EBA European Banking Authority

EBA/CP/2013/32

29 July 2013

Consultation Paper

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

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

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1. Responding to this Consultation

The European Banking Authority (EBA) invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the ‘send your comments’ button on the consultation page by 29 October 2013. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA’s rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA’s Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) N° 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

The Capital Requirements Directive (CRD) sets out requirements concerning remuneration, which apply from 1 January 2014, and mandates the EBA to prepare draft regulatory technical standards (RTS) on classes of instruments within the meaning of Article 52 or 63 of Regulation (EU) No 575/2013, or other instruments which can be fully converted to Common Equity Tier 1 (CET1) instruments or written down, that in each case adequately reflect the credit quality of the institution as a going concern and are appropriate to be used for the purposes of variable remuneration.

Main features of the draft RTS

The draft RTS set out the classes of instruments which can be used for the purposes of variable remuneration. The draft RTS introduce requirements for Additional Tier 1 (AT1), Tier 2 and other instruments to ensure that they appropriately reflect the credit quality of the institution and define for Tier 2 and other instruments the write-down and conversion mechanisms. For Additional Tier 1 instruments, the aforementioned mechanisms are defined by the Capital Requirements Regulation (CRR). Similar to share-linked instruments or equivalent instruments used by cooperative or savings banks, the classes of other instruments covered by these draft RTS include instruments which are linked to Additional Tier 1 and Tier 2 instruments.

For Additional Tier 1 instruments and Tier 2 instruments, the respective requirements of the CRR have to be complied with, while other instruments covered by these draft RTS do not count as own funds instruments and, therefore, the CRR does not contain specific requirements.

The draft RTS set out requirements to ensure that the credit quality of the institutions is reflected within the instruments and that they are appropriate for the purposes of variable remuneration. The link to credit quality as a going concern is established by introducing strict minimum trigger events for write-down and conversion of Additional Tier 1 and other instruments and the write-down of Tier 2 instruments.

In order to ensure that the classes of instruments are appropriate for the purposes of variable remuneration, the classes of instruments should provide appropriate incentives for long-term oriented and prudent risk taking of staff. Therefore, all instruments used for the purpose of variable remuneration must have a sufficient maturity to cater for deferral and retention arrangements. In addition, distributions should adequately reflect market conditions for comparable instruments. Conversion, write-down and write-up mechanisms should not create undue advantages for staff, which could be understood as a circumvention of the requirements of the CRD regarding the remuneration policies.

To ensure that the instruments used for the purpose of remuneration are issued at market conditions, the draft RTS require that either a significant portion, being not less than 60 %, of the instruments are issued publicly or privately to other investors or, if instruments are used for the sole purpose of variable remuneration, that a cap is set on the distributions paid.

In accordance with its mandate, the EBA will finalise the draft RTS at the beginning of 2014, taking into account the responses received during the public consultation and any opinion of the Banking Stakeholder Group, and submit them to the European Commission by 31 March 2014.

3. Background and rationale

The nature of RTS under EU law

The present draft RTS are produced in accordance with Article 15 of the EBA Regulation ([1]). Paragraph 4 of that same article provides that RTS shall be adopted by means of an EU Regulation or Decision.

In accordance with EU law, EU regulations are binding in their entirety and directly applicable in all Member States. This means that, on the date of their entry into force, they become part of the national law of the Member States and that their implementation into national law is not only unnecessary but also prohibited by EU law, except in so far as this is expressly required by them.

Legal basis and background

Article 94(1)(l) of Directive (EU) No 36/2013 (CRD) requires that 'a substantial portion, and in any event at least 50 %, of any variable remuneration shall consist of a balance of the following: (i) shares or equivalent ownership interests ... or share–linked instruments or equivalent non-cash instruments, in case of a non-listed company; (ii) where possible, other instruments within the meaning of Article 52 or 63 of Regulation (EU) No 575/2013 or other instruments which can be fully converted to Common Equity Tier 1 instruments or written down, that in each case adequately reflect the credit quality of the institution as a going concern and are appropriate to be used for the purposes of variable remuneration.'

Article 94(2) of Directive (EU) No 36/2013 mandates the EBA to develop 'draft regulatory technical standards with respect to specifying the classes of instruments that satisfy the conditions laid down in point (l)(ii) of paragraph 1...'

A similar requirement, but limited to Additional Tier 1 instruments, is already in place following CRD III. The EBA's predecessor, the Committee of European Banking Supervisors (CEBS), issued Guidelines on Remuneration Policies and Practices in 2010, and the EBA published an implementation review in 2012 ([2]). The EBA has taken these into account when developing the draft RTS.

The EBA has conducted an impact assessment of costs and benefits caused by the provisions contained in these draft RTS. The possibility of using Tier 2 and other instruments was introduced in

([1]) Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC.
([2]) Available on the EBA website together with the CEBS Guidelines under the following link:
http://www.eba.europa.eu/documents/10180/106961/Implementation-survey-on-CEBS--Guidelines-on-Remuneration--final-.pdf

the CRD during the legislative process, enabling institutions to use a broader scope of instruments within their remuneration framework. The EBA came to the conclusion that the additional costs caused by these draft RTS are very limited and mainly consist of one-off costs for the adjustment of remuneration policies, and minor adjustments in the terms of instruments and the prospectus, where institutions use such instruments for paying variable remuneration. The additional requirements are considered to have no impact on the ability of firms to issue capital instruments.

Regulatory approach within the RTS

The EBA took into account market practices for own funds instruments and has aimed to ensure that own funds issuances can also be used for the purpose of variable remuneration. While Additional Tier 1 and Tier 2 instruments are own funds instruments, other instruments are not.

Variable remuneration awarded in instruments should promote sound and effective risk management and should not encourage risk taking that exceeds the level of tolerated risk of the institution. Instruments should provide incentives for staff to act in the long-term interest of the institution.

The price or value of instruments awarded as variable remuneration should reflect changes in the credit quality of the firm, in particular if it deteriorates, to ensure that instruments awarded to staff participate in potential losses which have an adverse effect on credit quality as a going concern. This link provides incentives for prudent risk taking. Credit quality could be measured by different means, e.g. using a rating, spreads or own funds ratios. To ensure that a reliable measure exists for all institutions without creating costs for additional rating processes, regulatory capital ratios were chosen as an indicator for the credit quality as a going concern. Capital ratios are a strong indicator for credit quality and such ratios are audited, available and easy to apply. The use of the Common Equity Tier 1 ratio is consistent with the requirements with respect to the trigger event for Additional Tier 1 instruments. For Tier 2 instruments, a trigger based on the Tier 1 ratio, and for other instruments a trigger based on the total capital ratio is used, taking into account the different nature and seniority of such instruments and the fact that capital in firms can consist of a mixture of different instruments.

The qualification that the instrument shall reflect the credit quality of the institution as a going concern makes it necessary to introduce measures which ensure that the value of instruments is not reduced only when an institution is resolved. Therefore, the draft RTS propose trigger points at which write-off or conversion takes place which are above the regulatory minimum requirements.

Instruments must be appropriate for the purposes of variable remuneration. The CRD provisions for variable remuneration require deferral and retention periods and state, among other requirements, that variable remuneration is not paid through vehicles or methods that facilitate non-compliance with the requirements of either CRD or CRR. Consequently, the conditions instruments need to ensure are a sufficiently long maturity to account for deferral and retention periods and to be at market conditions to avoid that overly high distributions jeopardise the ability of institutions to strengthen the capital base or limits set for the variable components of remuneration. This is achieved by a cap on the distributions or the requirement to issue significant parts of an issuance publicly or privately to other investors.

