

***Important note:***

***This document is a working document of the Commission services for consultation.***

***It does not purport to represent or pre-judge the formal proposals of the Commission.***

You are invited to comment on the proposals in this paper. The proposals are only an indication of the approach the European Commission may take and do not represent the Commission's final policy position.

As well as expressing your views on the specific proposals, we also ask you to respond to the following questions:

- To what extent do your existing remuneration policies comply with the requirements of the proposals?
- To the extent that they are not compliant with the proposals, please indicate in which areas will you need to modify your policies to bring them in line with the proposals;
- Please indicate whether, and to what extent, modification of your policies will imply incurring additional costs. Please distinguish between one-off and recurrent costs.

While responding to the above, please do not take into account any savings, direct or indirect, with regard to the remunerations themselves, however substantial they may be.

This consultation will run for one week from Wednesday the 29<sup>th</sup> of April until the 6<sup>th</sup> of May. Please provide your responses to [markt-h1@ec.europa.eu](mailto:markt-h1@ec.europa.eu)

## Remuneration Policies

### Recitals

- Excessive and imprudent risk-taking in the banking sector has led to the failure of individual financial institutions and systemic problems in Member States and globally. While the causes of such risk-taking are many and complex, there is agreement by supervisors and regulatory bodies, including the G20 and the Committee of European Banking Supervisors, that inappropriate remuneration structures have been a contributory factor. Poorly designed remuneration policies that reward short-term profit and 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.
- Directive 2006/48/EC requires credit institutions to have arrangements, strategies, processes and mechanisms to manage the risks to which they are exposed, and Directive 2004/39/EC imposes similar requirements relating to internal control in investment firms. Directive 2006/48/EC requires competent authorities to review those internal arrangements, strategies, processes and mechanisms, and to determine whether the own funds held by the credit institution or investment firm ensure a sound management and coverage of the risks to which the institution or firm is or might be exposed ('Pillar 2 supervisory review'). That supervision is carried out on a consolidated basis in relation to banking groups, and includes financial holding companies and affiliated financial institutions in all jurisdictions. In appropriate cases where the internal arrangements adopted by credit institutions and investment firms do not meet the relevant requirements on a consolidated basis, competent authorities must require the relevant entities to take measures to rectify the deficiency. Those measures include obliging the credit institution or investment firm to hold own funds in excess of the minimum level required under Article 75 of Directive 2006/48/EC.
- In order to address the potentially detrimental effect of poorly designed remuneration structures on the sound management of risk and control of risk-taking behaviour by individuals, the requirements of Directive 2006/48/EC and Directive 2004/39/EC mentioned above should be supplemented by an express obligation for credit institutions and investment firms to establish and maintain remuneration policies and practices that are consistent with effective risk management. Member States should ensure that when drawing up and implementing their remuneration policies, credit institutions and investment firms take into account the principles on sound remuneration policies set out in the Commission Recommendation of [...] on remuneration policies in the financial services sector.
- In order to ensure effective supervisory oversight of the risks posed by inappropriate remuneration structures, the remuneration policies and practices adopted by credit institutions and investment firms should be included in the scope of the Pillar 2 supervisory review. In reviewing remuneration policies and practices and assessing their potential impact on risk management, competent authorities should have due regard to the general principles on sound remuneration policies set out in Commission Recommendation of [...] on remuneration policies in the financial services sector, on which guidelines to be published by the Committee of European Banking Supervisors should be based.
- Because poorly designed remuneration policies and incentive schemes are capable of increasing the risks to which credit institutions and investment firms are exposed, it is

appropriate that competent authorities should impose measures on the relevant entities that are designed to address problems that have been identified in relation to remuneration policies in the Pillar 2 supervisory review. Those measures should include a requirement to hold additional own funds in appropriate cases. Competent authorities should also be able to impose financial or non-financial penalties on credit institutions and investment firms that have remuneration policies that are not consistent with sound and effective risk management.

- In order to ensure fast and effective enforcement, competent authorities should also have the power to impose either financial or non-financial penalties for any breach of a requirement under Directive 2006/48/EC, and the penalties available should be effective, proportionate and dissuasive. Divergent levels of financial penalties across Member States may undermine the effectiveness of enforcement. Accordingly, the Commission should have the power to adopt technical implementing measures, in accordance with the regulatory procedure, to specify minimum levels of financial penalties if this is necessary to ensure a properly effective and dissuasive sanctions regime.

### **Amendments to Directive 2006/48/EC**

#### **[Article 22**

Changes to paragraph 1.

Home Member State competent authorities shall require that every credit institution have robust governance arrangements, which include a clear organisational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, ~~and~~ adequate internal control mechanisms, including sound administration and accounting procedures, and remuneration policies and practices that are consistent with and promote sound and effective risk management.

#### **Article 54**

The existing text of Article 54 is numbered paragraph 1.

Insert new paragraph 2

2. Member States shall ensure that, for the purposes of paragraph 1, their respective competent authorities have the power to impose both financial and non-financial penalties, which must be effective, proportionate and dissuasive.

#### **Article 136**

Insert new paragraph 3

3. When determining the appropriate level of own funds under Section 1 of Chapter 2 in the supervisory review process under Article 124 to cover all the risks to which a credit institution might be exposed, and in order to assess whether any imposition of a specific own funds requirement in excess of the minimum level is required under paragraph 2 of this Article, competent authorities shall take into account both the quantitative and qualitative aspects of

credit institutions' internal capital assessment under Article 123 and credit institutions' arrangements, processes, mechanisms and strategies under Article 22 and 123.

## **Article 150**

In paragraph 2, insert new sub-paragraph (g)

(g) specification of minimum levels of financial penalties provided for in Article 54;

## **Annex V**

New section 11

### **11. Risk arising in connection with remuneration policies**

16. When establishing and applying their remuneration policies, credit institutions shall comply with the following principles in a way that is appropriate to their size, internal organisation and the nature and scope of their activities:
- The remuneration policy is designed so as not to encourage risk-taking that exceeds the level of tolerated risk of the credit institution, is consistent with and promotes sound and effective risk management and does not have an adverse effect on the long-term interests of the credit institution.
  - The remuneration policy and its application are subject to oversight by the management body (supervisory function) of the credit institution, and to regular independent internal review with a view to assessing that it does not encourage imprudent risk-taking, create conflicts of interest, or otherwise undermine sound and effective risk management.
  - Remuneration of individuals engaged in control functions is based on the achievement of objectives linked to their functions, and is determined independently of the performance of the business areas they control or oversee.
  - The measurement of performance used to calculate bonuses or bonus pools includes an adjustment for current and future risks and takes into account the cost of the capital employed and the liquidity required.
  - Fixed and variable components of remuneration should be appropriately balanced so that the fixed component represents a sufficiently high proportion of the total remuneration to allow the credit institution to operate a fully flexible bonus policy, with the ability to pay no bonus if appropriate.
  - Payment of the major part of a significant bonus, irrespective of the form in which it is to be paid, is deferred for a period which is appropriate for the nature of the business in which the individual is engaged and its risks.

- Payment of the deferred part is linked to the future performance of the firm and, to the extent practicable, to the performance of the division or business unit of the individual.
  - Where remuneration is performance related, its total amount is based on a combination of the assessment of the performance of the individual and of the business unit concerned and of the overall results of the credit institution.
  - The assessment of individual performance takes into account non-financial criteria such as compliance with internal rules and procedures, and compliance with the standards governing the relationship with clients.
17. The Committee of European Banking Supervisors shall maintain guidelines on sound remuneration policies that support the principles set out in paragraph 16.