

**COMMISSION de SURVEILLANCE
du SECTEUR FINANCIER**

In case of discrepancies between the French and the English text, the French text shall prevail

Luxembourg, 11 March 2011

To all credit institutions and investment firms incorporated under Luxembourg law and to the branches of non-EU credit institutions and investment firms

CIRCULAR CSSF 11/505

Re: Details relating to the application of the principle of proportionality when establishing and applying remuneration policies that are consistent with sound and effective risk management as laid down in Circulars CSSF 10/496 and CSSF 10/497 ("CRD III Circulars"), transposing Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies ("CRD III").

Ladies and Gentlemen,

This circular specifies the CSSF's expectations as regards the application of the proportionality principle by credit institutions and investment firms when establishing their total remuneration policy in accordance with the "CEBS Guidelines on Remuneration Policies and Practices" ("CEBS guidelines") appended to the CRD III Circulars. It also specifies the requirements regarding the remuneration policies which may in principle be neutralised pursuant to the proportionality principle.

1. Hereinafter, the term "institutions" refers to credit institutions and investment firms except those excluded from the scope of Circular CSSF 10/497 (cf. point 2 below). Please note that where a provision only applies to one category of addressees, the term "credit institution" or "investment firm" (meaning an investment firm except those that are excluded from Circular CSSF 10/497 (cf. point 2 below) will be used.
2. Some investment firms and branches of non-EU investment firms do not fall within the scope of Circular CSSF 10/497, namely the persons referred to in Article 1-1(2) of the law of 5 April 1993 on the financial sector ("LFS") and the investment firms that are only authorised to provide the service of investment advice and/or receive and transmit orders from investors without holding funds or securities belonging to their clients.

Pursuant to point 2 of Part II of Circular CSSF 07/290, Luxembourg-incorporated management companies within the meaning of Chapter 13 of the law of 20 December 2002 as amended and Chapter 15 of the law of 17 December 2010, which provide the service of management of portfolios of investments, including those owned by pension funds, on a discretionary, client-by-client basis within the scope of a mandate given by investors, fall within the scope of Circular CSSF 07/290, if these portfolios include one or several instruments listed in Section B of Annexe II of the LFS. However Parts XVII and XVIII (including the provisions that transpose the requirements relating to the remuneration policies) of that circular do not apply to them.

Nevertheless, the entities referred to in this point must comply with the remuneration policy requirements laid down in Circular CSSF 10/437. With reference to point 1.5 of that circular, the CSSF will apply for these institutions the principle of proportionality.

3. The rules set out in the CRD III Circulars apply individually to the credit institutions and investment firms incorporated under Luxembourg law (including to their branches established abroad). They also apply to the parent undertakings that are heads of financial groups and that are submitted in Luxembourg to the control of the CSSF, either within the framework of the supervision on a consolidated basis, or within the framework of complementary supervision, as well as to any entity that is part of the supervisory scope on a consolidated/complementary basis.
4. The parent undertaking must ensure that the requirements of a group-wide remuneration policy are coherently implemented at group and subsidiary level (Luxembourg and foreign). To this end, a group-wide remuneration policy must take into account the local regulatory requirements of the jurisdiction in which the subsidiary operates. This requirement has also been stressed in paragraph 27 of the CEBS guidelines. The thresholds defined in points 10, 11 and 15 of this circular take into account the specificities of the Luxembourg financial sector. Thus, they must be considered in order to be able to apply them to Luxembourg subsidiaries when drawing up the group-wide remuneration policy and the Luxembourg subsidiary's remuneration policy.
5. According to the CEBS guidelines, the proportionality principle aims to match the remuneration policies and practices with the individual risk profile, risk appetite and the strategy of the institution. The proportionality principle applies to the general as well as to the specific provisions of the CRD III, with the effect that not all institutions have to give substance to the remuneration requirements in the same way and to the same extent. Proportionality implies that some institutions will need to apply more sophisticated policies in fulfilling the requirements whereas other institutions can meet the requirements of the CRD III in a less burdensome way.

The application of the proportionality principle may lead to the **neutralisation of some remuneration policy requirements**. These requirements relate to:

- pay-out of part of the variable remuneration in instruments;

- retention policy;
- deferral of part of the variable remuneration;
- *ex post* incorporation of risk;
- establishment of a remuneration committee.

These principles are those laid down in point 4-1, letters n), o) and p) and point 4-2 appearing in Section 12, point (2) of the CRD III Circulars.

