KK

*Ref.:* *EBA/CP/2013/32 – EBF Ref. 004791*  
  
Brussels, 27 October 2013

***Launched in 1960, the European Banking Federation (EBF) is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of some 4,500 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU alone.***

**EBF response to EBA Consultation Paper on Draft Regulatory Technical Standards on classes of instruments that are appropriate to be used for the purposes of variable remuneration under Article 94(2) of the Capital Requirements Directive**

**General Remarks**

The European Banking Federation (EBF) welcomes the opportunity to respond to the EBA consultation on draft Regulatory Technical Standards (RTS) that set out the classes of instruments which can be used for the purposes of variable remuneration, within the framework of the Capital Requirements Directive (CRD IV).

EBF agrees with the proposal to allow other relevant capital instruments, or instruments with similar characteristics, to be used for the purposes of variable remuneration, taking into account required retention and deferral periods. European banks recognise the importance of linking the remuneration of material risk takers with investor interests, and the rationale behind the use of a portion of deferred variable remuneration of material risk takers as a bail-in solution under going concern conditions, should the capital ratios of the institution deteriorate. In fact, instruments that include mechanisms equivalent to other capital instruments, as defined by the Capital Requirements Regulation (CRR) and which are treated as relevant capital instruments under the envisaged Bank Recovery and Resolution Directive (BRRD), focus on preserving the value of the instrument in a ‘going concern’ scenario. Consequently, employees are given an incentive to avoid scenarios leading to participation in a loss event or to the resolution of these instruments in accordance with their terms and conditions.

• Nevertheless, the advantages in terms of risk alignment of remuneration, compared to the other remuneration vehicles already used by institutions are not obvious. In practice, it is unlikely that the amounts involved will be significant enough to have a material impact on the institutions’ regulatory capital ratios. An award in the form of shares or share-linked instruments or even deferred cash with a write-down (or ‘*malus*’) mechanism linked to the level of the Common Equity Tier 1 (CET1) capital ratio of the institution would be simpler to implement, more easily understandable for employees and would achieve the same risk alignment objective. It would also indirectly contribute to the reinforcement of own funds in case of write down. The objective of the CRDIV is to ensure that remuneration provides incentives for prudent and long-term focused risk taking, however, if the structure and composition of the variable remuneration package becomes too complex, it will not achieve the required objective of influencing prudent risk taking behavior.

Given the above considerations, there should be a certain level of flexibility as to the level of constraint regarding the use of such instruments for remuneration purposes. Our understanding is that both payment in shares (Art 94 (1) (l) (i) CRDIV) and payment in instruments, which can be fully converted to CET1 instruments or written down (Art 94 (1) (l) (ii) CRDIV), meet the same risk-alignment and prudential objectives. Hence, flexibility should be given to credit institutions to use either shares or instruments, or both, as long as at least 50% of the variable compensation is concerned. Overall, institutions should be able to assess the suitability of using such instruments for remuneration purposes under the control of their supervisor, taking into account all relevant considerations, including cost / benefit assessment of implementation, and not just possible legal constraints.

• When considering which instruments should be used for variable remuneration, we believe that the following points should be borne in mind:

* the draft RTS will apply to all institutions, regardless of the number of employees eligible for deferred variable compensation and the volume of such compensation;
* the draft RTS will apply to employees whose remuneration only contains a retention and deferral mechanism, but also to employees categorised as material risk takers whose compensation schemes include further claw-back mechanisms, which may be part of the terms and conditions of the instrument;
* maintenance of these instruments and inherent trigger mechanisms should be consistent with the maintenance of capital instruments governed by the CRR and the proposed BRRD. The instruments should be properly integrated into an institution’s capital structure without increasing complexity;
* ongoing maintenance of these instruments as part of the compensation process (e.g. adaptation to employment contracts, monitoring individual employee claims such as ‘*good leaver / bad leave*r’ status);
* ‘arm’s length’ pricing of these instruments requires a market for the specific instrument or equivalent instrument with similar risk profile;
* the ability to “cash out” the instrument on the settlement date after the retention / deferral period requires synchronization of the maturity of the instrument with the remuneration scheme or, if instruments have a later maturity date, sufficient market liquidity;
* to the extent that such instruments are traditionally destined for institutional investors and that there is not a mature retail market, institutions must be able to ensure the liquidity of the instruments for its employees at the end of the deferral and retention periods.
* the instruments must be awarded as much as possible under market conditions in terms of conversion / write-down / write-up, triggers and distributions mechanisms, otherwise employees will not be treated equally compared to external investors, and this could lead to litigation procedures against the employers.

