Regulatory brief

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EU bonus cap: Proposed expansion curtailed

On December 16, 2013, the European Banking Authority ("EBA") issued its final draft regulation on criteria to identify "Material Risk Takers" ("MRTs") who will be covered by the EBA's expansion of the upcoming EU banker bonus cap.[1] The final draft regulation caps fewer bankers' bonuses than the EBA's previous proposal did. However, because the EBA's final draft came out sooner than expected (it was not supposed to be finalized until as late as March 31, 2014), the expansion will likely go into effect well before its previously anticipated implementation date of January 1, 2015.

Our PwC colleagues in the UK provided an extensive analysis of the EBA's current plan to expand the bonus cap.[2] This **Financial Services Regulatory Brief** highlights our US view of the significant changes, given that the cap applies to subsidiaries and branches of EU banks located in the US.

Key changes

The EBA's previous proposal sought to expand the EU's banker bonus cap to include (in addition to senior management) MRTs whose earning levels fall into one of the following four categories:

- Receive bonuses greater than 75% of their fixed salary[3]
- Earn more than €500,000 annually
- Are within the top 0.3% of a bank's earners
- Are in the senior management's earnings bracket

The final draft regulation takes a different approach from the proposal by focusing less on these earnings categories and more on whether the employee's role actually impacts the risk-level of the institution. This impact determination will be made by the banks themselves, based on the employee's assigned business unit and activities. However, the determination must be justified and will be subject to regulatory review (and to regulatory approval in some cases).

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[1] The EU bonus cap passed the EU Parliament in April 2013 as part of CRD IV (Europe's Basel III implementation) and takes effect on January 1, 2014 for senior management. In May 2013, the EBA issued a draft regulation to expand the number of bankers impacted by the bonus cap by using an expanded definition of MRTs. See PwC's *Financial Services Regulatory Brief, EU Bonus Cap Update: Cap to Apply More Broadly* (May 2013).

[2] See PwC UK's *Material Risk Takers: The EBA's final draft RTS* (December 2013).

[3] Bonuses needed to also exceed €75,000 in order for this provision to apply.

More specifically, the biggest change from the proposal is the complete elimination of the category of employees who receive a bonus that is greater than 75% of their fixed salary. This category was considered onerous because it could impact employees whose bonuses are, in absolute terms, relatively small.

The second biggest change is that banks can elect (if justified based on certain criteria) to exclude employees from the cap who earn more than €500,000 annually, but they must notify their national regulator of the decision. If the excluded employees' earnings are greater than €750,000, the bank will also need to obtain its national regulator's permission in advance.

Finally, a bank may exempt employees that are within the top 0.3% of the bank's earners, after obtaining approval by its national regulator. For employees in this group who earn more than €1 million, the regulators will apply a seemingly heightened standard (i.e., exemptions will only be approved in "well justified, exceptional circumstances") and must inform the EBA before making a decision.

The proposed fourth category of application of the bonus cap expansion (that the employee is in senior management's earnings bracket) remains unchanged.

What's next?

CRD IV goes into effect on January 1, 2014, so the bonus cap will begin applying to senior management at that time. However, the EBA's final draft regulation expanding the cap will not go into effect until later in 2014, after it is approved (and potentially amended) by the European Commission and then by the European Parliament. It is our view that these approvals will be obtained in the first half of 2014, making the cap's expansion effective then.

In the interim, firms should put in place rigorous processes for determining who should, or should not, be considered MRTs. The criteria are complex, so banks' human resources and risk functions will need to devote fairly significant resources to making this determination.

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