

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

2009/0099(COD) - 24/11/2010 - Final act

PURPOSE: to strengthen rules for capital requirements and remuneration in the banking sector.

LEGISLATIVE ACT: Directive 2010/76/EU 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.

CONTENT: it is widely recognised that weaknesses in the regulatory framework on capital requirements for the banking sector and in the risk management of financial institutions contributed to the crisis in global financial markets. The provisions of this Directive constitute steps in the reform process in response to the financial crisis. In line with the conclusions of the G-20, the FSB and the Basel Committee on Banking Supervision, further reforms may be necessary,

Following a first reading agreement reached with the European Parliament, the Council adopted a directive aimed at:

- strengthening capital and disclosure requirements and disclosure for the trading book and for re-securitisation instruments in the banking sector; and
- ensuring that remuneration policies in the banking sector do not generate unacceptable levels of risk.

Capital requirements: the directive sets higher and reinforced capital requirements for certain assets that banks hold in the trading book and for resecuritisation instruments. Such investments entail higher risks on account of their complexity and their sensitivity to losses. This is in line with the approach envisaged by the Basel Committee on Banking Supervision.

Disclosure: the directive also enhances disclosure requirements, in line with internationally agreed standards, in several areas such as securitisation exposures in the trading book and

sponsorship of off-balance-sheet vehicles.

Remuneration policy: the Directive also introduces a requirement that the remuneration policies of financial institutions be subject to supervisory oversight. As a result, supervisory authorities will from now on have to monitor the implications of remuneration policies for the risk management of financial institutions.

More specifically, the directive:

- imposes a binding obligation on credit institutions and investment firms to have remuneration policies and practices that are consistent with and promote **sound and effective risk management**;
- brings remuneration policies within the scope of supervisory review, so that supervisors may require firms to take measures to rectify any problems that they may identify;

- states that the competent authorities should also have the power to impose or apply financial or non-financial penalties or other measures for breach of a requirement under Directive 2006/48/EC, including the requirement to have remuneration policies that are consistent with sound and effective risk management.

Because excessive and imprudent risk-taking may undermine the financial soundness of credit institutions or investment firms and destabilise the banking system, it is important that the new obligation concerning remuneration policies and practices should be implemented in consistent manner and should cover all aspects of remuneration including salaries, discretionary pension benefits and any similar benefits.

The Directive specifies **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 credit institution or investment firm**. These principles are as follows:

- the assessment of the performance-based components of remuneration should be based on longer-term performance and take into account the outstanding risks associated with the performance. The assessment of performance should be set in a multi-year framework of at least three to 5 years;
- **variable remuneration should constitute a balanced proportion of total remuneration.** It is essential that an employee's fixed salary represents a sufficiently high proportion of his total remuneration to allow the operation of a fully flexible variable remuneration policy, including the possibility to pay no variable remuneration. In order to ensure 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 of the variable remuneration component, such as 40 to 60 %, should be deferred over an appropriate period of time.** Moreover, a substantial portion of the variable remuneration component should consist of shares, share-linked instruments of the credit institution or investment firm, subject to the legal structure of the credit institution or investment firm concerned or, in the case of a non-listed credit institution or investment firm, other equivalent non-cash instruments and, where appropriate, other long-dated financial instruments that adequately reflect the credit quality of the credit institution or investment firm.

Credit institutions and investment firms should ensure that the total variable remuneration does not limit their ability to strengthen their capital base.

Regarding entities that benefit from exceptional government intervention, priority should be given to building up their capital base and providing for recovery of taxpayer assistance. Any variable remuneration payments should reflect those priorities.

Good governance structures, transparency and disclosure: the text stresses that good governance structures, transparency and disclosure are essential for sound remuneration policies.

In order to ensure adequate transparency to the market of their remuneration structures and the associated risk, **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 credit institution or investment firm. That information should be made available to all stakeholders (shareholders, employees and the general public).

Benchmarking at national and European level: in order to promote supervisory convergences in the assessment of remuneration policies and practices, and to **facilitate information collection and the consistent implementation of the remuneration principles** in the banking sector, CEBS should elaborate guidelines on sound remuneration policies in the banking sector. The competent authorities should provide CEBS with that information in order 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 at least EUR 1 million** including the business area involved and the main elements of salary, bonus, long-term award and pension contribution. That information shall be forwarded to the Committee of European Banking Supervisors, which shall disclose it 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 this paragraph and ensure the consistency of the information collected.

Report: with regard to the international nature of the Basel framework and the risks associated with a non- simultaneous implementation of the changes to that framework in major jurisdictions, the Commission shall report to the European Parliament and the Council by 31 December 2010 on progress made towards the international implementation of the changes to the capital adequacy framework, together with any appropriate proposals.

ENTRY INTO FORCE: 15/12/2010.