Financial institutions: capital requirements for the trading book and for re-securitisations; supervisory review of remuneration policies

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The European Parliament adopted by 625 votes to 28, with 37 abstentions, a resolution amending the proposal for a directive of the European Parliament and of the Council amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies. The amendments are the result of a compromise between Council and Parliament. The main amendments are as follows:

Remuneration policies: the text states that the new obligation concerning remuneration policies and practices should be implemented in a consistent manner and should cover all aspects of remuneration including salaries, discretionary pensions benefits and any other similar benefits. In this context, discretionary pension benefits means discretionary payments granted by a credit institution to an employee on an individual basis payable by reference to or expectation of retirement and which can be assimilated to variable remuneration.

It is appropriate to specify clear principles on sound remuneration to ensure that the structure of remuneration does not encourage excessive risk-taking by individuals or moral hazard and is aligned with the risk appetite, values and long-term interests of the institution. These principles are as follows:

- the remuneration policy is in line with the business strategy, objectives, values and long-term interests of the credit institution, and incorporates measures to avoid conflicts of interest;
- where remuneration is performance related, the assessment of the performance must be set in a multi-year framework in order to ensure that the assessment process is based on longer term performance and that the actual payment of performance-based components of remuneration is spread over a period which takes account of the underlying business cycle of the credit institution and its business risks. The total variable remuneration must not limit the ability of the credit institution to strengthen its capital base. Guaranteed variable remuneration must be exceptional and occur only in the context of hiring new staff and is limited to the first year;
- to minimise incentives for excessive risk-taking variable remuneration should be a balanced proportion of total remuneration. It is essential that an employee's fixed salary represents a sufficiently high proportion of their total remuneration to allow the operation of a fully flexible variable remuneration policy, including the possibility to pay no variable remuneration. In order to assure coherent remuneration practices throughout the sector, it is appropriate to specify certain clear requirements. Guaranteed variable remuneration is not consistent with sound risk management or the pay-for-performance principle and should, as a general rule, be prohibited;
- **a substantial portion, which is at least 40 % of the variable remuneration component must be deferred over a period** which is not less than three to five years and is correctly aligned with the nature of the business, its risks and the activities of the member of staff in question. Remuneration payable under deferral arrangements vests no faster than on a pro-rata basis. In the case of a variable remuneration component of a particularly high amount, at least 60 % of the amount is deferred. The length of the deferral period is established in accordance with the business cycle, the nature of the business, its risks and the activities of the member of staff in question;
- **a substantial portion, which is at least 50 % of any variable remuneration should consist of shares**, share-linked instruments of the credit institution or investment firm, subject to the legal

structure of the institution concerned or, in case of a non-listed credit institution, in other equivalent non-cash instruments, and where appropriate, other long dated financial instruments that adequately reflect the credit quality of this institution;
- **in the case of credit institutions that benefit from exceptional government intervention**: (i) variable remuneration must be strictly limited as a percentage of net revenues when it is inconsistent with the maintenance of a sound capital base and timely exit from government support; (ii) the relevant competent authorities shall require credit institutions to restructure compensation in a manner aligned with sound risk management and long-term growth, including inter alia and when appropriate establishing limits to the remuneration of Directors; and (iii) no variable remuneration should be paid to the directors of that institution unless this is justified.

These principles are applied by credit institutions at group, parent company and subsidiary levels, including those established in offshore financial centres.

Review: by April 2013, the Commission shall review and report on the provisions on remuneration, with particular regard to their efficiency, implementation, enforcement, taking into account international developments. That review shall identify any lacunae arising from the application of the principle of proportionality to the provisions. The Commission shall submit this report to the European Parliament and the Council together with any appropriate proposals.