4. 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

In between the text of the draft RTS that follows, further explanations on specific aspects of the proposed text are occasionally provided, which either offer examples or provide the rationale behind a provision, or set out specific questions for the consultation process. Where this is the case, this explanatory text appears in a framed text box.

COMMISSION DELEGATED REGULATION (EU) No …/..-

of [date]

supplementing Directive (EU) No 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the classes of instruments that adequately reflect the credit quality of an institution as a going concern and are appropriate to be used for the purposes of variable remuneration

THE EUROPEAN COMMISSION,
Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive (EU) No 2013/36/EU[3] of the European Parliament and of the Council of 27 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, and in particular Article 94(2) thereof,

Whereas:

(1) Variable remuneration awarded in instruments should promote sound and effective risk management and should not encourage risk-taking that exceeds the level of tolerated risk of the institution. Therefore classes of instruments which can be used for the purposes of variable remuneration should align the interests of staff with those of shareholders, creditors and other stakeholders by providing incentives for staff to act in the long term interest of the institution and not to take excessive risks. In accordance with the last subparagraph of Article 94 (1)(l) of Directive 2013/36/EU Member States or their competent authorities may place restrictions on the types and designs of those instruments or prohibit certain instruments as appropriate.

(2) In order to provide the appropriate incentives to staff, the classes of instruments specified should adequately reflect the credit quality of the institution as a going concern. To ensure that there is a strong link to the credit quality as a going concern, appropriate trigger events should be defined together with provisions reducing the value of the instruments in situations where the credit quality of the institution as a going concern has deteriorated. The trigger events used for remuneration purposes should not change the order of subordination of the instruments and therefore should not lead to a disqualification of Additional Tier 1 or Tier 2 instruments as own funds instruments.

(3) While the provisions governing Additional Tier 1 and Tier 2 instruments are included within Article 52 and 63 of the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit

[3] OJ L 176, 27.6.2013, p. 338.

institutions and investment firms and amending Regulation (EU) No 648/2012[4], other instruments are not subject to specific conditions as they are not classified as own funds instruments for prudential purposes. Specific requirements should be set for different classes of instruments to ensure that they are appropriate to be used for the purposes of variable remuneration, taking account of the different nature of the instruments. The requirements for instruments used for the purposes of variable remuneration do not alter the requirements for Additional Tier 1 and Tier 2 instruments set out in Regulation (EU) No 575/2013 and the conditions under which they would qualify or not as own funds of an institution.

(4) The classes of instruments that may be used for variable remuneration other than Additional Tier 1 and Tier 2 instruments are debt instruments or debt-linked instruments that do not qualify as own funds. To ensure that these instruments reflect the credit quality of an institution as a going concern requirements should be set to ensure that the circumstances in which such instruments are written down or converted extend beyond recovery or resolution situations.

(5) When instruments are called, redeemed, repurchased or converted, such transactions should in general not increase the value of the remuneration awarded by paying out values that are higher than the value of the instrument or by conversion into instruments which have a higher value than the instrument initially awarded. The requirements on instruments used for the purposes of variable remuneration should not be understood as an incentive to redeem the instrument.

(6) When awarding variable remuneration and when instruments used for variable remuneration are redeemed, called, repurchased or converted, those transactions should be based on values that have been established in accordance with the applicable accounting standard. This ensures that the requirements of Directive 2013/36/EU regarding remuneration cannot be circumvented, in particular as regards the ratio between variable and fixed components of remuneration and the alignment with risk taking. Therefore a valuation of the instruments should be required in all these situations.

(7) Regulation (EU) No 575/2013 sets out the write-down and conversion mechanisms for Additional Tier 1 instruments. Additionally, Directive 2013/36/EU requires that instruments used for the purposes of variable remuneration other than Additional Tier 1 and Tier 2 instruments can be fully converted into Common Equity Tier 1 instruments or written down. As the economic outcome of a conversion or write-down of other instruments is the same as for Additional Tier 1 instruments, write-down or conversion mechanisms that take into account the mechanisms that apply to Additional Tier 1 instruments should be required, while also taking into account that these instruments are not qualified as own fund instruments from a prudential perspective. Tier 2 instruments are not subject to regulatory requirements regarding write-down and conversion under Regulation (EU) No 575/2013. To ensure that the value of such instruments is reduced when the credit quality of the institution deteriorates, the situations in which a write-down of the instrument is necessary should be specified.

(8) Distributions arising from instruments can be variable or fixed and may be paid periodically or at the final maturity of an instrument. For the purposes of variable

[4] OJ L 176, 27.6.2013, p. 1.

remuneration, only instruments with distributions which are paid periodically are appropriate, as, taking account of the Guidelines on Remuneration Policies and Practices issued by the Committee of European Banking Supervisors, during deferral periods no distributions should be paid. If zero bonds were awarded, staff would benefit during the deferral period from increasing values, which can be understood as equivalent to receiving distributions. Very high distributions can reduce the long term incentive for prudent risk taking if paid out at longer intervals than annually and could circumvent the provisions of Directive 2013/36/EU regarding the ratio between variable and fixed components of remuneration. Therefore distributions should not be paid in excess of market rates. This should be ensured by requiring the use of instruments which are issued privately or publicly to other investors or of instruments linked to such instruments, or by setting a cap on distributions.

(9) Deferral and retention requirements have to be met, including in situations when instruments are called, redeemed, repurchased or converted, therefore instruments should in such situations in general be exchanged with Additional Tier 1, Tier 2 and other instruments which reflect the credit quality as a going concern, have features equivalent to those of the instrument initially awarded, and are of the same value taking into account any amounts which have been written down. Instruments other than Additional Tier 1 instruments can have a fixed maturity date. To ensure that instruments used for the purpose of variable remuneration are consistent with requirements regarding the deferral and retention periods for variable remuneration, minimum requirements should be set for the remaining maturity of such instruments when they are awarded.

(10) Directive 2013/36/EU does not limit the classes of other instruments that can be used for variable remuneration to a specific class of financial instruments. It should be possible to use synthetic instruments or contracts between staff members and institutions which are linked to Additional Tier 1 and Tier 2 instruments which can be fully converted or written down. This should allow for the introduction of specific clauses applicable only to instruments awarded to staff, without the need to impose such conditions on other investors.

(11) In a group context not all institutions issue instruments which are appropriate to be used for the purpose of variable remuneration since issuances may be managed centrally within a parent undertaking. Regulation (EU) No 575/2013 enables Additional Tier 1 and Tier 2 instruments issued through an entity within the scope of consolidation to form part of an institution’s own funds subject to certain conditions. Therefore such instruments should also be usable for the purpose of variable remuneration, provided that there is a clear link between the credit quality of the institution using these instruments for the purpose of variable remuneration and the credit quality of the issuer of the instrument, as this is assumed to be usually the case between a parent undertaking and a subsidiary. Instruments other than Additional Tier 1 and Tier 2 instruments which are not issued directly by an institution should also be capable of being used for variable remuneration, subject to equivalent conditions. Instruments which are linked to issuances by parent undertakings in third countries which are equivalent to Additional Tier 1 or Tier 2 instruments should be eligible to be used for the purposes of variable remuneration if the trigger event refers to the institution using such a synthetic instrument.

