

## The regulation of remuneration at credit institutions

*Following the global financial crisis of 2007-08, the incentive systems at major financial institutions were one of the areas to come under scrutiny from regulatory and supervisory authorities. The financial crisis highlighted how incentive systems that primarily reward short-term success and that focus exclusively on financial performance targets can result in risks for individual financial institutions as well as for the financial sector as a whole. However, if these systems are based on long-term performance metrics and take sufficient consideration of both risk exposure and non-financial performance, they can make an important contribution to the long-term success of a financial institution and thus bolster financial stability. Here, particular focus is placed on variable remuneration, commonly referred to as bonuses.*

*This led to the development of dedicated remuneration requirements, which, since the end of 2010, have applied not only to major credit institutions, but to all credit institutions in the European Union (EU). In Germany, these form the basis of a comprehensive and detailed ruleset comprising directly applicable European regulations as well as national provisions enshrined in the German Banking Act (Kreditwesengesetz) and the Regulation on the Supervisory Requirements for Institutions' Remuneration Systems (Remuneration Regulation for Institutions – Institutsvergütungsverordnung).*

*In essence, these requirements ensure that credit institutions' risk management must include remuneration systems that are appropriate, transparent and oriented towards the institution's sustainable economic development. More specifically, a distinction is made between requirements that apply to all members of staff and those that apply only to key decision-makers, or "risk takers". Furthermore, for reasons of proportionality, there are also differences depending on whether or not the institution is a significant institution within the meaning of the Banking Act. Larger and more complex, and thus more systemically important, credit institutions are subject to more stringent regulatory and supervisory requirements with regard to their risk management and therefore also their remuneration systems. In this regard, the requirements comprise both material and procedural aspects.*

*Experience from supervisory practice shows that banks and savings banks have made significant progress in ensuring that their remuneration systems are appropriately designed and, in particular, have integrated their remuneration systems more closely with the other areas of their risk management. To ensure success over the long term, the rules contained in their remuneration policies must be applied consistently by the decision-makers at each credit institution. For this to be the case, changes to the European framework must only be made if they serve a supervisory purpose. This aims to help increase acceptance of the applicable rules among credit institutions and their staff, thus reducing the risk of these being circumvented. In this regard, following the principle of proportional regulation, it is important that smaller credit institutions with less complex business models are exempted from the remuneration regulations to reduce their administrative burdens as far as this is acceptable from a supervisory perspective.*

*Inappropriate remuneration systems may help create distorted incentives and thus jeopardise financial stability*

## ■ Introduction

The remuneration of staff at credit institutions is subject to comprehensive prudential regulation, which largely dates back to an international initiative by the Financial Stability Forum (FSF, now the Financial Stability Board (FSB)) following the global financial crisis of 2007-08. International regulatory and supervisory authorities assessed the systems of financial incentives at major enterprises in the financial sector and ascertained that inappropriate remuneration systems led to undesirable risk-taking and thus contributed to instability in individual enterprises as well as the financial system as a whole. This project resulted in the development of the FSF Principles for Sound Compensation Practices, which were expanded the following year to include additional standards by the FSB.<sup>1</sup> As they were approved for adoption in the respective jurisdictions of the G20 countries in April and September 2009, these FSB Principles and Standards (FSB P&S) represent a key milestone in the regulation of remuneration in the global financial sector. The FSB P&S focus on variable remuneration – i.e. bonuses – paid to what are known as “material risk takers” at major enterprises in the financial sector. They are aimed not only at major banks, but also systemically important insurance and investment companies. Risk takers are not limited just to members of management, supervisory and administrative boards, but also include any staff members that have a material impact on the risk profile of their respective enterprise.

The purpose of regulating remuneration is not to prohibit variable remuneration or to make variable remuneration unattractive. Offering variable remuneration can indeed have benefits. Specifically, provided that the institution’s sustainable<sup>2</sup> interests are taken into account and that inappropriate risk-taking is not incentivised, variable remuneration can contribute to the good performance and sound development of an institution by setting suitable incentives whereby employees and decision-makers

participate in both the success and failure of the business. At the same time, variable remuneration allows for cost flexibility and provides institutions the option of sanctioning undesirable behaviour, which helps to promote a sustainable corporate culture.

While the core principles of the FSB P&S continue to apply today, international remuneration regulation has evolved continually over the past 12 years, including in the EU and Germany. In the EU, the Capital Requirements Directive (CRD)<sup>3</sup> stipulates that credit institutions must have appropriate remuneration policies and practices.<sup>4</sup> This general requirement is complemented by dedicated provisions regarding the remuneration of persons with a material impact on the risk profile of the institution, i.e. risk takers.<sup>5</sup> In Germany, these requirements are implemented via the Banking Act (*Kreditwesengesetz*) and the Regulation on the Supervisory Requirements for Institutions’ Remuneration Systems (Remuneration Regulation for Institutions – *Institutsvergütungsverordnung*). After some of the CRD remuneration requirements were amended as part of the European banking package<sup>6</sup> in the summer of 2017, the remuneration-specific provisions in the Banking Act were changed accordingly at the end of 2020,<sup>7</sup> and the Remuneration Regulation for Institutions was updated only recently.<sup>8</sup> These provisions are complemented by disclosure re-

1 See Financial Stability Board (2009a, 2009b).

2 Within the context of remuneration regulation, the term “sustainability” was added to the Banking Act as early as 2010. It was understood as referring to remuneration systems that are viable or demonstrably sound over the long term. Although this also covered non-financial aspects such as good conduct from the very beginning, the focus was by and large on long-term performance. In recent years, “sustainability” has been viewed more from an environment, social and governance (ESG) perspective; these aspects are now also being increasingly incorporated into remuneration systems.

3 See Directive 2013/36/EU.

4 Article 74 CRD.

5 Articles 92 to 95 CRD.

6 See Deutsche Bundesbank (2019), pp. 31 ff.

7 The Banking Act was amended as part of the Risk Reduction Act (*Risikoreduzierungs-gesetz*). For more information, see Deutsche Bundesbank (2020), pp. 56 f.

8 Third Regulation amending the Remuneration Regulation for Institutions of 20 September 2021 (Federal Law Gazette, part I, No 67, 24 September 2021, pp. 4308 ff.).

quirements in the European Capital Requirements Regulation (CRR).<sup>9</sup> As is the case for two remuneration-related regulations from the European Commission,<sup>10</sup> the CRR applies to credit institutions directly and therefore does not need to be transposed into German law.<sup>11</sup>

## Basic principles of regulating remuneration at credit institutions

*Remuneration systems that are appropriate, transparent and oriented towards the institution's sustainable development*

The most important basic principle of regulating remuneration at credit institutions in Germany is found in Section 25a of the Banking Act, which stipulates that banks and savings banks must ensure, as part of proper business organisation, that they have appropriate and effective risk management that comprises, amongst other things, appropriate and transparent remuneration systems for both management board members and staff geared to the institution's sustainable development.<sup>12</sup> This core regulation is complemented by further provisions in the Banking Act and, in particular, in the Remuneration Regulation for Institutions. Here – in line with the notion of proportional regulation – a distinction is drawn between general requirements that fundamentally apply to all institutions<sup>13</sup> and their staff and members of their management boards, and special requirements that only apply to larger institutions (known as “significant institutions”<sup>14</sup>) and their risk takers.<sup>15</sup>

