

# **COMMISSION de SURVEILLANCE du SECTEUR FINANCIER**

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

Luxembourg, 30 October 2014

To all credit institutions and CRR investment firms<sup>1</sup>

## **CIRCULAR CSSF 14/594**

**Re:** **Transposition of the EBA guidelines on the applicable notional discount rate for variable remuneration**

Ladies and Gentlemen,

The European Banking Authority (EBA) published on 27 March 2014 guidelines issued in accordance with subparagraph 2 of Article 94(1)(g)(iii) of Directive 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, hereafter "Guidelines on the applicable national discount rate for variable remuneration".

Article 94(1)(g) of the aforementioned directive introduces a certain number of principles to enable credit institutions and CRR investment firms (hereafter the "institutions") to set the appropriate ratios between the fixed and variable components of the total remuneration, for categories of staff whose professional activities have a material impact on the risk profile of the institution.

The EBA guidelines on the applicable notional discount rate for variable remuneration aim to explain the calculation and the rules for applying the discount rate referred to in Article 94(1)(g)(iii) of the aforementioned directive.

Institutions may apply the discount rate in the calculation of the ratio between the fixed and variable components of remuneration to a maximum of 25% of the total variable remuneration provided it is paid in instruments that are deferred for a period of not less than five years. "Discount ratio" shall mean the value by which a nominal amount of variable remuneration which will be acquired in the future is multiplied to obtain the present value.

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<sup>1</sup> The investment firms within Article 4(2) of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

The latter is then used to calculate the ratio between the fixed and variable components of the total remuneration for the identified staff.

Luxembourg belongs to the Member States that have chosen to apply the discount rate. Consequently, the EBA guidelines apply to the Luxembourg institutions for the calculation of the ratio between the fixed and variable components of the remuneration of their staff with significant impact on their risk profile.

The EBA guidelines on the applicable notional discount rate for variable remuneration entered into force 1 June 2014. These guidelines are appended as an Annex to this circular. They are also available on the EBA's website at: <http://www.eba.europa.eu>

This circular comes into force with immediate effect.

Yours faithfully,

**COMMISSION de SURVEILLANCE du SECTEUR FINANCIER**

Claude SIMON	Andrée BILLON	Simone DELCOURT	Jean GUILL
Director	Director	Director	Director General

Annex:

- EBA guidelines on the applicable notional discount rate for variable remuneration

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EBA/GL/2014/01

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27 March 2014

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## Guidelines

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on the applicable notional discount rate for variable remuneration

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# 1. Executive Summary

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The European Banking Authority is publishing guidelines on the applicable notional discount rate for variable remuneration as mandated under Article 94(1)(g)(iii) of Directive 2013/36/EU 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 ('CRD'). The discount rate is only applicable if implemented by the Member State pursuant to Article 94(1)(g)(iii) of the CRD. The guidelines apply only for the purpose of calculating the ratio between the variable and fixed component of total remuneration awarded for service provided or performance from 2014 and onwards.

The CRD establishes that the variable component shall not exceed 100% of the fixed component of the total remuneration for those categories of staff whose professional activities have a material impact on the risk profile of the institution. Member States may set a lower maximum percentage. A higher ratio of up to 200% may be allowed, subject to shareholder approval.

For the purpose of calculating the ratio between the variable and fixed component of remuneration, Member States may allow institutions to apply a discount rate, the subject of these guidelines, to a maximum of 25% of the variable remuneration, provided it is paid in instruments that are deferred for a period of not less than five years, or to a lower maximum amount percentage prescribed by national law.

The EBA has combined three relevant factors to calculate the discount rate: the national annual inflation rate, the average interest rate of EU government bonds to take account of opportunity costs and inflation risk and a nominal factor to provide for incentives for paying variable remuneration in instruments which are deferred for a period of at least five years. The last factor depends on the length of the actual deferral period.

The discount rate calculated on the basis of the above factors ensures that the ratio between the variable and the fixed components of total remuneration is calculated in accordance with the CRD. These factors provide for appropriate incentives for the use of long-term deferred instruments; these elements should lead to more long-term orientated remuneration frameworks and facilitate prudent risk taking decisions.

## 2. Background and rationale

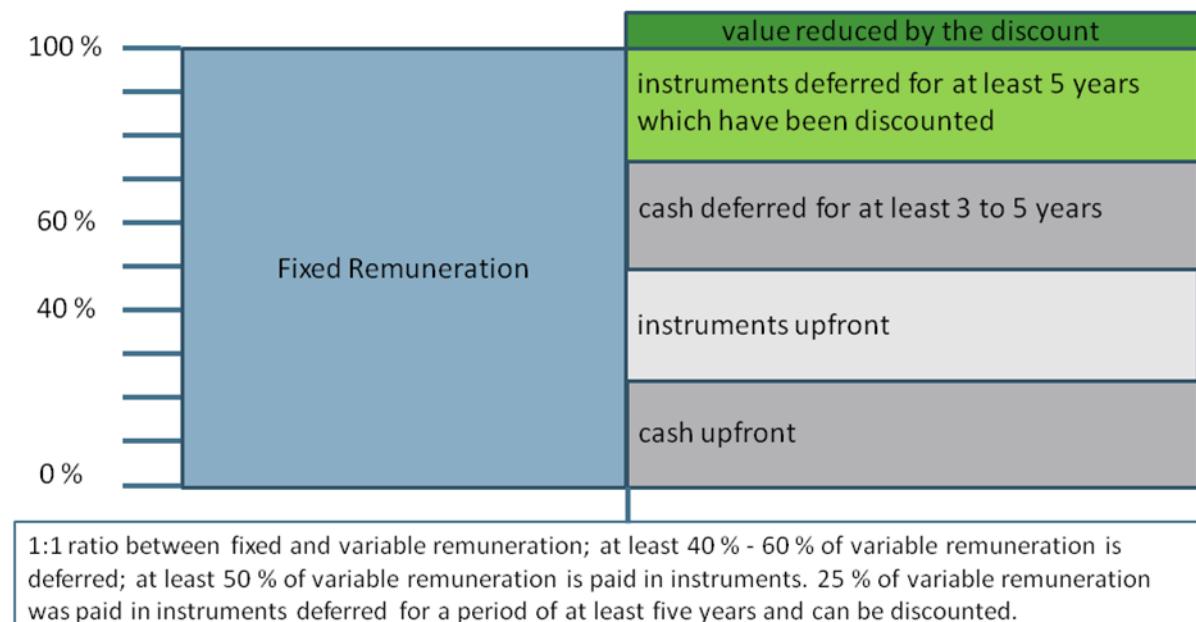
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### Legal Background

1. Article 94(1)(g)(i) of the CRD provides that 'the variable component shall not exceed 100% of the fixed component of the total remuneration for each individual. Member States may set a lower maximum percentage'. Article 94(1)(g)(ii), first subparagraph, provides that 'Member States may allow shareholders or owners or members of the institution to approve a higher maximum level of the ratio between the fixed and variable components of remuneration provided the overall level of the variable component shall not exceed 200% of the fixed component of the total remuneration for each individual. Member States may set a lower maximum percentage.'
2. Article 94(1)(g)(iii), first subparagraph, of the CRD provides that 'Member States may allow institutions to apply the discount rate referred to in the second subparagraph of this point to a maximum of 25% of total variable remuneration provided it is paid in instruments that are deferred for a period of not less than five years. Member States may set a lower maximum percentage.'
3. Pursuant to Article 162(3) of the CRD 'the laws, regulations and administrative provisions necessary to comply with Article 94(1)(g) shall require institutions to apply the principles laid down therein to remuneration awarded for services provided or performance from the year 2014 onwards, whether due on the basis of contracts concluded before or after 1 January 2014.'
4. The second sub-paragraph of Article 94(1)(g)(iii) provides that the EBA 'shall prepare and publish, by 31 March 2014, guidelines on the applicable notional discount rate taking into account all relevant factors including inflation rate and risk, which includes length of deferral. EBA guidelines on the discount rate must specifically consider how to incentivise the use of instruments which are deferred for a period of not less than five years.'
5. Recital 65 of the CRD recalls that 'with a view to encouraging the use of equity or debt instruments which are payable under long-term deferral arrangements as a component of variable remuneration, Member States should be able, within certain limits, to allow institutions to apply a notional discount rate when calculating the value of such instruments for the purposes of applying the maximum ratio. However, Member States should not be obliged to provide for such a facility and should be able to provide for it to apply to a lower maximum percentage of total variable remuneration than set out in this Directive. With a view to ensuring a harmonised and coherent approach which guarantees a level playing field across the internal market, the EBA should provide appropriate guidance on the applicable notional discount rate to be used.'

6. The EBA has published guidelines on remuneration practices and policies<sup>1</sup>. The general concepts of variable and fixed remuneration, deferral, vesting and retention are part of those guidelines and apply in the Guidelines on the applicable notional discount rate for variable remuneration under Article 94(1)(g)(iii) of the CRD.

**Figure 1: Schematic overview of remuneration components under a 1:1 ratio**



### Considerations regarding a discount rate

7. In these guidelines, in line with the CRD, discount rate is understood as the factor by which the amount of variable remuneration is multiplied to obtain its discounted value. Generally speaking, a discount rate is understood to be the interest rate which is used to discount future amounts of cash flows in a multi-period model; it is often denoted 'r'. Generally speaking, a discount factor, 'b', is equal to  $1/(1+r)$ . The future amount of cash flows must be multiplied by the discount factor 'b' in order to obtain the net present or discounted value and is referred to in this guidelines as discount rate.

8. The discount rate, if implemented by the Member State, can be applied to the variable remuneration of staff whose professional activities have been identified as having a material impact on the institution's risk profile, for the purpose of calculating the ratio between variable and fixed remuneration. For the identification of staff the regulation on criteria for identifying staff whose professional activities have a material impact on the institution's risk profile will need to be applied.<sup>2</sup> Since the maximum ratio applies to single staff members, the discount rate needs

<sup>1</sup> The guidelines can be accessed under the following link: <https://www.eba.europa.eu/regulation-and-policy/remuneration>.

<sup>2</sup> The EBA has submitted draft technical standards to the EU Commission for adoption. These draft technical standards can be found on the EBA website at <https://www.eba.europa.eu/regulation-and-policy/remuneration/draft-regulatory-technical-standards-for-the-definition-of-material-risk-takers-for-remuneration-purposes>.

to be applied to the variable remuneration which is paid to a single staff member as well. The discount rate can be applied only to variable remuneration paid in instruments that are deferred for at least five years. However, there is no obligation for the institution to make use of the discount rate. According to the CRD deferred variable remuneration must not vest faster than on a pro rata basis.

