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CEBS' CONSULTATION ON ITS GUIDELINES ON REMUNERATION POLICIES AND PRACTICES (CP42)
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AMAFI's answer

1. AMAFI welcomes CEBS' Guidelines on the remuneration requirements of the Capital Requirements Directive 3 (the Guidelines), which constitutes an essential tool to assist in a consistent implementation across the EEA.

Consistency is absolutely essential with respect to remunerations, which are a key aspect of the competitive landscape between financial institutions and of their capacity to grow and develop in the future both in their domestic markets and abroad. This is especially important for French banks and investment firms who have been subject to a specific regulation on remunerations since the 3rd of November 2009, a regulation with which failure to comply is punishable and that implements the FSB principles and standards in a precise and strict manner, most often more so than elsewhere in the world.

2. AMAFI is therefore keen on CEBS providing guidelines that are precise and allow for a consistent implementation within the EU. However, this level of detail should not be at the expense of the flexibility that the Directive allows in certain matters so that firms can tailor their remunerations policies and systems to their specific situations.

This basic principle of consistency - and need for detailed guidelines - are therefore at the heart of AMAFI's answer to the consultation, together with the consideration that detailed rules should not preclude the flexibility firms need.

A global level playing field in respect of remunerations requires flexibility as regards application of EEA rules outside of the EEA

3. As regards financial markets, which are global in nature, firms should be able to compete on equal terms in matters of remuneration. In particular, financial institutions that compete for talent in foreign labour markets via their foreign locations, should be subject to the same rules and regulations as their local competitors in respect of remuneration. This need for a level playing field as regards remuneration is recognised by the G20 and the FSB who both underline the necessity to avoid competitive distortions in this matter[1].

[1] "*Supervisors need to coordinate internationally to ensure that these standards are implemented consistently across jurisdictions*", FBS Implementation Standards on Compensation, September 2009; "*We fully endorse the implementation standards of the FSB*", Pittsburgh's G20, Leaders' statement, 24-25 September 2009.

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The CEBS Guidelines do consider this issue but only from a perspective internal to the EEA, i.e. without regard to rules and regulations that may exist outside the EEA. As far as non EEA subsidiaries and branches are concerned, the Guidelines state that "*the parent company should ensure that the requirements of a group-wide remuneration policy are coherently observed at group and subsidiary level (including non-EEA subsidiaries)*" (*§ 27 of the Guidelines*), as does the CRD3 for which the principles set in Annex V 11° point 23 "*shall be applied by credit institutions at group, parent company and subsidiary levels, including those established in offshore financial centres*"**.**

4. Besides, the detailed requirements of the CRD3 on remunerations are in many instances far more prescriptive than the FSB's principles and standards, which are the basis for existing rules on remunerations in the world, creating de facto competitive distortions in non EEA markets for European banks and investment firms. This is so for example on issues such as:

- the use of deferral plans and payment in restricted equity instruments
- the limitation on the cash that can be paid upfront
- guaranteed arrangements for new hires

These issues are such that EEA firms, which generally are not leading institutions in non EEA markets, and therefore not first choice employers for local labor, are burdened with an additional disadvantage. They are left with very little flexibility concerning their variable remuneration arrangements, which are therefore a lot less attractive compared with the ones of the local firms they compete against for talent. To a certain extent, the only workaround EEA firms are left with, providing they can afford it, is an increase in fixed remunerations to maintain a minimum cash compensation level. As a matter of fact, due to the prescriptive nature of the CRD3 provisions, this risk also exists within the EEA, thus these measures could paradoxically contribute reducing firms' ability to decrease remunerations in times of stress.

The expected consequence of the implementation of the CRD3 detailed requirements outside of the EEA is EEA firms' loss of competitiveness on these labour markets against their local counterparts and the risk that they cannot maintain their chance for future development, or even a presence, in non EEA countries, some of which show the strongest potential for growth in the world and are about to become leading players in financial markets (especially in Asia).

5. Competitiveness in these matters may not be a great concern to a number of EEA countries whose national financial markets may not represent a substantial part of their economy, however the impact of this legislation should be considered not only at a national level but also from the perspective of the European Union as a whole and its ability to keep a top-tear position in activities which are key for financing the growth of its economy.

