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Re: EBA Consultation Paper on Draft Guidelines on sound remuneration policies under Article 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013

The comments in the present documents are greatly based on a long-standing and thorough research conducted by the author with Professor Guido Ferrarini (University of Genoa) on executive remuneration in Europe and international principles for sound compensation practices at financial institutions, as well as on own practical experience in this area.

The following is a list of relevant selected references in this regard:

- Guido Ferrarini, "CRD IV and the Mandatory Structure of Bankers' Pay", ECGI Law Working Paper No. 289/2015, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2593757.
- Guido Ferrarini and Maria Cristina Ungureanu, "Executive Remuneration. A Comparative Overview", in Jeffrey Gordon and Georg Ringe (eds), *Oxford Handbook of Corporate Law and Governance* (forthcoming), also published as ECGI Law Working Paper, No. 268/2014.
- Roberto Barontini, Stefano Bozzi, Guido Ferrarini and Maria Cristina Ungureanu, "Directors' Remuneration before and after the Crisis: Measuring the Impact of Reforms in Europe", in Massimo Belcredi and Guido Ferrarini (eds), *Boards and Shareholders in European Listed Companies* (Cambridge 2013), 251 - 314.
- Guido Ferrarini and Maria Cristina Ungureanu, "Economics, Politics, and the International Principles for Sound Compensation Practices: An Analysis of Executive Pay at European Banks", *Vanderbilt Law Review*, 2011, 64, 431- 502.
- Guido Ferrarini and Maria Cristina Ungureanu, "Executive Pay at Ailing Banks and Beyond: a European Perspective", *Capital Markets Law Journal*, 2010, 5, 197–217.

European Commission and European Banking Authority initiatives in addressing the issue of bankers' remuneration is received with much interest and appreciation, as the matter has for long raised important concerns at the frontier between corporate governance and banking regulation.

Following are comments addressing specifically some of the questions EBA has raised for the purpose of the present Guidelines consultation. The questions not addressed herein are viewed by the author as non-problematic.

Q 1: Are the definitions provided sufficiently clear; are additional definitions needed?

Below comments and suggestions for improving the definitions as to the following terms. It is stated that: 'Variable remuneration' is all remuneration which is not fixed.

- The term should be extended, as to compensation that is linked to certain parameters pre-established by the institution.

It is stated that: 'Identified staff' are staff whose professional activities have a material impact on the institutions risk profile.

- 'Identified staff' definition should specify that the category is determined by each institution based on own internal assessment.

It is stated that: 'Upfront payments' are payments which are made immediately after the accrual period and which are not deferred.

- The definition may be confusing relative to the term 'accrual period' previously defined, as the accrual period can also be relative to the deferred period. Therefore, instead, upfront payments should refer to the payments made after the end of the first performance period, e.g. annual cash incentives.

It is stated that: The 'deferral period' is the period after the award of the variable remuneration and before the vesting of the variable remuneration during which staff is not the legal owner of the remuneration awarded.

- The term "awarded" in the definition can raise confusion and may be substituted with "granted". Also, the definition should make it clear that deferral period is not necessarily applicable to all variable remuneration.

It is stated that: 'Malus' is an arrangement that permits the institution to prevent the vesting of all or part of deferred variable remuneration based on ex-post risk adjustments.

- The definition should underline that the action of prevention considers a performance assessment based on the pre-determined performance parameters.

It is stated that: 'Clawback' is an arrangement under which the staff member has to return ownership of an amount of variable remuneration paid in the past or which has already vested to the institution under certain conditions.

- The definition should underline that the action of returning remuneration will be actioned in case of certain individual misconducts.

It is stated that: 'Shareholders' includes, depending on the legal form of an institution, other owners or members of the institution.

- The definition is ambiguous and needs to be explained in more detail.

- Missing definition of term that is of relevance: "Short-term variable compensation".

Q 3: Are the guidelines regarding the shareholders' involvement in setting higher ratios for variable remuneration sufficiently clear?

- Detailed information on remuneration policies and on their modifications should include, besides the points already listed, information as o the link between compensation and short-term performance, as well as sustainable performance.

- Clarity should be provided as to the frequency of the shareholder vote e.g. whether shareholders should vote on such ratio in consecutive years in case such ratio has been set at higher level year after year.

Q 4: Are the guidelines regarding remuneration policies and group context appropriate and sufficiently clear?

- Clarification as to the application of shareholder voting rights on the remuneration policy and higher ratio should be provided in reference to third countries, considering that the regulatory system in EU is different from non-EU jurisdictions in this regard.

Q 5: Proportionality

It is stated that: "Although the former CEBS Guidelines on Remuneration Policies and Practices allowed for the so-called 'neutralisation' of some provisions in small and less complex institutions. The terms of the CRD do not explicitly grant for such a right and therefore the preliminary assessment of the EBA is that a full waiver of the application of even a limited set of remuneration principles for smaller and non-complex institutions would not be in line with the CRD."

- The general principles as implicitly referred to in the introductory part of Article 92(2) CRD can in no way justify the non-application of one or the other rule contained in that provision, or indeed in Article 94(1) CRD. This applies in particular to the provisions referring to the deferral arrangements, the pay-out in instruments and the application of malus. Such provisions lay down clear rules and leave no room for exceptions or exemptions."

