eba European Banking Authority

Question ID

2023_6944

Legal act

Directive 2013/36/EU (CRD)

Topic

Remuneration

Article

94

COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations

EBA/GL/2021/04 - Guidelines on sound remuneration policies under CRD (repealing EBA/GL/2015/22)

Article/Paragraph

139

Type of submitter

Credit institution

Subject matter

Prospective remuneration plan for variable remuneration

Question

Guidelines, so that instruments awarded under then plan should exceptionally be valued for the purpose of the calculation of the ratio between variable and fixed components of the total remuneration with the market price or fair value at the time the prospective remuneration plan was granted? In particular, can an incentive plan which combines both short-term and long-term performance conditions fulfil the requirements of a “prospective remuneration plan” within the meaning of para. 139 of the EBA Guidelines?

Background on the question

In deviation from the general rule that instruments should be priced at the market price or their fair value on the date of the award of these instruments (see para. 278 of the EBA Guidelines), instruments that are awarded under a “prospective remuneration plan for variable remuneration, including LTIPs”, can be priced at the time the prospective remuneration plan was granted.
However, there is no definition of what constitutes a “prospective remuneration plan for variable remuneration”. Different market practices are observed and there is uncertainty whether instruments awarded under an incentive plan, depending on the shape of the incentive plan, should be priced at the time of the “award” or at the time of “grant”. This uncertainty carries the risk of an unintended breach of the “bonus cap” requirement.
One practical example is an incentive plan that provides for a pay-out to be fully made in a pre-determined amount of shares, as quantified based on the share value at plan start, depending on the level of achievement of both short-term and long-term future performance conditions. Performance is initially measured over one year (i.e. the first year after the plan start). Upon completion of the first performance year, an upfront quota is awarded and paid out subject to retention requirements, which is not subject to further performance conditions, while the deferred quota is subject to a further assessment of long-term performance conditions over an additional three-year performance period, and subsequently paid out subject to deferral and retention requirements. All the plan features (plan rules, performance indicators, targets, target bonus opportunity, deferral scheme and related share conversion price, etc.) are set by the relevant corporate bodies and formalised and communicated to the beneficiaries at plan start.

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92, par. 2, let. (a) and (b) of Directive 2013/36/EU (CRD) sets out that the remuneration policy "*is consistent with and promotes sound and effective risk management and does not encourage risk-taking that exceeds the level of tolerated risk of the institution*" and "*is in line with the business strategy, objectives, values and long-term interests of the institution […]".*

In line with the requirements, par. 236 of the Guidelines, states that variable remuneration should be awarded after the end of the accrual period as each element of variable remuneration should to be determined by past performance and instruments awarded are, as a general principle, to be valuated at award (i.e. after the performance period has ended). To meet all regulatory requirements, including the limitation of the ratio between the variable and fixed remuneration, the valuation of instruments might be done at a different point in time only in exceptional circumstances, in those cases where variable remuneration awarded under the general remuneration framework would not be able to provide for the intended incentives.

The valuation of instruments at grant (i.e. at the beginning of the performance period) under paragraph 139 of the Guidelines is limited to exceptional situations. The reference to LTIP in the GLs is only illustrative and intends to reflect the exceptional nature of the case where new staff may receive LTIP at the beginning of the first year of employment. In this situation and limited to the first year of employment, granting a LTIP that specifies a fixed number of instruments to be awarded in the future, only if performance conditions are met, aligns staff's incentives at the beginning of employment with the interests of shareholders or owners and relevant stakeholders. The value of the instruments should be the market price or their fair value at the time of the grant of the prospective remuneration plan for variable remuneration and no adjustments should be made. As stated in paragraph 139 of the Guidelines, all the remaining requirements to variable remuneration are applicable. Where such a market price does not exist a fair value for the instruments can be determined and used, provided that no payments of interest of dividends or adjustments of the price to compensate for deferral periods or for the inability to receive dividends and to vote should be made as the identified staff to which the shares have been awarded is not yet the legal owner of these shares.

The example provided in the Q&A is not considered as an exceptional situation. During the contract, the alignment of interests is achieved by the award of variable remuneration, which is partly paid out in instruments, whereby the number of shares is determined by the awarded variable remuneration and the market price at the date of the award. The valuation of shares at the date of grant of an LTIP could potentially entail, in the ongoing employment contract, a circumvention of the limitation of the requirement on the maximum ratio between the variable and the fixed remuneration.

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Answer prepared by

Answer prepared by the EBA.