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Interpretation of the proportionality principle as set out in Article 92(2) of the Capital Requirements Directive – Remuneration policies

Dear Ms Michou

Articles 74(3) and 75(2) of the Capital Requirements Directive 2013/36/EU (CRD IV) mandate the EBA to develop guidelines on sound remuneration policies which comply with the principles set out in Articles 92 to 95 of CRD IV. According to Article 92(2) of CRD IV, *‘Competent authorities shall ensure that, when establishing and applying the total remuneration policies [...], institutions comply with the following principles in a manner and to the extent that is appropriate to their internal size, internal organisation, and the nature, scope and complexity of their services’*. On this point, recital (66) of CRD IV states that *‘The provisions of this Directive on remuneration should reflect differences between different types of institutions in a proportionate manner, taking into account their size, internal organisation and the nature, scope and complexity of their activities. In particular it would not be proportionate to require certain types of investment firms to comply with all of those principles.’*

At the last meeting of the EBA’s Board of Supervisors held on 10 and 11 December 2014, different interpretations on the application of the proportionality principle as set out in the abovementioned Article 92(2) of the CRD IV were discussed. In line with current national regulatory and supervisory practices since the application of the CRD III remuneration provisions in 2011¹, a strong majority of the members of the Board interpreted the wording of this provision, in light of the abovementioned recital, in a way that allows small and non-complex institutions to partially or fully waive certain CRD IV remuneration provisions. These members are of the view that the terms *‘in a manner and to the extent that is appropriate’* could be relied on as a ground for not applying certain requirements for small and non-complex institutions. Those are the provisions in points (l), (m) and (n) of Article 94 (1) of the CRD, namely the deferral of variable remuneration, its pay-out in instruments and implicitly the application of malus, which can only be applied if remuneration is deferred. For those, minimum quantitative thresholds are set within the CRD.

¹ In fact, the 2010 CEBS guidelines on remuneration policies allowed a ‘neutralisation’ of a limited set of requirements in small and less complex firms.

The EBA's legal view, however, is that given that the CRD IV remuneration principles themselves must be considered proportionate², in the absence of any clear provision in the enacting terms of the directive, a waiver of the application of even a limited set of remuneration principles for smaller and non-complex institutions, when their risk profile allows, would not be in line with the CRD IV. The '*manner and extent*' wording would enable institutions to take different approaches to implement the principles and to vary the intensity with which they apply them, but subject always to achieving the requirements in the principles. Where principles are more specific, such as in relation to the deferral of the payment or vesting of a portion of the variable remuneration (Article 94(1)(m) CRD IV), the '*extent*' of compliance cannot fall below the figures set out in the principle (i.e. 40% deferral over 3 years) but more complex, larger institutions need to comply to a greater extent (e.g. by deferring more than 40% over 5 years or more).

However, from a policy perspective a waiver would appear justified for small and non-complex institutions, where only low amounts of variable remuneration are paid, even when the CRD IV contains a specific minimum threshold (i.e. on deferral, payment in instruments and retention, malus). Indeed, in these cases incentives to take excessive risks are practically non-existent; the level of risk which can be assumed by single risk takers is in most cases relatively low and cannot justify the application of ex-post risk adjustments to the variable remuneration, given also the low absolute levels of bonuses. If the EBA Guidelines had to adopt a strict legal interpretation, the proportionality principle established in the CRD IV would be severely constrained in its application and a substantial number of small and non-complex institutions, with very limited recourse to variable pay, would need to face significant implementation costs. In addition, in case waivers were to be explicitly allowed within the upcoming review of the remuneration provisions provided for in Article 161 of the CRD for mid-2016, institutions would be forced to change their remuneration policies unnecessarily.

The EBA is planning to finalise and publish a consultation paper at the end of February – following the meeting of the Board of Supervisors scheduled for 23 and 24 February 2015. The purpose of this letter is ask for the support of the Commission services to establish legal certainty regarding the scope and extent of application of the aforementioned proportionality principle as set out in Article 92(2) of CRD IV. In light of our tight deadlines, I would greatly appreciate if you could provide us with a response to this letter by 6 February 2015.

Thanking you in advance for your consideration.

Yours sincerely

Andrea Enria

CC: Jeroen Hooijer, Head of Unit A3 (Company Law)

² In this regard, it is worth noting that the UK has withdrawn its challenge to Article 94(1)(g) (the so-called 'bonus cap' provision) on, *inter alia*, proportionality grounds.