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Assessment of the remuneration rules under Directive 2013/36/EU and Regulation (EU) No 575/2013

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I. INTRODUCTION

The Capital Requirements Directive[1] ('CRD') and the Capital Requirements Regulation[2] ('CRR') contain a number of requirements regarding the remuneration policies and practices of credit institutions and investment firms. These requirements were introduced in the aftermath of the 2008 financial crisis to ensure that remuneration policies do not encourage excessive risk-taking behaviour[3].

The first set of rules on remuneration in the financial sector was put forward at EU level in the Commission Recommendation of 30 April 2009[4]. This was followed by the introduction of binding rules on remuneration for credit institutions and investment firms in CRD III[5], adopted in 2010. Those rules, which had to be implemented by the Member States by January 2011, were further extended following the adoption of CRD IV in 2013 (with the new rules applicable as of 2014).

This report was prepared to meet the obligation under Article 161(2) of the CRD that requires the Commission to report to the European Parliament and the Council on the efficiency, implementation and enforcement of the remuneration rules, and in particular on the impact of the maximum ratio between variable and fixed remuneration.

In carrying out this review, the Commission engaged in several work streams. It studied available academic literature and commissioned a study from an external contractor to assist with its assessment[6]. It sought stakeholders' input through a public consultation[7], a fact-finding stakeholder event and bilateral meetings with industry representatives. Moreover, the Commission engaged with Member State representatives and supervisory authorities. In accordance with the CRD mandate, the European Banking Authority was closely associated with the review process and delivered valuable information. In particular, the European Banking Authority reports on high earners and on benchmarking of remuneration practices at EU level[8] were a valuable source of data covering the years 2010-2014.

The details of the assessment required by the CRD of the efficiency, implementation and enforcement of the remuneration rules in general are set out in the Commission Staff Working Document SWD(2016)265 that accompanies this report. This assessment allowed identifying a number of rules in respect of which the Commission may consider further action, and a detailed evaluation of those individual rules is presented in the Commission Staff Working Document SWD(2016)266. This assessment will be taken into account in the context of the wider revision of the CRD and CRR now under consideration.

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[1] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

[2] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms.

[3] Recitals 62-68, CRD.

[4] Commission Recommendation 2009/384/EC on remuneration policies in the financial services sector, available at http://ec.europa.eu/internal_market/company/docs/directors-remun/financialsector_290409_en.pdf.

[5] Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 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.

[6] institut für finanzdienstleistungen e.V. (IFF, 2016), report available at http://ec.europa.eu/justice/civil/company-law/corporate-governance/index_en.htm.

[7] Public consultation on impacts of maximum remuneration ratio under Capital Requirements Directive 2013/36/EU (CRD IV), and overall efficiency of CRD IV remuneration rules (22.10.2015 – 14.01.2016).

[8] All publications are available at https://www.eba.europa.eu/regulation-and-policy/remuneration/-/topic-documents/ckV8kFRsjau9/more.

The Commission's review of the CRD and CRR remuneration rules is also linked to the Commission's ongoing work with respect to the Call for Evidence[9] on the EU regulatory framework for financial services that was launched on 30 September 2015 to investigate the impact of legislation (including the CRD and CRR). A number of responses to this call for evidence related to the CRD remuneration rules have been taken into account in this review.

Overall, the review exercise has been hampered to some extent by the relatively recent entry into force of some remuneration rules and by the fact that the rules are not always applied to their full extent, often on the grounds of proportionality considerations. This has created limitations in terms of data availability and has affected the ability to formulate, at this time, conclusive findings on some of the aspects of the analysis. Another difficulty resulted from the very nature of the rules: the rules are meant to curb incentives which may send the wrong signals to individuals and thus to impact individuals' behaviour. Measuring concrete impact on individuals' behaviour is very complex. Finally, it is important to recognise that the remuneration rules are just one element of the regulatory framework that was put in place with the purpose of fostering financial stability. For all these reasons, it has not been possible to precisely quantify the impact of the remuneration rules alone on financial stability, and a more qualitative assessment of certain aspects has been carried out.

II. CONTEXT

The introduction of the remuneration rules must be seen against the background of the financial crisis that emerged in 2008. Measures to restore financial stability involved unprecedented levels of public support. It is broadly recognised that financial incentives which sent the wrong signals to staff were one of the contributing factors to the crisis. Remuneration practices in the financial services industry meant that those incentives were not in line with the long-term objectives of firms and the need for responsible risk-taking.