A central element of the draft RTS is the interpretation of the requirement in Article 94 (1) (l) (ii) CRDIV for these instruments to “*adequately reflect the credit quality of the institution as a going concern*”. EBF does not agree that this should lead to the inclusion of additional trigger mechanisms apart from those already enshrined in the CRR and – to be enshrined – in the BRRD. In this respect, according to Articles 52 and 54 CRR, instruments with an AT1 host already contain a contractual trigger that leads to a write-down or conversion into CET1 when the CET1 ratio reaches a certain trigger level. Likewise, instruments with both AT1 and Tier 2 (T2) host are ‘relevant capital instruments’ and, hence, already subject to capital write-down at the ‘point of non-viability’, in accordance with draft Article 51 BRRD. In addition, the permanence requirement of these instruments is at least five years, in line with requirements for retention / deferral periods for instruments that could be used for variable remuneration

In particular, the ability to write down an instrument at the ‘point of non-viability’ prior to entry into resolution allows regulatory intervention even in a going concern. The reason is that the capital write-down tool is intended to keep an otherwise ‘too big to fail’ systemically important institution a going concern. The credit quality of the institution in such a scenario is then reflected in the write-down amount. For institutions that ‘may fail’ and enter liquidation, the credit quality of the institution is then reflected in the redemption value of this subordinate instrument.

• Furthermore, the consultation paper (page 12) suggests that “*institutions should be able to use instruments already issued also for the purpose of variable remuneration. The creation of specific instruments would create additional burden for institutions*”. EBF believes that this is not reflected in the requirements with respect to triggers for the instruments under consideration. To ensure transparency, it is essential that the existing capital structure is not further complicated by additional instruments that contain artificially constructed trigger levels (on T1 or total capital) that have no relevance in either the CRR or proposed BRRD regime.

The inclusion of such additional triggers would have immediate detrimental effects to the capital structure, as it would add complexity, thus, creating additional volatility in the capital management process of the institution, and would reduce transparency for investors, thus, increasing the costs of regular capital instruments. It should be mentioned that the higher trigger event for these instruments will likely compromise their placement with external investors, since the level of coupon required to attract investors under such conditions (complexity and high risk profile) would be too high – and even prohibitive – for the issuer. Concerns are also likely to arise with respect to the capital hierarchy of these instruments; material risk takers would be treated significantly worse than regular own funds investors.

The operational burden should also not be overlooked. In particular, the maintenance of these unusual triggers would require an ongoing additional procedure and infrastructure – including external disclosure, as it affects the capital structure.

• In order to meet the objective of the draft RTS, while ensuring consistency with the overall regulatory and supervisory framework under the CRR / CRD IV and the envisaged BRRD, EBF suggests the following principles:

* Instruments that qualify as own funds under the CRR, or relevant capital instruments under the BRRD, should generally be able to be utilised for the purposes of variable remuneration. Institutions should be free to use those instruments that best fit their capital structure and ongoing capital planning process.
* Given that instruments for remuneration purposes are identical to existing instruments, the ‘arm’s length test’ could be met if either a specific instrument is partially placed with external investors or the instrument is comparable to existing instruments so that the secondary market can be used as a reference for pricing (i.e. level of distributions).
* The requirements of Article 94 CRDIV with respect to retention and deferral should be met by related provisions in the compensation scheme linked to the employment contract.
* If required for senior management and / or risk takers and other relevant staff in accordance with Article 92(2) CRDIV, additional ‘*malus*’ and claw-back mechanisms will already be part of the employment contract. For this reason, there is no need for such mechanisms to be included in the instrument itself as well.
* In the case of an instrument not recognised as own funds under the CRR or as a relevant capital instrument under the proposed BRRD, contractual provisions should ensure that: (a) the capital write-down tool under draft Article 51 BRRD is applicable *pari passu* with T2; and (b) the instrument is *pari passu* with T2 with respect to its ranking in liquidation.

The above mentioned principles would allow these instruments to be integrated into the issuance and maintenance process of an institution’s capital structure, and would enable the HR maintenance process to be decoupled from the maintenance of individual instruments.