Provisions to improve corporate governance, transparency and disclosure: The amendments state that:

- credit institutions and investment firms that are significant in terms of their size, internal organisation and the nature, the scope and the complexity of their activities should be required to establish a remuneration committee as an integral part of their governance structure and organisation. The remuneration of the senior officers in the risk management and compliance functions is directly overseen by the remuneration committee;
- credit institutions and investments firms should disclose detailed information on their remuneration policies, practices and, for reasons of confidentiality, aggregated amounts for those members of staff whose professional activities have a material impact on the risk profile of the institution. That information should be made available to all stakeholders (shareholders, employees and the general public);

Benchmarking: in order further to enhance transparency as regards the remuneration practices of credit institutions and investment firms, the competent authorities of Member States should collect information on remuneration to benchmark remuneration trends in accordance with the categories of quantitative information that those institutions are required to disclose under the Directive. The competent authorities should provide CEBS with such information to enable it to conduct similar assessments at Union level.

Home Member State competent authorities shall collect information on the number of individuals per credit institution in pay brackets of EUR 1 million and upwards including the business area involved and the main elements of salary, bonus, long-term award and pension contribution. This information shall be forwarded to the Committee of European Banking Supervisors and it shall disclose this information on an aggregate home Member State basis in a common reporting format. The Committee of European Banking Supervisors may elaborate guidelines to facilitate the implementation of, and ensure consistency of information collected.

Implementing Basel: the resolution states as follows:

- the Directive lays down limited exceptions for certain correlation trading activities, where banks may be allowed by their supervisor to calculate a comprehensive risk capital charge subject to strict minimum requirements. In such cases the bank will be required to subject them to a capital charge equal to the higher of the capital charge according to this internally developed approach and 8% of

the capital charge for specific risk according to the standardised measurement method. It will not be required to subject these exposures to the incremental risk charge. It must, however, incorporate them in both the value-at-risk and stressed value-at-risk measures;

- Article 152 of Directive 2006/48/EC requires certain credit institutions to provide own funds that are at least equal to certain specified minimum amounts for the three twelve month periods between 31 December 2006 and 31 December 2009. In the light of the current situation in the banking sector and the extension of the transitional arrangements for minimum capital adopted by the Basel Committee on Banking Supervision, it is appropriate to renew this requirement for a limited period of time until 31 December 2011;
- in order not to discourage credit institutions from moving to the internal ratings-based (IRB) approach or advanced measurement approaches (AMA) for calculating the capital requirements during the transitional period due to unreasonable and disproportionate implementation costs, credit institutions that have moved to the IRB approach or AMA since 1 January 2010 and which have therefore previously calculated their capital requirements in accordance with the less sophisticated approaches may, subject to supervisory approval, be allowed to use the less sophisticated approaches as the basis for the calculation of the transitional floor. Competent authorities should monitor their markets closely and ensure a level playing field within all their markets and market segments and avoid distortions in the internal market.

Stronger Parliamentary Oversight: lastly, the text states that the measures in the Directive are steps in the reform process in response to the financial crisis. In line with the conclusions of the G-20, the Financial Stability Board and the Basel Committee on Banking Supervision further reforms may be necessary, including the need to build counter-cyclical buffers, "dynamic provisioning", the rationale underlying the calculation of capital requirements in Directive 2006/48/EC and supplementary measures to risk-based requirements for credit institutions to help constrain the build-up of leverage in the banking system. In order to ensure appropriate democratic oversight of the process, the European Parliament and the Council must be involved in a timely and effective manner.

The Commission should review the application of these Directives to ensure that its provisions are applied in an equitable way which does not result in discrimination between credit institutions on the basis of their legal structure or ownership model. It is empowered to adopt delegated acts in accordance with Article 290 TFEU in relation to the matters set out in the text. In this instance, the European Parliament or the Council have a period of three months from the date of notification to object to a delegated act. At the initiative of the European Parliament or the Council, this period can be prolonged by three months in significant areas of concern. The European Parliament and the Council may inform the other institutions of their intention not to raise objections. This early approval of delegated acts is particularly indicated when deadlines need to be met, for example to meet timetables set in the basic act for the Commission to adopt delegated acts.