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EBA CONSULTATION PAPER

Drat Regulatory Technical Standards on material risk takers
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Comments by AMAFI

1. Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI has more than 120 members operating for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives. Nearly one-third of its members are subsidiaries or branches of non-French institutions.

2. AMAFI welcomes the opportunity to answer the consultation of the EBA on its draft Regulatory Technical Standard (RTS) setting criteria to identify categories of staff whose professional activities have a material impact on the institution's risk profile (hereafter "material risk takers" or "MRT"), as mandated in CRD4. AMAFI is particularly keen to comment on this subject because it has been a key player for the implementation of the rules on remuneration in France, starting in 2009, before any European rules existed. It has set stringent standards to its member firms, via professional standards recognized by the French competent authority[1].

[1] Available in English at: http://www.amafi.fr/images/stories/11-20a_-_Revised_AMAFI_Standard_-_Remuneration_-_EN.pdf with an explanatory guide: http://www.amafi.fr/images/stories/11-20b_-_AMAFI_Standard_-_Remuneration_-_Implementation_guide_-_EN.pdf.

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A. General observations

Enforcing the rules instead of setting new ones

3. As a preamble AMAFI agrees that the differences in the ways the previous requirements on remuneration, as set out in CRD III, were implemented in the Member States are detrimental to the integration of financial services in the EEA. Such differences are especially blatant as regard the number of persons considered as MRT for credit institutions in the EEA that are similar in terms of size and activities.

AMAFI is however concerned that, based on the observation of these differences, EBA considers that the solution is to change the existing rules via the setting of absolute and overarching quantitative criteria to identify MRT, rather than into stronger enforcement of these rules, including at the EBA level. The result is twofold:

- The proposed RTS set a complicated and administrative process to identify MRTs, which, although it provides for interesting criteria to consider, establish an overly rigid framework, not adapted to some businesses and very burdensome to manage operationally. This is dreadful for smaller firms who do not have the capacity to set up such complex processes.

- The cap on variable remuneration would apply irrespective of the risks involved, which contradicts the level 1 text.

The proportionality principle, imbedded in Art. 88(2) of the CRD4, should be fundamental to these RTS

4. In the CRD4, the requirement to apply specific measures to the remuneration of some members of staff is based on the key principle of proportionality (i.e. appropriateness to the size, internal organisation and the nature, the scope and the complexity of the activities)[2]. Under this principle, proportionality applies with respect to the definition of material risk takers, as set out in the CEBS Guidelines on remuneration policies and practices dated 10 December 2010.

However, this key principle is neither mentioned nor considered in the draft RTS, which is not consistent with the level 1 text. And the application of the quantitative criteria irrespective of the materiality of the risks created by the activities of the staff concerned results in practice in denying the possibility to apply proportionality to the definition of MRTs.

Risks inherent to investment services are different from the ones in banking activities

5. It looks like the approach taken in the draft RTS is governed by the consideration of large banking institutions, as shown by the statistics used that are limited to a few banking institutions in each country. The diversity of firms in the EU financial industry does not seem to have been considered,

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[2] *"(…) institutions comply with the following principles in a way and to the extent that is appropriate to their size, internal organization and the nature, the scope and the complexity of their activities (…)" (Art. 88 of CRD4)*

especially in terms of the risks inherent to their business models. Hence, AMAFI considers it very detrimental that the reasoning, under which a remuneration of EUR 500 000 is inherently the mark of material risk, is applied with no discrimination, irrespective of the risks actually entailed by the professional activities of the individuals concerned and of their firm as a whole.

6. Prudential concerns for investment firms may be quite different from the ones in the banking industry depending on the activities undertaken by the firms. It would therefore be proportionate for investment firms to be allowed to apply proportionality to the planned criteria, and more specifically not to have to rely on quantitative criteria that are based on assumptions related to banking activities.

The CRD4 does embed some specific treatments for investment firms depending on the types of services they carry out (underwriting with firm commitment, holding of client money, trading for own account versus execution of client orders, reception and transmission of orders, placement without firm commitment, etc.). For example, the recognition that the risks entailed are different from the ones in the banking activities has lead to differences in the level of initial capital that is required from them (*CRR4, Articles 28 to 32*).

