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Eurosystem

Circular

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Remuneration policy: update of the legal framework and transposition of the EBA Guidelines of 2 July 2021 on sound remuneration policies under Directive 2013/36/EU (EBA/GL/2021/04)

Scope

- *credit institutions and their branches abroad,*
- *stockbroking firms as referred to in Article 1(2) and (5) of Regulation 2019/2033[1] (hereinafter "large stockbroking firms"), and their branches abroad,*
- *branches established in Belgium of credit institutions and large stockbroking firms governed by the law of States that are not members of the European Economic Area,*
- *in the context of consolidated supervision, approved or designated financial holding companies and mixed financial holding companies under Belgian law.*

Entities falling under the scope of this circular will hereinafter be collectively referred to as "financial institutions".

Summary/Objectives

This circular aims to clarify the update of the legal framework and to transpose the Guidelines of the European Banking Authority (EBA) of 2 July 2021 on sound remuneration policies under Directive 2013/36/EU into the Belgian prudential framework.

These EBA guidelines were published on 2 July 2021 and will replace – for the institutions within their scope – the EBA Guidelines of 27 June 2016 on sound remuneration policies (EBA/GL/2015/22) as of 31 December 2021. They provide guidance for the concrete oversight of the remuneration policies and practices of financial institutions. Financial institutions should therefore implement and comply with these guidelines as a supplement to the legal provisions on sound remuneration policies.

1 Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014.

The provisions of this circular which clarify the updated legal framework set out in the Banking Law[2] enter into force on the day on which this circular is published on the Bank's website, provided of course that the legal provisions to which they apply have also entered into force by that date. With regard to the other provisions, this circular is applicable from 31 December 2021 and from that date replaces, for the institutions within its scope, the previous Circular NBB_2016_44 on the same subject.

Dear Madam,
Dear Sir,

This circular aims to clarify the update of the legal framework set out in the Banking Law and to transpose the Guidelines of the European Banking Authority (hereinafter "EBA") of 2 July 2021 on sound remuneration policies into the Belgian prudential framework.

According to Article 75(2) of Directive 2013/36/EU (hereinafter the "CRD"), the EBA must issue guidelines on sound remuneration policies which comply with the principles set out in Articles 92 to 95 thereof. A first version of these guidelines was published on 27 June 2016 and was transposed into the Belgian prudential framework by Circular NBB_2016_44.

Directive (EU) 2019/878 of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures (hereinafter the "CRD V") amends, as indicated by its title, the rules on remuneration policies among other things. Practice had shown that certain rules on variable remuneration - in particular those on deferred payments and payments in instruments - were sometimes difficult to apply or were, for certain smaller institutions or individuals receiving limited variable remuneration, disproportionate to the prudential benefits. The CRD V therefore introduces a number of proportionality rules for the application of the rules on deferred payments and payments in instruments. In addition, this directive simplifies the application of the remuneration requirements on a consolidated basis and also requires institutions to apply gender-neutral remuneration policies to all staff.

These new directive standards have already been transposed as such into the Banking Law[3].

Consequently, it was also necessary to update the EBA guidelines of 27 June 2016. The EBA launched a three-month public consultation on the updated guidelines, which ended on 29 January 2021. The revised EBA guidelines of 2 July 2021 enter into force on 31 December 2021 and take into account both the changes introduced by the CRD V and the experience of European supervisors in the area of remuneration policies.

The EBA guidelines are part of an extensive and comprehensive reference document which serves as guidance for the concrete oversight of the remuneration policies and practices of financial institutions. These guidelines are therefore an integral part of this circular and are annexed hereto. Consequently, financial institutions should implement and comply with these guidelines as a supplement to the legal provisions on sound remuneration policies.

Furthermore, the Bank has performed regular horizontal reviews of compliance with the remuneration policy rules since 2011 and has also identified a number of points of attention in its day-to-day practice. As a result, the Bank below reiterates the main points of Circular NBB_2016_44 and addresses a number of new points.

2 Law of 25 April 2014 on the legal status and supervision of credit institutions and stockbroking firms.

3 Law of 11 July 2021 transposing Directive 2019/878 of the European Parliament and of the Council of 20 May 2019, Directive 2019/879 of the European Parliament and of the Council of 20 May 2019, Directive 2019/2034 of the European Parliament and of the Council of 27 November 2019, Directive 2019/2177 of the European Parliament and of the Council of 19 December 2019, Directive 2021/338 of the European Parliament and of the Council of 16 February 2021 and containing various provisions.

