

RBS response to the European Banking Authority's draft RTS on the identification of material risk takers.

Introduction:

We have contributed to the responses of a number of trade bodies and additionally set out below our responses to the consultation. We recognise the importance of ensuring consistency of approach in the identification of MRTs, but would make the following comments in respect of the RTS:

In terms of the proposals, a criteria based on remuneration levels alone will incorrectly identify certain staff as MRTs. Pay levels themselves do not equate to risk taking authority. Risk authorities are not granted on the basis of remuneration, but on the role, experience and knowledge of the individual in the role.

There are a number of roles where remuneration is above €500,000 but the individual is not in an MRT role. If the EBA believes there is a need to have a catch all remuneration threshold we believe this should be set at a higher level and the 'concessions' referred to in Article 4 should be applied to this criteria also.

Where other remuneration criteria are set (e.g. €75,000/ 75% of fixed pay or paid more than the lowest paid identified staff) it appears that staff who are deemed not to be MRTs in accordance with our internal qualitative and quantitative criteria would then need to be re-confirmed as not being MRTs. This increases the administrative requirement and cost in identifying MRTs. It would be simpler to allow staff who have not been identified under an internal quantitative/qualitative criteria to be excluded from the subsequent remuneration based criteria. This should yield the same result in terms of identifying true MRTs.

Using quantitative remuneration criteria (unless the suggestions above are incorporated) will result in a changing population of MRTs year on year simply due to individual performance or changes in foreign exchange rates where an individual is paid in a non Euro currency. Therefore these quantitative criteria will not correctly identify genuine MRTs.

Similarly, criteria based on CET1, which varies over time, will result in a change in the MRT population where the risk appetite of the firm or risk authority of an individual is unchanged. In setting our risk authorities we do not manage these on a per transaction basis but on an aggregate basis. The proposals as drafted would require us to re-align how we manage risk authorities in order to meet a remuneration related element of the directive.

In the context of our group structure we believe the relevant criteria should be assessed at group level and not at an individual entity level. This is more reflective of how the group is structured and managed, by reference to global product lines/businesses, operating via different entities, within various geographies. If entity-level application is implemented we believe that the criteria to apply at consolidated group level and at subsidiary level should be made clear so that the application is done in a proportionate way for entities below group level.

Responses to questions:

Question 1: *Is the list of specific functions listed appropriate or should additional functions be added?*

The list of specific functions in Article 3(1)(e) is already broader than in previous guidance and we believe should not be increased further. Terms 'budgeting' and 'economic analysis' need to be defined more clearly to ensure that they truly reflect MRT roles and ensure a consistency of approach between firms. Also these roles fall under a broader Finance function, which already has relevant identified staff roles, and the roles described in the RTS would be supervised by those in identified staff roles.

Question 2: *Can the above criteria be easily applied and are the levels of staff identified and the provided threshold appropriate?*

The phrase 'individually or collectively' is very broad and as written could capture some very junior staff on trading desks involved in committing to transactions. If this phrase refers to a credit committee, a 'collective' responsibility could be appropriate. However, referring to those collectively committing to transactions could capture an entire trading desk.

As written it appears the criteria is aimed to capture any individual who has the authority to approve the transaction, rather than the staff actually committing the transaction on behalf of the firm.

We believe that the criteria should capture only those senior roles authorising the risk, not those who actually commit to the exposure or approve the transaction from a counterparty credit risk perspective.

Given that we determine authority levels based on aggregable exposures there is a significant practical difficulty in adopting an approach based on a "per transaction" basis. We believe this will be an issue for a number of firms and suggest that this approach is not adopted.

We do not believe that the linkage to CET1 is appropriate, as this is a variable figure and therefore presents practical difficulties in setting authority levels and measuring adherence.

We do not believe that 0.25% of CET1 is an appropriate level at which to identify material risk takers. At that level a firm would have to lose the entire exposure 400 times over to destroy its capital. That level would not generally be considered material and is likely to capture a disproportionate number of staff, particularly if this is applied at subsidiary level against that subsidiary's CET1 – 0.25% of a subsidiary's CET1 could be a relatively small number. We suggest that the level is not specified in the RTS, but instead each regulator determines a limit appropriate for each firm. Alternatively the level should be increased to an aggregate exposure of 5% of a firm's CET1. These proposed levels are supported by the Basel Committee proposals that define a large exposure as being above 5% of an institution's CET1. Though it is in a different context it would seem contradictory for 0.25% of CET1 to be deemed material for identifying risk takers while concentrated credit exposures are not deemed material until they reach 5% of CET1.

Question 3: *Can the above criteria be easily applied and are the levels of staff identified and the provided thresholds appropriate?*

As with question 2 our view is that similar issues apply.

We do not believe that it is prudent to capture VaR in isolation, as this might encourage staff to take large, low probability risks rather than moderate risks with more predictable outcomes. It is also pertinent to note that stress measures are increasingly becoming the larger contributor to market risk capital.

Given that we determine authority levels based on aggregable exposures there is a significant practical difficulty in adopting an approach based on a "per transaction" basis. We believe this will also be an issue for a number of firms and suggest that this approach is not adopted.

We suggest that a criteria based on potential P&L outcomes, using a combination of VAR and stress measures (including SVAR and in-house stress tests) is a more appropriate measure and criteria.

Question 4 a) *Is this criterion appropriate to identify risk takers?*

Question 4 b) *Are the thresholds set in the criterion appropriate?*

We would echo the comments in our introduction that pay levels do not equate with risk taking authority.

