

Recent European Compensation Developments

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The Eurozone crisis and ensuing populist resentment over perceived compensation excesses have given rise to a recent wave of compensation measures and restrictions in Europe. As we explain in our [memo](#), the measures range from a cap on financial institution bonuses (the so-called “banker bonus cap”) in the EU, binding say-on-pay votes in several European jurisdictions and even criminal sanctions for violating compensation restrictions and corporate governance requirements in Switzerland. Simon Witty, a partner in our London office, explains the key aspects of these developments.

What is the banker bonus cap?

Under CRD IV, which is slated to go into effect for credit institutions (including banks) and investment firms (such as broker-dealer or wealth management firms) in January 2014, the basic rule is that bonus payments will be capped at 100% of total fixed pay or, with shareholder approval, 200% of total fixed pay. “Shareholder approval” means approval by either 66% of shareholders owning half the shares represented or, failing that, 75% of all shares represented. The effective bonus cap can go up by up to 25%, if the pay is in the form of long-term deferred instruments (*i.e.*, instruments deferred for a period of at least five years).

But there is a lot more to the banker bonus cap than just the cap. There are, for example, rules on how much of the bonus must be comprised of equity compensation or certain capital instruments, how much must be deferred and for how long, clawbacks, mandatory deferrals or holdbacks for discretionary pension benefits and the collection of information for individuals who are paid $\geq$ 1,000,000 or more in any given fiscal year.

Who will the banker bonus cap apply to?

As to which institutions, the cap will apply to all credit institutions and investment firms in the EU. The non-EU subsidiaries of institutions headquartered in the EU will also be caught, as will the EU subsidiaries of institutions headquartered outside the EU.

For example, if a financial institution is headquartered in London, all of its relevant employees (including relevant employees located in New York or Hong Kong) will be affected, and, even if a financial institution is headquartered in New York or Hong Kong, its relevant employees working for an EU subsidiary will be affected.

As to which employees at those institutions, the cap will not apply to all employees of a particular entity; rather, it will only affect employees whose professional activities have a material impact on the risk profile of the relevant financial institution. Examples of these employees are senior management; risk-takers; employees engaged in control functions; and employees whose total pay takes them into the same bracket as senior risk management and risk-takers.

Which companies will be affected by the proposed say-on-pay requirements?

The EU has announced a proposed mandatory EU-wide say-on-pay initiative. The U.K. is expected to implement a binding say-on-pay vote by October 2013, plus other related requirements. Another country that has received significant press coverage is Switzerland – its “Minder Initiative” introduces a binding say-on-pay vote, together with other executive compensation measures, which will come into force by March 2014. Germany and Spain have also announced say-on-pay initiatives, which will likely be binding.

Our current understanding is that these developments will just affect the companies incorporated in those jurisdictions. In contrast to the CRD IV compensation restrictions, which will apply to non-EU financial institutions (at least partially), we do not have any reason to think for now that the say-on-pay initiatives will apply to, for example, U.S. or Hong Kong

companies.

How will binding say-on-pay work?

In the U.K., the jurisdiction for which there is currently the most information, a binding shareholder vote will be held at least every three years on a company's remuneration *policy report*, which is *prospective* in that it will set out the company's future policy regarding the compensation (including "loss of office" payments) of directors, including executive directors. A company will continue to have an advisory shareholder vote each year on its remuneration *implementation report*, which is *retrospective* in that it will set out how the company's compensation policy was implemented in the past fiscal year.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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