**Responses to questions**

**Q1: Is a trigger event of no less than 7% of the CET1 appropriate for AT1 instruments to ensure that the instrument reflects appropriately credit quality as a going concern?**

The requirement for the write-down or conversion of AT1 instruments in accordance with Article 52ff CRR, as well as the envisaged write-down of capital instruments at the ‘point of non-viability’ or in the context of bail-in, already reflect the credit quality as a going concern. Both mechanisms are intended to strengthen the CET1 and preserve the going concern status of the institution, in particular systemically important institutions which are “too big to fail”.

Besides, taking into account recent market practices for own funds instruments, AT1 instruments are generally subject to a lower trigger. Relatively few transactions have taken place in the market with a 7% trigger, and such trigger has been set due to specific local capital requirements in certain jurisdictions. It should be noted that, in CRR, the going concern trigger is set at 5.125%. Therefore, it may be difficult to place AT1 instruments with a high trigger event with external investors.

Moreover, AT1 issuances with a high trigger event would lead to a higher coupon due to the increased risk of bail-in. Since the provisions of the Prospectus Directive require all holders of the same financial instrument to be treated in the same way, it is likely that the only solution possible for institutions will be to issue a private placement exclusively for employees (identified material risk takers) or to use a synthetic solution.

We would suggest then to maintain the trigger at the same harmonized level of 5.125% and leave it to the discretionary power of the institution to choose a higher trigger for an AT1 instrument to be used for the purposes of variable remuneration, as long as it is consistent with the overall capital structure of the institution.

**Q2: Would it be preferable for the trigger events for different instruments to be based uniformly on a CET1 ratio?**

Taking into consideration current market practices, both AT1 and Tier 2 (T2) issuances are subject to trigger events based on a CET1 ratio. Thus, from an operational standpoint, it would be less complex to manage trigger events for the different instruments – AT1 and T2 – that would be uniformly based on a CET1 ratio. Similarly, in the case of the use of synthetic instruments or contracts between identified staff material risk takers and institutions that are linked to AT1 or T2 instruments, and which would fall under “other instruments”, it would be more appropriate for the trigger event to be based on the same prudential ratio as that of the underlying instrument to which it is linked (i.e. CET1 capital ratio). If identified material risk takers receive instruments with trigger events that have not been tested in the market, it will significantly increase complexity of implementation, in particular with respect to the valuation of such instruments.

It should be noted that the market pricing would still differ for different instruments, since there are other features than the CET1 trigger that differ between the host instruments.

**Q3: What would be an appropriate differentiation with regard to the percentages set for a trigger event based on CET1 ratios for Additional Tier 1, Tier 2 and other instruments? Should there be a unique trigger level for all classes of instruments?**

A trigger set for T2 instruments would create a new type of instruments, as that mechanism is not formally required by regulation. Therefore, a single trigger level for all classes of instruments would be more appropriate (i.e. 5.125%, as stipulated in CRR), and the banks should have the option to choose higher levels for different instruments.

Institutions will likely use synthetic instruments for remuneration purposes, as this would significantly reduce the complexity and cost of implementation (see Q.11). In the case of international banking Groups, it may not be legally feasible to issue debt instruments for remuneration purposes, hence, the synthetic solution may be the only option in some countries[[1]](#footnote-1). A Group may wish to use both actual and synthetic AT1 / T2 instruments under the same Group remuneration plan, adapting on a case-by-case basis to the legal constraints in each country, as is currently the case for equity instruments. As such, the synthetic instrument should reflect as closely as possible the characteristics of the underlying instrument that is designed to replicate. Consequently, the synthetic instrument should be subject to the same trigger event as that which would have applied if the identified risk taker had actually received the underlying AT1 or T2 capital instrument.

For instruments used for the purposes of variable remuneration and are not recognised as own funds instruments under the CRR, and, consequently, are not treated as relevant capital instruments under the proposed BRRD, the capacity for capital write-down or conversion, as required by the proposed BRRD, should be included in the terms and conditions. The relevant tool should apply at the same time as it applies to relevant capital instruments.

**Q4: Is the cap on distributions in Article 1 (2) (a) set at an appropriate level?**

In general, we consider appropriate to avoid undue compensation as a result of an unjustified level of distributions. The level of distributions of an instrument to be used for the purposes of variable remuneration should therefore be set ‘at arm’s length’, that is to say, in line with the level of distributions of an instrument with the same risk issued and traded in secondary markets. If such an instrument is consistent with (even if not identical to) instruments already included in the capital structure of the institution, distribution levels for the instrument used as variable remuneration can easily be derived from secondary levels of outstanding instruments with an equivalent risk profile.

