EBA CONSULTATION PAPER ON DRAFT GUIDELINES ON SOUND REMUNERATION POLICIES[1]

- A RESPONSE FROM THE DANISH SECURITIES AND BROKER ASSOCIATION

Copenhagen, 28th of May 2015

Dear Sirs

INTRODUCTION

The Danish Securities and Broker Association welcomes the opportunity to respond to the European Banking Authority's draft guidelines on sound remuneration policies under Articles 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013 (the "Draft Guidelines").

The Danish Securities and Broker Association represents 23 small and medium size Danish securities and broking companies which are to a wide extent affected by the various regimes on variable remuneration.

Our members appreciate the guidance and clarifications envisaged by the Draft Guidelines. It is indeed appropriate and timely to clarify the various uncertainties with regard to the interpretation and application of the remuneration rules, since the many unanswered questions leave our members and the industry in general in a precarious situation.

However, many of our members are concerned about certain of the provisions in the Draft Guidelines. In particular, the concerns relate to:

- the amended approach to the principle of proportionality;
- the wording of the Draft Guidelines' definition of variable remuneration;
- the wording of the Draft Guidelines regarding the award of variable remuneration in instruments; and
- the wording of the Draft Guidelines regarding group context.

In the following, we have included our comments to the above themes and our responses to some of the questions raised by the EBA.

[1] EBA/CP/2015/03 of 4 March 2014 - Draft Guidelines on sound remuneration policies under Article 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013

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PRINCIPLE OF PROPORTIONALITY - SECTION 8 OF THE DRAFT GUIDELINES

Q 5: All respondents are welcome to provide their comments on the chapter on proportionality, with particular reference to the change of the approach on 'neutralisations' that was required following the interpretation of the wording of the CRD. In particular institutions that used 'neutralisations' under the previous guidelines for the whole institution or identified staff receiving only a low amount of variable remuneration are asked to provide an estimate of the implementation costs in absolute and relative terms and to point to impediments resulting from their nature, including their legal form, if they were required to apply, for the variable remuneration of identified staff: a) deferral arrangements, b) the pay out in instruments and, c) malus (with respect to the deferred variable remuneration). In addition those institutions are welcome to explain the anticipated changes to the remuneration policy which will need to be made to comply with all requirements. Wherever possible the estimated impact and costs should be quantified, supported by a short explanation of the methodology applied for their estimation and provided separately for the three listed aspects.

The principle of neutralisation as permitted under Danish law[2] plays a significant role for our members, as it allows them to omit establishing complex and comprehensive remuneration structures when granting small amounts of variable remuneration which do not create any incentive for excessive risk-taking.

It is thus very regrettable that the approach on neutralisation is radically changed, in particular considering the fact that only a very narrow exception is permitted under Danish law.

In the period following the first introduction of the regime on variable remuneration, our members have to a wide extent increased fixed salary against a reduction in the use of variable remuneration. Consequently, the fixed costs of our members have increased, and the possibility to quickly adapt to changes in the market conditions has been reduced.

Currently, the use of variable remuneration is limited among our members. However, in the ordinary course of business our members sometimes have a reasonable need to pay small amounts of variable remuneration to reward extraordinary performance of identified staff members, or to retain such staff. This type of variable remuneration does not create incentives for excessive risk-taking and may be in the form of e.g. compensation for a period of an excessive workload or retention payments in connection with for instance organizational changes. Typically, such variable remuneration does not exceed 1 or 2 months' fixed salary. From a business and HR perspective, it is of significant importance for many of our members that they have access to pay small amounts of variable remuneration and to leave that narrow room for sound management discretion and flexibility without being burdened by the administrative duty of building much more demanding remuneration structures.

Our members are small and non-complex undertakings which typical employ only a limited number of employees. For many of our members, establishing the required administrative basis for managing

[2] The Danish Executive Order no. 818 of 27 June 2014 provides that risk takers receiving an annual variable remuneration of up to DKK 100,000 (EUR 13,415) may be exempt from the requirement on deferral of variable remuneration, payment in instruments and malus provided that it is deemed prudent and justifiable under certain defined criteria.

