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Commission Delegated Regulation (EU) No 527/2014 of 12 March 2014 supplementing Directive (EU) No 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the classes of instruments that adequately reflect the credit quality of an institution as a going concern and are appropriate to be used for the purposes of variable remuneration (Text with EEA relevance)

COMMISSION DELEGATED REGULATION (EU) No 527/2014

of 12 March 2014

supplementing Directive (EU) No 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the classes of instruments that adequately reflect the credit quality of an institution as a going concern and are appropriate to be used for the purposes of variable remuneration

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive (EU) No 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC[(1)], and in particular Article 94(2) thereof,

Whereas:

(1) Variable remuneration awarded in instruments should promote sound and effective risk management and should not encourage risk-taking that exceeds the level of tolerated risk of the institution. Therefore classes of instruments which can be used for the purposes of variable remuneration should align the interests of staff with the interests of shareholders, creditors and other stakeholders by providing incentives for staff to act in the long-term interest of the institution and not to take excessive risks.

(2) In order to ensure that there is a strong link to the credit quality of an institution as a going concern, instruments used for the purposes of variable remuneration should contain appropriate trigger events for write down or conversion which reduce the value of the instruments in situations where the credit quality of the institution as a going concern has deteriorated. The trigger events used for remuneration purposes should not change the level of subordination of the instruments and therefore should not lead to a disqualification of Additional Tier 1 or Tier 2 instruments as own funds instruments.

(3) While the conditions which apply to Additional Tier 1 and Tier 2 instruments are specified in Articles 52 and 63 of Regulation (EU) No 575/2013 of the European Parliament and of the Council[(2)], the other instruments referred to in point (l)(ii) of Article 94(1) of Directive 2013/36/EU which can be fully converted to Common Equity Tier 1 instruments or written down are not subject to specific conditions pursuant to that

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Regulation as they are not classified as own funds instruments for prudential purposes. Specific requirements should therefore be set for different classes of instruments to ensure that they are appropriate to be used for the purposes of variable remuneration, taking account of the different nature of the instruments. The use of instruments for the purposes of variable remuneration should not in itself prevent instruments from qualifying as own funds of an institution as long as the conditions laid down in Regulation (EU) No 575/2013 are met. Nor should such use in itself be understood as providing an incentive to redeem the instrument, as after deferral and retention periods staff members are, in general, able to receive liquid funds by other means than redemption.

(4) Other Instruments comprise non-cash debt instruments or debt-linked instruments that do not qualify as own funds. Other Instruments are not limited to financial instruments as defined in point 50 of Article 4(1) of Regulation (EU) No 575/2013, but can also include further non-cash instruments, which could be included in agreements between the institution and staff members. To ensure that these instruments reflect the credit quality of an institution as a going concern, appropriate requirements should ensure that the circumstances in which such instruments are written down or converted extend beyond recovery or resolution situations.

(5) When instruments used for the purposes of variable remuneration are called, redeemed, repurchased or converted, in general such transactions should not increase the value of the remuneration awarded by paying out amounts that are higher than the value of the instrument or by converting into instruments which have a higher value than the instrument initially awarded. This is to ensure that remuneration is not paid through vehicles or methods that facilitate non-compliance with Article 94(1) of Directive 2013/36/EU.

(6) When awarding variable remuneration and when instruments used for variable remuneration are redeemed, called, repurchased or converted, those transactions should be based on values that have been established in accordance with the applicable accounting standard. A valuation of the instruments should therefore be required in all these situations in order to ensure that the requirements of Directive 2013/36/EU regarding remuneration are not circumvented, in particular as regards the ratio between variable and fixed components of remuneration and the alignment with risk taking.