9. In accordance with its mandate, the EBA has considered the relevant factors as indicated within the CRD for the calculation of the discount rate, and the incentive effects derived from the payment of deferred variable remuneration in instruments.

10. The extent to which the deferred part of remuneration may work as an incentive mechanism depends on what is, for the employee, the perceived value of this deferred remuneration when it is awarded. That is the net present value of remuneration which will only be obtained in the future. How a staff member perceives the net present value may differ between individual staff members. In general the perceived value depends on several factors: e.g. the expected return on another investment; the immediate financial needs the employee has; personal preferences; the risks of not being able to receive the full amount of deferred remuneration in the future; the reduction of the value due to inflation; and the uncertainty about future inflation rates. However, not all such elements are relevant for the discount rate. For example, clawback and malus mechanisms, which are part of the remuneration framework and are supposed to reduce the awarded remuneration if the institution or the staff member does not perform well, should not lead to an increase of the discount rate.

### 3. EBA Guidelines on the applicable notional discount rate for variable remuneration

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## Status of these Guidelines

This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC ('the EBA Regulation'). In accordance with Article 16(3) of the EBA Regulation, competent authorities and financial institutions must make every effort to comply with the guidelines.

Guidelines set out the EBA's view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. The EBA therefore expects all competent authorities and financial institutions to whom guidelines are addressed to comply with guidelines. Competent authorities to whom guidelines apply should comply by incorporating them into their supervisory practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

## Reporting requirements

According to Article 16(3) of the EBA Regulation, competent authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by 27.05.2014. In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form provided at Section 5 to [compliance@eba.europa.eu](mailto:compliance@eba.europa.eu) with the reference 'EBA/GL/2014/01'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities.

Notifications will be published on the EBA website, in line with Article 16(3).

## Title I - Subject matter and definitions

1. Article 94(1)(g) of Directive 2013/36/EU<sup>3</sup> requires institutions to set appropriate ratios between the fixed and the variable component of total remuneration for the categories of staff whose professional activities have a material impact on the risk profile of the institution (identified staff<sup>4</sup>). The maximum ratio between the variable and the fixed part of the total remuneration is limited to 100%. Member States may allow the ratio to be increased to a maximum of 200%.
2. These guidelines set out the calculation and application of the discount rate referred to in Article 94(1)(g)(iii) of Directive 2013/36/EU. Member States may allow institutions to apply the discount rate for the purposes of calculating the ratio between variable and fixed components of remuneration to a maximum of 25% of total variable remuneration, provided it is paid in instruments that are deferred for a period of not less than five years.
3. The guidelines apply to institutions which make use of the option to apply the discount rate for the purpose of calculating the ratio between the variable and fixed components of remuneration, and to competent authorities in Member States which have implemented the option of applying the discount rate.
4. For the purpose of these guidelines the discount rate is the value by which a nominal amount of awarded variable remuneration which vests in the future is multiplied in order to obtain its discounted value. The discounted value is then used for the calculation of the ratio between the fixed and the variable components of total remuneration for identified staff.

## Title II - Requirements concerning the discount rate for variable remuneration

### 1. Variable remuneration which can be discounted

5. Institutions can discount up to a maximum of 25%, or a lower percentage prescribed by the Member State, of the total variable remuneration which is calculated as the sum of all components of variable remuneration before the discount rate is applied. Only variable remuneration which is deferred for at least five years and is paid in equity or debt-instruments or instruments linked to such instruments which are eligible for the purposes of variable remuneration in accordance with point (I) of Article 94(1) of Directive 2013/36/EU should be discounted. This includes parts of the deferred variable

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<sup>3</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directive 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

<sup>4</sup> Staff should be identified by applying the regulatory technical standards on criteria for the identification of staff whose professional activities have a material impact on the institution's risk profile.

remuneration that vest during the deferral period. Variable remuneration payable under deferral arrangements cannot vest faster than on a pro rata basis<sup>5</sup>.

6. The amount of variable remuneration which can be discounted should be calculated on the basis of the total nominal amount of variable remuneration as set out in the EBA's guidelines on remuneration policies and practices.

## 2. Elements included in the calculation of the discount rate

7. As no distributions should be paid to staff with respect to instruments during the deferral period the discount rate should comprise the following three factors: inflation, interest rate for government bonds and an incentive factor linked to the use of long-term deferred instruments as set out in the following paragraphs of this section. For paragraphs 8 to 10, as part of their remuneration policy the institutions should implement the use of one of the following:
  - a. the most recently available data as at the date when the remuneration is awarded;
  - b. the most recently available data as at the date when the variable remuneration which could be awarded for the next performance period is determined.
8. For remuneration awarded in a Member State institutions should use one of the following with regard to the factor for inflation:
  - a. if the remuneration is to be paid in the currency issued by the Member State where the staff member mainly works, the average annual rate of change for the HICP published by Eurostat<sup>6</sup> for that Member State;
  - b. if the remuneration is to be paid in a currency issued by another Member State or a third country, official statistical data equivalent to that referred to in (a) above available for the country issuing the currency or the HICP rate applicable for the Member State in which the staff members carry on the predominant part of their activities;
  - c. the average annual rate of change under (a) or (b) above for the Member State of the EU parent institution.
9. For remuneration awarded in a third country<sup>7</sup> institutions should use the following for determining the inflation factor:

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<sup>5</sup> Article 94(1)(m) of Directive 2013/36/EU.

<sup>6</sup> Harmonised Indices of Consumer Prices (HICPs). The rate referred to can be accessed via the following link: <http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&language=en&pcode=tec00118&plugin=1>.

<sup>7</sup> ‘Third countries’ refers to countries which are not Member States of the Union.

- a. if the remuneration is to be paid in a currency issued by a third country, the official statistical data equivalent to that referred to in paragraph 8(a) available for the country issuing the currency or the HICP rate for the Member State of the EU parent institution;
  - b. if the remuneration is to be paid in a currency issued by an EU Member State, the HICP rate for the Member State of the EU parent institution.
10. For the interest rate for government bonds institutions should use:
- a. If the remuneration is to be paid in a currency issued by a Member State, the average yield for all Member States of the EU of long-term government bond yields as published by Eurostat;<sup>8</sup>
  - b. if remuneration is paid in a currency issued by a third country to staff predominantly located outside the EU, equivalent official statistical data available for the country issuing the currency or the rate under (a) above.
11. The incentive factor for deferred variable remuneration paid in instruments deferred for five years should be 10%. The factor should increase by four percentage points for each additional full year of deferral.

### 3. Calculation of the discount rate

12. Institutions should calculate the applicable discount rates for different parts of variable remuneration which are subject to different deferral and vesting arrangements and apply the discount rates accordingly. Institutions should use the applicable deferral periods documented within their remuneration policy.
13. The applicable discount rate equals one divided by the sum of one plus the three factors set out in section 2, raised to the power of the number of years of the vesting period, as shown in the formula below. The vesting period is the period after which the awarded variable remuneration vests. For this purpose the vesting period should be rounded down to the next integer. For pro rata vesting, institutions may also use a present value formula as described in the Annex, example 2.

#### Formulas for the calculation of the discount rate

$$\text{discount rate} = \frac{1}{(1 + i + g + id)^n}$$

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<sup>8</sup> For the calculation EU government bonds with a residual maturity of around 10 years are used. The information on the long-term EU government bond rates can be found under the following link:  
<http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&language=en&pcode=teimf050&plugin=1>.

i	= inflation rate of the Member State or third country
g	= interest rate for EU government bonds, EU average
id	= incentive factor for use of long-term deferral
n	= number of years of the vesting period

The application of the formulas is further explained in examples 1, 2 and 3 in the Annex to these guidelines.

#### 4. Application of the discount rate

14. The discount rate should be applied to a maximum of 25% of the total variable remuneration of an individual staff member (or a lower percentage prescribed by the Member State) paid in instruments that are deferred for at least five years.
15. Institutions should calculate for each individual staff member:
  - a. the sum of all amounts of variable remuneration which are awarded before the discount rate is applied;
  - b. the amount under (a) which is awarded in instruments and deferred for a period of at least five years; and
  - c. the amounts under (b) for which different discount rates apply.
16. In order to calculate the discounted variable remuneration the applicable discount rate should be applied by multiplying it by the relevant part of variable remuneration.
17. For the purpose of calculating the ratio between the variable and the fixed component of remuneration for an individual staff member, the total variable remuneration is the sum of all discounted amounts of variable remuneration and the non-discounted variable remuneration.

#### 5. Documentation and transparency

18. Institutions should document the calculation and use of the discount rate.
19. Institutions should keep a record of the fixed and variable components of remuneration awarded to an individual staff member, the parts of variable remuneration paid in instruments which are deferred for five years or more, the applied discount rate and the ratio between the variable and fixed component of total remuneration.
20. Institutions are required, in accordance with Article 16 of the EBA Regulation, to report, in a clear and detailed way, whether they comply with these guidelines. Institutions should provide information on the discount rates together with the disclosures required

regarding the remuneration policy under Article 96 of Directive 2013/36/EU and Article 450(1)(d) of Regulation (EU) No 575/2013<sup>9</sup>. In particular, institutions should disclose the following on a country by country basis:

- a. the extent to which the discount rate is used (the maximum being its application to 25% of the total variable remuneration or a lower percentage prescribed by the Member State); and
- b. the number of identified staff to whose variable remuneration the discount rate was applied.

## **6. Supervisory review of the discount rate**

21. When competent authorities review the remuneration framework of an institution, they should review how the discount rate is calculated and applied to the variable remuneration which was awarded to identified staff.

## **Title III - Final Provisions and implementation**

22. The guidelines apply from [1 June 2014] and apply for the purpose of calculating the ratio between the variable and the fixed component of total remuneration awarded for performance and services from the year 2014 onwards.

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<sup>9</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

## Annex - Examples of how the discount rate for variable remuneration is applied

Calculation of the discounted part of variable remuneration ('dvr') for the purpose of calculating the ratio between the variable and fixed component of remuneration:

$$dvr = \frac{vr}{(1 + i + g + id)^n}$$

Where:

- dvr = discounted variable remuneration;
- vr = variable remuneration subject to the discount (max 25% of total variable remuneration provided it is paid in instruments that are deferred for at least five years);
- i = inflation rate in percentage;
- g = interest rate for government bonds EU average in percentage;
- id = incentive factor for use of long-term deferral in percentage;
- n = number of years in the vesting period.

The total variable remuneration is the sum of the discounted part of variable remuneration and the non-discounted part of variable remuneration.

## Example 1

Assume for this example that the Member State in question has allowed institutions to apply a discount rate to a maximum of 25% of total variable remuneration. Assume also that the institution's shareholders have not approved a higher maximum ratio than the one provided for in Directive 2013/36/EU.

