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Amsterdam, 29 January 2021
Subject **Response to the Consultation Paper on Draft Guidelines on sound remuneration policies under Directive 2lgens013/36/EU**

Dear Madam/Sir,

On 29 October 2020, the European Banking Authority (**EBA**) has launched a public Consultation Paper on Draft Guidelines on sound remuneration policies under Directive 2013/36/EU (the **Draft EBA Guidelines**).

We welcome the opportunity given by the EBA to provide you with our comments to the Draft EBA Guidelines.

Our principal comments pertain to the proposed amended wording in respect of (i) severance payments and (ii) retention bonuses. Further restrictions are unwarranted in our view, whilst the relevant paragraphs would benefit from further clarity.

We would be happy to elaborate on our responses.

On behalf of Allen & Overy LLP,

Mr. drs. J.S. (Sander) Schouten and Mr. N.J. (Naomi) Reijn

ALLEN & OVERY LLP POSITION

1. QUESTION 1: ARE THE AMENDMENTS TO THE SUBJECT MATTER, SCOPE AND DEFINITIONS APPROPRIATE AND SUFFICIENTLY CLEAR?

1.1 Background and rationale

Executive Summery and Paragraphs 3, 29 and 52 (Background and rationale)

The Executive Summary and paragraphs 3, 29 and 51 refer to "a low level of variable remuneration". We suggest not to use a qualitative term such as "low" in this respect, but refer to the quantitative thresholds that apply in the individual Members States.

1.2 Draft guidelines on sound remuneration policies

Paragraph 8 (Scope of application)

The scope of the word 'including' in the first paragraph is unclear to us. Are the subsidiaries and branches mentioned under subparagraph (a) to (e) examples of subsidiaries and branches that may fall within the scope of prudential consolidation, is it intended to broaden the scope or does it concern an exhaustive list of in-scope subsidiaries and branches? We recommend further elaboration in this respect, especially since the definition of "prudential consolidation" is deleted in the definitions list.

With respect to paragraph 8 (b), it would be helpful if the EBA could give further guidance on how to determine that an undertaking established in a third country would not be subject to specific remuneration requirements in accordance with other Union legal acts.

2. QUESTION 2: ARE THE AMENDMENTS REGARDING GENDER NEUTRAL REMUNERATION POLICIES SUFFICIENTLY CLEAR?

2.1 Draft guidelines on sound remuneration policies

Paragraphs 24 - 27

We fully support the initiatives on gender neutrality. The Draft EBA Guidelines may suggest that the remuneration policy itself should address this important topic in full and that compliance cannot be addressed in another fashion. In practice, institutions already operate separate policies on gender neutrality or general non-discrimination policies. Within the context of proportionality, we suggest that the Draft EBA Guidelines specify that the remuneration policies of institutions are allowed to refer to existing policies or measures on this matter.

3. QUESTION 3: ARE THE GUIDELINES ON THE APPLICATION OF THE REQUIREMENTS IN A GROUP CONTEXT SUFFICIENTLY CLEAR?

3.1 Draft guidelines on sound remuneration policies

Paragraph 73 - 83

Reference is made to our comments in paragraph 1.2, which are of importance given the direct link with the concept of prudential consolidation in these paragraphs.

4. QUESTION 4: ARE THE GUIDELINES REGARDING THE APPLICATION OF WAIVERS WITHIN SECTION 4 SUFFICIENTLY CLEAR?

4.1 Background and rationale

Paragraph 29 (Background and rationale)

Reference is made to our comment in paragraph 1.1.

4.2 Draft guidelines on sound remuneration policies

Paragraph 94

This Draft EBA Guideline 94 explains how to apply Article 94(2)(b) CRD, i.e. the waiver of the variable remuneration pay-out process. We understand that the following should be taken into account for the determination whether the waiver can be applied to an award in a certain performance year: (a) fixed remuneration in the preceding performance year, (b) regular variable remuneration *awarded* in the relevant performance year for the preceding performance year, (c) the full amount *awarded* in the relevant performance year for the relevant and earlier performance years, and (d) special variable remuneration *awarded* in the relevant performance year.

Accordingly it makes sense to simplify this by stating that it concerns all variable remuneration *awarded* in a performance year compared to the fixed remuneration in the preceding performance year. We kindly ask the EBA to clarify.

Furthermore, at the time of the award of regular variable remuneration, it is not always clear whether or not the long term variable remuneration as set out under (c) or the special forms of variable remuneration as set out under (d) will be awarded in the same performance year even though that may impact whether the thresholds are met with. It would be appreciated that the EBA could provide guidance on how to deal with this. Several options are available, such as (i) a correction with retroactive effect of the regular variable remuneration already awarded – which would require a repayment of cash which is not practical – or (ii) no impact on the regular variable remuneration already awarded where the rules on the variable remuneration pay-out process, i.e. payment in instruments, deferral and retention, are applied to any variable remuneration awarded above the relevant threshold. At the time of award of regular variable remuneration as regards a preceding year, it may for example not be foreseen that a retention bonus will be awarded in the same performance year.

