LSEG Response to the European Banking Authority's consultation:

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

Background Information

The London Stock Exchange Group plc (LSEG) welcomes the opportunity to respond to the EBA's Consultation Paper on draft guidelines on sound remuneration policies under CRD4/CRR.

LSEG is a diversified international exchange and infrastructure group that operates a broad range of international equity, bond and derivative markets, and post trade services. LSEG operates two regulated markets (London Stock Exchange and Borsa Italiana) and three MTFs (Turquoise, EuroTLX and EuroMTS). LSEG is also the majority owner of LCH.Clearnet Group which operates a number of CCPs including LCH.Clearnet SA which is regulated in France as an EMIR authorised CCP. LCH.Clearnet SA is also regulated as a credit institution under CRD4.

Information on proportionality

The EBA has requested respondents to provide information on specific situations which justify the application of the proportionality principle to 'neutralise' certain remuneration rules for small or non-complex firms. This supports the Level 1 text of CRD4 which states, "***it would not be proportionate to require certain types of investment firms to comply with all of [the remuneration] principles***".[1] We agree with the EBA that the remuneration rules in CRD4 are conceived more in the context of banking-style institutions and not non-complex investment firms, trading venues or market infrastructure providers. In particular, where groups are exposed to CRD4 principles because of small, non-complex MTFs within their structure the proportionality principles should be capable of being applied (with national competent authority oversight) to neutralise certain provisions which are not relevant to the risk profile of the institutions in question or the group structure in which they are based. This reflects the principles of CRD4 that the remuneration policies should "be aligned with the risk appetite, values and long-term interests of the credit institutions or investment firms" as well as "[reflecting] differences between different types of institutions in a proportionate manner, taking into account their size, internal organisation and the nature, scope and complexity of their activities."[2]

We understand that the EBA believes that the legal advice it has been presented with cannot allow it to provide guidance on using proportionality to neutralise certain remuneration principles. However,

[1] Recital 66, CRD4.
[2] Recital 66, CRD4.

LSEG believes that the EBA should take into account the situation of mixed activity groups including financial market infrastructures which, unlike banks, do not seek to take market or credit risks both when finalising the guidelines and when preparing its advice to the Commission on proposed amendments to CRD4. In particular:

- Clear limits should be placed around the applicability of CRD4 requirements on group personnel who perform group-wide tasks or oversight. Where the group is not consolidated for supervision purposes the relevant personnel should be able to differentiate their group remuneration from their remuneration specific to the CRD4 regulated institutions. In particular, where time spent on a CRD4 regulated entity is limited and represents only a small amount of an individual's remuneration, national competent authorities should be able to 'neutralise' certain provisions (as is suggested by the EBA on page 6 of the consultation paper); and

- Looking ahead, a proportionality regime based on tiering of complexity for investment firms similar to the tiering system currently used by the Financial Conduct Authority in the UK (Levels 1, 2 and 3), could be included explicitly in the amended CRD4 legislation to better accommodate the large range of institutions across the EU which will be considered investment firms, particularly following the implementation of MiFID2.

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RESPONSE TO QUESTIONS

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

We have the following comments on the definition of "staff" and the standards proposed for currency conversion.

We believe the definition of "staff" should be clarified to ensure that persons "acting on behalf" of an institution are only covered by the remuneration principles where their activities have a material impact on the institution's risk profile. The current definition references not just the legal situation of a relevant person (i.e. whether they are employed by or on the management body of a CRD institution or subsidiary) but also whether a person is "acting on behalf" of the institution and its subsidiaries. The meaning of "acting on behalf" should be made clear to ensure that it is not overly wide and ensure the scope of the guidelines is consistent with CRD4. The Level 1 text of CRD4 only refers to "staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a **material impact** on [the institutions] risk profile" (Article 92(2)) (emphasis added).

There are two aspects to distinguish for institutions, (i) to what staff it should apply its overall remuneration policies to and (ii) in what instances are specific measures for "identified staff" applicable. It seems that the proper meaning of "staff", as intended by the Level 1 text, covers only natural persons employed by or holding management positions within the CRD4 institution.

