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## **EU Capital Requirements Directive (2010/76/EU)**

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### **What is it?**

The Capital Requirements Directive (CRD) amends two existing directives, Bank Consolidation Directive and the Capital Adequacy Directive, and was passed by the European Parliament in 2007. Further amendments (known as CRD iii) were made in July 2010, and the directive was enacted into Irish Law on 1<sup>st</sup> January 2011.

The directive requires credit institutions to adopt changed remuneration policies and practices, and limits the way in which remuneration packages for staff are structured. The new rules provide that a financial institution's remuneration policy should not encourage risk-taking that exceeds the level of tolerated risk of a firm and needs to be consistent with and promote sound and effective risk management.

### **What type of Companies will this affect?**

This directive will affect credit institutions, building societies and investments firms who fall within the scope of Article (1) of the Markets in Finance Instruments Directive (MiFID).

If a firm performs investment services and activities, it is subject to MiFID in respect of both of these and also of ancillary services. However if a firm only performs ancillary services, it is not subject to MiFID. MiFID covers almost all tradable financial products with the exception of certain foreign exchange trades. This includes commodity and other derivatives such as freight, climate and carbon derivatives.

Institutions are required to apply the new rules at the group, parent company and subsidiary levels, including those established in offshore financial centres. The implication of this large scope is that Irish regulated subsidiaries of an EU parent entity will have to comply with the particular rules of the parent jurisdiction on a group basis, and also with the regulatory regime in place in Ireland.

### **What type of Employees will this affect?**

At a Company level the new directive will apply to:

- Senior Managers,
- Risk Takers,
- Controller Roles; and
- Any employee whose total remuneration (including discretionary pension provisions), takes them into the same bracket as Senior Managers and Risk Takers.

It is primarily the responsibility of the individual Company to identify the members of staff whose professional activities have a material impact on the Company's risk profile. If looking to identify relevant employees the following should be considered:

- staff with the highest proportion of variable to fixed remuneration;
- staff earning above a certain absolute threshold of total remuneration; and
- staff members or a group, whose activities could potentially have a significant impact on the institution's results and/or balance sheet.

### **What affects will this have on remuneration?**

In the past, employees were incentivised to pursue short-term bonuses without regard to the long term health of the financial system. The new rules now provide that any bonuses should be linked to long term performance.

- *Maximum Limit.* Each institution must set a maximum limit on the size of bonuses, as a proportion of salary.

- *Compulsory Deferral.* 40-60% of any bonus must be deferred for at least three to five years. The 60% rule will apply in the case of “particularly high” amounts.
  - What constitutes a “larger bonus” will be determined by the Central Bank.
  - Claw back arrangements enable a deferred bonus sum to be decreased if it is later found that the basis on which the employee was awarded the bonus was incorrect and it is deemed that, with hindsight, the bonus is no longer justified at that level.
  - Contingent Capital. At least 50% of the total bonus must be paid as a combination of shares and “contingent capital” (i.e. funds to be called on first in case of financial difficulties).
  - These shares and contingent capital must be retained for an appropriate period.
- *Cap.* All upfront cash bonuses will be capped at 30% of the total bonus and to 20% for “particularly high” bonuses.
- *Pension Policy.* Discretionary pension payments must be held back in instruments such as contingent capital that link their final value to the underlying strength of the institution, to avoid situations in which some retire with substantial pensions unaffected by difficulties faced by the financial sector. Such capital must be subject to a five-year retention period.
- *Guaranteed Bonuses.* Such guaranteed variable remuneration must be exceptional and occur only for new hires within the first year of employment.
- *Termination Payments.* Termination payments must reflect performance achieved over time and should be designed in a way that does not reward failure. The EU Commission’s recommended that severance pay be capped at two years’ fixed remuneration.

### **How will this be enforced?**

The Directive authorises the Central Bank to take action against the financial institutions that fall within the scope of CRD if they fail to comply with its provisions.

### **How do I comply with the Directive?**

Companies should firstly seek to implement suitable remuneration structures, policies and practices or make necessary adjustments to existing remuneration policies and practices, particularly in relation to bonus schemes. Companies should then identify staff within the scope of the directive.

### **How Can Chamber HR Help?**

There are a range of potential employment law associated with this directive – for example, the extent to which such practices may contravene contractual rights for employees set out in their Terms and Conditions of Employment.

These will need to be addressed through appropriate employee consultation prior to effecting any unilateral changes required by the rules.

Even where existing arrangements provide the employer flexibility to award bonuses, some form of consultation with employees would be prudent.

If you are seeking to implement such changes please contact the Chamber HR 24 hour Advice Line on **1890 252 923** and one of our dedicated Employment Law advisors can assist you and guide you and help avoid any potential issues.

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