1. Points of attention

a. Responsibility of the financial institution regarding the remuneration policy

The requirements for remunerations in the financial sector stem from the various works carried out at the international level in the wake of the 2008 financial crisis. The de Larosière Report and the report of the Lamfalussy Committee identified the shortcomings in financial institutions' remuneration policies (including excessive premiums, bonuses and severance payments) as problematic[4].

As a result, the European legislator decided to regulate remunerations in the financial sector through European regulations, which have been translated inter alia in the CRD, the Banking Law, various EBA regulatory technical standards, EBA guidelines, and policies of national supervisors, including the Bank.

These regulations and guidelines go beyond the provisions of ordinary company and labour law in several areas. It is therefore the responsibility of the financial institutions to comply correctly with these specific regulations – both in text and in spirit – and to develop a coherent remuneration policy for this purpose.

However, in the context of its horizontal reviews and daily supervisory practice, the Bank has found that some institutions have not yet sufficiently integrated the precedence of these stricter remuneration rules into their remuneration policies, with the result that individual contracts with staff members and directors sometimes contain commitments that are incompatible with the provisions of the Banking Law or European regulations. This creates needless compliance risks that can lead to legal disputes and, in certain cases, the forced payment of contractually agreed remunerations in violation of the Banking Law or European regulations.

The Bank therefore wishes to remind institutions of their responsibilities and their obligation to comply with the specific prudential rules on remuneration. Violations of these rules constitute a breach of the Banking Law that may result in administrative measures and sanctions.

In line with the above, we also ask institutions to take special care to establish an appropriate legal framework for their relationship with directors. The rule that directors cannot exercise their directorship under an employment contract has long been enshrined in Belgian law[5]. This rule has now also been explicitly included in the Companies and Associations Code and in Articles 24, 25 and 62/1 of the Banking Law which, on the one hand, state that members of the management committee may not be linked in this capacity to the company by an employment contract and, on the other hand, also more generally prohibit members of the statutory governing body and members of the management committee from exercising a salaried function in the credit institution or in a company in which the credit institution has a participating interest. The existence of an employment contract presupposes a relationship of subordination which is in itself incompatible with a directorship. Furthermore, such a relationship of subordination on the part of directors is also contrary to the principles of good governance (including the principle of independence of mind, collegiality within the governing body, etc.).

Institutions that are currently in a situation contrary to the legal framework should settle this situation definitively for the future. A mere suspension of the existing employment contract for the duration of the directorship is not an appropriate solution in this context, as the person concerned would still be bound by the employment contract, which would be resumed at the end of the directorship, letting the above incompatibilities subsist. In this context, we would also like to draw attention to the fact that in the new Companies and Associations Code, the principle of *ad nutum* dismissal is now non-mandatory, and it is now also possible to grant members of the governing body financial compensation for a period of notice that was not served, which makes it possible to meet the legitimate expectations of staff who are confronted with a change in their status under labour law in the context of an appointment as director[6]. The latter aspect also makes it possible to correctly link any termination payments to the performance achieved over

4 Explanatory Memorandum to the Banking Law, Parl. Doc. Chamber, 2013-2014, Doc. 53 - 3406/001, p. 73-77.

5 Explanatory Memorandum to the draft law implementing the Companies and Associations Code and containing various provisions, Parl. Doc. Chamber, 2017-2018, Doc. 54 - 3119/001, p. 66.

6 Unless otherwise stipulated in the articles of association, the remuneration of members of the management committee falls under the competence of the board of directors, which may also provide for such financial compensation (see in this regard the preparatory works to the Law of 27 June 2021 - Doc. 55-1887/001, p. 54).

time as director, in accordance with Article 12 of Annex II to the Banking Law, and thus to avoid an amalgam of previous commitments under the old employment contract.

b. Documentation of the process for selecting Identified Staff

As set out in paragraph 98 et seq. of the EBA guidelines, it is the financial institution's responsibility to determine which persons should be qualified as "Identified Staff", i.e. the categories of staff whose professional activities have a material impact on the financial institution's risk profile.

In order to allow adequate oversight of this selection process, it should be documented sufficiently, including for staff that were identified on the basis of quantitative criteria but whose professional activities were ultimately considered to have no material impact on the institution's risk profile, in accordance with the Regulatory Technical Standards on Identified Staff[7]. In this context, each selection criterion listed should be followed by the qualifying functions and, where appropriate, it should be specified why a certain person identified on the basis of the quantitative criteria was ultimately not selected.

c. Importance of transparency

Transparency, not only towards the supervisor but also towards the other stakeholders, is essential for the pursuit of a sound remuneration policy.

