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European Union – New Rules to Shore Up Banking Sector Affect Bankers' Bonuses

by KPMG's EU Tax Centre, the Netherlands

The 'CRD IV' package that proposes amendments to the European Union's (EU) rules on capital requirements, country-by-country reporting of tax payments by certain EU financial institutions, and limitation of bankers' bonuses, was approved by the Economic and Financial Affairs (ECOFIN) Council of the EU on June 20, 2013.[1]

Background

On April 16, 2013, the European Parliament (EP) approved requirements for country-by-country reporting of tax payments by certain EU financial institutions under the 'CRD IV' package. The package, which was launched by the European Commission in July 2011, is aimed at strengthening the regulation of the EU banking sector through tighter bank solvency and liquidity requirements.

The CRD IV Directive also introduces a cap on bankers' bonuses and country-by-country reporting of tax payments made to governments by certain EU financial institutions. Under the new provisions on remuneration policies, the variable component (e.g., bonuses) should not exceed the value of the fixed component of remuneration, i.e., a salary-to-bonus ratio of 1:1. This ratio can be increased to up to 1:2, if approved by a majority of at least 66 percent of shareholders provided that at least 50 percent of the ownership rights are represented, or of at least 75 percent if there is no quorum. The first bonuses to be capped will be those paid in 2015 in respect of performance in 2014

Where variable pay includes equity or debt instruments payable under long-term deferral arrangements (not less than five years), member states may allow institutions to apply a notional discount rate when determining the cap. The discount rate may only apply to a maximum of 25 percent of the value of such instruments.

The measures set out further rules for the measurement of performance used to calculate variable remuneration packages and also their composition.

Approval by EU Council

During its meeting of June 20, the ECOFIN Council adopted the 'CRD IV' legislative package, which consists of a Directive on market access and prudential supervision (Directive 2013/36/EU), and a Regulation on prudential requirements for financial institutions (Regulation (EU) No 575/2013). Together, these two Acts will replace the currently applicable Capital Requirements Directives (2006/48 and 2006/49). The Acts were published in the Official Journal of June 27, 2013 (L 176, volume 56) and will apply from January 1, 2014.

KPMG Note on Bankers' Bonuses

According to an EU Parliament press release,[2] these measures have been introduced : "To curb speculative risk-taking and […] To encourage bankers to take a long-term view."

The cap on bankers' bonuses is to apply to compensation for performance after 1 January 2014, and, therefore, the cap should not apply to bonuses paid out in 2014 that relate to 2013 performance. Moreover, the rules apply not only within the EU; they have an extraterritorial effect. In other words, the cap on bonuses applies to all bankers working for European-headquartered banks, regardless of their location in the world.

The bonus cap rules address public outcry over excessive remuneration practices and risk-taking in the banking industry. They were included in this package of measures that was designed to bring European banks into line with the Basel III international banking agreement.

Financial institutions affected by the rules may wish to review and consider revising their remuneration practices.

Footnotes:

1 See 20 June 2013 press release from the Council of the European Union (11290/13) at: http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/137544.pdf .

2 "Parliament Votes Reform Package to Strengthen EU Banks" (16 April 2013): http://www.europarl.europa.eu/news/en/pressroom/content/20130416IPR07333/html/Parliament-votes-reform-package-to-strengthen-EU-banks .

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This article excerpts, with permission, from "Council of the EU Approves Country-by-Country Reporting Requirements" in *Euro Tax Flash* (Issue 216 – June 25, 2013), a publication of KPMG International. For the complete story, click here.

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