DISCOUNT RATE FOR VARIABLE REMUNERATION FOR CREDIT INSTITUTIONS AS MANDATED UNDER ARTICLE 94(1)(G)(III) OF DIRECTIVE 2013/36/EU ON ACCESS TO THE ACTIVITY OF CREDIT INSTITUTIONS AND THE PRUDENTIAL SUPERVISION OF CREDIT INSTITUTIONS AND INVESTMENT FIRMS.

INTRODUCTION

1. This Annex implements the *European Banking Authority ('EBA') Guidelines on the applicable notional discount rate for variable remuneration as mandated under Article 94(1)(g)(iii) of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC ('CRD')*. This Annex applies only for the purpose of calculating the ratio between the variable and fixed component of total remuneration awarded for service provided or performance from 2014 and onwards.

2. The BR/20 on Remuneration Policies and Practices establishes that the variable component shall not exceed 100% of the fixed component of the total remuneration for those categories of staff whose professional activities have a material impact on the risk profile of the institution. A higher ratio of up to 200% may be allowed, subject to shareholder approval.

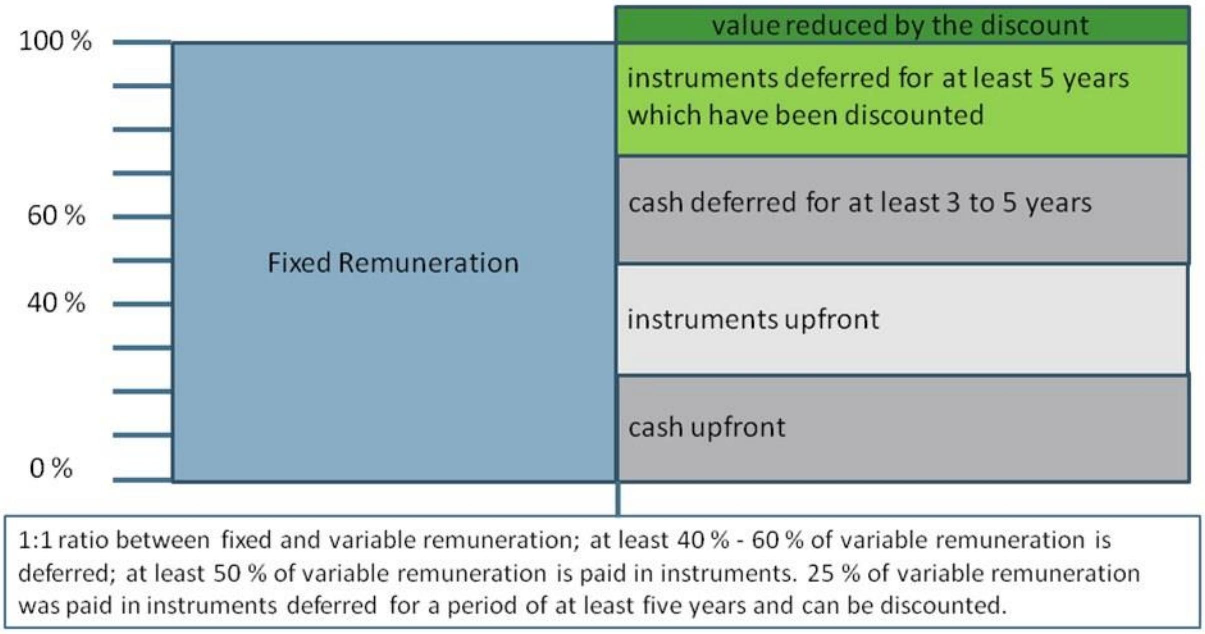
3. For the purpose of calculating the ratio between the variable and fixed component of remuneration, credit institutions may apply a discount rate to a maximum of 25% of the variable remuneration, provided it is paid in instruments that are deferred for a period of not less than five years.

4. There are three relevant factors which need to be considered when calculating the discount rate: the national annual inflation rate; the average interest rate of EU government bonds to take account of opportunity costs and inflation risk; and a nominal factor to provide for incentives for paying variable remuneration in instruments, which are deferred for a period of at least five years. The last factor depends on the length of the actual deferral period.

5. The discount rate calculated on the basis of the above factors shall ensure that the ratio between the variable and the fixed components of total remuneration is calculated in accordance with the BR/20. These factors provide for appropriate incentives for the use of long-term deferred instruments; these elements shall lead to more long-term orientated remuneration frameworks and facilitate prudent risk taking decisions.

6. Pursuant to Article 162(3) of the CRD ‘the laws, regulations and administrative provisions necessary to comply with Article 94(1)(g) as EU as transposed in paragraph 15, (vii) of BR/20 shall require institutions to apply the principles laid down therein to remuneration awarded for services provided or performance from the year 2014 onwards, whether due on the basis of contracts concluded before or after 1 January 2014.’