At the international level, the G20 Leaders in their Declaration from the Washington DC Summit on Financial Markets and the World Economy of 15 November 2008[10] called for priority work on *'Reviewing compensation practices as they relate to incentives for risk taking and innovation'.* The G20 London Summit Declaration of 2 April 2009 on Strengthening the Financial System[11] and the Statement from the Pittsburgh Summit of 24-25 September 2009[12] both confirmed agreement on the part of the global leaders that '*reforming compensation policies and practices is an essential part of our effort to increase financial stability',* and sealed their commitment to endorse and implement the principles and standards on sound compensation practices adopted by the Financial Stability Board (FSB)[13].

The CRD aims to implement those internationally agreed principles in the EU. One of the main differences between the EU rules and these principles and standards is the maximum ratio between variable and fixed remuneration, which is defined only in the EU.

Remuneration remains a high priority on the international policy agenda. The international

[9] Call for Evidence on EU regulatory framework for financial services (30.9.2015), available at http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/consultation-document_en.pdf.
[10] http://www.un.org/ga/president/63/commission/declarationG20.pdf.
[11] https://www.imf.org/external/np/sec/pr/2009/pdf/g20_040209.pdf.
[12] http://www.g20.utoronto.ca/2009/2009communique0925.html.
[13] The Principles for Sound Compensation Practices and their Implementation Standards, available at http://www.fsb.org/what-we-do/policy-development/building-resilience-of-financial-institutions/compensation/.

debate is now focusing on the role of remuneration practices in incentivising good conduct. The Financial Stability Board is examining whether there is a need to strengthen remuneration-linked disincentives to misconduct.

III. ASSESSMENT OF THE REMUNERATION RULES

This section first briefly discusses the implementation and enforcement of the remuneration rules (sub-section A). It then looks at the overall scope of their application (sub-section B). It subsequently looks at the different components of the rules: sub-section C focuses on the remuneration rules that have been in place since the adoption of CRD III (i.e. except for the maximum ratio)[14]; sub-section D focuses on the maximum ratio that was only introduced by CRD IV.

A. Implementation and enforcement of the rules

Member States had the obligation to transpose and apply the CRD IV remuneration rules by the end of 2013. By the time this report was drafted, all Member States had communicated to the Commission their transposition (with one Member State having communicated partial transposition). The Commission has completed a *prima facie* assessment of these communicated measures for 17 Member States; a full transposition check of all Member States is ongoing.

This report focuses on one recurring issue across the EU that was identified during the transposition check process, and one issue on which shortcomings in effective enforcement were revealed in several jurisdictions.

The first issue concerns the interpretation by Member States of the principle of proportionality that underlies the CRD remuneration rules in accordance with Article 92(2) of the CRD. It has been revealed that most Member States have put in place thresholds or criteria under which certain remuneration rules do not need to be applied, which are not in line with the text of the Directive (this issue is discussed in detail in section III.C.*(ii)*).

The second issue concerns the interpretation of what is 'fixed' and what is 'variable' remuneration. Indeed, it transpires that some institutions have, in view of the CRD requirements on remuneration, incorrectly classified 'role-based allowances'[15] as fixed remuneration, and that this practice has not immediately been ended by the supervisors (this issue is discussed in detail in section III.D.(i)).

B. Scope of application of the remuneration rules

This sub-section examines a number of questions concerning the scope of application of the remuneration rules.

[14] Some of the CRD remuneration rules have been strengthened by CRD IV. For the purposes of our assessment we looked at the rules as they are today.

[15] Role-based allowances are payments based on the role, function or organisational responsibility of a staff member. The label may differ according to the institution: 'role based pay, staff allowance, adjustable role allowance, fixed pay allowance', etc.

