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Client Alert Commentary

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New EU Capital Requirements Directive: Remuneration Rules Aim to Reduce Banking Sector Risk

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Member States must implement the Capital Requirements Directive V by 28 December 2020.

On 7 June 2019 the EU Official Journal published the text of the Capital Requirements Directive V (CRD V), which introduced several amendments to the remuneration rules of Capital Requirements Directive IV (CRD IV). Members States have until 28 December 2020 to implement CRD V. Until then, CRD IV and the current remuneration guidelines of the European Banking Authority (EBA) will remain in force. Notably, the controversial "bonus cap" will continue to apply under CRD V. The new Directive will implement material changes to the following areas:

- Proportionality principle
- Minimum deferral periods
- Share-linked instruments
- Material risk takers
- Gender-neutral remuneration policies

Previous EU Capital Requirements Directives

The previous EU Capital Requirements Directives introduced several remuneration principles that impacted the remuneration policies and bonus pay-outs for risk takers in the financial sector. These rules included, amongst others, a cap for bankers' bonuses, the obligation to defer a substantial portion of the bonus over a number of years, to pay a portion in shares or through instruments, and to include malus and clawback arrangements.

Proportionality Principle

The Commission's 28 July 2016 report on the assessment of the remuneration rules under CRD IV revealed that the requirements on deferral and pay-out in instruments, when applied to small institutions, were too burdensome and not commensurate with their prudential benefits.

CRD V amends Article 94 of CRD IV to exempt the application of payment in instruments, retention, and deferral to:

a) Non-large institutions (as the term is defined in point 146 of Article 4.1 of Regulation (EU) No. 575/2013/EU), in which the firm's average asset value on an individual basis is equal to or less than €5 billion over the four-year period immediately preceding the current financial year.

b) Staff members whose annual variable remuneration does not exceed €50,000 and does not represent more than one third of the staff member's total annual remuneration.

When implementing CRD V, Member States may however (i) lower or (for certain institutes) increase the threshold described in(a) above up to € 15 billion or (ii) decide not to exempt staff members entitled to an annual variable remuneration below the threshold described in (b) above. The EBA has a mandate to issue guidelines on this exception. In the UK, this new approach means that Level 3 proportionality firms will not be automatically exempt from the deferral and payment-in-instruments rules, nor from the bonus cap. That said, the European Commission has recognised in its Investment Firm Review that the CRD IV and V rules are more suitable to banks and large investment firms. The Investment Firm Directive (expected to be introduced in or around 2021) will require larger investment firms to comply with CRD V, but will set different rules for smaller investment firms that (subject to how each Member State implements the directive) should allow these firms to disapply the bonus cap.

Minimum Deferral Periods

CRD V increases the minimum deferral period from four to five years (previously the period was three to five years) and to five years for members of management bodies, and for members of senior management at institutions that are significant in terms of size, internal organisation, and the nature, scope, and complexity of their activities.

Share-Linked Instruments

The Commission's 28 July 2016 report found that the use of shares to fulfil the requirement that a portion of remuneration is paid in instruments can lead to considerable administrative burdens and costs. Currently, only non-listed entities can use share-linked instruments. CRD V will extend the possibility to use share-linked instruments to listed institutions, as well as unlisted institutions.

Material Risk Takers

CRD V lists categories of staff considered to have a material impact on an institution's risk profile. Material risk takers are:

- All members of the management body and senior management
- Staff members with managerial responsibility over the institution's control functions or material business unions
- Staff members entitled to significant remuneration in the preceding financial year, provided that the following conditions are met:
  - Staff members whose remuneration is equal to or greater than €500,000 and equal or greater than the average remuneration awarded to the members of the institution's management body and senior management
  - Staff members who perform the professional activity within a material business unit and the activity is of a kind that has a significant impact on the relevant business unit's risk profile

There is a mandate for the Commission to issue regulatory technical standards aimed at ensuring, among other outcomes, the consistent application of the new risk takers identification rules. EBA shall provide a draft of such standards to the Commission by 28 December 2019.

Subsidiary Undertakings

CRD V clarifies that the remuneration requirements will not apply on a consolidated basis to subsidiary undertakings that are subject to other specific remuneration rules, except if the subsidiary's staff members have a direct material impact on the business of the institutions within the group.

Gender-Neutral Remuneration Policies

Financial institutions must consistently apply the principle of equal pay for male and female workers for equal work or work of equal value (in accordance with other EU previous regulations). Therefore, these institutions must operate a gender-neutral remuneration policy.

The EBA has a mandate to issue guidelines on gender-neutral remuneration policies for institutions.

Application Date

CRD V must be transposed into national legislation by 28 December 2020.

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