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# REMUNERATION ASPECTS OF CRD V

**The Capital Requirements Directive IV (CRD IV) introduced several remuneration principles in order to curb excessive risk taking and short termism in the financial services sector. At the end of last week, the European Council formally adopted the text of CRD V. CRD V makes several amendments to CRD IV. It will be published in the EU Official Journal in June and Member States then have until 1 January 2021 to transpose it into national law.**

**CRD V will be supplemented by new European Banking Authority (EBA) guidelines on sound remuneration policies.**

CRD IV is being amended because the EU Commission's review of CRD IV indicated that the rules on deferral and pay-out in instruments are not workable for the smallest and least complex institutions and for staff with low variable remuneration. CRD IV also contains a proportionality principle that provides that when applying the Directive's remuneration principles, firms should do so "*in a manner and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities*". It became apparent from the Commission's review that this proportionality principle has been interpreted inconsistently across Member States.

## Key points

- Current position
- Proportionality
- Bonus cap
- Deferral periods
- Use of share-linked instruments
- Gender neutral policies
- Application to subsidiaries
- Implications in practice
- Revised framework for investment firms

## Current position

The CRD IV remuneration principles in relation to variable remuneration require: the deferral of payments, payment in instruments (shares), ex post risk adjustment and the imposition of a bonus cap; limiting the award of variable remuneration to 100% of fixed remuneration, or 200% with shareholder approval.

## CRD V: key changes to CRD IV remuneration provisions:

- **Proportionality:** CRD V clarifies that the rules in relation to deferral, retention and payment in instruments will apply to all institutions and their identified staff, except:
  - small and non-complex firms whose assets' value is on average equal to or less than EUR 5 billion over the four-year period immediately preceding the current financial year; and

   – staff members whose annual variable remuneration does not exceed EUR 50,000 and does not represent more than one fourth of the staff member's total remuneration.

- **Bonus cap:** this continues to apply to all firms and their staff.
- **Extended deferral periods:** CRD V adjusts the deferral period providing for a minimum deferral of **four** (instead of three) years. In the case of senior management, the minimum deferral period is **five** years.
- **Stricter approach:** Member States' regulators will be permitted to apply a stricter approach than set out in CRD V e.g. because of the nature and scope of the firm's activities, internal organisation or e.g. because of national market specificities in terms of remuneration practices or because of the nature of the responsibilities and job profile of specific staff.
- **Use of share-linked instruments**: listed firms will be permitted to use share-linked instruments that track the value of shares to meet the payment in instruments requirement. CRD IV requires listed institutions to use shares which has led to considerable administrative burdens and costs; currently only non-listed institutions are permitted to use share-linked instruments.
- **Remuneration policies and practices must be gender neutral**: reflecting equal pay for male and female employees for equal work or work of equal value. It is perhaps a little surprising that it was felt necessary to include such a provision in the Directive given that Member States should already have equal pay legislation. The EBA will issue guidelines on gender neutral policies.
- **Material risk takers:** the definition of identified staff/material risk takers will now be contained in CRD V instead of the relevant Regulatory Technical Standard (art. 92). This includes any staff that receives (i) remuneration of EUR 500,000 or more; or (ii) remuneration which is higher than the average remuneration that is awarded to senior management.
- **Application to subsidiary undertakings:** CRD V provides that the remuneration principles will not apply on a consolidated basis to subsidiaries that are subject to other specific EU remuneration requirements. This is however subject to exceptions including where the subsidiary's staff's activities have a direct material impact on the business of the institutions within the group.

## Implications in practice

These remuneration changes will in many cases require Member States to revisit their current proportionality regimes. For example, in the UK it will mean that level 3 firms will no longer be automatically exempt from the remuneration rules on deferral, payment in instruments and the bonus cap. In other Member States proportionality may have been applied on an ad hoc/ firm-specific basis and the impact of CRD V will therefore also need to be addressed accordingly.

## Revised Framework for Investment Firms

At present all investment firms are subject to CRD IV in conjunction with the Markets in Financial Instruments Directive (MiFID). The Commission's Investment Firm Review (IFR) however recognises that the CRD IV rules were developed for banks that have a very different business model. Accordingly, it is proposed that a bespoke regime will be introduced for

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smaller investment firms (the larger firms will remain subject to CRD IV/V). It is anticipated amongst other measures that the smaller investment firms will cease to be subject to the bonus cap arrangements, although based on the current wording of the draft Investment Firms Directive, Member States may impose a maximum ratio between variable and fixed remuneration on all or on specific types of investment firms.

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