(7) Article 54 of Regulation (EU) No 575/2013 sets out the write-down and conversion mechanisms for Additional Tier 1 instruments. Additionally, point (l)(ii) of Article 94(1) of Directive 2013/36/EU requires that Other Instruments can be fully converted into Common Equity Tier 1 instruments or written down. As the economic outcome of a conversion or write-down of Other Instruments is the same as for Additional Tier 1 instruments, write-down or conversion mechanisms for Other Instruments should take into account the mechanisms that apply to Additional Tier 1 instruments, with adaptations to take account of the fact that Other Instruments do not qualify as own fund instruments from a prudential perspective. Tier 2 instruments are not subject to regulatory requirements regarding write-down and conversion under Regulation (EU) No 575/2013. To ensure that the value of all such instruments, when used for variable

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remuneration, is reduced when the credit quality of the institution deteriorates, the situations in which a write-down or conversion of the instrument is necessary should be specified. The write down, write up and conversion mechanisms for Tier 2 and Other Instruments should be specified to ensure consistent application.

(8) Distributions arising from instruments can take various forms. They can be variable or fixed and can be paid periodically or at the final maturity of an instrument. In line with guidelines on remuneration policies and practices issued by the Committee of European Banking Supervisors[(3)], in order to promote sound and effective risk management no distributions should be paid to staff during deferral periods. Staff members should only receive distributions in respect of periods which follow the vesting of the instrument. Therefore only instruments with distributions which are paid periodically to the owner of the instrument are appropriate for use as variable remuneration; zero coupon bonds or instruments which retain earnings should not count towards the substantial portion of remuneration which must consist of a balance of the instruments referred to in point (l) of Article 94(1) of Directive 2013/36/EU. This is because staff would benefit during the deferral period from increasing values, which can be understood as equivalent to receiving distributions.

(9) Very high distributions can reduce the long-term incentive for prudent risk-taking as they effectively increase the variable part of the remuneration. In particular distributions should not be paid out at intervals of longer than one year, as this would lead to distributions effectively accumulating during deferral periods and being paid out once the variable remuneration vests. Accumulation of distributions would circumvent point (g) of Article 94(1) of Directive 2013/36/EU regarding the ratio between variable and fixed components of remuneration and the principle in point (m) of that Article that remuneration payable under deferral arrangements vests no faster than on a pro rata basis. Therefore distributions made after the instrument has vested should not exceed market rates. This should be ensured by requiring instruments used for variable remuneration, or the instruments to which they are linked, to be issued mainly to other investors, or by requiring such instruments to be subject to a cap on distributions.

(10) Deferral and retention requirements which apply to awards of variable remuneration pursuant to Article 94(1) of Directive 2013/36/EU have to be met at all relevant times, including when instruments used for variable remuneration are called, redeemed, repurchased or converted. In such situations instruments should therefore be exchanged with Additional Tier 1, Tier 2 and Other Instruments which reflect the credit quality of the institution as a going concern, have features equivalent to those of the instrument initially awarded, and are of the same value, taking into account any amounts which have been written down. Where instruments other than Additional Tier 1 instruments have a fixed maturity date minimum requirements should be set for the remaining maturity of such instruments when they are awarded in order to ensure that they are consistent with requirements regarding the deferral and retention periods for variable remuneration.

(11) Directive 2013/36/EU does not limit the classes of instruments that can be used for variable remuneration to a specific class of financial instruments. It should be possible

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to use synthetic instruments or contracts between staff members and institutions which are linked to Additional Tier 1 and Tier 2 instruments which can be fully converted or written down. This allows for the introduction of specific conditions in the terms of such instruments which apply only to instruments awarded to staff, without the need to impose such conditions on other investors.