In this context, the remuneration policy of each financial institution should include the following: (i) a precise description of the different components of the fixed and variable remuneration respectively, in accordance with the criteria laid down in paragraph 129 et seq. of the EBA guidelines; (ii) clear definitions and criteria for performance measurement and risk adjustments; (iii) a clear description of the decision-making process with regard to the remuneration of Identified Staff, particularly the way in which the decisions on performance measurement and risk adjustments are made; and (iv) where applicable, a clear description of the interaction with the group remuneration policy when determining bonus pools for the different activities.

Furthermore, the actual decision-making process regarding performance measurement and risk adjustments must be adequately documented, in particular with respect to the interaction between the use of risk-sensitive parameters and discretionary adjustments. Although decisions are rarely formulaic and often require a qualitative assessment, decisions taken on the different levels should be recorded clearly and completely.

d. Role of the risk committee

The risk committee has a special role in remuneration policy. In particular, the risk committee should examine whether the incentives in terms of variable remuneration are coherent with the management of the risks (i.e. they do not increase the risks), of the own funds requirements and of liquidity, taking into account the profitability prospects.

It is therefore important that the risk tolerance and strategy framework be integrated into the remuneration policy. In addition, the minutes of the risk committee should show that this matter receives the necessary attention.

7 Commission Delegated Regulation (EU) 2021/923 of 25 March 2021 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards setting out the criteria to define managerial responsibility, control functions, material business units and a significant impact on a material business unit's risk profile, and setting out criteria for identifying staff members or categories of staff whose professional activities have an impact on the institution's risk profile that is comparably as material as that of staff members or categories of staff referred to in Article 92(3) of that Directive.

e. Proportionality

Financial institutions should comply with the remuneration requirements in a manner and to an extent that is appropriate to their size and internal organisation and to the nature, scope and complexity of their activities. Paragraph 88 of the EBA guidelines contains a list of the criteria that can be taken into account for that purpose.

In this context, large and more complex financial institutions should pursue a more complex remuneration policy with more advanced risk measurement methods, while smaller and less complex financial institutions may pursue a simpler remuneration policy and simpler methods.

In addition, the current Banking Law also transposes the new CRD V exemption regime regarding certain aspects of variable remuneration. For instance, Article 9/1 of Annex II to the Banking Law introduces an exemption arrangement for the application of the rules on deferred payments and payments in instruments for credit institutions that:

(i) are not "large institutions" within the meaning of Regulation (EU) No 575/2013[8], and

(ii) whose assets do not exceed EUR 5 billion on average over a period of four years.

Notwithstanding the above, this exemption also applies to staff whose annual variable remuneration does not exceed EUR 50 000, provided that this does not represent more than one third of their total annual remuneration.

However, the above is without prejudice to the requirement to qualify all staff who have a material impact on the financial institution's risk profile as Identified Staff, as this category of staff is also subject to other rules such as (ex ante) risk adjustments to performance measurement and to the calculation of variable remuneration.

The old proportionality regime, where employees could benefit from certain exemptions if their variable remuneration does not exceed EUR 75 000, therefore no longer applies.

f. Group context

The remuneration rules (including the maximum ratio between fixed and variable remuneration) should be complied with on a consolidated or sub-consolidated basis. It should be noted that, as a rule, only "institutions" and "financial institutions" as defined in points (3) and (26) of Article 4(1) of Regulation (EU) No 575/2013 fall within the regulatory consolidation perimeter, irrespective of whether they are governed by the law of an EEA Member State or not. Consequently, Article 168, § 1 of the Banking Law does not in principle apply to non-financial institutions[9].

The above implies, among other things, that the Belgian rules on remuneration policies also apply to foreign subsidiaries within the regulatory consolidation perimeter, provided that they employ staff whose professional activities have a material impact on the group's risk profile.

However, according to the new Article 168/1, § 1 of the Banking Law, subsidiaries within the regulatory consolidation perimeter are exempt from the application of the remuneration requirements on a consolidated basis if they are subject to remuneration requirements under their own sector-specific rules. Thus, a priority regime is established.