Figure 1: Schematic overview of remuneration components under a 1:1 ratio



7. In this Annex, in line with the CRD as transposed in BR/20, discount rate is the factor by which the amount of variable remuneration is multiplied to obtain its discounted value. A discount rate is understood to be the interest rate which is used to discount future amounts of cash flows in a multi-period model; it is often denoted ‘r’. A discount factor, ‘b’, is equal to 1/(1+r). The future amount of cash flows shall be multiplied by the discount factor ‘b’ in order to obtain the net present or discounted value and is referred to in this Annex as discount rate.

8. The discount rate may be applied to the variable remuneration of staff whose professional activities have been identified as having a material impact on the institution’s risk profile, for the purpose of calculating the ratio between variable and fixed remuneration. For the identification of staff, the regulation on criteria for identifying staff whose professional activities have a material impact on the institution’s risk profile will need to be applied. Since the maximum ratio applies to single staff members, the discount rate needs to be applied to the variable remuneration which is paid to a single staff member as well. The discount rate shall be applied only to variable remuneration paid in instruments that are deferred for at least five years. However, there is no obligation for the credit institution to make use of the discount rate. Deferred variable remuneration shall not vest faster than on a pro rata basis.

9. The extent to which the deferred part of remuneration may work as an incentive mechanism depends on what is, for the employee, the perceived value of this deferred

remuneration when it is awarded. In general, the perceived value depends on several factors: e.g. the expected return on another investment; the immediate financial needs the employee has; personal preferences; the risks of not being able to receive the full amount of deferred remuneration in the future; the reduction of the value due to inflation; and the uncertainty about future inflation rates. However, not all such elements are relevant for the discount rate. For example, clawback and malus mechanisms, which are part of the remuneration framework and are supposed to reduce the awarded remuneration if the institution or the staff member does not perform well, shall not lead to an increase of the discount rate.

SUBJECT MATTER AND DEFINITIONS

10. As stated above, Article 94(1)(g) of Directive 2013/36/EU as transposed in paragraph 15, (vii) of BR/20 requires institutions to set appropriate ratios between the fixed and the variable component of total remuneration for the categories of staff whose professional activities have a material impact on the risk profile of the institution (identified staff[4]). The maximum ratio between the variable and the fixed part of the total remuneration is limited to 100%. The ratio may be increased, as stated above, to a maximum of 200%.

11. This Annex applies to credit institutions which make use of the option to apply the discount rate for the purpose of calculating the ratio between the variable and fixed components of remuneration.

12. For the purpose of this Annex the discount rate is the value by which a nominal amount of awarded variable remuneration which vests in the future is multiplied in order to obtain its discounted value. The discounted value is then used for the calculation of the ratio between the fixed and the variable components of total remuneration for identified staff.

REQUIREMENTS CONCERNING THE DISCOUNT RATE FOR VARIABLE REMUNERATION

VARIABLE REMUNERATION WHICH MAY BE DISCOUNTED

13. Institutions may discount up to a maximum of 25% of the total variable remuneration which is calculated as the sum of all components of variable remuneration before the discount rate is applied. Only variable remuneration which is deferred for at least five years and is paid in equity or debt instruments or instruments linked to such instruments which are eligible for the purposes of variable remuneration in accordance with point (l) of Article 94(1) of Directive 2013/36/EU as transposed into paragraph 15(xii) of BR/20 shall be discounted. This includes parts of the deferred variable remuneration that vest during the deferral period.

Variable remuneration payable under deferral arrangements may not vest faster than on a pro rata basis[1].

14. The amount of variable remuneration which may be discounted shall be calculated on the basis of the total nominal amount of variable remuneration as set out in the BR/20.

ELEMENTS INCLUDED IN THE CALCULATION OF THE DISCOUNT RATE

15. As no distributions shall be paid to staff with respect to instruments during the deferral period the discount rate shall comprise the following three factors: inflation, interest rate for government bonds and an incentive factor linked to the use of long-term deferred instruments as set out in the following paragraphs of this section. For paragraphs 16 to 18, as part of their remuneration policy the institutions shall implement the use of one of the following:

    a. the most recently available data as at the date when the remuneration is awarded;

    b. the most recently available data as at the date when the variable remuneration which could be awarded for the next performance period is determined.

16. For remuneration awarded in a Member State credit institutions shall use one of the following with regard to the factor for inflation:

    a. if the remuneration is to be paid in the currency issued by the Member State where the staff member mainly works, the average annual rate of change for the HICP published by Eurostat[2] for that Member State;

    b. if the remuneration is to be paid in a currency issued by another Member State or a third country, official statistical data equivalent to that referred to in (a) above available for the country issuing the currency or the HICP rate applicable for the Member State in which the staff members carry on the predominant part of their activities;

    c. the average annual rate of change under (a) or (b) above for the Member State of the EU parent institution.