*Restriction on variable remuneration for staff and members of the management board*

The general requirements set out in the Banking Act include a restriction on variable remuneration, known as the bonus cap.<sup>16</sup> This prohibits banks and savings banks from paying their staff or members of their management boards variable remuneration totalling more than 100% of their fixed remuneration each year. Variable remuneration may total up to 200% of fixed remuneration only with the approval of the shareholders and only if it is compatible with the requirement to maintain capital adequacy. This infringement on the freedom of contract is an EU-specific regulation for

credit institutions and has been in effect since 2014. Exemptions and/or special calculation methods are only permissible in specific cases.<sup>17</sup> In the German implementation of the requirements, the bonus cap and the general requirements of the Remuneration Regulation for Institutions apply to all of a credit institution's staff members, even though most of the CRD remuneration requirements are directed only towards risk takers. However, in its guidelines on sound remuneration policies, the European Banking Authority (EBA)<sup>18</sup> recommends that bonus caps should be applied to all members of staff.<sup>19</sup>

While a maximum ratio of 200% may seem high at first glance, the European bonus cap

<sup>9</sup> See Regulation (EU) No 575/2013.

<sup>10</sup> Commission Delegated Regulation (EU) 2021/923 of 25 March 2021 and Commission Delegated Regulation (EU) No 527/2014 of 12 March 2014.

<sup>11</sup> In addition, further requirements are set out, for example, in Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (MiFID) and also in generally applicable legislation such as labour law. These are not discussed here.

<sup>12</sup> Section 25a(1) sentence 3 number 6 of the Banking Act.

<sup>13</sup> Beyond credit institutions, financial services institutions are also considered “institutions” within the meaning of the Banking Act and the Remuneration Regulation for Institutions. However, some financial services institutions are partially or fully exempted from the remuneration requirements. Leasing and factoring enterprises, for example, are exempted by Section 2(7a) of the Banking Act and Section 1(1) sentence 2 of the Remuneration Regulation for Institutions.

<sup>14</sup> An institution qualifies as significant, inter alia, if its total assets average at least €15 billion over the last four financial years (see Deutsche Bundesbank (2020), p. 52).

<sup>15</sup> Deviating from this basic principle, the Third Regulation amending the Remuneration Regulation for Institutions amended Section 1(3) of the Remuneration Regulation for Institutions so that certain non-significant institutions are also subject to some of the special requirements pursuant to the Remuneration Regulation for Institutions.

<sup>16</sup> Section 25a(5) of the Banking Act.

<sup>17</sup> For example, certain severance payments are exempted by Section 5(6) sentence 5 of the Remuneration Regulation for Institutions, and sign-on bonuses and similar payments are exempted by Section 5(5) sentence 3 of the Remuneration Regulation for Institutions. In the case of multi-year retention bonuses, institutions can choose how to take account of these payments with regard to the bonus cap (Section 5(7) sentence 3 of the Remuneration Regulation for Institutions).

<sup>18</sup> For more information on the European Banking Authority and its regulatory work, see Deutsche Bundesbank (2011), pp. 86 ff.

<sup>19</sup> EBA guidelines on sound remuneration policies in accordance with Directive 2013/36/EU of 2 July 2021, Annex 1, p. 87.

for banks in fact represents a significant infringement on their remuneration practices when compared with other financial services sectors and other jurisdictions. For example, much higher ratios of variable to fixed remuneration can typically be seen in the area of asset management, in particular. Among the banks inspected by European supervisors on behalf of the EBA, this business area had the highest ratio of variable to fixed remuneration at more than 300% on average of all banks.<sup>20</sup> For subordinated investment management companies, the only remuneration requirements that apply are those from the sector-specific Directives,<sup>21,22</sup> which do not contain any requirements equivalent to the bonus cap.

*Prohibition of variable remuneration for members of administrative and supervisory boards*

Due to the special oversight functions of administrative and supervisory boards, the Banking Act has completely forbidden variable components of remuneration for members of these boards since the end of 2016.<sup>23</sup> Even before that time, the remuneration of board members was not allowed to cause any conflicts of interest with respect to their oversight functions. Furthermore, as members of administrative and supervisory boards are considered risk takers, they are subject to disclosure and reporting requirements. However, the Remuneration Regulation for Institutions is not applicable to these persons. As most of the provisions in that regulation relate to variable remuneration, there would be almost no scope for application in any case.

## General requirements for the appropriate design of remuneration systems in the Remuneration Regulation for Institutions

*“Remuneration” is not only salaries, but all benefits received by staff in respect of their professional activities*

The general requirements of the Remuneration Regulation for Institutions contain a comprehensive list of definitions. This is intended to help ensure clarity and legal certainty, and thus also reduce the risk that the rules will be cir-

cumvented. First, the Remuneration Regulation for Institutions sets out which payments and benefits must be considered remuneration and are thus subject to its provisions.<sup>24</sup> Remuneration within the meaning of the Remuneration Regulation for Institutions is not only the salary paid out via payroll accounting, but also includes all financial and non-financial benefits received by a staff member or member of the management board in respect of their professional activities for the institution. This means that, fundamentally, all ancillary benefits – such as benefits in kind, including the use of a company car or pension benefits – also fall under the definition of remuneration.<sup>25</sup> This also applies if the benefits are provided by a third party. In this context, all components of remuneration must be allocated to either fixed or variable remuneration; in cases of doubt, remuneration components must be allocated to variable remuneration.<sup>26</sup> Any remuneration established in a collective agreement or on the basis of a collective agreement is exempt from the requirements of the Remuneration Regulation for Institutions. Only the disclosure requirements apply in these cases.<sup>27</sup>

<sup>20</sup> See European Banking Authority (2021a).

<sup>21</sup> These are Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS Directive) and Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (AIFM Directive).

<sup>22</sup> Since 2019, a corresponding explicit exemption has been included in Article 109(4) of Directive 2013/36/EU. Individual Member States – including Germany – had already provided for equivalent exemptions for subordinated investment management companies.

<sup>23</sup> Section 25d(5) sentence 4 of the Banking Act; according to the explanatory memorandum of the Financial Market Stabilisation Agency New Regulation Act (*FMSA-Neuordnungsgesetz*), attendance fees are to be allocated to fixed remuneration.

<sup>24</sup> Section 2(1) of the Remuneration Regulation for Institutions.

<sup>25</sup> Exemptions have been granted only to a limited extent (see Section 2(1) sentence 2 of the Remuneration Regulation for Institutions).

<sup>26</sup> Section 2(2) and (6) of the Remuneration Regulation for Institutions.

<sup>27</sup> Section 1(4) of the Remuneration Regulation for Institutions.

