

EU Banker Bonuses: Collision Avoided?

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On November 12, 2015, the European Banking Authority (EBA) published a follow-up report on the treatment of role-based allowances (Allowances) paid by banks to their staff. The EBA's original, October 2014 report and opinion cast significant doubt on whether the majority of Allowances awarded by EU banks counted towards fixed (rather than variable) pay outside the scope of the banker bonus cap set out in the EU Capital Requirements Directive (the CRD).¹ The EBA follow-up report:

- outlines a number of Allowance features that EU regulators agree result in the Allowances being characterised as variable pay subject to the bonus cap and not fixed pay, as the relevant banks had originally thought. Banks will need to amend the terms on which the Allowances are paid in order to ensure that they are not subject to the bonus cap; and
- indicates that U.K. regulators also will fall in line with EBA views. The U.K. is the jurisdiction where the majority of Allowances are paid by banks. The EBA's October 2014 opinion appeared to set the U.K. on a collision course with the EBA on the interpretation of Allowances in particular and banker pay in general. It still is too early to tell, however, whether the U.K. supervisory approach to U.K. banks awarding Allowances in the 2015 performance year will be consistent with EBA views.

Further detail is given below.

Background

In October 2014, the EBA published an opinion and report on aspects of the CRD's "banker bonus cap" requirements, which limit the bonuses that EU banks² may pay to "identified staff". The CRD bonus cap limits variable pay to 100 percent of fixed compensation (e.g., salary and applicable allowances) paid to identified staff (or 200 percent with a super majority of nonstaff shareholders). The EBA examined banks' use of Allowances, which banks had argued to be fixed pay and not variable compensation subject to the bonus cap.

The EBA took the view that most Allowances it examined were not fixed pay, because:

- they were paid at banks' discretion;
- they were reviewable at any time;
- future payments could be adjusted upwards or downwards depending on certain nontransparent and discretionary factors;
- future payments were subject to forfeiture; and
- they were at least indirectly linked to performance, because they were intended to retain cost flexibility, even though they were not explicitly performance-based.

The EBA took the view that Allowances could be categorised as fixed pay if they were:

- Permanent, *i.e.*, maintained over a period tied to the specific role and organisational responsibilities for which they are granted;
- Predetermined, in terms of conditions and amount; and
- Nondiscretionary, nonrevocable and transparent to staff.

¹ Directive 2013/36/EU.

² Technically, the bonus cap applies to credit institutions and certain MiFID investment firms that deal as principal, underwrite, place securities or hold client assets before any application of the CRD's proportionality principle (to the extent that it remains available). We have used the term "bank" for convenience.

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In effect, the EBA envisaged Allowances counting towards fixed pay in significantly narrower circumstances than U.K. regulators and a significant number of EU Banks believed was warranted. At the time, the EBA's request that EU regulators ensure that the payment of Allowances complied with the principles set out in the opinion was thought to have set the EBA on a collision course with the U.K., which had made clear its general opposition to the bonus cap.

November 2015 EBA Follow-Up Report

On November 12, 2015, the EBA published a follow-up report on measures that EU regulators were taking to ensure banks complied with its October 2014 opinion on the status of Allowances.

The report gives examples of Allowances that EU banks had originally believed to be fixed pay, but that local regulators (or the banks themselves, after further consideration) deemed to be variable pay subject to the bonus cap. In effect, the EU banks concerned had to amend the terms of the Allowances in order to ensure that they counted towards fixed pay or reclassify them as variable compensation:

- **Ireland:** The local regulator required Irish banks to self-certify compliance with the EBA opinion. Three of the eight Irish institutions that paid Allowances made adjustments in relation to permanence, irrevocability and discretion.
- **Luxembourg:** The Luxembourg banking regulator required one local bank to amend its compensation scheme, which had enabled the payment of Allowances upon fulfilment of certain work objectives. The regulator also informed another bank that it could not grant certain instruments to senior management.
- **Italy:** The local regulator intervened when it found that one Italian banking group's compensation scheme envisaged the payment of fixed allowances for a three-year period that could then be revoked thereafter.
- **Belgium:** The Belgian regulator required one bank to amend its compensation scheme, which envisaged the payment of Allowances that were discretionary, based on a percentage of total remuneration and subject to annual review.

- **France:** The local regulator required two banking groups to revise how Allowances were set.
- **Netherlands:** One Dutch bank decided after discussions with the local regulator to reallocate 2014 Allowances to variable pay.

In addition, the EBA also gave its view that "matching share programmes", in which senior managers decide whether a staff member is eligible and then grant shares (the grant itself being discretionary and subject to change) three years later based on how many shares they already own, should be viewed as variable (not fixed) pay subject to the bonus cap. "Share appreciation rights" schemes, in which shares are awarded to senior managers with the vesting rights being based on performance, are still being assessed.

The report states that U.K. regulators have confirmed to the EBA that they will verify U.K. banks' compliance with the EBA opinion for the 2015 performance year. U.K. banks pioneered the payment of Allowances, and the U.K. is, therefore, the jurisdiction where most Allowances have been awarded. CRD restrictions on banker pay has been a bone of contention between the U.K. and the EU. News that U.K. regulators will take action to assess U.K. banks' compliance with the opinion appear to have avoided a collision between the U.K. and the EBA. However, it remains to be seen how stringently U.K. regulators will supervise the payment of Allowances awarded by U.K. for the 2015 performance year. Stringent supervision could arguably represent something of a U.K. climbdown on this issue. An EBA perception of less stringent U.K. implementation of its opinion will mean that the U.K. and the EBA remain on a collision course.

U.K. regulators stringently applying the EBA opinion to U.K. banks' awarding of allowances in the 2015 performance year also raises potential practical difficulties for banks. Employees might have a contractual entitlement to Allowances already promised. Banks could remove discretionary or other features that result in an Allowance being treated as variable pay. However, it is questionable whether these changes could apply retrospectively, even if the bank has a right under the employment contract to make adjustments to Allowances in order to comply with new interpretations of legal and regulatory requirements.