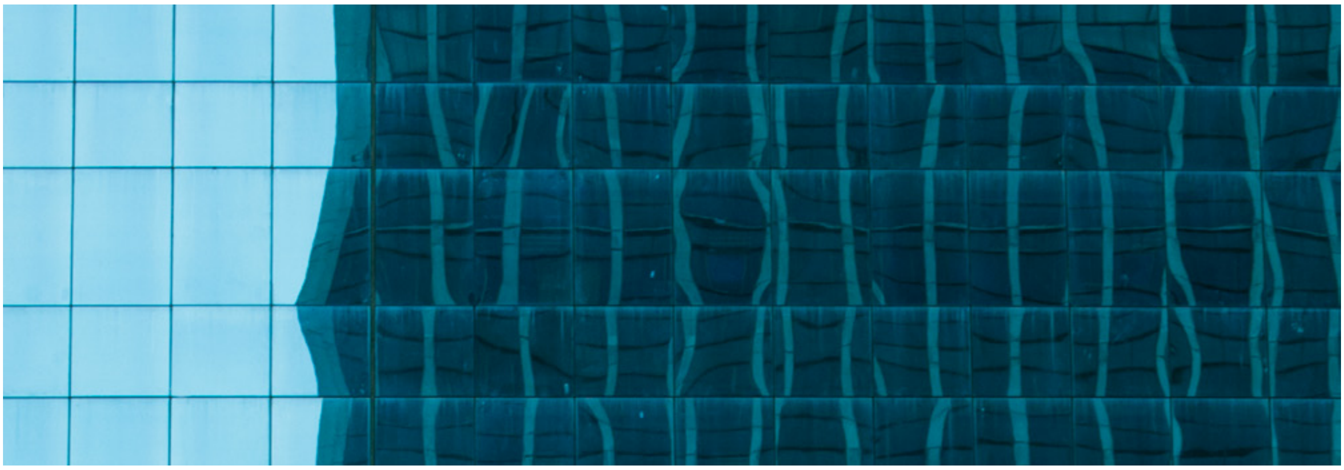

Revised remuneration standards for German financial institutions

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Under CRD IV, institutions are required to have in place a remuneration policy for all employees and members of the management body. From 1 January 2017, the EBA's Guidelines on sound remuneration policies (EBA/GL/2015/22) apply in replacement of the former CEBS guidelines. In Germany, a regulation governing the supervisory requirements for remuneration policies (*Institutsvergütungs-verordnung – the* "Remuneration Regulation") supplements the statutory rules included in the German Banking Act (KWG). The process to amend the Remuneration Regulation was launched in August 2016. On 19 January 2017, the German Federal Financial Services Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* – "BaFin") published a revised draft of the amendments to the Remuneration Regulation. We expect that the changes will be promulgated in February 2017 and enter into force on 1 March 2017.

Fixed vs. variable remuneration

In the new version of the Remuneration Regulation, BaFin clarifies the distinction as to when compensation components will be considered "fixed" or "variable" remuneration. This distinction is important because stricter regulatory requirements usually apply to variable remuneration. In particular, variable remuneration remains subject to a bonus cap, which means that variable remuneration paid to an employee or member of a management body may not exceed 100% (or, with the shareholders' consent, 200%) of the respective fixed remuneration.

The new rules stipulate that any remuneration that cannot be classified as fixed remuneration will in the future be deemed to constitute variable remuneration and, therefore, be subject to the stricter requirements.

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In order to qualify as fixed remuneration, the following criteria must be met:

— Agreed in advance

— Permanent

— Transparent to the employee or member of a management body

— No employer discretion

— Not dependent on performance or the occurrence of certain agreed events

— No incentive for the employee or member of a management body to take risks

— Institution cannot unilaterally reduce, suspend or cancel payment of the remuneration

Allowances paid to expatriate staff or allowances for assuming a specific function on a temporary basis shall in certain circumstances continue to qualify as fixed remuneration components.

