European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken

EACB position paper on EBA consultation on draft Regulatory Technical Standards on classes of instruments that are appropriate to be used for the purposes of variable remuneration under Article 94(2) of the Capital requirements Directive

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The EACB is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks" business model. With 4.200 locally operating banks and 63.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 160 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 50 million members and 750.000 employees and have a total average market share of about 20%.
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INSTRUMENTS ACCORDING TO ART. 94(1)(L)(I) – CEBS GUIDELINES

Before considering the draft regulatory technical standard (RTS) at hand, the EACB would like to draw the attention to the category of instruments under Art. 94(1)(l)(i), which is not addressed by the draft RTS. This provision is important for co-operative banks.

As the CEBS "Guidelines on Remuneration Policies and Practices" from 10 December 2010 point out (nr. 124ss), "*for institutions in the legal form of a stock corporation, shares or share-linked instruments are able to align the interests of the owners and staff,*" while "*for many institutions which are not stock corporations, share-linked instruments are not an option due to their legal form*".

As regards cooperative banks and mutuals, the Guidelines further point out that: *"…alternative instruments, also those based on cash pools, may be used that reflect the institution's value and have the same intended effect as share-linked instruments. Differently from shares and share-linked instruments, the value of these equivalent non-cash instruments is determined by a third party, not by a stock market. Instruments, other than shares or share-linked instruments, should have comparable features to shares in terms of their loss absorbency capacity. For the acceptance of alternative instruments like phantom plans based on a third party valuation, it is crucial that the institution's value is determined correctly and comprehensibly. To reflect the institution's current value in these alternative instruments the institution's value must be determined directly on the moment of awarding, before the vesting and before the retention period ends respectively. A negative development of the institution's value will so be reflected in the value of these alternative instruments."*

Thus, the 2010 CEBS Guidelines offer some (limited) explanations on what features the instruments under Art. 94(1)(l)(i) would have to have to be accepted for variable remuneration purposes. For the majority of co-operatives and mutuals, the alternative non-cash instruments reflecting the bank's value remain the only option. The rules governing those instruments are therefore of high importance, and we would make the following recommendations:

- As we have understood, the EBA's presumption is that the 2010 CEBS Guidelines remain in force. We believe that this should be explicitly indicated, possibly by a recital or a footnote in the RTS;

- Moreover, we would like to point out that under CRD IV, even relatively small banks may have to apply the standard. Having the *"correct and comprehensible value of the relevant instruments"* established by a third party, as indicated in the above quotation of the CEBS Guidelines, may turn out be a relatively expensive exercise. Simplified methods based on the audited balance sheet should be possible;

- Provision of a list of standard clauses would help constructing the instruments in line with the requirements for approval as those instruments;

- In addition, the Guidelines require that the instruments in question have comparable features to shares in terms of loss absorbency capacity, and in the sense that they must reflect the institution's value. However, this may not always correspond to the bank's cooperative mission, which is to create member value rather than share value: the management may prefer to accumulate profits rather than to generate member value. The Guidelines offer no further clarification on possible limits.

While we recognise that the above remarks fall outside the scope of the EBA standard, we nevertheless believe that the situation needs to be clarified. The EACB would like to see more explanations on those types of instruments following the 2014 review of the CEBS Guidelines.

INSTRUMENTS ACCORDING TO ART. 94(1)(L)(II) – DRAFT RTS

'Where possible'

The extensive deliberation on the types of instruments and the features they must have is set against a complete lack of clarification of the meaning and the consequences of the *'where possible'* caveat. This 'carving out' of the definition of instruments and their features from the wider context limits the contribution of the proposed standard towards clarity and consistency. Thus, the issue of the meaning of the phrase *'where possible'* should be accurately addressed. In particular, it would be necessary to specify in what circumstances it will be considered that the use of the specific instruments is possible, and when it is considered so, whether (and if, when) this would create a requirement to use such instruments. In particular, it should not be considered 'possible' unless the credit institution has issued the respective instruments and the instruments are securitized and tradable.

Indeed, requiring the issuance of specific instruments for the sole purpose of the application of Art 94.2 CRD IV would create some important difficulties and risks for co-operative banks:

- *in terms of limitation of risk*: credit institutions which are not active on capital markets should not be obliged to issue specific instruments simply to fulfil the remuneration provisions of Art 94.2. Such an obligation would mean forcing banks with a very conservative business model to move onto capital markets. This would not be desirable from an overall risk perspective. Taking this into account, under CRD III, certain Member States have allowed the possibility to waive the obligation to issue certain instruments according to this Article
- *in terms of additional burden*: as Recital 66 of CRD IV rightly states, the provisions governing remuneration should reflect the differences between various types of institutions (principle of proportionality).

Classes of instruments issued

Further clarification of what kind of instruments may be regarded as 'other instruments' as referred to in article 94 paragraph 1 under (l) (ii) would be necessary. The scope of this class is now described in Article 4 of the draft technical standards. From the conditions set in this article it seems that only instruments which are *issued* by the institution (or another entity within the group consolidation if certain conditions are met) may be used for this purpose. However, the explanation mentions that contracts between staff and institutions may in certain events also be used as 'other instruments', which cannot fulfil the requirement of being *issued*. If the EBA standards intends to broaden the scope of these instruments to such contracts as well, this should be explicitly mentioned in Article 4.

Similarly, it is not clear whether subordinated debt may qualify as Tier 2 instruments as described in Article 2, since again the draft only sets provisions for instruments that are *issued* by the institution.

More precise formulations should provide the necessary clarification on this point. In addition, provision of a list of standard clauses would help constructing the variable remuneration instruments in line with the requirements for their approval.

Uniform trigger event

It is doubtful whether regulatory capital ratios are the right indicators of the credit quality of an institution as a going concern. The credit quality of a bank is much more complex, with other aspects playing an equally important role.

However, if the capital ratio is opted for as a trigger event, it would be preferable to have a uniform trigger event for all the different instruments. There are no grounds to differentiate between instruments. A total capital ratio for all instrument would be more appropriate than the Tier 1 capital ratio or CET1 ratio.

Higher trigger event level

As for the level of the unique trigger event, it should be established at a lower level than currently proposed.

Write up / write down

The write-up should not be limited to Tier 2 instruments. This should be a option open for all classes of instruments. The proposal to treat the write-up amounts as a payment that results in a reduction of CET1 is not justified, especially for smaller banks.

As the "other' instruments are not classified as own funds, the requirements for such instruments should be simplified. One option could be to use the rules on write-down and conversion provided in the Directive on Bank Recovery and Resolution.

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