Nevertheless, the Eurostat Harmonised Indices of Consumer Prices (HICP) for July 2013 is 1.6%, which would currently mean a cap on distributions of 7.6%. This cap is lower than the recent market references for AT1 and T2 issuances (May, August and September 2013) by major EU banks under Basel III (coupon between 8.25% and 9% for AT1 instruments, and 8.125% for T2 instruments). The lower cap, in combination with the higher trigger imposed, would make the associated risks higher.

Furthermore, instruments can be issued in different currencies, where the cap cannot be assessed suitably. A 6% cap (fixed for all host instruments) could imply that, at issuance, the instrument should be issued below par, and this could have consequences when redeeming the instrument.

Our view is that it is difficult to set a uniform cap appropriate for all issuances by all institutions. Since the issuance of such hybrid instruments is subject to prior approval from the relevant supervisory authority, it would be more appropriate for this authority to review the level of coupons envisaged for a private placement for employees and to fix a suitable cap. The RTS could alternatively fix the criteria which should be taken into consideration by supervisors when fixing the cap, which could include the Eurostat HICP and consideration of the coupons observed on the market for comparable institutions and instruments over the past 6-12 months.

**Q5: Is the definition of the cap appropriate or should another rate be used as a basis for calculating the cap?**

As above mentioned, we see no objection to using the Eurostat HICP as one of the criteria for fixing the cap, even though market practices usually refer to a spread above swap rate (which includes market anticipation) rather than to HICP. In fact, market practice for such instruments should be considered and the appropriateness of any cap should be reviewed periodically by the EBA and/or by the national supervisory authorities, in light of distributions of such instruments observed on the market.

As also above mentioned, our view is that one fixed cap is not appropriate for all banks and instruments. Pricing of instruments is based on risk, and, thus, secondary levels reflecting the specific risk profile for capital investors in these instruments should be used as a benchmark. Hence, it cannot be concluded that a 6% spread above Eurostat HICP will be suitable for all banks.

**Q6: What are the additional costs of ensuring that instruments meet the criterion in Article 1 (2) (b) (60 % issued to other investors)?**

Since there is not currently a developed market for instruments with the characteristics set out by the draft RTS (i.e. higher trigger), placement of such instruments with external investors would have a direct impact on pricing of those instruments, making the level of coupon required to attract external investors prohibitive.

More specifically:

1. If the criterion in Article 1 (2) (b) applies, this would result in an instrument that institutions would not normally issue in the market.
2. For smaller institutions, or those whose sub-debt has a lower rating, this could lead to issuance costs that would significantly exceed the costs of their normal capital instruments. In particular, the issuance amount and the features of the instrument would probably result in a very illiquid position for investors.
3. Such instruments would not be consistent with the overall capital structure of the institution. This would lead to higher risk premiums having to be paid in the market. If, by contrast, instruments used for the purposes of variable remuneration were consistent with the capital instruments used by the institution anyway, the cost for such an instrument would be in line with the cost of own funds instruments in general. As secondary prices for existing instruments could be used for ‘arm’s length pricing’ (see response to Q4), there would be no additional costs.
4. If this feature is only applicable to a small part of the T1 capital needs of the bank, then the P&L impact would not be significant, but still, it would be burdensome to place different T1 instruments with different triggers in the market. It should be noted that it is not feasible to issue instruments externally when the volume is low.

It could be estimated that issuances of AT1 instruments with high trigger events on the external market would lead to a coupon of approximately 200 to 300 basis points (bps) above those observed on the market for AT1 instruments with a low trigger. Legal constraints to allocating a portion of a public issuance to a specific group (i.e. employees) should also not be overlooked, since, in case of over-subscription, all investors of the same instrument must be equally treated.

**Q7: Are the trigger events for Tier 2 instruments based on the Tier 1 capital ratio appropriately defined and easy to apply?**

As stated above (see our General Remarks and response to Q3), we have serious reservations about the introduction of additional contractual triggers in a T2 instrument that go beyond the requirements of the CRR and/or proposed BRRD, and we would therefore favour a single trigger level (CET1 ratio) for all classes of instruments that would simplify the trigger events.