Application to identified staff: An important step in ensuring the effectiveness of the remuneration rules is to correctly identify the staff to whom they should apply (i.e. staff members whose professional activities have a material impact on institutions' risk profile). Commission Delegated Regulation (EU) No 604/2014[16] has put in place harmonised criteria for identifying such staff. Thanks to this harmonisation, which has generally been well received by the industry, there are fewer discrepancies in the approaches followed by supervisors and institutions. Concerns have nevertheless been raised by the industry over the material increase in the number of identified staff. However, they still represent only a relatively small part of total staff (2.34 % on average in 2014[17]). Experience with the application of the relatively new criteria still needs to be gained and there will be a continued evaluation.[18]

Application to investment firms: Investment firms argue that the remuneration rules have been developed for credit institutions and are not suitable for their own business model and risk profile, which they maintain is very different from that of credit institutions. The Commission's review took note of the concerns raised by investment firms but was confronted with a limited availability of data, which did not make it possible to come to a conclusion on this aspect at this stage. As requested under the CRR[19], the Commission is currently reviewing the prudential regime applicable to investment firms. The question of applying in general the remuneration rules to investment firms may need to be revisited in light of the findings of this ongoing review.

Application at group level: Managers of undertakings for collective investment in transferable securities (UCITS) or of alternative investment funds (AIF) that are part of a CRD-regulated group are concerned about needing to comply in full with the CRD remuneration rules (in particular the maximum ratio), in addition to having to comply with their sector-specific legislation, which also regulates remuneration[20]. They argue that this would distort the level playing field with independent UCITS and AIF managers that are not part of a CRD-regulated group and have to comply only with the sectoral legislation (which is very similar to the CRD remuneration rules but does not contain the maximum ratio). It is important to note that, under the terms of the CRD, staff of UCITS and AIF manager subsidiaries only need to comply with the CRD remuneration rules applicable to their parent undertaking *if*, on the basis of the harmonised criteria for the identification of staff, it is determined that such staff have a material impact on the risk profile of the CRD group to which they belong.

[16] Commission Delegated Regulation (EU) No 604/2014 of 4 March 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile.

[17] EBA *'Benchmarking of Remuneration practices at Union level and data on high earners',* data as of end 2014.

[18] It is worth noting that also at the level of the Financial Stability Board, re-evaluation of the identification of material risk takers is planned for 2016-2017.

[19] Articles 493(2), 498(2), 508(2) and 508(3), CRR.

[20] For AIF managers, Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers, and for UCITS managers, Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), amended by Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014**.**

C. The rules introduced by CRD III

This section starts with an overall assessment of the various remuneration rules introduced by CRD III in the aftermath of the 2008 financial crisis ***(i)***. It then focuses on the concerns of the industry, Member States and supervisors about the need for a proportionate application of the rules ***(ii)***.

(i) Overall assessment

The requirements concerning the criteria and time horizon that need to be taken into consideration when ***measuring performance for the purpose of awarding variable remuneration***[21] have been positively assessed by stakeholders in general, who see the merit of combining individual with collective performance assessment, and financial criteria with non-financial ones. While supervisory authorities have seen progress in complying with the rules, there is still room for better incorporating risk-adjusted criteria in the assessment of performance.

The ***governance-related requirements***[22] were designed to ensure that institutions' boards had overall responsibility for and oversight of the general principles of the remuneration policy, that risk management was embedded in the establishment of sound remuneration policies and that remuneration committees were set up in 'significant' institutions. These governance rules have been generally assessed positively.

The requirements for institutions to ***disclose***[23] information on their remuneration practices serve to increase transparency, and are seen to contribute to better alignment of remuneration with institutions' performance and to facilitate supervisory oversight.

The CRD limitations on ***guaranteed variable remuneration***[24] ***and severance pay***[25] seem to have been effective: the use of both sign-on bonuses and severance pay has decreased considerably in recent years, suggesting a better framed use of these forms of remuneration, as intended by the CRD.[26]

Data shows that the use of ***deferral***[27] (as opposed to an immediate pay-out) and ***pay-out in instruments***[28] (as opposed to a pay-out in cash) have increased considerably since the introduction of the rules by CRD III.[29]

Overall, deferral has been positively assessed in terms of ensuring long-term performance alignment and deterring excessive risk-taking. It is a key mechanism for aligning variable remuneration with the long-term risks and performance of an institution, by enabling the

[21] Article 94(1)(a), (b) and (j), CRD.
[22] Articles 74, 76(4), 92(2) and 95, CRD.
[23] Articles 450, CRR and Article 96, CRD.
[24] Article 94(1)(d) and (e), CRD.
[25] Article 94(1)(h).
[26] In 2014, only 281 identified staff received sign-on bonuses, compared with 2 274 in 2011, and only 467 identified staff received severance pay, compared with 1 011 in 2011).
[27] Article 94(1)(m), CRD.
[28] Article 94(1)(l), CRD.
[29] While in 2010 on average 55.22% of the variable remuneration of identified staff was deferred, the deferred part went up to 62.50% in 2014. While in 2010 on average 48.50% of variable remuneration of identified staff was paid out in shares, the pay-out in shares increased to 55.69% of variable remuneration in 2014.

application of *malus.* It is even deemed by some that in certain cases a longer deferral period, better aligned with the length of financial cycles, would be desirable.