(12) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the European Commission.

(13) The EBA has conducted open public consultations on the draft regulatory technical standards, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010.

HAS ADOPTED THIS REGULATION:

Article 1

Classes of Additional Tier 1 instruments

Classes of Additional Tier 1 instruments satisfy the conditions laid down in Article 94(1)(l)(ii) of Directive 2013/36/EU if they meet each of the following conditions and the conditions in Article 7:

1. the provisions governing the instrument specify a trigger event for the purpose of Article 52(1)(n) of Regulation (EU) No 575/2013 which occurs when the Common Equity Tier 1 capital ratio of the institution referred to in point (a) of Article 92(1) of that Regulation falls below a level of no less than 7 %;

> Art 52 (1) (n) CRR: the provisions governing the instruments require, upon the occurrence of a trigger event, the principal amount of the instruments to be written down on a permanent or temporary basis or the instruments to be converted to Common Equity Tier 1 instruments, upon the occurrence of a trigger event.
>
> Art 92 (2) CRR: Institutions shall calculate their capital ratios as follows:
> (a) the Common Equity Tier 1 capital ratio is the Common Equity Tier 1 capital of the institution expressed as a percentage of the total risk exposure amount;
>
> By requiring a higher trigger event the RTS ensures that conversion or write-down are triggered under going concern conditions. A higher trigger event is not required for issuances which are not used for the purpose of variable remuneration.
>
> To consider differences within the capital composition, the draft RTS introduces trigger events for Tier 2 instruments and other instruments which are based on a Tier 1 capital and total capital ratio respectively. The EBA is reflecting on replacing the proposed triggers based on CET1, Tier 1 and total capital ratios by CET1 triggers for all classes of instruments.
>
> Q1: Is a trigger event of no less than 7 % of the CET 1 appropriate for AT1 instruments to ensure that the instrument reflects appropriately credit quality as a going concern?
> Q2: Would it be preferable for the trigger events for different instruments to be based uniformly on a CET1 ratio?
> 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?

2. one of the following requirements is met:

   (a) the instruments are issued for the sole purpose of being awarded as variable remuneration and the provisions governing the instrument ensure that any distributions are paid at a rate which is no higher than 6 percentage points above the annual average rate of change for the Union published by Eurostat in its Harmonised Indices of Consumer Prices. For a variable distribution the index available when the distribution is due shall be used. For a fixed distribution the index available when the instrument is issued shall be used;

   (b) at least 60 % of the instruments issued are publicly or privately placed, other than as variable remuneration and other than with staff members, when the instrument is awarded.

> 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. To ensure that market conditions are applied, a significant portion of an issuance shall be placed with other investors. This serves as a safeguard against possibilities to circumvent remuneration requirements set within the CRD. In addition for public issuances staff would often be able to sell those instruments after deferral and retention periods on a regulated market while this would not be possible for issuances created for the sole purpose of variable remuneration. When calculating the percentages parts of an issuance held within the scope of consolidation or by staff should not be considered to be issued to other investors, even if e.g. staff has invested in that product and not received the instrument as part of the variable remuneration.
>
> Based on recent experiences, inflation rates calculated by an EU body seem to be more objective than other alternative benchmarks. Inflation rates between Member States may differ and therefore EBA considered introducing a cap based on the national consumer price index within the member state where the instrument is awarded for the purpose of variable remuneration. As the use of instruments issued within the scope of consolidation will be permitted, the use of national harmonised indices of consumer prices would lead to inconsistencies and different treatment of staff located in different member states. Different rates may also have influence on the institution’s decisions where to issue instruments. To ensure harmonisation a European inflation rate was chosen as a basis for the calculation of the cap. Six percentage points above the average annual inflation rate for the European Union was considered to be an appropriate rate for the calculation of the cap, considering market rates paid for capital instruments and to ensure that remuneration provisions regarding the ratio between variable and fixed remuneration are not circumvented.
>
> Q 4: Is the cap on distributions in Article 1 (2) (a) set at an appropriate level?
> Q 5: Is the definition of the cap appropriate or should another rate be used as a basis for calculating the cap?
> Q 6: What are the additional costs of ensuring that instruments meet the criterion in Article 1 (2)(b) (60 % issued to other investors)?

Article 2

Classes of Tier 2 instruments

1. Classes of Tier 2 instruments satisfy the conditions laid down in Article 94(1)(l)(ii) of Directive 2013/36/EU if they meet each of the following conditions and the conditions in Articles 3 and 7:

   (a) at the time of the award the remaining maturity of the instruments equals at least the sum of the deferral and retention periods applicable to such instruments;

   (b) the provisions governing the instrument specify that when the Tier 1 capital ratio of the institution referred to in point (b) of Article 92(1) of Regulation (EU) No 575/2013 falls below a level of no less than 8.5 % the instrument shall be written down permanently or temporarily by at least 50 % of its nominal value and when the Tier 1 capital ratio of the institution falls below a level of no less than 8 % the instrument shall be fully written down permanently or temporarily;

> The trigger event for Tier 2 instruments was defined on the basis of the Tier 1 capital to take account of the fact that institutions capital compositions differs in terms of balance between CET1 and AT1 instruments which together form the Tier 1 capital. The ratio was set taking into accout the minimum Tier 1 capital requirement of 6 % with an additional buffer of 2.5 %.
>
> Q 7: Are the trigger events for Tier 2 instruments based on the Tier 1 capital ratio appropriately defined and easy to apply?
> Q 8: Are the percentages set for the trigger events appropriate?

   (c) one of the following requirements is met:

      i. the instruments are issued for the sole purpose of being awarded as variable remuneration and the provisions governing the instrument ensure that any distributions are paid at a rate which is no higher than 6 percentage points above the annual average rate of change for the Union published by Eurostat in its Harmonised Indices of Consumer Prices. For a variable distribution the index available when the distribution is due shall be used. For a fixed distribution the index available when the instrument is issued shall be used;
      ii. at least 60 % of the instruments issued are publicly or privately placed other than as variable remuneration and other than with staff members when the instrument is awarded.

Article 3
Procedures for Tier 2 instruments

1. This article specifies for the purposes of Article 2 the procedures and timing that shall apply for calculating the Tier 1 capital ratio and the amounts to be written down or written up in order for classes of Tier 2 instruments to satisfy the conditions laid down in Article 94(1)(l)(ii) of Directive 2013/36/EU.

2. The write-down of the principal amount shall apply on a pro rata basis to all holders of Tier 2 instruments that include a similar write-down mechanism and an identical trigger level.

3. Write-down shall reduce all of the following:

   (a) the claim of the holder of the instrument in the insolvency or liquidation of the institution;

   (b) the amount required to be paid in the event of the call or redemption of the instrument;

   (c) the distributions made on the instrument.

4. Write-down of the instrument shall, under the applicable accounting standard, generate items that qualify as Common Equity Tier 1 items.

5. Where an institution has established that the Tier 1 capital ratio has fallen below the level that activates write-down there shall be an irrevocable obligation to write down the respective part of the instrument and the write-down shall take place immediately.

