FS Regulatory Brief

Bonus Cap Proposal Advances in EU

March 2013

Overview

The EU's proposal to cap bankers' bonuses as part of CRDIV – the EU's Basel III implementation – advanced on March 5, 2013. The Economic and Financial Affairs Council (ECOFIN), made up of European Finance Ministers, agreed to its key terms, joining other EU negotiating bodies who reached a similar consensus last week.

The detailed draft text continues to be unavailable, but we understand that the key terms of the proposal remain unchanged and include the following:[1]

- A cap of 1:1 on the ratio of bonus to fixed pay for senior management and material risk-takers ("identified staff"). The cap can be increased to 2:1 if a quorum of shareholders representing 50% of shares participates in the vote and a 66% majority of them supports the measure. If quorum cannot be reached, the measure can also be approved if it is supported by 75% of shareholders present.
- Up to 25% of bonus pay receives a discounted valuation for the purposes of the cap, if this bonus pay is delivered over a long-term period. In addition, the long-term instruments have to be fully "claw-back-able" and "bail-in-able."
- Definitions of both bonus and fixed pay are still unclear; therefore, understanding exactly what is within and outside these definitions for applying the cap remains difficult.

[1] For further details, see *FS Regulatory Brief: Provisional Bonus Cap Added to EU Basel III Implementation Proposal (February 2013).*

These provisions will also apply to the staff of subsidiaries of European banks operating outside the European Economic Area and the European Free Trade Area. The European Commission will review and report on the impact of this provision in 2016, in close cooperation with the European Banking Authority (EBA), taking into account its impact on competitiveness and financial stability.

For non-EU headquartered firms, such as those based in the US, we understand that the shareholder vote requirement's draft text would allow for approval to be obtained from the parent firm, rather than from the ultimate shareholders of the parent.

Timing

The EU is targeting January 1, 2014 as the effective date of the proposed cap. The European Council indicated plans to seek agreement with the European Parliament by March 22, 2013 in order to allow enough time for EU Member States to implement the final proposal. If this deadline passes, individual Member States are likely to be given the option to delay the effective date beyond January 1, 2014.

Role of the European Banking Authority

A positive change for firms will be the extension of the EBA's deadline for submitting a regulatory technical standard (RTS) on the identification of risk-takers within identified staff. This extension will mean that any requirements to broaden the definition of risk-taker (and therefore increase the number of identified staff) will not apply by January 1, 2014.

We understand that the draft also provides that application of any discount to “long-term” remuneration will be issued as guidelines by the EBA, rather than as a RTS, with a deadline of March 31, 2014 (which could be accelerated). The EBA guidelines are to take into account relevant factors including inflation rate, risk and appropriate incentive structures.

Key issues for banks

EU Banks should now be planning for the consequences of a January 1, 2014 implementation date. Particular areas to consider will 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, especially given the substantial press attention.

Additional information

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