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deferred payments, payments in instruments etc. is associated with costs disproportional to the small amounts paid as variable remuneration. It is not possible to estimate the costs for our members if the current principle of neutralisation can no longer be applied. It is, however, clear that the costs - having regard to the size and complexity of our members - will be significant and may lead our members to abandon payment of variable remuneration all together. This will indeed constitute a significant - and to the best of our assessment disproportionate - disadvantage for our members when they compete with large investment firms forming part of large international financial groups.

Moreover, having regard to the typical ownership structure of our members and the illiquidity of their shares, shares and share-linked instruments are often considered to be highly unsuitable for remuneration purposes, and in order to meet the requirements for payment in instruments, our members would typically be required to establish new classes of instruments. Considering that the amounts paid as variable remuneration are small, such measures are highly non-proportional and will impose considerable direct and indirect costs upon our members.

Based on the above we strongly recommend that the principle of neutralisation is maintained or that the EBA works to ensure that relevant amendments to the CRD are introduced allowing for an exemption for small and non-complex institutions. We assess that such exemption would not in any way jeopardise the purpose of the remuneration regime if the exemption (being general or merely applicable to small, non-complex institutions) is limited to small amounts of variable remuneration.

DEFINITION OF VARIABLE REMUNERATION AND CATEGORIES OF REMUNERATION - SECTIONS 3 AND 11 OF THE DRAFT GUIDELINES

Q 8: Are the requirements regarding categories of remuneration appropriate and sufficiently clear?

We welcome the clarity provided by the Draft Guidelines' approach to remuneration, according to which remuneration is either fixed or variable.

Further, we appreciate that the definition of remuneration in item 6(a) of the Draft Guidelines clearly implies that payments - save for carried interest payments - only fall within the definition of remuneration if the payments are awarded in exchange for professional services rendered by staff.

However, the definition of remuneration also includes a very broad circumvention stipulation, according to which remuneration includes *payments made via methods and vehicles which, if they were not considered as remuneration, would lead to a circumvention of remuneration requirements*. This definition raises general concerns as to the institutions' legal certainty, since it is not clear which criteria need to be considered for the purpose of assessing whether a payment leads to a circumvention of the remuneration requirements. With that definition, our members are left in a situation where they are not able to reasonably assess or determine how to act in order to be in full compliance with the rules on remuneration.

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Moreover, the CRD only governs payments constituting remuneration, and we are concerned that a too broad circumvention definition may lead to payments being captured by the definition of remuneration notwithstanding that such payments fall outside the scope of the CRD. For instance, a number of payments that an institution may make to its identified staff employees cannot be considered remuneration, as they are not awarded in exchange for professional services rendered by the employees. This applies for instance to consideration paid by the institution for the purchase of goods from a business operated by the employee, or to distributions on shares in the institution held by the employee.

We are also concerned that a too broad definition without any guidance on the content of e.g. the terms *methods* and *vehicles* will lead to a non-uniform application across European supervisory authorities.

Thus, in the interest of ensuring legal security for the institutions and to safeguard that the Draft Guidelines are not applied in a non-uniform way or in a way that increases the scope of the CRD, we recommend that the circumvention definition is elaborated and narrowed. Such elaboration should preferably include mention of the types of payments that are not in general considered remuneration, e.g. gains obtained by employees if investing in the institutions.

AWARD OF VARIABLE REMUNERATION IN INSTRUMENTS - SECTION 17.4 OF THE DRAFT GUIDELINES

Q 16: Are the provisions on the award of variable remuneration in instruments appropriate and sufficiently clear? Listed institutions are asked to provide an estimate of the impact and costs that would be created due to the requirement that under Article 94(1)(l)(i) CRD only shares (and no share linked instruments) should be used in parallel, where possible, to instruments as set out in the RTS on instruments. Wherever possible the estimated impact and costs should be quantified and supported by a short explanation of the methodology applied for their estimation.

In our view, the provisions of the Draft Guidelines on the award of variable remuneration in instruments do not provide sufficient clarity with regard to the instruments that may be used by non-listed institutions organised in the legal form of stock corporations.

Our members are organised in the legal form of non-listed stock corporations. Thus, as stated in item 248 of the Draft Guidelines, shares and share-linked instruments are in principle available. However, a number of our members have a very limited group of shareholders. Using shares for the purpose of variable remuneration will thus entail an undesired and inappropriate change in the number and legal status of the shareholders.