## Risk takers

Unlike the Financial Stability Board (FSB),<sup>1</sup> whose principles and standards provide no more than general guidance on identifying what it calls “material risk takers”, the European Union has had uniform provisions for the identification of these individuals in place since 2014. The European Commission has issued a Delegated Regulation to supplement the provisions set out in the Capital Requirements Directive (CRD).<sup>2</sup> This Commission Delegated Regulation formulates quantitative and qualitative criteria beyond those of the CRD that institutions should apply when identifying risk takers – that is, “categories of staff whose professional activities have an impact on the institution’s risk profile”.<sup>3</sup>

In German law, the rules governing the identification of risk takers have been im-

plemented in Section 25a(5b) in conjunction with Section 1(21) of the Banking Act (*Kreditwesengesetz*), taking into account considerations of proportionality. According to these provisions, only significant institutions within the meaning of Section 1(3c) of the Banking Act<sup>4</sup> are required to perform a complete identification of risk takers and thus apply the criteria laid down in Commis-

<sup>1</sup> See Financial Stability Board (2009a, 2009b).

<sup>2</sup> See Directive 2013/36/EU.

<sup>3</sup> The CRD does not use the term “risk taker”, describing these individuals instead as “categories of staff whose professional activities have a material impact on the institution’s risk profile” (see Article 92(1) of the CRD). In the German legal context, “risk taker” is regarded as an equivalent term for this group of individuals, while the European Banking Authority (EBA) calls them “identified staff”.

<sup>4</sup> An institution qualifies as significant, inter alia, if its total assets average at least €15 billion over the last four financial years (see Section 1(3c) of the Banking Act).

### Criteria for identifying risk takers

All CRR credit institutions<sup>1</sup> and all significant non-CRR credit institutions pursuant to Section 1(3c) of the Banking Act are required to identify the following persons as risk takers:

Section 1(21)  
of the Banking Act:

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Section 25a(5b) sentence 1  
of the Banking Act:

- Members of the management board within the meaning of Section 1(2) of the Banking Act
- Members of the administrative or supervisory board within the meaning of Section 25d of the Banking Act

- Staff members immediately below management board level (senior managers)
- Staff members with managerial responsibility<sup>2</sup> for the control functions<sup>2</sup> or material business units<sup>2</sup> of the institution
- Staff members with remuneration in the previous year of at least €500,000, provided:
  - a) said remuneration equals at least the average remuneration of the members of the management board and of the administrative or supervisory board as well as of the institution’s staff members immediately below management board level (senior managers), and;
  - b) the staff members carry out professional activities in a material business unit and said activities have a material impact on the risk profile of that business unit<sup>2</sup>.

All significant institutions pursuant to Section 1(3c) of the Banking Act are furthermore required to perform a complete identification of their risk takers:

Section 25a(5b) sentence 2  
of the Banking Act:

Additional own risk analysis to identify risk takers based at least on the criteria of Commission Delegated Regulation (EU) 2021/923

<sup>1</sup> Section 1(3d) of the Banking Act defines CRR credit institutions as all credit institutions within the meaning of Article 4(1) point (1) of the CRR. <sup>2</sup> These terms are defined in Commission Delegated Regulation (EU) 2021/923.

sion Delegated Regulation (EU) 2021/923.<sup>5</sup> By contrast, all other institutions are only expected to apply the criteria set out in the CRD, as implemented in the Banking Act. In addition, they are required to apply only the definitions contained in Commission Delegated Regulation (EU) 2021/923. The identification criteria set out in the Banking Act thus already capture all major decision-makers, including those at smaller institutions. These individuals include not only the members of management boards and administrative or supervisory boards, but also staff members immediately below management board level (senior managers) as well as individuals with managerial responsibility for material business units and internal control functions, amongst others.

For the vast majority of non-significant credit institutions, the sole implication of identifying their risk takers is that they have to comply with the disclosure requirements set out under Article 450 of the Capital Requirements Regulation (CRR).<sup>6</sup> Only for the handful of non-significant credit institutions that fall within the scope of the new Section 1(3) of the Remuneration Regulation for Institutions (*Institutsvergütungsverordnung*)<sup>7</sup> are the consequences material in nature. This proportionate implementation of the CRD requirements is appropriate, particularly since most of the remuneration requirements in Germany, including the bonus cap, have to be applied explicitly to all staff members.

Articles 5 and 6 of Commission Delegated Regulation (EU) 2021/923 formulate more extensive qualitative and quantitative criteria that have to be applied by significant institutions under Section 1(3c) of the Banking Act to identify additional staff members as risk takers.

While Article 5 is based on the staff members' responsibilities, Article 6 focuses on individuals awarded particularly high amounts of annual remuneration. For these latter individuals, institutions must again examine whether their professional activities have a significant impact on the risk profile of a material business unit. If this is not the case, the members of staff concerned do not need to be identified as risk takers. For members of staff with annual remuneration above the threshold of €750,000, prior approval of the competent authority is required if the institution does not intend to identify these individuals as risk takers. For credit institutions with at least 1,000 staff members, this requirement also applies when the staff members in question earn less than €750,000 per year in absolute terms, but are within the 0.3% of staff members awarded the highest remuneration within the credit institution.

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<sup>5</sup> Commission Delegated Regulation (EU) 2021/923 of 25 March 2021 only entered into force on 14 June 2021. The previous Commission Delegated Regulation (EU) No 604/2014 ceased to be valid on the same date. The references in the Banking Act to this invalid piece of legislation still need to be updated accordingly.

<sup>6</sup> See Regulation (EU) No 575/2013.

<sup>7</sup> These are either CRR institutions at the consolidated or sub-consolidated level with total assets of more than €30 billion or CRR institutions with total assets of more than €5 billion on a four-year average that do not satisfy the conditions of letters (c) to (e) under the definition of small and non-complex institutions pursuant to Article 4(1) point (145) of Regulation (EU) 575/2013. Based on the institutional data as at 31 December 2020, a dozen credit institutions are likely to fall within this category.

*Remuneration Regulation for Institutions uses broad definition of staff members*

Alongside the definition of remuneration, the definition of “staff members” is also key. The Remuneration Regulation for Institutions uses a broad definition of staff members.<sup>28</sup> This means that staff members not only include persons directly employed by the credit institution, but also all natural persons the credit institution avails itself of in conducting banking business or providing financial services. This also covers intra-group secondments and outsourcing, for example. As a result, credit institutions must ensure in their outsourcing contracts that the external counterparties observe the prudential remuneration requirements. In practice, this requirement sometimes makes it very challenging for banks and savings banks to find a suitable counterparty that is willing to accept such an obligation.

*Alignment with strategies*

All banks and savings banks must ensure that their remuneration strategy and remuneration systems are aligned with their institution-specific business and risk strategies. Remuneration systems also need to be geared towards the given credit institution’s corporate values and culture, including its risk culture, and be in line with its long-term interests. Amongst other things, this means that the remuneration parameters<sup>29</sup> have to support the achievement of strategic objectives. They also need to take incurred risks into account. Relying solely on metrics without appropriate risk adjustment for earnings, turnover figures or share values, for example, is not permitted.

*Appropriate maximum level and determining the bonus pool*

Given this orientation towards institution-specific strategies, an “ideal” level of variable remuneration is not defined from a regulatory perspective. Rather, each credit institution is obliged to determine the maximum ratio between variable and fixed remuneration, i.e. the appropriate maximum level, for that institution specifically.<sup>30</sup> This maximum level not only has to be in line with the aforementioned bonus cap pursuant to the Banking Act, it must also take account of the business activities and risks of the given credit institution or business area, and of the role of the given person and their in-

fluence on the risk profile. This means that there may well be different maximum levels within a single credit institution.