Today the European financial system is strong, it is useful for the financing of the economy, creates jobs and contributes to the economic growth. If European firms are not able to compete on equal terms with their competitors in foreign markets that are the most dynamic globally, they are likely to be outpaced by the competition. And because the global nature of the financial systems makes it easy to service a geographical area like the EEA from other parts of the world, European firms could even see their positions in their domestic markets endangered. **The question here is whether the EU can maintain, on the mid / long term, a financial system of some importance – with its own capacity to help finance its economy - or whether it is prepared in the near future to rely on non EU institutions and markets for this purpose.**

6. In keeping with the CRD3's philosophy, a path exists yet that would reconcile the need for managing risks created by inadequate remuneration structures and the competitiveness imperative. The Directive's aim at "*credit institutions to have arrangements, strategies, processes and mechanisms to manage the risks to which they are exposed*" (*Recital 2 of the Directive adopted by the European Council on 11 October 2010 amending Directives 2006/48/EC and 2006/49/EC*). Risk is at the heart of the Directive's *raison d'être*, and in particular of its prescriptions on remunerations[2] and should also be at the heart of CEBS's guidelines, equally as regards application of the guidelines outside of EEA.

7. In this context, and considering the risks that untamed remunerations pose to the EU economy (via eventually last resort rescue packages by central banks), to export EU rules outside of the EEA makes sense only if the risks generated by a firm's location abroad are material to the firm as a whole. If it is not the case, it should be sufficient to require from the firm the application of the main principles of its remuneration policy to its local entity to ensure consistency within the group and compliance with both the principles of the CRD3 and the local rules in respect of remunerations.

Conversely, if this risk is considered material for the firm as a whole, consideration should be given as to whether the country where the entity is located applies the FSB principles and standards or not. To the extent that G20 member countries, including EEA ones, are bound by these principles and standards via their leaders' commitment to the G20 declarations, and that these leaders are satisfied that a process exists to check countries' compliance[3], there should not be a need to apply to EEA group's entities located in these countries the detailed requirements of the CRD3 on remunerations.

8. Without such flexibility, EEA firms would be confronted with conflicting or additional local rules, as local regulators' approaches to the issue may differ significantly from the EEA one. As differences are set to remain among non EEA countries in the way they implement the FSB's principles and standards, AMAFI's proposal should allow EU financial firms to adapt to specific regulations for their entities located outside of the EEA while managing risks for the firm as a whole.

9. AMAFI therefore suggests that EEA firms with locations outside the EEA consider the risks these locations generate for the institution as a whole. When this risk is material :

- **For locations in countries committed to the FSB's principles and standards, the group remuneration policy's main principles and the FSB rules as implemented locally apply;**
- **For locations in countries that are not committed to the FSB principles and standards, the CRDIII directive's requirements apply.**

This mechanism allows for proper consideration and management of risks, is consistent with the CRD3 philosophy and the international approach taken to the issue by the G20 and avoids inconsistencies in applying differing regulations that could create competitive distortions.

[2] "Remuneration policies which give incentives to take risks that exceed the general level of risk tolerated by the institution can undermine sound and effective risk management and exacerbate excessive risk-taking behaviour. The internationally agreed and endorsed Financial Stability Board (FSB) Principles for Sound Compensation Practices (the FSB principles) are therefore of particular importance" (*Directive adopted by the European Council on 11 October 2010 amending Directives 2006/48/EC and 2006/49/EC, Recital 1*)

[3] Cf. FSB's peer review process

Consistency within the EEA

10. As well as consistency is needed at a global level, it is required within the EEA. Entities located in the EEA that are part of a non EEA group should be subject to the same remuneration requirements as those that apply to their local competitors. However, the wording of the CEBS' guidance in this respect is somewhat ambiguous.

Where the EEA subsidiary is part of a non EEA group, "*the solo entity might need to ensure that the group-wide remuneration policies were taken into consideration within its own remuneration policies*" (*§29 of the Guidelines*). But what if the group-wide policies, set in accordance with the home rules, conflict with the EEA rules? Would that create the conditions for the EEA subsidiary to favour its home rules and potentially gain advantage over EEA based firms? Or would the group be subject to regulatory sanctions from its home regulator because it has not abided by its home requirements? There is obviously a need to ensure regulators co-operate on these to ensure on the one hand, that firms do not have to prove compliance with conflicting rules and on the other hand, that no competitive distortion is created among EEA firms. **CEBS should add to its guidelines some details on how this cooperation will be put into effect, e.g. which steps will have to be followed and how conflicts will be resolved?**

11. Similarly, the Guidelines set that "*each jurisdiction should consider applying the remuneration requirements to the staff of non-EEA branches of third country parent companies, operating within EEA member States*" (*§29 of the Guidelines*). For the sake of a level playing field within the EEA, such consideration should not be left to each jurisdiction's assessment – a common rule should apply irrespective of where the operations take place in the EEA. AMAFI therefore suggests amending the sentence as follows: "*each jurisdiction **shall apply** the remuneration requirements to the staff of non-EEA branches of third country parent companies, operating within EEA member States*".