Examples of activities carried out by investment firms that do not create the type of prudential risks that are considered in the criteria (in terms of impact on the CET1 or VAR) are as follows:

- Brokerage activities with institutional clients, conducted on an execution only basis on cash products like shares, generate a risk that exists only until the transaction has been settled, i.e. during a settlement cycle that in many cases cannot exceed three trading days and for amounts that do not represent the total nominal of the transactions (DvP settlement).

- Advice on mergers and acquisitions, which does not engage capital of the firm and does not involve risk taking.

- Placements of financial instruments on a back-to-back basis, i.e. the instruments are issued only because there is an investor's need and investor's commitment to buy them.

The biggest risk for these activities is the one inherent to any business, i.e. client disputes, which does not generally make the activities material in terms of impact on the firms' risk profile[3], as the firms can evidence using historical data. As far as these activities are concerned, applying the quantitative criteria foreseen would bring no benefit in terms of prudential stability, on the opposite it would make the firms more vulnerable (*see § 8 below*).

The recent decision by the European Parliament not to cap bonuses for UCITS fund managers highlights the need for appropriateness of the rules where the nature of risks is different. In relation to that decision, Sharon Bowles MEP, chairman of the EU's Economic and Monetary Affairs Committee said: "*I have always maintained that banks have a monopoly on liquidity and lending, both of which are ultimately provided at public expense. For this reason, I do not think it is appropriate to roll out the same bonus cap across all financial services legislation... We have to be proportional, not reactionary, when it comes to regulating the financial markets*".

[3] In such cases, the risk materialises a long time after the client has initially complained because of the judicial proceedings involved, especially if the amounts involved are such that the financial viability of the firm is at risk. Meanwhile, the supervisory authority has time to act if needed.

7. The regulation of the risk takers' remuneration aims at ensuring that these members of staff cannot receive a high level of variable remuneration, calculated relative to a short-term gain, while leaving their employer to shoulder the burden of risk on a longer timeframe: this is not the case in the examples provided, even if high remuneration is paid.

Highly remunerated employees should be tested with regards to their material impact on the risk profile of the institution to check that they are not getting today the reward of risks that will unfold later on, but they should not be considered as MRT per se. This is not consistent with the spirit of the level 1 text that is to mitigate risk created by inappropriate remuneration, not to regulate the level of remuneration in itself. By setting absolute criteria to identify MRT, the RTS actually go further than the level 1 text because they do not allow for consideration of the impact of the individuals' activities on the risks profile of firms. And as shown by recent debates on UCITS fund managers, it is not certain that this approach is in line with the political mandate provided by the Parliament, or at least this should have been discussed in this assembly.

Quantitative criteria should serve to test whether the persons concerned should be considered as MRTs, they should not be absolute

8. The application of purely quantitative criteria to define MRT, and specifically the one related to the total gross remuneration of at least EUR 500 000, would have the effect of restricting the remuneration of staff whose variable remuneration is not discretionary but commission-based, even when their professional activity does not create material risks for the firm. It is therefore likely to hurt the firm's revenues without improving its risk exposure and possibility instead worsening it.

The impact of such a measure on institutions that are not large is unlikely to be offset by the rise of fixed salaries, for two mean reasons:

- These firms are often not able financially to increase their fixed costs;
- Such an increase would expose them to higher financial risk in times of downturn, which is likely in today's unstable environment where each year is different from the other.

The likely consequence is on the one hand, a weakening of smaller-size intermediaries and the further encouragement of concentration of the financial industry among a few major players (thus increasing the concentration of risks), and on the other hand, the move of some of these high earners to unregulated activities.

9. AMAFI recognized as soon as 2009 that the ex-ante analysis of the risk entailed by each business line and function of the firm is not sufficient to identify MRTs and that staff earning high-level remuneration whose activities are not considered ex ante as posing a material risk to the firm should nevertheless be examined for potential inclusion in the MRT category. In the AMAFI Standards, the process for identifying MRTs is therefore twofold[4]:

- Based on its risk map, the institution should draw up the list of business lines and the functions within them that are deemed to be exercised by risk takers;
- Based on threshold(s) set by the decision-making body, those employees who are not considered as risk takers, as per the above, but whose total remuneration is similar to that of risk takers shall

[4] §§ 43 and 44 of the AMAFI Professional Standard

be identified. Activities of these employees shall be examined to assess whether they have a material impact on the institution's risk profile and whether they should be considered as MRT.