In their remuneration practices, credit institutions not only need to observe the previously defined maximum level, they also need to ensure that the amount of variable remuneration is determined on the basis of the previously defined remuneration parameters. Furthermore, each credit institution must check how much of its “bonus pool”, i.e. the “total amount of variable remuneration within a financial year”, it can actually “afford”. While the FSB P&S and the CRD only contain rough guidelines on this, Section 7 of the Remuneration Regulation for Institutions stipulates various criteria that are to be checked when determining the bonus pool. First, the regulatory capital requirements must be adhered to. Second, the institution must also adopt a broadened economic perspective that takes internal capital adequacy, the profit situation and multi-year capital planning into consideration. Ultimately, adequate liquidity resources need to be ensured.

One of the lessons learned from the 2007-08 financial crisis was that variable remuneration did not always adequately respond to poor performance or conduct. Since the reform of the provisions governing remuneration, variable remuneration has therefore had to be designed to be completely flexible. This means that it must be possible to reduce the variable remuneration up to the point of cancelling it completely in order to respond to changes in the performance of staff members or members of the management board, the business unit and/or the credit institution. This not only applies if the aforementioned review pursuant to

*Negative performance or misconduct must lead to a reduction in variable remuneration*

<sup>28</sup> Section 2(7) of the Remuneration Regulation for Institutions.

<sup>29</sup> Remuneration parameters are the parameters used to measure performance that are to be drawn on in determining the amount of variable remuneration. The remuneration parameters are also referred to as key performance indicators (KPI).

<sup>30</sup> Section 6 of the Remuneration Regulation for Institutions.

Section 7 of the Remuneration Regulation for Institutions is negative, but also in the case of misconduct on the part of staff members or members of the management board. For example, unethical or non-compliant behaviour, in particular, must lead to a reduction in the variable remuneration, or to its complete cancellation, and this may not be otherwise offset through positive performance.<sup>31</sup> In this respect, guaranteed variable remuneration is generally not permissible.

*Requirements for certain payment types: sign-on bonuses, retention bonuses and severance payments*

The Remuneration Regulation for Institutions contains special provisions for certain forms of variable remuneration. For instance, guaranteed bonus payments within the first year of employment are excluded from the aforementioned ban on guarantees.<sup>32</sup> These payments are typically a form of variable remuneration granted to staff members or members of the management board on top of their performance-related variable remuneration as a sign-on bonus, or the guarantee of a minimum amount of variable remuneration for the first months of employment, irrespective of whether the agreed performance goals are actually achieved. Furthermore, the Remuneration Regulation for Institutions permits retention bonuses in exceptional cases.<sup>33</sup> These are a form of variable remuneration paid to staff members or members of the management board for the purpose of tying them to the credit institution for a specific period of time. This is conditional on the credit institution being able to justify its legitimate interest in awarding the bonus and to demonstrate that it is in line with its business strategy. Moreover, the retention bonuses need to be affordable for the credit institution and they must not be a vehicle for offsetting any cancellation of the ordinarily envisaged variable remuneration. Finally, the Remuneration Regulation for Institutions also creates a framework for severance payments.<sup>34</sup> Within the meaning of the Remuneration Regulation for Institutions, this refers to all remuneration payments that staff members or members of the management board receive in connection with the early termination

of the employment, agency or service contract. Credit institutions must therefore ensure, inter alia, that principles for severance payments are established that set out either a maximum amount or criteria for determining severance amounts, and that internal processes governing severance payments are put in place. Ultimately, certain severance payments can be deemed appropriate a priori, meaning that they do not have to be counted towards the bonus cap and that other requirements under the Remuneration Regulation for Institutions can be waived. All other severance payments must be notified to the supervisory authority in advance, stating the reasons for awarding the payment and the appropriateness of the amount in order to claim this privilege.

## Requirements for the remuneration of certain categories of staff

In addition to other general provisions, the Remuneration Regulation for Institutions also sets out additional provisions, applicable to all banks and savings banks, for certain categories of staff. For staff in control units, stricter rules apply, for example, regarding the maximum amount of variable remuneration. Because of their particular oversight functions and to ensure their independence, most of their remuneration must fall under the fixed component. In its interpretation guide on the Remuneration Regulation for Institutions, the Federal Financial Supervisory Authority (BaFin) explains that the variable component should typically not exceed one-third and under no circumstances should it exceed 50% of the total remuneration of the staff member concerned.<sup>35</sup> Furthermore, con-

*Special provisions for the remuneration of control units, sales staff and management board members*

<sup>31</sup> Section 5(2) of the Remuneration Regulation for Institutions.

<sup>32</sup> Section 5(5) of the Remuneration Regulation for Institutions.

<sup>33</sup> Section 5(7) of the Remuneration Regulation for Institutions.

<sup>34</sup> Section 5(6) in conjunction with Section 2(5) of the Remuneration Regulation for Institutions.

<sup>35</sup> See Federal Financial Supervisory Authority (2018), p. 30.



licts of interest are also to be avoided by ensuring that the remuneration parameters of the control units are not synchronised with those of the units they control. This also applies to the member of the management board responsible for risk management. Conflicts of interest are also to be avoided in the remuneration of sales staff. Their remuneration systems are to be designed in such a way that consumer rights and interests are taken into account. In particular, the use of solely quantitative remuneration parameters – such as those geared exclusively towards sales – is not permissible. The requirements for staff members providing advisory services in connection with consumer credit agreements relating to immovable property are stricter still. In these cases, remuneration may not be linked in any way to sales targets for these agreements. The same also applies to staff members that perform the creditworthiness assessment for consumer credit agreements relating to immovable property.<sup>36</sup>

Special provisions are in place not least for the remuneration of members of management boards at all banks and savings banks.<sup>37</sup> Their variable remuneration must be based on a multi-year assessment. According to BaFin's interpretation guide on the Remuneration Regulation for Institutions, this means that the variable remuneration participates in negative developments for a period of at least three years.<sup>38</sup> This can be enabled through ex ante or ex post arrangements. Furthermore, two principles in the Remuneration Regulation for Institutions have been taken from stock corporation legislation and thus apply to all credit institutions regardless of their legal form. First, the total remuneration must be commensurate with the corresponding tasks and performance of the respective members of the management board and with the credit institution's situation. Second, the total remuneration may not exceed typical remuneration without special justification. It remains to be seen whether and to what extent the practical application of these principles in the supervision of institutions will have a restrictive effect.

## Special requirements for the appropriate design of remuneration systems in the Remuneration Regulation for Institutions

Unlike the general requirements mentioned above, the special requirements of the Remuneration Regulation for Institutions are to be applied specifically to the risk takers of significant credit institutions within the meaning of Section 1(3c) of the Banking Act, and in some cases to certain other credit institutions that are not significant. Among the material requirements, the main focus is on the ex ante and ex post risk adjustment of variable remuneration.