(12) In a group context issuances may be managed centrally within a parent undertaking. Institutions within such a group may not, therefore, always issue instruments which are appropriate to be used for the purpose of variable remuneration. Regulation (EU) No 575/2013 enables Additional Tier 1 and Tier 2 instruments issued through an entity within the scope of consolidation to form part of an institution's own funds subject to certain conditions. Therefore it should also be possible to use such instruments for the purpose of variable remuneration, provided that there is a clear link between the credit quality of the institution using these instruments for the purpose of variable remuneration and the credit quality of the issuer of the instrument. Such a link can usually be assumed to be the case between a parent undertaking and a subsidiary. Instruments other than Additional Tier 1 and Tier 2 instruments which are not issued directly by an institution should also be capable of being used for variable remuneration, subject to equivalent conditions. Instruments which are linked to reference instruments issued by parent undertakings in third countries and which are equivalent to Additional Tier 1 or Tier 2 instruments should be eligible to be used for the purposes of variable remuneration if the trigger event refers to the institution using such a synthetic instrument.

(13) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority (EBA) to the European Commission.

(14) EBA has conducted open public consultations on the draft regulatory technical standards, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council[(4)],

HAS ADOPTED THIS REGULATION:

Article 1

Classes of instruments that adequately reflect the credit quality of an institution as a going concern and are appropriate to be used for the purposes of variable remuneration

1 The following shall be the classes of instruments that satisfy the conditions laid down in point (l)(ii) of Article 94(1) of Directive 2013/36/EU:

a classes of Additional Tier 1 instruments where those classes fulfil the conditions referred to in paragraph 2 and Article 2, and comply with Article 5(9) and point (c) of Article 5(13);

b classes of Tier 2 instruments where those classes fulfil the conditions referred to in paragraph 2 and Article 3, and comply with Article 5;

c classes of instruments which can be fully converted to Common Equity Tier 1 instruments or written down and which are neither Additional Tier 1 instruments nor

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Tier 2 instruments ('Other Instruments') in the cases referred to in Article 4 where those classes fulfil the conditions referred to in paragraph 2 and comply with Article 5.

2 The classes of instruments referred to in paragraph 1 shall fulfil the following conditions:

a instruments shall not be secured or subject to a guarantee that enhances the seniority of the claims of the holder;

b where the provisions governing an instrument allow its conversion, that instrument shall only be used for the purposes of awarding variable remuneration where the rate or range of conversion is set at a level that ensures that the value of the instrument into which the instrument initially awarded is converted is not higher than the value of the instrument initially awarded at the time it was awarded as variable remuneration;

c the provisions governing convertible instruments which are used for the sole purpose of variable remuneration shall ensure that the value of the instrument into which the instrument initially awarded is converted is not higher than the value, at the time of that conversion, of the instrument initially awarded;

d the provisions governing the instrument shall provide that any distributions are paid on at least an annual basis and are paid to the holder of the instrument;

e instruments shall be priced at their value at the time the instrument is awarded, in accordance with the applicable accounting standard. The valuation shall take into account the credit quality of the institution and shall be subject to independent review;

f the provisions governing the instruments issued for the sole purpose of variable remuneration shall require a valuation to be carried out in accordance with the applicable accounting standard in the event that the instrument is redeemed, called, repurchased or converted.

Article 2

Conditions for classes of Additional Tier 1 instruments

Classes of Additional Tier 1 instruments shall comply with the following conditions:

(a) the provisions governing the instrument shall specify a trigger event for the purpose of point (n) of Article 52(1) of Regulation (EU) No 575/2013;

(b) the trigger event referred to in point (a) occurs when the Common Equity Tier 1 capital ratio of the institution issuing the instrument, referred to in point (a) of Article 92(1) of Regulation (EU) No 575/2013, falls below either of the following:

(i) 7 %;

(ii) a level higher than 7 %, where determined by the institution and specified in the provisions governing the instrument;

(c) one of the following requirements is met:

(i) the instruments are issued for the sole purpose of being awarded as variable remuneration and the provisions governing the instrument ensure that any distributions are paid at a rate which is consistent with market rates for similar instruments issued by the institution or by institutions of comparable nature, scale, complexity and credit quality and which in any case is, at the time the remuneration is awarded, no higher than 8 percentage points above the annual average rate of change for the Union published by the Commission (Eurostat) in its Harmonised Indices of Consumer Prices