10. Such an approach takes into account the suspicion that high level remuneration can induce material risk impact on the firms but recognizes as well that this may not always be the case, which is true in a number of activities carried out by financial institutions (*see § 6 above*).

11. In addition, the use of absolute quantitative criteria would create instability in terms of year-to-year comparison of remuneration figures and would be difficult to manage from an employee perspective (i.e. in terms of employees being subject to the rules on remuneration one year and not the other year, with the impact this can have in terms of visibility for them and consistency among staff) but also from an administrative point of view in terms of complexity to manage.

12. For AMAFI, the quantitative criteria set in Article 3 (2) should therefore serve as back-stops to verify whether all MRT have been identified through the other criteria but this should be based on the assessment of actual risks entailing from the activities of these employees and could result in them not being identified as MRT.

At a minimum, Article 4, which provides the possibility to make an assessment/demonstration of the materiality of the risk entailed by the staff member's professional activities, should be extended to all staff members identified solely as a result of the quantitative criteria listed in Article 3 (2) (hence removing the proposed limitation of this possibility to points (2) (a) and (b) of this Article) (*see also § 32 below)*.

13. Finally, since Article 4 also allows for the consideration of "*differences between the levels of remuneration which can be awarded in different jurisdictions where the institution undertakes business*", extending its application to all quantitative criteria would allow taking into consideration the international context whereby differences in absolute remuneration often result from distinct economic conditions and not necessarily from the risk resulting from the staff members' activities. Otherwise, a disproportionate number of staff will be identified as MRT in key financial centers outside the EU, thus exacerbating the distortions to the global level playing field caused by CRD4 remuneration provisions.

Identification of MRTs should be carried out at a group level

14. Article 1 (2) and Recital (2) of the draft RTS specify that the criteria should apply at group, parent and subsidiary levels. In the context of a group, this means that each separate legal entity will consider as MRT staff with such functions as head of internal risk, control/compliance/internal audit, head of legal, tax, HR, IT, 0.3% of highest paid staff,… without considering that many of them, who report to a manager in the parent company, are only responsible for implementing the group's policies and strategy not for setting them and therefore cannot make material decisions at their level. Such application, irrespective of the size, internal organization and the nature, scope and complexity of the activities of the entity, is in contradiction with the proportionality principle enshrined in the level 1 text.

In addition, although the level 1 text provides that the application of Articles 88(2) to 91 shall be ensured for institutions at group, parent company and subsidiary levels (*CRD4, art. 88(1)*), it does not mean that the group context should not be considered when identifying MRT to whom the measures will apply.

Finally, even if the criteria were to apply with no proportionality, the onward application of the proportionality principle to the remuneration rules applicable to MRTs listed in Articles 88 and 90 could in fact lead to the neutralization of some of the rules, as considered fit by national supervisory authorities,

who today apply proportionality differently. This could therefore lead to inconsistencies in the way the rules are applied to EEA institutions, including within the same group.

15. In AMAFI's view, the RTS should therefore provide that in a consolidated group context, the criteria should be assessed at the group level and not at the level of each EEA subsidiary subject to CRD4. Exceptions could be made to this rule for significant subsidiaries of an EU parent institution and those subsidiaries which are of material significance for their local market, who would apply the criteria on an individual or sub-consolidated basis. This would make the perimeter of MRT consistent with the scope of the disclosure requirements under the CRR.

The notions of significant subsidiary / material significance in the local market should be defined clearly and should be consistent with other regulations (i.e. the proposed definition of the European Parliament in Article 7. 1a of the draft Recovery and Resolution Directive).

16. In addition, the RTS should clarify that identification as a MRT does not preclude a subsequent neutralization of the requirements for all or some categories of MRT, according to the proportionality principle.