6. **In addition** to the principles laid down in point 5, investment firms authorised to provide the investment services of reception and transmission of orders in relation to one or more financial instruments (involving the holding of their clients' funds and/or securities), of execution of orders on behalf of clients, of portfolio management, of placing of financial instruments without a firm commitment basis and operation of a multilateral trading facility (MTF) (referred to in Annexe I, Section A, points 1, 2, 4, 7 and 8 of Directive 2004/39/EC), may, where applicable, apply **neutralisation** to the requirement to establish an appropriate ratio between the fixed and the variable component of the total remuneration (point 4-1, letter k) appearing in Section 12, point (2) of Circular CSSF 10/497).
7. In any event, the application of the proportionality principle does not exempt any institution to set up a remuneration policy and only allows neutralisation of certain requirements as defined in point 5 and, where applicable, point 6, if this is reconcilable with the risk profile, risk appetite and strategy of the institution. Neutralisation is never automatically triggered and institutions must be able to explain the rationale.

The CSSF reminds that an institution must indeed be able to draw up its own framework on risk adjustment according to its own specific needs and that it is therefore required to assess its own risk profile, risk appetite and other characteristics through a self-assessment when establishing its remuneration policy. In order to assist institutions in this exercise, the CSSF has developed quantitative criteria, in addition to those developed in the CEBS guidelines, that could contribute to applying the principle of proportionality when institutions perform their self-assessment. However, the CSSF specifies that it expressly reserves the right to rule out criteria, notably quantitative criteria, applied by the institutions within the scope of their self-assessment when the CSSF considers that these criteria are not adapted to the institution's real situation. The CSSF may also redefine the institution's situation by applying criteria which, given the available information, seem to best translate the risk profile, risk appetite and strategy of the institution concerned.

According to the CRD III, the principle of proportionality can apply at two levels: proportionality among different types of institutions and proportionality among different categories of staff whose activities have a material impact on its risk profile. The criteria defined by the CSSF also concern these two levels.

I. Application of the proportionality principle among institutions

8. The different risk profiles and characteristics among institutions (e.g. complex and/or international institutions on the one hand and less complex and/or local institutions on the other hand) justify a proportionate implementation of the remuneration principles.
9. According to the CRD III, criteria addressing the application of the proportionality principle among institutions are the size, internal organisation and the nature, scope and complexity of their activities.

In assessing what is proportionate, the focus should be on the combination of all the mentioned criteria. This is not an exhaustive list as other criteria might apply.

10. However, the CSSF considers that a credit institution whose balance sheet total exceeds EUR 5 billion and whose overall capital requirements exceed EUR 125 million (base 100%) or EUR 1,562.5 million (base 8%) respectively cannot put forward the proportionality principle for the institution. Both conditions apply concurrently.

These conditions also apply on an individual as well as on a consolidated basis, even if a credit institution subject to the CSSF's supervision on a consolidated basis in accordance with the LFS was likely to put forward the proportionality principle on an individual basis but not on a consolidated basis.

The CSSF may adjust the amounts specified in this point in order to take into account the development of the financial sector and/or the developments at an international level.

Even if a credit institution exceeds the aforementioned thresholds, it may put forward, where applicable, the proportionality principle for material risk takers.

11. As regards investment firms authorised to provide the investment service of dealing on own account or underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis (listed in Annexe I, Section A, points 3 and 6 of Directive 2004/39/EC), the CSSF considers that the proportionality principle cannot be operated at the level of the institution when the net profit generated by one of these activities exceeds 20% of the total net profit before tax of the institution concerned. Where an institution carries out these activities simultaneously, the proportionality principle cannot apply where the overall net profit generated by these activities altogether exceeds 20% of the overall net profit before tax.

The CSSF may adjust the percentages specified in this point in order to take into account the development of the financial sector and/or the developments at an international level.

Even if an investment firm as referred to in the first paragraph of this point exceeds the aforementioned thresholds, it may put forward, where applicable, the proportionality principle for material risk takers.

II. Application of the principle of proportionality among the material risk takers within a single institution

12. Material risk takers are defined in point 4-1 appearing in point (2) of Section 12 of the CRD III Circulars. The purpose of the following provisions is not to define the business lines whose employees should be considered as "risk takers" and to whom specific remuneration policy requirements should apply. Indeed, the remuneration policies of the different institutions often reflect the internal organisation strategies which vary from one institution to another. Thus, it is primarily the responsibility of the institutions to identify their material risk takers. To this end, institutions may refer to paragraphs 15 et seqq., and more particularly paragraph 16 of the CEBS guidelines.
13. The categories of staff whose professional activities have a material impact on the risk profile must comply with specific remuneration policy requirements which aim to manage the risks their activities entail.
14. The application of the proportionality principle allows institutions, other than those that may put forward the principle of proportionality in accordance with points 10 or 11 of this circular, to not apply the requirements specified in the first four indents of point 5 to the duly identified material risk takers whose impact may be considered as minor, as specified in point 15 below.
15. The criteria of size, internal organisation and nature, scope and complexity of the activities must be taken into account in order to determine the proportionality among risk takers. Paragraph 26 of the CEBS guidelines provides additional criteria that the institutions may take into account to define the proportionality (degree of seniority, power to commit the institution, collective impact that the activities of a group of persons may have on the institution's risk profile, ratio variable/fixed component and/or in combination with the total remuneration).