The institution would like to award a staff member total remuneration of EUR 285 000, of which EUR 135 000 is to be fixed remuneration and a potential amount of EUR 150 000 is to be variable remuneration. The staff member in question is identified staff and we are considering remuneration awarded for the performance year 2014. The ratio of variable/fixed remuneration based on nominal amounts would in this case be above the admissible 1:1 ratio. However, after application of the discount rate to the portion of variable remuneration paid in instruments deferred for a period of at least five years, the ratio is compatible with Article 94(1)(g) of Directive 2013/36/EU as shown below.

The structure of the variable remuneration would in this example be as follows:

- EUR 20 000 of the variable remuneration would be paid in instruments deferred for five years;
- EUR 10 000 would be paid in instruments deferred for six years;
- the remainder of the total variable remuneration would be paid up-front, not in instruments or would be deferred for a shorter period of time than five years.

Directive 2013/36/EU requires that at least 40% of the variable remuneration is deferred over a period which is not less than three to five years. In the case of a particular high variable remuneration component at least 60% needs to be deferred. At least 50% of the variable remuneration has to be paid in instruments. All these ratios apply to the amounts of variable remuneration awarded to the individual staff member before the discount rate is applied.

In this example, no pro rata vesting is considered. The amounts of EUR 20 000 and EUR 10 000 paid in instruments vest in full after five and six years, respectively.

Based on variable remuneration of EUR 150 000, a maximum amount of EUR 37 500 could have been discounted (which represents 25% of the total variable remuneration of EUR 150 000), if it were to be paid in instruments deferred for more than five years. However, in this example, only EUR 30 000 fulfil both these conditions and only these amounts can be discounted.

### **Factor for inflation (i)**

Assume the last available HICP rate for this Member State is 2%.

### **Factor for EU government bonds (g)**

Assume the last available average rate for long-term EU government bonds as published by Eurostat is 2.73%.

### **Incentive factor long term deferral (id)**

For the EUR 20 000 deferred for five years the incentive factor is 10%.

For the EUR 10 000 deferred for six years the incentive factor is 14% (10% + 4% for each additional full year).

### **Length of the vesting period (n)**

For EUR 20 000 the vesting period is five years.

For EUR 10 000 the vesting period is six years.

The discounted variable remuneration for the above example 1 is calculated as follows:

#### **Amount of EUR 20 000 deferred for five years:**

$$\frac{20\,000}{(1+0.02+0.0273+0.10)^5} = 10\,061.09$$

#### **Amount of EUR 10 000 deferred for 6 years:**

$$\frac{10\,000}{(1+0.02+0.0273+0.14)^6} = 3\,569.75$$

The sum of the discounted variable remuneration = EUR 13 630.84

**The total variable remuneration for the purpose of calculating the ratio between the variable and fixed component of remuneration and the ratio between variable and fixed components of remuneration are calculated as follows:**

The amount of variable remuneration that can be discounted because it is paid in instruments deferred for at least a period of five years is EUR 30 000. However, different discount factors have been used because the vesting period applied to the amount of EUR 20 000 is five years, while the vesting period applied to EUR 10 000 is six years. These two amounts vest in full at the end of the deferral period, hence the vesting period equals the deferral period. There is no pro rata vesting in this example. The total amount of the discounted part of variable remuneration equals EUR 13 630.84, resulting in a total amount of variable remuneration for the purpose of calculating the ratio between variable and fixed remuneration of EUR 133 630.84; that is  $(150\ 000 - 30\ 000 + 13\ 630.84)$ . The ratio between variable and fixed components of total remuneration in this example is  $(133\ 630.84 / 135\ 000) * 100 = 98.99\%$ .

To sum up, under the assumptions and the conditions set out above, the institution will be able to award a staff member EUR 285 000 total remuneration, consisting of EUR 135 000 in fixed remuneration and EUR 150 000 variable remuneration within the 1:1 ratio for variable and fixed remuneration.

Of the EUR 150 000 variable remuneration, at least 40 % (EUR 60 000) needs to be deferred. If, depending on the jurisdiction, this is considered to be a particular high amount at least 60 % (EUR 90 000) needs to be deferred. In any case at least EUR 75 000 needs to be awarded in instruments.

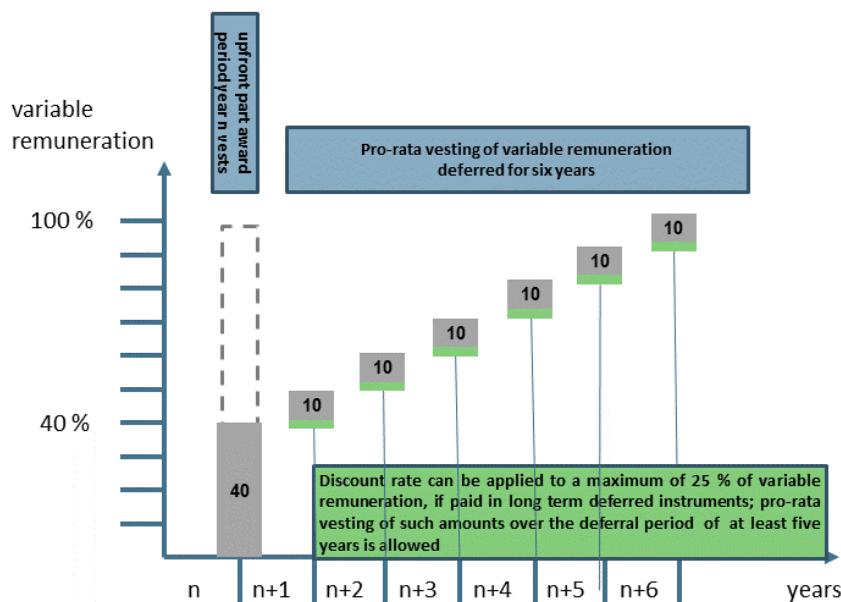
## Example 2

Assume that in a Member State, the institution would like to award a staff member (identified as having a material impact on the institution's risk profile) who receives EUR 135 000 as fixed remuneration, an amount of EUR 150 000 as variable remuneration. The same assumptions regarding the Member State's transposition of Directive 2013/36/EU (maximum 25%), shareholders' approval for ratio higher than 1:1 (none) and performance year (2014) apply as under example 1. The structure of the variable remuneration is as follows:

- 60% of the total variable remuneration, i.e. EUR 90 000, would be deferred for six years and would vest pro rata over this period,
- EUR 37 500 of the above variable remuneration deferred for a six year period would be paid in instruments. This implies that every year, an amount of EUR 6 250 paid in instruments would vest.

In this example, pro rata vesting is considered. The discount rate can be applied to a maximum of 25% of the total variable remuneration, provided it is paid in instruments deferred for a period of at least five years.

Figure 1: Schematic overview of deferral arrangements and the application of the discount rate to variable remuneration paid in instruments deferred for six years and with pro rata vesting.



40 % of total variable remuneration paid upfront; 60 % of total variable remuneration deferred for six years with even spread

### **Factor for inflation (i)**

Assume the last available HICP rate for this Member State is 2%.

### **Factor for EU government bonds (g)**

Assume the last available average rate for long-term EU government bonds as published by Eurostat is 2.73%.

### **Incentive factor long term deferral (id)**

For a deferral period of 6 years, the incentive factor is  $10\% + 4\% = 14\%$ .

### **Length of the vesting period (n)**

Pro rata vesting of the portion of variable remuneration of EUR 37 500 paid in instruments deferred for six years implies that every year EUR 6 250 vests. Hence, in the formula for the discount rate the length of the vesting period is: n=1 for the EUR 6 250 vesting after the first year, n=2 for the portion vesting after two years, n=3 for the portion vesting after three years, and so on until n=6.

The discounted variable remuneration for the above example 2 is calculated as follows:

In this example, EUR 37 500, which represents 25% of the total variable remuneration is paid in instruments deferred for at least five years and can be discounted.

**The discounted value of the amount of EUR 37 500 of variable remuneration deferred for 6 years and pro rata vesting is the sum of the following six values:**

$$\frac{6\,250}{(1+0.02+0.0273+0.14)^1} = 5\,264.04$$

$$\frac{6\,250}{(1+0.02+0.0273+0.14)^2} = 4\,433.63$$

$$\frac{6\,250}{(1+0.02+0.0273+0.14)^3} = 3\,734.21$$

$$\frac{6\,250}{(1+0.02+0.0273+0.14)^4} = 3\,145.13$$

$$\frac{6\,250}{(1+0.02+0.0273+0.14)^5} = 2\,648.97$$

$$\frac{6\,250}{(1+0.02+0.0273+0.14)^6} = 2\,231.09$$

The sum of the discounted variable remuneration is EUR 21 457.07 (5 264.04 + 4 433.63 + 3 734.21 + 3 145.13 + 2 648.97 + 2 231.09).

In case of pro rata vesting, the calculation can also be done using the present value formula:

$$dvr = vrpr * \frac{(r^n - 1)}{r^n * (r - 1)}$$

dvr = discounted variable remuneration

vrpr = pro rata amount of variable remuneration (in the above example EUR 6 250)

r = 1+i+g+id (i= inflation rate; g = rate for government bonds, id = incentive factor deferral)

n = length of the deferral period

**The total variable remuneration for the purpose of calculating the ratio between the variable and fixed component of remuneration and the ratio between variable and fixed components of remuneration is calculated as follows.**

The amount of variable remuneration that can be discounted, because it is paid in instruments deferred for a period of at least five years, is EUR 37 500. However, different discount factors (or the present value formula of the box above) have been used, because this amount vests pro rata over a six-year period. The total amount of the discounted part of variable remuneration equals EUR 21 457.07, resulting in a total amount of variable remuneration for the purpose of calculating the ratio between variable and fixed remuneration of EUR 133 957.07; that is (150 000 - 37 500 + 21 457.07). The ratio between variable and fixed components of total remuneration in this example is (133 957.07/135 000)\*100 = 99.23%.

#### **Comparison of the effect of the discount rate between pro rata vesting and full vesting after deferral periods**

If the EUR 37 500 had vested in full after the six-year deferral (no pro rata vesting), the discounted amount of the total variable remuneration would have been EUR 13 386.54.

$$\frac{37\,500}{(1+0.02+0.0273+0.14)^6} = 13\,386.54$$

The ratio fixed/variable remuneration would be equal to (125 886.54/135 000)\*100 = 93.25%, which is lower than the one obtained with pro rata vesting.

