

Flash News

Circular CSSF 11/505 dated 11 March 2011

March 15, 2011

Remuneration requirements within the financial sector and proportionality principle

Introduction

On 10 December 2010 the Committee of European Banking Supervisors (CEBS) published their final guidelines for achieving compliance with the remuneration provisions of the EU Third Capital Requirements Directive (hereafter referred to as “Directive” or “CRD III”). The final guidelines provide further clarification notably on the application of proportionality rules to remuneration structures.

Circular CSSF 11/505¹, issued on 11 March 2011, specifies this proportionality principle for Luxembourg entities and complement in this respect Circulars CSSF 10/496 and 10/497 (issued on 22nd December 2010) implementing the CRD III remuneration requirements for banks and investment firms (hereafter referred to as “financial institutions”).

Remuneration requirements

The Directive² and the related CSSF Circulars (10/496 and 10/497) include both (i) general requirements which have to be applied on an institution-wide basis to the whole staff (governance, disclosure, remuneration restrictions...) and (ii) specific requirements that apply only to some categories of staff (ratio between fixed and variable remuneration, deferred remuneration, pay-out in the form of shares or instruments...).

¹ http://www.cssf.lu/fileadmin/files/Lois_reglements/Circulaires/Hors_blanchiment_terrorisme/cssf11_505.pdf

² CRD III main remuneration requirements are mentioned in our previous Flash News dated 23rd July 2010 (http://www.pwc.com/en_LU/lu/hr/docs/pwc-hrs-230710.pdf).

Amongst these specific requirements:

- A portion of the variable component (40% up to 60% for higher risk takers) has to be deferred over at least 3 years.
- At least 50% of the variable remuneration has to be paid in shares and other instruments that reflect the credit quality of the financial institution. This 50% portion is subject to a retention period (no minimum is indicated) and applies irrespectively to the immediate payment and the deferral part.

The persons in scope are:

- Members of the Board of Directors and of the Management;
- Risk takers³: staff whose activities materially impact the risk profile of the financial institution;
- Staff responsible for independent control functions (Internal audit, Compliance, Risk Management) and Human Resources;
- Any other employee receiving total remuneration that takes him into the same remuneration bracket as senior Management and risk takers, and having a material impact on the firm's risk profile.

Proportionality principle

The CRD III allows financial institutions to “neutralize” a number of requirements based on their size and risk profile (nature, scope and complexity of the activities).

Circular CSSF 11/505 confirms whether certain financial institutions may benefit from the proportionality principle and establishes two thresholds. This **proportionality principle is not granted automatically** and has to be duly justified by the financial institutions. In addition, the proportionality principle does not exempt any financial institution to establish, implement and maintain a remuneration policy.

- **A first threshold** below which **financial institutions** should not apply some requirements.

For banks, this limit is based on two criteria:

- Total non-consolidated Luxembourg balance sheet < EUR 5 Billion; **or**
- Capital requirements to cover risks < EUR 125 Million (basis 100%).

For investment firms, this limit is based on the net result derived from dealing from the activities of own account and underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis:

- Net result of these activities < 20% of the global net result before taxation

³ The CEBS guidelines confirm that the definition of a risk taker is not dependent on the total level of remuneration. Rather, it is based on the level of influence that an individual has on the firm's risk profile. The burden of proof has been placed on institutions to justify why individuals are not risk takers.

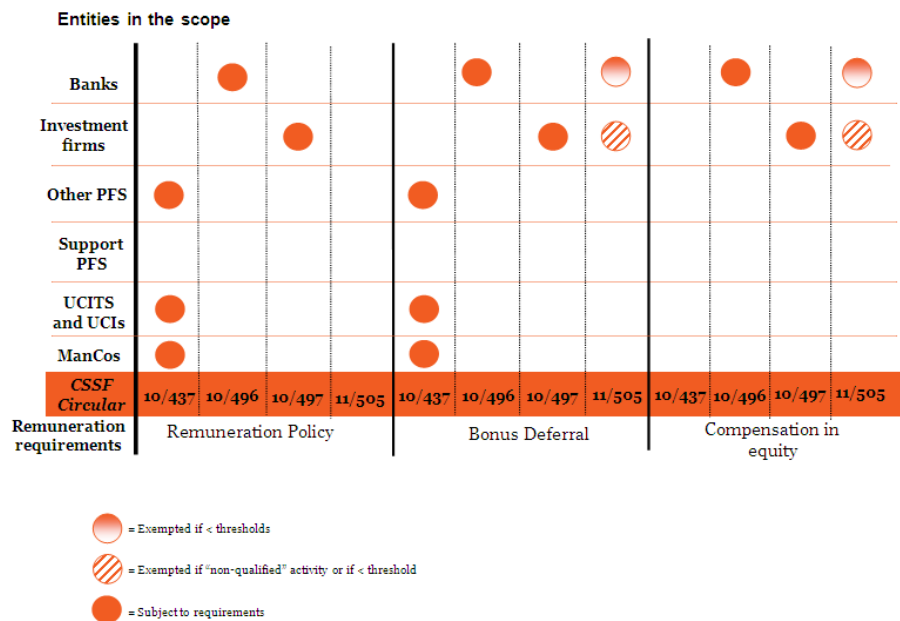
Where the financial institutions respect the above-mentioned conditions, the following requirements are not applicable:

- The bonus deferral;
- The 50% portion of non-deferred variable compensation in shares or similar instruments;
- A retention period;
- The performance adjustments on bonus; and
- The set-up of a remuneration committee.

- **A second threshold** representing a variable remuneration for a **specific person** (EUR 100,000) below which financial institutions, which are above the first threshold, are not required to differ and pay in the form of equity the remuneration, nor to apply a performance adjustment provision and are thus authorised to pay bonus full in cash.

This second remuneration threshold does not apply automatically and the financial institution must be able to demonstrate whether the said person has a limited material impact on the financial institutions risk profile.

A summary of the entities in scope of the various circulars and of the main requirements is presented below.



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