6. For the write-down to be considered temporary, all of the following conditions shall be met:

   (a) any distributions payable after a write-down shall be based on the reduced amount of the principal;

   (b) write-ups shall be based on profits after the institution has taken a formal decision confirming the final profits;

   (c) any write-up of the instrument or payment of coupons on the reduced amount of the principal shall be operated at the full discretion of the institution subject to the constraints arising from points (d) to (f) and there shall be no obligation for the institution to operate or accelerate a write-up under specific circumstances;

   (d) a write-up shall be operated on a pro rata basis among similar Tier 2 instruments that have been subject to a write-down;

   (e) the maximum amount to be attributed to the sum of the write-up of the instrument together with the payment of coupons on the reduced amount of the principal shall be equal to the profit of the institution multiplied by the amount obtained by dividing the amount determined in point (i) by the amount determined in point (ii):

      i. the sum of the nominal amount of all Tier 2 instruments of the institution before write-down that have been subject to a write-down;

      ii. the sum of total Tier 1 and Tier 2 capital of the institution;

(f) the sum of any write-up amounts and payments of coupons on the reduced amount of the principal shall be treated as a payment that results in a reduction of Common Equity Tier 1 and shall be subject, together with other distributions on Common Equity Tier 1 instruments, to the restrictions relating to the Maximum Distributable Amount as laid down in Article 141 of Directive 2013/36/EU.

7. For the purposes of point (e) of paragraph 6, the calculation shall be made at the moment when the write-up is operated.

> The CRR does not set out specific provisions for the write-down and write-up of Tier 2 instruments. According to the regulatory framework, Tier 2 instruments are subordinated to all non-subordinated claims of creditors. This ensures that Tier 2 instruments are written down fully, before any non-subordinated creditors' claim would be written down. It is expected that the Directive on Recovery and Resolution plans will require a write-down of Tier 2 in a situation of non viability. As instruments used for the purposes of variable remuneration should reflect the credit quality as a going concern it is appropriate to introduce trigger events which lead to a permanent or temporary reduction of the value of the instrument when the total capital ratio falls below a certain threshold.
>
> However, institutions may have different levels of Additional Tier 1 capital. To ensure that write-down is triggered under going concern conditions, the trigger was defined based on the Tier 1 capital ratio, while for Additional Tier 1 capital the trigger event refers to Common Equity Tier 1 as provided by the CRR. A write-down mechanism for Tier 2 instruments seems more appropriate to provide for incentives for prudent risk taking than a conversion mechanism, also when considering the additional complexity which would result from the introduction of a conversion mechanism for Tier 2 instruments within these RTS.
>
> Q 9: Is the write-down and write-up mechanism for Tier 2 instruments easy to apply?
> Q 10: Are there other write-down mechanisms which would be better suited for instruments used for the purpose of variable remuneration?

8. The governing provisions of the instrument shall provide that the institution shall immediately inform persons who were awarded the instruments as part of their variable remuneration and who continue to hold those instruments when the institution's capital ratio falls below one of the thresholds referred to in Article 2(1)(b).

Article 4

Classes of Other instruments

1. Classes of instruments which can be fully converted to Common Equity Tier 1 instruments or written down and which are neither Additional Tier 1 instruments nor Tier 2 instruments ("Other instruments") satisfy the conditions laid down in Article 94(1)(l)(ii) of Directive 2013/36/EU if they meet each of the following conditions and the conditions in Articles 5 to 8:

> Other instruments are not defined by the CRD and are understood to be debt instruments which do not count as own funds. Other instruments should be understood in a broad sense and therefore in addition to debt instruments can also comprise synthetic instruments which are linked to Additional Tier 1 and Tier 2 instruments.

The requirements for other instruments differ from own funds instruments as no provisions need to be applied that ensure that only own funds which are paid in and not purchased by the institution or group entities are considered as own funds. Other instruments can be perpetual or can have a fixed maturity. They do not require approval from competent authorities, when called, converted, redeemed or repurchased.

As Article 94(1)(l)(i) of Directive 2013/36/EU provides for the use of share linked instruments, it seems appropriate that also the classes of other instruments can contain synthetic instruments or contracts between staff and institutions as long as they are appropriately linked to the credit quality as a going concern of the institution, are appropriate for the purpose of variable remuneration and can be fully converted or written down.

Q 11: Is it appropriate to include instruments linked to Additional Tier 1 and Tier 2 instruments in the class of other instruments?
Q 12: Are the requirements set for linked instruments appropriate?

(a) instruments shall be issued directly or through an entity included within the group consolidation pursuant to Part One, Title II, Chapter 2 of Regulation (EU) No 575/2013 provided that a change to the credit quality of the issuer of the instrument can reasonably be expected to lead to a similar change to the credit quality of the institution using the instrument for the purpose of variable remuneration;

(b) the provisions governing the instruments do not give the holder the right to accelerate the scheduled payment of distributions or principal other than in the insolvency or liquidation of the institution;

(c) at the time of the award the remaining maturity of the instruments equals at least the sum of the deferral and retention periods applicable to such instruments;

(d) the provisions governing the instruments require that, upon the occurrence of a trigger event, the principal amount of the instruments be written down on a permanent basis or that the instruments be converted to Common Equity Tier 1 instruments;

(e) the provisions governing the instrument specify that when the total capital ratio of the institution referred to in point (c) of Article 92(1) of Regulation (EU) No 575/2013 falls below a level of no less than 10,5 % the instrument shall be written down permanently by at least 50 % of its nominal value or converted into Common Equity Tier 1 instruments and when the total capital ratio of the institution falls below a level of no less than 10 % the instrument shall be fully written down permanently;

Other instruments are not own funds instruments. Once converted or written down they increase the own funds of the firm. Hence EBA proposes a permanent write-down of such instruments.

The trigger event was based on the total capital ratio as the capital structures of institutions differs. The level of the trigger event was calibrated on the basis of the minimum capital requirements with an additional buffer of 2.5 %.

Q 13: Is it appropriate to allow for conversion of other instruments?

Q 14: Is is appropriate to require a permanent write-down for other instruments? Q 15: Are the trigger events for other instruments appropriately defined and easy to apply? Q 16: Are the percentages set for the trigger event appropriate?

(f) one of the following requirements is met:

i. the instruments are issued for the sole purpose of being awarded as variable remuneration and the provisions governing the instrument ensure that any distributions are paid at a rate which is no higher than 6 percentage points above the annual average rate of change for the Union published by Eurostat in its Harmonised Indices of Consumer Prices. For a variable distribution the index available when the distribution is due shall be used. For a fixed distribution the index available when the instrument is issued shall be used;

ii. at least 60 % of the instruments issued are publicly or privately placed other than as variable remuneration and other than with staff members when the instrument is awarded.

2. Classes of Other instruments which are linked to an Additional Tier 1 and Tier 2 instrument satisfy the conditions laid down in Article 94(1)(l)(ii) of Directive 2013/36/EU if they meet the conditions in paragraphs 1(a) to (e), the conditions in Articles 5 to 7 and each of the following conditions:

(a) the instruments are linked to an Additional Tier 1 or Tier 2 instrument issued through an entity included within the group consolidation pursuant to Part One, Title II, Chapter 2 of Regulation (EU) No 575/2013;

(b) the Additional Tier 1 or Tier 2 instrument referred to in point (a) fulfils the requirements of paragraphs 1 (c) and (f);

(c) the provisions governing the instruments specify that the trigger event refers to the total capital ratio of the institution which is using the instrument for the purposes of variable remuneration;

(d) the value of the instruments and of any distributions is at all times no more than the value of the instrument to which the instruments are linked and of any distributions paid under those linked instruments;

(e) the provisions governing the instruments require that if the linked instrument is called, converted, repurchased or redeemed within the deferral or retention period the instruments will be linked to an equivalent instrument of no higher value.