Pay-out in shares or equity-based instruments allows the interests of identified staff to be aligned with those of an institution's owners. Coupled with deferral and additional retention periods, during which staff member cannot access or sell the awarded instruments, pay-out in equity instruments helps to counter potential short-termism in the actions of identified staff and ensures alignment of their remuneration with the long-term risks and performance of the institution. Moreover, the use of debt instruments that can be bailed in helps to ensure alignment with the interests of creditors. The evidence to date nevertheless shows that in practice institutions predominantly use equity or equity-based instruments.

The CRD provides that variable remuneration can be reduced or cancelled through ***malus*** or through ***clawback.***[30] These tools have generally been positively assessed. While recognising that the mere existence of these ex-post mechanisms has a certain deterrent effect on excessive risk-taking, their actual use to reduce or cancel variable remuneration remains low in practice.

(ii) Specific concerns about the need for a proportionate application of the rules

While the requirements on the structure and pay-out of variable pay of staff are generally considered as effective mechanisms for linking remuneration with the long-term performance of an institution, many industry representatives and nearly all Member States and supervisors expressed serious concerns about the need for proportionate application of the remuneration rules and warned against a 'one size fits all' approach.

Most Member States have put in place thresholds or criteria under which certain remuneration rules do not need to be applied. This was based on their interpretation of the proportionality clause in the CRD and the Guidelines issued by the predecessor of the European Banking Authority, the Committee of European Banking Supervisors (CEBS) under CRD III . Such dis-application of rules is commonly referred to as 'waivers'. The scope of these waivers differs significantly across Member States in terms of both the type of institution and staff which may benefit from them and the remuneration rules to which they apply. Thresholds or criteria put in place by Member States concern, for example, the size of an institution, the nature of its business and the level of variable staff remuneration. Rules that have been subjected to such waivers are most often the requirements on deferral and pay-out in instruments and, in some Member States (following the adoption of CRD IV), the maximum ratio between variable and fixed remuneration for some types of institutions.

When the European Banking Authority (EBA) and the Commission confirmed that such waivers are legally inadmissible, this led to strong concerns being expressed last year by many industry representatives and nearly all Member States and supervisors. Moreover, EBA last year issued an Opinion recommending a legislative change to the CRD[31], which would ensure that some waiver practices could be allowed to continue lawfully. In particular, the EBA argued in favour of introducing in the CRD the possibility of waivers from the

[30] Article 94(1)(n), CRD.
[31] Opinion of the European Banking Authority on the application of the principle of proportionality to the remuneration provisions in Directive 2013/36/EU, available at https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-25+Opinion+on+the+Application+of+Proportionality.pdf.

application of the rules on deferral and pay-out in instruments for institutions which are small and non-complex and for staff receiving low levels of variable remuneration.

EBA estimates show that the requirements on deferral and pay-out in instruments may indeed be excessively costly and burdensome for small institutions and for staff with low variable remuneration. One-off costs to small institutions for applying these rules are estimated at between EUR 100 000 and EUR 500 000 and ongoing costs at between EUR 50 000 and EUR 200 000 per year. These costs relate to the fact that small institutions need to make considerable investments in human resources, IT and advisory services, and are often faced with difficulties in creating appropriate instruments, often due to their corporate statute or ownership structure. One-off costs to large institutions for applying the rules to staff on low levels of variable remuneration are estimated at between EUR 1 million and EUR 5 million and an ongoing annual cost of between EUR 400 000 and EUR 1.5 million. These costs relate to the fact that large institutions need to apply the rules to all of their identified staff, which will include a high number of individuals.