We have noted that the term "acting on behalf" in the draft guidelines is intended to apply to individuals who are undertaking activities which have a material impact on the institution's risk profile but are not employed by the institution or its subsidiaries (as per Article 92(2) of CRD4). We do not believe the intention is to apply the remuneration policies of the institution to all persons who undertake activities on behalf of institutions, including third party service providers or intra-group personnel. It would not be appropriate for the EBA's guidelines to broaden the scope of those covered by the requirements to include individuals who are not otherwise caught by Delegated Regulation 604/2014 on identified categories of staff. That delegated regulation represents the Commission's, Council's and Parliament's view of the extent of identified staff for CRD4 remuneration requirements and it is not within the remit of EBA guidance to broaden this approach. Therefore, it should be clear in the guidelines that the extension to other persons shall only be relevant where such person has a material impact on the CRD4 institution's risk profile in line with the criteria set out in Delegated Regulation 604/2014. We propose the following definition of 'Identified Staff' for consideration:

'Identified Staff' are ***those individuals who meet the criteria set out in Commission Delegated Regulation (EU) 604/2014*** whose professional activities have a material impact on the ***institution's*** risk profile.

In relation to the standards suggested for currency conversion, the proposed approach is not appropriate for firms which award remuneration in currencies other than euro. Such institutions may not award variable remuneration in December and salary payments will be made routinely throughout the year.

2) Are the guidelines in chapter 5 appropriate and sufficiently clear?

We believe the guidelines could be clearer with respect to the remuneration policy (see para 14). The context and legal requirements of CRD4 suggest that the remuneration policy should be in place for the institution as a whole. However, the proposed guidelines on what the policy should contain appear very granular, and seem to be specific to the individual staff member concerned. We do not support this approach. Staff in different business areas with different responsibilities may have different performance objectives, measurements of performance and structures for variable remuneration. It would be inappropriate (and risks violating data privacy and confidentiality laws)[3] to disclose publically an individual's performance objectives as part of an institution's general remuneration policies.

We suggest that the detailed requirements in paragraph 14 are removed, or at a minimum limited to identified staff only. The remuneration policies at the institution level will need to address the link between performance against risk objectives and remuneration. However, an individual's detailed objectives should remain part of his/her performance assessments and not included in the institution's disclosed remuneration policy itself.

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

In relation to shareholder involvement concerning any outsourced or intra-group service providers, the current text is not clear. The section explaining which shareholders are entitled to vote – *i.e. the ones in the institution where the identified staff operates* (paragraph 36 (a)) could be read as applying to (i) the entity providing the service or (ii) the relevant CRD4 entity. Given that the risk being addressed is that an institution is remunerating individuals to a level which undermines effective risk controls, the appropriate shareholders for such voting would be those of the regulated CRD4 institution and not those of the outsourced entity. This supports the position that only the remuneration in respect of the services to the regulated institution should be caught by the CRD4 requirements.

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

There are a number of instances where the guidelines say that the CRD4 requirements apply to the "group" but what the guidelines actually mean is "consolidated group" or "consolidated sub-group"; an example of this is the end of the first sentence of paragraph 63 which refers to activities having an impact on the "group's" risk profile. This contradicts other statements that 'identified staff' requirements should only apply to the extent that those individuals are influencing the risk decisions of

[3] For example, Directive 95/46/EC and its relevant national implementing legislation.

the CRD4 regulated sub-groups. This needs to be clarified to limit references to only “consolidated group” or “consolidated sub-group”.

It is not clear from the draft guidelines to what extent individuals employed in other parts of a mixed activity group that perform services on behalf of institutions within a consolidated sub-group subject to CRD4 are to be considered “identified staff” of the in-scope institution. Given that the remuneration requirements are intended to address risk taking of credit institutions and investment firms, it does not seem appropriate that individuals who are employed in horizontal support roles within a non-consolidated group (for example, internal audit or human resources) should be subjected to remuneration provisions where they do not have a material impact on the risk profile of the institutions within consolidated sub-groups that are subject to CRD4. The guidelines seem to acknowledge this issue when they discuss staff of subsidiaries only being subject to the extent that they perform the activities on a consolidated basis for the CRD4 regulated sub-group. The guidelines should make clear that the same considerations apply for all group staff and not just subsidiaries of the CRD4 institutions.