3. Classes of Other instruments which are linked to an instrument which would be an Additional Tier 1 instrument or Tier 2 instrument but for the fact that it is issued by a parent undertaking of the institution which is outside the scope of consolidation pursuant to Part One, Title II, Chapter 2 of Regulation (EU) No 575/2013 satisfy the conditions laid down in Article 94(1)(l)(ii) of Directive 2013/36/EU provided that:

(a) the competent authorities have determined for the purpose of Article 127 of Directive 2013/36/EU that the institution is subject to consolidated supervision by a third-country supervisory authority which is equivalent to that governed by the principles set out in that Directive and the requirements of Part One, Title II, Chapter 2 of Regulation (EU) No 575/2013;

(b) the instruments meet the conditions in paragraphs 1(a) to (e), in paragraphs 2(a) to (e) and in Articles 5 to 7.

The provisions of Article 4 allow the use of instruments issued by an entity of a group which is not the institution itself under certain conditions, in particular the existence of a link in terms of credit quality, between the entity and the institution using the instruments for the purpose of variable remuneration. They also make clear that this category of instruments includes instruments which are linked to AT1 and Tier 2 instruments, whether the linked instruments are issued directly by the institution or by another group entity within the scope of consolidation. The provisions also provide for the situation where the linked instruments are issued by a parent undertaking in third country. Q 17: Are the specified conditions appropriate? Should additional conditions be considered?

Article 5

Write-down or conversion of Other instruments

1. Where the provisions governing Other instruments require the instruments to be converted into Common Equity Tier 1 instruments upon the occurrence of a trigger event, those provisions shall specify either of the following:

    (a) the rate of such conversion and a limit on the permitted amount of conversion;

    (b) a range within which the instruments will convert into Common Equity Tier 1 instruments.

2. Where the provisions governing the instruments require their principal amount to be written down upon the occurrence of a trigger event, the write-down shall permanently reduce all of the following:

    (a) the claim of the holder of the instrument in the insolvency or liquidation of the institution;

    (b) the amount required to be paid in the event of the call or redemption of the instrument;

    (c) the distributions made on the instrument.

3. Write-down or conversion of instruments other than Additional Tier 1 or Tier 2 instruments shall, under the applicable accounting standard, generate items that qualify as Common Equity Tier 1 items.

4. The aggregate amount of instruments that is required to be written down or converted upon the occurrence of a trigger event shall be no less than the lower of the following:
   (a) if the trigger event specified for the purpose of Article 4(1)(d) is met, the amount required to restore fully the total capital ratio as specified in the provisions governing the instrument;

   (b) the full principal amount of the instrument.

5. When a trigger event occurs institutions shall under the governing provisions of the instrument be required to do the following without delay:
   (a) inform the staff who have been awarded the instruments as variable remuneration;

   (b) write down the principal amount of the instruments, or convert the instruments into Common Equity Tier 1 instruments without delay, in accordance with the requirements laid down in this Article and in Article 6.

Q 18: Is the conversion and write-down mechanism for other instruments sufficiently clear and easy to apply?

Article 6
Procedures for Other instruments

1. This article specifies for the purposes of Article 4(1)(d) the procedures and timing that shall apply for determining that a trigger event has occurred in order for classes of Other instruments to satisfy the conditions laid down in Article 94(1)(l)(ii) of Directive 2013/36/EU.

2. Where the institution has established that the total capital ratio has fallen below the level that activates conversion or write-down the management body or any other relevant body of the institution shall without delay determine that a trigger event has occurred and there shall be an irrevocable obligation to write-down or convert the instrument.

3. The amount to be written-down or converted shall be determined as soon as possible and within a maximum period of one month from the time it is determined that the trigger event has occurred.

4. The write-down or conversion of the instrument shall take place immediately once the amount referred to in paragraph 3 has been determined.

5. The amount of the instrument to be written down or converted shall be subject to independent review. Any such review shall be completed as soon as possible and shall not create impediments for the institution to write-down or convert the Other instrument and to meet the requirements of paragraphs 2 and 3.

Article 7

Conditions for all classes of instruments

1. Instruments shall not be secured or subject to a guarantee that enhances the seniority of the claims of the holder.

> Within Article 52 and 63 of Regulation (EU) No 575/2013 [CRR] this requirement is limited to guarantees provided by group or other related entities. To ensure that they reflect the credit quality of the institution as a going concern, instruments used for the purpose of variable remuneration should not be secured or subject to a guarantee . If securities or collateral would be accepted, the variable remuneration would be linked to the credit quality of the instrument which can differ from the institutions' credit quality.

2. If the provisions governing an instrument allow conversion of the instrument, such instrument shall only be used for the purposes of variable remuneration if the rate or range of conversion is set at a level that ensures at the point of time when remuneration is awarded that the value of the instrument received when the awarded instrument is converted is not higher than the value of the awarded instrument.

3. The provisions governing instruments which are used for the sole purpose of variable remuneration shall ensure that the value of the instrument received when the awarded instrument is converted is not higher than the value of the awarded instrument at the moment of conversion.

> Instruments may be repurchased, called or redeemed by institutions, in the case of Additional Tier 1 and Tier 2 instruments subject to the approval of the competent authority. Instruments which are used for the sole purpose of variable remuneration should in general not be called within the deferral or retention period. However, if this is the case, instruments should be exchanged with other eligible instruments.
>
> If instruments where a significant portion is issued to other investors are called, repurchased or redeemed this could interfere with deferral and retention periods, e.g. if instruments are called before the deferral period has ended. Institutions should be able to exercise such call options if appropriate for Additional Tier 1 and Tier 2 instruments subject to the approval of competent authorities, but should ensure by appropriate means that deferral or retention periods are respected.
>
> Deferral and retention periods are required by the CRD provisions regarding remuneration. To ensure that they are respected institutions can exchange instruments into other eligible instruments. In cases where cash is paid as a result of a call option, institutions shall take other measures which ensure that such arrangements are respected. E.g. during the retention period amounts could be paid into a frozen account.
>
> Q19: Are the above requirements regarding conversion sufficiently clear and easy to apply?

4. The provisions governing the instrument shall provide that any distributions are paid on at least an annual basis.

5. Instruments shall be priced at their value according to the applicable accounting standard when the instrument is awarded. The valuation shall take into account the credit quality of the institution and shall be subject to independent review.

6. The provisions governing instruments issued for the sole purpose of remuneration shall ensure that a valuation is carried out in accordance with the applicable accounting standard in the event that the instrument is redeemed, called, repurchased or converted.

7. When calculating the proportions referred to in Article 1(2)(b), Article 2(1)(c)(ii) or Article 4(1)(f)(ii), instruments held by the following shall not be taken into account:

   (a) the institution or its subsidiaries;

   (b) the parent undertaking of the institution or its subsidiaries;

   (c) the parent financial holding company or its subsidiaries;

   (d) the mixed activity holding company or its subsidiaries;

   (e) the mixed financial holding company and its subsidiaries;

   (f) any undertaking that has close links with entities referred to in points (a) to (e).