## Example 3

The following example is based on a given amount of fixed remuneration of EUR 100 000 and shows how to calculate the maximum possible amount of variable remuneration which could be awarded if 25% of the variable remuneration is paid in instruments that are deferred for five years, assuming that the full amount vests at the end of the deferral period. The inflation rate and interest rate for government bonds provided under example 1 are used. The same assumptions regarding Member State's transposition of Directive 2013/36/EU (25%), shareholders' approval for ratio higher than 1:1 (none) and performance year (2014) apply as under example 1. If lower rates are prescribed by the Member State, the formula needs to be amended accordingly by replacing 0.25 with the lower percentage.

In this example, the total variable remuneration that can be paid is up to a maximum of 100% of the fixed components of remuneration and the maximum variable remuneration that can be discounted is 25% provided it is paid in instruments that are deferred for at least five years.

Hence, we can write the following equation:

$$fr = (1 - 0.25) * tvr + \frac{0.25 * tvr}{(1 + i + g + id)^n}$$

fr	= fixed remuneration
tvr	= total variable remuneration
i	= inflation rate;
g	= interest rate for government bonds EU average;
id	= incentive factor for use of long-term deferral;
n	= length of the vesting period.

By replacing the corresponding amounts considered in this example for each variable in the equation above, we obtain:

$$100\ 000 = 0.75 * tvr + \frac{0.25 * tvr}{(1 + 0.02 + 0.0273 + 0.10)^5}$$

fr = 100 000

i = 2%, factor for inflation

g = 2.73% factor for government bond interest rate

id = 10% , factor for five year deferral,

n = 5, length of vesting period.

Solving the previous equation for tvr, we obtain:

$$tvr = \frac{100\ 000 * 1.987856}{0.75 * 1.987856 + 0.25} = 114\ 186.10$$

For the above example, the maximum variable remuneration which can be paid if 25% of the variable remuneration is discounted is EUR 114 186.10.

## 4. Accompanying documents

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### 4.1 Cost- Benefit Analysis / Impact Assessment

Article 16(2) of the EBA Regulation provides that the EBA shall analyse ‘the potential related costs and benefits’ of guidelines. This analysis should provide an overview of the findings regarding the problem identified, the solutions proposed and the potential impact of these options.

This note outlines the impact assessment (IA) regarding the draft guidelines on the applicable notional discount rate for variable remuneration under Article 94(1)(g)(iii) of the CRD.

#### 4.1.1 Problem definition

Remuneration policies and practices should be consistent with effective risk management policies and practices to ensure that staff members behave prudently, and should set incentives to ensure that staff members’ personal objectives are aligned with the long-term interests of the credit institution. To this end, the CRD requires that at least 40%/60% of the variable remuneration is deferred. In addition, a maximum ratio between variable and fixed components of total remuneration was introduced. Variable remuneration shall not exceed 100% of the fixed remuneration of a staff member who has a material impact on the institution’s risk profile (200% with shareholders’ approval).

Member States may allow institutions to apply the discount rate to a maximum of 25% of variable remuneration provided that it is paid in instruments that are deferred for at least five years. The application of this provision is subject to national discretion and Member States may choose not to apply this provision or to set a ratio lower than 25%.

The aforementioned discount factor is to be applied to the variable nominal remuneration taken into account in the calculation of the variable-to-fixed remuneration ratio. This allows the institutions which apply the discount rate to actually pay out variable nominal remuneration which exceeds 100% (200% subject to shareholders’ approval) of the fixed remuneration. According to Article 94(1)(g)(iii) CRD, when preparing guidelines on the applicable notional discount rate the EBA should consider all relevant factors, including inflation rate and risk, and should provide incentives for the use of long-term deferred variable remuneration.

Since the provisions regarding the discount rate were added at a late stage in the legislative process leading to the adoption of the CRD, the Commission did not evaluate this specific issue in the impact assessment accompanying its proposal for the CRD, as it was not included in the original proposal.

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*Issues addressed by the guidelines (GL) and objectives*

The CRD requires that when preparing guidelines on the applicable notional discount rate, the EBA should take into account all relevant factors including inflation rate and risk, which includes the length of deferral. The EBA GL should specifically consider how to incentivise the use of instruments deferred for a period of not less than five years. Beside those factors explicitly mentioned, the EBA has considered other relevant factors, e.g. the retention period and staff turnover.

Pursuant to the EBA's mandate, the guidelines take into account the following factors:

- a. inflation rate;
- b. the average interest rate of long-term EU government bonds with a maturity of around 10 years to consider additional opportunity costs of remuneration which is only available at a later point in time and thus is subject to inflation risk; and
- c. an incentive factor for the use of long term deferred instruments.

#### **4.1.2      Technical options considered**

The EBA understands that the term 'risk' within the above mandate refers to inflation risk and not to the risk profile of the institution or the risk of a specific instrument used.

The EBA has considered the following technical options:

##### *Options considered for the estimation of inflation rate and inflation risk*

Inflation reduces the value of the remuneration which will be paid out in the future. The euro area is subject to a common monetary policy with an inflation target set by the European Central Bank to keep inflation rates for the euro area below, but close to, 2% of the HICP in the medium term. Most of the non-euro area national central banks of EU Member States also have a price stability objective.

Temporary shocks to volatile components of inflation (for instance, commodity prices) tend to affect short-term expectations a great deal, as such shocks cannot be counteracted by monetary policy within short time horizons and can lead to considerable volatility in inflation. Until now, long-term inflation expectations in the euro area have been broadly insensitive to the propagation of temporary shocks<sup>10</sup>.

##### **Set of A options – which inflation rate to use**

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<sup>10</sup> [Assessing the anchoring of longer-term inflation expectations](#), p.65 – ECB Monthly bulletin, July 2012.

- **Option A1 – using the inflation rate for the European Union measured by the HICP**
- **Option A2 – using inflation rate for the Member State in which remuneration is awarded or the inflation rate applicable for the EU parent institution measured by the HICP**

Inflation is measured by the HICP which is publicly available and is calculated by Eurostat. While the use of a uniform inflation rate throughout the EU would lead to a harmonised discount rate, national inflation rates may differ significantly (Eurostat data from June 2013 shows an average annual inflation rate between 0.3% and 4.3%<sup>11</sup> among Member States). The inflation rate can span outside these limits for non-EU countries, affecting further the remuneration awarded outside the EU. To accommodate the different inflation rates among the euro area, non-euro area and non-EU third countries, option A2 was retained. For third countries, it is important to consider in which currency the remuneration is awarded as this has a significant influence on the effect inflation has on remuneration awarded to a staff member located in one country, but receiving remuneration based on a different currency. To avoid groups of institutions having to implement several different discount rates which could lead to an increase of administrative costs, the option of using the discount rate applicable to the EU parent institution was granted.

Current inflation rates as well as inflation rate forecasts are available from Eurostat, the European Central Bank and national authorities, for single Member States and the European Union. Long-term inflation expectations are surveyed quarterly in the ECB Survey of Professional Forecasters ('SPF') and the Euro Zone Barometer and semi-annually by Consensus Economics. Financial indicators of inflation expectations are available in some countries by determining the break-even inflation rates ('BEIRs'), calculated as the yield spread between nominal and inflation-linked bonds. There is currently a significant uncertainty surrounding the inflation outlook perceptible both in professional surveys and in financial market indicators. Nevertheless, on balance, available evidence from both survey data and financial market indicators suggests that euro area long-term inflation expectations remain firmly anchored at levels consistent with price stability<sup>12</sup>. Variable remuneration which is awarded in instruments deferred for at least five years could be discounted. The minimum deferral period under the CRD is three years, and thus the baseline for the impact assessment on the costs for using a five-year or longer deferral period is a deferral of three years. For a period of at least five years, it could be considered appropriate to apply a factor for inflation risk as the risk of rising inflation rates could be fully evolved over this period. Nevertheless, inflation rates may also decrease. Any inflation rate forecast has a margin of uncertainty and may therefore differ, over the period of the forecast, from the **future observed** inflation rates. Although available long-term estimates contain a high level of forecast uncertainty, it might be appropriate to use, as an alternative measure, an inflation rate forecast in case the forecast is higher than the current inflation. All in all, the inflation rate after a period of five years has a significant impact on the present value of the variable remuneration.

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<sup>11</sup> [Eurostat News release](#) – June 2013.

<sup>12</sup> [ECB Annual report 2012](#) – Box 3, pp.39-42.

- **Option A3 – using the inflation rate implied in financial instruments**

When pricing instruments, market participants take several factors into account, including inflation rates and inflation risk. If there were a risk-free financial instrument, the price would be influenced mainly by the future evolution of the inflation rate. EU government bonds have a zero risk weight<sup>13</sup> within the credit risk regime. Looking at historic interest rates it can be assumed that market rates take into account the actual inflation rate, the inflation risk and credit risks.

The sub-option A2 regarding the current inflation rate and option A3 with respect to inflation risk have been retained for the reasons explained above.

***Set of B options - incentives to use long-term deferred instruments and incentives for additional deferral periods***

**Option B1 – explicit factor to incentivise long-term deferral period when using instruments to pay variable remuneration**

**Option B2 – explicit factor to incentivise the use of additional retention periods**

**Option B3 – calculation of the discount rate which takes into account the length of the deferral period**

**Option B4 – allow additional discount depending on the type of instrument used**

The CRD requires the length of deferral periods within the guidelines to be considered and aims to incentivise the use of instruments which are deferred for a period of five years or longer. It is therefore appropriate to increase the discount rate with time, if instruments are deferred for a period longer than the minimum period of five years. To provide incentives to institutions to defer remuneration for longer periods, when developing the guidelines the EBA examined the inclusion of a standard incentive factor for variable remuneration deferred for five years which would be increased for the years exceeding five years and would be part of the discount rate. In order for this framework to provide enough incentives to use longer deferral periods than five years, it was decided that the add-on incentive factor is to be higher than the linear yearly evolution of the cumulative incentive factor for five years, i.e. cumulating discount factor for five years divided by five. Following these principles, the EBA set the cumulative discount factor for variable remuneration deferred for five years at 10%, plus a further ‘add-on’ factor of 4% for each additional year of deferral, which is double the linear yearly evolution of the cumulative discount factor ( $10\%/5 \text{ years} = 2\%$ ), to provide stronger incentives for the use of longer deferral periods.