Ex ante risk adjustment refers to the determination of the amount of variable remuneration. This means that the risk taker's performance at the time of the determination, including all current and future risks incurred, needs to be taken into account. The performance measurement includes both the risk taker's performance contribution and that of the respective business unit, as well as the overall performance of the institution or group. The performance contribution is to be measured using specific, previously agreed targets. The performance measurement is to be based on quantitative as well as qualitative, and financial as well as non-financial remuneration parameters. In general terms, the remuneration parameters used at all three levels should, in particular, be consistent with the objective of long-term success. Above all, these parameters should take into account incurred risks and their associated time horizons, as well as capital and liquidity costs. Ultimately, as outlined above, the risk taker's conduct should also be factored in, as

*Ex ante risk adjustment by way of performance measurement using risk-adjusted remuneration parameters*

<sup>36</sup> Section 5(1) numbers 3 to 5 of the Remuneration Regulation for Institutions.

<sup>37</sup> Section 10 of the Remuneration Regulation for Institutions.

<sup>38</sup> See Federal Financial Supervisory Authority (2018), p. 31.

improper conduct must at least lead to a reduction in the variable remuneration paid.

A comprehensive performance measurement of this kind is only effective if it covers a sufficiently long accrual period. For risk takers below the level of the management board, this period must be a minimum of one year, while for members of the management board, it must cover at least three years. The performance or risk adjustment of risk takers' variable remuneration is not yet finalised after this period, however, as it is then followed by the ex post risk adjustment, subject to a waiver threshold depending on the variable remuneration.

*Ex post risk adjustment based on deferral, payment in instruments, and malus and clawback*

Once variable remuneration has been determined, the period of ex post risk adjustment begins. This is based on three components: deferral of variable remuneration in conjunction with malus arrangements, payment in the form of instruments and a clawback mechanism to reclaim any variable remuneration already paid out.

*Deferral extends the period of explicit risk adjustment*

Deferral primarily means that risk takers cannot claim a portion of the calculated variable remuneration immediately, but only after a deferral period. This period must last at least four or five years. The minimum proportion of variable remuneration to be deferred varies from 40% to 60% depending on the category of risk taker and the amount of variable remuneration.<sup>39</sup> During the deferral period, this amount may be paid out in linear instalments at most. Backtesting is to be conducted before an instalment is paid out. This means that credit institutions have to check whether the original performance measurement still holds. Furthermore, the payment of the instalment has to be compatible with the credit institution's current situation after reviewing the criteria under Section 7 of the Remuneration Regulation for Institutions. If one of these criteria have not been met, a malus is applied, which means that the deferred component is reduced (explicit risk adjustment).

For each instalment that is paid out, at least half of it must be paid out as an instrument that reflects the credit institution's long-term growth (implicit risk adjustment). The choice of instrument depends largely on the credit institution's legal form. As such, they are frequently not "financial instruments" in the traditional sense. Although listed credit institutions can make the payment in the form of shares or share-linked instruments (such as phantom stocks<sup>40</sup>), other credit institutions usually choose contractual arrangements. These are contracts which set the criteria for measuring long-term equity value and thus the "instrument", usually depending on the development of certain financial and regulatory ratios. Common to all instruments is that they are to be subject to a vesting period of at least one year upon being paid out. Although no malus is applied during the vesting period, the instrument is subject to fluctuations in value – in both directions – during this period.

*Through payments in the form of instruments, risk takers implicitly participate in the institution's success or failure*

Since 2017, these components have been supplemented by a clawback mechanism.<sup>41</sup> This means that, in certain cases, variable remuneration already paid out must be recalled. This applies for a period of two years beyond the respective total deferral period of granted vari-

<sup>39</sup> Depending on the position, duties and activities of a risk taker as well as the amount of variable remuneration and the risks that a risk taker may establish, the minimum length of the deferral period increases to up to five years and the proportion of variable remuneration to be deferred rises to at least 60% (Section 20(1) sentence 2 of the Remuneration Regulation for Institutions). In the case of members of the management board and members of the next lower management level, at least 60% of variable remuneration must be spread over a deferral period of at least five years (Section 20(2) of the Remuneration Regulation for Institutions). The institution also has to set a threshold value for "high variable remuneration", above which the proportion of variable remuneration to be deferred rises to at least 60% (Section 20(3) of the Remuneration Regulation for Institutions).

<sup>40</sup> With phantom stocks, staff members or members of the management board do not receive real shares, but only fictitious ones. Their value is, however, geared to the exchange price of the underlying share, e.g. to its average price over a certain period prior to the variable remuneration being granted.

<sup>41</sup> Section 20(6) of the Remuneration Regulation for Institutions.

## Risk adjustment of variable remuneration for a risk taker

The below chart shows the payment regime for a risk taker who is not a member of the management board or of the next lower management level. In such cases, the minimum deferral period is four years and the minimum proportion of variable remuneration to be deferred is 40%.

An example: The variable remuneration calculated for the year  $t_0$  is €100,000.

Payment regime:

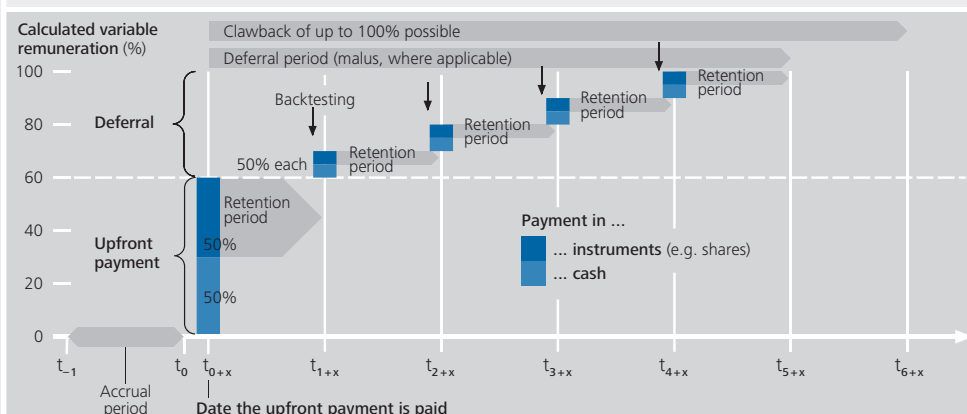
1. Of the €100,000, the risk taker is paid a maximum of €30,000 in cash at time  $t_{0+x}$  the date the variable remuneration is calculated.
2. A further €30,000 is paid out in instruments in accordance with Section 20(5) of the German Remuneration Regulation for Institutions (*Institutsvergütungsverordnung*), with a retention period of at least one year.
3. The remaining sum of €40,000 must then be deferred over a period of at least four years.
4. Should a linear pro rata payment structure be used, the risk taker receives €10,000

after the first year, at time  $t_{1+x}$ , so long as backtesting does not produce a malus. Of this amount, €5,000 is paid in cash and €5,000 is paid in the aforementioned instruments with a retention period of at least one year. This is repeated after two, three and four years.

5. For at least six years after the calculation of the variable remuneration at time  $t_{0+x}$  the institution must check whether the actions of the risk taker meet the criteria in Section 18(5) sentence 3 Nos 1 and 2 of the Remuneration Regulation and, where relevant, undertake to reclaim the entire amount of variable remuneration – including any amounts already paid out – through clawback and malus arrangements.

One possible alternative to the payment model described under point 4 is cliff vesting. In this model, the risk taker only receives the deferred variable remuneration once the entire deferral period is over, after successful backtesting. Half of this sum must still be paid out in instruments with a one-year retention period. Of course, other payment models are permitted, as long as they fall somewhere between the linear pro rata and cliff vesting variants.