The Guidelines interpret more strictly than necessary or desirable some provisions of the CRD3

12. The Guidelines introduce further prescriptions on the remuneration structure, which are not consistent with the FSB principles and standards and go beyond the provisions of the CRD3, which is not acceptable in principle and in practice, since they are not adapted to all firms in scope, create social issues and increase competitive distortions with non EAA financials firms as described.

- The Guidelines prescribe the application of the 50% equity payment to each of the immediate portion of the variable remuneration and the deferred portion

13. AMAFI does not share this interpretation of the CRD3, since it is not explicitly stated that the 50% calculation for equity payments should be based on each portion of the variable remuneration (immediate and deferred)[4].The interpretation of the CRD3 provided by the Guidelines means de facto that

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[4] We interpret the CRD3 requirement referred below as meaning that the 50% equity payment should be based on the total variable remuneration, both immediate and deferred :
« *(o) a substantial portion, and in any event at least 50 %, of any variable remuneration shall consist of an appropriate balance of:*
(i) shares or equivalent ownership interests, subject to the legal structure of the credit institution concerned or share-linked instruments or equivalent non-cash instruments, in case of a non-listed credit institution, and

the deferred portion of the variable remuneration will be higher than the 40% minimum limit set in the Directive, as employees will not be able to sell their shares immediately vested before the end of a retention period.

14. Also, some countries tax equity instruments at vesting, irrespective of whether the owner is allowed to make use or not of the instruments, meaning that **employees will have to pay upfront taxes on amounts that are not only unavailable immediately but also are at risk should the share value fall over the retention period**. This could also give rise to complex and problematic double-taxation issues in the case of internationally mobile employees, due to the lack of convergence of international taxation rules on such issues.

15. AMAFI therefore proposes that the 50% ratio for equity payments apply to the total variable compensation, in a proportionate manner to both immediate and deferred portions of the variable remuneration (for example a minimum percentage of equity payment upfront could be set to the extent that it is adapted to the circumstances - such as tax laws).

- The Guidelines introduce the obligation to add to the deferral period a retention period

16. Whereas the CRD3 calls for "*an appropriate retention policy designed to align incentives with the longer-term interests*" of the firm, the Guidelines set a prescriptive provision that any vesting of instruments should be coupled with a retention period. **AMAFI is of the opinion that it goes beyond the CRD3 requirements and that it is neither proportionate nor adapted to all institutions, whose risk profiles may differ significantly.**

Implementing such a measure would prove very complex for firms who would have to design compensation structures with several layers (cash upfront + equity upfront subject to retention + deferred cash + deferred equity subject to retention as well), whose characteristics would differ depending on the categories of staff considered and which will need to be administered separately over time and will give rise to unwarranted accounting and taxation complexity. Additionally, such a provision would heighten the acuteness of the tax issue highlighted above: the combination of the 50% equity rule and the deferral and retention requirements means that the upfront cash component is effectively limited to 20 to 30% of the total variable remuneration (which will likely have to be spent in paying taxes due on the total immediate portion).

These considerations are especially important when considering the poor outcome of the retention period in terms of aligning incentives with risk taking. In our opinion, **the deferral period meets this objective better than the retention period**:

- During the deferral period, the value of the deferred portion will fluctuate with the price of the share (as during a retention period) and
- The deferred portion is subject to the application of a *malus* clause, which is not applicable during a retention period.

(ii) where appropriate, other instruments within the meaning of Article 66(1a)(a), that adequately reflect the credit quality of the credit institution as a going concern.
The instruments referred to in this point shall be subject to an appropriate retention policy designed to align incentives with the longer-term interests of the credit institution. Member States or their competent authorities may place restrictions on the types and designs of those instruments or prohibit certain instruments as appropriate. This point shall be applied to both the portion of the variable remuneration component deferred in accordance with point (p) and the portion of the variable remuneration component not deferred" (*CRD 3 as adopted by the Council on 11 October 2010, Annex V, 11°*).