In this context, the CSSF considers that any person whose annual variable remuneration is less or equal to EUR 100,000 may reasonably be considered as a risk taker who has only a minor material impact on the entity's risk profile.

16. As there could be cases where the activity of one staff member may have a more material impact on the risk profile of the institution given the individual's particular job function, even though the remuneration is not material, the threshold shall not be applied automatically and generally. Institutions must limit their choice to the persons for whom they are able to justify and document their decision and for whose activity they can reasonably rule out a significant material impact on their risk profile.
17. In concrete cases, the CSSF can lower the threshold, given the risks that the current and actual activities of the person concerned involve. In general, the CSSF may adjust the amount specified in point 15 in order to take into account the development of the financial sector and/or the developments at an international level.

III. Entry into force

18. This circular comes into force with immediate effect.

Yours faithfully,

COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER

Claude SIMON
Director

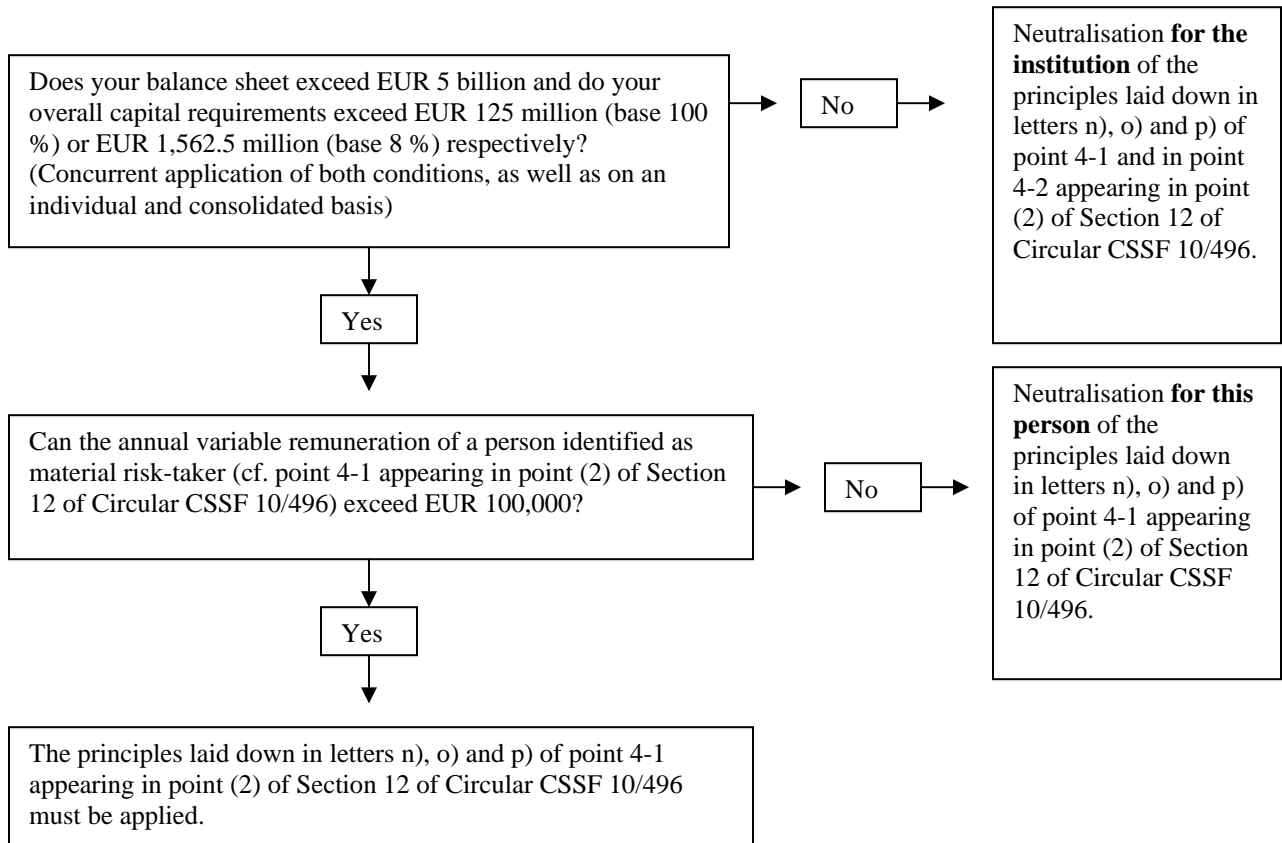
Andrée BILLON
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Simone DELCOURT
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Jean GUILL
Director General