17. For remuneration awarded in a third country[3] institutions shall use the following for determining the inflation factor:

    a. if the remuneration is to be paid in a currency issued by a third country, the official statistical data equivalent to that referred to in paragraph 16(a) available for the

[1] Article 94(1)(m) of Directive 2013/36/EU as transposed into paragraph 15 (xiii) of BR/20.
[2] Harmonised Indices of Consumer Prices (HICPs). The rate referred to may be accessed via the following link: http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&language=en&pcode=tec00118&plugin=1.
[3] 'Third countries' refers to countries which are not Member States of the Union.

country issuing the currency or the HICP rate for the Member State of the EU parent institution;

b. if the remuneration is to be paid in a currency issued by an EU Member State, the HICP rate for the Member State of the EU parent institution.

18. For the interest rate for government bonds institutions shall use:

a. If the remuneration is to be paid in a currency issued by a Member State, the average yield for all Member States of the EU of long-term government bond yields as published by Eurostat;[4]

b. if remuneration is paid in a currency issued by a third country to staff predominantly located outside the EU, equivalent official statistical data available for the country issuing the currency or the rate under (a) above.

19. The incentive factor for deferred variable remuneration paid in instruments deferred for five years shall be 10%. The factor shall increase by four percentage points for each additional full year of deferral.

CALCULATION OF THE DISCOUNT RATE

20. Credit institutions shall calculate the applicable discount rates for different parts of variable remuneration which are subject to different deferral and vesting arrangements and apply the discount rates accordingly. Institutions shall use the applicable deferral periods documented within their remuneration policy.

21. The applicable discount rate equals one divided by the sum of one plus the three factors set out in paragraphs 15-19, raised to the power of the number of years of the vesting period, as shown in the formula below. The vesting period is the period after which the awarded variable remuneration vests. For this purpose the vesting period shall be rounded down to the next integer. For pro rata vesting, institutions may also use a present value formula.

[4] For the calculation EU government bonds with a residual maturity of around 10 years are used. The information on the long-term EU government bond rates may be found under the following link: http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&language=en&pcode=teimf050&plugin=1.

Formulas for the calculation of the discount rate

$$discount\ rate\ = \frac{1}{(1+i+g+id)^n}$$

i	= inflation rate of the Member State or third country
g	= interest rate for EU government bonds, EU average
id	= incentive factor for use of long-term deferral
n	= number of years of the vesting period

The application of the formulas is further explained in examples 1, 2 and 3 in the Annex to these guidelines.

APPLICATION OF THE DISCOUNT RATE

22. The discount rate shall be applied to a maximum of 25% of the total variable remuneration of an individual staff member paid in instruments that are deferred for at least five years.

23. Institutions shall calculate for each individual staff member:

a. the sum of all amounts of variable remuneration which are awarded before the discount rate is applied;

b. the amount under (a) which is awarded in instruments and deferred for a period of at least five years; and

c. the amounts under (b) for which different discount rates apply.

24. In order to calculate the discounted variable remuneration the applicable discount rate shall be applied by multiplying it by the relevant part of variable remuneration.

25. For the purpose of calculating the ratio between the variable and the fixed component of remuneration for an individual staff member, the total variable remuneration is the sum of all discounted amounts of variable remuneration and the non-discounted variable remuneration.

DOCUMENTATION AND TRANSPARENCY

26. Institutions shall document the calculation and use of the discount rate.

27. Institutions shall keep a record of the fixed and variable components of remuneration awarded to an individual staff member, the parts of variable remuneration paid in instruments which are deferred for five years or more, the applied discount rate and the ratio between the variable and fixed component of total remuneration.

28. Institutions are required, in accordance with Article 16 of the EBA Regulation, to report, in a clear and detailed way, whether they comply with this Annex. Institutions shall provide information on the discount rates together with the disclosures required regarding the remuneration policy under Article 96 of Directive 2013/36/EU as transposed in BR/07, paragraph 32 and Article 450(1)(d) of Regulation (EU) No 575/2013[5]. In particular, institutions shall disclose the following on a country by country basis:

   a. the extent to which the discount rate is used (the maximum being its application to 25% of the total variable remuneration); and

   b. the number of identified staff to whose variable remuneration the discount rate was applied.

29. For detailed examples on how the discount rate for variable remuneration is applied, credit institutions may refer to the *European Banking Authority ('EBA') Guidelines on the applicable notional discount rate for variable remuneration as mandated under Article 94(1)(g)(iii) of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC ('CRD').*

[5] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).