Retention of vested instruments is an important element in the design of the long-term incentive structure of variable remuneration and is required for all instruments awarded according to Article 94(1)(l) of the CRD. Longer retention periods create an incentive for the employees for prudent behaviour even after the awarded remuneration has vested and link variable

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<sup>13</sup> The EU member states retain the discretion of applying a 0% weight on EU government bonds.

remuneration to the performance of the institution, which is influenced by decisions on risks taken in the past. By imposing longer retention periods, remuneration is better aligned with the long-term interest of the institution. Therefore additional incentives were considered if instruments which are deferred for more than five years are subject to additional retention periods after the deferral period has ended. However, as the amounts are already vested after the deferral period, the incentive factor should be lower than the one for deferral. While staff would not receive distributions during deferral periods they would receive distributions during additional retention periods. A retention period of one year could be considered as the minimum which should be applied, hence the EBA consulted on a proposal where only the use of longer retention periods of at least two years should be incentivised. However, the inclusion of additional elements also increases the complexity of the application of the discount rate and as the impact on the rate was low, the option to apply an additional incentive factor for retention was not retained.

A discount rate should be applied for every year to take into account the effect of inflation and other relevant factors throughout the deferral period. As the discount rate is expressed as an annual rate, it is appropriate to estimate the compounded impact on the cashflows that arrive later than the first year, i.e. raise the factor to the power of the number of years of the vesting period for each cashflow. For remuneration deferred for only three years inflation effects are not taken into account, hence the application of the rate for the full period of at least five years also provides incentives to make use of long-term deferred instruments.

Institutions can use different instruments for paying variable remuneration. Since stock prices have the potential to fluctuate more than debt instruments' prices, they have a higher down-side risk. Moreover, their distribution of pay-outs is also different; hence, one could consider differentiating the discount factors for different instruments. However, a differentiation would add complexity to the application of the remuneration framework and trigger additional implementation costs for institutions and for competent authorities reviewing the application of the discount rate. The same would apply if one differentiated the discount rate by reference to the credit risk of the issuer of the instrument used for the purposes of variable remuneration. Differing discount rates could also lead to differences in employment conditions. All instruments must be appropriate for the use of variable remuneration and must be subject to a remuneration policy, including deferral and retention periods. It cannot be proved that one class of instruments would provide better incentives for prudent risk taking. Instruments would be affected by inflation in the same way. Option B4 was therefore not retained.

Options B1 and B3 have been retained for the reasons set out above.

**Set of C options – opportunity costs**

**Option C1 – market rates, e.g. rate for 10-year EU government bonds**

**Option C2 – return on Equity ('ROE') of institution or the EU banking system**

The net present value of variable remuneration depends not only on the expected inflation rate, but also on the opportunity costs of the remuneration not available today for another use or an alternative investment. For the opportunity costs, a rate that measures the real yield, but excludes inflation, should be considered. However, as also mentioned above, market rates depend not only on inflation and credit risk, but also on the liquidity of the instrument and other aspects. If staff were to receive non-deferred remuneration, they could invest it in equity instruments, bonds, property or other investments. The opportunity costs depend also on the riskiness of the alternative investment and the perceived costs therefore differ for each individual staff member. The choice of the discount rate should aim at achieving maximum harmonisation. The rate should be easily available, objective and applicable, e.g. EU government bonds. When choosing a rate, the length of deferral periods should be taken into account, as rates are different for different maturities. A rate for long-term government bonds with maturity of around 10 years seems to be appropriate, considering both the length of deferral periods (which can be longer than five years) and the inflation risk, such bonds also being adequately liquid instruments. In general, instruments with longer maturities provide better indicators for inflation risks than instruments with shorter maturities. These instruments should not exceed maturities of 10 years, as beyond this period the instruments become illiquid in some countries. Interest rates differ significantly between Member States for several reasons; hence, an EU average for this value should be used to achieve harmonisation and also take into account the fact that EU parent institutions should be able to use the same discount rate in a group context. Given that the rate is added to the factor for inflation, the interest rate for EU government bonds with a maturity of around 10 years seems to be appropriate to cover opportunity costs for other investments and the inflation risk even if it leads to some extent to a double counting of the inflation rate, which is reflected in bond rates as well. The rate is easily available. Using this rate is transparent and leads to a high level of harmonisation. The rate fluctuates over time, but is – when using an EU average – more stable than rates for single Member States.

The rate for opportunity costs could be based on the average return on equity of all institutions within the European Union or institutions' individual profitability. The latter would not lead to harmonisation and could also create conflicts of interest regarding accounting and valuation issues. The average ROE for the EU banking system as published by the European Central Bank shows very volatile values and, therefore, the discount rate would significantly differ over time. Linking the discount rate to the ROE could also lead to incentives to increase the ROE in the short term, which could contradict the long-term interests of the institution.

Some respondents suggested that the rate of EU government bonds would not appropriately cover opportunity costs. Opportunity costs depend on the alternative investment which would have been made by staff if the remuneration had been paid up-front. The notional discount rate does not lead to an increase of taxable income. The discount rate only applies for the purposes of calculating the variable-to-fixed remuneration ratio. When considering the additional opportunity costs and risks of long term deferred instruments, one needs also to consider that in any case deferral requirements of at least 3 years apply to a minimum of 40% of the variable remuneration, without any further incentive being provided.

Adding additional relevant factors would lead to increased complexity and application costs of the guidelines, excessive volatility of the discount rate over time and differences in employment conditions. Therefore, the EBA decided to increase the incentive factor for additional years of deferral and not to allow for an incentive factor for retention as consulted on.

According to the ECB's statistical warehouse data, the median 'return on equity' of European credit institutions, since 2008<sup>14</sup>, has ranged between 4% and 6%. During the same period, the average EU long-term government bond rate has ranged from around 3% to 5% while the average annual inflation rate has ranged between 1% and 3.7%.

The discount rate takes into account the inflation rate. The data on inflation forecasts (five years ahead the ECB prognosis is a 1.9 % inflation rate for the euro area) suggest, at the moment, a limited risk of increased inflation rates. If one used the ROE as a proxy for opportunity costs the additional opportunity costs compared to government bonds should be roughly on average 1% to max 2%, if one considers data from 2008 onwards.

The calibration of the incentive factor accounts for all such rates mentioned above. By providing for a unique incentive factor, the discount rate is easier to apply and calculate compared to a broader set of factors. The unique incentive factor (10% for 5 years + 4% for each year thereafter) covers other potential relevant factors and provides for a discount rate which sufficiently incentivises the use of long-term deferred instruments, as the discount rate is in any case significantly higher than market rates for financial instruments. One needs also to consider that the discount rate takes into account the full length of the deferral period, while no discount can be applied when only a three year deferral period is applied.

After taking into account the reasons given above, option C1 has been retained.

***Other options considered:***

It was suggested from respondents to the public consultation that staff turnover (staff leaving the firm and therefore potentially not receiving the deferred variable remuneration) be considered in the calculation of the discount rate, as this would take into account the probability of a staff member receiving the variable remuneration after deferral where he had left the institution and his contract provided that in such a situation non-vested deferred remuneration was not paid. Such a rate can be calculated on historic staff fluctuation and the derived possibility of not receiving the remuneration could be factored into the discount rate. As the discount rate is intended to be applied to a single staff member, it is difficult to consider the general staff turnover within an institution and to apply this to remuneration awarded individually. Such figures would differ between institutions and Member States, which would not lead to harmonisation regarding the discount rate. The possibility of some staff members changing positions should not lead to a discounting of the variable remuneration for the purpose of

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<sup>14</sup> Due to the recent regulatory developments and economic conditions, it was considered appropriate to take into account the figures from 2008 onwards and not earlier data which could be misleading or not representative of the current conditions.

calculating the ratio. Long-term deferral should provide for long-term incentives for the individual. Deferred variable remuneration would not be retained in all cases if staff leave an institution. This depends on individual arrangements. Sometimes this is also compensated for by a signing on bonus.

Some respondents suggested, during the consultation, the use of performance criteria as a relevant factor for setting the discount factor. However, this was deemed redundant as performance is being considered when variable remuneration is awarded. Therefore, this factor was not considered to be relevant for the discount rate.

Respondents also suggested that the riskiness of the instrument and the complexity of the institution should be considered. As explained above, none of them have been taken into account, as this would lead to additional costs when applying the discount rate and when supervising the institutions and could have a negative impact on a level-playing field. In addition, if an institution had capital instruments which were associated with a high risk, one could argue that, rather than paying an increased variable remuneration by providing for a higher discount rate, the level of remuneration should be reduced in order to improve the capital basis and lower the risk assumed for the instrument.

*In summary, none of the proposed additional factors for adjusting the discount rate was retained.*

***Set of D options - amounts of variable remuneration which can be discounted***

**Option D1 – amounts that vest after a five-year deferral period should be eligible**

**Option D2 – if remuneration is deferred for at least five years all amounts that are paid in instruments (up to a maximum of 25% of variable remuneration) should be eligible, including amounts vesting before the end of the deferral period**

The CRD allows variable remuneration, paid in instruments, to be discounted if it is deferred for a period of at least five years. The discount rate should incentivise the use of longer deferral periods. Variable remuneration should not vest faster than on a pro rata basis.

Applying the discount factors to amounts which vest only after a minimum period of five years would provide a strong incentive to defer large parts of the variable remuneration for five years or longer and, by doing so, to provide for a good risk alignment. However, this may not be practical as staff would receive larger parts of the variable remuneration at a very late stage, reducing the net present value of variable remuneration and potentially the flexibility of staff to change work places. Both effects could lead to institutions not using long deferral periods, in order to avoid the negative effects. The discount rate may therefore not be applied at all.

Allowing the discounting of amounts which vest within a long deferral period would reflect the current remuneration practices in institutions, which often use pro rata vesting of variable remuneration. A sufficient risk alignment would still be achieved. The incentive to use long-term deferral would be increased, as the net present value of remuneration would not be reduced to

the same extent as under option D1. The discount rate would provide sufficient incentives to defer variable remuneration within the limits provided in the CRD for a longer time period, as the rate would consider the number of years it took for the variable remuneration to vest.

*Taking into consideration the above argumentation, option D2 was retained.*

#### *Calibration of the discount rate*

Some factors considered in the calculation of the discount rate are given externally (inflation, interest rate for Government Bonds), while one factor has been introduced to provide incentives to use longer deferral periods. The calibration of the incentive factor took into account current market conditions and other relevant factors and aims to provide for sufficient incentives to use longer-term deferred instruments. The discount rate is significantly higher than market rates for instruments which can be used for variable remuneration.

#### *Proportionality*

The discount rate can be applied to a maximum of 25% of variable remuneration awarded in instruments that are deferred for at least five years. Member States may set a lower maximum percentage. The discount rate is based on publicly available data. Therefore, smaller institutions should also be able to access the required information. The choice whether to apply the discount rate, if introduced within the national legal framework, is for the institution. In smaller institutions with lower staff numbers the calculation and the application of the discount rate seem to be possible without the implementation of IT systems or the allocation of additional resources.

