that allows allocation of indexed variable compensations, which would be paid at the end of a given retention period and the amount of which would be dependent upon the variation of a fixed economic indicator of the bank. We urge EBA to explicitly address this issue in the case of cooperative banks in the draft Guidelines. We are convinced that guidance is required particularly on this issue in order to avoid debates on the national level and to ensure a convergent application of the CRD IV.

We also note that in a number of jurisdictions award of remuneration in shares is not legally permitted. Same restrictions might be applicable to share-linked instruments which mimic the shares. The EBA draft guidelines should provide for guidance in such cases, which may particularly occur in jurisdictions outside the EU.

Secondly, the requirement that listed companies must use shares rather than share-linked instruments constitutes a considerable change of the regulatory practice. In addition, the implementation and administration of real share programs involves significantly increased resources, organizational burden (e.g. complex legal limitations and approval procedures for acquisition of own shares), money and time wise. The basic purpose of the instrument-requirement of CRD IV to put the staff into an owner-like position in order to align the staff´s interests with those of the stakeholders and to incentivize the staff to increase the institutions value can be just as well achieved when using share linked instruments which are calculated based on the share price (market price) of the listed institution. In this respect, we advocate for the maintaining the flexibility on the use of capital instruments for the payment of variable compensation.

In addition, we suggest that the EBA draft Guidelines should more clearly envisage that group-wide share-linked instruments can be used in a group context.

Finally, the requirement to pay out balance shares and other instruments will be difficult to implement what should be better reflected in the EBA draft Guidelines:

- Particularly for smaller institutions the pay-out in a second instrument would imply a significant increase of complexity and of the administrative burden. The fear of the administrative burden of the pay-out in two instruments might even be perceived by smaller institutions as a relevant obstacle for the issue ADT1 or T2 instruments. The obligation for a use of a second instrument should therefore be neutralized for smaller institutions and for lower amounts of variable remuneration. Moreover, the EBA should consider "*de minimis levels"* for the issue of ADT1 or T2.
- As for the availability of those instruments (para 250) the guidelines should explicitly state that any grandfathered instruments are not "available instruments". In quite some cooperative groups and networks certain own fund instruments, which do no more qualify as Common Equity under CRR have been "downgraded to ADT1 or T2. Many of such instruments are even "phased out" over time or even taken purchased back by the banks since they are no more attractive. By no means should such instruments, which were not issued as ADT1 or T2 be considered as available.
- We strongly support that banks which are typically not wholesale funded would be exempted from paying out in a second instrument.
- Awarding "other instruments" might also be very costly and less attractive for the staff members, since generally those instruments are designed and therefore more appropriate for institutional investors rather than for individuals. Particularly, due to regulatory restrictions normally such instruments may not be repurchased by the institution itself and the dates of first call for such instruments may not be aligned with the respective remuneration schemes.
- Another major concern is that such instruments are not very liquid and there is hardly any secondary market for the staff members to sell those instruments at the end of the retention period. Against this background, we suggest that an alternative mechanism should be considered allowing allocation of indexed variable compensations, which would be paid at the end of a given retention period and the amount of which would be dependent upon the variation of the value of a capital instrument issued by a cooperative bank (for those cooperative banks who have issued such capital instruments), other than cooperative shares. Since no payment would occur before end of a given retention period, this mechanism would avoid any adverse social and tax consequences for the concerned individuals.

Q 20: Are the requirements in Title VI appropriate and sufficiently clear?

Even if we much appreciate for transparency purposes the quantitative information on remuneration that banks must provide, we are quite concerned about the disaggregation of that information as required by para 305. For the small cooperative banks considering their mutual character and the fact that they mainly operate in limited geographical area, disaggregation data on remuneration could imply a privacy problem. In a number of small institutions there is only one senior management whose remuneration would be easily known by everyone. To avoid this, we are of the view that EBA should consider the provision of Art. 450 (2) CRR, which gives regard to the size, internal organisation and the complexity of the institutions' activities while imposing disclosure requirements.

Q 22: Institutions are welcome to provide costs estimates with regarding the costs which will be triggered for the implementation of these guidelines. When providing these estimates, institutions should not take into account costs which are encountered by the CRD IV provisions itself.

For small and non-complex institutions the costs which will be triggered by the implementation of the EBA draft Guidelines are not the only obstacle. We find quite problematic that the practical implementation of the Guidelines is general. Foreseeable consequence of such regulatory measures is most likely the termination of variable remuneration accompanied by a partly increase of fixed remuneration.

Conclusion

Considering the aforementioned remarks, EACB notes that the changes suggested by the EBA draft Guidelines will have major impact on all European banks, increasing strongly the complexity of implementation and leading to administrative burden and additional costs, without necessarily improving the risk alignment of the remuneration policies.

These new draft rules enhance an approach which is more stringent than the one taken under CRD IV. This will further extend the gap with the FSB principles applicable worldwide to all institutions and worsen the playing field for EU based institutions compared to their peers based in third countries. In this respect, we encourage the EBA to maintain a sufficient level of flexibility, which will allow an appropriate alignment of risk and reward, while ensuring level playing field within the banking sector.