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At a glance: The main innovations in the German Remuneration Ordinance for Institutions 3.0 (InstitutsVergV)

Within the framework of the implementation of the Guidelines for a sound remuneration policy (EBA), 27.06.2016, the regulations of the German Remuneration Ordinance for Institutions (Instituts-vergütungsverordnung – InstitutsVergV) were also revised. The consultation draft published in summer 2016, was, however, modified again due to a proposal by the EU Commission to change the Capital Requirements Directive (CRD).

After the final version came into effect on 4 August 2017 (Federal Law Gazette I No. 54, p. 3042 ff.), although the final interpretation guide is still absent, much is unchanged in the final version of the InstitutsVergV compared to the version already released in 2014. However, there are certain innovations such as the specification of variable remuneration components and also specific risk adjustments by means of clawback clauses. The main innovations are explained in more detail below.

The innovations are less significant than was originally assumed.

Rejected changes

Other than proposed in the 2016 consultation, the risk-bearer identification obligation will not be extended to all institutions (originally § 3 (2) of the draft consultation), but is only compulsory for significant institutions. Moreover, non-significant institutions that are subject to the Capital Requirements Regulation (CRR institutions) only have to disclose their compensation policy in respect of all employees if they exceed the total assets threshold of €3 billion. If they remain below this figure, a limited disclosure of the remuneration policy is sufficient.

Subordinate institutions which already apply sector-specific remuneration rules (AIFM Directive or UCITS Directive) are not subject to the provisions of the Group Compensation Strategies, as originally proposed in the Consultative Draft (§ 27). Fund employees of a bank are thus not covered by the InstitutsVergV, unless they have an influence on the risk profile of the entire banking group. The scope has not been significantly extended, so that massive increases in administrative effort are avoided at this point. Further changes, such as, for example, the waiver of naming the members of the management body in § 1 (1), who are numbered in contrast to the employees, only slightly affect the scope of application. However, this may still have practical relevance, for example in the case of Chief Risk Officers, for whom it has not yet been clearly decided how far they are subject to the limits on the variable remuneration of the employees of control units.

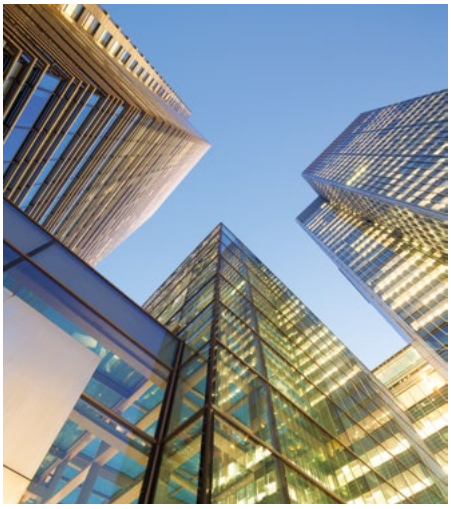
It is also worth noting that the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin) has left the limit for major institutions at total assets of €15 billion, although the EU Commission had already, at the end of 2016, expressed its intention to extend the scope of application of all remuneration regulations to institutions above total assets of €5 billion. Further developments remain to be seen.

Other than proposed in the 2016 consultation, the risk-bearer identification obligation will not be extended to all institutions, but is now only compulsory for significant institutions.

Remuneration components

In future, all benefits, whether financial or non-financial, will be considered as remuneration. This includes, for example, ancillary benefits such as occupational pension schemes (betriebliche Altersversorgung – bAV) and company cars. In addition, all remuneration must be classified as variable or fixed remuneration. There are no other types of remuneration. Institutions must record the total amounts of all remuneration, broken down into fixed and variable remuneration and also the number of beneficiaries of variable remuneration, by business division. Furthermore, the responsibilities and composition of the remuneration control committees are to be disclosed. The intention is to make decisions more transparent, both internally and externally.

Allowances such as foreign residency or functional allowances are to be treated as fixed remuneration, provided they are paid in the course of an institution-wide and non-discretionary scheme. However, severance payments are to be regarded as variable remuneration. On the other hand, the final version now refrains from treating these as being the same as the bonus. It is therefore, for example, still permissible, in principle and under narrow conditions, to pay compensation in the event of a negative business development. In addition, compensation payments can be excluded when calculating the ratio of variable to fixed remuneration if they do not exceed a maximum of €200,000 and 200 % of fixed salary (§ 5 (6.3)). Institutions which are neither significant nor CRR institutions are not subject to the obligation to qualify compensation payments as variable remuneration. This applies for example, to factoring or leasing institutions, depending on the institution's size. The new wording incidentally provides for administrative relief in the assignment to fixed and variable remuneration by establishing that immaterial remuneration components, such as a company mobile, no longer need to be disclosed separately. The administrative expense that accompanies the reinterpretation of the concept of remuneration is thus at least partially absorbed.



Overall, the rules on clawback clauses are to be regarded as surprisingly strict.

Bonus payments and clawback

With regard to retention awards, the new regulation has been aligned with the Committee of European Banking Supervisors (CEBS) and EBA guidelines. If retention awards meet the requirements for the calculation of the total amount and payment of variable remuneration and also the strategic orientation of the company, they are basically permissible. The revised InstitutsVergV furthermore specifies for major institutions, in § 20, the yardstick for the level and period of deferrals, and prescribes the principle of retrospective testing of remuneration levels.

The disbursement of variable remuneration components is only permitted if certain capital requirements at the time of the payment have been met. Negative profit contributions by risk bearers and also a negative overall result at major institutions must have a negative impact on variable remuneration. In severe cases, even a complete halt to variable remuneration must be made. Exceptions to this are to be made only if the institution is in a critical economic situation and, as a result, an imminently emerging reversal can be accelerated.

For significant institutions, clawback clauses have now been included in the rulebook. These institutions thus have an obligation to recover variable remuneration already paid in accordance with previously agreed clawback clauses, insofar as a risk bearer was decisively involved in or responsible for actions leading to regulatory sanctions or considerable losses for the bank.

The same applies if the risk bearer has seriously infringed "relevant external or internal regulations regarding suitability and behavior". However, an undisputed interpretation of this requirement remains to be seen.

Recovery of already paid remuneration can now be claimed for up to two years after the expiry of the deferral period. Up to 100% of the variable remuneration can be recovered. Should clawbacks initially apply up to the end of the deferral, this period is extended further under the new regulation. In the case of a five-year deferral, a bonus for managers and the lower management level can thus be recovered up to seven years after granting. Overall, these clawback clauses are to be regarded as surprisingly strict, since on the one hand clawback clauses are in some cases made obligatory, and on the other, a recovery corridor is defined which goes well beyond previous practice. However, considering the clawback rules from the point of view of labor law, effective implementation looks to be problematic at first.

Conclusion

The InstitutsVergV, which has now finally entered into force on 4 August 2017, ultimately aims at avoiding short-term “misguided” incentives and promoting an orientation towards long-term corporate objectives.
All in all, it can be said that the innovations are less significant than was originally assumed. Exceptions to this are the restructuring of the remuneration components and the clawback arrangements, which are more strict than in the 2016 consultation draft. The response of the labor courts to these innovations remain to be seen.

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