Article 8

This Regulation shall enter into force 20 days after publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

[For the Commission
The President]

[For the Commission
On behalf of the President]

[Position]

5. Accompanying documents

5.1 Draft cost–benefit analysis/impact assessment

1. Article 10(1) of the EBA regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council) provides that any draft regulatory technical standards developed by the EBA – when submitted to the EU Commission for adoption – shall be accompanied by an impact assessment (IA) which analyses 'the potential related costs and benefits'. The IA should provide the reader with an overview of the findings as regards the identification of the problem, and the options identified to remedy the problem and their potential impacts.

2. This note outlines the IA regarding the draft RTS on classes of other instruments within the meaning of Article 52 or 63 of Regulation (EU) No 575/2013, or other instruments which can be fully converted to Common Equity Tier 1 instruments or written down, that in each case adequately reflect the credit quality of the institution as a going concern and are appropriate to be used for the purpose of variable remuneration. The development of the draft RTS stems from the requirement in Article 94(2) of [Directive 2013/36/EU] of the European Parliament and of the Council on access to the activity of credit institutions and prudential supervision of credit institutions and investment firms (CRDIV).

5.1.1 Problem definition

Issues addressed by the European Commission (EC) regarding staff whose professional activities have a material impact on the institution's risk profile

3. In the impact assessment accompanying its proposal for CRD III, the Commission noted that in some cases, because of short-term oriented remuneration structures or herding behaviour, institutions did not react appropriately to changing economic conditions. In many institutions, remuneration policies entailed disproportionate rewards on the upside and insufficient penalties on the downside; in particular, risk adjustments and deferral arrangements were missing.

4. In order to address the harmful effects of poorly designed remuneration structures, CRD III included requirements for credit institutions and investment firms to establish and maintain, for those categories of staff whose professional activities have a material impact on the institution's risk profile, remuneration policies and practices that are consistent with effective risk management. These requirements aimed to create more incentives for staff members to behave prudently, by making short-term risk taking less attractive and ensuring that their personal objectives were aligned with the long-term interests of the institution. They were complemented at a later stage by CEBS Guidelines on Remuneration Policies and Practices ([5]).

5. After the implementation of CRD III, most institutions paid variable remuneration partly in cash and partly either in shares, share-linked or equivalent instruments. So-called hybrid instruments were not used because of stringent regulatory requirements and the need to increase the Common

([5]) http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Remuneration/Guidelines.pdf

Equity Tier 1 capital first. A survey published in 2012 by the EBA ([6]) found that no Additional Tier 1 instruments had yet been used to grant variable remuneration to persons who have a material impact on the institution's risk profile.

6. To encourage the payment of variable remuneration in instruments, CRD IV contains stricter rules regarding the structure of remuneration for identified staff. For instance, Article [94(1)(l)] CRD IV requires that '*a substantial portion, and in any event at least 50 %, of any variable remuneration shall consist of a balance of the following: (i) shares or equivalent ownership interests ... or share–linked instruments or equivalent non-cash instruments, in case of a non-listed company; (ii) where possible, other instruments within the meaning of Article 52 or 63 of Regulation (EU) No 575/2013 or other instruments which can be fully converted to Common Equity Tier 1 instruments or written down, that in each case adequately reflect the credit quality of the institution as a going concern and are appropriate to be used for the purposes of variable remuneration.*'

Issues addressed by the RTS and objectives

7. Until now, the use of Additional Tier 1 instruments and the setting of specific requirements were left to the national competent authorities, based on the CEBS Guidelines on Remuneration Policies and Practices and the provisions contained in CRD III. CRD IV has broadened the scope of eligible instruments, which now also encompasses Tier 2 and other instruments which can be fully converted into Common Equity Tier 1 instruments or written down. Once adopted by the European Commission, the proposed draft RTS will supplement at a technical level the provisions of CRD IV.

8. Following the mandate provided within Article 94(2) of the CRD, classes of eligible instruments will now be defined within this regulatory technical standard to ensure a harmonised application of the respective level 1 requirements within the European Union. In accordance with the mandate, the EBA has to propose requirements which aim:
   - to ensure that instruments awarded as variable remuneration adequately reflect the credit quality of the institution as a going concern;
   - to ensure that instruments are appropriate for the purpose of variable remuneration by providing incentives for long-term orientated and prudent risk taking; and
   - to set out additional requirements for 'other' instruments, including the situations in which they would be converted or written down, as unlike Additional Tier 1 and Tier 2 instruments, the CRR does not contain specific requirements for other instruments.

9. Instruments should reflect appropriately the credit quality of the institution. Changes in the credit quality should lead to changes in the value of the instrument. A strong link to the credit quality ensures also that the remuneration paid in such instruments is aligned to risks, and staff members receiving such instruments have an incentive to act in the long-term interest of the institution. For this reason, instruments must be compatible with deferral and retention requirements. Instruments should not provide for any mechanisms which may circumvent the remuneration requirements set out by the CRD and, in particular, the cap on the ratio between variable and fixed components of total remuneration.

([6]) Available on the EBA website together with the CEBS Guidelines on Remuneration Policies and Practices.

10. The EBA has proposed in an earlier consultation paper (CP on draft RTS on Own Funds[7]) additional technical requirements for Additional Tier 1 and Tier 2 instruments. All Additional Tier 1 and Tier 2 instruments used for paying variable remuneration to identified staff need to be compliant with all requirements contained in the CRR and CRD and all requirements contained within the RTS once they are adopted.

5.1.2 Technical options proposed

11. This section explains the rationale behind some of the choices that the EBA has made when designing the RTS proposals. In these RTS, the EBA has defined which additional requirements Additional Tier 1, Tier 2 and other instruments should meet to be eligible for being used for the purposes of variable remuneration. For other instruments not falling within the Additional Tier 1 or Tier 2 categories, no specific regulatory definition exists, so the proposed draft RTS set out the respective minimum requirements for such debt instruments, including on the conversion and write-down feature required for these instruments.

Common requirements for all three types of instruments

12. ***Issuance* –** Instruments should be issued on arm's length conditions and distributions paid should not lead to a circumvention of remuneration requirements. This can be ensured either by requiring the use of instruments where a significant portion (e.g. 60 %) has been privately or publicly placed or by introducing a cap for the distributions. Another option would be to require that instruments are issued only at market conditions.

    - When an instrument is privately or publicly placed, institutions will need to monitor the amount of instruments owned by staff and by other persons to ensure that 60 % of the instruments used for paying variable remuneration is held by third parties other than staff. The amounts held by the institution, within the group or by staff should not be accounted for in this calculation, to ensure that a significant portion of an issuance is placed. The amounts used for variable remuneration will need to be accounted. When the larger part of an issuance is placed with other investors, it can be assumed that this will be done at market conditions and that there will also not be any material conflicts of interest at a later stage, when instruments are called, converted, redeemed or repurchased. In addition, the valuation of such instruments is easier, as market rates would be available for most of such issuances.

    - When a cap is placed on distributions, the cap should be set on the basis of the average annual inflation rate within the Union plus a spread of 600 basis points, considering observed market conditions for contingent capital issuances. Taking into account the fact that issuances can be used within the scope of consolidation, it is appropriate to use an annual EU inflation rate as a basis. Inflation rates are measured by a European agency and provide an objective basis for the calculation of a cap. This also takes into account concerns about the objectivity of market rates, which could otherwise be used.

    - The option of requiring the issuance of instruments only at market conditions was considered to be not sufficiently effective and would also be difficult to supervise. Issuances used for the

([7]) The consultation paper on RTS on Own Funds is available on the EBA website.

sole purpose of variable remuneration would need to be scrutinised by competent authorities if a cap for distributions paid did not exist. Market conditions differ between institutions and the burden of assessing the appropriateness would lead to additional costs for institutions and competent authorities.