### **4.1.3 Monetary impact of these Guidelines**

The implementation of these Guidelines is limited to the setting and application of the discount rate for variable remuneration. The discount rate itself is part of the CRD requirements. The impact of the CRD has not been assessed. The marginal costs for applying the guidelines should be minimal. The costs of different options have not been analysed, as all options are based on data which are easily available and, therefore, costs for different options would be identical.

**Table 1 – Summary of the costs of applying the guidelines for institutions**

Costs	One-off	On-going
Changing the way remuneration policies are set, systems and controls.	a. Cost of additional staff time to review and align remuneration policies in order to reflect the discount rate and implementation of the discount rate in HR systems to calculate the levels of variable remuneration. Minor costs for training. However, this is triggered by the CRD. Costs to implement a system to calculate the effect of the discount rate should be minimal and occur only if the institution makes use of this possibility.	b. none
Calculating and applying the discount rate	c. none	d. Costs for the annual calculation of the discount rate and costs of applying it should be minimal. Cost for documentation.
Remuneration Benchmarking Exercise	e. minor costs for changing the existing IT systems for the processing of data to be disclosed and the reporting of remuneration figures to competent authorities	f. The scope of data which is collected for remuneration Benchmarking is extended by a few data fields containing readily available data, hence creating minor, if any, costs for reporting and analysis.

The introduction of a discount rate for variable remuneration may also have additional cost implications for national supervisory authorities, as they need to supervise the application of the discount rate if implemented by national legislation and used by institutions. However, this is not directly triggered by the guidelines, as this is already a CRD requirement. The application of the CRD, including the remuneration framework, is subject to supervisory review. The costs of the supervisory review are not driven by the way in which the discount rate is calculated, but stem mainly from the fact that compliance with the requirement regarding the ratio between variable and fixed remuneration needs to be supervised. However, an overly complex discount rate would increase the cost of its application and supervision.

#### *Benefits of the proposal*

By establishing harmonised rules for a discount rate, the remuneration framework between Member States remains comparable and transparent as regards the application of the cap for variable remuneration.

The following Table shows the magnitude of the costs and benefits for supervisors and credit institutions in relation to the current operational cost:

Stakeholder	Magnitude of costs	Magnitude of benefits	Net Impact (benefits minus costs)
<b>Institutions</b>	Low	Low	Negligible (positive)
<b>Competent authorities</b>	Low	Low	Negligible (positive)

## 4.2 Feedback on the public consultation

The EBA publicly consulted on draft guidelines which were updated and are contained in this paper.

The consultation period lasted for just under three months and ended on 18 January 2014. Ten responses were received, of which seven were published on the EBA website. The EBA did not receive an opinion from the Banking Stakeholder Group.

This section presents a summary of the key points and other comments arising from the consultation, the analysis and discussion triggered by these comments, and the actions taken to address them if deemed necessary.

In many cases several industry bodies made similar comments or the same body repeated its comments in the response to different questions. In such cases, the comment, and EBA analysis are included in the section of this paper where the EBA considers them most appropriate.

Changes to the draft guidelines have been made as a result of the responses received during the public consultation.

### **Summary of key issues and the EBA's response**

Many of the ten organisations who responded to the consultation paper felt that the guidelines did not sufficiently incentivise the use of long-term deferred instruments as in particular the proposed discount rate did not lead to a sufficient reduction of the variable remuneration. The net present value of deferred remuneration perceived by staff was lower than the net present value calculated using the discount rate. The effect of the guidelines on the ratio between variable and fixed remuneration was too limited. In general respondents agreed that such long term deferred instruments could play an important role in providing incentives for long-term oriented and prudent risk taking.

Some respondents acknowledged that the CRD provides the EBA with a narrow mandate to develop these guidelines, asked for simplifications, and recommended an increase of the discount rate to balance better administrative costs and the incentives provided. A few of them suggested the application of fixed discount rates for specific remuneration schemes.

A few other respondents interpreted the CRD differently and postulated that the 25% portion of variable remuneration paid in long-term instruments should be calculated after the discount rate has been applied. In particular these respondents asked to use internally estimated costs of risks or capital costs and a broader set of elements when calculating the discount rate. These respondents suggested that the application of the discount rate in the way they proposed provided sufficient incentives to use long-term deferred instruments and increased the cost flexibility of banks.

The EBA's specific mandate is limited to setting guidelines regarding the applicable notional discount rate. All guidelines have to be consistent with the EU Regulations and Directives. The guidelines take account of the CRD provisions regarding this issue. The EBA has reviewed the guidelines by reference to the elements of the discount rate to be used as outlined in the feedback table below. The amount of variable remuneration which can be discounted is already defined within the CRD and limited to 25% of the total variable remuneration. Variable remuneration is defined as the amounts which are awarded. The notional discount rate is only applied for the purpose of calculating the ratio between the variable and the fixed component of total remuneration. The guidelines clarify the application of the CRD provisions. The EBA has retained the approach of setting out a discount rate which does not differentiate between the institution's risk profile or the assumed riskiness of the specific instrument used. This is to reduce complexity and to increase predictability of the discount rate calculated under these guidelines, reduce the implementation costs for institutions and competent authorities, and achieve a level playing field in terms of employment conditions.

## Summary of responses to the consultation and the EBA's analysis

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<b>General comments</b>			
Application of the guidelines	<p>The national discretion set out in the CRD regarding the application of the discount rate may lead to a situation where in some Member States EBA guidelines are not applied. This could lead to differences in conditions of competition.</p>	<p>The EBA has a mandate to issue guidelines regarding the applicable notional discount rate. Member States may decide to allow institutions to apply a discount rate to a maximum of 25 % of the total variable remuneration. This national discretion is part of the CRD. Guidelines cannot override EU legislation, and therefore Member States may indeed implement different requirements as regards this issue, leading to small differences in conditions of competition.</p>	No change
Unintended consequences of the guidelines	<p>A few respondents state that the guidelines would have unintended consequences as they would lead to higher amounts which can be paid up front or under short-term deferral arrangements as the discount rate increases the overall variable remuneration which can be paid compared to a certain fixed remuneration.</p>	<p>The CRD sets a cap for variable remuneration. Respondents did not compare the situation before the introduction of CRD IV with the actual framework, but assumed that under a ratio of 1:1 the same total remuneration would be paid as beforehand and that the variable remuneration would be increased above this level if parts of variable remuneration were awarded in long term deferred instruments.</p> <p>The described alleged unintended consequence is a result of the changed regulatory requirements and the assumption made by respondents that institutions would be increasing the variable remuneration.</p>	No change
		<p>A remuneration package of EUR 200 000 could be</p>	

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		<p>awarded in several ways, e.g.:</p> <ul style="list-style-type: none"> <li>- By paying out EUR 100 000 fixed and a maximum of EUR 100 000 variable remuneration (ratio 100%)</li> <li>- By paying out EUR 66 667 fixed and a maximum of EUR 133 333 variable remuneration (200% ratio, subject to shareholder approval)</li> <li>- By paying out around EUR 85 000 fixed and a maximum of around EUR 115 000 variable remuneration, if 25% of them are paid out in variable instruments and deferred for at least five years and the discount rate can be applied to this amount subject to the implementation of this possibility by the Member State.</li> <li>- Respondents suggest that in fact EUR 100 000 fixed remuneration would be paid out and around EUR 115 000 discounted variable remuneration would be awarded to incentivise the use of long term deferred instruments. However such a remuneration package would result in total remuneration of EUR 215 000.</li> </ul>	
Clarity regarding the possible amount of variable remuneration paid	The guidelines should be drafted in a way that ensures that staff would know the maximum ratio of variable remuneration when payment conditions are agreed.	The EBA has reviewed the guidelines and made various amendments regarding the data elements to be used as part of the discount rate. The data can be the most recent available data either at the time the remuneration is awarded or at the time the possible variable remuneration is determined.	Point 7 amended

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Complexity of the calculation	<p>A few respondents propose that e.g. a uniform discount rate or discount factor table applicable to defined remuneration schemes could be used to simplify the guidelines and that it should be possible to use a single rate within a group. Compared to the small increase of the ratio the costs would be high and therefore the discount rate may not be used.</p>	<p>The EBA's mandate requires taking into account all relevant factors including inflation rate and risk, which includes length of deferral. If a single rate for specific remuneration schemes were used, the EBA would need to review and amend the established discount rates from time to time. A definition of the relevant elements avoids this need and provides clarity about future changes of the discount rate. This also enables institutions to develop their own remuneration policies as required by the CRD. However, institutions will be able to use the same discount rate in a group context to allow for an easier application of the guidelines in a group context.</p>	No change
Payment of interest during deferral periods	<p>One respondent stated that the draft EBA guidelines did not consider the practice under which staff would receive interest payments during deferral periods.</p>	<p>During vesting periods the staff member is in general not considered to be the legal owner of the instrument. The existing 'Guidelines on Remuneration Policies and Practices' provide that distributions should not be paid to staff during such periods. However, if such payments were made the discount rate should obviously not be applied as set out in the guidelines as the staff member would already be compensated for inflation rate and risk and opportunity costs.</p>	No change
Other relevant factors	<p>A few respondents stated that the draft guidelines do not take account of all the factors relevant to the discount rate, in particular staff turnover and performance criteria, but also internal risk costs and the nature, size and complexity of the institution.</p>	<p>The EBA's mandate provides that the EBA shall take all relevant factors into account when developing guidelines. The options chosen regarding the factors are explained in the impact assessment. Some of these factors are considered explicitly in the discount rate, while other factors are implicitly</p>	The discount rate was simplified and recalibrated

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		<p>considered within the incentive factor for long-term discounted variable remuneration. The guidelines include elements which change over time and elements which are kept stable.</p>	<p>The incentive factor has been reviewed and further explanations have been provided in the impact assessment. The incentive factor for retention was not retained, but the additional percentage for additional deferral periods beyond five years was increased to 4%. Including a broader set of single factors which changed over time would complicate the calculation of the rate. Many respondents even requested that the draft guidelines be simplified; hence a more granular approach was not implemented.</p>
		<p>The chosen approach ensures that the guidelines achieve a level playing field, while the discount rate appropriately reacts to changes of the core elements required by CRD.</p>	
Retention periods	<p>A few respondents commented that the guidelines do not provide adequate reasons for requiring retention periods and do not see the need to differentiate between incentives for retention and deferral periods. These respondents pointed to some points which are problematic when retention periods apply; taxation of retained income differs between Member States, labour law may prevent the use of clawback and malus clauses, and retention periods trigger administrative costs to ensure compliance.</p>	<p>Article 94(1)(l) of the CRD requires retention periods to be applied to all instruments used for the purposes of variable remuneration, including components which have been deferred. A minimum retention period could be considered to be at least one year. However, the draft guidelines consulted on proposed an additional incentive to use longer retention periods subsequent to the deferral period within the remuneration scheme.</p>	<p>The factor for retention was deleted</p>
		<p>However, the incentive factor for retention periods has not been retained (please see above for more</p>	