The date of publication of the RTS should be moved forward for timely implementation by financial institutions

17. The submission of the RTS to the Commission is planned for the end of March 2014 whereas institutions are required to apply the new rules to remuneration awarded for performance from 2014. This will imply changes to processes and policies, IT adjustments, communication to employees, potential modification of contractual arrangements, etc. Also, for members of staff whose variable remuneration is paid on a monthly basis, the processes should be in place as soon as February 2014.

It is therefore essential that the calendar for the publication of these RTS, that will be instrumental for the identification of MRT, be moved forward to the fall of 2013.

B. Specific comments and AMAFI's answers to the list of questions

Article 2(3) – factors to take into account for developing internal criteria

18. Among the factors that should be taken into account in developing internal criteria is the extent to which the professional activities of the staff could have a material impact on the institution's annual financial results. If risk can indeed impact financial results, the reverse is not necessarily true, i.e. an activity having an impact on financial results may not necessarily carry a significant risk for the firm[5] (*see § 9 above*). If this concept was to be maintained, then AMAFI suggests that it be related to the notion of risk that is the one considered at level 1, i.e. this point could read "*the extent to which the professional activities of the staff could have a material impact on the institution's annual financial results or balance sheet because of the risk they carry*".

Q1: Is the list of specific functions listed appropriate or should additional functions be added?

19. The proposed specific functions are appropriate, subject to the ability to make the assessment at a group level (*see § 14 above*).

If the analysis had to be performed at an entity level, it is essential that the materiality of the responsibilities be assessed in the context of the group considering the importance of the business units or legal entities concerned and their significance in the local market.

Q2: Can the above criteria be easily applied and are the levels of staff identified and the provided threshold appropriate?

20. A criterion based on the CET1 is relevant as it provides consistency across institutions and takes into account size and risk profile. However, the threshold of 0.25% would catch other activities than those having a "material impact on the institution's risk profile": 1% would be more appropriate for that purpose.

Q3: Can the above criteria be easily applied and are the levels of staff identified and the provided thresholds appropriate?

21. The criteria use the concept of individual and collective authority as regards the ability to commit to transactions on the trading book. Although market risk exposure is generally set and managed at desk level as assumed in Recital (9) of the draft RTS[6], accountability for abiding by that limit is most of the time on the desk head, not the other traders of the desk. The MRT should therefore be the staff member who is directly accountable for the limit and not all traders on the desk, otherwise junior traders who are simply executing instructions and are only authorized to take positions/commit to transactions subject to supervision of their line management, would be deemed MRT.

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[5] This can be especially true for firms with a unique business line, which by definition makes 100% of the financial results.

[6] "*Within the trading area, limits are often set on a trading desk level, which is responsible for trading certain types of instruments (...). Limits of authority in the trading area should therefore be based on the aggregated exposures taken by a trading desk, encompassing all staff who have the authority to enter into such positions*"

22. As regards criterion g. ii, referring to the internal model based approach, the 95th percentile is not used by all institutions, some using the 99th percentile. Some flexibility should therefore be incorporated so that institutions can use their existing models. Also, for these institutions using the 99th percentile, 5% of VAR limit is too low to capture "material impact on the institution's risk profile": 10% would be more appropriate.

Article 3(1) h and i – Staff members with managerial responsibility

23. Point h assumes that the sum of individual authorities can be compared to the VAR limit set in g. ii or the credit exposure limit set in f. However, it is not appropriate because the sum of risk authorities will not take into account the resulting overall risk exposure that benefit from diversification of risk and netting effect. The sum of individual authorities could lead to the identification of MRTs without them taking any overall significant exposure.

It would be more appropriate to identify as MRT any staff member who "has managerial responsibility" for a MRT identified under Article 3(1) f. and g, following the same logic as the one in point i.

Articles 3(1) j and 3(3) – Individual and collective authority

24. AMAFI agrees with the criterion based on the authority to take, approve or veto material decisions. However, it does not agree with the approach taken to consider that collective authority includes "*staff who are responsible for advising on or initiating such commitments or decisions*".

This could potentially capture not only employees who make decisions but also all employees whose advice is taken by committees and decision making staff without them having a decisional power (such as credit analysts, compliance and legal staff, back-office or IT employees, control functions…). Considering that the heads of support functions such as IT, legal, HR, credit, compliance, control, etc. are already considered as MRT as per Article 3(1) c. and e., such extension could result in the inclusion of more junior staff in these functions only because they participate in committees as advisors.