5. QUESTION 5: IS THE SECTION 8.4 ON RETENTION BONUSES SUFFICIENTLY CLEAR?

5.1 Draft guidelines on sound remuneration policies

(a) Paragraph 142

Paragraph 142 states that institutions should not award to a staff member multiple retention bonuses under the same event or justification or under simultaneous events or justifications. This is not included in the current version of the EBA Guidelines and concerns a tightening of the rules, which may inadvertently affect the prudent application of a retention bonus.

In practice, institutions may well want to grant a retention bonus relating to the completion of a corporate event (such as a merger or IPO) and a period thereafter. For retention purposes, an institution may well want to offer a retention award in two parts with a retention period until completion of the event and with a retention period until a certain date following completion. Under the current version of the EBA Guidelines, this is not restricted. In our view, the amendments of CRD V, which do not relate to retention bonuses, do not imply a further restriction on the retention bonus regime.

We recommend that the sentence "Institutions should not award to a staff member multiple retention bonuses under the same event or justification or under simultaneous events or justifications" is therefore removed. Alternatively, the EBA could consider to (i) specify that multiple tranches of a retention bonus may be agreed that vest in case of continued employment, provided that there is only one award of the retention bonus, or (ii) include that it is allowed to grant more than one retention bonus linked to one event, provided that the aggregate amount is taken into account for purposes of the relevant bonus cap.

Paragraph 142 of the Draft EBA Guidelines furthermore states that for example, retention bonuses may be used under restructurings, in wind-down or after a change of control, including e.g. initial public offerings of shares that lead to a change of control or specific projects within an institution. It is unclear to us what is meant by "special projects". It would be helpful if the EBA could provide examples of such "special projects".

The example of an "*initial public offerings of shares that lead to a change of control*" is mentioned. We note that an initial public offering should be distinguished from a change of control, since in practice it is not uncommon that an initial public offering does not result in a change of control. It is not uncommon to award a retention bonus in case of an initial public offering. In order to avoid that the example is explained as a restriction, we suggest to delete the wording "*that lead to a change of control*".

(b) Paragraph 146

Where the current EBA Guidelines state that retention bonuses are based not on performance, but on other conditions (i.e. the circumstance that the staff member stays in the institutions for a predetermined period of time or until a certain event), paragraph 146 of the Draft EBA Guidelines states that retention bonuses are not exclusively based on performance criteria, but on other conditions. We support having clarity of being allowed to attach some performance conditions to the award. The current drafting may however imply that retention bonuses should at all times be partly based on certain performance criteria, which does not seem its intention. Therefore, we suggest to rephrase this paragraph as follows: "*retention bonuses are <u>not, or not exclusively, based</u> on performance criteria*".

6. QUESTION 6: IS THE AMENDED SECTION 9 ON SEVERANCE PAYMENTS SUFFICIENTLY CLEAR?

6.1 Draft guidelines on sound remuneration policies

(a) Paragraph 164

This new paragraph is not included in the current version of the EBA Guidelines.

It is unclear to us what hat is exactly meant by such "additional payments". We recommend that the EBA deletes this paragraph or in any case explains this further. The wording seems to comprise termination payments in case of non-extension of a management board position combined with a termination or expiry of the relevant employment agreement or services agreement should qualify as variable remuneration and count towards the bonus cap, even if such termination payment is agreed upfront or is legitimate given the circumstances at hand or even based on a predefined general formula set within the remuneration policy.

(b) Paragraph 165

First, we note that new the letter e) no longer refers to a "potential labour dispute", but only to an "actual labour dispute which could potentially lead to a court ruling". In our view, the actual reasons for and meaning and consequences of such amendments are not entirely clear. We kindly request the EBA to clarify and expand on this with practical examples.

Second, we suggest to clarify that the subparagraphs in Draft EBA Guideline 165 are examples of severance payments taking into account the more wider definition of severance payment, and not intended to be exhaustive.

(c) Paragraph 170

For severance payments exceeding the statutory minimum, the possibility granted by the current EBA Guideline 154(c), to not take these into account for the ratio and to disapply the deferral and pay-out rules for "severance payments under paragraph 149, not fulfilling the condition in point (a) of this paragraph, where the institution has demonstrated to the competent authority the reasons and the appropriateness of the amount of the severance payment" is often used in some jurisdictions in practice.

