Pérez-Llorca

Legal Briefing

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THE CNMV ADOPTS THE EBA GUIDELINES ON SOUND REMUNERATION POLICIES FOR ESIS UNDER DIRECTIVE (EU) 2019/2034

1. Introduction

On 11 May 2022, the Spanish National Securities Market Commission (*Comisión Nacional del Mercado de Valores*) (**"CNMV"**) notified the European Banking Authority (**"EBA"**) of its intention to comply with the Guidelines on sound remuneration policies for investment firms under Directive (EU) 2019/2034 (the **"Guidelines"**), published on 14 March 2022.

The Guidelines outline certain aspects of the governance and implementation of remuneration policies for all staff and for the staff (**"Identified Staff"**) whose professional activities have a material impact on the risk profile of investment firms (*empresas de servicios de inversión*) (**"ESI"**) or the ESI's relevant assets under management. In addition, they establish the supervisory approach to be applied by competent authorities in the supervision of remuneration policies and practices.

With its publication, the EBA seeks to improve harmonisation between supervisors in this area, following the amendments introduced by Directive (EU) 2019/2034 of 27 November 2019 on the prudential supervision of investment firms (the **"IFD Directive"**), which has not yet been transposed in Spain regarding remuneration policies. One of the objectives of the IFD Directive has been to establish clear rules on corporate governance and non-discriminatory remuneration rules for ESIs and has therefore established, *inter alia*, (i) the general criteria for ESI remuneration policies; (ii) the requirements for variable remuneration of Identified Staff.

Now, as a further development of the IFD Directive, the Guidelines expand upon and specify the requirements that ESI remuneration policies must comply with in terms of:

- Gender neutrality, whereby all staff receive equal pay for equal work or work of equal value, regardless of gender.

- The granting and payment of variable remuneration for identified staff, particularly regarding the issues of deferral of variable remuneration and payment in instruments.

- Remuneration ratios for the proportion of variable remuneration of identified staff existing under previous regulations.

2. Content of the Guidelines

(i) Obligation to have a Remuneration Policy for all staff

Under Article 26 of Directive (EU) 2019/2034, ESIs shall have a **remuneration policy** for all staff, which is (i) gender-neutral, including with regard to salary increases and career progression; (ii) aligned with the objectives of its risk and business strategy, including objectives relating to environmental, social and governance (ESG) risks; and (iii) consistent with the requirement for ESIs to have a robust capital structure.

The remuneration policy must specify all components of remuneration and, also, the pension policy, including, where appropriate, the framework for early retirement. Where variable remuneration is granted, it must be based on the performance of the ESI, the employee and, where applicable, the business units, and shall take into account the risks assumed.

In addition, the institution must ensure that potential conflicts of interest caused by the payment of instruments as part of fixed or variable remuneration are identified and managed and must be able to demonstrate to the competent authorities that the remuneration policy and practices promote and are consistent with sound and effective risk management.

(ii) Remuneration governance

- **Responsible body: Board of Directors. Remuneration Committee. General Meeting**

  The Guidelines provide that the Board of Directors shall be responsible for adopting, maintaining or amending the remuneration policy of the ESI, as well as for overseeing its implementation, working closely with other Board committees, such as the risk and remuneration committees, where appropriate, to ensure that the remuneration policy is consistent and promotes sound and effective risk management.

  It is noteworthy in this respect that the Guidelines provide that the approval of the remuneration policy of the ESI and, where applicable, decisions regarding the remuneration of members of the management body and Identified Staff may also be made by the shareholders' meeting under the company law of the Member State in question.

Unless otherwise provided for in national legislation, an ESI with on-balance sheet and off-balance sheet assets with an average value of more than EUR 100 million during the four-year period immediately preceding the relevant financial year must establish a remuneration committee to advise the management body in its supervisory function and to prepare the decisions to be made by the management body. The Guidelines include detailed provisions on their composition and functions.

- **Documentation and periodic review of remuneration policies and practices**

  Remuneration policy and practices and the procedures for determining them must be clear, transparent and well documented, and there shall be an effective framework for performance measurement, risk adjustment and links between performance and reward. The Guidelines include detailed criteria on how remuneration policy reviews should be conducted. These reviews must be carried out at least once a year.