Example payment regime for variable remuneration of risk takers



able remuneration.<sup>42</sup> This clawback arrangement is only legally envisaged in cases of serious misconduct or in cases where conduct has resulted in material regulatory sanctions, material supervisory measures or considerable losses.<sup>43</sup> Clawbacks are still considered to be one of the most controversial requirements as they are difficult to implement under labour law. That said, regulators and supervisors are convinced of their usefulness because they act as a deterrent. Moreover, malus and clawback requirements force credit institutions to develop specific concepts of what constitutes unacceptable behaviour.

In terms of the impact that the ex ante and ex post risk adjustment has on risk management at credit institutions, it should be noted that the requirements are complex and place a considerable administrative burden on credit institutions. In this regard, the restriction of these requirements to risk takers at significant institutions pursuant to Section 1(3c) of the Banking Act takes into account the principle of proportionality. Extending the application of these requirements to all credit institutions would, on account of the associated administrative costs, lead to greater restructuring of remuneration systems in favour of fixed remuneration components. Since ex post risk adjustment, in particular, entails high administrative costs and at the same time can probably only take effect above a certain amount, the Remuneration Regulation for Institutions provides an exemption threshold depending on the amount of variable remuneration.

## Corporate governance requirements

*Responsibility for appropriateness lies with management board or administrative or supervisory board*

The material requirements outlined above are augmented by rules relating to governance. In line with general corporate governance principles, the management board is responsible for remuneration systems for staff members, while the administrative or supervisory board is responsible for remuneration systems for mem-

bers of the management board.<sup>44</sup> The administrative or supervisory board also monitors the remuneration systems for staff members. In practice, this means that important decisions require the explicit support of the management board and administrative or supervisory board. These include not only radically redesigning a remuneration system, but also the annual decision on the bonus pool or the variable remuneration of senior managers directly below the management board level.

To ensure that remuneration systems are appropriately linked up with the other areas of risk management at a credit institution, the internal control units and the human resources function must be involved in decision-making processes, within the scope of their duties. For example, the risk control function should play a supporting role in defining appropriate risk-based remuneration parameters and provide information relevant to this.

As outlined above, the material and also governance-related requirements increase in line with the size and complexity of credit institutions. The administrative or supervisory board of a significant institution pursuant to Section 1(3c) of the Banking Act is required to appoint from among its members a remuneration control committee.<sup>45</sup> This committee prepares decisions of the administrative or supervisory board on the remuneration of members of the management board and monitors the appropriateness of remuneration systems for staff members and for the management board. The intention behind this is to enable these issues to be addressed more deeply and in more detail than would normally be possible within the administrative or supervisory board. However,

*Involvement of control units in decision-making processes*

*Remuneration control committee and remuneration officer at significant institutions*

<sup>42</sup> For example, if the agreed deferral period for members of the management board corresponds to the minimum requirement of five years, the minimum period for a clawback arrangement is seven years.

<sup>43</sup> Section 18(5) sentence 3 of the Remuneration Regulation for Institutions.

<sup>44</sup> Section 3 of the Remuneration Regulation for Institutions in conjunction with Sections 25a and 25d of the Banking Act.

<sup>45</sup> Section 25d(7) and (12) of the Banking Act.

## Third Regulation amending the Remuneration Regulation for Institutions of 20 September 2021

The Third Regulation amending the Remuneration Regulation for Institutions (*Institutsvergütungsverordnung*) of 20 September 2021 served the primary purpose of implementing changes resulting from the amendment of the Capital Requirements Directive (CRD)<sup>1</sup> in 2019.<sup>2</sup> The amendments to the Remuneration Regulation for Institutions supplement the amendments to the Banking Act (*Kreditwesengesetz*) that entered into force at the end of 2020.

These amendments largely concern the following matters:

- extending some of the special requirements regarding risk adjustment pursuant to Section 1(3) of the Remuneration Regulation for Institutions to cover those CRR institutions<sup>3</sup> that do not qualify as significant institutions under Section 1(3c) of the Banking Act but nonetheless fulfil certain secondary conditions;<sup>4</sup>
- introducing the requirement to operate gender neutral remuneration policies and practices for staff members and members of the management board in Section 5(1) number 6 of the Remuneration Regulation for Institutions – the corresponding arrangement for members of the supervisory or administrative board is governed by Section 25d(5) sentence 3 of the Banking Act;
- adjusting the disclosure requirements in Section 16(2) of the Remuneration Regulation for Institutions for institutions that do not qualify as significant institutions under Section 1(3c) of the Banking Act, in particular the abolition of additional disclosure requirements for unlisted small and non-complex institutions;
- adjusting the threshold stated in Section 18(1) of the Remuneration Regulation for Institutions such that the annual variable remuneration of a risk taker is not only not permitted to exceed the threshold of €50,000, but also does not represent more than one-third of the staff member's total annual remuneration so as to remain exempt from the requirements of Sections 20 and 22 of the Remuneration Regulation for Institutions;

- extending the minimum length of the deferral period from three years to four years in Section 20(1) of the Remuneration Regulation for Institutions;
- adjusting the group-wide remuneration rules in Section 27 of the Remuneration Regulation for Institutions, in particular as regards the predominant non-inclusion of subordinated undertakings that are subject to sectoral remuneration rules (e.g. investment management companies and investment institutions).

In amending the Remuneration Regulation for Institutions, BaFin – in its capacity as the authority issuing this regulation – made full use of the available discretionary scope under the CRD to make allowances for the special features of the German banking market and proportionality considerations.

Besides being amended to implement the CRD, the Remuneration Regulation for Institutions was also adjusted to modify the duties of remuneration officers in Section 24 of the Regulation. Furthermore, Section 1(1) sentence 2 of the Remuneration Regulation for Institutions exempts leasing and factoring undertakings from the requirement to apply the Remuneration Regulation for Institutions.

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<sup>1</sup> See Directive 2013/36/EU.

<sup>2</sup> See Directive (EU) 2019/878 amending Directive 2013/36/EU.

<sup>3</sup> The Remuneration Regulation for Institutions continues to use the term “CRR institutions” to refer to those entities that qualify as institutions as defined in Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR). With “CRR investment firms” now no longer falling within the scope of the Banking Act, the amendment of the Banking Act of 26 June 2021 replaced this term with “CRR credit institution” (see the Act implementing Directive (EU) 2019/2034 on the prudential supervision of investment institutions of 12 May 2021 – *Gesetz zur Beaufsichtigung von Wertpapierinstituten*, WpIG). This necessitated an amendment to Section 1(3) of the Remuneration Regulation for Institutions, which BaFin put out for public consultation in a draft umbrella regulation on the WpIG on 4 May 2021 (see <https://www.bafin.de/dok/15992230>). Completion thereof is still pending.

<sup>4</sup> See footnote 7 of the box on pp. 89 f.

the decisions are still made by the administrative or supervisory board. To assist the remuneration control committee and thus the administrative or supervisory board, significant institutions are required to appoint a remuneration officer.<sup>46</sup> The remuneration officer's main tasks are to monitor on an ongoing basis the appropriateness of remuneration systems for staff members and prepare an annual remuneration control report. This kind of function is unique to German regulation of remuneration, and stems from the fact that the remuneration control committee, in line with German corporate governance principles, has no dedicated staff resources at the institution.