Introducing trigger events that are not observed on the market would increase complexity in the valuation of such instruments and the capital structure, reduce transparency, impose an operational burden, and render placement with external investors highly complicated. Instead, it should be ensured that employees receiving a T2-hosted instrument for variable remuneration should have to adhere to an aggregate retention and deferral period equal to an original maturity of at least five years as required for T2 instruments sub-debt. On this issue however, the regulation on variable compensation for material risk takers calls for a deferral period of three to five years.

**Q8: Are the percentages set for the trigger events appropriate?**

See our response to Q7.

If, however, a T1 trigger is chosen, the trigger event should be aligned with the CET1 trigger of 5.125%, and thus, 5.125% + 1.5% = 6.625%. A 6.625% trigger follows the same methodology as proposed by the draft RTS, but uses the harmonised 5.125% trigger stipulated by CRR for AT1 instruments.

We would also like to stress that a 50% intermediate write-down event is not market practice. Such instruments generally either have a progressive write-down clause until the minimum CET1 ratio is re-established, or a 100% write-down. Once again, alignment with market practice is preferable.

**Q9: Is the write-down and write-up mechanism for Tier 2 instruments easy to apply?**

See our response to Q7.

In addition, the draft RTS do not allow for T2 instruments with equity conversion mechanisms. It is yet not clear whether local requirements, due to Pillar 2 framework or proposed BRRD, will allow contingent capital (e.g. with T2 as host and specific loss absorption features, such as conversion to equity). If the draft RTS are implemented as they stand, these instruments should also be used for variable remuneration purposes. In this case, the write-down feature should be aligned with those instruments.

**Q10: Are there other write-down mechanisms which would be better suited for instruments used for the purpose of variable remuneration?**

See our response to Q7.

In general, a write-down mechanism in line with market practice for such instruments would be more appropriate (see our response to Q8). In this respect, ‘*malus*’ clauses applicable to variable remuneration generally provide for either 100% reduction or progressive reduction between levels of performance.

**Q11: Is it appropriate to include instruments linked to Additional Tier 1 and Tier 2 instruments in the class of other instruments?**

It should be feasible to use instruments that qualify as own funds under the CRR or relevant capital instruments under the proposed BRRD for the purposes of variable remuneration. Institutions should be free to use those instruments that best fit their capital structure and ongoing capital planning process. This possibility would significantly reduce the complexity and cost of implementation (legal, tax, accounting considerations), and the staff members could easily ‘cash-in’ their instruments at the end of the deferral and retention period.

It is our understanding that the instruments linked to AT1 and T2 instruments, as referred to in the draft RTS, are actually instruments that have either an AT1 or T2 host, which complies with the CRR requirement for own funds, but, at the same time, those instrument include additional provisions relating to retention / deferral or risk taker claw-back. With respect to ‘other instruments’ not recognised as own funds under the CRR or relevant capital instrument under the proposed BRRD, contractual provisions should ensure that:

1. the capital write-down tool under Article 51 proposed BRRD is applicable *pari passu* with T2; and
2. the instrument is *pari passu* with T2 with respect to ranking in liquidation.

Based on the above, Article 4(1)(e) draft RTS includes an additional trigger criterion that has no justification in light of the regulatory requirements and related mechanisms under the CRR or proposed BRRD. An instrument with those additional triggers only would add undue complexity to the capital structure of an institution, and would give employees less favourable treatment compared to regular capital investors in the institution.

As for the ‘cash-in’ by staff members of their instruments at the end of the deferral and retention period, from an own funds perspective and a risk alignment objective, this would be equivalent to awarding deferred cash with vesting contingent on the specific capital ratio (preferably CET1 capital ratio). Should an institution wish to issue actual AT1 or T2 instruments for variable remuneration purposes, the draft RTS do not address the issue of how the instruments could be held during the vesting period. By analogy with treatment of equity instruments, transfer of ownership to employees does not occur until the end of the vesting period. However, an institution cannot hold its own AT1 or T2 instruments or repurchase them on the market without them disqualifying as own funds instruments. Therefore, the incentive of using actual AT1 or T2 instruments is again weakened due to their ineligibility for own funds during the entire vesting period.