13. ***Issuance in a group –*** In a group context, not all institutions issue instruments which are appropriate to be used for the purpose of variable remuneration. Additional Tier 1 and Tier 2 instruments when the instrument is issued through an entity within the scope of consolidation pursuant to chapter 2 of Title II of Part One of the Capital Requirements Regulation and the proceeds are immediately available to the institution without limitation and in a form that satisfies the conditions or Article 53 or 63 of Regulation (EU) No 575/2013 [CRR] count as own funds instruments for this institution according to Article 52 (1) (p). Therefore such instruments should also be usable for the purpose of variable remuneration provided that there is a clear link between the credit quality of the institution using these instruments for the purpose of variable remuneration and the credit quality of the issuer of the instruments. For other instruments this should apply analogously. The link to the credit quality of the institution would be stronger if it were required to use only issuances of the institution. However, if issuances needed to be made by each institution using instruments, the costs of issuing the instruments for the purpose of remuneration, including the costs of the prospectus, would be significant. In addition, the issuances would have a smaller nominal amount, which could impede their placement with institutional investors.

14. ***Issuance by third-country institutions –*** Issuances by institutions seated in third countries are not covered in the aforementioned scope of consolidation. However, instruments used by institutions for the purpose of variable remuneration could be linked to instruments issued by the parent institution in a third country if those instruments are equivalent to Additional Tier 1 and Tier 2 instruments beside the fact that they are issued by the parent institution in a third country and if the trigger event defined refers to the institution within the EU. This option was added in the draft RTS, considering that some groups manage issuances of capital instruments centrally at the level of the parent institution. This possibility, combined with the trigger event set at the EU institution level, ensures that issuances within the group can be used, while the link to the credit quality of the institution awarding remuneration in such instruments is ensured. Allowing the use of instruments linked to other instruments which are not equivalent to Additional Tier 1 and Tier 2 instruments was considered, but not included in the draft RTS, as subsidiaries of non-EU parent institutions can create other instruments for the sole purpose of variable remuneration themselves. As such instruments would not be issued publicly, the EBA considered that the additional burden of issuing such instruments, compared with the costs for the creation of another instrument at the parent institution level and the creation of a linked instrument at the subsidiary level, if any, would be very low.

15. ***Maturity –*** While Additional Tier 1 instruments are perpetual, Tier 2 and other instruments can have a fixed maturity. To be suitable for the purposes of variable remuneration, the remaining maturity needs to allow for deferral and retention periods.

16. ***Triggers –*** The objective of these RTS is to ensure that the value of the instruments awarded as variable remuneration is effectively aligned with the risk profile of the institutions. The draft RTS

introduce specific minimum trigger events for the write-down or conversion of Additional Tier 1 and other instruments and requires a write-down mechanism for Tier 2 instruments. The EBA set the trigger events above the minimum capital requirements to ensure that they reflect the credit quality as a going concern. The triggers proposed reflect the different quality of Common Equity Tier 1, Additional Tier 1 and Tier 2 capital instruments and take into account that the composition of the own funds of institutions differs. Therefore, the trigger event for Additional Tier 1 instruments is set on the basis of Common Equity Tier 1 capital, for Tier 2 instruments is set on the basis of the Tier 1 capital and for other instruments is set on the basis of the own funds requirements. As the minimum own funds requirements do not establish trigger events on a going concern basis, an additional buffer has been added to the minimum requirements and the trigger events have been set at 7 % of the CET1 capital ratio, 8.5 % of the Tier 1 capital ratio and 10.5 % of the total capital ratio respectively. Choosing a uniform trigger event seemed not to sufficiently take account of the differences in the capital structure of firms and the different levels of seniority of such instruments.

17. **Conversion, redemption, call and repurchase of instruments –** The value of instruments changes over time and instruments could be converted, redeemed, called or repurchased. To ensure that such transactions in instruments which have been awarded as variable remuneration are done at fair values, a valuation of instruments in such situations is required. This also ensures that there cannot be undue gains for staff which could lead to a circumvention of the remuneration requirements. A valuation is also needed when instruments are awarded, to ensure that they equal the value of the awarded remuneration.

18. ***Guarantees* –** To ensure that instruments reflect the credit quality of the institution, the EBA proposes that they should not be subject to any guarantees or other measures which enhance the seniority of the claim, as this would weaken the link to the credit quality of the institution. This requirement is stricter than the requirements set out by Articles 52 and 63 of CRR regarding Additional Tier 1 and Tier 2 instruments. For the purposes of own funds, instruments which are guaranteed by parties outside the scope of connected entities are allowed. However, as explained above, stricter requirements need to be complied with, if such instruments are also used for variable remuneration. This should not hinder the issuance of such instruments, as institutions can, and regularly do, issue instruments where no guarantees are provided, and only instruments used for the purpose of variable remuneration need to fulfil this additional requirement.

Requirements for other instruments

19. Some flexibility has been granted to institutions with regard to paying variable remuneration using other types of instruments. The aim was to allow institutions to use instruments which are linked to the risk profile of the institutions while other instruments do not need to comply with the additional requirements for Additional Tier 1 and Tier 2 instruments and do not affect directly the own funds that institutions hold. To that end, institutions are allowed to use debt instruments or synthetic instruments linked to Additional Tier 1 or Tier 2 instruments. The use of synthetic instruments will ensure that institutions can add additional specific clauses for staff with respect to the deferral and retention arrangements or call options included in the provisions governing the instrument to which such instruments are linked without violating requirements of the prospectus directive, which ensure that all investors are treated in the same way. This will also ensure that measures to increase own funds are not hindered by requirements for variable remuneration.

20. ***Payment and distribution* –** Other instruments should not give the holder the right to accelerate the future scheduled payment of distributions or principal other than in the insolvency or liquidation of the institution. This is to ensure that deferral and retention arrangements are respected. This requirement is already part of the regulatory requirements for Additional Tier 1 and Tier 2 instruments and, therefore, needed to be included only for other instruments.

21. The CEBS Guidelines on Remuneration Policies and Practices set out that during deferral periods no distributions should be paid. Therefore, instruments should have at least annual distributions. This ensures that during deferral periods no distributions would be paid, while for retention periods staff would be able to receive distributions. If zero bonds were allowed for paying variable remuneration, the value would increase over time, which is equivalent to receiving distributions. Therefore institutions are required to use instruments which pay distributions out at least annually.

22. ***Write-down and conversion* –** The draft RTS introduce a permanent write-down and conversion mechanism for other instruments and a permanent or temporary write-down mechanism for Tier 2 instruments, which are closely linked to the applicable mechanisms for Additional Tier 1 instruments. This is to avoid institutions having to develop separate processes. Other instruments are not own funds mechanisms, so the processes for write-down or conversion do not need to ensure that institutions' own funds figures are appropriately calculated. For this reason, the processes have been simplified.

23. The CRD requires for other instruments that they can be converted into CET1 instruments or fully written down. The conversion mechanism established ensures that, in general, conversion does not lead to an increase of the variable remuneration. A permanent write-down mechanism was provided for to ensure that, when the trigger event is established, CET1 capital is generated. A write-up at a later stage would weaken the capital base of the institution, as other instruments are not own funds instruments.