Additionally this criteria assumes that a certain ratio of variable to fixed pay also equates to risk taking authority which is not the case in practice. This approach would initially capture staff who are paid in a way where fixed pay is relatively low (in line with market practice for their role), but variable pay exceeds the €75,000/75% threshold and who do not have a material influence over the firm's risk profile. Given the global application of this RTS this would have a disproportionate impact in certain non EU countries where in particular roles the structure of pay results in a large number of employees exceeding these amounts/ratios, but they are not risk takers (e.g. financial advisory staff). Also this criteria would potentially capture a disproportionate number of junior staff where fixed pay is lower, but a more senior individual with higher fixed pay and a lower bonus would not be identified. Whilst there is the ability to exclude employees caught by this criteria, where they are not in risk taking roles, this seems an unnecessary administrative burden which does not yield any value in identifying MRTs. A firm's own internal criteria would have identified these roles as being/not being MRT roles so to repeat the exercise in order to exclude these non MRT roles does not seem to be necessary.

We believe that the criterion should be removed as they do not assist in identifying MRT roles.

Question 4 c) *What would be the number of staff members identified in addition to all other criteria within the RTS?*

This criteria would identify another c1,000 employees, however, as these employees do not meet our internal qualitative and quantitative definition of MRT they would then be excluded. There are MRTs who fall within this definition, but they have already been identified under either our own criteria or previous criteria set out in the RTS.

Question 4 d) *What would be the additional costs of implementation for the above criterion if an institution applies Article 4 in order to exclude staff from the group of identified staff?*

The costs will depend on how the EBA expect this to be implemented. If a firm is required to examine each role identified and demonstrate again (having already deemed these roles not to be MRT roles by reference to their internal criteria) this will be a significant and costly administrative exercise.

It would seem more appropriate and simpler for firms to be able to dis-apply the criteria completely where they have been able to demonstrate to their regulator that their internal criteria adequately captures MRT roles.

Question 5 a) *Can the above criterion be easily applied?*

This will result in a changing population of MRTs year on year simply due to individual performance and consequent remuneration. There will be instances where an individual's pay has not changed year on year but they would move between being an MRT/non MRT (before any exclusion is applied) due to the pay level of other staff. Also changes in foreign exchange rates, where an individual is paid in a non Euro currency, could also result in an individual changing MRT status where their remuneration has not changed. It is difficult to justify a role being deemed a MRT in one year and not in the next (and vice versa) simply due to a change in remuneration, but with no change in their actual role. Therefore these quantitative criteria will not correctly identify genuine MRTs.

Question 5 b) *Would it be more appropriate to use remuneration which potentially could be awarded as a basis for this criterion?*

Question 5 c) *What would be the difference in implementation costs if the potentially awarded remuneration would be used as a basis?*

We do not believe it would be appropriate to use remuneration that could potentially be awarded. That would capture many staff for whom a certain level of remuneration is theoretically possible, but in practice would not be received or be expected to be received. As with question 4 this would be a significant administrative task, both to document the potential remuneration, but also the reasons for then excluding individuals as they are not in MRT roles.

Question 6: *Can the above criterion be easily applied and are the threshold and the levels of staff identified appropriate?*

As mentioned in our introduction remuneration levels are not a proxy for risk taking authority. This criteria will capture individuals not in risk taker roles purely because they exceed a pay level. Using quantitative remuneration criteria will result in a changing population of MRTs year on year simply due to individual performance whereas their role is unchanged. Also changes in foreign exchange rates where an individual is paid in a non Euro currency could result in individuals moving in and out of this category where their pay (received in local currency) has not changed.

It is not clear why the two year element is included in this criteria. This will further exacerbate the change in population year on year.

Therefore, we believe these quantitative criteria will not correctly identify genuine MRTs. If there is a desire to have a catch all criteria, we believe the threshold should be increased to reduce the chances of including non MRTs, and have an “exclusion clause” as per Article 4.

Question 7: *Can the above criteria be easily applied and are the levels of staff identified appropriate?*

Whilst we would reiterate the comments made earlier that pay levels do not denote risk taker status or authority this is a more proportionate approach than the other quantitative remuneration approaches suggested. The assumption is that this would be applied at a group level and not at each legal entity within a group and this aspect is worthy of clarification in the final RTS.

Question 8: *Are there additional criteria which should be used to identify staff having a material impact on the institutions risk profile?*

This criteria is already very broad. Whilst staff may provide advice or initiate the commitment this of itself would not mean they materially influence the risk profile. Staff who do have a material influence would have already been identified under the internal criteria and the proposals in Article 3(1) and (2).

Question 9: *Could you indicate whether all the main drivers of direct costs from the RTS have been identified in the table above? Are there any other costs or benefits missing? If yes, could you specify which ones?*

Yes the main drivers of direct costs from the RTS appear to have been identified.

Question 10: *For institutions, could you indicate which type of costs (a, b, c, d) are you more likely to incur? Could you explain what exactly drives these costs and give us an indication of their expected scale?*

Costs will be incurred for all aspects of compliance. The expectation is that the on going costs would be the greatest. Given the proposals under Article 4 this will involve significant work in identifying and then excluding non MRT roles. The scale of this cost will be largely

determined by the approach that regulators take to the implementation of this aspect of the RTS. If there is a requirement to detail at an individual level why a role was excluded under Article 4 this will create a significant amount of additional and on-going work.

Question 11: *Do you agree with our analysis of the impact of the proposals in this CP? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals?*

We believe that the impact will be greater than envisaged. In particular the work involved in identifying large numbers of staff under various criteria and then excluding them seems to be an activity which does not result in the identification of true risk takers. It does, however, increase the workload for firms and their regulators. We believe the changes outlined in our response would result in a more proportionate approach in identifying a firm's material risk takers.