However, in order to prevent unlawful circumventions of the rules, the legislator explicitly provided for an exception to the aforementioned priority rule: the remuneration requirements applicable on a consolidated basis continue to apply to staff members of subsidiaries who provide certain specific services referred to in the Law, such as portfolio management or order execution, and who have a mandate, in whatever form, to

8 As clarified in paragraph 94(b) of the EBA guidelines, when assessing whether a consolidating institution meets the threshold to qualify as a large institution as referred to in point 146(d) of Article 4(1) of Regulation (EU) No 575/2013, the criteria are met if the amount on a consolidated basis exceeds the threshold.

9 However, ancillary services undertakings are included in the consolidation in the cases and according to the methods described in Article 18 of Regulation (EU) No 575/2013.

perform professional activities that allow them to be considered staff members who take on material risks at the level of the group to which the credit institution belongs. The latter also includes mandates involving delegation or outsourcing arrangements between the subsidiary employing the staff and other institutions within the same group.

Apart from the specific case described above, the prohibition on unlawful circumventions of the Belgian remuneration rules laid down in the Banking Law also applies more generally, of course. In this respect, reference is also made to section 10.2 of the EBA guidelines, which states that circumvention occurs when the actual objective of the remuneration requirement is not met, even if the letter of the requirement has been formally complied with. For example, employees of a Belgian (subsidiary) company may not be assigned to or employed or remunerated by another (foreign) entity of the group that is subject to less strict rules if the activities carried out are not consistent with the normal activities of that entity, or if there are no actual services being rendered to that entity in return, or if this assignment is essentially motivated by the aim of avoiding stricter remuneration rules.

The above further illustrates the need for both banking and bancassurance groups to develop adequate remuneration policies at group level which provide sufficient guarantees for a consistent application of the remuneration rules to all group entities in general and to members of staff who have a material impact on the group's risk profile and who are active in the various group entities in particular.

g. Deferred payments

With regard to deferred payments, paragraph 259 of the EBA guidelines provides that both the proportion of the variable remuneration to be deferred and the duration of the deferral may vary based on, inter alia, the activities and the level of the variable remuneration of the staff member concerned, and are therefore not limited to the legal minimum. In this respect, Article 7 of Annex II to the Banking Law stipulates that the deferral period may not be shorter than five years for members of the statutory governing body and senior management of significant credit institutions.

According to paragraph 263 of the EBA guidelines, institutions should define what level of variable remuneration constitutes a particularly high amount, of which at least 60 % should be deferred. Under no circumstances should this amount exceed EUR 200 000.

In the context of the transposition of the CRD V, Article 6 of the Banking Law also eases the rules on instruments that are eligible to be paid as variable remuneration, by expanding the possibilities for the use of share-linked instruments.

h. Internal control statement by the senior management

Without prejudice to the overall responsibility of the statutory governing body as described in paragraph 28 et seq. of the EBA guidelines, the implementation of the remuneration policy is, in Belgium, also covered in the annual assessment of the internal control measures by the senior management, in accordance with Circular NBB_2011_09 of 20 December 2011. The senior management is assisted in this assessment by the independent control functions, specifically to review the implementation of the remuneration policy against the policies and procedures established by the statutory governing body and to review these procedures against the legal and other regulatory requirements on remuneration policies. In this respect, particular attention should be paid to avoiding incentives for excessive risk-taking and other non-constructive behaviour.

i. Termination payments and severance payments

In line with the CRD and the EBA guidelines, Article 12 of Annex II to the Banking Law specifies the regime applicable to termination payments, which also include severance payments.

The legal aspects of this regime and the manner in which it should be applied in practice are explained in great detail in the preparatory works to the Law that amended the Banking Law. This explanation is therefore not repeated in this circular.

However, the Bank wishes to highlight the following specifically regarding severance payments.

Severance payments are always considered as variable remuneration. This is clear from both Article 94(1)(h) of the CRD and section 9.3 of the EBA guidelines. As a rule, such payments should therefore be subject to all rules applicable to variable remuneration.

However, the EBA guidelines provide for a limited number of exhaustively listed situations in which (part of) the severance payment may be excluded from (i) the calculation of the fixed/variable remuneration ratio, and (ii) the application of the rules on deferred payments and payments in instruments. The rationale for these limited exceptions is based on the observation that, while the payments mentioned in these exhaustively listed situations legally meet the definition of "severance pay" as defined in the EBA guidelines, the application of the fixed/variable remuneration ratio or of the rules on deferred payments and payments in instruments is either not legally possible (e.g. due to a court ruling) or not entirely appropriate given the sometimes unfortunate circumstances at the basis of the dismissal (e.g. failure, material reduction of the activity, etc.).