24. The CRD does not establish a conversion mechanism for Tier 2 instruments and, therefore, the EBA refrained from doing so within these RTS, also to avoid an overly complex regulation for this type of instruments. For Tier 2 instruments, the write-down could be temporary. This is appropriate, as after a write-up, the total capital of the firm would stay the same as before the write-up, but the capital composition would differ. The write-up mechanism was aligned with the write-up mechanism for Additional Tier 1 instruments.

Proportionality

25. Under Article 94(1)(l)(ii), institutions should if possible use Additional Tier 1, Tier 2 or other instruments for the purposes of variable remuneration which meet the requirements of these draft RTS. Smaller institutions are less likely to issue Additional Tier 1 and Tier 2 instruments, and therefore, for those institutions (which include many cooperative banks and savings banks), the EBA has tried to facilitate the use of other instruments.

26. The category of other instruments has been interpreted in a broad sense. The draft RTS allows for the use of linked or synthetic instruments which can be linked to Additional Tier 1 and Tier 2

instruments issued by the institution, if the requirements set out in the draft RTS are met. The class of other instruments allows also for issuances in the form of contracts between institution and staff. Such instruments would not need to have a prospectus and would not be issued to other investors, which should reduce compliance costs. This should also allow smaller and less complex banks to create linked, synthetic instruments or individual issuances under the class of other instruments.

5.1.3 Impact of the proposals

Costs

27. The implementation of these draft RTS will lead to incremental compliance costs for firms. There will be two main drivers of costs:

- Institutions need to ensure that the provisions governing the instruments to be used for the purposes of variable remuneration meet the requirements. This may increase the costs for issuing instruments which should be used for paying variable remuneration.

- Institutions need to ensure that the required write-off or conversion is applied where necessary and need to value the instruments when awarded, called, redeemed, converted or repurchased. This may possibly increase the administrative costs for variable remuneration awarded in such instruments. However, similar processes need to be applied if remuneration is awarded in shares or other equity instruments.

28. These draft RTS only specify classes of instruments within the meaning of Article 52 or 63 [CRR] and other instruments that adequately reflect the credit quality of the institution and are appropriate to be used for the purposes of variable remuneration. Beyond this specific aspect, they do not set additional requirements for the variable part of remuneration. The requirements as such are set by the CRD; the draft RTS complement such requirements by adding the necessary technical standards. Therefore, the impact assessment is limited to this specific aspect. The requirement to use such instruments if possible is contained in the CRD and is therefore also not assessed. Consequently, the incremental costs directly imputable to this RTS should be limited.

29. So far, competent authorities have not observed the use of Additional Tier 1 instruments for paying variable remuneration. Therefore, the draft RTS will only have an impact on the costs when institutions start to use Additional Tier 1, Tier 2 or other instruments as part of their remuneration policies as required by the CRD. For this reason, no grandfathering arrangements for already awarded instruments need to be considered, and no additional costs for the transformation of awarded instruments are triggered by the RTS, as no such instruments were used for the award of variable remuneration.

Table 1 – Summary of the costs of the RTS for institutions

Costs	One-off	Ongoing
Changing the way remuneration policies are set, systems and controls	a. Cost of additional staff time to review and align remuneration policies in addition to the review caused by other regulatory changes. This is likely to be small, as it affects only a limited number of aspects within the remuneration policy and is relevant only when institutions start to use such instruments for paying variable remuneration as required by CRD.	b. None

Adjusting instruments used to pay variable remuneration	c1. Cost of ensuring that instruments comply with these RTS in addition to requirements set by the CRD or the RTS on own funds. This is likely to be small, as the RTS allows for a broad range of instruments and the requirements are mainly based on concepts already introduced by the CRR for Additional Tier 1 instruments. c2.Costs for the prospectus and introduction of instruments. Most instruments would be introduced to trading on the market anyway; additional costs should therefore be low. In addition, instruments can be created that do not need to be introduced to a regulated market.	d. None
Monitoring of the 60 % condition	e. Implementation of reports to collect the necessary information before remuneration is awarded. This cost is likely to be small, as the underlying information is available in the accounting and reporting systems.	f. Annual calculation of the amounts held by other persons, when the instrument is used for awarding variable remuneration. This cost is likely to be small, as the calculation will require information that should be readily available.
Prudent valuation of instruments	g. Valuation methodologies should be in place, hence no additional cost should arise.	h. Valuation of instruments would need to be done potentially more frequently (annually for instruments that are awarded and when call options etc. are exercised), but, as this is a standardised procedure, the costs would be low.

30. The implementation of these RTS may also have additional resource implications for national supervisory authorities. However, they should be somewhat limited, as the own funds of institutions are in any event subject to regular supervisory review and the scope of the additional review is limited to the scope of these draft RTS.

Benefits

31. By establishing harmonised classes of eligible Additional Tier 1, Tier 2 and other instruments for paying variable remuneration, the RTS will ensure that institutions in different Member States use the same practices and ensure that the benefits of better aligning remuneration to risk, sought by the CRD, are met. This will also increase the legal certainty of institutions developing such instruments. This may, in turn, also reduce the costs for institutions which use such instruments in a group context in different Member States of the European Union.

Q 20: Do you agree with our analysis of the impact of the proposals in this consultation paper?

Q 21: 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?

Q 22: Do the draft RTS lead to any impediments regarding the issuance of own funds instruments?

5.2 Overview of questions for consultation

Additional Tier 1 instruments

Q1: Is a trigger event of no less than 7 % of the CET 1 appropriate for AT1 instruments to ensure that the instrument reflects appropriately credit quality as a going concern?
Q2: Would it be preferable for the trigger events for different instruments to be based uniformly on a CET1 ratio?
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?
Q 4: Is the cap on distributions in Article 1 (2) (a) set at an appropriate level?
Q 5: Is the definition of the cap appropriate or should another rate be used as a basis for calculating the cap?
Q 6: What are the additional costs of ensuring that instruments meet the criterion in Article 1 (2)(b) (60 % issued to other investors)?

Tier 2 instruments

Q 7: Are the trigger events for Tier 2 instruments based on the Tier 1 capital ratio appropriately defined and easy to apply?
Q 8: Are the percentages set for the trigger events appropriate?
Q 9: Is the write-down and write-up mechanism for Tier 2 instruments easy to apply?
Q 10: Are there other write-down mechanisms which would be better suited for instruments used for the purpose of variable remuneration?

Other instruments

Q 11: Is it appropriate to include instruments linked to Additional Tier 1 and Tier 2 instruments in the class of other instruments?
Q 12: Are the requirements set for linked instruments appropriate?
Q 13: Is it appropriate to allow for conversion of other instruments?
Q 14: Is is appropriate to require a permanent write-down for other instruments?
Q 15: Are the trigger events for other instruments appropriately defined and easy to apply?
Q 16: Are the percentages set for the trigger event appropriate?
Q 17: Are the specified conditions appropriate? Should additional conditions be considered?
Q 18: Is the conversion and write-down mechanism for other instruments sufficiently clear and easy to apply?
Q19: Are the above requirements regarding conversion sufficiently clear and easy to apply?

Impact assessment

Q 20: Do you agree with our analysis of the impact of the proposals in this consultation paper?
Q 21: 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?
Q 22: Do the draft RTS lead to any impediments regarding the issuance of own funds instruments?

5.3 Views of the Banking Stakeholder Group (BSG)

The Banking Stakeholder Group was notified about the publication of the consultation paper and asked to provide its opinion by the end of the consultation period.