

## *Financial Services and Markets*

### *CRD3: European Union Proposals on Remuneration*

You may have read alarming reports in the press this morning that the European Union had decided to impose strict conditions on any bonuses paid to senior staff at banks and investment firms. Some of the headlines have referred to the fact that these requirements will apply to hedge fund managers and other investment managers.

It is not quite as straightforward as that. The likely outcome is that (a) some managers will be exempt from the new requirements and that (b) some managers that are covered will nonetheless be given the opportunity to comply with the requirements in a manner "proportionate" to their business. In other words, it is not accurate to say that all managers will be subject to the same strict rules as those for bankers. More details are provided below:

- The European Union legislation to which the press reports are referring is a draft amending Directive to the Capital Requirements Directive (a package of measures commonly referred to as "CRD3"). This will amend both the Banking Consolidation Directive ("BCD"), which applies to banks, and the Capital Adequacy Directive ("CAD"), which applies to both banks and many investment firms.
- CRD3 is not yet finalised. The draft text is to be submitted to the European Parliament on Wednesday 7 July 2010. If approved, the current intention is that the provisions should be in force by January 2011. FSA rules will be needed to apply the requirement to UK firms. The FSA has not yet consulted on these rules, but may do so later this month as part of a wider consultation on changes to FSA remuneration rules.
- The draft amending Directive sets out detailed remuneration requirements, including the cash bonus restrictions reported in the press this morning. These are based on G20 proposals for remuneration requirements in the financial services sector.
- It looks likely that, broadly speaking, the proposals will apply to all investment firms subject to MiFID (the Markets in Financial Instruments Directive), other than firms known as "exempt CAD firms". They will therefore apply to most UK hedge fund managers and some of the larger private equity firms. The majority of private equity firms will be outside the scope of the provisions; the same will be true of investment firms permitted only to advise their offshore affiliates and arrange deals.
- There has been an awareness, amongst the UK supervisory authorities and others, of the potentially disproportionate impact that the proposals might have on those investment firms caught by them. They are disproportionate because the requirements may not be appropriate to the structure of some investment firms, particularly unlisted firms and, in any event, such firms would not pose the same risks as a bank or, for example, large investment bank.
- There has therefore been pressure for a 'proportionality override' so that the strict remuneration requirements will not necessarily be mandatory for all investment firms. In the current draft of the amending Directive (which is dated yesterday, 30 June 2010) a recital acknowledges that the remuneration principles recognise that credit institutions and investment firms may apply the provisions in different ways according to their size, internal organisation and the nature, scope and complexity of their activities.
- The extent to which the proposals would impact on those firms within the scope of the proposals will depend on the extent to which the proportionality test is allowed to apply in practice - the FSA is likely to have an important role to play in this for UK firms.

The CRD remuneration provisions are just one of many proposals which seek to change remuneration practices. For example, the draft Alternative Investment Fund Managers Directive, now likely to be voted on in September, also contains remuneration provisions which are largely drawn from CRD3.

We will be providing a full analysis of the various regulatory proposals relating to remuneration once their final form is clearer, but if you would like further details in the meantime please contact one of the following partners in the Financial Services and Markets Group.

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