In relation to the above, repurchasing a sufficient volume of instruments on the secondary market for remuneration purposes could be complex because of the relatively low liquidity of such instruments. In order to avoid this problem, the institution should be able to reserve the instruments destined for employees at the time of issuance (for instance, by holding them in a trust or specific dedicated fund) without this leading to their ineligibility for own funds instruments.

**Q12: Are the requirements set for linked instruments appropriate?**

See our responses to Q2, 3, 7, 8 and 11.

In general, trigger events based on total capital ratios and intermediate write off (50%) are not in line with market practices for such instruments, therefore valuation and implementation would be complex. Moving away from market practice means that issuers will need to increasingly mandate external advisers to handle the specific constraints, and this will increase implementation costs.

**Q13: Is it appropriate to allow for conversion of other instruments?**

In principle, conversion of other instruments into CET1 instruments is appropriate to allow, even though it would be difficult to manage, since it is not otherwise provided for in the regulatory texts nor is it practiced on the market. In addition, the employer would have to set aside sufficient equity instruments in case of conversion, either by purchasing them on the market or, alternatively, by carrying out a capital increase, which adds complexity.

Apart from this, instruments to be used for variable remuneration should – either by their nature as ‘relevant capital instruments’ under the proposed BRRD or through the inclusion of equivalent contractual language – be subject to the capital write-down tool under Article 51ff of the proposed BRRD. This will ensure that these instruments are an integral part of the general recovery and resolution mechanisms that apply to institutions – in particular global systemically important banks (G-SIBs) and domestic systemically important banks (D-SIBs) – and are intended to keep the institution a going concern.

**Q14: Is it appropriate to require a permanent write-down for other instruments?**

See our response to Q13.

In general, permanent write-down is provided for in the regulatory texts. From a remuneration point of view, this is comparable to a ‘*malus*’ mechanism and therefore is appropriate if the total capital ratio falls below a suitable trigger level. It should be stressed, though, that with a permanent write-down mechanism in place, the position of employees would be worse than that of the shareholders, should the bank recover.

**Q15: Are the trigger events for other instruments appropriately defined and easy to apply?**

See our responses to the previous questions, in particular Q2, 3 and 7. Any additional trigger outside the CRR and BRRD framework for relevant capital instruments would lead to additional costs, less transparency for investors and undue complexity. Trigger events based on CET1 capital ratios would be easier to apply, in line with market practices.

Other than this, Article 4 (2) (c) of the draft RTS provides that, in the case of synthetic instruments linked to AT1 or T2 instruments, the trigger event refers to the total capital ratio of the institution which is using the instrument for the purposes of variable remuneration. In other words, a subsidiary can use instruments linked to its parent’s AT1 or T2 instruments for remuneration purposes, provided that the trigger event refers to the capital ratio of the subsidiary itself. This option seems to have been envisaged for subsidiaries of non EEA firms (recital 11). However, in the absence of specification within the text, this would mean that an EEA headquartered bank, which would otherwise run a unique global remuneration plan throughout the group, would have to differentiate the trigger event for employees on a subsidiary-by-subsidiary basis. This requirement (conversion of the variable remuneration into a given number of instruments will be based on the value of the AT1 / T2 instruments of the parent, but the trigger will be based on the total capital ratio of the subsidiary employing the material risk taker) would render operational implementation more costly and complex, and could initiate litigation procedures against the employers on grounds of unfair treatment.

**Q16: Are the percentages set for the trigger event appropriate?**

See our responses to Q7 and 8. Any additional trigger outside the CRR and BRRD framework for relevant capital instruments would lead to additional costs, less transparency for investors and undue complexity.

If, however, a capital ratio trigger is chosen, the trigger event should be aligned with the CET1 trigger of 5.125%, and thus, 5.125% + 3.5% = 8.625%. An 8.625% trigger follows the same methodology as proposed by the draft RTS, but uses the harmonised 5.125% trigger stipulated by CRR for AT1 instruments.

**Q17: Are the specified conditions appropriate? Should additional conditions be considered?**

See our responses to Q7 and 8. Any additional trigger outside the CRR and BRRD framework for relevant capital instruments would lead to additional costs, less transparency for investors and undue complexity.

In the case of EEA headquartered institutions (see our response to Q15), consideration should be given to allowing a trigger based on the consolidated CET1 ratio of the Group for all staff concerned by the Group remuneration plan, rather than having a trigger set on a subsidiary-by-subsidiary basis. This approach would also simplify the managing of material risk takers employed outside the EEA.