This would trigger a detrimental effect in terms of attendance of advisory functions to committees, or at best would require an administrative process of documenting the non-decisional role of these staff members in these committees, without ensuring better management of the risks taken by the firm.

25. The scope should therefore be limited to staff members who have a significant impact on the risk profile due to them having the authority, individually or collectively, to make commitments or decisions.

Q4 a) Is this criterion appropriate to identify risk takers?
Q4 b) Are the thresholds set in the criterion appropriate?
Q4 c) What would be the number of staff members identified in addition to all other criteria within the RTS?
Q4 d) What would be the additional costs of implementation for the above criterion if an institution applies Article 4 in order to exclude staff from the group of identified staff?

26. This criterion is not possible to implement because it is based on potential remuneration ("*could be awarded under the remuneration policy*"). It is counterintuitive in terms of staff motivation that an

institution's remuneration policy would set formal caps for variable remuneration awards. Hence this criterion would encompass all the institution's staff, even though in reality many of them will not be awarded this level of remuneration.

Besides, this notion of potentiality is at odds with the level 1 text that aims at "*any employee receiving total remuneration that takes them into the same remuneration bracket*" (CRD4, Article 88(2)), not any employee who could receive such remuneration.

As a result, AMAFI believes that this criterion is counter-productive and should be removed.

Q5 a) Can the above criterion be easily applied?
Q5 b) Would it be more appropriate to use remuneration which potentially could be awarded as a basis for this criterion?
Q5 c) What would be the difference in implementation costs if the potentially awarded remuneration would be used as a basis?

27. This criterion implies that a comparison should be done between the total gross remuneration of all MRTs to find out which one is the lowest, over two years. It also implies that once done, the total gross remuneration of any member of staff in the institution be compared, over two years, to this lowest remuneration. This is definitely a burdensome and administrative process and one that is not adapted to international institutions with varying levels of remuneration depending on the locations.

In addition, as the perimeter of MRT can be very wide depending on the application of the other criteria (like f. and j. in Article 3(1)) and as the variable remuneration of MRT can fall to zero, the lowest level of gross remuneration for an MRT is likely to be low both in absolute terms and compared to the other members of staff' remuneration. Hence this criterion would result in the identification of many other MRTs. The effect will also be that the population of MRT could vary significantly from one year to the other (*see § 11 above*), whereas the risks inherent to the activities performed may not.

Even as a back-stop test, this criterion is poor because it will trigger the review of a very high number of employees with no impact on risk exposure.

28. If it were to be kept as a back-stop test nevertheless, one option could be to individualise this threshold so it can be set at the level of each entity or branch and defined by each entity in its remuneration policy, based on its historical data.

Q6: Can the above criterion be easily applied and are the threshold and the levels of staff identified appropriate?

29. Please see §§ 5, 8 and 12 above.

An additional issue with setting an absolute level of EUR 500k, if it were to be used as a back-stop, is that it may help capture staff whose activities may have a material impact on the risk profile of the institution in some countries but may be of no use in others where remuneration standards are a lot higher or a lot lower due to different costs of living. For e.g., this would trigger the consideration of a disproportionate number of staff in some locations (i.e. New York, London, Hong Kong), staff with no material impact on the risk profile of the institution or group and, on the contrary, would be irrelevant in some EEA countries.

Q7: Can the above criteria be easily applied and are the levels of staff identified appropriate?

30. The proposed 0.3% of highest paid staff can be a useful reference for large institutions, but does not take into account proportionality and is likely to be non feasible practically for small institutions.

Therefore, Article 4 should also encompass point d. of Article 3 (2) d. so that staff identified under this criterion could be considered as not being MRT if their activities do not have a material impact on the risk profile of the institution.

Q8: Are there additional criteria which should be used to identify staff having a material impact on the institutions risk profile?

31. No.

Article 4 - Staff with no material impact on the risk profile

32. If the quantitative criteria proposed in the draft RTS are kept as is then a very large number of employees could have to be reviewed. Article 4 should therefore provide for the possibility to exempt some categories of staff (based on their activity or functions) rather than only individuals, on a case by case basis.