Moreover, for our members, the use of share-linked instruments suffers from the disadvantages that often no *market price* of the shares is available, and the exercise of determining the *fair value* is impractical, and the result hereof is often associated with significant uncertainty and costs. For a number of our members, shares and share-linked instruments are thus often considered highly

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unsuitable for remuneration purposes irrespective of our members being organised in the legal form of stock corporations.

Article 94(1)(l) of the CRD can in our opinion not be construed to require that shares or share-linked instruments must be used based on the mere fact that the institution concerned is organised in the form of a stock corporation. In particular, the principle of proportionality as set forth in Articles 92(2) and 94(1)(l) of the CRD should in our opinion be construed to allow at least small and non-complex institutions to meet the requirement of payment in instruments by using *equivalent non-cash based instruments* e.g. in the form of synthetic instruments that are equivalent to shares in terms of loss absorbency (ranking *pari passu* with shares in the event of the institution's bankruptcy) but where the value of the instrument is not otherwise directly linked to the price of the institution's shares.

We consequently strongly recommend that section 17.4 of the Draft Guidelines is amended and aligned with Article 94 (1) (l) of the CRD to reflect that - at least small and non-complex - institutions may fulfil the requirement of payment in instruments by using other instruments than shares or share-linked instruments irrespective of such institutions being organised in the form of stock corporations.

GROUP CONTEXT - SECTION 7 OF THE DRAFT GUIDELINES

Q 4: Are the guidelines regarding remuneration policies and group context appropriate and sufficiently clear?

The application of remuneration policies and the regime on variable remuneration in a group context has given rise to an outspoken uncertainty among our members. We are therefore pleased that the Draft Guidelines aim to provide clarity in particular with regard to the application of the requirements of Articles 92(2), 93 and 94 of the CRD to staff in subsidiaries which are not subject to the CRD.

However, we assess that the Draft Guidelines do not with sufficient clarity reflect that under Articles 92(1) and 109 of the CRD the application of the remuneration regime in a group context is limited to a top-down approach entailing, for instance, that parent and/or superior group/holding companies which are not subject to the CRD cannot be captured by the regime merely due to the fact that they have a subsidiary which is subject to the CRD. We recommend that the Draft Guidelines are amended to reflect this.

Moreover, the approach to the application of the rules in subsidiaries which are not subject to the CRD is in our opinion too extensive. It goes beyond the legal requirements of the CRD and does not take fully into account the principle of proportionality. In particular, this is the case with regard to the requirements of Article 94.

For instance, it appears that an employee of a non-CRD subsidiary who meets one of the quantitative criteria in Article 3 of the RTS on identified staff, e.g. by earning EUR 500,000 or more, is considered identified staff. We consider this neither compliant with the scope of the CRD nor with the

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supervisory authority vested in the national FSAs if the employee does not carry out any functions at group level at all. Furthermore, it is deemed burdensome to an undue extent that the institutions are *either* to procure that the requirements of deferral, payment in instruments, malus etc. are met in relation to payments from their non-CRD subsidiaries *or* to observe the information requirements of Article 4(3)(4)(5) of the RTS on identified staff when excluding the specific employees.

In our view, Article 109 of the CRD cannot be construed to exclude the access for small and non-complex institutions to - having regard to the principle of proportionality - be exempt from applying the requirements of Article 94 of the CRD to subsidiaries which are not subject to the CRD, if this is justified by their size, internal organisation and the nature, scope and complexity of their activities.

We therefore recommend that section 7 of the Draft Guidelines is amended to reflect the access for small and non-complex institutions to apply the group context provisions using the principle of proportionality and thus to deviate from the specific requirements for which application in non-CRD companies are not explicitly required in the CRD.

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On behalf of the Danish Securities and Broker Association and our members we once again kindly thank the European Banking Authority for the opportunity to present our comments to the Draft Guidelines. We remain at your assistance if you have any follow-up questions or need us to elaborate on any of the above, and we hope that our comments will be included in the following stages of finalisation of the Draft Guidelines.

Sincerely yours
The Danish Securities and Broker Association

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