Employers were previously able to rely on this to make higher, purpose-based settlement payments to avert complex disputes before litigation is commenced without applying the pay-out rules or including the amount in bonus cap calculations. In addition, there generally is no clear obligation to get pre-clearance for such payments from the competent authorities. Rather, firms were required to justify the payment if it were to be subsequently challenged. This option is no longer available under the Draft EBA Guidelines. Accordingly, if the condition of Draft EBA Guideline sub (a) or (b) is not met, the settlement payment will count towards the bonus cap and will be subject to the deferral and pay-out rules.

This contingent and "at risk" element may make individuals less inclined to settle and may lead to more litigation as individuals seek court awards that are unrestricted - which is neither in the institutions' or the wider public's interests.

We strongly recommend the EBA to allow institutions to pay severance payments above the amount as pre-determined in accordance with sub (b) under (i) if the institution is able to demonstrate – or, if needed, demonstrated to the regulator – the reasons and appropriateness of the severance payment, *e.g.* by explaining that the payment is justified given the situation at hand due to the potential savings by avoiding court proceedings, the avoidance of other risks for the institution and that the payment cannot be seen as a mechanism to avoid the important rules on award and payment of variable remuneration.

It is important to emphasise that the CRD merely states that severance payments must reflect performance achieved over time and should not reward for failure or misconduct. This requirement is mandatory for identified staff only, institutions should merely *consider* applying the requirements to all staff. The wording of the CRD should allow companies to grant severance without such severance qualifying as variable remuneration or the need to assess this with the competent authorities, in light of settlement discussions.

Paragraph 170 mentions that severance payments may be left out of the calculation of the bonus cap in case it concerns severance payments calculated through an appropriate predefined generic formula set within the remuneration policy in the cases referred to in paragraph 165. The word "appropriate" has been added in this respect. In our opinion, in this paragraph the reference to the calculation formula being "appropriate" is, again, an excessively generic expression, therefore subject to different interpretations. Please elaborate, e.g. by giving examples, what is meant by "appropriate", as the addition of the word makes the use of the paragraph more vague.

Also, please consider that the strict use of a predefined generic formula entails the risk that it will become the new 'normal', with financial institutions being, in practice, required to pay severances calculated in accordance with such formula to staff. In this respect, we note in particular that paragraph 170(b)(i) applies the singular use of formula. In practice though, the quantum of severance amounts are related to a multiple of factors, such as the extent to which there is sufficient ground for termination, the urgency in coming to a conclusion, the necessity of an orderly leadership transition, etc. To retain some flexibility to cater to the situation at hand, in the best interest of the institution, we suggest to the EBA – on top of what we have set out above –: to clarify that (i) multiple predefined generic formulas are allowed and (ii) within such predefined generic formula, an institution may use a discretionary factor or multiple (as, in some jurisdictions, is common to reflect the particulars of a case) if the institution can continue to demonstrate the appropriateness of (which may include factors such as consistency of application) and the reasons for an increase above a neutral application of such formula.

(d) Paragraph 171

See our comment with respect to paragraph 170. We suggest to delete this paragraph. The severance payments calculated in accordance with Draft EBA Guideline 170 (b)(i) and (ii) should at no times require prior consultation of the regulator. An option to consult the regulator and to demonstrate the appropriateness of a severance above these limits could be an option as set out above.

(e) Paragraph 173(a)

See our comment with respect to paragraph 171. We suggest to delete this paragraph.

7. OTHER COMMENTS

7.1 Draft guidelines on sound remuneration policies

(a) Paragraph 12 (Date of application)

Please provide clarity on whether the Draft EBA Guidelines are intended to apply to all awards following 26 June 2021 including awards in relation to earlier performance periods or not. We would recommend to only apply the Draft EBA Guidelines to awards following June 2021 unrelated to the performance year 2020 for purposes of legal certainty.

Clarity is required as institutions will need some time to adapt their policies in respect of the changes.

(b) Paragraph 135

It is unclear to us why the reference to paragraph 182 (currently paragraph 200) has been deleted in paragraph 135 under c. In our opinion, it remains relevant that reference is made to paragraph 182/200 in order to emphasise that differences on the basis of the criteria set out in paragraph 18/200 are permissible and legit. We recommend to re-insert this reference.

(c) Paragraph 155

The new paragraph 155 states that institutions and competent authorities may **decide to** not include the amount of guaranteed variable remuneration in the calculation of the ratio between the fixed and variable components of the total remuneration for the first performance period, where the guaranteed variable remuneration is awarded when hiring new staff before the first performance period starts. We assume that "*and competent authorities*" will have to be deleted as we assume it will be left to the discretionary judgement if the institution to include it or not.