## Documentation and disclosure requirements

*Credit institutions must document and disclose certain remuneration-related matters*

There are explicit documentation requirements for credit institutions designed to ensure that decisions relating to remuneration can be better tracked, but also to restrict the discretionary scope of decision-makers ex ante. Thus, the principles for the design of the remuneration systems and the composition of the remuneration as well as the associated procedural rules along with the relevant responsibilities must be set out in organisational guidelines. In addition, actual decisions, such as performance measurement/evaluation or determination of the total bonus pool in a specific case, have to be documented appropriately. Not least, the amount of remuneration and its subdivision into fixed and variable components also has to be documented and disclosed as an aggregate.

To ensure that credit institutions disclose their remuneration practices consistently, the disclosure requirements were transposed from the CRD to the CRR in 2014. The latter contains extensive provisions on which quantitative and qualitative information relating to the remuneration systems for risk takers has to be disclosed. The Remuneration Regulation for Institutions additionally requires the disclosure of certain information relating to the remuneration of all

staff members depending on the size and complexity of the credit institution. When the CRR was being revised in 2019, the issue of proportionality was taken into account by stipulating that small and non-complex institutions, in particular, no longer need to disclose this information if they are non-listed institutions within the meaning of the CRR.<sup>47</sup> This approach is now also followed in Section 16(2) of the Remuneration Regulation for Institutions, as last amended. In the interests of reducing bureaucracy, this is to be welcomed.

## Supervision of remuneration systems by the Bundesbank, BaFin and the European Central Bank

To monitor compliance with the remuneration requirements, the Bundesbank's Regional Offices work together with BaFin or – for significant institutions within the meaning of Article 6(4) subparagraph 2 of the SSM Regulation<sup>48</sup> – with the European Central Bank (ECB). In addition, on-site inspections are also carried out on a case-by-case basis at the request of BaFin or the ECB. Given that approximately 1,500 banks and savings banks currently fall within the scope of the Remuneration Regulation for Institutions, a risk-oriented supervisory approach is necessary. Thus, credit institutions considered to be potentially or actually systemically important receive particular attention. Equally, supervisors especially focus on higher levels of remuneration or high variable components, including at smaller credit institutions. Since 2010, the Bundesbank has conducted annual surveys of remuneration practices among German credit institutions. The information is provided to the EBA, which publishes it in reports

*Bundesbank Regional Offices monitor remuneration systems jointly with BaFin or ECB*

<sup>46</sup> Sections 23 to 26 of the Remuneration Regulation for Institutions.

<sup>47</sup> Article 433b(2) of the CRR.

<sup>48</sup> Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (SSM Regulation).

## “High earners” in the European Economic Area from 2010 to 2019

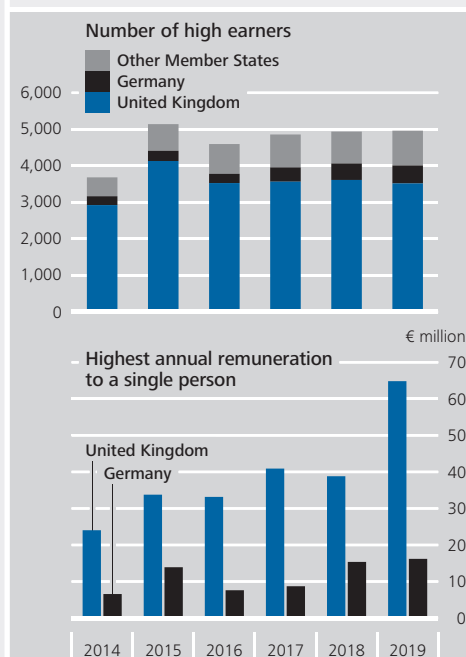
Since 2010, banking supervisors in the European Economic Area (EEA) have collected information from “CRR institutions”<sup>1</sup> regarding the members of their management board, the members of their supervisory board and staff who are active in the EEA and received remuneration of €1 million or more for a given reporting year (“high earners”). This information is published by the European Banking Authority (EBA) for each Member State – since 2014, including payment brackets with intervals of €1 million.

The figures published by the EBA for the years from 2010 to 2019<sup>2</sup> reveal that the United Kingdom had the highest absolute number of high earners, with Germany following some way behind in second place. Data on high earners with the highest remuneration per Member State have also been available since 2014; the United Kingdom tops this list as well. Where a high earner in Germany has reached a figure in the double-digit million euro range since 2014, this has always been attributable in part to severance payments.

<sup>1</sup> The term “CRR institutions” refers to those entities that qualify as institutions as defined in Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR). Since 26 June 2021, “CRR investment firms” no longer fall within the scope of the Banking Act (*Kreditwesengesetz*) and so the reporting requirements pursuant to Section 24(1a) number 6 of the Banking Act will apply to “CRR credit institutions” in future.

<sup>2</sup> Although the information for 2020 has already been collected by the national competent authorities, it has not yet been published by the EBA. As the data are collected from superordinated institutions for the entire EEA, a complete picture for individual Member States can be obtained only once the data have been aggregated by the EBA.

### High earners in the EEA\*



Source: European Banking Authority (2016, 2017, 2018, 2019, 2020 and 2021a). \* The United Kingdom was a member of the European Economic Area up to the end of 2020.

prepared annually or every two years.<sup>49</sup> It also feeds into the work of the supervisor responsible for the respective credit institution. Together with other information, particularly the audit reports compiled by the auditor of the annual accounts,<sup>50</sup> the data are used to assess the appropriateness of remuneration systems as part of the supervisory review and evaluation process (SREP).<sup>51</sup>

*Supervisors have rich toolkit to address shortcomings*

Any shortcomings of the remuneration systems feed into the assessment of the adequacy of internal governance. Based on a final score as part of an overall assessment, the SREP can result in a higher institution-specific capital add-on in accordance with Section 10(3) of the Banking Act or, for credit institutions directly supervised by the ECB, in accordance with Article 16(2) of the SSM Regulation, or to qualitative requirements for the institution. Outside the SREP, too, formal or informal requests can be made for the rectification of any irregularities. If serious irregularities in risk management are identified, the relevant supervisory authority can not only issue an administrative fine, but ultimately also demand that members of the credit institution's management board be removed. Furthermore, the competent supervisory authority – be it BaFin or the ECB – has the right to reduce a credit institution's total variable remuneration or get rid of it entirely if the institution is not fulfilling its obligations to ensure adequacy of own funds and/or liquidity.<sup>52</sup>

## ■ Outlook

*Proportional regulation required for small and non-complex institutions*

Variable remuneration at credit institutions is one of the most regulated and monitored incentive systems in the private sector. It is probably undisputed that regulation has contributed to deeper integration of remuneration systems into risk management as well as improved risk adjustment for remuneration. FSB analyses show that financial institutions, especially credit institutions, have made great strides when it comes to refining their remuneration systems.<sup>53</sup> For example, approaches involving

the holistic inclusion of ESG risks<sup>54</sup> are increasingly being used when designing remuneration parameters, through the integration of non-financial criteria such as good conduct.