Moreover, the Commission's assessment of the effectiveness of these rules, on the basis of arguments put forward by the industry, supervisors and the EBA, showed that, if the rules on deferral and pay-out in instruments were actually to be applied within small and non-complex institutions and to staff with a non-material level of variable remuneration, this would probably lead to the disappearance of variable remuneration in many cases, and thus of the link between pay and performance. In such a case, the objective of aligning remuneration with the risk profile of the institutions concerned would not be achieved.

In the case of small and non-complex institutions and staff with non-material amounts of variable remuneration, it can be concluded that the application of the rules on deferral and pay-out in instruments is not efficient if consideration is given to the particular costs and burdens triggered by the rules on the one hand and the absence of clear beneficial effects on the other. Given that the current CRD text does not allow the rules on deferral and pay-out in instruments to be waived for small and non-complex institutions and for staff with non-material levels of variable remuneration, the Commission will consider proposing a legislative amendment allowing the use of some waivers. Before proposing any such amendment, an impact assessment will be conducted. Any flexibility in the application of the deferral and pay-out in instruments requirements would need to be properly framed and delineated in order to prevent circumvention or an overly permissive interpretation of the rules and to ensure a level-playing field across the EU.

A second issue that was identified concerns the requirement for listed institutions to use only shares (and not share-linked instruments) to meet the CRD pay-out in instruments requirement.

The Commission's assessment of the arguments put forward by listed institutions and by supervisors confirmed that there are impediments to the repeated use of shares for the purpose of paying out variable remuneration. Share-linked instruments on the other hand are as effective as shares in terms of aligning the interest of staff members with those of shareholders and with the long term interest of the institution, provided that they closely track the value of shares (without a leverage effect). It is therefore acceptable to allow listed institutions to use share-linked instruments under these terms and the Commission will consider proposing a legislative amendment to that effect, following an impact assessment.

D. The maximum ratio between variable and fixed remuneration

CRD IV introduced a maximum ratio between the variable and the fixed remuneration component of identified staff[32]. Variable remuneration must not exceed the fixed remuneration or, with shareholders' approval, twice the fixed remuneration. Article 161(2) of the CRD requires the Commission to report on the impact of the maximum ratio on competitiveness, financial stability and on staff working in non-EEA subsidiaries of EEA parent institutions.

This sub-section first looks at an issue concerning the correct mapping of 'fixed' and 'variable' remuneration ***(i)***. It subsequently looks at the overall impact of the maximum ratio on remuneration packages ***(ii)***. It then examines the effects of the maximum ratio on financial stability from two angles: the effects on risk-taking and conduct ***(iii)*** and how it impacted firms' fixed costs and profitability ***(iv)***. It also examines the impact of the maximum ratio on firms' competitiveness in terms of attracting and retaining talented staff ***(v)***. It concludes by considering whether the rule should continue to apply to staff working for subsidiaries of EEA institutions outside the EEA ***(vi)***.

It is too early to appropriately and fully assess the impact of the maximum ratio, given that the rule has been in force for only one year of the period covered by this report's analysis. Moreover, some Member States used proportionality considerations to waive the maximum ratio for some institutions, or staff and institutions avoided the application of the rule by making use of specific remuneration mechanisms (the role-based allowances as discussed in paragraph *(i)* below). The analysis is also affected by the fact that harmonised rules on staff identification entered into force in 2014, and thus statistics from before and after the maximum ratio entered into force (in 2014) concern a somewhat different staff population.

It is therefore important to keep in mind that the below represents the Commission's findings *to date*, based only on the limited data available, given the short period of time since the rule is in force and the limited experience with its application.

(i) Classification of 'fixed' and 'variable' remuneration

Following the entry into force of CRD IV, institutions made frequent use of so-called role-based allowances, which were treated as fixed remuneration (thus allowing more variable remuneration). At the Commission's request, the EBA looked into the use of these allowances and found that they were often wrongly classified as 'fixed' remuneration. Following an Opinion issued by the EBA, all Member States have meanwhile reported that they have taken measures to ensure the correct mapping of these allowances.

(ii) How does the maximum ratio affect remuneration packages?

The maximum ratio does not impact directly on the level of pay but sets the proportions between the variable and fixed components. The proportion of staff affected by the rule is limited. The maximum ratio only applies to identified staff who, in 2014, represented on average 2.34 % of all staff[33]. Most of them were not receiving variable pay above the CRD maximum ratio before its introduction.

[32] Article 94(1)(g), CRD.
[33] EBA *'Benchmarking of Remuneration practices at Union level and data on high earners',* data as of end 2014.