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Proportionality	<p>One respondent requested that the approach implemented in the CEBS 'Guidelines on Remuneration Policies and Practices' be retained. For investment firms a proportionate approach should be applied under CRD IV with regard to all remuneration provisions.</p>	<p>details).</p> <p>The EBA will review the 'Guidelines on Remuneration Policies and Practices' issued by CEBS as soon as possible and will consider the issue of proportionality in the update of these Guidelines.</p> <p>The discount rate should be easy to apply for all institutions. There is no obligation to make use of the possibility of applying the discount rate. If the level of the discount rate were to be differentiated based on the nature, size and complexity of firms, different rates would apply leading to greater complexity, differences in employment conditions and an impact on conditions of competition.</p>	No change
Application of CRD IV before the guidelines are published	<p>One respondent suggests that institutions should already be allowed to apply the discount rate on a best effort basis as the possible variable component of remuneration for 2014 is to be agreed now.</p>	<p>The CRD is being implemented by Member States and institutions are aware of the requirements. The possibility of applying the discount rate is subject to Member State discretion.</p> <p>The guidelines will come into force only after their publication. Subsequently, competent authorities will implement them into their supervisory practices and institutions should make every effort to comply with the guidelines.</p>	No change
Guidelines not in line with CRD	<p>One respondent claimed that the guidelines were not in line with the CRD and that the EBA had misinterpreted the CRD requirements. The guidelines did not provide, unlike as intended by the European Parliament, for appropriate incentives to pay variable remuneration in a way that promoted long term and prudent risk taking.</p>	<p>The guideline follows exactly the intention of the CRD, adopted by the European Parliament and the Council, of limiting the amount of variable remuneration which can be paid to identified staff compared to fixed remuneration and defines the discount rate which is as such part of the CRD requirements. Within the intended limits, the</p>	No change

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Application to branches of third-country institutions	<p>The EBA had misinterpreted the proportion of variable remuneration that could be discounted. This respondent suggested in detail a different approach, which would allow for a significant increase of variable remuneration compared to fixed remuneration with ratios which could easily exceed significantly the ratios set within the CRD based on the assumption that the discounted variable remuneration paid in long-term deferred instruments should equal 25 % of the variable remuneration combined with the possibility of using individual and higher discount rates.</p>	<p>discount rate will lead to an increase in the permitted level of variable remuneration compared to the fixed remuneration.</p> <p>The EBA has analysed the response received and the proposed alternative approach. The respondent may not have fully understood the intention of the CRD to limit the amounts of variable remuneration which could be paid in order to avoid incentives for excessive risk taking. Even if the discount rate is applied to calculate the ratio between variable and fixed remuneration one needs to consider that in fact the non-discounted amount of variable remuneration will in general be available after deferral and retention periods. In particular the amount which can be discounted is already clearly defined within the CRD.</p> <p>Please see also the comments under Question 1.</p>	No change
		<p>According to Article 47(1) of the CRD ‘Member States shall not apply to branches of credit institutions having their head office in a third country, when commencing or continuing to carry out their business, provisions which result in more favourable treatment than that accorded to branches of credit institutions having their head office in the Union.’ This requirement should ensure a level playing field between such branches and institutions.</p>	

### Responses to questions in Consultation Paper EBA/CP/2013/40

Question 1.	A few respondents feel that the guidelines should	Article 94(1)(g)(iii) of the CRD explicitly states that	No change of the GL,
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Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>define the amount which can be discounted differently and suggest that the variable remuneration paid in long-term deferred instruments after applying the discount should equal 25% of the total variable remuneration.</p> <p>This would allow institutions to incentivise staff better and would increase the cost flexibility of institutions as a significant uplift of the possible ratio between variable and fixed remuneration would be achieved. Some respondents suggest that this would be more in line with the EBA's mandate to develop guidelines to incentivise the use of long-term deferred instruments.</p> <p>These respondents pointed out that the guidelines would only lead to a small increase of the ratio between variable and fixed remuneration and would therefore not provide for an appropriate incentive.</p> <p>Other respondents acknowledge the limited scope of the guidelines due to the limitation of variable remuneration which can be discounted.</p>	<p>'Member States may allow institutions to apply the discount rate ... to a maximum of 25% of total variable remuneration provided it is paid in instruments that are deferred for a period of not less than five years.' Recital 65 of this Directive explains that '[i]n any event, in order to avoid excessive risk taking, a maximum ratio between the fixed and the variable component of the total remuneration should be set... Member States should be able, within certain limits, to allow institutions to apply a notional discount rate when calculating the value of such instruments for the purpose of applying the maximum ratio...'</p> <p>The guidelines cannot amend the CRD requirements; the EBA should publish guidelines on the applicable notional discount rate. EBA guidelines must specifically consider the use of long term deferred instruments.</p> <p>Total variable remuneration consists of all elements of variable remuneration before the discount rate is applied. According to the CRD only a maximum of 25% of this total amount can be discounted. The EBA disagrees with the view of some respondents that the CRD should be understood to allow for a discount of a potentially very high amount of variable remuneration paid on long-term deferred instruments which could, after the application of a discount rate, equal 25% of the sum of non-discounted variable remuneration and discounted variable remuneration. Depending on the applied discount rate, such an interpretation could lead to ratios between variable and fixed remuneration of</p>	IA amended

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Question 1.	<p>Most respondents support that the discount rate can also be applied to amounts which vest pro rata. However, one respondent deems this to be inappropriate as this would reduce the amount which is deferred for a long term and reduces the total amount of variable remuneration which can be paid up front and in total compared to a deferral of the full amount for five years.</p>	<p>several hundred percent.</p> <p>Such an interpretation would be against the wording of the CRD and also against its objective to introduce a maximum ratio between variable and fixed remuneration. The discount rate should increase the variable remuneration which could be paid only within certain limits.</p> <p>The incentive the discount rate could provide is limited by the framework set by the CRD requirements. The EBA has considered the incentives to use long-term deferred instruments by consulting on a discount rate which is significantly higher than the yield for alternative investments</p> <p>When analysing the incentives one needs to consider that in any case a deferral of at least three to five years is required for 40% to 60% of the total variable remuneration paid; the longer deferral only adds limited opportunity costs and risks to a remuneration scheme based on the minimum requirements for which no discount rate can be applied.</p>	No change

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Question 1	One respondent asked for confirmation that variable remuneration could also be discounted if the amounts were settled in cash, provided that in the given jurisdiction it was not possible to pay variable remuneration in equity instruments or bonds.	If institutions pay out a higher level of remuneration, this can lead to an increase of different payment components as the CRD requirement to defer 40% to 60% of the variable remuneration for at least three to five years applies to the amount of total variable remuneration before the discount rate is applied.	No change
Question 1	Most respondents find the calculation of the amount to be sufficiently clear. However, one respondent finds the reference to total variable remuneration not clear as this term is not defined within the CEBS Guidelines.	The CRD requires that variable remuneration can only be discounted if it is paid in instruments deferred for at least five years. Institutions may use e.g. share linked instruments, Other Instruments or Other Instruments linked to Additional Tier 1 or Tier 2 instruments in accordance with the CRD requirements and the upcoming RTS on instruments.	No change
Question 2	Most respondents find the use of the HICP appropriate. Some respondents find the provisions quite complex as they would lead to the application of different rates for different institutions within a group and suggest that it should be possible to use the same rate used by the EU parent institution throughout the group. One respondent suggests using a uniform rate for all European institutions to ensure a level playing field, e.g. the EU average could be used.	The term 'total variable remuneration' is used in various CRD provisions. Total variable remuneration consists of all amounts of variable remuneration before the discount rate is applied.	Point 8 amended
Question 2	Some respondents pointed out that the rate	The guidelines specify the HICP to be used. The HICP	Point 7 amended

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Question 2	<p>should be set in a way that enabled staff and the institution to derive the exact amount which could be paid in variable remuneration when the payment conditions were agreed on, and that using the rate when the remuneration was actually paid would not achieve this objective. One respondent asked for clarification on the exact inflation rate, as at the time of its publication, to be used for the purpose of calculating the discount rate.</p>	<p>is published by Eurostat. The guidelines refer to this publication. The draft guidelines which were the subject of the public consultation refer to the last available HICP when the variable remuneration is awarded. The guidelines were amended to allow the use of the last available HICP rate published before the level of variable remuneration which could be paid is agreed. However, contracts can also refer to the inflation rate applicable when the variable remuneration is awarded.</p>	
Question 3	<p>One respondent felt that the rate was not appropriate as the HICP was not an inflation forecast and the GL do not use an indexation to cover the inflation risk. In addition the country where the employee was based or taxed should be used as a basis to determine the inflation rate to be applied and suggested deriving an inflation rate from the forward inflation yield curve. Another respondent suggests linking this rate to an existing instrument or the credit quality of the institution.</p>	<p>While the suggested options would be valid alternatives, the EBA has retained its approach. The proposed options would lead to an increase in costs for institutions to determine such a rate, increased costs for supervisors to review the remuneration framework, and to differences in conditions for competitions between institutions. Most respondents find that the proposed rate covers the inflation risk appropriately.</p>	No change
	<p>Most respondents find it appropriate to use the rate of government bonds as a proxy for inflation risk. As regards opportunity costs, respondent suggested rates of capital instruments, indices, a multiple of the proposed rate or other proxies should be used.</p>	<p>The EBA has considered the various options proposed. Institutions can only award either equity or equity-linked instruments or instruments in line with the upcoming RTS on instruments which can be written off or converted into CET 1 instruments. The riskiness of the instruments which can be used differs, but is within a limited range. Considering the riskiness of the chosen instruments would increase the complexity of the guidelines; other respondents suggested simplifying the calculation of the discount rate.</p>	Impact assessment amended; the incentive factor for additional years of deferral was increased.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	A few respondents asked for clarification as to which data exactly should be used for the calculation and for clarification as to whether the rate should be the EU average or the rate for the Member State, suggesting that the EU average rate would be more appropriate.	The average interest rate for EU government bonds based on all EU Member States should be used. The guidelines were clarified. The guidelines contain a link to the publication.	Point 10 amended
Question 3	A few respondents pointed out that the government bond rate outside the EU may include a risk weight and that therefore institutions should be able to use these rates as an alternative to EU government bond rates.	The government bond rates are used as a proxy for inflation risk and opportunity costs. Opportunity costs are also covered to some extent in the incentive factor. Differences in the inflation rate are already sufficiently taken into account as institutions can use the rates published for the third country under certain conditions. For staff located in a third	Point 10 amended

