Regulatory brief

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EU bonus cap to take effect January 1, 2014
US-based subsidiaries and branches impacted

The EU bonus cap has been moving its way through the EU legislative process as part of CRD IV (implementing Basel III in Europe) for much of this year. It became final on June 27th when it was published in the EU's "Official Journal." Because the text met the July 1st publication deadline (after being translated into the EU's official languages), the cap will take effect on January 1, 2014 (applying to compensation for performance starting on that date).

The bonus cap

Bonuses will be capped at the level of a banker's fixed compensation. The cap would be allowed to increase to twice the level of fixed salary, subject to a super-majority shareholder vote of 66%. However, if fewer than half of shares are voted, a 75% super-majority would be required.

Up to 25% of bonus pay may benefit from a discounted valuation for the purposes of the cap. This portion would need to have a five-year vesting period, be subject to claw back, and be delivered in shares or bail-in bonds.

Employees covered

The cap applies to senior management and material risk-takers ("MRTs") at EU-based banks, including their subsidiaries and branches located outside of the EU. The European Banking Authority recently approved draft regulations to expand the definition of banks' MRTs to include all employees whose total remuneration is greater than €500,000, which would lead to a significant expansion of employees subject to the cap.

The regulation though wouldn't come into effect though until likely mid-2014. The public comment period doesn't expire until August 21, 2013. Therefore, unlike the rest of the cap, this expansion of covered MRTs would not take effect on January 1, 2014.

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Key issues for banks

EU banks should already be planning for the consequences of a January 1st implementation date. Areas to consider include:

- Restructuring of compensation to meet the cap's requirements.
- Timing of any needed shareholder approvals.
- Communicating with covered employees about the impact on their compensation.

EU compared to US

In the US, the federal banking agencies proposed incentive-based compensation rules for financial institutions in early 2011.

- Financial institutions with over $1 billion of assets would be subject to principles-based prohibitions on providing incentive-based compensation that is excessive or that could lead to material financial loss to the institution.
- Financial institutions with over $50 billion of assets would be required to defer 50% of incentive-based compensation paid to executive officers and to review and approve incentive-based compensation paid to non-executive officers who individually have the ability to expose the institution to substantial risk.

Final action on these proposed US rules could be taken this year, but the process will likely extend beyond that time. While some legislators in the US may find a bonus cap appealing, the likelihood of such a proposal making any meaningful traction in the US in the current environment is highly unlikely.

Additional information

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