5) All respondents are welcome to provide their comments on the chapter on proportionality, with particular reference to the change of the approach on ‘neutralisations’ that was required following the interpretation of the wording of the CRD. In particular, institutions that used ‘neutralisations’ under the previous guidelines for the whole institution or identified staff receiving only a low amount of variable remuneration are asked to provide an estimate of the implementation costs in absolute and relative terms and to point to impediments resulting from their nature, including their legal form, if they were required to apply, for the variable remuneration of identified staff: a) deferral arrangements, b) the pay out in instruments and, c) malus (with respect to the deferred variable remuneration). In addition those institutions are welcome to explain the anticipated changes to the remuneration policy which will need to be made to comply with all requirements. Wherever possible the estimated impact and costs should be quantified, supported by a short explanation of the methodology applied for their estimation and provided separately for the three listed aspects.

We believe the CRD4 measures and the proposed Guidelines on Remuneration are intended to protect against a culture of excessive risk taking by the risk takers of institutions that intentionally take balance sheet risk as part of their core operations. This is not the case for investment firms whose only investment activity is operating an MTF. We believe the regulatory requirements should be refined in order to reflect more accurately the substance of any activities carried on within different categories of entities. We would encourage the EBA to consider potential recommendations in this area taking into account the interpretation and approach of national competent authorities. In our view it is not the policy intention to apply the remuneration rules to entities that do not seek to take balance sheet risk as part of their core operations. As the CRD4 itself says, “***it would not be proportionate to require certain types of investment firms to comply with all of [the remuneration] principles***”[4] and it should be made clear that for certain types of investment firms and market infrastructure providers many provisions are inappropriate and not necessary to address the Parliament’s and Council’s concern of excessive risk taking by institutions.

[4] Recital 66, CRD4.

The investment firms within LSEG operate as neutral, open access trading platforms, for equities and bonds respectively. They do not take positions, or risk principal or otherwise engage in risk taking activities that are intended to be the primary focus of CRD4. The tiering system that was put in place by the UK Financial Conduct Authority (and similar arrangements in other member states) to deal with such types of investment firms subject to CRD4 addresses the risks posed by MTFs (which are designed to be risk neutral) by putting them at the lowest level of application of the remuneration rules, with neutralisations of certain principles being possible. **We believe that for institutions which are designed to be non-complex and do not seek to take market or credit risks, CRD4 should be amended to explicitly reflect that many neutralisations would be appropriate in practice.**

Additionally, CCPs such as LCH.Clearnet SA are designated as credit institutions under French law for a number of domestic reasons, including but not limited to, access to the central bank liquidity necessary to operate a CCP and not because of any conventional banking or investment activity that it undertakes. Furthermore, operational and governance risks specific to CCPs and their operating structures are addressed in EMIR and its delegated acts (which comprise specific remuneration rules for CCPs) and the CRD4 should be amended so as to allow for proportionate neutralisations where CCPs have to manage their risks pursuant to other relevant EU legislation.

6) Are the guidelines on the identification of staff appropriate and sufficiently clear?

The Guidelines suggest that the self-assessment exercise for 'identified staff' should take place annually, but then later says that the self-assessment should be updated 'periodically'. We understand that this periodic updating should be annually or wherever a person begins or ends a term of work in a function with a material risk impact on the consolidated sub-group.

Regarding the measures to be documented in the self-assessment exercise, we would expect that the means by which people are identified as risk-taking staff pursuant to Regulation 604/2014 would be part of the standing remuneration policies. In addition, some of the minimum information to be included in the self-assessment is unclear:

- It is not clear how the self-assessment is supposed to be coherent with the "business strategy and models" of the consolidated institution. These terms are very vague and it is not clear how an institution would document this.
- It is not clear what "the requirements regarding the documentation of the identification outcome" means. If this is meant to say that evidence of the identification process should be retained, the guidance should say this in a clear manner.

For the guidance on identification of staff where they are responsible for functions on a consolidated or sub-consolidated basis (para 101), there is no discussion of how this works for group staff which are not subsidiaries of the regulated institution but rather staff employed by unregulated entities within the group who provide services across all group entities. It should be equally clear that staff of unregulated group entities should also be excluded from the remuneration requirements where they are not primarily responsible for the functions of the CRD4 regulated institution, or only have peripheral connection to such functions.