In the draft RTS is stated that instruments issued by other Group entities can be allowed, provided that there is a link in terms of credit quality. The interpretation of this link is cumbersome, and multiple triggers with separate legal entity triggers, in order to fulfil the link requirement, are not desired.

**Q18: Is the conversion and write-down mechanism for other instruments sufficiently clear and easy to apply?**

See our responses to previous questions regarding the absence of a regulatory framework for conversion of other instruments, and our position that any additional trigger outside the CRR and BRRD framework for relevant capital instruments would lead to additional costs, less transparency for investors and undue complexity.

**Q19: Are the above requirements regarding conversion sufficiently clear and easy to apply?**

See our responses to previous questions regarding the complexity of conversion of other instruments, and our position that any additional trigger outside the CRR and proposed BRRD framework for relevant capital instruments would lead to additional costs, less transparency for investors and undue complexity.

As far as the provisions on valuation of the instruments are concerned, they seem appropriate, since the overview of such instruments, including their valuation, is subject to review by the relevant supervisory authorities and market regulators.

**Q20: Do you agree with our analysis of the impact of the proposals in this consultation paper?**

We do not fully agree with the impact assessment. A requirement for instruments to be used for variable remuneration as defined in the draft RTS would lead to additional costs, less transparency for investors and undue complexity of the liability structure. A bank should have the right to choose only shares or share-linked instruments, as shares should be the most loss absorption capital for a bank, and any issuance of other instruments should be optional and assessed by the bank under the control of its supervisor. Before choosing an instrument, all relevant considerations should be taken into account, including cost / benefit assessment of implementation, and not just possible legal constraints

Moreover, we do not agree with the cost impact as displayed in Table 1 of the consultation paper. Based on our members’ experience with the implementation of current risk takers compensation rules and regulations, the following – higher – costs can be assumed:

1. Changing the way remuneration policies are set // One-off: medium to high;
2. Adjusting instruments used to pay variable compensation // One-off: medium;
3. Adjusting instruments used to pay variable compensation // Ongoing (new): low;
4. Ongoing effort is expected due to the higher complexity of compensation structures.

Besides, the main driver of costs is not the incremental cost of respecting the conditions of the RTS, but the requirement to implement such instruments as part of variable remuneration (namely, assessment of legal aspects which go beyond those applicable to external investors – labour law constraints, tax and social security obligations, accounting treatment in all countries concerned; operational costs including drafting of plan documentation and communication to employees, adaptation of information systems to track the valuation of the instruments over time etc.). Having the ability to issue a unique “Group” remuneration plan would limit such costs to a certain extent (see our response to Q15).

**Q21: Can you provide any evidence or data that may further inform our analysis of the likely impacts of the proposals? Is there any relevant impact of the draft RTS on other areas which the EBA has not considered?**

EBA argues that 60% of the instruments should be placed with third party investors to ensure that the instruments are issued at market conditions, unless the distribution of the instrument is capped. If the features of the instruments are not aligned with other capital instruments used for meeting other regulatory requirements, the banks are not likely to use this option (and if they do, they will only issue in small amounts), since it would be burdensome to issue these instruments to the market place. Without issuing in the market place, the distribution of the instrument should be capped, and, in case the market rate differs from the cap, this could imply accounting issues and complicated redemption concerns.

In addition, identified material risk takers may be considered as retail clients and, as such, MiFID considerations will need to be reviewed.

As for benefits, a further benefit could be added from the identified material risk takers’ perspective; AT1 and T2 instruments will most likely reduce the volatility of deferrals compared to share-linked instruments.

**Q22: Do the draft RTS lead to any impediments regarding the issuance of own funds instruments?**

See our responses to previous questions and, in particular, Q20 and 21.

In general, we do not agree with the inclusion of any additional triggers outside the CRR and proposed BRRD framework for relevant capital instruments. Against this background, own funds instruments designed in accordance with these draft RTS would most likely not be suitable as instruments for variable compensation, and their issuance with these characteristics to external investors will be problematic, since market conditions are not taken into account. In addition, as previously mentioned, consideration needs to be given as to how the instruments (other than the synthetic) can be held during the vesting period without compromising their qualification as own funds instruments.

1. For instance, FSB second progress report on implementing sound compensation practices and standards of August 2013 with respect to Russia states: “…remuneration in debt instruments is forbidden by the law”. [↑](#footnote-ref-1)