Looking at European averages, data collected by the EBA shows that, while average fixed remuneration per identified staff has increased in recent years, average variable remuneration has decreased. It therefore follows that the relative weight of variable remuneration of total remuneration has decreased. However, these trends had already begun several years before the introduction of the maximum ratio. There are elements other than the maximum ratio that would impact on the levels and proportions of remuneration components (e.g. financial performance, profitability and general prudential requirements). Moreover, an increase in the fixed portion of remuneration has also been observed in several non-EU jurisdictions (including the US and some Asian countries).

These findings have been reached on the basis of averages of data collected mainly from large banking groups, and need to be interpreted with care. While the overall shift towards fixed remuneration cannot clearly be attributed to the maximum ratio, it is likely that in some individual cases the maximum ratio has led to a shift from variable to fixed remuneration.

(iii) How does the maximum ratio affect risk taking and conduct?

The maximum ratio was introduced as a form of behavioural safeguard, aimed at curbing the excessive risk-taking incentives caused by the high level of variable remuneration. Part of the industry, some Member States and some academics nevertheless consider that increased reliance on fixed pay may adversely affect the alignment of the staff's incentives with the interests of the firm and society.

The impact on individuals' behaviour is difficult to measure. A recent survey[34] showed that institutions were divided on the expected impact of the maximum ratio on behaviour, with suggestions being made that it may also depend on cultural background. Surveyed staff did not seem to feel that a greater proportion of fixed remuneration had an impact on their motivation or risk-taking (neither to take more, nor less risks).

Arguments have been advanced that the maximum ratio would limit the portion of performance-related remuneration to which risk-aligning tools such as deferral, pay-out in instruments and *malus* and clawback can be applied. However, data suggests that the variable remuneration that can be awarded within the limits imposed by the maximum ratio can accommodate greater use of these mechanisms, especially *malus* and clawback (see Section III.C (i)).

Moreover, ex-post adjustment tools, even if they have some deterrent effect, are inadequate on their own in mitigating adverse risk incentives or misconduct, given that they are essentially applied as a reactive tool in the event that damage materialises.

Given the recent introduction of the maximum ratio and the limited experience with its application, it is too early to draw clear conclusions on its impact on incentives for excessive risk-taking behaviour and on misconduct. This has also been recognised by some supervisors.

(iv) Impact of the maximum ratio on fixed costs and profitability

According to EBA estimates, the fixed remuneration of identified staff is of relatively low importance for most institutions examined: it represents below 5 % of the total administrative costs and 1 % of own funds. The EBA also found that the increase in fixed costs from 2013 to

[34] IFF, 2016.

2014 was very small for most of the institutions examined[35]. Similarly, other sources have suggested that the impact of the variable-to-fixed shift on the fixed cost base of institutions would not be material[36].

In any event, the extent to which institutions can reduce their total cost base by reducing variable remuneration should not be overstated given that, as shown by the EBA's analysis, in 2014 the total amount of variable remuneration of identified staff accounts for only 1 % to 2 % of the total administrative costs of most of the institutions examined. Moreover, the extent to which institutions can use the variable remuneration of identified staff to reduce their cost base even increased in 2014, due to the larger population of identified staff.

With respect to the impact of the maximum ratio on institutions' profitability, the EBA's analysis noted that between 2013 and 2014 the profitability of institutions remained largely stable. Moreover, according to EBA estimates, in 2014 the total fixed remuneration cost of identified staff on an aggregate basis was relatively small compared with the net profits of institutions. This suggests there is a non-negligible margin for fixed remuneration to increase before reaching a level that would threaten the overall profitability of institutions.

Finally, unlike some other remuneration provisions (i.e. deferral and pay-out in instruments), which in some cases can be associated with significant implementation and compliance costs and burdens, as explained in Section III.C.*(ii)*, the rule on the maximum ratio is uncomplicated, its implementation is not linked to notable administrative costs and it is easy to apply[37].

At this early stage, considering the recent introduction of the maximum ratio and the limited experience with its application, the assertions as to loss of cost flexibility, increased vulnerability of institutions to business cycles and the negative impact on institutions' regulatory capital ratios and profitability, can be considered to be unsubstantiated, in particular with respect to credit institutions.