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

We agree with the EBA's assessment that it is important that the remuneration policy is considered in the firm's capital and liquidity planning. In this way the policy would contribute to safeguarding a sound capital base and prevent it from leading to shortcomings in the institution's liquidity or capital position that it is required to maintain under Basel III/CRR. However, it is important to stress that use of variable remuneration which can decrease in times of low performance is a useful method for mitigating capital risk.

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

We agree that most of the criteria for determining whether remuneration is fixed (outlined in paragraph 117 of the Guidelines) are reasonably clear. However, further clarification may be needed in relation to Paragraph 117 (c) – which requires that the conditions for award of the remuneration are transparent to staff. It is not clear whether the conditions have to be transparent to all staff of the entity, a sub-set of staff, or just to the staff member concerned.

Importantly, the guidelines related to LTIP appear to suggest that it should be valued at the time of vesting and not the time of award. This is inappropriate for a number of reasons:

- A significant increase in share price between the time of award and the time of vesting or the achievement of full performance conditions would imply that annual bonuses may have to be reduced or cancelled in order to achieve a compliant fixed to variable pay ratio. It would be impossible for an institution to project share price three years in the future in order to attempt to value the award accurately;
- It creates an inappropriate incentive whereby an increase in share price or the achievement of full performance conditions (to the benefit of shareholders) would result in a reduced bonus payout to the relevant staff. Also, it is not always possible to align the timing of the annual bonus payout and the vesting on a long-term award in order to meet the required 'bonus' cap. The incentive this provides goes against what the EBA should be trying to achieve, i.e. incentivising staff to act in the best interest of shareholders; and
- It is not clear how existing LTIP awards would be characterised and valued.

9) Are the requirements regarding allowances appropriate and sufficiently clear?

We understand the EBA's position that *allowances* should not be used as a vehicle to facilitate circumvention of the rules. However, if a firm is required to provide an explanation (as proposed in Paragraph 123), this is likely to increase the regulatory burden even though it is not clear how this, alone, would make circumvention less likely.

We believe the removal of current allowances could lead to an increase in base pay in order to compensate for its removal. It is difficult to see how this could have a positive impact on financial stability.

10) Are the requirements on the retention bonus appropriate and sufficiently clear?

It is important that the draft guidelines clarify that staff who do not pose material risks for the CRD4 institution should not be considered in scope of the rules on retention bonuses. This is relevant in a group context where the staff member is not primarily responsible for the institutions subject to CRD4. The guidelines should make it clear that the rationale for retention bonuses can be in respect of the services supplied to and needs of unregulated parts of a group which are not CRD4 institutions.

11) Are the provisions regarding service payments appropriate and sufficiently clear?

In Paragraph 143 (a) it is not clear what constitutes an *obvious failure.*

The proposed one-year retention period on buy-outs penalises staff who are recruited from non-regulated organisations or from a different sector as the rules mean they will have to wait an additional year to receive their deferred compensation, even though it is not connected with any regulated activity.

12) Are the provisions regarding personal hedging and circumvention appropriate and sufficiently clear?

The rules in respect of personal hedging are relevant for the malus and clawback provisions are applicable to identified staff (Article 94(1)(n) of CRD4), but the draft guidelines appear broader and could apply to all types of staff or those individuals acting on behalf of the CRD4 institution. The guidelines should be clarified to ensure that they are aligned to the Level 1 CRD4 text and apply only to identified staff.

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

In respect of the factors for determining fixed remuneration, it is very unclear what is meant by “the constraints” and how these are relevant. In terms of determining suitable fixed remuneration, institutions should be in a position where they can best determine remuneration based on their business need, in line with applicable national employment legislation and applicable collective bargaining agreements. The guidelines are unhelpful in suggesting social/cultural considerations which are outside of an institution’s capacity to determine.

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

Outlined below are some of the areas that stand to benefit from further clarity, or that are not appropriate in their current form in our view:

- We agree that there should be transparency regarding the compensation process. The Remuneration Committee with input from Risk has the ability to apply judgement to the level of an award and its refund) (paragraph 190).