Severance payments

The requirements for severance payments will be expanded and tightened up under the new Remuneration Regulation. The institution's internal guidelines must specify maximum amounts of severance payments as well as specific criteria according to which severance payments will be determined. In addition, they will be deemed variable remuneration. While severance payments will therefore be subject to the bonus cap, BaFin provides for exceptions from this rule in the case of severance payments based on statutory law or on a court ruling or a settlement in court, or severance payments that are awarded, in accordance with internal guidelines, upon a mutually agreed redundancy or a termination in the context of a business restructuring. However, for all severance payments exceeding the limits provided for in the institution's internal guidelines, the specific reasons and the adequacy of the amounts must be demonstrated to the supervisor.

Retention incentives

Under the new version of the Remuneration Regulation, retention bonuses may only be awarded in exceptional cases and subject to strict requirements. In particular, they will be treated as variable remuneration for purposes of the bonus cap. This will limit the situations where retention bonuses can practically be used for staff whose variable remuneration already represents a significant portion of their total compensation.

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Significant institutions

Remuneration policies of significant institutions are subject to additional requirements, including deferral and clawback of variable remuneration as well as taking into account the success of the institution or group as a whole and the contribution of the individual employee and its business unit. The criteria for determining 'significant institutions' will be amended. The new Remuneration Regulation stipulates that credit institutions which are part of a banking group directly supervised by the European Central Bank ("**ECB**") will not be deemed significant institutions for purposes of the Remuneration Regulation just because of that direct supervision by the ECB. Rather, going forward, these institutions will only be considered significant if their average total assets during the previous three fiscal years exceed EUR 15 billion on a solo basis. As before, even where these criteria are not met, BaFin may determine that an institution is significant based on an individual risk analysis.

Material risk takers

Significant institutions will continue to be required to identify 'material risk takers' and to apply stricter rules to their remuneration. The initial idea proposed by BaFin to extend the requirement to identify material risk takers to all, i.e., also to smaller, non-significant credit institutions has been dropped.

Non-significant institutions may be affected, however, if they are part of a group the parent of which is a significant institution. In such case, the parent must identify risk takers whose activities may have a material impact on the group's risk profile ('material group risk takers') and who may be employees or members of the management body of a non-significant group company.

Deferral

The provisions applicable to the deferral of variable remuneration paid by significant institutions will be tightened. The minimum period for which a portion of a material risk taker's variable remuneration must be deferred will be increased to five years for members of the management body, senior management and other material risk takers receiving sizeable amounts of variable remuneration. For all other staff, the minimum deferral period remains at three years. The proportion of variable remuneration that needs to be deferred must generally be set at 40% at least, but can run up to a minimum of 60% depending on the material risk taker's position.

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Clawback

For the first time, rules regarding clawback of variable remuneration that has already been paid out will be introduced in Germany. In case of serious personal misconduct of members of a management body or other material risk takers, the institution will be required to claw back from the relevant risk taker variable remuneration already paid out and to cancel any claims to payment of variable remuneration. If the current service and employment contracts do not provide for such clawback, the institution must seek to amend the contracts to the extent legally possible.

Group level standards for remuneration policies

Generally, the Remuneration Regulation as well as the statutory bonus cap must be complied with both at the level of the individual institution and at group level. This means that a group-wide remuneration strategy must be put in place at the level of all groups of institutions, financial holding groups and mixed financial holding groups which are subject to consolidated supervision. However, the new Remuneration Regulation also provides for some relief in this regard: UCITS management companies and alternative investment fund managers belonging to a group will be exempt from the Remuneration Regulation and the statutory bonus cap. Other group companies will be affected by the group-wide application of the Remuneration Regulation and the bonus cap only if they are either themselves subject to supervision as an institution or if material group risk takers have been identified within the company.

Application of the new standards from March 2017

The provisions of the new Remuneration Regulation will presumably enter into force on 1 March 2017 and it appears that there will be no transitional provisions or other forms of 'grandfathering'. Therefore, institutions must be prepared to apply the new rules to any remuneration granted on or after 1 March 2017. Remuneration components granted for 2016 or earlier years remain subject to the provisions of the current version of the Remuneration Regulation.

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