It is not yet possible to draw a final conclusion on how efficient malus and clawback arrangements are, especially as these instruments tend to be seldom used. However, this does not necessarily mean that the relevant supervisory requirements have no effect. Rather, institutions' internal rules on these matters already create a positive incentive to develop a risk-appropriate corporate culture. Credit institutions must ensure, though, that consistent action is taken when staff members or members of the management board engage in misconduct.

Given the complexity of the issue and its importance for corporate culture and risk management at financial institutions, an evaluation of the underlying FSB P&S would be a welcome move. This could examine the efficiency of the requirements and help optimise the regulation of remuneration.

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<sup>49</sup> These are the annual report on employees with remuneration of at least €1 million per year (EBA Report on High Earners, last published in 2021 with data for 2019), and the report comparing remuneration trends and practices (EBA Report on the benchmarking of remuneration practices at the European Union level, last published in 2020 with data for 2017 and 2018). The reports are published on the EBA website at <https://www.eba.europa.eu/risk-analysis-and-data/remuneration-data>

<sup>50</sup> When auditing an institution's annual accounts, auditors also check compliance with certain regulatory requirements pursuant to Section 29 of the Banking Act. The subject of the audit is specified in the Regulation governing the auditing of the annual accounts of credit institutions and financial services institutions as well as the reports to be drawn up on these (Audit Report Regulation (*Prüfungsberichtsverordnung*)). Section 12 of that Regulation contains the list of duties with regard to institutions' remuneration.

<sup>51</sup> More information on the SREP can be found in Deutsche Bundesbank (2017), pp. 44 ff.

<sup>52</sup> Section 45(1) in conjunction with (2) sentence 1 numbers 10 and 11 of the Banking Act and Article 16(2) letter (g) of the SSM Regulation.

<sup>53</sup> See Financial Stability Board (2019).

<sup>54</sup> The EBA, for example, defines ESG (environmental, social and governance) risks as the risks of any negative financial impact on the institution stemming from the current or prospective impacts of ESG factors on its counterparties. See European Banking Authority (2021b), p. 6.



## Remuneration practices and trends at German credit institutions from 2014 to 2019

On the basis of Section 24(1a) number 5 of the German Banking Act (*Kreditwesengesetz*), the Bundesbank collects information annually on remuneration practices and trends at significant institutions within the meaning of Section 1(3c) of the Banking Act. Since 2014, this data collection has been carried out in compliance with the current guidelines of the European Banking Authority (EBA),<sup>1</sup> which require data to be collected at the consolidated level. When interpreting the following figures it should be noted that the number of surveyed credit institutions fluctuates somewhat over time<sup>2</sup> and that major institutions with large numbers of staff or high levels of remuneration have a considerable impact on the aggregate figures.

On average, roughly 4% of the surveyed institutions' total staff were risk takers in the financial year 2019. This share has remained largely unchanged since the data were first collected using the current format in 2014. Investment banking and retail banking each account for roughly one-quarter of all risk

takers. Members of management boards and administrative or supervisory boards, who are automatically considered to be risk takers, account for around 15% of the total. The distribution of risk takers among the individual business areas fluctuated only marginally over time.

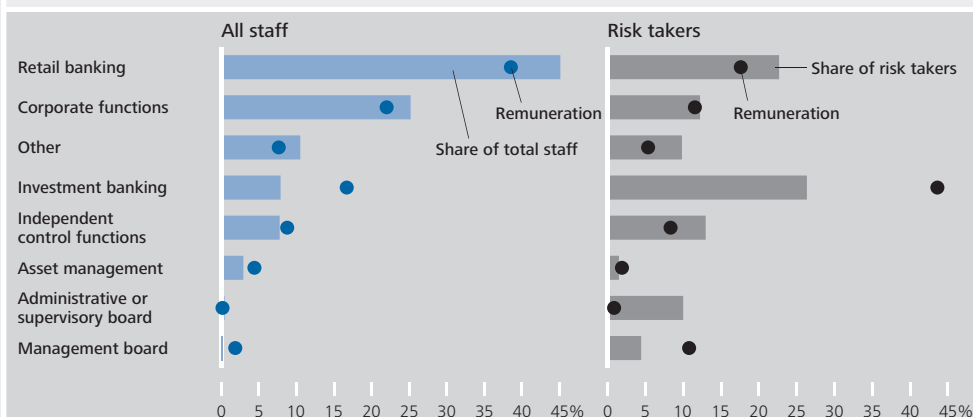
In 2019, the average remuneration for risk takers amounted to around four times the average of all staff members. The significance of variable remuneration is also considerably higher for risk takers than for all staff on average. In 2019, the ratio of variable to fixed remuneration amounted to 45% on average for risk takers, compared to just 15% on average for all staff members. However, from 2014 to 2019, a downward trend can be observed in this regard for both risk takers and all staff members.

<sup>1</sup> See European Banking Authority (2014).

<sup>2</sup> The survey comprised 25 institutions in 2014 and 36 institutions in 2019.

### Remuneration by business area at significant German credit institutions

2019



Overall, in 2019, credit institutions paid out roughly 45% of risk takers' variable remuneration in the form of instruments that are linked to the institution's performance (such as shares in the institution). Instances where the 50% minimum requirement was not met at individual credit institutions were largely attributable to the €50,000<sup>3</sup> waiver threshold for variable remuneration.<sup>4</sup>

In 2019, roughly 60% of risk takers' variable remuneration was deferred on average. The current figures show that credit institutions sometimes perform an explicit ex post risk adjustment (malus)<sup>5</sup> for deferred remuneration. The amounts of the adjustments vary considerably between credit institutions and from year to year, depending on the circumstances. With a few exceptions, the amounts involved are only small.

<sup>3</sup> Section 18(1) of the Remuneration Regulation for Institutions (*Institutsvergütungsverordnung*).

<sup>4</sup> When collecting the data, the item "variable remuneration" also encompasses privileged severance payments pursuant to Section 5(6) of the Remuneration Regulation for Institutions. These are not subject to the requirements of Sections 7 and 20 of the Remuneration Regulation for Institutions and do not have to be taken into account when calculating the ratio of variable to fixed remuneration pursuant to Section 25a(5) of the Banking Act.

<sup>5</sup> The reasons for ex post risk adjustments are not captured when collecting the data. Possible reasons may, for example, arise from Section 7(2) and Section 20(5) of the Remuneration Regulation for Institutions or from additional performance criteria in the case of long-term incentive plans.

The objective for the future should be regulation of remuneration based on consistent principles. Moreover, if any changes to the framework are necessary, European legislators should ensure that the costs of the ensuing transition processes are as low as possible for credit institutions. This should help to boost understanding of the meaning and purpose of the rules among the affected credit institutions and their staff members. Greater acceptance of the agreed rules may help minimise attempts to circumvent them.

At the same time, some thought should be given to whether the EU's current remuner-

ation regime is appropriate to the target group and objectives when it comes to small, non-complex institutions or whether they need even more proportional regulation. The amendment of the CRD to introduce greater proportionality of remuneration rules should be regarded as just the first step. The forthcoming transposition of the Basel III reform package into European law provides an opportunity to further exempt small, non-complex institutions from the administrative burden of remuneration rules, where they are not required by supervisors.

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