In summary, it can be said that the EBA only intended to target a number of very specific and exhaustively defined (well-founded) situations.

In view of the rationale underlying the aforementioned exceptions, the Bank expects institutions wishing to apply them to do so with respect for the spirit of the text, which logically entails that this will only occur sporadically in practice.

In order to avoid unauthorised use of these exemptions, Article 12/1, § 2 of Annex II to the Banking Law stipulates that institutions wishing to make use of this exemption regime in a specific case must first notify and justify their intention to the supervisor[10]. If the supervisor considers that the conditions for granting the exemption are not met, the remuneration concerned must be treated according to the normal regime applicable to variable remuneration.

The exemption regime provided for in the abovementioned Article 12/1, § 2 should also not be confused with the exemption regime set out in Article 12/1, § 1 of Annex II to the Banking Law. For example, Article 12/1, § 1, 2° of Annex II to the Banking Law provides that severance payments to which the person concerned is entitled on the basis of their seniority pursuant to the legal provisions on dismissal within the framework of an employment contract are exempt from the application of Articles 1, § 2 and 2 to 8 of Annex II. The same also applies *mutatis mutandis* to company directors who are not bound by an employment contract. Consequently, the remunerations referred to in Article 12/1, § 1 are, of course, also not subject to the notification requirement in Article 12/1, § 2 of Annex II to the Banking Law.

However, the exemption provision in Article 12/1, § 1 remains strictly limited to the remunerations referred to in that article. Any other/additional remunerations paid in the context of such dismissal should be subject to the normal rules on termination payments or, provided the relevant conditions are met, may be subject to other exceptions in the Law which, where appropriate, fall under the notification requirement in Article 12/1, § 2.

j. Gender-neutral remuneration policies

Article 67 of the Banking Law now also explicitly states that remuneration policies should be gender neutral.

The principle of equal pay for male and female workers for equal work or work of equal value is enshrined in Article 157 of the Treaty on the Functioning of the European Union (TFEU). The CRD requires institutions to develop gender-neutral remuneration policies, i.e. remuneration policies that are based on equal pay for all employees for equal work or work of equal value, for all staff, including risk-takers.

10 On this specific point, the Explanatory Memorandum to the draft Law of 11 July 2021 (Parl. Doc. Chamber, 2020-2021, Doc. 55 - 1999/001, p. 123) specifies that in assessing the justification for such an exemption, the supervisor should take into account the prohibition of rewarding failure or misconduct, as well as the fact that such an exemption can only be justified in specific and exceptional situations which should therefore not be defined specifically and pre-emptively in the institution's remuneration policies.

Where the remuneration of the majority of staff is subject to collective bargaining and the resulting contracts apply irrespective of the gender of staff, it is easier to monitor that the remuneration policies are applied in a gender-neutral manner. Ensuring gender neutrality with regard to individually agreed contracts is more complex and requires a more sophisticated approach.

The EBA guidelines set out the prudential expectations for gender-neutral remuneration policies in several sections. In particular, paragraphs 23 to 27 indicate which elements should/could be taken into account when developing gender-neutral remuneration policies, as well as how this process should be documented and monitored. Additionally, paragraph 57 emphasises the fact that the remuneration committee also has an important supporting and advisory role in this area.

Finally, section 10.2 of the EBA guidelines also clarifies that any measures that would result in remuneration policies no longer being gender neutral, would constitute a form of circumvention.

2. Entry into force

Financial institutions should comply with the EBA guidelines as transposed and clarified in this circular as of 31 December 2021 and apply them to remunerations accorded from that date onwards, regardless of when the services covered by this remuneration were provided.

The provisions of this circular which clarify the updated legal framework in the Banking Law enter into force on the day on which this circular is published on the Bank's website, provided of course that the legal provisions to which they apply have also entered into force by that date[11].

A copy of this circular will be sent to your institution's accredited statutory auditor(s).

Yours faithfully,

[AUT:S] Pierre WUNSCH

Digitally signed by [AUT:S] Pierre WUNSCH
Date: 2021.12.14 15:26:57 +01'00'

Pierre Wunsch
Governor

Annex: EBA Guidelines of 2 July 2021 on sound remuneration policies under Directive 2013/36/EU (EBA/GL/2021/04)

11 In the meantime, however, institutions are expected to refrain from taking any new actions or concluding any contracts that might impede or prevent the correct application of new legal provisions that have already been published but will enter into force at a later date.