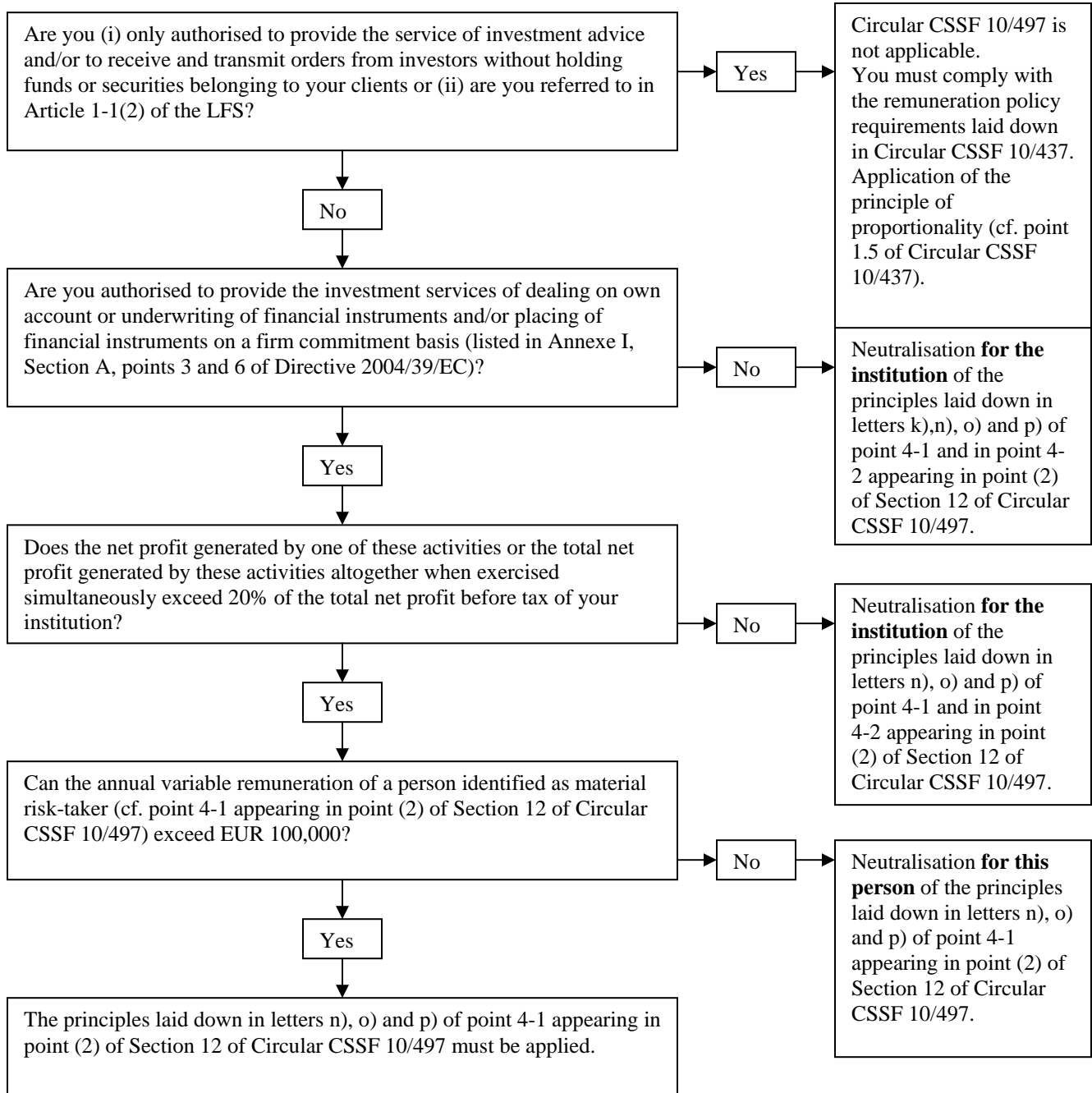
Annexes

Annexe A:
Simplified illustration¹ of the application of the proportionality principle by a Luxembourg credit institution or a branch of a non-EU credit institution.



¹ The application of the principle of proportionality does not exempt the credit institution from establishing a remuneration policy. Besides, neutralisation is never automatic but the institution must at all times be able to explain the rationale.

**Annexe B:
Simplified illustration of the scope of Circular CSSF 10/497 and the application of the principle of proportionality² by a Luxembourg investment firm or a branch of a non-EU investment firm.**



² The application of the principle of proportionality does not exempt the investment firm from establishing a remuneration policy. Besides, neutralisation is never automatic but the institution must at all times be able to explain the rationale.