- Already within the previous CRD III, Article 22 (2) CRD III included a proportionality principle, referring to the nature, scale and complexity of the credit institution's activities. In addition, the CRD III provided that some general requirements (such as the establishment of a remuneration committee) and more specific ones (such as deferral in equity) could be fully neutralized in the case of non-complex organizations and for low-risk employees. On the whole, the scope for neutralization was already rather limited at the time, making EU rules on bankers' bonuses more rigorous than the underpinning global (FSB) and US regulation.

- The current CRD IV and related EBA principles not allowing any neutralization may be seen contrasting with the EU objective of the market reforms, which has been to generate a single rule-book and, to the extent relevant, to remove national options and discretions.

- Therefore, some additional flexibility, giving option to neutralization, needs to be enabled, specifically for special circumstances and for small and non-complex institutions.

Q 7: Are the guidelines regarding the capital base appropriate and sufficiently clear?

- It is understood that institutions which do not have a sound capital basis or where the soundness of the capital base is at risk should apply certain measures, including malus and clawback. Meanwhile, as also provided for within the main regulatory framework of these Guidelines, the two measures are risk-adjustment mechanisms that need to be adopted by institutions regardless of the state of the capital base. Therefore this provision may be better explained as:

'Institutions facing problems with the soundness of their capital base particularly needing to enforce such mechanisms and adopting careful assessments of the identified staff performance ahead of applying them.'

Q 8: Are the requirements regarding categories of remuneration appropriate and sufficiently clear?

- The Guidelines provide detailed explanations on the fixed component of remuneration; however they do not provide explanations on the breakdown of variable remuneration i.e. short- and long-term incentives.

- The categories of remuneration should additionally make reference to the termination plans, including severance payments and retirement plans, which also constitute elements of compensation.

Q 9: Are the requirements regarding allowances appropriate and sufficiently clear?

- Provisions as to disclosure of determining such allowances should be added to the current Guidelines, in order to facilitate understanding of this pay element by the shareholders during the approval process.

Q 13: Are the requirements on remuneration policies in section 15 appropriate and sufficiently clear?

It is stated that: "Where institutions consider paying out less than 100 % of the fixed component in cash, this decision should be well reasoned and approved as part of the remuneration policy."

- Paying out a variable component above 100% of the fixed component in cash should also be very well reasoned and approved as part of the remuneration policy (which is specifically subject to shareholder approval).

- Clarification should be made as to the meaning of "shareholding requirement", i.e. referring to shareholder ownership requirements. - It is stated that:

It is stated that: "The institution should specify how the variable remuneration reacts to performance changes and the performance levels where variable remuneration decreases down to zero. Unethical or non-compliant behaviour should lead to a significant reduction of staff member's variable remuneration."

- These provisions should be carefully reviewed.

Whilst a decrease in performance should lead to a decrease in variable remuneration down to nil (mechanism known as "malus"), unethical or non-compliant behavior of the individual should lead to the non-payment / withdrawal of the variable remuneration (mechanism known as "clawback"), and not just a significant reduction in payment, which would mean the individual would still be awarded incentives in case of misbehaviour.

- As to the policy on fixed remuneration, the Guidelines should make provisions that discourage banks from establishing so-called "role-based allowances" without appropriate reasoning but as a means to circumventing the law (as experienced recently in the UK banking sector). In case the institution decides to implement such allowances, thus increasing the fixed pay of the executive(s), such policy must be well reasoned and explained.

It is stated that: "The pay out of fixed remuneration in instruments, if any, should not impair the ability of the institution to apply a fully flexible policy on variable remuneration."

- More clarity should be provided in this regard, in particular as to what type of 'instruments' can make up the fixed remuneration.

- As to the ratio between fixed and variable remuneration, more clarity is needed as to what constitutes the variable remuneration, i.e. "as the sum of all variable components of remuneration that could be awarded as a maximum in a given performance year". It is unclear from the respective provisions (180-185) whether the variable remuneration includes vested awards resulting from equity or other financial instruments, relative to the performance year.

Q 14: Are the requirements on the risk alignment process appropriate and sufficiently clear?

It is stated under Risk Alignment Process that: "The risk alignment process includes the performance and risk measurement process (section 16.1); the award process (section 16.2); and the pay-out process (section 17)."

- The definition is relevant, however the structure of the Guidelines does not fully follow it.

For the purpose of providing a proper overview of the Risk Alignment process and approach, the pay-out process, which discusses the ex-post risk-adjustment mechanisms, can not be separated from the ex-ante risk-adjustment mechanisms. Institutions should make qualitative ex-ante risk adjustments when determining the bonus pool and staffs' remuneration. Therefore, ex-post risk-adjustments should be placed under the umbrella of Risk Alignment Process, thus in the same Chapter/Section.

Q 18: Are the requirements on the ex post risk adjustments appropriate and sufficiently clear?

Yes. However, in addition:

- EBA should consider the clawback mechanism also for fixed payment including benefits, in certain cases of misconduct such as fraud and other negative situations affect the business. Major misconduct from the part of the leadership of the banking institution must be punished severely, in order to avoid critical mass negative impact on the business and the actual survival of the institution.

Q 19: Are the requirements in Title V sufficiently clear and appropriate?

It is stated that: "The relevant competent authority may require the institution not to award any variable remuneration to members of the management body as long as the exceptional government support is not yet paid back, or until a restructuring plan for the institution is implemented or accomplished."

- The conditions for awarding variable remuneration should be directed towards the timeline of the implementation of the restructuring plan for the institution rather than the timing of the return of the government support; rather than giving an "or" option between the two conditions, in order to reflect the real progress of the plan and the contribution of the individual in such progress.

- Termination payments should also be addressed within the policy of the institutions benefiting from exceptional government support.