(iii) Remuneration policies in ESI groups

For ESI groups, the remuneration requirements applicable in the Member State where the EU parent undertaking is established shall apply. At the consolidated level, a remuneration policy should be applied for all staff, including all identified staff, in all ESIs, all their subsidiaries and other entities within the scope of prudential consolidation.

(iv) European subsidiaries with parent companies in third countries

Parent company staff who are temporarily seconded to an ESI or EU subsidiary and who, if employed directly by the ESI or EU subsidiary, would be considered Identified Staff, shall be considered Identified Staff. Such seconded staff shall be subject to the remuneration provisions as applied in the Member State where the ESI or EU subsidiary is established.

For subsidiaries, the remuneration requirements shall apply to an ESI in a Member State irrespective of the fact that it is a subsidiary of a parent ESI or entity in a third country.

(v) Identified Staff: identification process, remuneration policies, deferral of variable remuneration, reduction and clawback of remuneration

- **Identification process**

  ESIs must conduct an annual **self-assessment** to **identify** all staff whose professional activities have or may have a material impact on the risk profile of the ESI or the assets it manages. The identification process will be part of the ESI's overall remuneration policy. ESIs shall keep records of the identification process and its results and must be able to demonstrate to the competent supervisory authority how Identified Staff have been identified.

- **Specific remuneration policies for identified staff. Fixed/variable ratio, risk adjustment**

  Furthermore, Title IV of the Guidelines states that ESIs must implement, for the different categories of Identified Staff (Board members, heads of Internal Control units, etc.), specific remuneration policies and appropriate risk alignment mechanisms to ensure that the impact of the category of Identified Staff on the risk profile of the ESI is appropriately aligned with their remuneration. This remuneration policy for Identified Staff shall establish an appropriate ratio between the variable and fixed components of the total remuneration, which shall be set independently of any possible *ex-post* adjustment for future risk or fluctuations in the price of the instruments.

  The Guidelines also set out the criteria applicable to remuneration policies for Identified Staff and flexible permanent variable remuneration, the requirements for the ratio between fixed and variable remuneration and the processes for alignment with risk and for measuring performance and risks. They also point to the mechanisms for establishing remuneration funds for bonuses for Identified Staff, and for "*ex-ante* risk adjustment" in the process of awarding bonuses.

- **Deferral of variable remuneration**

  For variable remuneration, deferral schedules may be established, which should appropriately align staff remuneration with the activities of the ESI, the business cycle and the risk profile and activities of the Identified Staff members. The Guidelines specify the components of deferral schedules for deferred remuneration. These are (i) the proportion of variable remuneration deferred; (ii) the length of the deferral period, which may exceed the minimum period of three to five years; and (iii) the speed at which deferred remuneration vests, including the length of time between the end of the vesting period and the vesting of the first deferred amount.

  In setting the effective deferral period and the proportion of remuneration to be deferred, ESIs shall consider (i) the responsibilities and skills of the identified staff and the tasks they perform; (ii) the business cycle and the nature of the ESI's activities; (iii) the expected fluctuations in the economic activity, performance and risks of the ESI and of the business unit, as well as the impact of the identified staff on those fluctuations; and (iv) the approved ratio between the variable and fixed components of total remuneration and the absolute amount of variable remuneration.

In particular, it is noted that ESIs must set the appropriate proportion of remuneration to be deferred for an identified category of staff or for an identified staff member at a minimum of 40%. Where the amount of variable remuneration is particularly high, the deferral ratio for such staff members shall be at least 60%.

- **Payment through capital instruments**

  It also regulates certain aspects of the granting of variable remuneration in instruments, which must be commensurate with the ESI's performance and risks. In this regard, ESIs will prioritise the use of instruments rather than cash, with a minimum percentage in instruments of at least 50%. Where ESIs grant a proportion of variable remuneration in instruments that exceeds 50%, they shall prioritise the setting of a higher percentage of instruments in the deferred part of the variable remuneration component.

  Variable remuneration may consist of a balance of different types of instruments. Priority should be given to the use of instruments issued by the ESI itself, while certain instruments issued within the scope of consolidation may also be used, and a mechanism for requesting the use of alternative mechanisms should be regulated.