17. As such, the requirement for a retention period could even be counter productive, as it could encourage the implementation of a shorter deferral period (for e.g. a deferral of 3 years coupled with a 1 year retention, whereas 4 years of deferral is more restrictive).

At best, the systematic application of a retention period would add to the alignment of incentives towards risk only for those members of staff whose actions can affect the firm's stock price. However, very few staff members have such ability and therefore are likely to be prevented in their behaviours from taking more risk because of that measure. Applying such a provision is likely to be relevant for the most senior staff only. On the opposite an all encompassing application would unfairly subject half of the variable remuneration of all Identified Staff to the fluctuation of the firm's share value, i.e. to risk factors over which they have little or no control[5].

18. **AMAFI therefore strongly supports a more flexible approach to this issue to allow firms to take responsibility for the practicalities of the way they align incentives with risks as regard matters of retention/deferral.**

Implementation issues and review clause – the need for a proportionate approach

19. Publication of the guidelines as well as national transpositions of the CRD3 will take place late in the year, leaving a very short time to firms to adapt and inform their staff on the changes to their remuneration structures. Moreover, these regulatory changes can lead to very complex remuneration structures and legal issues that will need to be resolved. In cases where work contracts or collective agreements include some provisions of the remuneration policy, firms will need to set up relevant instruments in a sound and non-risky way, investigate tax concerns that in some cases may even trigger changes to tax legislation, hold shareholders' general meetings as and where necessary, and negotiate and execute new agreements with staff.

20. A full implementation by January 1 would undoubtedly raise important operational risks. In AMAFI's view this creates a strong basis for considering a proportionate implementation. **AMAFI therefore suggests, as allowed in § 146 of the Guidelines for disclosure, that institutions also be permitted "*to undertake an evolutionary process for the first periods*" for the implementation of the requirements on the structure of remunerations*.***

21. In addition, as the Guidelines provide interpretations of the Directive that could be difficult to implement consistently in the EEA and that are likely to create major competitive distortions outside of the EEA, **CEBS should consider planning for a review of the Guidelines after a given period to reconsider their appropriateness. The review should allow ample time for consultation and conclude sufficiently early in the year that the problems with retrospective application that are a necessary consequence of the current process could be avoided. For economic reasons, this**

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[5] As stated by the Basel Comittee, "*Implicit ex post risk adjustments are not likely to be effective tools on their own for providing appropriate risk-taking incentives to most employees because market prices may move due to many different reasons unrelated to the actions taken by the employee (for example, the market-wide price of equity-market risk may change) and because for most employees the value of the firm is not likely to be much affected by their individual decisions or performance. It is possible that implicit adjustments may be somewhat more effective for very senior executives because their actions affect the entire firm. Thus, in principle, their actions should affect the market price of the firm's stock. Whether the link between their actions and the stock price is strong enough is an open question*" (*§ 163 of the Consultative document - Range of Methodologies for Risk and Performance Alignement , Basel Committee on Banking Supervision, October 2010)*

review should take place before the one planned by the Directive whereby : "*by 1 April 2013, the Commission should review the principles on remuneration policy with particular regard to their efficiency, implementation and enforcement, taking into account international developments including any further proposals from the FSB and the implementation of the FSB principles in other jurisdictions including the link between the design of variable remuneration and excessive risk-taking behaviour*" (recital (6) of the Directive).

Other comments on the Guidelines

- Which staff? The need for a *de minimis* rule

22. Whereas the paper sets a general principle that it is the firms' responsibility to identify the members of staff whose professional activities have a material impact on the institution's risk profile (*§ 15 of the Guidelines*), it then follows on with the presumption that some staff members are to be considered as Identified Staff unless firms can demonstrate they have no material impact on their risk profile *(§ 16 of the Guidelines*).

This approach lacks consistency and is not adequate since, in any case, firms must be "*able to demonstrate to supervisors how they have assessed and selected Identified Staff*" (*§15 of the Guidelines*). The categories of staff listed should only be categories that firms should assess with respect to their relevance to their risk profile. This comment is especially important for such functions as:

- Control ones: by nature, these functions are not taking risk, as their mandate is rather to mitigate risks and their decision power is not autonomous from the one of the management body (risk arising from these functions is operational in nature, it can result in failures to follow procedures for example but is not inherent to the function itself) – hence the importance of considering only the senior staff in these functions[6], which the guidelines do highlight but whose application should be consistent among regulators (for example, a function title in itself is not sufficient to be seen as "senior" – real decision making power should be considered).