- Having established that institutions should use the same risk measurement models for compensation calculations as internal risk measurement (paragraph 196), which seems plausible, the document goes on to indicate that therefore 'more sophisticated ICAAP models should lead to a more sophisticated variable remuneration policy' (paragraph 197). In light of the call for firms to use the same risk model as the one used in their internal risk measurement, it is not clear why the Guidelines then go on to specify a preferred model.

- We believe paragraph 228 should be deleted; in our view it is unnecessary and would deliver the wrong outcome. If a requirement is needed at all, it should be for institutions to use measures for determining bonuses that are consistent with the financial reporting methods, rather than potentially requiring them to be different.

15) Are the provisions on deferral appropriate and sufficiently clear?

In paragraph 237 it is not clear what constitutes a "high amount". Further clarity is required to enable businesses to determine situations in which a 60% deferral would apply.

We believe the CRD4 measures and the proposed Guidelines on Remuneration are intended to protect against a culture of excessive risk taking by the risk takers of institutions that intentionally take balance sheet risk as part of their core operations. This is not the case for investment firms whose only investment activity is operating an MTF. We believe the regulatory requirements should be refined in order to reflect more accurately the substance of any activities carried on within different categories of entities. We would encourage the EBA to consider potential recommendations in this area taking into account the interpretation and approach of national competent authorities. In our view it is not the policy intention to apply the remuneration rules to entities that do not seek to take balance sheet risk as part of their core operations. As the CRD4 itself states, "***it would not be proportionate to require certain types of investment firms to comply with all of [the remuneration] principles***"[5] and it should be made clear that for certain types of investment firms and market infrastructure providers many provisions are inappropriate and not necessary to address the Parliament's and Council's concern of excessive risk taking by institutions.

16) Are the provisions on the award of variable remuneration in instruments appropriate and sufficiently clear? Listed institutions are asked to provide an estimate of the impact and costs that would be created due to the requirement that under Article 94(1)(l)(i) CRD only shares (and no share linked instruments) should be used in parallel, where possible, to instruments as set out in the RTS on instruments. Wherever possible the estimated impact and costs

[5] Recital 66, CRD4.

should be quantified and supported by a short explanation of the methodology applied for their estimation.

Paragraph 247 states that variable remuneration in instruments should "consist of a balance of different types of instruments". It is not entirely clear what this means. Additionally, if the requirement for a balance of different types of instruments is intended to lead to a mixture of different types of instruments, this may not be easy to reconcile with the second part of the same paragraph which suggests firms should prioritise the use of instruments subject to bail-in, the effect of which is to reduce the level of choice.

Banning the payment of dividends on deferred awards in shares decouples the alignment of the interest of identified staff with that of shareholders. This could reduce the incentive of senior management of an institution to award dividends in the first place (which could prejudice the interests of shareholders who are not identified staff).

Similarly, banning the payment of interest on deferred awards in cash erodes the value of the award over a number of years and reduces both incentivisation and retention of key staff at the expense of the firm's success and shareholders' benefit.

17) Are the requirements regarding the retention policy appropriate and sufficiently clear?

We believe it should be for national competent authorities to determine what institutions are considered "large" or "complex". In addition, such designation should relate to the structure of the consolidated sub-group in question and not the overall group structure where the institutions are part of a mixed activity group.

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

We agree that identified staff should be rewarded in a way that does not endanger the long-term sustainability of the business, and are aware of the role of ex-post risk adjustment (via payout in suitable instruments and the application of malus and clawback) in achieving this. Such ex post risk adjustments should recognise different institutions have very different risk profiles, as is seen in Article 95(1) of CRR which sets lower capital requirements for investment firms that only operate an MTF.

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

This question is not directly relevant for LSEG.

20) Are the requirements in Title VI appropriate and sufficiently clear?

Yes.

21) Do institutions, considering the baseline scenario, agree with the impact assessment and its conclusions?

No response.

22) Institutions are welcome to provide cost estimates with regard the costs which will be triggered for the implementation of these guidelines. When providing these estimates, institutions should not take into account costs which are encountered by the CRD IV provisions itself.

We are happy to discuss with the EBA costs related to implementation and the associated methodology directly.