An ESI shall have access to the instruments granted when the variable remuneration is consolidated into instruments, although it may decide not to hold the instruments during the deferral period, in which case it shall take into account relevant market risks. No interest or dividends shall be paid in respect of instruments that have been granted as variable remuneration with deferral provisions to Identified Staff but shall be deemed to have been received and owned by the ESI.

- **Reduction and recovery of remuneration paid**

  Concerning *ex-post* risk adjustment, the Guidelines detail certain aspects of reduction of remuneration (*malus*) and clawback clauses. These *ex-post* risk adjustments will (i) always be linked to performance or risk; (ii) relate to actual risk situations or changes in the persistent risks of the ESIs, business lines or staff activities; and (iii) not be based on the amount of dividends paid or the evolution of the share price.

  ESIs may apply reduction-of-remuneration or recovery-of-remuneration-already-paid clauses to up to 100% of the total variable remuneration, regardless of the method used for payment, following the performance and risk criteria initially applied to ensure a link between the initial assessment of performance and its retrospective testing. Among these criteria to be applied, the Guidelines highlight the following (i) evidence of misconduct or gross error by the staff member; (ii) if the financial results of the ESI and/or the business unit subsequently suffer a downturn; (iii) if the ESI and/or the business unit in which the identified staff member works suffers a material failure in risk management; (iv) significant increases in the regulatory or economic capital structure of the business unit or the ESI; (v) regulatory sanctions to which the conduct of the Identified Staff member has contributed.

(vi) Remuneration structure, remuneration of specific functions and Identified Staff

Title II of the Guidelines includes an analysis of the remuneration structure that may be established by an ESI, detailing, *inter alia*, the categories of remuneration, what may be considered fixed or variable remuneration, the specific details of certain remuneration components (salary supplements, variable remuneration based on future performance, dividends and interest payments, retention bonuses, discretionary pension benefits, etc.), as well as the different exceptional remuneration components (guaranteed variable remuneration, compensation or payment for loss of wages accrued in a previous contract, severance payments and other payments after the termination of a contract).

Title II also establishes certain prohibitions on personal hedging strategies, as well as mechanisms to avoid instruments or methods that are intended or actually lead to non-compliance with the Guidelines.

Title III of the Guidelines contains provisions on the remuneration of certain specific functions within ESIs, in particular, the remuneration of the members involved in managing and supervising the management body and the remuneration of the control functions.

(vii) Proportionality

The principle of proportionality should be taken into account when applying the remuneration requirements and the provisions of the Guidelines, so that remuneration policies and practices are consistent with the individual risk profile, risk appetite and strategy of the ESI, in order to effectively meet the objectives of the remuneration requirements. This shall take into account the nature, scale and complexity as well as the risks inherent in the ESI's business model and activities.

The Guidelines include details of the parameters to be taken into account in assessing proportionality and determining the required level of complexity of remuneration policies and risk measurement approaches.

3. Application of the Guidelines

Neither the Guidelines nor the IFD Directive applies to small and non-interconnected ESIs. The provisions on remuneration and corporate governance provided in Directive 2014/65/EU will apply to these entities.

For those ESIs that do fall within the scope of the Guidelines, the Guidelines apply as of 30 April last, so they must have adjusted their remuneration policies by 30 April 2022 and updated the required documentation accordingly. In the event that such revisions require shareholder approval, they must be requested by 30 June 2022. The governing bodies of the ESIs concerned shall accordingly approve and document remuneration policies, including, at a minimum, the following issues: (i) the governance, control and compliance structure for their effective implementation; (ii) their periodic review; (iii) the process for the identification of Identified Staff; (iv) risk-adjusted remuneration and policies for deferral, payment in capital instruments, reduction and recovery of remuneration.

In any event, and without prejudice to the transposition of Directive (EU) 2019/2014 into national law, the remuneration policy should be applied in accordance with the Guidelines for any financial year starting after 31 December 2021.

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The information contained in this Legal Briefing is of a general nature and does not constitute legal advice. This document was prepared on 19 May 2022 and Pérez-Llorca does not assume any commitment to update or revise its contents.

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