- Other risk takers: by definition, it can not be assessed that a firm could demonstrate that they do not have a material impact on the institution's risk profile because they can be qualified as risk takers only if they do take material risk for the firm, i.e. the first sentence of § 16 is not consistent with the paragraph on other risk takers.

We therefore suggest amending the first sentence of § 16 to read:
"In assessing identified Staff, firms should consider the following categories of staff to the extent that they have a material impact on the institution's risk profile: (…)".

23. More generally, we would argue that when determining the members of staff whose professional activities have a material impact on the institutions risk profile, subsidiaries and branches of foreign institutions be allowed to make this assessment considering the group they belong to.

[6] Who, arguably, may have an influence that places them in a situation where they could create material risk for the firm. For groups, the assessment of this seniority should be made at a group level: for example, a local compliance officer in a foreign subsidiary may be seen as senior from a local perspective but not from a group's perspective, because the firm's head of compliance is at the group's headquarters and the local compliance officer's ability to create material risk locally is inexistent due to the reporting lines in place.

The materiality of the risk should be assessed in consideration of the entity's importance and complexity locally but also on its importance to the risk profile of the group it belongs to.

24. Finally, one should note that this materiality assessment is one that firms find difficult to make because depending on their activities, their size, their local regulators' perception, the "criteria" to assess materiality may differ. The scope of the Identified Staff could be very large and is difficult to define with certainty.

In applying a proportionate approach to the firms in scope of the Directive, a standard threshold of total variable remuneration (or the principle of a threshold local regulators would set) under which members of staff would not be Identified Staff as long as their variable remuneration is below a set percentage of their total remuneration, would help firms set the perimeter of Identified Staff and would bring consistency across the EEA.

For example, following last year's implementation of the FSB rules in several countries, some firms of similar sizes and profiles of activities may have counted as Identified Staff from 200/300 persons to 1,000/3,000 depending on their jurisdictions. **AMAFI therefore suggests that CEBS set a *de minimis* rule in its Guidelines, under which there is no Identified Staff. To ensure this rule does not lead to undue avoidance, CEBS could also plan for a review of its effectiveness at regular times.**

25. Similarly some investment firms that have no dealing for own account and no credit activities may be out of scope for some regulators and in scope for others. There is uncertainty on the type of financial activities that should be considered for inclusion. This is certainly an analysis that CEBS can not perform ex ante but it **could further help firms and regulators adopt a more consistent approach to the issue by reviewing after a year how the Directive was implemented in this respect. Using data from local supervisors, quantitative comparisons should be made with different cuts (country, activities, size of the firm, etc.) to determine which population is considered as Identified Staff.**

- Which remuneration?

26. The Guidelines consider a retention bonus as a form of variable remuneration (§ 12 of the Guidelines), hence subjecting it to the same requirements as variable remuneration and in particular to the obligation to pay at least 50% in instruments. Conversely, the Guidelines state that a welcome or sign-on bonus can be granted either in cash or instruments (§ 69 of the Guidelines).

As a result, if a member of staff is offered a sign-on bonus in cash by a competitor, its employer, to retain him or her, would not be on an equal footing, since it would not be able to offer a retention bonus in cash. These differing approaches to the two legs of the same issue are a concern because it puts current employers at a disadvantage compared to aggressive hiring. **In AMAFI's view, retention bonuses should be subject to the same treatment as sign-on or welcome bonuses.**

- What is “an alternative for equity-based remuneration”?

27. Many non listed firms are uncomfortable with the requirement to pay part of their variable remunerations in equivalent non-cash instruments. Firstly, they are not used with these mechanisms that are not widespread and secondly, such mechanisms seem quite often unnecessarily complex to set up whereby risk alignment is already obtained via deferral periods and *malus* clauses[7].

AMAFI encourages CEBS to further consider this point and describe the alternatives for equity-based remuneration that could be considered.

[7] For example, a firm that implements an adjustment process with deferral periods and ex-post risk adjustments (that could also include a consideration of the share price evolution or the net earnings of the firm as an input into the decision over the final payment of the amount already accrued) performs an alignment of remunerations to risk that is more efficient than the one done via the payment of 50% of the variable in instruments because it is based on explicit risk adjustment measures instead of implicit ones based on the fluctuations of the share price.