(v) Impact of the maximum ratio on competitiveness

Concerns have been raised that the maximum ratio would reduce institutions' competitiveness by negatively affecting their ability to attract and retain talented staff in comparison with non-regulated firms (either within the financial industry sector or in other sectors to which skills are transferable). Many elements play a part in a staff member's decision to move, such as job security, promotion prospects, the reputation enjoyed by the sector, taxation, family, language and living conditions. Also, the question on whether a staff member prefers variable or fixed remuneration may essentially be down to personal or cultural preferences. So far, besides general and often rather theoretical claims made by the industry, there is no concrete evidence suggesting that the competitiveness of EU institutions in terms of attracting and retaining staff has been affected by the maximum ratio, but this may merit further assessment when more experience with the rule is gained.

[35] EBA *'Benchmarking of Remuneration practices at Union level and data on high earners data as of end 2014'.*

[36] Autonomous 'Bonus cap versus bowler hat' (2013); New Financial 'Feeling the squeeze?' (2015), available at http://newfinancial.eu/wp-content/uploads/2015/02/Feeling-the-squeeze-July-2015-updated.pdf.

[37] The EBA in its Opinion on the application of proportionality of 21 December 2915 (EBA/Op/2015/25) stated that *'waivers of the limitation of the ratio between variable and fixed remuneration should not be introduced for institutions falling under the scope of Directive 2013/36/EU'* considering that '*The so-called bonus cap is easy to apply and does not create additional administrative costs. The cap ensures that no inappropriate incentives for risk-taking can be provided*'.

(vi) Staff working for non-EEA subsidiaries

Some internationally active institutions with EEA headquarters suggested that it is difficult to compete for talent with local firms abroad, and that staff turn-over in non-EEA locations has increased. They could however not quantify this nor show that this can be attributed to the maximum ratio. It has also been suggested that differences in the rules across countries may have hampered internationally active banks in setting consistent, organisation-wide compensation strategies and that there might be compatibility concerns with local remuneration regimes.

The reason why internationally active institutions with EEA headquarters need to apply the remuneration rules on a consolidated basis, including to their non-EEA subsidiaries, is that these subsidiaries can have an impact on the soundness and stability of the group. Another reason is to address the risk that non-EEA subsidiaries are used to avoid the application of the remuneration rules. Staff working for non-EEA subsidiaries will only need to comply with the CRD remuneration rules applicable to their parent undertaking *if* it is determined that they have a material impact on the risk profile of the CRD group to which they belong. Thus, the number of staff generally affected is likely to be limited. Also, the CRD explicitly stipulates that the rules do not need to be applied if it can be demonstrated that their application would be unlawful under the laws of the third country where the subsidiary is established[38].

The assessment of the impact of the maximum ratio in non-EEA jurisdictions is currently subject to the relatively limited experience with this rule. Based on the available information, there are insufficient elements to suggest at this stage that the maximum ratio should not continue to apply to such staff.

IV. CONCLUSION

The Commission has carried out a review of the CRD and CRR remuneration rules, following the mandate set out in Article 161(2) of the CRD and in line with its ongoing work with respect to the Call for Evidence on the EU regulatory framework for financial services[39].

This review allows for a largely positive assessment of the rules on the governance of remuneration processes, performance assessment, disclosure and pay-out of the variable remuneration of identified staff, introduced by CRD III. These rules were found to contribute to the overall objectives of curbing excessive risk-taking and better aligning remuneration with performance, thereby contributing to enhanced financial stability.

The review also revealed that the deferral and pay-out in instruments requirements are not efficient in the case of small and non-complex credit institutions and investment firms, and of staff with low levels of variable remuneration. The Commission will therefore conduct an impact assessment which will examine options for addressing this issue in particular by exempting these institutions and staff from these specific requirements. This impact assessment will also look at allowing listed institutions to use share-linked instruments under the CRD pay-out in instruments requirement. This will be part of the wider work to prepare the revision of the CRD and CRR now under consideration.

[38] Article 109(3), CRD.
[39] The summary of the contributions to the 'Call for Evidence' is available at http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/summary-of-responses_en.pdf

With regard to the maximum ratio between variable and fixed remuneration introduced by CRD IV, the review found that for the time being there is insufficient evidence to draw final conclusions on the impact of the rule on competitiveness, financial stability and staff working for non-EEA subsidiaries. It seems that conclusive findings can only be reached once more implementation experience is gained.