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Question 3	One respondent did not find the rate for government bonds appropriate as their maturity does not equal the vesting period and as they are usually considered to be risk free investments and therefore not appropriate to represent risks within the discount rate. Institutions should rather be allowed to use an internally derived rate which appropriately reflects the risk of the institution in addition to a risk free rate.	country the EBA has added the suggested option.  As explained above the EBA has retained a common interest rate. Vesting periods can differ and for discounted variable remuneration a deferral period of at least five years is required. It is necessary to apply additional retention periods. The vesting periods can differ. The EBA is of the opinion that the maturity of the government bond rate used and the deferral period are sufficiently aligned. Longer maturities should also better indicate the assumed inflation risk.	No change
Question 4	Most respondents stated that the incentive factor is not appropriate and that its calibration is not sufficiently clear. The factor is too low to provide an incentive, in particular as it is limited to a small part of variable remuneration and as recipients would apply a higher discount rate for deferred remuneration. The discount rate does not reflect the real costs of deferral perceived by staff. The additional percentages for additional years are too low to provide for an appropriate incentive to apply even longer deferral periods. The years of service needed to receive the deferred variable remuneration and the risk of not receiving the remuneration awarded initially need to be taken into account. One respondent suggests using an incentive factor of 15% and 3% for each additional year.	The EBA has maintained the incentive factor of 10%, but increased the additional percentage for each additional year of deferral to 4% to incentivise longer deferral periods. The incentive factor for retention was not retained.  The total discount rate is well above rates for investments in alternative high yield instruments, e.g. interest rates of contingent convertible instruments at the moment range between roughly 8% and 12% depending on the rating and other conditions of the instrument.	Impact assessment amended; the incentive factor for additional deferral periods was increased
Question 4	One respondent suggested using a progressive or exponential factor for the incentive factor, in order	The EBA has recalibrated the discount rate and increased the percentage for additional years of	The incentive factor for additional

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	to increase the effect of the discount rate.	deferral.	deferral periods was increased
Question 4	One respondent suggested aligning the factor with the nature, scale and complexity of the firm.	As explained above the EBA guidelines aim to implement a discount rate which is easy to calculate and apply, and which leads to a level playing field. This would not be achieved if there were material differences between discount rates. Deriving appropriate risk-based discount rates would be more challenging for smaller or less sophisticated institutions.	No change
Question 5	<p>Most respondents found that the additional incentive factor for retention periods was too low to provide for an appropriate incentive. The factor is even lower than for deferral periods. The additional factor would increase the complexity of the calculation of the discount rate; given its limited impact this would not be appropriate. A few respondents criticised the fact that a retention period of one year would not count against the discount rate.</p> <p>A few other respondents supported an additional factor, if calibrated appropriately and if it did not create additional complexity. One respondent suggested acknowledging the retention period in the discount formula and applying a higher factor.</p>	<p>While the CEBS ‘Guidelines on Remuneration Policies and Practices’ establish that distributions payable during deferral periods should not be paid to staff, distributions payable during retention periods would be paid out. For this reason it would not be appropriate to take the years of additional retention periods into account in the same way as deferral periods, as inflation, inflation risk and opportunity costs would not need to be considered during retention periods. However, as respondents point out, institutions are more likely to apply additional deferral periods as they have a higher impact on the discountable variable remuneration. To simplify the discount rate and its application, the incentive factor for retention was deleted and the incentive factor for additional deferral periods was increased.</p>	Point 11 amended
Question 5	One respondent in particular questioned the need to apply retention periods in addition to long term deferral periods.	The application of retention periods to variable remuneration is required under the CRD. Please refer also to the CEBS ‘Guidelines on Remuneration Policies and Practices’.	No change

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Question 6/7	Most respondents deemed the calculation of the discount rate to be sufficiently clear. However, a few respondents pointed out that the calculation should be simplified and in particular in a group context the same rate should be applied.	The EBA has included the option of using the same discount rate throughout a group. The discount rate needs to change over time to accommodate e.g. changes of the inflation rate. This is ensured by adding elements to its calculation which are updated regularly.	Point 7 amended
Question 7	One respondent suggested clarifying that the discount will be applied for the variable remuneration paid for a performance year.	Variable components of remuneration should not exceed 100% of the fixed components. For the purpose of this calculation a discount rate can be applied under certain conditions to the total variable remuneration paid. In general a period of one year is used for calculating the variable remuneration which is awarded for the purpose of calculating the ratio. As regards this issue, please refer also to the CEBS 'Guidelines on Remuneration Policies and Practices', which will be reviewed by the EBA as soon as possible.	No change
Question 7	One respondent asked for clarification that in paragraphs 15 to 17 the amounts always refer to the variable remuneration of the individual staff member.	The amounts refer to the individual staff member; the guidelines have been clarified.	Points 15-21 amended
Question 8	Most respondents stated that the costs for these additional requirements would not be significant as they would be dealt with by existing staff using existing data. However, some costs for IT implementation, training and compliance would arise. The costs could be reduced by using a uniform discount rate within the group. Instead of disclosure one respondent suggested requiring the provision of information to the competent	The EBA has reviewed the disclosure requirements. Institutions should be able to provide all these and additional information if requested to the competent authority. The CRR already requires institutions to disclose the main features of a remuneration policy and the amounts of variable remuneration. Information on the discount rate is needed to understand the information provided. The draft guidelines consulted on set out some	Point 22(a) and (d) of the consulted GL were deleted

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Question 8	authority.	information which should be disclosed in any case. The EBA has simplified the disclosure requirements within the guidelines.	No change
Question 9	One respondent stated that there would be no costs as institutions will not make use of the guidelines as it does not provide for sufficient incentives to use long-term deferred variable remuneration. Institutions would continue to pay out the maximum amount up front and use short deferral periods.	There is no requirement to make use of the discount rate. However, it is good practice to appropriately align remuneration with the impact staff have on risk profile and to set appropriate incentives for long-term oriented and prudent risk taking. The CRD requires an appropriate remuneration policy to be applied. Competent authorities are reviewing the appropriateness of the remuneration policies.	Example 1 amended
Question 9	In general respondents find example 1 sufficiently clear, but state that the CP contains a minor calculation error. The clarity of the example could be improved further, if all payment components after the award were included. One respondent suggests using real data for all examples.	The examples use real data which were taken from the various websites when the examples were developed. The EBA has amended the example to point out the requirements applicable to the non-deferred part of the variable remuneration and some illustrative examples with regard to the paid amounts. However, as different remuneration schemes can be used and as the guidelines focus on the application of the discount rate, the EBA did not include examples which showed all payments over the deferral period made to staff for an award, including amounts deferred for periods of less than five years or deferred cash elements.	No change

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Question 10	Most respondents replied that example 2 is sufficiently clear, but that the formula displayed contains an error. One respondent stated that the present value formula can only be applied if a ratio of 100% were used.	discount rate are provided in the above responses, in particular under questions 1 and 4. Some clarification has been given as described under the above comment.	Example 2 amended
Question 10	A few respondents found example 2 confusing, as it does not show all payment components and does not foresee retention of non-deferred variable remuneration. With pro rata vesting the example does not consider a decrease of the discount rate for shorter periods. One respondent stated that in the example the deferred amount would be considered to be a 'particularly high amount' as set out in Article 94(m) CRD.	The example explains how the discount rate would be applied. The guidelines do not define what a particularly high amount is; this amount should also be differentiated taking into account the remuneration level in the Member State or institution. The CRD requires deferring at least 40% of the variable remuneration and at least 60% if a particularly high amount is awarded. Institutions are not obliged to defer only the minimum amount required.	Example 2 amended
Question 11	Most respondents found example 3 sufficiently clear. Some respondents suggest adding further	The example clarifies the application of the guidelines for a defined scenario where 25% of long-	Example 3 amended

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>examples based on a higher maximum ratio (e.g. 200%). One respondent suggested adding an example which explains how to calculate the maximum variable remuneration if pro rata vesting is used as otherwise this could lead to administrative errors. One respondent pointed out that the 25% which can be discounted is the maximum value and stated that this is not considered in the formula.</p>	<p>term deferred variable remuneration can be discounted. It does not intend to provide general applicable formulas for all situations. The mathematical complexity of the guideline is limited and institutions should be able to do the calculations correctly in line with their remuneration policy. However, small modifications to the example were made for clarification purposes.</p>	
Question 12	<p>Respondents stated that the impact of the guidelines as such is limited, but that none the less the administrative burden combined with the small impact on the ratio between variable and fixed remuneration did not provide sufficient incentive to make use of the guidelines. The level of the discount rate achievable under these guidelines will not match the perceived value of deferred awards to employees.</p> <p>Simplification of the guidelines would be welcome and might encourage institutions to consider increased deferrals and/or additional retention requirements in their long-term incentive plans. If a non-volatile discount rate were used the impact of the guidelines would be lower.</p> <p>As the discount rate does not consider performance conditions, institutions might reduce the use of performance considerations when awarding variable remuneration.</p>	<p>The EBA has reviewed the impact assessment. However, as the discount rate has to follow the CRD requirements the general approach taken was retained. The administrative burden should be low once the discount rate is implemented. It is not mandatory to apply the discount rate to variable remuneration. The EBA has also clarified the considerations to be taken into account when calibrating the discount rate in the impact assessment.</p> <p>As described above the EBA made changes to simplify the calculation of the discount rate and to allow the use of a uniform rate in a group context.</p>	IA amended.

## 5. Confirmation of compliance with guidelines and recommendations

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Date:

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Member/EEA State:

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Competent authority

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Guidelines/recommendations:

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Name:

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Position:

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Telephone number:

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E-mail address:

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I am authorised to confirm compliance with the guidelines/recommendations on behalf of my competent authority:  Yes

The competent authority complies or intends to comply with the guidelines and recommendations:  Yes  No  Partial compliance

My competent authority does not, and does not intend to, comply with the guidelines and recommendations for the following reasons<sup>15</sup>:

Details of the partial compliance and reasoning:

Please send this notification to [compliance@eba.europa.eu](mailto:compliance@eba.europa.eu)<sup>16</sup>

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<sup>15</sup> In cases of partial compliance, please include the extent of compliance and of non-compliance and provide the reasons for non-compliance for the respective subject matter areas.

<sup>16</sup> Please note that other methods of communication of this confirmation of compliance, such as communication to a different e-mail address from the above, or by e-mail that does not contain the required form, shall not be accepted as valid.